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B/f wk in response
AT 7/12

PRIME MINISTER

FINANCIAL SERVICES WHITE PAPER

In my minutes of 12 July and 9 October I outlined my initial proposals on City regulation. You agreed these, subject to some points on the institutions (the correspondence rests with your Private Secretary's letter of 14 November). I am now writing to let you know the main features of the draft White Paper before circulating it to all Cabinet colleagues.

Objectives and Principles

2 My starting point is our agreed objectives - efficiency; competitiveness; investor confidence; and vigorous enforcement. The last of these is a matter for Government. The first three are best served by increasing the scope for market forces to operate. To this end, I do not advocate detailed regulation of the financial services sector by Government. Instead, the White Paper will propose a clear statutory framework (to help with enforcement and deter fraud and malpractice), and will state general principles. Within these, practitioners in the market will be free to operate and compete, encouraged to innovate but also required to maintain high standards of conduct. I also plan measures to improve disclosure (see para 8), though we will not be seeking over-elaborate requirements that lead to the publication of worthless information.

Scope

3 The scope of the proposals will depend on how we define

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investment. I intend to adopt a wide definition, encompassing almost all paper investments but excluding physical assets. I would take powers to bring new items within the definition by Order if need be. Likewise, the White Paper will define an investment business; and anyone carrying on such a business will have to be authorised to do so, as at present for securities.

City Bodies

4 With the exception of life assurance companies (where EC Directives require me to retain formal powers), this authorisation will be granted not by me, but by bodies - of which we propose there should initially be two - set up by the City, but to which I shall delegate necessary powers: one securities and investments; the other unit trusts and life insurance marketing. The legislation will not prescribe the number of supervisory bodies, so that there will be nothing to stop the two currently in prospect from being merged into one. I will only delegate powers of authorisation and supervision if I am satisfied that the bodies' proposed rules for investment businesses meet certain statutory requirements; and that the bodies have the resources to ensure that authorised investment businesses comply with them. To make enforcement easier, and to deter fraud and malpractice, the bodies will need specific powers to supervise and monitor the conduct of authorised investment businesses. These should include powers to require documents to be provided, and to impose sanctions, including the withdrawal of authorisation to carry on investment business. The bodies would in turn have the power to recognise a second tier of self-regulatory agencies, provided these met the necessary criteria: these could be existing organisations (like The Stock Exchange). No individual business would be



obliged to be part of one of these second-tier organisations: it could seek authorisation direct from the supervisory body.

5 The point of this practitioner-based approach is to provide adequate investor protection with the maximum freedom for market forces to operate. The Debate in July showed that some opinion on both sides of the House may raise constitutional objections to these proposals. The fact that I shall be delegating my statutory power for rule-making to a private sector body, not accountable to Parliament, may give particular cause for concern. But I am convinced that a new statutory body - the approach favoured by some - would not satisfy the objective of an efficient and competitive financial services sector. I believe Ministers would find themselves exposed in Parliament to questions arising between individual firms and their investors, in precisely the way you suggest we should avoid. We have a good case to make to Parliament on the accountability of the supervisory bodies: I will want them to report annually through me to Parliament on the exercise of their delegated powers; I will have considerable powers to appoint and dismiss the Chairmen and Members (see para 9); and further safeguards will include an independent procedure before a new and independent body whose members I shall appoint for determining disputes on authorisation and the application of rules, and my powers to revoke rules which are anti-competitive or contrary to international obligations (para 6). I shall discuss the question of accountability with the Attorney General.

Rule Changes

6 I believe the competitive aspects of the new regime merit special arrangements and particularly close supervision. The Director General of Fair Trading will advise me on the



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bodies' rules, and I shall have powers to approve, revoke or amend rules which have anti-competitive effects, but only on the Director General's advice. He must propose, and I must dispose, to change a rule. This is right if I am to have a defence against PQs seeking me to challenge rules. I will also need to have powers to require rule changes to meet our international obligations. Otherwise, I believe the rule-making powers should reside with the supervisory bodies subject, of course, to my powers to withdraw my delegation of authority to them in whole or in part if I am not satisfied by their performance.

Legal Aspects

7 My proposals do not in fact create new criminal offences but they significantly re-draw and extend the boundaries of existing offences. In addition to the sanctions available to the supervisory bodies and the sanctions attached to breaches of the criminal law (which will be for Government to police), remedies will be available to investors under civil law for them to enforce if necessary through the courts. Other reforms include proposals to tighten up on advertising calculated to defraud investors, and amendments to existing insider dealing legislation to make it more effective. I hope that the new FIG arrangements and the results of Roskill will add to the enforcement armoury.

Disclosure

8 On disclosure I propose:

- a) nearly all offers to the public will require a prospectus, which will have to be more informative than at present. Among other things this will

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improve the quality of information made available in the fast growing over-the-counter market which is important to small firms and potential investors in them;

- b) the same requirements will apply to take-over documents;
- c) commissions paid to intermediaries by life insurance companies and unit trusts will have to be disclosed. This approach is more consistent with our general philosophy than statutory backing for commission agreements, which some parts of the insurance industry advocate.

Appointments

9 We are agreed that the formula for appointments needs to reassure Parliament about the accountability of these bodies, while giving the practitioners the confidence that they are not merely instruments of a state quango for which they will be expected to pay. For the securities and investments body, therefore, I propose to appoint the Chairman, with the agreement of the Governor; the Governor will formally appoint members, with my agreement. For the insurance and unit trusts body, I will appoint both the Chairman and members after appropriate consultation with the industry. In both cases, I shall have powers to dismiss the members.

Other Points

10 The White Paper is not intended as a consultative document. However, it is inherent in a practitioner-based system that many of the detailed rules remain to be



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formulated, by bodies which do not yet exist. Subject to these unavoidable caveats, I want the White Paper to be as firm as possible, setting out our decisions, rather than being a yet further piece of consultation. That said, I accept that some of my proposals may need to be modified in the light of public and Parliamentary reaction to them, as well as the work of the practitioners.

11 This minute covers most of the immediate concerns expressed in your Private Secretary's letter of 14 November. I shall arrange for you to have separate replies on the equity and gilts markets, and on delegating my Department's work supervising marketing of insurance and unit trusts.

12 Nigel Lawson has seen this minute and is content with it.

13 I am sending a copy of this minute to Nigel Lawson, Willie Whitelaw and Sir Robert Armstrong.

McCarthy
(seen and approved by the Secretary of State,
and signed in his unfired absence)

N T

7 December 1984

Department of Trade and Industry

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Exam Pt. 1. Games Report on Invertebrate Protection



17 DEC 1984
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For information of the Committee, I have the pleasure to inform you that the Committee has received your letter of the 12th October and has considered the same. The Committee has decided to refer the matter to the relevant authorities for their consideration. The Committee will be pleased to receive your views on this matter and will be glad to discuss them with you at any time.

1. The Committee is aware of the importance of the work of the Invertebrate Protection Society and is pleased to hear of your recent success in your efforts to protect the interests of the Society. I shall be glad to have your views on the matter and will be pleased to discuss them with you at any time.
2. The Committee has also been informed of your recent success in your efforts to protect the interests of the Society and is pleased to hear of your recent success in your efforts to protect the interests of the Society.
3. I am sending you a copy of this letter for your information and will be glad to discuss it with you at any time.

(This copy is for the Committee and is not to be used for any other purpose.)

Yours faithfully,
[Signature]