Private Edge Knowledge Bank

Pension Trustees' Conflicts of Interest

PENSION TRUSTEE LIABILITY

The need to Identify, Monitor and Manage Conflicts

Trustees of pension schemes must be aware of possible conflicts of interest that could arise whilst carrying out their duties. Conflicts of interest can lead to breaches of duty, which can have very serious consequences. This article focusses on conflicts of interest which can arise when employees or officers of businesses are also pension scheme trustees.

What are conflicts of interest and how can they arise?

A conflict of interest arises when a trustee is required to make a decision which, in line with their fiduciary duties, is in the beneficiaries' best interests but they have a personal interest in the decision, or owe a fiduciary duty to another beneficiary or entity, which has a conflicting interest.

It is common for senior staff or officers of the sponsoring employer to be appointed as trustees of a corporate pension scheme. However, this is likely to lead to a conflict of interest as they will owe fiduciary duties to the company as an employee or officer, and, at the same time, they will owe a fiduciary duty to the scheme's beneficiaries as a trustee. It can sometimes be difficult to act in the best interests of both.

For example, a situation could arise where a trustee who is a senior officer of the company is aware of confidential company information, such as the financial health of the company. They may be required to disclose this information to the trustee board as part of their duty as a trustee to act in the best interests of the beneficiaries. However, they could be in breach of their duty to the company by disclosing it. No primacy of role has been determined by any existing authority, so it is difficult to know how to balance such conflicts of interests.

These types of conflict are more likely to arise where senior employees of the company are appointed as trustees, but it can also be an issue for junior employees.

What could be the consequences of a conflict of interest?

A trustee who acts in breach of their duties to the beneficiaries can be held personally liable for a breach which causes the scheme to suffer a financial loss. This is known as equitable (or reasonable) compensation. The amount of compensation ordered will reflect the amount necessary to restore the scheme to its value, had the breach not taken place.

It's important to remember that trustees can be held jointly and severally liable for losses caused as a result of the trustees acting jointly. This means an individual trustee could be held liable for all of the losses suffered by the scheme, even where they were only one of many who breached their duties or where they take a less active role in decisions.

This could amount to a very significant amount of compensation, and means that trustees need to do everything they can to ensure these types of conflict do not arise.

If, however, the trustee of the scheme is a corporation rather than an individual, then the directors of the corporate trustee have some protection from liability. In the event of a breach, the company will be held liable, rather than the individuals (always assuming that dishonesty is not involved).

How can I prevent conflicts of interest causing a breach of duty?

Given the severe consequences that conflicts of interest can have for trustees, serious thought should be given to how best to avoid them occurring, and in the event that they cannot be avoided, how to deal with them. There should always be a system in place which allows conflicts of interest to be identified, monitored and managed. In some cases, a conflict may be so pervasive that it may be better for the trustee to resign and avoid the risk entirely than attempt to manage it.

Set out below are some tips on how to manage conflicts of interest. Further detailed information is available on The Pensions Regulators website.

1 Express provisions allowing conflicts

You could include a provision in both the pension scheme rules and in the articles of association for the company which permit conflicts of interest in certain circumstances. For example, the articles of association could specify that an officer of the company will not automatically be in breach of their fiduciary duties by disclosing confidential information to the board of trustees for the pension scheme.

2 Observers instead of trustees

The issue of conflicts of interest could easily be resolved by having a policy that senior officers simply will not be appointed as trustees. However, this means you would lose the benefit of having someone with a high level of knowledge and experience of the scheme sponsor on the board. Some companies reach a middle ground whereby they have senior officers attend trustee meetings as observers, to comment and advise where able, rather than in the capacity of a trustee. This means that they are not duty bound to provide confidential company information where it could be harmful to the company, but are still able to offer advice and valuable insight, when appropriate.

3 Confidentiality Agreements

Having a formal confidentiality agreement in place will help give the company assurance that any information they want kept confidential will be. In addition to this, you could agree a procedure by which trustees can supply relevant information to the trustee board without being in breach of their duties to the company. Having agreed protocols in place will help everyone understand what they can do without breaching their duties, either as trustees or officers of the company. However, trustees should not take such agreements to mean they are protected from any breach their duties and should still take additional steps to avoid conflict.

4 Register of Interests

Some schemes keep a register of interests for each trustee, which records any actual or potential conflicts. Trustees must make declarations of interest for the register when they are appointed as trustees. Having a procedure such as this in place will help to encourage a culture of openness about conflicts in which they can be properly addressed. Conflicts are very likely to arise where you have officers of the scheme sponsor as a trustee so this should not be something from which trustees try to shy away.

5 Independent Chair of Trustees

The Chair of Trustees plays an important role in ensuring that the correct systems are in place to identify, monitor and manage conflicts of interest, and to make sure trustees are aware of their duties. Where the chair is personally conflicted, this can create difficulties in their capability to supervise conflict management. It is a good idea to make sure an independent trustee is appointed as chair to avoid these issues.

6 Policy for dealing with conflicts

Where a conflict is identified, it is important to have a policy in place which governs if and how that conflict will be managed. The policy should set out the criteria which a conflict would have to meet to require active management, and the steps that would be taken to manage that conflict. Trustees need to consider whether the conflict will influence their decision and whether they could defend their decision by demonstrating the steps taken to ensure the conflict has not had a detrimental effect on the beneficiaries. Where trustees decide that a conflict is likely to affect the beneficiaries' interests, it will need to be actively managed and it will be vital to keep records of the steps taken to do so. All trustees should be made aware of, and given training to comply with, any such policy.

7 Legal Advice

The law on conflicts of interests is far from clear and there will always be risks no matter what precautions are taken. Where conflicts could have a serious detrimental effect on the actions of trustees, the government regulator expects trustees to obtain legal advice when considering their options.

Trustees may also remain exposed to claims even after they cease to be trustees so retired trustees may wish to consider whether independent insurance is required if adequate cover is not maintained for them after they retire. Any trustees considering purchasing trustee liability insurance should fully understand how the policy works alongside any existing exoneration and indemnity provided under the scheme rules and as part of their risk management process they should review all cover from time to time to ensure they are appropriately protected.

This guidance note is not intended to constitute a definitive, up-to-date, or complete statement of the law, nor is any part of it intended to constitute legal advice for any specific situation. You should take specific advice when dealing with specific situations and jurisdictions outside England & Wales.

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