

Pension schemes urged to eradicate conflicts of interest

By David Johnson, Consulting Director, Trustee GAAPS

The time for procrastination is over. Pension schemes which yet haven't dealt with conflicts of interest have come under the spotlight following highly surprising figures from the National Association of Pension Funds (NAPF), which show that 64% of them still have directors from sponsoring companies on their trustee board. According to calculations by Trustee GAAPS, close to 5,000 defined benefit schemes are affected.

Despite the growing recognition that situations where trustees with obligations to both the sponsoring organisation and scheme members are likely to breed conflicts of interest, some schemes have been extremely slow at addressing the problem. As the issue is becoming more contentious, trustees with competing responsibilities are at growing risk of being sued for breach of trust.

It is troubling that schemes have not been more proactive in identifying and managing potential and actual conflicts of interest as required by the Pensions Act of 2004. As pressure is building up a huge amount of work needs to be done in a diminishing period of time.

According to the NAPF, Finance Directors are acting as trustees of 30% of employer sponsored pension schemes. This is even more alarming considering that the issue of conflicts of interest is potentially more acute for Finance Directors because they are likely to be more conscious how decisions to direct more (or less) money to pension schemes may affect shareholder value.

There are plenty of cases one can think of where decisions made by a Finance Director who is also a pension fund trustee could lead to conflicts of interest. Undertaking an M&A transaction to increase the company's debt level or negotiating over funding levels paid by the company to the pension scheme are common examples of them.

Finance Directors are still a primary choice to sit on trustee boards. Pension funds say that their reliance on Finance Directors is due to the lack of expertise amongst the majority of part-time trustees, as the role of trustees becomes ever more complex. However, this argument is becoming less tenable as the ranks of professional, independent trustees swell. Professional trustees possess those vital skills necessary to deal with crucial issues such as assessing the investments risks of the pension scheme.

The problem has become such a pressing concern that the Pensions Regulator felt obliged to intervene with draft proposals intended to provide guidance to pension schemes on implementing formal policies to manage conflicts of interest. The consultation clearly encourages schemes to adopt a more proactive stance and notably advises the appointment of independent trustees as a more complete solution as they would inherently have no conflicts of interest.

So as it becomes less and less acceptable that directors of sponsoring companies sit on trustee boards, the trend is relentlessly towards fully independent trustees. The Pensions Regulator in this regard is firm: schemes that have been in denial are now being asked to take action.

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