

Financial Services

Developments in regulation

by Andrew Haynes



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'Of the vainglorious Don Quixote's success in the dreadful and never before imagined Adventure of the Windmills, with other events worthy of happy record.'

The Chancellor's sudden announcement last year that a major restructuring is to take place in the regulatory structure for banking and financial services, raises an inevitable question – is the right target being attacked? What is on offer is that a super Securities and Investments Board (SIB) – the Financial Services Authority – is to take over the regulatory responsibilities of the Bank of England, the self-regulating organisations, the recognised professional bodies and certain other issues such as ministerial responsibility for insurance. It will also take over responsibility for regulating Lloyd's of London.

The cause of this is the understandable belief that some of the regulatory bodies have failed to reach the standard that might be hoped for. The Bank of England failed to some extent over Barings and spectacularly over BCCI. IMRO were lucky to survive as a regulator at all after the Maxwell saga. FIMBRA and LAUTRO did not survive as such in any event. The real issue for the average investor though is; what are the real causes of losing money? Without in any way minimising the sufferings of Maxwell pensioners, or those who had deposits with BCCI, far greater numbers are suffering financial loss on a daily basis because the regulations permit it.

MORTGAGES

The largest financial commitment the average person in this country makes is their mortgage. Despite this, there remains an absence of legislation protecting consumers taking out such loans. Mortgages are not a category of 'investment' as defined by the *Financial Services Act 1986*. Nor is it within the definition of 'consumer credit' within the Act of that name of 1974. Thus, on arrival at the bank or building society which offers the loan, the consumer is provided with no legal protection stopping the lender from recommending the mortgage which provides the lender with the greatest profit, rather than that which is most appropriate for their customer.

Many borrowers take out endowment mortgages. The term life policy element of these are covered by the financial services regime – because term life assurance of ten years or over is categorised as an 'investment' by sch. 1 to the *Financial Services Act*. Likewise, the less common PEPS mortgages and pension mortgages will also have the investment element regulated, as both PEPS and most pensions are caught by the definition of 'collective investment schemes', within sch. 1 and s. 75. This raises the illusion that the financial services regime provides a real degree of protection. For some it will. One bank and a few building societies operate as independent financial advisers and are thus required to offer the best advice (or 'standards of advice' to use the less illuminating current terminology) in relation to the investment element. However, only a small minority of investors will find themselves with this protection. The other banks and building societies are all tied to investment product providers which they either own or with whom they have contractual agreements. Their legal obligation does not involve choosing between different products – merely in selling what they have.

There is another element – the requirement of 'suitability'. This requires all investment product advisers to advise

in favour of, or sell, only those investments that are suited to their customers' needs. This entails filling in a questionnaire about the customer's circumstances and then making sure that an appropriate category of investment is offered. One could imagine steps being taken by a regulator if a product provider were habitually selling pension mortgages to those who would be better suited to endowment mortgages. But are there any steps being taken by regulators to try and control the extent to which investment related mortgages are sold to those who, in many cases, would be better advised to take out a repayment mortgage and invest any surplus income in a way that better suits their needs?

FEES v COMMISSION

Another common problem is that when faced with independent financial advisers, customers are often offered a choice between paying a fee or allowing the adviser to keep the commission. Faced with a choice between writing out a cheque and having the fee taken care of by what will seem to many to be 'funny money', it is not surprising that the majority opt for the latter, even when the commission is significantly higher than the fee would be. In all fairness to the advisers who are paid in this way, they will often provide ongoing advisory services free of charge because of the greater profit on the original deal. Nonetheless, the commission on a term life policy will amount to a significant part of the first year's payments. On a lump sum pension they can be even higher. Best advice ought to entail advising the client to request the adviser to re-invest the commission on the client's behalf. Failure to do this means that by the maturity of their investment the client could have lost a significant amount of money i.e., the commission and the investment proceeds, which would have been accrued to it during the time concerned.

NO FUNDAMENTAL FLAW

There are other examples that could be cited, but the core issue remains the same. The regulatory structure

established pursuant to the *Financial Services Act 1986* and the *Banking Act 1987* is not fundamentally flawed. Most problems flow from the regulations and the interpretations put on them. If the Chancellor wishes to make financial regulation work it would be better advised to focus on this, and tinker as necessary with the regulatory structure. Instead they are committed to a vainglorious restructuring of the regulatory bodies,

which at best risks matters getting worse before any improvement takes place due to near inevitable teething problems. This is not a message to which the Chancellor seems receptive.

'Take care, your worship,' said Sancho; 'those things...are not giants but windmills, and what seem to be their arms are the sails, which are whirled round in the wind and make the millstones turn.'

'It is quite clear,' replied Don Quixote, 'that you are not experienced in this matter of adventures. They are giants, and if you are afraid, go away and say your prayers, whilst I advance and engage them in fierce and unequal battle.' 

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Legal Education & Practice

Assessing the strengths and weakness of a Judicial Appointments Commission

by Dr Kate Malleson



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The role of the judiciary in public life has expanded significantly in recent years. This change has come about partly as a result of the growth in size of the judicial system and partly because of the increased activism of the judiciary through the development of judicial

review. One consequence of this development has been to raise the level of interest in the judicial appointment process. As the size and political influence of the judiciary has increased, so have the demands for changes in the way judges are appointed. This link between the expansion of the judicial role and moves to reform the appointment process is not unique to England; it has also arisen in Canada, Australia, New Zealand and South Africa.

The Human Rights Bill incorporating the European Convention on Human Rights into English law, which is currently going through Parliament, will take this process one stage further and, as Lord Irvine has acknowledged, will significantly increase the power of the judges (interviewed in *New Statesman*, 6 December 1996). The pressure for reform is therefore very likely to grow after incorporation.

Before reviewing the possible effects which changes to the appointment process might have on the judiciary, it is worth examining more carefully the nature of the present system and the concerns which it has generated, in order to assess exactly what any reforms are intended to achieve. There are two aspects to the criticisms of the present system:

- the procedural failings of the system in terms of accountability, judicial independence and openness; and
- its failings in terms of the type of judge appointed.

THE APPOINTMENTS PROCESS

The Lord Chief Justice, Lord Bingham, argued in 1996 that the key to a successful appointment process lies in:

'... an assumption shared by appointer, appointee and the public at large that those appointed should be capable of discharging their judicial duties, so far as humanly possible, with impartiality.' (*Judicial Independence*, speech to the Judicial Studies Board, 5 November 1996, p. 5)

According to Lord Bingham, the principle of impartiality, though not synonymous with independence, is its 'close blood tie' and therefore lies at the heart of a good appointment process. Thus judicial independence and, crucially, public and judicial confidence in its existence, is a central concern. The principle of judicial independence demands that judges should be free from outside interference in their decision-making, in particular, from those in government. To avoid this danger it is often said that the judges should not owe their office to the executive. On the face of it, therefore, the current arrangements whereby the Lord Chancellor and, in the case of the senior judges, the Prime Minister, have control of the appointment process, risks contravening the principle of judicial independence.

The Home Affairs Select Committee which reviewed the appointment process in 1996 considered this problem in some detail. The concern of those witnesses heard by the Committee, who criticised

REFORMS ELSEWHERE

In Canada and South Africa significant changes in appointments processes have been introduced in recent years (see M Fitz-James, 'Free expression and the Judges', *New Law Journal*, 30 April 1993 and S Kentridge, 'Parliamentary Supremacy and the Judiciary under a Bill of Rights: Some Lessons from the Commonwealth' *Public Law*, Spring 1997).

In New Zealand and Australia the systems remain largely unchanged but there have been growing calls for structural reforms. See the speech of the New Zealand Attorney General, P East, to the New Zealand Bar Association, March 1995, p. 2.