

## **Section 89 report – G.E.C. 1972 Plan (telent)**

This report is published under s89 of the Pension Act 2004. It concerns the recent role of the Pensions Regulator ('the regulator') in relation to Pension Corporation's purchase of telent limited ('telent'), the sponsoring employer of the G.E.C. 1972 Plan.

Pension Corporation came to the regulator's attention during the course of 2007 through its acquisition of the Thresher Group, Thorn Ltd and telent, all of which sponsor pension schemes.

### **The G.E.C. 1972 Plan ('the Scheme')**

In October 2007, the regulator was approached by the trustee of the Scheme, Stanhope Pension Trust Limited ('the Trustee'), in relation to the proposed takeover by Pension Corporation of telent, the sponsoring employer of the Scheme.

The trustee was concerned because Pension Corporation was in the business of providing investment management services to (amongst other things) pension schemes and its takeover of telent appeared to be with a view to ensuring that Pension Corporation could manage or determine the investment strategy of telent's very substantial pension scheme with the aim of producing a profit for itself.

Employers usually take over other employers with a view to managing the business of that employer, not to manage the investment strategy of its pension scheme in order to generate a profit for itself from the assets of the scheme. The regulator takes the view that such a strategy is highly likely to give rise to serious conflicts of interest between the employer and the members of its pension scheme.

In relation to telent, the potential for conflicts was further increased because of the existence of a fund of £514m held in escrow. This sum was available to the trustee of the Scheme if it decided to safeguard members' benefits by the purchase of annuities (and the escrow was needed to fund that purchase). However, if annuities were not purchased and the assets of the Scheme increased to 105% of liabilities, the £514m would be released to telent (controlled by Pension Corporation).

It was the view of the regulator that Pension Corporation's interests and the interests of the beneficiaries of the Scheme were not aligned in all circumstances and that there were potentially acute and pervasive conflicts of interest in relation to investment strategy in particular.

Pension Corporation bid for telent with the intention of applying its desired investment strategy to the management of the Scheme. The Trustee was concerned that in order to implement its proposals, Pension Corporation intended to obtain 'control' of the Scheme by using its ownership of telent on the completion of the takeover to appoint a majority of its own representatives to the board of the Trustee, as it had done in relation to other pension schemes that it had acquired.

The concern was that the effect of such appointments would be that these representatives of Pension Corporation would have a direct interest in the investment strategy of the Scheme and predetermined ideas about how to achieve Pension Corporation's business aims of releasing a profit for its investors. This would significantly compromise the independence of the Trustee board, raising issues of acute conflict of interest between the stated business aims of Pension Corporation and the benefits of members under the Scheme contrary to the fiduciary duties owed by the Trustee.

An urgent application was consequently made to the Determinations Panel under the Special Procedure for the appointment of independent trustees to the Scheme under sections 7(3)(a) and 7(3)(c) of the Pensions Act 1995.

On 19 October 2007, the Determinations Panel made an order appointing three independent trustees ('the Independent Trustees') to the Scheme with exclusive powers until 18 April 2008 ('the Order'). The Order was upheld at a contested compulsory review hearing before the Determinations Panel on 7 November 2007.

Prior to the hearing before the Determinations Panel on 7 November 2007 nothing that Pension Corporation said or did gave the regulator any comfort that the conflicts the regulator had identified were likely to be avoided by Pension Corporation, or even that they were properly understood. On the contrary, Pension Corporation appeared to the regulator to be intending to press on with the implementation of its strategy without properly addressing the concerns the regulator had raised about conflicts of interest.

In the reasons given for its decision<sup>1</sup>, the Determinations Panel accepted the submission of the regulator that there were three main situations in which the business model adopted by Pension Corporation gave rise to serious conflicts of interest in relation to the Scheme<sup>2</sup> and noted that Pension Corporation had made no arrangements for the identification and management of these conflicts. The situations identified were:

- (i) the use by telent, if controlled by Pension Corporation, of the power to appoint its director to the board of the Trustee where there was a risk that

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<sup>1</sup> <http://www.thepensionsregulator.gov.uk/pdf/TelentReasonsofDeterminationsPanel.pdf>

<sup>2</sup> See paragraph 21 of the reasons

- those appointees would wish to implement Pension Corporation's investment strategy;
- (ii) the new trustees, if appointed by Pension Corporation would have a conflict of interest when deciding whether to exercise their powers of investment and when deciding on whether to appoint Pension Corporation as the Scheme's investment manager; and
  - (iii) if Pension Corporation were appointed as the Scheme's investment manager or its personnel were involved in decisions on investment policy or its application then a conflict of interest could arise on every occasion that Pension Corporation (or its personnel) provided investment advice to the Scheme.

The Determinations Panel also agreed<sup>3</sup> with the concern that the business model operated by Pension Corporation, which involved the acquisition of a principal employer to profit from its pension scheme, placed it in a fundamentally different position in relation to the Scheme than a typical employer. This was particularly the case given the existence of a £514 million escrow account the terms of which enabled it to be released to the employer (ultimately Pension Corporation) if the funding level of the Scheme were pushed above 105%.

Specifically, the Determinations Panel stated at paragraph 39 of its reasons that:

“At the heart of the objections raised to the [telent] Offer is PC's business model and investment strategy. PC's literature, and the evidence before the Panel, suggested that it was not interested in the commercial activities of the Employer nor in the employers that it had acquired in the past. PC's business is the management of pension schemes. It is implicit that the Offer was made with a view to profit for its investors (some of whom were to be appointed to the Trustee board). The language that PC uses in describing its business is indicative of the approach that PC would take should the Offer be successful. The Panel did not feel that the use of terms such as “control” and “own” was merely superficial. PC's intentions, which it never denied, were to manage the assets of the Scheme in a way that would generate a return for its investors. The Panel considered that the relationship between the Employer/PC and the Scheme would be fundamentally different in this case from a typical employer/scheme relationship. This was because of PC's business model, the Escrow and its terms and because of the unusual ratio between active and deferred members”.

Having resisted the application to the Determinations Panel and denied that there was a serious problem with conflicts of interest, the regulator is pleased to note that Pension Corporation has subsequently engaged with the regulator and the

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<sup>3</sup> See paragraph 39 of the reasons

other parties to achieve an effective governance structure for the Scheme which addresses the concerns which led the Determinations Panel to appoint the Independent Trustees with exclusive powers in order to protect the Scheme and its members.

The intention is that the new structure will govern the Scheme going forward after the expiry of the Determinations Panel Order on 18 April 2008

In order to achieve this, the following accommodation has been reached by the affected parties:

- (1) The Unilateral Undertaking: Pension Corporation has given a unilateral undertaking to the regulator that it will not permit anyone from Pension Corporation or a wide range of associated entities to be appointed as a trustee of any scheme in which Pension Corporation has a specified financial interest or liability without the prior approval of the regulator ('the Undertaking').

The permission of the regulator will not be sought on a regular basis and in any event not within 18 months from the date of the Undertaking. It has been made clear to Pension Corporation that unless there are substantial changes in the circumstances surrounding the Scheme to remove the issue of conflicts of interest, the regulator's position is very unlikely to change.

The Undertaking reflects the regulator's view that where there is an acute and pervasive conflict of the type that arose in relation to the present scheme the best course is usually to avoid (rather than to attempt to manage) that conflict by preventing that person being on the board of the Trustee at all.

The Undertaking has been incorporated into the trust deed and rules of the Scheme as well as into the Articles of Association of the Trustee. Pension Corporation is also required to use its best endeavours to incorporate the Undertaking in relation to other schemes in which it controls the principal employer.

- (2) 3:3:3 Governance Structure: The board of the Trustee, or any subsequent trustee, will continue to comprise nine directors, with three employer nominated directors, three member nominated directors and three independent directors. This ensures that there will always be independent directors with appropriate expertise for the management and protection of the Scheme.
- (3) The Independent Directors: The independent directors must be verifiably independent. The first independent directors of the Trustee will be the

- three Independent Trustees appointed by the Order of the Determinations Panel on 19 October 2007. The independent directors will thereafter appoint their own successors from the regulator's list of independent trustees.
- (4) Chairman: One of the independent directors will be appointed as the Chairman of the Trustee board.
  - (5) Incorporation of the Governance Structure: The 3:3:3 governance structure, together with the provisions relating to the independent directors, has been incorporated into the trust deed and rules of the Scheme as well as the Articles of Association of the Trustee. These provisions have been entrenched in the trust deed of the Scheme so that they can only be altered by the agreement of all the independent directors.
  - (6) Conflicts of Interest Protocol: The Scheme will adopt a protocol for the effective identification and management of conflicts of interest. The key provisions are:
    - (a) The three independent directors of the Trustee are to act as conflicts directors with responsibility for keeping a register of disclosed conflicts and for making final and binding decisions in relation to how to manage conflicts of interest that arise.
    - (b) Guidance is provided in relation to how material conflicts of interest should be managed which may require that a particular trustee be disbarred from voting or ultimately resign from being a director.
    - (c) The express recognition of the fiduciary obligations of the directors of the Trustee to disclose to co-trustees and to use for the advantage of the members of the Scheme any relevant information acquired in any capacity.
    - (d) The express recognition that conflicts of interest are most acute for Pension Corporation in relation to decisions about investment matters. The three independent directors of the Trustee will determine whether any directors who they determine to have a conflict in relation to investment matters can participate in any decision on investment matters.
    - (e) Any advisory or other service role adopted by Pension Corporation in relation to the Scheme will be on terms determined entirely by the board of the Trustee acting collectively and will be supplemented where appropriate by parallel independent input.

It is anticipated that Pension Corporation will adopt a similar protocol as soon as possible.

The regulator believes that this package of measures addresses the concerns that were before the Determinations Panel. In particular, they provide express recognition of the significant risks posed by conflicts of interest for the Scheme and establish a structure of governance to provide effective management of such risks. The regulator has nevertheless reserved its right to exercise any of its statutory powers in relation to the Scheme in the future.