
Editorial

Regulation of the Securities Industry

"Self-regulation has the advantages of flexibility, ability to deal with the spirit as well as the letter, personal expertise, ability to act speedily, and lesser demands on the public purse. Its disadvantages are the risk of vague rules, difficulties of effective enforcement over non-members, possible insulation from public opinion, and, in particular, the danger that self-interest will outweigh public interest or appear to." So writes Professor Gower in his seminal discussion paper "Review of Investor Protection" (HMSO £6.60). He goes on to state that governmental regulation and self-regulation "would work best if both operated within a statutory framework with the day-to-day regulation (which Government does badly) undertaken by self regulatory agencies and the Government exercising a residual and supervisory rule."

The review was prompted by recent collapses of investment advisers such as Norton Warburg. The Paper expresses concern at the present piecemeal arrangements for regulation of the securities industry under which a number of bodies with varying standards regulate different parts of the industry. Some parts, such as commodity brokers, are presently subject to no such regulation — financial and commodity futures are now considered to fall within the scope of the review.

The Paper suggests the closure of an existing loophole in the Prevention of Fraud (Investments) Act 1958 under which life assurance policies are not covered by the Act's rules against "securities hawking". This seems a sensible move as investment vehicles are frequently dressed up as insurance arrangements and there seems no reason to maintain this artificial distinction (provided that suitable exemptions are retained to cover the kinds of traditional policies which are entered into mainly for the life cover element). There are already signs that some companies are using this loophole to make preliminary introductions to "prospects"

through the life assurance route, the opportunity being taken at a subsequent meeting to market unit trusts.

Professor Gower does not favour the establishment of an "SEC" though he supports an umbrella role for the Council for the Securities Industry under an overall Securities Act. He favours the establishment of self-regulatory bodies for the sectors of the market not covered by such bodies, such as the insurance companies — and suggests that some of the Department of Trade's present regulatory powers should be delegated to such a body. A similar body is also suggested to cover the merchant banks, issuing houses and licensed dealers — the more upmarket merchant banks are, surprisingly, not concerned at such a possibility, not least because they would be required to contribute a large part of the resources of a contingency fund against the failure of any of the members of the body.

This thoughtful study merits serious consideration (further details at p 77, post) and comments are sought by May 31.

More imminently, the Government is shortly to amend the Licensed Dealers Rules to increase investor protection. Dealers will be required to maintain separate client accounts and to carry suitable fidelity insurance cover. The manner in which the dealers conduct clients' business will be more closely regulated and discretionary management arrangements would have to be set out clearly in a written agreement. The Department of Trade would also assume prudential regulation of the dealers by requiring regular returns to be submitted and applicants for licences under the 1958 Act will in future be more closely vetted.

The takeover provisions of the rules are likely to be revoked, the matter to be regulated solely by the Takeover Code, though this will need to be extended to cover takeovers of private companies.

The proposed amendments will ease current problems. But sight should not, however, be lost of the urgency of the wider-ranging reforms advocated by Professor Gower.