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SENSE FOR THE CITY

The Financial Services Bill which was published yesterday is the logical culmination of a process started in 1981, when a committee was set up to review investor protection after scandals involving uncontrolled new forms of investment. The scheme of regulation it sets up is the better for that long and careful evolution. It is not an instant response to the latest revelations about Johnson Matthey Bankers or Lloyd's, which are covered by separate legislation. Nor is it primarily aimed at improving the prosecution of fraud, which vital task is likely to be tackled by a new Criminal Justice Bill in the next session of Parliament.

Its main purpose is to increase protection for investors by ensuring that anyone from doorstep life assurance salesman to City commodity broker is subject to regulation and obliged to operate according to rules that will be fair to investors. Because of the Bill's timing, just ahead of sweeping changes in the structure of the Stock Exchange to promote competition in securities dealing, it particularly aims to protect investors from new conflicts of interest that will come from the breaking down of traditional barriers.

The present hue and cry over fraud has inevitably affected the way the Bill will be judged. So has distrust of the arrogance of finance at a time when the City is enjoying a boom absent from parts of manufacturing industry. Aside from the exemption of Lloyd's, the Bill stands up remarkably well to new circumstances and this harsher scrutiny. The system would probably, for instance, have coped both with the problems at Lloyd's and those at the London Metal Exchange, had it applied. That in itself is a reason for confidence, since its recommendations are in essence those developed several years ago.

The basis of that system is self-regulation with the additional protection that self-regulating organizations (SRO's) like the Stock Exchange are under the continuous supervision of a permanent board. That is the vital difference between the system now proposed and that set up by the Lloyd's Act of 1982 and found so conspicuously wanting.

The supervising board is to set model rules for the SRO's aimed at raising standards in different businesses to the highest common factor and enforcing a series of common principles that are fully laid down in the legislation. The most important of these fair-dealing principles is that of disclosure.

Providing investors with the maximum amount of information, whether on life assurance commissions or bond prices, is the greatest safeguard that does not destroy the benefits of competition.

The success of the system will depend, to a large degree, on the will and power of this supervisory board to take the customer's side in its dealings with the SRO's. The Bill gives it considerable power, not just to authorize self-regulation in each trade, but also to ask the courts to impose rules where necessary. If the board uses its powers to protect the customer, the structure may well prove, as ministers claim, to be both strong and flexible.

There are a number of misjudgements in the Bill. The exclusion of Lloyd's, which would plainly benefit from continuous supervision, is one of them. If, as it appears, it would be too complex to include Lloyd's in the Bill, then the Trade Secretary, Mr Leon Brittan, should give an early pledge to amend the Lloyd's Act to this end. It would also be better to include the City Takeover Panel in the supervisory system to help it bear the greater strains likely to be imposed on it by increased competition in the City. The system of three-man appeal tribunals envisaged to vet decisions of the supervisors looks ill thought out, and may tend to undermine the authority of the regulators. The clause seeking discretionary powers to ban firms from countries that do not have such an open financial system as Britain looks no more than a sneaky piece of discriminatory protectionism that surely has no place in this Bill.

For all the easy charges of cosiness levelled at self-regulation the argument over the basic structure is likely to be remarkably narrow. The Opposition's demand for statutory control amounts in practice to little more than a desire for a supervisory board that is less dominated by practitioners and a feeling that more breaches of the rules should be made criminal offences. The first point can easily be met in the selections made by successive Secretaries of State. There is more substance in the second. The Bill relies principally on making it criminal to trade without authorization, the ultimate punishment of self-regulation. That could be strengthened by putting the power to fine miscreants into the system. Experience does not suggest, however, that making malpractice a crime is an effective way of stamping it out. The Insider Trading laws, for instance, have proved so ineffective that the measures now being taken to enforce them have an air of desperation.

The threat of wider criminal sanctions if the system fails will undoubtedly strengthen the regulator's hand. But it should not be pushed too far at this stage. With the exception of dealings on the Stock Exchange (which has a good record but now faces stiff new pressures) the Bill will greatly improve safeguards for investors, without the heavy-handed regulation that would kill London's future as an international financial centre.

In practice, the system will undoubtedly be found fallible under some of the new pressures it will have to withstand. But that is an inevitable by-product of the tension between regulation for fair dealing on the one hand and freer competition for efficiency and lower costs on the other.