

The Pensions Regulator  
Napier House  
Trafalgar Place  
Brighton BN1 4DW

10 April 2008

Dear Sir/Madam

## **Conflicts of interest: Consultation document**

PricewaterhouseCoopers LLP and PricewaterhouseCoopers Legal are pleased to have the opportunity to respond to this consultation.

As consultants and legal advisers to a wide range of clients we understand the importance for both trustees and sponsors of pension schemes of the need to address conflicts of interest. These are a significant challenge and trustees have been devoting increasing time recently to addressing and establishing formal policies to deal with them. Our recent 2008 Governance Survey reveals that only 6% of trustees of the largest schemes have not considered a process for managing conflicts compared with 37% in our previous 2006 survey. The position may not be the same for smaller schemes.

We support the need for guidance, but we have concerns with the existing draft. This letter sets out our general comments. More detailed comments are provided in the Appendix.

- **Five high-level principles:** The five principles would be better ordered as principles 3, 4, 5 and 2. There is no need for principle 1 as it should be a given that trustees understand the importance of conflicts of interest because of the TKU requirements. We strongly believe that the guidance for trustees should set out that the best approach for them to take is that of successively identifying, assessing, managing and then monitoring any conflicts of interest. Producing a formal conflicts of interest policy should come last.
- **Guidance should not only be for trustees:** The guidance has been drafted for trustees only, except for one reference at paragraph 121 that the principles apply to pensions managers. The guidance should consider other parties who may be involved in any conflicts such as employers (who are obviously interested in the financial management of their schemes), administrators (who are very often neglected in such issues) and independent trustees (bearing in mind the importance placed on their role in the guidance). Advisers should also be wary of conflicts but they are under their own professional responsibilities, and the guidance for trustees should only refer to the need to check that their advisers are able to provide the advice required objectively. We recommend that guidance instead requires trustees to check that their advisers are able to provide the advice required objectively and that appropriate ethical walls are in place.
- **Lengthy document:** The guidance is lengthy and wide-ranging. It would better meet the needs of the audience, and have greater impact on future behaviour, if it focused on addressing the issue only. It is currently unnecessarily complicated by references to TKU, reporting breaches of the law, internal controls and trustees' remuneration. At 45 pages, it is overly long and not appealing to users or easy to use. Additionally, the purpose of the document needs to be determined – is it to be a training guide as for the TKU guide (we do not feel it should be), or reference material for the trustee “toolbox” in a similar vein to a code of practice?

- **Need for legal advice:** The need to seek legal advice is stressed throughout the guidance, with only two brief references at paragraphs 5 and 69 to seeking advice from other professional advisers. The value of competent advice from other independent advisers should not be underestimated. More importantly, if trustees are required to seek legal advice at every stage, this will unnecessarily lead to an increase in costs. This does not tie in with the current BERR consultation on “A Code of Practice on Good Guidance on Regulation”, which stresses good guidance reduces the need to pay for external advice which currently costs businesses £1.4 billion a year.
- **Need for transparency and difficulties with “perceived” conflicts:** There is a need for transparency in the process, particularly with any perceived conflicts which are difficult to measure. Transparency would ensure there is more chance of withstanding scrutiny from any source. For example, any guidance needs to be considered from the viewpoint of members who may be concerned about conflicts. Without transparency it may be hard for trustees to demonstrate either that there was no conflict or that any conflict was managed properly. Repercussions can be far-reaching with loss of both reputation and members’ faith. Indeed, any policy (but not any register of interests) should be made available to members on request.
- **Appointment of independent trustees:** The guidance states that the appointment of independent trustees may be the only option to solving some conflicts of interest. We do not believe the Regulator should be promoting any one solution without due consideration and evidence. While we agree independent trustees can bring benefits to the board, it should be recognised that they themselves may have conflicts such as a desire to remain as a trustee and receiving remuneration for their services. This is not acknowledged in the guidance. Additionally, the emphasis throughout the guidance appears to be that it is with employer appointed trustees that conflicts will arise. This is not necessarily our experience.
- **Mix of trustees:** We firmly believe it is imperative that there is a good mix of skills and experience on the trustee board and that one particular group of trustees should not be favoured over another. All groups of trustees have the potential to be conflicted to some extent, and the aim should be to ensure there is a correct policy and procedure in place to manage any conflicts which arise. It should be noted that it is not necessarily the trustee board which determines the structure of the board, since this may be dictated by a scheme’s Trust Deed and Rules.
- **Conflicts of interest policy:** A conflict may arise when there are parties with different objectives. Any policy needs to be based on the circumstances which can give rise to conflicts rather than focussing on the people who will be affected. A policy needs to provide a procedure for how to deal with and manage any conflicts – logging and declaring conflicts on a register is a good start but does not go far enough. The aim of any policy should be to enable the mobilisation of the policy once a conflict is identified i.e. it needs to be centred on actions. We have our own version of a policy, which we will be sending you separately from this response.

We would be very happy to discuss any of the points above. Please contact either Louise Inward on 020 7213 1003 or Peter Tompkins on 020 7804 3458.

Yours faithfully



Peter Tompkins

## Appendix – detailed comments

Our more detailed comments on the guidance are set out below.

### Conflicts of interest at a glance (page 3)

- Paragraph 1 – The word “fiduciary” should be replaced with “trustee” to avoid the use of jargon and make the guidance more user-friendly.
- Paragraph 2 – We believe the three key stages should be in the following order – firstly identification, secondly managing and thirdly monitoring. This ties in with the comments made in our covering letter on the five high level principles.
- Paragraph 8 – The reference to “conflicts” in the first sentence should refer to “conflicts of interest”.
- Paragraph 10 – Following on from our comment on the emphasis placed on the need for legal advisers. Surely any competent advice from any advisers will suffice?
- Paragraph 11 – If it is intended that the guidance does not focus on the complexities surrounding the concept of conflicts of interest, then this will not allow the trustees to be able to identify them and manage and monitor them accordingly. This approach means this document would fail the test of being “guidance” and take the form of a TKU document.
- Paragraph 12 – This refers to the interests of “some or all beneficiaries at risk” – our view is that sometimes it may be necessary for some beneficiaries to be at risk which is preferable than all beneficiaries being at risk.
- Paragraph 13 – We question why the appointment of an independent trustee is considered the best solution for any conflict – surely the appointment of any other type of trustee will suffice. Solutions should be driven by the conflict circumstances and will rarely have a blanket approach.
- Paragraph 19 – The reference to “sometimes” in brackets should be changed to “often”.
- Paragraph 24 – We strongly disagree with the statement that independent trustees will ordinarily have no conflicts of interest. While we recognise the value of independent trustees, they will have an obvious desire to remain in the post. For example, they will wish to continue being remunerated for their services, to maintain their reputation and they may have family or financial connections to the scheme. We stress again that the Regulator should not be promoting the use of independent trustees without due consideration and evidence. Independent Trustees may also have other conflicts arising from professional relationships with providers.

### Principles of sound conflict management arrangements – a summary (page 8)

- Point 3.1 – This needs to emphasis that trustees need to identify any current and potential conflicts as opposed to only considering future conflicts which may arise - managing conflicts is an ongoing process.
- Point 4.1 – The words “where possible” should be removed – it is always possible to manage conflicts and should be a requirement emphasised in the guidance.
- Point 4.4 – We disagree that the resignation or appointment of an independent trustee is the “only option” – there are plenty of other options available to trustees.

- Point 5 – Note that professional advisers are already under obligation to follow their professional codes of conduct and inform trustees of any conflicts.

## Principle 1: Understanding the importance of conflicts of interest (page 10)

- Paragraph 29 – The “understanding” required of trustees is a TKU point and there is no need for this to be addressed in the guidance.
- Paragraph 30 – We would suggest the emphasis is changed from the chair of a trustee board “can” to “should” play a pivotal role in the effective operation of the board.
- Paragraph 32 – We repeat the point made under paragraph 24.
- Paragraph 33 – The conflicts policy is not the right place to set out examples of the types of conflicts that may arise – the identification and understanding of conflicts should be addressed in the TKU requirements. We strongly believe the conflicts policy should deal solely with the process for identifying, assessing and managing, and then monitoring any conflicts.
- Paragraph 35  
Role related
  - Second point refers to senior employees – this should not be restricted and should refer to any employee position held with the sponsoring employer.Situation specific
  - Second point should refer to in-house services, as this may include secretariat and not only administration.
  - Seventh point should recognise that any trustee may become privy to sensitive employer information.
  - Eighth point should just refer to a decision to wind-up/close the scheme.
  - Ninth point needs to be made more generic in relation to conversion terms for member options.
  - There should be a new tenth point highlighting the conflicts where trustees who are close to taking their benefits, may also be motivated by favourable options or changes to the scheme.
- Paragraph 36 – If the Regulator is going to state that there may be circumstances where conflicts of interest are authorised in scheme documentation, then it must also be stated that legal advice should be sought. If scheme documentation “purports to authorise or permit conflicts of interest”, then surely the Regulator should encourage trustees to seek legal advice with a view to necessary amendments being made to a scheme’s Trust Deed and Rules?
- Paragraphs 40 – 41 – These paragraphs are TKU requirements and should be removed.

## Principle 2: Conflicts of interest policy (page 15)

- Paragraph 43 – This appears to imply trustees should breach a scheme’s Trust Deed and Rules if it appears to authorise any conflicts of interest. We stress again the point made in paragraph 36.
- Paragraph 47 – The first two bullet points are TKU requirements and should be removed.
- Paragraph 48 – We do not consider Appendix D to be sufficiently detailed or wide-ranging enough to be a protocol of a policy document. [As mentioned in our covering letter, we will be sending you an example of our conflicts of interest policy.]

- Paragraphs 49 and 51 – It is not necessary for a scheme’s legal advisers to be involved in every change made to the conflicts policy, as this will add unnecessary costs for the scheme.

### Principle 3: Identifying conflicts of interest

- Paragraph 56 – This states that processes should be in place to require trustees to declare conflicts “upon appointment”, which contradicts what is written under point 3.2 on the same page i.e. that “Trustee appointment procedures would require trustees to disclose any conflicts”.

### Principle 4: Evaluation, management or avoidance of conflicts

- Point 4.4 – Again, we disagree that appointing an independent trustee is the only option.
- Paragraph 79 – We do not believe it is appropriate to state that a conflicted trustee who remains in a meeting and abstains in a decision may unduly influence an outcome. This implies that the remaining trustees would allow themselves to be inappropriately influenced by the conflicted trustee. A conflicted trustee should only be required to leave a meeting if their presence would undermine the trustees negotiating power with the employer. The policy document should address such a scenario.
- Paragraph 82 – Consideration should be given to the downsides of appointing independent trustees. A statement is made in this paragraph that “*However, it is important to note that the appointment of an independent trustee is not itself a solution for managing the conflict of interest. It may need to be combined with a number of other activities*”. We agree with this statement, however, this contradicts what is written elsewhere in the guidance that the appointment of independent trustees will be the only viable solution (such as paragraphs 13, 24 and 32).
- Paragraphs 85 and 86 – The guidance fails to expand on the issue of “perceived” conflicts.
- Paragraphs 92 – 97 – There is no need for a guidance on conflicts of interest to cover the issue of trustee remuneration, particularly paragraphs 92 and 93 which sets out background information. The guidance needs to be focused on conflicts of interest only.

### Principle 5: Managing adviser conflicts

- Paragraph 109 – Note that good practice and legal requirements require professional advisers to have conflict management procedures in place.
- For example, a firm may act for trustees of a pension scheme, advising them of the implications for the scheme of a potential change in ownership of the participating employer. Other advisers in the same firm may act for one or more of the potential purchasers of the participating employer.

It could be argued that this is not actually a conflict of interest but there are certainly heightened confidentiality issues. Firms generally manage these by putting up ethical walls between the respective teams. This should guarantee that no confidential information from one engagement team falls into the hands of another.

If an adviser had to inform the trustees of these situations, the very fact of informing them would be a breach of our confidentiality obligations to the team(s) representing the potential purchaser. It may also have implications with the Takeover Panel.

Case studies

- We do not find the case studies particularly helpful as they are not short or succinct enough. We suggest they are either removed or placed in an appendix to not unnecessarily lengthen the document or distract the reader from the content.