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ProTRUST to change its name to Trustee GAAPS

- **Name changed as part of expansion**

ProTRUST, the pension fund trustee search and selection firm, is to change its name to Trustee GAAPS in November. Trustee GAAPS is part of GAAPS International, the leading actuarial staffing company.

The name change follows the appointment of David Johnson, a former Director of Mercer Human Resource Consulting to head-up its expansion.

The new name will ensure consistent use of the GAAPS brand name across the group companies for the first time. It will clearly associate Trustee GAAPS with GAAPS International, the market leading actuarial staffing company.

David Johnson, Consulting Director, of Trustee GAAPS, comments: “GAAPS is a strong brand in the pensions recruitment sector and we felt it would be beneficial to make the connection between our trustee recruitment business and GAAPS International more transparent to the market.”

He adds: “Our purpose is to help trustee boards solve skills gaps, so the name Trustee GAAPS is much more descriptive of what we do than the old name, and should help increase awareness among Trustee boards that there is now a dedicated provider of independent trustees.”

Trustee GAAPS also provides professional advice and specialist search services in the selection of investment advisers and chairs of trustee boards of pension plans.

Trustee GAAPS says that the increasing demand for its services is, in part, being created by the exit from pension fund trustee boards of executives from the sponsoring companies.

The name change will also remind clients and candidates that Trustee GAAPS, though a specialised practice, is backed by the resources of a larger, long established staffing company, and is headed by an experienced management team with a proven track record in recruitment.

GAAPS Group was established 17 years ago by Dr Geraldine Kaye, a qualified actuary. Prior to establishing GAAPS Dr Kaye was a Senior Research Fellow at City University and she is a former Council Member of the Institute of Actuaries. She has been an Executive Member of the Pensions Research Accounting Group, and was also Chairman of the Association of Search and Selection Consultants for two successive terms.

64% of companies still experiencing potential conflicts of interest from trustee boards

- Smaller schemes less likely to have independent trustees
- Over 3,700 defined benefit schemes with directors as trustees

New research reveals just 36% of workplace pension schemes have ‘no’ directors from sponsoring companies on the trustee board, according to Trustee GAAPS, the trustee search and selection firm: so there is still a huge amount of work to be done to remove conflicts of interest from trustee boards.

According to Trustee GAAPS, the annual survey of 310 schemes carried out by the National Association of Pension Funds shows just how surprisingly slow the majority of schemes have been to remove potential conflicts of interest for the benefit of scheme members.

Based on figures from the Pension Protection Fund (PPF), this would suggest there are over 4,900 defined benefit schemes that still have Company directors acting as trustees.

Trustee GAAPS says that directors are increasingly at risk of being sued for breach of trust if they allow their legal responsibilities towards their shareholders to conflict with their obligations as fund trustee, as the tide moves inexorably towards fully independent trustees.

David Johnson, Consulting Director, Trustee GAAPS, comments: “It’s striking that such a small percentage of schemes have completely eradicated potential conflicts of interest on trustee boards despite the growing recognition of how much of a problem this is.”

“The Pensions Act of 2004 introduced the requirement that trustees identify and manage **potential** and actual conflicts of interest, but there is a concern as to whether schemes need to be more proactive in upholding that requirement.”

David Johnson adds: “As the issue of conflicts of interest becomes more contentious, there is an increasing risk of law suits against trustees with dual obligations to both the sponsoring organisation and scheme members.”

The figures also reveal that Finance Directors are acting as trustees of 30% of workplace pension schemes. They are the single category of director most likely still to sit on trustee boards. Finance Directors are trustees of 39% of schemes with assets of less than £100 million.

Trustee GAAPS says that the issue of conflicts of interest is potentially more acute for Finance Directors than other directors on trustee boards because they are likely to be more conscious how decisions to direct more money to pension schemes may affect shareholder

value.

David Johnson explains: “It’s a concern that Finance Directors are still seen as the natural choice for the trustee board when their fiduciary duty to shareholders and responsibility for corporate finance activity has the potential to put them into such direct conflict with scheme members.”

“Any number of activities that a Finance Director might pursue in the interest of shareholders, such as pursuing 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” lay the problem bare.”

However, David Johnson says that where Finance Directors exit trustee boards they need to recruit successors who have similar expertise in financial and accounting issues.

ENDS

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.



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The Regulator is clearly signaling 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.

By David Johnson, Consulting Director, Trustee GAAPS

Collapse in applications to Pensions Regulator for clearance puts more responsibility on trustees

- Clearance applications down 23%
- M&A activity continues at high level
- Draft new guidance may make trustees' reporting requirements more taxing

The collapse in the number of applications to the Pensions Regulator for clearance before corporate events occur is putting added pressure on trustees to keep the Regulator informed of events which may materially affect schemes, says Trustee GAAPS, the pension fund trustee search and selection firm.

David Johnson, a former Mercer director and now Consulting Director of Trustee GAAPS, says the decline in applications to the Pension Regulator at a time when mergers and acquisitions (M&A) activity has remained steady suggests that companies are becoming too complacent about the risks to schemes by neglecting to get clearance from the Pension Regulator for corporate events when they should.

Figures published by the Pensions Regulator show that the number of applications for clearance has fallen by 23%, from 269 applications in 2005/06 to 207 applications in 2006/07. The number of M&A deals has declined just 3.8% over the same period.

David Johnson also points out that conditions in the corporate debt market have declined significantly since the credit crisis making these deals much harder to finance.

Trustee GAAPS says that this puts additional pressure on trustees to whistle-blow on companies and inform the Pensions Regulator of events which may have a detrimental impact on schemes.

David Johnson comments: "If applications for clearance are falling, but corporate activity is relatively stable, it suggests companies are not always notifying the Regulator when they should."

"The responsibilities on trustees are growing all the time. If companies are not applying to the Regulator because they are complacent or do not understand the reporting process, trustees will have to step in and bridge that information gap."

He adds: "For part-time trustees, who are often under-qualified and over-worked, knowing when they should whistle-blow is a difficult judgement call to make."



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According to Trustee GAAPS, the new draft guidance, rather than giving specific examples of events that should trigger applications for clearance, simply states that companies should notify the Regulator of any event which is *'materially detrimental to the ability of the scheme to meet its pension liabilities.'*

David Johnson says: "The new draft guidance could potentially make the clearance process even more problematic, as it does away with the tick box approach and asks companies to use their discretion. This could lead to fewer clearance applications, which trustees will have to be alert to, but knowing when to step in and inform the Regulator will demand even more of trustees."

ENDS

Regulator steps up pressure on pension schemes to eradicate conflicts of interest

- **Recent Pension Regulator Consultation gives strong steer towards appointment of independent trustees**

Regulatory pressure is beginning to mount on pension schemes to eradicate conflicts of interest from their trustee boards, says Trustee GAAPS, the trustee search and selection firm.

Trustee GAAPS says that the Pensions Regulator's "Conflicts of Interest Consultation Document" is the strongest official steer yet towards the appointment of independent trustees as the best means of managing potentially dangerous conflicts of interest. Section 4.4 of the proposed Principles says that in some circumstances the appointment of an independent trustee may be the "only option" for resolving conflicts of interest.

There has been a growing awareness of the difficulties that a pension fund trustee, who is also a director of the company that is funding the pension scheme, has in balancing their duties to the pension fund members and to the shareholders of the company they work for.

A Finance Director who is also a pension fund trustee might, for example, decide it is in the interest of shareholders to pursue a large corporate takeover or to increase the company's debt level even though this could run contrary to the interests of the pension fund members. A common conflict might also be created by negotiations over funding levels paid by the company to the pension scheme.

David Johnson, Consulting Director, Trustee GAAPS, comments: "With this Consultation Paper, the Pensions Regulator is strongly underlining the importance for pension schemes of adopting a proactive approach to managing conflicts of interests."

Trustee GAAPS says that the Regulator notably encourages the appointment of independent trustees as they will have no conflicts of interest and yet will still bring the knowledge and expertise needed to replace those directors stepping down from trustee boards.

The Pensions Regulator says some ad hoc methods of controlling conflicts of interest, such as the relevant trustee abstaining from a particular vote, may not always be effective as their presence may still unduly influence the decision making of the other trustees. The Pensions Regulator also points out that where a trustee abstains from a decision they may still be held legally liable for that decision.

The Consultation Paper also suggests other measures for dealing with conflicts of interest, such as maintaining a register of conflicts, which David Johnson says trustees may find controversial.

Explains David Johnson: “I am not sure that a Finance Director is going to want to list down, on paper, all their possible conflicts of interest for other trustees to examine. If they were to do this properly they would in many cases have to disclose potentially price sensitive information.”

David Johnson says that while conflicts of interests are complex by their nature, appointing independent trustees would remove the majority of the problems outright at the source.

Independent trustees are usually recruited for a combination of their expertise and their skills at chairing a board. Some commentators have described independent trustees as playing a similar role to that of non-executives in a listed company. However, David Johnson explains that a good independent trustee will also take up practical and management responsibilities to assist in the day-to-day function of the trustee board and the fund.

ENDS

Number of pension schemes experiencing problems recruiting trustees jumps by a third

- **Survey by the Pension Regulator**
- **Focus on conflicts of interest discouraging directors from becoming trustees**

The number of pension schemes experiencing difficulties recruiting trustees has jumped by almost a third in one year as potential candidates become more aware of the growing complexity and responsibilities of the trustee role, says Trustee GAAPS, the trustee search and selection firm.

A survey by the Pension Regulator disclosed in its annual Corporate Plan revealed that 19% of schemes are now admitting to problems recruiting trustees compared to 15% in 2007, an increase of 27%.

According to Trustee GAAPS, the true extent of the recruitment problems facing schemes is likely to be far more severe than reported as many schemes would be reluctant to disclose any difficulties they are having to the Regulator, or simply be unaware of the problem.

David Johnson, Consulting Director, Trustee GAAPS, comments: "It's a significant jump in the number of schemes having problems recruiting trustees in a single year. Potential trustees are increasingly withdrawing from the job market as the complexity of trusteeship grows and their ability to deal with that complexity comes under ever-greater scrutiny."

"The growing burden of legislation, codes of conduct, and regulatory pressure to resolve conflicts of interest is all piling the pressure on part-time trustees. The role of trustee is increasingly untenable as something people do in their spare time while keeping the day job."

He adds: "The problem is almost certainly worse than the Regulator's research suggests. There is a dwindling pool of trustees who are prepared to take on the responsibilities of the role on an unpaid basis, and a rising demand for paid, professional trustees."

Trustee GAAPS says that the publication of a major consultation paper by the Pension Regulator in the last few months urging schemes to do more to resolve conflicts of interest is likely to further discourage company directors from becoming trustees.

David Johnson says: "The Regulator is clearly taking the issue of conflicts of interest much more seriously. Trustees who also serve as directors with scheme sponsors are finding that conflicts of interest which 10 years ago would have received little attention are now deemed unacceptable."

Trustee GAAPS says that in its consultation paper the Regulator notably encourages the appointment of independent trustees as they will have no conflicts of interest and yet will

still bring the knowledge and expertise needed to replace those directors stepping down from trustee boards.

Trustee GAAPS also points out that fresh conflicts of interest have emerged in the past year, such as new International Accounting Standards' (IAS) guidelines regarding the treatment of pension scheme surpluses, which took effect in January 2008.

The new IAS guidelines could mean that surplus funds in a pension scheme will no longer count as assets on the company balance sheet. Companies could seek to reduce payments into schemes or change scheme rules so that repayments are not contingent on the approval of trustees. This could create new conflicts of interest for trustees with responsibilities towards scheme members and sponsoring companies.

David Johnson says: "It's yet one more headache for trustees who also serve as directors with the sponsoring company to grapple with, and makes the balancing act required to discharge both roles competently even more challenging."

ENDS

No Snoozing: eradicate conflicts of interest on trustee boards

By David Johnson, Consulting Director, Trustee GAAPS

In a recent survey of 310 schemes carried out by the National Association of Pension Funds (NAPF), it appears that nearly two thirds of the pension schemes (64%) still have directors from sponsoring companies on their trustee boards. This may have left some schemes feeling somewhat exposed! But when the Pension Regulator published draft guidance on eliminating conflicts of interest last month, it became clear that the vast bulk of schemes would have had no other choice than to wake up and address this issue.

Together with figures from the Pension Protection Fund (PPF), this would suggest there are over 4,900 defined benefit schemes that still have company directors acting as trustees - a surprisingly high and rather disconcerting number.

Despite the growing recognition of the scope of the problem, the majority of schemes have been slow in removing potential conflicts of interest from trustee boards. This is a potentially dangerous approach in view of the growing risk of lawsuits against trustees with obligations to both the sponsoring organisation and scheme members.

The Pensions Act of 2004 introduced the requirement that trustees identify and manage **potential** and actual conflicts of interest, but the recent figures clearly demonstrate that schemes are not being proactive enough in upholding that requirement, and that significant work still needs to be done to eliminate conflicts of interest from trustee boards.

The figures from the NAPF also reveal that Finance Directors (FDs) are the single category of director most likely still to sit on trustee boards (30% of all FDs are sitting on a trustee board). Conflicts of interest are potentially more acute for Finance Directors, as they are likely to be more conscious of how decisions to invest extra money into pension schemes may adversely affect shareholder value.

A Finance Director who is also a pension fund trustee might, for example, favour a large corporate takeover or to increase the company's debt level, because it is in the interest of shareholders, even though this could run contrary to the interest of the pension fund members. A common conflict might also be created by negotiations over funding levels paid by the company to the pension scheme.

It is concerning that Finance Directors are still seen as the natural choice for the trustee board, despite the mounting evidence that their fiduciary duty to shareholders and corporate finance activity has the potential to put them into such direct conflict with scheme members. One reason often put forward by pension funds for their reliance on Finance Directors as trustees is that their knowledge of financial and accounting issues are indispensable expertise that schemes cannot do without. However, this justification increasingly lacks real credibility when you consider the growing pool of professional, independent trustees, and how well placed they are to fill the skills gap left by departing Finance Directors.

To compound matters, fresh conflicts of interest are coming to light on a regular basis – often as a consequence of regulation. A new conflict of interest has recently arisen with the International Accounting Standards’ (IAS) new guidelines regarding the treatment of pension scheme surpluses. The new IAS guidance, IFRIC 14, which took effect in January 2008, could mean that, in many cases, surplus funds in a pension scheme will no longer count as assets on the company balance sheet. Companies could seek to reduce payments into schemes or change scheme rules so that repayments are not contingent on the approval of trustees. This could create new conflicts of interest for trustees with responsibilities towards scheme members and sponsoring companies.

Current market volatility is also bringing the issue of conflicts of interest into sharp relief. In the wake of the subprime meltdown, pension schemes are increasingly coming under pressure to undertake much more rigorous contingency planning to protect their funding plans. The seizing up of the credit markets over the summer illustrates how quickly a sensibly thought-out plan can become redundant by a change in asset values. For contingency plans to be effective they should cover a wide range of scenarios from uninvited takeover or merger approaches to financial difficulties faced by the sponsoring employer and changes in the investment markets. Here again, trustees could find themselves in a difficult position.

Pressure to resolve the issue has been building for some time, forcing the Pension Regulator to step in with draft proposals on how pension schemes should put together formal policies on managing conflicts of interest. The Regulator, which lists conflicts of interest as one of the seven governance priority areas fundamental to the successful running of pension schemes, is clearly signalling that it wants to see a faster shift towards a more proactive approach to managing conflicts of interests.

In its “Conflicts of Interest Consultation Document” the Regulator notably encourages the appointment of independent trustees stating that they would inherently have no conflicts of interest and yet will still bring the knowledge and expertise needed to replace those directors stepping down from trustee boards.

Most part-time trustees are not pension experts and they usually have a day job to occupy their time and energy. With the role of the traditional fund trustee becoming increasingly complex, a large number of trustees do not have time to gain the necessary financial knowledge to deal with issues that can be crucial to the pension fund, such as, for example, assessing the investments risks of the pension scheme. Here, the knowledge and experience that independent, professional trustees can offer, would be invaluable in strengthening the trustee board and, at the same time, would give key executives more time to concentrate on running the business.

It makes sound business sense: many senior executives would rather spend more time focusing on corporate matters and consider their duty to the pension fund trustee board as bothersome. Independent trustees are a cost-effective solution to this problem.

In some ways independent trustees are an equivalent to companies’ non-executive directors (NEDs) in the sense that they both play an important role in good governance. Just as the role of NED involves resolving conflicts of interest issues and ensuring board decisions¹⁴

reflect shareholders' interests rather than managements'; similarly, independent trustees can help ensure that decisions are made in the best interests of scheme members. In the last five years, the role of the NED has become a more high-profile job involving more significant responsibilities. In the same way, the role of trustee has grown in complexity and we are expecting independent trustees to take up more seats on trustee boards.

So now the momentum is clearly behind the belief that greater use of independent professional trustees is the best way of addressing conflicts of interest. Many larger schemes have already seen the benefit of appointing an independent trustee to their trustee board. The Regulator will publish its final proposals later on in the year. Schemes should consider taking action now, or risk finding themselves in a position where they have to put in place a comprehensive conflicts of interest management policy within a very short time frame. The Regulator has rung the alarm bell. Schemes can no longer afford to snooze and sidestep this crucial governance issue.

By David Johnson, Consulting Director, Trustee GAAPS

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.



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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.

By David Johnson, Consulting Director, Trustee GAAPS

Poor contingency planning can take its toll...

The US sub-prime meltdown and ensuing financial market chaos is now serving as a timely wake-up call for pension fund trustee boards about the need to adopt more rigorous contingency planning to protect their funding plans. Unforeseen events, such as the sub-prime meltdown, can significantly challenge the underlying assumptions on which these funding plans are based. Over 10 years of economic growth can sometimes make us forget that!

The seizing up of the credit markets indicated just how quickly an “acceptable” level of gearing could become “unacceptable”. Just as global markets seemed to be riding the crest of a wave, an increasing number of pension funds could once again find themselves in financial jeopardy. Many trustees are now realising just how fragile their planning has been.

Company boards have had to become experts at grappling with the ‘known unknowns’ and seeking out potential new threats and have evolved much better contingency plans in recent years – so it is time for pension fund trustee boards to catch up.

For contingency plans to be effective they should cover a wide range of scenarios from uninvited takeover or merger approaches to financial difficulties faced by the sponsoring employer and changes in the investment markets. This will allow the pension fund to react expediently to a wide range of situations and ease the pressure placed on trustees.

If the current philosophy on pension fund management persists, there is a danger that pension funds will become ever more at the mercy of economic forces that move across borders at ever faster rates.

The belief that independent professional trustees provide the best solution is gaining more and more weight as it becomes apparent that the role of the traditional fund trustee is increasingly complex and is not always compatible with a normal ‘day’ job. A large number of trustees, whilst efficient at their ‘second’ jobs, simply do not have the necessary qualifications, experience and most importantly, time to prepare for eventualities that can deteriorate at an alarming speed.

Trustees are now not only expected to take charge in a crisis and avert impending disaster, but they are also expected to ensure procedures are in place in case of any event that may lead to a significant deficit in the fund.

Putting in place contingency plans is now often one of the first tasks that independent professional trustees are asked to undertake when they are appointed to pension fund boards.

The sub-prime meltdown is one crisis that few pension fund trustee boards could really claim they were prepared for. Only history will judge how dangerous that oversight has been; however the warning bell has tolled and it should be heeded to avoid further crises.

By David Johnson, Consulting Director, Trustee GAAPS

New accounting rules will create new conflict of interest for Directors on trustee boards

- **Companies may reduce funding so surpluses do not arise**
 - **Additional layer of complexity to trustee role**

New International Accounting Standards (IAS) guidelines which concern the treatment of pension scheme surpluses could create new conflicts of interest for Directors of sponsoring companies who also act as trustees, warns Trustee GAAPS, the trustee search and selection firm.

The new IAS guidance, IFRIC 14, which took effect earlier this month, could mean that in many cases surplus funds in a pension scheme will no longer count as assets on the company balance sheet.

According to Trustee GAAPS, under IFRIC 14 companies must have an ‘unconditional right’ to a refund, or ‘sufficient scope to reduce future contributions’ for a surplus to be included on the balance sheet. An ‘unconditional right’ means companies do not need trustees’ approval to recover excess funds.

Trustee GAAPS says that if companies are unable to include surpluses on balance sheets as assets, they may stop putting money into schemes – particularly as many schemes are now in surplus – or they may even try to renegotiate the rights of the pension fund over the control of surpluses.

David Johnson, Consulting Director, Trustee GAAPS, comments: “Companies could seek to reduce payments into schemes or change scheme rules so that repayments are not contingent on the approval of trustees. Trustees with responsibilities towards scheme members and companies may find themselves in a difficult position.”

“Directors will be concerned that surpluses may be trapped and will come under pressure from shareholders to address that - but how can they while simultaneously discharging their responsibilities to scheme members?”

He adds: “It adds another layer of complexity to the job of being a trustee and heaps further potential conflicts of interest on trustees who are connected with sponsoring companies. The case for independent trustees is becoming increasingly compelling.”

Trustee GAAPS says that an additional complication arises if trustees demand extra funding, as under the new guidance that could mean companies have to widen their stated deficit.

David Johnson says that this may make trustees associated with sponsoring companies more reluctant than independent trustees to request additional funding, accentuating the division within trustee boards between independent and company trustees.

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Smaller pension schemes struggle most to fill funding deficits

- Conflicts of interest inevitably more acute

Smaller defined benefit pension schemes are more likely to be underfunded due, in part, to the stronger conflicts of interest created by their company directors sitting on their trustee board, says Trustee GAAPS, the trustee search and selection firm.

A recent joint study¹ by the Pensions Regulator and the Pension Protection Fund, found that larger schemes tend to have higher funding levels with the weighted average funding levels falling from 113% for schemes with more than 10,000 members to 98% for schemes with under 10,000 members.

The study also finds that smaller schemes tend to have higher insolvency probabilities with a weighted average insolvency probability of 0.77% for schemes with under 10,000 members compared just 0.30% for schemes with more than 10,000 members.

David Johnson, Consulting Director at Trustee GAAPS says: “The poorer funding of smaller schemes is only partly explained by the higher profit margins of larger sponsoring companies. The stronger conflicts of interest that exist on the trustee boards at many smaller pension funds plays its role.”

“Small schemes find it hard to catch up with larger schemes in improving their funding levels because of their inability to convince sponsoring companies to make higher contributions.”

“The link between directors and shareholders is much more tightly drawn for smaller companies than larger companies. The smaller the company the more likely it is that directors will have a controlling stake in that company.”

“If you are a director/trustee at a small or medium sized company you may be more reluctant to top up your employees’ pension scheme as that money is coming out of your, or your fellow directors’ pockets.”

David Johnson adds: “The Pensions Regulator is starting to encourage the removal of conflicts of interest but we need to be aware that the problem may get worse over time.”

“Funding levels need to be managed more carefully as they are subject to greater challenges of more volatile market conditions and changing demographic expectations, such as increasing life expectancy.”

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¹ The Purple Book 2007, DB Pensions Universe Risk Profile.