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HOUSE OF COMMONS
LONDON SW1A 0AA

December 1985

Dear Colleague,

As you know, the Government has today published the Financial Services Bill and, given the widespread interest in the Bill and matters affecting the City, I thought it would be helpful if I set out the major provisions within it and our reasons for adopting the approach we have.

The Bill is based closely on the White Paper on "Financial Services in the United Kingdom" which Norman Tebbit published in January. The Bill will establish a new framework for investor protection designed to promote an efficient and competitive financial services industry and create a system of regulation which is both flexible and inspires confidence in users and investors that the financial services sector is a clean place in which to do business. Whilst the Bill builds on the tradition of self-regulation, it ensures that self-regulation has the teeth and the statutory backing it needs to be effective.

Under the provisions of the Bill, investments and investment business will be clearly defined and all those persons carrying on investment business will require authorisation. It will be a criminal offence to carry on investment business without authorisation. The power of authorisation will be with the Secretary of State, who will be able to transfer it to a Designated Agency, made up of practitioners and users of financial services, on condition that he is satisfied that their rules meet the specified criteria contained within the Bill. In turn, the Agency will be able to recognize other self-regulating organisations, such as the Stock Exchange, provided that their rules set equivalent standards of behaviour.

I must emphasize that the Government has decided to adopt this course of practitioner-based regulation within a statutory framework because I believe it will result in a more effective system of regulation. The City is changing continually and it is thus essential that the regulatory bodies which oversee it should be close to the market and have the flexibility to adapt with it, rather than be stuck in a straitjacket of statute. It is for this reason that I believe this approach is superior to the creation of a wholly statutory body like the American SEC; indeed, the

Chairman of the SEC has recently stated that, were he given the chance to start again from scratch, then he too would recommend this approach.

While the differences between this system and a wholly statutory one are real, they should not however be exaggerated. The fall-back powers of the Designated Agency itself will be considerable, quite apart from its ultimate responsibility for the self-regulating organisations' discharge of their duties in a proper manner and an ability to derecognize a self-regulating organisation which fails to regulate properly. The sanctions available for use against investment businesses will extend from a simple reprimand through suspension right up to a removal of authorisation, making it illegal for the person or business to engage in investment business thereafter. In addition, there will be powers to apply to the Courts for a 'restitution' order to force a business to recompense investors for any loss they have suffered as a result of its breaking the rules, as well as seek an injunction restraining the business from continuing its activities in breach of the rules.

I know that there are those who believe that Lloyds should also be included within the provisions of the Bill. I would point out to them that Lloyds already has its own regulatory system, established under the Lloyds Act of 1982, and that the events at Lloyds which have given rise to such notoriety in recent months originated before that Act was passed. I believe it is still a little early to pass judgement on the effectiveness of the new regulatory regime at Lloyds but I assure you we are keeping a close watch on events there. If it does become necessary to legislate further, I will of course not hesitate to do so, but I remain to be convinced that the Financial Services Bill would be an appropriate vehicle even if it became clear that further legislation for Lloyds was required.

I hope you will agree that the system we propose under the Bill provides an effective means of regulation and investor protection while at the same time ensuring that the City of London remains one of the great financial centres of the world. It is, of course, just one of a range of measures being introduced by the Government to tackle the problem of fraud. In particular, I would mention Lord Roskill's forthcoming report on the procedure for trying cases of criminal fraud, which we shall be studying carefully. But I am convinced that by improving both the vetting and control of all those in investment business, it will make a major contribution to the eradication of financial fraud.

With best wishes for Christmas and the New Year.



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