# Setting Strategic Investment Objectives: do you measure up?

By Donny Hay, Director, IC Select

**Following the CMA legal requirement on 10 December 2019 for Defined Benefit (DB) trustees to set clear strategic investment objectives for their investment adviser, whether an investment consultant or a fiduciary manager, properly reviewing your investment adviser is going to be a priority in 2020 and beyond for DB pension trustees.**

**IC Select believe this ruling is a game-changer and will be the beginning of the end for investment mediocrity** which has plagued too many DB schemes for too long.

Setting strategic objectives is just the start of the process. To be effective, trustees also require a framework to assess performance against these objectives and The Pensions Regulator (TPR) has already inferred that having consultants mark their own homework is against the spirit of the orders. And now the tools exist for trustees to assess how effective their investment adviser is in meeting their strategic objectives with integrity and independence.

The information imbalance between trustees of DB pension funds and their investment advisors (IAs) has marred the industry for decades. For example, the funding level of 96% of the 5,450 DB pension schemes in the PPF 7800 index at 31 January 2020 is still lower than it was 10 years ago despite the huge deficit recovery contributions from sponsors and near record rises in equities and credit over that period, indicating that IAs have not exactly excelled at their job.

The asymmetric relationship between trustees and IAs has essentially been a relationship between professionals and laypersons, forcing trustees to blindly trust IAs giving them the upper hand and no interest in changing the status quo. This has created an environment which has not encouraged transparency and challenge which in turn has led to poor standards, and a lack of clear objectives and expectations of the services provided. The general lack of oversight, accountability and responsibility has further undermined the standards of investment governance. Considering that investments make up 75% of total cost of ownership for pension funds, a greater emphasis upon the effectiveness of your investment adviser has been long overdue.

Setting strategic investment objectives is, however, only the beginning of the process and needs to be combined with an evaluation framework. **You can't value what you don't accurately measure**; now the performance, cost and other comparison tools are available to allow trustees to take control.

**At IC Select we recommend using a balanced scorecard approach where all the objectives proposed are realisable, achievable and measurable (RAM).** It's a dynamic structure where the key factors such as financial performance, advice and Environmental, Social and Governance (ESG) are then broken down into further areas and objectives which are weighted and scored to reflect trustee priorities. This has become a well-honed art in the Netherlands but is new to the UK. The approach recognises that some objectives are quantitative in nature, for example, around financial performance and reporting, but in practice most are qualitative, for example, around advice, working relationship and ESG. A quantitative or hard measure might be 'achieving the investment objective of gilts + 2.0%', and a qualitative or soft measure might be whether 'reporting is easy to understand, comprehensive and succinct'. For the hard measures IC Select, with input from the trustees, develop a graduated score, for example, achieving gilts +2.1% might score a 7 out of 10, and for the soft measures the scores can be collected using periodic (usually annual) questionnaires which we would recommend are scored by the trustees, sponsors and their advisors. The balanced scorecard can then form the basis of the next year's action plan which, being based on measurable data, will raise the bar for the entire industry.

This framework will enable trustees to evaluate the performance of their advisers against their own specific pension schemes objectives as well as benchmark the IAs capabilities against peers. And, in turn, help trustees understand in detail the positive and negative drivers of the performance and service, in isolation and compared to the performance of other similar funds. In this way performance, cost, reporting, service etc. can be properly evaluated.

Combining the new requirements to set strategic objectives with the appropriate framework for evaluation, produces a virtuous circle of objectives, assessment and improving investment governance. **After all, what gets measured gets done**.