

Consultation report

A response from the Pensions Regulator
Guidance – Conflicts of interest

October 2008

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1. Introduction

On 22 February 2008 we began a consultation aimed at providing practical guidance to trustees in relation to the governance of conflicts of interest. The publication of this guidance is one of a number of initiatives that the regulator is undertaking to assist trustees on the theme of promoting good scheme governance.

The consultation highlights three important stages which should be considered by trustees when seeking to manage conflicts of interest:

- (1) identification;
- (2) monitoring; and
- (3) managing;

and includes five high level principles which will assist trustees with the formalisation of conflicts management procedures.

This guidance is not designed, nor intended, to provide legal advice to trustees. It does not replace the need to obtain independent legal advice.

The consultation period ended on 30 May 2008. We received 42 responses (one which included the consolidated views of over 50 individuals) from a broad cross-section of stakeholders, including trustees and firms of Independent Trustees, legal firms, professional and trade bodies, consultants, trade unions and employers. A list of the respondents is attached as an appendix. We are extremely grateful for all the responses received, which have helped us considerably.

We are pleased to report that, while a number of views were expressed on different aspects of the guidance, the majority of respondents supported our initiative to produce guidance – with many noting that they were very supportive of the ideas and concepts set out in the consultation document. In fact, of the responses received, only one objected, in principle, to the regulator issuing guidance on conflicts of interests.

While there were many helpful suggestions about how we might make further improvements to the draft guidance, there was no evidence to suggest that we should fundamentally change the key messages outlined in each of the five principles. The identification of conflicts of interest is a critical part of the governance process and trustees should be aware that conflicts will be inherent with all trustee appointments, particularly the appointment of senior employees of the sponsoring employer. The importance of formalising and implementing robust conflicts management procedures, built around the three key stages referred to earlier, remains the same.

As a matter of good practice, trustees should embrace a culture of openness which will include internal policies and processes for disclosing and recording conflicts.

In response to a number of issues commonly raised, we have re-examined the tone and content of our original drafting and have made changes where appropriate.

Section 3 of this paper sets out our response to comments raised in responses.

2. What the consultation said

The consultation paper was essentially built around five high level principles which are considered in detail in each section of the full guidance. These principles are accompanied by practical guidance, case examples and sample documents to help trustees explore options for implementing robust conflicts management arrangements. Of course, the guidance is not intended to be a definitive guide and trustees, many of whom have already made very good progress in this area, may identify alternative solutions.

The five principles identified are summarised below:

Principle 1: Understanding the importance of conflicts of interest;

Principle 2: Identifying conflicts of interest;

Principle 3: Evaluation, management or avoidance of conflicts;

Principle 4: Managing adviser conflicts; and

Principle 5: Conflicts of interest policy.

Throughout the draft guidance we emphasised the importance of seeking independent legal advice, noting that the law relating to conflicts of interest is complex and comes from a variety of sources.

The guidance also paid particular attention to the appointment of senior members of staff of the employer(s) as trustees and the fact that conflicts are inherently likely to arise. It is important to note at this stage that it is not the regulator's view that such appointments are inappropriate, merely that the likelihood of a non-trivial conflict increases and thus such appointments need to be managed accordingly. Of course, in extreme cases, there will be circumstances when the nature of the conflict is so acute or pervasive that resignation (or avoidance) may be the only appropriate course of action.

While respondents were free to provide comments on any aspects of the draft guidance, we specifically sought comments on the following questions, which were included in the consultation document:

Structure and layout of the guidance

1. Does the guidance provide sufficient information for you to understand what a conflict of interest is and how it can affect the role of a trustee?
2. Does the guidance provide a clear enough background to the framework of principles that underpins the process of managing conflicts of interest?
3. Do you feel that you are able to extract the relevant information at a level that is appropriate for you? Is there a sufficient level of background where it is appropriate for you?

Guiding principles

4. Do you think the principles cover all the key areas relating to conflicts management arrangements or are there other areas of equal prominence which should be covered in the guidance?
5. Do the updated principles provide sufficient guidance on how to approach the subject? Are there any principles you think apply that should be added?

Case Examples

6. In this guidance we have included a number of actual case examples to help demonstrate the application of best practice principles. Do the case examples help provide some additional clarity in relation to the application of the principles, or are there examples which you have experienced which would add more value? If so, please could you provide a brief case summary of how the conflict was managed – we may wish to include this in our finalised guidance.

3. Main points raised in responses

The majority of respondents raised common issues or concerns. These are noted below, together with our response.

Structure and layout of the guidance

- 1. Does the guidance provide sufficient information for you to understand what a conflict of interest is and how it can affect the role of a trustee?**

The majority of respondents stated that the guidance does provide sufficient information to help understand what a conflict is and how this can affect the role of a trustee. However, the common view was that the guidance was too long, with a number of respondents saying that too much detail was provided.

As noted throughout the paper, the management of conflicts of interest is both extremely important and complex. It was initially our view that the level of information provided was commensurate to the nature of the subject matter and aimed to provide guidance to trustees with differing levels of knowledge and skills. Concern was, however, raised that the level of detail (and repetition) could overshadow important messages. We have therefore re-examined the guidance and have made a number of amendments to the original draft, while still retaining the core messages and a sufficient level of detail to support these messages.

The result of many of these changes, as well as incorporating a number of very important points raised by respondents, is a comprehensive suite of principles to aid the identification, monitoring and management of conflicts.

To address concerns that the guidance may be too overwhelming, we have also produced a *summary (or abridged) version of the guidance* which simply summarises the key principles and some of the questions trustees should be asking themselves. This may be a particularly useful tool for smaller schemes.

We understand that there cannot be a 'one size fits all' approach - smaller schemes may need to take a proportionate approach when seeking to apply the principles in practice. It is, however, our view that good practice material in the full guidance is equally relevant to small schemes, particularly when seeking to manage non-trivial conflicts.

It is also important to note that we would expect all trustees to read the summary version in conjunction with the main guidance. The summary version has been produced to provide trustees with a useful summary for discussion at meetings, and to provoke debate.

A number of respondents raised a concern that we were overemphasising the risks of having or appointing trustees who also hold senior positions within the employer – respondents suggested that this could result in a number of trustees resigning as a result of our guidance. We have examined this area and have updated our guidance. We note that such appointments can be beneficial, but clearly there can be circumstances when conflicts become untenable and resignation is the most appropriate course of action. This is a matter of fact.

2. Does the guidance provide a clear enough background to the framework of principles that underpins the process of managing conflicts of interest?

Again respondents were mainly supportive of the background to the framework. One respondent noted that 'the structure and layout.....offer adequate flexibility for trustees to apply it to the needs of their scheme.' This is an extremely important point to note. We acknowledge that conflicts can vary enormously from one scheme to another and processes to manage these conflicts will be scheme and fact specific. We hope that the principles offer a degree of flexibility and can therefore be applied to specific circumstances.

Many responses mention the number of references made in the guidance to obtaining legal advice. Throughout the development of this guidance it was quite apparent that views vary considerably where considering matters relating to conflicts of interest. As such it was extremely difficult to produce definitive guidance and solutions to all matters relating to conflicts of interest. As noted, the law relating to conflicts of interest is extremely complex and comes from a number of legal sources; and of course is open to interpretation. In view of this the regulator considered it appropriate to emphasise the need to seek independent legal advice particularly as this guidance is not a substitute for seeking such advice.

However in view of the number of responses that commented on the references to legal advice, we amended the draft where appropriate. The regulator would expect trustees to seriously *consider* obtaining independent legal advice, when seeking to manage a non-trivial conflict of interest, where the conflict could have the potential to be detrimental to the conduct or decisions of the trustees, and act on this advice.

3. Do you feel that you are able to extract the relevant information at a level that is appropriate for you? Is there a sufficient level of background where it is appropriate for you?

While many points were noted by respondents, for example the length of document, detail etc, many stated that they were able to extract the relevant information. One commentator noted that the guidance was ‘very readable, comprehensive, and provided useful illustrations and examples.’

Another comment noted that the guidance was ‘sufficiently clear for lay trustees to gain a good understanding of the problems arising from conflicts.’

In contrast, two respondents noted that the level of detail may be sufficient for professionals, independent trustees and advisers. In response, our expectation is that trustees collectively have sufficient knowledge to implement robust conflicts management procedures. In terms of accountability we would expect all trustees to have a good understanding of the risks relating to conflicts and all trustees should be able to demonstrate that they have taken action as appropriate.

Concern was raised that the guidance was DB specific. The view was that it may be difficult for trustees of DC arrangements, particularly smaller schemes, to identify any key messages.

The guidance now makes even more references to DC schemes and also includes case examples specific to such arrangements. However it is important to note that all the principles and much of the detailed guidance is relevant to both DB and DC schemes and therefore it was not considered appropriate to draw a distinction.

Guiding principles

4. Do you think the principles cover all the key areas relating to conflicts management arrangements or are there other areas of equal prominence which should be covered in the guidance?

Of all those who specifically referred to this question (and subject to the paragraph below) the response was that the principles cover all the key areas. It was suggested, by more than one respondent, that Principle 2 – Conflicts of interest policy, should in fact be the last step of the cycle, once other principles have been addressed. In terms of practicality, this is a very sensible suggestion and has been actioned accordingly.

A number of responses suggested that the regulator’s guidance should consider in more detail the impact of confidential information. We have considered this point in some detail and have made some changes to this section of the guidance. Legally this is very complex; it was apparent from the responses received that legal views differ and given the nature of the guidance it was considered inappropriate for the regulator to provide a detailed assessment relating to the duty to disclose confidential information.

- 5. Do the updated principles provide sufficient guidance on how to approach the subject? Are there any principles you think apply that should be added?**

The general consensus was that the principles provide sufficient guidance and that generally the principles are complete. Comments were raised with regards to the application of guidance for smaller schemes and DC arrangements, although these points are addressed above.

Case Examples

- 6. In this guidance we have included a number of actual case examples to help demonstrate the application of best practice principles. Do the case examples help provide some additional clarity in relation to the application of the principles, or are there examples which you have experienced which would add more value? If so, please could you provide a brief case summary of how the conflict was managed – we may wish to include this in our finalised guidance.**

The majority of respondents who commented on question 6 were supportive of the inclusion of case examples, noting that they add value and are helpful. One respondent noted that ‘The approach of high level principles supported by practical guidance and case studies works well.’

However there was a view that the cases were rather long and too detailed, and could be written in a ‘more reader-friendly way’. We have therefore made a number of changes to the existing cases as well as add two further examples.

One respondent was not in favour of the case examples.

Options for managing conflicts of interest

- 7. Does the section on options for managing conflicts of interest (paragraphs 71 – 90) suitably explain how these arrangements help manage potential or actual conflicts? Are there any other options which need to be added to the guidance?**

The general view was that the options, which were never intended to be an exhaustive list, are comprehensive. There were concerns that there was too much emphasis on the appointment and role of independent trustees as a means of managing conflicts of interest throughout the paper. One comment stated that the guidance comes close to ‘suggesting that an independent trustee is a panacea for all problems concerning conflicts of interest’. We have re-examined references made to independent trustees. Whilst we have made some changes to the original drafting, we are not of the view that our guidance implies that *any* course of action is a panacea for conflicts management. The guidance includes a number of options and quite rightly notes that a particular course of action may be appropriate in certain circumstances.

In terms of offering other options for managing conflicts, at least two respondents suggested that conflicts could be managed at the ‘employer end’. This would be particularly relevant for trustees who also hold positions within the

employer, whereby they withdraw from employer negotiations which may impact on the pension scheme. This has now been added as an additional option.

4. The way forward

The management of conflicts of interest is an ongoing process. We will continue to assess the extent to which trustees have embraced good practice and have implemented robust conflicts management arrangements.

This will be done in a number of ways. Primarily we will gauge the effectiveness of this guidance through research gathered from our annual governance tracker survey. Through the work undertaken by our practices, we will also be able to identify to what extent schemes have identified and sought to manage conflicts and we may endeavour to share this knowledge through additional case examples. It would, of course, be our intention to update the guidance in light of experiences from case work as well as trends identified in the governance survey.

Our expectations remain that:

- this guidance will continue to promote the importance of good scheme governance. It seeks to share good practice arrangements which trustees may wish to adapt for their schemes and will provide a valuable source of information to assist with matters relating to the governance of conflicts of interest;
- following the publication of this guidance we would hope to see a marked improvement in areas of conflicts management, for example it is acknowledged that the production of a conflicts policy plays an important role in communicating important messages to trustees, but still very few schemes have yet to put a formal policy in place.

Conflicts of interest will continue to be a key governance priority for the foreseeable future and we will continue to liaise with industry with the objective to share good practice and raising standards of governance in work based pensions.

Appendix

The following organisations provided responses to the consultation:

Association of Consulting Actuaries
Association of Pension Lawyers
Allan Martin
AstraZeneca Pensions Trustee Limited
Bernard Potter
CAA Pension Scheme
CBI
Group Pensions Department, Co-operative Group Limited
Coronet Holidays Limited Retirement Benefits Plan (1974)
Electricity Supply Pension Scheme
Eversheds
Freshfields Bruckhaus Deringer
Jardine Lloyd Thompson Benefit Solutions
Hewitt Associates Limited
The Hundred Group
Hymans Robertson
ICAEW
Invensys Pension Scheme
Investment Management Association
The Independent Pension Trustee Group
Independent Trustee Services
James Whittell
Lane Clark & Peacock LLP
Linklaters LLP
Macfarlanes LLP
Mercer
NAPF
Norwich Union
Occupational Pensioners' Alliance
Paul Lockley
PMI
PricewaterhouseCoopers LLP
Prudential
Railways Pension Trustee Company
Royal Bank of Scotland
Royal Mail Pensions Trustees Ltd
Sacker & Partners LLP
Society of Pension Consultants
Travers Smith
TUC
UNISON