



Pensions Regulator in conflict

Conflict of interest in pension schemes

The Pensions Regulator (TPR) has issued draft guidance on conflict of interest for pension scheme trustees and employers. The guidance illustrates how difficult this topic is and, while TPR has done its best to provide high level guidance, the real emphasis is on taking independent legal advice.

Pensions partner Richard Knight comments:

“On a rough count, the draft guidance presses the need for independent legal advice 50 times in as many pages. Although guidance with such an insistent caveat might frustrate some, TPR is really just recognising the complexity of the issue. There is no “one size fits all” answer to conflicts of interest.”

The consultation draft starts from five high level principles and moves on to show that the disciplines of good governance are vital for dealing with conflict of interest in practice. It is important for trustees to absorb both the principles and the importance of procedure.

One issue that deserves more attention than it gets is the handling of confidential information. In practice, this is a common question and legally one of the trickiest. But there is a practical answer (see below).

Trustees are not alone

Conflict of interest is a problem for all fiduciaries, not just trustees. Fiduciaries are people who, by law, must put the interests of someone else above their own. They include trustees who must put their beneficiaries first, and company directors who must put the interests of the company before their own.

Any trustee who is involved with a scheme in another capacity is a candidate for a conflict of interest. The other role could be as scheme member, senior manager or director of the employer, union representative, shareholder in the employer, or trustee of a sister scheme, for example.

It is the trustee who is also a director – say the finance director – of the employer and a member of the scheme who often faces the most acute conflict of interest. He may have two types of conflict:

- the easier one to deal with is conflict between his *duty* to his beneficiaries and his *self interest* as a member;
- the tougher one is conflict between his *duty* to the scheme beneficiaries and his *duty* to the company.

Confidential information

Confidential information is one aspect of the conflict between competing duties. When a trustee/director has information that is relevant to the trustees but confidential to the employer, he has a duty to the employer to keep it confidential and an equal but opposite duty to disclose it to the other trustees. The practical answer here is for the employer to waive the trustee's duty to keep the information confidential and to allow him to share it with the other trustees (on condition they sign a confidentiality agreement that it goes no further). This deserves to be a topic in its own right in the guidance, but it is dealt with only briefly.

Legal risk

The legal risk in conflict is that, at the request of a beneficiary, the court can set aside the action of a trustee who acts in the face of a conflict. This is so even if the beneficiary has not suffered any prejudice. But, crucially, the court has discretion whether or not to set an action aside, and in general has not been quick to do so in the pensions context. The fact remains, however, that a transaction based on decisions taken by a conflicted individual is on fragile foundations. This is the legal problem with conflict.

Conflict comes in different degrees. As the draft guidance recognises, with mild conflict it can be sufficient that a conflicted trustee discloses his conflict to the rest of the trustee board, and is self-consciously correct in the way he acts from then on. At the other end of the scale, where conflict is acute and pervasive, the only correct approach may be to resign as trustee.

Draft guidance

The consultation document (issued on 22 February) starts from five high level principles that it then fleshes out. The principles ask trustees to act as follows.

Understanding the importance of conflict of interest

- Understand what duties they have as trustees and to whom they owe them. This primes them to recognise obligations or interests that pull in a different direction.
- Be alert for circumstances in which they may face a conflict. These are essentially where they want – or, legally speaking, ought to want – different outcomes in

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their competing roles e.g. over the employer's contribution rate or investment strategy.

- Tell prospective new trustees about the difficulties of conflict, and help any chairman of trustees (often an influential figure) who has competing roles to be alert to his own conflicts. An independent chairman can be a marked advantage.
- Recognise that conflict is a tricky legal area on which they should seek legal advice.

Setting a conflicts policy

- Agree and write down a policy for identifying and managing conflict. The consultation document offers a specimen (while making clear that a scheme's policy should reflect its own specific circumstances).
- Train all the trustee board on the policy.
- Regularly review compliance with the policy – and the policy itself.

Identifying conflicts

- Learn to spot potential conflicts coming up before they become real by looking ahead to decisions the trustees need to take in the foreseeable future.
- Have a rule that a trustee with a conflict must disclose it to the trustee board.
- Keep an up-to-date register of trustees' conflicts.

Evaluating, managing and avoiding conflicts

- After legal advice, set up procedures to evaluate and manage conflicts.
- Record conflicts in the minutes as they are identified and set out how they will be managed.
- Take independent legal advice.
- Acknowledge that some conflicts cannot be managed and that resignation is the only correct course even though this might deprive the board of useful expertise (say, over the evaluation of the employer's covenant). Short of resignation, these are among the options for managing conflict (subject to a scheme's own legal advice):
 - set up a sub-committee that excludes the conflicted trustee and delegate the sensitive issue to it,
 - the conflicted trustee withdraws from meetings when the sensitive agenda item comes up and takes no part in decisions on it,

- add an independent trustee to the trustee board. This does not resolve the conflict, but creates an authoritative figure who can help manage it,
- apply to the court for its approval of a decision the trustees have in mind. If the court approves it, it is beyond challenge. But this slow and costly process is not a practical answer in the long run, or
- a combination of the above.

- Do not expect TPR's guidance to answer all the questions.

Managing advisers' conflicts

- Actively raise the question of conflict with advisers to ensure their advice is independent.
- Require advisers to disclose any conflicts they face (though some must do this by law already).
- Recognise that sometimes it may be necessary to change advisers.
- If the scheme is administered by the employer's pensions manager or HR department, understand whether their lines of responsibility could give rise to conflict.

Consultation

The consultation runs until the end of May 2008.

The chances are that it will be autumn before the final guidance is available.

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