

Relieve the pressure: remove conflicts of interest

By David Johnson, Consulting Director, Trustee GAAPS

The National Association of Pension Funds' (NAPF) annual survey should serve as a timely wake-up call for pension funds to adopt a more rigorous attitude towards eradicating conflicts of interest from trustee boards. Amongst the 310 schemes sampled, 64% admitted to still having directors from sponsoring companies on the trustee board.

According to calculations by Trustee GAAPS based on the NAPF figures, over 4,900 defined benefit schemes still have company directors serving as trustees – an astounding number considering how thorny this issue has become in recent years. There is growing recognition that trustees who fail to discharge their duties to scheme members because of their responsibilities to shareholders are increasingly at risk of being sued for breach of trust.

Trustees have a statutory obligation to identify and manage potential and actual conflicts of interest according to The Pensions Act of 2004, but the recent figures clearly demonstrate that schemes need to be more proactive in upholding that requirement, and that significant work still needs to be done to eliminate conflicts of interest from trustee boards, to avoid the building pressure.

The figures from the NAPF also reveal that Finance Directors are acting as trustees of 30% of workplace pension schemes. Arguably, they are the single category of director most likely to have to grapple with conflicts of interest due to their knowledge of how decisions to direct more money to pension schemes may undermine shareholder value.

Any number of activities that a Finance Director might pursue in the interest of shareholders, such as a large M&A transaction or increasing a company's debt burden, can conflict with the interests of pension scheme members. Most directors do their level best to manage these conflicts but it is becoming an increasingly precarious balancing act. Phrases like "Chinese Walls of the Mind" are barely adequate in describing the mental discipline Finance Directors are expected to have.

That Finance Directors are still seen as the natural choice for the trustee board is worrisome. Pension funds often say that most part-time trustees are not pension experts and have little time to gain the necessary financial knowledge to deal with issues that can be crucial to the pension fund, such as assessing the investments risks of the pension scheme. The heavy reliance on Finance Directors' competencies is, therefore, claimed to be unavoidable. This justification, is losing credibility as there are an increasing number of professional, independent trustees who are well placed to fill the skills gap left by departing Finance Directors.

The Pension Regulator recently published draft proposals on how pension schemes should implement formal policies on managing conflicts of interest. The Regulator is clearly signalling that it wants to see a faster shift towards a more proactive approach to managing conflicts of interests. Amongst other measures, the Regulator notably encourages the appointment of independent trustees, stating that they would inherently have no conflicts of interest and yet would still bring the knowledge and expertise in financial and accounting issues needed to replace those directors stepping down from trustee boards. Not forgetting

the fact that an independent trustee can offer a complementary skills set to those of the rest of the board.

So it seems that the substantial pressure that has been building on pension schemes to reduce conflicts of interest is becoming irresistible. As the tide moves inexorably towards fully independent trustees, there is less and less scope for directors of sponsoring companies to sit on trustee boards. The Pensions Regulator's message is clear. Schemes should act now; relieve the pressure on themselves: the conflict of interest issue can be no longer ignored.

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