

# Conflicts of interest

Consultation document

**February 2008**

[www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk)

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## Introduction

This is a consultation document on guidance in relation to the governance of 'Conflicts of Interest' produced by the Pensions Regulator ('the regulator'), the body that regulates work-based pension arrangements.

The management by trustees of conflicts of interest is integral to good scheme governance. One of the key aims of this guidance is to provide practical assistance to trustees in relation to improving the management of conflicts of interest. It is important to note at the outset that this guidance is not designed, nor intended, to provide legal advice to trustees and does not replace the requirement to seek independent legal advice, which would be tailored to scheme specific circumstances.

The publication of this guidance is one of a number of initiatives that the regulator is undertaking to assist trustees on the theme of promoting good scheme governance. Our aim to improve standards in scheme stewardship were set out in our governance discussion paper "The governance of work-based pension scheme", published in April 2007 (our response to this discussion paper was published in October 2007).

This discussion paper flagged seven governance priorities, areas which we considered to be fundamental to the successful running of a pension scheme and included 'conflicts of interest'. We are pleased to note that respondents were supportive of all the priorities we identified.

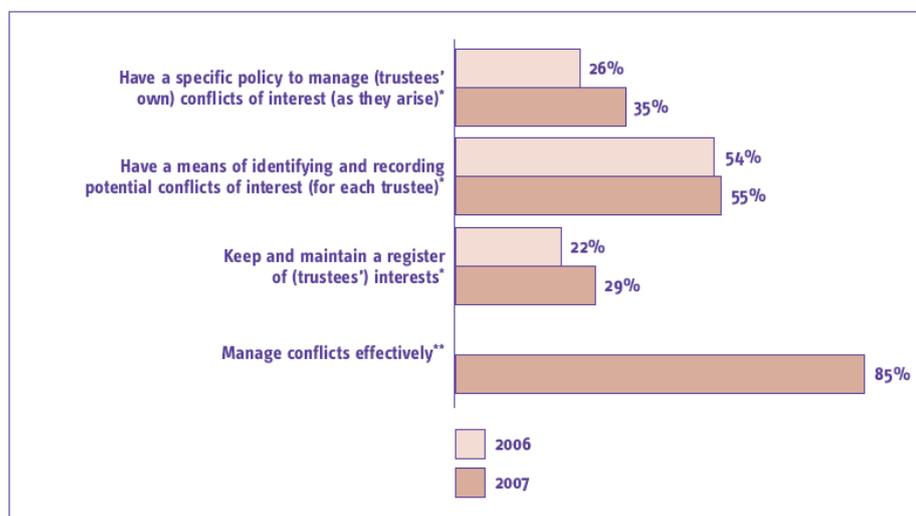
The regulator recognises that conflicts of interest introduce a number of complexities for a trustee board in terms of management. It was therefore considered appropriate to provide further guidance material to assist trustees.

Our regulatory approach to governance continues to be evidence based; our governance priorities will continue to be influenced by industry practices as well as by the results of our annual governance tracker survey. This survey aims to identify trends in the performance of trustee boards in a variety of areas of scheme governance. The results of the first survey (2006) played an important role in our initial thinking on governance and assurance related matters and as a result influenced our current governance priorities. In July 2007 we published the findings of our second governance survey and we aim to publish the 2008 results later this year.

We welcome the commitment to conflicts management already shown by trustees. This has become apparent during the course of our discussions leading up to the publication of this guidance. Whilst many trustee boards already have robust arrangements in place, the development of this paper has triggered a number of reviews to reassess the adequacy of arrangements. A key to any successful conflicts management programme will be the production of a policy (or protocol) outlining the processes for identifying, monitoring and managing conflicts. We recognised the importance of formulating and documenting arrangements in a policy when we undertook our surveys in 2006 and 2007. The results however, whilst showing a positive trend, indicate that a low number of schemes have established a formal policy.

The table below provides a useful summary comparing the results of the survey in relation to key areas of conflicts management (or processes that will support a management framework):

**Chart 9**  
Activity in the area of managing conflicts



Base: 2006: Interviews with trustees representing 500 schemes (unweighted), 9,901 schemes (weighted)  
2007: Interviews with trustees representing 500 schemes (unweighted), 9,020 schemes (weighted)

\* Slight change in wording: text in brackets added in 2007

\*\* Question was not asked in 2006, therefore no comparable results are available

Whilst the need for conflicts to be managed efficiently and effectively is equally important to both defined benefit and defined contribution schemes, the trends indicate that approaches to managing conflicts is not well balanced. For example, the proportion of defined benefit (DB) schemes that have a specific policy in place to manage conflicts is significantly higher (38%) than defined contribution (DC) schemes (27%). This trend was also observed in respect of schemes that have a means of identifying and recording conflicts of interest; 59% of DB schemes compared to 46% of DC schemes.

## Purpose of the guidance

As indicated earlier, the primary objective of this guidance is to continue to promote the importance of good scheme governance arrangements in respect of conflicts of interest. It emphasises the importance the regulator places on having effective processes in place for identifying, monitoring and managing conflicts of interest.

The guidance also supplements the regulator's e-learning programme, [www.trusteetoolkit.com](http://www.trusteetoolkit.com), which provides learning about identifying and managing conflicts. Trustees will already be aware from our scope guidance on trustee knowledge and understanding that we would expect them to have appropriate knowledge in this area.

## Content of the guidance

By their very nature conflicts of interest can be very difficult to manage, and hence pose a risk to good governance. They are also subject to some very complex legal

considerations. Throughout the paper we have emphasised that these legal complexities exist and the importance (in most situations) of obtaining independent legal advice when seeking to mitigate the legal risks associated with the conflicts.

The guidance includes five high level principles:

Principle 1 – Understanding the importance of conflicts of interest;

Principle 2 – Conflicts of interest policy;

Principle 3 – Identifying conflicts of interest;

Principle 4 – Evaluation, management or avoidance of conflicts; and

Principle 5 – Managing adviser conflicts.

The principles are supported by practical guidance on matters relating to the governance of each. We have also included case examples which have been provided by both external stakeholders and operational teams at the regulator. We hope that these will give an indication of how the governance of these principles may work in practice. To assist trustees further we have also provided an example of a conflicts register and an example of a policy (or protocol) - these are only examples, we would expect trustees to tailor these documents accordingly.

The guidance refers specifically to potential conflicts experienced by trustees who also hold a senior position within the sponsoring employer; we believe such emphasis is appropriate given the scope for conflicts, as well as attention already given to such conflicts in these circumstances. It should not be forgotten employers have some interests in common with the beneficiaries. One example is, where there are active members for whom the pension promise is integral to the remuneration package. There may, nonetheless, be a divergence of views between employer nominated and other trustees, for instance in relation to the strength of the employer; where there is a perception that views diverge as a result of a conflict of interest, this must be managed accordingly.

Employer nominated trustees may experience a conflict of interest where they have a personal stake in particular decisions, for instance through profit sharing arrangements where profits, in the short term at least, are effected by trustee decisions. This may also be the case where the trustee is associated with a company that could benefit financially from trustee decisions. In such cases conflicts may be so acute or extensive as to make them very difficult or impossible to manage.

There may be a variety of ways to manage a conflict, however, in cases of an acute or pervasive conflict it may even be appropriate for a trustee to resign and an independent trustee appointed in their place.

## **Looking to the future**

The improvements made over the past year in respect to formalising conflicts management arrangements are pleasing. However, a large proportion of schemes have yet to implement a policy or a register. We have a particular concern that some

trustee boards may not be identifying conflicts. This is not desirable nor will be the outcomes affected by this lack of awareness.

Following the publication of this guidance we would hope to see a marked improvement in the governance of conflicts. The guidance will also compliment the work already undertaken by a number of trustee boards; we will continue to gauge performance by reference to the results of the 2008 and 2009 governance survey.

Whilst there has been a general improvement, we recognise that there is still some way to go. Trustee training is a key contributor to a well run scheme and training on managing conflicts should be an integral part of this.

The deadline for submission of responses to this consultation paper is 30th May 2008. More information on how to submit responses can be found in Appendix E at the end of this document.



# **Conflicts of interest**

(A consultation document)

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Guidance from the Pensions Regulator

**February 2008**

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## Conflicts of interest at a glance

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- 1 A conflict of interest may arise when a fiduciary is required to take a decision where (1) the fiduciary is obliged to act in the best interests of his beneficiary or principal and (2) at the same time he has or may have either (a) a separate personal interest or (b) another fiduciary duty owed to a different beneficiary or principal in relation to that decision, so that there is a conflict with his first fiduciary duty<sup>1</sup>. It can inhibit open discussions or result in decisions, actions or inactions that are not in the best interests of beneficiaries. This in turn may result in the trustees acting improperly, lead to a perception that the trustees have acted improperly and may also invalidate a decision or transaction.
- 2 Broadly, when considering the issue of conflicts of interest this can be done in three key stages; first, identification; second, monitoring; and third, managing. It is this third stage which is a complex and difficult area. The way in which conflicts are managed will clearly be scheme specific. This is a difficult area due to the various sources that govern this area (for instance, common law, equity and trust law and pensions and general legislation).
- 3 Conflicts of interest may be classified as either real conflicts or potential conflicts; nonetheless they must first be identified<sup>2</sup>. For any conflicts management procedure to be successful, it must include a process for identifying in advance potential conflicts of interest.
- 4 The regulator recognises that in certain circumstances, there may be some benefits from appointing senior members of staff of the employer as trustees or to the trustee board. However, if representatives of an employer are trustees of a scheme (or directors of a trustee) conflicts are inherently likely to arise. It is therefore vital that those conflicts are appropriately identified, monitored and managed, if they cannot be avoided completely.
- 5 There may be a variety of ways to manage conflicts, including the use of a number of measures or a combination of approaches, for example using an independent trustee, establishing an executive sub committee or the trustee withdrawing from the meeting for the relevant agenda item. In cases of an acute or pervasive conflict it may even be appropriate for a trustee to resign. There are potential issues with any approach and trustees should therefore obtain independent legal advice when considering any option<sup>3</sup>. This may include advice from a lawyer and from other professional advisers depending on the nature of the matter in hand. This advice should be sufficient to support decisions made in respect of conflicts management.

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<sup>1</sup> Such conflicts of interest may affect not only trustees but also directors, agents, professional advisers and others.

<sup>2</sup> Unless otherwise stated, references to conflicts of interest include real and/or potential conflicts.

<sup>3</sup> All examples in this guidance are for illustrative purposes only and do not negate the trustees' duty to seek independent legal advice where appropriate. All conflicts scenarios are scheme specific and fact dependent and these should be discussed with the legal adviser.

- 6 Trustees also need to ensure that when engaging advisers, conflicts that may affect the independence of the advice are identified and appropriately managed, for instance where an individual adviser is appointed to advise both sides of a negotiation.
- 7 There should be a culture of openness around the disclosure of conflicts of interest. Identifying, reporting and managing them should be embraced not ignored.
- 8 We expect conflicts to be resolved amicably between employers, trustees and their advisers. Where a conflict comes to the attention of one of our regulatory teams that presents a significant risk to members' benefits we may decide to take action.
- 9 Whilst this guidance acknowledges that there are certain respects in which the law is unclear in relation to this area it is not the regulator's role or intention to provide definitive legal answers to these questions in this guidance.
- 10 This guidance does **NOT** therefore replace the requirement to seek independent legal advice which should be tailored to the specific circumstances of the situation.
- 11 This guidance is not intended to focus on the complexities surrounding the concept of conflict of interest. However, it does deal with the governance issues arising from this concept. This is in line with the regulator's objective to promote and improve understanding of the good administration of work-based pension schemes.

## About the guidance

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- 12 Conflicts of interest are a serious concern for the regulator. They are likely to arise in the trustee model of governance because many trustees have some kind of stake in the scheme or its sponsoring employer. This does not mean that the conflicts can be ignored, it means that, where they do arise they must be managed appropriately. If they are not effectively managed decisions may be taken that put the interests of some or all beneficiaries at risk, or subsequently prove to be invalid. It is our aim that trustees know how to identify and manage conflicts in a way that avoids such consequences.
- 13 Furthermore, in some situations the conflicts of interest may be so acute or pervasive it would be better to avoid them entirely, for example by the appointment of an independent trustee in place of a trustee with an acute conflict.
- 14 This guidance supplements the information provided in the regulator's e-learning programme and *Trustee, Knowledge and Understanding (TKU)* framework (code of practice, scope and syllabus<sup>4</sup>).
- 15 We recognise that many schemes already have conflict management arrangements in place. We have therefore issued this guidance to assist trustees of occupational pensions schemes and help improve their governance arrangements by:

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<sup>4</sup> [www.trusteetoolkit.com](http://www.trusteetoolkit.com)

- assessing the adequacy of the arrangements they currently have in place to manage conflicts of interest;
  - addressing any gaps that are identified; and
  - understanding what the regulator’s expectations are in respect of sound conflict management arrangements.
- 16 The table on page 7 summarises the key principles of sound conflict management arrangements. This table should be used by trustees to gauge the extent to which they have, at a high level, addressed the key principles in establishing sound conflict management arrangements. The remainder of the guidance illustrates ways in which we have seen trustees dealing with the issue of conflicts of interest and includes some real life case examples. However, we are not endorsing the legality of any particular approach which must take into account the circumstances in which the conflict of interest has arisen. In determining the appropriate approach the trustees should seek legal advice on the scheme specific and fact dependent nature of their particular situation.
- 17 This guidance is specifically not intended to provide exhaustive guidance on what trustees need to do to comply with the relevant legal requirements. Trustees should look to their legal advisers for this. This guidance is to promote, and to improve understanding of, the good administration of work-based pension schemes<sup>5</sup>. Trustees should continually assess what arrangements (i.e. measures, processes and procedures) they need to have in place in order to ensure they effectively identify, manage or avoid conflicts if they arise.

## **The trustees’ role**

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- 18 This guidance is relevant for trustees of all occupational pension schemes. Whilst conflicts may arise in contract-based arrangements, this guidance is not intended to cover these as they may differ considerably in nature.
- 19 A well run scheme will be underpinned by a robust governance framework. Such a framework will support the trustees in fulfilling their role of acting in the best interests of scheme beneficiaries (which will sometimes involve balancing the interests of different beneficiaries). Trustees are continuously required to make decisions on behalf of scheme members. It is essential that these decisions are not affected by conflicts of interest so that valid decisions are made, and are perceived to be made, in the beneficiaries’ best interests.

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<sup>5</sup> Section 5(1)(d) Pensions Act 2004

- 20 The duty of a trustee to act in the best interests of beneficiaries is imposed by the principles of trust law. Whilst conflicts may be inevitable in some cases, the pertinent issue is that they are properly identified, monitored and managed. The failure to deal with the issue of a conflict of interest in a proper way could result in trustee actions being set aside and/or personal liability for the trustees.
- 21 Trustees who are also directors of the employer will also need to consider, and seek legal advice on the requirements of the Companies Act 2006<sup>6</sup> and the obligation on directors of a company to avoid a situation in which they have, or can have a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company where such a situation arises. It is beyond the scope of this guidance to consider this legislation in detail and the trustees should discuss this with their legal adviser.
- 22 Having senior staff of the employer on the trustee board may also bring some benefit to the effectiveness of the trustee board, particularly in terms of their knowledge and expertise. Against this however, it needs to be recognised that such trustees may face conflicts of interest both as members of the scheme and servants of the employer.
- 23 All trustees must remember that whilst acting as a trustee their main duty is to the beneficiaries of the scheme. Trustees should also be aware that there are circumstances, for example a requirement to report to the regulator a breach of law under section 70 of the Pensions Act 2004 (the Act), which override the other duties of the trustee.
- 24 Each trustee board will need to determine the correct mix of trustees to suit each pension funds circumstances. There is much to be said (if the resources of the scheme permit it) for the practice of employing independent trustees. Independent Trustees will (almost by definition) ordinarily have no conflicts of interest and yet will still bring knowledge and expertise to bear on the issues to be decided by the trustees.

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<sup>6</sup> The Companies Act 2006 Section 175

### ***Other guidance to consider***

The Institute of Chartered Accountant's in England and Wales (ICAEW) helpsheet on managing conflicts describes the circumstances in which employees may be afforded protection under employment rights legislation if they are penalised for carrying out the duties as a trustee and/or for reporting matters to the regulator, contrary to the employer's instructions. It states that a report, which does not disclose information subject to legal professional privilege, under section 70 (breach of law) of the Act is likely to be a protected disclosure. Employees suffering detriment or dismissal as a result of making such a report may seek protection under the Employment Rights Act 1996 (ERA).

**The Institute of Chartered Accountants in England and Wales (ICAEW) *Acting as a trustee for the pension fund of your employer, Guidance to manage conflict* issued January 2007 (revised June 2007)**

**The section of this guidance headed "Other references" includes references to other documents and sources which you may also find useful.**

## **Principles of sound conflict management arrangements – a summary**

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Listed below is a summary of some of the key principles that underpin sound conflict management and governance. Trustees can refer to this table for an easy reference to some of the issues that trustees should consider, along with their legal advisers, when adequately mitigating the risks associated with managing conflicts. These principles are covered in more detail in the subsequent sections of this guidance which provide suggestions as to how the principles may be applied in practice.

### **Table 1 - Summary of key principles**

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#### **Principle 1: Understanding the importance of conflicts of interest**

- 1.1 Trustees should be aware of their fiduciary obligations to beneficiaries, the requirement to exercise independent judgement and to be perceived to be doing so.
- 1.2 Trustees should have a clear understanding of the circumstances in which they may find themselves in a position of conflict of interest.
- 1.3 Trustees should communicate to those persons nominated to be a trustee, or upon appointment, the legal requirements imposed on trustees and their legal duties.
- 1.4 Trustees must recognise that conflicts of interest is a legally complex area and should seek legal advice as necessary.

#### **Principle 2: Conflicts of interest policy**

- 2.1 Trustee boards should agree and document their policy (or procedures) for identifying, monitoring and managing its conflicts.
- 2.2 Trustees should ensure that their conflicts management policies (or procedures) are kept under regular review.
- 2.3 All trustees should understand their conflicts policy, with training provided as required.

#### **Principle 3: Identifying conflicts of interest**

- 3.1 Trustees should consider in advance any conflicts that may arise in the future and notify the trustee board as soon as practically possible.
- 3.2 Trustee appointment procedures should require trustees to disclose any conflicts.
- 3.3 Trustees should confirm that they are not aware of any further conflicts that have not been disclosed to the trustee board.
- 3.4 Trustee boards should maintain an up-to-date register of each trustee's interests, e.g. financial interests (shares etc) and other appointments.

#### **Principle 4: Evaluation, management or avoidance of conflicts**

- 4.1 Trustee boards should following legal advice implement procedures for evaluating and, where possible, managing conflicts that have been identified in a way that ensures that decisions are not compromised by the conflicted trustee(s).
- 4.2 Minutes of meetings should clearly detail conflicts which may arise during a decision-making process and record the action taken by trustees to manage the conflict.

- 4.3 Independent legal advice should be sought by trustees where a material conflict of interest is identified or when legal advice is required to help decide the best approach to be used to attempt to manage a conflict.
- 4.4 Trustees should be aware that some conflicts due to their acute or pervasive nature cannot be managed and in association with their legal adviser may determine that resignation and appointment of an independent trustee is the only option.
- 4.5 The regulator cannot give guidance appropriate for every scheme as this depends on the nature of the conflict and the scheme's trust documentation which is why seeking independent legal advice is emphasised throughout this guidance.

**Principle 5: Managing adviser conflicts**

- 5.1 Trustees should actively manage their relations with advisers to ensure that advisers are able to provide independent advice.
  - 5.2 Trustees should require their advisers to declare any conflicts that may arise in respect of their engagement, noting that some advisers are legally obliged to do so.
  - 5.3 Trustees need to consider in advance whether conflicts make it undesirable for a particular adviser to be appointed or continue to act for the trustees in circumstances where a conflict with the may arise.
  - 5.4 Where a conflict is declared to the trustee board, the trustees should evaluate the nature of the conflict and determine what course of action is appropriate.
  - 5.5 Trustees served by an in-house pensions manager and secretariat need to understand the reporting lines and conflicts these individuals may have.
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25 The following pages share approaches we have seen which apply the principles of sound conflict management. Inclusion of an approach within this guidance should not be taken as the regulator's endorsement of that approach. Whilst the principles may be applicable to most schemes we understand that there cannot be a 'one size fits all' approach. The nature of the legal problem and how trustees resolve these issues will vary from scheme to scheme. Therefore the specific nature of the arrangements put in place will need to be tailored to be scheme specific. Trustee boards are best able to assess their needs, upon appropriate independent advice (legal and otherwise). This guidance does not negate the trustees' responsibility to seek independent legal advice.

# Principle 1: Understanding the importance of conflicts of interest

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- 1.1 Trustees should be aware of their fiduciary obligations to beneficiaries, the requirement to exercise independent judgement and to be perceived to be doing so.
  - 1.2 Trustees should have a clear understanding of the circumstances in which they may find themselves in a position of conflict of interest.
  - 1.3 Trustees should communicate to those persons nominated to be a trustee, or upon appointment, the legal requirements imposed on trustees and their legal duties.
  - 1.4 Trustees must recognise that conflicts of interest is a legally complex area and should seek legal advice as necessary.
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- 26 Trustees have a legal obligation (*inter alia*) to act in the best interests of the scheme beneficiaries<sup>7</sup>. The “rule” which prohibits conflicts of interest exists because of the *possibility* that, if a conflict arises, it may lead to a breach of this duty to act in the best interests of the scheme beneficiaries, or otherwise result in a trustee failing to properly consider a decision. The rule against conflicts is therefore a preventative measure, designed to remove the *risk* of improper conduct. For this reason, a decision taken by a person with a conflict may be invalidated (or restrained) without any proof that a trustee has been (or will be) swayed by improper or irrelevant considerations as a result of the conflict<sup>8</sup>. Equally however, the existence of a conflict will not *per se* invalidate a decision *provided that* steps have been taken to properly manage the conflict such that there is no realistic possibility of the conflict having operated so as to cause the trustees to have acted for an improper purpose<sup>9</sup>.
- 27 A trustee of a trust-based pension scheme in general must be a fit and proper person<sup>10</sup>. Amongst other matters this requires that trustees have a knowledge and understanding of the law relating to pension schemes generally. As explained in the regulator’s code of practice no.07: *Trustee knowledge and understanding* and the *trustee toolkit* this includes being able to identify the range of situations which may give rise to conflicts and how to manage those conflicts<sup>11</sup>.
- 28 The law relating to conflicts of interests is complex and comes from a variety of sources. Some comes from the common law (case law); some from the rules of equity and from legislation (for the purposes of

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<sup>7</sup> In some cases the trustees may also have to consider the interests of other persons such as the sponsoring employer, e.g. in a winding up when there is a surplus.

<sup>8</sup> *Bray v Ford* [1896] AC 44 at 51-2.

<sup>9</sup> *Public Trustee v Cooper* [2001] WTLR 901 at 932H-936H.

<sup>10</sup> Or they can be removed under section 3 of the Pensions Act 1995 (as amended by section 33 of the Pensions Act 2004).

<sup>11</sup> For newly-appointed lay trustees and lay directors of corporate trustees these particular requirements for knowledge and understanding and to be conversant with scheme documents will not apply for a period of 6 months from the date of appointment as trustees to a scheme - (*The Occupational Pension Schemes (Trustee’s Knowledge and Understanding) Regulations 2006*).

this guidance pensions and trust legislation). This is why when trustees consider how to best manage an identified conflict, the role of the legal adviser is important.

29 In order to establish sound conflict management arrangements trustees must understand their duties, including the fiduciary obligation to act first and foremost in the members' best interests. Specifically, trustees should have an understanding of the:

- trustee's fiduciary duties, including the distinction between duties, powers and responsibilities;
- obligation to take into account the needs of all beneficiaries;
- concept of duty of care and the standard to which it should be exercised;
- requirement to act impartially;
- meaning of acting responsibly and prudently;
- duty not to profit from the trust; and
- duty to see that sums owed are paid.

Have you considered the role of the chair in identifying and managing conflicts?

30 The chair of a trustee board can play a pivotal role in the effective operation of the board and plays an important part in establishing robust conflict management arrangements. In fulfilling this role, the chair should ensure that:

- trustees are appropriately informed of their duties and responsibilities in relation to conflicts of interest;
- trustees are aware of the importance of declaring any conflicts to the trustee board; and
- any conflicts declared to the board are documented and monitored so that the board has ample opportunity to consider the management or avoidance of a conflict.

31 In some trustee boards a senior employee of the sponsoring employer has been appointed as chair to the board of trustees. Where this is the case, trustees will need to think very carefully about the processes they would need to manage or avoid any conflicts that involve the chair.

32 In contrast, appointing an independent trustee as chair of a trustee board avoids such problems. An independent chair is ideally positioned to supervise conflict management and avoidance procedures.

## Types of conflicts

33 Trustees who have a thorough understanding of their duties and responsibilities are best placed to recognise conflicts that may arise. The trustees' conflicts policy should provide examples of the types of conflicts that may arise for that scheme. This will assist in informing

trustees of the circumstances or events which may cause a conflict of interest to arise. Where conflicts are identified, trustees are able to then put in place appropriate measures to monitor and if possible manage them.

Have you debated and agreed the types of conflict that may arise in your specific circumstances?

34 Conflicts are likely to be of two main types:

- conflicts of personal interest between the trustee, a director or staff member and those of the fund (e.g. personal financial gain); and
- conflicts of duty owed to the fund and to another party (e.g. the fiduciary duty to act in the best interests of the members may conflict with the duty of directors to act in the best interests of the sponsoring employer/shareholder).

35 Some examples of situations where an individual may find themselves in a position which could constitute a conflict of interest include:

- role related
  - where a trustee is a significant shareholder in the sponsoring employer (particularly common for smaller companies) and where as a result of his holding is able to exercise a degree of influence over decision making at a company level.
  - where a trustee is a director or senior employee of the sponsoring employer.
  - where a trustee is a member or beneficiary of the scheme<sup>12</sup>.
  - where a trustee acts on the boards of more than one scheme with the same sponsoring employer.
  - where a trustee is also a director of a company providing services to the scheme.
  - where a trustee is also a union representative or employee representative.
  - where a trustee is also employed by or on the board of a potential service provider to the pension scheme.
- situation specific
  - where the sponsoring employer(s) pay any expenses e.g. administration in respect to the scheme and the objective is to minimise costs, which may diverge from the trustees' decision to raise standards of service provision at a higher price.
  - in-house pensions administration where the pensions manager is responsible for providing services to one or a number of schemes, as well as advising the employer on pensions related matters, especially if considered to be strictly private and confidential, e.g. potential corporate transactions.

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<sup>12</sup> Section 39 of the Pensions Act 1995 provides that the rules of law on conflicts of interest shall not apply to a trustee, who is also a member of a pension scheme, exercising the powers vested in him in any manner, merely because their exercise in that manner benefits, or may benefit him *as a member of the scheme*; but that statutory provision does not offer protection in any other situations where conflicts of interest arise.

- investment decisions where an individual trustee may have shares or other pecuniary interests in companies in which the board of trustees may wish to invest.
- funding decisions where the trustees' views on the strength of the employer covenant, assumptions to be chosen or affordability may differ from those of the sponsoring employer or result in higher levels of contributions.
- funding decisions which are unduly influenced by a trustee who also holds a senior role within the employer.
- trustee involvement in corporate transactions involving the sponsoring employer where the interests of the scheme as a creditor may diverge from the benefits accruing to other parties to the transaction.
- employer-nominated trustees may also become privy to sensitive information relating to the employer which could have an impact or potential impact on the scheme.
- a decision by trustees to windup/close the scheme to future accrual which may conflict with the views of employee representatives or the interests of active members.
- Where conversion terms for member options are under discussion, particularly those for commutation of pension at retirement - whilst trustees are likely to be motivated to ensure broad cost neutrality within the scheme, the employer may prefer to see and encourage conversion terms that lead to lower expected costs.

### **Conflicts purportedly “authorised” by the scheme**

- 36 It is not infrequent to find provisions in the governing documentation of schemes (including in the articles of association of a corporate trustee), which purport to authorise or permit conflicts of interest on the part of trustees, or trustee directors. Sometimes these provisions do not require any steps to be taken to deal with the conflict other (perhaps) than that the conflict is disclosed. The regulator does not regard it as safe, still less does it consider it to be best practice, to treat such provisions as obviating the need for proper conflict management procedures in all situations.
- 37 The only conflict that is clearly authorised is that of a member of the scheme by virtue of his or her membership. Section 39 of the Pensions Act 1995 provides:
- “No rule of law that a trustee may not exercise the powers vested in him so as to give rise to a conflict between his personal interest and his duties to the beneficiaries shall apply to a trustee of a trust scheme, who is also a member of the scheme, exercising the powers vested in him in any manner, merely because their exercise in that manner benefits, or may benefit, him as a member of the scheme.”*
- 38 Beyond section 39 it is unclear whether provisions in the governing documentation of a scheme, which purport to authorise conflicts, can

simply be taken at face value. On general principles of construction, for a conflict to be authorised by such provisions, the conflict would have to be of a type which would have been in the contemplation of the draftsman of the provision in question. A general authority in a trust deed and rules to act notwithstanding a conflict may therefore be construed as applying only to conflicts of a type which arise out of the normal relationship between trustees, employers and members of a pension scheme. Furthermore, a provision in the articles of association of a corporate trustee may authorise conflicts only as regards the shareholders of the trustee (who are bound by the articles) and may not preclude the members of the pension scheme complaining of a conflict if it arises.

- 39 Finally, it should be noted that provisions like section 39 which “merely” authorise conflicts, do not permit a trustee to act if the conflict would actually cause a trustee to be swayed by improper or irrelevant considerations (e.g. where the conflict would result in a trustee acting other than in the best interests of the beneficiaries).

Do newly appointed trustees receive induction training on their roles and responsibilities?

### **Newly appointed trustees**

- 40 As a matter of good practice newly appointed trustees should receive induction training that provides an understanding of the special nature of a pension trust and the duties, obligations and powers of trustees to operate pension schemes<sup>13</sup>. All trustees should undertake training in relation to conflicts of interest, for instance on how to identify conflicts and what to do.
- 41 Trustees should be made aware of, and ensure they understand, the scheme’s policy on identifying and managing conflicts. This means trustees need to be vigilant to the possibilities of conflicts arising and continually review this possibility on a regular basis.

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<sup>13</sup> Trustee Knowledge and Understanding Indicative Syllabus.

## Principle 2: Conflicts of interest policy

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- 2.1 Trustee boards should agree and document their policy (or procedures) for identifying, monitoring and managing its conflicts.
  - 2.2 Trustees should ensure that their conflicts management policies (or procedures) are kept under regular review.
  - 2.3 All trustees should understand their conflicts policy, with training provided as required.
- 

### Conflicts of interest policy

Do you have a documented conflicts of interest policy?

- 42 It is good practice for trustees to have in place a documented policy on conflicts of interest which includes the procedures adopted by the board to enable conflicts to be identified and managed. The policy can be a stand-alone document, part of the scheme's governance policy, or code of conduct for trustees, or be included in the trustees' compliance procedures. It should be formulated and approved by the board. Various titles can be used for a stand-alone document, including 'protocol' and 'procedure'. It will commonly be appropriate for the policy to encompass the management of conflicts affecting others with a fiduciary responsibility including the secretary to the board or pensions management department, or a separate policy may be approved for such persons.
- 43 The pension scheme's governing documentation may include some provisions relating to the management of conflicts. These documents may therefore be the starting point for the formulation of your policy but they should not be regarded as the end point. In particular (as set out in paragraphs 36 - 39 above) the more widely drafted provisions found in some governing documents should not necessarily be taken to authorise all conflicts whatever their nature and whatever the circumstances. If in doubt, legal advice should be obtained. Provisions of the governing documentation should be taken into account in preparing the policy but are unlikely by themselves to cover the full range of issues that the trustees will wish to detail in the policy. As referred to in Principle 1.4 there are a variety of legal sources around the legal aspects of conflict of interest which should be discussed with the legal adviser.
- 44 Having a policy should help trustees comply with the legislative requirement to have adequate internal control mechanisms in place to adequately secure that the scheme is administered and managed in accordance with the scheme's trust deed and rules and the legislation. This is further explained in the regulator's code of practice no. 9 *Internal controls*. Therefore, the trustees' risk management framework should incorporate specific policies or procedures to manage conflicts of interest as part of ensuring that the decision-making process is independent and unfettered.

Are trustees familiar with the policy?

45 There are two further benefits of documenting the trustees' policy:

the process for documenting governance policies and procedures provides an opportunity for trustees to analyse the governance issues relevant to their scheme. It also helps ensure that all issues have been addressed by the development and implementation of appropriate policies and procedures, including amendments to scheme rules where appropriate; and

it can enable the trustees to demonstrate that they have taken necessary steps to ensure that a conflict is appropriately managed and that ultimately members' benefits are protected, thereby managing perceptions that actions that were conflicted have been dealt with properly.

46 The policy should be tailored to reflect the operations of the trustee board. Larger or more complex schemes may generally need more detailed policies whilst smaller schemes may need less detail. However, the need for a documented policy applies to all schemes.

47 The sorts of policy details that could be covered include:

- Understanding the scheme trust deed and rules as this is critical;
- the trustees' fiduciary and statutory obligation 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;
- processes in place to avoid conflicts;
- the options available for the trustee in managing conflicts (this will almost certainly require some legal input); and
- monitoring compliance with and review of the policy itself.

48 A number of trustee boards have already produced a tailored policy document for their scheme, some of which are very comprehensive. Whilst the level of detail is a matter for the trustees to decide upon, the policy document should be a clear and concise working document. We have included one example of a scheme's conflicts protocol (or policy) in Appendix D to give an idea of what is currently prepared in practice. Please note that this example does not negate the trustees' duty to seek independent legal advice.

Does the policy have a process for monitoring compliance?

## Monitoring compliance with the policy

49 The legal obligations and liabilities of trustees in trust law are complex and in some respects unclear. **It is therefore essential that the scheme's legal advisers review and advise on the policy.**

50 For a policy to be effective it should be implemented and accompanied by effective compliance monitoring. In this regard the policy should contain or refer to procedures for identifying instances of non-compliance with the trustees' conflicts management arrangements. There should also be procedures disclosing how non-compliance is

dealt with, for instance, how it is recorded and reported to the trustee board.

Does your policy have a process for its review?

## Review of the policy

- 51 It is good practice that the policy is regularly reviewed to ensure that it is current and reflects the trustees' operations. The policy should nominate the person who should be responsible for review, eg a trustee, compliance officer, scheme secretary or internal auditor. In any event the scheme's legal advisers should be involved in any change that is made. This could be linked with the scheme's risk review cycle<sup>14</sup>. Reviewing the policy may identify instances where the trust deed and rules should be amended to facilitate the management of conflicts (for instance by enabling an executive sub-committee to be established to handle situations, particularly if more serious conflicts seem likely to arise).
- 52 There should be a culture of openness around the disclosure of conflicts of interest. Identifying, reporting and managing them should be embraced not ignored.

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<sup>14</sup> The Pensions Regulator's code of practice no. 09 – internal controls.

## Principle 3: Identifying conflicts of interest

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- 3.1 Trustees should consider in advance any conflicts that may arise in the future and notify the trustee board as soon as practically possible.
  - 3.2 Trustee appointment procedures would require trustees to disclose any conflicts.
  - 3.3 Trustees should confirm that they are not aware of any further conflicts that have not been disclosed to the trust board.
  - 3.4 Trustee boards should maintain an up-to-date register of each trustee's interests, e.g. financial interest (shares etc) and other appointments.
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- 53 Trustees who take the time to identify any conflicts of interest are in a better position to handle conflict situations that arise. In some instances such conflicts are inherent. One example of circumstances where a conflict would arise is in relation to the funding of the scheme where trustee and employer views or interests may diverge; (under the Act<sup>15</sup> and supporting code of practice trustees are expected to consider closely the strength of the employer's covenant and ensure that prudent assumptions are set as a basis for future funding).
- 54 Conflicts that have materialised are deemed to be *actual or real conflicts*. At this stage, the trustee must manage the conflict by determining what further action, if any, is required. Some of the options available to the trustee are discussed further in the next section.
- 55 Trustees should also be aware of any perceived conflicts. Such conflicts exist when a trustee's decision or activity is quite proper; however, the decision or activity may appear to others to have been influenced, or to be open to influence, by other persons or responsibilities held by the trustee and, thus, to be to the detriment of the scheme.

### Declaring interests

- 56 Importantly, before conflicts can be identified, trustees must be aware of any other interests or obligations owed by individual trustees to another party which may conflict. Trustee boards should have a process in place to require trustees to declare conflicts upon appointment and thereafter as and when they arise. This is considered in a little more detail below:

Do you require new trustees to declare any interests and potential conflicts?

- *Upon appointment* – new trustees should be required to complete a declaration disclosing any conflicts or interests. This can be as simple as requiring the trustee to declare that he or she is not aware of any conflicts of interest which may adversely affect his or her suitability for the position, other than those interests which have

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<sup>15</sup> Pensions Act 2004

been expressly disclosed (see Appendix C for an example). This enables the trustees to be aware of any conflicts and monitor any potential conflicts that may materialise in the future.

Do you have a process to identify any new conflicts?

- *Regular monitoring of status of trustees* – to be effective, the declaration of interests needs to be updated at least annually and also when any changes to personal circumstances occur. Trustees should consider including conflicts as a standard agenda item in each meeting, requiring trustees to declare circumstances that could give rise to a conflict.

57 Declarations should always be recorded in the minutes of the meeting, together with the actions taken. Where a register is also maintained the trustee should cross refer a note in the minutes to the record (which should include any action taken in respect of the conflict of interest) within the register.

58 In addition to trustees making declarations, it is also good practice for the scope of declarations to include advisers and pensions managers (especially if in-house), both at appointment and thereafter. This is considered further in Principle 5.

## Recognising potential conflict situations

59 There are numerous mechanisms that boards can implement to ensure that conflicts are identified, including the maintenance of a register and consideration of key decisions in advance. The chair will also have a key role in recognising conflicts, as well as determining how to manage them.

Do you have a means, eg a register, to record any interests or conflicts that are declared?

- *Maintaining a register of conflicts/interests* – a register of conflicts is a simple and effective method of monitoring conflicts; actual, potential and perceived. It is good practice for trustees to maintain such a register to record any conflicts that have been disclosed to the board of trustees and any that the board has agreed should be monitored (see Appendix B for an example). A register can help demonstrate that the trustees are taking the necessary steps to discharge their fiduciary duty to act independently. It should be remembered that declaring a conflict is a necessary but not sufficient way of dealing with it. It is a starting point for allowing the conflict to be managed

Have you considered the key decisions to be made in the future and whether there may be any conflicts that are likely to arise?

- *Thinking ahead* – the importance of recognising when an identified conflict may crystallise and advance planning cannot be emphasised enough. In the majority of situations, trustees who are able to identify potential conflicts in advance of a decision have sufficient opportunity to put the necessary measures in place to ensure that at the time of the decision being made there is minimal disruption.

60 Trustees should take time to consider what key decisions may be made during, say, the calendar year. For example, where the trustees of a defined benefit scheme will be commencing funding discussions with the employer over the forthcoming year the trustees should

document the decision making process. This should include key dates and determine whether there are any conflicts likely to arise during the decision. If so, the trustees can then plan in advance how to manage the conflict, minimising any disruption to the decision making process, and possibly the costs associated with any last minute action. For example, trustees of a defined contribution scheme may be looking to appoint different investment managers in the foreseeable future. This may incur additional costs which the employer may be reluctant to pay. It would therefore be prudent for the trustee board to identify in advance those trustees whose views may be somewhat biased as a result of their employment with the employer.

- 61 The identification of an actual or potential conflict of interest is pivotal to conflicts management. However, this will only be the first stage of the process. Where a conflict is identified, and where the effect of such a conflict could be, for example, materially detrimental to the conduct or decisions taken by the board of trustees, mitigating action must be taken. The case example below provides a useful example of how the trustees' actions and decisions could be open to question as a result of an identified conflict which has not been suitably addressed.

## **Case example**

### **Importance of identifying conflicts of interest – funding negotiations**

This particular case was opened initially following the receipt by the regulator of the scheme's recovery plan where it became apparent that optimistic funding assumptions had been adopted.

The trustee board consisted of 50 per cent member-nominated and 50 per cent employer-nominated trustees. One of the employer-nominated trustees involved in the negotiations leading to the agreement of future deficit funding was the finance director (FD) of the sole employer. Upon further investigation of the financial health of the employer, it was apparent that the employer covenant was weak.

To assist with the review of the recovery plan, the regulatory staff met with the trustees of the scheme to find out how the assumptions behind the technical provisions, particularly those in relation to investment return had been set. The trustees advised that they had commissioned an independent covenant assessment and provided the regulator with a copy as well as authorising access to the report's author.

However, it became obvious from reading the report and speaking with its author, that the report's remit had been simply to consider the affordability of payments to the pension fund. It did not provide an assessment of the company's future trading prospects (going concern) nor give an overall summary of the covenant to the trustees, for the purposes of informing their decisions on investment return assumptions etc. Furthermore, the report did not surmise that the employer was 'strong' and the decision to base funding assumptions on this basis was contentious.

When asked how they dealt with any conflicts of interest on the trustee board, the trustees said that the FD had declared a conflict of interest in relation to discussions about the recovery plan and had therefore withdrawn from any decision making process. When asked if the FD/trustee was present in discussions regarding the setting of the investment return for the technical provisions, the trustees confirmed that he had. The conflicted trustee had advised the trustee board collectively that there were many positive attributes which the independent report had failed to address. Although these representations made by the conflicted trustee were unsubstantiated the trustees formed a view, based on this advice that the covenant was stronger than the independent report suggested. As a result of discussions with the regulator, the trustees agreed to reconsider the way in which they addressed the conflict of interest and to consider again whether the technical provisions truly reflect the covenant of the employer. Upon reflection the trustees, excluding the conflicted FD/trustee, resubmitted a revised recovery plan adopting a more prudent set of assumptions which were more aligned to the covenant of the employer. The trustees also developed and implemented a policy specifically for managing conflicts, not just a process for identifying them.

This case example provides some important messages in relation to conflicts management. Whilst the conflict in this particular case had been identified, nothing was done to manage the potential impact of the conflict (and potential impact to members' benefits). In this particular case the FD/trustee had helped influence the decision made by the trustees. Clearly the conflicts arising in this case influenced the decision making process and made it difficult for the trustee board to defend its proposed course of action.

## Principle 4: Evaluation, management or avoidance of conflicts

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- 4.1 Trustee boards should, following legal advice, implement procedures for evaluating and, where possible, managing conflicts that have been identified in a way that ensures that decisions are not compromised by the conflicted trustee(s).
  - 4.2 Minutes of meetings should clearly detail conflicts which may arise during a decision-making process and record the action taken by trustees to manage the conflict.
  - 4.3 Independent legal advice should be sought by trustees where a material conflict of interest is identified, or when legal advice is required to help decide the best approach to be used to attempt to manage a conflict.
  - 4.4 Trustees should be aware that some conflicts due to their acute nature cannot be managed and in association with their legal adviser may determine that resignation and appointment of an independent trustee is the only option.
  - 4.5 The regulator cannot give guidance appropriate for every scheme as this depends on the nature of the conflict and the scheme's trust documentation which is why seeking independent legal advice is emphasised throughout this guidance.
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### Evaluating a conflict

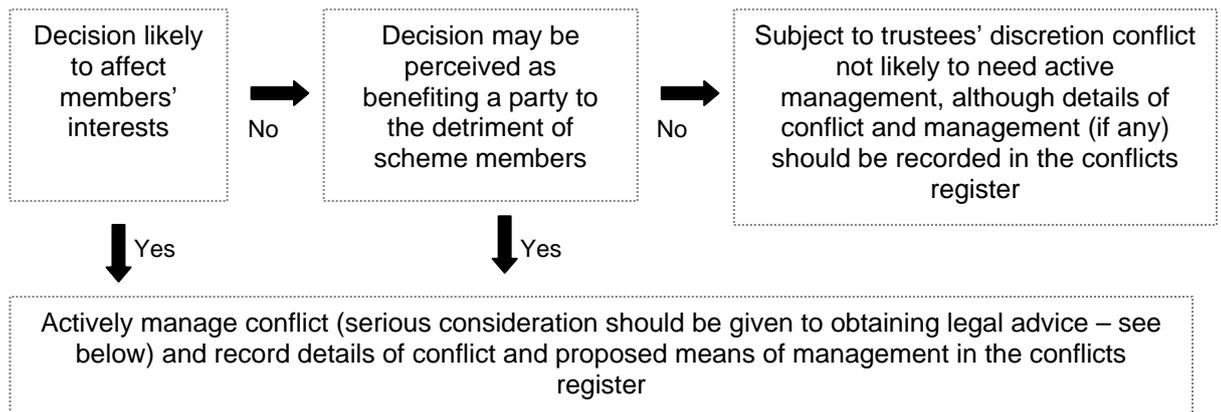
Do you have an agreed policy on how it will be decided whether or not a conflict should be managed?

- 62 When a conflict has been identified it is essential that trustees have a process for assessing whether disclosure of the conflict suffices or whether a more active form of management is needed. Given the serious possible impact on the validity of their decisions, trustees should seriously consider taking independent legal advice.
- 63 After deciding that a conflict is to be actively managed, the trustees need to determine how to do so. Whilst we have seen different ways of doing so, the trustees should have regard to the specific circumstances of the decision being made and the potential impact on scheme members.
- 64 Public perception (particularly that of the scheme's membership and other beneficiaries) should always be considered if a trustee decision will benefit a particular trustee or any person or organisation with whom they are associated. Questions trustees should be asking themselves include:
  - could the trustee board defend its decisions to the beneficiaries and the regulator on the basis that, because of the steps taken to manage the conflict, there was no realistic *risk* of the conflict resulting in a decision being influenced by improper or irrelevant considerations?

- would the conflict of interest prevent the trustee board demonstrating that it is operating independently of other organisations and that it is taking appropriate steps to manage conflicts?

65 The following decision tree may assist trustees to determine whether a conflict should be actively managed. It presumes that the trustee board is in the process of making a decision and a conflict of interest is identified by the trustees.

**Figure 1 - Determining whether to actively manage a conflict of interest**

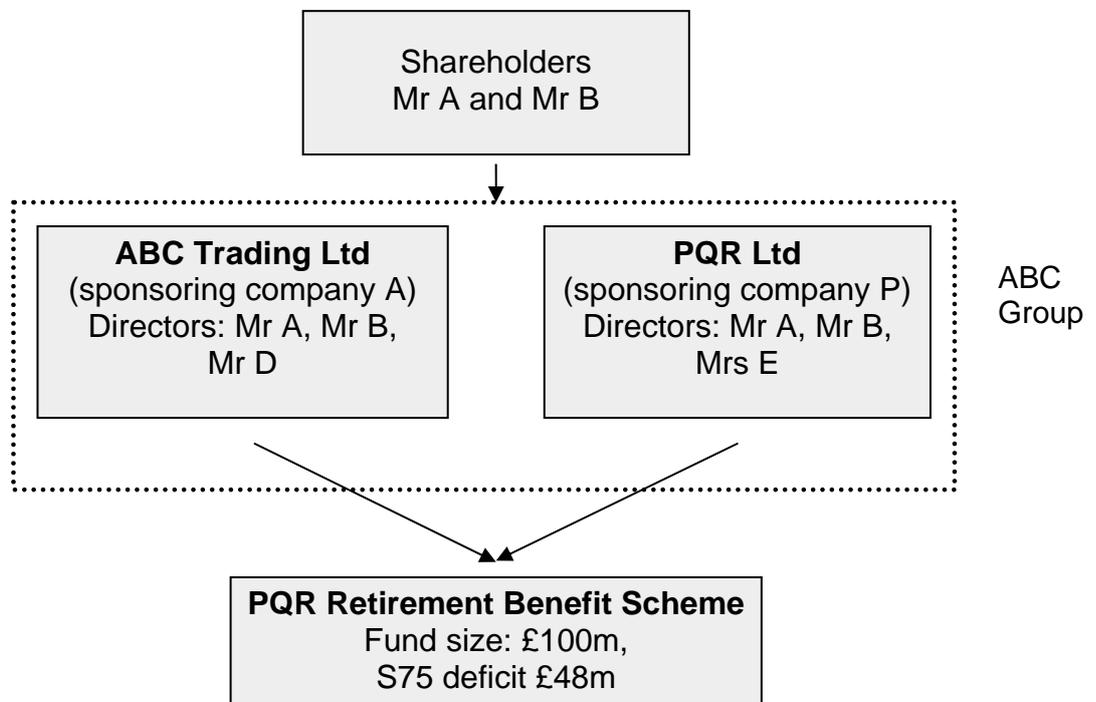


## Seeking independent legal advice

- 66 For any identified conflict of interest, we would expect trustees to seek legal advice in those cases where a conflict is positively identified to ascertain the best way to attempt to manage it. As stated earlier this guidance aims to provide practical assistance in relation to the governance aspects of conflicts of interest and is not designed as a substitute to obtaining scheme specific legal advice.
- 67 For many schemes, particularly those where certain trustees are also directors of the sponsoring employer, their ability to exercise independent judgement on some matters may be inherently compromised due to the conflict between their duty to members and their interests in the employer company as directors or shareholders. Typically, in these situations the first step to manage the conflict is to seek independent legal advice and act on that advice accordingly.
- 68 Seeking independent legal advice may provide the trustees with a professional opinion on which to base an objective decision on behalf of scheme beneficiaries. Obtaining independent legal advice does not however overcome the conflict if the trustees feel they are unable to act independently on this advice. In situations where a trustee's independence of judgement is compromised the advice will need to be accompanied by other conflicts management arrangements.
- 69 Independent legal advice should assist trustees to identify where their decisions are being or could be perceived to be coloured by conflicts and help trustees find ways of managing a conflict or whether this

could lead to a decision becoming invalidated at a later date. For example, conflicts of interest are inherent in any funding exercise or corporate transaction where key members of the trustee board are represented by senior employees of the sponsor, for example company directors. It is therefore vitally important that conflicts are appropriately managed. Independent legal advice may need to be obtained to assist with the management of the conflict, but advice may also need to be obtained from other independent advisers (e.g. an actuary or accountant) to help with any decisions relating to funding and employer affordability – any such decisions should be free from any potential or perceived bias by a conflicted trustee to ensure decisions are valid.

In this example, we explore this very matter whereby two principal shareholders (Mr A and Mr B) in an owner managed business held dual roles as directors of companies A and B and also acted as trustees of the pension scheme. This is depicted diagrammatically below.



ABC Trading Ltd (company A) and PQR Ltd (company P) contributed to a defined benefit arrangement. As part of a business expansion programme, the directors of company A, led by Mr A and Mr B, sought to raise debt using existing assets of company A as security. The projected period for investment payback was predicted in year 5. During this time, company A would be committed to paying both its share of the funding deficit as well as servicing the new debt. This would ultimately be financed by company P under the current arrangements. As a sponsoring employer of the scheme, company A was unable to withdraw from participation as it was not in a position to meet its share of the section 75 debt. It was also probable that company P was sufficiently constrained in terms of its covenant as to be able to provide a credible guarantee in respect of company A's withdrawal. However, the directors continued with their proposal to restructure the group, the result of which could be a potential weakening of both the employer covenants.

As trustees, their responsibilities extended to ensuring that a decision was made that best reflected the position for the scheme membership; that scheme benefits were protected. This required the trustees to independently scrutinise the proposals and assess the transaction in terms of a possible dilution in the employer covenants and future trading prospects. As the trustees were also directors, their ability to exercise independent judgement had been compromised due to the conflict between their duty to members and their interests in the company as directors and shareholders.

In this case where the conflict became untenable the trustees considered the appropriate option to manage the conflict was to initially seek independent legal advice. Acting on that advice the trustees considered it appropriate to appoint an independent trustee. In certain circumstances such an appointment may be made solely for the purpose of managing the conflict during the period of the transaction or event where the conflicted trustees' actions could be perceived as influencing the decisions made by the trustee board, rather than on an ongoing basis.

Should the conflict remain unresolved, placing members' benefits at risk, the regulator would consider intervening.

Does your policy outline the options available to *manage* conflicts?

70 While each of the principles of sound conflict management will apply to schemes of all sizes, small schemes may find that some of the methods outlined below may be less practical for them. In all cases trustee boards (after seeking legal advice) as a matter of good governance should determine the approach or mix of approaches which are most appropriate.

### **Options for managing or avoiding conflicts of interest**

71 Trustees should always declare a conflict to the board of trustees so that the board can evaluate and consider it. The need to manage a conflict of interest does not simply mean that an individual would not be able to act, or be appointed, as a trustee where a conflict exists. It does not provide that a trustee can never be conflicted but rather, that all conflicts of interests be adequately managed - some conflicts may

be managed by a combination of internal controls and disclosure, while others will require more proactive management acting upon the suggestions of the legal adviser.

- 72 The measures or controls that trustees use to manage a conflict will differ according to the nature of the conflict and scheme specific and fact specific circumstances. Trustees commonly use a combination of the following measures as detailed below to manage conflicts, although it should be noted that many other potential options are available.
- 73 The options identified to manage the conflict appropriately will need to take into account the particular circumstances of the conflict and the actual risks the conflict poses. Legal views vary on the effectiveness and validity of different options and the attendant risks, and the board of trustees should therefore seriously consider taking legal advice regarding the identification and management of the conflict of interest. Dependent on the substance of that advice, one or more of the following options may need to be considered (although this list is not exhaustive). It may well be the case that none of the suggested options below resolves the legal problems, if so the trustees will need to explore alternative options with their legal adviser.
- 74 Some conflicts may be so acute or pervasive that they should be avoided entirely, by not making an appointment of a person so conflicted, or even by the resignation of an existing trustee. This may be preferable to having to make arrangements designed to prevent the person in question from influencing one or more decisions of the trustees (or even to prevent the person from gaining knowledge of the other trustees' plans or thought processes) when, for example, they are required to negotiate with the employer.
- 75 It is not possible to provide an exhaustive list of situations where conflicts might be regarded as so acute or pervasive that they should be avoided entirely. However, by way of example only, such conflicts might arise:
- i. Where the trustees of a scheme in deficit have to assess, possibly over an extended period, whether to demand a substantial contribution from an employer in financial difficulties or whether to exercise a power to put a scheme into winding up, triggering a similar demand under section 75.
  - ii. Where the principal activity of the employer, or those who own or control the employer, is that of "management" or provision of investment advice to pension schemes, or they are otherwise seeking to profit from growth in the assets of the scheme.

In these situations conflicts may be better avoided entirely by not appointing representatives of the employer to the trustee board or the resignation of those already appointed and the appointment of independent trustees in their place.

## **Establishing a sub-committee**

- 76 In relation to certain tasks, for example scheme funding, managing corporate transactions or investment related activities, the trustee board may choose to delegate a particular decision to an executive sub-committee. Trustees should seek legal advice if considering this option as there are many scheme specific and legal factors to be considered on whether delegation is possible or desirable and the extent to which this will bind the other trustees. One advantage of setting up a formal sub-committee is that decisions may be delegated to an independent group whose views will not be compromised by another conflicted trustee. At the discretion of the trustees, the sub-committee can be formed on either an ongoing basis or on an ad hoc basis. The trustees are required to act prudently when choosing members of a sub-committee.

## **Withdrawal from decision making process**

- 77 Many trustee boards use formal sub-committees to manage conflicts, and responsibilities are delegated accordingly as detailed above. In the absence of a formal power of delegation of responsibilities to a sub-committee, trustees may wish to consider, after taking legal advice, whether a similar outcome could be achieved by a trustee withdrawing from discussions in relation to a matter on which they are conflicted. Once again the trustees will need legal advice as whether it is possible to manage a conflict in this way as scheme rules may require a unanimous decision of the trustees. If necessary they should first share any information that is material to the decision before any discussion takes place between the remaining trustees.
- 78 The withdrawal from the discussion or decision making would help to ensure that decisions are made without being influenced, or being perceived to be influenced, by a conflicted trustee who may have an interest in the outcome which may not necessarily be in the best interests of the scheme. When considering withdrawal as means of managing a potential conflict, the trustees must consider the merits on a case by case basis with the input of an independent legal adviser. As with all of these suggested methods of conflict management, withdrawal may not always be a solution and may still leave trustees liable; the trustees independent legal adviser will be able to advise on the suitability of this option.
- 79 The regulator is aware that some trustee boards allow the conflicted trustee to remain in the meeting rather than withdrawing. It is for trustees to consider in association with their legal adviser whether this is appropriate in the circumstances, but they should recognise that a trustee who simply abstains while remaining present may still unduly influence or invalidate the outcome or discussion in which case this approach would be ineffective.
- 80 Trustees should recognise that views vary on the risks involved in being liable for decisions taken from which they have withdrawn or abstained, and the validity of such decisions. Trustees should expect their legal advisers to advise on this issue when reviewing the conflicts

policy (see paragraph 51 above) or in relation to the particular decision.

### **Case example**

This case originally came to the regulator's attention as a result of a scheme funding issue (the scheme in question is a small defined benefit arrangement with approximately 300 members).

The regulators scheme specific funding team were approached jointly by both the trustees and employer to listen to their concerns regarding future funding. The employer had a number of concerns following the publication of the regulator's statement on funding, and wished to discuss the impact on what they considered to be a fragile employer covenant. Following discussions with regulatory staff, it was evident that the managing director, with a dual role as chairman to the trustees, was subject to a material conflict of interest which was beyond mitigation.

In light of the circumstances, and taking into account the dialogue which would take place between the trustees and the employer, it was evident that the conflict would prejudice the role of the trustees. Had any comments from the conflicted person resulted in a certain course of action being taken, it would be difficult for the trustees to demonstrate that they had had full regard to their fiduciary obligation to members.

As a result of the circumstances, the conflicted director/trustee having taken independent legal advice withdrew his involvement in the decision making process as well as attendance at meetings until such time that the funding issues had been addressed fully. This was supported by the role of the independent trustee, who had been a member of the trustee board for a number of years, and who was able to negotiate the exclusion of the conflicted trustee on an entirely amicable basis. In these particular circumstances this was considered by the trustees and their lawyers to be the most appropriate course of action bearing in mind that the conflicted person had in the past provided the trustee board with a level of scheme knowledge which would not have been available to the board had his initial appointment not been approved.

- 81 Whatever course of action is undertaken trustees should be mindful of any quorum requirements stipulated in the trust deed and rules. If there are issues in relation to these procedural elements, alternative options will need to be adopted to manage the conflict (e.g. delegation to a sub-committee) or changes may need to be made to procedural requirements.

### **Appointing an independent trustee**

- 82 Consideration should be given to the potential benefit that appointing an independent trustee, and in particular independent chairs of trustee boards, could bring to the governance process. Just as the *Combined Code on Corporate Governance of UK listed companies* recognises the importance of having an independent non-executive director on the board to ensure the right checks and balances are in place, an

independent trustee or equivalent for trustee boards can play a valuable function. An independent trustee, who would not necessarily have to be a professional trustee, would be able to ensure trustees' decisions are not prejudiced by a conflict of interest. However, it is important to note that the appointment of an independent trustee is not itself a solution for managing the conflict of interest. It may need to be combined with a number of other activities. The duration of the appointment may be solely for the decision being made, or on an ongoing basis. While the independent trustee does not necessarily have to be a professional trustee, if he or she is not, the trustees need to check that the candidate is appropriately qualified to discharge the role expected.

### **Avoiding conflicts by the resignation/non- appointment of trustees**

- 83 In the majority of cases, conflicts can be managed and there are various options available to the trustee upon which they should seek legal advice. Trustees who have implemented processes to identify and monitor conflicts should also have sufficient notice to adequately manage conflicts in many cases.
- 84 Notwithstanding the foregoing, consideration should always be given as to whether it is appropriate to appoint a trustee who is likely to face a conflict of interest in performing his role as trustee. This is particularly so where the conflict is of an acute or pervasive nature and which may be better avoided than managed once the trustee is in place.
- 85 Furthermore, where an existing trustee faces a conflict of interest which is particularly acute or pervasive, resignation may be the most appropriate option in order to remove any possible suspicion that the conflict has influenced the outcome of one or more decisions. Although it may result in a loss of expertise from the trustee board, resignation may be a more straightforward solution for dealing with acute or pervasive conflicts where the alternative is constantly having to deal with issues in one or more sub-committees, or make one or more applications to court for approval of decisions made.
- 86 Obviously, in cases where resignation is deemed appropriate, careful thought needs to be given to the identity of any replacement trustee and the conflicts that they will face in relation to the same or other issues. Especially where there is perceived to be an acute or pervasive conflict, trustees should explore with their legal advisers whether appointment of an independent trustee should be considered.

### **Application to Court**

- 87 If one or more trustees have serious conflicts which cannot be satisfactorily managed or avoided using the methods suggested above (or if there is no agreement on how to manage or avoid the conflict), it is always open for the trustees to apply to Court for approval of their

decision, or to surrender their discretion to the Court<sup>16</sup>. Such applications may be expensive and may take a little time, but a decision made by or with the approval of the Court will be unimpeachable in subsequent proceedings. An application to court may therefore be an appropriate course in some cases, particularly if the proposed decision is one of importance to the administration of the scheme.

## Confidentiality agreement

How do you deal with conflicts of a confidential nature (ie those where disclosure may not always be an available remedy)?

- 88 Acute conflicts can arise where an employer-nominated trustee is privy to employer information relevant to the pension scheme that conflicts with his duty to share information with fellow trustees because of a duty of confidentiality to the employer, for instance, in relation to a planned corporate transaction or the affordability of a scheme valuation. Trustees in this situation will need to seek independent legal advice. It is not clear that excluding a trustee from decision making as a result of a sub-committee would necessarily excuse the trustee from the duty to share information. More effective solutions could include the employer waiving confidentiality duties (on the basis that all trustees have signed a confidentiality agreement), or the trust deed absolving the trustee from sharing information in specified circumstances. If the employer does not feel able to agree to this, there may be little alternative but for the trustee in question to resign to avoid being left in a position of acute conflict.
- 89 A confidentiality agreement may facilitate the sharing of confidential and sensitive information with the trustees without the worry that it will become public. Such agreements require that the trustees agree not to share the information they receive in order to discharge their obligations and duties as trustees with third parties. This should ideally be done every time a new trustee joins the board.
- 90 However, a confidentiality agreement cannot abrogate the trustees' duties. That is, the trustees cannot maintain confidentiality if to do so would be a breach of trust or contrary to pensions legislation. It is therefore essential to seek legal advice and professional input into the drafting of such agreements.
- 91 The case example below draws together a number of the themes covered above.

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<sup>16</sup> see e.g. *Public Trustee v Cooper* [2001] WTLR 901

### **Case example**

NOP Ltd (NOP), prior to its dissolution, was the principal employer of the NOP Pension Fund. When the liquidators were appointed, they appointed DEF Trustees Limited (DEF) as statutory independent trustee. The directors of NOP were Mr N, Mr O and Mr P.

DEF obtained ad-hoc legal advice from a legal firm regarding an investment in an offshore company where Mr N was also a director and major shareholder. One of the directors of DEF was also one of the partners in the legal firm and, due to his knowledge of the pension scheme, provided the legal advice himself. Therefore, the legal adviser to the scheme was also acting as trustee. This constituted a serious conflict.

Although a pension scheme is not required to have a legal adviser in the same way that it can be required to have an auditor or actuary, where legal advice is sought regarding the pension scheme, the legal adviser must be correctly and formally appointed. At the time the appointment letter had to state that where the legal adviser becomes aware of anything that would cause their appointment to be invalid, they must advise the trustees immediately. In this case, if the correct procedure had been followed, it may have highlighted the need to have an impartial adviser who has no conflicts of interest in his role.

Using the legal advice from the conflicted trustee/legal adviser, the trustees also invested approximately 20 per cent of the pension scheme funds in an offshore company of which Mr N was a director and major shareholder. There was a substantial risk that Mr N would benefit financially from this investment.

Following investigation and intervention by the regulator, the trustees formally appointed another unrelated legal adviser and realised the investment. The regulator considered that the investment was imprudent and should have been considered with more care. The legal advice obtained should have been received from a correctly appointed and non-conflicted legal adviser.

## **Remuneration**

- 92 Generally as a matter of trust law, a trustee is not entitled to remuneration from the trust fund for acting as a trustee, unless this is permitted by the trust deed or rules, a statutory provision<sup>17</sup> or an order of the court. The historical reason for the general rule was that, but for the rule, the trustee could be faced with a conflict between his personal interest and his duty to the beneficiaries.
- 93 The authority to remunerate trustees is generally expressed within the trust deed and rules of the scheme. The decision to remunerate trustees is a matter for the trustee board's consideration and will usually involve balancing the cost to members with the need to attract suitably qualified people, and to compensate for the high level of

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<sup>17</sup> See e.g. section 29 of the Trustee Act 2000

responsibility. The regulator does not have a view on this matter, so long as the decision is prudent.

- 94 Where the trustee board does elect to remunerate its trustees, there should be a formal and transparent procedure for developing policy for determining remuneration for individual trustees. Importantly, the trustee should not take any part in the trustees' discussions and decisions which affect the settling of terms and conditions of his or her appointment. The trustee concerned should withdraw from all discussion of these issues, and must not vote on them, or be counted as part of the quorum necessary to validate a meeting at which a relevant decision is taken.
- 95 Depending on the size of the trustee board and whether resources permit, it may be more efficient for this task to be delegated to a remuneration committee<sup>18</sup>. The duties of such a committee could include reviewing and recommending to the trustee board remuneration policies for trustee board members, the method of reviewing remuneration on a regular basis and whether the chair would be more highly paid than other trustees.
- 96 It may be the case that the employer or sponsoring employers would be willing, as a matter of ensuring good governance, to fund the remuneration of trustees directly. This would be a matter of negotiation between the trustee board and the sponsoring employers.
- 97 For multi-employer schemes, consideration will also need to be given to other matters which may impact on the level of remuneration a trustee may be entitled to.

## Disclosure of related parties

- 98 Scheme trustees have a general duty to act in good faith in relation to their dealings with the scheme and its assets. However, from time to time, trustees may lawfully undertake transactions with related parties. The application of *Financial Reporting Standard (FRS) 8 – Related Party Disclosures* aims to ensure that financial statements, including those for pension schemes, contain the disclosures necessary to draw attention to the possibility that the reported financial position and results may have been affected by the existence of related parties and by material transactions with them. By complying with this Standard, trustees ensure transparency through financial reporting.

## Board meeting minutes

Do the minutes of meetings record when conflicts are either disclosed or identified and the action taken to address the conflict?

- 99 The trustees should clearly record all decisions that have been made and the key factors that have been considered in reaching a decision. Where a conflict is identified at the commencement of any item being discussed, the trustees should clearly document any action taken to manage the conflict. This may include an assessment deeming the conflict to be inconsequential and therefore no action being required or alternatively, how that conflict will be managed.

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<sup>18</sup> But see paragraph 76 *ibid*

## Principle 5: Managing adviser conflicts

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- 5.1 Trustees should actively manage their relations with advisers to ensure that the advisers are able to provide independent advice.
- 5.2 Trustees should require their adviser to declare any conflicts that may arise in respect of their engagement, noting that some advisers are legally obliged to do so.
- 5.3 Trustees need to consider in advance whether potential conflicts make it undesirable for a particular adviser to be appointed or continue to act for the trustees in circumstances where conflict with the sponsoring employer may arise.
- 5.4 Where a conflict is declared to the trustee board, the trustees should evaluate the nature of the conflict and determine what course of action is appropriate.
- 5.5 Trustees served by an in-house pensions manager and secretariat need to understand the reporting lines and conflicts these individuals may have.

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100 Where trustees require specialist knowledge, such as a detailed understanding of trust law or funding rules, trustees without such knowledge should seek professional advice. However, trustees should be confident that the advice is independent and that any potential or actual conflicts are disclosed to the trustee. Trustees also need to ensure that adviser conflicts are managed.

Does your conflict of interest policy or other procedures detail your procedures for ensuring adviser conflicts are identified and managed?

101 There are two main types of adviser conflicts that may arise:

- a) an adviser may have a conflict of interest if he or she (or the same firm) is also advising the employer or, in certain circumstances, advising another scheme or employer with whom the trustees are engaged e.g. an actuary, auditor or lawyer; and
- b) where the advice provided by the adviser is biased due to financial or non-financial benefits derived by the adviser, or the adviser's firm.

102 The risk to the trustees in both situations is that the adviser does not provide, or is not seen to provide, independent advice. Accordingly, the trustees' conflicts management arrangements should also contain measures to mitigate this risk. These measures can be outlined in the trustees' conflicts of interest policy or in other documented procedures, such as those relating to the appointment of an adviser, and should be subject to ongoing review.

### Disclosure of conflicts

103 Some advisers are obliged to disclose conflicts. For example such an obligation exists for activities that are regulated by the Financial Services Authority (FSA) while many professions have codes of conduct by which they must abide which cover disclosure of conflicts.

- 104 Trustees should expect regulated advisers to provide the disclosure required. They should also recognise that there are circumstances where their adviser may not be regulated or required to comply with a professional code of conduct, e.g. pension consultants or investment consultants providing advice to the trustees. In such cases the trustees should request that their adviser provides a similar level of disclosure to those abiding by their professional codes of conduct.
- 105 Trustees should also look carefully into how the advisers would propose to manage any conflicts identified and disclosed, for example, FSA regulated advisers have to bear in mind the requirement to 'treat customers fairly'. Trustees should in particular seek to minimise the risk that their adviser will need to resign at a 'crucial' moment because of a conflict arising.
- 106 Many organisations currently include a conflict statement within their terms of engagement. For example, guidance issued to the audit profession includes example paragraphs for terms of engagement and recommends that their auditors notify the trustee immediately upon becoming aware of the existence of any conflict of interest in relation to their client. Trustees should consider that prior to the engagement of an adviser, the appointment letter has an explicit requirement that the adviser informs trustees if he/she becomes conflicted.
- 107 Trustees should be mindful that disclosure of a conflict does not in itself manage it. Therefore, there is a key role for trustees to determine whether the advice provided is in fact independent and most importantly provided in the members' interests.
- 108 Where there is likely to be a serious or persistent conflict of interest in giving advice, such as where there is a commercial association between the adviser and the employer, trustees should consider very carefully whether it is appropriate to appoint the adviser in the first place. It may also be necessary to consider carefully whether they should take steps to remove an adviser who has already been appointed. Trustees should ask themselves what are the advantages for members in retaining a conflicted adviser if (as may well be the case) they could instruct alternative advisers with similar expertise who would not be conflicted.

Does the letter of appointment to the adviser require disclosure of any conflicts that arise?

Do the trustees, as part of the selection of an adviser, make enquiries into the adviser's conflict management procedures?

## Managing adviser conflicts

- 109 Trustees should, as part of the selection process, ascertain whether the adviser has any existing conflicts or sees any potential for conflict to arise. Trustees should make enquiries into the adviser's own conflict management procedures.
- 110 In selecting an adviser the trustees should enquire and be satisfied about an adviser's conflict management arrangements. As a suggestion trustees may seek confirmation on the following:
- Is the adviser engaged to provide services for any party related to the scheme?

- Does the adviser have any other commercial association with another party related to the scheme, such as the employer?
- how does the adviser deal with conflicts of interest arising from associations he has which, in some way, may prevent the trustees from receiving objective advice?
- Is the adviser required to comply with a professional code that requires him to disclose any conflicts of interest (both actual and apparent) to his client? Will this be formalised in a letter of engagement upon appointment?
- Where the adviser is not required to comply with a professional code or standards of practice, the trustee should ask their advisers as a matter of good practice whether they have processes in place to identify any conflicts both prior to, and during, the engagement?
- Whether the adviser and/or firm has measures in place to manage conflicts such as:
  - disclosing an interest to a customer; or
  - relying on a policy of independence; or
  - establishing internal arrangements (e.g. Chinese walls); or
  - declining to act for a customer.
- What procedures and controls (Chinese walls) does the adviser have in place to prevent confidential information obtained from the scheme or advice given to the scheme being disclosed to other parties, in particular to the employer or the employer's competitors?

111 When advisers are actively advising their clients in relation to activities which may result in the appointment of a new service provider, the trustees should ensure that they are aware of any underlying relationships. In this familiar consultant related scenario we give an indication of how the above prompt list could be applied in practice.

**Case study**

A pension scheme appointed XYZ consultancy to advise on fund manager selection. XYZ proposed to the trustees that they consider its manager-of-investment managers service whereby XYZ picks the best of breed managers in particular asset classes. These offerings can then be mixed and matched depending on the client's investment objective and asset allocation requirements. These fund management services are typically contracted in a bundled form with clients.

In this case the trustees asked their consultant whether the basis of engagement of managers is purely performance related or whether other considerations are relevant, such as managers' willingness to pay a fee to be included on their platform.

## **Sharing advisers with the sponsoring employer**

- 112 Trustees will need to pay particular attention to the management of conflicts if they are using the same adviser as the sponsoring employer. The regulator recognises that it is hard to give general guidance on such situations as the circumstances in which trustees and employers use the same advisers can be very different. For example, there is a difference between situations where the same individual provides advice to both the trustees and the employer and situations where the same firm is involved (but different individuals and sometimes completely separate 'teams' of staff). There is also a difference between 'advice' and 'information services', but in relation to pension schemes this distinction is capable of becoming blurred where the information is implicitly based on an expression of opinion, for example in relation to the state of funding of a scheme.
- 113 Conflicts of interest for advisers, where the trustees and employer are both clients, have to be managed professionally by the advisers, but the trustees should ensure that they are fully aware of the circumstances in which their adviser will provide services to the employer and that they understand and are content with the information barriers that are in place and with the arrangements as to what will happen if a conflict arises.
- 114 As a general principle, trustees should give careful consideration to the situations where the same firm or individual provides advice in situations where the interests of the scheme and employer diverge. The acceptability of the same individual or firm advising both parties in such situations depends on the extent and nature of the divergence but it is likely that there will be situations where such a practice would be unacceptable. Trustees should therefore seek to avoid using the same individual where such situations are expected to occur, to avoid the risk of having to change adviser at a crucial moment.
- 115 A common approach, adopted in particular by actuarial consultancies, is the 'Y Model' in which a single part of the firm provides calculations (e.g. accounting numbers) which can be used both by the trustees and the employer, but where different individuals within the firm give advice on how this information should be interpreted and used to make decisions. Such a model has the potential of reducing overall costs for the employer while ensuring that the advice provided to the trustees is not conflicted. Trustees may nonetheless wish to consider whether it would be preferable to use a different firm from the employer to avoid the risk that the firm decides that it is too conflicted to advise both at a crucial moment or that the advice given will be constrained by the need to avoid any perception of conflict.

## **Intra-adviser relationships (commercial interests)**

- 116 It is not uncommon for advisers to refer the service or products of related parties to their clients, for which there may be some form of financial or non-financial consideration. Whilst the regulator recognises that there may be benefits to the trustees as a result of this referral, it is crucial that trustees are fully aware of the conflicts that

may arise as a result of this arrangement. As a matter of good practice, trustees should evaluate the nature of the conflict and whether the independence of any advice received is compromised.

- 117 Where the trustees are of the view that any advice given under this arrangement may be compromised, the trustee should consider further measures to manage the conflict. This may include dialogue with other service providers, putting the referred service out to tender, undertaking a comparison of the referred products to other suitable market options and generally considering other alternatives before the referred party is appointed, or product is selected.
- 118 A common example of a conflict which may arise as a result of financial or non-financial bias is where consultants have a number of roles that they may fulfil, for example, asset liability modelling, strategic asset allocation advice, risk modelling and fund manager selection and monitoring. This is also commonly referred to as implemented consulting<sup>19</sup>.
- 119 Although such an arrangement offers the benefit of an 'all in one' service, there is a risk that scheme members may be disadvantaged. Specifically, the trustees' duty to act in the best interests of members could be compromised if the trustees unwittingly accepted, without independent review of the selection process, an implemented consultant's recommendation for retention or engagement of a fund manager or product manager related to that consultant. One way to manage such a conflict may be to limit implemented consultant recommendations to unrelated parties. Alternatively, trustees could ensure that disclosure of related party engagements is required in their agreement with the implemented consultant, and the manner in which conflicts are managed could be part of the independent review of the selection process.
- 120 Whilst any person who carries on a regulated activity<sup>20</sup> in the UK must be authorised by the Financial Services Authority or be exempt (an appointed representative or some other exemption), the advisory services offered by investment consultants to institutional clients may not be regulated activities. This is the case for strategic asset allocation advice and for fund manager selection, where the latter involves selecting an investment firm as opposed to an investment product.

## **The role of the pensions manager**

- 121 The principles outlined elsewhere in this guidance apply also to pensions managers.
- 122 Whilst not strictly a pure advisory role, pensions management and administration services provided in-house by the employer can lead to

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<sup>19</sup> 'Implemented consulting' is an extension of traditional asset-consulting services where investment advice and fund manager selection services are combined into an integrated service. Effectively, this allows a trustee of a pension scheme to delegate the role of selecting investment managers to the asset consultant.

<sup>20</sup> A regulated activity includes managing investments, assisting in the administration and performance of a contract of insurance, establishing etc collective investment schemes and personal pension schemes, advising on investments (section 19 Financial Services and Markets Act 2000).

a number of situations which result in conflicts of interest. Trustees need to be minded of the fact that the pensions manager, who will normally be employed by the company, will have a number of reporting lines.

- 123 It would not be uncommon for the pensions administration and management team to provide services to a number of other employer-sponsored schemes. In this situation the pensions manager, who would tend to report to the trustees on scheme related matters, would be acting for a number of trustee boards in respect of schemes which may have a differing status, e.g. open, closed, DB or DC. Significant information regarding the employer and other schemes would most probably be known to the pensions manager and trustees should be aware of these relationships.
- 124 The pensions manager will also respond to employer driven projects or requests for additional information. This could include detailed information which may assist in the making of a decision which could have a material bearing on the scheme and its members, e.g. a change in benefits or scheme closure. In these situations and when dialogue has commenced with the trustee board, the pensions manager will act as a conduit between the employer and the trustees.
- 125 Trustees need to therefore ensure that when in discussion with the pensions manager or receiving advice, they are clear in which capacity the pensions manager is responding, i.e. in an employer capacity or a trustee appointed capacity.

## Other references

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### The Pensions Regulator

- The regulator's e-learning programme [www.trusteetoolkit.com](http://www.trusteetoolkit.com)
- Code of practice 01 – reporting breaches of the law
- Code of practice 02 – notifiable events
- Code of practice 03 – funding defined benefits
- Code of practice 07 – trustee knowledge and understanding (TKU)
- Trustee knowledge and understanding – the Foundation Indicative Syllabus
- Code of practice 09 – internal controls
- Clearance guidance

### Other sources

- The Institute of Chartered Accountants in England and Wales (ICAEW), Acting as a trustee for the pension fund of your employer, Guidance to manage conflict issued January 2007 (revised March 2007)
- Charity Commission, A Guide to Conflicts of Interest for Charity Trustees, Version 03/04
- Office of the Scottish Charity Regulator, 'Guidance for Charity Trustees' Section 3.3 (issued August 2006).
- Solicitors' Conduct Rules - [www.sra.org.uk](http://www.sra.org.uk) and [www.rules.sra.org.uk](http://www.rules.sra.org.uk)



## Appendix C - Declaring interests

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**Below is an example of a declaration that can be made by an elected trustee prior to appointment. This is just one example and does not negate the trustee's duty to take legal advice. As good practice this should be supported by affirmations made by trustees as to their ongoing status at each board meeting.**

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### **Declaration of interests**

I, [full name] am a director of the following companies [list name(s) of companies].

I also am a shareholder in the following public companies or subsidiaries of public companies [list name(s) of companies].

### **Other interests**

I, [full name] am also a trustee on the following boards:

[list name(s) of companies].

### **Potential conflict**

I, [full name] am to be regarded as interested in any contract that may, after the date of this notification, be made with any organisation listed below. I am:

- (a) an officer; or
- (b) a member of the following corporation or organisation, and that may result in a conflict between my personal interests and duties and my duties or interests as a trustee.

[list name(s) of organisations and office held].

### **Undertaking**

I undertake to notify the board of trustees of:

- (a) any changes in the facts set out above; and
- (b) any further acquisition of any interest, direct or indirect in a contract or proposed contract with the trustee.

**Signature of trustee** .....

**Date** .....

## **Appendix D- Example of a conflicts policy/procedure document**

The following policy/procedure document illustrates the sort of information which could be included to help inform trustees on conflicts related matters<sup>23</sup>. This is just one example and does not negate the trustees' duty to take legal advice. Whilst this is not intended to be a model document, the contents could be tailored to schemes of varying size.

### **Trustee policy and procedure for managing conflicts of interest**

#### **Background**

Conflicts of interest have always existed for pension scheme trustees and their advisers. This simply reflects the fact that individual trustees and their advisers will have a variety of other roles and responsibilities e.g. as members of the scheme or as senior managers of the sponsoring employer or as union officials.

Trustees have a strict duty to act in the best interest of the members but this does not preclude a trustee from having other roles or responsibilities which may result in a conflict of interest. Note 1 contains various guidance notes issued by the Pensions Regulator on this matter, plus Note 2 which details types of conflicts.

The trustees must be able to identify conflicts of interest and have procedures in place to manage them. This document outlines the procedure the trustees have adopted to do this.

#### **Policy and procedure**

For this policy and procedure to work the trustees have agreed that they must:

- acknowledge any potential conflict of interest they may have;
- be open with each other on any conflicts of interest they may have;
- adopt practical solutions;
- plan ahead and agree on how they will manage any conflicts of interest which arise.

With these objectives in mind the trustees have adopted the following procedure/

1. Maintain a register of trustees' interests which could give rise to a conflict of interest.
2. Maintain a register of interests covering the trustees' advisers and the in-house management team of the pensions department.
3. Each trustee, trustee adviser and member of the in-house management team of the pensions department to sign an annual return confirming that their

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<sup>23</sup> This example is based on a conflicts policy document prepared by the trustees of EDF Energy.

information contained in the register of interests is correct. The updated register to then be circulated to the full trustee board. These two events to be added to the trustee calendar of events distributed with each set of trustee meeting papers.

4. Fund secretary to identify any potential conflicts of interest and to advise the chairman. The independent trustee should also be alerted so they could be ready to comment on how best to deal with this matter. The chairman to decide on the action required and to advise the trustees of any actions taken.
5. Company issues or proposals covered at trustee meetings to be presented by a company representative who is not a trustee e.g. the pensions manager.
6. Any trustee wishing to speak from the company's view to state this clearly at meetings and have this recorded in the minutes.
7. Any trustee who feels that they, another trustee, adviser or member of the pensions department has a conflict of interest on a particular topic to advise the fund secretary prior to the meeting or to state this clearly at the meeting. The chairman to then decide whether the conflicted individual needs to leave the meeting during the discussion on the conflicted matter or, if a trustee, to withdraw from voting on the conflicted matter. If such a conflict is identified outside of a trustee meeting the chairman will consult with the Independent Trustee prior to making a decision. If the conflict is identified at a trustee meeting the chairman will consult with the other trustees prior to making a decision. In this way the conflict of interest and the action taken can be recorded in the minutes.
8. Any trustee to identify information which they think should not be shared with company representatives and to advise the scheme secretary. The fund secretary to then advise the full trustee board, including the independent trustee, seeking a decision from them on whether this information should be withheld from the company representatives.

## **Note 1 – Guidance from the Pensions Regulator**

The regulator has provided guidance to trustees on how they should manage conflicts of interest in a number of codes of practice and guidance notes issued since April 2005, *including their guidance on conflicts of interest*. Other than the conflicts guidance, conflicts of interest are referred to specifically in some detail in:

- **Code of practice on funding defined benefits**
- **Guidance on clearance statements**

The full codes and guidance can be found on the Pension Regulator's website [www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk)

## **Note 2 – Types of conflict**

### **General principles**

The basic principle in relation to conflicts of interest can be found in the High Court case of *Re Thompson's Settlement* [1986] where the Court held that:

“...a man must not put himself in a position where duty and [personal] interest conflict or where his duty to one conflicts with his duty to another unless expressly authorised”.

## **Trustees**

The regulator does not consider that the mere potential for conflict (as a result of the other positions held by the trustee) should preclude the appointment of a trustee. However this does not justify the appointment of a trustee if this is likely to give rise to acute or pervasive conflicts. Furthermore the benefits of having a mix of trustees with wider roles and responsibilities must always be balanced against the risk of conflicts and the problems for the management and administration of the scheme to which such conflicts are likely to give rise.

Possible areas that could give rise to conflicts of interest include:

- setting investment strategy;
- setting assumptions for actuarial valuations;
- setting contribution rates;
- setting a recovery plan for correction of a deficit;
- dealing with bulk transfers in or out;
- discussing benefit changes proposed by the company; and
- dealing with the allocation of surplus.

The principal challenges for trustees are in relation to conflicts of duty in two key areas.

1. Negotiations between the trustees and the sponsoring employer.
2. The management of confidential information.

On the first point the regulator has made it very clear that it expects a trustee who could be involved in both sides of a negotiation to consider their position very carefully. One option to manage this conflict of interest could be the delegation of duties to a sub-committee.

On the second point it is important to note that all trustees have signed a confidentiality agreement concerning company information.

With regard to trustees sharing confidential trustee information with other parties (e.g. company, unions, other members etc) it is important to remember that each trustee has a fundamental responsibility to act on behalf of the scheme and this duty should not be compromised by acting on behalf of other groups.

## **Advisers**

The trustees appoint their own advisers. There may be circumstances where these advisers are asked to give advice to the company in relation to pension matters, but this can only happen where there is no conflict of interest. If there is a potential conflict of interest the company will appoint its own adviser(s).

All of the trustees' advisers also have a professional responsibility to advise the trustees if any circumstances arise in which they feel they are conflicted. These responsibilities and guidelines for dealing with them are also covered by the respective professional bodies.

A summary of the position with regard to the trustees' main advisers is set out below.

- Legal advisers – the company obtains separate legal advice from SBS LLP and JAS LLP. It is also important to note that the trustee receives legal advice from separate law firms.
- Actuarial advisers – DM Ltd advise both the trustees and the company. However separate teams fulfil these roles within DM Ltd. It is also important to remember that separate teams within DM Ltd also provide advice to other schemes sponsored by the employer.
- Investment advisers – LPS provide investment consulting advice solely to the trustees. In order to provide this advice they may need to consult with the company. The company does not currently obtain separate pension investment advice.
- Auditors – VAS LLP are the auditors of the scheme. The company use ABC LLP for company accounts purposes.

### **Pensions department**

The senior management team of the in-house pensions department are all employed by the company and currently comprise:

- pensions manager;
- pensions strategy and investment manager;
- fund secretary; and
- pensions operation manager.

This team work closely together and liaise closely with trustee boards, the trustees' advisers and the company's senior management. As such they are privy to a wide range of information and it is therefore important that they are included in the procedures adopted for managing conflicts of interest.

The team has been structured so that the fund secretary provides the key support to both trustee boards together with the pensions operations manager.

## **Appendix E - How to respond to the consultation**

The regulator would like to hear from interested stakeholders on the areas covered in this consultation document. We would welcome feedback on the guidance in general, but we are particularly interested in comments on the following areas.

### **Structure and layout of the guidance**

1. Does the guidance provide sufficient information for you to understand what a conflict of interest is and how it can affect the role of a trustee?
2. Does the guidance provide a clear enough background to the framework of principles that underpins the process of managing conflicts of interest?
3. Do you feel that you are able to extract the relevant information at a level that is appropriate for you? Is there a sufficient level of background where it is appropriate for you?

### **Guiding principles**

4. Do you think the principles cover all the key areas relating to conflicts management arrangements or are there other areas of equal prominence which should be covered in the guidance?
5. Do the updated principles provide sufficient guidance on how to approach the subject? Are there any principles you think apply that should be added?

### **Case Examples**

6. In this guidance we have included a number of actual case examples to help demonstrate the application of best practice principles. Do the case examples help provide some additional clarity in relation to the application of the principles, or are there examples which you have experienced which would add more value? If so, please could you provide a brief case summary of how the conflict was managed – we may wish to include this in our finalised guidance.

### **Options for managing conflicts of interest**

7. Does the section on options for managing conflicts of interest (paragraphs 71 – 90) suitably explain how these arrangements help manage potential or actual conflicts? Are there any other options which need to be added to the guidance?

## **Responding to the regulator**

Responses may be made in any of the following ways:

- by email to: [conflictsguidance@thepensionsregulator.gov.uk](mailto:conflictsguidance@thepensionsregulator.gov.uk)  
(preferably documents should be in Word format)
- by post to: The Pensions Regulator, Napier House, Trafalgar Place,  
Brighton BN1 4DW

We may need to share the feedback you send us within our own organisation or with other government bodies. We may also publish this feedback as part of our response to the consultation. If you wish your comments to remain anonymous, please state this explicitly in your response.

If you wish your response to be kept confidential, please make this known and we will take the necessary steps to meet your request. However, please be aware that, should we receive a formal request, under Freedom of Information legislation we may be required to make your response available.

When responding, please advise whether you are responding as an individual or on behalf of an organisation (and if the latter, which organisation).

We would be grateful for any comments that you may have by 30<sup>th</sup> May 2008.