

PRIME MINISTER

18 September 1985

CITY REGULATION

I met Mark Weinberg yesterday to discuss with him progress being made in regulating the City, in view of your fears.

He reported that the legislation is well advanced in draft at the DTI, and that the Marketing of Investments Board is making rapid progress in tackling the difficult issues before it. The various interests in the insurance industry have now reached an agreement on disclosure of commissions: all those living within a maximum tariff system will have to report that they are operating under that agreement, and those outside it will have to declare their actual commissions.

They are dealing with the problem of conflicts of interest, where individual intermediaries sell insurance policies to the public but are at the same time in the pay of leading insurance companies. Either an insurance broker has to be an independent broker and act in the best interests of his client - he will be subject to tests to make sure that he is doing so - or he will have to be the agent of one insurance company and state clearly that he is on commission.

The Securities and Investment Board is finding its task more difficult because it has such a wide range of different

businesses to regulate. However, it is making progress in defining the separate areas for the self-regulatory bodies and in thinking about the kind of tight disclosure requirements and monitoring that will be necessary to ensure reasonable practice. I urged Mark to be very firm on the clarity of disclosure of interests, dealing prices and commissions.

The main problem which they have not tackled is the question of solvency. As we saw with JMB, a regulator finds it extremely difficult to know what is reasonable business practice to ensure that the business being monitored remains solvent. If the regulator moves in too quickly, it can bankrupt a perfectly reasonable business because people's confidence will be lost as soon as a business is subjected to special scrutiny. If, however, the regulators dither, the problem builds up with disastrous results. There is no easy answer to this.

The challenge for the regulators will be to create a climate in which people find it worthwhile to be respectable and solvent, and attract clients by so doing. Only through there being a market interest in solvency and good behaviour will we succeed in having a financial industry reasonably free of bankruptcy and scandal.

I have written a longer piece on the pitfalls and problems for the regulators for publication next April (attached).

John and I agreed that there was no need to bother you with this now.
John Redwood
JOHN REDWOOD