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The Rt Hon Norman Tebbit MP
Secretary of State for Trade & Industry
Department of Trade & Industry
1 Victoria Street
London SW1H 0ET

15 January 1985

WHITE PAPER ON FINANCIAL SERVICES

Thank you for copying to me your minute to the Prime Minister of 8 January, in which you sought the approval of Cabinet colleagues to the publication of the White Paper.

Your proposals provide a bold and imaginative framework for an effective system of self-regulation. I am glad to see that the text takes full account of the concerns registered in my letter to you of 8 October 1984, and especially that you envisage that the Governing Councils of the new supervisory bodies will draw on a wide body of experience and expertise; that there will be a genuinely independent Appeals Tribunal, able to substitute its judgment for that of the bodies, and with Court powers; and that you envisage the possibility of there being only one supervisory body rather than two. I should have preferred a warmer reference to this possibility, but I understand your reasons for not wanting to tread too heavily.

I am content with the arrangements for appointment of the members of the Councils of the two bodies. I should, however, be grateful for your confirmation that in the event of the two bodies coalescing, no further primary legislation would be required to set in hand the new arrangements.

There is, however, one drafting point of which I should be grateful if you would take account before publication.

In 4.3(3) bank, and building society and friendly society deposits are included within the definition of investments, even though they are excluded from the coverage of the financial services legislation by paragraph 4.18. It would be better not to include them in the first place.



There is a significant and important difference between making an investment, where the investor has no guaranteed return of his capital from the person with whom he places his money, and making a deposit, where he does. There have always been great difficulties in arriving at a water-tight definition of deposit-taking, and hence in establishing enough evidence to make successful prosecutions for illegal deposit-taking under the Banking Act. I think it is confusing and unnecessary to include deposit-taking in your definition of "investments" since there is considerable practical benefit in maintaining a clear distinction between the two activities and the separate areas of supervision and legislation.

I know that the difficulty arises because of your - and my - desire to cover deposit-brokers as well as investment intermediaries. I would ideally have liked deposit-brokers to be brought into the new arrangements. The new advertising regulations, to be enacted shortly, should however go some way towards controlling their activities. If their coverage can only be achieved by inclusion of deposits in 4.3(3), we and the Bank would prefer to drop 4.3(3) and accept that deposit brokers would fall outside the scope of the new arrangements.

In paragraph 4.23 I wonder if the gullible rich are given enough protection against unscrupulous investment companies.

In paragraph 5.11, you describe the arrangements for the appeals tribunal. You propose that it should be financed from public funds. You give no indication of the likely scale of its activities or costs, and I quite see that an estimate would be difficult at this stage. I understand however that the new tribunal will subsume the functions of the existing Prevention of Fraud (Investments) appeals tribunal, and that the costs of the new tribunal can be met from your Department's existing PES provision.

I read with particular interest paragraphs 5.12 and 5.13 on the implications for supervision of the trend towards financial conglomerates. The financial services sector is clearly in the early stages of a transitional period of radical change, and we shall have to keep our supervisory arrangements under constant review, not only in the areas covered by your White Paper, but also in banking and building societies legislation. I shall certainly be considering the relationship between the Bank of England and the new supervisory bodies in the review of banking supervisory arrangements now in train.

In 5.15 and 5.16, I am content with the reference to the proposed new arrangements for the gilts market. But more work needs to be done in defining the precise relationship between the Bank of England, the new SIB, and the appeals tribunal. This is just one of the details to be settled during the present consultative period on the Bank's proposals.

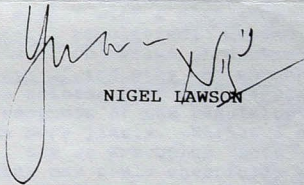


On paragraph 7.12, I wonder whether it is wise to aim at 100 per cent compensation for private investors. I accept that you are not proposing such compensation against commercial risk; but even for "capital-certain" deposits in banks, building societies and licensed deposit-takers, the compensation available against fraud or insolvency is quite severely limited. Is it not wrong in principle to give no incentive to the investor to consider carefully the standing and reliability of the person to whom he entrusts his funds? I understand however that you do not intend to give 100 per cent statutory compensation, but that you do not wish to undermine existing best practice. On this basis I can agree the text.

Paragraph 9.10 refers to unit trusts investing in assets such as money market instruments. There are some definitional problems about money funds, and there remains some doubt as to the precise and desirable boundaries between the proposed financial services legislation and the Banking Act. I understand that our officials are considering these questions urgently.

On Chapter 13, I was concerned that the effect would be to make it virtually impossible for a company to make a public offering by use of the short prospectus procedure. I understand, however, that under the new listing regulations all listed companies will be free to make offers using the short prospectus procedure, both in initial flotations and in raising subsequent capital. If you can confirm that nothing in the White Paper prevents this, I am content with the drafting.

I am copying this letter to the Prime Minister and to **Cabinet** colleagues.



NIGEL LAWSON

Econ Bd: Cover report on Investor Protection

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15 JAN 1985



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