Oil and water don't mix…

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The Select Committee on the Big 4 and anti-competitive behaviours said "The culture of advisory services is about helping management; and the culture of audit is about challenging management. When combined in one large-multidisciplinary firm these two cultures mix like oil and water."

The same applies in the trustee world. The culture of advisers is to help trustees and pension managers; the culture of trustees is about taking advice and challenging advisers. When combined in one firm, conflicts may arise.

Equally this applies to firms who offer consulting/ administration services and also offer outsourced pension management and secretarial services. Advisers/ administrators provide services to trustees and trustee secretaries/ pension managers assist trustees in overseeing those services. Can trustee secretaries/ pension managers mark their own firm's homework?

The recent CMA review has also highlighted the conflicts that can arise when investment consultancy and fiduciary management services are provided to a pension scheme by the same firm.

Other examples of conflicts include:

- The scheme's pension manager and resources may 'double hat' by providing pensions support to the sponsor as well as the trustees. This can lead to efficiencies and a better level of support to both parties but can become unsustainable in fractious valuation negotiations or corporate transactions as the pension manager will need to make a choice about who their 'client' is.
- Company or member nominated trustees with significant sponsor shareholdings, or senior employees with remuneration linked to profitability may be conflicted in negotiations relating to deficit repair contributions, or mitigation in response to a corporate transaction.
- Trustees personally affected by decisions concerning discretionary pension increases or cessation of accrual may be conflicted.
- Independent trustees appointed by the company, or with strong ties to particular advisers or services must also consider whether their behaviour might be influenced by those relationships.
- Many advisers such as actuaries or lawyers provide services to both the trustees and employer. Whilst this can be beneficial, the risk is that the trustees' advice becomes compromised due to the advisory firm placing a greater commercial weight on the sponsor relationship.
- Trustees should be alert to the risk that a firm providing the scheme with multiple services may be subject to internal conflicts and pressures. For example, if the same firm provides both actuarial and administration services, the actuary may find it difficult to call out data issues or other administrative failings. Similarly, the administrator may feel inhibited from being open about the quality of actuarial advice relating to factor changes or unnecessarily referring cases to the actuarial team rather than building in administrative efficiencies.

- Member administration services are often provided to the employer and trustees by the same provider, or by the employer themselves, so that, for example, benefits from a pensions trust can be co-ordinated with other employer provided benefits. Trustees should be vigilant that employer projects and initiatives are not inappropriately prioritised over those they have an obligation to provide.
- Trustees should be careful about being pressurised to use certain providers where the employer benefits from discounts or synergies as long as the trustee uses them too. This is particularly the case where better support would be available by switching to an alternative provider.
- Trustees should also be wary of defaulting to certain employer provided services – for example internal audit, finance or communication services – when a better, more specialised service might be available elsewhere.
- It's also important to be aware that certain projects or transactions may throw up conflicts that did not previously exist. For example, the current trustee legal adviser supporting a buy-in or buy-out, but whose firm also has a significant relationship with one or more of the insurance firms bidding for the transaction.
- The use of scheme funds and expense allowances can also give rise to conflicts if they are inadvertently used to subsidise or pay for employer initiatives or services that might more properly be funded separately from the scheme.

Trustees have long been required to identify and manage conflicts more broadly. TPR states that a well-run scheme will be underpinned by a robust governance framework. It is vital that trustee decisions are valid, and not tainted by actual or perceived conflicts of interest.

How do you handle conflicts?

As well as practical measures such as having a conflicts policy, a conflicts log, an agenda standing order and trustee training, there are a number of other measures that trustees can take to identify and manage conflicts:

- Request that all advisers, providers, professional/ independent trustees and trustee secretaries, particularly those providing multiple services, document their approach to conflicts, including the controls in place where they are privy to sensitive information, or have broader stakeholder relationships that might impact trustee business.
- Put in place additional conflict protocols for advisers that have relationships with both the sponsor and trustees. These would typically document what sort of 'Chinese walls' are operated within the adviser's organisation, and which party would continue to be supported by the adviser should an untenable conflict arise.
- Particular care is needed with firms providing multiple services. It is essential to understand how conflicts are managed within the provider's business.
- Be prepared to challenge those with conflicts (or even those that say they do not have any conflicts).
- If a trustee has a key skill set which the board depends on, put in place a succession and/ or contingency plan for temporary or permanent conflicts.

- Put in place contingency plans to deal with existing conflicts that become unmanageable or new ones that emerge. For example, retaining external resources to supplement or replace the existing pensions management or secretariat team. In the case of an adviser or provider, a tender exercise to source an alternative may be required.
- Where services are provided by or shared with the employer, clearly document the trustee services and obtain management reports to enable oversight of them. It may also be helpful to establish a forum where priorities can be agreed.
- Understand the scheme's cost controls and payment authorisation procedures, to ensure scheme funds are only used for their intended purpose.

Are conflicts always a problem?

Conflicts are not forbidden nor necessarily bad. The relationships and knowledge that give rise to conflicts often bring material benefits; for example, a trustee that has decades of experience of the sponsor and its industry, or an advisory firm that seamlessly co-ordinates multiple trustee services behind the scenes.

As can be seen, there are a number of scenarios in which conflicts can arise; indeed, one could argue that anyone purporting not to have a conflict of interest is someone that isn't experienced enough to recognise the conflict in front of them.

The goal is therefore to identify and manage conflicts, and not necessarily to eliminate them. For most schemes, a strong governance infrastructure, backed up by independent support and advice where necessary, will be sufficient to achieve this.

But if your advisers, providers, professional/ independent trustees and/ or trustee secretaries have an ongoing conflict, consider whether you should change the provision of some of your services by shifting to another provider. Using an independent third-party evaluator for this can be very helpful in navigating the issues that typically arise and ensuring solutions reflect best practice.