

## Conflicts of interest

*When and why might there be a conflict?*

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# Conflicts of interest – case study

Which of the following events could, potentially, give rise to a conflict of interest? Why? For whom?

Events	For trustees who are also representatives of the employer	For actuaries or other professional advisers
1. Determination of corporate accounting disclosures	Very unlikely	Very unlikely
2. Determination of contribution rate and funding strategy	Likely	Possible/likely
3. Setting of investment strategy	Possible/likely	Possible
4. Calculation of scheme factors (including transfer values)	Possible	Possible
5. Wind-up of a pension scheme	Possible/likely	Possible/likely
6. Merger of pension schemes	Likely	Likely
7. Sale or acquisition involving a pension scheme	Likely	Likely
8. Alteration of benefits	Minor – possible Major – likely	Minor – possible Major – likely
9. Benefit augmentation	Possible	Possible
10. Granting of discretionary benefits	Possible	Possible
11. Communication to members	Possible	Very unlikely
12. Financial restructuring of employer	Likely	Likely

## When or why might there be a conflict?

Conflicts of interest can occur in many situations when operating a pension scheme. Advisers may face a conflict of interest where they act for both the trustees of a scheme and the sponsoring employer. Trustees who are also senior employees in an organisation face similar issues. Can they act impartially as a trustee while being a company officer, knowing that decisions they take as a trustee will not necessarily be in the best interests of the company (and vice versa)?

We set out below some areas where conflicts could potentially occur. It is by no means a comprehensive list, nor do the comments cover the issue in any detail. It is intended as a reminder to trustees and employers that they need to be aware of conflicts in carrying out their duties.

The key factors involved in determining and managing conflicts include:

- the scheme rules
- the financial status of the scheme
- personalities involved
- processes in place
- materiality or size of the issue.

Early recognition of an issue usually means it can be dealt with more easily and, indeed, an actual conflict can often be avoided. It is important that both employers and trustees recognise potential danger areas to avoid unnecessary cost and to avoid leaving themselves in unmanageable positions.

## Examples of areas of conflict

### 1. Determination of corporate accounting disclosures

Interpretation of (and disclosure of figures on) a particular accounting standard may lead to decisions about changes in benefit structure.

### 2. Determination of contribution rate and funding strategy

The contribution rule is critical. It is more likely to be a conflict issue if the trustees have powers – which they will have following the introduction of the new scheme-funding framework. As an adviser or as a trustee, can you divorce the interests (or knowledge of finances) of the sponsoring employer?

### 3. Setting of investment strategy

The investment strategy can affect the setting of the contribution rate. If allowance is made for investment returns above risk-free returns, investing more in equities can reduce the contribution requirements.

### 4. Calculation of scheme factors (including transfer values)

The factors used can directly affect the cost of the scheme. If trustees set the factors, will they be swayed by employer influences to set factors that are unfavourable to members? Again, what the rules say is critical. However, the employer will not have a say in the setting of the transfer value basis, but will be interested in any possible restriction of transfer values.

### 5. Wind-up of a pension scheme

This area is possibly less of an issue now that the 'debt on an employer' on wind-up is the full buyout cost of benefits. However, employers

may wish to take a different view from trustees over investment strategy to aim to minimise any debt. Where a scheme terminates, the trustees will often also have the choice of continuing to run a scheme on before wind-up or deciding to call for the debt. Additionally, where an employer is in serious financial difficulty, there are situations where it may be appropriate to consider compromising the statutory debt.

### 6. Merger of pension schemes

Differing funding positions of schemes can make it difficult to justify mergers. However, employers may be keen to progress for employment or cost reasons. Advisers may be acting for one or more sets of trustees and one or more sponsoring employer.

### 7. Sale or acquisition involving a pension scheme

The actuary often negotiates a bulk transfer (acting for an employer) and then, under scheme rules, needs to advise trustees whether it is appropriate to pay that amount (or accept it for the promise of a certain level of benefits). The Trustees may also have an issue if they are representatives of the employer, since the employer will not want to fund any shortfall above what the trustees pay. There can also be knock-on effects on funding requirements for the scheme.

### 8. Alteration of benefits

The potential for conflict will depend upon the rules. There may or may not be a requirement for trustees to agree to a benefit alteration. Generally, benefit changes relate to future service only, and the potential for conflict often depends upon the magnitude of any alteration.

### 9. Benefit augmentation

See 10 below.

### 10. Granting of discretionary benefits

The employer may wish to augment benefits. The trustees need to ensure sufficient funding is provided. Even if the augmentation or discretionary benefits rule does not grant trustees power, there will be knock-on implications under the contribution rule.

### 11. Communication to members

It is unlikely to be an issue, but trustees should ensure that an 'inappropriate spin' is not used in communications.

### 12. Financial restructuring of sponsoring employer

Any financial change to a sponsoring employer could affect the employer's strength of covenant and ability to pay contributions to the scheme. Items as simple as a dividend payment could affect the position. The scheme-funding framework introduced under the Pensions Act 2004 requires trustees to take into account the strength of employers in determining an appropriate funding strategy.

This is particularly so where the scheme is in deficit, when the company is technically a creditor of the scheme, which the trustees are bound to protect, and now that the Regulator is urging trustees to behave as strongly as a bank would.

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