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Secretary of State for Trade and Industry

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4 April 1986

David Norgrove Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

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Prime Minister
Rumours have reached the press. DTI will provide a line for Questions tomorrow.
DRN
7/4.

Dear David,

UK PROVIDENT INSTITUTION

I am writing to give you prior warning of a matter concerning an insurer which may shortly become public knowledge and which arises from the exercise of the DTI's role as supervisors of the insurance industry.

2 The insurer is the United Kingdom Provident Institution (UKPI) - a long established mutual life office of good standing and with a high proportion of with-profits policy holders.

3 In the course of the DTI's regular monitoring of insurers it came to our notice that UKPI's cover for its statutory solvency margin might be less than adequate. A combination of poor investment performance, the cost of financing a rapid expansion of business and high bonus declarations had eroded UKPI's investment reserves. The major factor in the poor investment performance was a decision in 1979 to make substantial investments in "unquoted situations" e.g. small deposit takers and investment management companies here and in the US and oil development in the US.

4 Since this came to light we have examined carefully with UKPI the solvency margin position and the need for effective corrective action by the company to rebuild its reserves. We now believe that the statutory solvency margin is covered but there is no way in which the company can properly continue to maintain previous levels of bonus declarations or seek to obtain new with-profits business on the basis of those previous levels except in association with another company willing to inject a substantial amount of new capital.

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5   There are potentially two partners: one (the Trustee Savings Bank) who would envisage a capital injection and the other (a large mutual life office, Friends Provident) who would not inject new capital so that a reduction in bonuses would be inevitable. These discussions continue but we are not willing to let them drag on not least because it is clear that the UKPI needs to bring its sales promotion into line with its revised prospects.

6   Given speculation in the market place that UKPI may be in difficulty we think that an announcement will have to be made next week of agreement in principle to one of the two mergers or that UKPI has closed for new business. We would want any announcement to highlight the fact that the UKPI position is special to that office and not typical of other parts of the life insurance industry.

7   It is important to underline that this is not a situation where an insurer is about to collapse with losses falling on the insured. We believe that UKPI is covering its statutorily required margin of solvency; that should ensure that whatever results from the current discussions contractual benefits are fully covered and that substantial bonuses will still be available to policy holders, albeit on a lesser scale than they have become accustomed to in recent years.

8   I am sending a copy of this letter to Philip Wynn Owen (Treasury).

Yours ever,

Michael

MICHAEL GILBERTSON
Private Secretary

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