Why independence matters

June 2024

Understanding independence in pension schemes

Independence is defined as "the complete freedom from control or influence by another party". But why is this concept so crucial for pension schemes?

As a trustee, your fiduciary duty is to ensure the correct amounts are paid to the right beneficiaries at the right time. You are the custodian of the scheme's assets, acting in the best interests of the beneficiaries. Naturally, you seek advice and services from various providers. To make the best decisions, it is essential to consider the degree of reliance you place on your advisers and providers and understand what influences them.

Conflicts of interest exist in all walks of life and, with appropriate transparency and controls, can be managed. But it is crucial to recognise when they might arise and how they can impact your scheme. Then trustees can decide what safeguards are needed to manage any conflict or whether they need to think about an alternative arrangement if a conflict cannot be managed.

Here are several scenarios where your advisers and providers may face pressures that could influence their advice:

Pressures to sell more services

Every business will have a commercial objective, but what is fuelling that drive? We've seen the rise of private equity backed firms in the pension industry. Now, that's not necessarily a bad thing, but like everything it depends on what the drivers are. To understand why that can cause a conflict, we must first explore private equity. Private equity involves investment firms providing capital to a business in exchange for equity ownership. They aim to improve the business's profitability with the goal of selling their stake at a higher value to generate significant returns. Providers backed by private equity will need to improve their profit, usually through expanding their offering. Now that's okay, but this is where you need to be careful to manage conflicts.

Let's look at an example. The power of trustees lies in the ability to ultimately hire and fire. Now with the rise of 'all service' professional trustee companies, trustees running the scheme can become, implicitly or explicitly conflicted, through the provision of wider services, whether that be investment and/or governance services, or wider scheme support.

While you can assess whether the advice and services are appropriate for your scheme, the asymmetry of information and experience can make this assessment challenging.

Group wide views and beliefs

Some advisers and providers operate under group-wide agreed views and beliefs. This means they stick to a party line regardless of the individual needs of the scheme. That can lead to advice that is either not tailored to your scheme's requirements or may conflict with your own beliefs. A group-led approach can be cost-effective but may not always be the right fit for your scheme. It's important to understand the extent of peer review and how it impacts the advice you receive.

Differing interests based on your funding journey

The interests of your beneficiaries may differ depending on whether your funding journey is towards an endgame (e.g. buy-out) or ongoing management (e.g. benefiting from a surplus). Ensure that your advisers' and providers' interests align with your desired outcomes, as their motivations may differ based on fee structures and future business prospects.

Governance and objectivity

Your advisers and providers play a crucial role in the governance of your scheme. It can be challenging to get an objective assessment of that governance effectiveness if the information comes solely from those already involved. When you're asked to mark your own homework it's unlikely to get the objectivity it really deserves – getting independent verification can provide a more accurate picture.

Incentives and performance

You might not be interested in what your advisers are paid, but the compensation structure of your main contacts at your advisory firms may be directly tied to the revenue they generate. This could lead to pressure to cross-sell services, which may not always be in the best interest of your scheme. It's important to always evaluate whether the services provided are needed and, if they are, whether they are the most effective and efficient options available.

Bundled services and performance issues

If you receive bundled services from a provider and one aspect is underperforming, it can be difficult to address the issue without affecting the other services. Understanding the internal dynamics of your providers can help you navigate these challenges.

While conflicts of interest can be managed, certain situations may require complete independence. An experienced independent adviser can offer solutions that are free from any ties, providing a "no strings attached" perspective.

If you value independence or need to discuss a sensitive situation, we're here to help. Give us a call.

Do you need help, or want to know more?

Contact Barry for practical help and independent advice at:
barry.mack@museadvisory.com