Managing conflicts of interest is never easy, but is something trustees increasingly have to cope with, finds Andrew Sheen.

Conflicts and dilemmas are part and parcel of everyday life and most people are used to dealing with them. But for trustees of pension schemes, it is often not so easy. Navigating the moral maze of pension management can be difficult and complex.

And as trustees are professionally minded and take their duties seriously, the nature of the conflicts and dilemmas they can potentially face, and how they go about dealing with them, is vital to the smooth running of schemes.

Brian Critchell, a principal at independent trustee firm PAN Governance, says that conflicts of interest are “the nub of the challenge” facing trustees today.

“As a trustee, conflicts have to be managed,” he says.

By far and away the most important and potentially damaging conflict of interest that trustees face is the fact that they, in all but a few cases, either employed by the scheme sponsor or else are members of the scheme. As such, there are several ways in which their loyalties could be seen to be compromised.

Anne Kershaw, associate director at Muse Advisory, says: "Member nominated trustees can often find themselves facing difficulties, because they will have been elected by their colleagues, yet they have to represent all interests equally – not just those of the active membership."

The same is also potentially true of employer-nominated trustees (ENTs). An ENT put forward by the company may be expected to represent more strongly the views of the employer or be expected by their bosses to be a ‘pushover’ when it comes to defending corporate, rather than scheme, objectives.

“A senior individual on the finance team, for example, who’s an ENT, might come under pressure from the finance director, especially these days when there’s so much concern about deficits,” Kershaw says.

The challenges of managing conflicts of interest has been in the spotlight at British Airways (see case study page 24). Conflicts seem to be built into the system as senior management ENTs sit on both of the company’s schemes – the Airways Pension Scheme (APS) and New Airways Pension Scheme (NAPS) – while being members of only one. With both schemes in deficit, the two are effectively in competition with each other for finite resources available for extra funding.

Cliff Pocock, a former member-nominated trustee for APS and one of three trustees who quit controversially over the use of an ENT, says that this dynamic is a significant challenge for trustees. He says: “It’s a conflict of interest to sit on two schemes that are in deficit and the two schemes are competing for the same resources.”

The case study of British Airways illustrates how complex and challenging these issues can be. It also highlights the importance of having a clear and effective governance framework in place to manage such conflicts of interest.
of CPI for indexation purposes, says this state of affairs puts the schemes’ ENTs in “an extremely difficult position”.

“There’s a huge potential for the perception of conflict there and as the Regulator has pointed out, perception is as important as reality,” he says.

But having senior management on a board of trustees can help by bringing a higher level of knowledge of the culture of the company and the environment in which the company operates, as well as a better understanding of financial matters which may not be apparent to other trustees.

Malcolm Curzon, retiree chair of the Habitat UK pension scheme and former company finance director, says the scheme sponsor has a “close and open relationship”, with a senior executive from the company, such as the HR director, sitting in on trustee meetings.

“That helped ensure that communications were good and we had a fairly open and transparent relationship with the company,” he says. “We didn’t have any secrets. We think the pension plan and the company should be very much in partnership – each depends very much on the other.”

The Habitat scheme also includes company-appointed members, balanced by independent trustees, who hold the casting vote in any decisions. Curzon says the trustees have so far never had to resort to calling on the independent trustees’ casting vote, as issues have been resolved by consensus, and Curzon is in favour of company representation on the board.

“I am not one of those people who believe you have to do away with conflicts and say that therefore people on the finance side shouldn’t be trustees – it adds a lot of expertise. At the end of the day, the company is supporting the pension fund, so I think it’s very good for them to be involved.”

But Sarah Smart, trustee chair of The Pensions Trust, a multi-employer scheme which provides pensions to charity and not-for-profit organisations, warns about cases where a trustee who also holds a senior management position may not even recognise a conflict. A finance director who also sits on the board, for example, may be opposed to de-risking on the grounds of it damaging the sponsor, rather than acting in the members’ interests.

She notes: “It’s all very well to say that ‘this is what to do when you recognise you have a conflict,’ but the actual act of recognising you have a conflict often doesn’t happen.”

Another important issue is when an employer may be in a financially weak position yet the scheme faces a deficit. While a trustee’s overriding priority is to protect the scheme and seek the best deal possible to ensure benefits will be paid, there are cases where doing so could seriously jeopardise the sponsor’s ability to stay in business. Looking for more money from the sponsor when that may in itself cause the business to fail is a clear dilemma and one that must be approached delicately.

Critchell notes: “A trustee’s situation is very complex. They’re appointed to manage the pension scheme to pay benefits for members, but in order to ensure that the fund keeps going then there might have to be difficult decisions.”

A case in point is the fate of chilled food manufacturer Uniq, which was forced to pass over 90% of the company equity to its trustees in order to repair a £436m pension scheme deficit. In exchange for the equity and a cash injection of £14m from the parent company, the trustees agreed to relinquish all future claims for support from the sponsor.

The company recently re-floated on London’s AIM stock exchange, before the trustees agreed to sell the firm to rival food manufacturer Greencore for £113m. It is currently unknown whether the sale is enough to prevent the scheme from entering into the Pension Protection Fund (PPF).

In order to deal with conflicts and dilemmas, it is vitally important for a board to have a good governance structure in place to recognise and deal with potential problems. The Pensions Regulator has issued its own guidance on dealing with conflicts of interest (see box: Dealing With Conflicts).

Curzon says the Habitat scheme has a conflicts policy, as recommended by the Regulator, and processes to resolve any problems, although these have rarely needed to be used as the trustees are able to act in the best interests of the scheme.

“The trustees declare what their interests are and we have a process that asks for anyone who might be conflicted because of the agenda, and we go through it and resolve it. But people take their responsibilities to the plan very seriously and we’re able to concentrate on that,” he says.

However, The Pension Trust’s Smart is somewhat critical of a box-ticking approach that a simplistic view of compliance can lead to.

“Boards can say they have a policy, but that doesn’t mean much – just that everyone will declare their conflicts. It comes down to effective chairing and governance and knowing when someone is speaking from a position of conflict and when they’re not,”

“I would hope the majority of trustees would more often than not recognise their own conflict and be able to say ‘no, I’m conflicted I can’t take part in this discussion’ or ‘I am conflicted but I don’t think it affects how I see the issue’. As long as everyone knows what the conflict is,
Earlier this year, the British Airways pension scheme made headlines throughout the pensions media, and even mainstream press, with the shock resignation of three trustees from the Airways Pension Scheme (APS). Member nominated trustees Mike Post, Cliff Pocock and Graham Tomlin chose to leave the scheme over the company’s decision to tie inflation-based increases to the lower Consumer Prices Index (CPI), rather than the more generous Retail Prices Index (RPI).

As Cliff Pocock explains, it was not a decision lightly reached. Having been a trustee of the APS fund for over eight years, he says many issues had come up during his tenure on the board over which a consensus was either reached immediately, or over time, through debate.

“But on this occasion, I felt it was an issue that went to the heart of trusteeship – whether the trustees were acting in the best interests of members,” he says.

For decisions of the nature of changing indexation, a two-thirds majority would be required. With the 12-strong trustee board comprised half-and-half of member-nominated and employer-nominated trustees, with an independent chair, Pocock says he realised that the arguments he put forward in favour of retaining RPI and then establishing an explicit link to the index in the scheme rules “would not achieve a consensus”.

“I think this is a good rule, because rules shouldn’t be changed on a whim. But it became quite clear to me that this majority vote to hard wire RPI wouldn’t be achieved, no matter how strong I felt the arguments were,” he says.

Having been elected on to the trustee board by over 7,000 members – over a third of the scheme wouldn’t be achieved, no matter how strong I felt the arguments were,” he says.

Having been elected on to the trustee board by over 7,000 members – over a third of the scheme membership – Pocock said he felt the issue was sufficiently important that he needed to explain to the members exactly where he stood.

But this raised the issue of how far he was able to express his opinion while remaining on the board. Legal advice at the time suggested that he would have to follow fellow members and resign his position, if they wanted the freedom to criticise the decision taken by the employer.

“I was advised that I couldn’t express a personal opinion and had to accept ‘cabinet responsibility’. Similar to government ministers, they have to accept cabinet responsibility for policies they don’t agree with, but sometimes they simply decide that the policy being pursued is so wide of their own views that they have to speak out and thereby resign,” he explains.

This left Pocock open to the accusation that aside from garnering headlines, his resignation would undermine further attempts at reform, since he and his fellow trustees would no longer have a voice on the board to influence decisions. It is a criticism he “absolutely” accepts. “I should have stayed onboard and tried to fight the good fight.”

But having taken further legal advice, Pocock says it is acceptable for trustees to raise concerns publicly, provided they do so in a personal capacity. “I’m a member of the scheme so I’m able to speak out as any other member of the scheme can,” he says.

With an active online presence via his blog and twitter account, Pocock has decided to stand for re-election because “there will be other issues ahead and the members need the strongest possible representation”.

Chief among his tasks, if successful, will be helping to restore some of the trust and goodwill on the board, which he believes has broken down as a result of the indexation argument.

“At the same time I feel more at liberty to say publicly when I disagree with the direction of travel or decisions, and in doing so I would be prepared to say that it’s my personal decision,” he says.

...they can make their own decision as to whether they’re coming from an untenable position or not. A lot of it is common sense,” says Smart.

When a conflict may involve relations with the sponsor, Kershaw recommends trustees and the sponsor drawing up a memorandum of understanding in advance of any issue – perhaps when new members come onto the board or around the time of a valuation – to set out and agree the broad positions and principles of any deal. She also says they should be willing to take legal advice if necessary.

“Trustees can often sell themselves short if they’re not prepared to pay for advice,” she says, but adds that they should also stand their ground. “The employer needs to know that the trustee role must prevail.”

Yet there may be times when trustees find themselves impotent in the face of an intransigent employer, determined to push through measures which may improve their own bottom line at the expense of the scheme. Trustees may simply not have the power to change the scheme rules if the employer acts unilaterally, as has happened with sponsors looking to impose CPI, close schemes or freeze accrual.

In such a situation, trustees can feel they have a moral duty to speak out either to the rest of the board or more broadly, to the employer or even the media.

“It depends on the gravity of the situation, but if one trustee doesn’t speak up, then others won’t. Trustees must not be cowed,” Muse’s Kershaw says.

Like the film ‘Twelve Angry Men’, unless one trustee with an issue about a decision before them is prepared to speak out and debate and try to convince others, things will not change.

Critchell adds: “The only decisions that stick are consensus decisions. A trustee board has collective responsibility, so if a decision is not a consensus that suggests there is more mileage to the debate – nobody got the perfect answer.”

But Smart says: “It’s a bit weak to say that if you don’t agree [with a decision] it can be noted in the minutes, or you’ll leave and allow the board to carry on. If you fundamentally believe that what the board is doing is wrong and they’re doing that because they are conflicted then you need to make that known. It’s not necessarily about going public, but can be going to the Regulator and whistle-blowing.”

Critchell agrees: “In my opinion, it’s better to remain a trustee and fight for your point of view than relinquish your position. It’s better to stay on and fight.”

Staying on to fight for members’ interests – or taking concerns public – may be approaches taken by some trustees, but for others, the pressure of serving two masters can be too much to take.

Pocock concludes: “I know individuals who’ve found the strains of the different interests that they’re expected to satisfy extremely difficult and on occasion have left office because they’ve felt they could no longer serve the best interests of the members because of their competing responsibilities.”