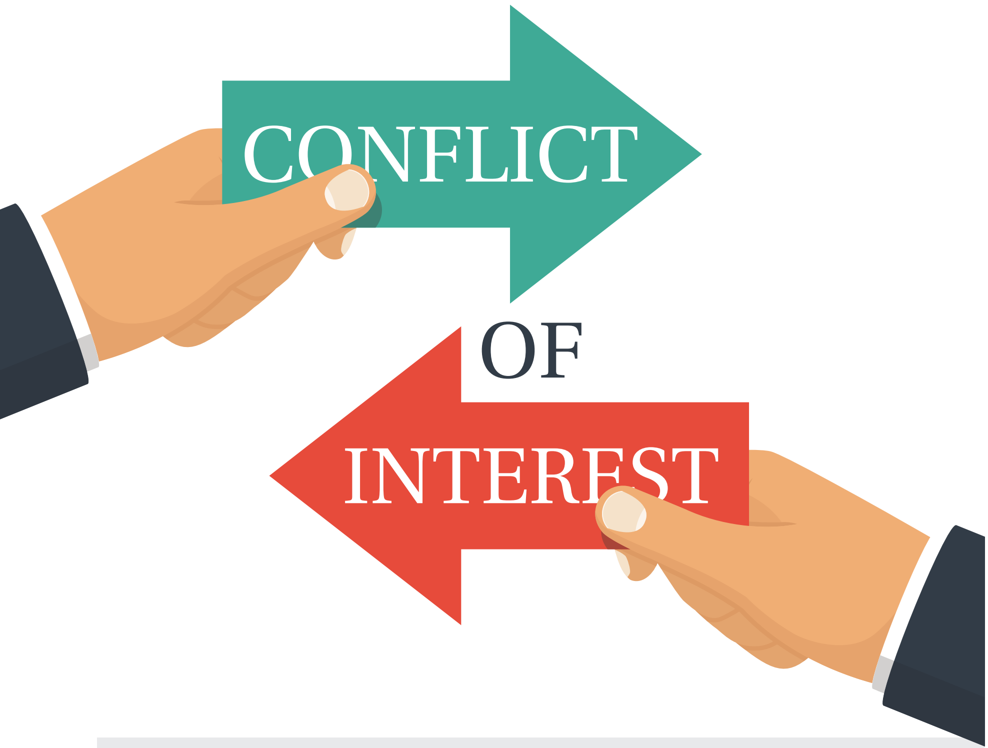

Summary

- Conflicts of interest are inherent in all schemes and must be identified and managed effectively.
- Member-nominated and professional trustees could have conflicts of interest through their relationship with the sponsor.
- Providers offering multiple services can create conflicts.

Expression of interest

Conflicts of interest are inherent in any pension scheme. Identifying and managing them are part of good governance, says Maggie Williams

Conflicts of interest exist in any line of business, and pension schemes are no exception. Personal conflicts – in which an individual feels torn by the demands of multiple roles; commercial conflicts – affecting the services a scheme buys and where it buys them from; and member conflicts – deciding what actions will be in a member's best interests – are all a part of the challenge of running a scheme.

As such, conflicts of interest shouldn't pose a threat. However, the approach that a scheme takes to identify and manage them – and the way their advisers support them in doing so – can have long-term ramifications for scheme governance and members' pension savings.

Personal conflicts

Member-nominated trustees (MNTs) arguably always have a conflict of interests. They are ultimately employees of the company that provides the pension scheme and as such, decisions that affect the scheme may have repercussions for their day jobs. MNTs with financial responsibilities both for the sponsor and the scheme, such as a finance director who is also a trustee, are an obvious example, but other MNTs may also feel under pressure when it comes to negotiating with the sponsor over defined benefit (DB) scheme funding. This can be particularly sensitive in stressed schemes with weak covenants, where the viability of the sponsor's whole business could be at risk.

But The Pensions Regulator (TPR) is adamant that trustees must overcome this. "We want trustees to negotiate robustly with employers, and especially so if *[the scheme is underfunded]* and the sponsor is paying big dividends to shareholders," says TPR executive director of frontline regulation Nicola Parish. And, with TPR set to have more robust powers as a result of the Department for Work and Pensions' recent White Paper Protecting Defined Benefit Pension Schemes, trustees' negotiating skills will be brought into even greater focus. "We will be quicker and tougher in the use of our powers where we see this type of disparity," adds Parish.

For trustee boards struggling to negotiate with their sponsor, an independent trustee can add a degree of much-needed objectivity. But professional trustees must deal with conflicts of their own. "Professional trustees are almost always paid by the sponsor of the scheme, so there could be a temptation to give them an easy ride," says PTL managing director and independent trustee Richard Butcher. "There might be a consideration of, 'this is a comfortable revenue stream for me, how much do I want to challenge it?'"

Commercial conflicts

Professional trustees, and other employees of service providers, may find themselves faced with commercial conflicts if they are part of a company that also offers other services to pension schemes, such as legal or actuarial advice. Says Butcher: "Individuals may be motivated by their company to bring in additional revenue by selling extra services. They may also be directly incentivised for that, in the form of a bonus. Then, do you deliver what's right for your client – or what's right for your employer?"

While the two parts of that dilemma may be aligned, often they are not. Nowhere has this been more evident than in the Financial Conduct Authority's (FCA) decision to refer investment consultants offering fiduciary management services to the Competitions and Markets Authority (CMA). "Fiduciary management has been seen by some consultants as a way of getting another income stream," says Barnett Waddingham partner Paul Jayson. "That can lead to conflicts if you are proposing and delivering a solution." Pensions and Lifetime Savings Authority policy lead for investment and defined benefit Caroline Escott adds that concerns over the "potential for misalignments of incentives" in the sector has also been a concern. "It is vital that every part of the investment chain works effectively and that the interests of intermediaries are aligned with those of pension schemes and their members," she says.

Speculation remains rife as to whether or not investment consultants will be required to separate out their fiduciary management arms from their consulting businesses, with the CMA's final report due in 2019. Whatever the outcome, Jayson believes there are issues to address that go beyond simple conflicts of interest. "The key points are education for trustees and disclosure from the providers. Sometimes buyers haven't known what they are buying into – and the sellers weren't open about what they were selling."

The consultancy sector has also seen significant consolidation over the past decade. With both sponsors and trustees requiring advisers, could those changes in the market also drive conflicts of interest, with the same firm potentially advising both sides?

Jayson believes it is not a concern. "There have been mergers and shrinkages, but there are plenty of providers out there," he says. His views are backed up by findings from the CMA, released in April this year. The watchdog's working paper into concentration in the consultancy (and fiduciary management) markets showed little current cause for concern. The three largest providers, Aon, Mercer and Willis Towers Watson, collectively make up less than 50 per cent of market share, and 10 firms cover 75 per cent of the investment consultancy market.

It also found that there were few barriers to entry into the market. "There are also new providers starting up and offering new types of service," adds Jayson. "Traditional models are changing and addressing different gaps in the market."

Member conflicts

Since the 2015 pension reforms, creating the right balance between supporting members' freedom and ensuring their best interest has introduced new types of conflict for scheme trustees of both DB and defined contribution (DC) schemes.

All DB scheme members considering a pension transfer must take advice – but should that be through an adviser recommended by the scheme, or sourced by the members themselves? Wealth at Work director Jonathan Watts-Lay is adamant that the scheme should be involved. "We've seen the factory gating in South Wales *[relating to the British Steel Pension Scheme (BSPS)]* and some of the extortionate charges being made," he says. "If schemes and employers found advisers that could deliver financial advice, did due diligence and compliance checks on them, and agreed a price that employees would ultimately pay, that would make the process more robust."

For advisers themselves, there is also a clear conflict of interest when it comes to contingent charging models for pension transfers (where a fee is only paid if the transfer goes ahead). The Financial Conduct Authority identified this in its March 2018 report on DB to DC transfers, as did the Work and Pensions Committee (WPC) in its report into the BSPS, released in February this year. "Genuine independence is not compatible with a charging model that only rewards advisers for recommending a particular course of action," concluded the WPC.

"It may well be necessary for this to be banned from pension transfer advice," adds Barnett Waddingham senior consultant Malcolm McLean. "If there is evidence to show that contingent charging is contributing to the level of unsuitable advice being dispensed… the FCA should probably intervene and bring the practice to an end."

DC trustees (and others with responsibility for DC schemes) have similar conflicts over access to advice around pension freedoms. Recent research by Zurich found 41 per cent of those opting for drawdown had received no guidance or advice in advance – and that 44 per cent of those in drawdown said that there was nothing that would prompt them to seek guidance. While, ultimately, that is a member's personal choice, trustees may feel they should be more robust in sourcing and offering advice, to ensure that their members make appropriate choices and don't run out of money in retirement. Zurich pensions expert Alistair Wilson believes that government needs to go even further, saying that it should enforce mandatory guidance for drawdown, or at least require individuals to opt in or out of guidance before getting access to their pension savings.

There will always be areas of pensions where opposing priorities and individual judgement play a part in decision making. Ensuring that trustees and others are equipped with strong negotiating skills, empowered to ask appropriate questions and able to act objectively on the answers they receive, will always be at the heart of protecting a scheme and its members' best interests.

Written by Maggie Williams, a freelance journalist