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CONFLICTS GUIDANCE – A HIGH FIVE FROM THE REGULATOR

1 INTRODUCTION

With the primary objective of promoting “good scheme governance arrangements”, the Pensions Regulator’s long awaited draft guidance on “Conflicts of Interest” has finally been published for consultation¹. Recognising the fact that trustees often have “some kind of stake” in either the scheme or the sponsoring employer, the draft guidance is aimed at the trustees of all occupational pension schemes.

Long and detailed, the draft guidance consolidates, and builds on, existing guidance on conflicts in other Pensions Regulator publications, such as the Code of Practice on Scheme Funding.

Consultation closes on 30 May 2008.

2 KEY POINTS

- The draft guidance sets out “five high level principles” which “underpin sound conflict management and governance” (see section 4).
- The Regulator recommends that trustees implement a written conflicts policy (section 5).
- The Regulator comments extensively on managing conflicts (section 6).
- The draft guidance reaches beyond trustee conflicts to adviser conflicts (section 7).

¹ <http://www.thepensionsregulator.gov.uk/whatsNew/pn08-04.aspx>

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3 WHAT IS A CONFLICT?

For over 100 years it has been settled law that trustees should not put themselves in a position where a conflict arises². But since 1996 a statutory easement has allowed a trustee to continue to act where his duty and interest (as a member of the scheme) conflict³. This means that the focus has shifted to so-called “duty/duty” conflicts. The classic example of a duty/duty conflict is the Finance Director who is a trustee and owes duties to both the company and trustee board.

The existence of a conflict does not mean that a trustee decision is automatically void, but the onus will be on the trustees to prove that the actual decision made was fair and reasonable, regardless of the conflict. In the words of the Regulator, a conflict can “inhibit open discussions or result in decisions, actions or inactions which are not in the best interests of beneficiaries”.

4 THE “HIGH FIVE” – AT A GLANCE

In future, trustees are being urged to focus on conflicts by reference to the following five high level principles:

- *Principle 1 - Understanding the importance of conflicts of interest*

The Regulator’s first high level principle requires trustees to understand the importance of conflicts. This can be met through trustee training - both by meeting the requirements of trustee knowledge and understanding and also by “induction training” for a newly appointed trustee.

- *Principle 2 - Conflicts of interest policy*

In July 2007, the Regulator’s Governance Survey reported that nearly 60% of defined benefit schemes have a means of identifying and recording conflicts of interest, while little over a third actually have a written conflicts policy or protocol.⁴

² *Bray v Ford* [1896] AC 44

³ Pensions Act 1995, section 39

⁴ For DC schemes, the figures were 46% and 27% respectively

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Although the Regulator acknowledges that this shows a “positive trend” (when compared with their 2006 survey), it remains concerned that a small number of schemes have a formal policy. With this in mind, the draft guidance recommends that trustees have a written conflicts policy (see section 5).

- *Principle 3 - Identifying conflicts of interest*

Trustees should keep (and annually review) a register of interests as a “simple and effective method of monitoring conflicts”. It will also aid advance planning as trustees can identify when a potential conflict may become an actual conflict in the context of an upcoming decision, thus ensuring “minimal disruption”.

- *Principle 4 - Evaluation, management or avoidance of conflicts*

Where a conflict is identified, and where the effect of such a conflict could be “materially detrimental to the conduct or decisions taken by the board of trustees, mitigating action must be taken”. The action required depends on the conflict. Indeed, a conflict may require managing in one or more ways (see section 6).

The Regulator places the onus for ensuring that there is a robust conflict management system squarely at the door of the chair of trustees.

- *Principle 5 - Managing adviser conflicts*

As well as focusing on trustee conflicts, the draft guidance also makes a number of comments on adviser conflicts (see section 7).

5 CONFLICTS POLICY

Principle 2 requires trustees to “agree and document” a policy (which should be revised from time to time) for identifying, monitoring and managing conflicts.

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Whilst the draft guidance says that the policy will need to be “tailored” to meet the scheme’s circumstances, it could cover the following⁵:

- understanding the scheme trust deed and rules “as this is critical”;
- the trustees’ fiduciary and statutory obligations in respect of acting independently and in the members’ best interests;
- the processes for identifying conflicts including a description of the types of conflict (actual and potential) that may arise in acting as a trustee of the scheme;
- the processes in place to avoid conflicts;
- the options available for the trustee in managing conflicts; and
- monitoring compliance with and reviewing the policy.

6 MANAGING CONFLICTS

In a serious case, an application to the court may be made, but in general one or more of the following options are likely to be sufficient:

Authorisation

A trustee may be authorised by the scheme rules⁶ to continue to act in a conflict situation but it should be noted that a trustee under an actual conflict must still properly discharge his duties to members. The Regulator obviously has concerns about the improper use of such powers and concludes that they are limited to “conflicts of a type which arise out of the normal relationship between trustees, employers and members of a pension scheme”.

⁵ An example of a conflicts policy is given as an Appendix to the draft guidance

⁶ There may be other ways of authorising a conflicted trustee to continue to act

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Withdrawal

Withdrawal from the decision-making process can help ensure that decisions are not influenced (or perceived to be influenced) by a conflicted trustee. However, the Regulator suggests seeking legal advice on whether a conflicted trustee should be allowed to sit in on a decision (even if they are not allowed to vote).

Resignation

When a trustee faces a particularly “acute or pervasive” conflict of interest, resignation may be the most straightforward solution even though it will result in a loss of expertise from the trustee board.

Appointment of an Independent Trustee

The appointment of an independent trustee, particularly as chair of trustees, is explicitly sanctioned by the Regulator as they are “ideally positioned to supervise conflict management and avoidance procedures”. Independent trustees can be appointed for a specific project (for example, on an acquisition involving the scheme sponsor), as well as a permanent appointment.

7 ADVISER CONFLICTS

Finally, the draft guidance also makes a number of comments regarding adviser conflicts:

- The Regulator recommends that trustees should ascertain whether the adviser has any real (or potential) conflicts during the selection process and what arrangements are in place should conflicts occur.
- Particular issues can arise where the trustees share an adviser with the sponsor.

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- Trustees should be “fully aware” of the conflicts that may arise where advisers refer the services or products of related parties to their client (for example, where a consultant recommends a product provided by a subsidiary).
- The pensions manager (and in-house administration team) may be subject to a conflict as they provide services both to the trustees and to the sponsor. Trustees need to ensure that they understand in what capacity the pensions manager is acting in a given situation.

8 THE REGULATOR’S ROLE

The draft guidance pulls back from giving definitive advice on conflicts. A constant theme is the need for independent legal advice “which should be tailored to the specific circumstances of the situation”. But trustees should be alive to the possibility that seeking legal advice does not “overcome the conflict if the trustees feel they are unable to act independently on this advice”.

The Regulator expects conflicts to be “resolved amicably” between sponsors, trustees and their advisers. Nevertheless, it says it may “take action” where a conflict represents a significant risk to members’ benefits.