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B/F a Friday 11/1

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PRIME MINISTER

FINANCIAL SERVICES WHITE PAPER

I have already discussed with you and the Chancellor of the Exchequer our policy towards financial services which I plan to announce to the House as soon as possible, with my target date being 22 January. I have also taken the advice of the Attorney General on aspects of the institutional structure. My proposals have been drawn up in close consultation with the Governor of the Bank of England.

2 In order to promote the competitiveness of our financial services industry and to improve investor protection, my proposals involve a radical reform of the regulation of those in the City and elsewhere who undertake investment business. These proposals are described in the attached draft White Paper (a summary of the major points is also attached). They will be the basis of new legislation to be introduced in the 1985/86 Parliamentary Session. To meet my publication date, I would be glad to know by not later than noon on 15 January whether you and other Cabinet colleagues are content.

Objectives

3 The financial services sector is undergoing revolutionary change. A major impetus was our agreement with The Stock Exchange in 1983 to abolish minimum dealing commissions. Modern technology is also transforming the way in which business is conducted. International competition is increasing. My proposals are intended as an effective response to the challenge presented by the new circumstances.

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When the House debated these issues last July, I stated my preference for regulatory safeguards to be provided through institutions financed and largely administered by the financial services industry itself, within the framework of a clear and simplified investment law. I also set out our objectives - efficiency, competitiveness, investor confidence and vigorous enforcement of the law. These were welcomed by the House and more generally in the City. They form the basis of the White Paper proposals.

### Institutions

4 The institutional arrangements described in the White Paper have been developed from the recommendations of the industry itself. The Governor proposed that regulation of business involved in investments and securities should be entrusted to a new body set up by and composed of practitioners, users of financial services and other lay members; the life assurance and unit trust industries proposed a corresponding body to regulate the marketing of such pre-packaged investments. Alex Fletcher announced our acceptance of the proposed institutional arrangements in a speech made on my behalf on 17 October. The bodies are now being established.

5 Provided that Parliament enacts the legislative proposals to enable me to do so, I shall delegate my regulatory powers to these bodies. The bodies, which may well become a single body if the practitioners conclude this would be more effective, would be subject to statutory safeguards against the abuse of these powers. I will have considerable powers to appoint and dismiss the chairmen and members. Their decisions on authorisations and sanctions will be subject to adjudication by an independent tribunal



which I will appoint. Further safeguards would be provided by my right, on the advice of the Director General of Fair Trading, to revoke or amend rules which have anti-competitive effects. There will be a power to require rule changes to meet our international obligations. The Boards will report to me annually and I will lay their reports before Parliament. In other respects regulatory authority will reside with the bodies subject, of course, to my power to withdraw my delegation of authority in whole or in part if I am not satisfied by their performance.

6 The Attorney General has advised me that, while he does not think that there is any genuine constitutional principle at stake, the rule-making powers could attract Parliamentary criticism and resentment. But I believe that the advantages of placing the main regulatory responsibility on practitioner based bodies are adequately counter-balanced by the safeguarding provisions which I have set out above and that criticism can be effectively refuted.

#### Legal Aspects

7 The new legislation will set out a wide definition of investments in order to deal with the inadequacies of the existing, and out-dated, Prevention of Fraud (Investments) Act 1958. It will also define an investment business - anyone carrying on such a business will have to be authorised to do so. That is the task I propose delegating to the new bodies (or body).

8 A new set of regulatory principles which are intended to govern the conduct of all investment business will be in the legislation and will be the basis of the rules to be applied by the bodies authorising investment businesses. These are \_\_\_\_\_



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derived from our Licensed Dealers (Conduct of Business) Rules 1983, but take account of the need to provide for protection against abuses of conflicts of interest in investment businesses.

9 Better disclosure of relevant information will be required; (eg for share offers, take-overs, life insurance and unit trust brokers' commissions). This will allow investors to make more informed decisions on their own - supplanting the need for much regulatory "nannying". Disclosure of commissions paid to intermediaries by life insurance companies and unit trusts is an approach more consistent with our general philosophy than the statutory control over levels of commissions agreements which some parts of the insurance industry advocate.

10 My proposals do not create new criminal offences, but they significantly re-draw the boundaries of existing offences. Remedies will also be available to investors under civil law. Other matters include:

- (i) proposals to tighten up on advertising calculated to defraud investors;
- (ii) proposals to limit the marketing of life assurance by companies not based in this country or elsewhere in the European Community;
- (iii) amendments to existing insider dealing legislation to make it more effective.

#### Conclusion

11 It is inherent in a practitioner-based system that many

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of the detailed rules remain to be formulated, by bodies which do not yet exist. Subject to these caveats, I want the White Paper to be as firm as possible, setting out our plans rather than being yet a further piece of consultation. That said, I accept that some of my proposals may need to be modified in the light of public and Parliamentary reaction to them, as well as the work of the practitioners. It is on this basis that I commend the White Paper to my colleagues.

12 I am sending copies of this minute and attachments to all members of the Cabinet, to the Chief Whip, to the Paymaster General and to Robert Armstrong.

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8 January 1985

SUMMARY OF WHITE PAPER ON FINANCIAL SERVICES  
(to be included as Chapter 16 of the White Paper)

## 16 SUMMARY

The Main Proposals

- 16.1 The Government propose new legislation on financial services in the United Kingdom. The main elements will be as follows:
- (i) a new regulatory system for investment business - to replace the Prevention of Fraud (Investments) Act 1958 (PF(I) Act);
  - (ii) → deregulation of unit trusts;
  - (iii) new standards for the marketing of "pre-packaged" life assurance and unit trusts and other "pre-packaged" investments;
  - (iv) provisions to regulate businesses involved in the administration of pension schemes;
  - (v) provisions governing the issuing of advertisements and circulars about investments;
  - (vi) provisions to require the issue of a prospectus for all public offers of investments unless specifically excepted;
  - (vii) → provisions to revise and extend the insider dealing provisions of the Companies Act 1980;
  - (viii) provisions to outlaw acts calculated to defraud or deceive investors.

The Regulatory System

16.2 This will have four main elements:

- (i) a definition of "investments", which will include, for example, in addition to securities already covered by the PF(I) Act, financial and commodity futures and options. Life assurance will remain subject to the requirements of the Insurance Companies Act 1982 but marketing of life assurance contracts will be treated as far as possible in a similar way to that of other investments. The definition will exclude property which passes under the direct physical control of the investor if purchased.
- (ii) a definition of "investment business" which will include, for example, investment dealing, management, and marketing. Investment advisers will also be included. Financial journalists,

and those who publish analytical information without making recommendations (eg Extel cards) will not.

- (iii) provisions making it an offence to carry on investment business as defined without authorisation.
- (iv) provisions giving the Secretary of State authority - which he will be empowered to delegate to a regulatory body which appears to him to satisfy criteria laid down by the legislation - to grant, vary, make subject to conditions, suspend or revoke such authorisation and to lay down requirements for the conduct of business by those authorised.

#### Institutional Structure

- 16.3 The legislation will permit the Secretary of State to delegate his powers in whole or in part. The City and the life assurance and unit trust industries have recommended that delegation should be split between two practitioner-based regulatory bodies, which would be created by the industry:
- (i) a 'securities and investments board';
  - (ii) a 'marketing of investments board', covering in particular life assurance and unit trusts.

However, the legislation will in no way prevent delegation to a single practitioner-based regulatory body.

- 16.4 There will be provision for existing self-regulatory organisations such as The Stock Exchange, the National Association of Security Dealers and Investment Managers, the Association of Futures Brokers and Dealers and the Insurance Brokers Registration Council to continue to regulate their members if their rules are acceptable to the regulatory board, or boards.

#### Criteria for Delegation by the Secretary of State

- 16.5 The main criteria for delegation will be:
- (i) that the body's proposed rules are such as to ensure that those authorised by it are and continue to be "fit and proper" to carry on

investment business;

- (ii) that its proposed conduct of business rules afford adequate protection to investors, and are consistent with basic principles set out in the legislation (covering eg conflicts of interest, compensation and protection for clients' funds).
- (iii) that all these rules are no more restrictive of competition than is justified for the protection of investors.

#### Safeguards

- 16.6 The Government propose the following safeguards:
- (i) no board member can be appointed without the Secretary of State's agreement.
  - (ii) Board members will include users as well as practitioners.
  - (iii) the Secretary of State will be entitled to withdraw regulatory authority in whole or in part if he considers that at any time a Board ceases to conform to the criteria set out in the legislation.
  - (iv) a board's rules and practices will be subject to initial and continuing scrutiny for anti-competitive elements; the Secretary of State will have power to revoke or amend rules after obtaining the Director General of Fair Trading's advice.
  - (v) the Secretary of State will retain power to require the revocation or amendment of the rules of the Boards if they are contrary to the United Kingdom's international obligations.
  - (vi) there will be provision for an independent procedure before a new and independent body whose members will be appointed by the Secretary of State for determining disputes on authorisation and the application of sanctions by the Boards.

#### Unit Trusts

- 16.7 The present controls will be changed to allow a greater variety of unit trusts to be made available to the general public and more speculative arrangements to be offered



(and promoted) to authorised businesses, and by them to sufficiently expert investors.

#### Investment Advice and the Marketing of Investments

- 16.8 Investment advisers including those who advise on life assurance or units in unit trusts will be subject to the same basic conduct of business principles as other investment businesses. They will be under a duty to disclose "relevant information" including any material interest they have in a recommendation - for example commissions defined as any financial or other reward received from other parties. This will enable investors to make more informed decisions.
- 16.9 Under the PF(I) Act it is already a criminal offence to make misleading, false, deceptive or reckless statements or forecasts about investments. The new legislation will extend this provision to cover acts or courses of conduct calculated to defraud or deceive investors or potential investors.

#### Pension Schemes

- 16.10 Any investment manager or adviser involved in the administration of pension schemes as a business (ie other than simply as an employee) will require authorisation. No decisions have yet been taken on the regulation of personal pensions but the intention is that these should be subject at least to the same safeguards as other forms of investment.

#### Advertisements and Circulars

- 16.11 Only authorised investment businesses will have a statutory right to issue advertisements or circulars likely to lead to the sale or purchase of investments. 'Advertisements and circulars' will be defined to include all forms of media. "Cold-calling" will not be banned for the sale of investment products for which a cooling off period can be provided.

#### Public Offers and Take-overs

- 16.12 The legislation will provide that all public offers of securities, primary or secondary, and including offers made on take-over bids, will be subject to the same statutory regime. All

offers to the public will require a full prospectus, unless specifically excepted (eg Eurobond offers). The minimum contents of prospectuses will be set out in regulations made by the Secretary of State.

- 16.13 The Government is willing to provide statutory backing for a city code on take-overs and mergers if persuaded that this is necessary.

Insider Dealing

- 16.14 The legislation will extend the insider dealing provisions of the Companies Act 1980 to cover all securities, including options and futures contracts based on them, and also to make enforcement more effective.

Enforcement

- 16.15 The regulatory board (or boards) and its recognised self-regulatory organisations will be responsible for enforcing their respective rules. The Department of Trade and Industry and the prosecution authorities will be responsible for enforcing the criminal law. There will be provision for civil law remedies for loss due to breach of the criminal law or of the board's rules. Finally, to facilitate the enforcement of these civil law rights, the Government propose powers for the Secretary of State to seek injunctions and 'disgorgement orders' against businesses in breach of the criminal law or of rules of business conduct.