

# SUPERVISION OF THE LIFE AND PERSONAL PENSIONS SECTOR

## The Labour Party's Approach

*By Alistair Darling, M.P.*

This year sees the 10th anniversary of the Financial Services Act, the single piece of legislation which regulates the financial services industry.

The financial services industry is of immense importance to the future of this country, both as a major employer and wealth creator. It provides options to people to help them save and invest for their future, at a time when the need for saving has never been greater, not only for the individual but because saving makes funds available for investment. Encouraging investment, particularly long-term investment, is essential if we are to achieve sustainable economic growth. The promotion of saving and investment will therefore form a major part of a Labour Government's economic strategy.

This country, in common with other Western economies, faces formidable problems in providing a standard of living which will come near meeting the rightful expectations of the nation. Increasingly, people will want to make provision for themselves over and above that which they can reasonably expect from the State.

However, before people can be encouraged to save and invest, two pre-conditions must exist:

*Firstly, Government must maintain economic stability and avoid inflationary pressures which impact hardest on business and people on low incomes. A commitment therefore to low inflation coupled with sustainable long-term growth is an essential prerequisite to encouraging people to save.*

*The second condition is that the public must have absolute confidence that the financial services industry, into whose hands they place their savings funds, is properly supervised and regulated.*

It is not a question of more regulation: rather we need to concentrate on fewer rules,

but rules that actually work. The present system is cumbersome, irrational and expensive. Compliance costs, for instance, represent an increasing burden on the industry. (When a company finds that its compliance department is growing faster than its marketing department, something is very wrong!)

Over the past two or three years, public perception of and confidence in the quality of supervision and regulation of the financial services sector has taken a severe knock. Perception is very important. Whether it be Barings or pension transfers, public confidence in the regulatory system is not high and must be restored. If it is not, the industry will suffer as people become reluctant to save, and investment slows down. Perception matters because perception can become the reality.

Reform, therefore, is essential. But so too is the need to reassess the nature of regulation itself. Good regulatory sense should be the same as good business sense. The two should go together and should be compatible. The industry should regard the regulatory system as a professional protection, in the same way as a doctor regards his or her medical registration as something to be prized and valued; it protects the doctor and it gives the patient confidence.

There is no more appropriate time for reform than in this, the 10th anniversary of the Act. Indeed, there is a growing consensus not only that reform is necessary, but as to the direction that reform might take. So, what should we do ?

Firstly, we should forget about self-regulation. Self-regulation is a fiction. The present system is rooted in statute. We know that the SIB is guided by the Treasury and the SRO's have to do precisely what the SIB tells them. But the concept of "self-regulation" suggests that the trade interests might prevail. That perception, which is highly damaging, needs to be laid to rest once and for all. The public needs to know at the end of the day that the regulator is acting in their (the public) interest. In any event, members of SRO's might have greater influence if the fiction of self-regulation were abandoned once and for all. (Members, of course, have no choice in this matter; if they don't join their SRO they can't work).

The second step would be to simplify the present structure.

A Labour government will make the SIB directly responsible for the regulation of the industry, broadly covered by the 1986 Act. It would have two separate operating divisions, to recognise the difference between what is required at the wholesale end of the market where institutions deal with one another, and the retail end, where we are dealing with relations between the institution and the saver, the man or woman in the street.

It is vital that the SIB should continue to have significant practitioner input which we in the Labour Party believe is of the utmost importance. If the system is to work and enjoy the confidence of both public and industry alike, a proper blend of public and industry interest is absolutely essential.

A Labour Government would have no intention of importing other countries' solutions to the problem; we don't want a new bureaucracy. We want to build on what we have and, in particular, to build on the good work that has been done by the existing SROs. Wholesale disruption would be expensive and, we believe, would further undermine confidence. That is yet another reason for ensuring that, as far as is possible, we take people with us in reforming the present system.

Before turning to the nature of regulation, let us look at the question of prudential supervision.

The financial services industry is going through a dramatic period of change. Banks and building societies are merging, insurance companies are becoming banks and the clear distinction between institutions is fast disappearing. Many questions arise on how best to supervise the industry. Should the Bank of England, the Building Societies, the DTI and others all be involved in prudential supervision? And in the aftermath of the Barings' collapse, ought the Bank of England's supervisory duties be separate from its monetary duties, so that it can fully focus on supervisory problems? Questions arise as to how the Bank of England, which has responsibility for supervising the banking system, should work with the Securities and Futures Authority which has specific responsibility so far as securities are concerned. The arguments are finely balanced.

As with reform elsewhere, it is important to build on what we have and not to embark on change for change's sake. And, above all, it is essential to remember that the quality of supervision or regulation depends, at the end of the day, on the quality of the people it employs. Putting a different brass plate on a different door is not the answer. It is the quality of personnel at the front line which makes the difference between a good and bad system.

But let us now return to the nature of regulation, particularly at the retail end of the market. The present system is highly unsatisfactory. The provision of good advice is essential and the objective of the regulatory system must be to ensure that people can make a proper and informed choice.

We should aim, so far as is possible, to put buyer and seller on an equal footing. The buyer needs to have as much information as is necessary to make an informed choice and to choose between products and providers.

A long-term professional ethos is an essential pre-requisite to the dissemination of good advice. We don't believe that good advice can ever be obtained by box ticking and that approach to compliance must end.

The present system is also distorting the market. People should have the right to buy on an execution-only basis, should they so choose. But it would be quite wrong for the regulatory system to force providers to sell on an execution-only basis in order to avoid the burden of compliance. That can't be in the public interest. If it takes six hours to sell a pension, one has to ask whether the buyer is any the wiser at the end of the process - and the cost of selling by this method are bound to act as a disincentive. It cannot be in the public interest if the cost of the regulatory system drives people out of business.

The regulatory system cannot and should not seek to substitute its commercial judgment for that of individuals. The doctrine of caveat emptor will still apply, and so it should, but the system must create the sort of environment where the public can confidently deal with the industry. The provision of fewer rules, but rules which actually work, would be a very good start.

To change the culture of regulation needs a structural change; there is a consensus that change is necessary. It should be possible to reform the present system in such a way that it will command the confidence of both the public and the industry. Only a Government can give a lead and promote informed discussion to provide solutions.

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This article summarises his address to BILA in December 1995.*