PO-CH/NL/0462 PTA

Part. A.

SECRET

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Begins: 12/9/85.
Ends: 14/10/87.

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PO CH / NL / 0462.
Pt. A.

Chancellor's (Lawson) Papers:
Amendments to The Financial Services Act 1985.

PO CH / NL / 0462. Pt. A.

D.D's: 25 Years
[signature]
9/2/96.

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

JU956
Secretary of State for Trade and Industry

bf work advice

12 September 1985

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1P 3AG

13/9

CH/EXCHEQUER
REC. 12 SEP 1985
ACTION FST
COPIES TO

Dear Nigel,

I thought it would be timely to write to colleagues concerned with privatisation both to let them know what I propose for the Financial Services Bill provisions dealing with disclosure liability, and as the Minister responsible for this area of the law, to stress the importance of Government maintaining the highest standards in its own offerings.

I propose that the Financial Services Bill should draw no distinction between privatisation offers by Government and offers made by private issuers.

Even if we did not have the Bill coming, I would see no reason to prevent pursuing that policy. The uncertainty of Government's liability under the existing law is a nuisance to privatising Departments, including my own. On the other hand, the agonies all concerned go through in preparing offer documents stem as much from circumstances peculiar to the offer as from doubts about the law. Tiresome as they are, these doubts are not an obstacle to our pursuing a policy of maintaining the highest standards of disclosure observed by private offerers.

There is a considerable case for Government seeking some relief from a level of liability which bears more heavily on Government, simply because it is Government, than it does on private issuers. The adversarial relationship which can develop between Government and a recalcitrant privatisee and the ability of the latter to use its effective monopoly of prospectus information to put pressure on the former has no parallel in the private sector. Neither does Government's constructive knowledge of an almost infinite variety of circumstances which may have a bearing on a privatisee's fortunes.

I do not under-estimate these considerations. But I do not, for three reasons, consider that they are sufficient grounds for mitigating Government's liability.

The first is that any such proposal would attract intense criticism in Parliament, and probably the Press. The considerations outlined above are perfectly genuine, but they will not cut much ice in the House.

Secondly, anything less than the total exclusion of Government liability would mean drawing a line somewhere. Although the factors peculiar to Government are easy to describe, it is very difficult, if not impossible, to determine the quantum of relief appropriate to them - let alone give it certain statutory effect.

Thirdly, I am not proposing that any offerer's liability should be based on "uttermost good faith". My intention is to extend to all offerers the general duty governing the provision of information which already applies to those publishing listing particulars - i.e "to provide the information which, according to the particular nature of the issuer and the securities ...... is necessary to enable investors and their advisers to make an informed assessment". This seems to me, having regard to its recognition of the particular circumstances and the availability of the established defences, to set a standard Government can reasonably be expected to adhere to.

During the next Session there will not only be a number of privatisations but also a Bill which is highly susceptible to amendment by the opponents of privatisation. It is important to reduce their opportunities both by making the Bill difficult to assail and by following the highest standards in the conduct of privatisations. My Department which has considerable experience of privatisations as well as responsibility for this area of the law, is very willing to offer advice to others.

Love,

Leon

LEON BRITTAN

CONFIDENTIAL

bf with 2765 advice (pl chase)

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

DW724

Secretary of State for Trade and Industry

bf 30/10

7 October 1985

CONFIDENTIAL

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1

CH/EXCHEQUER
REC. 7 OCT 1985
ACTION EST
COPIES TO

EST or us?

Dear Nigel,

FINANCIAL SERVICES BILL : INTERNATIONAL RECIPROCITY

I am writing to let you know that I have come to the conclusion that the Financial Services Bill should include a discretionary power enabling me to declare ineligible to conduct investment business in the UK a firm from any country which does not accord British firms broadly equivalent access to its financial markets.

2 I understand that you too are in principle in favour of such a power. The City itself is divided on the subject, but I am satisfied that we need to have such a power, in reserve, in order to defend ourselves against discrimination abroad and to strengthen our hand in securing the progress towards international liberalisation that we seek.

BRITTAN → CH/EX 7/10

X 3 I know that you have already begun to consider the merits of including a similar provision in the forthcoming Banking Bill. Though some considerations here may be different, we will want to be as consistent as those considerations allow; and so my officials will be giving yours details of the power proposed for the Financial Services Bill as soon as possible.

4 I am sending a copy of this letter to Geoffrey Howe.

Yours,
Leon

LEON BRITTAN

999-1

332/17

CONFIDENTIAL

FROM: D L C PERETZ
DATE: 31 October 1985

cw. 1 November

1. SIR PETER MIDDLETON
2. CHANCELLOR

cc Economic Secretary
Minister of State
Sir Geoffrey Littler
Mr Cassell
Mr Lavelle
Mr Fitchew
Mr Mountfield
Mr Sedgwick
Mr Scholar
Mr Hall
Mr Kelly
Mr Board
Mr D Jones
Mr H Davies

Miss Wheldon, T/Sol

Ch.
A reply to Mr Brittan is long overdue (for reasons which are clear from this minute) I doubt if you will have much difficulty with this advice

better to wait?

Yes pse. RL 7/11

INTERNATIONAL RECIPROCITY IN FINANCIAL SERVICES AND BANKING

We owe you advice on the Secretary of State for Trade and Industry's letter of 7 October which records his conclusion that he should include in the Financial Services Bill a discretionary power to deny access to UK markets to firms from countries that do not permit reciprocal access by British firms to their markets. The Foreign Secretary has now written (his minute of 25 October) giving his support to Mr Brittan's proposal.

2. As Mr Brittan acknowledges, there is a close read-across between what is done in financial services, and what is done for banks - with the latter being your responsibility. We have now had an internal Treasury meeting on all of this, with Sir Peter Middleton, taking account also of the Bank of England's views as expressed in the Deputy Governor's letter of 2 October to Sir Peter Middleton (copy attached).

hence the length of time in responding to this minute (I warned DTI of likely delay; they weren't bothered)

3. Our conclusion - which is different from the Bank's - is that we must follow the same approach on reciprocity in both areas - and that we should take powers under which authorisation

60

in the UK of both foreign banks and investment businesses could be refused (or removed) on the grounds that reciprocal access was not being permitted to UK banks or investment businesses.

Background

4. Mr Brittan's decision follows a consultative process undertaken by the DTI which we understand has produced a mixed response, but included sufficient support for Mr Brittan to want to proceed. We have not seen the details of the DTI provision, but we understand that the power would be exercised by the Secretary of State (rather than the SIB), would be discretionary, could be applied selectively (ie would not have to be applied against all institutions from an offending country), and would allow for both refusal and revocation of authorisation.

5. As you know we have in parallel been considering the possibility of a reciprocity provision in the Banking Bill. We have not, however, made this public. The possibililty was not floated in the consultative papers recently published by the Bank of England. But we have discussed the issue with the Bank, and the Deputy Governor's letter is the result of their deliberations. Their opposition to a provision in the Banking Bill but not one in the Financial Services Bill seems to reflect differences within the Bank of England, which the Deputy Governor's letter only papers over with the thinnest of paper.

Japan

6. This whole subject, of course, has been given focus by the current discussions with Japan. Were such powers to be used Japan would certainly seem to be the most likely candidate. You have Sir Geoffrey Littler's report, in his minute of 30 October, of the most recent Anglo-Japanese financial talks. The clear link established in these talks between Japanese applications for banking licences in the UK, and UK applications for licences for securities business in Japan is of course an important factor in our conclusion that anything we do in one

area we must do in both. It also seems clear that were we to announce that we were not going to take reciprocity powers in the Financial Services Bill and/or in respect of banks, then we would have greatly weakened our negotiating position with the Japanese.

Interconnection between banking and financial services

7. There are three reasons for wishing to follow the same line on reciprocity in financial services and banking:-

(i) There would appear no convincing arguments that could be deployed to justify different treatment in the two areas. For example, try substituting "Financial Services Act" for "Banking Act", and "investor" for "depositor" in the first full sentence on page 2 of the Deputy Governor's letter.

(ii) The dividing line between banking and other investment business is becoming less and less clear. With the development of combined bank/security house conglomerates it would be very odd to have a reciprocity provision covering one part of their business but not the other.

(iii) As noted above, the cross relationship between the two areas is already clearly established in the negotiations with the Japanese.

8. For all these reasons it seems clear that we must go for a common treatment in the two areas. This means that, in effect, we have to reach a decision now on whether or not to go for a reciprocity provision in banking. If we wished to draw back from that, then we should oppose Mr Brittan's proposal for the Financial Services Bill.

Problems

9. It is argued that the taking of such powers would be a step back from free trade. Certainly there would be some dulling in the lustre of our present virtuous position which other things being equal it would have been preferable to avoid at a time when we are trying to bring services into GATT (though the concept of reciprocity in the financial sector is not unknown even in the UK). But most other major EC countries already have such reciprocity provisions - the Germans introduced their own power of this kind last year - and the DTI are confident that our position on free trade generally would not be significantly damaged.

10. It is argued that the power would not be usable. There are two points here. First, it is argued that its use would be subject to judicial review, and that in practice that would mean that it could only be used absolutely fairly - ie to deny access and remove existing licences from all institutions from the offending country. DTI lawyers are however taking a much more robust view than this, and believe, for example, that it would be possible to grant licences on a one-for-one reciprocal (first-come-first-served) basis.

11. Second, there is the potential EC loophole. The Treaty of Rome would prevent the power being used in respect of other EC countries, and institutions from third countries might be able to gain access to London via a subsidiary in, say, Germany. However, the legal advice is that this is by no means certain: it would need to be tested in the Courts.

12. It is perhaps relevant that the Japanese, against whom the power would mainly be directed in the first place, are not naturally litigious in the same way as, say, US institutions might be. Even so, everyone accepts that the main purpose of the provision would be to act as a deterrent: we would hope that it would not prove necessary actually to use it in practice at all.

13. The final argument, included for example in the Deputy Governor's letter, is that imposition of such a provision (at least in banking) could do damage to London's position as an international financial centre. But this would depend much more on how the weapon was used, rather than its mere existence. The aim, in fact, would be to use it to help establish UK financial businesses in other financial centres, strengthening the position of UK-based financial institutions worldwide - and hence, quite possibly, strengthening the position of London as a financial centre as well.

Advantages

14. None of these difficulties looks overriding. On the other hand there are clear advantages in taking powers in respect of both banks and investment businesses - not least in relation to the current negotiations with the Japanese.

15. Moreover, since we think it important to act in the same way in both areas, if we wished to oppose a reciprocal provision for banks we would also need to persuade Mr Brittan. In practice that might well not be possible. The Foreign Secretary, who might normally be relied upon to oppose such ideas (as damaging to foreigners) has supported it.

Recommendation

16. So our recommendation is that, on merits, it is right to take powers that could be applied both to banks and to other financial businesses. The powers to deny licences to institutions seeking authorisation under the Financial Services Act would be vested in the Secretary of State. We would recommend that the parallel power in respect of banks should be vested in the Treasury or yourself, rather than the Bank of England. Inter alia, we are advised that were the power vested in the Bank of England it would be more open to challenge in the Courts.

17. If you agree with this recommendation, there is one technical point which we should like to pursue with DTI officials. There

are some attractions in trying to include both powers - for banks and investment businesses - in the Financial Services Bill, rather than leaving the power in respect of banks for the Banking Bill. Putting them both in the Financial Services Bill would demonstrate the close relationship we see between the two areas, and could make it simpler to provide the ability to use leverage on overseas banks' access to London to secure access overseas in the financial services area, and vice versa. It would also avoid the delay there would otherwise be until the powers in respect of banks could be introduced in the Banking Bill.

18. On the other hand including both in the one Bill could pose problems for DTI, for example if it widened the scope of the Financial Services Bill in an unacceptable way. So we need to discuss it with them.

19. If you agree, I suggest you write to Mr Brittan on the lines of the attached draft. Sir Peter Middleton would then need to let the Deputy Governor have a reply to his letter of 2 October, recording your decision and the reasons for it.

DLCP

D L C PERETZ

Pl hjk.

DRAFT LETTER FROM THE CHANCELLOR TO SECRETARY OF STATE FOR TRADE AND INDUSTRY

FINANCIAL SERVICES BILL: INTERNATIONAL RECIPROCITY

Thank you for your letter of 7 October about your proposal to include a reciprocity provision in the Financial Services Bill. I have also seen Geoffrey Howe's minute to you of 25 October.

As you know, I have been considering whether there should be a similar provision for banks. I have concluded that we must follow the same approach in both areas. There are no convincing arguments to justify a different approach for banking than for businesses covered by the Financial Services legislation; the distinction between banking and securities business is likely to become less clear over time; and in any case a direct link between access of foreign banks to the UK and UK securities houses to overseas markets has already been made in negotiations with the Japanese.

I have concluded that we need reciprocity powers of the kind you propose in both areas. I also believe it will be right to allow in the legislation for some crosslinkage between the two. I suggest that our officials should discuss urgently how best to give effect to this, and whether it would be sensible to use the Financial Services Bill to give us the powers we want in relation to banks as well as other financial businesses.

I am sending a copy of this letter to Geoffrey Howe.

CONFIDENTIAL

(PM)

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

M Jones
We must reply.

DW724

Secretary of State for Trade and Industry

CH/EXCHEQUER	
REC.	11 OCT 1985

7 October 1985

ECONOMIC SECRETARY	
REC'D	11 OCT 1985
ACTION	MR HALL
COPIES TO	PPS CST FST MST SIR PETER MIDDLETON MR BAILEY MR CASSELL MR MONCK MR PERETZ MR GRIMSTONE MR BOARD MR BRUMMELL - T.SOLS

CONFIDENTIAL

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1

Dear Nigel,

Banking Bill

FINANCIAL SERVICES BILL : INTERNATIONAL RECIPROCITY

I am writing to let you know that I have come to the conclusion that the Financial Services Bill should include a discretionary power enabling me to declare ineligible to conduct investment business in the UK a firm from any country which does not accord British firms broadly equivalent access to its financial markets.

2 I understand that you too are in principle in favour of such a power. The City itself is divided on the subject, but I am satisfied that we need to have such a power, in reserve, in order to defend ourselves against discrimination abroad and to strengthen our hand in securing the progress towards international liberalisation that we seek.

3 I know that you have already begun to consider the merits of including a similar provision in the forthcoming Banking Bill. Though some considerations here may be different, we will want to be as consistent as those considerations allow; and so my officials will be giving yours details of the power proposed for the Financial Services Bill as soon as possible.

4 I am sending a copy of this letter to Geoffrey Howe.

Yours,

Leon

LEON BRITTAN

CONFIDENTIAL

ECONOMIC SECRETARY
REC'D 25 OCT 1985
ACTION MR HALL
COPIES TO PPS CST FST MST SIR PETER MIDDLETON MR BAILEY MR CASSELL MR MONCK MR PERETZ MR GRIMSTONE MR BOARD MR BRUMMELL T.SOL.

CH/EXCHEQUER
REC. 25 OCT 1985
ACTION EST
COPIES TO

FCS/85/275

SECRETARY OF STATE FOR TRADE AND INDUSTRY

PS

BCC/360

yes it does.

Financial Services Bill: International Reciprocity

1. Thank you for copying to me you letter of 7 October to Nigel Lawson on this subject.

2. While I regret the necessity of having to move away from the principles of the open trading system, I agree with you that we do need such a discretionary power, in reserve, to defend ourselves against foreign discrimination and strengthen our hand in negotiating liberalisation in overseas markets. Japan is, of course, the most prominent example of a country whose financial markets are blatantly protected from foreign operators. The very existence of such a power may increase the likelihood of the Japanese doing something to remedy the inequality of our present respective practices. Certainly we should continue to take every opportunity to impress on the Japanese that unless progress is made soon on financial liberalisation, we shall come under increasing pressure to think in terms of reciprocal action. Your proposal will be an important weapon in that armoury.

3. I am sending a copy of this minute to Nigel Lawson.

903/x

Mr Hall

It seems to me this makes it much harder for us to object.

28/10

(GEOFFREY HOWE)

Foreign and Commonwealth Office

25 October 1985

CONFIDENTIAL

THE DEPUTY GOVERNOR

BANK OF ENGLAND
LONDON
EC2R 8AH

2 October 1985

PERM. SEC'S. OFFICE
RECEIVED
- 2 OCT 1985

Action	Mr Hall
Copies To	Mr A Wilson
	Mr Cassell
	Mr Ralet

Sir Peter Middleton KCB
H M Treasury
Parliament Street
London
SW1P 3AG

Dear Peter,

BANKING BILL: RECIPROCITY

Your officials have been consulting mine regarding the proposition that the new Banking Bill might contain a reciprocity provision. We have been giving this question much thought and have to say we see considerable difficulties with the suggestion.

I would certainly not want to argue against the idea of reciprocity provisions in principle. We have, as you know, concluded that on balance a reciprocity provision would be helpful to British interests in the international securities markets and have therefore favoured its inclusion in the Financial Services Bill. But we believe the arguments run differently for the banking sector.

For banks we have fostered, over many years, a liberal entry regime based on national treatment; as a result, we have welcomed banks from most countries in the world and in so doing have built for London an international pre-eminence as a banking centre. I think it would be generally agreed that the UK has gained as a result. Conversely we believe that reciprocity provisions applied in a number of other countries have been a factor in inhibiting the development of centres which can compete effectively with London.

It is not clear to us what it would be hoped to achieve by a reciprocity provision. In contradistinction to the experience in the securities field, UK banks abroad are not at the moment noticeably being prevented from doing business to any significant extent in places they would otherwise wish to. This suggests that we would probably have little to gain in the banking field from such a provision. We might well, however, have something to lose, because there must always be the danger that the threat to use reciprocity will result in retaliatory action against British banks abroad.

If the aim were to use a reciprocity provision in the Banking Bill to provide a means of applying pressure <u>outside</u> the banking sector - that is to say, a transfunctional provision enabling us to block banking access as a weapon against barriers to entry in other areas - we should be greatly concerned. This would be

42

going well beyond questions of reciprocity per se to straightforward bargaining. Once we introduced horse-trading of this kind into the implementation of the Banking Act we would call in question its whole prudential and depositor protection basis. It would remove the strong ground we have hitherto occupied in consistently emphasising to the Japanese that our unwillingness to grant banking authorisation to the Japanese securities houses rested on prudential considerations and was not linked to the ambitions of UK banks and security companies in Japanese markets.

Apart from these arguments of principle we see severe practical difficulties in actually making any use of a reciprocity provision. It could not be used against EC countries, nor be effective against foreign acquisition or establishment of UK entities without further legislation complications. Moreover, given the number of foreign banking institutions already authorised here, reciprocity could only offer us any significant leverage if we were prepared to see it used retroactively to revoke existing authorisations. I trust however that retroactivity is not in question: that would without doubt do enormous damage to London's reputation.

In sum, we cannot see how a reciprocity provision would help us and we can see a number of ways in which it might do us harm.

Yours

Kit

PWP

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

JU601
Secretary of State for Trade and Industry

12 November 1985

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
London SW1

CH/EXCHEQUER
REC. 13 NOV 1985
ACTION EST
COPIES TO

✓ 13/11

C. To note. Sounds encouraging, though it remains for officials to resolve nuts and bolts. ✓r RWO 13/11

Dear Nigel,

FINANCIAL SERVICES BILL: INTERNATIONAL RECIPROCITY

Thank you for your letter of 4 November. I agree that it would be sensible that reciprocity powers of the kind we intend to seek in the Financial Services Bill should apply to banks as well as to investment businesses and insurance companies. It would probably be most convenient to take all the relevant powers in the Financial Services Bill and my officials are in touch with yours about this.

I am sending a copy of this letter to Geoffrey Howe.

Lowe,
Leon

LEON BRITTAN

999-1

2382/067

CONFIDENTIAL

FROM: M NEILSON
DATE: 18 November 1985

C To note,
DTI moving in opposite direction from public pressure.

MR PERETZ

cc: PS/Chancellor
Sir P Middleton
Mr Cassell
Miss Kelley
Mr Scholar
Mr Hall
Mr Walsh
Mr H Davies

FINANCIAL SERVICES BILL : INSIDER DEALING IN GILTS

The Economic Secretary has seen your minute of 14 November. He agrees that if this is the best DTI can do, the Treasury should try to get the proposed clause dropped from the Bill altogether.

2. However the Economic Secretary noted from the weekend press (eg The Sunday Times page 58) that Sir Nicholas Goodison has written to the Prime Minister about Insider Dealing; he would be interested to see that letter, and to be kept informed of how the DTI intend responding.

M NEILSON

Ch

Do you want to take up the invitation in the final paragraph?

RL 25/11

yes pse

FROM: H J DAVIES
DATE: 25 NOVEMBER 1985

CHANCELLOR

cc FST
EST
Sir P Middleton
Mr Cassell
Mr Peretz
Mr Hall
Mr Cropper
Mr Grimstone
PS/IR

NYSE CONFERENCE: THE CHANGING WORLD OF FINANCIAL SERVICES

As you know, I attended a conference on Friday and Saturday sponsored by the New York Stock Exchange and Templeton College. The aim was to exchange views on the forthcoming 'big bang'.

2. It was a distinguished group, particularly on the American side. But time was short, some of the speakers were dreadful, and the discussion was unstructured. There were too many chiefs content to talk at a level of generality often indistinguishable from platitude. But four subjects of interest to us were intermittently raised.

i) Regulation. Sir Kenneth Berrill spoke after dinner. His remarks went down badly with the British brokers present. Jeffrey Knight of the Stock Exchange was particularly critical of the SIB's slowness in making its intentions clear. The after-dinner mood was one of surprise that Sir Kenneth seemed so vague about the number and coverage of SRDs. Graeme Gilchrist was especially outspoken. And Gordon Pepper spoke to me in apocalyptic terms about conflicts of interest, banana skins etc. He said it was vital for the Government to take hold of the problem. Things were in a pickle because all the leading players had been lawyers. He told me he had made all these points forcibly to Professor Griffiths last week.

SRAs?

(as usual)

ii) Wider Share Ownership. A lot of discussion, and a wide diversity of views. Brew (Grieveson) and Brooks (K.B.) thought the Government had 'done nothing at all' to promote wider share ownership. They should abolish Stamp Duty and CGT. And simplify transactions procedures by creating a modern dealing system (they saw this as the Government's responsibility). There was support for HMG from Hoare Govett and Credit Suisse, however. Hoare's were particularly bullish about the marketing possibilities on the back of BT and BGC. The Americans all believed that there was huge retail potential. But pushed, Merrill Lynch said the minimum net worth they were interested in for a small client was $200,000, and they believed they were as aggressive as anyone in the US.

iii) Privatisation. Some criticism from the British side of our use of foreign brokers overseas. And also of excessive reliance on placements. Showing a lack of confidence, or some said belief, in wider share ownership.

iv) Tax. Smithers of Warburg was very aggressive about the dangers of maintaining stamp duty against a background of globalisation of markets (the buzzword for the weekend). Growth in trading of UK securities could take place in ADR form. Brooks (K.B.) thought the whole Eurobond market would go offshore. The Americans did not support any of these dire prophecies, and argued that deregulation would ensure that London remained a 'big three' player (with New York and Tokyo). Indeed London might gain market share in some areas.

3. I shall produce a slightly fuller record for the Economic Secretary and Mr Hall - and you or any others on request.

HJD

H J DAVIES

036/1948

FROM: **M A HALL**

29 November 1985

CHANCELLOR

c c Economic Secretary
Sir Peter Middleton
Mr Cassell
Mr Peretz
Mr D Jones
Mr Board

Mr Bridgeman RFS
Mr Quinn BoE
Mr Brummell T.Sol

C/
To note.
Rns 29/11

CIVIL LIABILITY OF SUPERVISORS

The Secretary of State for Trade and Industry wrote to the Lord Chancellor on 7 November (attached) proposing that designated agencies (at present the SIB and MIB) and competent authorities (i.e. the Stock Exchange Council in respect of its functions concerning listing regulations) should be excluded from liability for damages for any Act or omission in the performance of their statutory functions under the Financial Services Bill. The Secretary of State did not seek similar immunity for SROs. The Governor has written in support, urging extension to the SROs. The Lord Chancellor has now replied (also attached) shooting the idea down in flames.

2. If the Lord Chancellor had agreed with the Secretary of State, we would have put to you arguments by the Bank of England and the Chief Registrar of Friendly Societies in favour of extending such immunity to themselves. In view of the Lord Chancellor's reply, however, there is no need for you to intervene in the correspondence at present.

MH

M A HALL

FROM: H J DAVIES
DATE: 2 DECEMBER 1985

Cy
See p11 - Privatisation
gather you probably
suspected anyhow.
RC
3/12

CHANCELLOR

Thanks. This interesting; this was v. impressive. N.L.

cc CST
FST
EST
Sir P Middleton
Mr Cassell
Mr Monck
Mr Peretz
Mr Hall
Mr Grimstone
Mr Cropper
Mr Lord

THE CHANGING WORLD OF FINANCIAL SERVICES

You asked to see my more detailed record of the Oxford Conference on 22-23 November. I attach a set of notes which cheerfully breaches the Chatham House Convention under which the conference took place, but I would be grateful if others could note the point.

2. I am sure copy recipients will not wish to be influenced in future beauty contests by the radically different views on the privatisation programme and this Government's encouragement to wider share ownership expressed at this conference.

3. The other issues of interest to us are the future of regulation, and potential conflicts of interest. On neither of these did the conference offer any comfort or reassurance, though some were prepared to give Sir Kenneth Berrill the benefit of the doubt until the New Year. Unfortunately, participants were long on critical comments and short on practical suggestions. The atmosphere also did not encourage the resolution of clear differences of view expressed in debate. But that is the way of conferences with too many chiefs and few indians.

4. A list of participants is also attached.

HJD

H J DAVIES

1250/11

THE CHANGING WORLD OF FINANCIAL SERVICES

Conference sponsored by the New York Stock Exchange and Templeton College in Oxford on 22-23 November 1985

First Session: Introductory Speeches

Bill Schreyer of Merrill Lynch opened the conference. His theme was the increasing globalisation of equity markets. He noted that in the first half of 1985 US companies had raised more money overseas than in the US, and worldwide there were 328 companies with active markets in their shares outside their own country, 100 more than last year. But there was a clear need for even greater globalisation of the equity markets, to match what had happened in the debt markets. The UK government deserved "enormous respect" for what it had done to open and liberalise its stock market. Japan should and would follow a similar path.

The regulation of international equity markets was a matter of great concern. Inevitably, more responsibility would be placed on private sector operators, in the absence of a single regulatory body. Private operators must do more to fill the regulatory gap which was now appearing. He proposed a four point plan:

i) Major international equity firms should first meet amongst themselves to discuss the principles of self-regulation

ii) They should work with different stock exchanges to devise methods of investor protection for individuals and institutions

iii) They then needed to establish a dialogue with governments and

iv) Press them to bring down the barriers to free flows of capital.

Win Bischoff of Schroders spoke next. He identified three forces behind the current trend towards deregulation. Institutional, economic and technical.

He described some of the institutional changes in the UK and elsewhere in Europe, focusing on the reductions in transactions costs in various markets, and the opening of trading to external participants.

He believed that economic developments had required deregulation. There were severe balance of payments imbalances caused initially by OPEC and subsequently by the US deficit. These disequilibria created the need for an escape hatch for footloose funds. The LDCs were not an appropriate home for capital surpluses. As a result the escape hatch had been created in the euromarkets and through the securitisation of debt. Government responses to these changes had been different. The United Kingdom had been particularly imaginative in first devising a broader range of debt instruments itself, notably indexed gilts, and subsequently promoting rapid and far reaching market liberalisation. Economic forces had also led to increasing volatility in exchange rates. The sources and consequences of this volatility are still not well understood by investors. Futures and options markets were under development and were essential if the exchange rate risks were to be appropriately redistributed. But they were insufficiently used so far.

The technological developments he described were straightforward, screen markets etc.

He then focused on the implications of all these changes for fund management. He believe that the scope for the development of international fund management had been inadequately appreciated. The old strategy of picking long term investment homes and trading little would no longer do. The reduction in commissions would enable investors to churn their portfolios more frequently. This offered a major opportunity for UK managers. He believed that they had a comparative advantage. They had a long tradition of investing abroad and were skilled and assured in doing so in both London and Edinburgh. And they had a good track record. There would be additional competition, but the UK could look forward to it with confidence. Turning to the conflict of interest problem he believed that there was an excess of sensitivity to the point in London. It did not seem to worry other countries. But in spite of this some of the new institutional groupings were creating divisions within their organisations which would be disfunctional. The potential synergies were being lost as an excess of scrupulousness caused central management to re-partition their empires.

After these two opening statements there was a loose and unstructured debate. I have recorded only the most notable points in it.

Underwriting

The first subject which generated any light or heat was the future of underwriting in the London market. **Andrew Smithers** of Warburg believed that the old London system had a number of attractions, in directing institutional funds into the underwriting business. The institutions were the right place for the risk to lie. In future the benefit of doing so would be lost, which would be a pity. But **John Brew** of Grieveson Grant considered that existing sub-underwriting arrangements were too inflexible. It was the tightest cartel in the City. It was inevitable that London would move to the US system. He noted that Grieveson Grant had on that day fixed the price for Laura Ashley and arranged the sub-underwriting. He frankly confessed that there was no need to incur the sub-underwriting costs. There was a zero probability that the issue would be undersubscribed. He could not

indeed

produce any defence for what they had done.

Peter Buchanan observed that in the United States investment banks were natural risk takers. But the forces of competition had meant that there was now no money in underwriting at all. The streamlined registration procedure (415) had meant that anyone could come to the market at any time. The underwriting process was therefore handled at a junior level and in a totally routine fashion. Only firms with large scale capital and a high tolerance of risk could do business. The old syndicates no longer existed. Fifteen years ago before a major issue he would have been in meetings all weekend discussing the fine terms of the syndicate. Now one of his 26 year old dealers handled the underwriting on the 'phone one afternoon and he learned about it, if at all, three weeks later.

London's market share

The future importance of London was then discussed. Some of the UK participants were pessimistic about London's long term market share. But **Bill Schreyer** believed that the Government's courageous decision would mean that in the long term London would be if anything an even more important market. He was "bullish on London".

John Phelan, the Chairman of the NYSE, said that it was sensible to assume that the market would expand. He saw in the long term three equally important market centres in New York, London and Tokyo.

Wider Share Ownership

The discussion staggered on towards the needs of the private individual investor and the potentiality for wider share ownership. **Bill Schreyer** said that Merrill Lynch had always believed in "taking Wall Street to Main Street". **Stanley Yassukovich** thought that a major cultural change was still required in the UK. Building societies would need to get involved. The UK government had had exaggerated expectations for the privatisation programme and the way in which it would affect wider share ownership. **Howard Davies** defended the government against the charge of unfounded optimism, commenting that the BT issue attracted far more shareholders than was expected. The number of individual shareholders had been doubled at a stroke by BT. Also, since 1979 1 million people had joined employee share ownership schemes. The question was whether these people could be attracted to broaden their portfolios. There might be a role here for the new financial conglomerates.

?. **John Brew** was critical of the government. They should stop privatising with poor prospectuses, which in many cases had deliberately deterred the individual investor, telling them in effect that they ought to be an institution if they wanted to get a big piece of the action. What the government ought to do was put its energies behind creating a decent system of security transfer. There was too much paperwork. This government had in practice done nothing whatsoever to encourage wider share ownership.

Tony Greayer of Hoare Govett took a different position. Much of the blame for the lack of small equity shareholders in the UK rested with the financial institutions themselves. Bank managers were uninterested and inaccessible. All of the clearing banks might appear to have share retailing as part of their long term strategies, but relatively little had been done so far. Hoare Govett were talking to the building societies and were optimistic. They had recently made a new marketing pitch, involving sending out simple plastic cards to potential investors describing a non threatening and cheap dealing service, and they had been astonished by the market's response.

Defending the clearing banks **Peter Leslie** of Barclays said that they believed that in the long term the individual equity shareholder was an attractive target. But at the moment share turnover through the clearing banks was negligible. Only 25 Barclays branches had turnover of any significance at all, and handling it was very expensive.

Bill Schreyer described Merrill Lynch's marketing efforts, through a cash management account, which had attracted 1.3 million people. The average sum held in the account was $91,000 and the minimum required was $20,000. He believed that there was a big market out there if the institutions were imaginative enough to go for it. Everybody wanted to save "a dumb dog who doesn't bury a bone". (But one of his colleagues said later that they looked for minimum net worth of $200,000 before advising people to trade individual equities).

Philip Chappell believed that the Government should remove stamp duty from equities. **Gordon Pepper** was concerned about how well small shareholders would handle the changing technologies in the market place. **Sir David Nicholson** thought that the ambition of every company should be a broker in the workplace on the model of the bookies runner. **Andrew Smithers** thought that growth in the first place was likely to come through varieties of institutional investment, such as unit trusts.

Second Session

The Saturday morning session was even less coherent, with four discussion leaders on a panel, each of whom talked in an unstructured fashion about different subjects. The floor contributions ranged even more widely.

Local Markets

John Brew began by giving his perspective of the shape of the London market after the big bang. He saw the blueprint as being a New York Nasdaq market rather than the Main Board.Primary markets would become far more capital intensive, but secondary markets would be less so. He thought the gilt-edged market was quite irrelevant (no-one appeared to understand the force of this remark).

Andrew Smithers was bullish about the prospects for the upmarket merchant banks. Fund managers wanted liquidity and high quality advice rather than cheap dealing, and would be prepared to pay for them. **Tyo van Marle** of Credit Suisse thought that in practice we were still a long way from globalisation. Some companies did have overseas distribution of their shares but that was not at all the same thing. He rather disagreed with Bill Schreyer's view of the importance of that development. In the first place companies would use the eurobond distribution system, and subsequently their shares might be handled locally. The question was how international market makers would react in a long bear market, would they maintain day to day international churning or retrench? **Xavier Dupont** thought that there would be increasing conflicts between stock exchanges and banks. He saw the need to establish a "constant pricing system".

Summing up this part of the discussion **John Phelan** said that those present appeared to believe that local markets would retain a very large part of dealing in their own stocks. The influence of time zones was still important, but nobody knew how international equity markets would develop in the medium to long term.

Efficient Markets

Dean Lebaron delivered an entertaining lecture describing his efficient market based investment management operation. He has made large sums for himself and his clients through using a set of mechanistic formulae operated by a small computer to bet against the market consensus. His costs are very low - 30 employees for funds exceeding $11bn. But the rest of the participants were not willing to grapple with the fundamental issues about the implications of the efficient market hypothesis or the structure and operations of their institutions.

Conflicts of Interest

Brandon Gough of Coopers and Lybrand focused on potential conflicts of interest in the London market and therefore introduced an interesting discussion. He began by acknowledging that there would be costs involved in separating out the functions of the new financial conglomerates, and costs which would ultimately need to be paid by the users of the service. He focused on the problem as it affected merchant banks. He characterised four distinct areas of merchant banking activity, market making, corporate finance, underwriting and distribution, and investment management. Using this framework there were five pairings which represented potential conflicts of interest:

i) Broking and market making. Here he thought that the conflict was not serious. If a broker was quoting his client a price taken from the in-house market making function which was not in line with the market then that would be very quickly apparent. And it would simply not be worth the institution's while to alienate clients in this way.

ii) Analysis and market making. He saw a clear conflict of interest here and believed that institutions would cease to look to brokers who were part of merchant banks for this kind of advice. The question was where would they go to instead?

iii) Corporate finance and market making. This would focus on the problem of pricing new issues. In the past brokers had provided an independent view on pricing.In future this would be more difficult to obtain.

iv) Mergers and takeovers. He saw potential conflict between advice to management and to shareholders, and the ability of institutions to hold stock in the companies involved.

v) Investment management and market making. This was a potential conflict, but the industry would probably be able to minimise the damage without much difficulty.

The ensuing debate was lively. On the one hand **Philip Chappell** thought that severe problems would occur. Politicians perceived more conflicts than market participants did. He thought there would be a severe crisis, and in the way of things it would be likely to occur just before the next election. Therefore would it not be better to insist on the separation of functions now? A long silence ensued.

Gordon Pepper thought that the broker/agency issue was not a real problem. But the analysis/market-making problem was more difficult than Brandon Gough had implied. As was the question of mergers and takeovers. On fund management, this conflict had not been managed before. He noted that Salomon Brothers and Goldman Sachs did not have discretionary fund management operations themselves. This point was somewhat spoilt by a Merrill Lynch intervention pointing out that they had dealt with this conflict for many years.

John Brew said that all this was a lot of fuss about nothing. There were strong in-house pressures which would mean none of these conflicts would in practice arise and no-one needed to worry. The City should be left alone. Various American participants had some difficulty in understanding quite why this issue generated so much heat in London.

John Browne, who has taken over from Q Morris at BP, thought that major companies would be much more selective in their use of City institutions. They would move away from long-term 'relationships', and choose individual firms for their expertise in a particular area. Furthermore, they would not put any of their advisers fully in the picture. In this way they could guard against some of the more dangerous implications of the conflicts of interest which had been described.

The fourth panel speaker, **John Creedon** of Metropolitan Life, delivered the most boring and inconsequential speech I have ever heard.

Sir Kenneth Berrill: After Dinner Speech

After dinner **Sir Kenneth Berrill** described the latest state of play on work of the Securities and Investments Board. He described the timetable, and, in a discursive fashion, touched on some of the difficulties involved in deciding how many SROs there should be and who should be subject to which and why.

His talk did not go down well. Considerable concern about the timetable and the SIBs vagueness was expressed by **Jeffrey Knight**, the chief executive of the Stock Exchange and **David Poole** of Capel, Cure Myers in particular. They were alarmed to hear that Sir Kenneth had not made more progress and that the important issues of SRO coverage appear to remain entirely unresolved.

On the question of fraud **Sir Kenneth** said that he himself was dissatisfied with the arrangements. The difficulty was that prosecutions were very slow to prepare. The Director of Public Prosecutions would not go to court unless he had at least a 50 per cent chance of winning. This meant that the announcement impact of cases was much reduced. He saw the fundamental problem, however, as lying with the jury system, which the lawyers appeared remarkably reluctant to modify.

Corridor chat

A number of particular points were made to me in the margins of the conference.

R Brooks of Kleinwort Benson was critical to the point of rudeness about the government. Without abolition of all capital taxes and of stamp duty the government faced disaster in the City of London. The whole Eurobond market might move offshore, and he could imagine nothing worse for the future of the country.

creep

Win Bischoff, on the other hand, was very bullish about the privatisation programme. He had the highest admiration for the Ministers and officials in the Treasury who were handling the issues. In the past mistakes might have been made on the targeting of individual sales, but the Treasury was becoming very sophisticated in its management of the programme and as a result it would go from strength to strength.

Tony Greayer was similarly optimistic, and believed that privatisation was causing a lot of institutions to think very hard about their private client business, and its scope, whatever some of them might profess in public.

Peter Gottsegen of Salomon Brothers, who is advising the Department of Transport on BA, was very bullish about the BA's prospects in the US. He believed that US investors perceived BA to have better routes and better management than many US airlines, and that therefore it could expect to go in the US at a higher PE than those attaching to most major US airlines. This was evidently a plea for a large proportion of the issue to be sold in the US, but the point was of interest nonetheless.

Tyo van Marle talked about a presentation made to CSFB by Brian Bassett of Royal Ordnance. They had been quite impressed and now thought that a Royal Ordance flotation could be a success. Institution investors had an underweighting in the defence sector, which Royal Ordnance could help to offset.

heard this before anywhere. — but see final sentence over.

Gordon Pepper buttonholed me at lunch. He saw severe political problems ahead. **Sir Kenneth Berrill** was doing his best, but the structure is misconceived. There was a clear danger of embarrassing scandals and 'accidents'. City regulation had been mishandled in Government for years because all the Ministers in charge were lawyers. It was vital for someone to 'take hold of the problem'. That someone should probably be the Chancellor, who had the key merit of not being a lawyer. He had made these points to Brian Griffiths the week before.

Graeme Gilchrist was unhappy about the SIB. It needed a leader, not a Whitehall-style committee chairman.

HD

H J DAVIES
3 December 1985

NYSE/TEMPLETON COLLEGE

The Changing World of Financial Services
22nd - 23rd November 1985

LIST OF ACCEPTANCES

WILLIAM ABRAMS	General Partner, Stern Brothers Inc
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W.G. ALLEN	President, Performance Service and Finance Inc
MICHAEL ACZEL	Research Consultant, Templeton College
CHARLES BARBER	Director, NYSE; Former Chairman of ASARCO
SIR KENNETH BERRILL	Chairman, Securities and Investments Board
W.F.W. BISCHOFF	Chief Executive, Schroders PLC
CHARLES BREED	President, Templeton College, Associates Council
JOHN BREW	Chief Executive Partner, Grieveson Grant & Co
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BRANDON GOUGH	Senior Partner, Messrs Coopers & Lybrand
ANTHONY B. GREAYER	Deputy Chief Executive, Hoare Govett Ltd
JOHN E. HERZOG	President & CEO, Herzog Heine Geduld Inc

[illegible].E. HEWITT	Head of Financial Supervision, Bank of England
SIR JASPER HOLLOM	Chairman, Panel on Takeovers and Mergers
JOHN HOLMES	Managing Director, Morgan Grenfell Securities Ltd
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UWE KITZINGER	President, Templeton College
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DEAN LeBARON	Trustee, Batterymarch
LUCIEN R. LeLIEVRE	Partner in Charge, Goudert Brothers
P.E.LESLIE	Chief General Manager, Barclays Bank PLC
ANDRE LEYSEN	Chairman, Gevaert Photo-Producten, N.V.
ALBRECT MATUSCHKA	Chairman, Matuschka Group
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ALAIN MORVAN	International Director, AECA, Paris
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ANDREW SMITHERS	Director, S.G. Warburg & Company Ltd
DAVID SURATGAR	Director, Morgan Grenfell & Company Ltd
DOUGLAS THERRELL	Vice-President, Cameron-Brown Company
RICHARD THORNTON	Chairman, Thornton Management Ltd
PETER M. TOCZEK	President, New York and Foreign Securities Corporation
J.T.van MARLE	Executive Director, Credit Suisse First Boston Limited
SIR MALCOLM WILCOX	Chairman, Rea Brothers
S.M. YASSUKOVICH	Chairman, Merrill Lynch Europe Ltd
MOHAMED S. YOUNES	Chairman, Kidder, Peabody International Ltd.

2384/032

CONFIDENTIAL

ECONOMIC SECRETARY TO THE TREASURY

Meeting

(+ note from Sir P Middleton)

FROM: M NEILSON
DATE: 4 December 1985

PS/CHANCELLOR

cc: Sir P Middleton
Mr Cassell
Mr Peretz
Mr Hall
Mr D Jones
Mr Board

Mr Bridgeman - RFS
Mr Quinn - BoE
Mr Brummell - T.Sol

C, If the Ld Chancellor's block on extension is serious, the only logical way to meet this point from EST would be to withdraw immunity from those who already have it — Lloyds, the IBA and the Patent Office.

R 5/12

CIVIL LIABILITY OF SUPERVISORS

The Economic Secretary has seen Mr Hall's minute of 29 November on the Civil Liability of Supervisors. He has commented that he really does not see how immunity can be limited to Lloyds (and Stock Exchange?). Lloyds have more to answer for than anyone.

MN

M NEILSON

352/059

FROM: T J DAVIES
DATE: 6 December 1985

PS/CHANCELLOR

C/ OK?

Ro 6/12

~~NB~~ Who SofS DTI asked to be a backer of the BSoc? Bill? If so, what was the response? If not, why not?

BACKERS FOR THE FINANCE SERVICES BILL

The Secretary of Sate for Trade and Industry has asked if the Chancellor would be prepared to be counted as a 'Backer' for the above mentioned Bill.

2. The Bill implements the proposals set out in the White Paper on Financial Services published on 29 January 1985 (Cmnd 9432) and seeks to improve investor protection whilst allowing the Financial Services industry to operate efficiently and competitively, and represents a major updating of the regulatory system.

3. As the Chancellor will be aware, being counted as a "Backer" does not commit him in any way to assist with the passage of the Bill through the House; this rests with DTI Ministers.

4. HF1 have no objections.

5. We have been asked to reply as soon as possible.

T J DAVIES
Parliamentary Section

49

RSP

From: SIR PETER MIDDLETON

Date: 9 December 1985

I had time to discuss with Percy @ Mon's breakfast. N

CHANCELLOR

cc Chief Secretary
Financial Secretary
Minister of State
Mr A Wilson
Mr Cassell
Mr Peretz
Mr Hall
Mr Watts

FINANCIAL SERVICES BILL

... You and your colleagues might find it useful to have the attached account (by Mr Watts) of the state of play on the Financial Services Bill. A print of the Bill is available if anyone wants to have the real thing.

2. There have been extensive discussions with DTI about the Bill although we are severely limited in the resources we can put on to it. We have therefore concentrated on those areas where consistent - though not necessarily identical - treatment is needed in the financial services, building societies and banking legislation; examples are disclosure and auditors. The Financial Services Bill has been prepared in such a hurry that some changes will be needed at Committee stage to ensure full consistency.

3. There have also been some areas of serious concern to the Treasury - classification of money market instruments; disclosure for prospectus purposes; overlap with the Banking Act. As you will see from the note, these are not all resolved but they are being pursued with a view to amendments at Committee stage.

4. I have promised you a separate note on conglomerate supervision when the full report being prepared by a group chaired by the DTI is available.

5. I need hardly say that this Bill could scarcely be taken in a worse climate. It has the disadvantage, compared with the Banking White Paper, that it does not contain any element of tightening in supervision and can be made to appear the reverse. However, it seems quite inevitable to me that the Government had to give this traditional route a run for its money before looking at more bureaucratic options. And the whole financial services area is moving so quickly that I doubt whether any of the three pieces of legislation will survive without substantial change over a long period.

Pm

P E MIDDLETON

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FINANCIAL SERVICES BILL

Timetable

1. A new print of the Bill is currently being prepared for consideration by L Committee on 17 December. DTI are planning to publish the Bill on 19 December. Second Reading debate is expected in late-January.

A New Regulatory Framework for Investment Business

2. The Bill provides the Secretary of State with powers to authorise and regulate investment businesses, defined as businesses involved in dealing in, advising on or managing (but not issuing) investments. Investments are defined to include shares, debentures, Government and public securities, depository receipts, unit trusts, options, futures and long term insurance contracts.

Self-Regulation within a Statutory Framework

3. The Bill enables the Secretary of State to delegate the majority of his powers to a "designated agency". In line with the policy of "self regulation within a statutory framework", the Bill envisages that the designated agency will be a private sector body financed entirely by investment businesses. This general line was cleared with the Prime Minister in exchanges of minutes with the Prime Minister through the Autumn of 1984 (copies attached) and announced in DTI's White Paper "Financial Services in the United Kingdom", published in January 1985.

Delegation to Designated Agency

4. Although they will not enjoy statutory backing until the Bill receives Royal Assent the bodies intended to fulfil the role of "designated agency" - the Securities and Investments Board (SIB) chaired by Sir Kenneth Berrill and the Marketing of Investments Board Organising Committee (MIBOC) by Mr Mark Weinberg - are up and running. DTI appear to have been persuaded that SIB and MIB should be merged to form a single Board in due course.

Self Regulatory Organisations

5. The SIB/MIBOC will in turn be able to recognise self-regulatory organisations (SROs) which will themselves be able to authorise and regulate investment businesses. Membership of a recognised SRO will confer authorisation for the purposes of the legislation. Although no formal announcement has yet been made the SIB has indicated that it has in mind to recognise seven SRO's (see Annex A).

Powers Delegated to SIB/SROs

6. The Bill will prohibit the carrying on of an investment business unless an institution is authorised or exempted. It will be a criminal offence to carry on such business without authorisation. An institution can choose to seek authorisation either from the SIB or by securing membership of a recognised SRO.

7. The SIB/SRO will also enjoy powers to make rules about the way in which investment business is to be conducted and to investigate and monitor to ensure compliance. Breaches of the rules could lead to revocation of authorisation and will give rise to civil liability in that clients would be able to sue for losses suffered.

8. Ultimate responsibility for enforcing the criminal law will continue to lie with DTI.

Accountability

9. It will be without precedent for statutory powers of authorisation and regulation to be given to private sector bodies in the way envisaged in the Bill.

10. There will however be procedures for accountability. The Secretary of State will appoint the Chairman of the SIB with the agreement of the Governor of the Bank of England. The Governor will appoint other members with the agreement of the Secretary of State. The Secretary of State will retain the power to withdraw the authority delegated to the SIB should it cease to conform with the criteria set out in the Bill. The SIB will be obliged to report annually to the Secretary of State who will lay its report before Parliament.

Lloyds

11. Lloyds main non-life insurance business does not fall within the Bill's definition of investment business. However underwriting agents at Lloyds undertake investment business in managing the insurance funds of names and in soliciting new names. Lloyds is specifically exempted on the face of the Bill.

Likely Criticisms of the Bill

12. Criticism of the Bill is likely from two directions.

13. The first is that self-regulation in the City is no longer

sufficient in the light of (i) the inevitable conflicts of interest which will be faced by institutions after "Big Bang" next year, and (ii) the charges of corruption and fraud surrounding Lloyds and JMB. The second concern, shared by the Lord Chancellor, is the direct lack of accountability of a private sector regulator to Parliament. The two issues are interrelated in so far as strengthening the powers available to the SIB/SROs necessarily worsens the problem of accountability.

14. DTI Ministers have responded already publicly to such criticism by emphasising that

(i) the Bill will help fight fraud by providing wider powers for investigators and by including new provisions on insider dealing

(ii) that the proposed arrangements enjoy the advantage of making use of the expertise of practitioners and, unlike the SEC in the United States, offers speed and flexibility in that conduct of business rules can be amended without the need for legislation.

Alternative Ways Forward

15. All sides recognise that the Bill represents a last chance for self-regulation. Should this option fail then there would seem to be little alternative to introducing a body endowed with a statutory constitution, with specific statutory responsibilities and funded primarily by the Exchequer.

Specific Treasury and Bank Concerns

16. We have kept in touch with DTI during the drafting of the Bill on a number of points of specific Treasury and Bank interest:

(i) Reciprocity. The Bill contains reciprocity provisions. These will provide powers in respect of banking, as well as investment, authorisation.

(ii) Overlap with Banking Bill. We have reached broad agreement on how best to supervise the difficult grey area between banking and securities business. Mr Cassell is corresponding with DTI about the treatment of CDs, other money market instruments and foreign exchange contracts.

(iii) Exchange of information between supervisors. It will be essential after "Big Bang" that supervisors should be able to exchange supervisory information. The Financial Services Bill includes the necessary statutory provisions to permit this.

(iv) Insider dealing in gilts. We have persuaded DTI to drop their proposed clause to extend the offence of insider dealing to gilts.

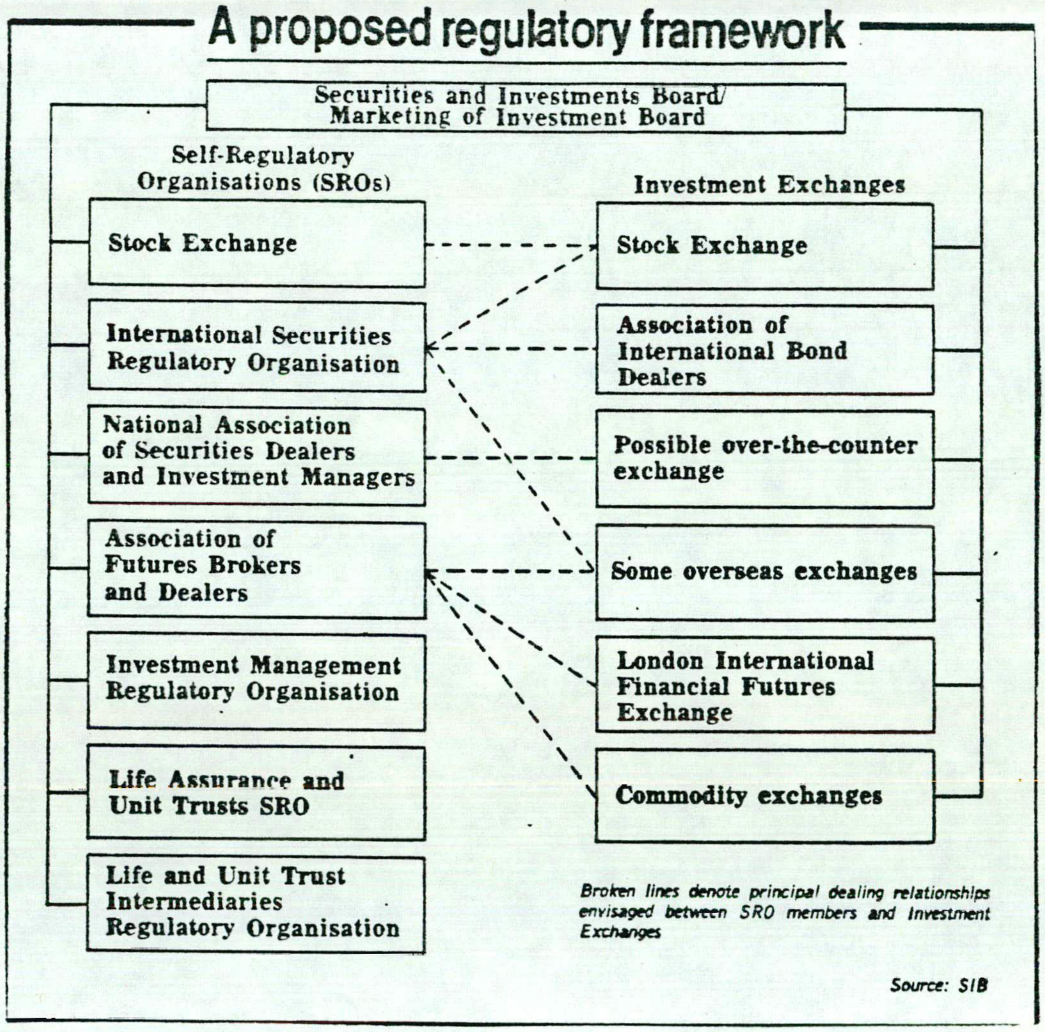
(v) Powers of Takeover Panel. DTI do not intend to take powers in the Financial Services Bill to provide the Takeover

Panel with statutory backing. The Bill will contain provisions on conduct during takeovers, and on the content of documents, but these will apply only to institutions carrying on investment business. The problem in going further is that DTI have concluded that it would not be proper for a private sector body like SIB to exercise authority over persons other than authorised businesses. This was accepted by the Chancellor in recent correspondence.

(vi) Prospectus Requirements. PE2 are in discussion with the DTI about the proposed requirements imposed on HMG in respect of privatisation prospectuses.

(vii) Auditors. DTI are content with the Banking White Paper, and intend to publish a consultative document along similar lines.

ANNEX A


A proposed regulatory framework
Securities and Investments Board/ Marketing of Investment Board
Self-Regulatory Organisations (SROs)
Investment Exchanges
Stock Exchange
International Securities Regulatory Organisation
National Association of Securities Dealers and Investment Managers
Association of Futures Brokers and Dealers
Investment Management Regulatory Organisation
Life Assurance and Unit Trusts SRO
Life and Unit Trust Intermediaries Regulatory Organisation
Stock Exchange
Association of International Bond Dealers
Possible over-the-counter exchange
Some overseas exchanges
London International Financial Futures Exchange
Commodity exchanges
Broken lines denote principal dealing relationships envisaged between SRO members and Investment Exchanges
Source: SIB

Mr Watts

B3

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CH/EXCHEQUER

REC.	-9 OCT 1984
ACTION	MR HALL
COPIES TO	CST, FST, MST, EST
	SIR P. MIDDLETON
	MR CASSELL
	MR BATTISHILL

MR LANKESTER
MR LAVELLE
MR SAUNDERS
MR RIDLEY
MR PORTILLO

PRIME MINISTER

FINANCIAL SERVICES

I sent you a minute on 12 July about our new policy for financial services and set out the line I proposed to take in the July debate in the House. You replied on 16 July agreeing with my approach.

2 The House and the City generally welcomed the policy objectives I stated: competitiveness, enforcement and freedom for market forces to stimulate competition and innovation, allied to a regulatory framework aiming to provide effective protection for the investor.

3 I have now concluded that, for the regulatory element in that policy, self-regulation within a new statutory framework is my preferred approach. To maintain the favourable momentum in City opinion (not least by allowing the Governor to get ahead with preparations which must be set in hand), and to give firm Government leadership, I think this should be publicly known ahead of issuing the full White Paper.

JH4ALC

4 I explained to the House my preference for institutions devised and largely administered by the financial services industry itself within the framework of a clear and simplified investment law. I welcomed the invitation by the Governor of the Bank of England to a group of senior City figures to advise him on the structure and operation of self-regulatory groupings which could be formed in the near future. I also referred to the similar group set up by Alex Fletcher to advise on parallel action concerning the marketing of life assurance and related products.

5 I have now received the Governor's advice and discussed it with him. He has told me that he favours, and believes he can deliver, a single City body of practitioners, users and independent people with business experience to oversee the securities and investment industries. The insurance industry has proposed a similar single body to oversee the marketing of life insurance policies and unit trusts.

6 There is a fine balance to be struck here. I need to ensure that there is in fact self-regulation, with flexible response to changes in practice, which means that we must not as Government be too directly involved; at the

same time, if these two bodies are to be effective "self-regulators", they need statutory backing. I would be willing to give them that backing on condition that they satisfied basic principles of conduct to be laid down by Government e.g pattern of membership, constitution, competition, safeguards against conflicts of interest, protection for clients' funds. My plan therefore is to seek powers under new legislation which I would then delegate to these new bodies provided they meet the tests. As an additional safeguard against abuse, I would not want these bodies to have the final say on licensing and disciplinary questions; but to avoid involving myself in such matters I would require the bodies to have an independent tribunal whose members I would appoint. On this basis we should be able to harness the present - welcome - City impetus to achieve self-regulation to a measure of ultimate control and influence. I should also avoid being too closely involved in answering to Parliament. The legislation would be so drafted so as to ensure no obstacle to eventual amalgamation of these two bodies, if that were to be how they evolve.

7 I propose, and shall bring forward in due course, a White Paper. As well as being our major policy statement giving details of our plans for legislation and of these

institutional arrangements this White Paper will contain the Government's response to the recommendations made by Professor Gower in his report and to the resulting comments on it from a wide cross-section of City opinion. To give time to prepare an adequately comprehensive document, and to give colleagues time to consider it, I have in mind publication early in December.

8 I have discussed with the Governor the danger that the currently favourable momentum in City opinion might be jeopardised if I give no further public indication of the Government's thinking before the White Paper is published. I am sure that it would maximise our chances without damaging the White Paper announcement if I stated publicly in the near future our decision to go for self regulation within a statutory framework as the preferred option and outlined how we see this developing on the lines of this minute. This would clear the way for further progress in establishing support for the City for the proposed arrangements and in implementing them.

9 I have discussed this with Nigel Lawson who is content.

10 I am copying this minute to Nigel Lawson, Quintin Hailsham, the Governor of the Bank of England and Sir Robert Armstrong.

M McCarthy

PP

N T

9 October 1984

(Approved by the Secretary of State and signed in his absence)

Department of Trade and Industry

JH4ALC

B3

H/EXCHEQUER
REC. 12 OCT 1984
ACTION MR HALL
COPIES TO CST, FST, MST, EST
SIR P MIDDLETON
MR CASSELL
MR BATTISHILL
MR LANKESTER
MR LAVELLE
MR SAUNDERS
MR RIDLEY
MR PORTILLO

10 DOWNING STREET

From the Private Secretary

11 October, 1984

Dear Callum

FINANCIAL SAVINGS

The Prime Minister has seen your Secretary of State's minute of 9 October. She is content with the general shape of the proposals which he has worked out in conjunction with the Chancellor of the Exchequer and the Governor of the Bank of England.

There are, however, a number of points on which it would be helpful for the Prime Minister to have further clarification.

(i) What action does your Secretary of State have in mind to toughen up the law governing the issue of prospectuses and the provision of false and misleading information?

(ii) The Prime Minister understands that Justice Roskill is considering the use of juries in fraud cases, and that 30 September was the deadline for evidence to his Inquiry. Is it known when he will be reporting?

(iii) Is it intended to give the Office of Fair Trading a continuing remit to scrutinise the self-regulatory agencies to ensure that they do not relapse into cartels?

(iv) What will be the relationship between your Secretary of State and the two main supervisory bodies? What powers will be delegated to them and who will appoint their members?

(v) Is it intended to transfer the supervision of the marketing of insurance and unit trusts from DTI to the Investments Marketing Authority? Will this save any Civil Service posts in the Department?

I am copying this letter to David Peretz (HM Treasury), Richard Stoate (Lord Chancellor's Office), John Bartlett (Bank of England) and to Richard Hatfield (Cabinet Office).

Yours sincerely
Andrew Turnbull

(A. Turnbull)

C. McCarthy, Esq.,
Department of Trade & Industry

CONFIDENTIAL

002/1949

CONFIDENTIAL

This is v. tedious. All that was required was a short note along the lines of my PS minute yesterday. Instead, 24 hours wasted in preparing this nightmare draft. I have been some... But save the texts, pse stand as shortened & amended.

FROM: M A HALL

10 December 1985

1. ECONOMIC SECRETARY ✓ as amended

2. CHANCELLOR

c c Sir Peter Middleton
Mr Cassell
Mr Peretz
Mr Board
Mr D Jones

Mr Bridgeman RFS

Mr Nicolle)
Mr E George) BoE
Mr M Hewitt)

C/ A very tentative draft from Martin, but cleared with the Bank and Registry. EST has amended somewhat. Content with draft?

Ro 10/12

FINANCIAL SERVICES BILL : CIVIL LIABILITY OF SUPERVISORS

Undeterred by the Lord Chancellor's letter of 28 November, the Secretary of State for Trade & Industry is continuing to press for inclusion in the Financial Services Bill of his proposal to confer on designated agencies (the SIB and, if it survives, MIB) an immunity from liability for damages in respect of acts of commission or omission done in the discharge of their supervisory functions. Mr Brittan also proposes to continue the Stock Exchange's present immunity as a competent authority (for listing). He has not, however, accepted the Bank of England's arguments for giving the SROs immunity as well. (The Governor's letter of 15 November).

2. In his further letter of 6 December, the Lord Chancellor expresses continuing unease, but leaves it to Mr Brittan's judgment. He has, however, copied the whole correspondence to the Prime Minister and Cabinet colleagues.

3. This matter is extremely urgent. If you are to intervene, your letter should go today. No 10 and DTI have been warned that you will be writing.

4. We discussed at official level with the Bank and RFS the possibility of immunity for supervisors in the context of the Building Societies Bill, and concluded that it would be politically

extremely awkward to propose immunity from civil damages for supervisors of banks and building societies. This would look like removing a pressure on the supervisors to be vigilant, at a time of strong political pressure to do the opposite. The timing seemed particularly unfortunate, when both bank and building society supervisors were being given greatly increased powers, and in a context strongly influenced by JMB. In our further discussions with the Bank and the Chief Registrar however, we agreed to look again at the question if it was proposed in the context of the Financial Services Bill.

5. Both the Bank and the Chief Registrar consider that the threat of being sued for damages would be a considerable inhibition on the supervisor in a financial world increasingly populated by American and other international companies accustomed to litigation. They also consider that exposure to damages suits would be a significant deterrent to recruitment, since individual supervisors would become liable to being sued. Against this, however, it can be argued:-

(a) The powers of the supervisors are formidable, and they should be fully accountable for their actions.

(b) Immunity would encourage the supervisors to take less care over performance of their duties.

(c) Investors should have the full armoury of legal rights to protect their interests.

6. On the merits of the case, we agree with the Bank and the Chief Registrar. We think that the Secretary of State effectively answers points (a) and (c). (b) is unlikely to be a factor, since total immunity is not being proposed, and a court can still make it quite clear that the supervisor was to blame in a particular instance. The fact that he was not facing damages would not prevent this from being a serious blow to his prestige.

7. On merit therefore we see no reason to advise you to oppose the Secretary of State's suggestion in respect of the designated agencies under the FS Bill. We think there is a good case for extending immunity to the Bank of England and to the Building Societies Commission. There is no particular Treasury interest in supporting the Bank's case for extending immunity under the F S Bill to the SROs.

8. The Secretary of State makes a special case for the designated agencies, on the grounds that they have no funds of their own, and to the extent that they were sued, would have to meet the costs of any award by making a further levy on authorised institutions. The SROs would of course be in the same position, but, as the Secretary of State says, whilst the designated agencies would be performing statutory functions using powers delegated by the Secretary of State, strictly speaking the SROs would not be performing statutory functions at all - they will be approved, self-regulatory organisations, without any delegated powers. If other supervisors are given immunity the Bank's role as supervisor of the gilts market will require careful thought. It is non-statutory, and more akin to the SROs than to the banking supervisors.

9. Lack of funds seems a poor reason for granting immunity from damages to one particular supervisor rather than another. It could be argued that in an increasingly litigious financial services industry, supervisors with money behind them - such as the Bank of England, or the Building Societies Commission be a <u>more</u> likely target for law suits by companies or individuals with nothing to lose.

Conclusion

10. This is essentially a political choice. Our advice on the merits is to support the Secretary of State, but to point out that the reasons for singling out the regulatory agencies are weak, and that in the interests of more effective supervision immunity should in logic be extended to the supervisors of deposit-taking institutions as well. Against that, however, the presentational and political difficulties will be considerable

so the choice really lies between giving immunity to all or none. And if none, should Lloyds retain it?

11. A draft letter is attached. It suggests retention of the draft clause, and careful attention to the reaction it evokes.

12. The Bank and Registry are content.

M A HALL

CONFIDENTIAL

Secretary of State for Trade & Industry

Pl ~~type~~
(draft below)
ASAP.

December 1985

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

Thank you for copying to me your letters of 7 November and 5 (and 10) December. I have also seen Quintin Hailsham's replies of 28 November and 6 December, and the Governor's letter of 15 November. The arguments for and against granting immunity from damages to the designated agencies have been well aired in your correspondence, and I find the case finely balanced.

If more effective supervision were the sole concern, I agree that the supervisors would feel they had a freer hand if they were not constrained by fear of massive suits for damages. The nature of the City is changing, and the American influence is likely to become stronger. Increasing litigiousness is a likely and unwelcome price we shall have to pay for London's place ~~growth~~ as a world financial centre.

This argument applies equally, however, to the Bank of England and the Building Societies Commission, who will respectively be supervising banks and building societies. Neither institution would face bankruptcy if successfully sued for heavy damages. But arguably a supervisory body which had ample funds would be a more promising target for litigation, particularly where the plaintiff had little or nothing to lose. It would be odd to base such an important legal distinction between supervisors solely on their relative access to financial resources.

So if you decide to include immunity from damages for the designated agencies in the Financial Services Bill, I should be inclined to do the same in respect of the Building Societies Commission, in the Building Societies Bill, and of the Bank of England in next year's Banking legislation.

~~I was, however, also impressed by the strength of the arguments put by Quintin Hailsham.~~

On the other hand, the lack of direct accountability of the SIB - and the Bank of England - is certainly an argument for exposing them to the normal process of law. There are also a number of shorter term political arguments, which will undoubtedly be deployed. ~~against this proposal~~.

In the first place, Lloyds, who already have such immunity, are widely felt to have been remiss ~~less than rigorous~~ in their supervision of the market and individual syndicates in recent years. The political pressure is ~~much~~ more likely to be for removal of this immunity from Lloyds, than for its extension to others.

The aftermath of the JMB case also makes a particularly ~~unfortunate~~ awkward back~~cloth~~ground to th~~is~~e ~~suggestion.~~ proposal. It will appear that, at the first opportunity after a failure of supervision, the Government is taking action to protect supervisors from the possible consequences of subsequent shortcomings. I do not think this is a narrow banking point.

~~I have no particular view on whether or not the SROs should have immunity from damages suits. But if you propose immunity for the designated agencies, the ~~Parliamentary~~ pressure to treat SROs in the same way will surely be ~~overwhelming,~~ very strong since the financial considerations are identical in their case~~s~~.~~

~~I therefore see the arguments as finely balanced.~~

~~Whil~~st~~e I think that on supervisory merits both the regulatory agencies and the bank~~ing~~s and building societies should ~~probably~~ be given immunity as you propose, I ~~do think~~ accept that ~~these~~ such proposals will be ~~highly~~ controversial, and will not assist the passage of the Financial Services Bill. I can equally see that the clauses would be more difficult to introduce at Committee, than to include in the Bill at introduction stage. Perhaps~~ the more sensible thing is to gauge the reaction to them, ~~and~~ such and be prepared to drop them if they are strongly opposed. Meanwhile, I shall arrange for ~~clauses~~ Consider (similar) preparing clauses to be prepared for the Building Societies Bill on a contingency basis, for introduction at a

On balance, it may be that the most sensible thing is to include in the Financial Services Bill clauses granting the immunity you propose, later stage if your own proposal goes ahead.

Like Quintin Hailsham, I am copying my letter to the Prime Minister, ~~and to~~ members of the Cabinet ~~colleagues~~, and to Sir Robert Armstrong. A copy also goes to the Governor.

NIGEL LAWSON

2381/56

FROM: MRS K S MEASON
DATE: 10 December 1985

ECONOMIC SECRETARY TO THE TREASURY

APS/CHANCELLOR

cc: Mr Dyer
Mr T J Davies

BACKERS FOR THE FINANCIAL SERVICES BILL

The Economic Secretary has read your minute of 9 December, and Mr Davies' of 6 December. He is content to act as backer for this Bill.

Katherine Meason

MRS K S MEASON

TELEPHONE - 01-634 3333
TELEX - 892131 CSFB G
FACSIMILE - 01-623 2363
(UNATTENDED GP. 3)

REGISTERED IN
LONDON Nº 891554

CREDIT SUISSE FIRST BOSTON
LIMITED

22 BISHOPSGATE, LONDON EC2N 4BQ

JOHN M. HENNESSY
CHIEF EXECUTIVE OFFICER

Mean
Has EST copied this to DTI?
RWO 16/12

R/o
NO BUT THEY WILL IF YOU WISH
TONY L 17/12

TL/
Yes pl
RWO 17/12

CH/EXCHEQUER
REC. 13 DEC 1985 13/12
ACTION EST
COPIES TO

11th December 1985

The Right Hon. Nigel Lawson, M.P.,
Chancellor of the Exchequer,
11 Downing Street,
London, SW1.

Dear Chancellor,

The Proposed Financial Services Legislation

We refer to the forthcoming publication of the Financial Services Bill.

First, we would wish you to know that we thoroughly endorse the basic aims of the Government in introducing the intended measures of self-regulation in the City. Indeed, we are taking an active role in the evolution of the self-regulated organisation structure being established under the Securities Investment Board. As a UK Bank, actively involved in a number of areas to be covered by the Bill, and in particular, as a major participant in the field of the International Capital Markets, we believe that it is appropriate to demonstrate to the financial community throughout the World the determination of the City of London, under the guidance of the British Government, to adopt adequate self-regulatory controls for those firms located in the UK who are engaged in these important and expanding markets.

The proposed legislation will impact upon London's role as a primary new issue centre and as a major secondary market factor in the field of the International Capital Markets. You will be aware of the very significant size of these markets and their expected continued growth as well as the benefits, in tangible economic terms and in international prestige, that are compatible with London's established pre-eminence in this field.

Given the fundamental importance of the proposed legislation, and the imminence of the publication of the draft Bill, we would wish to comment that we have received very little information on the detailed provisions which are expected to be included in the Bill. We understand that only limited information has been made available to the financial community although it is possible that individual houses have been consulted more fully.

In view of the importance of the fundamental changes which the proposed legislation might impose, and the possibilty that, unless the Legislation adequately takes account of certain special aspects of the International Capital Markets (without diluting the self-regulation provisions) the continued location in the City of London of the International Capital Markets might be jeopardised, we do urge that the legislative process of the Bill through Parliament will allow for adequate consultation and constructive discussion following the publication of the Bill. In particular, whilst we would entirely support the aim that the sooner the proposed legislation can be enacted and applied the better and although it may be desirable to set a target date by which the legislation should take effect, one would hope that any such target date would be referred to as a date which could be changed if the proposed consultation process has not been satisfactorily completed before such date.

It is likely that the continued existence of the International Capital Markets in London will depend upon the legislation now being proposed and in order to ensure its continued presence, we cannot emphasise too strongly the need for detailed consultation with those engaged in the market. Without having seen the Bill, it is difficult to gauge the time that will be necessary for sufficient discussion to take place; hence we believe that some flexibility must be built into any target date for the legislation to become effective.

Yours faithfully,

JM Hennessy

.28

Thanks. Pls let me have a note on [illegible] I would like to raise Lloyds when we next see [illegible]

FROM: H J DAVIES
DATE: 18 DECEMBER 1985

CHANCELLOR

cc EST
Mr Cassell
Mr Peretz
Mr Hall

FINANCIAL SERVICES BILL: CONSERVATIVE BACKBENCH VIEWS

I attach a copy of a record made by Conservative Research Department of a meeting of backbenchers with Mr Michael Howard MP. We have already heard a brief report of the proceedings in a morning meeting.

2. But the more detailed record shows that Mr Patrick Jenkin led the attack on the scope of the Bill, arguing strongly for its extension to cover Lloyds. It seems that a majority of those present supported him.

HJD

H J DAVIES

The Governor. Peter Middleton [illegible] down the [illegible] of an outside appointment or the Chairmanship [illegible] non-executive [illegible]

Conservative Research Department

32 Smith Square Westminster SW1P 3HH Telephone 01-222 9511

Director: ROBIN HARRIS

CONSERVATIVE TRADE AND INDUSTRY COMMITTEE CONFIDENTIAL

Thursday, 5th December 1985

Speaker: Michael Howard

Chairman: Michael Grylls

25 members present

Mr Howard said that he attached great importance to what colleagues had to say about the Financial Services Bill. DTI Minister had inherited the Tebbit/Fletcher White Paper which had received a wide welcome both inside and outside the House. The Bill was on the same lines as the White Paper and remained faithful to it in providing a comprehensive regulatory framework for the investor.

The Bill proposed to give wide ranging powers to the Secretary of State which could then be transferred to a board or boards. (Mr Howard indicated that there was likely to be one board).

These comprised:
- a power of authorization. It would become a criminal offence to practice without authorisation;
- action to deal with breaches of the rules.

These powers would only be transferred if the Secretary of State was satisfied that the rules of the board met the principles enshrined in the legislation. These included principles relating to fair dealing, separation of funds, conflicts of interest and disclosure. Mr Howard stressed that transfer of these powers was revocable. The board would make an annual report of the Secretary of State and Parliamentary accountability would be ensured by laying the report before Parliament. The board would only recognise self-regulatory organizations (SRO's) if their rules provided equivalence with the board's own.

Mr Howard then turned to the powers that would be available to deal with breaches of the rules. These ranged from reprimand, through suspension to a full ban. An important sanction would be the power to order 'disgorgement' of profits made as a result of breach of the rules. Furthermore, those suffering loss would be able to seek civil redress.

The most common criticism of the proposals was that there was too much dependence on self-regulation. Instead, they wanted a 'fully statutory system'. But what was meant by this label? Comparisons were made with the SEC in America. However, Mr Howard had recently talked to both the operators and regulators there. It was clear from this that the US system was essentially self-regulatory. The difference lay in that the supervisory boards were fully statutory organisations, deriving all their power from legislation and were therefore constrained by it. Thus a changed situtation would call for a change in the legislation. The framework proposed by the Bill would enable the supervisory board to change its rules to meet changing conditions within the statutory principles.

Mr Howard had been told in America by amongst others the Chairman of the SEC that if they could start from scratch, they would want the system proposed in the Bill. The basic system was right, it had decisive advantage over the others. However, the precise demarcation between the board and the SRO's was a finely balanced judgement. Mr Howard said that he would listen to colleagues' views on the precise distinctions.

Mr Howard recognised that fraud was the issue of the moment. Neither the supervisory board or the SRO's would have a duty to enforce the criminal law. That would remain the duty of the law enforcement agencies. However, the new framework would help tackle fraud. Many activities in breach of SRO rules would be liable to civil action and would also be a criminal offence.

Mr Howard hoped that SROs would not insist on the strict rules of evidence and the burden of proof needed to satisfy juries. The Government looked to the Roskill Commission to suggest ways of overcoming procedural problems associated with fraud trials.

Concluding, Mr Howard said that the Government proposed to exempt Lloyds from the Bill as Lloyds' central insurance business fell outside the Bill's definition of investor business. To do otherwise would require a radical change of the Bill.

Mr Patrick Jenkin stated that the Government could not expect to 'get away' with this Bill if it did not deal with Lloyds. The fact was that the 1982 Act had not worked. Mr Jenkin noted that an important consequence of the appointment of Ian Hay Davison was that it gave Lloyds staff the security to investigate even the best known names. This would be totally undermined by the Miller minister/civil service analogy of the role of the Chief Executive. The logic of Hay Davison's resignation meant that the Committee of Lloyds had to be brought within the scope of the law. The Government should now recognise this.

Mr Howard had already set out the reasons why Lloyds would not be brought within the scope of the Bill. Most of the current stories in the press were about events twhich took place before the 1982 Act. It was too soon to make definitive statements. The system established by the Act was not fully in place. If the Act had demonstrably failed, this Bill was not the appropriate vehicle to remedy the problem.

Mr Howard would examine very carefully the terms of reference of Mr Hay Davison's successor. He would have to be responsible to the Council of Lloyds as a whole thus giving the staff the security as Mr Jenkin had indicated. The terms of reference were of the 'greatest importance' and Mr Howard expected no changes in them.

Mr Alan Howarth said that whilst he accepted the commercial needs that gave rise to financial conglomerates they needed to be reconciled with investor protection. He did not believe that chinese walls were very effective for large conglomerates.

Mr Howard said that we must not loose sight of the need to maintain the competitiveness of the City of London. Last year it earned £6 billion in foreign exchange. Chinese walls were not sufficient. Statutory principles such as the subordination of the interests of the company to the investor and disclosure were better guarantees. A recent speech by Sir Kenneth Berrill had set out the problems and the way forward. Conglomerates in the US had sorted out these matters.

Mr Nicholas Soames endorsed Mr Jenkin's comments. Lloyds was imperfectly understood. Justice had to be seen to be done. At the moment it looked very bad indeed. He had many constituents writing to him about this. We had to be able to explain the problem. Lloyds was closed unable to see the damage being done to it. Furthermore it was politically damaging.

Mr Howard commented that if Lloyds was not aware of this, they should be by now. They had internal disciplinary proceedings under way, there was a fact finding enquiry, a DTI enquiry and cases were with the DPP. How would bringing Lloyds within the scope of the Bill help?

Mr Andrew Rowe said that small businessmen were pursued by the Inland Revenue, those on benefit were often thoroughly investigated and councillors guilty of misdemenours, were severely dealt with. Yet in the City, if you made enough money, you could get away with it. Public feeling was very considerable. Mr Rowe suggested that practitioners, if they had been suspended, should be allowed to sue to overturn the suspension, if they dared to.

Mr Howard said that public feeling could only be dealt with by a radical streamlining of the criminal law as the offences Mr Rowe had talked of were criminal ones. The Roskill Commission report was due early next year. It should give the Government ammunition to tackle the root causes of the problem. Mr Rowe commented that that should be made clear.

Mr Hugh Dykes said he shared the anxieties of members. An SRO for Lloyds should be brought within the scope of the Bill. This argument may be emotional, but it was important that the Government should reconsider the Bill. The Lloyds Act was not much more than a technical Act. Mr Howard registered this concern.

Mr Tim Smith said that the Lloyds argument was finely balanced. However the 1982 Act was not just technical. Many of its provisions had yet to come into effect.

X)

Mr Bill Cash was concerned that monopolies, backed by the clearing banks could predominate. He was also unhappy that Lloyds had not been included. He recognised that possibility hybridity as an obstable to doing this. Mr Howard said that hybridity was one of the problems. On the monopoly point, the Bill would ensure that the rules of the SROs must not be anti-competitive.

Mr Robert McCrindle asked whether each individual life assurance salesman would have to be licensed and why it was thought that a declaration of commisions amounted to consumer protection.

Mr Howard said that no decision had been made on the first point. It would not be in the Bill as published. MIBOC was in favour but the Director General of Fair Trading had reservations. On the second point, Mr Howard said that declaration of commissions was one aspect of the general principle of disclosure at the heart of the Bill. It was not sensible to make exemptions from this principle.

Mr Keith Best endorsed Tim Smith's view that the Bill should not encompass Lloyds. Lloyds would get its own house in order. It was a scandal that criminal proceedings had been delayed for so long.

Sir Brandon Rhys Williams suggested that comments by the Reagan SEC appointees could be discounted as they were 'minimalists'. They appeared to be ashamed of where they were. Sir Brandon had recently met the Commisioner of the Metropolitan Police and members of the Fraud Squad investigating JMB who had told him that they should have been consulted.

Mr Howard said the importance he attached to what he had been told in the US was the reasons given for their views. On consultation with the Fraud Squad, Mr Howard emphasised that that dealing with criminal fraud was not the prime purpose of the Bill. Nevertheless, they had been consulted before the White Paper. No doubt they could have informed the DTI after that.

Mr Roger Freeman asked about the resources of the supervisory board and how SRO's would cover multi-functional firms. Mr Howard said that the beneficiaries of the framework - the industry - would provide adequate resources. They had an incentive to do so because if they did not, and the Secretary of State was unsatisfied, he could revoke. The question of demarcation between the SIB and the SRO's was 'vexed'; it was up to the SIB to come up with effective proposals.

Mr Hugh Dykes said that hybridity would not be a problem if the SIB could choose which areas would need an SRO. Then there would be no need to exempt Lloyds. Would the Commodities and Futures SRO be split up? Would the Insider Dealing Act be 'consolidatable' into the Financial Service Bill?. Were there implications with respect to EEC investor requirements?

Mr Howard said there was a practical difficult in addition to hybridity and Lloyds. One of the supervisory board's main sanctions would be to remove an SRO's power. This would not be disastrous since individual practitioners could apply for direct authorisation. But that sanction could not be used with Lloyds since in practice it would be impossible to withdraw recognition from Lloyds.

There would be SRO's for both the Stock Exchange and NASDIM. Insider dealing was difficult to prove, accounting for the small number of cases brought to the courts, but the Bill would strengthen enquiries into insider trading. Mr Howard would write to Mr Dykes about the EEC implications.

Mr Patrick Jenkin thought that Messrs Smith and Best had missed the point. If Lloyds was left alone, the 'Spanish Customs' would remain unchallenged. The 'everybody does it' argument had a deep hold. There was no evidence that the present council would put matters right. The true situation was shown when the Chairman of Lloyds was unable to answer questions put to him on BBC's Panorama.

Mr Jenkin repeated his warning that the Government would not be able to sustain the Bill's passage through Parliament. Mr Howard said that it was not the case that there was no independent element in Lloyds. They did have rules. However the system was not fully in place.

Mr Tim Smith felt that there could be common ground. He believed that 'baby syndicates' were utterly indefensible. Mr Keith Best said that baby syndicates were virtually dead.

Sir Michael Shaw said that it was important that if the Government were to shift, pressure for change in the Lloyds issue was seen to come from our side rather than the Opposition. Mr McCrindle believed that the Labour Party would move amendments at Committee stage to incorporate Lloyds into the Bill. Mr Jenkin felt that this could even happen at the Second Reading.

Rupert Darwall
6th December 1985

2565/10

CONFIDENTIAL

PSP.

From: D L C PERETZ
Date: 20 December 1985

PRINCIPAL PRIVATE SECRETARY

cc PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Hall
Mr H J Davies

FINANCIAL SERVICES BILL : CONSERVATIVE BACKBENCH VIEWS

I do not think there is anything we can do about it, but I was struck by a rather odd reference in the record of the meeting attached to Mr Davies' minute of 18 December.

2. Sir Brandon Rhys Williams is quoted as saying that he "had recently met the Commissioner of the Metropolitan Police and other members of the Fraud Squad investigating JMB ...".

3. I can see why he might have wanted to talk to the Commissioner about financial fraud in general. But since I assume we can take it that he was not himself being questioned, I am less clear as to why he should have been talking to the particular members of the Fraud Squad investigating the JMB affair.

at a Xmas party.

DLCP

D L C PERETZ

CONFIDENTIAL

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5422
GTN 215) ....
(Switchboard) 01-215 7877

Secretary of State for Trade and Industry

Ch/ Advice coming forward early tomorrow. We are asked for reactions by close tomorrow. Crisis of the matter [illegible] 4-6 (an idea with a strangely familiar ring to it!) RL 6/1

CONFIDENTIAL 6 January 1986

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

CH/EXCHEQUER
REC. 06 JAN1986
ACTION EST
COPIES TO

6/1

BRITTAN → CH/EX 6/1

Dear Nigel,

LLOYD'S AND THE FINANCIAL SERVICES BILL

As you of course know, we have been under heavy pressure, not just from the Opposition but also from many on our own side, to include Lloyd's within the Financial Services Bill. The Prime Minister made it clear in the House on 19 December that the Government is keeping a close watch on events at Lloyd's, and that if it becomes necessary to take action or to legislate we would not hesitate to do so. With Second Reading of the Financial Services Bill approaching on 14 January, I have been considering how we can strengthen our position.

2 I have been reluctant to include Lloyd's in the Financial Services Bill itself, but have so far not totally excluded the possibility of doing so. It would be very difficult to do so, but not absolutely impossible. The difficulty stems from the fact that the Bill is about the protection of investors, and the Government's regulation of Lloyd's has been primarily concerned with protecting policyholders. There is a risk that an attempt to include Lloyd's within this Bill would render the Bill hybrid.

3 I would therefore prefer to indicate more firmly that I do not regard this Bill an an appropriate vehicle for statutory regulation of Lloyd's, even if such regulation were regarded as necessary. On the other hand, I think it is important to support this position by providing some machinery for reaching a conclusion as to whether or not the Lloyd's constitution and the steps taken by Lloyd's under it by a given date do provide adequate protection for Members of Lloyd's as Investors. We have pointed out that it is still a comparatively short while

I don't see the [illegible] of [illegible] to embark on a course that is bound to yield further contentious legislation in this field unless [illegible] are certain that there would be no possibility to include Lloyd's in the FS Bill without making it hybrid. I am not certain that this is so: there is no need to mention Lloyd's, merely to include the activity (generically) engaged in by Lloyds names.

JF5ATJ

999-1

since the Lloyd's Act came into effect, and that the internal regulatory regime set up under it has only gradually been put into place. But we are entitled to expect that a satisfactory regime should be in place within a very short period of time if further statutory intervention into affairs of Lloyd's is to be avoided. And outsiders can reasonably expect to know how and when we intend to decide whether further action on the part of Government is necessary.

4 What I therefore propose is to announce on or shortly before Second Reading that I have set up an inquiry into Lloyd's, either by an eminent person or a very small committee under his chairmanship. The inquiry would be asked to consider whether the existing Lloyd's Acts and the bye-laws and other arrangements adopted under them provide sufficient protection for external members of Lloyd's as "investors" having regard both to the development of investor protection arising out of the Financial Services Bill and the need also to provide adequate protection for Lloyd's policyholders. I would ask it to report by, say, July 1986; this would allow time for legislation (which could well be hybrid) in the 1986/87 Session. However I would hope such legislation would not be necessary; Lloyd's have extensive powers to amend their rules and constitution under their existing Act, and the inquiry would put considerable pressure upon them to produce or complete an adequate regulatory regime.

5 To be effective such an inquiry would need to be headed by a person unconnected with Lloyd's who commands wide respect in the City and elsewhere. Among names I have in mind are Sir Patrick Neill, ex-Chairman of the Council for the Securities Industry; Sir Ian Fraser (a recent past Chairman of Lazards; (subject to enquiries on whether he is a member of Lloyds); Lord Richardson (who when Governor of the Bank was largely responsible for the appointment of Mr Ian Hay Davison as Chief Executive of Lloyd's); and Sir Edwin Nixon, Chairman of IBM. My Department would provide a small secretariat.

6 I need to act quickly if I am to have the inquiry in place for second reading. I would therefore be grateful for rapid confirmation that colleagues are content with this course by close of play tomorrow (Tuesday). My officials will be separately approaching the Bank of England. I shall write again when I have reached a decision on the person I consider should head the inquiry.

JF5ATJ

CONFIDENTIAL

7 I am copying this letter to the Prime Minister, the Lord President of the Council, the Lord Privy Seal, the Chief Whip and Sir Robert Armstrong.

Yours,
Leon

LEON BRITTAN

JF5ATJ

999-49

022/1949

FROM: **M A HALL**

6 January 1986

CHANCELLOR

c c Economic Secretary
Sir Peter Middleton
Mr Cassell
Mr Peretz
Mr Board
Mr H Davies

FINANCIAL SERVICES BILL : LLOYDS

By chance, officials in the DTI put up a note to their Ministers on precisely the question of how the Financial Services Bill might be amended to cover Lloyds, on the same date as my minute to Howard Davies of 18 December. I attach DTI officials' conclusions. In brief, amendment of the FS Bill to cover investment managers of names' funds would be the least difficult of the possibilities, but even this, for a series of technical reasons, would be difficult and unsatisfactory.

M A HALL

HALL → CH/EX 6/1

Reference FG 21643

cc MJG

To:

PS/Secretary of State

From:

P S SALVIDGE
I4
Room 402
Sanctuary Buildings
215 3679

18 December 1985

cc PS/Mr Howard
PS/Mr Butcher
PS/Lord Lucas
PS/Sir B Hayes
PS/Sir J Sterling
Mr Caines
Mr Rickford The Solicitor
Mr Muir I
Mr Hilton FS
Mr Whittingdale
Miss Bowe Inf
Mr Bovey Sol B
Miss O'Flynn Sol B
Mr Lane I1

FINANCIAL SERVICES BILL: LLOYD'S

At his meeting of 12 December, the Secretary of State asked for "a full survey" on bringing Lloyd's into the Financial Services Bill. This is attached.

2 Our conclusions ~~our~~ are that:-

(i) At a technical level of what is legally possible, it would be possible to remove the exemption and this would have the effect of the Bill seeking to protect the interests of names, that is to say investors, whilst the Lloyd's Act regulated the affairs of the Society, covering names and the protection of policyholders.

(ii) Simply removing the exemption would result in a situation where as a matter of law it was extremely uncertain whether rules and regulations made under the Bill would prevail over rules made under the Lloyd's Act or vice versa.

(iii) This uncertainty could be removed in a variety of ways and we identify what appears to be the most attractive solution to resolving such conflicts.

(iv) There is no obvious way of achieving this without risking having insufficient powers, or seeking offensively wide powers or making the Bill hybrid.

and (v) Most importantly moving from legal questions to the value of split system of supervision, the division of responsibility and power between the Lloyd's Act and the Bill would threaten confusion, inefficiency and friction.

SALVIDGE → PS/DTI 18/12

3 We therefore strongly recommend against removing the exemption. The practical arguments apply most strongly to removing the exemption from managing agents and least strongly to removing it from the investment management of names' funds. However the latter would be a minor gesture and not a real threat. The middle course, removing the exemption from members agents would pose less severe practical problems but would call for the full provision to deal with conflicts (see (iv) above) with all the risks identified there.

4 Ministers will wish to consider this, and we are looking at other options to put pressure on Lloyd's. We have not delayed this submission while that further work is done.

5 Solicitors have seen and agreed the attachment, but have not seen this minute.

P S SALVIDGE

2565/47

CONFIDENTIAL

Pn X

From: D L C PERETZ
Date: 7 January 1986

Cx/ see also further notes from Mr Hall & PS/EST below.

CHANCELLOR

cc Economic Secretary
Sir P Middleton
Mr Cassell
Mr Scholar
Mr Hall
Mr Board
Mr H Davies

PERETZ → CH/EX 7/1

LLOYDS AND THE FINANCIAL SERVICES BILL

I attach a largely self-explanatory draft reply to Mr Brittan's letter of yesterday. This will need to reach DTI today.

2. You will by now have seen the attachment to Mr Hall's minute to you of 6 January, which summarises the position on bringing Lloyds into the Financial Services Bill. As I understand it, it is by no means certain that this would make the Financial Services Bill hybrid. That depends in part on how far it is thought necessary to amend the Financial Services Bill to provide for resolution of possible future conflicts between the Lloyds Act (dealing with protection of policy holders) and the Financial Services legislation (which would deal with investor protection aspects of Lloyds). I am not myself yet convinced that this would necessarily lead to a hybrid Bill - nor do DTI officials claim that it would. They just think there is a fairly high risk that it could, if the legislation to provide for resolution of conflicts were to be wholly satisfactory.

See Mr Hall's note for explanation

3. I have also spoken to David Walker at the Bank, who has been consulted orally by John Caines. The ~~fourth~~ uncertainty point in the draft about uncertainty and appointment of the new Lloyds Chief Executive is one suggested by him. In general the Bank's main concern seems to be with the potential period of uncertainty that an inquiry (which could easily drag on well beyond July) would breed.

4. I understand the Prime Minister's initial reaction to the proposal is also negative. You may want to discuss it with her, briefly, when you see her this afternoon. Once the immediate deadline of the Financial Services Bill's second reading is past there should be a little time for officials to look more closely at the other options: but I think it would be well worth having at least a preliminary Ministerial discussion at the Prime Minister's meeting on Thursday.

5. I believe the Governor is coming to that meeting. So if it is decided to discuss the issue there all the correspondence would presumably need to be copied to the Governor.

D L C PERETZ

2385/036

CONFIDENTIAL

FROM M J NEILSON
DATE 7 January 1988

PPS

cc Sir P Middleton
Mr Cassell
Mr Peretz
Mr D Jones
Mr H Davies
Mr Hall
PS/IR

Neilson → PPS 7/1

LLOYDS AND THE FINANCIAL SERVICES BILL

The Economic Secretary has seen Mr Brittan's letter of 6 January and your minute of 7 January. He wonders whether Mr Brittan's approach is not governed by tactics, since including Lloyds in the Financial Services Bill now would involve DTI eating their words about the unsuitability of the Bill for dealing with Lloyds.

2. He is not attracted to legislation in 1986/87 for obvious political reasons. On suitability of the Financial Services Bill as a vehicle the Economic Secretary would go further than the Chancellor - not only does he think there is no insuperable objection to including Lloyds in the Financial Services Bill, it is actually the appropriate vehicle for investor (i.e. member) protection. The basis of UK supervision is by function not by institution, so it is anomalous to exclude the investment angle of Lloyds, which is not covered by the Lloyds Act.

but see Mr Hall's note - LOT have "some fine examples"

M J NEILSON

2566/004

CONFIDENTIAL

FROM D L C PERETZ
DATE 13 January 1986

CHANCELLOR

Ce
I suppose we can
bend by...,
P/S talk tomorrow?
RL
13/1

cc Economic Secretary
Sir P Middleton
Mr Cassell
Mr Scholar
Mr Hall
Mr Board
Mr H Davies

Yes: but it is unclear that if it cannot be done by Easter,

LLOYDS AND THE FINANCIAL SERVICES BILL

You asked (Mrs Lomax's minute of 10 January) whether the Prime Minister's proposal that the inquiry into the adequacy of the Lloyd's Act be completed by Whitsun would leave time for an amendment to be introduced to the Financial Services Bill, if necessary.

2. The answer is no. ? On the current timetable the Financial Services Bill should have finished its committee stage by April, with Report stage in early May. It would then go to the Lords. So the only possibility would be to introduce an amendment in the Lords. But I cannot imagine that would be acceptable for an amendment as important as this would be.

Don't make this one

3. All in all, it would seem very much better to try to get the inquiry completed by Easter, if that were at all possible. That would leave time for amendments to be introduced in the Commons (probably at Report stage), if necessary. This would be a difficult timetable for Sir Patrick Neill, but not necessarily impossible.

4. I have it in the back of my mind that were legislation to be thought necessary, and a recommendation to be made too late to incorporate it in the Financial Services Bill, then there is some risk that we could come under pressure to add a Lloyd's provision to the Banking Bill in the 1986-87 session. (Clearly something we would want to resist very strongly).

and if the Neill inquiry shows that legislation is urgent,
~~the [illegible] is [illegible]~~
then we would have to introduce ~~[illegible]~~
including amendments to the FS Bill in the Lords — v. much a 2nd best, but the only ~~[illegible]~~ alternative.

5. Would it be worth sending a Private Secretary letter, on the lines attached?

DLCP

D L C PERETZ

CONFIDENTIAL

FROM: D L C PERETZ

FROM: 13 JANUARY 1986

CHANCELLOR

See also CST's (very hostile) view under your Prayers folder

cc: PS/EST
Sir P Middleton
Mr Cassell
Mr Hall
Mr Davies

CLEANING UP THE CITY

I can see the case for an inquiry on the lines described by Mr Davies. But I do think it bears just considering a little how it would fit in with things already going on. Mr Davies notes several of these.

2. On the prosecution of fraud, Lord Roskill is about to report. Rumour has it that his report will include a number of recommendations of a kind that would be seen as important steps if followed up with action. If so that action in itself would be presentationally helpful.

3. The main overlap of the terms of reference, as drafted, would be with the SIB draft guidance (to SROs) on "conduct of business rules". As I understand it, the SIB has now more or less completed work on this guidance. The intention is to publish it to be available as soon as the Financial Services Bill goes to Committee in the New Year. I suppose we could set up a high powered inquiry to make recommendations -as long as it was done pretty quickly - about the SIB's guidance, though I think the original idea of publishing these in January was so that the House had a fair idea of what the rules would be while debating the FS Bill.

4. It would perhaps help in this respect if we could present this aspect of the terms of reference as going wider than the area covered by the FS Bill. That would, presumably, bring

CONFIDENTIAL

it into Banking White Paper/Building Societies Bill territory.

5. The real problems, it seems to me, are first that it is becoming more and more widely accepted that we will have to move to a SEC - and probably sooner rather than later; and second that Sir K Berrill may be the wrong chairman for the SIB. But I suppose there is no possibility of early action on either of those?

DLCP

D L C PERETZ

1776/004

Ch/ You said you wanted to raise Lloyds with the Governor (in your comment on HJD's note of 18/12)

AWK 17/1

From: R.J.T. WATTS

Date: 17 January 1986

A Board 17/1

1. MR BOARD
2. MR HALL - not available
3. PPS

Thank you

- Meena

cc Mr H.J. Davies

LUNCH WITH GOVERNOR : LLOYDS

1. You asked for a note on Mr Tim Smith's claim that many of the provisions of the Lloyds Act 1982 had yet to come into force.

2. The 1982 Act conferred on the Council of Lloyds a wide power to make bye-laws for the regulation of the market. The Council has been active in making new bye-laws and has developed the practice of appointing working parties, issuing consultative documents, issuing exposure drafts and finally adopting bye-laws. There are now, amongst others, bye-laws concerning investigative and disciplinary procedures, syndicate accounting and auditing, disclosure of interests, the terms of agreement between a member and the member's agent and between a member's agent and a managing agent.

3. Two of the most vital bye-laws have either just been issued, or are just about to be issued, by the Council. The first, the bye-law on "preferred underwriting" or "baby syndicates", was issued just before Christmas. Baby syndicates will not be prohibited but tight conditions for disclosure will be laid down. The second, which is a bye-law to prevent conflicts of interest by preventing the placing of business with an insurance company or through a non-Lloyds broker either of which is related to the syndicate's managing agent ("related party" reinsurance), is expected to be issued this month.

4. Once these two reforms are in place most of the reforms called for by the Fisher working party would appear to be in place. The principal remaining "outstanding business" is the requirement of the 1982 Act that brokers divest themselves of underwriting interests. The Act provides a period of 5 years for this process.

R. Watts

R.J.T. WATTS

JU241
Secretary of State for Trade and Industry

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5422
GTN 215) ....
(Switchboard) 01-215 7877

23 January 1986

CONFIDENTIAL

Mrs Rachel Lomax
Principal Private Secretary to the
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
London SW1P 3AG

CH/EXCHEQUER
REC. 24 JAN 1986
ACTION EST 24/1
COPIES TO

Dear Rachel,

LLOYD'S AND THE FINANCIAL SERVICES BILL

Thank you for your letter of 14 January.

The inquiry under Sir Patrick Neill's chairmanship has been asked to report by the summer. Easter is out of the question if its work is to be done well. The subject matter is complex. In addition, the time that Sir Patrick Neill will be able to give it before the current university term ends is limited. But we shall do what we can to see that the inquiry is carried out expeditiously.

dsiv order!

In any event, even if primary legislation turns out to be needed, the Secretary of State continues to have serious doubts that the Financial Services Bill would be the appropriate vehicle for it. He has heard no fresh argument to convince him that would not be the case. Moreover, I understand from No 10 that the Business Managers have expressed the strong view that Lloyd's should not be included in the Bill.

I am copying this to the recipients of your letter.

Yours sincerely,

John Mogg

J F MOGG
Private Secretary

This is disingenuous! Not the Business Managers [illegible] [illegible] just [illegible] rather than a separate Bill: they want it in. N.

~~b/f 14/4 (Philip)~~
(Did Sec. Baker raise in Washington?)

THE SECRETARY OF THE TREASURY
WASHINGTON

CH/EXCHEQUER
REC. 10 APR 1986
ACTION Mr Watts
COPIES TO PS/CST
Sir P. Middleton
Mr Cassell
Mr Peretz

b/f 16/4 pl

April 1, 1986

10/4

Dear Nigel:

Mr Turnbull
Mr Burgner
Mr Gilmore
Mr Hall
Mr Revolta
Mr Board

I am writing to tell you of a serious concern I have about the Financial Services Bill which, I understand, is now before Parliament. I am referring to Clause 151 of Part IX of the Bill, which authorizes H. M. Treasury or the Secretary of State of the Department of Trade and Industry to take actions in the event either determines that U.K. persons do not enjoy reciprocal treatment abroad in investment, insurance, or banking business. This provision, if enacted, could set an unfortunate precedent that could have major, adverse effects on world financial markets in general and, potentially, on dealings between participants in U.S. and U.K. financial markets.

The U.S. Government remains deeply committed to the principle of national treatment, including the right of establishment. We have strongly resisted application of the principle of reciprocity both in the United States and elsewhere. Our actions are based on the belief that reciprocity, strictly applied, can only hamper the growth of world financial services upon which our economies increasingly depend and would create severe administrative burdens requiring different sets of rules for banks and financial institutions from different countries.

The OECD Codes of Liberalization also have an important bearing on this issue. In the case of the Code of Liberalization of Capital Movements, members of the OECD have accepted a general obligation to permit inward direct investment, including the right of establishment. Moreover, reciprocity measures of all kinds are inconsistent with the principle of nondiscrimination between OECD members as embodied in the Code. Similarly, reciprocity is contrary to the spirit of the Code of Liberalization of Current Invisible Operations. Work is underway to bring a broad range of financial services within the discipline of the Codes for the first time. The OECD's National Treatment Instrument clearly establishes national treatment as a principle to be followed by all OECD countries to the maximum extent possible. Obviously, it would be damaging to the goal of improving the international regime for financial services if a major OECD member sought to introduce exceptions and widen the scope of potential future restrictions on the grounds of reciprocity.

A particularly disturbing feature of the reciprocity clause in the Financial Services Bill is its retroactive nature. It has been customary that when changes in laws governing financial institutions are made, some form of "grandfather" provision is also introduced. Certainly, this has been the case in the United

States. As a result, a number of foreign, including British, banks and financial institutions enjoy greater freedom than U.S. domestic institutions in key areas. We felt this was worth doing, rather than disadvantage firms which had previously established themselves in good faith.

In my view, the retroactive nature of the reciprocity clause unfairly changes the rules of the game very late in the day. It reminds me of the retaliatory legislation on unitary taxation, on which my views are well known.

If experience is any guide, changes in laws which carry retro-active provisions have often been as damaging to the host government as they are to those governments against which the legislation is aimed. In this Bill's case, such provisions could inhibit foreign firms from investing in the U.K. and potentially drive established foreign financial firms from London altogether. Since a number of foreign financial firms are already nervous about other provisions in the Bill and most of their business in London is non-sterling-denominated and with non-residents, I believe such a possibility is not totally hypothetical.

At the same time, application of reciprocity by the U.K. would add to the continuing concerns of many observers here over the growing force of foreign firms in U.S. financial markets, much of which represents dollar-denominated business with residents.

I very much hope that the final version of the Financial Services Bill does not embody the concept of reciprocity or that, at a bare minimum, it provides specific grandfathering provisions exempting existing firms and their operations in the U.K. from Clause 151.

I look forward to hearing from you on this very important matter.

Sincerely,

Jim

James A. Baker, III

The Right Honorable Nigel Lawson
Chancellor of the Exchequer
of the United Kingdom
London

This must be done before I go to Washington.

DEPARTMENT OF THE TREASURY

EMBASSY OF THE
UNITED STATES OF AMERICA

24 Grosvenor Square
London W1A 1AE
April 2, 1986

So far as the reciprocity provision is concerned.

The draft reply must explain clearly that we really are not retrospective. This is why we do not allow ... I shd like a draft on this ASAP. I cannot agree ... I can not ... any retrospective ...

Dear Chancellor:

Secretary Baker has asked me to deliver to you the enclosed letter concerning those sections of the Financial Services Bill which pertain to reciprocity. I would be happy to forward your response to him.

Sincerely,

Jerry M. Newman

Jerry M. Newman
U.S. Treasury Representative

Rt Hon Nigel Lawson, MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
London SW1P 3AG

Enclosure

Ch/ We await advice, but you shd be aware in case Sec. Baker raises the subject next week.
AWK
3/4

* DRAFT REPLY BY 9/4/86 PLEASE

CH/EXCHEQUER	
REC.	- 3 APR 1986
ACTION	MR WATTS *
COPIES TO	PS/EST
	SIR P. MIDDLETON
	MR CASSELL, MR PERETZ, MR TURNBULL, MR BURGNER
	MR GILMORE, MR HALL, MR REVOLTA, MR BOARD

Sir G Littler

J 4/4

THE SECRETARY OF THE TREASURY
WASHINGTON

April 1, 1986

Dear Nigel:

I am writing to tell you of a serious concern I have about the Financial Services Bill which, I understand, is now before Parliament. I am referring to Clause 151 of Part IX of the Bill, which authorizes H. M. Treasury or the Secretary of State of the Department of Trade and Industry to take actions in the event either determines that U.K. persons do not enjoy reciprocal treatment abroad in investment, insurance, or banking business. This provision, if enacted, could set an unfortunate precedent that could have major, adverse effects on world financial markets in general and, potentially, on dealings between participants in U.S. and U.K. financial markets.

The U.S. Government remains deeply committed to the principle of national treatment, including the right of establishment. We have strongly resisted application of the principle of reciprocity both in the United States and elsewhere. Our actions are based on the belief that reciprocity, strictly applied, can only hamper the growth of world financial services upon which our economies increasingly depend and would create severe administrative burdens requiring different sets of rules for banks and financial institutions from different countries.

The OECD Codes of Liberalization also have an important bearing on this issue. In the case of the Code of Liberalization of Capital Movements, members of the OECD have accepted a general obligation to permit inward direct investment, including the right of establishment. Moreover, reciprocity measures of all kinds are inconsistent with the principle of nondiscrimination between OECD members as embodied in the Code. Similarly, reciprocity is contrary to the spirit of the Code of Liberalization of Current Invisible Operations. Work is underway to bring a broad range of financial services within the discipline of the Codes for the first time. The OECD's National Treatment Instrument clearly establishes national treatment as a principle to be followed by all OECD countries to the maximum extent possible. Obviously, it would be damaging to the goal of improving the international regime for financial services if a major OECD member sought to introduce exceptions and widen the scope of potential future restrictions on the grounds of reciprocity.

A particularly disturbing feature of the reciprocity clause in the Financial Services Bill is its retroactive nature. It has been customary that when changes in laws governing financial institutions are made, some form of "grandfather" provision is also introduced. Certainly, this has been the case in the United

BAKER → CH/EX 1/4

States. As a result, a number of foreign, including British, banks and financial institutions enjoy greater freedom than U.S. domestic institutions in key areas. We felt this was worth doing, rather than disadvantage firms which had previously established themselves in good faith.

In my view, the retroactive nature of the reciprocity clause unfairly changes the rules of the game very late in the day. It reminds me of the retaliatory legislation on unitary taxation, on which my views are well known.

If experience is any guide, changes in laws which carry retroactive provisions have often been as damaging to the host government as they are to those governments against which the legislation is aimed. In this Bill's case, such provisions could inhibit foreign firms from investing in the U.K. and potentially drive established foreign financial firms from London altogether. Since a number of foreign financial firms are already nervous about other provisions in the Bill and most of their business in London is non-sterling-denominated and with non-residents, I believe such a possibility is not totally hypothetical.

At the same time, application of reciprocity by the U.K. would add to the continuing concerns of many observers here over the growing force of foreign firms in U.S. financial markets, much of which represents dollar-denominated business with residents.

I very much hope that the final version of the Financial Services Bill does not embody the concept of reciprocity or that, at a bare minimum, it provides specific grandfathering provisions exempting existing firms and their operations in the U.K. from Clause 151.

I look forward to hearing from you on this very important matter.

Sincerely,

Jim

James A. Baker, III

The Right Honorable Nigel Lawson
Chancellor of the Exchequer
of the United Kingdom
London

020/2952

SECRET

* Thanks. I will speak to Baker on Tues on the lines fm, & this will do in place of a speech note. But I must be aware/ certain @ para 5. The 'prudential' argument is a complete red herring: do we really need to have powers to withdraw existing licences on non-prudential grounds? But we do surely find it difficult, from prudential grounds, to refuse to renew licences. Urgent advice pse.

FROM: M A HALL

4 April 1986

See para 6.
Let me know early on Monday if you, nonetheless, need more on this by Monday close. Otherwise HF do not intend to provide it. Squaring Mr Channon in time available would be tricky.
RO 4/4

CHANCELLOR

cc PS/Economic Secretary
Sir Peter Middleton
Sir Geoffrey Littler
Mr Cassell
Mr Peretz
Mr Kelly
Mr D Jones
Mr P Hall

FINANCIAL SERVICES BILL : SECRETARY BAKER'S LETTER

Please refer to Tony Kuczys' minute of 4 April. I promised a note on this before the week-end.

2. I understand that you and Sir Geoffrey Littler will be having a discreet meeting with Secretary Baker on Tuesday. HF's and OF's combined advice is that you take the following line:-

(a) That this is not legislation for which you are primarily responsiblc, though you are of course fully aware of what is proposed; after consulting colleagues, you will let Secretary Baker have a full reply shortly, but

(b) He should not be too concerned about these proposals. They are primarily aimed at the Japanese. Like the Americans, we have found that a tough approach is the best means of making progress in gaining access for our institutions to Japanese markets. We have found this proposed legislation a useful weapon in our negotiations.

SECRET

3. We see no advantage in giving Secretary Baker a substantive reply before you see him. You are not in a position - nor would you want - to offer substantive concessions, and this is a subject which could consume both time and energy better spent on subjects of more direct concern to you. We would like to clear the draft reply with the DTI, Bank of England and FCO. All this can of course be done in time to reply on Monday night, but a later, more carefully argued response might better serve your purpose.

4. Mr Baker's point on retroaction is that the new powers enable authorisation to be taken away from already authorised institutions, both in the financial services and banking areas. The powers are not strictly retrospective, in the sense that they do not apply a new regime to actions which have already taken place. But they do enable the authorities to deprive an institution of an authorisation already granted.

5. If you cannot avoid pressure on this from Secretary Baker, you could point out to him that it is usual for the authorities to be in a position to revoke authorisations on prudential grounds. These are reserve powers, which we do not envisage having to use. They are intended as a deterrent. But in extreme circumstances - e.g. if a foreign government (e.g. Japan) were to start revoking licences already granted, we should want to be in a position to do the same.

6. If, notwithstanding this advice, you do want to send an early reply, it would be helpful if your office could let us know as early as possible on Monday. Likewise, if you require briefing beyond what is in this note.

MAH

M A HALL

FINANCIAL SERVICES BILL-RECIPROCITY

023/2952 CONFIDENTIAL

FROM: M A HALL

7 April 1986

CHANCELLOR

cc Economic Secretary
Sir Peter Middleton
Sir Geoffrey Littler
Mr Cassell
Mr Peretz
Mr D Jones
Mr P Hall

FINANCIAL SERVICES BILL : SECRETARY BAKER'S LETTER - RECIPROCITY

Philip Wynn Owen asked for a note on the power to revoke on non-prudential grounds.

2. The power to revoke, as well as the power to refuse an application for authorisation, has always been part of the reciprocity package, to be included in the Financial Services Bill. See, for instance, paragraph 3 of David Peretz' minute of 31 October 1985 (attached).

3. Two factors make this power an important part of the overall reciprocity proposals:-

(a) There is currently a large imbalance of market penetration as between London and Tokyo. Many Japanese institutions are already here, as a result of our traditional open policy. UK firms are still struggling to get a foothold. So there is always a possibility that a stage might be reached in the negotiations where the Japanese would be content to rest with the status quo, rather than allow further UK penetration of their market. It adds greatly to the credibility of our reciprocity powers, if they include a power to revoke existing authorisations.

(b) There is a need to prevent forestalling. We do not know when the relevant parts of the FS Bill will come into force. If the Bill as originally published last year had made it clear that any foreign institutions which could obtain authorisation in time would be safely "grandfathered", we could have expected a wave of applications. There will be no legal means of rejecting them, beyond a decent period of delay.

4. It is also worth bearing in mind - though not in the context of the FS Bill - that we shall be relying on a prudential power to reject - in the last resort - unwelcome takeover bids. This is likely to rest on the somewhat tendentious argument that it would be imprudent to grant authorisation on the grounds that the Treasury was minded to revoke the authorisation - on reciprocity grounds - of the UK institution when it came under the control of a foreign predator.

5. We cannot say categorically that the power to revoke will never be used. We hope not. But like the reciprocity provisions generally, it is there to deter, and to give bite to negotiations aimed at opening up others' markets to free access.

6. Nor can Secretary Baker be given any undertaking about US firms. He can, however, be reassured that we are only talking about serious discrimination. The powers also require that the Chancellor (or Secretary of State) must consider that it would be in the national interest to use the powers - which allows a wide view to be taken. The Act will also require prior consultation with bodies representing the interests of the institutions affected.

7. We have also drawn to Ministers' attention a particular problem arising from revocation - or the threat of revocation - of the authorisation of existing deposit-taking institutions. The banks collectively could be expected to complain at being asked to

compensate depositors - through the Deposit Protection Fund - of a foreign bank which had suffered a run as a result of fears of government action in an escalating argument about reciprocity. The Economic Secretary took the view, however, that if the banks wanted reciprocity powers - as they appear to - they must also accept the implications, including Deposit Protection Fund cover.

MAH.

M A HALL

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215)
GTN 215) 5422
(Switchboard) 01-215 7877

Secretary of State for Trade and Industry

bf with advice

17 April 1986

17/4

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Dear Chancellor,

FINANCIAL SERVICES BILL: STATUS AND POWERS OF THE DESIGNATED AGENCY

We need to decide before Report Stage in the Commons how to deal with various backbench amendments which were carried against the Government during Committee Stage. These amendments were tabled by Anthony Nelson and Tim Smith. On the basis of conversations which Michael Howard has held with them, it appears that their support for the main provisions in the Bill would be secured if the Government bring forward amendments on the lines described below.

My first proposal concerns amendments passed to clause 96, which were intended to be the first steps towards turning the private sector designated Agency into a statutory commission set up under the Bill. We were able to defeat other steps designated to this end and it would be a key element in our understanding with Messrs Nelson and Smith that they would support the Government in resisting any attempt to reopen those issues or to create a statutory commission.

The modest concession I propose on Clause 96 would be to name the Securities and Investments Board in the Bill. If it appeared to meet the existing criteria in the Bill, it would be the only body to which the Secretary of State would be able to transfer his powers when the first delegation order is made. The Secretary of State would still have discretion as to the extent of the transfer. The Secretary of State would, moreover, be free to transfer powers to any body in any subsequent delegation order (which he would not be free to do under the Nelson/Smith amendments). Thus any power

DW4AXQ

999-1

not included in the first order could be given to another body, as could any power which were resumed from SIB. (The Secretary of State would also have the hypothetical option of giving powers to another body in the first delegation order, if at that time the SIB did not appear to meet the criteria.)

... A copy of the draft amendment prepared by Counsel is attached.

This approach would confer statutory recognition on the SIB, but it would remain a private sector body and would not be a body created by the statute. This corresponds to the reality of the current situation since there is in practice little real prospect for an alternative body being in a position to seek powers in the first instance. The Secretary of State would also retain the option of keeping some or all of the powers. The provision would restore the option of giving some or all of the powers to a fresh body if SIB fails to continue to comply with the criteria set out in the Bill. That would reinforce the accountability of SIB and would also enable powers to be split between bodies if we were to decide that further developments in the marketplace or other reasons made this necessary. It was the elimination of this flexibility which led to the greatest concern at the implication of the amendment to Clause 96 which was carried in Standing Committee.

The other two amendments concern the extent to which the Secretary of State's powers may be transferred to a designated Agency. The first would enable the Securities and Investments Board to prosecute for offences under the Bill and the other would give the Board powers to investigate persons who are not authorised to carry on investment business.

The Bill as introduced reserved prosecutions (with one exception) to the Secretary of State, the DPP or the DPP for Northern Ireland. I now propose that the Secretary of State should be able to transfer his prosecution power to a designated Agency. This approach echoes the provisions for transferring the majority of his other powers in the Bill to an Agency. He should be able to transfer the prosecution power in whole or in part, and to make the transfer subject to whatever conditions or restrictions he may impose from time to time. Any powers transferred would be exercisable concurrently by the Secretary of State.

Provided that the Agency is in due course able to satisfy us that it is capable of undertaking prosecutions, giving it this power would have considerable practical advantage. In many cases the Agency will be the first to detect that an offence has been committed and will also be able to decide whether to prosecute and/or take any regulatory action which may be needed to protect investors.

We envisage that the Agency would prosecute the more straightforward cases, particularly those relating to maintaining the integrity of the regulatory system. More complex or serious cases would be handled elsewhere, and there would have to be suitable arrangements for bringing in at an early stage the DTI or DPP (or the new Unified Fraud Organisation if we set that up).

I do not believe that the prosecution role is inconsistent with the private sector status of the agency: many offences can be prosecuted by private bodies. It is clear that there is a substantial body of opinion in favour of widening the agency's powers in this way.

I hope that the Attorney General in particular will agree that my proposals in this area are justified on their own merits. They are also part of the package designed to secure the support of Messrs Nelson and Smith.

The proposal would not of course apply to prosecutions in Scotland, which fall to the procurator fiscal.

The principal investigation powers in the Bill appear in Clause 92 and enable the Secretary of State to investigate the affairs of anyone (with minor exceptions) who is carrying on investment business. At present Clause 96(5) limits the extent to which these powers may be transferred to a designated Agency. Broadly speaking the Agency would only be able to investigate an authorised investment business and when doing so would not be able to obtain information from a third party unless he was also an authorised business or connected to such a business. I propose to remove these limitations so that it would be possible for the Secretary of State's power to be transferred in full to the Agency. This would make the powers easier to use in practice, avoiding duplication of effort between the Secretary of State and the Agency and making it possible to provide the Agency with investigation powers to back up the prosecution role I envisage for it.

These proposals on prosecution and investigation powers do not extend the scope of the powers available under the Bill in any way: they are purely concerned with the distribution of those powers between the Secretary of State and the designated Agency. The proposals would make it possible for the powers to be fully transferred to the Agency, but the Secretary of State would retain discretion as to how far the powers should be transferred, and that transfer would require approval by both Houses of Parliament. In practice it may be sensible to transfer the powers in stages as the Agency builds up its expertise.

There is a risk that extending the list of powers which are capable of transfer to the Agency will strengthen the hand of the Opposition, who are arguing in favour of a public sector statutory commission. I believe we can meet that by pointing out that it is not uncommon for private bodies to be able to prosecute. My proposals would increase the effectiveness of the new regime under the Bill and should therefore help to secure support for it. Tony Nelson and Tim Smith have been canvassing support for their original approach, and I am convinced that if we can bring forward amendments which satisfy them we can expect a greater degree of support from the Conservative backbenchers on Report, which may in turn help us in the Lords.

I would like to be able to table the necessary amendments for Report Stage and I fear I must therefore ask for comments by lunchtime on Monday 21 April.

I am copying this letter to the Prime Minister, the Lord President, the Lord Chancellor, the Home Secretary, the Attorney-General, the Lord Privy Seal, the Chancellor of the Duchy of Lancaster, the Lord Advocate, the Chief Whip, Lord Denham, the Minister of State (Privy Council Office), the Governor of the Bank of England and Sir Robert Armstrong.

Yours sincerely,

Michael Gilbertson

PAUL CHANNON

[Approved by the Secretary of State and signed in his absence]

1786 1986 BOARD OF TRADE BICENTENARY

DW4AXQ

DRAFT AMENDMENT TO CLAUSE 96

After subsection (l) (as in the introduction, not the amended, print), insert:

"(l)(A) The body to which functions are transferred by the first order made under subsection (l) above shall be the body known as The Securities and Investments Board Limited if it appears to the Secretary of State that it is able and willing to discharge them, that the requirements mentioned in paragraph (b) of that subsection are satisfied in the case of that body and that he is not precluded from making the order by the provisions of this section or Chapter XII of this part of this Act."

L18AAJ

1869/031

CONFIDENTIAL

C/ Cleared with all relevant officials in other departments and Bank, but DTI are putting to one of their Ministers this weekend too.

No concession (other than a tiny one) I'm afraid.

Content with draft?

Ro 18/4

MW 18/4

FROM: D JONES

18 April 1986

1. MR HALL

2. CHANCELLOR

c c PS/Economic Secretary
PS/Sir P Middleton
Sir G Littler
Mr Cassell
Mr Peretz
Mr P Hall

OK as drafted?

FINANCIAL SERVICES BILL: RECIPROCITY - SECRETARY BAKER'S LETTER

A draft reply to Secretary Baker's letter is attached. It defends the FS Bill provisions as they stand but says what we can to be reassuring about the use of the provisions without giving any hostages to fortune.

2. The letter does not offer any substantial concession on the 'retroactive' aspect of the provisions that Secretary Baker is worried about. We have looked at this again, and discussed it with DTI.

3. What Secretary Baker wants is a 'grandfathering' provision, which would exempt from the provisions all existing authorised institutions. He does not go into detail and there are several ways of interpreting this. One option would be to remove from the Bill the power to <u>revoke</u> authorisation on reciprocity grounds. This would leave a power to refuse new applications or to restrict authorisation; but an authorisation once obtained could not be removed. A further variant would be to retain a power to refuse, but have neither the power to revoke, nor to restrict, nor take any other action against an existing authorisation.

4. Alternatively, it would be possible to retain the full range of powers, including revocation, but to have them applicable only

to institutions authorised after the provisions come into force (This seems to be more what Secretary Baker has in mind). In this case, it would not be possible at any time in the future to restrict or to revoke the 'authorisation' of any foreign institution which is currently operating here.

5. Although 'authorisation' would have a clear meaning in the context of banking and insurance business, it is not clear that this last provision could be readily implemented for investment business, where there is currently no comprehensive system of statutory authorisation. But we consider that there are in any event overriding objections to any of these alternatives.

6. The main problem is that as a result of the imbalance of market opportunities Japanese institutions are already well-established in London, while UK firms have yet to establish anything like a comparable presence in Tokyo. (This imbalance is not only with Japan.) In banking, for example, figures recently prepared by the Bank show that 341 of the 596 UK authorised banks are foreign institutions. Of these, the 27 Japanese banks have 25 per cent of total deposits; 23 per cent of total assets; and 31 per cent of total market loans. (These figures are for the end of 1985: equivalent figures for the end of 1980 were 14 per cent; 13 per cent and 19 per cent.) Comparable figures for UK banks in Tokyo are not available. However, as an indication of relative scale, the six UK banks there probably have less than one per cent of the total business.

7. The presence of foreign banks in London does of course raise the total volume of business done here above what it might otherwise be, and the two markets are different in kind: the figures do not therefore represent a share of something that one could simply call "UK Business" and strict comparisons are difficult. But we nevertheless consider that the imbalance is large enough to put us at a serious disadvantage in negotiations about future authorisation. The Japanese start better off; have less to gain, but conversely more to lose. The provisions need to be a credible threat and an effective weapon to use. They would be weakened by the absence of a power to remove existing authorisation.

8. There is also a need to prevent forestalling. If the Bill as originally published last year had made it clear that any foreign institutions which could obtain authorisation in time would be grandfathered, then we could have expected a wave of applications with no legal means of rejecting them, beyond a decent period of delay. Even in the present circumstances it is not easy to keep Japanese applicants at bay and a measure of bluff is involved.

9. There is a further factor relevant to banking. Our ability to block unwelcome bank take-overs by foreign institutions will be based on a combination of the prudential blocking power to be incorporated in the Banking Bill and the FS Bill's reciprocity provisions. The Bank's grounds for exercise of this blocking power will be prudential rather than reciprocity based. And there is no blocking power in the FS Bill on reciprocity grounds. Rather than create another power, it has therefore been decided that it will be sufficient for practical purposes if disruptive take-overs can be blocked by the Bank on the grounds that it would be imprudent to approve the take-over if the Treasury was minded to use its reciprocity power to revoke the institution's authorisation after the takeover took place. This arrangement would of course collapse if the power to revoke were removed from the FS Bill.

10. Finally, there is one point of detail in the drafting of the Bill which gives scope for a minor 'concession', although it hardly goes any way towards meeting Secretary Baker's point. As the provisions are presently constructed, authorisation would be removed by the issue of a 'disqualification notice' which would cancel any existing authorisation. This provision adds retrospectivity to retroaction. It was noted in Committee that, unless qualified, this would have the effect of making all further business illegal - including the performance of contracts entered into before the notice was issued. This would cause problems for customers and is not the intended effect, except with regard to long term contracts, such as investment management, which should be discontinued. New provisions will therefore be prepared to allow explicitly for the windingup of existing contracts where

an institution's authorisation is removed. This does no more than soften the blow of de-authorisation but you could nevertheless mention it, and an appropriate reference is included in square brackets in the draft.

11. This advice and the draft letter have been cleared with DTI, the Bank and the Foreign Office. (DTI also report that they have received no representations from US financial institutions on this issue, attributing Secretary Baker's oppostion more to the traditional US opposition to the principle of reciprocity, and their preference for non-discrimination and 'national treatment' as the appropriate principles for international financial business.)

DEREK JONES

2951/048

CONFIDENTIAL

FROM: M HALL
DATE: 21 April 1986

EST content
MJN
21/4

1. ECONOMIC SECRETARY
2. CHANCELLOR

cc Sir Peter Middleton
Mr Casssell
Mr Peretz
Mr Turnbull
Mr Burgner
Mr P Hall
Mr Ross-Goobey
Mr Brummell T-Sol

FINANCIAL SERVICES BILL: STATUS AND POWERS OF THE DESIGNATED AGENCY

The Secretary of State for Trade and Industry has written to the Chancellor seeking his urgent agreement to a deal he has struck with Conservative backbenchers on the status of the SIB. Our strong advice is to accept these amendments, and in view of the shortage of time, I hope that the Economic Secretary's office can telephone Mr Channon's office by lunchtime conveying Treasury Ministers' agreement.

The effect of the proposed Government amendments would be as follows:-

(a) The SIB will be named in the Bill. Provided it meets the existing criteria set out in the Bill, it will be the only body to which the Secretary of State would be able to transfer his powers in the first delegation order. SIB will remain a private sector body, and not a body created by the statute. The Secretary of State will have discretion over how far he delegates powers to the SIB, and will also be able to designate other bodies in subsequent designation orders, if this proves necessary.

(b) The SIB would be given the powers of a prosecuting agency. There is an oddity about a private sector body being given such powers, but this is a point for the Law Officers' and the Lord Chancellor, rather than us. From our point of view, this will help to secure effective enforcement of the new supervisory legislation (you will recall that the Bank of England is a prosecuting agency under the Banking Act 1979).

(c) The SIB is to be given the power to investigate unauthorised as well as authorised businesses. This again is sensible, and we are introducing a parallel extension of the Bank of England's powers in the new Banking Bill.

A draft letter for the record is attached for the Chancellor's signature.

MAH

M A HALL

2951/050

A typo

DRAFT LETTER FROM THE CHANCELLOR TO:

THE SECRETARY OF STATE FOR TRADE AND INDUSTRY

FINANCIAL SERVICES BILL: STATUS AND POWERS OF THE DESIGNATED AGENCY

Thank you for your letter of 17 April. As you will already have heard, I am content with the amendments you propose, and am glad you have been able to strike a bargain with our backbenchers which leaves the fundamental policy intact.

I am copying this letter to the recipients of yours.

NIGEL LAWSON

THE SECRETARY OF THE TREASURY
WASHINGTON

May 28, 1986

Dear Nigel:

Thank you for your letter of April 21 replying to my concerns about Clause 151 of the Financial Services Bill. The careful thought you have given to my views is much appreciated. Having studied your reply, I am reassured, but not completely.

Our countries do share a long and honorable tradition of having financial markets open to those who meet the criteria for doing business in them; I thus am reassured from your comments that the reciprocity provisions of Clause 151 are not aimed at U.S. financial institutions. I also am pleased that you recognize the dangers of a policy based on strict reciprocity.

I continue to be concerned, however, that reciprocity requirements often lead to retaliation, which can result in counter-retaliation and potentially do considerable damage to the interests of all those involved. As I indicated to you previously, I believe that a policy based on national treatment is preferable. Indeed, it would be a shame if retaliatory practices spilled into the financial markets which are so important to both our countries.

Let me close on a positive note. Both our governments have urged the OECD and its members to improve and strengthen the OECD Codes of Liberalization. In the months to come, U.S. Treasury officials will be working to achieve this objective. Based on your comments, I trust they will have the strong support of U.K. delegates in the appropriate OECD Committees.

I am pleased to have had this exchange of views, which clarifies our differences, but which I also hope will strengthen the cooperation between our Treasuries in seeking to achieve less restrictive and more efficient international capital markets.

BAKER
→ CH/EX
28/5

Sincerely,

Jim

James A. Baker, III

CH/EXCHEQUER
REC. 12 JUN 1986
ACTION MR HALL
COPIES TO
EST
SIR P MIDDLETON
SIR G LITTLER
MR CASSELL
MR PERETZ
MR D JONES
MR P HALL

The Right Honorable Nigel Lawson
Chancellor of the Exchequer
of the United Kingdom
London

✓ 12/6

Public Securities Association
40 Broad Street
New York, NY 10004-2373
(212) 809-7000

Nigel
PSA deal
D
12/5

C
I have not attached the very bulky document
An acknowledgement
– from me?
D
9/5

PSA

May 7, 1986

Yes – but also circulate to relevant officials (not many)

PMP

The Rt. Hon. Nigel Lawson, M.P.
HM Treasury
Parliament Street
London, SW1

Dear Mr. Lawson:

X Enclosed for your information is a copy of the Public Securities Association London Primary Dealers Committee's submission to the Department of Trade and Industry on the Financial Services Bill.

The PSA is a U.S. organization of banks, dealers and brokers that underwrite, trade and distribute U.S. government and federal agency securities, mortgage-backed securities, state and local government securities and money market instruments. All 36 primary dealers in U.S. government securities as recognized by the Federal Reserve Bank of New York are members of PSA.

Although PSA has a rather broad constituency, our comments on the Bill focus more narrowly on its likely impact on the U.S. government and federal agency securities market.

We wish to note, that PSA shares the interest of the Chancellor of the Exchequer that the new regulatory framework not impede the potential for future growth and development of London as one of the world's major financial centers.

We hope that our comments, despite being submitted quite late in the legislative process, will be seriously considered by the Chancellor of the Exchequer in formulating its views on the bill.

We would be pleased to meet with you at your convenience to further discuss our comments.

CH/EXCHEQUER	
REC.	12 MAY 1986
ACTION	12/5
COPIES TO	EST SIR P MIDDLETON MR CASSELL MR PERETZ MR CROPPER MR ROSS GOOBEY

Sincerely,

Robert A. Portnoy

Robert A. Portnoy
Deputy Executive Director
and General Counsel

RAP:nm
Enclosure

NB A copy of X is held in the Chancellor's Office.

351/30

Thanks. Glad the Bills are all to plan; this will ~~the~~ mean [illegible] achievement. [illegible] Law

P.S. What state of play on the Fin [illegible] Bill? N

FROM: B O DYER
DATE: 16 July 1986

CHANCELLOR

cc Mr Pratt - CU

1985-86 LEGISLATIVE PROGRAMME : BILLS WITH A HIGH TREASURY PRIORITY

You may like to have a state of play report on those Bills in the current programme to which the Treasury attached a high priority. This is appended below. In brief, all are expected to receive Royal Assent on Friday 25 July (except, of course, for the Airports Bill which had Royal Assent on 8 July).

Bill:	**Stage**	**Royal Assent expected**
Finance Bill	All Stages in Lords 25 July	25 July
Building Societies Bill*	[Consideration of Lords Amendments by Commons on 24 July]	25 July
Gas Bill	3rd Reading Lords 17 July [Consideration of Lords Amendments by Commons on 22 July]	25 July
Wages Bill	3rd Reading Lords 22 July [Consideration of Lords Amendments by Commons on 23 July, and back to Lords on 24 July]	25 July
Airports Bill	Received Royal Assent on 8 July	
Social Security Bill	3rd Reading Lords 21 July [Consideration of Lords Amendments by Commons on 23 July] (back to Lords on 24 July).	25 July

Note
[ ] = Current timetable
* Conclusion of Report Stage (Lords) on 18 July
3rd Reading in the Lords on 23 July

B. Dyer

B O DYER

351/8

FROM: B O DYER
DATE: 17 July 1986

Rachel: In which case, when will legn take effect? Perhaps HF can advise. N.

01-233 4749

CHANCELLOR

cc Mr Pratt

FINANCIAL SERVICES BILL

You asked for the current state of play on the Financial Services Bill.

2. I am afraid this Bill has no prospect of reaching the Statute Book before the House rises for the Summer Recess. It received its Second Reading in the Lords on Friday 11 July and is scheduled to go into Committee on Monday 21 July for four days, with completion of Committee stage on Tuesday 29 July. Report stage is provisionally scheduled for the week beginning 6 October, with Commons consideration of Lords amendments in the rump of this Session.

B. Dyer

B O DYER

CORRESPONDENCE ABOUT RECIPROCITY WITH SECRETARY BAKER

C28/2958

1. Nigel (A) thanks

2. b/f 23/9 A

FROM: **M A HALL**

21 July 1986

pwp

CHANCELLOR

c c Economic Secretary
Sir Peter Middleton
Mr G Littler
Mr Cassell
Mr Peretz
Mr Kelly
Mr P Walker
Mr D Jones
Mr P Hall

CORRESPONDENCE ABOUT RECIPROCITY WITH SECRETARY BAKER

... Secretary Baker wrote to you on 28 May (copy attached). No reply was required.

2. You will however note that in paragraph 4 Secretary Baker asks you to support US efforts to improve and strengthen the OECD codes of liberalisation. The UK delegation to the OECD have suggested that it would be helpful in raising the profile of these codes if you were to take up Secretary Baker's point. Both we and the DTI think this is a good idea.

HALL → CH/EB 21/7

3. There are two OECD codes, one on Capital Movements and the other on Invisibles. They are intended as a gentlemanly means of keeping up international pressure for liberalisation. They are policed by OECD committees, and derogations have to be sought and justified by a country which wants to introduce new restrictions. The codes are presently being reviewed in an ad hoc OECD group, intended to lead to more demanding codes. Other ways are also being considered of giving the codes more teeth. We, like other countries in the same position, are entering a specific reservation in respect of the reciprocity provisions of the Financial Services Bill. We have very similar positions to the Americans on the merits of the codes generally, and it would do no harm at all to assure Secretary Baker of our support.

4. It would probably overdo the point to write specially; but

it is a point worth making to Secretary Baker when you see him, and publicly when a suitable occasion arises.

Ch/

MA. I will let you have these papers again for your Washington trip, in case you want to raise with Secretary Baker. As to making the point publicly, Washington might be the best opportunity for that too? AWK 22/7

M A HALL

c c	Mr Davies	UKDEL OECD
	Mr Willetts	BoE
	Mr Wells	DTI
	Hon H Maud	FCO

CONFIDENTIAL

Cy

I don't find this reassuring

RL 23/7

FROM: P S HALL

DATE: 22 July 1986

1. MR PERETZ
2. CHANCELLOR

cc: Financial Secretary
Economic Secretary
Sir Peter Middleton
Sir Geoffrey Littler
Mr Cassell Mr Scholar
Mr M A Hall
Mr Board
Mr D Jones (or)
Mr Pratt
Mr Saunders
Mr Dyer

This is the first official admission we have had from the DTI of what their "realistic" timetable really is for bringing in the main provisions of the Bill — though it is not entirely surprising. The SROs were always bound to take time to get their acts together. Other parts of the Bill will come into force quicker — including eg the provision on prospectus requirements for commercial paper issues by UK Companies.

DLP 22/7

FINANCIAL SERVICES BILL: TIMETABLE

You asked when the FS Bill will take effect.

Regulation of Investment Business

2. The core of the Bill - the regulation of investment business - is in Part I. I attach some DTI papers explaining when these provisions are likely to take effect (a timetable, an explanatory note and some Q and A briefing). The key points are:

- the public timetable envisages that criminal sanctions for carrying on unauthorised investment business will apply from the summer of 1987;

- the confidential (and pragmatic) internal timetable envisages that the system will not be ready for this until the end of 1987.

3. I understand that outside Government only SIB knows of the realistic timetable. DTI are worried that SROs may not even meet the "pragmatic" timetable if they know they have more time.

Other FS Bill Provisions

4. The timetable for other Parts of the Bill is still uncertain. However, the following gives an indication of current thinking:

- Part II,	Insurance Companies:	mainly as for Part I, but a few aspects early 1987;
- Part III,	Friendly Societies:	likely to be as for Part I;
- Part IV,	Official Listing of Securities:	early 1987 (when Stock Exchange rule book changed);
- Part V,	Offers of Unlisted Securities:	Spring 1987
- Part VI,	Take Over Offers:	in period from Assent to early 1987
- Part VII,	Insider Dealing:	in period from Assent to early 1987
- Part VIII,	Restrictions on Disclosure of Information:	at stages in period from Assent to end 1987; and
- Part IX,	Reciprocity:	Late 1987 (although banking and insurance provisions could be brought into force separately in early 1987).

P S Hall

P S HALL

RESTRICTED

BACKGROUND NOTE

FS BILL: TIMETABLE FOLLOWING ROYAL ASSENT

If Royal Assent is in October 1986

	Howard's preference Public	Confidential	Undesirable
1. Royal Assent	end Oct. 86	end Oct. 86	end Oct. 86
2. Lay delegation order	early end Jan. 87	end Feb. 87	end April 87
3. Complete recognition of SROs	first half end Apr. 87	end June 87	Oct. 87
4. Closing date for applications	Summer end June 87	end Aug. 87	Dec. 87
5. Appointed day	2nd half 87	end Dec. 87	June 88

Assumptions: 2-Preparation for delegation assumed to take 3-6 months from Royal Assent.

3-Assumed to take 3-6 months after transfer of functions.

4-Allows 2 months for submission of applications following completion of recognition of SROs.

5-Assumed to take at least 2 months.

1786
1986
BOARD OF TRADE
BICENTENARY

999-49

FS BILL: TIMETABLE FOLLOWING ROYAL ASSENT

The attached ranges of forecasts have been made on the basis that the stages following Royal Assent willbe as described below. The assumptions about the time taken for each stage are set out beneath the forecasts. The target dates are for completion of each stage.

2 Following Royal Assent (Step 1 on the forecast), SIB will have to finalise its rules in consultation with DGFT and others and submit a formal application. The rules will then have to be formally vetted by DGFT and any points raised on competition grounds considered by the Secretary of State. All the forecasts assume that there will have been advance contact with the DGFT and that no serious problems will arise at this stage. If they do, the whole timetable will be significantly set back. Assuming the application is accepted, a delegation order will then need to be drafted and this could be a lengthy process if the functions to be delegated require significant supplementary provisions to be included in the order. The order will then be laid (Step 2 on the forecast) and will come into force when approved by both Houses, probably about a month later.

3 The next stage is recognition of SROs. Again all the forecasts assume that a great deal of preparatory work has been done but no application can be formally submitted to SIB until SIB itself has received delegated powers and, more seriously, equivalence cannot be judged until SIB's rules have actually been made. It may well be that these rules differ marginally from previous drafts as a result of changes made during the final pre-delegation discussions. The final versions of the rules submitted by applicant SROs will then need to be vetted by DGFT and given the number of SROs likely to be involved this is bound to take some time (even assuming, as the forecasts do, that there has been prior consultation). It is also realistic to assume that there may well be difficulties either on competition or investor protection grounds with the rules of some of the applicant SROs and that these problems may take some time to sort out. Step 3 on the forecast is the completion of recognition (or rejection) of all SRO applicants.

4 Unfortunately experience suggests that many businesses will not decide how to obtain authorisation until all the new arrangements are in place ie rules and fees have been published in final form and all the SROs have been recognised. They will then have to be allowed some time (the forecasts suggest two months) to submit applications. All applications received by a date to be specified (Step 4) will be eligible for interim authorisation if they have not been determined by the time the central requirement to obtain authorisation to carry on investment business and the

criminal and civil consequences for carrying on business when unauthorised are brought into effect (the appointed day - Step 5). SIB and the SROs will need to be allowed some considerable time after the cut-off date for applications to process those applications. Some of the new SROs, particularly those concerned with intermediaries, may have very large numbers of applications to deal with. We would want to keep the number of interim authorisations to a minimum particularly as this group might well include many businesses whose applications, for very good reasons, took a particularly long time to process. There will be a balance to strike between the desire to bring the central provisions into force and not having too many interim authorisations. It is particularly difficult to estimate now how long this stage will take as it will depend on how many businesses still need to join an SRO or seek direct authorisation.

5 The timetables do not specifically mention professional bodies. This is because the transitional arangements in the Bill for such bodies mean that all that is necessary is for them to obtain interim recognition before the appointed day. All their existing members will then be able to benefit from authorisation by virtue of their membership of the body. This has the advantage that vetting of professional bodies' rules can be left until after completion of the vetting of SRO rules. The timetables also do not mention recognition of investment exchanges and clearing houses. Again this is because this does not have to be completed until the appointed day.

LM4ABA

PUBLIC LINE TO TAKE 50

TIMETABLE FOR NEW REGULATORY FRAMEWORK

Q1 WHEN WILL BILL REACH STATUTE BOOK?

A1 The aim is to achieve Royal Assent for the Bill during this Parliamentary Session (by end October 1986).

Q2 WHEN WILL POWERS BE TRANSFERRED TO THE BOARD (SIB)?

A2 Once the Bill receives Royal Assent, we will examine whether the Board (the 'Designated Agency') satisfies the criteria laid down in the Bill and has rules which comply with specified principles to promote investor protection. The Government hope that it will be possible to transfer powers to the Board early in 1987 and to bring the new arrangements fully into operation in the course of next year.

Q3 WHAT WILL THE BOARD BE DOING MEANWHILE?

A3 There is a tremendous amount of work to be done, for example in establishing a suitable network of self-regulating organisations and drawing up conduct of business rules appropriate to the various financial sectors, in readiness for consideration as the Designated Agency once the Bill has been enacted. First drafts of rules covering many items have already been prepared and published. SIB and MIBOC will also be forming one single authority.

Q4 WHAT WILL HAPPEN AFTER BIG-BANG?

A4 "Big Bang" - October 27 - is a development restricted to The Stock Exchange, a body which already has an extensive rule-book to cover its trading practices. It also has the benefits of seeing SIB's draft rules to shape its own thinking. The Stock Exchange should therefore be well- placed to regulate matters after Big Bang, and in due course, to become a recognised self-regulating organisation under the new regime.

PWP

FROM: **P S HALL**

DATE: 8 September 1986

1. MR ~~ILETT~~ M. 8/ix
2. CHANCELLOR

cc Financial Secretary
Economic Secretary
Sir Peter Middleton
Sir Geoffrey Littler
Mr Cassell
Mrs Lomax
Mr Scholar
Mr Peretz
Mr M A Hall

FINANCIAL SERVICES BILL: TIMETABLE

You asked what can be done to reduce the period between Big Bang and the coming into force of the FS Bill (Mrs Lomax's minute of 24 July to Mr Peretz). I am sorry you have not had earlier advice.

2. Treasury officials have already been pressing for the earliest practicable introduction and we shall continue to do so. DTI are also keen to expedite matters and have taken on board our suggestion that certain elements of the Bill, such as those on insider dealing, might be brought into force somewhat earlier than previously envisaged.

3. However, this was already reflected in the timetable shown in my minute of 22 July, and the provisions on the regulation of investment business in Part 1 cannot be advanced in the same way. As you recognise, the main difficulty is our dependence on SIB and the SROs. Reliance on self-regulation inevitably limits our ability to control the timetable.

4. I understand that DTI met SIB on 3 September to emphasise the need for greater speed in preparing for the new regime, for example in the preparation of the SIB rule book. DTI may also suggest, through SIB, that the new SROs should be recruiting staff more rapidly. At present DTI would not regard the late summer/early autumn 1987 as impossible, although end 1987 still seems a more likely prospect. As I mentioned on 22 July, the public timetable remains late summer 1987 in order to keep pressure on the SROS; if they think they can have more time their preparations may drag on interminably.

5. There seems little that the Treasury can do at the moment to assist DTI in expediting matters beyond taking advantage of any opportunities to press the point. However, early next year (when SIB's rule book has been issued and approved by DTI and the Office of Fair Trading, and DTI have accordingly delegated their powers to SIB) we and DTI could review the prospects for requiring all investment businesses to be authorised from the outset.

6. For example, if by the summer three-quarters of the SROs had properly constructed rule books and had processed all the applications for authorisation made to them - but the others (covering a discrete area of business) required, say, a further three months - one option might be to exclude the others temporarily from the definition of investment business under the new regime (and therefore from its civil and criminal penalties). However, at present it is too early to judge whether such arrangements would be feasible. DTI would probably consider them only as a last resort, as they would produce their own presentational and administrative difficulties.

I would hope we could avoid this complication.
M.

7. During the next few months we will, of course, be keeping you closely in touch with progress in setting up the new regime.

P S Hall

P S HALL

- 1534/012

CONFIDENTIAL

PPS
A more dynamic chairman of SIB might help. Berrill has just gone on 3 weeks holiday to the Aegean can you believe. But that is water under the bridge. However, I detect some fresh impetus at the Bank. RL. 9/9.

M. 8/ix

FROM: **P S HALL**
DATE: 8 September 1986

1. MR ~~ILETT~~
2. CHANCELLOR

Ch
still not v satisfactory
AA

cc Financial Secretary
Economic Secretary
Sir Peter Middleton
Sir Geoffrey Littler
Mr Cassell
Mrs Lomax
Mr Scholar
Mr Peretz
Mr M A Hall

A letter from me to Mr Channon, copied to the PM, seems indicated.

FINANCIAL SERVICES BILL: TIMETABLE

You asked what can be done to reduce the period between Big Bang and the coming into force of the FS Bill (Mrs Lomax's minute of 24 July to Mr Peretz). I am sorry you have not had earlier advice.

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I wish to express my concern at a prolonged period of exposure, at the worst poss. time politically, & to point out that anything that goes wrong during that period might tend to discredit the whole system.

5. There seems little that the Treasury can do at the moment to assist DTI in expediting matters beyond taking advantage of any opportunities to press the point. However, early next year (when SIB's rule book has been issued and approved by DTI and the Office of Fair Trading, and DTI have accordingly delegated their powers to SIB) we and DTI could review the prospects for requiring all investment businesses to be authorised from the outset.

I would hope we could avoid this complication. M.

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7. During the next few months we will, of course, be keeping you closely in touch with progress in setting up the new regime.

P S Hall

P S HALL

2314/27

CONFIDENTIAL

Ch
Uncomfortable, but perhaps not impossible
AA

From: J P McINTYRE

Date: 12 September 1986

Does the Bill (when an Act) override the common law (Slaughters' interpretation of the position)? If not, amendment of the Bill is of course irrelevant. But in any case it would be unwise. NL

1. MR MOORE

2. FINANCIAL SECRETARY

cc Chancellor
Economic Secretary
Sir P Middleton
Mr Monck
Mr Scholar — D.J.L. Moore
Mrs Brown oa
Mr Ilett
Mr Colman
Mr Robson
Mr Ross Goobey — Mr McIntyre
Mr Hyett (Treasury Solicitors Dept)

As explained below, this question arises from the tiresome view taken by Slaughters, but not other lawyers, on disclosure requirements. Slaughters are advisers on both BGC and BA. But we do not believe there is a real problem in practice, nor that there is a need to ask for an amendment to the Bill. JM 12/9

FINANCIAL SERVICES BILL : PROSPECTUS DISCLOSURE REQUIREMENTS FOR GOVERNMENT SHARE SALES

This submission reports on the prospectus disclosure provisions presently in the Financial Services Bill and their effects on the government as a promoter and vendor of shares in the privatisation programme. It points out that, as the Bill stands, the government might be under an obligation to reveal in prospectuses decisions (taken or seriously contemplated but not announced) which would affect an investor's decision to invest. However, we are not convinced that the problem would arise in practice, and our recommendation is against proposing an amendment to the Bill to remove any doubt that we might be under this obligation.

2. We have been prompted to look again at the Financial Services Bill provisions in the light of preparations for the BGC and BA sales. Our legal advisers for these sales are Slaughters, and it is they who believe our disclosure obligations extend to decisions affecting potential investors generally. A key question is how far their view, if accepted, would inhibit us in carrying out a privatisation issue in the approach to the Budget.

3. Clause 142 of the Bill describes an issuer's general duties of disclosure in listing particulars. DTI's intention in this Clause is to put into English law the requirements of the EC Listing Particulars Directive, which has been in force since 1984. In other words, the broad aim is to maintain the existing level of disclosure requirements.

4. The objective is to make sure that potential investors have adequate information about the company when shares are being offered (the Clause is not concerned with decisions which might affect potential investors generally - a point which probably only applies to the government as a vendor, as only the government has the power to make such decisions).

5. Clause 142 requires prospectuses to contain:

> "all such information as investors and their professional advisers would reasonably require, and reasonably expect to find there, for the purpose of making an informed assessment of -
>
> (a) The assets and liabilities, financial position, profits and losses, and prospects of the issuer of the securities; and
>
> (b) The rights attaching to those securities".

6. The government is also under a common law duty of disclosure as a <u>promoter</u> in a share sale. (A promoter is someone concerned with the preparation of a company for sale and possibly also the flotation itself. In privatisations, the government is a promoter as well as an issuer of the shares). Government lawyers take the view that Clause 142's requirements are at least as wide as those of the common law duty; this means that in complying with Clause 142, an issuer is also complying with his common law duty of disclosure.

7. However, Slaughters take the view that the common law obligation on promoters <u>does</u> go further than that imposed by the Bill in requiring information materially affecting investors to be disclosed. We are not aware that Slaughters' view is shared by any other leading City firm, and it was rejected by Mr Richard Sykes QC, a leading silk in this area, in connection with the BT sale. But the consequence of this difference of view is that for BGC and (unless we amend the Bill) for privatisations after the Bill comes into force, the government will have to take a view on whether Slaughters are right.

8. In the case of BGC, the problem is unlikely to arise because the sale will be well in advance of the Budget. The Department of Energy has in any case agreed that it will be for the Treasury, advised as necessary by the Treasury Solicitors, (and for Departments generally) to decide whether there is anything in this category which should be reported to them for possible inclusion in the prospectus.

9. When this part of the Bill is in force (and this is likely to be the case for BA), there will, in theory, be a choice if we were to decide that Slaughters' advice could not be safely ignored. We could make the disclosure, or we could seek an exemption under Clause 144 of the Bill, which allows the Stock Exchange to authorise the omission of information if disclosure were against the public interest or seriously detrimental to the issuer. There is also provision in this Clause for the government to issue a certificate to the effect that disclosure would be contrary to the public interest (eg because of the need for Budget secrecy) and the Stock Exchange could act on this certificate to grant an exemption. When an exemption has been given, failure to disclose carries no liabilities.

10. Circumstances might arise in which we or another Department would want to use this route. But seeking an exemption would also risk provoking the accusation that the government had something to hide from investors.

11. One option would be to amend the Bill to remove any doubt on the point made by Slaughters. This could be done at Report stage, which is scheduled for mid-October. However, we doubt whether an amendment would make any real difference to the government's position as a vendor in the approach to the Budget or the Autumn Statement.

12. If Ministers were planning a share sale, and especially one aimed at attracting large numbers of private investors, it seems implausible that they would also be contemplating a measure (to be introduced a few months later) which would materially worsen the position of investors generally. Conversely, if they were thinking of such a measure, it seems unlikely that they would be planning a share sale shortly before it. And if a sale <u>were</u> to

go ahead in those circumstances, and the share price were to fall following the Budget, it is hard to see how the government's position could be defended, whatever the exact legal provisions.

13. Even if there were any practical advantages to be had from amending the Bill, there could be serious presentational difficulties in moving an amendment of this kind. It would probably be seen as a measure designed to enable the government to sell shares on the basis of an incomplete prospectus. However strongly this charge might be refuted, any publicity given to it might serve to undermine investors' confidence in the privatisation programme.

14. For these reasons, we recommend against proposing to DTI that the Bill be amended to remove the doubts raised by Slaughters' opinion. If, however, you wanted the possibility of an amendment to be further explored, we would need to raise this very quickly with the DTI.

Paul McIntyre

J P McINTYRE

3731/027

CONFIDENTIAL

papers please

I wouldn't recommend writing now - unless there is some more specific point you want to make. It's difficult to see what more can be done to expedite the bulk work directly related to the Big Bang, given the legislative timetable.

As you know, DTI & the Bank are working on papers on the Big Bang for the PM, following her meeting earlier this year. X That might be a better peg for some general reflections on the Big Bang & he should see them soon. R 23/9

FROM: N J ILETT
DATE: 23 September 1986

1. ~~MRS~~ LOMAX
2. CHANCELLOR

cc: CST
FST
EST
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Scholar
Mr Peretz
Mr M A Hall
Mr Neilson
Mr P S Hall
Mr Cropper
Mr Ross Goobey

Ch
Content not to write? X below might be worth picking up.
AA

X I agree that plus a passage in the MH speech would probably be better than a letter now. But I think Chancellor concerned about the 'gap'. R.

FINANCIAL SERVICES BILL: TIMETABLE

You were thinking of writing to Mr Channon to express concern at the prolonged period of exposure between the Financial Services Bill reaching the statute book and the regime for which it provides actually coming into force. Subsequently the merger between the Stock Exchange and ISRO has shown that at least in this area - the most significant in terms of activity and probably of potential for major disorder - things are moving reasonably well so far.

2. Some delays will be inevitable after the Act is in place because of the decision to set up a multi-tier self regulatory system. (Indeed, even under a statutory system such as the 1979 Banking Act a fair amount of time was necessary to get even the basic machinery working.) Mr P Hall's submissions of 22 July and 6 September set out the timetable with these in mind. Further delays could well follow because some of the SROs (particularly those covering retail intermediaries) are slow to get their act together; this is of course the area in which pressure will be needed. A reminder to the self regulators to prove that they can regulate themselves quickly and efficiently might go in your Mansion House speech.

3. It would be foolish to make predictions about the extent to which we are particularly exposed to some kind of scandal

during the interim period. However, the link between Big Bang and the Financial Services Bill is more tenuous than is sometimes thought; and the Financial Services Bill is not of course breaking new ground over much of what it covers.

4. First, the FS Bill regime is essentially aimed at investor protection, rather than prudential supervision or preventing systemic failure. The existing Stock Exchange and ISRO mechanisms, together with what has so far been assembled in the way of conglomerate supervision through lead regulators etc would have to cope with failure as best it could whether or not the Financial Services Act was in place. This is a subject to which we will need to give a good deal of further thought.

5. Further to the same point, the Financial Services Act does not of course change the arrangements for the supervision of banks and building societies, of insurance companies (as opposed to insurance industry intermediaries), or Lloyds, (which is not to say they will not be a source of political trouble).

6. Second, the Stock Exchange has pretty much got its house in order already. It will be introducing new conduct of business and dealing rules on Big Bang day (27 October). What is missing is the ultimate statutory backing from SIB (along with the final version of the SIB rules) and some of the enforcement powers such as the wider powers to investigate insider dealing. However, the new powers to act against insider dealing will be among the first to be brought into operation.

7. Big Bang will produce difficulties of conflict of interest, though some of these are already emerging, and a poorer deal for some investors etc; these might be termed "low-intensity" subjects compared to the traditional scandals of fraud or reckless conduct leading to major capital losses. On fraud, the Government has of course a separate and rather good story to tell.

8. The very large group of retail intermediaries covered by FIMBRA (Financial Intermediaries Managers and Brokers Regulatory Association) is more or less covered, albeit less than satisfactorily, by existing DTI supervision which will continue until the FS Act is operational. Also, FIMBRA is operational

on a non-statutory basis. And registered insurance brokers members of LAUTRO (the Life Assurance and Unit Trust Regulatory Organisation) are at present supervised on a statutory basis by the British Insurers Brokers Association. The major groups unregulated at present are futures and commodities dealers and those insurance intermediaries who do not describe themselves as brokers.

9. Arguably it could be more embarrassing if fishy characters get through the supervisory net after it is in place, rather than in the interim period, as this would be taken as evidence - whatever the facts - that self-regulation had failed. (One of FIMBRA's and LAUTRO's main problems and a reason why they look further down the line to active SRO status than the Stock Exchange/ISRO is that they will have to authorise thousands of people.) This is perhaps an argument against pushing the SIB and the SROs to move before they are ready.

10. I attach a possible draft letter to Mr Channon. Our advice is, however, that this is perhaps not the best time to write, with the Stock Exchange/ISRO merger just agreed in principle and DTI Ministers understandably preoccupied in getting the FS Bill though in a less than fulsome atmosphere. You might prefer to wait for the time being, or just have a word with Mr Channon and the Prime Minister.

Not in fact attached! (can chase in the morning if you do want to write)

pp N J ILETT

CONFIDENTIAL

FROM: **M NEILSON**

DATE: 13 October 1986

1. MR ~~ILETT~~ M. 13/x

2. CHANCELLOR

Mr Parker

Meena please thank "most grateful" etc

CR 17/10

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir T Burns
Mr Cassell
Mr Monck
Mrs Lomax
Mr Scholar
Mr M Hall
Mr Ilett
Mr P Hall
Mr Blower
Mr Cropper
Mr Ross Goobey

FINANCIAL SERVICES BILL: STATE OF PLAY

We thought you might find it useful to have a short assessment of where the Financial Services Bill now stands, and what issues are due to be dealt with in the remaining stages.

2. As you know, Report stage in the Lords is now fixed for 14, 16, and 20 October. The date for Commons consideration of Lords amendments is not yet fixed.

3. There are about 350 government amendments and more than 150 others. None of the Government amendments affect the basic structure of the Bill, and DTI do not expect many of them to be controversial. Most have been tabled in response to representations either in Lords Committee or over the summer. It is reassuring that Mr Bryan Gould, the Opposition spokesman on the Bill, has made it clear that, though they will be debating the more important points, it is not their intention to prevent the Bill from getting on to the statute book.

4. It is those areas where the Government has refused to make amendments that are likely to provide most controversy. The Opposition has tabled amendments on some of the long running themes; bringing Lloyds within the scope of the Bill; giving

statutory backing for the takeover panel; turning the SIB into a statutory body along the lines of the Securities Exchange Commission in the United States. At a less fundamental level, but with more direct Treasury interest, the opposition propose that the Secretary of State for Trade and Industry should be jointly responsible with the Governor of the Bank of England for the listing of money-market institutions under the non-statutory arrangements for wholesale markets. DTI will oppose this. Other of their amendments seek to prevent building societies getting involved in secondary mortgages - a subject which Dr MacDonald spent a lot of time on during the passage of the Building Society Bill. DTI expect to succeed in voting down all these amendments.

5. One area where DTI do see potential difficulties is in holding the line against extending immunity from damages to registered professional bodies. Immunity was only extended to SROs because there appeared to be a genuine risk that without immunity it would be difficult to recruit suitable members. This is clearly not the case with long-established professional bodies. DTI have also always argued that professional bodies are not as vulnerable as SROs since investment is not their mainstream business. But the pressure groups have attracted substantial support and could conceivably win a vote in the Lords.

The following are the main points upon which government amendments have been tabled:

Central Compensation Scheme

6. The Government amendments include provisions for the SIB to establish a compulsory central compensation scheme. It had originally been envisaged that SIB would set up a compensation scheme, but that the SROs would have the choice of joining the SIB scheme or setting up their own scheme, which would have to provide protection at least equivalent to the SIB scheme. The SIB however have argued strongly that a central scheme should be imposed, since the larger the scheme the better the level of compensation that could be offered for a given level of

contribution. Their concern was that, if the SIB scheme ended up covering only the small number of directly authorised institutions, it would only be able to offer a low level of protection, and have to charge a large contribution. Since other SROs would only have to offer equivalent provisions, this would tend to undermine compensation arrangements generally. The Secretary of State concluded that the SIB concerns were wellfounded, and has introduced appropriate amendments.

7. The Stock Exchange has opposed the proposal for a compulsory central scheme, largely because it feared that this would involve Stock Exchange member firms subsidising less reliable institutions authorised by other SROs. The Government amendments seek to deal with the Stock Exchange's concerns by imposing two conditions on any central compensation scheme that is set up. First, that the body running the scheme should be fully representative of these contributing to it. Second that, as far as practicable, compensation claims relating to members of an SRO should be financed by that SRO. It will be up to the body making the scheme rules-almost certainly the SIB - to decide at what point an SRO should be entitled to call on the central scheme for financial assistance. DTI think that the Stock Exchange will accept this scheme if it is imposed on them, but it looks likely that they will put up a fight in the Lords. DTI expect to be able to hold the line.

Definition of Investment Business: Corporate Treasurers

8. DTI have made amendments to deal with the concerns expressed by both the Association of Corporate Treasurers and the CBI that non-financial companies carrying out their normal activities might be caught by the definition of investment business and have to seek authorisation. The Bill as originally drafted had, unintentionally, caught some of these activities.

9. The new provisions widen the activities that companies can carry out on behalf of other companies in the same group, and

on behalf of customers when directly related to a non-investment transaction. It also provides the SIB with a catch-all power to exempt non-investment companies from the need for authorisation if their investment activities are of a nature which makes it inappropriate to require them to be authorised. This power is drawn widely because it is envisaged that it should enable the SIB to deal with other tricky cases where an institution is unintentially caught by the definition of investment business.

10. CBI and ACT have welcomed these amendments.

Equity Price Stabilization

11. It has long been practice in the Eurobond market for the issuing house to take steps to stabilize a bond's price around the period of a new issue. The Bill as originally drafted made provision for stabilization operations only in the Eurobond market. DTI have received strong representations, including from the SIB, that failure to allow stablization provisions in other markets would undermine the City's international competitiveness. In particular it would restrict the use of new capital raising techniques such as the "bought deal".

12. DTI have accepted these arguments, and introduced amendments which will allow price stabilization for new equity issues, though only for heavily traded stocks, and in a number of other categories. The new provisions also make it explicit that gilts can be the subject of stabilization measures. This extension has been balanced by new safeguards, requiring the SIB and SROs to introduce rules to ensure appropriate investor protection.

Technical Changes of Interest to the Treasury

13. Three groups of amendments relate directly to Treasury interests:

(i) minor changes in the provisions excluding wholesale market transactions from the scope of the Bill. These are essentially tidying up amendments, the most significant of which allows institutions on the Bank of England's list to arrange as well as enter into wholesale money market transactions.

(ii) a large number of amendments relating to friendly societies. The main purpose of these is to provide a transitional regime for small friendly societies, but the bulk of the amendments simply bring the friendly society provisions into line with the main body of the Bill as amended.

(iii) The Bank are concerned that the powers for SROs to delegate monitoring to other regulators are not sufficient to allow the lead regulator scheme to be operated as currently proposed. Parliamentary Counsel is looking at this again and a late amendment may be required.

Next steps

14. Subject to any unexpected reversals in its remaining stages the Financial Services Bill is now in virtually final form. The focus will now shift to the finalisation, first, of the SIB conduct of business rules, and, subsequently, to those of the SROs. Most of the SIB rules now exist in draft form, but there are still some gaps, notably on capital adequacy. We shall continue to report significant developments.

M NEILSON

The Rt Hon
PS | Nigel Lawson
RP

PSO attach copy of att.

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215)
GTN 215) 4417
(Switchboard) 01-215 7877

From the Parliamentary Under Secretary of State for Corporate and Consumer Affairs

The Hon Francis Maude MP

CH/EXCHEQUER
REC. 25 AUG 1987
ACTION FST
COPIES TO

David Norgreave Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

25 August 1987

Dear David,

FINANCIAL SERVICES ACT

Mr Maude has asked me to let you know that he will be announcing at 2.30 pm on 26 August the revised timetable for implementing the Financial Services Act. I attach a copy of the Press Notice, which has been discussed in draft with officials from DHSS and Treasury.

Mr Maude will be taking the opportunity to stress that this is still an extremely demanding timetable and that businesses should now be taking the necessary steps to ensure that they can carry on trading legitimately after next April. He sees this announcement as the first stage of a major awareness campaign in the national and local press, as well as in trade journals, which will continue throughout the autumn. He is also writing to Members of Parliament urging them to get the same message over to businesses in their constituencies.

X I understand that DHSS are separately issuing a Press Notice about the implications of this announcement for the timing of the introduction of personal pensions.

I am sending copies of this letter to the Private Secretaries to other members of the Cabinet and to Sir Robert Armstrong.

Yours sincerely,

David Roe

DAVID ROE
Private Secretary

J04BTM

999-9

DTI Press Notice

Department of Trade and Industry
1 Victoria Street SW1H 0ET
Press Office: 01-215 4472/4471
Out of hours: 01-215 7877

Number: 87/488

Date: 26 August 1987

TIMETABLE FOR IMPLEMENTATION OF FINANCIAL SERVICES ACT

Francis Maude, Corporate Affairs Minister, today (26 August) urged firms carrying on investment business to be ready to apply for authorisation under the Financial Services Act before the end of the year.

Mr Maude said that it was the Government's intention to implement Section 3 of the Financial Services Act, which will make it a criminal offence to carry on investment business in the United Kingdom unless authorised or exempted, early in 1988.

He said:

"We intend to bring Section 3 into force at the beginning of April. This demanding timetable means that investment businesses must be ready to apply for authorisation by the end of the year, or they risk losing the right to carry on their business.

"That means they need to be thinking about it now: not just the big City firms, but everyone who advises on investments, in every High Street in every town.

"There is much to be done before the new system can be brought fully into force but the Government believes that it is important to press ahead as quickly as possible so that investors can receive the protection afforded by the Act."

The Financial Services Act 1986 is being brought into effect in stages. Four self regulating organisations (SROs) have already applied to the Securities and Investments Board for recognition under the Act and a fifth application is expected shortly.

MORE/...

The Director General of Fair Trading is examining the rules of those organisations which have applied to see whether any are likely to have anti-competitive effects. The Secretary of State, after considering the Director General's reports, will decide whether to give leave for the recognition of the SROs by the Securities and Investments Board. (These procedures are established in the Act.) If so, it is hoped that the five SROs will all be recognised by early December.

The Act provides that a person who has applied for membership of an SRO by a particular date (P-day) and whose application has not been determined by the day on which section 3 comes into force (A-day) will receive interim authorisation for the period until his application is settled. If all the SROs are recognised in early December it should be possible to set P-day for the middle of January and A-day in early April 1988. Any business which needs authorisation and has not applied for it before P-Day is very unlikely to receive it in time to be able legally to carry on investment business after A-Day.

NOTES TO EDITORS

1. The four SROs who have already applied to the SIB for recognition under the Act are the Financial Intermediaries and Brokers Regulatory Association (FIMBRA), The Securities Association (TSA), the Investment Management Regulatory Organisation (IMRO) and the Association of Futures Brokers and Dealers (AFBD). The Life Assurance and Unit Trust Regulatory Organisation (LAUTRO) is expected to apply shortly.

2. Anyone who is uncertain about how the Act affects their activities should contact the SIB or the relevant SRO. A free introductory guide to the Act is also available from the Department of Trade and Industry, Room G07, 10/18 Victoria Street, London SW1H 0NN. Telephone 01-215 3065.

ENDS

Department of Health and Social Security

PRESS RELEASE

Alexander Fleming House
Elephant and Castle
London SE1 6BY

Telephone 01-407 5522

87/300 26 August 1987

REFORMING SOCIAL SECURITY: NEW TIMETABLE FOR PERSONAL PENSIONS

The start date for the new personal pensions introduced by the 1986 Social Security Act is to be postponed for six months following a delay to the timetable for bringing in new investor protection rules under the Financial Services Act. The decision was announced today by Michael Portillo, Parliamentary Under Secretary of State for Social Security.

Mr Portillo said:

"When we decided that personal pensions as an alternative to the State earnings-related pension scheme should be available from January 1988, it was on the premise that we expected that the new Financial Services Act framework would be in operation by that date. It is now clear that the main provisions of that Act cannot be in force before April. Moreover, the recent announcement by the Securities and Investments Board that certain key rules affecting consumers' rights will be brought into force on 1 July 1988 makes it prudent for us to set the same start date for the new personal pensions. The Government must ensure that anyone taking out one of the new personal pensions should benefit from the investor protection measures introduced by the Financial Services Act, or equivalent safeguards.

"This announcement does not alter the timing of the important reforms affecting occupational scheme provision introduced by the 1986 Act. Money-purchase contracting out, the right not to belong to an employer's scheme, and the measures associated with them, will come into force as planned on 6 April 1988. Nor is there any change in the right to backdate membership of a contracted-out personal pension scheme to 6 April 1987, so people taking out a personal pension before 6 April 1989 will still be able to have the extra year's National Insurance rebate and incentive payment."

[MORE]

NOTES FOR EDITORS

1. A statement on the Financial Services Act timetable is issued today by the Department of Trade and Industry; and a statement on the implications for the legislation on the tax approval of personal pension schemes is issued today by the Inland Revenue.

2. The Securities and Investments Board announced on 7 August that its rules covering the illustration of benefits, disclosure of product particulars and disclosure of commissions on life assurance and unit trusts will come into force on 1 July 1988. Cancellation Rules, requiring a 14-day "cooling-off" period, are also to come into effect on that day.

3. The operative dates of certain regulations made under the Social Security Act 1986 will be amended to reflect the July start date.

[ENDS]

1316/24

CONFIDENTIAL

FROM: MRS R LOMAX

DATE: 29 September 1987

ECONOMIC SECRETARY

cc PS/Chancellor
PS/Sir P Middleton
Mr Cassell
Mr Ilett
Miss Noble
Mr Board
Mr Neilson
Mr Hall
Mr Cropper

ANDREW LARGE ON FINANCIAL SERVICES ACT

Andrew Large's article in today's FT is very much to the point. The risk that the new system will prove over-burdensome and litigious clearly exists, and is giving rise to last minute concern at the DTI, as well as the Bank and (predictably) TSA. Lord Young is said to have been fairly horrified at what he found when he came to contemplate the new Financial Services regime, and officials are currently casting round to see what can be done.

2. The most substantial measure in prospect is the one identified by Andrew Large: that is, deferring the implementation of Section 62 for, say, 12 months. This is the provision that makes breach of an SRO's rules grounds for civil litigation. We understand that DTI are now seeking the Law Officers' advice on just this point - and in particular whether it can be argued that deferral will thwart the will of Parliament.

3. Civil sanctions were envisaged as far back as the Gower Report and the 1985 White Paper: they were by no means an afterthought. But it seems fairly clear that Lord Young <u>will</u> want to defer Section 62, unless he is told in terms that he cannot do so. Whether the effect would be as far reaching as Large claims I cannot say. But S62 has certainly been the main excuse for the very detailed and legalistic nature of the SIB's

rule book; so postponing S62 would be an important signal - to the SROs as well as to practitioners.

4. The other line of attack is via the SIB itself. As Andrew Large says, they need to be more flexible in applying the concept of "equivalence" to SRO rules. I gather that Lord Young plans to take an early opportunity to congratulate Sir Kenneth Berrill in public for his "flexibility." In fact, we understand that SIB are being more flexible - though it is a virtue they have acquired very recently (and not from Ken Berrill, who is only just back from holiday). We gather, for example, that it has been agreed between SIB and TSA that a number of rules can be disapplied for professional investors, though we do not know the full details.

5. I have to confess that we are not as well informed about what is going on at DTI as we should be: partly because DTI officials are chafing a bit at the abrupt change in Ministerial priorities, which makes them feel a trifle foolish. But we are doing some detective work and will report further. In the meantime, it may prove easier to pick up information on the political net, where the sensitivities should be rather less.

6. I am not too optimistic. If Lord Young is serious about sticking to the April deadline for implementing the Financial Services Act (as his latest minute to the Prime Minister suggests) there must be a severe limit to how much can be done to lighten the regime in practice.

RL

RACHEL LOMAX

Regulation of the City is, says **Andrew Large**, turning into a damaging lawyers' paradise

Save us from Section 62

WE HAVE reached a critical stage in the development of the new system of investor protection. For the first time, the full implications and practical details of the proposed system are becoming clear to practitioners. There is a danger that it will turn out to be impractical and over legalistic. No one wants the system to fall into disrepute by being honoured in the breach, or to damage the industries it is meant to be regulating.

There is, of course, a great deal at stake. The financial services industry has been one of the most successful and vital parts of the UK economy in recent years. But much of the international success of the City has been a result of relative freedom from regulation. This has afforded London a significant competitive edge, shown by the spectacular growth in the Euromarkets over the past 10 years. Despite the absence of any formal regulation, the international market has been remarkably free of major scandals during his period. All this could be put at risk if we fail to establish the right balance in the regulatory system.

I must stress that all participants in the post Big Bang era accept the need for an adequate and just system of investor protection. No one questions the principles behind that aim. The problem is that each layer of the system—Government, the Securities and Investments Board (SIB) and the Self Regulating Organisations (SROs)—feels the need to be cautious and to be seen to be responsible. In an attempt to meet the detailed concerns of the various critics of the previous system each layer draws up rules or legislation. The result of this process is a mass of detailed technical rules which many people are now saying amount to regulatory overkill.

It is worth looking back at the Government's January 1985 White Paper on investor protection. This makes clear the intended objectives of the legislation. In order of priority, the regulatory system was to ensure efficiency, competitiveness (both domestically and internationally), confidence and flexibility. It said: "Excessive regulation would impose unnecessary monitoring and enforcement costs; and would stop or delay new services and products being developed in response to market opportunities. The Government therefore intend that the regulation of the financial services industry should be no more than the minimum necessary to protect the investor."

Up to now, everyone has been under tremendous pressure to get on with it and create the best machinery possible. But it is only now, a short time before rule books are meant to be set, that the full implications of the system are beginning to be appreciated.

From most angles, the Financial Services Act is a solid and well-intentioned piece of work. But it is dealing with highly complex issues. The result is an Act which, inadvertently no doubt, has a number of ambiguities and uncertainties, especially in relation to international business.

But the single section in the Act which has had the greatest influence on the development of the new regulatory regime is Section 62. This is a statutory provision that allows a customer to sue an investment business for damages if the rules of a SRO have been broken. Acceptable business practice should not have to be continually defined in lengthy court proceedings, and therefore The Securities Association (TSA) has felt obliged to draw up detailed and long rules in an attempt to avoid uncertainty. The clause is there with the best of intentions, but its influence now extends throughout the whole chain of regulations.

In the light of this unanticipated effect, the question should therefore be asked whether this particular clause is necessary. I am not a lawyer, but I do wonder whether investors really need such a clause given the rights they already enjoy elsewhere under the regulatory regime as well as under common law. A provision of this sort will do nothing to guarantee the probity of the tiny minority of less than honest practitioners currently involved in the industry. It is the responsibility of the regulatory organisations and their screening procedures, to detect malpractice and set the general standards.

The real danger of Section 62 will be to introduce new and dangerous litigious attitudes and sidetrack the determination of practitioners to live by the spirit rather than the letter of the rules. It would be a lawyer's paradise, but is surely not the way to run a collection of complex and competitive markets.

The second major element in the regulatory process is of course the SIB. Many now argue that the SIB's rule book has been drawn up in a way not envisaged by the regulators, even though the SIB's intentions were laudable from a regulatory point of view. The SIB's rules are detailed and at times complex. In some important areas the SIB seems to have extended regulatory controls beyond the apparent minimum requirements of the Act. It is against this rule book that the various SROs will be judged and recognised.

The third link in the chain is the SROs. The problem here is that their rules have to be equivalent to those of the SIB. The detail and reach of the SRO rules is a direct "knock on" from the detail and reach of the SIB rules. At TSA, we have tried to draw up rules that will result in equivalent investor protection. Some rules are stricter than those proposed by SIB and others less so. I am perhaps more optimistic than many that the SIB will look at SRO rule books such as TSA's for their overall effect rather than for precise equivalence.

So there is a section in the Act which contains an obvious invitation to litigation; an agency in the shape of the SIB which has not so far chosen to lean against over-regulation; and, as a result, SROs such as TSA which have sought precision and clarity but been obliged to frame rules which are already looking more complex and hard to comply with than they should be.

The real danger is that domestic business in the UK will suffer as fewer and fewer firms are prepared to bear the costs of compliance and take the risks of litigation in providing services to ordinary investors. This would indeed be ironic. After all, by far the most important goal of the Act is to protect precisely these investors, not to regulate the products they are offered out of existence. I cannot imagine that this is what the Government intended. Moreover, the professional international businesses who operate from London will begin to find other homes. Many have argued that this could never happen because of London's advantages. In my opinion this is a complacent and dangerous view to take. There are many ready to challenge London's position.

The SROs must be allowed to draw up rules with some freedom

What can be done to avert the problem? Perhaps it is too much to expect changes in the Act at this stage. But would it not be possible to consider deferring the implementation of Section 62 so that the new system can take root in a healthy way? Even in the United States, the regulatory system does not provide such automatic recourse to litigation. Surely it would be reasonable to see if the mainstream regulatory arrangements will adequately protect investors before going over to a litigation-based system?

In addition, SROs must be allowed to draw up rules with some freedom. This implies that "equivalence" be interpreted broadly. The judgment of responsible practitioners, who are exposed directly to market forces and who give time as voluntary regulators, must be trusted if the present system is going to work. This was, after all, one of the corner stones of the self-regulatory system.

It is true that many of the concerns now being advanced about regulation have been heard before and dismissed as being attacks upon the principle of investor protection by an industry which wanted a quiet life. This can no longer be said to be the case. The industry is not questioning the principle of investor protection but it does now have hard evidence of the difficulties caused by the current approach.

The unworkable parts of the regulatory process should be rethought and, provided we can establish satisfactory transition arrangements, there is no reason why this should delay the introduction of the essential provisions of investor protection envisaged by the Act.

The author is chairman, The Securities Association.

1316/35

CONFIDENTIAL

pwp

FROM: MRS R LOMAX
DATE: 2 October 1987

ECONOMIC SECRETARY

cc ~~Principal Private Secretary~~
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Ilett

FINANCIAL SERVICES ACT: SECTION 62

You asked whether deferring Section 62 would do any good. You may now have seen the Financial Times's attempt to answer the same question, in today's Second Leader (attached).

2. I agree with much the FT says. In particular, it is true that Section 62 represents an attempt to codify existing common law and, to that extent, its significance has been exaggerated. That is not to say that Section 62 is unimportant: the act of codification, by clarifying common law rights, and making people more aware of them, may make it more likely that they will be exercised, even if those rights are not changed or strengthened in any way.

3. Just deferring Section 62, in isolation, would be a symbolic gesture. And the FT is surely right to say that it would provoke a political row, as well as conciliating the City. You will no doubt recall Brian Gould's mastery of the intricacies of the Financial Services Act. If it were to have any substance, the purpose of deferring Section 62 would have to be to allow breathing space for a reworking of the SIB/SRO Rule Books. No one has yet suggested that Section 62 should be rewritten, with more limited sanctions.

4. Any substantial reworking of rule books at this stage would run a strong risk of seriously disrupting the timetable. This is essentially because the SROs are not yet recognised. Changes in their rules now would almost certainly need to be submitted to Borrie, and considered by SIB, before the SROs could be

recognised: and the SROs need to be recognised before they can authorise investment businesses. Once the SROs are recognised, however, their rule books can still be changed by negotiation with Borrie and SIB. So all is not lost - providing that the will to modify rule books exists.

5. That is the rub. In particular, the behaviour of SIB is the crux of the matter. I do not agree with those who say that problems have only emerged "over the summer". The general shape of the problem has been apparent since the first draft of the SIB Rules appeared at the end of last year. Even at that stage, it was clear that the lawyers had got the upper hand at the SIB. And SIB's conduct during the debate on polarisation and the lead regulator arrangements only reinforced this conclusion.

6. Several things <u>have</u> happened in recent months: the City has begun to wake up to the implications of the Financial Services Act, as the task of gearing up for it has become more pressing: and no doubt the assessment of what is politically possible has shifted, since the Election (and maybe with the advent of Lord Young). Also relevant is the fact that the most able member of the SIB staff, Kate Mortimer, the Policy Director, left in July.

7. As to why the lawyers got the upper hand at the SIB, that has at least as much to do with personalities, as with Section 62. Berrill is part of the problem, of course, but also relevant is the way the practitioners on the SIB Board have behaved. Based on the experience of the last year, I think one can argue that practitioners are <u>more</u> legalistic and cautious than bureaucrats. That is one reason why I am very sceptical of Lord Young's insistence that Berrill's replacement should be a practitioner. The Bank of England is a far less lawyer-driven institution than the SIB. What is actually needed at the SIB is someone of standing in the City, who is occasionally prepared to take risks to achieve a sensible outcome.

8. Finally the question of whether Lord Young <u>can</u> defer S62 now rests with Treasury Counsel. LOD officials expect the advice to be that S62 cannot be deferred.

RL

RACHEL LOMAX

Priorities for City rules

A NEW TEAM of ministers at Britain's Department of Trade and Industry is suddenly under intense pressure from the City of London to soften the impact of the Government's own Financial Services Act. That was only to be expected: the switch from self-regulation and club rule to practitioner-based regulation within a statutory framework was bound to be painful for most of those involved. But the starting date for the Financial Services Act, which will implement the new system, has already been deferred once and City interests were closely consulted throughout the passage of the bill. It seems highly questionable whether this is the moment to slow the impetus towards a full system of investor protection.

That is not to say that the City's criticisms are wholly without foundation. The draft rule book of the Securities and Investments Board (SIB), the City's new watchdog, is unquestionably cumbersome and legalistic. So, too, are those emerging from the Self Regulating Organisations (SROs) in the City, which the SIB is shortly expected to recognise. And there is not much doubt that some members of the SIB's staff have erred on the side of bureaucracy in their examination of the SROs' rule books, whereby they seek to establish whether the rules provide an equivalent standard of protection to those of the SIB. It has become clear in the course of the summer that the new system is not working quite as originally intended or as the City had hoped.

Legalistic rules

Much of the problem stems from section 62 of the new act. This gives individual investors the right to sue if they have lost money as a result of a breach of the rules. In consequence, the SIB and the SROs have been obliged to frame their rule books in a legalistic way because each rule potentially exposes practitioners to legal liability. Hence the incomprehensibility of many of the rules. Hence, too, an appeal this week by the chairman of The Securities Association, the SRO for the Eurobond markets and the domestic stock market, for some delay in implementing the section. If the new system then worked adequately, runs the argument, there would be no need to move to a more legalistic system redolent of the US.

The problem here is that section 62 constitutes the chief means of enforcing the provisions of the act. It also represents an attempt to codify forms of protection that already exist for investors under common law. And it is hard to see how implementation could be deferred without provoking a monumental political row. If the law was regarded as necessary by the Government before the general election, failure to push it through now would invite accusations of a cynical sell-out to the City, while raising complex issues for legal policy. So what else could Lord Young, the Trade and Industry Secretary, reasonably do?

City concern

His initial response to City complaints has been to rally to the support of the SIB, while simultaneously reassuring market practitioners that he expects the SIB and the SROs to operate with all the flexibility that the act permits. He has also pledged no further delay on the implementation of the new system. All of this makes sense, as does the more conciliatory stance that is becoming apparent at the SIB. At this stage it would be fatal to undermine the SIB's authority or for the atmosphere to be soured by further acrimonious argument.

But there is still some question in Whitehall about whether City concern over section 62 could be allayed by deferring some of the more contentious parts of the new rule books which seem most likely to give rise to litigation. Yet in practice most of the issues they are still giving rise to difficulty, such as capital adequacy and the treatment of clients' money in the securities and futures markets, are not the ones where the threat of legal action is the problem.

At this late stage the priority should be to continue along the lines already proposed by Lord Young and to put the system into operation as soon as possible. It should then be subjected to frequent and pragmatic review to ensure that adequate investor protection is not incompatible with flexible market practice.

1317/12

Confidential

FROM: M J NEILSON
DATE: 14 October 1987

ECONOMIC SECRETARY

cc: PPS
Mr Cassell
Mrs Lomax
Mr Ilett
Mr Board
Mr P Hall

FINANCIAL SERVICES ACT: SECTION 62

Mrs Lomax reported in her minute of 29 September that DTI were seeking the Law Officers' advice on whether implementation of Section 62 of the Financial Services Act could be deferred. DTI have now received this advice, and Lord Young has today announced that he will indeed be deferring Section 62. I attach a copy of the relevant section of his speech to an FT conference.

2. What Lord Young has decided is to defer Section 62 - the provision that makes breach of an SRO's rules grounds for civil litigation - for six months in respect of SRO rules, but to bring it into effect in respect of SIB rules at the outset. This will require an Order relaxing the equivalence test in this particular respect. Since the vast majority of firms will be subject to SRO rules, DTI hope that it will satisfy most City critics.

3. This rather odd-looking arrangement results from the Law Officers' advice. They considered that a decision to defer Section 62 for SIB and SRO rules would involve a very high risk of legal challenge through judicial review. Deferral for SRO rules only still involves some risk, but the Law Officers' judgement was that the risk was substantially smaller. The very firm statement that the deferral is temporary also reflects Law Officers' advice.

4. Since the DTI proposal does achieve what the City wanted there must be some chance that it will be welcomed. But six months is not very long. The arrangement will also adversely

affect firms which intend seeking authorisation direct from SIB, such as a number of the large building societies.

5. Much of the rest of the speech is devoted to stressing that the new system will not result in excessive regulation:

- it is a practitioner-based system

- the competition test (that rules should not restrict competition more than is necessary for investor protection)

- that the rules themselves incorporate flexibility, including the SIB's power to disapply particular rules, the fact that SRO rules do not have to be identical to SIB rules, but rather to provide an equivalent level of investor protection.

If you are asked about this issue you might point out that Lord Young's decision to defer Section 62 shows that the Government is aware of the importance of maintaining flexibility in the new regime, without sacrificing the interests of investors. It is important that the other elements of flexibility built into the framework (outlined above) should be used effectively.

M J NEILSON

I mentioned earlier the concern that has been expressed that some aspects of the new regime may lead to business being driven away from the UK. As I have said, I do not believe this is true, and I do not believe it is seriously argued, of regulation per se. Nonetheless, it is clear that inappropriate regulation in some areas could have that effect. It is not my purpose to discuss specific areas this morning. Under the Act it is necessary for me to give leave before any SRO can be recognised, taking into account the Director General of Fair Trading's report, and it would be wrong to express a view on any of these issues before I have considered the Director General's report.

In general terms, however, I should make clear that it is no part of Government policy to encourage measures which will drive business away. The White Paper was quite explicit about this. It stated that "the Government ..... intend that the regulation of the financial services industry should be no more that the minimum necessary to protect the investor". Indeed, we believe that excessive regulation is as much against the interest of investors as it is against the interests of the financial services industry itself.

This may be an appropriate point to make some mention of one particular aspect of the Act which has attracted some criticism in recent months. I refer to Section 62, which gives an investor who has suffered loss as a result of the breach of a rule made under the Act a right of civil action. I stress that this has become an issue in recent months. The principle was clearly stated in the 1985 White Paper. Nor was the basic principle challenged while the Bill was being considered in Parliament, although there was some discussion of the grounds on which an action could be mounted. Under common law a person who has suffered a loss could well be able to get the Courts to apply the normal rules of tort on breach of statutory duty and the purpose of Section 62 was to clarify this point.

I should emphasise that I regard this principle as important and there is no question of abandoning it. If an investor loses money as a direct result of a firm's misconduct, the punishment of the firm, however severe, is likely to be of little comfort to him. A compensation scheme, while it can restore at least some of the losses, is not of itself a full answer. The terms of the scheme being established under the Act would in fact have to be adjusted before it would work satisfactorily without section 62. But in any case, I question the principle that firms who have conducted themselves properly should have to bear such a burden while the firm whose misconduct has caused the loss is itself still able to pay. You will also understand that I have problems in accepting that SIB's power to apply for a restitution order under section 61 is sufficient. This is a useful power in some circumstances, but I do not accept that such powers given to a central body, however august, should replace entirely the individual's right to take action himself.

I know that it is alleged that this section has led to the rules both of the SROs and the SIB being more detailed and legalistic than they need be. I have to say that I am doubtful about such arguments. First, caselaw suggests that breaches of existing requirements give rise to civil liability. Under such circumstances, in the light of the points I have already made, I am very doubtful about doing anything which could be construed as taking away from investors rights they already have. Secondly, I believe there is a great deal of nonsense talked about the consequences of section 62. It has even been suggested to me that if a salesman fails to hand over a business card at his initial meeting with an investor his firm could subsequently be sued for an investor's losses made on any contracts made thereafter. That is of course absurd. The standard defences against a breach of statutory duty apply in section 62 cases. In particular, a firm can only be liable for losses which were a consequence of the breach of the rule in question.

Nonetheless, I have considered very carefully, in the interests of introducing the new regime as smoothly as possible, whether it is possible and desirable to ensure in some way that section 62 does not come into operation for a period after the main provisions of the Act are brought into force. I have concluded that simply deciding not to commence section 62 as it stands would not be a proper use for the commencement order provisions in the Act. I do not believe, however, that this problem arises to the same degree in deferring commencement of section 62 as it applies to rules made by self-regulating organisations (and professional bodies). I have decided therefore, under the powers in section 118, to bring section 62(2) into force six months after the main powers of the Act are implemented. This temporary breathing space will allow companies operating under the rules of SRO's or of professional bodies to sort out any initial teething problems involved in implementing the new rules, whether in administrative procedures or computer systems, before section 62(2) comes into force. I accept that this would mean that in this respect an SRO's rules might temporarily not offer investors the same rights as in their dealings with businesses authorised by the SIB directly. In order to allow recognition of SROs to proceed, I propose to make an order under section 118(2) of the Act modifying the equivalence test in this very limited respect. In all other respects the SRO rules will be expected to meet the Act's equivalence test, of which I shall have more to say shortly.

This brings me to the question of whether the rules to be applied under the new system will in fact result in excessive regulation. I do not pretend that there will not be problems from time to time. Inevitably, some rules may have unintended side-effects. This is a particular danger where new requirements are being introduced into areas not previously regulated or where the markets themselves have been subject to significant changes. Moreover, we must recognise that in a fast-changing world changes in the rules will be necessary to reflect new circumstances. However, the Act contains a number of safeguards designed to ensure both that these problems are minimised and that they are dealt with effectively when they arise. Those who talk of business being driven away from the

UK have not, I believe, recognised the strengths of these safeguards.

First and foremost, we must not forget that we have created a practitioner-based system. This practitioner element is designed to ensure that when amendments are needed - whether before or after the system starts - they can be made quickly in close consultation with those involved in the market. That represents a tremendous advantage over reliance on statute or statutory instruments. It is essential, however, that practitioners recognise the role they have to play. Although practitioner-based, the statutory framework of the new system - necessary to give it effectiveness - means it is more formal than the old self-regulatory arrangements. That means that all practitioners at every level have to be prepared to play their part. It is no use expecting that a few "committee-types" will deal with all the issues. Practical inputs and constructive suggestions from those operating in the market or those with day-to-day responsibility for compliance are vital. Moreover, firms must be willing to continue providing some of their best people to staff the various regulatory bodies. I am sure that, as in other countries, this will prove to be in the best long-term interests of all concerned.

I should like at this stage to pay tribute to the contribution which every-one concerned with setting up the new system - at the SIB and in the various self-regulating organisations, including The Securities Association - has made so far. We should not underestimate what has been achieved in drawing up a coherent body of rules covering such a diversity of kinds of business in a relatively short time.

A second safeguard is the special competition regime introduced by the Act. The competition test laid down by the Act is a broad one - rules made under the system should not have, to any significant extent, the effect of restricting, distorting or preventing competition greater than is necessary for the protection of investors. It will be apparent that this is wide enough to embrace many of the things we are concerned about when we talk about international competitiveness. The Director General of Fair Trading has, rightly, a central role in assessing these effects. However, the final decision is one for me and I can assure you that I take that responsibility very seriously.

Finally, and most significantly, I attach great importance to the flexibility allowed in the rules which firms must comply with. This takes three forms. The first is the ability - common in self-regulatory systems but more novel in a statutory system - to disapply the rules in appropriate circumstances. The second is the relationship between the SIB and SRO rules. The rules most people will have to contend with, day to day, will not be SIB's rules but those of the SROs. The Act very carefully does not require SROs' rules to be identical to SIB's, or even to achieve an identical effect.

Instead it requires that they should provide an equivalent level of investor protection. This reflects our conviction that, within the principles laid down in the legislation, self-regulating organisations are best placed to decide on the structure of rules most appropriate for their members. SIB's job is to bring about common principles and standards overall. This is critically important to meeting genuinely different needs of different players in different markets and I know that SIB shares this broad approach to the question of equivalence. Moreover the Act specifically requires different but appropriate forms of regulation for professional investors and the small private investor. SIB has shown itself ready to make several changes to various rules in this area over the past months and I welcome that. I am not sure that the full significance of these adjustments has yet been absorbed by all practitioners.

The third area of flexibility lies in the speed with which rules can be adjusted to take account of developing experience. The system will be coming into force at a time of continuing rapid change in the City. It will be important, particularly in the early days, to keep the rules under constant review to ensure that they are kept abreast of changes. And they will need to be changed if they impose unnecessary burdens on business. The system is designed to allow flexible and quick response to the needs of practitioners, and I am confident the regulatory authorities will be ready to make such changes whenever the need for them emerges.

Because of the importance I attach to ensuring that this flexibility operates in practice, I have asked the SIB, for the first year or two of the new system, to make regular assessments for me of the impact of the rules on business, and what has been done to mitigate unintended consequences. These assessments should focus attention on practical implementation problems as they arise and the solutions adopted. They should also monitor both the effectiveness of the regime in protecting investors and the effects of bringing business to or driving it away from London. I would expect such assessments to incorporate the views of the SROs.

I spoke earlier of the challenge which faces us in producing a framework which will serve us in a rapidly changing world. I can appreciate the uncertainty which some feel at the present time, waiting for that new framework to be introduced. We all know that it could not be introduced overnight, but can't help wishing that it could. I suspect that as implementation proceeds, the strengths of the practitioner based structure will become more apparent. And I am sure that we can rely on practitioners to play their part in making the system work. The UK's positon as a major international centre of finance certainly depends on that.