

273.

CONFIDENTIAL FILING

Pension funds

ECONOMIC POLICY

March 1987.

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
29.7.87							
30.7.87							
12.1.88							
30.7.87							
<p>PREM 19/2098</p>							

file
DGZ CCC
bc DG



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

30 July 1987

Dear Eamonn,

PENSION FUNDS

Thank you for your letter of 17 July and the attached note on pension funds.

The Prime Minister believes that the problems caused by fund surpluses in cases of company take-overs and mergers warrant a fuller discussion. She has asked that your Secretary of State should circulate a full paper on this subject for discussion at E(A) in the autumn. The paper should also deal with local authority pension funds.

It would make sense for this paper to be discussed alongside the DTI paper on the review of mergers policy (E(A)(87)28) which was postponed from an E(A) scheduled for earlier this month.

I am copying this letter to Trevor Woolley (Cabinet Office).

Yours sincerely,

David Norgrove.

David Norgrove

Eamonn Kelly, Esq.,
Office of the PUSS (Mr. Nicholas Scott MP),
Department of Health and Social Security.

2

PRIME MINISTER

PENSION FUNDS

At a meeting in March you raised the question of the way in which some companies seem to be buying others in order to strip assets out of their pension funds. A reply on this arrived at long last from the DHSS in time to be discussed alongside the review of mergers policy. That discussion has, of course, now been put off until the Autumn. But I thought you might now like to see the paper which the DHSS has produced.

The paper itself is very thin and although it acknowledges that there are problems, it offers no acceptable solutions.

I recommend that you should ask the DHSS and other departments to produce a full paper which can be discussed at E(A) alongside the review of the mergers policy.

Agree?

DKW

D.R.N.
29 July 1987

PMMAEM

Yes - but we must also look at the rules applying to local authority pension funds in view of some very unwholesome investments.



DEPARTMENT OF HEALTH AND SOCIAL SECURITY

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

Telephone 01-407 5522

From the Parliamentary Under Secretary of State for Social Security

David Norgrove Esq
Private Secretary
10 Downing Street
London SW1A

Dear David,

17th July 1987

PENSION FUNDS

I understand that yesterday you spoke to Bruce Calderwood and requested a briefing note on Pension Funds. I attach a note prepared in consultation with the other interested Departments. It covers the problems caused by fund surpluses, in particular, in cases of company takeover or mergers. Also attached is a note provided by the Department of Environment on local authorities pension funds.

Yours ever

Eamonn

EAMONN KELLY
Private Secretary

PENSION FUNDS

The Problems

1. The major issue is: "who owns the pension funds?" There is no straightforward answer. It is this problem which underlies concern about disposing of fund surpluses, particularly following a takeover or merger.

2. Members of benefit-defined schemes do not own individual shares of the assets. The assets are held under trust to fund the pensions promise. The employer has an obligation to contribute as necessary to enable the fund to honour the promise. This applies whether the scheme is in deficit or surplus.

3. **Who appoints the trustees?** The power to appoint and dismiss trustees is normally vested in the employer. He has a long-term financial commitment which is closely bound up with the efficient administration of the scheme. But his interests may conflict with the duties of the trustees under trust law. Such conflict may be seen in "raids" on surplus funding, either by the original employer or a new employer after a takeover.

4. **Who controls schemes?** There is no comprehensive legislative framework. The major controls are derived from:
 - * trust law - laid down to a large extent in case law;

 - * Inland Revenue controls - concerned mainly with regulating the tax reliefs. The 1986 Finance Act introduced new measures to deal with funding surpluses which were receiving unjustified tax exemptions;

 - * Social Security legislation - concerned mainly with the conditions for contracting-out of SERPS, requirements on equality of access to membership of schemes, disclosure of information to members and rights for early leavers. The Occupational Pensions Board ensures compliance with the contracting out legislation; the remaining provisions are implemented through scheme rules and are thus subject to trust law.

5. **How effective are the controls?** The statutory controls are generally effective in achieving their particular intentions. Neither Inland Revenue nor DHSS legislation, however, directly addresses the basic problems outlined above, and trust law is by its nature rather fragmented in its provisions.

6. The recent Hanson case illustrates the problem. The judgement in that case was that while scheme members had no legal right to participate in the fund surpluses of existing schemes, either by way of a "contributions holiday" or by the enhancement of benefits, they were entitled not to be irrevocably parted from them by decisions of a takeover "raider". The particular circumstances of the case were that the acquired Courage Group companies had been sold on and it was intended that the employees should be transferred to the pension scheme of that owner, while the original Courage pension schemes remained with Hanson. In different circumstances, for example where an acquired company remained with the new owner, the judgement might not apply in full.

7. The new Revenue rules will help to prevent excessive surpluses from building up, and make raids less attractive to a predator. That is, however, a solution in the longer term.

Possible Solutions

8. There are other possible solutions. **Payments of surplus funding to the employer could be restricted or made subject to stringent conditions.** Given, however, that the surplus may have arisen because the market had out-performed the actuarial assumptions and the employer's contribution set too high in consequence, to prohibit a payment in the employer's favour would be to create a "ratchet effect" against him. He would be required to make good any deficit but not be permitted to correct a surplus.

9. A surplus can arise following large-scale redundancies because the benefits for early leavers are set at a lower level than for those who remain in membership to pension age. In those circumstances **a solution would lie in improving or changing the basis of early leavers' benefits.** For example, preserved benefits and transfer values could be based on projected final salary at the date of leaving. Changes on these lines would, however, have

long-term implications for scheme funding which would impact after the present surpluses had been reduced. This would inevitably mean imposing new funding burdens on the employer.

10. It has been suggested in some quarters that trustees concerned to fight off a predator should write increased liabilities into the scheme rules to take effect in the event of a takeover. Reducing a projected surplus by increasing scheme liabilities might deter a predator, but trustees would need to guard against imposing additional liabilities on the current employer if the takeover were defeated or which could lead to the new employer winding-up the scheme. And such steps taken in the knowledge of an actual or likely takeover bid might run counter to Rule 21 of the City Code on Takeovers and Mergers.

LOCAL GOVERNMENT PENSION FUNDS

1. The local government scheme is a statutory scheme, and the benefits payable to employees are not affected by the investment performance of the funds. The rules governing the use and investment of the funds are set out in regulations. As with all local government funds the pension funds are subject to audit, and any breach of the investment rules could be expected to attract the auditor's attention.

2. The funds are valued at five-yearly intervals, and in the light of his valuation the actuary fixes the level of employers' contributions for the succeeding five years. The most recent valuation at 31 March 1984 showed that overall investment performance had exceeded expectations, and contributions (which are paid from the rates) were significantly reduced.

3. The investment controls were relaxed in 1983 following complaints that the earlier restrictions were inhibiting sound investment policies. DOE Ministers are now considering whether the controls should be tightened to guard against potential misuse. The main problem is that the controls apply indiscriminately to all local authorities which administer superannuation funds, and it is difficult to control the activities of the few which may be contemplating misuse without at the same time fettering the decisions of the remainder.

CONFIDENTIAL*LCB*

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

26 May 1986

The Rt Hon Douglas Hurd CBE QC MP
Secretary of State for the Home Dept
Home Office
50 Queen Anne's Gate
LONDON
SW1H 9BW

NBM

Dear Home Secretary,

will request if required.

I am sorry not to have replied before now to your letter of 1 May about the effect of my Budget proposals on the police and fire service pension schemes. These proposals were dropped from the Finance Act following the announcement of the Election, but I have promised that they will be reintroduced.

I can give you the assurance you seek. The proposals to limit lump sums would apply in two ways. First, the maximum tax-free lump sum would be £150,000 in present-day terms. The intention would be to increase this limit when appropriate. I do not think new entrants to the police and fire service schemes would be caught by this provision, which is aimed at a relatively small number of high earners.

Second, I proposed that the maximum tax-free lump sum should be based on accelerated rates of accrual only if total pension benefits are calculated on the same basis. This change - which I think is what you have in mind - was aimed at a particular device by which members of private sector occupational schemes can maximise their tax-free lump sum at the expense of their taxable pension. Even though their total pension benefit is based on normal rates of accrual (generally reaching the maximum only after 40 years service) the proportion of the total that can be commuted is based on accelerated accrual (reaching the maximum after as little as 20 years service).

This device is not available to members of the police and fire service pension schemes. It is true that the normal rate at which their pension benefits accrue means that they may reach the maximum

CONFIDENTIAL

CONFIDENTIAL



after 30 years. But that is because many officers are obliged to retire as early as age 55 and could not normally attain 40 years service. The rules concerning lump sums are clear and apply equally to all members of these schemes: there is certainly no question of some individuals maximising the amount of their lump sums in a way which is contrary to the spirit of the rules.

In fact, these changes would have no direct effect on the police and fire service schemes, which obtain their tax reliefs under separate legislation. And I can confirm that, in the light of my proposals, I should not expect them to amend their rules to keep in line with the new requirements.

I am copying this letter to the Prime Minister, Willie Whitelaw, Norman Tebbit, Malcolm Rifkind, Tom King and John Wakeham.

Yours sincerely,

Canny Ryding

NIGEL LAWSON

(Approved by the Chancellor
and signed in his absence)

CONFIDENTIAL



Chancellor of the Duchy of Lancaster

CABINET OFFICE,
WHITEHALL, LONDON SW1A 2AS

Tel No: 270 0020
270 0296

6 May 1987

Alex Allan Esq
Principal Private Secretary to the
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1 3AG

NBM

Dear Alex,

The Chancellor of the Duchy has seen a copy of the Home Secretary's letter of 1 May to the Chancellor of the Exchequer concerning the possible implications of Schedule 5, Part II of the Finance Bill for the pension benefits of new entrants to the police and fire services.

The Chancellor shares the Home Secretary's concern about this, and agrees that it would be most desirable if the latter could be in a position, if necessary, to give an unqualified assurance that the present arrangements for the commutation of pension benefits to a lump sum will continue.

I am sending a copy of this letter to Mark Addison (No.10), William Pittall (Home Office), Robin Masefield (NIO), Robert Gordon (Scottish Office) and Murdo Maclean (Chief Whip's Office).

Yours Sincerely,
Andrew Lansley

ANDREW LANSLEY
Private Secretary

ECON POL - Budget
PE 16



010
CONFIDENTIAL
CSG



QUEEN ANNE'S GATE LONDON SW1H 9AT

1 May 1987

NBM.

Dear Nigel,

I understand that proposals in Schedule 5, Part II, of the Finance Bill, as published, would have the effect of sharply curtailing the amount of pension benefits which new entrants to the police and fire pension schemes could commute. Members of these schemes have long enjoyed the facility to commute up to a quarter of their pensions. The lump sums so obtainable are sizeable, and those in the police and fire service attach considerable importance to them not least as a means of financing a second career, given their early compulsory retirement ages.

I recognise that your proposals would apply only to new members, but this will not prevent a major row with the police and fire interests once they realise the implications, unless you can agree to the police and fire schemes being excluded from the Bill's provisions. While I do not question the principle of the case for restricting the proportion of pension benefits payable as a tax free lump sum, the present provisions in the police and fire schemes have been in operation since 1964 and 1966 respectively and 99% of retiring officers commute the maximum allowed. We may very well be asked questions about this over the next few weeks, and I want to be able to give a direct and unqualified answer that the present arrangements will continue.

I am copying this to the Prime Minister, the Lord President of the Council, the Chancellor of the Duchy, the Secretaries of State for Scotland and Northern Ireland and the Chief Whip.

Yours,
Douglas

The Rt Hon Nigel Lawson, MP

CONFIDENTIAL

file J2ANG

bc BS



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

24 March 1987

PENSION FUNDS

The Prime Minister is aware of concern that the possibility of taking resources from company pension funds may still be playing an unhealthy role in takeovers. (This was raised for example at a meeting of NEDC which she chaired recently.) The Secretary of State for the Environment has also mentioned to the Prime Minister his concern that some local authorities may now be misusing pension fund resources.

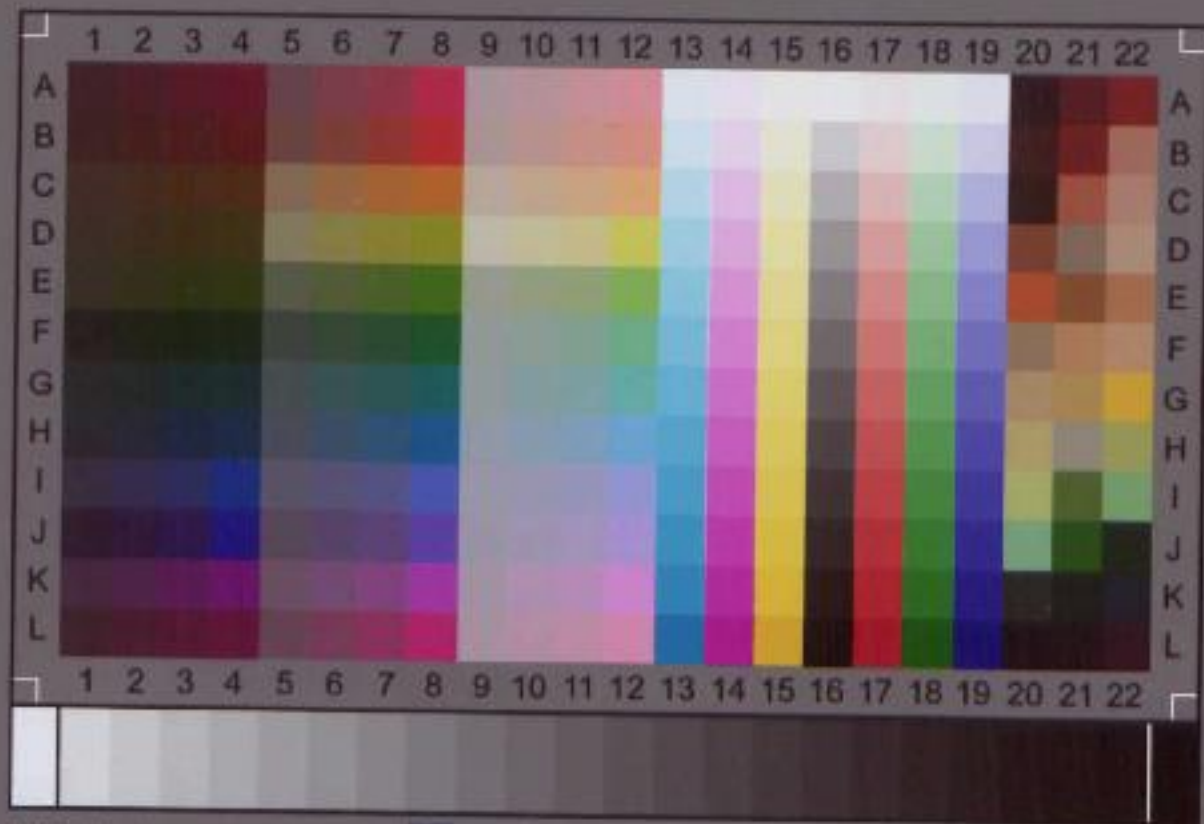
The Prime Minister is of course aware of the action taken in the 1986 Finance Act to improve the tax treatment of withdrawals from pension funds and to set a proper framework of rules for pension fund surpluses, contribution holidays and the like. However it does still seem to be possible for a predator to take over a company, then to make numbers of its employees redundant, so creating a surplus in the pension fund because ex-employees' pension rights are less valuable than their accrued rights had they remained with the company.

This is quite possibly an incoherent account of the position. But, in view of the concerns which have been expressed, the Prime Minister would be grateful for a note on the changes which have been made in this area, and an assessment of any problems which remain. The note should also cover the position of local authority pension funds.

I am copying this letter to Richard Stoate (Lord Chancellor's Office), Alex Allan (HM Treasury), Paul Steeples (Department of Trade and Industry), Joan MacNaughton (Lord President's Office), Andrew Lansley (Chancellor of the Duchy of Lancaster's Office), Murdo Maclean (Chief Whip's Office), Robin Young (Department of the Environment) and to Trevor Woolley (Cabinet Office).

(DAVID NORGROVE)

Geoffrey Podger, Esq.,
Department of Health and Social Security.



IT8.7/2-1993

2009:02

Image
Access

IT-8 Target

Printed on Kodak Professional Paper

Charge: R090212