

# Gower urges sweeping new powers to supervise City

BY JOHN MOORE, CITY CORRESPONDENT

WIDE-RANGING proposals to overhaul the regulation of Britain's financial community, including sweeping new powers for the Department of Trade and Industry were published yesterday in a controversial report commissioned by the Government.

Ministers have already made clear their determination to introduce legislation for improved investor protection, though the pressure on Parliamentary time may mean new laws will not come into force for some time.

Financial organisations, ranging from merchant banks and large stockbroking concerns to small firms of investment advisers and financial journalists, would be supervised in a formal regulatory framework outlined in a 212 page report prepared by Prof Jim Gower, consultant research adviser on company law to the DTI.

The report was commissioned in 1981 following a series of scandals in securities firms which were not members of the London Stock Exchange, and malpractice in the London commodities markets.

Prof Gower revealed yesterday in his report that over 50 commodity firms were presently under official investigation. These investigations involve inquiries by the DTI and the City of London Police Fraud Squad.

In concluding his report Prof

## KEY RECOMMENDATIONS

- Investment business illegal unless advisers and companies recognised by a Government agency or members of a recognised self-regulatory agency.
- Number of self-regulatory agencies to be expanded, based on existing professional institutions.
- The Council for the Securities Industry to act as umbrella for other self-regulatory agencies and co-ordinate their activities. Department of Trade and Industry to maintain contact with the CSI.
- Tighter regulation of sale of life assurance.
- Statutory provisions for the public issues of securities, takeovers and insider-dealing transferred from the Companies Acts to new Investor Protection Act.
- Investor Protection Act to encompass the above recommendations.

Gower warns that "unless my proposals are implemented essentially on the lines proposed, further serious scandals undermining public and international confidence are, in my view, inevitable. If they were implemented scandals would not be wholly prevented but I believe that they would be fewer and that when they occurred less irremediable damage would be suffered."

Professor Gower has recommended a mixture of statutory and self regulation for his proposed framework for further

investor protection. A new Investor Protection Act would enable the DTI to supervise the financial community.

The Act would make it a criminal offence for firms to carry on investment business unless they are registered directly with the DTI or through membership of a self regulatory agency approved by the department.

He said that the recognised self regulatory agencies would initially have to be based on existing professional associations.

Among those likely to qualify for recognition, he said, were the Stock Exchange, the National Association of Security Dealers and Investment Managers, representing dealers who are not members of the Stock Exchange, a unit trust agency, the Association of Futures Brokers and Dealers, the Lloyd's insurance market and a certifying body for life insurance intermediaries.

The recognised self regulatory agencies should be represented on the Council for the Securities Industry which would maintain a role as the umbrella and co-ordinating body of self regulatory agencies and associations. There should be regular consultation between the council and the DTI, said Prof Gower.

The Council for the Securities Industry, which has been attempting to establish itself as the City's main self regulatory body and was alarmed that its role might be diminished, said that Prof Gower had attempted to meet several points of concern.

The council said it saw the publication of Prof Gower's report "as a significant step in the process of overhauling the

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## Gower

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outdated legislation which now governs the securities industry."

Mr Norman Tebbit, Secretary for Trade and Industry, said that interested parties would have until April 30 to submit comments on Prof Gower's recommendations.

Mr Tebbit said yesterday: "I call on all concerned to consider Prof Gower's proposals in a constructive and positive spirit, remembering that his present report is already based on extensive consultation with interested parties."

He added that Prof Gower's "principle of self regulation within a framework of statutory supervision may well be a way forward."

Sir Nicholas Goodison, chairman of the Stock Exchange indicated some concern over the prospect of established and successful self-regulation being adversely affected should

powers be given to the Government to alter non-statutory rules. But he noted that Prof Gower now proposed that Government Orders for such changes should have Parliamentary approval.

"The Stock Exchange appears to conform in every respect to Prof Gower's model of a well organised self-regulatory agency," he said.

Mr Ian Hay Davison, chief executive of the Lloyd's insurance market, said he welcomed the Gower report. "If the Government accepts the report's recommendation for formal recognition of self regulatory agencies, we shall seek it."

The National Association of Security Dealers and Investment Managers said it was glad to see that Prof Gower had stuck to a broad approach and had defined the role of the Council for the Securities Industry.

## Proposals for the regulatory system

THE Prevention of Fraud (Investments) Act would be repealed and replaced by an Investor Protection Act. Responsibility for the administration of the new Act would be vested in the Department of Trade and Industry or in a self-standing commission answerable to the Secretary of State.

With certain exceptions, the Act would make it a criminal offence to carry on any type of investment business unless registered. The present distinction between licensed dealers and exempt dealers of various types would disappear; all would be registered.

Registration would either be directly with the department, or commission, or through membership of a self-regulatory agency recognised by it.

The Act or regulations made under the legislation by the Secretary of State would lay down the basic requirements which those registered would have to observe and would prohibit certain activities relating to investments whether or not carried on by registered persons.

The Act would empower the department, or commission, to make rules of conduct binding on those registered directly with it and not

through membership of a self-regulatory agency. Breaches of these rules, unlike the regulations, would not be criminal offences but could lead to cancellation or suspension of registration.

A self-regulatory agency would not be recognised unless it satisfied certain conditions, including having rules which, having regard to the character of its membership, would ensure protection to investors at least equivalent to those of the department, or commission, and the ability to monitor their observance.

The recognised self-regulatory agencies would be responsible for ensuring the observance of the rules and regulations by their members and would, as an adjunct of recognition, enjoy certain powers and privileges.

Registration under the Act would obviate the need to be licensed under the Banking Act unless the firm accepted deposits otherwise than for the purpose of investment.

The Act would make provision for a harmonised system of regulation of public offerings, whether on an issue (primary or secondary) or a takeover and would contain a modernised version of the prospectus provisions presently in the Companies Act 1948.

# Dealing under school rules

THE FINAL draft of the Gower report on investor protection contains few surprises; except on the structure of self-regulation for the City. Prof Gower has not felt it necessary to make any radical changes in the draft which appeared in 1982 and has been widely discussed.

The Government, in the person of Mr Norman Tebbit, has given it an initially rather guarded welcome—self-regulation subject to official supervision "could offer the way forward." However, Mr Tebbit has set a tight timetable for any further discussion, between the lines, it seems, this lucid report will indeed be the way forward. For all the clear guidance offered, it is not going to be an easy one.

Before we come to the difficulties, it is worth rehearsing the arguments in favour of self-regulation, as opposed to wholly official policing. They lie in what might be called the field of ethics rather than of outright fraud—two topics which are inclined to get entangled in investor protection.

## Ethos

Fraud can only be checked by clear rules, tight auditing and adequate punitive powers, and must always be a concern of the law. The more shadowy demands which must be met if high rather than minimal standards are to be met have always seemed to us better imposed by what amount to club rules.

Prof Gower draws attention to the public school ethos of the City, in which it is bad form to sneak; but this is the strongest argument in favour of self-regulation. Public school-boys can be quite ruthless in imposing their own code, provided the beaks are not called in.

However, this is not enough: the club rules must themselves be scrutinised, as recent experience in Lloyd's reminds us painfully.

This is the essential structure which Prof Gower proposes, and on paper we would judge it to be the right one; but it is going to take a great deal of hard work to make it a reality.

First, there must be a big effort on the part of the industry itself. Even its best regulated sectors, such as the Stock Exchange, fall a good way short of the scope which will be required—for example, there

are no rules at all governing the fund management activities of stockbrokers. Other groups, and especially among the elite, have no effective disciplinary code.

Nor will they find it easy to meet what seem reasonable standards. The essential part of "ethical" investor protection, as Gower points out, is disclosure—of individual deals and of potential conflicts of interest—and disclosure is not a City habit.

The Government also has a difficult job to do. Gower effectively offers a choice to those who handle investors' money—join a club, or come under direct official supervision. The job, however, will be far beyond the capacity of any existing government agency unless club membership becomes the general rule.

This may involve a good deal of arm-twisting. For example, as the rules on dealing capacity and minimum commissions are removed, the costs and restrictions which have led to the growth of parallel securities markets in London—between overseas dealers and brokers or between accepting houses, for example—will also be removed. It will still not be easy to persuade these independents to join their former rivals in a single organisation with a single set of rules.

Given the difficulties, there will be a strong tendency in the City to stonewall, and to argue that practices which have served for more than a century are still adequate: it is this pressure which politicians, who tend to be overruled in face of the City, will find it hardest to resist.

This will not do. The old disciplines were based on old separations of function and interest which are breaking down as economies of scale, and the trend to one-stop financial services, create new complications with built-in conflicts of interest.

The Government must also steel itself against its general prejudices, to make available adequate resources to do the central job of scrutiny and supervision—which could well be paid for by the hardly poverty-stricken industries which are to be supervised. If the job is done half-heartedly, and scandals break out, the whole subtle and economical system which Prof Gower proposes could be damaged beyond repair. This could be the last chance for public school rules.

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