MR NORGROVE 10 December 1985

FINANCIAL SERVICES BILL
INDEMNITY FOR DESIGNATED AGENCIES

There is a disagreement between Leon Brittan and the Lord Chancellor about providing indemnities in the Financial Services Bill for designated agencies from liability for damages. The latter objects to the inclusion of such a clause.

It is unlikely that adequate insurance can be obtained for such bodies whose assets are negligible, and, without either this, an indemnity for the organisation as a whole, or individual personal indemnities, it would seem unlikely that suitable persons would be found to act as members.

The Bank of England's regulatory functions are not covered by indemnity at present, nor is the matter dealt with in the coming White Paper. It is understood, however, that they seek to have such an indemnity included in the Banking Bill to be introduced in the next Session.

We support the inclusion in the Bill of an indemnity clause for designated agencies. This appears preferable to individual indemnities for members from the Government, or to trying to enforce indemnities from the whole Financial Services industry, since the agencies will be carrying out statutory functions for the Government.

We also support Leon Brittan's rejection of the Bank of England's suggestion that self-regulatory agencies should also be indemnified. Such bodies should be indemnified by the members who are the subject of self-regulation (eg insurance companies, unit trusts, etc).

David Hobson

DAVID HOBSON

CONFIDENTIAL

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

Secretary of State for Trade and Industry

10 December 1985

CONFIDENTIAL

The Rt Hon Lord Hailsham
of St Marylebone CH, FRS, DCL
House of Lords
LONDON
SW1A OPW

Dear Quintin,

Thank you for your prompt reply to my letter of 5 December.

The key financial protection for investors is that a designated agency will be required, as a condition for the transfer of powers, to have rules which provide for compensation for investors who suffer loss as a result of a breach of rules by, or the insolvency of, an authorised business. These rules may require insurance cover to be obtained by the authorised business and/or contributions to be made to a compensation scheme. Clients' funds will also be required to be segregated. Unless I am satisfied on both these points, I cannot transfer any functions to a designated agency. Parliament will also have to be satisfied as the Bill makes delegation orders subject to affirmative resolution.

In the event of a loss arising from a breach of rules or insolvency, the investor's first claim will be against the investment business concerned. If it cannot pay, then the compensation arrangements will ensure that most private investors' losses are met. If the arrangements described in my previous letter are implemented, such losses will be met, in full, up to £30,000 for each investor.

It is only losses above this limit, or losses incurred by persons other than private investors, which might give rise to a claim against the designated agency. Such a claim would only arise if the agency had either negligently failed to take some reasonable action which would have prevented or reduced the losses or had taken some unreasonable action which precipitated the losses.

The prospects for such a claim would be at best uncertain and I would not expect investors to regard the absence of a right to bring such a claim as significantly reducing the protection available to them. They will, rightly, look to the Government to ensure that the designated agencies carry out their functions efficiently. As I explained, in my first letter, the regulatory authorities, both statutory and self-regulating, in the United States are excluded from liability for damages and there does not seem to have been any misunderstanding as a result.

As to insurance, I am not quite sure what your reference to a master policy or mutual insurance means. On the assumption that there will only be one designated agency, namely the Securities and Investments Board, SIB has explored the possibility of obtaining insurance. But the cover that could be obtained is quite inadequate to meet the potential risks and the cost (which would be borne by investors) for even this limited cover would be very high. This confirms the experience of other, established, regulatory authorities and of my own department's discussions with the insurance industry. I see no prospect therefore of SIB being able to obtain adequate insurance cover for this purpose in the foreseable future.

As you rightly say in your letter in the last resort I must strike the balance. I remain convinced that the Bill should provide for an exemption from liability for SIB and I propose to include such an exemption in the Bill on introduction. If this has your support, so much the better. After introduction I shall naturally want to listen to the arguments which are raised in debate.

I am copying this letter to the recipients of yours.

LEON BRITTAN

Econ. Pol. Covers.

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CC B/G

FROM:
THE RT. HON. LORD HAILSHAM OF ST. MARYLEBONE, C.H., F.R.S., D.C.L.

HOUSE OF LORDS.
LONDON SW1A 0PW

CONFIDENTIAL

6 December 1985

NBPM

My dear Leon:

FINANCIAL SERVICES BILL

Thank you for your further letter of 5th December 1985 ~~ATTACHED~~.

I am still not happy about your proposal to exempt the statutory agencies from liability for damages.

Whilst having every sympathy with your difficulties I wonder if you have sufficiently explored the possibility of a master policy or mutual insurance to be obtained by these bodies. Are you really satisfied that the City and the wider investing public will appreciate in practice and in the long term that these statutory agencies offer no direct financial protection in giving their approval or licence? Of course in the last resort you must balance between the needs of self-regulation and the exclusion of that liability which you agree would exist but for these proposals.

I am copying this letter and, for ease of reference, our earlier recent exchange of correspondence, to the Prime Minister and Cabinet colleagues and to Sir Robert Armstrong.

yrs:

L.

The Right Honourable
Leon Brittan QC MP
Secretary of State for
Trade and Industry

cc BG

To Mr Seater

COPY For Advice & draft reply

COPIES TO
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DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SWIH 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

Secretary of State for Trade and Industry

5 December 1985

CONFIDENTIAL

The Rt Hon The Lord Hailsham of
St Marylebone PC CH FRS DL
The Lord Chancellor
House of Lords
London SW1A OPW

Please advise & remind

I dont like this - Can they not get a master policy or a mutual insurance?

Dear Quintin,

FINANCIAL SERVICES BILL

I have considered again most carefully the arguments in your letter of 28 November about my proposal to confer on designated agencies an immunity from liability for damages for anything done or omitted in good faith in the discharge of functions exercisable by those agencies by virtue of a delegation order.

I share your reluctance to depart from the normal principles of liability. As you say, the Government did not propose this in the White Paper. Indeed, my own initial view was that we should not make any special exemption for designated agencies. But in the past year, indemnity insurance has become increasingly difficult for any regulator to obtain. Even regulators with excellent track records have found that they have not been able to obtain the major amounts of cover they need and the cover they have been able to obtain has increased enormously in cost. In all the circumstances, I have been forced to the conclusion that an exemption from liability for damages is necessary. The crucial factor for me is my concern about the disastrous consequences for the whole regulatory system if an award was made against a designated agency of such a size that it became insolvent. The agency would not then be able to continue its role and the Government would have to resume all its regulatory functions at very short notice, without having the resources or the expertise to undertake them effectively. The consequences for the regulatory system and investor protection would be very serious. I do not believe that we should take the risk of this happening.

You mention two particular concerns: relative lack of Parliamentary accountability and protection of the small investor. Parliamentary accountability will be provided largely through my powers (jointly with the Governor) to appoint and remove members of the governing body of designated agencies and my power to withdraw transferred functions in whole or in part if a designated agency

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does not continue to meet the criteria for delegation. I shall therefore be accountable to Parliament for the use of these powers. The agencies will also be required to publish annual reports which will be laid before Parliament and no doubt fully debated. Protection of small investors is one of the prime objectives of the Bill. Under it, I shall not be able to transfer powers to a designated agency unless I am satisfied that the rules of that agency make the best possible provisiosn for indemnity against losses arising from defaults by investment businesses. In considering whether the provision is adequate, I shall be looking particularly at the position of the private investor. The Securities and Investments Board is now working out compensation arrangements for such losses and is considering proposing a compensation scheme which would meet in full losses incurred by private investors up to £30,000. If, as I hope, this can be achieved, the protection afforded to small investors would be virtually complete (and much better than that available to depositors under the Banking Act) and the question of recourse against the agency by small investors would not arise even if it to prevent the losses arising.

I welcome the considerable debate which I agree there will be about giving designated agencies an immunity from damages. I remain convinced that, despite the disadvantages, the exemption is necessary for the proper functioning of the new regulatory arrangements. In view of the shortness of time before introduction, Parliamentary Counsel has included an exemption in the current print of the bill (and it will also appear in the next Legislation Committee print) on the basis that it is still provisional pending further consultation with you. I attach a copy of the relevant provision. The current exemption for The Stock Exchange as competent authority is continued by the Bill.

I think that this is an issue on which the Government needs a clearly defined view when the Bill is introduced. I must introduce the Bill immediately after Legislation Committee on 17 December if, as has long been planned, it is to be published before Christmas. I would like to resolve this issue well before then so that the text of the bill can be finalised. It would, therefore, be most helpful if you would let me know within the next day or so if you wish to pursue this point further, and in that case perhaps we might have a word about it.

I am copying this letter to the Chancellor of the Exchequer and the Governor of the Bank of England.

LEON BRITTAN

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FINANCIAL SERVICES BILL

Exemption for designated agencies

Schedule 7, paragraph 3:

Neither a designated agency nor any member, officer or servant of a designated agency shall be liable in damages for anything done or omitted in good faith in the discharge or purported discharge of the functions exercisable by the agency by virtue of a delegation order.

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HOUSE OF LORDS.
LONDON SW1A 0PW

28 November 1985

My Dear Leon,

Financial Services Bill

Thank you for your letter of 7 November 1985 on your proposal to confer on designated agencies an immunity from liability for damages for anything done or omitted in good faith in the discharge of functions exercisable by those agencies by virtue of a delegation order.

I can well see that the SIB or MIBOC may feel inhibited in the exercise of their delegated functions by the prospect of possible actions for damages, should any negligence be attributable to them. I do not think it follows self-evidently that such a liability ought to be excluded. The normal means of protection for anyone - even a statutory corporation - whose skill and judgment may be called into question is for him to seek indemnity by insurance. In your letter you explain that even insurance is virtually unobtainable for an 'untried regulator'. I would point out, however, that this point was not raised in the White Paper and it has not been thought necessary, until now, for any immunity from liability for damages to be conferred on the designated agencies.

As you will know, I did indicate to your predecessor some concern over the relative lack of Parliamentary accountability inherent in the self-regulatory system which was being proposed.

The Right Honourable
Leon Brittan QC MP
Secretary of State for Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
London
SW1H 0ET

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RESTRICTED

The lesser the degree there is of direct Parliamentary accountability, the greater the need, I would suggest, for the designated agencies to be subject to the ordinary law. I do forsee considerable opposition to such an immunity being conferred on an agency which is only indirectly subject to Parliamentary control. You have identified the risk as arising from large-scale claims for damages, but we must also bear in mind the protection of the small investor whose rights would be curtailed. There is no satisfactory means of distinguishing, for the purposes of granting immunity, between two broad classes of claim and I do not think the attempt should be made.

The Governor of the Bank of England has copied to me his letter to you of 15th November 1985, arguing that your proposals for immunity should be extended to self-regulating organisations recognised by the SIB. I note, and support, your intention to resist pressure to extend any immunity to these organisations. As you rightly say, these bodies cannot be said to be exercising any statutory function.

I am copying this letter to the Chancellor of the Exchequer and the Governor of the Bank of England.

YRS:

ACTION | To Mr Saker

COPY | For Adv... early reply

COPIES TO

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Secretary of State for Trade and Industry

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET 5422
TELEPHONE DIRECT LINE 01-215
SWITCHBOARD 01-215 7877

7 November 1985

The Rt Hon the Lord Hailsham of St Marylebone PC, CH, FRS, DL
The Lord Chancellor
House of Lords
LONDON
SW1A 0PW

Dear Quintin,

FINANCIAL SERVICES BILL: CIVIL LIABILITY OF DESIGNATED AGENCIES AND COMPETENT AUTHORITIES

I am writing to seek your agreement to the inclusion in the Financial Services Bill of a provision excluding designated Agencies, competent authorities and their staff from liability for damages for any act or omission in the performance of their statutory functions under the Bill, unless the act or omission is done in bad faith.

2 As you know, the Bill will enable the Secretary of State to transfer many of his functions under the Bill to a designated Agency or Agencies which meet specified criteria. The Securities and Investments Board (SIB) and the Marketing of Investments Board Organising Committee (MIBOC) have been set up. I have been considering whether designated Agencies should be relieved of liability for damages. I have no doubt that they should remain liable to suit so that any person concerned can invoke the aid of the Courts if the Agencies fail properly to carry out their functions, but liability for damages raises more difficult issues.

3 The main problem arises because of the size of the claims which might be made against an Agency. If a large investment business fails and it is claimed that the Agency could and should have taken some action to prevent the failure, the claims could run into millions, possibly even tens of millions, of pounds. The Agencies will have no funds of their own. They will be financed almost entirely out of the fees paid by recognised bodies and authorised persons. For an untried regulator, indemnity insurance is virtually unobtainable. A successful claim for a large amount of damages could be disastrous. At best, it would involve a substantial increase in fees, possibly by several hundred per

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cent; at worst, it could mean insolvency and the collapse of the Agency, with the regulatory functions reverting to my Department, with all the resource implications that would involve. I would also want the Agency to exercise its statutory powers free from concern about a major damages claim. Such a risk could well inhibit the use of the powers and make it over-cautious.

4 I conclude that we must avoid these problems by giving the Agencies and their staff an exclusion from liability for damages in respect of acts or omissions in performing statutory functions under the Financial Services Bill. The exclusion should not apply if decisions have been taken in bad faith.

5 There are several precedents for excluding regulators from liability for damages. Lloyds already has such an exclusion although that has been challenged. So do the Independent Broadcasting Authority and, within my own Department, the Patent Office. In the United States, the Federal agencies and the self regulating bodies are largely excluded from liability, except where there is bad faith (although the effect of that exclusion is probably not exactly the same as under our legal system).

6 I have considered carefully the effect on investors and investment businesses of an exclusion from liability for damages. One of the criteria for the transfer of functions to an Agency is that the Agency's rules make proper provision for compensation. I shall be considering particularly the adequacy of compensation for private investors. For authorised businesses, they will be able to seek judicial review if an Agency improperly uses its intervention powers and will also be able to go to the Tribunal. In my view, therefore, the effect of exclusion from liability for damages would not be unduly serious and is outweighed by the advantages of having an effective regulatory system.

7 Under Regulation 8 of the Stock Exchange (Listing) Regulations 1984, the Council of The Stock Exchange is given freedom from liability for damages for acts or omissions in carrying out its functions as the competent authority for the purpose of the listing regulations. The Financial Services Bill will replace the listing regulations by primary legislation. I propose that it should continue The Stock Exchange's existing exemption.

8 It is likely that the self-regulating organisations (SROs) which are expected to seek recognition under the Bill will also press for exclusion from liability. I intend to resist any such pressure on the basis that SROs, unlike the Agencies and The Stock Exchange Council in its capacity as competent authority, will not be exercising statutory functions.

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9 It would be most helpful to have your comments as soon as possible as I would like to include this subject in the bill on introduction.

10 I am copying this letter to the Chancellor of the Exchequer and the Governor of the Bank of England.

Yours,

LEON BRITTAN

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