

Part A

# TREASURY

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Part A

Working Group On The Law  
And Conventions Governing  
Pension Funds

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REFER TO

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DATE

1983

THIS FOLDER HAS BEEN  
REGISTERED ON THE  
REGISTRY SYSTEM





PS/Secretary of State

cc Mr Reid

During his recent meeting with Mr Sharp the Secretary of State indicated that he would be interested to read the attached report of the Inter-Departmental Working Group on the Law and Conventions Governing Pension Funds. I should be grateful for the return of the document when the Secretary of State is finished with it.

W COOK  
PS/K J Sharp  
Head of the Government Accountancy Service  
Room 910 Ashdown House  
123 Victoria St  
212 6692

20 June 1983





*Pension  
file*

PS/Secretary of State (Mr Coll)

cc as on attachment  
Mr Reid o/r

QUEEN'S SPEECH AND LEGISLATION COMMITTEE:  
SOCIAL SECURITY BILL

I attach briefing for the meeting of this Committee on 24 June, which Mr Reid has asked me to deliver to the appropriate Minister.

2 You have told me that none of our Ministers is a regular member of this Committee, that non-members are not being invited to tomorrow's meeting, but that Treasury Ministers are represented amongst the regular membership. In view of the form of Mr Reid's recommendation, I do not think we should need to press for representation at this meeting if possible, but the Secretary of State may wish to have notice of the Departmental interest in this Bill in advance of the discussion of the legislative programme in Cabinet. Fuller briefing is in preparation.

*RW*

R M WATSON  
CL1C  
Rm 504, S/B  
215 5361

23 June 1983







QUEEN'S SPEECH AND FUTURE LEGISLATION COMMITTEE

SOCIAL SECURITY BILL

This Bill will be before the QL Committee but its content has not been determined. Specifically it has not been decided whether it shall contain provisions relating to the disclosure of pension fund information and the regulation of the funds themselves. Both matters are likely to come to the H Committee shortly.

At the QL Committee it is very desirable that these questions should be kept open and that a decision on the size and timing of a Social Security Bill should not be allowed to pre-empt the policy decision and when that decision is given effect. We understand (via the Treasury) that Dr Rhodes Boyson wants to deal with the pension funds but not in this session. We (and the Treasury) believe that the decision about timing should be a matter for collective ministerial decision in the light of a policy paper. Accordingly I recommend that you should support the objection that a Treasury Minister is being advised to make to clearing any Social Security Bill in a form which pre-empts the decision of the H Committee about the session in which there is legislation on pension funds.

*RM*

*PP* M H M REID  
CL.  
Rm 502 S/B  
215 5962

23 June 1983

cc Ministers  
Sir Anthony Rawlinson  
Sir Brian Hayes  
Mr Sharp ✓  
Mr Dell  
Mr Leeming ICB  
Mr Kemmis SF1  
Mr Watson CL1



cd to  
~~Somerset~~ 24/6  
Reference .....

*Pensions folder*

Mr Winkett ICB1

cc PS/Mr Sharp  
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Mr Kemmis SF1  
Mr Watson CL1

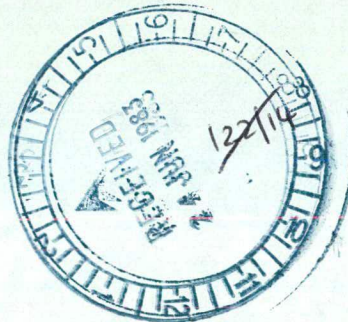
I attach the draft of a paper I propose to put up about the Partridge report. I have tried to treat your point of view fairly but I shall be very ready to modify it if you want me to. I gather time is relatively short. An H Committee paper may come round in a week or ten days time.

May I have comments by the close of June 28, please.

*M.H.M. Reid*

M H M REID  
CL  
Rm 502 S/B  
215 5962

24 June 1983





DRAFT MINUTE TO:-

Mr Fletcher

cc PS/Secretary of State  
PS/Sir Anthony Rawlinson  
PS/Sir Brian Hayes  
Mr Sharp  
Mr Dell  
Mr Leeming ICB  
Mr Kemmis SF1  
Mr Watson CL1

#### PENSION FUND LAW

A report from an inter-departmental official committee appointed last year by the H Committee is about to come to Ministers. It deals with the provision of information to members of private pension funds, accounting requirements for such funds, the question whether trust law is an adequate basis for them and whether or not there should be a supervisory system comparable to those for other major financial institutions.

2 The group was set up as a result of a proposal from Lord Cockfield that consideration should be given to creating a supervisory system for the pension funds about which at present relatively little information is publicly available. A copy of the report is attached.

3 The working party agreed that members of pension funds should be given a clearer idea of what their legal rights to a pension amounted to. This is often not very much and the pension paid is in practice worth more than the legal entitlement with the employer normally making up the difference.

4 The Social Services Secretary announced at the time the working party was set up that the Government were committed to the principle of greater disclosure of pension fund accounts. The group is agreed on the framework of the accounts and what other information should be disclosed. They also agreed that the accounts should be independently audited by qualified auditors. A summary is set out in Annex 3.

5 After considerable argument and hearing a variety of opinions the group came to the conclusion that trust law provided a satisfactory basis for the administration of pension funds but that it required amplification in statute for a number of purposes - most obviously of course in respect of disclosure and accounting formats.



6 The group agreed that there should be an obligation on pension funds to deposit accounts with a Registrar who would have an obligation to make them available to the public. It disagreed as to whether or not a Registrar (or a Minister) should have any power of supervision and intervention.

7 The Department of Trade (as was) took the lead in arguing that there was enough anecdotal evidence of malpractice to make a supervisory system appropriate. Such systems had been created for the banks, the building societies and the insurance companies as a result of scandals when there was no adequate supervisory authority and it is current City gossip that the pension funds are likely to be the place where the next scandal will emerge. The note annexed to this minute prepared by a leading firm of actuaries is the only specific evidence we have of malpractice but in the nature of things fraud is not likely to be detected in organisations which are under no obligation to produce accounts or to submit to audit.

8 Fraud is not, however, the only or the major risk. There are no standards other than those of trust law to indicate what constitutes a prudent investment policy. Self-investment is widely practised even though it means that the employees of a firm which becomes insolvent lose not merely their employment but their pensions also. There are no rules relating to the spread of risk, to the incurring of exchange risks or to investment in non-income producing assets (old silver, **Pissarro**s etc). It is likely that the disclosure provisions will reveal a considerable range of imprudent investments, perhaps particularly in the smaller and less professionally managed schemes.

9 The Department of Trade argued that it would be unsatisfactory for Government to be left in the position of having to tell pensioners and potential pensioners dissatisfied about the handling of "their" assets that they must bring action for breach of trust in the Chancery Division. In any event without any prudential standards being established in statute it was quite unpredictable how the Chancery Court would determine such actions if pensioners were able to afford to bring them.



10 The Department of Trade accordingly argued that there should be a power to make prudential rules comparable but by no means identical to those applying to life insurance companies and that the Registrar should have powers to inspect books and papers in the same way that the Department of Trade can inspect companies and that he should have a power to require imprudent practices to be put right subject to an appeal to the court. The Registrar would of course have a power and indeed a duty to prosecute dishonesty when he found it.

11 The majority of members of the working group took the view that the case for a supervisory regime was not made out. It was not established that either imprudence or dishonesty was widespread and disclosure would itself be a substantial safeguard for the future. Pension fund trustees normally were closely related to employers and ~~thus~~ had an interest in the efficient and honest management of the fund since otherwise they would be likely to have to make it up. In any event recourse to the courts would rarely be necessary since Trade Unions or other bodies representing employees would be in a position to put pressure on trustees through the employer to put an end to imprudent or improper practice.

12 The decision between these two positions is likely to be the major issue before Ministers when the matter comes back to the H Committee.

13 Representatives of the Department of Industry sought to limit the obligations which were imposed on small firms as a result of new legislation relating to pension funds. The group however concluded that the funds of small firms should not be exempted from the disclosure requirements since it was probable that they were the least well run of all schemes and there was no reason why the employees of small firms should be at a disadvantage in respect of the security of their pensions. The disclosure requirements for ~~any short~~ <sup>insured</sup> schemes will however be substantially less than for ~~well~~ <sup>self</sup> administered schemes and this is likely to reduce the burden for many small firms.

14 After consulting colleagues in other parts of the Department who were concerned in the working group I recommend that there is a good case not



merely for proper disclosure of the affairs of funds to members and the interested public but that there should be a power to make prudential rules relating to investments, a power to make spot checks into the books and papers of funds and a power to intervene to require bad practice to be stopped and/or reversed. This would mean the appointment of a Registrar with a professional staff able to form a view about the affairs of pension and qualified to intervene effectively. The group thought that a staff of about 100 would be needed over a period; and that the expenses should be met from registration fees levied on the funds. Since the funds are probably worth about £100 billion and the running costs would be perhaps £3 million the charges would be low and much less than those arising from disclosure.



## HOW MUCH DOES AN INVESTMENT MANAGER CHARGE FOR HIS SERVICES?

About five years ago a memo was circulated which dealt with the methods which Investment Managers can use to obtain additional remuneration from their discretionary pension clients. It was hoped that publicity would be given to some of the practices and that this would lead to change. Although a few investment managers now assure their clients that they only obtain remuneration from their direct (scale) fee, the vast majority still make use of a number of ways of obtaining additional remuneration.

In January 1978 the National Association of Pension Funds published a list of questions which trustees should ask when they interview potential investment managers. Although their list is heading in the right direction, it only touches the edge of the problem and it is a great pity that the NAPF has been unable to follow this through to obtain a radical change in the system.

This note outlines and comments on the various methods of remuneration available to investment managers.

### 1. Scale Fees

Apart from Stockbrokers who generally make no charge for managing a discretionary pension fund, apart from commission on dealing, investment management organisations generally charge a scale fee based on the value of the assets under management. These fees are normally of the order of 0.2% - 0.3% of the market value of the fund per annum. Even for a fairly large fund, 0.3% of the value of the assets often does not come to a great deal of money when compared to the cost of the services which investment managers offer. The levels of scale fee in the U.K. are probably uneconomic as they stand and are much lower than the levels seen in the U.S. where indirect sources of remuneration are not permitted.

### 2. Fixed Fees or Fees related to dealing?

The manager could receive income for investment advice (and in some instances for acting as Custodian Banker) in a number of ways, for example, in the form of a fixed fee, a fee depending on the value of the portfolio or from profits and



commission arising from dealing on behalf of the portfolio. Since the client's aim is to achieve the maximum return from his investments commensurate with an acceptable level of risk, it is desirable to ensure that the fee structure does encourage the investment manager to achieve this aim. Although as mentioned above, it is common to charge a scale fee which varies with the value of the portfolio, it is quite reasonable to argue that a manager should only receive a fixed fee for giving investment advice, since the time required does not directly depend on the size of the portfolio. However, some form of fee related to the size of the portfolio is usually charged since managers would argue that larger clients need more attention. There is certainly a case for clients to negotiate a fixed fee, with a separate fee negotiated for any Custodian Banking services, so that the latter can be directly compared with the Custodian services offered by the Clearing Banks.

Fees related to dealing are most undesirable from the client's viewpoint since it cannot be argued that the value of investment advice is related to the level of turnover of the portfolio, and furthermore there is no evidence to suggest that funds which deal actively have better investment performance than funds which deal infrequently (in fact, we suspect the opposite). Moreover, the profits which can accrue to the investment manager on dealing can be much larger than the investment management fee on the scale basis. It is undesirable for a client to be unaware of the income which his investment manager is receiving on dealing, but this is the case for the vast majority of investment managers.

Stockbrokers generally receive all their remuneration from a pension fund from commission when they deal, and there is always the suspicion that the broker may deal more than is necessary, to enhance his remuneration. Comparisons can be made of the levels of turnover of securities in funds managed by stockbrokers and other institutions, but this can be misleading since most of the other institutions are also receiving substantial amounts of money from dealing.

### 3. Dealing Profits

Some of the ways in which the investment manager makes money when dealing on behalf of the portfolio are discussed below:

- (i) Investment manager acts as agent in deals using a contract note from the stockbroker.

It is now quite rare to see a contract note from the stockbroker if the



investment manager is a licensed dealer in securities. If it is done in this way, and the institution is on the Stock Exchange Register of Authorised Recipients of Commission, the stockbroker will pay to the investment manager up to one quarter of the commission which he charges. The rates charged by the broker are determined by Rule 212 (2) Appendix 41 of The Stock Exchange, and range from 1.5% on the first £7,000 of the bargain to 0.17% on the excess over £1.75 million for equity purchases.

The advantage of the contract note coming from the stockbroker is that the client is sure that the prices of the deals were those available at the time of dealing and that the stock came from the Stockmarket or from a known source. This advantage might outweigh the additional commission payable.

(ii) Investment manager acts as agent in deals with contract note from the investment manager.

In general this is the method usually favoured by investment managers and it enables them to obtain a profit from commission differentials which is usually larger than the profit which would accrue to them if they dealt as agent with the contract note coming from the stockbroker. The institution will instruct the stockbroker to buy the shares and will be charged the Appendix 39 commission rate on Stock Exchange deals. This is a lower rate of commission than Appendix 41 and commissions range from 1.5% on the first £7,000 of a transaction to 0.125% on the excess over £1.75 million for equities. If the investment manager buys £1 million of an equity, it pays to the stockbroker the Appendix 39 commission rate applicable to the million pounds (£2,982.50). If it then allocates the shares to pension funds in parcels of £50,000, it receives commission from its clients equal to 20 times the individual commission for a £50,000 deal ( $20 \times £320 = £6,400$ ). It is possible for investment managers to make profits in excess of  $\frac{3}{4}\%$  of the value of the transaction, using this method, provided that they keep the list of equities which their clients hold small. This is because those deals made within the "continuation period" are treated for commission purposes as if they were a single deal. Hence, it is possible to buy the same equity through the same broker over a fairly long period and for all the deals to be aggregated together for the purposes of assessing the commission payable by the



Moreover the client does not have the guarantee that he has paid the lowest possible price for the shares which he has bought. This is because the investment manager will probably not have given the broker any details about the final recipient of the shares at the time of dealing; the broker would usually be told merely that it was for an XYZ Bank Limited account client. Since the ultimate recipient of the shares is "open" at the actual time of purchase, there is always the danger that the stock can be allocated to other accounts if it goes up in value during the day, but be booked to discretionary pension funds if it has not increased in value.

(iii) Investment manager acts as principal.

Although the investment manager will show that he has acted as principal on the contract note, stocks may be sold from one discretionary pension fund under the institution's management to another under the same management. Let us suppose that the Stockmarket price for a share is 99p - 101p. Pension Fund A sells to the XYZ Bank Limited at 99p less, say, an allowance for 1% commission and therefore receives 98p per share (approximately). Pension fund B buys at 101p plus a similar 1% commission and therefore pays a net price of 102p per share (plus, of course, stamp duty). The difference of 4p per share goes to the Bank and on a £50,000 transaction this amounts to £2,000. This is clearly a most reprehensible situation and gives the Bank an incentive to find an inhouse buyer before it puts the stock on the market. Since it has discretion for many of its pension fund clients, finding a buyer may be relatively easy!

(iv) Large lines of stock

When blocks of shares are bought outside the Stockmarket often at a substantial discount on the market price, the investment manager may decide to sell the stock it has acquired to discretionary pension funds at a smaller discount to the market price, so giving itself a "turn" on the deal. For example, if the shares are sold at a 10% discount on the market price, the investment manager may sell shares onto its clients at say a 2% discount to the market price giving itself an immediate profit equal to 8% of the value of the transaction. Of course, it can



be argued that the funds are still getting the stock at a discount and so they are better off than if they dealt direct. However, one must then ask the question as to whether the stock would have been bought at all in the normal course of events.

(iv) Unit trusts managed by the investment manager.

In recent years most of the leading managers have set up specialist unit trusts which are used for their own in-house clients. These unit trusts are often bought for funds which are quite large enough not to need the diversification advantages of unit trusts. From the manager's point of view, they make management of funds much easier, and in addition, and probably much more important, the manager often obtains an initial fee when it puts its clients into these trusts and an annual fee which is higher than the agreed annual scale fee for direct investment. It is, therefore, desirable for trustees to give their specific permission each time a purchase of in-house unit trusts is recommended.

(v) Deposits and other transactions.

Cash awaiting permanent investment is often held by the investment manager, and deposited with its banking department. Although some banks do have an independent way of calculating a fair rate of return on the money invested, others do not, and this can be a substantial source of profit to the bank. In addition, the manager can obtain remuneration from deals in the Foreign Exchange Market, since these transactions are also undertaken by the banking department.

(vi) Other interests of the adviser.

The corporate finance departments of financial institutions in the U.K. arrange new issues for clients and there is an obvious conflict of interest when discretionary pension funds managed by the same institution are asked to subscribe to (or underwrite) these issues. A procedure is needed to deal with such conflicts of interest.

(vii) General.

The note circulated by the NAPF in 1978 is attached and this gives



further useful guidance.

It is somewhat strange that action has not been taken to protect pension fund investors in the same way as unit trust investors. Perhaps the reason for this is that the trustees of a pension fund are thought to be able to protect their beneficiaries in an adequate way by direct negotiation with the institution concerned. In fact, apart from the very largest funds, the trustees are unable to exercise sufficient muscle to control the charges made by banks over and above the agreed scale fee and trustees of even large funds cannot be expected to have the sophistication and expertise needed to deal with all of the problems outlined above.

October 1981



This also came  
'Tuned Immediate'

Reference

*Penrose Rider*

KJ

Mr Winkett ICB1

cc PS/Mr Sharp  
Mr Leeming ICB  
Mr Kemmis SF1  
Mr Watson CL1

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24 June 1983

CODE  
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(ii) Investment manager acts as agent in deals with contract note from the investment manager.

In general this is the method usually favoured by investment managers and it enables them to obtain a profit from commission differentials which is usually larger than the profit which would accrue to them if they dealt as agent with the contract note coming from the stockbroker. The institution will instruct the stockbroker to buy the shares and will be charged the Appendix 39 commission rate on Stock Exchange deals. This is a lower rate of commission than Appendix 41 and commissions range from 1.5% on the first £7,000 of a transaction to 0.125% on the excess over £1.75 million for equities. If the investment manager buys £1 million of an equity, it pays to the stockbroker the Appendix 39 commission rate applicable to the million pounds (£2,982.50). If it then allocates the shares to pension funds in parcels of £50,000, it receives commission from its clients equal to 20 times the individual commission for a £50,000 deal ( $20 \times £320 = £6,400$ ). It is possible for investment managers to make profits in excess of  $\frac{3}{4}\%$  of the value of the transaction, using this method, provided that they keep the list of equities which their clients hold small. This is because those deals made within the "continuation period" are treated for commission purposes as if they were a single deal. Hence, it is possible to buy the same equity through the same broker over a fairly long period and for all the deals to be aggregated



Moreover the client does not have the guarantee that he has paid the lowest possible price for the shares which he has bought. This is because the investment manager will probably not have given the broker any details about the final recipient of the shares at the time of dealing; the broker would usually be told merely that it was for an XYZ Bank Limited account client. Since the ultimate recipient of the shares is "open" at the actual time of purchase, there is always the danger that the stock can be allocated to other accounts if it goes up in value during the day, but be booked to discretionary pension funds if it has not increased in value.

(iii) Investment manager acts as principal.

Although the investment manager will show that he has acted as principal on the contract note, stocks may be sold from one discretionary pension fund under the institution's management to another under the same management. Let us suppose that the Stockmarket price for a share is 99p - 101p. Pension Fund A sells to the XYZ Bank Limited at 99p less, say, an allowance for 1% commission and therefore receives 98p per share (approximately). Pension fund B buys at 101p plus a similar 1% commission and therefore pays a net price of 102p per share (plus, of course, stamp duty). The difference of 4p per share goes to the Bank and on a £50,000 transaction this amounts to £2,000. This is clearly a most reprehensible situation and gives the Bank an incentive to find an inhouse buyer before it puts the stock on the market. Since it has discretion for many of its pension fund clients, finding a buyer may be relatively easy!

(iv) Large lines of stock

When blocks of shares are bought outside the Stockmarket often at a substantial discount on the market price, the investment manager may decide to sell the stock it has acquired to discretionary pension funds at a smaller discount to the market price, so giving itself a "turn" on the deal. For example, if the shares are sold at a 10% discount on the market price, the investment manager may sell shares onto its clients at say a 2% discount to the market price giving itself an immediate profit equal to 8% of the value of the transaction. Of course, it can



be argued that the funds are still getting the stock at a discount and so they are better off than if they dealt direct. However, one must then ask the question as to whether the stock would have been bought at all in the normal course of events.

(iv) Unit trusts managed by the investment manager.

In recent years most of the leading managers have set up specialist unit trusts which are used for their own in-house clients. These unit trusts are often bought for funds which are quite large enough not to need the diversification advantages of unit trusts. From the manager's point of view, they make management of funds much easier, and in addition, and probably much more important, the manager often obtains an initial fee when it puts its clients into these trusts and an annual fee which is higher than the agreed annual scale fee for direct investment. It is, therefore, desirable, for trustees to give their specific permission each time a purchase of in-house unit trusts is recommended.

(v) Deposits and other transactions.

Cash awaiting permanent investment is often held by the investment manager, and deposited with its banking department. Although some banks do have an independent way of calculating a fair rate of return on the money invested, others do not, and this can be a substantial source of profit to the bank. In addition, the manager can obtain remuneration from deals in the Foreign Exchange Market, since these transactions are also undertaken by the banking department.

(vi) Other interests of the adviser.

The corporate finance departments of financial institutions in the U.K. arrange new issues for clients and there is an obvious conflict of interest when discretionary pension funds managed by the same institution are asked to subscribe to (or underwrite) these issues. A procedure is needed to deal with such conflicts of interest.

(vii) General.

The note circulated by the NAPF in 1978 is attached and this gives



further useful guidance.

It is somewhat strange that action has not been taken to protect pension fund investors in the same way as unit trust investors. Perhaps the reason for this is that the trustees of a pension fund are thought to be able to protect their beneficiaries in an adequate way by direct negotiation with the institution concerned. In fact, apart from the very largest funds, the trustees are unable to exercise sufficient muscle to control the charges made by banks over and above the agreed scale fee and trustees of even large funds cannot be expected to have the sophistication and expertise needed to deal with all of the problems outlined above.

October 1981

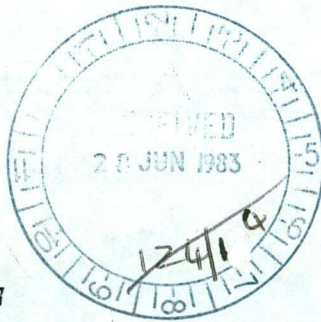


Pension Folder

KJ

- 1 Mr Winkett
- 2 Mr Reid - CL

c c PS/Mr Sharp  
 Mr Leeming  
 Mr Kemmis  
 Mr Watson - CL1



## PENSION FUND LAW

We discussed Mr Reid's draft submission to Mr Fletcher on the Report of the Partridge working group on this subject. In the light of our conversation, and the rather different emphasis you thought should be placed on the group's recommendations from that suggested by Mr Reid, I have put together the attached revised draft paper.

2 I have not attempted to redraft the final paragraphs on the differences between the then DOI and DOT positions regarding the need for a supervisory regime. However, you thought that Mr Reid should take account of the following points in redrafting these paragraphs:-

- (i) the former Department of Industry has not been persuaded of the need for supervision;
- (ii) the extra cost of a registry involving supervision as distinct from a registry which did not would amount to perhaps £2 million a year and 100 staff. This would be an additional and much-resented burden on employers. The OPB themselves argued that disclosure alone should be given a chance before any supervisory regime was contemplated (para 4.22);
- (iii) the question of departmental responsibility would arise. In Committee Mr Reid argued that supervision ought to be the function of a unit reporting to a Minister, and not to a quango. It seems probable that a deposit registry could be run by the OPB, but on that argument supervision would need to be done by a Department of State, at a cost in terms of staff. Ministers should be made aware of this.

3 Mr Kemmis may wish to comment further on the section of the draft paper dealing with the impact of the recommendations on small firms. I also suggest that the submission be copied to Mr Trippier (for his small firms interest) and to Mr Lamont who attended the meeting of H Committee when the decision was taken to establish the working group.

M R COHEN  
 IC(B)1a  
 Rm 313a Ashdown  
 212 0207  
 28 June 1983



DRAFT MINUTE

Mr Fletcher

c c PS/Secretary of State  
PS/Mr Lamont  
PS/Mr Trippier  
PS/Sir Anthony Rawlinson  
PS/Sir Brian Hays  
Mr Sharp  
Mr Dell  
Mr Leeming  
Mr Kemmis SP1  
Mr Watson CL2

PENSIONFUND LAW

Last year, H Committee accepted a recommendation by the Occupational Pensions Board (OPB) that occupational pensions schemes should be required to disclose information about their affairs to their members. The Committee set up a working group of officials to consider the need for a review of the "trust law" basis of such schemes and the responsibilities and powers of pension fund trustees. The group was also asked to consider the need for a supervisory regime for occupational pension schemes along similar lines to those operating for other ~~similar~~ institutions, as had been suggested by the then Secretary of State for Trade, Lord Cockfield.

2 The report of the working group is attached. The Government statement at the time the committee was established is at Annex 1 and the full terms of reference at Annex 2. A summary of the conclusions and recommendations is on pp 29 - 34. Mr Sharp, Mr Winkett (Department of Industry) and I were members of the working group.

Disclosure of Information

3 The group agreed that the information to be disclosed by a fund should be such as to permit a qualified adviser properly to understand its affairs. A summary of what the group considered should be disclosed is at Annex 4 to the Report.



4 The committee were concerned to avoid imposing unreasonable burdens on small firms (see paragraphs 3.10 - 3.13) but concluded that small firms should not be exempt from the disclosure requirements. The disclosure requirements should, however, be substantially less onerous for insured schemes than for self-administered ones and this is likely to reduce burdens on many small firms (it is estimated that over three-quarters of schemes applying to less than 100 employees are in the former category). Small Firms Division did not dissent from this conclusion but they have suggested that the material relating to Small Firms might be put more tentatively in any statement of Government conclusions.

#### Trust Law

5 The working group began its deliberations against a background of calls for a review of trust law in relation to pension schemes and its replacement by new legislation. However/<sup>in</sup>the course of the Committee's discussions there appeared to be a shift in outside opinion in favour of the view that in principle it was better to stick with trust law, and that any necessary amendments or clarifications, or extra provisions, should be built on this foundation. (The OPB made clear in their evidence to the committee that they took this view, and the TUC retracted an earlier call for new major legislation.) The committee therefore adopted this approach in its recommendations.

#### A Tracing or Deposit Registry

6 It is desirable at least that pension funds be required to supply certain minimum information to a public official, such as the names and addresses of trustees and the secretary, so that actual or potential beneficiaries know whom to contact. The group recommended that it would also be right to require such funds to deposit with a registrar the documents which they were required by the legislation



to disclose to members (the trust deed, and the annual report and accounts). These documents would then be available to the public.

### Supervision

7 The Committee was, however, divided on the question of whether the legislation should go further. The Department of Trade (as was) took the lead in arguing that there was enough anecdotal evidence of malpractice to make a supervisory system appropriate. Such systems had been created for the banks, the building societies and the insurance companies as a result of scandals when there was no adequate supervisory authority and it is current City gossip that the pension funds are likely to be the place where the next scandal will emerge. The note annexed to this minute prepared by a leading firm of actuaries is the only specific evidence we have of malpractice but in the nature of things fraud is not likely to be detected in organisations which are under no obligation to produce accounts or to submit to audit.

8 Fraud is now, however, the only or the major risk. There are no standards other than those of trust law to indicate what constitutes a prudent investment policy. Self-investment is widely practised even though it means that the employees of a firm which becomes insolvent lose not merely their employment but their pensions also. There are no rules relating to the spread of risk, to the incurring of exchange risks or to investment in non-income producing assets (old silver, Pissarro's etc). It is likely that the disclosure provisions will reveal a considerable range of imprudent investments, perhaps particularly in the smaller and less professionally managed schemes.

9 The Department of Trade argued that it would be unsatisfactory for Government to be left in the position of having to tell pensioners and



potential pensioners dissatisfied about the handling of "their" assets that they must bring action for breach of trust in the Chancery Division. In any event without any prudential standards being established in statute it was quite unpredictable how the Chancery Court would determine such actions if pensioners were able to afford to bring them.

10 The Department of Trade accordingly argued that there should be a power to make prudential rules comparable but by no means identical to those applying to life insurance companies and that the Registrar should have powers to inspect books and papers in the same way that the Department of Trade can inspect companies and that he ~~should~~ have a power to require improdient practices to be put right subject to an appeal to the court. The Registrar would of course have a power and indeed a duty to prosecute dishonesty when he found it.

11 The majority of members of the working group (including the representative of the then Department of Industry) took the view that the case for a supervisory regime was not made out. It was not established that either imprudence or dishonesty was widespread and disclosure would itself be a substantial safeguard for the future. Pension fund trustees normally were closely related to employers and thus had an interest in the efficient and honest management of the fund since otherwise they would be likely to have to make it up. In any event recourse to the courts would rarely be necessary since Trade Unions or other bodies representing employees would be in a position to put pressure on trustees through the employer to put an end to imprudent or improper practice.

12 The decision on supervision is likely to be the major issue before Ministers when the matter comes back to H Committee. The arguments are discussed in paragraphs 4.1-4.23 of the Report



JF3697

*Pension  
fund  
folder*

CONFIDENTIAL

MR COOK  
PS/K J Sharp

cc PS/Mr Reid CL

..... The Secretary of State was grateful to you for the loan of the report of the Working Group on the Law and Conventions Governing Pension Funds, which I return herewith.

*Ruth Thompson*

RUTH THOMPSON  
PS/Secretary of State for Trade & Industry  
Room 11.01, Ashdown House  
212 3301  
27 June 1983





Received  
June 1st  
1933

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Mr. C. C. ...  
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The Secretary of State was directed to you for the purpose of  
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Wm. L. Thompson

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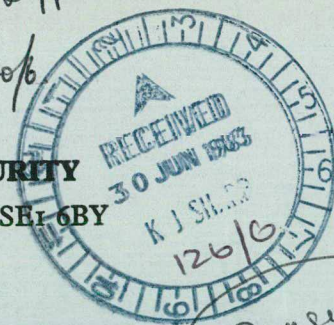


*I suppose this is O.K. but it has been cleverly drafted to ensure that the supervision option (N.B. the ordering of para 4 and the choice of words in para 5) - I think M Reid can look after himself though!*



*Phoned M Reid  
Mr Sharp will not initiate any rebuttal but will support Mr Reid if he wishes to do so.*

*C 30/6*



*Pensions folder*

**DEPARTMENT OF HEALTH & SOCIAL SECURITY**

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

Telephone 01-407 5522 ext 6905

K J Sharp Esq TD  
Department of Trade  
and Industry  
Ashdown House  
123 Victoria Street  
London SW1

29 June 1983

*Dear Ken,*

**WORKING GROUP REPORT**

As promised, I enclose a draft paper for H Committee to cover the submission of our report.

We have had a preliminary discussion with Mr Fowler and Dr Boyson, and they very much welcome our report. Mr Fowler is clearly going to take a close personal interest in pushing forward initiatives on this and action on early leavers, which is encouraging. He would like to submit our report to H Committee in July, with a recommendation to colleagues that our proposals should be accepted. He wants to set our proposals in the context of a strategy on occupational pensions over the next few years, on the lines indicated in the draft paper, although the draft has not yet been seen or approved by our Ministers.

The way they see this strategy developing is with a meeting in July with the Occupational Pension Schemes Joint Working Group on early leavers; a public conference on 14 September on the same subject; and the publication of a Green Paper on our proposals (which will be bound to be raised in the July and September meetings) in October, before the Institute of Actuaries conference on 16 November, which would get the public consultation off to a good start, with the good offices of Edward Johnston. Legislation would follow in the 1984/5 Session.

Because our Ministers attach considerable importance to this subject and our proposals, they are inclined not to take the disclosure proposals out of what they see as a Pensions Act package for 1984/5 and put it in the Social Security Bill on equal treatment on certain social security benefits which we are planning to introduce shortly. That is still a matter for



E.R.

consideration, and it would always be possible to add it to the Bill in Committee later this year or early next year; but they have provisionally decided against that course.

I should be most grateful if, on this last lap (at least before I approach you for help with drafting a Green Paper), you could let me know as soon as possible of any amendments, additions or comments which you have on the draft H Committee paper. I have to be away from the office on Friday and from Tuesday to Friday next week, visiting various offices, but Joe Ward will be available to take any points which you may have.

*Yours ever,*

*Michael*

M J A PARTRIDGE



Draft Memorandum by the Secretary of State for Social Services  
to H Committee

OCCUPATIONAL PENSION SCHEMES: REPORT OF WORKING GROUP ON  
LAW AND CONVENTIONS GOVERNING PENSION FUNDS

Introduction

I attach the report of the inter-Departmental Working Group of officials which I announced on 19 October 1982 was being established to examine a number of issues which had arisen on the law and conventions governing the conduct of pension funds. The Working Group's remit was approved by H Committee, to whom they were asked to make recommendations identifying options for further action by Ministers. The report was completed in May 1983 but its submission to H Committee had to be deferred by the Election.

The Working Group's conclusions and recommendations

2. These are summarised in Chapter 6 of their report. They make recommendations for an early White or Green Paper, to be followed by legislation, on proposals for:-

- (a) regulation-making powers to implement the commitment which I announced on 19 October 1982 on fuller information for members of occupational pension schemes (recommendations (3)-(9));
- (b) a deposit register with which all schemes would be required to lodge copies of their main documents, such as the trust deeds, scheme rules, latest annual report. This deposit register should also serve the function of a tracing register which would enable scheme members to keep track of their pension rights (recommendations (10) and (11));



(c) placing a legal obligation on employers under the employment protection legislation to inform their employees what their pension rights are and the extent to which they are enforceable under their contract of employment (recommendation (13));

(d) amending trust law on various points in its relation to occupational pension funds, to clarify the powers and duties of fund trustees and employers (recommendation (14)).

3. The thrust of these proposals, as the Working Group make clear in their conclusions (1) and (2), is to bring home to employees, employers, trustees and their professional advisers and managers what their pension rights and obligations are and the risks to which they are subject; and to amend the existing law to clarify the position and to provide all parties concerned with better information than they have now, so that they can take greater personal responsibility for looking after their interests. The Working Group rejects the idea of State intervention to provide greater security for pension rights, whether by State guarantees, statutory funding controls or mandatory credit insurance, with the adverse effects these might have in stifling further growth, burdens on industry and additional bureaucracy.

4. The majority of the Working Group also recommends against legislation to establish a public Registrar, backed by prudential regulations, with powers to inspect and intervene in the management of pension funds (recommendation (12)). The arguments for and against are set out in Chapter 4 and summarised in Chapter 6.6-6.9, and Ministers are invited to decide whether they wish to pursue statutory supervision, or to legislate but hold the powers in suspense until the need was demonstrated, or to reject it.



A strategy on occupational pensions

5. I seek my colleagues' agreement to pursue the Working Group's recommendations as an important component of a strategic policy on these and related aspects of occupational pension schemes which I should like to see us develop over the next few years. I agree with the Working Group's approach and with all their recommendations, which I consider will forward our strategy of encouragement for personal initiative and responsibility in the further development of private pension provision and minimal State intervention. On the particular issue of supervision in recommendation (12), I agree with the majority of the Working Group that this extension of State powers and intervention is not justified, when neither the Group nor the Occupational Pensions Board (OPB) have found any firm evidence of impropriety, as is acknowledged in the alternative option of legislating but holding the powers in suspense until the need is demonstrated, in which I see no attractions.

6. If my colleagues agree, I should like to set officials to work to draft a Green Paper containing detailed proposals on these recommendations for our consideration, which we could publish later this year as a basis for consultation with the various pensions interests, to be followed by a Pensions Act next Session. I would propose to bring into this the better protection of the pension rights of early leavers, to carry forward our Manifesto promises as part of a planned strategy. I have had useful reports on these matters from the OPB and I have made it clear to the pension scheme interests that, while I have given them the opportunity to make progress voluntarily, these are matters of growing public interest and concern, and that we would not hesitate to legislate if they did not have advances to report soon.



7. I now propose to see shortly the Joint Working Group (JWG) which represents the four main occupational pensions organisations\* for a progress report from them. I also propose to follow up this meeting with a public conference in September on pension rights for early leavers, to stimulate debate on possible remedies which have been mooted and to re-inforce our intention to make progress. The Working Group's existence was publicly announced, and our conclusions on its report will be a matter of considerable interest, as they will be at other conferences on these matters which other organisations are known to be planning for this Autumn, including an important one by the Institute of Actuaries on 16 November. If we seize the initiative with my meeting with the JWG and the September conference, and follow up later this year with a Green Paper on all these issues, consultation early next year, legislation next Session and implementation in 1986, we shall build a good record of achievement on this subject in the present Parliament.

#### Public expenditure and manpower

8. These are expected to be very small, because the Working Group have had as an aim to minimise State involvement. There would be small costs for a deposit and tracing register, but the Group recommends that these should be recouped from fees charged to pension schemes and members for the services provided. If the Group's recommendation against full supervision were not accepted, there would be costs for the Registrar's office, which should also be recouped by charging fees to the industry, although these would not be as acceptable to schemes as the deposit and tracing register fees because supervision would be opposed.

9. Thus the extra costs would essentially fall on the industry, but the Group have sought to minimise these, especially to small firms. In particular, the additional costs of disclosure on which we are already committed in principle to legislate, should

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\*The National Association of Pension Funds, the Life Offices' Association, the Society of Pension Consultants, and the Association of Consulting Actuaries.



not be much more than that which schemes should already be carrying if they are being run properly; and the extra costs of a deposit or tracing register above that should be minimal.

Summary

10. I seek my colleagues' agreement to:-

- (a) the Working Group's recommendations in favour of
  - (i) disclosure of information;
  - (ii) a combined deposit and tracing register;
  - (iii) amendment of employment protection legislation on pension rights;
  - (iv) amendment of trust law in relation to pension schemes;and against
  - (v) any new State guarantees of pension rights;
  - (vi) statutory supervision of pension funds by a new public Registrar;
- (b) the preparation of a Green Paper on the recommended proposals and on early leavers, for publication later this year;
- (c) my proposals for handling this as part of a planned strategy on occupational pensions over the next three years.

DHSS

July 1983

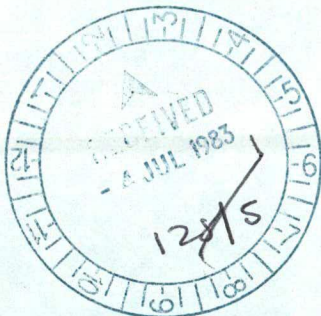




*Pensions folder*

*KJ*

Mr Fletcher  
through Mr Dell



cc PS/Secretary of State  
PS/Mr Lamont  
PS/Mr Trippier  
PS/Sir Anthony Rawlinson  
PS/Sir Brian Hayes  
Mr Sharp  
Mr Gill  
Mr Dell  
Mr Leeming ICB  
Miss Blow MSM  
Mr Kemmis SF1  
Mr Watson CL1

## PENSION FUND LAW

Last year H Committee accepted a recommendation by the Occupational Pensions Board (OPB) that occupational pensions schemes should be required to disclose information about their affairs to their members. The Committee also set up a working group of officials to consider the need for a review of the "trust law" basis of such schemes and the responsibilities and powers of pension fund trustees. At the instigation of Lord Cockfield the group was also asked to consider the need for a supervisory regime for occupational pension schemes along lines comparable to those operating for other financial institutions.

2 The report of the working group is attached. The Government statement at the time the Committee was established is at Annex 1 and the full terms of reference at Annex 2. A summary of the conclusions and recommendations is on pp 29 - 34. Mr Sharp, Mr Winkett (then Department of Industry) and I were members of the working group.

### Disclosure of Information

3 The group agreed that the information to be disclosed by a fund should be such as to permit a qualified adviser properly to understand its affairs; that annual accounts should be audited and that there should be a full actuarial report every three years. A summary of what the group considered should be disclosed is at Annex 4 to the report.

4 The Committee were concerned to avoid imposing unreasonable burdens on small firms (see paragraphs 3.10 - 3.13) but concluded that small firms should not be exempt from the disclosure requirements. The disclosure requirements should, however, be substantially less onerous for insured schemes than for self-administered ones and this is likely to reduce burdens on many small firms (it is estimated that over three-quarters of schemes applying to less than 100 employees are in the former category). Small Firms Division did not dissent from this conclusion but they have suggested that the material relating to small firms might be put more tentatively in any statement of Government conclusions.





### Trust Law

5 The working group began its deliberations against a background of calls for a review of trust law in relation to pension schemes and its replacement by new legislation. However in the course of the Committee's discussions there appeared to be a shift in outside opinion in favour of the view that in principle it was better to stick with trust law, and that any necessary amendments or clarifications, or extra provisions, should not disturb this framework. (The OPB made clear in their evidence to the Committee that they took this view, and the TUC retracted an earlier call for new major legislation.) The Committee adopted this approach in its recommendations.

### A Tracing or Deposit Registry

6 It is desirable at least that pension funds be required to supply certain minimum information to a public official, such as the names and addresses of trustees and the secretary, so that actual or potential beneficiaries know whom to contact. The group recommended that it would also be right to require such funds to deposit with a registrar the documents which they were required by the legislation to disclose to members (the trust deed, and the annual report and accounts). These documents would then be available to the public.

### Supervision

7 The Committee was, however, divided on the question of whether the legislation should go further. The Department of Trade (as was) took the lead in arguing that there was enough anecdotal evidence of malpractice to make a supervisory system appropriate. Such systems had been created for the banks, the building societies and the insurance companies as a result of scandals when there was no adequate supervisory authority and it is the current City prediction that the pension funds are likely to be the place where the next scandal will emerge. The note annexed to this minute prepared by a leading firm of actuaries is the only specific evidence we have of malpractice but in the nature of things fraud and bad practice are not likely to be detected in organisations which are under no obligation to produce accounts or to submit to audit.

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9 The Department of Trade argued that it would be unsatisfactory for Government to be left in the position of having to tell pensioners and potential pensioners dissatisfied about the handling of "their" assets that they must bring action for breach of trust in the Chancery Division. In any event without any prudential standards being established in statute it was quite unpredictable how the Chancery Court would determine such actions if pensioners were able to afford to bring them.





10 The Department of Trade accordingly argued that there should be power to make prudential rules analogous in purpose to those applying to life insurance companies but undoubtedly different in structure and detail. It also argued that the registrar should have power to enforce these rules and indeed those relating to disclosure by a power to make spot checks on the books and papers of pension funds. A routine scrutiny of all annual accounts would be impractical given the number involved but spot checks would provide an incentive to trustees and managers to comply with legislation. The Department has powers to inspect the books and papers of companies "when there is good reason to do so". For pension funds which are not necessarily companies, the power would be comparable but the registrar would be able to make a number of random scrutinies and if necessary to follow them up. He would have a power to require bad practice to be put right subject to an appeal to the court. The registrar would also of course have a power and indeed a duty to prosecute dishonesty if he found it.

11 The majority of members of the working group (including the representative of the then Department of Industry) took the view that the case for a supervisory regime was not made out. It was not established that either imprudence or dishonesty was widespread and disclosure would itself be a substantial safeguard for the future. Pension fund trustees normally were closely related to employers and employers had an interest in the efficient and honest management of the fund since otherwise they would be likely to have to make it up. In any event recourse to the courts would rarely be necessary since Trade Unions or other bodies representing employees would be in a position to put pressure on trustees through the employer to put an end to imprudent or improper practice.

12 The decision on supervision is likely to be the major issue before Ministers when the matter comes back to H Committee. The arguments are discussed in paragraphs 4.1-4.23 of the report. It is now necessary to settle what line the unified Department should take.

13 The two parts of the unified Department took different views on the need for supervision and the power of intervention. Mr Leeming (IC(B)) takes the view that the interest represented by CL is the major one and provided that his concerns and those of the Small Firms Division are set out he is content that I should make a recommendation that the combined Department should support the case for supervision and a power of intervention.

14 In summary the case is as follows:-

- (i) The pension funds dispose of tens of billions of pounds. In other financial institutions handling large sums without adequate supervision and regulation there has been imprudence and fraud.
- (ii) City opinion is not unanimous, but it is a widely held view that "the next scandal will be in the pension funds".





- (iii) Disclosure and auditing is likely to reveal imprudent investment. With thousands of fund managers standards will vary enormously. Without a power of intervention Ministers will be aware of the risks being incurred with pensions' money but powerless to limit the risks.
- (iv) Politically it will not be easy to argue that a high court action for breach of trust is an adequate safeguard for pensioners' money. A more modern method of enforcement will be expected by the public.
- (v) The cost of a supervisory staff of say 100 would be about £2 million. This could be financed by an average annual fee of about £20-£25 per fund - a small fraction of the accounting and audit fees which Government has decided to impose on all funds.
- (vi) The fact that the funds themselves are hostile to supervision is a reason for wariness. The banks and insurance companies - where standards are high - accept it without complaint.

15 We have just received the draft of the paper the Social Services Secretary will be circulating (Annex B ). It is a fair ex parte statement. If you accept the force of the foregoing arguments the best way to give effect to them would be a paper in rejoinder. I recommend that we should put one in.

16 If we do make the case for a supervisory authority with powers of intervention we are likely to be asked if we want to run it, and provide the resources. The answer to the first question is that the machinery of Government experts should advise; and to the second that the fees should make the operation self-supporting. But an effective supervisor needs Ministerial backing. It would be unsatisfactory to give the task to an advisory body such as the Occupational Pensions Board whose members are drawn from the TUC, CBI, actuaries and fund managers.

M. H. M. Reid

M H M REID  
CL  
Rm 502 S/B  
215 5962

1 July 1983



## HOW MUCH DOES AN INVESTMENT MANAGER CHARGE FOR HIS SERVICES?

About five years ago a memo was circulated which dealt with the methods which Investment Managers can use to obtain additional remuneration from their discretionary pension clients. It was hoped that publicity would be given to some of the practices and that this would lead to change. Although a few investment managers now assure their clients that they only obtain remuneration from their direct (scale) fee, the vast majority still make use of a number of ways of obtaining additional remuneration.

In January 1978 the National Association of Pension Funds published a list of questions which trustees should ask when they interview potential investment managers. Although their list is heading in the right direction, it only touches the edge of the problem and it is a great pity that the NAPF has been unable to follow this through to obtain a radical change in the system.

This note outlines and comments on the various methods of remuneration available to investment managers.

1. Scale Fees

Apart from Stockbrokers who generally make no charge for managing a discretionary pension fund, apart from commission on dealing, investment management organisations generally charge a scale fee based on the value of the assets under management. These fees are normally of the order of 0.2% - 0.3% of the market value of the fund per annum. Even for a fairly large fund, 0.3% of the value of the assets often does not come to a great deal of money when compared to the cost of the services which investment managers offer. The levels of scale fee in the U.K. are probably uneconomic as they stand and are much lower than the levels seen in the U.S. where indirect sources of remuneration are not permitted.

2. Fixed Fees or Fees related to dealing?

The manager could receive income for investment advice (and in some instances for acting as Custodian Banker) in a number of ways, for example, in the form of a fixed fee, a fee depending on the value of the portfolio or from profits and



commission arising from dealing on behalf of the portfolio. Since the client's aim is to achieve the maximum return from his investments commensurate with an acceptable level of risk, it is desirable to ensure that the fee structure does encourage the investment manager to achieve this aim. Although as mentioned above, it is common to charge a scale fee which varies with the value of the portfolio, it is quite reasonable to argue that a manager should only receive a fixed fee for giving investment advice, since the time required does not directly depend on the size of the portfolio. However, some form of fee related to the size of the portfolio is usually charged since managers would argue that larger clients need more attention. There is certainly a case for clients to negotiate a fixed fee, with a separate fee negotiated for any Custodian Banking services, so that the latter can be directly compared with the Custodian services offered by the Clearing Banks.

Fees related to dealing are most undesirable from the client's viewpoint since it cannot be argued that the value of investment advice is related to the level of turnover of the portfolio, and furthermore there is no evidence to suggest that funds which deal actively have better investment performance than funds which deal infrequently (in fact, we suspect the opposite). Moreover, the profits which can accrue to the investment manager on dealing can be much larger than the investment management fee on the scale basis. It is undesirable for a client to be unaware of the income which his investment manager is receiving on dealing, but this is the case for the vast majority of investment managers.

Stockbrokers generally receive all their remuneration from a pension fund from commission when they deal, and there is always the suspicion that the broker may deal more than is necessary, to enhance his remuneration. Comparisons can be made of the levels of turnover of securities in funds managed by stockbrokers and other institutions, but this can be misleading since most of the other institutions are also receiving substantial amounts of money from dealing.

### 3. Dealing Profits

Some of the ways in which the investment manager makes money when dealing on behalf of the portfolio are discussed below:

- (i) Investment manager acts as agent in deals using a contract note from the stockbroker.

It is now quite rare to see a contract note from the stockbroker if the



investment manager is a licensed dealer in securities. If it is done in this way, and the institution is on the Stock Exchange Register of Authorised Recipients of Commission, the stockbroker will pay to the investment manager up to one quarter of the commission which he charges. The rates charged by the broker are determined by Rule 212 (2) Appendix 41 of The Stock Exchange, and range from 1.5% on the first £7,000 of the bargain to 0.17% on the excess over £1.75 million for equity purchases.

The advantage of the contract note coming from the stockbroker is that the client is sure that the prices of the deals were those available at the time of dealing and that the stock came from the Stockmarket or from a known source. This advantage might outweigh the additional commission payable.

(ii) Investment manager acts as agent in deals with contract note from the investment manager.

In general this is the method usually favoured by investment managers and it enables them to obtain a profit from commission differentials which is usually larger than the profit which would accrue to them if they dealt as agent with the contract note coming from the stockbroker. The institution will instruct the stockbroker to buy the shares and will be charged the Appendix 39 commission rate on Stock Exchange deals. This is a lower rate of commission than Appendix 41 and commissions range from 1.5% on the first £7,000 of a transaction to 0.125% on the excess over £1.75 million for equities. If the investment manager buys £1 million of an equity, it pays to the stockbroker the Appendix 39 commission rate applicable to the million pounds (£2,982.50). If it then allocates the shares to pension funds in parcels of £50,000, it receives commission from its clients equal to 20 times the individual commission for a £50,000 deal ( $20 \times £320 = £6,400$ ). It is possible for investment managers to make profits in excess of  $\frac{3}{4}\%$  of the value of the transaction, using this method, provided that they keep the list of equities which their clients hold small. This is because those deals made within the "continuation period" are treated for commission purposes as if they were a single deal. Hence, it is possible to buy the same equity through the same broker over a fairly long period and for all the deals to be aggregated for the purposes of assessing the commission payable by the



Moreover the client does not have the guarantee that he has paid the lowest possible price for the shares which he has bought. This is because the investment manager will probably not have given the broker any details about the final recipient of the shares at the time of dealing; the broker would usually be told merely that it was for an XYZ Bank Limited account client. Since the ultimate recipient of the shares is "open" at the actual time of purchase, there is always the danger that the stock can be allocated to other accounts if it goes up in value during the day, but be booked to discretionary pension funds if it has not increased in value.

(iii) Investment manager acts as principal.

Although the investment manager will show that he has acted as principal on the contract note, stocks may be sold from one discretionary pension fund under the institution's management to another under the same management. Let us suppose that the Stockmarket price for a share is 99p - 101p. Pension Fund A sells to the XYZ Bank Limited at 99p less, say, an allowance for 1% commission and therefore receives 98p per share (approximately). Pension fund B buys at 101p plus a similar 1% commission and therefore pays a net price of 102p per share (plus, of course, stamp duty). The difference of 4p per share goes to the Bank and on a £50,000 transaction this amounts to £2,000. This is clearly a most reprehensible situation and gives the Bank an incentive to find an inhouse buyer before it puts the stock on the market. Since it has discretion for many of its pension fund clients, finding a buyer may be relatively easy!

(iv) Large lines of stock

When blocks of shares are bought outside the Stockmarket often at a substantial discount on the market price, the investment manager may decide to sell the stock it has acquired to discretionary pension funds at a smaller discount to the market price, so giving itself a "turn" on the deal. For example, if the shares are sold at a 10% discount on the market price, the investment manager may sell shares onto its clients at say a 2% discount to the market price giving itself an immediate profit equal to 8% of the value of the transaction. Of course, it can



be argued that the funds are still getting the stock at a discount and so they are better off than if they dealt direct. However, one must then ask the question as to whether the stock would have been bought at all in the normal course of events.

(iv) Unit trusts managed by the investment manager.

In recent years most of the leading managers have set up specialist unit trusts which are used for their own in-house clients. These unit trusts are often bought for funds which are quite large enough not to need the diversification advantages of unit trusts. From the manager's point of view, they make management of funds much easier, and in addition, and probably much more important, the manager often obtains an initial fee when it puts its clients into these trusts and an annual fee which is higher than the agreed annual scale fee for direct investment. It is, therefore, desirable for trustees to give their specific permission each time a purchase of in-house unit trusts is recommended.

(v) Deposits and other transactions.

Cash awaiting permanent investment is often held by the investment manager, and deposited with its banking department. Although some banks do have an independent way of calculating a fair rate of return on the money invested, others do not, and this can be a substantial source of profit to the bank. In addition, the manager can obtain remuneration from deals in the Foreign Exchange Market, since these transactions are also undertaken by the banking department.

(vi) Other interests of the adviser.

The corporate finance departments of financial institutions in the U.K. arrange new issues for clients and there is an obvious conflict of interest when discretionary pension funds managed by the same institution are asked to subscribe to (or underwrite) these issues. A procedure is needed to deal with such conflicts of interest.

(vii) General.

The note circulated by the NAPF in 1978 is attached and this gives



further useful guidance.

It is somewhat strange that action has not been taken to protect pension fund investors in the same way as unit trust investors. Perhaps the reason for this is that the trustees of a pension fund are thought to be able to protect their beneficiaries in an adequate way by direct negotiation with the institution concerned. In fact, apart from the very largest funds, the trustees are unable to exercise sufficient muscle to control the charges made by banks over and above the agreed scale fee and trustees of even large funds cannot be expected to have the sophistication and expertise needed to deal with all of the problems outlined above.

October 1981



Draft Memorandum by the Secretary of State for Social Services  
to H Committee

OCCUPATIONAL PENSION SCHEMES: REPORT OF WORKING GROUP ON  
LAW AND CONVENTIONS GOVERNING PENSION FUNDS

Introduction

I attach the report of the inter-Departmental Working Group of officials which I announced on 19 October 1982 was being established to examine a number of issues which had arisen on the law and conventions governing the conduct of pension funds. The Working Group's remit was approved by H Committee, to whom they were asked to make recommendations identifying options for further action by Ministers. The report was completed in May 1983 but its submission to H Committee had to be deferred by the Election.

The Working Group's conclusions and recommendations

2. These are summarised in Chapter 6 of their report. They make recommendations for an early White or Green Paper, to be followed by legislation, on proposals for:-

- (a) regulation-making powers to implement the commitment which I announced on 19 October 1982 on fuller information for members of occupational pension schemes (recommendations (3)-(9));
- (b) a deposit register with which all schemes would be required to lodge copies of their main documents, such as the trust deeds, scheme rules, latest annual report, <sup>and accounts</sup> This deposit register should also serve the function of a tracing register which would enable scheme members to keep track of their pension rights (recommendations (10) and (11));



(c) placing a legal obligation on employers under the employment protection legislation to inform their employees what their pension rights are and the extent to which they are enforceable under their contract of employment (recommendation (13));

(d) amending trust law on various points in its relation to occupational pension funds, to clarify the powers and duties of fund trustees and employers (recommendation (14)).

3. The thrust of these proposals, as the Working Group make clear in their conclusions (1) and (2), is to bring home to employees, employers, trustees and their professional advisers and managers what their pension rights and obligations are and the risks to which they are subject; and to amend the existing law to clarify the position and to provide all parties concerned with better information than they have now, so that they can take greater personal responsibility for looking after their interests. The Working Group rejects the idea of State intervention to provide greater security for pension rights, whether by State guarantees, statutory funding controls or mandatory credit insurance, with the adverse effects these might have in stifling further growth, burdens on industry and additional bureaucracy.

4. The majority of the Working Group also recommends against legislation to establish a public Registrar, backed by prudential regulations, with powers to inspect and intervene in the management of pension funds (recommendation (12)). The arguments for and against are set out in Chapter 4 and summarised in Chapter 6.6-6.9, and Ministers are invited to decide whether they wish to pursue statutory supervision, or to legislate but hold the powers in suspense until the need was demonstrated, or to reject it.



#### A strategy on occupational pensions

5. I seek my colleagues' agreement to pursue the Working Group's recommendations as an important component of a strategic policy on these and related aspects of occupational pension schemes which I should like to see us develop over the next few years. I agree with the Working Group's approach and with all their recommendations, which I consider will forward our strategy of encouragement for personal initiative and responsibility in the further development of private pension provision and minimal State intervention. On the particular issue of supervision in recommendation (12), I agree with the majority of the Working Group that this extension of State powers and intervention is not justified, when neither the Group nor the Occupational Pensions Board (OPB) have found any firm evidence of impropriety, as is acknowledged in the alternative option of legislating but holding the powers in suspense until the need is demonstrated, in which I see no attractions.

6. If my colleagues agree, I should like to set officials to work to draft a Green Paper containing detailed proposals on these recommendations for our consideration, which we could publish later this year as a basis for consultation with the various pensions interests, to be followed by a Pensions Act next Session. I would propose to bring into this the better protection of the pension rights of early leavers, to carry forward our Manifesto promises as part of a planned strategy. I have had useful reports on these matters from the OPB and I have made it clear to the pension scheme interests that, while I have given them the opportunity to make progress voluntarily, these are matters of growing public interest and concern, and that we would not hesitate to legislate if they did not have advances to report soon.



7. I now propose to see shortly the Joint Working Group (JWG) which represents the four main occupational pensions organisations\* for a progress report from them. I also propose to follow up this meeting with a public conference in September on pension rights for early leavers, to stimulate debate on possible remedies which have been mooted and to re-inforce our intention to make progress. The Working Group's existence was publicly announced, and our conclusions on its report will be a matter of considerable interest, as they will be at other conferences on these matters which other organisations are known to be planning for this Autumn, including an important one by the Institute of Actuaries on 16 November. If we seize the initiative with my meeting with the JWG and the September conference, and follow up later this year with a Green Paper on all these issues, consultation early next year, legislation next Session and implementation in 1986, we shall build a good record of achievement on this subject in the present Parliament.

#### Public expenditure and manpower

8. These are expected to be very small, because the Working Group have had as an aim to minimise State involvement. There would be small costs for a deposit and tracing register, but the Group recommends that these should be recouped from fees charged to pension schemes and members for the services provided. If the Group's recommendation against full supervision were not accepted, there would be costs for the Registrar's office, which should also be recouped by charging fees to the industry, although these would not be as acceptable to schemes as the deposit and tracing register fees because supervision would be opposed.

9. Thus the extra costs would essentially fall on the industry, but the Group have sought to minimise these, especially to small firms. In particular, the additional costs of disclosure on which we are already committed in principle to legislate, should

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\*The National Association of Pension Funds, the Life Offices' Association, the Society of Pension Consultants, and the Association of Consulting Actuaries.



not be much more than that which schemes should already be carrying if they are being run properly; and the extra costs of a deposit or tracing register above that should be minimal.

Summary

10. I seek my colleagues' agreement to:-

- (a) the Working Group's recommendations in favour of
  - (i) disclosure of information;
  - (ii) a combined deposit and tracing register;
  - (iii) amendment of employment protection legislation on pension rights;
  - (iv) amendment of trust law in relation to pension schemes;and against
  - (v) any new State guarantees of pension rights;
  - (vi) statutory supervision of pension funds by a new public Registrar;
- (b) the preparation of a Green Paper on the recommended proposals and on early leavers, for publication later this year;
- (c) my proposals for handling this as part of a planned strategy on occupational pensions over the next three years.

DHSS

July 1983



*Pensions  
Folder*

Mr Winkett IC(B)

→ cc

PS/Mr Sharp

Mr Reid CL

Mr Watson CL1

Mr Leeming IC(B)

Mr Cohen IC(B)

## PENSION FUND LAW

1 Mr Cohen invited me in paragraph 3 of his minute of 28 June to comment on the section of the draft paper on impact of the recommendations on small firms. I have only one comment to make.

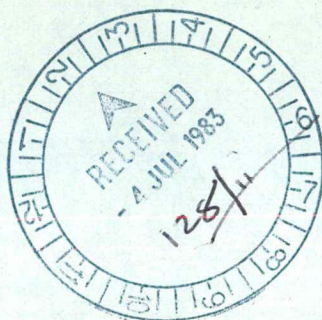
2 I was able to agree to the conclusion that disclosure should apply to small firms only on the understanding that the additional burden for a properly run scheme would be marginal. However, this would need to be tested against the views of small business representatives, and I had suggested that it be put tentatively in any Government statement so that there would be proper consultations about it. To make sure this is quite clear I would like the final sentence of paragraph 4 of the draft replaced by:

"Small Firms Division did not dissent from this conclusion in view of the Committee's assessment that the additional burden would be marginal for a properly run scheme. Organisations representing small firms will, however, need to be consulted and, for this reason, Small Firms Division have suggested that any Government statement of its conclusions should be tentative concerning the impact on small firms".

*OK KEMMIS*

O H KEMMIS  
AS/SFD1  
Room 232  
Ashdown House  
X 6665

1. July 1983





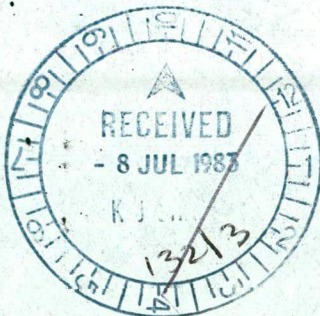


*Pension Files*

105

DMDOM NO 211/83

MR FLETCHER



cc PS/SOS  
PS/Sir Anthony Rawlinson  
PS/Sir Brian Hayes  
Mr Sharp ✓  
Mr Gill  
Mr Reid CL  
Mr Leeming ICB  
Miss Blow MSM  
Mr Kemmis SF1  
Mr Watson CL1

#### PENSION FUND LAW

When we spoke about priorities yesterday, I mentioned the attached submission coming forward from Mr Reid about pension fund law. You will remember that concern about the control of pension funds was one of the points raised by the Secretary of State when he held his initial meeting with Deputy Secretaries on the former Trade side.

2 Mr Reid's submission covers the report of an official Working Group chaired by DHSS to look into the current "trust law" basis of pension fund schemes and the responsibilities of trustees, and to consider also the possible need for a supervisory regime. The majority view of the Committee, supported by the former Industry side of the Department, was that there was no need for a full supervisory system, but the former Trade view set out in paras 7-10 of Mr Reid's minute was that a supervisory regime was justified. The exact method of instituting such a supervisory regime was not covered by the Working Group, but full supervision would probably require a staff of about 100 and, given the pressure on staff numbers, it seems unrealistic to think that this could have a very high priority as an extra task for Government either here or in DHSS. It might therefore be necessary to establish a separate Registrar with a small office.

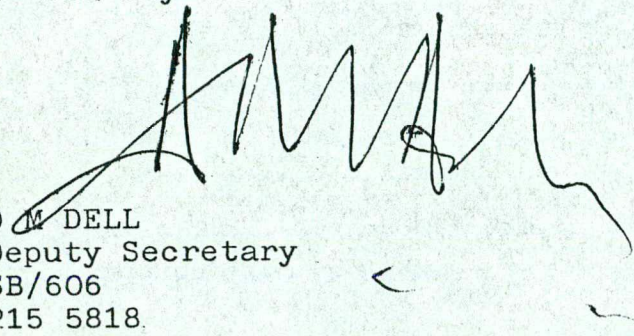
3 The issue is likely to come back to H Committee shortly on the basis of the memorandum by the Secretary of State for Social Services attached as the annex to Mr Reid's minute. This recommends against a supervisory regime. Unwelcome as further supervision is, I do find Mr Reid's arguments in favour of it convincing, and the Industry side





(para 13 of Mr Reid's minute) seem ready to accept this. If you agree, we shall need to think quickly about the form a supervisory regime might take.

4 You may like to discuss this with me, and perhaps Mr Gill.



D M DELL  
Deputy Secretary  
SB/606  
215 5818  
7 July 1983





*Pension Adviser to Sharp*  
105

CABINET OFFICE  
Central Policy Review Staff

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London, SE1 6BY



7 July 1983

*Dear Michael*

WORKING GROUP ON LAW AND CONVENTIONS GOVERNING PENSION FUNDS

Thank you for your letter of 29 June enclosing a draft paper for H Committee.

2. There are a few points we would want to make in any discussion of your paper. If the paper comes to H Committee before the end of July, when the CPRS is to be disbanded, we shall be able to make them ourselves in a paper or orally or both. But it seems best to let you have a note of the points now, and you may indeed wish to take them on board in your paper.
3. First, it seems to us that Ministers might well be concerned about the burden which the disclosure arrangements would impose on small schemes and small companies. In this context, it is worth bearing in mind that by excluding from compulsory disclosure all schemes with fewer than 10 members one would be cutting out two-thirds of all schemes, while subjecting to the disclosure requirements schemes covering 96.5 per cent of all scheme members. It is questionable whether going to 100 per cent coverage is worth the extra administrative burden.
4. Second, we are concerned about the costs of a Register for deposit of scheme documents. The purpose of the Register would be to ensure that those entrusted with responsibility for schemes were carrying out their legal obligations on disclosure. But the Register would be superfluous if a very high proportion of those concerned would in any event comply with the law. Ministers might therefore prefer to take powers to require the deposit of scheme documents but to use those powers only when and if it became plain that the law on disclosure was being significantly flouted. Before incurring costs of some £2-3 m a year harder evidence is needed about the benefits to be achieved.



Third, we agree with the conclusions about supervision but wonder if the case against it deployed in 4.19-4.23 could not be rather stronger. The most important point, au fond, is the security of the individual's pension. Contracted out schemes cover nearly 90 per cent of all scheme members and are already supervised by the OPB, at least in so far as their capacity to pay GMPs is concerned. This must be a considerable safeguard.

6. Fourth, on a more general note, if we were writing a paper we would seek to relate your proposals to wider government objectives. For example, we should make the point that action on early leavers could significantly improve the working of the labour market; and on disclosure, we should underline its contribution to the 'visibility' of pension arrangements, so ensuring that scheme members understood better the link between the success of the economy and their own living standards in retirement. Disclosure should also help to protect pension funds from direction or interference which is not calculated to be in the interests of scheme members. You may feel that these points could be reflected in your paper e.g. in paragraph 3.

7. Lastly, we very much welcome the intention to tackle the problems of the occupational pensions sector on a wider basis; and in particular we would support legislation on early leavers as recommended by the OPB. But we should perhaps be careful not to lay public claim to a strategy on occupational pensions without having at least reviewed Government policy on some important aspects which are not mentioned in the paper. We have two in particular in mind -

- (a) there is likely to be pressure on the Government to move towards the 'individual' pension and the Government will need to have thought out its position on the subject, at least in a preliminary way, before its Green Paper later this year;
- (b) the tax treatment of pension contributions and funds. The present arrangements obviously favours saving through occupational pension schemes as compared with other channels of saving and this raises social policy questions (e.g. as to the incidence of the tax reliefs) as well as economic and industrial issues.

8. I am sending copies of this letter to the other members of the Working Group.

*Yam*  
*Crabbe*

(G A HART)



*Pensions Folder.*  
Reference .....

*KJ*

MR DELL

PS/SECRETARY OF STATE  
PS/SIR ANTHONY RAWLINSON  
PS/SIR BRIAN HAYES  
MR SHARP ✓  
MR GILL  
MR REID  
MR LEEMING ICB  
MISS BLOW MSM  
MR KEMMIS SF1  
MR WATSON CL1

**PENSION FUND LAW**

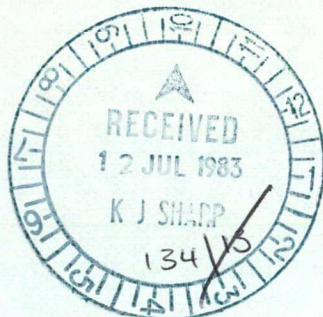
Mr Fletcher was grateful for Mr Reid's submission undercover of your minute of 7 July. He has commented as follows:

"We should prepare a paper proposing a supervisory body, but one which is self-financing and capable of being "hived-off"."

2. The Minister would be pleased to discuss this in due course.



D WALLACE  
APS/PUSS (CCA)  
R.806 1V/S  
215 5663  
11 July 1983





CONFIDENTIAL

Mr Reid

*Pension's  
folder*cc Mr Sharp  
Mr Leeming IC5  
Mr Kemmis SF1

## PENSION FUND LAW

PUSS OM No 713 of 11 July 1983 to Mr Dell confirmed Mr Fletcher's wish for us to prepare a paper proposing a supervisory body, but self-financing and capable of being "hived off". Mr Dell asked me to prepare a draft for him, but in view of your particular interest in this subject I submit the attached draft first to you.

2. I spoke to Mr Partridge towards the end of last week about the timetable. He said that the earliest H Committee could consider this would be 26 July, but that given the current volume of issues on Social Security, consideration might well have to be deferred until September.

*Rmw*R M WATSON  
CLIC  
504 SB  
215 5361

18 July 1983





CONFIDENTIAL

Draft Memorandum by the Secretary of State for Trade and Industry to  
H Committee

OCCUPATIONAL PENSION SCHEMES: REPORT OF THE WORKING GROUP ON THE LAW AND  
CONVENTIONS GOVERNING PENSION FUNDS

The Memorandum from the Secretary of State for Social Services (H )  
commends the majority recommendation of the Working Group against legislation  
to establish a public Registrar, backed by prudential regulations, with powers  
to inspect and intervene in the management of pension funds, and proposes  
preparation of a Green Paper reflecting this recommendation. I seek to  
persuade colleagues that it would be premature to exclude consideration of  
the need for prudential regulation from a Green Paper.

2. The then Department of Trade took the lead in the Working Group in  
arguing that there is sufficient anecdotal evidence of malpractice from City  
and other sources to give grounds for concern that pension funds are likely  
to be the place where the next major financial scandals will arise. Pension  
funds have custody of tens of billions of pounds. Regulatory systems for  
other financial institutions managing money on this scale, including banks,  
building societies and insurance companies have all been established in  
response to failures in which the public have lost money heavily. The  
proposed Green Paper would present an ideal opportunity for us to explore  
whether there are sufficient grounds for disquiet to justify introducing a  
system of prudential regulation to forestall comparable losses of what for  
most people is their most important financial "investment". It would be  
irresponsible for us not to take this opportunity.

3. I am particularly concerned that the measures which the Secretary of  
State for Social Services proposes, while in themselves wholly commendable,  
would expose significant shortcomings in the management of pension funds,  
but leave the Government powerless to bring about improvements. I cannot  
share the confidence of the majority of the Working Group that accountability  
through disclosure to employees, with clarification of the powers and duties  
of fund trustees and employers, is likely to be enough to improve the  
management of funds to any significant extent. Above all, it lacks political  
credibility to argue that a high court action for breach of trust is an  
adequate safeguard for pensioners' interests: such action is likely to arise,  
if at all, only when those interests have already been significantly and



irreversibly damaged.

4. Nevertheless, I support the Working Group's rejection of the idea of State intervention through State guarantees or mandatory insurance and share their concern that this would impose excessively on companies and threaten the growth of pension schemes. But I believe that responses to a Green Paper might well confirm a need for public disclosure and active, external and disinterested supervision of pension funds' affairs. Such supervision need not be stiflingly bureaucratic, nor very costly, and there need be no charge to public expenditure.

5. A registry with a staff of 100, for example, could recover all of its costs by charging an annual fee of about £25 per pension fund, a small fraction of the accounting and audit fees envisaged. A registry might well need, in addition to having the function of pursuing defaulters in submitting returns, powers to ensure conformity with prudential requirements on assets held. It is possible that such requirements could be developed on a self-regulatory basis by the pension fund movement, and that the movement itself could develop an enforcement capability. In this case statutory supervision would not need to be extended further than at present<sup>proposed</sup>. But it is also possible that this would prove to be beyond the movement's capability, and that statutory prudential rules and a power to enforce through bringing prosecutions would need to be conferred on the registry. In this case the registry would be a public sector body, but could remain self-financing and free-standing outside Government. Inevitably there would be a degree of Ministerial accountability, but this could be long range.

6. Accordingly, I support the Secretary of State's for Social Services positive recommendations for a Green Paper to make the proposals he outlines, but urge colleagues that the Green Paper should also discuss:-

(a) the possible need for a public register of statements of pension fund affairs;

(b) the possible need for disinterested supervision to ensure compliance with prudential standards; and

(c) the question of whether such a register and such supervision could be achieved through self-regulation, or would have to be pursued through statutory means.



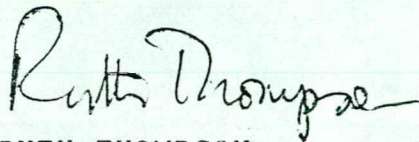
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PS/Mr Fletcher

cc PS/Sir Anthony Rawlinson  
PS/Sir Brian Hayes  
Mr Sharp ✓  
Mr Dell  
Mr Gill  
Mr Reid  
Mr Leeming  
Miss Blow  
Mr Kemmis  
Mr Watson CL1

## PENSION FUND LAW

The Secretary of State has seen your PUSS OM 713 of 11 July, Mr Dell's minute of 7 July, and Mr Reid's submission. He has said that he will be particularly interested to see the paper Mr Fletcher has commissioned, and has commented that it is indeed unrealistic to consider establishing a comprehensive supervisory body which would require staff of around 100.



RUTH THOMPSON  
PS/Secretary of State for Trade and Industry  
Rm 11.01 Ashdown Ext 3301

20 July 1983





1 MR DELL  
2 MR FLETCHER  
3 SECRETARY OF STATE

cc Mr Muir  
Mr Knox  
Mr Lowry  
Mr Bovey

*file*  
*Partridge works*  
*Group*  
*releasian*

Mr Fowler is setting up a committee of Ministers and officials with two or three non-official members - including Mr Stuart-Lyon (Legal & General), the President of the Institute of Actuaries and Mr Marshall Field of the Phoenix Assurance Company who is Chairman of the Life Offices Association - to make an inquiry into retirement provisions. This rather imprecise phrase means reviewing the present arrangements under which the private sector pension funds are run and considering what scope there is for changing the consensus based on the 1975 Social Security Act and replacing it with schemes giving greater scope for individual management of pension "savings" but less security from employers. The treatment of early leavers is very much part of the problem. A good deal of work has already been done on pension provisions by an interdepartmental group which met under the chairmanship of Mr Peter Middleton in 1981 - 82 and by the CPRS. The issues are technical and political, and likely to be difficult in both senses.

2 The technical issues relate to the actuarial assumptions on which funding is provided, the investment risks which may legitimately be taken and the dynamising of the fund which the employer may be expected to provide. The latter question has a political aspect because it involves a judgement between the claims upon income between those still earning and those retired.

3 Private sector pensions are all (or virtually all) funded. Hence their management is a very important part of the securities industry. Such management is very largely what the Gower report is about. Funds are managed by insurance companies, merchant banks, stockbrokers, subsidiaries of employing companies, employees and by individual trustees. Whatever is done to implement the Gower Report ought to be kept consistent with policy on pensions. In a sense Gower is looking after the interests of individuals in their own investments including pensions. The Department has an interest also in the obligations that these place on employers at least in the sectors we sponsor.

4 The industrial as well as the regulating sides of the Department must accordingly be brought in, but coordinating "Gower" policy including its implications for the life assurance companies with pensions policy is the main political need and I accordingly recommend that Mr Fletcher should represent the Department on Mr Fowler's Committee.

5 At official level the Departments of Industry and Trade were both represented in the Partridge Working Group. Mr Ken Sharp and Mr Winkett represented the former and I represented the latter. As I am much more closely involved in the Gower exercise I recommend that I should be the official alternate.

M H M REID  
CL DIVISION  
ROOM 502/SB  
215 5962

6 December 1983

*M.H.M. Reid*



**DRAFT**

Addressed to:

The Rt Hon Norman Fowler MP  
Secretary of State for  
Social Services  
Department of Health & Social  
Security  
Alexander Fleming House,  
LONDON SE1 6BY

**File No.**

Copies to:

PS/Mr Fletcher  
PS/Sir A Rawlinson  
PS/Sir B Hayes  
Mr Dell  
Mr Cooper  
Mr Caines  
Mr Wright  
Mr Reid (on file)

Originated by:  
(Initials and date)

MHMR/SAS 6.12.83

Seen by:  
(Initials and date)

Enclosures:

Type for signature of

SECRETARY OF STATE...  
(Initials and date)

**DEPARTMENT OF TRADE AND INDUSTRY**

Thank you for your letter of December 1 about your inquiry into retirement provision.

Pension funds raise questions about the investment of enormous sums of money. The private sector funds - insured and uninsured - are certainly the largest under management.

You know that Professor Jim Gower has just delivered me his report on investor protection and my officials are in touch with yours about its handling. It discusses and makes recommendations about the way professionals - market makers, brokers, managers, advisers and others - should be required to handle the public's money. The recent scandals in this field are all too well known.

Work on the pension funds and on the Gower Report can and should go ahead together. It may well be right to legislate on both in the next session though this will have to be examined. But obviously the two exercises must be closely coordinated. Alex Fletcher will be leading on the Gower Report here and I should accordingly like him to be our member of your Committee. Malcolm Reid who is in charge of Companies Legislation Division and who deals with securities regulation will be his alternate.



(CONTINUE TYPING HERE)

File No.

I am sending copies of this letter to Nigel Lawson  
and Tom King.



JU264

Mr Reid

cc PS/Mr Fletcher  
PS/Sir Anthony Rawlinson  
Mr Caines  
Mr Dell  
Mr Muir  
Mr Knox  
Dr Howe  
Mr Lowry  
Mr Bovey

The Secretary of State was grateful for the advice in your minute of 6 December on the subject of representation on the Committee of Ministers and officials considering retirement provisions. He is keen that the work done on this Committee should cover not only the investor protection aspects which you describe, and on which the draft letter placed emphasis, but also - and at least equally - the effects on the economy generally of promoting job mobility through greater mobility of pension arrangements. The Secretary of State believes it vital that the representations made by this Department, at both Ministerial and official level, should take full account of the economic importance of the second, and should not (repeat not) be subordinated to the questions of regulation, important though these are.

2 I should be grateful if the briefing which you and Mr Caines' side of the House provides for meetings of this Committee could reflect the Secretary of State's view; and if you would bear this actively in mind when you and Dr Howe represent the Department as alternates to Mr Fletcher. In view of the keen interest expressed by the Secretary of State, it would be useful if he could see the briefing for meetings, at the same time as this is put to Mr Fletcher.

*McCarthy*

M C McCARTHY  
PS/Secretary of State for Trade & Industry  
Rm 803 V/S 215 5422

19 December 1983





*Pensions folder*



Mr Fletcher

cc Sir Anthony Rawlinson  
Mr Sharp  
Mr Dell  
Mr Gill  
Mr Leeming ICB  
Miss Blow MSM  
Mr Lowry CL1  
Mr Kemmis SF1  
Mr Watson CL1

#### PENSION FUND LAW

I attach a paper in response to your PUSS OM 713 about the supervision of pension funds. It proposes a capacity for the Registrar to make prudential rules and to intervene and inspect. The operation would be financially self-supporting because there would be registration fees pitched at a level to meet the full cost.

2 The registry could be hived off. If it were a plain deposit registry it would probably be right to make it responsible to the Occupational Pensions Board (OPB). They already have a staff which works closely with the Superannuation Funds Office of the Inland Revenue to scrutinise the deeds of new funds for compliance with tax and contracting out requirements. Since the OPB is itself a non-Government body it should not be constitutionally difficult for the staff to have the same status.

3 I should however want to argue strongly that a power to make prudential rules and to intervene in fund affairs would hardly be workable unless it was done by a Government Department rather than by a quango. The OPB (appointed by the Social Services Secretary) is drawn from employers, fund managers, actuaries and the TUC. Even if Parliament was prepared to delegate the rule-making function, the Board would have difficulty in agreeing what the rules should be. It would be too much subject to the interests of the OPB members. As to inspection and intervention a Department representing a Minister responsible to Parliament would be more effective in using whatever sanctions were at its disposal than a hived off body.

4 A quango would be more open to pressure and more likely to have its interventions challenged and even subjected to judicial review. I think the working group - though divided on the question of creating a power of intervention - was agreed that it should be in a Department if it was created at all.

5 I have not dealt with the question of hiving off in the paper, and I suggest that at this stage at least it is better not to do so. The proposal for action comes from the DHSS. We were involved in the Working Group because Lord Cockfield proposed that the pension funds should be supervised at about the time as the Social Services Secretary was proposing that they should produce and disclose their accounts. Further action is not for this





Department unless Ministers specifically decide that it should be. Any suggestion about the constitution of the Registry will probably be taken as a bid to have it here. Would it not be better to avoid that?

6 The working group did not make any precise estimates about staff numbers. But it suggested that the cost of a deposit registry might be £2m to £3m a year which implied some 100 staff. The net figure would probably be less because of savings in the OPB staff. The inspection staff would be extra. I guess - and it is no more - that the extra figure is 80-100 costing net up to £3m but not financed from taxation. The banks, the building societies and the life companies pay nothing for supervision, but are supervised. Would it be wise to deprive the pension funds of a comparable safeguard?

7 Nothing will happen inter-departmentally until next month. But in September the Social Services Secretary will put in the paper of which I have shown you a draft. I suggest this paper as a rejoinder.

*M. H. M. Reid*

M H M REID  
CL  
Rm 502 S/B  
215 5962

4 August 1983



OCCUPATIONAL PENSION SCHEMES REPORT ON THE LAW  
AND CONVENTIONS GOVERNING PENSION FUNDS

The memorandum for the Secretary of State for Social Services (H ) endorses the recommendations of the Working Party and supports the majority view on the functions of a pensions registry, namely that it should be a registry pure and simple without power to make prudential regulations or to intervene in the affairs of pension funds. I agree with the recommendations except on the latter points. The purpose of this paper is to present the case for our having power to make prudential regulations and to intervene when regulations are broken or when misconduct is apparent or suspected.

If the recommendations of the Working Party are accepted we shall be committed to achieving a substantial degree of public disclosure of pension fund information and to providing the staff for the deposit registry. The information in the registry will enable a proper comparison to be made between the performance of the funds and will almost certainly bring out the wide variation between them in investment skills and costs of management. It will also bring out the extent to which the funds expose themselves to particular types of risk. The scheme proposed by the majority of the Working Party will not however give us any opportunity to fix prudential standards or to intervene if there is evidence of imprudence or even dishonest practice. That would be left entirely to the members of the schemes - pensioners and contributors.

In my view the most probable examples of unsatisfactory investment will be the following:-

- i) Excessive investment in the employing company or related companies.
- ii) Excessive concentration of investment.
- iii) Excessive exchange risks.
- iv) Excessive investment in assets (eg pictures) which produce no income and whose future value is accordingly unpredictable.
- v) Unnecessarily high management or dealing expenses.



Even though there is at present no firm evidence of dishonest practice, it would be unwise to ignore persistent City rumours that some of the pension funds are dishonestly managed and that a scandal may soon come to light. The requirement for disclosure and auditing is likely to bring out malpractice and we shall be in an embarrassing position if we have deprived ourselves of any means of enforcing prudent and honest standards.

The great majority of funds are no doubt honestly and wisely invested: I recognise that employers in most cases have every interest in seeing that this is done and <sup>have</sup> the capacity to enforce that interest; but there are probably exceptions particularly in small and closed funds. I do not consider that our position will be easy if we have to advise pension fund members - particularly if they are already pensioners - to take their grievances to the High Court or go to the Police.

I consider that it would be wise for us to take power to establish minimum prudential standards (particularly in respect of self-investment, other concentrations of investment, investment involving an exchange risk and perhaps investments not producing an income); and to intervene either on a spot-check basis or when there is good reason to do so in the affairs of pension funds, (for example if the managers appear to be benefitting unreasonably at the expense of the beneficiaries).

The Department of Trade and Industry does have powers to inspect the books and papers of a company "when there is good reason to do so". There are also extensive powers of intervention by regulatory authorities in other "high risk areas" such as the banks, the building societies and the insurance companies. But the pension funds where the risks are at least as great as in these would be subject to no scrutiny or intervention unless we provide for it. It will not be within the resources of my Companies Investigation Branch to take on effectively responsibility for inspecting the papers on funds which do incorporate themselves into companies.

The expenses of the registry should certainly be borne by the funds and there should accordingly be registration fees fixed at a level to meet the full cost. A capacity to intervene would entail an increase in the cost

and they  
would remain the  
only



and in the number of staff. So far as numbers are concerned the bulk of the staff would be employed on registration, securing compliance with the regulations requiring deposit of documents and providing public access. The cost of an inspecting staff would have to be borne by the funds as a whole: it would not be reasonable to impose the cost of an inspection on the beneficiaries of a particular fund, but the existence of even a small organisation is likely to be a deterrent to bad practice and to repay its cost in terms of benefit to pensioners.

My proposal is that the White Paper should state a decision

- (i) to take powers for a Minister to make regulations establishing prudential standards for pension fund investors arrived at after consulting the interests concerned;
- (ii) that the registrar should have power to inspect the books and papers of the funds and to insist on proper practice.

Department of Trade and Industry  
September 1983