

Capital Cranfield Pension Trustees Limited

Conflicts of Interest Policy

Background

The Pensions Regulator [tPR] has issued a consultation paper on conflicts of interest. The paper recommends that all trustee boards should implement a conflicts of interest policy, and suggests that the role of any independent trustee on the Trustee Board is critical to implementing and monitoring this policy.

What are conflicts of interest?

A conflict of interest arises when a trustee has difficulties in carrying out his functions as a trustee because of an interest or duty elsewhere. Such conflicts may arise because of:

- his membership of the scheme;
- his position within the company;
- his position as a union representative or representative of other such group.

There may be other conflicts of interest, such as adviser conflicts of interest, which trustees also need to monitor.

Aim of this Conflicts of Interest Policy

This is not a legal paper, and does not constitute legal advice. Individual client directors should take legal advice from the scheme lawyers before implementing a conflicts of interest policy. However, given that this is a complex area, and the perception is that different law firms have differing views, the intention is that client directors can use this policy as a starting point to enter into discussions with co-trustees, sponsoring employers and advisers, with the aim of:

- ensuring good governance;
- ensuring a degree of consistency among our schemes; and
- enabling schemes that cannot afford to enter into a costly exercise with lawyers to implement a policy relatively painlessly.

Legal position

There is neither case law nor statute that sets out the position of pension scheme trustees in a conflicts of interest situation. This is why there is some debate about the issue; because lawyers have to look at case law, some of it quite old, relating to the position of fiduciaries generally, and extrapolate from that what they think a judge would decide if a conflicts issue, relating to pension scheme trustees, came to court.

Most lawyers, if quizzed, would say that there are aspects of the law on conflicts on which there is a certain amount of debate. However, my perception from analysing the advice of many of the leading pensions experts (including a pensions barrister) is that most of them have drawn very similar conclusions from such case law as there is.

The key aspects, so far as they relate to pensions trustees, are as follows:

Can a trustee be subject to a conflict of interest merely because he is a member of the scheme?

Yes, but this is allowed by statute and should not prevent the member acting. However, a member of a very small subset with special terms may want to declare an interest if a decision is being taken which affects those beneficiaries, and it may be appropriate for him not to take part in the decision making process.

Can a director of the sponsoring employer be a trustee of the pension scheme?

Yes. Many of the decisions taken as a trustee (eg investments, governance, administration, legal compliance) do not generate a conflict between the individual's trustee duties and his duties as a director. However, some decisions may generate a conflict – for example, scheme funding, and this may require careful handling (and chairing). Because of this, it may be sensible for a director not to act as chair of trustees. The draft policy document assumes a director of the sponsor will not be chair.

If a director/trustee is subject to a conflict of interests, is it enough for him simply to declare his conflicting interest and carry on as normal?

No. This could leave him (and the ultimate decision reached by the trustees as a whole) vulnerable to challenge. Basically the onus is on the conflicted trustee to show that he was not prejudiced by his conflict when he took the decision, which would be tough to try to prove. In order to avoid this, he should not take part in decisions where there is a direct conflict. However, there is nothing to stop him participating in other decisions taken at that meeting where there is no conflict.

We should note that amendments to the Companies Acts introduced in October 2008 also prevent company directors acting if they have a conflict of interests. Again, the views are that this only applies to the decision in question, not to whether they can act as a trustee at all.

If he can't take part in decisions, does this prevent him participating in discussions leading up to that decision as well?

This will often be the case. Otherwise – particularly if it can be shown that the individual is a person who could influence the decisions of others, as such individuals may well be – the decision could be challenged on the basis that the

other trustees were acting in breach of trust because they were overly influenced by the conflicted views of that trustee. If discussions are at an early stage and are more in the nature of information sharing (e.g. presentation of preliminary actuarial results) it would usually be acceptable for the conflicted individual to attend.

Is a non-director in the same position as a director?

No, because they don't have fiduciary duties to shareholders in the same way as directors do. A non-director's fiduciary duties to beneficiaries of the pensions trust are held to "trump" his duties as an employee. Therefore it is expected that, in a situation where he has to choose between the members' interests and the company's interests, a non-director will choose the members' interests.

In practice, it may not be that straightforward. The employee may have personal reasons, or reasons that relate to their specific duties, why they feel particularly conflicted, even though technically they are not. An example is where an employee is responsible for implementing a company strategy that will impact pensions benefits. In that situation, in order to avoid any trustee decision about that strategy being open to challenge, it would be advisable to treat that individual in the same way as a director.

However, for a non-director, these situations should be the exception rather than the rule, and the basic premise is that trustees should be aware at all times that, when acting as a trustee, the interests of the members are paramount. The role of the independent trustee and advisers should be to guide any trustees who are struggling with this.

If a trustee absents himself because of a conflict of interests, does he have to explain why?

No, other than to say that the absence is due to a conflict of interests. In fact, it is better if he doesn't give an explanation, otherwise he could inadvertently generate discussion on the issue he is trying to avoid.

If a trustee is in possession of confidential information, which he has gained in another capacity (eg as director/employee of the company), is he under an obligation to disclose this to his co-trustees?

Yes, but the view of many lawyers is that this obligation arises only if the information relates to the decision/discussion under consideration at the time. So, by way of an example, let's assume the trustees are about to take certain decisions on the basis that the employer's covenant is strong. If a trustee has information that is likely to lead the trustees to take different decisions (because he is aware, say, that the covenant is not as strong as they think), then he must disclose it as long as he is present when the issue is being discussed. If he is already absent (because he has declared a conflict), he does not need to disclose the information, even if he is present when the trustees are discussing other things. Some lawyers

take the view though that he is under a duty to disclose this sort of big picture information if he is aware that it is likely to make a difference to trustees' behaviour. To overcome this issue some lawyers recommend putting a 'waiver clause' into the Scheme's rules whereby the individual is not required to disclose the confidential information. However, these clauses have not been tested by the Courts.

However, what he cannot in any case do is realise half way through a discussion that he has confidential information and get up and walk out. Lawyers are agreed that, by that stage, it is too late. He has to disclose the information.

Even if the individual (who can be either a director or a non-director in this instance) has managed to absent himself for the relevant agenda items, he is nevertheless in a difficult position if his employer has required non-disclosure. What happens if, say, the discussions turn to the issue about which he has the information earlier in the meeting, and he has no chance to leave before things are underway? Also, what about the (very likely) scenario, which is that no decision is being taken that depends on the employer covenant, for the very reason that the trustee board thinks that all is well? Does the individual with the confidential information have an obligation to suggest to the trustees that the employer covenant should be reviewed? If so, would this put him in breach of his duty of confidentiality? For this reason, even the version of the draft policy which allows non-disclosure of confidential information under certain circumstances does not prohibit a trustee from recommending a covenant review or scheme valuation if he feels it appropriate.

Independent Legal Advice

Another issue to consider is where the potentially conflicted trustee can go to get advice. He can't go to the trustees' lawyers, because he may need to provide information to them that they (as fiduciaries) would be under a duty to disclose to the trustee board. For similar reasons he can't go to the company's lawyers.

We would like to put in place arrangements with a panel of top tier pensions law firms (so that there would always be at least one non-conflicted law firm) who would be prepared to give independent legal advice to any trustee of a Capital Cranfield scheme who contacted them. That way we could make clear that if a trustee wanted legal advice, we could put him in touch with someone – we would then play no role in the relationship, clearly, and the lawyers used by that individual would bill the scheme directly.

We should investigate which firms would be interested in this work, and see if we could come to an arrangement on a fixed fee basis (say, £250-£300 for a confidential telecom with the individual, and a further £250-£300 if a follow up email/letter were needed).

Implementing a conflicts of interests policy

Given the legal position, as well as the recommendation by TPR that all trustee boards have a conflicts of interests policy, we suggest that all client directors consider suggesting that their trustee boards implement (in consultation with the sponsoring employer, and after having taken advice from the scheme lawyers) a policy based on either Policy A or Policy B. If there is a policy drafted by the scheme lawyers, that is fine, as long as it reflects the issues raised in this paper. However, some schemes (particularly smaller ones) may simply want to adopt our policy.

The reason for having a policy alternative is because of the difficulties surrounding disclosure of confidential information – the only difference between the two is how the trustees propose to handle this issue. In practice, this will depend on how comfortable the employer is with disclosure of information.

We would suggest that Policy A represents best practice; has the merit of simplicity; is less likely than Policy B to involve significant legal and forensic accountancy fees, and is less likely to put trustees in a difficult position in the way they carry out their functions.

Trustees who have implemented Policy A can freely discuss any issue, whether or not this is subject to a duty of confidentiality, on the understanding that they themselves will keep the issue confidential. We would suggest that this situation is preferable, as it facilitates a free and open debate; encourages a healthy and honest relationship with the sponsoring employer, and reduces the need for external covenant assessors.

For example, if the individual in the example given above is aware of information relating to the employer covenant; under Policy A he would share the information, and the trustees would discuss the implications of this. If there is an atmosphere of openness, the trustee board may well conclude that they will take no action at the moment, and review the situation at the time of the next valuation. Or they might feel it appropriate to schedule a meeting with key directors to discuss the matter in more detail.

However, if the individual is operating under Policy B; he will not disclose the information, other than to declare a conflict, and absent himself. If no issue is under discussion, and the trustee with the information thinks that his information could lead to the ability of the company to fund the scheme to be significantly affected, that trustee should suggest to the trustees that they undertake a review of the employer covenant, possibly in conjunction with a scheme valuation, if the trustees have the power to decide on the timing of valuations. This will lead to a time and cost consuming exercise for trustees, employers and their advisers, at least some of which could have been avoided.

That said, some sponsoring employers may struggle with the fact that, under Policy A, everything is potentially disclosable to the trustee board. For that reason, we suggest Policy B as an alternative. If carefully handled, we are comfortable that this also represents a reasonable governance framework. However, there is no doubt that Policy B involves more hoops, and will be far trickier to administer in a way that minimises the risk to a conflicted trustee. It also involves much more care needing to be taken, both by the conflicted trustee, and the Chairman of trustees. For this reason, we do not think it suitable for smaller schemes or schemes where there may be resistance to incurring legal/forensic accounting fees at a level necessary to reduce risk to the trustees to an acceptable level.

Policy B includes the requirement to include a waiver in the trust deed and rules of trustees' duty to disclose confidential information.

Joanna Matthews
Capital Cranfield Pension Trustees Limited

10 November 2008

Conflicts of Interest

Policy A

1. Each trustee will, on appointment, enter into a confidentiality agreement with the employers requiring him to keep confidential all matters disclosed to him in his capacity as trustee, unless disclosure is required by law or becomes in the public domain.
2. A director of the employers may act as trustee. However, the employers shall ensure that not all company-nominated trustees are directors, and the trustees shall make arrangements to ensure that the trustee board is quorate and can still take decisions if all trustees who are employer directors are absent.
3. The trustees shall keep a register of any conflicts of interests declared, either in a meeting or outside the meeting.
4. Provided discussing the matter with the Chair is not likely to lead to the Chair being subject to a conflict of interests, if a trustee believes he may be subject to a conflict of interests in relation to a matter on the agenda, he shall first discuss the position with the Chair. The trustee may then decide to absent himself from that agenda item if the Chair agrees that this would be appropriate. However, if the trustee believes that discussion with the Chair is likely to lead to the Chair having a conflict of interests, then the trustee should simply notify the Chair that he will need to absent himself from the agenda item in question. In either situation the trustee may take legal advice if he or she is unsure of the appropriate course of action.
5. The agenda for each trustee meeting shall include, before any substantive issues are discussed (including matters arising from previous meetings), an item on conflicts of interests. Any trustee who is subject to a conflict in relation to any of the agenda items shall declare that he is under a conflict at that stage, and that he intends to absent himself for those items. The chairman of trustees shall ensure that, where a conflict has been declared in relation to a particular issue, discussions about that issue do not take place while the conflicted trustee is present.
6. The minutes shall note the absence of that trustee for the agenda item in question.
7. All trustees shall, however, disclose to the trustee board any information which that trustee feels might impact any decision to be taken by the trustee board, or any decisions that might be taken if the information is known. The employers acknowledge that any duty of confidentiality imposed on trustees will not apply to disclosure to the trustee board, or its advisers.
8. The trustees will ensure that minutes of trustee meetings, and any supporting documents, are kept confidential.

Joanna Matthews
Capital Cranfield Pension Trustees Limited

Revised June 2009

Conflicts of Interest

Policy B

[1-6 as per Policy A]

1. Each trustee will, on appointment, enter into a confidentiality agreement with the employers requiring him to keep confidential all matters disclosed to him in his capacity as trustee, unless disclosure is required by law or becomes in the public domain.
2. A director of the employers may act as trustee. However, the employers shall ensure that not all company-nominated trustees are directors, and the trustees shall make arrangements to ensure that the trustee board is quorate and can still take decisions if all trustees who are employer directors are absent.
3. The trustees shall keep a register of any conflicts of interests declared, either in a meeting or outside the meeting.
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6. The minutes shall note the absence of that trustee for the agenda item in question.
7. Any trustee who has been notified by his employer that he is obliged, by reason of an arrangement in place between him and his employer, to keep certain information confidential, shall, in advance of a trustee meeting, consider whether that information may be relevant to any of the decisions to be taken by the trustees at the meeting, or any discussions on a particular issue. If appropriate he shall take independent legal advice on his position.
8. If he concludes that the information in his possession is relevant to any decision to be taken at the meeting, he shall notify the chair of trustees that he has a conflict of interests in advance of the meeting, as he would under 4

above, and then declare a conflict at the meeting and absent himself in the manner set out at 5 and 6.

9. However, the employer shall ensure that such arrangements requiring confidentiality shall not prevent a trustee from notifying the chair of trustees that it may be advisable to review the employer covenant and/or carry out a scheme valuation, if a trustee feels this to be appropriate.
10. The employer and the trustees shall ensure that a waiver exists in the trust deed and rules of trustees' duty to disclose confidential information to their co-trustees.
11. The trustees will ensure that minutes of trustee meetings, and any supporting documents, are kept confidential.

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