Pensions Perspective

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Advisers: Endgame

Avengers: Endgame was the blockbuster to end all Avengers films. Several actors were apparently out of contract at the end of the film, which may help explain which superheroes died or disappeared off into a life of obscurity. Hopefully Marvel fans will forgive us when we turn the focus on advisers to DB and DC pension schemes and ask whether some of them should also now be facing termination?

Whether it is driven by concerns about increasing or uncertain fee levels, problems arising from poor quality service, the realisation that new ideas are not being shared with the trustees or simply a desire for good governance, carrying out a formal review of scheme advisers is becoming increasingly common. But does this necessarily mean a full market tender, or can it be something less definitive?

In this Pensions Perspective, we look first at the different types of adviser review and when and how they might best be used. Then we focus on how to design a smooth and efficient process for a full market tender.

bac's credentials are that we have carried out twelve scheme actuary and/or investment consultant market tenders for DB schemes larger than £1 billion in size over the past three years. Two-thirds of these reviews led to a new advisory firm being chosen, reflecting the fact that trustees are often genuinely surprised by both the ideas and the quality of advice and service they discover when they carry out a full market tender. Of those where the incumbent was retained, in all but one case there was a fundamental redesign of the services and team provided by the adviser, reflecting what the trustees had now learnt was available to them in the market.

Too risky to change?

Furthermore, like the Avengers, DB pension schemes are also getting much closer to their endgame. As a result, trustees will want to ensure they have the best advisers in place to help them navigate the journey that lies ahead. We recently worked with a trustee board which has a long-standing but not totally satisfactory relationship with its scheme actuary. However, the scheme is probably less than ten years away from buying out all its liabilities with an insurer. This made the trustees feel quite reluctant about the possibility of changing advisers. We challenged them on this, pointing out that, if you are between five and ten years away from your scheme's endgame, it is arguably even more critical to make sure you are getting the best possible advice. Once they had read the RFP responses and seen the other candidate firms' presentations, they realised why we had pushed back on this timing point. In the end they chose a new scheme actuary firm.

More generally, by far the most common reason for not wanting to review advisers is the fear of losing historic scheme knowledge. Almost every time **bac** is appointed to run an adviser review, a client starts by telling us that their scheme is uniquely complex and it might be too risky to bring in someone new. We have two problems with this:

- it is almost never true – yes, the scheme may be hugely complex but top-end advisers can come up to speed very quickly
- if the incumbent adviser does not believe the relationship will be at risk if they don't deliver, the client is unlikely to succeed in getting the very best from their adviser.

Of the three most complex schemes where we have helped run adviser reviews, all three have moved to new advisers. In part, this was because the adviser thought their position was secure and did not properly listen to the client's concerns.

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And, most importantly, we can vouch for the fact that, in all three cases, the trustees and the in-house pensions team are very happy with the new level of advisory support which they are receiving.

Different types of review

If your scheme has a trusted adviser who delivers a good quality service, you may feel it is questionable whether a review process would be of great value at any time. However, even the best adviser relationships can become stale over time, with the result that bad practice gradually develops. This could emerge through problems with the budgeting process and fees, a team structure that becomes less appropriate over time or simply a lack of fresh thinking and innovation. Whilst we believe that changing your adviser is a measure of last resort, we do think that there should be at least an annual review of all the scheme's advisers.

Desktop

Typically, the annual review would be a desktop process which would not involve other firms. The exception would be if the annual review raised serious issues, which were not easily resolved with the incumbent. The desktop process involves seeking feedback on the adviser's performance from some key trustees, as well as from representatives of the in-house pensions team and the company. It would also involve a review of fees against budget. This feedback will allow you to tackle any developing issues before they become serious. It

also allows the trustees to set their adviser a number of key objectives for them to deliver in the year ahead.

However, for good governance reasons alone we think that schemes should carry out a formal adviser review at least once every three to six years. This is especially true if problems identified from the desktop review persist. A formal review is the only way to ensure that the trustees have a good understanding of what other providers could offer and to see whether a fresh perspective might add value.

Halfway house

A formal review usually means a full market tender, but this is not always the case. There is what we call a halfway house, which we have used in two recent scheme actuary reviews. In both, a trustee committee met formally with the incumbent on two occasions, first to give feedback on their recent performance and then to hear how they intended to address the issues that had been identified. In one sense this was no more than a more formal version of the annual desktop review. But, prior to these meetings, the trustee committee also met with three other scheme actuary firms, both to understand their service offering and to meet some of their people. They shared a pack of scheme information with the other firms prior to meeting them, which meant that they got to hear these firms' best ideas for the development of the scheme's funding and investment strategy.

In both cases the meetings with other firms proved to be something of an eye opener. In one case, it eventually led to a full market tender. For the other scheme, it led to some specific challenges being presented to the current scheme actuary, who was sufficiently open and responsive that they retained the appointment without being subject to a full market tender.

Full market tender

The advantage of a full market tender relative to the halfway house is that you get full written responses from all candidate firms. Whilst it is not quite a level playing field between the incumbent and the other candidate firms, it does allow a comparison to be made on a like-for-like basis between all of the firms.

Not surprisingly, given that fees do not tend to feature in the halfway house approach, you are likely to achieve a much better result on fees (both in terms of the overall level of fees and how much is genuinely fixed) by running a full market tender. We have typically seen reductions of at least 20% in overall fee levels following a market tender, even when the incumbent has been re-appointed. In addition, it is now possible to fix a large proportion of adviser fees (and we do mean genuinely fixed fees), so there is far less scope for future fee surprises.

So the full market tender does have some very real advantages. In the remainder of this article we look at how to design a market tender process which:

- minimises the disruption to the day-to-day running of the scheme
- creates a level playing field for all candidate firms bidding for the work
- maximises the likelihood of the right firm being appointed
- ensures the appointed firm has a clear understanding of what is expected of them.

The principles we describe below apply equally to any type of adviser market tender, whether the appointment is by the trustees or the company.

How to prepare?

Once you have decided to carry out a full market tender, the starting point is to articulate clearly to the stakeholders (both trustees and key company contacts) why a review is needed and what you are aiming to achieve from it. At the outset, you will want all of the stakeholders to have bought into the need for the tender process and agreed a common set of objectives, or success criteria. This may take some time to achieve but it is vital to the success of the whole process.

The other key element of preparation is to design and plan a robust review process.

Key stages

Most full market tenders for scheme advisers will involve some version of the following.

Stage	Comment
Decide on long list of candidate firms	Probably 5 or 6 firms
Issue a request for proposal (RFP)	Identify contacts at each firm
Fact-finding stage	Ensure diaries are cleared for fact-finding meetings and include these dates in RFP
Written submissions	Limit size of submissions to a certain number of pages
Develop short list of candidate firms	Probably at least 2 or 3 firms (one of which is likely to be the incumbent)
Presentations by short-listed firms	Make sure presentation dates are included in the RFP
Select new adviser	Need to agree their terms of engagement

Things to remember

Long list of candidate firms

As in any industry, consulting firms are configured differently to meet their clients' many and varied needs, ranging from top-end blue chip advisers with a global presence through to more cost-effective advisers with a simplified offering.

When deciding who to put on your long list, you need to consider carefully the reasons for the review and your stated success criteria, as well as the depth of experience and resources you require from your adviser team. It is vital that the firms invited to tender all have the potential to be a good fit with your requirements.

Request for proposal (RFP)

Try to keep the RFP short by covering essential information only. To be most effective, the candidate firms should only be asked a small number of key questions, the answers to which will help provide potential differentiation between the firms.

Fact-finding stage

Taking part in a tender process costs consultancy firms significant amounts of time and money. As a result, they are unlikely to take part in the process unless they feel they have a realistic chance of winning. Indeed it is quite common for major consultancies to decline an invitation to tender if they conclude the scheme in question is not serious about the review, for example if it is simply using the process to put pressure on the incumbent adviser.

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This means that the fact-finding stage is critically important, first to make sure candidate firms know that you are serious about the process and secondly to give them sufficient understanding of what you are looking for to prepare a focussed and quality proposal. To kick off the fact-finding process, candidate firms will want to meet with some of the key stakeholders to discuss the background and cover various technical questions.

Irrespective of the thoroughness of the RFP and the fact-finding meeting, candidate firms will still have follow-up questions and you need to consider how you will handle these. It is very important to maintain a level playing field in terms of information-sharing throughout the process, so that all firms have access to all the questions and answers. This will ensure that the tender responses reflect the quality of the firm, not simply which ones asked the most pertinent questions (an important skill but not the only one you want to test).

The use of a dedicated tender website can help significantly with this information-sharing stage. As well as including a library of scheme documents and the timetable for the review process, the use of a frequently-asked-questions page allows the answer to a question asked by one of the candidate firms to be made available to all of them in a matter of minutes.

Written submissions/short listing candidate firms

If the RFP has been drafted well, the written submissions should provide clear evidence of what the different firms have to offer. To evaluate who should be shortlisted, you need to have prepared a scorecard, based on your stakeholders' success criteria. This should have been agreed internally before the RFP is issued. A well-designed scorecard will help you identify your shortlist fairly easily. Again you should agree at the start of the process who will be asked to score the written submissions, so that all stakeholders are adequately represented in the decision making.

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Presentations by short listed firms/selection of new adviser

You need to give the short-listed firms a clear steer on what you want them to cover in their presentations, who should attend and timings. This is important so that you are able to compare like-for-like presentations. For this stage, a scorecard is less likely to be of value as more subjective factors that emerge through the presentations will probably be key in your decision making, for example the chemistry between individuals. It is also important that you agree at the outset who will attend on behalf of the stakeholders, i.e. which trustees and company representatives.

The last word

A successful adviser review is all in the planning. You need to be crystal clear why you are doing the review, making sure your stakeholders buy into the success criteria and design a well thought-through process. Part of the value of carrying out a formal review (whether full market tender or halfway house) is the opportunity to hear fresh thinking and a new perspective on your current issues, so you should ensure you go into the process with an open mind.

Finally, and without giving away too much in terms of spoilers, the plot of Avengers: Endgame rests crucially on the ability of our superheroes to travel in time, with all the ensuing complications when someone goes back into the past and changes something. Whilst trustees do not have the luxury of going back in time to change a decision or an adviser appointment that did not work out as it should, most still have plenty of time until their scheme reaches its own endgame. For that reason alone, it is vital that trustees have the right advisers in place now. If there is any doubt about that, then the performance of the incumbent needs to be reviewed, so that the doubt can be removed. In most cases, this will not lead to a formal review, but in one or two it might.

We have seen far too many cases of trustees being aware of potential issues with their adviser but choosing to do nothing about it. Unlike Avengers: Endgame, that never ends well!

For more information on how **bac** can support you cost-effectively with an adviser review process, please contact one of our senior team on governance@bathactuarial.com.

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