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PART A

FINANCIAL SERVICES ACT

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PO -CH /NL/0368

PART A

23-11-87

18/3706

CONFIDENTIAL

FROM: P S HALL

DATE: 14 JULY 1987

This is scarcely surprising: but you should be aware of the implications for personal pensions. DTI ministers will be writing shortly RL.

14/7.

1. MRS ~~LOMAX~~

2. ECONOMIC SECRETARY

cc Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Scholar
Mr Peretz
Mr Ilett
Miss Noble (o/r)
Miss Sinclair
Mr Board
Mr Murphy
Mr Neilson
Mr Cropper
Mr Tyrie
PS/IR
Mr Corlett IR
Mr Munro IR
Mr Hinton IR

Chancellor
Is there any way in which implementation of the FS Act can occur in stages? Sport SRO rules will be cleared well before others. N.

FS ACT DELAYED IMPLEMENTATION: PERSONAL PENSION PROBLEMS

At last weeks City Issues meeting, chaired by Sir Peter Middleton, DTI officials confirmed that it is now certain that the implementation of the Financial Services Act will be delayed for several months, instead of coming into effect on 1 January 1988. DTI are reluctant to commit themselves to a new date at this stage, but their favoured date at present seems to be 31 March 1988 (we guess that a more relaistic deadline might be 30 June 1988). Nor have DTI decided when to go public on the delay.

2. A major factor is the need for the Director General of Fair Trading to scrutinise the rules of the self-regulating organisations on competition grounds. Not all the SROs rules are likely to be available before September (eg those of the Life Assurance and Unit Trust Regulatory Organisation - LAUTRO), and the DGFT may take 3 to 4 months to report on all 5 SROs' rule books.

172/28

3. If the implementation of the Financial Services Act is delayed to 31 March 1988 (for obvious reasons DTI are trying to avoid implementing on April Fools Day), there will be major problems for DHSS over personal pensions. At present personal pensions are due to be available from 4 January 1988 and DHSS had been relying upon the FS Act for much of the investor protection regime. They were particularly relying on FS rules on advertising, cold calling, cooling-off, commissions, and, perhaps most importantly, compensation (an FSA compensation scheme would apply to personal pensions based on unit trusts).

4. DTI should be writing to DHSS at Ministerial level in the next day or two. DHSS officials already have an inkling that there are problems. The most obvious alternatives are probably:

(i) to operate PPs with inadequate investor protection requirements for three months or so (which DHSS Ministers will probably regard as politically unacceptable);

(ii) for DHSS to introduce a set of regulations under the Social Security Act which duplicate as many provisions as possible of the FS Act regime (this would be a considerable burden and may not be practicable - for example from earlier discussions with DHSS we understand they cannot replicate every relevant rule even if all the self-regulating organisations rules were available in time; which seems unlikely given the fact that the OFT will not have reported on all of them until the end of 1987, at the earliest);

(iii) to delay the introduction of PPs by 3 months or so (which may be strongly opposed by those pension firms successfully gearing up for 4 January 1988, and which will cause some political embarrassment - though it may be welcomed in some parts of the pensions industry); or

(iv) to try to introduce PPs on 4 January with some sort of voluntary arrangements mimicking the relevant FSA provisions (this might well prove more administratively unwieldy than any of the other options).

Finance Bill

5. The personal pension provisions in the Finance Bill are due for introduction by January 1988, with some aspects - the additional voluntary contributions (AVCs) - operative from October 1987. The Chancellor was also the first to announce the 4 January 1988 date for personal pensions (in his last Budget speech).

6. The existence of the Finance Bill provisions may point towards retaining the 4 January 1988 date for personal pensions as a whole. It could be argued that on the previous FS Act timetable free standing AVCs might have been available from October 1987, before the FS regime was in place. There would not have been a compensation scheme for those based on unit trusts; so the delay in implementing the FS Act would increase the risk rather than introduce a new risk.

7. However, it is probably best to await DHSS's formal views before making judgements about the dangers of proceeding on the existing timetable. What is clear is that if there is any announcement about delay it should first come from DTI. While some of the pensions industry will no doubt welcome more time to prepare themselves, some will be vociferous critics.

Interim authorisation procedure

8. On a wider issue - which may or may not have a bearing on personal pensions, we cannot yet tell - DTI are also considering how many months before "A day" - the date when it becomes a criminal offence to do investment business without FS Act authorisation - they should introduce the provisional or interim authorisation procedure ("P day"). P day could be one, two or three months earlier than A day. Obviously, once you announce P day you also have to announce A day.

9. All applicants whose applications are received by P day, but have not been processed by the SROs by A day, will be treated as if they were directly authorised by SIB; ie they will be subject to SIB's rules, not those of the SRO (this is the effect of Schedule 15, paragraph 1(1) of the FSA, and there is no provision for amending paragraph 1(1) by secondary legislation). We will have to keep an eye on these interim authorisation plans since there might be considerable problems where the SIB's rules differ from the rules of the particular SRO, eg on capital. It might be difficult for some firms, particularly smaller ones, to cope with such short-term changes.

Further Action

10. The Inland Revenue will be submitting a separate note to the Financial Secretary on the implications, if any, for the Finance Bill's provisions for personal pensions and freestanding AVCs. We can then feed our views as necessary into the DTI/DHSS correspondence.

P S Hall

P S HALL

3758/064

CONFIDENTIAL

FROM: P D P BARNES
DATE: 15 July 1987

MR HALL

cc PS/Chancellor
PS/Financial Secretary
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Scholar
Mr Peretz
Mr Ilett
Miss Noble
Miss Sinclair
Mr Board
Mr Murphy
Mr Neilson
Mr Cropper
Mr Tyrie

Mr Corlett - IR
Mr Munro - IR
PS/IR

FS ACT DELAYED IMPLEMENTATION : PERSONAL PENSION PROBLEMS

The Economic Secretary was grateful for your submission of 14 July. The Economic Secretary thinks that if delay is inevitable an early announcement is desirable.

PB

P D P BARNES
Private Secretary

CONFIDENTIAL

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

? still awaiting reply to my minute of 15/7 (attached) but you may like to see this CR 17/7

There is clearly a problem here for DHSS. But I should see no compelling reason to delay the introduction of the new tax regime, which has wider significance than contracting-out of SERPs - even if delay were feasible at this stage. NLM. 16.7

FROM: J D HINTON
DATE: 16 July 1987

1. ~~MR MUNRO~~
2. FINANCIAL SECRETARY

FS ACT DELAYED IMPLEMENTATION : PERSONAL PENSION PROBLEMS

1. In his note of 14 July to the Economic Secretary about a likely delay in implementing the Financial Services Act, Mr Hall refers to the potential effect this could have for the proposed 4 January 1988 start date for contracted-out personal pensions. This note is about the possible implications for the proposed start dates for tax approved personal pensions and free-standing AVCs.

Background

2. There are two strands to personal pensions. First, there are the DHSS plans for personal pensions through which an employee could contract-out of the State Earnings Related Pension Scheme (SERPS). Second, there are the proposals in the current Finance Bill which modify and update the existing retirement annuities tax code, with effect from 4 January 1988.

cc Chief Secretary
Chancellor
~~Financial Secretary~~
Paymaster General
Sir P Middleton
Sir G Littler
Mr Cassell
Mrs Lomax
Mr Scholar
Mr Peretz
Mr Ilett
Miss Noble
Miss Sinclair
Mr Board
Mr Murphy
Mr Neilson
Mr P S Hall
Mr Cropper
Mr Tyrie
Mr Isaac
Mr Corlett
Mr Beighton
Mr Munro
Mr Lusk
Mr McNicol
PS/IR
Mr Hinton

3. The DHSS have proposed very tight investor protection rules for contracted-out personal pensions, and were relying heavily on various parts of the Financial Services provisions. The main reason for the DHSS approach is that contracted-out personal pensions will be directly funded by the Government. The DHSS would pay to the scheme "minimum contributions" which represent the difference between the contracted-in and contracted-out rates of National Insurance Contributions. If therefore the investor protection safeguards were not in place DHSS Ministers would need to consider the sort of options listed in Mr Hall's note.

4. The same considerations do not necessarily apply to personal pension schemes, which will be tax approved under the Finance Bill provisions. Many of these - for example, those taken out by the self-employed, will not be contracted-out of SERPS.

Implications for the Finance Bill

5. In his Budget Statement, the Chancellor announced a 4 January 1988 start date for personal pensions and this date is contained in the Finance Bill legislation. The Finance Bill timetable means that any amendment to substitute a later date would have to be tabled tomorrow, at the very latest.

6. As Mr Hall says, any postponement would be embarrassing. But this may not be necessary: from a tax point of view the FSA provisions have not up to now been considered crucial.

7. Present legislation is adequate in relation to insurance based personal pensions. Deposit based schemes operated by banks and building societies are not subject to FSA rules: they have their own, separate, legislation which

is already in place. The only type of personal pension providers which could be directly affected by the FSA delay are unit trust based schemes.

This date does not appear in the Finance Bill. [signature] 16.7

8. Moreover, in so far as free-standing AVC schemes are concerned, it has always been our intention that these should start in October 1987: up to 3 months before the original FSA target date. One of the main reasons why this is acceptable is that tax rules will require free-standing AVC schemes to be set up under irrevocable trusts if the usual tax reliefs are to be available. Members of such schemes would therefore have the same protection under general trust law as is currently enjoyed by occupational pension scheme members.

9. An irrevocable trust has also been considered desirable for deposit based personal pension schemes, for the protection it gives both to scheme members and to the Revenue (against misuse of the tax reliefs).

10. It is, however, arguable whether unit trust based schemes should be permitted before the FSA is implemented. But it has been anticipated that they too should be capable of being free-standing AVC scheme providers if authorised under the existing provisions of the Prevention of Fraud (Investments) Act 1958. To maintain a level playing field, Ministers may therefore regard it as acceptable that, until the FSA takes effect, unit trusts authorised under current law should be allowed to be personal pension providers of tax approved schemes. This might necessitate a Treasury Order to amend Clause 20 - but that should be a relatively straightforward matter.

Conclusion

11. In the light of these considerations, we recommend that any delay in the FSA should not hold up the launching of

free-standing AVCs and tax approved personal pension schemes beyond their projected start dates.

Nem

for J D HINTON

CONFIDENTIAL

28

FROM: N WILLIAMS
DATE: 20 July 1987

MR HINTON IR

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
Sir P Middleton
Sir G Littler
Mr Cassell
Mrs Lomax
Mr Scholar
Mr Peretz
Mr Ilett
Miss Noble
Miss Sinclair
Mr Board
Mr Murphy
Mr Neilson
Mr P S Hall
Mr Cropper
Mr Tyrie
PS/IR

FS ACT DELAYED IMPLEMENTATION : PERSONAL PENSION PROBLEMS

1. The Financial Secretary was grateful for your note of 16 July.

2. He agrees with your recommendation that any delay in the FSA should not hold up the launching of free-standing AVCs and tax approved personal pension schemes beyond their projected start dates.

NWilliams

NIGEL WILLIAMS
(Assistant Private Secretary)

SIB TIMETABLE

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

Secretary of State for Trade and Industry

24 July 1987

Urgent advice please

The Rt Hon Nigel Lawson
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

CH/EXCHEQUER
REC. 24 JUL 1987 24/7
ACTION EST
COPIES TO

see earlier papers below which referred to that AA

Dear Nigel,

In the context of the introduction of the new personal pension schemes I wrote to John Moore earlier this week to draw to his attention an unavoidable slippage in the timetable for setting up the new regulatory structure under the Financial Services Act.

Once John Moore has had the opportunity to reply I would propose to write to colleagues more generally. But I thought you would also appreciate an early sight of my letter.

I am copying this letter to the Prime Minister, John Moore and Sir Robert Armstrong.

Yours

David

LORD YOUNG OF GRAFFHAM

DW4CJD

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

Secretary of State for Trade and Industry

20 July 1987

The Rt Hon John Moore MP
Secretary of State for Social
Services
Department of Health &
Social Security
Alexander Fleming House
Elephant and Castle
LONDON
SE1 6BY

Dear Secretary of State,

IMPLEMENTATION OF THE FINANCIAL SERVICES ACT

I am writing to draw your attention to what looks like some unavoidable slippage in the timetable for setting up the new regulatory structure under the Financial Services Act.

In May last year my predecessor took the view that it should be possible to bring in the key provisions of the Act, which revolve around the date (the "Appointed Day") on which it becomes an offence to carry on investment business without authorisation, by the end of the year. That timetable was based on assumptions which have already been invalidated. SIB applied for designation in February rather than November as originally envisaged and on the basis of a rule book parts of which had been given only rushed consultation. That caused problems for OFT's consideration and we ourselves were forced to allow an additional consultation period. Accordingly, delegation took place in May, rather than January as initially envisaged. We have, however, continued to aim for the end of the year, in the belief that, provided SROs worked on their application for recognition in parallel with SIB, the ground lost so far could be recovered.

DW1DEO

It is now clear that the SROs have also experienced slippage. Three have only recently made their formal application and submitted their rules. LAUTRO will probably not do so until next month. Moreover, OFT, following their experiences over the SIB rules, are anxious to have sufficient time to look at the rules which will after all be those which apply to the majority of firms. They expect to spend up to four months on The Securities Association rules, which are I understand are quite unlike The Stock Exchange rules, and between two and three months on the others. Given the DGFT's statutory obligations under the Act and the possibility of judicial review, there is little we can do to speed up this process.

Even when recognition is granted - and on the above basis that could be December for the Securities Association - there are further periods we must allow if we are to avoid uproar from the many businesses, large and small, in the financial services sector. First, they must have time to decide which route of authorisation they wish to seek. Second, because the Act provides a mechanism under which firms applying for authorisation but whose application is not determined have interim authorisation, there must be a decent interval to weed out at least some of the obviously undesirable applicants.

The above problems all relate to the authorisation side of the system. I should also add that I am receiving various reports of the difficulties which firms will have in complying with the new SRO or SIB rules if they are introduced at the end of the year. Again, the major problem is that the shape of many of the key SRO rules has until recently remained unknown. There are other ways of dealing with the problem - by transitional arrangements for some rules for instance - but there is a limit to how many rules can be dealt with in this way without making the entire process meaningless.

These various considerations have convinced me that the Appointed Day should be deferred until the beginning of April. I reach this conclusion with very great reluctance. The introduction of an adequate system of investor protection has been an important part of our programme. We have in effect admitted that the present system is unsatisfactory and are vulnerable should there be any failures in the coming months, especially since there is no compensation scheme in place. Nevertheless, we have established a practitioner-based framework at arm's length from Government, and our scope for influencing what SIB, the SROs or the OFT do is very limited. If we were to attempt to commence the central provisions of the Act before the authorisation machinery was functioning, the

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result would be that hundreds, perhaps thousands, of firms would be unable to continue carrying on investment business.

I shall be writing to colleagues shortly to inform them of this conclusion, but before doing so I wanted to alert you to the implications for the timing of the introduction of the new personal pensions schemes. Earlier this year we agreed that personal pensions should be allowed to be sold from January 1988. This decision was taken on the basis that the new investor protection framework provided by the Financial Services Act would be in place by then. I know that considerable importance was attached to this. For the new pensions regime to commence without adequate investor protection hardly gives it the best basis for the future.

Given the impossibility of having the FS Act machinery in place, I think we have to decide whether it is preferable to continue with the plans for introducing some personal pensions for those outside occupational schemes without benefit of the FS Act, or whether introduction of such pensions should be delayed until 6 April, the date on which pensions for those inside occupational schemes are introduced and which I propose should also be the day on which the relevant sections of the FS Act are commenced.

I realise that your predecessor laid the relevant commencement order, and that a change may require a further order. I also appreciate the political importance of an early start to personal pensions. However, without the FS Act in place there will be little effective regulation of the marketing of insurance and unit trust based schemes. I understand that there are powers in the Social Security Act which could be used to provide some controls on marketing, but these would certainly fall short of what will be provided by the FSA regime. Moreover, it will be difficult to authorise unit-trust based schemes. This latter problem may tempt a number of practitioners to offer unauthorised schemes. On balance I think it more important that the regime is established on a sound basis, rather than one which could be represented as being open to abuse, and I would therefore favour a deferral. This would give the industry the time it needs to cope with the significant regulatory changes being made and to provide a successful launch to personal pensions.

I think we also need to consider how any announcements on this subject should be handled. I am keen to maintain the pressure on SIB, the SROs and OFT to make better progress than has so far been the case and would prefer to avoid letting them off the hook with an announcement about the Appointed Day at this stage. I realise, however, that would-be providers of personal pensions from 4 January will wish to begin advertising early in the Autumn and we will presumably need to say something on that account. Unless you believe it would be possible to achieve this without compromising our objective on the FS Act, I think this points to announcement before the middle of September of revisions in both the FS Act and personal pension timetables.

Yours sincerely,

Paul Steeples

pp LORD YOUNG OF GRAFFHAM
(approved by the Secretary of State and signed in his absence)

DW1DEO

RESTRICTED

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ppsn.

CH/EXCHEQUER
31 JUL 1987
EST
COPIES TO

DEPARTMENT OF HEALTH AND SOCIAL SECURITY

Alexander Fleming House, Elephant & Castle, London SE1 6BY

Telephone 01-407 5522

From the Secretary of State for Social Services

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON SW1

30 July 1987

IMPLEMENTATION OF THE FINANCIAL SERVICES ACT: IMPACT ON PERSONAL PENSIONS

Thank you for your letter of 20 July explaining that it will not be possible for the Financial Services Act machinery to be in place by January 1988. I know you will have reached this conclusion with great reluctance and accordingly, I assume there is no prospect of pressing the SIB and LAUTRO to speed up their procedures so as to meet the original deadline. As you recognise, the delay poses problems for the January start date for personal pensions, and I am grateful for the opportunity to comment before you give your conclusions wider circulation.

I am convinced that we cannot allow people to be persuaded into joining a personal pension scheme to be used in place of SERPS without the benefit of the investor protection measures we all agree are necessary. The political attractions of personal pensions would be negated if people are sold unsuitable pensions contracts because the disciplines of the Financial Services Act cannot be enforced.

Given that starting point, I have two broad options. One is to attempt to implement key elements of the investor protection machinery - for example, product disclosure rules and cancellation rights - in time for a January start. This could be achieved either by making regulations under the Social Security Act 1986 or by a voluntary agreement with the providers. But there are clear drawbacks to this approach, not least the likelihood, as the ABI have pointed out, that substantial numbers of providers would simply not be able to comply with the rules by January. Moreover, the delay in preparing unit trust regulations under the Financial Service Act means that in practice no authorised unit trust personal pension schemes will be available by January. This would not help our objective of increasing competition among pension providers.

E.R.

The other option, which I see as the only viable one, is to defer the start date for personal pensions. You propose a postponement to 6 April 1988, to coincide with the introduction of the changes for occupational pension schemes. I certainly hope that the Financial Services Act machinery will be in operation by then. Yet, given the limits on the influence we have over the SIB and the SROs as well as the ABI's view that some providers may not be able to comply with the full SRO rules until July 1988, I would not propose at this stage to announce a revised start date for personal pensions. There is no need to amend the operative dates of the Social Security Act regulations until later this year, by which time I hope it will be clear whether the Financial Service Act machinery will be effective from April or a later date.

We also need to consider the timing of an announcement that the January start date is to be postponed. I understand your concern to defer an announcement until September so as to keep up the pressure on the SROs. But I am afraid I do not think we can keep pension providers unaware of our intentions for as long as that. If we do not make an early announcement, we will be rightly criticised for allowing the industry to carry on with what might well be abortive work. Moreover, we have to change the timing of our own publicity, which means telling the outside agencies and the Occupational Pensions Board. An early announcement gives us the freedom to present the decision on our terms rather than be forced into responding to rumours.

I hope you will be able to reflect these considerations in the advice you will shortly be putting to colleagues. Subject to their views, we can the agree the exact content and timing of the necessary announcements. I am copying this letter, as you did yours, to the Prime Minister, Nigel Lawson, and to Sir Robert Armstrong.

John

JOHN MOORE

29/2

b/f 3/8 with further advice from Mike Neilson
AWK

FROM: N J ILETT
DATE: 30 July 1987

CHANCELLOR

c c Financial Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Scholar
Mrs Lomax
Mr Peretz
Miss Noble
Mr Neilson
Mr Cropper

PS/IR
Mr Hinton IR

THE FINANCIAL SERVICES ACT TIMETABLE

Lord Young's letter of 24 July says that the timetable for setting up the new regulatory structure under the Financial Services Act must now be extended from the end of this year until 6 April 1988. Mr Hall's submission of 14 July warned that DTI Ministers would be writing to this effect.

2. The postponement is unfortunate, but inevitable. As you know, we have anticipated it for some time, and the City is unlikely to be surprised. The procedures in the Act are complex, involving the vetting of draft SRO rules by both SIB and OFT. There were delays in getting the SIB operational, and there are now additional delays with the SROs. Some of the incidental provisions of the Financial Services Act, for example investigation powers, are already in force. But the main supervisory powers rest on the prohibition on doing investment business without authorisation, and that prohibition can only be brought into effect when all the SROs are ready. The original timetable was unrealistic and there must be some doubt whether April 1988 is realistic.

3. Lord Young poses two immediate questions:-

a. Should the introduction of personal pensions bc postponed from 4 January until the Financial Services Act is ready?

b. More generally, what should DTI Ministers say in public about the timetable, and when?

4. On b., the DTI is worried that once the SROs know they have more time they will take things easy, and then miss the extended deadline. This is why the DTI is only now proposing to say publicly that the present timetable is unrealistic. Ideally DTI officials would like to stick to the present timetable in public until much later in the year. The difficulty is that the personal pensions industry is working towards the 4 January date, and must therefore be warned if that date is to change.

5. Lord Young's letter of 20 July to the Secretary of State for Social Services (copied to you with his letter of 24 July) discusses whether the Government should proceed with personal pensions on 4 January even though the new investor protection apparatus will not be in place. Mr Hall's submission of 14 July looked at this question in detail. Apart from postponement, the options are to go ahead with a voluntary investor protection scheme, to do without investor protection for a few months, or to attempt to cobble together some kind of parallel investor protection regime under DHSS legislation (a major task, certainly inadequate and perhaps impossible).

6. Lord Young favours postponement. This would provoke some unwelcome political comment, probably more in the way of teasing than of criticism of substance. While one or two of the institutions which are preparing to enter the market may be upset, DHSS officials reckon that most will be happy to have a little more time <u>provided</u> they are warned before they start to commit advertising resources etc to the 1 January date. (Advertising space in the glossies and the trade press is booked early). I do not think any of the other options are viable. DHSS officials take the same view and are so advising Mr Moore.

7. Assuming postponement is agreed, Lord Young proposes a compromise on timing. He wants to keep the pressure on the SIB/SROs by delaying his announcement until September. He thinks

this will give the personal pensions operators sufficient warning.

8. The questions for Treasury Ministers at this stage are:-

i. How to respond to Lord Young on the delay in implementation in general;

ii. What, if anything, to say about the personal pensions dilemma;

iii. Whether to accept Lord Young's proposals for the timing of his announcement.

9. On i., there is no point in chiding Lord Young for delays which are unavoidable and (given the requirements and structures of the FS Act) now outside DTI's control. Whether 6 April 1988 is realistic is really a matter for his judgment, but you could express the view that this postponement must be the last, ie whatever date is now announced must be met.

10. On ii., the decision is in the first instance for Mr Moore. You could wait until he has written, but this is not essential. You might say that although you would regret the postponement of the introduction of personal pensions you would understand if Mr Moore shared Lord Young's view that the alternatives are even more unattractive (alternatively, if Mr Moore has written in this sense by the time you write, that you accept his judgment). (He has now written—below—and I have amended the letter accordingly.)

11. On iii., given that an announcement about personal pensions must be made in the recess, I think the balance of the arguments points to announcing postponement now so as to minimise the impact on the personal pensions industry, rather than to wait until mid-September. A few weeks could be important for the personal pensions industry and is unlikely to make much difference to the pressure on the SROs.

12. I attach a draft letter to Lord Young which makes these points. [~~I do not think this need wait any further for Mr Moore's reply.~~]

M.

N J ILETT

The Rt Hon Lord Young of Graffham
Secretary of State for Trade & Industry

FINANCIAL SERVICES ACT : TIMETABLE

You wrote to me on 24 July with a copy of your letter to John Moore of 20 July.

I agree that, in all the circumstances, some slippage in the timetable for setting up the Financial Services Act timetable cannot unfortunately now be avoided. However, I think it essential that the new date which the Government ~~may~~ now sets for the "Appointed Day" must be met, ie that there are no further postponements.

I would regret any delay in the introduction of personal pensions beyond the date we have already announced. However, I see the force of your arguments and I would understand if John Moore (his letter of 30 July) comes to the same conclusion. But, like if John, does agree to postpone introduction until the Financial Services Act investor protection machinery is in place, I think we owe it to the personal pensions industry to make an immediate announcement, rather than to wait until the middle of September.

I am sending copies of this letter to the Prime Minister, John Moore and Sir Robert Armstrong.

NIGEL LAWSON

1528/017

FROM: N J ILETT
DATE: 3 August 1987

PRINCIPAL PRIVATE SECRETARY

cc: PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Scholar
Mrs Lomax o.r
Mr Peretz
Mr McIntyre
Miss Noble
Mr Neilson
Mr Cropper

PS/IR
Mr Hinton IR

Ch/ Content to write as drafted?

THE FINANCIAL SERVICES ACT TIMETABLE: PERSONAL PENSIONS

This minute brings my submission of 30 July up to date, as the Secretary of State for Social Services has now replied to Lord Young's letter of 20 July.

2. Mr Moore:

(i) Agrees that he cannot bring personal pensions into operation until the Financial Services Act investor protection system is in place;

(ii) Thinks the decision to postpone personal pensions should be announced immediately, not in September; and

(iii) Would prefer not to announce the new date for the introduction of personal pensions for the moment.

3. On (iii) Mr Moore is (rightly) worried that DTI will not make 6 April 1988 for the Financial Services Act, so that if he

announced 6 April for personal pensions he would have to make yet another change to his timetable later.

4. The choice is difficult. As I explained in my submission of 30 July, there is real doubt whether the FS Act machinery will be ready by 6 April, and much of the work is beyond DTI's control. On the other hand, the personal pensions industry are entitled to a clear start date and it would suggest indecision, to put it no more strongly, to postpone sine die.

5. After discussion with ST, I recommend that the Chancellor should say that he finds the prospect of a postponement sine die extremely unattractive, and that this underlines the importance of getting the new start date for the Financial Services Act right now, so avoiding any further postponements. The implication is that Lord Young should reconsider whether he ought to allow more time for the FS Act, but as that is a political decision which he is best placed to take the draft does not say so in terms.

6. I have amended the draft letter accordingly, and attach the revised version.

7. I should also record the Revenue's advice that a change of date may imply a need for a minor technical provision in next year's Finance Bill.

N.

N J ILETT

~~RESTRICTED~~

C/1

Re type [illegible]

DRAFT LETTER TO:

Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry

FINANCIAL SERVICES ACT : TIMETABLE

You wrote to me on 24 July with a copy of your letter to John Moore of 20 July, ~~and~~ I have seen John Moore's reply of 31 July.

I accept ~~agree~~ that some slippage in the timetable for setting up the Financial Services Act machinery is now regrettably ~~unfortunately~~ inevitable. While ~~I would regret~~ any delay in the introduction of personal pensions beyond the date we have already announced, but a disappointing development, I see the force of your arguments and I do not dispute the conclusion which you and John Moore have reached. I share John Moore's view that the decision should be announced as soon as possible so as to minimise the disruption to the personal pension industry.

However, I think it would but most unsatisfactory ~~look very odd~~ if we announced the postponement of personal pensions without at the same time stating firmly the new date for their introduction. Other considerations apart, silence on this point would undermine the credibility of the revised timetable for the FS Act system generally. I think it essential

we) (a timetable

that ~~whatever new timetable is~~ now set for the

which we are confident can be

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and announce the

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needs to know, accordingly.

I am sending copies of this letter to the Prime Minister, to John Moore and to Sir Robert Armstrong.

NIGEL LAWSON

PH1/34

CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

4 August 1987

The Rt Hon Lord Young of Graffham
Secretary of State for Trade & Industry
1 Victoria Street
LONDON SW1

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Scholar
Mrs Lomax
Mr Peretz
Mr McIntyre
Mr Ilett
Miss Noble
Mr Neilson
Mr Cropper
PS/IR
Mr Hinton IR

Dear David,

FINANCIAL SERVICES ACT: TIMETABLE

You wrote to me on 24 July with a copy of your letter to John Moore of 20 July. I have seen John Moore's reply of 31 July.

I accept that some slippage in the timetable for setting up the Financial Services Act machinery is now regrettably inevitable. While any delay in the introduction of personal pensions beyond the date we have already announced is a disappointing development, I see the force of your arguments and I do not dispute the conclusion which you and John Moore have reached. I share John Moore's view that the decision should be announced as soon as possible so as to minimise the disruption to the personal pension industry.

However, I think it would be most unsatisfactory if we announced the postponement of personal pensions without at the same time stating firmly the new date for their introduction. Other considerations apart, silence on this point would undermine the credibility of the revised timetable for the FS Act system generally. I think it essential that we now set a timetable for the FS Act system which we are confident can be achieved, and announce the new personal pensions start date, which the industry needs to know, accordingly.

I am sending copies of this letter to the Prime Minister, to John Moore and to Sir Robert Armstrong.

Yours
Nigel

NIGEL LAWSON

fim2.cd/neilson/min1

FROM: M NEILSON
DATE: 5 August 1988

ECONOMIC SECRETARY

cc PS/Chancellor
PS/Sir P Middleton
Sir Geoffrey Littler
Mr Scholar
Mrs Lomax
Mr Peretz
Mr Ilett
Miss O'Mara
Miss Noble
Mrs Ryding
Mr Jenkins - TSol

FINANCIAL MARKETS BILL: TREASURY INTEREST

You will recall that QL has agreed that the Companies Bill should include provision dealing with insolvency in financial markets. There are two Treasury interests:

i. to ensure that the wholesale money market supervised by the Bank under Section 43 of the Financial Services Act can benefit from the legislation

ii. to take this opportunity to deal with some problems posed for the Central Gilts Office (CGO) by the 1988 Insolvency Act

This minute explains where we have got to on both points, and seeks your agreement in principle to a change in the Conditions and Arrangements for admission to the Bank's list to allow clearing systems (as opposed to market makers and brokers) to appear on it.

Clearing systems in the Wholesale Market

2. The problem DTI is aiming to deal with is that under current insolvency legislation the arrangements made by various clearing systems (including the Stock Exchange, LIFFE, and the commodity exchanges) to ensure that the insolvency of one of its members does

not have knock on effects for other members, is invalidated by the insolvency legislation. DTI see no way of developing alternative arrangements without amending that legislation.

3. We agree that there is a problem, (see, for example, Mr Ilett's minute of 2 December 1987) but have always felt that DTI's solution to it is over-elaborate. DTI have gone some way in simplifying the proposals, and we would not advise raising further objections at this stage. You should be aware however, that DTI intend that their provisions should be retrospective from the date the bill is introduced. We are not sure this is necessary. However Mr Maude intends consulting colleagues on the point, so we can see what arguments he puts forward before taking a final view.

4. The markets where this problem arises are all regulated under the Financial Services Act, so DTI's original proposal was to give protection only to Recognised Investment Exchanges (RIEs) and Recognised Clearing Houses (RCHs). But it is possible that clearance systems in other financial markets, outside the Financial Services Act regime may develop, which may need protection. This applies in particular to the wholesale markets. You may have seen recent press reports of the collapse of Londonclear (copy of recent article attached), which would have been exactly the sort of system that would need protection under the DTI legislation. (It had been intended that Londonclear would provide a depository facility for money market instruments, so that trading could take place electronically, with no physical transfer of documents.) Despite the collapse of Londonclear the Bank are confident that there will be a successor to Londonclear. We need a way of making clearing systems like the new version of Londonclear eligible for protection under the DTI legislation.

5. But first a decision is needed on how they should be regulated. The Banks' view is that the Bank rather than the SIB should regulate clearing systems in the wholesale markets area, since they have responsibility for all other aspects of the conduct of these markets. We agree. The simplest solution is to make clearing systems eligible to appear on the list that the Bank maintains under

Section 43 of the Financial Services Act. This would mean that Londonclear (or its successor) would not require authorisation under the SIB regime.

6. Eligibility for the list is determined by the Conditions and Arrangements prepared by the Bank for approval by the Treasury. Only a small change to the Conditions and Arrangements (marked on the attached copy) would be needed to extend eligibility to clearing systems in the wholesale markets. Treasury Solicitors advise that such a change is within the scope of the Section 43 exemption. There are no formal Parliamentary procedures for changing the conditions and arrangements; our normal practice is simply to draw attention to any changes in an arranged Written Answer.

7. There is no immediate need to make this change to the Conditions and Arrangements, since there is no prospect of a successor to Londonclear for some time. We also need to agree with the Bank details of how they will supervise clearing systems appearing on their list before making the change (our responsibility for approving the Conditions and Arrangements extends to assuring ourselves that the Bank have in place adequate systems for supervising listed institutions).

8. The immediate need is for your agreement in principle that this is how clearing systems in the wholesale markets should be treated, It will then be possible to ensure "listed" clearing systems can be eligible to benefit from the DTI legislation.

Assured Payments Systems

9. The CGO is as assured payments system for transactions in gilts. The CGO problem is a more limited one. Payment for the transactions of trading members in the CGO is assured by settlement banks. This removes the risk of counterparty default. But it means that the settlement banks take on the risk that their trading member will default. To cover this exposure the banks normally take out a floating charge over the trading member's gilt holdings in the CGO. The problem is that the Insolvency Act 1986, which introduced the

Administrator, has undermined the effectiveness of this charge in certain circumstances. Briefly, when an administrator is appointed he is given a free hand to manage the assets of the company in order to maintain it as a going concern or to ensure a controlled winding up. This free hand includes the power to disregard charges over property, including those held by the CGO settlement banks

10. Not surprisingly, the banks have expressed concern about this, and have only reluctantly agreed to continue providing assured payment arrangements on the understanding that this problem will be resolved. We think, that it is worth giving the banks the degree of special treatment that would be involved in order to facilitate the development of assured payment systems, which provide a good way of minimising counterparty risk. The DTI legislation gives us the opportunity to deal with their concerns.

11. Our objective has been to meet the settlement banks' concerns by protecting from the Administrator all charges that relate to assured payments. DTI have agreed to take powers in the Bill to achieve this in secondary legislation. We are still debating with the Bank and DTI how best to define the type of charge so as to achieve the minimum necessary protection.

12. The Bank have argued throughout for other changes to the insolvency legislation, to make the effectiveness of the banks' charges beyond doubt. Treasury Solicitor advises that there is nothing in these points, and we are therefore unwilling to go beyond protection from the Administrator, unless the settlement banks make a convincing case. The Bank have therefore agreed that, for the time being, we should only aim to protect the charge from the Administrator, but that this is subject to the arguments put forward by CGO members when consulted about the proposals.

13. The proposals covering CGO can also be applied to other assured payments systems; the Stock Exchange operate a form of assured payments for equity bargains (but only when the share certificate in question has been deposited with the Stock Exchange). It is possible that, in due course, the successor to Londonclear will operate assured payments.

Consultation

14. The next step is consultation. DTI are preparing a consultative document outlining their proposals, and covering our interest, for circulation on a personal basis to those market authorities and practitioners who are aware of the problem - the Stock Exchange, LIFFE, etc. Given the tight timetable for drafting the legislation (the Bill is due for first reading in November) they intend circulating this in the course of August. The Bank will consult the CGO settlement banks on the basis of the DTI document.

15. We see a strong presentational case for allowing the DTI to continue to make the running on this; it is much easier to justify the degree of priority we are giving to the settlement banks as part of a more broad-ranging package making more substantial changes to the insolvency legislation for the benefit of other markets. As long as the CGO proposals are seen as only a small part of the DTI legislation it is likely that DTI Ministers will be willing to handle the whole package themselves when it is debated.

Conclusion

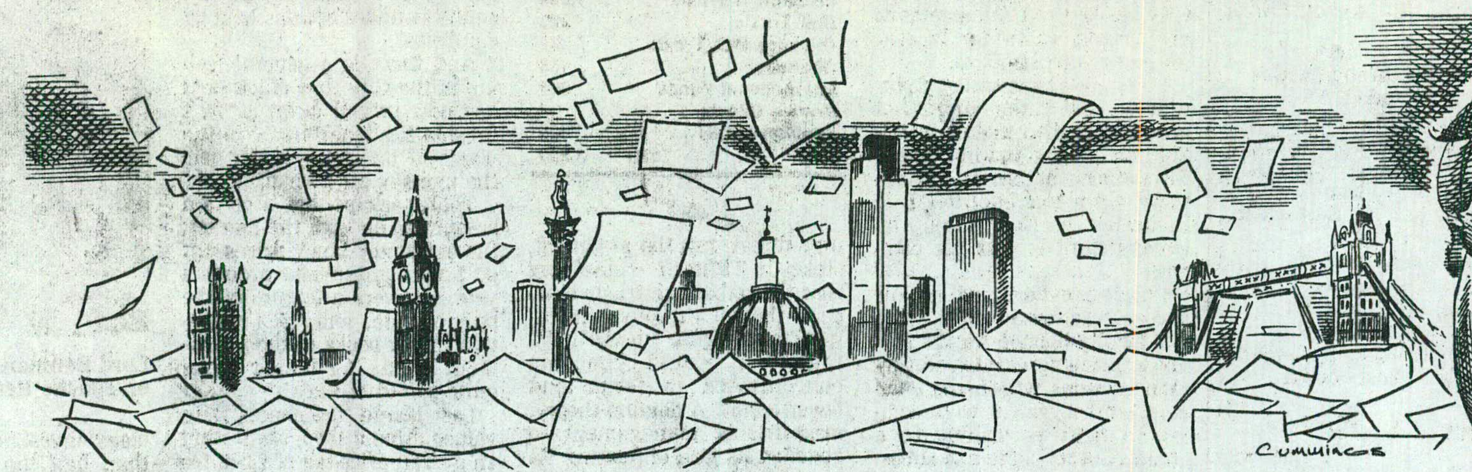
16. We recommend:

i. That you agree in principle to the change in our Conditions and Arrangements to allow clearing systems to appear on the Bank's list under Section 43.

ii. That the financial market clauses in the Companies Bill should allow clearing systems on the Bank's list to be eligible to receive the protection of the DTI legislation, in the same way that RIEs are.

iii. That the consultative document being prepared by DTI for limited circulation, should be issued as soon as possible (which will probably mean that you will not see it in advance) and should outline the arrangements described above for listed clearing systems and for assured payments systems like the CGO.

M NEILSON



City sticks to a paper standard

D. McWILLIAM

David Lascelles examines a setback to automated clearing in London

The collapse of LondonClear has caused considerable embarrassment and some recrimination in the City of London. The project, launched a year ago by 36 UK banks with the backing of the Bank of England, would have automated the City's paper-based sterling markets. But on Monday it foundered on the reluctance of its backers to cover its £12m launch costs.

Is the collapse a sign of the short-sightedness of London's financial institutions, as some people such as Mr David McWilliam, LondonClear's chief executive, have claimed? And in that case does it reflect badly on London's ability to compete in the international financial marketplace? Or was LondonClear ill-conceived, and therefore rightly terminated? What everyone agreed yesterday was that something needs to be done about the sterling markets, where billions of pounds worth of bills and other money instruments are traded daily – and delivered by messengers plying the City's streets. LondonClear would have provided an independent, computer-based system using the Bank of England as a depository, to replace paper with electronic blips.

But after three years' work LondonClear attracted only 40 would-be members, well below the 70-plus which it needed. And it got only half a million pounds compared with the £9m it wanted for the first phase.

Bankers yesterday cited two reasons for the poor response.

One was cost. The total of £12m, not including £4m of lease finance, was far more than they had been led to expect. This would amount to several hundred thousand pounds per member, some of which retain profits of barely £1m a year.

The twist to the situation is that the clearing banks with the deep pockets are not the biggest users of the money markets: they issue a lot of paper but they deal less in the secondary market than small banks and discount houses. So they were reluctant to put up large sums. Conversely, the smaller institutions which are bigger dealers could not afford a heavy investment.

Many bankers also complained that LondonClear was trying to create a "Rolls Royce" system with an array of options, when the City needed "a Ford Cortina," straight and simple.

Ironically, LondonClear would not have saved enormously on existing costs. One clearing banker estimated yesterday that the entire market used only 30 messengers at a total cost of well under £1m. His own bank kept all its money market paper in a single small safe.

Mr McWilliam rejects the criticisms about excessive cost. He says that banks were "deeply consulted" about the system's requirements and costs at all stages, and had plenty of opportunities to voice their worries.

He also defends the decision to go for a high quality system on the grounds that a market where banks manage their liquidity and the Bank of England makes its interventions must be totally reliable. He said it was essential, for example, that the computers be duplicated for emergency or breakdown – even though this doubled the equipment costs – and that they be sophisticated enough to adapt to changes in the market.

"If you cut costs, you also have to take short cuts with equipment and software – or change the nature of the service," he said.

The second complaint was bureaucracy. With several committees and much consultation machinery, some bankers felt LondonClear could never be flexible enough. Again, Mr McWilliam denies this charge, claiming that LondonClear was designed to be highly responsive.

There were also some doubts in people's minds as to whether London needed to create a new system from scratch. Two banks – Chase Manhattan and First Chicago – already supply automated clearing and settlement services for the London markets, and both are eager to expand their business in sterling instruments. But though the collapse of LondonClear removes a potential rival, they are not comparable: as dealers in their own right, they lack the independence the LondonClear would have had.

The most likely entity to pick up LondonClear's pieces seemed yesterday to be the Association for Payment Clearing Services (APACS), the umbrella body for the UK clearing system.

APACS had two members on LondonClear's board, and it will now be considering whether to take its work forward. APACS would be quite different from LondonClear: the disadvantage is that it is dominated by the clearing banks rather than the main users of the sterling markets.

On the other hand, it is a deep repository of experience in settling and clearing.

The collapse of LondonClear has set back the modernisation of the London markets at a time of heightening international competition. Although New York's money markets are still paper-based, continental countries such as France, Italy and Spain are going over to computers, and Australia recently introduced a system very similar to that planned by LondonClear.

The UK's domestic markets are neither as big or as important internationally as the Euromarkets, also based in London, so the damage caused by the setback will be limited. But this is not a moment when London can afford big blunders.

FT 3.8.88

FROM: N J ILETT

DATE: 2 December 1987

ECONOMIC SECRETARY

cc: PPS
Sir P Middleton
Mr Cassell
Mr A Wilson
Mrs Lomax
Mr Peretz
Mr Board
Mr Neilson
Ms Ryding

Mr Jenkins T.Sol.

FINANCIAL MARKETS BILL

Introduction

My submission of 19 November discussed Mr Francis Maude's proposed statement on this Bill. The present submission considers the "DTI" part of the Bill itself, ie the proposals to restrict the application of insolvency law to financial markets. The DTI have to get the Instructions to Counsel next Monday, 7 December. The "Treasury" part of the Bill, which deals with the security of floating charges within the Central Gilts Office system, will be the subject of another submission shortly. (Parliamentary Counsel is allowing us a little extra time.)

Background

2. The justification for the Bill was set out in a little detail in Annex A to my earlier submission. I attach this for ease of reference.

3. One point merits further expansion. There is a key difference in the Bill between markets which work on margin, and markets which do not. The whole purpose of margin is to give the people handling the business in the market, which can mean the central market authorities, cash with which to transfer the market positions of a defaulter to somebody else, so that the market as whole can have confidence that deals which have already been set up will be completed. This is essential in the derivative markets, because the failure of bargains which market members think they have struck

can mean that their position is the opposite of what they thought. There is no point in running a market on the basis of margins if the margin has to be returned to an insolvency administrator precisely when it is actually needed for the purpose for which it was designed.

4. The Bill will also apply to non-margined markets, notably the Stock Exchange. The justification for this has always been less evident than for the margined markets, because the effect of the Bill is not simply to protect the concept of "margin" but to privilege unsettled transactions within the Exchange over creditors outside the Exchange. This is justified in the Instructions largely on the grounds of the potential domino effect of the collapse of one member firm on other member firms. Imagine that a significant market-maker had gone down after the recent price collapse; and that the insolvency administrator enforced all sales by that market-maker but refused to honour any purchases. Other members of the market who thought they had sold out when prices were higher would now find they still had their stock but it would be worth less.

5. The Bill will therefore validate <u>new</u> Stock Exchange rules which require the totality of a failed member's bargains to be netted out a "hammer" price. (It is disconcerting to learn that the Stock Exchange have lived with the problem the Bill is designed to solve since a House of Lords judgement in 1877. The argument is that the new-style market would find it harder to cope than the old-style market.)

6. One final piece of background. My last submission reported that Treasury Counsel had advised the DTI and the SIB that the SIB should not recognise "Recognised Investment Exchanges" (RIEs) under the Financial Services Act if their rules were in conflict with insolvency legislation. This meant that this Bill must reach the statute book before "A" day in April 1988. The effect is further to hazard an already dodgy timetable. The Stock Exchange now has a contradictory Opinion from an eminent QC.

Structure of the Bill

7. The DTI's approach has been to bolt this Bill on to the Financial Services Act. This is a ponderous and arguably unnecessary procedure, involving a range of technical provisions whose description takes up most of the 130 pages of Instructions to Counsel. The effect is to allow RIEs to make rules which, once vetted by the SIB, cannot be overridden by insolvency law.

8. I attach the latest draft of the Instructions. DTI are committed to getting these to Parliamentary Counsel next Monday. **This is all optional reading and most is even more optional than the key passages on pages 2-10 (marked in yellow).** If you want to get some of the flavour of some of the detail, the yellow highlighting of occasional bits of the rest of the text is a guide. (Copy recipients who want to see the Instructions should ask me.)

Assessment

9. As I have mentioned before, I think this Bill is more complicated than it needs to be, that it would better not to have linked it to the Financial Services Act, and that it would have been wiser to get the markets to do more to reduce their own exposure to these risks by adapting settlement practices, altering contractual relationships etc before embarking on legislation which risks being interpreted as a panic measure. The timing of the Bill - introduction in February or March - will probably leave something to be desired, assuming that the equity markets are still fragile.

10. That said, we have no reason to suppose that the Bill will not actually work, DTI Ministers have been closely involved in its preparation and are responsible for insolvency law, Treasury Ministers supported the concept of the Bill back in the Summer and it is not really worth your arguing with Mr Maude about points of detail even if time allowed. Also, we are "demandeurs" on the gilts market part of the Bill, which weakens our negotiating position on the "DTI" part.

11. There are two main Treasury interests to watch:

(i) Whether the balance of interest to the economy justifies special arrangements for insolvency in these markets. This includes looking at the Revenue's position as a potential creditor;

(ii) Whether the Bill interferes with <u>banking</u> payment systems.

12. On (i), the Revenue is happy to leave decisions to the Treasury. Our support for the concept of the Bill back in the Summer would make it very difficult to argue now that the DTI's judgement on the balance of interest to the economy is wrong. But there is one specific point on which DTI have almost certainly gone too far. This is that the Bill will allow exchanges to make rules about the insolvency of people who are <u>not</u> members of the exchanges, but simply large customers of members.

13. The thought is that some of these customers, if they defaulted, could hit the exchange as hard as the failure of the firms through which the customer was dealing. However, it would be both difficult and controversial to attempt to decide whether or not a particular failure by a large customer merited special treatment even if the principle of giving special treatment to anybody outside the exchange "family" could be defended. I have already expressed some surprise at this proposal to DTI officials, but Mr Maude is said to be wedded to it. (The relevant bits of the Instructions are paragraphs 3.26 and 3.27 which attempt to limit an RIE's ability to make rules applying to non-members to people whose default would affect the "continued viability of the market". But, as paragraph 3.28 says, "It is difficult to express the concept".)

14. On (ii), as things stand we are reasonably happy that there is a clear line between the markets the Bill will cover and banking payment systems. Financial markets systems are concerned with the transfer of assets in exchange for cash, which is quite different from the settling of purely cash payments. But we shall have to watch the drafting of the Bill very carefully.

<u>Conclusion</u>

15. Taking this Bill forward is going to be a pretty thankless task; a seed of doubt sown by an American lawyer's analysis of

ng-standing City procedures has grown into a rather unw~~h~~ieldy instrument intended to solve a problem whose existence is not generally known and, to the extent that it was suspected, was largely ignored.

16. You will become involved to some extent because of the "Treasury" bit of the Bill. But there is no need at this stage for you to get involved actively in the DTI provisions; rather the contrary. It would be safer to hold your fire for later, in case the draft of the Bill highlights something on the DTI side on which you need to intervene or the DTI get difficult about our bit of the Bill.

17. So I suggest that I write to my opposite number at the DTI to put it on the record that, as I have already told him, the Treasury has reservations about the way in which the Bill applies to non-margined markets, specifically the Stock Exchange, and in particular about the proposal to extend it to defaults by some non-members of the markets. I would add that we shall need to look at the Bill itself very carefully once it has been drafted, and to be ready to review aspects of the policy which further work and Parliamentary discussion show to be controversial or doubtful. But given that there is no time left for discussion now we agree these Instructions must go to Counsel now.

18. Would you be content for me to write in these terms and for the Bill to be drafted on the lines the DTI wish?

N J ILETT

(From submission of 19 November).

THE PROBLEM WITH INSOLVENCY LAW

1. For simplicity, the following paragraphs refer to the Stock Exchange. Problems of the same order are thought to arise in other financial markets, but they may show up in a number of different ways, depending on technicalities.

2. The Bill is intended to cope with the following point. A Stock Exchange member firm will have a number of positions in the market. By the time the Account ends, some transactions undertaken during the Account will prove profitable; others may not. Other members of the market will be the counterparties to each of these transactions, and will rely on the first member firm to come up with the securities or the money on the due day.

3. If the first member firm becomes insolvent, the Exchange rules would require these bargains to be completed, so that any net surplus of funds could be handed over to the receiver or administrator, and any net shortfall could be presented as a claim of the Exchange on the assets of its insolvent member. The risk which the DTI perceives, however, is that the administrator of the insolvent firm could make other member firms with whom the insolvent firm had profitable bargains pay up, while at the same time refuse to honour bargains in which the insolvent firm came off worse (ie "to pick the cherries out of the pie".) It is not <u>certain</u> that the courts would maitain an Administrator's attempt to operate in this way if that conflicted with the Exchange's rules; DTI legal advice is that there is a substantial risk, which DTI Ministers judge they must remove.

4. This argument has been simplified even in relation to the Stock Exchange. But it applies to a number of other markets, and in particular to futures and options markets which work on margin and where a central organisation, such as the International Commodities Clearing House (ICCH), takes over as counter-party to each of the sides in the original deal. In practice, problems on how to close out deals when insolvency strikes are more likely to arise in these markets than in the Stock Exchange.

The consequence the DTI fear is that other market users who thought they had a given position in a particular stock, commodity, future or whatever would suddenly find that they did not have that position, or did not know their position because there was uncertainty about which bargains the administrator handling their insolvent counterparty's affairs would honour. The thought is that it would be at the least unhelpful if market authorities hesitated to apply their rules because they were not sure whether the Courts would find that those rules were in conflict with insolvency procedures (though the Stock Exchange rules are actually inadequate anyway post-Big Bang). Worse, an Administrator might attempt actively to interfere with the market authorities' crisis control operations.

6. At best, the argument goes, if this weakness in the UK legal framework underpinning financial markets became known, people would be more reluctant to do business here - especially North Americans who are used to more protection from insolvency procedures. (It was a US lawyer who drew the DTI's attention to the problem in UK law.)

7. At worst, the loss of profitable bargains or of hedged positions and uncertainty as to members' actual positions could trigger a progressive collapse in a particular market. If a firm which aims to be fully hedged does not know what contracts will be honoured it cannot take action to restore its fully hedged position and is thus exposed to an unknown client.

8. The justification for the Bill is therefore the need to remove the uncertainty about the present legal position which has emerged since the insolvency Administrator procedures came into force in the last couple of years. As yet, the suspected need for legislation is not widely known, though the DTI have been consulting the market authorities in confidence and some lawyers with special interest in this area of the law also know that the DTI thinks there is a problem.

The Central Gilts Office part of the Bill

9. The Bill will also deal (at Treasury behest) with the following possible problem in the gilts market.

The Central Gilts Office operates by ensuring that the package of gilts one way and the money in payment for them travelling the other way arrive at their respective destinations at the same time. The banks which operate the CGO guarantee these transactions. So if the customers of one of these banks defaults that bank has to make good any loss to counter-parties in the market from transactions which are going through the CGO system. The banks protect their position by a floating charge over the gilts they hold on behalf of their customers, but there is some doubt as to whether this charge would work in all circumstances, which makes the banks reluctant to admit further members to the CGO whose ability to meet any commitment which may arise is perhaps less certain.

The structure of the Bill

11. The approach the DTI is adopting is to graft the legislation onto the Financial Services Act and to use the Act's administrative machinery. The Bill would enable markets ("recognised investment exchanges") which have appropriate insolvency rules, duly vetted by the SIB under principles laid down in the Bill, to carry out those rules notwithstanding any provisions of insolvency legislation.

12. The advantage of this approach is that it limits the damage done to the principles of the Insolvency Act (all creditors to be treated alike), by restricting the special treatment to markets which have proper rules on this subject. The disadvantage is that it is more complex than generic amendment of the Insolvency Act, it adds to the SIB's duties when the SIB has quite enough to do already, and it risks something of a rerun of the themes of the Financial Services Act in Parliament.

13. The approach we intend to recommend on the CGO provisions is to protect assets in assured payment systems listed by the Treasury under subordinate legislation on the recommendation of the Bank - we will of course let Treasury Ministers see detailed proposals when the work has gone a little further.

A[illegible] and repurchase transactions (item 13) below the lim[illegible]uld be exempt only where both counterparties are listed institutions and are acting as principal.

13 A 'wholesale counterparty' is a person other than a listed institution who has entered into a transaction at or above the minimum limits during the past 18 months with, or as a result of arrangements by, a firm on the Bank's list in one of the relevant Financial Services Act instruments (items 6 to 12). *These include some transactions which do not constitute investment business: for example, a bank issuing its own CDs.* Such a person is, however, a 'wholesale counterparty' *only* in relation to the counterparty with whom he or she carried out that transaction. For example, investor A carries out a transaction in a debenture worth £120,000 with listed institution B. For the next 18 months B will be exempt in respect of any further transaction with A in any relevant instrument (items 6 to 12) regardless of the size of the transaction. But the transaction between A and B will not entitle another listed institution, C, to treat A as a 'wholesale counterparty'.

14 Any listed institution which proposes to enter into a transaction over the minimum limit with a customer who would thereby become a 'wholesale counterparty' in relation to that institution must warn its customer of the consequences in terms of loss of protection under the Act *before* entering into the transaction. Wholesale counterparties should thereafter be reminded, by appropriate wording on the written confirmation of exempt deals, that the transaction is *not* protected by the Act but is subject to the London Code of Conduct. This requirement is discussed in greater detail below in paragraph 36 of Chapter II.

15 It will be open to a listed institution to decide that it will only deal with certain types of 'wholesale counterparty'. It might, for instance, decide as a matter of practice to deal under the limit only with those counterparties whose last transaction over the limit was within the previous year, or some other period of less than eighteen months. However it has no discretion over the statutory period for which they will remain wholesale counterparties, and should ensure that any such practice cannot compromise the intentions of the Act.

16 In cases other than those covered in paragraphs 12 and 13, the Bank will not regulate small transactions or transactions to which neither counterparty is listed. Such transactions in instruments which fall within the definition of investments under the Financial Services Act (items 6 to 13) will be regulated under that Act. The taking of deposits irrespective of size is regulated under the Banking Act.

The conditions and arrangements for listing

17 Section 43 of the Financial Services Act requires the Treasury to approve the conditions which the Bank will impose for admission to the list, and the arrangements it will make for admission to and removal from the list. The conditions and arrangements which the Treasury has for the time being approved are as follows:

An applicant will need to satisfy the Bank that it is 'fit and proper', by reason of its capital, managerial and operational resources, its standards of business conduct and its high reputation and standing, to undertake the particular activity and also that it acts on a regular basis as a market maker, ~~or~~ broker or clearing house in one or more of the wholesale market instruments. In determining whether an applicant meets these conditions, the Bank will take into account the following factors:

- *(a) that the financial position of the applicant is sound;*
- *(b) that its ownership structure does not result in any unacceptable conflicts of interest, nor is in any other way a source of potential weakness;*
- *(c) that its management and staff are of high quality and appropriate experience and that its systems are effective;*
- *(d) that its reputation in the market place is good;*
- *(e) that it is able and willing to adhere to an undertaking to observe the London Code of Conduct, as specified by the Bank of England from time to time;*
- *(f) that it acts as a market maker (either as principal or as agent for related principals), ~~or~~ broker or clearing house in one or more of the wholesale market instruments.*

A firm applying for inclusion on the list will be required to submit a business plan setting out the type or types of activity it intends to undertake, including types of instrument (and currencies) in which it intends to trade. Its permitted scope will be limited to those activities agreed with the Bank, subject to review.

Applicants should supply any information requested by the Bank which the Bank reasonably requires to form its view on the application.

Applications should in any event, unless explicitly agreed with the Bank, include the business plan described above, a description of the applicant's organisation and staff resources, details of ownership, information on directors and managers, and details of internal control systems. Where appropriate, applicants should specify which of their operations are already supervised, and by whom.

The Bank will also require the applicant's latest audited accounts. Where it would fall to the Bank to assess an applicant's capital adequacy, the applicant will be asked for any additional information necessary to demonstrate its financial soundness.

The Bank will aim to give its decision within three months of receiving an application. Where the Bank is minded to reject an application, it will give the applicant notice of that fact and specify its reasons. The Bank will allow the applicant reasonable opportunity to make representations and will consider any representations made before coming to a decision.

CONFIDENTIAL

Papers PSE

FROM: P S HALL

DATE: 20 August 1987

1. MR ILETT

2. ECONOMIC SECRETARY

This outcome is consistent with the Chancellor's letter to Lord Young; while postponement is unfortunate, it is inevitable and is essentially a matter for DTI Ministers' political judgement.

M. 20/viii

cc: PPS
PS/Financial Secretary
Sir P Middleton o.r
Sir G Littler o.r
Mr Cassell o.r
Mrs Lomax
Mr Peretz
Mr Scholar
Mr McIntyre
Miss Noble
Mr Neilson
Mr Cropper

PS/IR
Mr Munro IR

FINANCIAL SERVICES ACT TIMETABLE

You will recall that on 4 August the Chancellor replied to Lord Young's letter of 20 July about the delay in the FS Act timetable (a copy of the relevant Ministerial correspondence is attached for ease of reference). The DTI and DHSS have now decided to make public announcements about the delay in the FS Act timetable and the implications for personal pensions (PPs) on Wednesday 26 August. Copies of the draft press releases are attached as Annexes A and B.

2. The main developments since Mr Ilett's minutes of 30 July and 3 August are that DTI have formally decided to refer to early April 1988 for implementation of the FS Act authorisation regime, whereas DHSS are to announce 1 July for personal pensions. However, it is clear from the wording of DTI's press release and from official discussions that DTI accept there is a considerable risk that early April will not be met. One of the points which influenced DHSS's decision to announce 1 July is the recent, very low key announcement by the SIB that some SIB rules (in particular those on disclosure of benefits and commissions and those which require cooling off periods - which

are very important for PPs) will not come into force until 1 July 1988.

3. This difference in operative dates may prove somewhat embarrassing politically for DTI, but, as Mr Ilett pointed out in his minute of 3 August, whether or not to allow more time for the FS regime is a political decision which DTI ministers are best placed to take. I understand that DTI intend to circulate the final draft of their press statement to ministerial colleagues early next week for information only. I do not think that the present draft of the DTI press release requires any comment by Treasury Ministers.

4. As to the statement on PPs, the Inland Revenue now consider that some relatively minor tax implications will result from the delay in the implementation of the Financial Services Act regime. Mr Munro is putting up a separate submission to the Financial Secretary about these tax implications and about any statement about the tax position of PPs which might be included in the DHSS press release.

5. We suggest that the DHSS press release does not need to mention any of the difficulties we have been experiencing over deposit based PPs. However, one advantage of the delay to 1 July 1988 is that the longer timetable does give us considerably more time to resolve our problems on this type of PP.

6. We would be grateful for your authority to give the Treasury's agreement to the DTI and DHSS announcements, subject of course to the Financial Secretary's views on the tax point.

P S Hall

P S HALL

ANNEX A

FROM 01 222 9280 '87.08.20 15:08

270 5553

DRAFT PRESS NOTICE

TIMETABLE FOR IMPLEMENTATION OF FINANCIAL SERVICES ACT

Francis Maude, Corporate Affairs Minister, today (xxxx) urged firms carrying on investment business to be ready to apply for authorisation under the Financial Services Act before the end of the year.

He said:

"We intend to implement this at the beginning of April. This demanding timetable means that investment businesses must be ready to apply for authorisation by the end of the year, or they risk losing the right to carry on their business. That means they need to be thinking about it now: not just the big City firms, but everyone who advises on investments, in every High Street in every town. There is much to be done before the new system can be brought fully into force. But the Government believes that it is important to press ahead as quickly as possible so that investors can receive the protection afforded by the Act."

Mr Maude said that it was the Government's intention to implement section 3 of the Financial Services Act, which will make it a criminal offence to carry on investment business in the United Kingdom unless authorised or exempted, in early 1988.

The Financial Services Act is being brought into effect in stages. Four self regulating organisations (SROs) have already applied to the Securities and Investments Board for recognition under the Act and a fifth application is expected shortly.

The Director General of Fair Trading is examining the rules of those organisations which have applied to see whether any are likely to have anti-competitive effects. He hopes to submit his reports to the Secretary of State by the middle of November. The Secretary of State will consider these reports and decide whether to give leave for their recognition by the Securities and Investments Board. (These procedures are established in the Act.) If so, it is expected that the five SRO's will all be recognised by early December.

The Act provides that a person who has applied for membership of an SRO by a particular date (P-Day) and whose application has not been determined by the day on which section 3 comes into force (A-Day) will receive interim authorisation for the period until his application is settled. If all the SROs are recognised in early December it should be possible to set P-Day for the middle of January and A-Day in early April 1988. Any business which needs authorisation and has not applied for it before P-Day is very unlikely to receive it in time to be able legally to carry on investment business after A-Day.

NOTES TO EDITORS

1 The four SROs who have already applied to the SIB for recognition under the Act are the Financial Intermediaries and

Brokers Regulatory Association (FIMBRA), The Securities Association (TSA), the Investment Management Regulatory Organisation (IMRO) and the Association of Futures Brokers and Dealers (AFBD). The Life Assurance and Unit Trust Regulatory Organisation (LAUTRO) is expected to apply shortly.

2 Anyone who is uncertain about how the Act affects their activities should contact the SIB or the relevant SRO. A free introductory guide to the Act is also available from the Department of Trade and industry, Room G07, 10/18 Victoria Street, London SW1H ONN. Telephone 01 215 3065.

ANNEX B

DRAFT PRESS RELEASE

REFORMING SOCIAL SECURITY: NEW TIMETABLE FOR PERSONAL PENSIONS

The start date for the new personal pensions introduced by the 1986 Social Security Act is to be postponed for six months in the light of ~~following a delay~~ ~~to~~ the latest timetable for bringing in investor protection rules under the Financial Services Act. The decision was announced today by Michael Portillo, Parliamentary Under Secretary of State for Social Security.

Mr.Portillo said:

"When we decided that personal pensions as an alternative to the State earnings-related pension scheme should be available from January 1988, we expected that the new Financial Services Act framework would be in operation by that date. It is now clear that the ~~main~~ provisions of that Act cannot be in force before April. Moreover, the recent announcement by the Securities and Investments Board that certain key rules affecting consumers' rights cannot be brought into force until 1 July 1988 makes it prudent for us ~~leaves us with no option but~~ to defer the start date for the new personal pensions until July.

"~~We are disappointed not to be able to adhere to the January start date.~~ The Government must however give priority to ensuring that anyone taking out one of the new personal pensions should benefit from the investor protection measures introduced by the Financial Services Act, or equivalent safeguards. ~~Indeed, in the light of representations made to us, we believe that this relaxation of the time table will be generally welcomed by pension providers.~~

"The announcement ~~postponement~~ does not alter the timing of the important reforms affecting occupational scheme provision introduced by the 1986 Act. Money-purchase contracting out, the right not to belong to an employer's scheme, and the measures associated with them, will come into force as planned on 6 April 1988. Nor is there any change in the right to backdate membership of a contracted-out personal pension scheme to 6 April 1987, so people taking out a personal pension before 5 April 1989 will still be able to have the extra year's National Insurance rebate and incentive payment."

NOTES FOR EDITORS

1. A statement on the Financial Services Act timetable is issued /today/ by the Department of Trade and Industry.

2. The Securities and Investment Board rules which will not come into force until 1 July 1988 are those covering the illustration of benefits, disclosure of product particulars and disclosure of commissions on life assurance and unit trusts. Cancellation Rules, requiring a 14-day "cooling-off" period, are also deferred until 1 July.

3. The operative dates of certain powers in the Social Security Act 1986 and of the relevant regulations made under the Act will be amended to reflect the July start date.

3762/057

FROM: G R WESTHEAD
DATE: 21 August 1987

MR P S HALL

cc PPS 2
PS/Financial Secretary
Sir P Middleton o/r
Sir G Littler o/r
Mr Cassell o/r
Mrs Lomax
Mr Peretz
Mr Ilett
Mr Scholar
Mr McIntyre
Miss Noble
Mr Neilson
Mr Cropper

PS/IR
Mr Munro - IR

FINANCIAL SERVICES ACT TIMETABLE

The Economic Secretary has seen and was grateful for your submission of 20 August and is content for you to proceed as you propose in your paragraph 6. He has commented that DTI seem to be aware that investment firms need spurring into action as well as SROs meeting deadlines.

Guy Westhead

GUY WESTHEAD
Assistant Private Secretary

Inland Revenue

Policy Division
Somerset House

Papers P2l.

FROM: N C MUNRO
24 August 1987

Financial Secretary

FINANCIAL SERVICES ACT TIMETABLE

1. Mr Hall's minute of 20 August to the Economic Secretary notes that the decision to delay the introduction of personal pensions has some minor tax implications.

2. The problem is this. The legislation in this year's Finance (No2) Act introduces the new tax regime for personal pensions with effect from 4 January 1988. Since personal pensions will take the place of retirement annuities (or 'Section 226 policies'), the legislation prevents any new retirement annuity contracts from being made on or after that date.

3. Section 226 restricted retirement annuity business to institutions 'lawfully carrying on in the United Kingdom the business of granting annuities on human life' - ie insurance companies and friendly societies. This year's personal pensions legislation further opens up the field, from next January, to unit trusts, banks and building societies.

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cc Chancellor of the Exchequer
Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Cassell
Mrs Lomax
Mr Peretz
Mr Scholar
Mr McIntyre
Miss Noble
Mr Ilett
Mr Neilson
Mr P S Hall
Mr Cropper
Mr Isaac
Mr Beighton
Mr Corlett
Mr Lusk
Mr Munro
Miss McFarlane
Mr Hinton
PS/IR

4. The relevant provision is Section 20 of this year's Act. This follows the approach adopted by the DHSS legislation on personal pensions, and prohibits the establishment of personal pension schemes by any person other than:

i. a person authorised under the Financial Services Act to carry on insurance or unit trust business;

ii. a building society within the Building Societies Act;

iii. a bank or other institution within the Banking Acts of 1979 or 1987.

5. The delay in implementing the Financial Services Act has no implications for banks and building societies, which are subject to different rules for investor protection. The problem arises with insurance companies and unit trusts: because the relevant part of the Financial Services Act will not be in force by January 1988, such institutions could not be authorised under it.

6. Our earlier advice (Mr Hinton's minute of 16 July) was that any hold-up at the DTI or DHSS end should not necessarily delay the implementation of the new tax regime for personal pensions and free-standing AVCs (which will commence on 26 October this year). For AVCs, that remains our view.

7. For personal pensions, we have had second thoughts. It would be possible to bring in the new tax regime on 4 January (amending Section 20 by Treasury Order so as to include insurance companies and unit trusts under present legislation). But we wonder whether a better course might not be to delay the implementation of the new tax regime (as is clearly implied in the Chancellor's letter of 4 August to Lord Young).

8. The <u>advantages</u> of this approach are:

- it is consistent with what DTI and DHSS Ministers have agreed;

- it would give personal pension providers more time to prepare for the new market, and occupational schemes more time to prepare for what they see as the new threat; and

- it would allow more time for the ironing-out of a possible legislative wrinkle in the Building Societies Act, which may inhibit their ability to offer deposit-based personal pensions (currently being considered by the Economic Secretary).

9. The <u>disadvantage</u> of this approach is that it would require minor legislation in next year's Finance Bill, to amend this year's Finance (No2) Act - so that the existing retirement annuities legislation could remain in force until 1 July 1988. But this would probably be short, uncontentious and straightforward.

10. If you are content to proceed in this way, an announcement would be necessary. Ideally, this should be made on Wednesday to link up with the announcements by Mr Maude and Mr Portillo. I attach a draft for your consideration.

Ncm,

N C MUNRO

DRAFT INLAND REVENUE PRESS RELEASE

"Today's announcement that the introduction of personal pensions is to be postponed has implications for the tax legislation in the recent Finance Act", said the Rt Hon Norman Lamont MP, Financial Secretary to the Treasury. "Amending legislation will be included in next year's Finance Bill".

"Legislation is required because this year's Act provided for the introduction of personal pensions from 4 January 1988, and the consequential phasing-out of the tax regime for retirement annuities. With the postponement of the start date for personal pensions, we need to legislate so that retirement annuities can continue for a further six months".

NOTES FOR EDITORS

1. The new tax regime for personal pensions is contained in the Finance (No2) Act 1987 (Sections 18 to 57 and Schedule 2). It replaces the present retirement annuities legislation in Section 226 et seq of the Income and Corporation Taxes Act 1970. With effect from 4 January 1988, no new retirement annuity contracts can be made (although premiums can continue to be paid, with full tax relief, to regular premium contracts made before that date).

2. The postponement by six months of the commencement date for personal pensions necessitates a similar postponement in the phasing out of retirement annuity contracts. This year's legislation therefore has to be amended in a number of places, and the necessary provisions will be included in next year's Finance Bill.

PRESS-R.DRA

3362/13

FINANCIAL SECRETARY TO THE TREASURY

ND

FROM: N WILLIAMS
DATE: 25 August 1987

Janet - pse let me have this back when you find other papers!

Cathy Nigel says these are now in.
C.

MR MUNRO IR

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Cassell
Mrs Lomax
Mr Peretz
Mr Scholar
Mr McIntyre
Miss Noble
Mr Ilett
Mr Neilson
Mr P S Hall
Mr Cropper
PS/IR

FINANCIAL SERVICES ACT TIMETABLE

1. The Financial Secretary was grateful for your minute of 24 August.

2. He is content to proceed in the way that you suggest and is also content with the draft Press Release attached to your minute.

N Williams

NIGEL WILLIAMS
(Assistant Private Secretary)

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

FROM: N C MUNRO

13 November 1987

1. Mr Isaac 13/11

2. Financial Secretary

FINANCE BILL 1988: STARTER 151

PERSONAL PENSIONS

1. You have already agreed to a minor provision changing the start date for personal pensions, and the necessary legislation has virtually been drafted.

2. The purpose of this note is to identify a few additional technical problems that we have discovered in this year's personal pensions legislation.

3. One is potentially awkward, since it conflicts with DHSS policy on contracting-out of SERPS. The others are minor tidying-up measures which in themselves probably do not matter too much. But, since we shall be legislating anyway in this area, I hope you agree that they should be cleared up.

---

cc Chancellor of the Exchequer
Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Cassell
Mr Scholar
Miss Peirson
Miss Sinclair
Mr McIntyre
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill
Mr Isaac
Mr Beighton
Mr Corlett
Mr Lusk SFO
Mr Munro
Mr Hinton
Mr Annys
PS/IR

Mr Jenkins (Parliamentary Counsel)

4. The amendment to deal with the contracting-out point would be welcomed by the industry, which is becoming aware of the problem. The others would generate very little interest.

The contracting-out point

5. The problem arises in connection with personal pension schemes which are used for contracting-out of SERPS.

6. One representation which you did not accept was that members of contracted-in occupational pension schemes should be able to contract-out of SERPS through a special personal pension without having to leave their scheme. The personal pension would be 'special' in the sense that the only contribution it would receive would be the DHSS 'minimum contribution' - in other words, neither the employee nor his employer would contribute directly to it.

7. This idea was rejected because of the practical impossibility of enforcing the occupational pension benefits. So anyone in a contracted-in scheme who wants to contract-out on an individual basis has a choice:

a. He can leave his scheme and take out a contracted-out personal pension; or

b. He can remain in his scheme and (in most cases) contract-out with a free-standing AVC (which will be subject to the benefit limits).

8. In both cases it is DHSS policy that the contracting-out can be effective from 6 April 1987 for arrangements entered into before 6 April 1989: in other words it can be backdated.

9. The legislation - Section 30(2)(b) of this year's Finance (No2) Act - prevents someone from participating simultaneously in an occupational pension scheme and a personal pension scheme - as we intended. But it also effectively prevents someone who leaves a scheme before 6 April 1989 from backdating his contracting-out - which we did not intend. This is because he is prevented by our legislation from having a personal pension in respect of any period when he was a member of an occupational pension scheme.

10. Nor will the problem go away after April 1989. Because, under DHSS requirements, an individual can only contract-out for the whole of a tax year, anyone leaving a contracted-in scheme in the middle of a tax year could only be contracted-out from the beginning of the next tax year.

11. The second aspect of the problem (paragraph 10) arises from DHSS policy. But we understand that an amendment to their policy would create considerable operational difficulties. And it would not solve the paragraph 9 problem. Both problems however could be resolved relatively easily through a small change in the tax legislation.

<u>Minor changes</u>

12. The other points are very small and, so far as we know, have not yet been spotted by the industry. These were unfortunately overlooked when we were instructing Parliamentary Counsel earlier this year.

a. <u>Paragraph 3, Schedule 2</u>

This extends to personal pension schemes the statutory tax exemption for lump sums conferred by Section 14(1) Finance Act 1973. But there has always been a defect in Section 14 in that it only refers to lump sums paid <u>on retirement</u>. Strictly speaking, therefore, a lump sum paid on the due date is not exempt if the recipient does not in fact retire. In the past we have dealt with this point through a discretionary practice, but there may be an advantage in legislating for it now. It would need a couple of lines.

b. Section 16 Finance Act 1973

This provision imposes an income tax charge on discretionary trusts but excludes (Section 16(2)) occupational pension schemes established under irrevocable trust. It does not however exclude personal pension schemes established under trust, as those offered by non-insurers must be. (The problem does not arise with retirement annuities, which can only be offered by insurance companies.) Again, the necessary amendment would be short and uncomplicated.

Conclusion

13. Since we shall be legislating anyway on the start date, we recommend that these further amendments be made. In total they should amount to less than half a page. If you are content, we also recommend that a low key announcement should be made about the contracting-out point, to quell the concern which some people in the industry are beginning to feel.

Norm,

N C MUNRO

CONFIDENTIAL

3362/13

pnp

MR MUNRO - IR

FROM: MISS S J FEEST

DATE: 23 November 1987

cc Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Cassell
Mr Scholar
Miss Peirson
Miss Sinclair
Mr McIntyre
Mr Cropper
Mr Tyrie
Mr Call
Mr Jenkins (Parly Counsel)
PS/IR

PERSONAL PENSIONS: STARTER 151

The Financial Secretary was grateful for your minute of 13 November 1987 and agrees that the minor amendments should be made.

SUSAN FEEST
Assistant Private Secretary