Public and Private Regulation of Financial Services.

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Abstract

This thesis explores the changing nature of policy making in Britain. It considers the example of a self regulatory regime (under the Financial Services Act 1986), in order to draw conclusion about compenetration of the public and private spheres. Legitimacy is its main focus. It draws conclusions about legitimacy of this particular system, from the viewpoint of industry practitioners and the more general public interest. The empirical work focused upon one group of industry practitioners, and via a postal questionnaire discovered their views about how the regulatory system actually operated. This work, therefore, adds to the literature on the internal legitimacy of self regulatory systems. Furthermore, it looks beyond this internal aspect. By using public law literature it contributes to the debate around how constitutional and administrative law should respond to the growth of various regulatory systems. It argues that self regulation provides a potential for increased legitimacy in policy making but that this self regulatory regime failed to realise that potential. It argues that only a full acceptance of the benefits of self regulation will solve the potential legitimacy deficit that public/private compenetration can cause.

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Abbreviations

DTI	Department of Trade and Industry
FIMBRA	Financial Intermediaries, Managers and Brokers Regulatory Association
FSA	Financial Services Act 1986
IBRC	Insurance Brokers Registration Council
ICS	Investors Compensation Scheme
IFA	Independent Financial Adviser
IMRO	Investment Managers Regulatory Organisation
LAUTRO	Life Association and Unit Trust Regulatory Organisation
NASDIM	National Association of Securities Dealers and Investment Managers
OFT	Office of Fair Trading
PIA	Personal Investment Authority
RCH	Recognised Clearing House
RIE	Recognised Investment Exchange
RPB	Recognised Professional Body
SFA	Securities and Futures Authority
SIB	Securities and Investments Board
SRO	Self Regulatory Organisation
TCSC	Treasury and Civil Service Select Committee

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Chapter One: Introduction

This thesis is about changes in the modern state. It uses the example of regulation of the financial services industry, under the Financial Services Act 1986 (the FSA) to explore and consider the way in which private bodies are exercising public powers. This is an important area for study because these private bodies are removed from the traditional accountability mechanisms which operate in the British state. From the public law perspective it is therefore important to consider how policy is made by these private bodies to ensure that standards of accountability and openness are maintained. A failure to adhere to these basic principles will undermine the legitimacy of these decision makers.

One of the major difficulties facing all those involved the financial services industry has been the fact that regulation in this area has been in a state of almost constant change. As this thesis shows the FSA regulatory regime has been transformed from its inception in 1986. But now the whole regime is being replaced by what claims to be an entirely new regulatory system. The new Labour Government announced in May 1997 that is would replace the various regulatory bodies, which have been the focus of this empirical study, with a new single regulatory body. This process has already begun, and is due to be completed in 1999 (Financial Times 29 Oct. 1997).

This move has inevitably turned this study into a more historical piece than was originally intended, but it has given the focus on this work increased relevance and importance[1]. I will argue that major change is once again being embarked upon without a full and clear understanding of the problems and advantages of the system being replaced. Before embarking on a major change it is obviously desirable to consider the working of the system which will be replaced, in order to improve upon it. This thesis provides such an analysis of exactly how the FSA regime operated. However, I shall argue that there has been a lack of such consideration, in the proposals for change. A failure to consider the problems of the FSA regime means that they are likely to be repeated in the new system. This likelihood is increased by the fact that the new regime, whilst novel in many respects, is attempting to use many of the same methods to achieve the same objectives of the FSA system it will replace. For example whilst practitioner input is to be reduced it is not to be excluded totally, and both systems also share a commitment to investor protection as their main objective. It is likely that unless lessons are learnt from the existing system, similar mistakes will be made in the new one.

This thesis therefore provides an analysis of how the FSA system operated over its ten year history. In particular it considers how, and why, change was undertaken in this system. This focus will inform the critique of the new proposals for change by highlighting the problems that have persistently occurred in this area of regulation. It shows how controversial regulation has been, in both theory and practice, not only in the

[1] It has also created some practical problems. For example the Securities and Investment Board (the SIB) changed its name to the Financial Services Authority in August 1997, the possibility of confusion with the Financial Services Act 1986 (FSA) is clear. However, as the new system is not yet in place, it seems premature to use any (as yet speculative) terminology. Thus, in this thesis the abbreviation FSA refers to the Act, and the terminology of that system (such as SIB and SRO etc.) will be used throughout, as it is still the current legal basis for regulation.

financial services industry but generally. In particular the growth of self regulation, in its many forms, creates problem of legitimacy and effectiveness which must be addressed in the design of any new system. This exploration of how one particular system worked therefore can be used to illuminate the path for future change.

In order to undertake this analysis both the internal workings of a particular Self Regulatory Organisation (SRO), which authorises and regulates firms under the Act, and the workings of the financial services regulatory system as a whole, will be considered. A central concern throughout this thesis will be the input that various actors, particularly from inside the industry, have had on policy formation. The meso and macro level analysis involves a consideration of the input into the regulatory system of the various (and varying) firms in the industry, as well as the relationship between these firms, their regulators, and the Government. Conclusions will then be drawn as to whether the regulatory system of this important industry is operating as public law principles dictate that it should i.e. in the public interest, and in an open and accountable way.

Regulation And Public Law

The Conservative Governments between 1979 and 1997, attempted to alter the fabric of the British state, and this has been no more clearly emphasised than in the changes in the way many important sectors of society are regulated. It is important to emphasise that the question of regulation is a central concern to public law. Until the election of the Labour Government in 1997, governments since the 1970s had not responded favourably to the call for formal constitutional change in areas such as reform of the House of Lords or the electoral system. However there were important constitutional changes under the Thatcher and Major administrations although for the most part they were not seen to be within traditional, relatively narrow focus, of constitutional law (see Graham and Prosser 1988).

One of the roles of public lawyers is to analyse where public power is being exercised in society and to try and ensure that those wielding that power are accountable and not acting in an arbitrary way (Harden and Lewis 1987, Lewis 1996). Major changes have occurred in the UK, in the last fifteen years, which need serious consideration. It is necessary to expand the traditional focus of public law, with its emphasis on Parliament, government and the courts to look at the burgeoning number of quasi-public bodies that are exercising policy making and regulatory powers over a large proportion of business and personal activity in the UK . While Conservative Party rhetoric whilst in office was that of reducing the state in order to allow more personal and market freedom, I shall argue that state intervention simply altered form rather than being reduced in the eighteen years of Conservative rule. New quasi public bodies grew in importance during these years, and, as the new Financial Services Authority shows this seems to be a trend which will continue under the Blair administration. These bodies are one step removed from government, yet government still exercises considerable power over how they operate. This power is simply wielded in a more indirect, and less accessible way. A lack of transparency means that the issue of the accountability and openness of those wielding power becomes an important issue to consider.

The successful 1979 Conservative election campaign was based upon the need to break with the post war consensus of how Britain should be governed (Gamble 1988). Corporatism, it was claimed, was undermining government action and the nation's economic success. Private bodies (in particular the Trade Unions) were seen to have too much power and influence over government action, as the then Labour government sought to gain a consensus and respond to the claims of various interest groups (see Gamble 1988). The incoming Conservative government promised an end to this corporatist approach, with government alone exercising power, rather than operating with a corporatist network of relationships (Lewis and Wiles 1984). But contrary to expectations there has been a growth in the publicly recognised power of certain private groups, although this has taken place without any serious consideration of its constitutional implications. I shall argue that the UK has witnessed a continuation, indeed perhaps acceleration, of this trend. This can be called public/private compenetration, as there is a blurring of the two concepts with private actors taking on public roles. These then become hybrid actors, as they are both public and private.

It should however be made clear at the outset that whilst these hybrid (i.e. public and private) bodies are largely outside traditional constitutional law study, they are not necessarily illegitimate in terms of accountability and participation. Indeed they provide an opportunity to revitalise the democratic system by encouraging more and greater participation. The question is not: should these hybrid bodies exist? They do and it seems difficult to imagine effective government without them. Rather, it is, how do they operate?

When considering the areas that are the traditional focus for public law it is possible to ascertain a certain standard of openness and accountability which is expected of these hybrid bodies. It is this openness and accountability which legitimises public action, with its claims to be acting on behalf of all citizens. As Harden and Lewis (1987) have shown, these standards do not always exist in practice, but this does not undermine the power of a critique which argues that public bodies should operate in an accountable and legitimate way. Once it is accepted that regulation of an industry, with it basis in statute and claims to be operating in the public interest, is a public task (whoever actually implements the regulations) then it becomes important to consider the regulators and their operations in detail.

The danger with hybrid bodies is that they may not be subject to the same standards as public bodies. And because they combine public and private elements there is a danger that the private will dominate at the expense of the public. Without the close scrutiny of public accountability mechanisms it is likely that decisions will be made secret, with little or no scope for the decision makers to be called to account, either by those being regulated or by public bodies such as Parliament. This research has been designed to consider how policy is being made in one particular area of regulation. The empirical work has focused on the question of which actors have been successful in influencing their own, and the general, regulatory environment. Such work allows the policy making process to be conceptualised in terms of ideal types identified from the literature. As the financial services system is once again undergoing radical regulatory change, such an analysis of the out going system is vital if a proper evaluation of the proposed alternative is to be undertaken. This thesis provides a way of judging the proposed benefits of the new system, and the chances of them being realised. This is particularly the case because regulation cannot only be judged in terms of its effectiveness for that particular sector of society.

As a public lawyer, my concern is not only to discover how policy is being made and whether it is leading to benefits for one particular group. Public law goes beyond this descriptive and functional approach in order to evaluate the policy making that process itself. This thesis will consider the acceptability of this particular policy making process in terms of public law ideals (for example, openness) and the general public interest. It will go beyond the purely descriptive to consider the legitimacy of the current arrangements and to consider how the law can be used to encourage greater participation and accountability in decision making.

Self regulation is claimed (see chapter two) to be more effective because those actually regulating are more responsive to their regulatees than would be a government bureaucracy. In the financial services industry this means that industry practitioners should have a close relationship with the regulators. The quality of practitioner input is therefore important. The retail financial services industry, the object of study in this thesis, is very diverse. Therefore it is important to ask which industry actors have input into the regulatory system, and to consider if some groups are more effective than others at influencing their regulatory environment. For example, it seems likely that the size of a firm, or the way firms are organised into trade associations will affect input, and there is a danger that some type of firms will be excluded altogether. This question is central to the accountability of the whole system. The law should ensure that all affected parties are able to call to account those that wield power over them.

Furthermore, whilst the system is supposed to be one of self regulation this thesis will demonstrate that the government has not simply retired from the scene. In this particular area government ministers still have many powers under the relevant legislation. In addition, it will be important to discuss and analyse the informal way in which governments are able to exert influence on private bodies. The lack of openness and accountability, when government uses informal methods, needs to be considered alongside the lack of accountability of the private regulatory bodies concerned.

The Industry and Its Regulation.

The area of focus chosen to develop these ideas of compenetration and public law is regulation under the Financial Services Act 1986 (FSA or the Act from now on). This legislation established a comprehensive regulatory system for much of the financial services industry. It is a complicated piece of legislation (see Rider et al 1997), but the basic concept was to be that all those giving advice on investment (as defined by the Act) would forthwith have to be authorised. However, authorisation could come from a variety of sources, with an array of organisation involved. The FSA gave these powers to the relevant government minister (since 1992 the Chancellor of the Exchequer), however, section 114 allowed for many of these powers to be delegated to a 'designated agency', identified in the Act (s114(2)) as the Securities and Investment Board (the SIB). But the SIB was also allowed to delegate its powers, most importantly to Self Regulatory Organisations (SROs), under s7. This, combined with bodies which have exemptions and detailed legislative requirements, makes the system somewhat complicated.

The new system under the Financial Services Authority is designed to simplify regulation in this area. The new Authority will be directly responsible regulating firms, and will cover a considerably wider area of financial services than under the FSA. However, one of the reasons the FSA was such a complex and controversial piece of legislation was that it introduced a regulatory system for the whole of the financial services industry, something which had not existed previously (Black 1997). The increased scope of the new proposals means that they too represent a radical restructuring of regulation. It is therefore, important to consider the debate prior to and following the inception of the FSA regime, in order to gain an insight into the dynamics of regulatory policy making in this area. These dynamics will undoubtedly effect the operation of the new regime.

For example, the scope of the FSA system was a source of much opposition from the industry (Rider et al 1997:1-23; Gower 1988). Gower (1988) says that whilst there was acceptance that some rogue advisers existed, much of the industry was opposed to a general requirement of authorisation. They considered it only necessary to regulate 'fringe operators'. Moreover, even when it became widely accepted that regulation of some kind was inevitable there remained a feeling that government regulation was not the way for the system to operate (Rider 1997:18-19). The industry feared that direct regulation by a government department would be bureaucratic and unresponsive to their needs. The Conservative government of the time was also hostile to direct government regulation. For a combination of ideological and cost reasons the government wanted to see the industry take on its own regulatory burden.

Thus there was much emphasis placed upon the new system being a voluntary 'self regulatory' one, rather than a governmental bureaucratic one. This was reflected in the structures that emerged to implement the FSA. The SIB was a private company, funded by the industry (s112, s115 of the FSA), and was specifically formed to take on the role delegated to it under s114. Whilst this successfully "off loaded" the cost of regulation from the public purse, government involvement was still strong. For example the Chairman and Board of Directors of the SIB were appointed, and could be removed, by the mutual consent of the Chancellor of the Exchequer and the Governor of the Bank of England (see Sch. 7 para 1 (2) of the Act). The power of appointment gave the Government considerable influence as to the overall approach taken to regulation. This influence can be seen with the replacement of Sir Kenneth Berrill, by Sir David Walker, as chairman of the SIB which resulted in a change of regulatory policy (Rider 1997:31, Black 1997:93). It is clear therefore that the SIB was a hybrid body. It was privately financed, but had a public element controlling its leadership and therefore its approach to its task.

Nevertheless, even this situation of regulation by a body one step removed from the government did not placate demands that the system should be voluntary. Many in the industry did not feel that they should be forced to join any regulatory body. The Self Regulatory Organisations (SROs) were intended to overcome this opposition by being 'front line' regulators. These SROs were initially based upon existing trade associations in the various areas of the financial services industry and whilst the SIB maintained the ability to authorise firms directly (under s25), the vast majority gained authorisation from membership of an SRO (see Figure three: page 125 below). Thus the FSA regulatory system involved delegation of power from the Minister to the SIB and then on again to the various SROs. However, the SIB maintained the ability to set standards and impose criteria for regulation on the subordinate SROs because the SIB had to recognise the SROs (s9) and this would only be done if the SRO met certain criteria, most importantly that it had adequate rules to protect investors (Sch. 2). As I shall discuss, these powers gave the SIB considerable power to control SRO operations.

There was constant tension and change in this three tier system. The SIB was criticised both for being over prescriptive in the standards it requires from the SROs (Veljanovski 1988) and for failing to ensure that they set and maintain high enough standards (Black 1997:84). There was criticism of the need for two layers of self regulation (i.e. both the SIB and the SRO) and much discussion as to whether a government body should take responsibility for regulation altogether (see the PIA debate in chapter five). Due to all these pressures the system has been in almost constant change, and is once again in flux given the announcement of a new Financial Services Authority which is currently taking regulatory power from the former SIB and other bodies. The changes that have occurred, and the pressure for further change which has not been successful, form the basis of much of this thesis, and this will emphasise both the hybrid nature of the whole system and the power (or lack of power) of the various actors in this area.

Before highlighting the area of the industry that will be my particular focus, some further preliminary points concerning the FSA need to be made. In addition to establishing the requirement of authorisation for those giving investment advice (s3) the FSA led to further changes in the financial services industry. The SIB drew up rules (under s114 which delegated power to it). These covered a variety of areas (see Rider 1997:196-7). One particular area of interest is the power under section 48, which empowers the SIB to issue conduct of business rules. Whilst these only apply to persons directly authorised by the SIB , they have in practice been incorporated into SRO rule books in order to meet the schedule 2 criteria. The SIB has laid down that a person giving investment advice either has to be tied (that is linked) to one investment company or be able to give advice on all the suitable products on the market. This concept, known as polarisation, is important because it marks the difference between the various financial intermediaries that operate to advise the public. Independent Financial Advisers (IFAs) are able to give advice on any product available from any product provider in the market. In contrast, other firms and salespeople can only advise on one company's products, that is the one to which they are tied. This latter group consist of both sales forces employed directly by a product provider and firms that have chosen to become tied, whilst maintaining their separate identity. If firms become tied in this way they do not (by virtue of s44) need to join an SRO themselves. They are agents of the product provider and do not need separate authorisation.

The difference in outlook of these two groups, tied firms and IFAs, is considerable, with IFAs considering the whole market, and tied firms only considering the one product provider. Firms also vary greatly in size and circumstances. IFAs tend to be small firms, often sole traders, who operate with relatively small budgets. Tied and direct sales firms, in comparison, are often part of a very large company. Insurance companies often have substantial numbers of direct salespeople working on their behalf. While some tied firms are small businesses, others are the sales advisers of very large financial institutions such as banks and building societies. This highlights another difference with IFAs. These differences will be discussed in more detail later in this thesis, in particular when consideration is given to the formation of the Personal Investment Authority (PIA) as the regulator of both tied and independent advisers. But it is clear that there are divisions within the industry and this leads to different viewpoints as to how regulatory policy should develop.

Another area of controversy in the FSA regulatory system was the compensation scheme. The SIB established, under section 54, the Investors Compensation Scheme (ICS) in order to compensate, up to a certain limit, investors when a firm is unable or likely to be unable, to satisfy a civil liability made against it in respect of their investment business. The scheme is run by the Investors Compensation Scheme Company which has further defined when a firm will be 'in default' and therefore compensation due to its investors (Rider 1997:213). The almost inevitable problem with the ICS has been over its funding. It was designed as a scheme to be funded by the industry itself, but although it was an industry wide scheme, the funding mechanism recognised that different sectors would cause varying demands on its funds. A system was devised whereby members of each SRO would pay for the compensation arising from the act of (former) members of that SRO up to a certain limit. Beyond this all regulated firms would contribute, with the scheme also having an annual absolute limit for all claims.

While this means that the different risks and trading activities of each sector of the industry are recognised, it did lead to a financial crisis in one particular sector. Those firms, mainly small IFAs, regulated by one SRO, the Financial Intermediaries Managers and Brokers Regulatory Association (FIMBRA),caused by far the greatest burden on the ICS funds (see figure two, page 123). This meant an ever higher compensation bill for FIMBRA members which eventually undermined the long term viability of FIMBRA. As I shall discuss, FIMBRA's financial crisis was one of the most important factors leading to the establishment of the PIA, and much of this was due to the way the compensation scheme is financed.

The problems FIMBRA encountered, and the role played by its members is the focus for this thesis. The financial services industry is so large, and the way it is regulated so diverse, that a narrowing of focus was needed to make this research project into a manageable size. The particular focus was chosen for several reasons. While the FSA covers all those giving investment advice it is possible to draw a distinction between the retail and professional sectors of the financial services industry. The retail sector refers to those products aimed at, and firms that advise, the general public. This can be contrasted with the professional sector which involves deals between fellow market professionals. The retail sector has been chosen as the main focus of this thesis because it is in this area that effective external regulation seems most necessary. The investing public will inevitably have less information and understanding than market professionals about financial products and markets. They also have proportionally more to lose if investment advice is unsuitable. Few people have two sets of life savings to invest. Therefore, it seems reasonable to conclude that those advising them should be subject to closer regulatory supervision. The public interest argument for regulation is stronger here than in the professional markets where information is more evenly distributed between the parties.

Furthermore, the timing of this work suggested that the retail sector should be its main focus. It is the regulation of this sector which has been most controversial in recent years. The establishment of a new SRO, the Personal Investment Authority (PIA) and various high profile scandals, have ensured this sector was constantly in the news. This has meant a considerable amount of public debate and discussion. Hence a great deal of material has been readily available for research purpose. This would not necessarily have been the case with the professional markets which function more as a private club with issues being considered behind the scenes rather than in the press. These changes have ensured that issues which highlight the concerns of this thesis have been easily accessible. The move to the PIA, for example, highlighted not only the importance of the idea of public interest in regulatory change but also allowed an exploration of the input and influence of various industry actors and the government. Therefore, it provided an opportunity to consider how open and accountable policy making was, and to assess if all interested parties had meaningful participation in the regulatory change.

Empirical Work

Another reason for adopting a clearly defined focus for this work was to allow for the design of a manageable workload of empirical data collection. Hence information was gathered from one particular group within the retail sector, namely those firms regulated by the Financial Intermediaries, Managers and Brokers Regulatory Association (FIMBRA). This group was chosen because it consisted mainly of small firms which, often have the most difficulty exerting influence over their external environment (Atkinson and Coleman 1985). The method used to assess their views and input was a postal questionnaire (see appendix one and two). This elicited their views on a variety of topics including: the compliance practices of FIMBRA, members perceived input into FIMBRAs operations, and their views on the changes then proposed for the regulatory system as a whole. The questionnaire mostly consisted of tick box type responses (see appendix one and two). This style was adopted partly because speed of completion would boost the response rate, and partly because it provides quantitative data on the views of this group. This was something that had been lacking previously in this area. However, at several places in the questionnaire, space was left for respondents to include their own more qualitative views. This questionnaire was sent to 554 members of FIMBRA in June of 1994 (followed by a reminder letter sent to non-respondents in August). This sample represented one in ten of the firms then regulated by FIMBRA. The response rate was forty nine percent.

Analysis of this questionnaire will be used throughout the thesis in order to relate the theories of compenetration and regulation to practice in the UK today. It provides an original insight into several important areas, for example, the influence firms have had over their particular regulator and into the system as a whole. This allows an assessment of the relative influence of various actors. Moreover, by asking about how regulatory visits were conducted by FIMBRA it also gives an empirical basis on which to consider how regulation was actually being conducted on a day-to-day basis.

Regulation: Theory and Problems.

Before moving on to discuss the specific regulatory regime, I want to give some consideration as to why regulation occurs at all. Most western economists would argue that free markets are the most efficient and desirable way of conducting economic activity (see generally Ogus 1994). It is markets, and the competition they bring, that most efficiently allocate goods and provide services for consumers, and therefore for society as a whole. Interference in this free operation, and in particular state regulation, is to be avoided because it will reduce competition and hence productivity and economic growth (Veljanovski 1987 provides a discussion of how this view influenced British politics in the 1980s and Hayek 1944 provides a strident argument for the free market on economic and political grounds which Mrs. Thatcher claimed to be influenced by).

However, a problem with this approach is that modern capitalism is not characterised by free markets and open competition. Rather markets have developed as strong monopolies or oligopolies (for a legal response to this see Whish 1993). This undermines the idea that it is in the public interest not to regulate markets because they are competitive and therefore an efficient way to allocate resources. Regulation then becomes necessary for various reasons (the following discussion draws in particular on the analysis in Ogus 1994:29-71).

Regulation is needed to ensure that monopolists do not exploit their dominant position at the expense of consumers and the wider public. That is, the market can no longer be relied upon as the best operating system, because it is no longer a free market. This market failure dictates that regulation should be used, firstly, to control monopolists and secondly, if possible, to attempt to make the market more competitive (Langevoort 1992). But it is not just the failure of a particular market to work in a competitive way which would justify regulation. The market may be operating in such a way that its entire future is being undermined. Regulation may be needed not only to protect an individual from the power of a monopolists but also to ensure that the market, as a system, continues. This "systematic failure" may be beyond the powers of the individual market participants to remedy. Indeed it may be of little interest to them with their focus on short term profits and their individual firm. So an outside actor, like the state, is needed to ensure the market continues.

It is clear that the reasons for regulation are many and varied. It may be driven by a desire to increase competition within a market and make it more efficient. However wider concerns can also justify regulation. For example a desire to ensure stability (and so reduce dramatic market shifts) may lead to regulation. Also, regulation can be used to ensure the long term future of the market itself. This later reason may be closely tied to wider macro economic policies like the desire to encourage employment and economic growth. Moreover, it may be wider socio-political concerns that are seen as central when analysing regulation.

Regulation often occurs for reasons which have less to do with the market in question, and more to do with the political or social concerns of the wider society. For example investor protection is an important reason for regulation of the financial services industry. Whilst this can partly be explained in terms of systematic considerations, that is the need to ensure investors see the market as a fair one, so they will participate in it (Black 1997:53). There are other reasons behind its importance. Particularly in the financial service industry, regulation is seen as desirable in order to protect the vulnerable and ill-informed (Foley 1991). In an area which has complex terminology and products, which the public find difficult to grasp, regulation is needed to ensure that sufficient information is provided and properly explained so that the public can make proper and informed decisions. Compulsory information disclosure equalises the public/expert imbalance of knowledge and should therefore stop people suffering from sharp business practice. This type of regulation obviously undermines the idea of a free and unhindered market but is desirable in order to give people faith in the whole system.

However, whilst all these are reasons why regulation may be desirable they do not necessarily prove that it should occur. That is, the reasons for regulation may exist but the disadvantages of implementing it may outweigh the benefits to be gained. Whilst the market may not be perfect, in economic or other terms, it does not automatically follow that the situation will be improved by regulation. The costs of implementing regulation may outweigh the benefits it brings. These costs come not only in financial terms, that is how much it costs to employ regulators and change working practices, there are also indirect costs, in terms of lost innovations and competition (Sunstein 1990).

Furthermore, even if it is decided that regulation should take place, the above arguments do not explain what form this should take. There are many different forms of regulation, each with advantages and problems, and there is action other than regulation which could achieve the same results, for example state provision of a service or a total ban on a type of activity. So consideration must be given to whether, or not, regulation is the most appropriate way to overcome the perceived inadequacies of the market, and if so what form this will take.

In relation to these issues it seems appropriate to discuss the perceived problems of regulation of markets in general, as specific problems of the regulatory form used in the financial services industry will be considered in later sections of this work. Perhaps the most prominent line of criticism is that of the public choice theorists (for general discussion see Self 1993). They fundamentally disagree with the whole basis of regulation (see Stigler 1971). The common theme in the above discussion of why regulation should take place is that it was in the public interest, either to overcome market inadequacies or to protect consumers. The public choice theorists in contrast argue that regulation does not operate for the public good. They argue that regulation inevitably comes to serve narrower interest rather than the general public interest. This may be the interests of those being regulated (the regulatees) or some section of there of.

Or it may be those that actually do the regulation (the regulators) who come to benefit most from regulation.

Agency capture is the phrase used to describe a situation when regulation is serving those it is supposed to control. The theory is that regulatory bodies (and the bureaucrats that run them) will inevitably come to serve their regulatees rather than the public interest. This occurs for various reasons. Baldwin and McCrudden (1987) outline how the approach and determination of an agency changes over time, and how regulatees can come to dominate it. Sabtier (1976), following Bernstein call this the "life cycle" hypothesis of regulatory agencies. This theory suggest that initially it is likely that a new regulatory body will be implementing a regulatory system which has a relatively high public profile, because public and political pressure will have led to its establishment. In the early days the agency will be under considerable public pressure to perform and it is likely that the new agency staff will be enthusiastic about their workload. However both public and regulatory zeal will wane over time. The fickle public will move on to the next scandal or problem and cease to exert much pressure on the regulators. However, the regulatees will not as easily lose interest in the workings of those that regulate their business. Whilst an individual consumer may not be concerned with the regulation of for example widgets (because it effects her life so little) to a widget manufacturer regulation will be of vital concern because it fundamentally affects his business. As Gowland puts it:

> "Say the regulations cost each of 10,000,000 consumers 10p each but convey benefits of £800,000 to a group of producers. No consumer will be prepared to contribute anything, nor to choose to vote for a pro-widget-consumer candidate, but producers will" (Gowland 1990:29).

Therefore due to the relatively little importance attached to regulation by individual consumers, the regulator is likely to come under sustained pressure from only one source, the regulatee. The regulators actions will be of considerable importance to regulatees and they will continue to pressure for favourable treatment. If they are able to gain such treatment, to the extent that regulators serve their interests, they will have 'captured' the regulator.

But it is not just external pressure which is likely to make the regulators move to be more favourable to regulatees. There are internal logistical considerations as well. For example it is likely the regulators will need to work closely with their regulatees, in order to gain information and generally ease their work. This close working relationship is likely to lead to a situation where regulators do not want to undermine their flow of information or make their work more difficult by antagonising those with whom they have to work , i.e. the regulatees. Put simply, with little public pressure for strong regulation, the regulators easiest course of action is to ensure that regulatees are willing to co-operate and this is likely to mean regulations which favour the industry.

But it is not just the case that regulators seek a quiet life. Self (1993) outlines the various theories which show that bureaucracies and bureaucrats do not act in the public interest. They work in their own interest and will attempt to maximise their own income and status (for an American financial services example of this argument see Langevoort 1990). They will seek to operate in such a way that they will be seen as efficient and effective (especially compared to other agencies) so that new regulatory jobs will be placed with their agency or at least that their budgets will be increased. Moreover, an agency which is suffering few public protests is likely to be seen as effective, and this may mean that an agency will placate its regulatees in order to try and prevent them publicly raising opposition to its actions. Naturally this would also be the case with the general public who could criticise an agency for inaction if it is perceived to be too close to the industry concerned, but it is likely that the public criticism will be less easily aroused and less visible if it does occur. This is because an industry trade association, for example, is likely to lobby ministers and officials, the people who allocate budgets and responsibilities, in a way that an individual consumer is not.

Moreover, in many areas of regulation, including the regulation of the financial services industry, those being regulated have some choice as to how they are regulated. For example, financial services firms can in theory choose which SRO to join. This situation creates a danger of 'regulatory arbitrage'. If firms can move between regulators, this can lead to an undesirable competition as regulators seek to maximise their membership, and therefore income and prestige. There is a danger that regulators will compete by driving down standards. Firms will be attracted to the regulator which places the least burden on them as firms seek to minimise the costs and pressures of regulation. Regulatory arbitrage may prevent a regulator from imposing strong regulation because their membership base will be undermined as a result because firms may move to other regulators. The effect of regulatory arbitrage on FIMBRA and the regulatory system will be discussed in detail later in this work.

Therefore the public choice theorists argue that regulation will legitimise private gains under the guise of acting in the public interest. Regulatees may capture the system by constant pressure or because of regulators' inertia. Moreover, public choice theory stresses that the regulators will have their own agenda which does not correspond to the wider public interest. They have their own private interest even though they are ostensibly public officials. This private agenda can also come to dominate regulatory practice, as regulators adopt policies designed, for example, to increase their budget or workload. Domination by either a private regulator's agenda, or the narrow interest of regulatees, undermines the legitimacy of regulation. It means that it is not a vehicle for public policy implementation and so negates the main reason for interference with the market.

Furthermore, there are other criticisms of regulation which go beyond its practices and success in its own terms, and suggest that regulation is undesirable because it undermines the workings of the market in an undesirable way. For example, if regulation has established a system whereby practitioners have to be authorised, then those dealing with them may come to believe that authorisation provides some guarantees of standards. They will be less cautious in their dealings with an authorised firm because they believe it will necessarily operate properly. This has been called a 'moral hazard'. Advocates of this theory argue that regulation leads to people failing to demand information on which to base decisions, and failing to exercise skill and judgement when entering agreements. Without regulation people would be more effective market players, because they would be more active in protecting their own interests. So, regulation actually makes people more vulnerable, because it reduces their protective instincts.

Regulation can also be seen as undermining the market because it imposes additional costs upon market participants. These cost can take several forms. Obviously complying with regulatory rules will impose direct costs upon a firm, whatever form it takes, for example altered working practices and staff training. But there is also an indirect cost to firms. Time spent complying with a set of regulations may be quite considerable and involve senior staff. There is an 'opportunity cost' to be considered when analysing the costs of regulation. Time spent on compliance could have been spent on other matters. This opportunity is lost and as a result less transactions are made and the market suffers a reduced turnover.

Regulation can hinder the market in other ways. For example it is likely to create either entry or exit costs and so stop a free market from operating. If a truly free market was operating, then firms could simply leave or join when they decided it was desirable to do so. As prices and profits rose firms would move into that area to take advantage of this, and firms would simply exit if the costs outweighed the benefits. However, regulation is often designed to stop this occurring. It often puts up barriers to entry, such as licensing and similar requirements. It can also reduce the scope for firms to easily leave a market sector by, for example, insisting that records be kept for a minimum number of years. All this results in the free market being undermined and does not necessarily benefit the consumer. Indeed it may simply benefit the producers already in the market because it reduces the scope for firms to enter and compete with them.

There is another problem with regulation which has been a particular issue in the financial services industry. When a large and diverse industry is being regulated there is a likelihood that different views will exist as to the form that regulation should take. Firms of differing sizes and from different sectors of the market are likely to favour different regulations. The danger is that regulation, and the regulatory agencies then become an arena in which these differences can be fought out. The various firms may attempt to have regulations enacted which not only favour their own working practices or products, but also positively hinder the opposition in some way. If the regulatory process becomes like this, then once again there is a concern that regulation is not serving the wider public interest, but is actually being used by a narrow constituency of those it should be regulating.

Many of these concerns about regulation are directly applicable to the regulation of the retail financial service industry, and will form the basis of much of the discussion which follows. But at this stage it should be clear that regulation as such, and not just the details within any industry, is controversial. Few doubt that it has a legitimate role to play in rectifying market failure and ensuring that the market continues, but it also has many detracting points. It may come to serve those it was designed to control or it may simply impose costs which do not justify the benefits it brings. Moreover even if the benefits outweigh the problems this does not dictate what form regulation should take.

Regulation: Forms and Devices.

It is possible to split regulatory forms into two types, formal and informal, although even within these two approaches many actual methods of regulation can be identified. The informal approach has characterised much of regulatory practice in the UK, although this may be changing. Informal regulation can be contrasted with formal regulation because it relies upon internal norms and values, rather than formal rational techniques, for enforcement. Therefore the main forms of censor, in an informal system, are based around lack of trust and goodwill, rather than formally imposed sanctions. The main point about informal regulatory systems is that they operate most effectively in a closed, or at least partly closed market, for example where entrants are vetted. If there are relatively few market players and participants are known to each other then informal criticism is likely to carry substantial influence. Those in the market will be keen to avoid others considering them untrustworthy and will generally act to prevent problems arising. But, such an informal basis for control and regulation needs a closed, club like, market to work properly, that is, a place were all the participants share the same values and norms. If market participants do not consider informal criticism as a serious sanction and they are not concerned about the feelings of fellow players, then the informal system has difficulties working. This is particularly likely when the benefits of breaking an informal rule, in terms of profit, outweigh an informal sanction, for example loss of goodwill. Only a formal legal approach, with forcible imposed external sanctions, will be able to make players amend their behaviour. Ultimately the informal system will lack sanctions against transgressors of its code.

A more formal regulatory system can take several forms. It may consist of a variation of the informal regulatory system with a trade body simply enacting more formal disciplinary rules and procedures. A more explicitly formal approach would be to use a regulatory body established under statute, or to use a government department as the regulator, or simply to enact a statute and leave the courts to enforce compliance under the ordinary law.

Whatever form the regulatory system takes there are various devices that it can use to control the regulatees. Gowland (1990) outlines the major approaches adopted in the financial services industry. As in informal systems, entry requirements or restrictions can play a major role in formal regulation. This may take the form of prior licensing procedures, which allow the vetting of applicants before they enter the market. Or it may take the form of minimum entry requirements, e.g. exam or other formal qualifications, which applicants need in order to be able to enter the marketplace. Once firms are operating, however, many regulatory devices can also be used. For example, there may be a requirement that firms have insurance to ensure that consumers do not suffer if a firm becomes insolvent, or there may be controls on how the firm is run which attempt to minimise the chances of such insolvency. Controls may be placed upon the assets of the firm, or how these assets are used, in order to ensure that not all assets are placed in risky areas. Regulators have also insisted upon standards of record keeping, and passing of information to them, as a means of ensuring that a firm is being run in a manner that does not endanger the interests of consumers. Indeed there are many best practice requirements that regulators can promulgate in order to attempt to control the internal running of a regulatee firm. All these procedures are used to some extent in the regulation of the financial services industry, and specific devices relating to that area will be discussed throughout this work.

Thesis Plan

The plan for this thesis is as follows. First it will explore the widespread discussion of the changes that are occurring in the modern state and the way in which public law needs to respond to these. Secondly it will give a more detailed background of the retail financial services industry. This having been done it will then go on to explore the workings of the regulatory system. It will look at how FIMBRA actually operated, for example was it a lax or strict regulator. It will also consider what input FIMBRA members had into both their own, and the wider, regulatory environment.

From this it will be possible to draw conclusions concerning how accountable and open this system was. As I shall show the literature suggests that different groups have different input into the regulatory system. Larger and better organised firms may be able to press their views with more force than small firms which lack a coherent common position. Hybrid regulation should over come this problem because policy is made by those actively involved in the industry. Under the FSA, the SROs should provide an opportunity for all firms to have an input, because they are run by the practitioners themselves. This thesis will therefore give an analysis of how legitimate this particular hybrid policy making system was, by providing original data on how practitioners actually affected their regulatory environment.

Chapter Two: Theory And Central Themes

Introduction.

This chapter will discuss the theoretical basis of this thesis. By discussing terminology and placing this particular area within a wider context it will provide a background for the in-depth discussion of the regulation of the financial services industry which will follow. Thus, I will discuss the views of a variety of writers and their various ways of conceptualising the changes in the modern state and society. My main concern is how policy making and implementation is taking place. I will focus upon the way that groups are included, or excluded, from this process and the role that government plays in order to assess the legitimacy of the system in terms of its openness and in terms of ways in which actors participate in policy making. Therefore, I wish to draw upon the literature which discusses interest intermediation and changes in the role of the modern state, to contextualise the empirical work of this thesis.

The FSA established a particular system of regulation, which explicitly claimed to draw upon practitioner views and knowledge to implement regulation which provided investor protection. Thus it combined both private and public interests explicitly within the regulatory system. Such an explicit move means that discussion of the public/private divide is essential to consider if the regulatory system is operating as it claims to be. This requires a consideration of the interest intermediation literature. The SROs were supposed to provide a link between those being regulated and the new regulatory system. They were to be a channel through which practitioners' input could ensure that appropriate and effective rules were made which did not stifle the industry. Much of the empirical work of this thesis has analysed one SRO's operations in great detail in order to see if this was really the case. But before this study can be considered, a discussion of the works which have conceptualised and discussed the way in which groups have an input into the policy making process is needed. This chapter provides such a discussion.

In this chapter, I will firstly discuss the public/private divide, in both a historical context, and in terms of the changes occurring in the modern state. I will argue that these previously theoretically distinct spheres are compenetrating, intermingling, so that the boundary between them can no longer be clearly identified. This means that private bodies are performing public tasks. This is of particular interest to public lawyers, because the move to private bodies means that the accountability and openness devices associated with public bodies can easily be lost (Birkinshaw, Harden and Lewis 1990). It is important to consider how decision making is actually occurring.

The next part of this chapter will discuss the ways of conceptualising the links between society and the state, and what this means for actors having input into policy formation and implementation. In particular it will discuss the growth of hybrid actors, i.e. those that sit in both the public and private spheres. This is not only because they seem to be a growing phenomenon, but also because the SROs (created by the FSA) appear to be an example of such hybrid bodies.

This chapter will discuss the various ways in which the growth of hybrid bodies can be related to changes in the modern state. Some commentators (Birkinshaw Harden and Lewis 1990, Cawson 1985, Streeck and Schmitter 1985) see them as corporatist bodies, essentially operating as intermediaries between the state and their members. As such they help to ensure that the state's objectives are achieved and that their members have an input into the state's operations. I shall discuss corporatism in more detail shortly but one preliminary distinction needs to be made. In general, corporatism conceptualises the state as the apex of a hierarchy, in which it deals with a limited number of corporatist bodies. This contrasts with those who argue that society, and state relations with it, is more pluralist in nature (see generally for examples Salisbury 1979, Schmitter 1977). The pluralist approach is that there are a large number of private bodies each competing for power, and that the state is essentially a judge of these competing forces. It implements the policy which has the most support at that time. This approach therefore does not see society as hierarchical with the state at the top but as heterarchical (see Black 1996), that is consisting of different, separate spheres which are important power centres in their own right and not dominated by the state.

While the corporatism and pluralism concepts appear different I shall show how they can be conceptualised as extremes on a continuum, a continuum which has few non state actors at one end (corporatism) and many at the other (pluralism). Viewing them this way emphasises the important similarities of the two concepts, and shows how they can provide a useful way to analyse the growth of hybrid bodies and hybrid policy making which is occurring (Birkinshaw et al 1990).

Both corporatism and pluralism describe situations where non state actors (be they few or many) have a legitimate role in policy making. Sometimes, as under corporatism, they will have a dominant position, both making and implementing policy. In other, more pluralist situations, non state actors will have little influence on their own, but will need the support of other similar bodies to affect policy. However, whatever the specifics of any situation the important point is that policy is being influenced, and sometimes made by actors which are outside the traditional legal devices which bring accountability and control over those making policy.

Public law in the UK has tended to focus upon the Westminster Parliament as the center for policy making. The idea of parliamentary sovereignty, espoused most famously by Dicey, has dominated the consideration of public lawyers. The corollary of this has been a focus upon ministerial accountability, to Parliament, as the main (and indeed practically sole) device for calling policy makers to account (Harden and Lewis 1987). Moreover this doctrine has been of ever growing ineffectiveness, and has come to serve to falsely legitimate unaccountable power. It provides formal legitimacy without the substantive elements, of accountability and participation, which make power truly legitimate. As the location of power and policy making alters, with the growth of hybrid bodies, it is important to ensure that substantive legitimacy is brought to their actions.

Basic principles and legitimacy.

That law embodies basic principles is accepted by all but the most extreme legal positivist. Harden and Lewis (1987) argue that even the ineffective UK system of accountability, based around Parliament, has underlying principles which inform its workings. They see this (1988: chapter 2) as embodied in the widely used phrase, the 'rule of law', which embodies many principles based around controlling power. They say, following Selznick, that the rule of law

> "...speaks to a belief in the kind of polity which seeks to subordinate naked power and to elevate civic order and rational progress. It implicitly rejects the idea of immunity from criticism, of being above collective institutions rather than facilitating their operation. Legality assumes a shared sphere of legitimate action and has come to be concerned with procedures for the emergence of policies and rules." (Harden and Lewis 1987:19)

It therefore means that law is not simply a system of morally neutral rules via which power is exercised. Rather law embodies basic concepts which it imposes upon decision makers thus legitimising their power. This argument is usually condensed into the phrase 'natural law' (for example see Beyleveld and Brownsword 1986), and means that it is the standards that law imposes on decision makers, rather than the fact that the law itself is used, which makes legitimate that exercise of power.

The basis for this natural law position varies amongst writers (see generally Harris 1997, and more specifically Beyleveld and Brownsword 1986), and much debate in this area is of a highly philosophical nature and beyond the focus of this thesis. However, some discussion of several recent works will emphasise that the search for basic principles relates directly to how policy is (and should) be made. Therefore it will provide a basis for critiquing how policy is made under the financial services regulatory system.

Choice, Participation and Accountability

I have already noted how the phrase 'the rule of law' can be seen as having a qualitative content, which requires more than just form for legal action to be seen as legitimate. Harden and Lewis (1987) argue that these principles are inherent, if lacking, in the British constitution and argue for changes in the "business of governing" to more fully operationalise these principles (1987: part three). In a more recent work Lewis (1996) has re-emphasised why it is necessary for law to contain basic ideas which protect and enable the individual.

Lewis' (1996) starting point for these basic principles is philosophical, but hardly contentious, namely that people are ends not means (1996:6). (For a deeper philosophical basis for much of this discussion see Gewirth (1978), and Beyleveld and Brownsword (1986)). This "ends not means" starting point, means, Lewis (1996) argues that if people are to be given the space to develop their own innate worth then choice (the ability of individuals to choose) should be at the heart of how society works, and therefore the basis of how law structures that society. This structuring most obviously takes place in constitutional law (Lewis 1996: chapter four), but Lewis also emphasises (chapter seven) that choice is at the heart of the idea of free markets. However, he rejects the argument of those thinkers (e.g. Hayek 1944) who see the state as stifling the free market and therefore to individual choice. Lewis argues that markets can be desirable because they enable choice, but shows that modern capitalism creates markets which stifle choice and competition (1996:113). The state therefore has to intervene to ensure that choice is really occurring in a market situation. Regulation become the device for ensuring choice and personal freedom rather than stifling it. This conclusion means that formal legal structures should be used to ensure that choice is actually achieved in decision making, be it by the market or the state.

A similar conclusion can be drawn from another philosophical tradition. Prosser (1982) considers the earlier work of Habermas (1971) to argue that public law should be used to achieve the fundamental aim of empowering the individual. Prosser (1982) accepts

Habermas' argument that undistorted communication, or discourse, lies at the heart of empowering an individual, because it allows them to make decisions based on a rational decision making process. This rational decision making process is one which

> "...rests on an implicit consensus consisting of the mutual acceptance of various claims; these will include the truth of assertions and the correctness of norms referred to in speech. If this consensus is disturbed by challenge of these claims, this can be remedied only by the testing of their truth or correctness through discourse. Discourse is a special form of communication shaped only by the force of the better argument." (Prosser 1982:10)

Prosser argues that this discourse should form the basis for decision making based as it is on argument rather than force or distortion. From this starting point Prosser advocates two principles which law should attempt to instill in decision making so that it can be seen as truly legitimate.

> "The first is *participation*; however deficient its implementation in practice may be, this concept is centred around the development of institutions for the expression of the ideal of discussion free from domination, with equal power to affect decisions give to all affected. The second basic concept is *accountability*, which is centred around the development of the means to ensure that justifications in the form of reasons must be given for action."(Prosser 1982:11. Original emphasis, references removed)

Participation and accountability should therefore form the basis for structures which facilitate and operationalise policy making. Prosser argues (1982:2-3) that this has not been the case with decision making in the UK, a conclusion which he shares with Harden and Lewis (1987) account of the UK constitution.[2]

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[2]Interestingly Habermas (from who Prosser drew inspiration) has come to a different conclusion when analysing the German constitution. Habermas (1996) argues that the German constitution does provide an opportunity and devices for discourse and therefore rational decision making. See also Slater's (1997) discussion of Habermas's conclusion.

The way in which policy is made, and the existence or lack of openness and accountability, becomes of increasing concern as the public and private realms compenetrate. Previously there existed some (if inadequate) devices for ensuring participation and accountability in the public realm. These in the UK were centred around elections and accountability enforced by Parliament. The private realm also had these characteristics, when the free market allowed easy entry and exit, and real competition. However, the danger is that as hybrid decision making processes develop they will lack the desirable characteristics from either sphere, and that this will lead to domination by a few actors, with others unable to call them to account. It is this possibility which I want to explore in relation to the regulation of the financial services industry, but before considering this area in detail it is necessary to outline more fully the idea of a public/private divide and to show how this is breaking down.

The Public and Private Spheres

A main theoretical concern of the thesis is the changing nature of the relationship between the state and private society, and what this means for the legitimacy of policy making. In particular I want to focus upon the way in which the boundary between the public and private sectors is breaking down and the two sectors are increasingly compenetrating. There are many reasons behind these changes and it has important implications for many sections of society. (For some background to this see Austin 1982, Horwitz 1982, and Mnookin 1982). I first want to trace the history of the two spheres and then focus upon the work of Poggi (1978,1990) as he discusses the way in which the two spheres have come to lose their distinctive identity.

The division between private and public realms has been a contentious area for philosophers and sociologists for centuries. The existence, scope and role of a civil society, as a private realm outside the state's control, continues to be a contentious issue. Many commentators trace the public/ private debate back to ancient times. For example, Seligman (1992:17) highlights the ancient Greek system which sought, after the collapse of the city State, to develop a relationship between individuals and society in terms of a natural overarching order. This same idea can be attributed to the early Christian natural lawyers who argued for an ultimate legal order, which was derived from the teachings of the Christian Church. These were attempts to delineate and detail acceptable conduct, especially the relationship between individuals and society. Both provide early examples of a separate public (society) and private (individual) realms, and show the problem of satisfactorily explaining the interaction between the two.

But it was with the development of capitalism that this distinction took on a further importance. Developments towards early capitalism (and the combined religious changes) saw the breakdown of common normative beliefs and a move towards the idea of rational individuals interacting solely via the use of contracts. (See Vago 1981, Unger 1976 for a discussion of the changes taking place in society). Seligman puts it as follows:

> "The break with past traditions and customs --as the binding forces of society-- engendered the search for new principles of moral unity within...societies. The obligations implied by contract and the necessary and

complementary idea of the agentic and autonomous individual upon which the contract rested were both formidable concepts in the seventeenth and eighteenth century search for a new model of the social order." (1992:17)

With the development of capitalism came an emphasis upon the individual, and his private property rights. Whilst it may appear that this would undermine the concept of a public sphere, the very concept of a private actually serves to reinforce the need for a public sphere. It has been emphasised (Unger 1976:58) that the idea of a private sphere, in which individuals can operate unhindered, presupposes a public sphere which is different. And many of the concepts, like private property, which are the foundation of a private sphere, rely upon a common (public) recognition and enforcement system (law) if they are really to mean anything. It is only if other people accept the concept, and it can be enforced publicly that private property means anything.

Indeed the search for this model and for what it means for the interaction between an individual's public and private actions has continued up to the present day. However, I do not want to labour on the various arguments that have raged over the last couple of centuries, in any detail. I simply want to highlight some prominent writers who have acknowledged the importance of the public/private distinction in order to justify my use of the concepts and to show how they came to be seen as separate spheres.

As we shall see the boundaries between the two, and the reasons why the two spheres should be seen as separate (i.e. the varying principles which underlie them and make them different) have been a focus for much debate and disagreement, but it is the recognition that they were for so long seen as different and yet complementary concepts, which I want to stress. This is because this thesis will focus upon the legal effects of the compenetration of the two rather than attempt the more philosophical and sociological task of clearly expounding the conceptual differences.

Having said that it does seem necessary to discuss, albeit briefly, some of the ways in which various writers have conceptualised the distinction in order both to highlight the variety of approaches and to show how central the divide has been to many philosophers and social scientists.

Public/Private Divide: Themes And Writers

The growing importance of the public/private divide was highlighted by the Scottish Enlightenment writers (see introduction and extracts in Campbell and Wiles 1979). During the Eighteenth Century changes in society, particularly the breakdown of an established normative religious order, meant that the previous basis for the relationship between society and the individual could no longer be relied upon. Much of the work of these writers, therefore, was an attempt to provide a new basis for social order. However, much of this group's work still relied upon religion as a tool for discerning the basis for legitimate public and private action. For example, Locke's, discussion of the rights and privileges which form the basis of civil society, draws heavily upon Christian belief. His answer to the question of what common ground provides a basis for a community or society, was that all men are made by God and that this gives them the common features which are essential for society to function. This use of the Christian religion is emphasised in the following quotation:

> "For men (sic) being all the workmanship of one omnipotent and infinitely wise Maker-all servants of one sovereign Master, sent into the world by His order, and about His business-they are His property, whose workmanship they are, made to last during His, not another's pleasure, and being furnished with like faculties, sharing all in one community of nature, there cannot be supposed any such subordination amongst us, that may authorise us to destroy one another, as if we were made for one another's uses, as the inferior ranks of creatures are for ours" (Locke *quoted in Seligman 1992:23)*

But this reliance upon religion to provide common normative beliefs for society could not be sustained as capitalism, and other developments, served to continue the erosion of religion, and the dominance of Christian religion in particular. The change to a more secular, and religiously diverse, society only served to make the importance of the divide between the public and private spheres more important. Without a religious basis for action the danger was that society would simply breakdown. This could be because an authoritative state could impinge totally upon the private actions of individuals (something which became more possible with technological and communicative developments). It could also be because the civil society sphere (where individuals interacted with others e.g. markets) broke down as a result of the participants' lack of a common normative order. As Seligman says the more secular society simply made the definition of what was acceptable public and private behaviour more important. He says:

> "When the sources of morality and of constitutive good lay beyond the human world, the distinction between both realms (public and private) was irrelevant for the conduct of the good life. The field of morality -- precisely because it was defined in transcendent terms -- embraced both spheres equally and in fact obviated any distinction between them. When, however, the field is inherently human, that distinction within the human world, between the individual and the social, the private and the public, takes on a new resonance and must be addressed in terms of the moral basis of the social orders" (Seligman 1992:30)

This need to define the basis for social interaction (and therefore of the public and private spheres) has formed the basis for much work ever since this time. It is possible to identify several important themes within this work which are useful in highlighting the importance of the public/private divide.

Important in early writing was the distinction drawn between morality and reason. That is, between the individual ethics of a person and an objective rationality. This is important, because it provides a basis for differing normative values to be attributed to the public and private realms. Kant for example, took this type of approach, arguing that the public sphere was the place where man exercised his rational self interest, whilst the private sphere was the place for emotion and ethics. Again, it is clear that Kant recognised separate spheres, but stressed their interdependence. As Kant stresses, privateness can only be recognised by the concept of a public sphere. One needs the other to have any meaning, and it is the lack of public involvement which defines the private sphere. There needs to exist a public sphere, in which debate and discourse can take place. Kant's linking of reason and public good suggests that this public sphere would be the place where the best and most rational policies would be decided upon for the public good.

Therefore we have a two spheres, one the realm of rational discourse the other the private realm of individual ethics. However, this approach as the basis for defining the public/private divide was rejected by others such as Hegel and Marx, although they acknowledged the importance of the divide itself. Hegel, for example, rejected any clear distinction between the rational and the moral. He to accepts that while private property gives an individual status, it is only the public recognition of this status (of the concept of private property) which gives it any real meaning. The divide remains important.

Furthermore, another aspect of Hegel's work has particular relevance to the study undertaken in this thesis. Hegel saw corporations as having an important mediating role to play between individuals and the state. Corporations (such as trade and professional guilds) represented their individual members and sought to improve their position. The state, however, should represent the public good, not just the particular interests of any one group. The state would overcome the private interests of the corporations. As I shall show, this is still an important argument today, and one to which corporatist writers have devoted much time.

Marx should also be mentioned in a consideration of the importance and role of the public and private divide. Whereas his predecessors had seen the public sphere as a place where rational discourse would generate the public good, Marx saw this argument as merely a device to benefit one particular class in society. He rejected the idea of natural power and saw the workings of the public sphere as being to maintain the capitalist system and the owners of the means of production. The important point is, however, that whatever the results of the divide, Marx did still conceptualise society as having a public sphere and a private sphere, which where different but essentially linked. For example he said

> "Where the political state has attained its true development, man-not only in thought, in consciousness, but in reality, in life-leads a twofold life, a heavenly and an earthly life: life in the political community, in which he considers himself a communal being, and life in civil society, in which he acts as a private individual, regards other men as a means, degrades himself into a

means and becomes a plaything of alien powers" (Marx quoted in Seligman 1992:54).

Marx saw the state as a power centre which operated to maintain capitalism. It is interesting that this view is echoed by right-wing liberal theorists. They see the state's role as being to bolster the free market (by, for example, providing services which would not or could not be provided by the market) and therefore the capitalist means of production.

It is this approach, broadly encompassed by the phrase 'liberal theory' which came to dominate western societies in the nineteenth and twentieth centuries (Poggi 1978: Chapter V). The liberal approach sees only a very limited role for the state, with as much activity as possible left to the working of the (private) free market. State action should be limited to providing the framework in which the market can operate, and trying to restore the market when if fails. However, it is clear that this view presupposes a divide between the state and society, with each having a different role and characteristics (Poggi 1990: chapter 2). The state is seen as external to society. It is a unitary body, which has a monopoly of coercive force. It uses this to ensure social order is maintained, and private agreements enforced. But this is only seen as legitimate action if the state acts in a neutral and rational way, and is not dominated by one group from society. Private society, in contrast, is considered to be made up of diverse and independent actors who freely deal in the marketplace on a more or less equal basis, via freely made contracts. It is the consent of society, however, which gives state action its legitimacy, and in liberal theory, it is Parliament, elected by the people, which provides the conduit for this consent.

Modern Changes: Compenetration and its Effects

Poggi (1978 Chapter VI) discusses how all these views, which form the basis of the 'liberal theory' of the state, are being undermined by changes in modern society. He shows how the operation of the political process altered, as an organised working class developed, a movement which was keen to capture the state and alter its operations towards their own ends (1978: 122-125). One of the main mechanisms for this was the extension of the franchise, so that it eventually became universal. By achieving votes for all, the working class were able move into a position of dominance in the 'public sphere', that is the politically active and influential section of society. This led to changes in the scope and method of state operations. The state no longer claimed simply to serve the free market, but sought to relieve some of the problems created by the market. However, this does not mean that it acted in a way that undermined capitalism. Poggi (1978:127) argues that these changes were inevitable within the logic of changes in capitalism and for the state that supported it.

Changes were needed to maintain developments within the capitalist means of production. Working practices were becoming more complicated and mechanised and this required better educated workers. Thus, it was inherent in the logic of capitalism, that the welfare state would develop in order to ensure that education was provided at an appropriate level to the majority of people. With this the means of production could be maintained and continue to develop. Moreover, if capitalism required a pro-active and expanded state, other changes had to occur. Only by bringing the majority of the people into the electoral system could the state and state actions still be seen as legitimate. It is the consent of the people that ultimately forms the basis for effective state action. A system based on oppression could not hope to sustain it in the long term, hence the move to a formal democratic system.

The growth of an organised working class also reflects other changes in the means of production that have occurred over the last hundred years and in particular the last fifty. Society is no longer characterised solely by individuals and small associations. Groups have developed of such size and influence that they cannot be ignored when it comes to policy making. Organised trade unions are one example. They became powerful groups in their own right, able to control and influence large numbers of working people. This power meant that the state had to accommodate and bargain with these groups (see Panitch 1980, and on how this has changed in the UK, Lewis and Wiles 1984). Modern capitalism also resulted in small competitive firms giving way to large monopoly firms as the dominant type of business organisation. These large, often multi-national firms, control large amounts of production, and employ thousands of people. Their decisions have a significant effect on a national economy, and their refusal to comply with a state policy could seriously undermine its effectiveness. Any state thus had to consider and negotiate with these large businesses.

These changes have important consequences for the liberal theory of the state and society. Firstly, they undermine the idea that the state is a unitary entity, whilst private society is diverse, made up purely of individuals. As working class organisations and business concerns developed, to encompass more people and a bigger proportion of economic output, this idea could no longer be sustained. Private society has formed into associations which, by mobilising their membership, can exert influence upon policy making. An individual may therefore lose some autonomy but potentially becomes more influential by collective action, and the private sphere no longer consists simply of equal autonomous individuals.

These changes have important implications for the public/private divide. If the state is now having to bargain with private actors then this suggests that these private actors are becoming involved in activities which would have previously been the preserve of the state alone. The boundary between state and non-state action is breaking down. It is not just societal pressure which has broken down the divide, the state also acts in ways which erode the boundary. The state will want to incorporate these new organisations, and the power they can wield, into its own operations in order to boost the effectiveness and implementation of its polices. For example, a state can cut costs if private organisations take on a policy implementation role, and can reduce conflict if policy is negotiated with, and agreed by, interested organisations. So it is not just private society which is developing to erode the public/private divide, the state is also acting in such a way as to increase compenetration.

Compenetration and the Pursuit of Wealth.

Changes in the characteristics of state and society are not the only reasons which have undermined the liberal theory of the state. Many of these pressures leading to compenetration stem from what Poggi (1978) terms the 'pursuit of wealth' idea. This has come to dominate the political agenda in western countries since the Second World War. Poggi argues that the whole rationale behind state action and purpose has altered, to focus upon economic growth and success as the overwhelmingly important concern. This has replaced the aggressive inter-state wars and imperial expansion, which previously provided much of the rationale for state action (Poggi 1990:109). Instead it is now industrial output that marks the battle ground between independent nations, and states see boosting this as their central concern. It is economic success which provides the legitimacy for state actions. This has implications both for the public/private divide and for the structure of the state itself.

In order to achieve the desired economic growth, states have become more involved in the means of production, intervening in many areas to boost or secure jobs. So instead of the market being left to operate in a free way, it is now managed, to varying degrees by parts of the state. The state may own and manage important firms or industries, it may provide financial support and guarantees for strategic firms or new technologies. Above all it will try to manage the whole economy in such a way that jobs and growth are secured (whether this is through Keynesian demand side policies or a monetarist supply side approach). The state is no longer operating simply in order to help the free market function properly, it is positively part of the market itself, it is a major player in this previously private area.

This emphasis upon the pursuit of wealth is conducted in such a way that the nature of the state is also altered. This is because economic growth is seen as a technical matter, which requires the input of experts rather than the views of conviction politicians. The importance of trained and specialist civil servants has grown as technical information gains growing importance. Outside experts are also used to boost the flow of expertise in policy formulation, often being at least partly co-opted into the state apparatus, as expert advisers. Indeed, more fundamentally, new devices are developed to implement these new policies outside the traditional devices of government departments, which are seen to lack the knowledge and expertise required to implement highly technical rules. (e.g. in the UK examples of this can be seen in the Next Step Agencies and the Child Support Agency). The traditional boundaries between the state and society are broken down as private actors take on policy formulation and implementation roles previously done by the state itself.

These changes have important implications for state legitimacy, because the traditional centre for decision making in the state, the elected Parliament, becomes marginalised (Poggi 1978:141). The growing amount of information needed for policy implementation means that a large debating chamber is no longer suited to making policy choices, and the growing strength of party discipline only serves further to stifle proper debate and questioning of the ministers who are deciding policy. Parliaments' become ritualised forums for party point scoring, with votes cast on strict party lines decided before the debate. But if Parliaments' are being sidelined because decisions are being taken elsewhere, (for example by ministers and civil servants or the party leadership) and outside the public gaze, then the state's claim for public support and legitimacy has been undermined. As Poggi says:

> "The cumulative impact...is to shunt parliament away from the effective centre of a country's political life, leaving in control the state's executive organs, and especially its administrative apparatus, now thoroughly 'interlaced' with those various controlling nonstate forces"(1978:144)

The problem is therefore, that a legitimacy crisis develops. Parliament still represents the main device designed to give state action the legitimacy of public approval, but as it becomes increasingly irrelevant, state action lacks the support and legitimacy it needs. The voters are not able to control and direct public policy. This question of accountability and legitimacy is central to this thesis, and is one which will be addressed in great detail in relation to the regulation of the financial service industry in subsequent chapters.

Poggi (1987) identifies other changes which have created legitimisation difficulties for the state. Whilst the welfare state has expanded into an ever larger part of private society it has not always been able to live up to the growing demands of this expanded responsibility. The state has not been able to fulfill its claims because of the ever growing cost of the welfare state. It has only been able to serve the very extremes of the problems, providing only the most basic of provisions. Moreover, even in the pursuit of wealth the state has proved increasingly less successful. Western states have failed to manage and steer the whole economy despite the growing intervention in the market place. They have only been able to attempt to alleviate the worst excesses of cyclical capitalist boom and bust, without really being able to alter the whole process. This distinct lack of success has meant that the expanded role of the state, in the economy and via the welfare state, has been fundamentally questioned, and therefore its whole legitimacy of action.

It is not just the lack of sustained economic success that has brought into question the legitimate role of the modern state. As Poggi (1987)outlines, public actors have failed in other areas as well. For example, there has been a growing problem of crime in western societies since the Second World War and it has seemed that the state has failed to provide an adequate remedy or solution to this. Despite the rhetoric of strong law enforcement and of being tough on crime that has come from governments, little dent has been made in the crime rates. It seems that the state has failed to live up to partly self created expectations and this has undermined the legitimacy of its claims to be steering and controlling, in a beneficial way, the whole of society. Poggi (1987) also identifies the lack of standards in public life as a major problem for state legitimacy. That is, corruption and scandals amongst public officials only further weakens the legitimacy of their speaking for, and controlling, much of society. It simply leads to disenchantment with all public officials and again undermines the legitimacy of state action generally.

Therefore a variety of reasons lie behind the compenetration of the previously separate public and private spheres. These come from the state and private society side of the divide. The state seeks more effective, and less costly, ways of pursuing the dominant policy of economic expansion. Groups and associations in society seek to influence, and control, policy making. Together this means that traditional theories of the position and role of the state and society can no longer be sustained. Moreover, it undermines traditional methods of controlling state action, in particular weakening the role of Parliament. Fundamentally, this threatens the whole legitimacy of the modern state.

However, this compenetration need not necessarily lead to a total loss of legitimacy. I have already argued that participation and accountability can be seen as legitimating devices for policy making. Whilst it is clear that compenetration undermined the way in which these were achieved under liberal theory (in particular an elected parliament and free markets) new hybrid bodies can create new opportunities for achieving legitimacy, with improved scope for participation and greater accountability. Therefore before moving on to focus upon policy formulation in one particular area (i.e. the financial services industry), I wish to look in more detail at the type of bodies which have grown with this compenetration. I want to consider the hybrid (i.e. both public and private) policy making apparatus that has developed. This will highlight more strongly the advantages and problems of compenetration, and provide a theoretical basis for use in analysing the financial services regulatory system.

Hybrid Policy Making: Ideal Types

In this section I want to look at how state/private groups interaction and policy making has been conceptualised. Several ideal types can be identified from the literature. After giving the basic characteristics and differences of each, I want to focus upon corporatism and pluralism. Thus I will discuss the proposed benefits of each characterisation, and the problems with their definitions and application to empirical examples. Corporatism in particular will be focused upon because it appears to resemble closely the rationale of the regulatory system established under the FSA. This system consisted of a few private bodies (the SROs) taking on regulatory powers, whilst also being responsive to their members. Thus, a discussion of the problems, both definitional and practical, of corporatism gives a basis for an analysis of the Financial Services Act regulatory system.

Four ideal types can be identified from the literature, namely: Monism, Pluralism, Corporatism and Syndicalism. The following quotations from Schmitter (1979) are surprisingly prevalent in the literature, and seem to provide a widely acknowledged definition, albeit one which is often attacked for being inadequate. They therefore deserve to be quoted in full.

The first ideal type I want to consider is monism. This is an ideal type which seeks to describe the old soviet style of government. Under this system the state and the party are inseparable, and the party channels all views and implements all policy. The state and society can no longer be separated. Schmitter says, monism is.

> ."a system of interest representation in which the constituent units are organised into a fixed number of singular, ideologically selective, non-competitive, functionally differentiated and hierarchically ordered categories, created, subsidised and licensed by a single party and granted a representational role within that party and vis-à-vis the state in exchange for observing certain controls on their selection of leaders, articulation of demands and mobilisation of support". (Schmitter 1979:16)

Thus this system has a few organisations which control their members. These groups (or their leaders) become part of the party/state apparatus, and therefore the party is able to control and limit the demands of individuals. Obviously this system makes few claims for democracy. The best that can be said is that this singular system should provide stability and social control. Whilst the collapse of the Soviet Union, and other East European communist regimes, would appear to have made this a political system of the past, it should be remembered that one party systems still exist. Indeed the Far East versions have achieved considerable economic success in recent years. However, I wish to limit my discussion of monism because my focus is the UK, and it cannot be said to exist here.

If monism represented the old Soviet system, the next ideal type, pluralism, finds most of its advocates in the USA. It developed as political scientists there sought a way of analysing the multitude of private organisations which the US seemed to possess in greater numbers than other Western democracies. Schmitter again provides a basic definition.

> "Pluralism can be defined as a system of interest intermediation in which the constituent units are organised into an unspecified number of multiple, voluntary, competitive, nonhierarchically ordered, and self-determined (as to type or scope of interest) categories that are not specifically licensed, recognized, subsidized, created, or otherwise controlled in leadership selection or interest articulation by the state and that do not exercise a monopoly of representational activity within their respective categories" (Schmitter 1977:9)

Therefore pluralism has many competing groups which attempt to work with other groups to get policies favourable to them adopted and implemented. Individuals voluntarily join these private organisations and are not controlled by them. People simply participate if they feel that the group is benefiting their own interests. Each individual may be a member of several groups, not only because she may have a variety of interests but also because there may well be several groups seeking to advocate a particular position, which she supports or would welcome. The state does not take an active role in forming these groups, nor does it attempt to influence or control the policies advocated, or the leaders that do this. Rather the state does adopt and implement policies, but in a pluralist system these policies are decided by the ability of groups to form alliances with other groups, so that its policy has more support. The state simply implements the policy with the most support, which means that as alliances change (and groups decline or increase in effectiveness) policy will also alter. Pluralism can therefore be seen as a free market in interest intermediation with many competing groups attempting to win support for their policies, and new groups entering and leaving all the time.

The third ideal type identified is corporatism. This has a much less fluid and open system than pluralism, and sees the state as an active participant, working closely with private organisations. Schmitter defines it as follows:

> "Corporatism can be defined as a system of interest intermediation in which the constituent units are organised into a limited number of singular, compulsory, non-competitive, hierarchically ordered, and functionally differentiated categories, recognized or licensed (if not created) by the state and granted a deliberated representational monopoly within their respective categories in exchange for observing certain controls on their selection of leaders and articulation of demands and supports" (Schmitter 1977:9)

Corporatism, therefore, invokes a limited number of groups working with the state to develop and implement policy. The groups attempt to control their members, in order to limit dissent, and better implement policy. Their ability to do this is boosted by the fact that members have no choice but to join. The state plays an active role in creating and supporting these private organisations and, in exchange for controlling members and implementing policy, it gives them special privileges (like monopoly on representation). Just as the organisation's leadership must be able to ensure that its members will follow the agreed policy, the state must also be able to ensure that it too can do this. Thus the state involved must be strong enough to ensure this happens.

Before going on to discuss corporatism in more detail I want briefly to outline a fourth ideal type identified in the literature. Syndicalism is a system which seems to most clearly divide state and society. Here the state withdraws and private organisations are left to determine and implement policy. Schmitter offers this definition:

> "Syndicalism could be defined as a system of interest aggregation (more than representation) in which the constituent units are an unlimited number of

> singular, voluntary, non-competitive (or better hived-off) categories, not hierarchically ordered or functionally specialised, neither recognised, created nor licensed by state or party, not controlled in their leadership selection or interest articulation by state or party, not exercising a representational monopoly but resolving their conflicts and 'authoritatively allocating their values' autonomously without the interference of the state." (Schmitter 1979:17 emphasis added)

This means that the state has little role to play in policy making, with decisions left to the groups concerned. I shall return to this idea in due course because it seems very similar to the concepts of Private Interest Government (PIG) and regulated autonomy, which have been developed by writers who began from a corporatist perspective (Streeck and Schmitter (1985) and Birkinshaw, Harden and Lewis 1990). As we shall see they have described situations where, once general conditions have been set, the state withdraws from the regulatory policy making process.

However, firstly, I want to discuss corporatism in more detail partly because corporatism is a more prominent form of theorising in the literature, and partly because it seems to relate closely to the working of the financial services industry.

Corporatism

Streeck and Schmitter (1985) provide a particularly coherent definition and one which is often quoted, and criticised, by other writers. They give three possible alternatives for conceptualising the way in which social cohesion is secured, namely community, market and state/bureaucracy. They see corporatism as a fourth approach, which overcomes some of the problems inherent in the other three. Corporatism is based upon the interaction and allocation of privileges between a limited and fixed number of groups.

They stress that this is between independent organisations, not ones controlled by the state. These groups need a monopoly of representation (for their specific area) and to be able to control their members so that they can bargain in a predictable way with the state and other organisations. But this control must not be overbearing, otherwise members will leave because they do not feel that their true interests are being advanced. One way that Streeck and Schmitter identify, for overcoming this problem, is for the organisation to take a pro-active role in influencing what its members see as their interest, or the best way to promote those interests. The organisation must not just reflect the wishes of the members, it must actively seek to define those interests and to gain the trust of the members so that the organisation's leadership has room for manoeuvre when dealing with the state or other groups. If members trust their leaders, then they do not seek to ratify every decision taken by the them, but will co-operate with decisions taken on their behalf. For this to happen, it is important that the members believe that the work of the organisation will benefit them in the long term, so each individual decision becomes less important.

In an earlier work Schmitter (1979) emphasise that corporatism must work in the long-term if it is to be a meaningful concept. This long term view means that it is not possible, in the short term, to make an evaluation as to which groups have benefited and which have lost out. This, combined with the fact that decisions are often made in secret bargaining between the state and an organisation's leadership, means that there can be a 'legitimacy deficit'. This works on two levels. Firstly, the general public may feel that the private bargaining gives a particular organisation (and its members) an unfair special advantage, that a group is able to bend policy making to its, rather than the public, interest. Secondly, and in contrast, the members may feel that the policy outcome is not really in their interests. There is a danger that an organisation's leadership will be undermined by a more radical movement from the rank and file, who consider that they are sacrificing too much to the state's wishes, at the expense of their own best interests. The leadership has to be aware of this problem and overcome it if the corporatist arrangement is to work in the long term.

These problems notwithstanding, Schmitter (1979) have shown what type of organisation is needed for corporatism: one that is stable, hierarchical and has a monopoly representation.

It is not just the structure of the private organisation which is important. For corporatism to be successful, the state also has to posses certain characteristics and abilities. Several writers (Hughes 1985, Streeck and Schmitter 1985, Birnbaum 1982, Winkler 1976) stress that the state has to be able to provide its part of any bargain, and therefore, like the private organisation involved, it needs to be powerful. It must be able to ensure that policies agreed with the organisation are actually implemented; that factors like the internal working of the state bureaucracy, or party politics do not undermine an agreement made with an organisation's leadership. The state must be able to offer an organisation a monopoly representative and implementing role, and so be able to exclude other groups. Otherwise an organisation will not gain enough from the corporatist bargain.

So corporatism theorises a position where both the state and the private actors must be strong. The state must be able to exclude other representative groups and overcome internal problems to ensure that the agreed policy is implemented. The private organisation must be able to discipline and control its members to do likewise. This can be partly achieved by attempting to set the priorities of those members.

This is a fairly clear situation, desirable from both sides. The private organisation gains influence and power over policy making and implementation, and is thus able to ensure policy favours its members. Members do sacrifice some individual autonomy, but this should be repaid in the long run. The state benefits because it greatly simplifies its external environment. Under corporatism it has to deal with a very limited number of private actors. Costs are reduced, because a stable relationship replaces time consuming conflict, and because the state is able to shift the burden of policy implementation on to the private actor.

It can also be argued that corporatism may actively enhance democracy and participation. Individuals will be involved in the policy process as members of the private organisations, and this can give them greater influence than via formal national elections to Parliament. But this does raise problems because the use of private actors undermines traditional accountability devices, and corporatism raises the problem of policy being developed to favour one group rather than the public interest.

However, whilst corporatism has been discussed by many writers and many advantages have been claimed, there still remain fundamental problems. This is not only to do with the benefits, or not, of a corporatist system, but also to do with the meaning and application of the term itself.

One of the problems with corporatism is the variety of meanings it has developed. Panitch (1980) argues that the term is to widely used, and in contradictory ways, that it has lost any common or meaningful sense. He says

> "...the first thing that strikes one as one reads through the recent literature on modern corporatism is the profound lack of agreement on what the concept actually refers to. It is obvious that considerable confusion must attend a field in which the central concept is variously understood to connote a distinct economic system or mode of production (feudalism, capitalism, socialism...corporatism), a state form (parliamentarism, fascism...corporatism), and a system of interest intermediation (pluralism, syndicalism, monism...corporatism). This confusion must be compounded when, for instance, within the interest intermediation approach alone, one finds a range of theoretical and research practices which are at odds with one another,." (Panitch 1980:159)

Some discussion of the way in which the term is used will highlight these problems and illuminate the way in which I wish to use it in this thesis.

An early article by Winkler (1976) gives a background to the use of the term corporatism and shows how it can have a very broad meaning. Winkler discusses how the term was used to characterise the Fascist regimes of the 1920's and 1930's in Italy and Germany, to such an extent that it became almost interchangeable with Fascism, as a description of an economic system. Winkler says

> "...Fascism is sometime seen as a system of domination by big business, meaning particularly the armament manufacturers and the providers of autarkic necessities for war, who were able to control (for their own profit) regimes bent on military conquest" (1976:101)

This link to militaristic and authoritarian regimes, meant that corporatism as a phrase and concept fell into disuse. It began to be rehabilitated in the 1970's. Winkler (1976), provides a good example of the wider possible meaning of corporatism. He sees it as a way of conceptualising and describing a complete economic system. For example, he argues that corporatism is an economic system in which ownership is still in private hands , but where the state comes to control (not just support or influence) business and industry (1976:103-105). In this way he argues it is comparable to, and an alternative to, other ways of controlling and organising the means of production, like socialism and capitalism (1976:113). He thus is using the term in the broadest possible way.

While some have used corporatism as an all encompassing term other writers have criticised the phrase and its advocates for their narrow approach. Panitch (1980) for example argues that there has been a lack of analysis of the role of the state in corporatist work. He disagrees that the state is merely a socially neutral actor, and argues that class should be a central consideration in any analysis. This leads him to argue that corporatism, with its incorporation of private organisations (like Trade Unions) in policy implementation, is simply a way of maintaining capitalism by tying the working class more closely into its operations. Panitch (1980:167) criticises corporatist writers for failing to problematise the way in which the economic system is organised, and argues that far from being stable (as many have claimed) corporatism is more likely to be unstable. This is because the working class will eventually realise that power is not truly being redistributed, that the old capitalist arrangements are simply being bolstered by their closer involvement, and that they are not really gaining. Panitch highlights the rank and file militancy of the 1970's as evidence for this.

Panitch (1980) also argues that by focusing on the way in which corporatism brings private groups into the power relations, corporatist theorising has failed to consider the corollary of this. Namely that certain groups are excluded. Nedleman and Meier (1977:40) make a similar point when they argue that there has been a lack of analysis of why some groups form stable relations with the state. They argue that such an analysis will uncover an equally important point, namely why some groups do not form these relationships.

As Nedleman and Meier (1977) argue this goes to the crux of the debate about corporatism. One important issue is whether the term is to be used merely in a descriptive way, or also as a prescriptive device. That is, are the corporatist theorists merely describing a situation as it exists, or are they advocating this as a desirable ideal system. Nedleman and Meier sum up their thoughts, and the problems of the purely descriptive approach in the following terms:

> "Our impression is that the corporatist model should be regarded principally as a descriptive model, that is, as a set of assumptions concerning selected features of reality which does not relate these features explicitly to each other. From this descriptive character, however, follows one problem typical of descriptive models in general: it seems rather arbitrary in its selection of the types and range of structural elements included." (1977:40)

Like Panitch (1980), Nedleman and Meier (1977) call for wider societal concerns to be considered, and for questions to be raised about why certain groups form and how they become powerful. The cultural and legal system of a country are central, they argue.

The latter point is particularly important, because it raises the question of empirical work and corporatism. It is clear that each western country has a different cultural and legal tradition. Studies in one country (which purports to show corporatist arrangements) may not be applicable to another country. This therefore hinders the general applicability of the concept, and undermines its claims to be based upon fundamental changes in the capitalist means of production.

Schneider (1985) undertook a comparative study of the United States and German chemical industries, and he highlights the difference in regulation in the two countries. He concludes that it is the cultural and legal differences which affect the regulation of what is in essence the same type of industry. Thus the different constitutional and administrative law systems are seen to lie behind the openness of the regulatory process. The US has extensive requirements for open decision making and Freedom of Information legislation which limits the ability of the state to give just one organisation a more privileged position. This is the case not only because of legislation in the Chemical industry (specifically the Toxic Substance Control Act TSCA) but the US constitutional law in general. As Schneider says:

> "In US regulatory proceedings, even peripheral groups have the opportunity to voice their interests, and TSCA itself provides organised groups and individuals with several 'avenues' for direct participation in the making of rules."(1985:178)

But it is not just the law which is important. Schneider (1985) shows how the different political arrangements also play a central role in the way regulation is conducted. In the German governmental system the legislature is less of a decision making forum and more of a 'rubber stamp' for policies advocated by the executive. This means that policy is already set by the time a proposal is presented to the legislative assembly. The public debate and scrutiny it receives there is unlikely to alter the eventual outcome. However, while in Germany decisions are taken in private, in the US the more active role played by the legislature ensures openness. In the United States the executive and the legislative branches of government are more often in open conflict. There is no guarantee that any proposal presented to Congress will be passed, and there is a likelihood that it will be altered as the Congressional debate takes place. This more open and unpredictable policy making process means that there are more opportunities for interested parties to have an input, and by influencing the legislators, to affect policy.

Salisbury (1979) also discuss the lack of corporatist arrangements in the United States. He identifies further the characteristics of American society which militate against corporatism developing. He stress both the diversity of American society and the distrust of private groups exercising power. He argues that the US is a much more economically and socially diverse country compared to its European counterparts. The sheer size of the country, with its great regional variations and variety of national and cultural backgrounds, means that it is not possible for one group to develop a monopoly representative position for any particular section of society. Moreover, businesses and firms in the US are generally larger than in Europe, and this means that they have the resources and personnel to undertake lobbying and make representations without the need to join together into a collective organisation (within which they would have to compromise to some extent). Salisbury (1979) also argues that strong individualistic tendencies in American society undermine the formation of strong private associations. There is a belief that private groups operate against the public interest (serving only their own narrow interests) and so they are viewed with suspicion. This is one of the reasons that the US has more 'open Government' requirements than many other countries, and is also reflected in the fact that lobbying (of the legislature and the executive) is a regulated and controlled activity, in contrast to most European countries. All these factors mean that corporatism has not developed in the United States in the way it has in other western countries, which undermines the claims that corporatism is anything more than a descriptive term.

Another problem with the definition and discussion of corporatism is that it fails to define adequately what it means by the state. It is agreed that the state must be strong, and that some characteristics like a federal structure will undermine its ability to ensure it can implement the bargains reached with private actors. But whilst this tells us the general characteristics necessary, it does not adequately outline which organs of the state are the central players in corporatism. Wilson (1983) criticises the way in which corporatist writers stress the importance of the state, yet fail to define fully what they mean. He says

> "...neo-corporatist literature is usually vague on the nature of the state and its actual activities. A very basic question left unanswered in most discussion of neo-corporatism is, what is the state. Is it the parliament and government, elected public officials, the bureaucracy, or some combination of these ?" (1983:111-112)

Therefore it is possible to identify several basic problems with the use of corporatism, and with the inadequacies of its development as a concept. Partly, it seems this is because corporatism was developed because the dominant American way of conceptualising social relations, namely pluralism, was no longer seen as adequate for analysing several western countries.

Schmitter (1979) argues that corporatism and pluralism share many common features, in particular the way they ways of conceptualise social relations and power. Both concepts put great importance on formal associations and attempt an analysis based upon their more obvious input (or attempted input) into policy making. They do not consider the informal way in which actors may exercise power. Nor do they consider the internal decision making processes of private organisations in order to assess how representative the organisation is and what factors influence the internal agenda setting. Moreover, corporatism and pluralism share common assumptions about the way in which people define their own interests and so seek representation of their views. Both concepts accept that territorial and religious concerns have declined in favour of functionally interests. Moreover they see these as being in conflict, although there is not a consensus over whether this a desirable feature or not. Corporatism and pluralism also share common features with regard to changes taking place in the state. They describe the growth of a specialist information and technical part of the state, which has the knowledge and ability to interact with private organisations in the policy making process. This is seen as part of the expansion of public policy into ever increasing and formerly private areas. Public/private compenetration is seen as a central feature of both systems.

These common features had led some to argue that corporatism is merely a rejection of pluralism (Nedleman and Meier 1977) and that therefore it has failed to really develop because it has been defined simply in terms of what it is not. That is, its tenets are more a contradiction of pluralism than a new and coherent theory. Indeed it has also been argued (Wilson 1983) that corporatism is not a separate theory but just a modified form of pluralism. Wilson (1983) argues that rather than seeing corporatism and pluralism as separate competing theories, their common assumption and focus, mean that they should be seen as the extremes on a continuum. Each has its ideal or pure form, which rarely exists in the actual policy making process. Policy making actually takes the form of a mixture of these two extremes and corporatism and pluralism can co-exist in any society.

This approach is obviously in contradiction to the idea that corporatism can be used to describe the whole of society. Corporatism cannot be seen as an alternative to capitalism, for example, if it is seen only to exist in certain circumstances and rarely in a way which fulfills all its basic ideas. But it can be seen as an example of interest intermediation, within a capitalist system, even if it rarely exists in a pure form. This is how I will use the term in this work. I want to consider how the various interests in the financial services industry have been able to influence policy making, in the regulatory system. I do not feel that corporatism has really developed as an all encompassing economic form, but rather that it adequately describes the policy making process at a micro and meso level in several areas. Moreover, if law is to have a qualitative rather then just a formal element it must consider not just the mechanics of decision making, but the openness and fairness of these procedures. I will consider who participates in decision making and how accountable those taking decisions are. It is not clear whether corporatism is merely describing a decision making process, or whether it is advocating it as a way which should be adopted. But either way there are problems, which must be considered in terms of how legitimate the system is. In particular, questions around why certain groups are excluded from corporatist arrangements, and whether policy making comes to serve the private interest rather than the public interest, are central to the question of legitimacy. It does initially seem that corporatism, with its emphasis upon a limited number of private groups, acting with state backing to control and regulate their members, is descriptive of the aims of the system established under the Financial Services Act. Therefore it will provide a useful tool with which to consider the empirical work of this thesis.

Private Interest Government and Regulated Autonomy.

One other aspect of the corporatist literature needs discussion before moving on to consider the empirical work on the financial services industry. Private Interest Government (PIG) has been used (Streeck and Schmitter 1985) to describe a situation which appears to be a particularly extreme form of corporatism. Here the state no longer takes an active day-to-day role in policy making. Rather it withdraws and the private organisation makes and implements policy without interference. Advocates of this approach see the state as being responsible for setting guidelines and the initial controls on the private organisation. These would, hopefully, ensure that the public interest is maintained and regulation does not come simply to serve the private organisations alone. But the state's role is not to actively intervene to ensure this on a regular basis.

It has to be said that PIG is not fully developed in the literature and it is not entirely clear if it is an entirely new theory, in opposition to corporatism, or merely a variation of it. I would argue that it is the latter. As PIG was developed by those who emphasised the variety of meanings for corporatism (Streeck and Schmitter 1985 for example), then perhaps this was a way of creating a separate identity for the interest intermediation variety of corporatism (and so splitting it from the macro meanings), rather than identifying an entirely new concept. Having said that it does seem slightly different because the state does withdraw, and corporatism seems based upon a constant state/private organisation relationship.

Importantly it seems that something like PIG was claimed for the regulatory regime established under the Financial Services Act. The industry was particularly keen to avoid what is saw as harmful and unnecessary government interference, and the government claimed this was part of its ongoing emphasis upon the free market. In theory the phrase often used to describe the system (self regulation within a statutory framework) does suggest a PIG type arrangement whereby the statute sets the boundaries but the industry then regulates on day-to-day matters. As Birkinshaw, Harden and Lewis put it:

> "...it must be recalled that this move (i.e. the FSA) was heralded as an exercise in setting the City free: an exercise in deregulation." (Birkinshaw, Harden and Lewis 1990:236)

They classify this type of situation, where power is delegated to a private body as 'regulated autonomy' but it seems very similar to PIG. Whatever the phrase used, and whether it is seen as a type of corporatism (which Birkinshaw, Harden and Lewis (1990) suggest it is) this PIG type of policy making raises even more sharply the questions of accountability and openness which concern public lawyers. As Birkinshaw, Harden and Lewis say:

> "To some extent regulated autonomy will involve functional groups relieving the state of difficult problems of control and even of legitimation, but it is the cost at which this is undertaken that should interest us most. Leaving aside the control or influence which the group exercise over its own memberships, to what extent will it subject itself to public inspection and render to account ?" (Birkinshaw, Harden and Lewis 1990:241)

This is a particularly problematic issue in the UK where, without a Freedom of Information Act and 'open government', much policy making can go on without public knowledge and scrutiny. It is the case that the government may appear to withdraw from day-to-day decision making, and still be having a very important, but informal and unaccountable, input.

It is these questions which form the basis of this thesis. In the next chapter I will give a more detailed description of the financial services industry, and the background to the regulatory changes in the 1980's. This shows clearly the variety of actors involved in the policy making process. Such diversity necessitates a closer focus in order to consider fully the legitimacy of the decision making process. Therefore, in chapters four and five, I will focus on one particular group of practitioners (FIMBRA members) in order to consider the twin issues of participation and accountability. It is clear from the above discussion of corporatist policy making, that it can increase participation. This is because the corporatist body must be responsive to its membership if it is to be able to get them to fulfill its bargain with the state. Ordinary members are therefore able to participate in, and influence, policy making, and are able to call their leadership to account if their interests are not being served. However, this does not necessarily lead to the policy making system being legitimate. There is a danger that the membership will be too influential, and so will be able to subvert the process, to such an extent that policy comes to serve only their narrow self interests. The issue of participation and accountability must also be seen in terms of the wider public interest. A system will lack legitimacy if it is dominated solely by private interests.

It is these alternative issues of legitimacy which I will consider using my empirical work. On a micro level I will analyse how responsive FIMBRA was to its membership, and whether its members had too much influence. On the meso level I will consider these issues by looking at whether FIMBRA members were able to influence regulatory policy in relation to the whole of the financial services industry. It will then be possible to make an assessment of how legitimate the policy making process has been in this industry.

Chapter Three: The Financial Services Industry.

Introduction

This chapter will focus on some of the history of the current regulatory regime. This will serve two purposes. Firstly, it will give the factual background (e.g. important developments and technical terms) needed for the later discussion of more recent policy making. Secondly, the historical analysis will provide a basis for some preliminary analysis of decision making, which can then be expanded upon in the later chapters using original material. My main concern is to look at how policy is made; which actors participate and how accountable the whole system is. By looking at the FSA debate and outcome it will be possible to highlight these issues.

It soon becomes clear that there are large number and variety of industry actors. In the next chapter I will focus upon one group in particular, to see how influential they were, but this chapter will detail the different sectors of the industry and show the varying profiles they each have. By highlighting the constant policy battles, and showing the variety of actors involved, this chapter will provide a basis for the detailed and particular analysis of regulatory change which will follow. It will also show clearly, how policy making in this area is hybrid in nature, and will therefore link with previous chapters theoretical considerations.

From the above discussion it is clear that what is meant by corporatism, and its potential usefulness for analysing particular practices, is unclear. However, whilst there are inadequacies, and variations, in the use of the phrase I feel it does provide a useful tool with which to discuss hybrid policy making. This is particularly so if the term is used in its narrower sense, namely as a way of describing interest intermediation. This is because corporatism stresses the inclusion of private actors in the policy making and implementation process, and this opens the way not only for greater effectiveness, but also greater legitimacy. The corporatist body's leadership will need the support of its members if it is to implement any policy agreed with the state. This support is only likely to be forthcoming if the membership have a meaningful role in policy formulation and approval. It is this type of improved participation and accountability which can bring increased legitimacy.

However, their is a danger that this type of 'internal accountability' (Birkinshaw, Harden and Lewis 1990:183) will undermine wider a public legitimacy. The compenetration of public and private raises the possibility that private actors (such as a corporate bodies membership) will come to dominate policy making at the expense of the public interest. However, the blurring of public and private, discussed above, means that defining the public interest becomes very problematic. As I discussed above (see Poggi 1987,1990) there is no longer the shared values and norms which characterised society prior to capitalist developments, and so postulating any particular policy as having universal support becomes difficult. Yet without such values it is likely that the most powerful private actors will simply come to make policy in their own favour. It is to prevent raw power becoming the basis for policy making that various writers have attempted to define basic principles for an equitable decision making system. Both Lewis (1996) and

Prosser (1982) attempt to do this, and whilst they come from different theoretical backgrounds they both see law as central to ensuring that a fair, and therefore legitimate policy making system operates.

The discussion of private interest domination is particularly pertinent to the regulation of the financial services industry, under the Financial Services Act. This is because the FSA attempted to introduce a system of 'self regulation' in which the private actors most closely involved in this area (industry practitioners) were explicitly to be involved in regulatory policy and implementation. As I shall discuss in this chapter, this was designed not only to bring the benefits of corporatist arrangements, considered above, namely more efficient and effective policy making and implementation, but also to ensure that policy was also made in the interest of the wider public, both as investors and generally. Self regulation would thus deliver a much improved system of policy making. However, there is a possible contradiction embodied in the term 'self regulation', because there is always the likelihood that there will be a conflict between practitioner views (the self) and the wider public interest (regulation). If this does occur then their are two possible dangers: firstly, that the industry (the self) will dominate, and be able to make policy simply in their own interests, a form of agency capture as discussed in Chapter One; secondly, that the industry will be excluded (in favour of the regulation element) and that rules will be made which over burden the market and are generally ineffective. For self regulation to be fully effective and legitimate it needs to balance these two elements, and be a way in which industry views can be channeled into policy making, but not to such an extent that they dominate the system.

It is the consideration of these issues, in relation to the financial services self regulatory system which forms the basis of this thesis. But before turning to the empirical data, it is necessary to discuss how the regulatory system came to be implemented. This will highlight the reasons behind its self regulatory nature, and emphasise that this is only one example of the effects of compenetration on state and society relations.

Political Change and the Financial Services Industry.

Regulation in this particular industry reflects broader changes with regard to the state and policy making which are occurring. Therefore it is necessary to give an introduction to the changes in the UK political environment. Moreover, the financial services industry operates on a global basis and this too has affected how the UK industry is regulated. Therefore some consideration of these factors is also important.

In the UK, a convenient starting point for policy making is the 1979 Conservative Party election victory. This saw a Government elected which claimed to be determined to break with the post-war political consensus, and to introduce change throughout British society (see generally Gamble 1988, Hutton 1996). Many of its proposed policies are directly related to the theoretical concerns of this thesis, namely the role of the state and policy making. The Conservative Party claimed that the state was operating in too many areas; that it had taken over roles which should be left to the free market or to individual provision. It was determined to roll back the boundaries of the state, to reduce what it saw as state over provision and interference (Gamble 1988:31-32).

Moreover, it also challenged the way that it perceived government policy had been made in recent years. It criticised the role of special groups (especially the Trade Unions) and sought to end what was widely perceived to be the corporatist policy making which had seen them included in decision making (Lewis and Wiles 1984). The justification for ending the inclusion of private interest groups in policy making was that these groups had been able to subvert the policy process to their own ends. As a result, rather than policy being made in the public interest, it was favouring one particular group (Lewis and Wiles 1984:31-32).

Thus the Conservative party appeared to be rejecting corporatist arrangements, because they were illegitimate. However, as I shall discuss, the policy making approach adopted by the party in Government can still be characterised as corporatist. There was still considerable use of private actors. It was simply that the type of private actors concerned altered, with business being included but Trade Unions excluded. This was seen in the debate leading to the new regulatory structure for the financial services industry. As I shall consider below, there was an emphasis placed upon decisions being taken not by a central bureaucracy but by industry practitioners, who were closer to the market affected. This was re-inforced by a rhetoric of free markets operating with minimum state interference. How this affected policy formation will be discussed in detail.

Firstly, however, some background is needed on the UK financial services industry. The 1980's can be seen as a time of great change in the financial services industry. This was due partly to the policies of the Conservative Government (for example the abolition of exchange control and the promotion of home ownership) which provided new opportunities and markets for the industry. Also Conservative rhetoric of breaking with the past and sweeping away old outmoded and restrictive practices was to affect the industry, for example the reform of the Stock Exchange.

But it was not just domestic factors which gave an impetus to change in the financial services industry. At this time advances in technology and the removal of trade restrictions meant that the financial markets began to operate not on a national level but on a global scale. Money could easily be invested on a world wide basis and London had to compete with other international centres for business.

These two factors, globalisation and the national political agenda, combined to cause great change in the way the financial services industry operated and was regulated. Prior to the changes of the 1980's, the regulatory system was best characterised as a 'club system', that is an informal one, which relied upon commonly held internalised normative values, to prevent misconduct. Under this system, if a member broke the rules, sanctions came from his peers in the form of private criticism, and disapproval. One commentator describes the system as follows:

> "The basis of the system was trust -- a belief that others in the institution operated under the same code of conduct. Trust was reinforced by the shared values, belief in professional expertise, common social origins and experiences, and the exclusiveness of the City's participants" (Fishman 1993:37)

There are many problems with this type of system, which became highlighted as changes occurred throughout the 1980's. Firstly, this system only works if all those operating in the market share the same values and if they see criticism from other players as undesirable and to be avoided. If this is not the case then the emphasis upon informal methods of discipline and control means that the system is unable to control those who are determined to break with agreed norms of conduct. As new players entered the de-regulated financial services it could no longer be said that there existed shared norms of conduct. The common social origins, which Fishman identifies, declined. The new players saw little reason to comply with previous norms, when the only sanction was an informal one.

This more heterogeneous industry, which was no longer bound by past conventions, was seen as more able to compete in the growing world market. Its greater flexibility and more dynamic attitude would, it was hoped, ensure that London continued to be a major world financial centre. But the end of previous practices did create some problems for London's position as a financial marketplace. With the end of the club style of control, there no longer existed a regulatory structure which would provide security and stability for those using the market. This lack of a regulatory structure was perceived as a major problem for London's competitiveness on the world stage. Fishman again puts it simply:

> "The government feared that if the City was perceived to be ridden with misdeed and scandal, institutional business would move abroad, probably to the United States" (Fishman 1993:40)

It was clear that some system of regulation was needed, one which was more formal and open than the previous system, and which would give investors confidence in the UK financial services industry.

This desire to establish a system which provided investor confidence and protection was not just related to the international position of the London market and its institutional investors. The Conservative Government was promoting domestic policies which placed heavy emphasis upon the use of the financial services industry. The privatisation of formerly state owned businesses, and other policies, promoted wider share ownership. The growth of home ownership saw millions of people using financial products for the first time. Indeed the attempts to reduce state provision and the welfare state meant that the Conservative Government needed a strong domestic retail financial services industry to provide the pension, insurance and others products that people required. Such a growth in consumer use of the financial services industry also required a coherent and effective regulatory structure. Without it the less well informed retail investor was likely to suffer from fraud and mis-selling, and this could undermine faith in the system as a whole. Regulation would ensure that people had faith in the financial services industry, so that they would invest money in the long term. Investor protection therefore became very important, not only in the short term to stop scandals, but also as part of the longer term objective of getting individual consumers to use the financial services industry.

This is the market stability and confidence arguments identified in chapter one, as reasons for market regulation. A free and unregulated market was not perceived to be working. The imbalance in power between private individuals and market professionals was too great, to such an extent that if could not considered a free market. Indeed this imbalance meant that the whole survival of the market, in the long term, was in doubt if regulation did not occur.

Gower Report.

It was clear that, for both international and domestic reasons, a full review of the regulatory structure of the UK financial services industry was needed. In particular the control of those marketing investment products under the Prevention of Fraud (Investments) Act 1958 seemed to be in need of urgent review. This Act required licensing or exemption (by joining a recognised association) for those advising on securities, but had failed to be effective because many associations became recognised, not just one which could have been strong enough to operate effectively. Moreover, many firms were exempt. The Act had failed to prevent misconduct and the embarrassing collapse of financial firms. These inadequacies may have been obvious for some time (Gower 1988:6-7) but in the early 1980's several scandals highlighted them, and embarrassed Government departments and the Bank of England, in such a way that the problem could not be ignored anymore. Professor Gower was commissioned in July 1981 to undertake such a review of the regulatory system.

His terms of reference were as follows:

> (a) to consider the statutory protection now required by (i) private and (ii) business investors in securities and other property, including investors through unit trusts and open-ended investment companies operating in the United Kingdom
> (b) to consider the need for statutory control of dealers in securities, investment consultants and investment managers; and
> (c) to advise on the need for new legislation.
> (From Gower 1984: para 1.01)

The choice of a one man review, rather than a committee, was undoubtedly aimed at saving time, with the Government originally asking Gower to complete his work within two years (he declined see Gower 1988:8). As to why Gower was chosen to undertake such a task, and the negotiations he undertook before accepting, he offers the following insights:

> " You may well ask, as I did, why me ? The answer is that I happened to be on the spot as a part-time adviser to the Department on company law matters and they could not think of anyone else who might be foolish enough to accept. I tried to wriggle out of such an unexpected and onerous assignment by pointing out that I was unlikely to be *persona grata* in the City Establishment and by laying down conditions which I expected to be rejected. But apparently the Establishment failed to black-ball me - probably, in the light of their subsequent reactions, because they had failed to recognise that the wide terms of reference covered their operations and not merely those of the small fry. And the Government accepted all my conditions - albeit after a heated argument" (Gower 1988:7)

Gower's appointment may not have raised much opposition in the City Establishment but his first proposals, published in a discussion document in January 1982, certainly did. His main interim recommendations were for a comprehensive regulatory system, covering all those in the financial services industry, and secondly for this to be overseen by a self standing commission. The industry rejected both points.

The industry, it seemed, did not feel that such an all encompassing system was needed. Many perceived the problem of mis-advice and fraud to be one which was confined to fringe operators. They argued that it was not necessary to extend regulation to all firms, as the majority operated in the best interests of their clients (Gower 1988:9). Gower's other proposal, for a commission to be the overseeing body, was also opposed as unnecessary interference. The industry stressed the belief that self regulation was best; that only those working in the industry really understood its practices and so were well placed to discover wrongdoers. It argued that such practitioner based regulation would be far more effective than government control.

As Gower says (1988:8), the City believed it had a genius for self regulation and so did not need the involvement of an external body, be it government department or a new commission. They feared, in particular, a strong body like the United States' Securities and Exchange Commission (SEC) overseeing and regulating their activities. (Gower describes the prevailing view of the SEC as an almost paranoid fear and dislike 1988:8). The City believed that it should be left alone to regulate its own activities and that formal external involvement should not occur.

But as noted above, the prevailing type of regulation in the City was more like a private club, with a reliance upon shared values and informal discipline rather than a coherent and open, legally based system. This informal regulation was viewed as ineffective and simply serving the interests of the those in the industry, rather that the public interest. It did not seem that wrongdoers were properly punished by this informal system, and this meant that there was no deterrent to stop future malpractice. The constant occurrence of scandals and the disappearance of the previous homogeneity which had characterised City players meant that, to Gower, it was clear that a new, and comprehensive system of regulation was needed.

His report, when finally published in January 1984, called for legislation to establish a new comprehensive system of regulation, and detailed the reasons why. As one commentator said:

> "The report highlighted the mixture of strong and weak supervision which was inconsistent, complicated, uncertain, inequitable, tending to create elites

and fringes, and involving an unnecessary diversity of regulations and regulators" (Goacher et al 1987 :438)

Gower himself seems clear on what he saw as the most desirable way to overcome these problems. He said:

> "For what I believed was needed was something similar to the system adopted in the United States...I wanted statutory control of investment business, widely defined, under which all those conduction that business would be authorised by, and regulated through, membership of a few self regulatory organisations recognised by, and under the surveillance of, a governmental or quasi-governmental body which, ideally should be a self-standing Commission." (Gower 1988:8)

To this end, his lengthy report called for the repeal of the Prevention of Fraud (Investments) Act to be replaced with new legislation. This would make it a criminal offence to carry on investment business unless registered (see Gower 1984: para 2.11 for outline of recommendations) with registration coming either from a government department (or a new commission) or from membership of a self regulatory agency recognised by the department. It seems that he did envisage most firms being regulated by a self regulatory agency, with the department (or commission) overseeing the whole system, rather than the day to day conduct of industry participants. On the question of a government department, or a commission taking on this strategic role, Gower lists several advantages and disadvantages for each (see paras 3.01-3.16). His overall conclusion on this point is not, however, entirely clear. He does say (para 3.16a) that the Department of Trade and Industry should initially be responsible, but in the next paragraph recommends that if the volume of work becomes substantial, that a self-standing commission, responsible to the minister, should be established.

It is unclear whether this is a proposal or merely a possible option. However the quotation above shows that Gower did favour a commission, and so one can conclude that his failure to recommend it in his report was likely due to factors outside his control. Two particular sources of opposition have already been noted. Firstly, the industry was strongly opposed to an SEC type body because it feared this would have excessive powers. Rather it favoured self regulation. Secondly, the idea of a new commission did not comply with the stated government policy of reducing quangos.

It seems clear that outside actors had influenced Gower in his final conclusion. The question is the extent of this influence and the desirability of it. It is clear that industry voices were being heard and listened to. The question arises, as to whether this is in the public interest. I have already shown that participation is crucial if modern policy making is to be effective and to have legitimacy. The collapse of the public/private divide, and the developments of a hybrid decision making process, presents an opportunity for more voices to be heard in the policy making process. Both corporatist and pluralist models represent ways in which this can be achieved.

My concern, however, is in assessing how this participation affects the public interest in policy making. The danger is that only a narrow range of views will be involved and that they will be able to pervert policy making in their favour (the main criticism of the corporatist model and the basis of agency capture theory).

However, the previous devices for policy making, centering on Parliament, no longer provide a satisfactory way of developing the public interest and facilitating participation (due both to the compenetration of public and private realms as well as inadequacies in the system itself). It is necessary to recognise that wider participation is both occurring and necessary for the policy making process.

This means that the industry views represent one, amongst many, legitimate concerns which should have some influence. This recognition does complicate the idea of a 'public interest' because it undermines the idea that this is a single (or simple) position. However my argument is that the public interest should be seen to lie in full participation (by all concerned parties) and post hoc accountability for decisions made. This represents a widely applicable concept, which recognises the variety of interested parties, but also prevents one interest dominating policy making.

So it is not necessarily the case that because the distinct views of the industry (against a self standing commission) were reflected in the Gower report, that they had detrimentally affected its conclusions. Rather, it should be seen that this argument represented a wider position, supported by other players, and that the participation of those affected by a policy is desirable.

Indeed it is clear that the legislation which followed the Report was not simply designed to placate industry views. The White Paper which lead to the FSA talks in particular of the inter action between industry confidence, regulation and efficient market operation. It says:

> "In all developed countries proper regulation to protect the interests of investors is seen as a necessary element in the healthy development of financial services. All should know that they are doing business within a system which is properly regulated, where fraudulent or dishonest conduct is prohibited and where high standards are expected and obtained. This is in

> the interests of both those who provide and of those who use financial services. Our existing investor protection laws are outdated and incomplete. They need to be made more straightforward, more consistent, more comprehensive, and more suited to the present and future challenges facing the financial services industry. (Department of Trade and Industry 1985:1)

Thus it is clear that the government accepted the main thrust of Gower's report, namely that a new comprehensive regulatory system was needed, something which was not accepted by the whole industry.

Indeed it is interesting to note that, whilst Gower had produced a very comprehensive report and had sought, and considered, the views of the industry (in particular by issuing interim conclusions and asking for comments), the Government still sought the views of practitioners before issuing the White Paper (see Department of Trade and Industry 1985: para 2.18). This took the form of asking two leading figures to chair groups of practitioners in order to give recommendations on the form of, and prospects for, practitioner based regulation. One group, established on the Governor of the Bank of England's initiative, looked at the general structure, but declined to consider the issues around the marketing of life insurance and unit trusts. Therefore, a second group, consisting of representatives of eighteen trade associations working in this area, was formed to look at this specifically (See Gower 1988:10-11).

So the government did not feel confident enough simply to follow Gower's recommendations. It felt it necessary to bring practitioners more directly into the policy making process. This is important because it highlights how practitioners had an influence from the very outset of the regulatory change. The government did not, it seems, feel able to impose a regulatory structure upon the industry, without first ensuring that it would have their support. The fact that the government was determined to establish a 'self regulatory' system and needed the industry to actually establish the bodies which would provide their members with authorisation, added to the need for industry support.

This provides an example of the way in which the state was forced to bargain with private interests. The modern policy making process requires that private actors are involved, as public/private intermingling reduces the capacity of the state to impose a system without their support. It is clear that the financial services regulatory regime was, from the outset, an example of this hybrid decision making process. The question remains, however, as to which actors were involved, and the extent of their ability to dominate the system.

The fact that eighteen trade bodies in the marketing sector were consulted does suggest that this was a more pluralist than corporatist arrangement. Although it should be remembered that in pluralism it is influence that is widespread, merely having an opportunity to put your views, but with no influence, is not enough. In pluralism the state acts as judge, implementing the policy favoured by the majority of interested parties. One actor or group does not dominate the process. But it does seem that the group established by the Governor of the Bank of England, and consisting of leading City practitioners (Gower call them the 'ten wise men' 1988:10) was more influential. It gave recommendations on the whole structure of a self regulatory regime, rather than focusing on one particular area. In terms of the accountability of this decision making process two questions arise. Firstly, why were these particular people chosen? It is stated in the White Paper that they are 'leading City practitioners' but we are not given any more authority for their appointment. This is hardly an unproblematic definition. The danger is that only a narrow section of industry views was represented. In particular it seems that those who already had considerable influence where able to recommend, and actually achieve, a system which would uphold their favourable position. The second problem relates to our ability to question the views canvassed by this group. As it recommendations were never published, it is not possible to access the input of various actors or draw conclusions about how decisions were arrived at. This is another example of the lack of openness in decision making is endemic throughout British policy making. This severely reduces the ability of outsiders to call those wielding power to account, by criticising their conclusions and recommendations. It is clear therefore that this was a process which had some participation, by some actors, but little in the way of accountability. It legitimacy is therefore weakened.

Moreover, the background to the FSA provides an example of the new hybrid approaches to policy making. The problem of regulation had been clear for some time and whilst the Government had its own political reasons for wanting to establish a new regime, it did not simply impose it. The particular concerns of the industry (i.e. private actors) had to be addressed, and they were brought directly into the policy making process. This happened both via Gower's consultations, and again via the groups of practitioners established after he had reported. It is clear that the public and private sectors were intermingling to devise policy. However it is not clear that this necessarily led to the possible advantages, in terms of participation and accountability identified earlier. Certainly more groups participated in the policy making process, but doubts arise as to the weight given to each sector, with some actors having more influence than others. Moreover the lack of openness reduces the scope for exploring whether this was the case, and for calling the policy makers to account. The main argument against corporatist decision making (that a few vested interest twist policy to their narrow advantage) is therefore difficult to dismiss.

These issues will arise throughout this thesis, but first I wish to explain and consider the legal regime which did eventually follow the Gower report.

Financial Services Act: General Principles

The white paper did form the basis for legislation, namely the Financial Services Act 1986 (FSA or simply the Act). While this is a long and detailed piece of legislation, with regard to the focus of this thesis, its basic premise is quite straightforward. The Act defines investment business (s1(2)) and requires that anyone carrying on such business must be authorised to do so, or be specifically exempt from authorisation (s3). However, the way in which authorisation, and exemption, can occur, and the detailed provisions relating to those bodies which administer the regulatory scheme, make consideration of the Act a complex affair.

Throughout the Act powers are vested in the Secretary of State. Until 1992 this was the Secretary of State for Trade and Industry, but following the Transfer of Functions (Financial Services) Order 1992, most (although not all, of these powers were moved to the Treasury (see Rider 1997:128). However, the Act (s114) also contains a provision for most (although not all, s114(5) and (6)) of the ministers powers to be delegated to a 'designated agency' (s114(1)). This can only occur if the requirements of Schedule 7 of the Act are meet. This includes provisions as to the bodies constitution (Schedule. 7, para 1), and how it is to discharge it functions (para 2). It also contains provision which require the agency to ensure that it is monitoring the firms it regulates (para 3), and to have effective arrangements to investigate complaints against such firms (para 4).

The constitutional arrangements show clearly that the designated agency is to be a hybrid body. The chairman and governing body must be appointed by the Treasury and the Governor of the Bank of England acting jointly (Schedule 7, para 1(1). They can also be removed by such joint action. Schedule 7(para 1(3)) also states that the governing body must include both members with experience of the industry and

> " (b) other persons, including regular users on their own account or on behalf of others of services provided by persons carrying on investment business" (Sch. 7, para 1 (3b)).

This opens the way for non-industry persons to be appointed to the governing body, and the next line of the Schedule states that the composition of the governing body must be such that a 'proper balance' is struck between the interests of industry practitioners and the interests of the public. Therefore, it is clear that the industry will have an important role to play in the governing body of this agency. The Governor of the Bank of England is often seen as conduit between the financial services industry and the government (Birkinshaw, Harden and Lewis 1990:86-89) and his prominent position in the appointments process can be seen, to some extent, as another form of industry input. But this private sector influence is to be tempered both the requirement of 'proper balance' in the governing bodies composition, and by the role of the Treasury. It is therefore the case that both private and public actors play a crucial role in the agencies composition and operations.

However, whilst the Act uses the term agency relation to the body to which powers can be delegated, it then goes on (s114 (2)) to specifically state that the Securities and Investment Board Limited (the SIB) shall be the body to which powers are actually delegated, if, it is willing and able to discharge these duties, it meets the requirements of Schedule 7 and such delegation is approved by both Houses of Parliament (s114(11). This delegation did take place, on 18th May 1987, by virtue of the Financial Services Act 1986 (Delegation) Order 1987, in which the Secretary of State affirmed that the SIB had met all the relevant statutory requirements (see Rider 1997:28-29).

The SIB is a private company limited by guarantee, and was specifically established to take on this regulatory role (Rider 1997:31). Whilst the powers delegated to it are considerable (Rider 1997:29-30), the Treasury always has the power to revoke this delegation (s115), and this combined with the power to appoint and remove members of SIBs governing body (Schedule 7 para 1) means that the SIB can be seen as a hybrid body. Its private membership does not have control of how the company operates, as it must comply with detailed statutory requirements or suffer the intervention of the government. Rider (1997) describes this situation in the following terms:

> "Thus, although the SIB is a private company, its position as the body vested with primary responsibility for the regulation of investment business in the UK depends upon satisfaction of statutory criteria and is subject to continued statutory regulation and control." (Rider 1997:27)

Therefore while the delegation of powers to the SIB moves policy making in this area away from traditional public decision making forums, namely government and Parliament, it is clear that this is not simply a shift to the private sector. While the SIB is a private company, and is privately funded, it is still controlled in many clearly public ways, namely statutory requirements and possible intervention by government ministers. The inclusion of public interest members on its governing body emphasises again that this is a hybrid regulator. Indeed the total control over the SIB's governing board, and the lack of independent power, without government delegation, means that the SIB can be seen as towards to public end of a public/private spectrum. The role for industry involvement is circumscribed, and the constant government monitoring seems to preclude the possibility that private industry actors would be able to 'capture' the SIB and twist policy making to their own narrow interests. But there is also a danger that industry concerns will not be sufficiently reflected in the SIB's operations, precisely because it is too dominated by non-industry actors and statutory controls.

Greater industry input does, however, come from another source. This is because while the Act requires that those carrying on investment business must be authorised (s3), it provides several ways in which this can be achieved. Although the SIB is able to authorise investment firms directly (s25), it was never envisaged that the SIB would be the main regulator of firms (Rider 1997:35). This role was to be delegated to other bodies, most notably the Self Regulating Organisations (SROs). The Act (s7) provides that membership of an SRO makes a person authorised. The role of SROs is central to this thesis, and therefore they will be discussed in detail below, but it is important to note that several other channels for authorisation exist under the Act. For example, section 15 allows for authorisation by membership of a Recognised Professional Body (RPB) and section 22 creates authorisation for insurance companies who are already authorised to carry on insurance business under the Insurance Companies Act 1982. Another important exemption relates to 'appointed representatives' under section 44.

A further complication to the authorisation question is created by Chapter IV of the Financial Services Act 1986. This deals with exempted persons, that is, those who do not need to seek authorisation. Recognised Investment Exchanges (RIEs) and Recognised Clearing Houses (RCHs) fall into this category and are dealt with under sections 36-39 of the Act. What is meant by an RIE is not defined in the Act, but the SIB may only recognise a body as one, and therefore make it an exempted person (s36), if certain criteria are complied with (s37(2)). These criteria are laid down in Schedule 4 of the FSA, and relate to the financial resources (para 1) of the Exchange, as well as requirements as to safeguarding investors by orderly practices (para 2), effective monitoring and enforcement market rules (para 3) and investigating complaints (para 4). Even if these criteria are meet, the SIB still has a discretion whether to grant recognition, and at present their are six organisations recognised as RIEs (see Rider 1997:49). The role of RCHs is closely linked to that of RIEs, because the former exist simply to provide clearing services in respect of business done on a RIE (s38(2)). The requirements necessary before recognition of a RCH are essentially the same as those for a RIE (s39(4)) with the SIB again having a discretion as to recognition (s39(3)). The SIB has recognised two bodies (the London Clearing House, and CrestCo Ltd.) as an RCH.

While a consideration of these specialised markets are outside the scope of this thesis, the above brief outline shows clearly that the regulatory structure established by the FSA is not a simple one. However, one route to authorisation has had a considerable affect on the retail sector and FIMBRA in particular. That is the ability of professional bodies to become recognised by the SIB (s17, s18) as RPBs and therefore to provide their members with authorisation (s15) without the need to join an SRO. These provisions were designed to cover the fact that professionals, like solicitors and accountants, often give some investment advice as an incidental part of their main business (Rider 1997:46), and it alleviates the need for them to join an SRO for what is only a small part of their business. To this end the definition of a professional body in the Act (s16(1)), is given as simply a body which regulates the practice of a profession except one which consists mainly or wholly of investment business. And the Act goes on to require (s18 (3)) that the RPB must set acceptable limits on the extent of a members investment business.

There are other requirements which must be met before the SIB can recognise a body as an RPB and these are laid down Schedule 3 of the Act. These relate to: investor protection (para 3); monitoring and enforcing rules (para 4); investigating complaints (para 5) and promoting and maintaining high standards (para 6). With regards to investor protection the RPBs are subject to the same requirement as SROs namely that they must have rules which provide an adequate level of investor protection. There is no automatic right to be recognised by the SIB, but once a body has been recognised as an RPB it can then grant a certificate to its members which means that they become an authorised person under the Act (s15).

Currently there are nine bodies which have gained recognition as RPBs (Rider 1997:46). They are the Institute of Chartered Accountants in England and Wales, the Institute of Chartered Accountants of Scotland, the Institute of Chartered Accountants in Ireland, the Chartered Association of Certified Accountants, the Law Society, the Law Society of Scotland, the Law Society of Northern Ireland, the Institute of Actuaries and the Insurance Brokers Registration Council.

Most of these bodies are widely known, and have proved fairly uncontroversial as financial services regulators. However, the Insurance Brokers Registration Council (IBRC) is a rather obscure body which has proved the most controversial RPB. It has certainly had a large impact on the retail sector, which is the focus of this thesis. It therefore deserves some consideration. The IBRC regulates those firms that describe themselves as insurance 'brokers'. Under the Insurance Brokers (Registration) Act 1977 anyone using the term 'broker' must register with, and comply by the rules of IBRC, which cover for example separate insurance broking accounts and solvency margins (Rider 1997:371). In order to comply with the FSA requirement, that investment business can only be incidental to an RPB members main business, the IBRC has set an upper limit of forty nine percent of total business which its members can conduct as investment business. This is clearly only just within the statutory requirement and, as I shall consider in the next chapter, this high figure has created potential problems for the SRO which could have regulated IBRC members, namely FIMBRA. This is because it allowed many firms which carry on substantial investment business to be authorised by the IBRC rather FIMBRA, something which affected FIMBRAs financial position. But before focusing on one sector in detail, it is necessary to fully explain the FSA system by considering the bodies take are the regulators for most firms, that is the Self Regulatory Organisations.

Self Regulatory Organisations

While there is a right to be directly authorised by the SIB (s27(2)), if certain criteria are meet, the SIB was not intended to be the main regulator for the financial services industry. Section 7 (1) of the Act gives authorisation to members of Self Regulating

Organisations (SROs). An SRO is defined (s8) as a body which regulates those carrying on investment business, by making and enforcing rules. As with RIEs and RPBs recognition from the SIB is needed and s10 and Schedule 2 of the Act lays down the criteria which must be meet before recognition of an SRO will be forthcoming. In many ways the SRO requirements are similar to the other bodies, with for example, a need to effectively monitor and enforce its rules (Schedule 2 para 4), effectively investigate complaints (schedule 2 para 6) and to promote and maintain standards (Sch. 2 para 7).

However, overall the criteria are more detailed than those covering the RPBs and RIEs, and in some ways they are similar to the requirements that SIB itself must meet before powers can be delegated to it. These statutory controls mean that the SROs can be considered hybrid bodies, being both privately responsible to their members but also publicly control by the FSA and the SIB. I have already identified the SIB as such a body, and placed it towards to public end of the spectrum. The statutory controls over the SROs are less than those over the SIB and this means that they must be placed more towards the private end of a public/private continuum, whilst still being seen as hybrid in nature.

The clearest control over how the SROs operate comes with the requirement as to their governing bodies (Schedule 2 para 5). In a similar way to the SIB there is statutory control over the balance of interests on this body. But these controls do not just relate to external accountability, in terms of public interest members, they also relate to the internal accountability the body has to its membership. This is because there is a need for a 'proper balance'

"(a) between the interests of the different members of the organisations; and
(b) between the interests of the organisation or its members and the interests of the public." (Sch. 2 para 5 (1) (a) and (b).)

Therefore the internal power relations of these private companies are regulated by statute, with the governing body required to reflect the variety of interests which may exist within its membership. This evidence of the SRO's hybrid nature is re-inforced by a further requirement (Schedule 2 para 5 (2)) that, in order to meet the need for a public interest balance, the governing body must include individuals who are independent of it and its members. These are clearly not private bodies which can set their own internal rules.

The statutory control over how the SROs operate is also clear in relation to who they can allow to become members, and therefore as authorised under the Act. In a criteria which reflects SIBs own requirement, SROs must ensure (Schedule 2 para 1) that its members are 'fit and proper' to carry on investment business. What this test has meant for SRO applicants will be discussed shortly. But this test is closely related to a further requirement, namely that SROs have rules which provide an "adequate" level of investor protection (Sch. 2 para 3). As I shall show shortly, this requirement has been amended (by s203 (1) Companies Act 1989) since the Act was originally enacted, but it still represents a way in which the operation of SROs can be controlled. This is because it is for the SIB to decide what is 'adequate' and it has several powers which can be used against an SRO if the statutory requirements are not being fulfilled, even after recognition has been given. As an ultimate weapon the SIB can revoke recognition (s11 (1)) but less drastically it can (s12) apply to the High Court for an order to alter an SROs rules if it is not meeting the statutory requirements. Moreover, the SIB may (s13) direct an SRO to alter rules, or itself alter rules, if the SRO is not providing adequate investor protection.

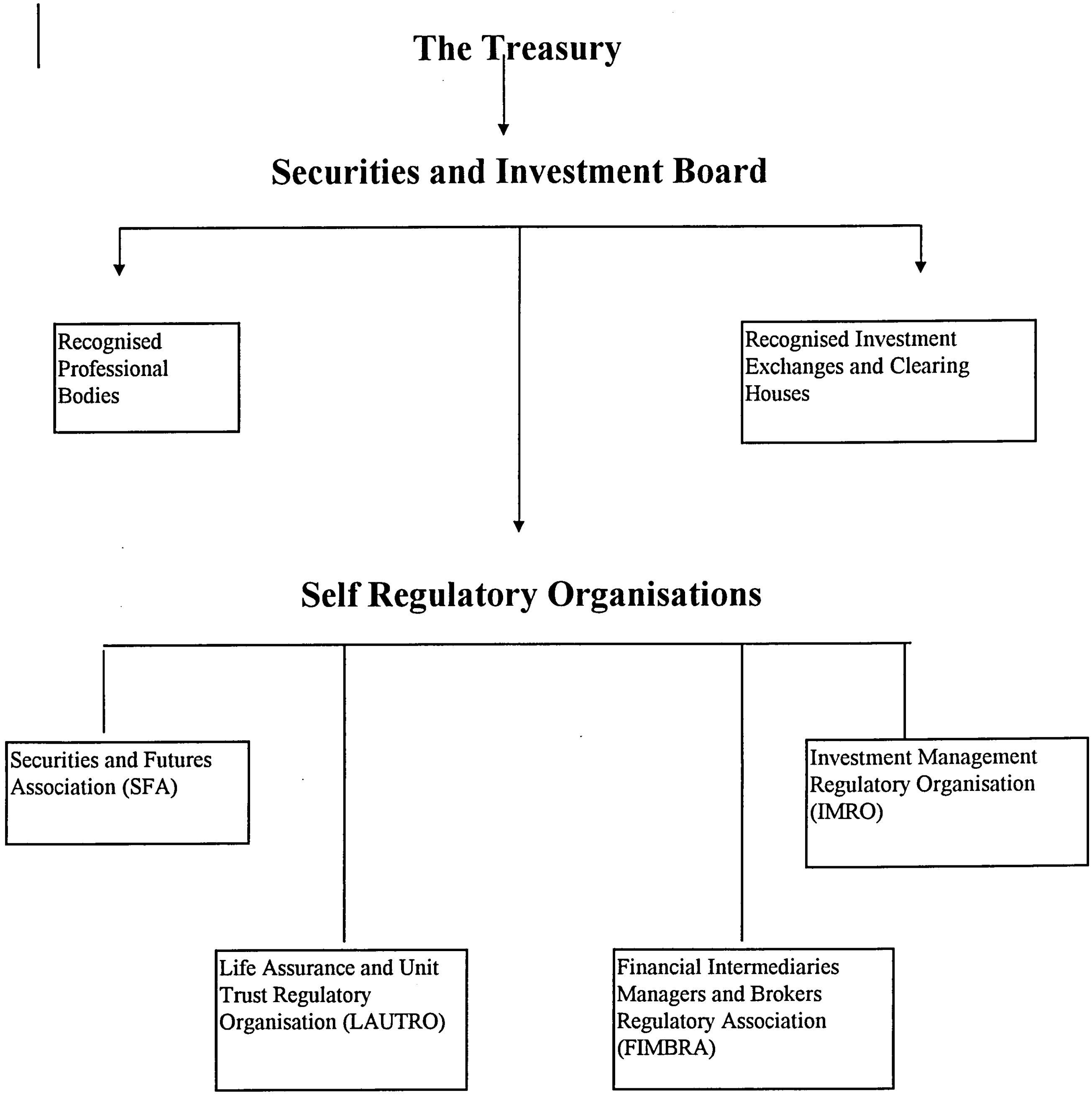
It is clear that these provisions represent a considerable control over an SRO, but while the SIB decides what is generally acceptable, in terms for example of adequate investor protection, it is still left to each individual SRO to set its own rules, rules which can reflect the particularities of the market they regulate. It is these rules which are binding on member firms as part of their contract of membership. This shows how SROs are both publicly and privately accountable. They must meet criteria laid down in the statute, but are also intended to be responsive to their membership, with its greater knowledge of market situation. This clearly makes them hybrid bodies, and as such they can be seen in the context of the theoretical discussion above (chapter two). SROs can be seen as corporatist type bodies, making and implementing policy, whilst also providing a channel for individual members to have an input into policy making. They also can be viewed in terms of the Private Interest Government, and regulated autonomy, literature. This is because once policy has been set (by the FSA) there is scope for these private bodies to regulate their members, with effective public authority, with little in the way of governmental or state interference. For example there is no definition of 'fit and proper' in the Act and so an SRO must decide itself what criteria to apply to prospective members (see Rider 1997:185-186, Goacher 1993:194 for the criteria applied). This however, raises the danger that private actors will be able to make policy in an illegitimate way, based on their own narrow interests.

It is these issues of practitioner and public interest input which have been central to the debate, and reforms, which have followed the implementation of the FSA. And it is these issues which the original empirical work undertaken for this theses has considered. However, before considering this data it is necessary to consider the early years of the FSA regulatory system, in order to provide a background for the particular focus on one SRO and its members.

Financial Service Act: Initial Structure and Problems

Therefore the initial structure under the FSA (which came into operation on 28 April 1988, know as 'A' day) was a complex one, with SROs, RPBs, RIEs, RCHs and the SIB itself able to provide the authority to conduct investment business. Whilst this was simplified somewhat by the merger, in April 1991, of two SROs (the Securities Association and the Association of Future Broker and Dealers) to form the Security and Futures Association (SFA), the variety of regulators was a prominent criticism of the structure. The structure is illustrated by the following diagram

Figure One: Regulatory Structure under the Financial Services Act 1986. (Prior to formation of Personal Investment Authority.)



(Goacher 1993:189)

However, before looking in detail at the changes which were implemented in response to the criticism of the specific rules made by the SROs, I wish to outline in more detail some of the concepts and working practices which came into force under the FSA. In the retail sector the concept of polarisation (see Goacher 1993:197) was perhaps the most controversial.

In this sector a split can be made between firms which advise on products as intermediaries, and firms which actually provide the product, the latter being for example, life insurance companies, which will actually manage and pay out on the product (the product providers). The former simply advise on which product to purchase. The SIB rule book sought to make a clear distinction between these two types of firms. It introduced the concept of an Independent Financial Adviser (IFA), by dictating that any firm or individual must either give advice on only one firm's product, or they must be able to give advice on all products in the marketplace. Thus IFAs came into being as the firms which could advise on the whole range of products, whilst tied agents could only sell the products of the company with which they had a tied agreement. Moreover, product providers maintained their own direct sales forces, which used the product providers brand name to sell its products. Therefore, the practice of 'multi-tying', whereby a firm would limit its advice to a few product providers, was outlawed. Polarisation meant it had to be either advice to buy from only one product provider or on all the products available in the market.

Polarisation was designed to boost independent advice by creating a clear distinction (between tied and independent) that could easily be understood by the public. But problems occurred because polarisation seemed to have the opposite effect upon the provision of independent advice. The number of advisers giving independent advice was reduced by two factors. Firstly, most of the large high street financial institutions, banks and building societies, opted almost immediately to tie to one product provider, very often developing their own product provider (e.g. a wholly owned subsidiary) in order to do this. This meant the advice offered in high street branches could only be about the provider wholly owned by that bank. Secondly, the existing product providers took this opportunity to expanded their tied agency network. Many smaller firms of financial advisers, saw the extra regulatory requirements of the FSA as a considerable burden. They felt the extra costs meant that they would no longer be profitable. So they opted to become tied. By becoming tied to a single product provider, they became the agent for that much larger firm, and so avoided much of the regulatory. This is because a tied agent does not have to join an SRO in its own name, as authorisation comes from the product provider's membership. Therefore smaller firms chose this option because it allowed them to avoid the considerable extra paperwork and responsibility which is inherent in being an IFA. All this served to reduce the number of firms offering independent financial advice. As we shall see, the fact that the number of IFAs was considerably smaller than anticipated was to put severe financial strain upon the SRO which predominantly regulated such firms. Therefore, polarisation fundamentally altered the working practices of the industry.

Another important concept introduced by the first wave of rule books in the retail sector was that of best advice (see Goacher 1993:195). This meant that recommending the best product to a client was now a regulatory requirement. But, in order for this to mean anything in terms of checking and ensuring compliance, the idea of best advice also necessitated a large increase in record keeping. Advisers had to show that they had obtained enough information to make a proper judgement as to which product was best for this particular client. This necessarily required more record keeping and the use of "fact finds", a document which showed that the consumer had been asked all the relevant questions (for example on given their particular circumstances, future needs, views on risk etc.) on which the adviser had made a judgement concerning which product to sell. This increase in paperwork was resented by many advisers as simply an unnecessary burden. It produced large amounts of paper records which then had to be stored. But it is important to note that this extensive record keeping was designed as a direct regulatory tool, in that the records could be checked during compliance visits. As the original empirical work will show, IFAs still resent this burden and have strong doubts about the effectiveness of it as a regulatory tool.

I will return to focus on the concerns of this sector of the industry in the following chapter, but first I wish to consider the wider initial reaction to the FSA regime, in order to consider how various actors were able to alter policy once it had been adopted.

Immediate Problems

The criticisms and problems with the FSA as originally established can be divided into two (albeit overlapping) categories; firstly, complaints about the system as a whole its nature of the rules and regulators, and secondly, these general concerns were narrowed into more detailed complaints relating to the working of specific rules enacted by the SIB and the various SROs. Blair (1991:1-4) provides details of both these complaints. He identifies three particular problems which have cause sustained criticism, namely, compliance costs, the number of regulatory bodies, and the size and form complexity of rule books.

In relation to costs, the rather obvious claim is that they have been too high. That is, that the burden placed upon firms in terms of both the initial implementation of the system, and in relation to on-going compliance costs have proved excessive and unnecessary. These costs have outweighed the benefits arising from the new regime. These extra costs pushed up charges and so have had a detrimental effect upon investors, the very people the system was designed to benefit.

Secondly, Blair identifies the problem of too many regulatory bodies, many with overlapping jurisdictions. Within this he identifies three specific complaints, namely that the system required:

> "(a) multiple and variegated compliance within firms and groups
> (b) multiple and variegated systems of protection for investors, leading to complexities for them, and for those concerned with giving them advice, and
> (c) orderly co-ordination and effective cooperations between regulatory bodies"
> (Blair 1991:2)

The large number of regulatory bodies caused extra compliance costs for the industry, especially those businesses that offered a wide range of financial products and services, as these fell within more than one SROs jurisdiction. It also caused problems for investors. They were without an easy way of discovering if a particular adviser was properly authorised, and lacked a single body to approach if they wished to raise a complaint. Overall the profusion of regulators simply added to the bureaucracy of the system, because its effective operation required them to co-ordinate their actions.

The third criticism Blair (1991) makes of the FSA regime, is narrower in its focus. It concerns the rules and rule books made under it, rather than the system as a whole. He argues that there was considerable industry disquiet about the size and nature of the rules. They were seen as too long and detailed, and drafted in such a way that even experienced practitioners had difficulty understanding them. Moreover, the different styles and frameworks of the various SROs meant that it was not always possible to integrate their rules. This was a particular problem for firms dealing with more than one SRO. Moreover, the prescriptive and legalistic nature of the rules also served to stifle industry operations generally and new innovations in particular. This was expressed most clearly in relation to that section of the industry which dealt with fellow professional investors. Here, the concern was that the rules failed to distinguish between professional and non-professional investors. This led to unnecessary burdens on those dealing with the former. The fact that market professionals have more information and experience, and so required less protection was not, it was felt, fully considered.

Other commentators raised similar concerns, both in relation to the system as a whole and in relation to specific rules. Veljanovski (1988) argued that the cost of the new regulatory system was not fully considered either in the Gower report, or subsequently in the FSA itself. He says that the Gower report assumed

> "...that costs are minimal and then proceeded on the basis that this assumption is an established fact " (Veljanovski 1988:12)

Veljanovski (1988) argued that this uncritical approach is fundamentally flawed. It seems to be based upon the assumption that costs are so small as to be of little significance and that they are spread evenly throughout the industry. Veljanovski challenged both these assumptions, saying that they have created many of the regulatory systems problems. Veljanovski (1988) claimed that regulatory costs are a greater burden for certain types of firms. Smaller firms, for example are unable to bring economies of scale to compliance, and this soon results in compliance becoming a very large proportion of their overall costs. Therefore a small increase in such costs will have a disproportionately large affect on their business.

Veljanovski also argued that the effect on new entrants has not been fully considered. Extra compliance costs will inhibit them from entering, and so will benefit those already in the market. Indeed he argues that indirect costs, (like reduction in competition and stifling new product development) are a considerable part of the over-all cost of the FSA system, something which has not been fully considered. The focus has been too much on the direct costs in terms of time and new procedures. Veljanovski also disputes the assumption that because compliance costs are spread over the whole industry, the additional cost on any particular transaction is negligible. Any price increase will affect demand and competitiveness, especially in the financial service industry, where a very competitive market had reduced margins.

It is clear, therefore, that the FSA system was from the outset seen as flawed. Some of this stemmed from ideological opposition to any regulation at all, that it was an unnecessary interference which only hindered the market. If the free acting market is perceived as responsive to consumer demands, then any regulation will be harmful to investors. Moreover, whilst the Gower Report (1984) makes it clear that many in the industry had concluded that some form of regulation was necessary, it is not so clear the whole industry realised the full impact of the FSA until it actually came into force. Some undoubtedly, believed that the system would not apply to their specific firm (either because it was well respected or because it was not dealing with the public) and were shocked to discover that the Act was drafted so that it did cover their activities. Given this background it was inevitable that the new system would encounter opposition. Different sectors of the industry at once started to lobby for changed which would create a more diverse system.

New Settlement

The change which resulted from this lobbying is known as the new settlement, and occurred less than two years into the new regime, the legislative changes being in the Companies Act 1989. The new settlement attempted to address both the general and the specific criticisms which had been made. Firstly, in relation to the general structure, the new settlement sought to alter the relationship between the SIB and the SROs in order to reduce duplication and bureaucracy.

This was done by the SIB laying down basic principles, and allowing individual SROs more scope to develop rules within these principles in a way suitable to their particular area of the industry. To this end the SIB laid down ten principles, which formed the basis for the operation of the whole industry. These are couched in very general terms and basically lay down that firms should act in a fair and diligent way. Such general statements could indeed have provided the basis for the SIB to withdraw, leaving the SROs to define exactly what these general principles meant in any particular circumstance. Blair says:

> "The main purpose of that reform was to give the SIB a power to state essential or central requirements, on a unified basis, leaving it to the other regulatory bodies to create for themselves the supporting detail which the might find desirable" (Blair 1991:3)

However, the fact is that the SIB laid down a further set of core rules (both in the conduct of business and financial supervision), which each SRO had to follow, and which are much more detailed than the principles.

These core rules cover all aspects of the industry's work, from dealing with clients to record keeping and internal controls. They consisted of forty rules in relation to the conduct of business and a further five in relation to financial supervision. The detail contained in the rules, along with their number and the fact that they must be seen within the context of the over-arching ten principles, led commentators to suggest that the simplification aimed at in the new settlement was not have been achieved (see Smith and Rees 1990). This argument is further strengthened by the uncertain nature of the relationship between the principles and the core rules. The SIB statement on the principles is not totally clear. It says:

> "The principles are not exhaustive of the standards expected. Conformity with the principles does not absolve a failure to observe other requirements, while the observance of other requirements does not necessarily amount to conformity with the principles" (Statement of Principles quoted in Blair 1991:157)

As Tennekoon (1989) argues, the uncertain legal nature of all the principles and the rules means that a firm may be acting illegally even if it is obeying the rulebook of the SRO of which it is a member. Moreover, Herrington and Sabalot (1990) argue that the general nature of the principles may have left the regulators with too much discretion. As a result the new settlement may be just as restrictive as the previous arrangements because firms will act defensively because they cannot be sure exactly what conduct will be deemed reasonable by the regulators. This is despite the fact that the new settlement was aimed to overcome the feeling that the rules stifled innovation.

The contrary view, has however, as been proposed. That is that the general nature of the principles may prove of little worth when analysing a firms conduct, because they leave too much scope for a firm to argue it did act reasonably. Morris (1992) argues that the principles with their use of words like reasonable, are so uncertain as to be of little worth. Pressure within firms, he argues, will always be on selling, rather than compliance and vague rules will therefore have very marginal effect on operations. He stresses that this is particularly like given the low profile and status of compliance officers within firms.

The new settlement also tackled some of the regulatory details which had been criticised, particularly the lack of a differentiation between those advising the public and those dealing with other market professionals.

The new rules distinguish between two types of customers. Firstly there are: ordinary business customers, which is defined as "a public corporation or a company, partnership or trustee" which meets certain size criteria. Secondly, there is a private customer which is someone not dealing in the course of a business or a small business investor (a company, partnership or trustee) which does not meet these size criteria. As noted above this distinction is important because the new civil liability only applies in dealings with private customers. This is also the case with some of the new core rules. For example, the rules on polarisation and various rules about advice on packaged products and oversees investment do not apply when a regulated firm is advising a company of sufficient size. The industry had consistently called for this distinction to be made on the grounds that different groups needed different standards of protection. Dealings between professionals should not be hindered by too many over complicated rules designed to protect the more vulnerable private clients. The distinction would therefore, they argue, continue to ensure that private clients were fully protected, whilst recognising that larger firms and fellow market players had the ability and information to bargain on an equal footing with their advisers.

The validity of this argument is open for debate, for example Pritchard (1992b) argues that the definition leaves small businesses, who like private individuals lack information and market sophistication, without adequate protection. Yet despite these concerns the change was enacted. Once again this raises the danger that the industry was able to alter rule to its own advantage. If the industry is able to alter a fundamental rule, and reduce the protection offered to a large range of clients, without a public debate or report, and so soon after the system has been implemented, then this must be a cause for concern. It suggests that the industry had too much influence over regulatory policy, that they have captured the system, and that decision making was too closed. These concerns can be levelled at the whole new settlement changes.

One area where this concern was raised, in relation to the new settlement changes, was section 62 of the FSA. This section originally created a civil claim for any investor who suffered loss due to a breach of the regulations. This, as Pritchard (1992a) points out was a response to the belief that the criminal law was inefficient and unsuitable for combating fraud in the financial services industry. Section 62 thereby sought to create a new device for combating misconduct. But it was widely criticised by the industry. Basically the industry feared that it would result in an expansion of litigation, even for relatively minor rule breaches. The industry argued that litigation and the threat of litigation would stifle business and lead to defensive actions by firms. As Walker said:

> "The problem (with s62) was that it focused the attention of practitioners and more particularly their lawyers, on amending their rules, not to improve them generally, but simply to minimise the possibility of claims" (Walker 1989:51)

Hence there was strong pressure to reduce the scope of s62. This was eventually successful in the new settlement with the FSA being amended by the Companies Act 1989 to create a new s62A. This new section limits the ability to seek civil damages to private investors only. However, whilst this may indeed reduce the amount of possible litigation and ease the job of firms' lawyers, criticisms can be made of this change. Pritchard (1992b) argues that the rationale for this change was not as strong as many made out, and in particular that the feared expansion of litigation did not actually occur. He also criticises the change arguing that it creates inconsistencies and possible unfairness. For example by denying a civil remedy to small businesses, and by restricting the civil remedy to private investors only, it has ceased to be any form of deterrent or of use in ensuring regulatory compliance. This is because the firms with the financial ability and interest to mount such a claim are now unable to do so.

I would argue that these changes fail to address the problems which caused the initial introduction of s62, namely that the criminal law had failed in this area and that civil law may provide a better alternative, both to encourage compliance and punish wrongdoers. Whatever the arguments about the problems of using the civil law, the criminal law remains inadequate, and these changes simply result in one avenue of possible remedy being closed off, for exactly those clients who are most likely to use it, without tackling the problem with the criminal law.

Whilst the details of these change are interesting, it is the timing of the new settlement and why it occurred which casts light on the nature of policy making in this area. As noted above there had been considerable debate (and a full legislative process) prior to the FSA system coming into operation. This included a consultative process during and following the Gower report and the White Paper. Yet less than two years into this new system, the new settlement instigated major changes. We have already noted that particular sections of the industry were calling for changes in the way they were regulated, and the new settlement raises the danger that the rules were altered simply because the industry found them too onerous. It suggests that the 'self regulatory' balance had shifted too far toward the 'self'; that it was the industry which set regulatory policy rather than the concerns of external regulation and investor protection.

This is particularly worrying because it has already been shown that the industry had a large input into the process leading into the FSA. Indeed, paradoxically the SIB chairman, when the new settlement was instigated, suggests that the FSA was too dominated by industry views.. He says of the original rulebook:

> "But the wish (and indeed the political need) to satisfy the legitimate concerns of practitioners as they arose during its development had lead to a series of important defects. Essentially, the rulebook was over-long, over-complicated and over specific" (Walker 1989:51)

This is an interesting quotation because it suggests that whilst industry concerns had been considered in the original rule making process, the industry was not fully satisfied. Hence there were the changes which followed David Walker being appointed SIB chairman, in 1989. The industry, it seems, had two chances for input, both of which successfully altered the regulatory system. It is clear that this is an on going hybrid policy making process, with private actors having continuous input and influence. The problem is however that one group, the industry (or a section of it), was able to dominate at the expense of other legitimate interests e.g. consumers and wider non-industry public interest.

However, it may be too simplistic to argue that the industry had been able to capture their regulatory environment. One crucial factor in the implementation of the new settlement was the support of the new SIB chairman, David Walker. The government had taken the decision not to re-appoint the founding chairman, Berill, and had instead chosen Walker to replace him.

Again this can be seen as a victory for the particular interest of the industry, Berill having been responsible for the heavily criticised original system. But, it is important to note that it was the government which took this decision. If it had supported the pre-new settlement system then it would have been logical to re-appoint its architect. The choice of a new chairman signaled that the government wanted the system to change.

It is possible that the industry was able to subvert government policy to serve simply its own objectives. But, in a democratic system we have to assume the elected government will consider wider questions (and its own electoral success) when making policy. This is particularly the case in this area which as shown above has a more pluralist, than corporatist, policy making process. It may, of course, be the case that the government viewed the public interest as being the same as the arguments proposed by the industry, but this would be based on ideological or political motive and does not necessarily mean that the industry has captured the policy making process. So the appointment of Walker, whilst suggesting simply a response to industry wishes can also be seen as a move to improve the regulatory system in order to favour the consumer and the wider economy (non-industry public).

Indeed this was the rationale given by the new chairman when explaining his reasons for instigating the review which lead to the new settlement. He says, and this follows immediately from the quotation above,:

> "Accordingly, one of my first steps on taking office was to set in train a re-examination to see whether significant simplification could be achieved, so as to introduce greater flexibility and cost-effectiveness without compromising client protection, and whether greater emphasis could be placed on the underlying principle than its application in a detailed rule" (Walker 1989:51)

This quotation is interesting because it seems to suggest that change was only a possibility. But the changes which did occur seemed to match exactly this move to the idea of principles rather than detail. The views and support of the SIB chairman are obviously important. It was not just on this issue, of the new settlement, that Walker signaled a change in strategy from the SIB. Throughout his tenure, the lead regulator sought to take a more 'hands off' approach to the SROs and to be less prescriptive in the rules it made. This can be contrasted with the detailed rulebooks laid down originally when Berill was chairman, and indeed, the detailed pronouncements and involvement of the next SIB chairman, Andrew Large.

The importance of an individual and his interpretation can be seen in other parts of the new settlement. It has already been noted that the new settlement sought to give the SROs more leeway in relation to the rules laid down by the SIB. This was done not only by the move to principles, but also by the formally altering the legal relationship between the respective rulebooks. Prior to the new settlement SRO rulebooks had to be 'equivalent' to the SIB rules. However, this was altered so that they simply had to be 'adequate' to protect the consumer.

It has been pointed out (Pritchard 1992, Vaughan 1989) that the reason for this change was that originally "equivalent" was interpreted to mean identical, and so the SROs where left with very little scope to vary rulebooks from that of the SIB. Pritchard stresses that this need not have been the case, and that it was the way the SIB interpreted the rules, rather than the rule itself, which affected its control of the SROs.

Thus, it is clear that the new settlement did not achieve its aim of simplifying the rules and regulatory environment within which the industry was operating. Taken together the principles and core rules are comprehensive and in places detailed. They do not automatically provide the basis for a strategic withdrawal by the SIB. That this did not happen can be seen by limited leeway given to SROs to derogate from the core rules in their particular rulebooks. Whilst in some case quite substantial derogation was sought, in practice the SIB allowed relatively little. For example the SFA, one of the SROs, sought derogation around the rules which apply to 'market counterpartys' that is those investors who should be treated as fellow players in the market rather than customers. While the SIB did allow some derogation (see Walmsley 1992, Norwood 1993) this was not as much as the SRO had wanted and the SIB seemed cautious to allow any, stressing that it would keep the situation under review. (Mercer 1992; and Chance 1991a outline the similar reluctance with regard to the IMRO rule book).

Conclusions

It is clear that the new settlement did not achieve either of its main objectives. The vagueness of the principles, their uncertain legal status and unclear relationship to the core rules, meant that the system was not really simplified. Moreover, the fact that little derogation was allowed meant that the SROs did not in practice have much further leeway as was intended. However, the important question for this thesis, and for public lawyers, is why did these changes occur at all. There was a distinct lack of debate preceding these changes and certainly not the considerable efforts which preceded the FSA, which had been in operation less than two years. To undertake such radical alterations without a full inquiry raises serious concerns. There was a lack of openness and whilst it is possible to identify input from sections of the industry, participation by other actors is lacking. Moreover, the industry was calling for exactly the sort of alterations which the new settlement (in theory at least) implemented. This suggests that the industry had too much influence upon its regulatory environment, and that wider interests were not being given prominence in the regulatory system. This does suggest that the industry was able to capture, and control its regulatory environment,

These then are the concerns which I will focus upon in the remainder of this thesis. The continued regulatory changes after the new settlement will form the basis of the next two chapters. This analysis will use original empirical work to consider concerns around which actors are exercising influence over the regulatory system, and to consider how open and accountable policy making in this area is.

The industry focus of this work will be the retail sector. This particular sector was chosen for reasons relating to both the regulatory changes which have occurred and because, as a public lawyer, I am especially concerned with the role that government has played in policy making. I am interested in the retail sector because it is here that the general public, who are usually weaker in terms of knowledge and bargaining power, become involved in the financial services industry. It is a concern of public law, that weaker parties are given adequate protection and input into policy making, in order to comply with ideals of fairness and democracy. Moreover, as a public lawyer it is always of interest to see how the government, as a body with the legitimacy to represent the public interest, is operating, and in particular to consider if its input and influence is being used in a open and public way. Unless it is then such actions cannot be truly called to account, and so the legitimacy of its actions will be reduced.

But it was not just the concerns of public protection and government openness which suggested that the retail sector should be the focus of this thesis. The regulatory changes which occurred after new settlement were predominantly in this sector. Almost immediately after the new settlement changes had been implemented, it became clear that the whole regulatory system was in crisis, because one SRO (FIMBRA) was in severe financial difficulty. FIMBRA's problems, and the problems of the IFAs it regulated, came to dominate the regulatory debate and were behind the major restructuring which eventually occurred.

Thus at the time this thesis was commenced (February 1993) the retail sector was certainly the highest profile area with regard to regulatory policy and potential changes. This ongoing debate meant that there was a large amount of information, and views from all sides being published in various journals and the trade and quality press along with various reports and studies, from a wide number of sources. The easier access to information this active debate provided naturally encouraged the research focus in this area. The practicalities of research should not be underestimated. Access to information can often hinder research and with the taxing timescales demanded of Ph.D. work, easy of access is an important factor. So practicalities and my public law concerns combined to suggest that the retail sector would be the most rewarding area to concentrate upon for this thesis.

In the remainder of the thesis I will concentrate upon two interlinked aspects of the analysis of how self regulation is working, and the problems it raises. Firstly, I will consider one particular group in the industry, and their regulator. This is the industry is made up of many types of firms. An analysis focusing upon one group will illuminate the way in which they sought to influence policy, and their success (or lack of success) in doing this. It will therefore shed light upon the question of whether a particular regulator came to be dominated by its regulatees, or whether it provided strong external regulation, in the public interest.

In the following chapters, four and five, I will widen this consideration of how self regulation is working. By looking at the industry as a whole, and regulatory changes in general, it will be possible to see which type of actors had dominance. This will include a full consideration of the various actors from the industry (and the various issues they attempted to influence) but it will also discuss the role of the Government and others purporting to represent the public interest. Combined, these chapters will provide an analysis of how policy was made with regard to regulation of the retail financial services industry. It will then be possible to fully evaluate this. This critique will not only consider how the system worked in its own terms, (was it dominated by the industry, or some actors from the industry, rather than by the idea of the public interest?) but will also consider how the system fulfilled criteria seen as vital for a publicly accountable process. The final chapter, therefore, will discuss the way in which policy was made, with regard to the ideals of openness and accountability which are seen as vital if the policy making process is to be seen as legitimate in a democratic society.

Before this analysis is commenced, it is necessary to first outline the changes, and problems which occurred in the retail sector. The next chapter will therefore provide the background to the crisis in one SRO, in order to introduce the regulatory debate which follows.

Chapter Four: FIMBRA and Self Regulation.

The previous chapter provided an analysis of the general regulatory structure, and highlighted the potential problems for policy making with this self regulatory system, namely that practitioners may have too much or too little influence. Participation without capture is needed for effective regulation in the modern state, because public/private compenetration means that neither the state nor a private group can effectively, or legitimately, regulate alone.

This chapter will consider these issues in relation to one of the SROs, namely FIMBRA. Using the questionnaire data, and secondary sources, it will consider the influence of FIMBRA members on their regulation. It will consider if they had too much, or indeed enough influence on FIMBRA, in order to see if the system was legitimate. It will focus on the ideals of participation and accountability as a basis for providing legitimacy in hybrid policy making systems.

Under the FSA, legitimacy would occur in two ways. Firstly, a regulatory system that was effective and efficient would be seen as legitimate by the general public, and the government. But these public interests would be fulfilled by the participation of private actors. The FSA envisaged that more effective regulation would be forthcoming by involving practitioners. Their knowledge and experience would lead to effective rule making and earlier detection of malpractice. Therefore, secondly, the private industry players would also see the system as legitimate, because they would be actively involved in policy making via the Self Regulatory Organisations (SROs). It would not be a system simply imposed upon them. The SROs would be closer to their practitioner members than any state organisation could be, and would be able to channel members views into actual regulatory practice.

This is a hybrid regulatory system, involving both private and public actors and principles. This is the very nature of any self regulatory system. The danger is, however, that the private actors will be able to take a dominant role in the policy making process, and that this will in fact lead to regulation which favours the industry rather than the investing public. I argued above (chapter two) that legitimacy should be seen in terms of procedures, with a focus on participation and accountability. In this way the debate shifts from whether a financial rule was good or bad (something which will always be open to debate) and becomes rather how was the rule made, and is it possible to criticise those that made it, that is which actors had an influence and input on the rule making process.

This chapter will consider this issue in detail by looking at how FIMBRA interacted with its regulatees, and what influence they had on their regulator. It will consider how members participated in FIMBRA operations, and generally how they viewed the SRO.

It is important for the legitimacy of the self regulatory system that members participate, and this study by means of the questionnaire allows consideration of the extent of such input. However, the most prominent fear is that FIMBRA members had too much influence. That they were able to capture the SRO, to such an extent that FIMBRA had a lax and ineffective regulatory approach. Only an appropriate balance between regulatee input and agency capture will give the SRO full legitimacy.

The questionnaire's original data provides a unique way of assessing how FIMBRA actually operated. It provides substantial quantitative data in an area where it has been lacking. The debate concerning regulatory practice has often been reduced to anecdotal discussion, and the questionnaire therefore overcomes this. Moreover, while the general structures are important, the problems of each SRO must be analysed. The questionnaire provided an opportunity to discover how individual FIMBRA members inter-acted with their SRO and what their own views of its operations were. Therefore, it allows the secondary sources to be considered in full, and puts the general discussion, of for example agency capture, into a specific context.

Before moving on to the empirical study, it is necessary to consider the nature and history of FIMBRA. This will provide the basis for the following discussion of its regulatory practice.

FIMBRA: Structure and History.

Whilst FIMBRA was formed in order to undertake a regulatory role under the FSA, its history can be traced back through several trade associations. In 1979 the Association of Licensed Dealers in Securities was founded (Money Marketing 10th September 1995 gives background). This organisation sought to represent firms dealing in securities and licensed by the DTI under the Prevention of Fraud Investments Act 1958. It was clearly a trade association with its aims limited to advocating members interests as well as advising them. But, the exclusively private nature of this body began to change as time progressed. In 1982 it became the National Association of Security Dealers and

Investment Managers (NASDIM). This extended it membership, and undoubtedly improved it financial position. These improvements led to the private organisation taking on a more public role by becoming recognised as a regulatory body under the 1958 Act. As noted this Act allowed members of recognised associations to avoid direct licensing by the DTI. Therefore this move gave NASDIM a much more public nature. It is therefore clear that even before the FSA, and FIMBRA, regulation in this area was hybrid in nature.

FIMBRA itself was formed in 1987 (Gower 1988) to take on the new regulatory role created by the FSA. Like the SIB it is a private company, formed to undertake a regulatory role under statute. The company is run by a governing body called a council, which had the usual Companies Act responsibilities, for example keeping fair and accurate accounts and publishing annual reports. The council consisted of the chairman, deputy chairman and, as the FSA required, two distinct type of members, namely independent members and practitioner members. The council itself appointed the chairman and deputy chairman and the independent members. The practitioner members were elected by members after a nomination process had created a short list. For the most part this created a council of around eighteen members. Only four of these were independent members, who aimed to represent the public interest, as opposed to the private/practitioner interest. While it is clear that this was a practitioner led organisation, the important issue is whether the rules it made were likewise.

I have noted the hybrid nature of the whole FSA regulatory system, and the claimed advantages of practitioner's input. However, it is clear from FIMBRA constitution that the threat of practitioner domination, at the expense of investors' and the general public's interests, was very real. There was a real danger that whilst FIMBRA was now much more of a public body than its predecessor organisations, it was still in essence a private trade association. That is, that it would represent rather than regulate its members, and design its own rules with a concern to limit the burden on members rather than considering the protection they would afford the investing public. Again, it is worth noting that as FIMBRA regulated those firms advising the general public (a group with little knowledge or expertise in financial services and who would therefore need the greatest protection) this was a particular concern.

The hybrid nature of regulation raises questions about its effectiveness in fulfilling the main objective of the FSA, namely investor protection. It also highlights the issue of legitimacy in terms of which groups participate in regulatory policy making, and how these decisions are called to account. The FSA system was premised on some participation by, and accountability to practitioners in the industry. The SROs, like FIMBRA, would use their expertise and greater knowledge to both formulate better rules and to spot malpractice. However, many critics (Bosworth-Davies 1993a) feared that practitioner input would simply lead to agency capture. That is that the regulators would be dominated by those they were supposed to be regulating. It is this issue, in relation to FIMBRA that I will now turn to.

FIMBRA: Agency Capture and Regulatee Input

Throughout FIMBRA's existence it came under consistent criticism for being a weak and ineffective regulator (Carey 1991, Bosworth-Davies 1993b, Hall 1994). One example of this weakness was said to lie in the fact that many FIMBRA firms stopped trading in such a way that investors lost money. This lead to FIMBRA firms being the dominant source of payment from the Investors Compensation Scheme (ICS). In the first five year of the ICS, from August 1988 to March 1993, payment to investors were as indicated in figure two.

Figure Two: Investors Compensation Scheme Payments 1988-March 1993

Former Regulator	Cost	Cost As Percentage	Number Of Firms In Default	Number Of Firms As Percentage
FIMBRA	29.5m	80	77	85
FSA	4.5m	12	10	11
IMRO	2.6m	8	3	3
Total	36.6m		90(plus one SIB firm)	

(Source Investors Compensation Scheme Annual Report 1993, Hodgin 1994)

It is clear from these figures that by any calculation FIMBRA members (or ex-FIMBRA members) were the largest drain on the ICS. A greater number of FIMBRA regulated firms were going into default, more than five time the combined total for all the other SROs and SIB. Moreover, whilst FIMBRA firms tended to be relatively small, in terms of their financial liabilities, they still accounted for over eighty percent of actual payouts from the scheme.

These figures added to the view that FIMBRA regulated more than its fair share of untrustworthy firms, and that its weak regulatory approach had failed to exclude this type of firms. The argument is that such firms only left the industry when they became bankrupt, causing losses to investors, and hence cost to the ICS. It can be argued that if FIMBRA had taken a tougher stance, both when the firms applied for membership and as part of the on going regulatory supervision, investors loses could have been avoided.

This argument is, in summary, that FIMBRA was an ineffective regulator. The question which needs to be answered is why this was the case. As I shall discuss the answer usually posited is that FIMBRA was dominated by its members and so failed to establish a strong regulatory regime which would have really controlled their actions. This then allowed many to operate in a way which lead to investors suffering loses. In short the agency capture theory.

I shall seek to explore this argument in full shortly, but before turning to it I wish to consider the conclusion which can be drawn from the ICS figures above. At first glance they do seem to suggest that FIMBRA was, overwhelmingly, the worst performing SRO. But a more in depth consideration does cast doubt on such a clear conclusion.

For example, the type of firms FIMBRA regulated can, to some extent, explain its prominence in these figures. FIMBRA members tended to be small firms (High and Shah 1993), often employing only one or two advisers. This is borne out by the empirical study which found that 63.6% of members employed two or less, and nearly ninety percent five or less, FIMBRA authorised advisers. In general small businesses are more prone to collapse than larger concerns, and so it is not surprising that a large absolute number of FIMBRA firms went into default compared to other SROs. Furthermore, the fact is that FIMBRA regulated a much larger number of firms than other SROs which regulated larger firms. For example, at 5th February 1992, the relative memberships were as shown in figure three.

Figure Three: Self Regulatory Organisations Memberships.

Regulator	Number of firms regulated
FIMBRA	6724
SFA	1374
IMRO	1245
LAUTRO	646
SIB	74

(Figures from Clucas 1992)

Thus with more than twice as many members as all the other SROs and SIB combined it is hardly surprising that FIMBRA would dominate in terms of the absolute number of firms collapsing.

Therefore it is possible to analyse the above ICS figures in a way which undermines the automatic assumption that FIMBRA domination in terms of financial payout was due to its weakness. FIMBRA's membership profile with a larger proportion of financially weaker firms does to some extent explain the higher proportion of compensation claims paid to the clients of its ex-regulatees. It is not possible to draw a firm conclusion about

FIMBRA's effectiveness, or lack of effectiveness, simply by considering the compensation claims caused by its regulatees. It is necessary to consider the way FIMBRA operated in more detail to assess whether it was really a weak regulator, and whether this was because it was captured, or whether it can be said to have been effective given the circumstances in which it operated.

Those who argue that FIMBRA was ineffective do however have some high profile examples of FIMBRA's inadequacies to support their claim. For example in June 1990 the financial firm Dunsdale collapsed (see Financial Times 12 June 1990). This was a considerable embarrassment for FIMBRA because less than a year earlier Dunsdale had passed its compliance visit with the SRO not uncovering any problems. Indeed it seemed that the regulator was the last to become aware of Dunsdale financial crisis. It only acted when some of the firm's clients started legal moves to recover their investments (Money Marketing 15th June 1990). Within six months of this FIMBRA's effectiveness was again questioned by an even higher profile collapse, that of the Levitt group (see Financial Times 10 Dec. 1990). This group had debts of over £34 million, which had been built up over several years.

These large failures, combined with the general dominance of FIMBRA in the ICS payments, suggested that FIMBRA was a weak and ineffective regulator. Critics argued that rather than controlling its members FIMBRA was dominated by them, resulting in inadequate protection for the investing public.

In the Financial Times (13 June 1990) Waters argued that FIMBRA relied too much on its members for gathering information. He argued that unless FIMBRA undertook its own independent research into regulatee's activities firms would be able to hide malpractice resulting eventually in loses for investors. He argued that Dunsdale and Levitt where simply the biggest of a long list of such cases. In conclusion, Waters argued that FIMBRA was simply not putting enough resources into compliance checks and investigations, and that without these self regulation was simply a veil behind which industry malpractice could thrive.

This argument was supported by the consistent rise in complaints made against FIMBRA firms in the first few years of the SRO's operations. In the year to July 1991 FIMBRA received 2651 complaints against members, rising to 3212 in the following year (Financial Services Law Letter 1993c). This represent complaints against nearly one thousand member firms, around one sixth of all members, with eighty six firms having more than five complaints against them (Chance 1993b). It was clear that investors were showing growing dissatisfaction with FIMBRA firms. This supports the argument that FIMBRA was not regulating firms adequately, thus resulting in investor complaints.

But, even if this was the case it does not follow that FIMBRA's inadequacies resulted from domination by its members. It may have been the case that FIMBRA was not performing well for other reasons. For the agency capture theory to be supported it is necessary to have more evidence of the regulatees usurping the regulatory agenda. Once again a more in-depth consideration of the early years of FIMBRAs operations in needed.

FIMBRA: Agency Capture.

The early years of FIMBRA's operations show considerable evidence of practitioner unrest and dissent, but the evidence as to capture is contradictory. FIMBRA members often complained of lack of input whilst press critics complained that the regulatees had captured the SROs operations. This picture, and possible explanations for it, will become clearer when the questionnaire findings on regulatee input are considered. But first, some background, in terms of the early years will highlight arguments around the agency capture thesis.

Within eighteen months of the FSA regime coming into operation FIMBRA faced an open rebellion from its membership. In July 1989 FIMBRA announced plans for a compulsory Professional Indemnity (PI) insurance scheme. This required all members to take out insurance so that investors loses, due to professional malpractice, would be compensated (see Money Marketing 10th September 1995). However, whilst the principle of such a scheme was accepted by most members, it was their opposition which forced the FIMBRA council to withdraw its proposals.

The reasons behind this opposition highlight the contradictory arguments suggested above, namely whilst members complained of lack of consultation others saw it as member's dominance. In relation to the PI scheme members complained that the FIMBRA plans were being rushed through with undue haste. The proposals were to be implemented by November 1989, just months after the scheme had been announced. Members complained that they had been presented with a fait accompli and that their opposition to the schemes details (rather than the principle of PI insurance) was not being considered. This opposition centred round the fact that FIMBRA had negotiated an arrangement with a single insurer, Pointon York Vos, and this did not allow members to get cover from other firms. Members felt that it was unfair to limit them to just one provider. They wished to negotiate the best possible cover, and price, from the variety of insurers offering PI cover.

The opposition of members eventually resulted in the FIMBRA proposal being dropped. Member were slow to join the scheme, to the extent that one month before its planned commencement over one thousand had still not joined. Such a large number cast doubt on the whole scheme. The result was that just four days before it was due to start, at an emergency council meeting FIMBRA abandoned the Pointon York Vos scheme.

While this was undoubtedly what many members had wanted, the Council's decision simply led to further criticism from within the SRO. Members saw the whole matter as an example of poor management, and it became clear that members would act to ensure that their grievance concerning lack of consultation was remedied.

Immediately after the Professional Indemnity insurance scheme was dropped several trade associations representing members announced that they would attempt to use the December 1989 FIMBRA AGM to oust the chairman, Lord Elton. The Institute of Insurance Brokers (IIB), the Institute of Insurance Consultants (IIC) and the National Federation of Independent Financial Advisers (NFIFA) combined to seek a vote of no confidence, in order to force his removal. There is no doubt that the FIMBRA leadership saw the possibility of such a move as highly undesirable. FIMBRA was already the most criticised SRO and an acrimonious public disagreement between the council and the members could only further weaken its position.

In order to avoid such a disagreement a private agreement was struck (Money Marketing 10th September 1995). This resulted in the trade associations agreeing to use their proxy votes against any no confidence motion, something which so effectively ensured its defeat that it was not presented. But this move by the trade associations was gained at a price. This price became clear when Lord Elton resigned soon after the AGM (see Financial Times 23 Jan 1990).

Therefore, a public defeat of the FIMBRA leadership was avoided, but this was seen to be a victory for the members. Members it seemed were asserting the idea of practitioner input, which was supposed to be central to the self regulatory system under the FSA. However, whilst this may have been part of the underlying ethos of the system, other developments in January 1990 suggested that it may not have been entirely desirable. After Lord Elton had resigned the FIMBRA council announced that its public interest members and its practitioner representatives would meet separately, before the full council convened (Financial Times 23 January 1990). This move suggested starkly that the public and practitioners interests were diverging. The explanation for the different members not simply coming together in one meeting seemed to be that they had different agendas. Central to the FSA regime was the view that practitioners input would be in the wider public interest, in terms of better regulation. But this move showed that practitioners had a different viewpoint from those representing the public interest. This was confirmed when an independent council member, Pat Cook, resigned (Financial Times 25 Jan 1990). Cook had been central to the ill fated PI scheme. Criticism of his role in this, and the subsequent changes led him to resign saying that members' actions had made his position untenable.

Therefore, it is clear that by 1990 members were indeed beginning to assert some influence upon FIMBRA leadership. They had blocked an important policy initiative and caused the resignation of two senior figures. This appears to represent active participation by members. It can be seen as the input and involvement which I argued earlier (chapter two) is needed to give a policy making process legitimacy and effectiveness, an approach which was part of the self regulatory system under the FSA. However, it can also be argued that this type of input was undesirable. Too much practitioner input could be a sign of ineffective regulation, and could lead to rules favouring regulatees rather than the investing public. At the time of these changes within FIMBRA several commentators argued that they represented a type of agency capture. For example, on the moves which ousted Lord Elton the Financial Times leader said:

> "..the member's action gave the impression that they were endeavouring to take a dominant role in the running of the SRO" (23 Jan 1990:8).

The Financial Times clearly saw this as undesirable when in another leader (Financial Times 9 March 1990) it suggested that members were seeking to weaken standards in order to ease their own regulatory burden. The Financial Times believed that FIMBRA, in becoming more responsive to its members, was undermining effective protection for investors. Ward (1993) takes a similar view in an article which looks back over this period. She says that the FSA had two aims; investor protection and to ensure a competitive financial services industry. The problem she argues is that

> "..when these two conflict self regulation tends to mean industry interests dominate" (1993:11).

Ward (1993) highlights FIMBRA as an example of this saying the regulator failed to develop a systematic regime with members' standards its highest priority.

It is clear therefore that too much practitioner input can lead to a loss of legitimacy. Participation and accountability must not be restricted to practitioner alone. An SRO has other audiences, not just its members. Unless an SRO can be seen to be protecting the investing public, and representing the wider public interest it position will be undermined.

However, with hindsight it is now possible to re-assess FIMBRAs early operations and cast doubt on the agency capture thesis. Such an analysis shows that FIMBRA did have some success in improving its sector of the industry and that what came to be seen as mistakes were at the time supported by many commentators.

In 1994 in evidence to the House of Common Treasury and Civil Service Select Committee (TSCSC) FIMBRA gave a defence of its early operations. In a coherent statement FIMBRA said:

> "The investor is demonstrably better served today than at any time in the past. In terms of prudential regulation most of the firms regulated by FIMBRA were not regulated in any way prior to April 1988. Of the 12,000 firms which applied to FIMBRA for authorisation in 1987-8, some 3,000 withdrew their applications because they could not meet FIMBRAs standards. Since then FIMBRA has taken away authorisation from no fewer than 986 firms which were found wanting as a result of both routine monitoring and special investigations. Hundreds of firms have from time to time been disciplined or fined where they have failed to comply with the rules;" (Evidence to Treasury and Civil Services Select Committee 1993/94)

The SRO evidence then goes on to say that whilst its regulatees dominated the ICS payments, such claims have been reduced over time.

This provides a clear defence of FIMBRA's operations. The proposition is basically that FIMBRA performed well in difficult circumstances. It suggests that the large number of FIMBRA firms in default, and the hundreds more it expelled or suspended, should be seen in as a positive sign. They can be seen to represent the fact that FIMBRA was instigating a tough regulatory regime. That the SRO was determined to remove malpractice, and so expelled firms operating in an unsatisfactory way. FIMBRA cannot be blamed for the previous lack of regulation, which had left this section of the industry with undesirable members. Company Lawyer (1991 12 (1)), for example, recognises that FIMBRA faced a difficult task in trying to reform its member firms, and argues that once it had the power to act FIMBRA proved willing to do so.

Moreover, whilst scandals cast FIMBRA in a bad light, a re-assessment is possible. For example, the most prominent scandal, concerning the Levitt group, resulted in much criticism for FIMBRA. But it should be noted that FIMBRA investigations were responsible for uncovering the problem (see Financial Services Law Letter 1994b). A month before the group collapsed a random FIMBRA check uncovered disorganisation in the company's financial records, and FIMBRA forced Levitt to stand down as chairman. Whilst FIMBRA could be criticised for not uncovering the problems earlier, the SRO was not alone in this. Several large institutions had taken shares in the Levitt groups (Financial Times 10 December 1990) and as one commentator put it

> "there were many who exhibited 20/20 hindsight in claiming they had 'always known' there was something wrong with Levitt....there were very few prepared to put their head above the parapet when the Levitt Group was apparently producing record business" (Slade: Money Marketing 10th September 1995)

The general argument in FIMBRA's defence is that after a slow start it did improve regulation, in an area where it had been distinctly lacking. Indeed this was recognised by some commentators at the time. Carey (1990) said that whilst few celebrated the second year of FSA regulation the SROs had:

> "discovered and expelled many crooks, and therefore greatly improved the industry" (1990:629)

He goes on to highlight FIMBRAs problems saying that this improvement is largely unquantifiable, whereas compensation costs are clear and easily quoted.

FIMBRA gives another explanation of, and defence for, the early criticism it suffered. In its 1990 Annual Report the SRO argued that people expected too much from the FSA regulatory regime, and that this created many unjustified complaints. The report says:

> "No system can be infallible, no system can prevent all wrongdoing and a balance has to be struck between protection for investors and the burden and costs which such protection imposes on business." (FIMBRA Annual Report 1990:15)

Therefore, several conclusions can be drawn in relation to the early years of FIMBRA's operations. The debacle over Professional Indemnity Insurance scheme, and Lord Elton's removal suggested considerable practitioner input, but it is not clear whether this gives the SRO greater or lesser legitimacy. Similarly different views were drawn from the fact that so many regulatees stopped trading. Some saw this as a sign of regulatory weakness, whilst the SRO used the same statistics to show its effectiveness.

Conclusions are therefore difficult to draw. Much of the secondary data is written from a preconceived position. For example, FIMBRA was from 1990 seeking to secure its survival, and so its claims must be treated with some scepticism. Many commentators (Ward 1993, Carey 1990 and the Financial Times leaders) mention FIMBRA only as part of a wider consideration of regulation as a whole.

This thesis is aimed at drawing conclusions about how the regulatory system operated, therefore the empirical work was designed to take a closer look at how FIMBRA operated. The questionnaire sent to members in the summer of 1994, allows an original and objective insight into the SROs workings. It allows an assessment of the central questions of input and capture in relation to FIMBRA. It gives original data on how member participated in its operations, and assesses the extent to which this amounted to agency capture. As I shall show the answers given by members themselves cast serious doubts on the participatory legitimacy of FIMBRA, although they do not provide enough evidence to discount capture completely.

FIMBRA: Input by Members.

It is clear that as an SRO FIMBRA was a hybrid organisation. The FSA's main stated objective was investor protection, but this 'public' objective was to be achieved by using private actors. The whole rationale of the system was that practitioners would be active in the SRO's and that this would lead to more appropriate regulatory policy.

From the above consideration of its early years one can conclude that FIMBRA did contain elements of both public and private influences. The members were able to alter policy set by the SRO, and even unseat its chairman. But the SRO also claimed considerable success in expelling members who did not comply with regulations, and in generally raising regulation in a previously weakly controlled industry.

It is not clear, therefore, which objective, private members' self interests, or wider public regulations dominated the SRO. In the following section I will analyse the data provided by FIMBRA members in order to consider this question. The questionnaire looked at both aspects. It provides an insight, firstly, into how active members actually were in FIMBRA operations, and secondly, how constrained and regulated they were by the SRO. Combined these will allow an analysis of the input members had into FIMBRAs operations, and whether this amounted to agency capture.

Questions 17-19 of the questionnaire (see appendix two) was aimed at discovering how active members were in FIMBRA's operations. This section asked members about the various ways in which they could have influenced FIMBRA policy. Firstly, it asked about FIMBRA meetings attended, secondly, about any formal input they had made, and finally about any informal input. Responses to the questions allow conclusions to be drawn as to how active members were in their SRO, and how influenced their regulation was likely to be by their views. If members had little contact with FIMBRA, as an organisation, it seems unlikely that they would be greatly influencing it operations. This would undermine the agency capture hypothesis.

The general conclusion from the three areas of input is that few members felt they made any input into FIMBRA's activities. In all three areas (see appendix five) the majority replied negatively. The scope for potential influence is therefore very narrow. However, if this is considered along with other data from the questionnaire, particularly concerning FIMBRA's regulatory visits, then the lack of member's input cannot totally rule out the capture theory. But first it is necessary to analyse responses to the input section in detail.

The first question concerning input (question 17, see appendix two) asked members if they had attended any internal FIMBRA meetings, for example an AGM. This was designed to judge how active members were in the organisation. Taking the time and effort to attend meetings obviously shows a high degree of interest and commitment to the organisation, and provides substantial opportunities not only to learn about the working practices of FIMBRA but also to influence them. However, the conclusion to be drawn from the questionnaire responses is that few members actually used this opportunity. In response to this question 83.9% said they had not attended any FIMBRA meetings (see appendix five for details of all responses). This is a surprisingly high figure given the fact that the whole basis for an SRO is that it is responsive to members. It shows that few members were prepared to spend the time to attend meeting, and casts doubt on the idea that FIMBRA was dominated by its members.

However, a consideration of the details given by those (16.1%) that did attend gives some interesting insight into members relationship with their SRO. Various types of internal FIMBRA meeting were mentioned. The AGM was most frequently cited, although workshops and seminars were also mentioned. The other details respondents gave, for example when and where they attended meetings, provides possible reasons why the majority did not attend. Frequently the attendance at such meetings was several years ago. For example reference was made to meetings before FIMBRA was actually established, some six years before the questionnaires was completed. Several respondents said they had attended the initial AGM but have not attended since. As one put it “when first set up-never again!”.

It also seems that the location of meetings was a factor. Several mentioned that they had attended meetings which were held locally. This view was expressed not only by respondents from the remoter parts of the country for example Northern Ireland and northern Scotland but also by respondent in Yorkshire and the Midlands. For example, one West Midland IFA complained that after holding an AGM in Birmingham, FIMBRA had “retreated to London” and he had not attended since.

Certain conclusions can, therefore, be drawn from the responses to the question concerning attendance at internal FIMBRA meetings. The clear fact is that the vast majority of members never attended at all. Possible explanations for such a large figure suggest themselves. Most FIMBRA members were small businesses, often little more than self employed advisers. They may not therefore, have been able to spare the time, or staff, needed to attend meetings.

However, I would argue that practical difficulties can not easily explain the overwhelming size of non-attendance. FIMBRA had been in existence for several years, and so many opportunities for attendance (not only at the annual general meeting, but also at seminars etc.) had been missed. It is likely that if such meetings had been viewed as important, then at some point over the years more firms would have made staff available to attend. It seems that these internal FIMBRA meetings were simply not viewed as important by its members. While FIMBRA could have been more sensitive to the geographical diversity of its members, the overwhelming non-attendance seems to be more symptomatic of apathy than practical problems.

It could, therefore, be the case that members did not attend meetings because they felt that this was not a useful way of influencing FIMBRA's activities. But, it does not automatically follow that members did not have any input. It may be that members had influence by other means, and therefore did not feel attendance at formal meetings was necessary. Members may have stayed away from AGMs because they felt that other channels already gave them sufficient input.

This point was addressed in question 18 and 19 of the questionnaire. Question 18 asked if FIMBRA had ever made any formal requests for the firms views on the SRO's operations. This was designed to uncover how often FIMBRA had been active in seeking members views, and how responsive members had been to such requests. It is suggested that whilst members may have been reluctant to commit the time, and traveling, involved in formal meetings, they would be more willing to respond in writing to a request for their views. So it is likely that a request for a firm's views would yield a larger response than attendance at meetings. The later requires a pro-active stance and therefore is an unlikely forum for those who are uncommitted or undecided. A more reactive response to a formal request, however, should provide an easy opportunity for members to air their views, and is more likely to appeal to those with less strongly held opinions. In comparison with question 17 therefore, the hypothesis was that question 18 would yield a higher positive response, as members took an easy opportunity to express their views.

However, whilst question 18 did yield a very interesting conclusion, the response did not provide data which can fully answer this hypothesis. This is because the vast majority of respondents, 95.9% said that they had never received a formal request from FIMBRA relating to their views on its operations. That is that only 4.1%, less than one in twenty, had actually been asked by the SRO for their views. This is a startlingly low figure when it is remembered that FIMBRA was designed to use practitioner input in order to improve regulation. It is clear from the responses given, that FIMBRA was failing to formally seek the views of its members regarding its operations and their regulation. Again this places considerable doubt on the thesis that FIMBRA was captured by its regulatees. If the SRO did not attempt to discover what the priorities and wishes of its members were, how could it alter regulatory policy to favour them? It is clear from the discussion above, question 17, that members themselves were not proactive, in terms of attending meetings. Therefore it is unclear exactly how FIMBRA could have developed a coherent policy based on its members views, which it could then have followed.

However, whilst the agency capture hypothesis is severely weakened by these results, it would be premature to dismiss it completely. The next question, 19, suggests that members did have some input into FIMBRA's operations, and, as I shall discuss, this combined with responses to other parts of the questionnaire, does give some weight to the capture theory.

Question 19 asked if respondents had made their views on FIMBRAs operations known to the SRO via informal channels. It specifically mentioned meetings with officials as an example of such informal input. However, the question was left open in terms of what exactly constituted informal input, so that respondents would feel free to included anything they considered important. Overall this question received a considerably more positive response, than other types of input. Exactly one fifth, 20%, said they had made such informal input.

The nature of this input varied. Some respondents had taken the initiative and written or phoned FIMBRA in order to lodge a complaint or raise an issue. This is in contrast to the very poor response rate in terms of attending meetings discussed above (question 17) and raised the possibility that time, rather than inclination, limited the regulatees attendance at formal meetings.

Several other methods of informal input were mentioned. Amongst these was the discussion respondents had with the FIMBRA compliance officer during their inspection of the firm. Whilst these were not unanimously seen as positive meetings (see question 16 appendix five) it is enlightening that members saw this as a channel for input into FIMBRA's operations. I have already shown that respondents did not feel that FIMBRA was seeking their views via formal channels. Yet when an official did actually visit the firm, primarily to check the firm's practices, respondents took this opportunity to raise issues in such a way that it was considered by them to be informal input. This suggests that if FIMBRA had systematically sought the members' opinions, by post or particularly by the visit of an official, members would have been forthcoming with their views. It is suggested that the low response rate for question 17 and 18 may have had more to do with FIMBRA's remoteness than members willingness to state their opinions. Indeed other parts of the questionnaire stress that many members had strongly held views on their regulation, and were willing to express them given the opportunity.

While question 19, on informal input, does suggest that FIMBRA could have done more to encourage practitioner input, the responses do suggest that FIMBRA was close to at least some of its members. For example one respondent said, in replying to the question of informal input with FIMBRA:

> "Yes we now have a regular contact who are very helpful e.g. PIA application forms"

In giving details of the type of informal input they had had, several others mentioned indirect input via trade associations, with NFIFA and IFA Promotion both being mentioned prominently. Moreover, informal input also took the form of meetings at conferences and FIMBRA roadshows. Here members were able to meet with officials of the SRO. In particular the annual PIMS trade conference was mentioned as a place were such informal input took place. Respondents said that at such meetings they had informal discussions with FIMBRA council members and other officials.

So, it is clear that some respondents did have informal input into FIMBRA's operations, and this puts the earlier very low response rate regarding more formal input in a particularly poor light. The fact that nearly five times as many respondents had made informal input than had formally been approached by FIMBRA, suggests that the SRO was failing to fully exploit the views of a keen and articulate membership.

Overall this section of the questionnaire casts considerable doubt on the agency capture hypothesis. It has shows that the majority of members did not feel they had any input into FIMBRA's operations and that FIMBRA was not systematically, and in a formal way, seeking the views of its members. With such little interaction between FIMBRA and its members it is difficult to conclude that the regulator was captured. However, I have already suggested another theory which would make the questionnaire results, at least partially, fit an agency capture theory. It is possible that FIMBRA members did not feel inclined to make a contribution to the SROs operations because they already felt it was operating in their best interests. That is, they were inactive because they did not feel any need to become involved. Such a theory would suggest that FIMBRA was already captured by its members, so they felt no need for further involvement. I have discussed the events early in FIMBRAs operations which gave credence to this argument, particularly the resignation of Lord Elton.

By its nature such a hypothesis is difficult to prove, as inaction is taken to represent positive consent. However, the questionnaire allows two ways of assessing the validity of this theory. Firstly, a major section of the questionnaire (section two, see appendix two) focused on the compliance visit to the firm, undertaken by the SRO. A consideration of how this was conducted, and what respondents views of it were, gives a valuable insight both into FIMBRA's day-to-day operations, and into the interface between regulators and regulatees. Secondly, the questionnaire also asked members views on several possible roles for FIMBRA. Question 20 asked how important respondents thought a role should be, and question 21 asked them to indicate how effective FIMBRA had actually been in fulfilling this role (see appendix two). A comparison of these two questions, therefore allows conclusions to be drawn as to whether FIMBRA was effectively fulfilling the priorities of its members. If members felt that their views were being effectively implemented by FIMBRA then this would add weight to the agency capture theory, notwithstanding the general lack of input discussed above. But before turning to this section I wish to consider the compliance visit details in full.

FIMBRA Operations: the Compliance Visit

It is clear that the structure and role of FIMBRA meant that it was a hybrid body, sitting between the public and private spheres. It was a private company with direct input to its board from it private members, yet it also performed regulatory function under a statute designed to operate in the public interest. I have discussed how this could add both to legitimacy and effectiveness of a regulatory system, by incorporating the experience and support of those most directly involved. What is still unclear, however, is whether FIMBRA successfully managed to straddle the possibly contradictory pressures of input and public interest. That is, did FIMBRA become subservient to, or captured by, its regulatees at the expense of investor protection.

The first area I will focus upon is the compliance visit which FIMBRA undertook. The purpose of this visit was to ensure that FSA regulations, like best advice and record keeping, were being complied with by firms. Moreover, it should also have ensured that the firm was only operating within the remit authorised by FIMBRA. FIMBRA divided its membership into three separate categories, depending on the type of business they conducted, and had different checks for each group. Category 3 members, for example, were not allowed to handle client money, they could only act for product providers, and so the compliance visit should have ensured that the firm was not holding money in its own name. Also these compliance checks should naturally have revealed any fraud or general malpractice occurring in a firm.

The compliance visit therefore represents a vital part of the regulatory regime. It provides an opportunity to look beyond the more general compliance checks, e.g. application form, questionnaires and annual returns, which FIMBRA also had. This was the way in which generic issues of compliance could be applied in a specific setting and where any determined and sophisticated fraudster should be uncovered. The way in which the visit was conducted, i.e. how thorough it was, will cast light on how effective FIMBRA was in its role as a regulator of firms. It will allow consideration of whether FIMBRA was captured, by it regulatees, to such an extent that they did not suffer proper compliance checks.

I will discuss the questionnaire data on the compliance visit in some detail, but two general conclusions are worth giving in advance. Firstly, the compliance visit was not something which most firms found particularly demanding or difficult. It was short and several respondents gave details of its perceived inadequacies as a method for uncovering regulatory breaches or fraud. Secondly, as noted above, several respondents did express the view that the visit provided useful opportunity for the firm to have an input into FIMBRAs operations, and for it to benefit from compliance and general advice. This is interesting because while it is in keeping with the idea that the SRO was an organisation with practitioner input, it weakens the supposedly central role of the compliance visit. It suggests that this important regulatory tool was less about controlling and checking regulatees than should have been the case. This adds a further dimension to the question of regulatory capture which will be expanded on by consideration of questions 20 and 21 in due course.

Before this, I will give details of how the compliance visit was conducted, and the firms' views of it. The first point to make is that a compliance visit was a regular occurrence for most firms (see question 7, appendix two). The overwhelming majority, 78.2%, had been visited twice or more in the six years (1988-94) since FIMBRA began its operations. The majority, 88.4% (see question 8) had been visited in the preceding two and half years, with sixty percent having a visit within the previous eighteen months (One respondent said that the last compliance visit was in 1983. I can only assume that this was a mistake as FIMBRA did not exist then. It seems likely that this may have been in fact 1993, which would give a further increase to the recent visit rate).

This regular visiting rate, and in particular the fact that over half of all members, 50.9%, were visited in one year (1993) does support the FIMBRA statements (see 1990 Annual report) that the SRO would make greater use of compliance visits to uncover regulatory problems. Almost all respondents, 96.2%, said that they had been visited since the 1990 claim. It is clear, therefore, that FIMBRA did make frequent and regular compliance visits on its members. Such visits suggest that FIMBRA was a diligent regulator, closely monitoring the work of its regulatees. Such frequent checks does not add any weight to the theory that FIMBRA was captured by its regulatees.

However, a more detailed examination of how the visits were conducted undermines this, and casts doubt on the probable utility of them as a regulatory tool. The length of time the visit took, and members views on it suggest that the compliance visit was not as thorough and taxing as it could have been.

Question 9 of the questionnaire (see appendix two) asked how long the compliance visit took. If the aim of the visit was to look in depth at a firms' compliance procedures, and to seek to uncover sophisticated fraud, the responses are disturbing. The vast majority, 85.5%, said that the visit was completed in less than one day. A further 14.5% said that the visit took less than two days. No firm said that the visit took more than two days.

This means that visits were very short considering the variety of checks to be performed. It suggests that compliance officers were taking a merely cursory glance at files and procedures. Less than a day does not afford enough time to undertake an in-depth analysis of a representative sample of client files. Moreover, one of the purposes of the visit was to ensure that any determined fraudster, who had been deliberately deceiving FIMBRA in annual returns for example, would be uncovered by an on the spot investigation. Again, it seems safe to conclude that an individual who had been sophisticated enough to pass a secondary analysis of his business would be able to conceal wrongdoing sufficiently from a visit lasting such a short time.

Further doubt on the quality of compliance visits arises from a consideration of the amount of notice a firm was given before the visit took place. FIMBRA had itself, in its 1990 annual report, said that more visits would take place unannounced. This was part of its drive to improve compliance, and was seen as a way of preventing firms hiding malpractice by altering files prior to a visit. It seem obvious that a lack of notice is more likely to uncover any omissions in a file, and prevent superficial tampering to correct them. However, whilst unannounced visits may have been desirable the questionnaire responses make it clear that visits were not conducted in this way.

Less than once percent, 0.8%, of firms said that they were given no notice of their last compliance visit. Whilst this rises to 8.8% when those given less than a day are included, the majority had at least a full working days notice of the impending visit. While a day does not appear to be a particularly long notice period, affording only limited opportunity to alter files, many firms were in fact given much longer. Over forty percent of firms said they had over three days notice, with 7.2% of these saying that they had more than a working week (five days).

It is clear, therefore, that despite FIMBRA's stated aims, compliance visits were generally preceded by notice. While the majority, 51.9% had a relatively brief period (less than two days) the fact remains that compliance officers generally attended firms that could have altered records knowing they were about to be inspected. I should make it clear that I am not suggesting that members actually did falsify records prior to a visit. Rather notice of a compliance visit does afford any malpracticing firm an opportunity to attempt to conceal its practices, and that therefore, unannounced visits would be more effective at ensuring compliance.

The conclusion to be drawn is that the opportunity for discovering malpractice that compliance visits represented was not fully realised. The visit was generally too short to include a full analysis of records and the preceding notice represented a possible opportunity to effectively conceal malpractice from the officer. Therefore, while the fact that visits were taking place regularly can be seen as representing a determined approach by FIMBRA, a detailed look at how they were conducted suggests a different picture. The questionnaire responses do support the theory that FIMBRA was not undertaking tight checks on its members.

Indeed, this is a concern expressed by many respondents to the questionnaire. The space left for further comments on the compliance visit yielded much interesting data. Regulatees aired their concern about the utility of such visits, both in terms of compliance and client gains.

For example, on the issue of fraud, some respondents specifically said that they did not think the compliance visit, as conducted at their firm, would have uncovered fraud. For example one said

> "If our firm was stealing money a FIMBRA check would be unlikely to detect even the most basic fraud"

This is echoed by another who commented

> "Had we been crooked in any way, I have no confidence that the visit would have uncovered this"

and a third, who said:

> "visit OK. We had to alter one or two forms we used for compliance. They spent too much time worrying about minor problems and it was difficult to decide if the check was as thorough enough with regard to more important issues"

It is clear that members felt that the compliance visit lacked depth. This reinforces the argument that a brief visit could not possibly uncover sophisticated malpractice, and that the investing public were, therefore, not benefiting from FIMBRA compliance checks. This argument was also expressed by several respondents who, rather than commenting on the lack of depth of the visit, criticised instead its over detailed, but as they saw it incorrect focus. That is, several members felt that the visit was detailed, but that its over concentration of formal FIMBRA rules made it ineffective in terms of client protection.

For example:

> "These visits are a paper chase with little client protection content. If the paperwork is right you get a pat on the head. Compliance should be client and policy focused"

and

> "the emphasis was largely misdirected i.e. concentration on compliance and adherence to rule book. There was no interest in where client investments were being place i.e. no client protection check"

Indeed one commented that this emphasis upon minor points may actually have hindered the compliance of his firm. This respondent said of the compliance visit:

> "strong compliance structure somewhat undermined by what many perceived to be petty comments/criticisms"

These type of comments offer little comfort to the investor. Taken together they suggest that the regulator's visits lacked both depth and focus in terms of protecting clients. This combined with the fact that visits were so short and usually preceded by notice, leads to a general conclusion that compliance visits were not as useful a regulatory device as they could have been. The promising fact that most firms were visited regularly seems to have been undermined by the way in which such visits were conducted.

Another quotation emphasises this point.

> "the FIMBRA compliance officer was not very helpful nor a pleasant man (obnoxious). He came determined to find something wrong. No experience in Accounting matters as he appeared to have no understanding of double entry book keeping. As to knowledge of computers, he appeared nervous of them, he wanted all information held in paper file not on computer. He never asked for a computer printout and was not interested in one when offered"

This, at first glance, again suggests that the compliance visit, or more exactly the compliance officer was inadequate. The lack of basic accounting and computer skills is likely to lead to an inadequate visit in terms of analysing records and files. However, this member also says that the officer was determined to find fault with the firm's practices. This, in contrast, suggests a critical even over zealous compliance visit, although the quality of the officer would undermine the effectiveness of the approach.

Indeed one can look at the above criticism, of the focus of FIMBRA visits, and draw more favourable conclusions in terms of the SRO's compliance procedures. I have shown how members were critical of the compliance visits minor, technical issues. But perhaps these comments should be seen positively, that is that the compliance officer was thorough in applying the FIMBRA rules in force at that time. Whilst members may not have agreed with these rules their comments imply that the FIMBRA officer was ensuring their compliance nevertheless. That is, that the rules were being applied although members thought them inadequate or wrong. The SRO, of course, would disagree that they were wrong, and as I have shown above, it argued (in its Treasury and Civil Service Select Committee evidence 1993/4) that it had brought tough regulation to this area. It is clear that there are two separate arguments being proposed by members, firstly that the rules were not being applied, and secondly that whilst the rules were being applied they were inadequate to prevent malpractice. This second point is however a value judgement, and there is evidence of a satisfactory and thorough approach by the SRO.

For example one respondent said of the compliance visit:

> "Although it may seem like nit-picking it does make sure you stick to the rules down to the last line"

Moreover, the action taken by FIMBRA following the visit suggests that it was ensuring that member firms complied. Question 14 (see appendix two), asked if FIMBRA had requested that the firm alter its working practices after the compliance visit. This found that over half, 55%, of all firms had been so requested. One can only conclude from this that the compliance officers were uncovering breaches of the rules and procedures which firms then had to remedy. This gives some credibility to the idea of the visit as a effective control on members. Several respondents also gave details of how they felt the visit had improved their firm's compliance.

For example:

> "helped in understanding what the rule book actually means",
>
> "there are always 'grey' areas in compliance which can be discussed at such meetings"

and

> "it is not always easy to read all the compliance manual and therefore a chat with somebody is helpful to fully understand what is required in order to comply"

All this suggests that the compliance visit did improve adherence to FIMBRA rules and that therefore firms were being monitored, with their procedures being altered, in order to protect the public.

Therefore, it is possible to draw varying conclusions from the questionnaire data concerning the compliance visit. As would be expected respondents gave differing views on their own experience, and on the visits perceived effectiveness. It is clear that some saw the visit as a pointless exercise, whilst others gained from it. With such a large membership such varying responses were inevitable. Encouragingly, for investors, some of this divergence appears to come from the fact that the compliance officers were inquiring into how the firm operated. Something which some saw as useless nit-picking, while others considered it useful help. Moreover the fact that the majority of firms were asked to change the way they operated suggests that the visits were having some effect.

However, while this may be a positive point overall I would argue that the questionnaire casts serious doubt on the compliance visit. The fact remains that visits were very brief, mostly less than a day, and almost always preceded by notice. It is likely that even more problems, in terms of working practices which needed altering, would have been uncovered by longer and unannounced visits. Furthermore, while it can be argued that members complaints about the visits' focus and depth simply represent a different view of compliance, and that FIMBRA's record proves that it had a correct focus. I find it particularly difficult to dismiss the respondents who suggest that the visit would not have uncovered fraud in their firm. This is a serious allegation, and one that cannot be dismissed by arguing that FIMBRA had an adequate but different approach.

Despite some encouraging findings the general conclusion is that the FIMBRA compliance visit was a lost opportunity and that serious doubts remain about the thoroughness, and focus of the SROs regulatory approach. When data from the questionnaire is considered with the above discussion of FIMBRA's early problems, it is clear that the effectiveness of the SRO is in doubt, and that the statement of a more determined approach, following 1990, is not borne out in practice. However, doubt has also been cast on the conclusion drawn from this by several commentators (e.g. the Financial Times leader), that the SRO was captured by its regulatees. I have shown how few members felt they had input into FIMBRA's operations, by formal or informal channels. Without such input it is difficult to see how FIMBRA could have responded to its members' wishes. The conclusion may be that FIMBRA was lax, without this reflecting capture by its members. It may be symptomatic of other failures.

FIMBRA Operations: Members Satisfaction

However, one possibility concerning input and capture, mentioned above, needs further consideration. It may have been the case that members were not active in their SRO because they felt that it already operated in a satisfactory way. That is, that members felt no need to be pro-active in raising their concerns, and trying to alter policy, because FIMBRA already operated as they would wish. If such a situation existed it would represent a form of agency capture, even without members having much direct interaction with their regulator. This possibility opens the way for a substantially different conclusion to be drawn from the finding concerning members input, and therefore needs some in depth consideration.

The hypothesis that FIMBRA was dominated by its members, despite their lack of direct input, highlights the sophistication of the agency capture theory. It may be the case that direct input by members is not necessary, for a regulatory body to become dominated by the particular concerns of its regulatees. Many factors may be influential. For example, if the staff, in particular the senior policy making staff, come from an industry background, it is likely that their previous concerns will affect their regulatory work and policy. Members may feel it is not necessary to become involved, because they know that the organisation is being run by people with similar concerns. A regulators staff is also likely to develop views similar to its regulatees the more regular their contact. This contact may take various forms, not perceived as input, for example the compliance visits discussed above. Indeed the implementation of policy may lead to an almost symbiotic relationship developing between regulator and regulatee.

Regulators will wish to be seen, by their wider audience (of politicians and public) as being effective. One way to achieve this is to set policies which can be fulfilled with ease. Lower standards will more readily be met and therefore give the impression of success. Working closely with regulatees will also help to set standards which can realistically be achieved. It is in neither parties interests for the wider public to perceive the regulatory system as failing. If this occurred the regulator is likely to lose prestige and possibly its whole existence, as an alternative regulatory body is established in search of more effective regulation. Moreover, the regulatees will not want a new body whose whole rationale is to regulate them more strongly, and with which they will necessarily have to build completely fresh relationships. It is better for regulatees to continue with the current system, where they know the rules and the people who enforce them. Any change is likely to give them less influence over their regulatory environment.

Therefore, as regular contact develops between regulator and regulatee they may begin to work together, in their own self interest, without this being perceived as input by either side. Indeed it should be remembered that this type of interaction was exactly what the FSA regime was supposed to be. The industry would work with regulators to set policy, and so ensure effective regulation. This would be close regulator/regulatee interaction for the benefit of the consumer, without the negative weakening of regulation which comes with agency capture. Such a continuous interaction may help explain the low participation rates, because members believed the regulator already operated as they would have wished.

The questionnaire was designed to consider this possibility. It offered members five possible roles for FIMBRA (see question 20, appendix two) and asked them to indicate how important each role should be in FIMBRA's operations. Answers to this question give the priorities that members themselves would have wished FIMBRA to have. Then members where asked (question 21, appendix two) to indicate how effective they thought FIMBRA had actually been in fulfilling these five possible roles. Thus a comparison between the responses to the two questions (20 and 21) allows consideration of whether members felt that their own priorities were actually being reflected in FIMBRA operations. If the agency capture, or less problematically the practitioner input, envisaged by the FSA, was taking place (despite the general lack of specific input) then it would be expected that members would consider FIMBRA to have been effective in the areas they saw as important. There would be a correlation between what was seen as important in question 20, and where FIMBRA was seen as effective in question 21.

An analysis of the responses to these two question leads to mixed conclusions as to whether FIMBRA was fulfilling the priorities of its members. However, overall the conclusion is that members did not feel that their own priorities were being actually fulfilled by FIMBRA. This again undermines the agency capture theory, and casts a blow to the idea of self regulation with practitioner input. It is clear from the responses that there was generally a consensus about what should be important in FIMBRA operations, but this is not the case with how effective FIMBRA actually was.

The one exception to this situation was the possible role of "regulating member firms" (question 20a and 21a). Nearly all firms (97.5%) saw this as an important or very important role for FIMBRA to fulfill. This was obviously something which members felt should be given a priority in the SRO workings, as over seventy percent saw it as very important. Whilst the figures for how FIMBRA actually operated are not as overwhelming, a clear majority (73.5%) did feel that FIMBRA was effective or very effective in this role. Therefore this was a characteristic which was seen as important by almost all firms, and which three quarters of them also felt that FIMBRA was effective in fulfilling. As far as "regulating member firms" is concerned members did feel that their concern was reflected in FIMBRA's work.

However, this positive link between the importance given to a role and the effectiveness of FIMBRA in fulfilling it, is not present in the other characteristics. For "preventing fraud" there was once again an overwhelming consensus (97.5%) that this was important or very important role for FIMBRA to fulfill. Indeed a very high 87.2% said it was very important. But only just over a third of members (38.2%) felt that FIMBRA was effective or very effective in fulfilling this role. Indeed nearly a fifth of all firms (18.9%)

felt that FIMBRA was positively ineffective in this role. It is clear that members did not feel FIMBRA was as effective in preventing fraud as they would have wished.

This not only further suggests a lack of influence on the part of members, but also reinforces the compliance visit responses which criticised the focus of the FIMBRA regulatory check. It again suggests that FIMBRA may have not been captured, but was still a lax regulator whose own members felt it should do more to prevent malpractice.

But, preventing fraud was not the only characteristic which saw a considerable disparity between members priorities and their views on FIMBRA operations. With regard to the role of "representing members vis-à-vis the government" a substantial majority, 78%, saw this as important or very important. Yet only around a fifth of members, 19.6%, considered FIMBRA to be effective or very effective. Indeed with this role the relationship is almost the opposite of what would be expected if agency capture was occurring. Almost four fifths of members see this as important or very important role, and an identical proportion consider FIMBRA only marginally effective or positively ineffective in this area. There seems to a correlation between how important members view this role and how poorly they feel FIMBRA is in actually achieving it.

This negative relationship between the importance of a role and FIMBRA's effectiveness is also present with regard to "representing members vis-à-vis the public". Here nearly eighty percent (79.2%) considered it important or very important whilst over seventy percent (72.8%) said FIMBRA was marginally effective or positively ineffective in fulfilling this role. The gap between members' priorities and their views on how FIMBRA operated is starkly shown by the fact that a third of members saw this role as very important, and yet less than one percent (0.9%) felt FIMBRA was very effective in this area.

The combination of these results concerning these possible role for FIMBRA therefore show that generally members priorities were not, they felt, reflected in how FIMBRA operated. The notable exception is "regulating member" although it should be noted that while most did feel FIMBRA was effective, over a quarter considered it of only marginally effect or actually ineffective. The near unanimity of importance is not entirely reflected in views on actual operations, even for this role.

It is clear that the argument for agency capture is weakened by these responses. The conclusion must be that members felt their own priorities were not reflected in how their regulator operated. One potential weakness to this conclusion is provided by the argument that the questionnaire only covered a limited number of possible roles. It could be the case that there was a closer affinity between the SRO and its members priorities in other areas. That is, that the questionnaire scope was too limited to draw such a conclusion. The potential of this argument was considered in the questionnaire design by specifically providing respondents with a space to write in any specific additional role they considered important (see question 20f and 21f, appendix two). This opportunity was taken by very few respondents, and there was considerable diversity amongst even these limited responses. This suggests that all the major roles envisaged by FIMBRA members were already included in the questionnaire.

Naturally the questionnaire was designed to cover all the main areas of FIMBRA's operations. The specified categories cover the dual aspect of the FSA self regulatory system, namely the role of representing members interests and yet also controlling them. It was hoped that this would, as was the case, limit the need for respondents to include their own extra roles. Generally, I would argue that the breadth of the selected roles give the conclusion, about regulatee views on FIMBRA's work, a firm basis. These responses add further weight to the earlier conclusions which cast doubt on the argument that FIMBRA was captured by its members. They show that members did not feel that the SRO was effective in areas which they considered important. This is particularly noticeable in the representative role which FIMBRA had. Members clearly did not feel that the SRO was advocating their interests with either the government or the wider public. This would not be the position if they dominated its workings.

Conclusion.

By analysing the brief history of FIMBRA, and using the empirical data it is possible to consider how hybrid policy making operated in practice. The most important potential problem of hybrid 'self regulatory' bodies are that they attempt to use the active participation of their members to more effectively regulate those same members. The danger is that this results in regulatees capturing the regulator and perverting policy to favour them rather than the investing public. The conclusion as to whether this happened with FIMBRA are however mixed, and generally suggest that it did not.

There is some evidence to the contrary in FIMBRA's early operations. The abandonment of the professional indemnity insurance scheme, and the forced resignation of Lord Elton were perceived examples of this agency capture. These, combined with the high profile problems of some individual firms, and the prevalence of FIMBRA firms in the compensation scheme payments, led several commentators to conclude that members had a dominant position in FIMBRA operations. However, these facts do not necessarily lead to a conclusion of agency capture. FIMBRA's 1990 annual report, for example, argued that compensation payments were due, not to regulatory failure, but in fact to regulatory success and that FIMBRAs new, and much tougher, standards were forcing firms who could not match them to leave the sector. While this caused the short term compensation payments, it was in fact improving the standard of firms in the sector overall.

The secondary data, concerning FIMBRA's first few years can then be interpreted in various ways. The questionnaire however provides original data which clearly casts doubt on the agency capture theory. From the above discussion, of several parts of the questionnaire, some clear conclusions can be drawn. The compliance visit was not it seems particularly thorough or effective. This was the best opportunity to look in-depth at a firms procedures, and to uncover any previously hidden malpractice. The brevity of the visit, and the notice given before it took place, means that this was a missed opportunity. While the questionnaire does provide some evidence that FIMBRA was improving compliance, by forcing members to alter their working practices the fact remains that most members did not think that FIMBRA was having a significant effect on preventing fraud (see question 21b, appendix five).

However, I would argue that it would be too simplistic to conclude that low regulatory standards automatically represent a case of agency capture. In this particular case it is noticeable that regulator and regulatee seem to have had very little contact. Members did not on the whole attend FIMBRA meetings, and the SRO was not proactive in seeking members views. Without concerted membership action, it is not clear how the SRO could have been dominated by them. Indeed without wide consultation by FIMBRA it is unclear how the SRO could form any picture of the concerns of members which it could then act upon.

One possibility is that the staffing and day to day working of the system resulted in the regulator developing similar concerns to its regulatees. This would mean that members did not have to be proactive, as the system already operated as they wished. But the questionnaire shows that members did not feel that their priorities were effectively implemented by FIMBRA. The fact that this was particularly so with the representative roles means that the agency capture hypothesis is not supported by the questionnaire.

The conclusions from the original data is that FIMBRA certainly had many flaws, which cast doubt on it ability to fully protect the investing public. But these problems do not appear to be due to undue influence by its regulatees. Indeed the lack of interaction between FIMBRA and its members means that it was not fulfilling its role as a self regulatory body. Members were not dominating the organisation, but it seems that they had very little influence over it at all. The idea of practitioner based (self) regulation was not occurring in FIMBRA. It seems that FIMBRA was failing on both aspects of the self regulatory approach, it did not have the participation of its members nor did it have an adequately strict regulatory regime which would protect the wider investing public. Both should cause concern, but of particular concern for this thesis is the legitimacy 'gap' this creates for the whole regulatory system. I have discussed how hybrid policy making processes rely upon active participation by, and accountability to those most directly affected in order to be seen as fully legitimate. It is encouraging that, in the case of FIMBRA, this participation has not extended to capture. However, the distinct lack of membership input, and in fact contact with the regulator, means that this hybrid body lacks legitimacy. If members are not influential in setting policy, it is necessary to consider what other actors are. This requires a consideration of the wider regulatory system under the FSA. It may be the case that FIMBRA gains its participatory legitimacy as part of the larger policy making process, and that a micro focus, just on its regulatees, leads to a inadequate conclusion.

The next chapter will therefore focus on the regulatory system as a whole. It will consider the eventual demise of FIMBRA in favour of the PIA, in order to consider how legitimate the meso level policy making was in this area. It is possible that this analysis will provide FIMBRA with the legitimacy which the membership responses, in the questionnaire, do not provide. But it is clear that members were not influential, and certainly not overly influential, in how this particular SRO operated.

Chapter Five. From FIMBRA to the Personal Investment Authority

The previous chapter focused on FIMBRA and considered the way it operated. The conclusion drawn from this was that in terms of the twin legitimating processes of self regulation (effective regulation and practitioner input) FIMBRA was failing. The SRO continued to preside over scandals and malpractice, and its regulatory visits were inadequate to fully investigate each firm. But, it is difficult to conclude that this was due to membership dominance. The regulator had little contact with its regulatees, and they did not feel that their own priorities were reflected in the SROs operations.

This creates a legitimacy gap for hybrid bodies and systems, such as FIMBRA and the FSA regulators, because it is the closer relationship with those most involved in this area which legitimises their actions without the traditional device of accountability to Parliament.

This chapter will consider the legitimacy issue from a wider perspective by looking at the whole regulatory system established by the FSA. It may have been the case that FIMBRA had legitimacy problems, but was this also true in relation to the overall system? Answering this question involves a consideration of how effective the regulation of the financial services industry was, and what input practitioners had.

One distinct characteristic of the regulatory system since the FSA has been change. As I discussed in chapter three, from its beginning there has been criticism and change. This chapter will focus on changes which took place in the retail sector, with the demise of FIMBRA and the birth of the Personal Investment Authority in 1994. It was around this time that the questionnaire to FIMBRA members was completed, and it was designed to consider the respondent's views on this change. Therefore, the particular focus for considering practitioner input will be FIMBRA members. The answers they gave concerning not only the old FIMBRA system, but also the changes, provide a unique insight into the priorities of practitioners. It is possible from this to consider how these priorities were reflected in the system which came about. Some practitioner input is needed for legitimacy, but too much could result in a loss of legitimacy as the system favours regulatees at the expense of the investing public and the wider public interest. I concluded in the previous chapter, that FIMBRA members did not capture the SRO. The discussion that follows, in this chapter, will consider their influence on the wider regulatory system.

This larger scope obviously means that practitioners from outside FIMBRA would be affected and should therefore have input. However, the particular focus on FIMBRA members reflects the fact that in the retail sector they constituted the largest group of firms (see figure three: page 125). Moreover, as a diverse group, mostly consisting of small firms, these are the types of actors the literature (see discussion in chapter two) suggests will have little influence on policy affecting them. It is therefore important in terms of legitimacy, to see if the idea of practitioner input is fulfilled for this usually excluded group.

FIMBRA: Financial Crisis.

The problems of FIMBRA members, and FIMBRA itself, dominated the debate preceding changes in the regulation of the retail sector. As I discussed above, FIMBRA was criticised for failing to implement a sufficiently strict regulatory regime. But criticism and problems spread so that the future of the SRO was in doubt. By early 1991 FIMBRA was facing a severe financial crisis. Carey (1991) outlined the problems FIMBRA faced, particularly in meeting its payments to the Investors Compensation Scheme (ICS).

As noted above (figure two) FIMBRA members were responsible for most of the payments from the ICS. This scheme paid up to £48,000 to investors who lost money as a result of a regulated firm ceasing trading. Its funding came from regulated firms, with each SRO's proportion being calculated on the basis of the burden caused by its members (Chance 1988 vol. 3(5)). Therefore, FIMBRA was forced to increase the compensation levy paid by its members. However, as this was due to members going out of business, for the reduced membership the increase was a substantial burden. For example, the increase in January 1991 represented an increase of as much as twenty five percent for individual firms (see Financial Times 11 Jan 1991).

FIMBRA firms acted to avoid the growing compensation costs, by changing the way they were regulated. For many firms there existed an alternative source of authorisation which did not entail losing their independence. This process, of changing regulator, but not business practice, was known as "regulatory arbitrage". It was possible because the Financial Services Act, (s15) gave members of Recognised Professional Bodies (RPBs) authorisation, provided the member did not carry on a business "consisting wholly or mainly of investment business" (s16). If this was the case then there was no need for a

RPB member to seek authorisation by joining an SRO. One such RPB recognised under the Act (section 18) was the Insurance Brokers Registration Council (IBRC). This regulated firms advising on general insurance, under the Insurance Brokers (Registration) Act 1977. However, its rules allowed members to also advise on investment products, covered by the FSA, provided this did not constitute more than 49% of their total business. Many FIMBRA firms advised on general and investment based insurance products, and so the IBRC provided a source of authorisation with little change to their commercial operations. Rising FIMBRA costs encouraged members to make move regulator, and of the 2300 who left FIMBRA in the period to February 1992, eleven percent moved to the IBRC (Clucas 1992:16).

A larger proportion decided to give up their independent status and become tied to one of the product provider's. While this meant they could only sell that product providers policies, it removed the regulatory burden from the firm. As a tied agent the firm was exempt from the requirements to be authorised by virtue of section 44 of the FSA, which covers appointed representatives. Thus, by becoming tied the ex-IFA shifted the regulatory burden to the product provider, and therefore reduced their own costs. Of the firms leaving FIMBRA before February 1992, twenty five per cent choose this option. But this proportion increased to 60% if those who did not gain authorisation elsewhere were excluded. It is clear that becoming tied, and so avoiding all direct regulatory costs, was the most popular option for firms wishing to remain in the industry but wishing to avoid FIMBRAs increasing costs. This is illustrated in the figure Four.

Figure Four: Firms leaving FIMBRA between 1988- February 1992

	Number Of Firms	Percentage	Firms Still Authorised
Becoming Tied	575	25	60
IBRC	253	11	27
To Other Regulator	115	5	13
Leaving Industry	1357	59	---

(Source Clucas 1992)

FIMBRA was therefore losing members for several reasons. It was weeding out unsuitable firms as part of its regulatory process. But this increased compensation payments to member firms, who reacted by seeking authorisation in a different way or by leaving the industry altogether. However, this reduction in FIMBRA membership simply meant that fewer firms were available to pay FIMBRA costs, with the result that the burden on those remaining increased. This naturally encouraged them to consider a regulatory or business move. As Clucas (1992:17) points out FIMBRA seemed to be caught in a downward circle with the possibility that higher compensation payments

> "... could lead members to move elsewhere; that this could lead to a smaller membership base; that this could lead to higher subscriptions; that this could lead to further loss of members; and so on in a vicious spiral." (Clucas 1992:17)

But it was not just the reduced total membership which placed a strain on individual FIMBRA firms. The way that IFAs are paid by the product providers added to the problem. Most IFAs are paid by commission. They do not directly charge the client a fee, but rather get a commission from the provider of the product their client buys. The questionnaire found that 92.6% of FIMBRA members use predominantly or only commission for charging clients. This has advantages for the IFA. For example, a prospective client will not be deterred by a high charge simply from seeking financial advice. The client is given advice and pays for it over time as part of the premiums on the product they buy. However, the IFA will normally gain payment in full from the product provider once the product is sold. This system is known as "front end loading". This is despite the fact that the client will pay this commission (as a proportion of the premiums) over a number of years. Therefore, commission, and in particular front end loaded commission, allows the IFA to receive immediate payment without a direct charge on the client.

However, the rate of commission is set by the product provider, not the IFA. This means that the IFA is not able to increase his income at his own initiative, as he would for example if he charged clients a fee. Rather an IFA's rate of income is determined by product providers. So as IFA costs rose, due to higher FIMBRA and compensation costs, they were not able to increase their income by charging clients more. They could not pass on their higher costs to their clients (Chance 1992a) and so faced financial problems. This was another factor adding to FIMBRA's problems because it encouraged members to attempt to reduce their costs by changing regulator or becoming tied.

FIMBRA's problem of falling membership and rising costs meant that the SRO could not meet its compensation costs. The product providers who sold their products via IFAs therefore had to act. They relied upon FIMBRA regulated firms for their own survival and so channelled money to support the regulator. This was done via an organisation known as the Independent Market Assistance Group (IMAG). This had originally been set up, by product providers, in 1987 to help IFAs with FIMBRA membership applications. But as the financial crisis worsened it changed from offering advice to IFAs to offering money to support their SRO. In total the IMAG channelled over £4m from product providers to FIMBRA. (Clucas 1992:15).

This financial assistance prevented a collapse of the system, but by 1991 it was clear that this informal system could not continue and that change must occur. In February 1991, the FIMBRA chairman, Gordon Downey, wrote to the Trade and Industry Secretary, John Redwood, to call for fundamental change in the regulatory system. Downey said (Money Marketing 20th September 1995) that FIMBRA faced an ever deepening financial crisis, which could only be cured by

> "a fundamental realignment of regulatory responsibilities" (Downey quoted in Money Marketing 20th September 1995).

This call for change was initially dismissed by the SIB chairman, David Walker, (Financial Times 12th February 1991) but FIMBRA's financial position continued to worsen. In March 1991 IMAG agreed to a further payment of £1.5m to cover FIMBRA's compensation costs, but stressed that this was only to

> "provide a breathing space to facilitate completion of a much needed review of certain aspects of the regulatory process" (quoted in Clucas 1992:15)

It was clear that the product providers would not continue to finance FIMBRA in this way indefinitely. The basic problem of FIMBRA's rising costs and falling membership had to be addressed.

By October 1991 the SIB chairman had altered his position and he called upon Sir Kenneth Clucas to consider changes in the regulation of the retail sector. Specifically his terms of reference were to consider:

> "Whether it would be feasible and appropriate to set up a new self regulating organisation for the retail sector" (Clucas 1992:7)

Clucas Report

It is clear that FIMBRA's problems lay at the heart of the perceived need for this investigation. Clucas himself says the commissioning of his report:

> "was occasioned by a belief on the part of SIB and the existing SROs that it is now appropriate to consider whether the regulation of retail intermediaries could be carried out more effectively and efficiently - consistently with proper standards being maintained- if it were done as part of the operational task of a new SRO." (Clucas 1992:7)

One can only presume that a new SRO was needed because of the failure of the present ones. Clucas details in his report (page 16-17) the problems that FIMBRA, in particular faced, and he draws important conclusions as to why these had developed.

I have discussed above the view that FIMBRA was captured by its regulatees, to such an extent that regulation was lax. The conclusion drawn from the questionnaire was that members had little input into the SRO, and that capture could not be proved. The Clucas Report agrees with this conclusion. It says (1992:15) that the high number of FIMBRA members in default should not lead to the conclusion that FIMBRA was lax. It identifies several possible reasons for default. In particular he notes the fact that FIMBRA members were small and usually unable to pay any compensation from internal funds. This suggests that it was not weak regulation, caused by agency capture, which failed to uncover problems before a firm went into default, that should be blamed for FIMBRAs financial problems. Indeed Clucas argues that FIMBRA falling membership was, at least in part, due to regulatory success "in weeding out unsuitable applicants and members." (Clucas 1992:16)

The Clucas Report gives several reasons for FIMBRAs problems which have little, or nothing to do with the way the SRO operated. It argues that the combination of the type of firms in this sector (small and financially weak), the way they were remunerated (by commission) combined with the ability of firms to move easily to other regulators (regulatory arbitrage) were the cause of FIMBRAs financial crisis. These were factors over which FIMBRA, as a regulator, had no control. Clucas' analysis of FIMBRA's problems suggests that it was not the effectiveness or legitimacy of the regulatory system, and FIMBRA in particular, which necessitated change. That is, that it was not the lack of investor protection, or the extent of practitioner input, which drove change in the retail sector. This is especially so as the Report argues (1992:16) that regulatory arbitrage was cause by perception, and not by the IBRC having weaker regulation.

It seems that it was the remuneration and structure of the industry, and the financial problems this caused which dictated regulatory change, not the issue of regulation itself. The twin legitimating devices of investor protection and practitioner input which had been behind the FSA system seemed to play little role in the Clucas Report and its conclusions.

While financial stability is obviously important it does not give any hybrid system legitimacy. It would be quite possible to have a financially stable system which failed to protect investors or to incorporate practitioner views. This would not fulfill the underlying philosophy of the FSA system. It seems that by stressing FIMBRA's financial position, rather than its regulatory history, Clucas did not give weight to the basis of the FSA regulatory system when attempting to find a solution to the SRO's problems.

This is borne out clearly when Clucas discusses (1992:20-21) the essential requirements of any new SRO. The first requirement concerns money, not regulation. It says the new SRO must

> "It must solve the problems of regulatory and compensation cost by providing a firms 'taxation base'" (1992:20).

I would argue that the first requirement of any SRO should be good investor protection. I accept that its financial base is important, but it is not legitimate for this to be the top priority. Investor protection, which in hybrid bodies comes from practitioner input, should come first, and then it should be ensured that this has a sound financial base, rather than starting from finance and then working to effective regulation.

This analysis casts doubt on the legitimacy of the Clucas recommendations. It seems that the legitimacy which comes from effective regulation was being down played at the expense of financial concerns. The other legitimating device in this hybrid self regulatory system is practitioner involvement. When compiling the Report Clucas did himself have meetings with many practitioners, but again I would argue that this was generally inadequate.

Given the short time in which the Report was compiled (only six months) Sir Kenneth did not conduct a wide consultation process. He did not call for written submissions, although a few were given (Clucas 1992:8). Rather he based his report on meetings with forty six organisations and office holders, and a series of informal meetings with individuals. (See Clucas 1992:8 for the brief paragraph on methodology).

The groups with whom Clucas had meetings (1992:49) included all the regulatory bodies (including the RPBs), certain trade associations, as well as individual practitioners and consumer groups. This does represent the diversity of actors and views from inside and outside the industry. However, the actual practitioner involvement is heavily biased towards larger product providers. Only one firm giving independent financial advice was consulted (the Bradford and Bingley Building Society) and no FIMBRA regulated firms. They did have an input via trade associations, but given the fact that FIMBRA and its member's problems were the cause of the Reports commissioning, it is inadequate that they were not directly consulted. This is particularly so given the much larger number of FIMBRA members compared to other sectors of the industry. A trade paper, Money Marketing, did conduct a survey of IFAs, the findings of which were passed to Clucas (1992:8). But the fact that Clucas did not conduct a systematic survey of the largest group of practitioners in the retail sector seriously undermines the legitimacy of the Report. It suggests that FIMBRA members could have had little influence on what was to be fundamental change in their regulatory environment. Not only does this add considerable weight to the previous conclusion about claims of agency capture, drawn in relation to FIMBRA in chapter four, but it again leads to the conclusion that practitioner input, while an inherent part of any self regulatory system, was not in fact occurring under the FSA system, certainly in relation to the IFAs regulated by FIMBRA.

This conclusion, combined with the downplaying of investor protection in favour of financial stability, means that the recommendations of Clucas do not appear to have the full legitimacy possible, especially considering the wide ranging change recommended.

Clucas Recommendations

Having considered the problems of FIMBRA, and his remit, Clucas recommended that a new retail SRO should be formed. He argued (1992:22) that this should be an entirely new body which would regulate all those giving advice to private investors. In coming to this conclusion the Report rejects three possible alternatives for a new SRO. It should be noted that some of the reasons given for rejecting these alternatives concern the issues of investor protection and practitioner input, which were lacking in the analysis of FIMBRA's problems. For example in rejecting a simple FIMBRA/LAUTRO merger (1992:21-22) Clucas highlights the difference in the nature of the firms regulated by each SRO, and argues that any combined SRO is likely to be dominated by product providers at the expense of IFAs. He therefore rejects this because one group of practitioners would have insufficient input into their regulator.

However, it is clear that financial concerns still had a large influence. It is these which lead to the rejection of a new Independent Practitioner SRO, which would have included all IFAs wherever regulated. Clucas says that this lacks a "sufficiently firm financial base" (1992:22) without the product providers support. This is exactly the reason given for not recommending a continuation of FIMBRA. I have discussed how Clucas rejected the claims that FIMBRA was a lax regulator, blaming its financial crisis on other industry factors. The rejection of a new Independent Practitioner SRO also concentrates not on its regulatory effectiveness, but on its financial weakness. But this recommendation was not without some consideration of practitioner input. Clucas (1992:19) makes it clear that product providers have an interest in the survival of the IFA sector which sells their product. Therefore if an IFA SRO cannot be financially viable, product providers should contribute to ensure their products are sold to the public. This rejection of an IFA only SRO is based upon the assumption that product providers will not give such financial support unless they also have input into the SRO they are in effect paying for.

It is clear that Clucas' recommendation for a new SRO, covering all those advising the public is based in part on the argument that some practitioners must have an input, namely the product providers. This is encouraging in terms of legitimacy, because practitioner input should ensure the system is both effective and supported by those most closely affected. However, it is important to remember that product providers do not represent all practitioners in this sector. IFAs make up the largest group advising the public, but Clucas does not give consideration to their views in a new SRO. Indeed it seems that the IFA's financial weakness meant that they carried little influence in determining what changes should occur. While criticising those who concluded that IFAs were particularly prone to "misbehaviour" (1992:15) and arguing that FIMBRA was as effective as an other regulator, Clucas then rejects the ways to maintain an SRO almost exclusively on the basis of finance (1992:19-20).

Overall, I would conclude that while Clucas gives some consideration to practitioner input, the basis of his recommendations seem to have little to do with the self regulatory system. He suggests that it already provides adequate investor protection, and does not make it clear how a new SRO will improve this. He does claim that a new SRO will have a sound financial basis, and therefore provide a long term regulator for the financially weak IFAs, and independent advice is available to the investing public. But this is merely a continuation, not an improvement of the current situation. I would argue that any change should improve the position of the investing public, in terms of advice and protection, if it is to be justified. Clucas, at best only offers no worsening of the position.

Furthermore, in terms of practitioner input, while Clucas does (as with investor protection), stress its importance throughout the report, I would argue that only one group of practitioners has really been considered. The financial weakness of IFAs, and the relative strength of product providers, meant that the former were given little consideration. It seems that FIMBRA's financial weakness ruled out any IFA based SRO. Product providers therefore had to be included. Clucas ruled out a FIMBRA/LAUTRO merger, because product providers would dominate, preferring instead a new SRO which would have some members from SIB, IMRO and SFA (see Clucas 1992:25). However, even this would still gain most members from FIMBRA and LAUTRO , even with the addition of some larger IFAs formerly regulated by IMRO. The danger of product provider dominance was therefore very real. The lack of systematic consultation with IFAs before the report was published, further highlights the marginalised position when discussing the regulatory future.

This re-inforces the previous chapters conclusion, that FIMBRA members were not influencing their SROs operations. But whilst a lack of agency capture is encouraging, and gives legitimacy to the regulatory system, in a self regulatory system the participation of industry players is needed for full legitimacy. This is the essence of 'self' in self regulation. There needs to be a position with some practitioner participation, but not to the extent that they dominate and capture the system, creating lax rules for their own benefit.

However, in an industry as large as the financial services industry, there are many different types of practitioners, with varying interests and views. For 'self' regulation to be meaningful, and legitimate, these variety of actors must all have some input into their regulation. The exclusion of one group reduces the legitimacy of any policy adopted without their input.

It seems from the analysis of FIMBRA operations, in particular the information given in the empirical research, that IFAs had little input into their immediate regulator. The consideration of the Clucas Report suggests they were also marginalised when it came to policy making in relation to the larger regulatory structure. They were not extensively consulted before the Report was written, and while Clucas stresses the importance of the continuation of a wide choice of financial advice (1992:7) there was a considerable danger that the new SRO would be dominated by just one group, namely product providers.

IFA Input and Regulatory Change.

The issue of practitioner input, and the legitimacy it gives regulatory policy, is an important issue because following the Clucas Report major changes occurred in the regulation of the retail sector. The recommendation that a new retail SRO should be established was acted upon. The Personal Investment Authority (PIA) effectively replaced FIMBRA and LAUTRO in the summer of 1994, as the regulator for those firms (IFAs and product providers) dealing with private clients. The establishment of the PIA was not, however, a simple process despite Clucas' recommendations. Many objections were raised to any reform, and to the PIA in particular, from various sources. The debate centred around the two main objectives and legitimating devices of the FSA system, namely investor protection and practitioner input. The system and the PIA were criticised as providing inadequate investor protection, and for failing to reflect the diverse views of practitioners. An analysis of the validity of these two criticisms, and how they shaped the eventual new SRO, allow consideration of the legitimacy of the policy making process in this area.

As throughout this thesis the role of FIMBRA members will form the basis for consideration of practitioner input. Before looking at their input and influence on the formation of the PIA I want to discuss their general attitude to regulatory change. Once again the space provided on the questionnaire for extra comments gives valuable qualitative data. This provides an insight into members views of how the regulatory system was operating, and their opinion on changes to it.

A difference of opinion regarding the need for change is shown in the qualitative data gathered by the questionnaire. Some respondents expressed satisfaction with the pre-PIA system and were clearly disgruntled by the establishment of the new SRO. Others welcomed the change as a welcome development which would improve the regulatory system. The following quotes show the diversity of views.

For example, several expressed the view that change was not necessary, and that the previous system (i.e. prior to the PIA) was working well. One said

> "FIMBRA and LAUTRO have in last few years become effective organisations. Why set up another body which will require a long time to become effective ?"

Likewise another said of regulatory change:

> " The public have after several years started to recognise that independent advice is best advice. They also recognise that FIMBRA regulates Independent advisers. The public will now see the waters muddied again which is a major set back for IFAs"

A third respondent was against change for similar reasons, he said:

> " The public, who the whole system was set up to protect, have only just started to understand FIMBRA and LAUTRO. To change this situation will mean another wasted five years, for the public to understand the new scheme."

What these respondents are saying is that the pre-PIA system, i.e. FIMBRA and LAUTRO, was effective and understood. Any change was therefore unnecessary, and would simply confuse the public and practitioners. As another member said:

> " It is so sad that now the name FIMBRA is established and known by the general public that we have to change yet again. I don't see why the powers in charge can't improve on the present system."

When combined with the quantitative data the quotations make it clear that some FIMBRA members did not feel any regulatory change was necessary. This adds weight to the view that Clucas' conclusion, that a new retail SRO should replace FIMBRA and LAUTRO, did not have full legitimacy in terms of practitioner input. Moreover, the quotations suggest that the regulatory system was working well, especially in terms of public awareness, and that therefore there was no need for any change. Indeed one practitioner clearly thought that change was occurring not because of any regulatory failings, but simply because of FIMBRA's financial problems. This member said he supported change but:

> "only because FIMBRA is not and cannot be adequately capitalised without a product levy and HM Government is not prepared to assist with this".

A product levy, whereby each transaction bore a relatively small charge towards a compensation fund, could have replaced the compensation charges paid by firms, and therefore improve the financial burden on FIMBRA firms. This was considered by Clucas (1992:19-20) but rejected largely because it would require change to the Financial Services Act itself. The Government had made it clear that they would not countenance any new primary legislation, and so Clucas did not see it as a feasible way of solving FIMBRA's financial problems.

There is, therefore, significant evidence to suggest that FIMBRA members did not favour change. This is at odds with the Clucas Reports recommendations that a new SRO be established. Such divergence suggests that not all practitioners have input into, and influence over, the Report. Any self regulatory system needs practitioner input to function with real legitimacy. So it is disturbing when practitioner views are excluded.

However, as with members views of FIMBRA operations the questionnaire was designed to provide quantitative data on members views of regulatory system as a whole. It asked (question 22 and 23 appendix two) respondents to consider five possible features of a regulatory system. FIMBRA members were asked to indicate how important they thought each role <u>should</u> be in a regulatory system, and then to say to what extent they thought the system (prior to the PIA) actually fulfilled this role. As previously, a comparison of the responses to these two questions gives a snapshot of members satisfaction with how the regulatory system was operating. If the characteristics that members thought <u>should</u> be important are also the ones which they think the system actually possesses then one can conclude that the FIMBRA members felt that the regulatory system reflected their priorities, that is that for these characteristics they were satisfied with how it operated. Such satisfaction would suggest that they did not consider change necessary, and would therefore add to the view that their opinions were not influential in the Clucas report, when it recommended change. This would further weaken the Reports legitimacy in terms of practitioner input.

An analysis of these two questions (see appendix five) however, gives mixed conclusions as to FIMBRA members satisfaction with the regulatory regime. For one feature "it provides good investor protection" there was a clear correlation between how important they felt the system <u>should</u> be and how strongly they felt the pre-PIA system did actually provide good investor protection. Almost all respondents, 94.6%, felt that good investor protection was important or very important. Indeed a high 72.2% said that it was very important. While the responses regarding how effective the system actually was were less clear cut, two thirds, 66.7% did agree, or strongly agree that the system provided good investor protection. So, clear majorities felt this feature was important and that the system actually operated to fulfill this role. This suggests they would not see change as necessary.

A similar conclusion can be drawn for the characteristic that the system "is self regulatory". More than two thirds of respondents, 70.5%, felt that it was important or very important that the system is self regulatory. An even larger proportion, 86.6%, said they agreed or strongly agreed that the system actually possessed this characteristic. Therefore, there is a clear majority who think this characteristic is important, and that the system fulfills the priority felt by members.

However, there was a discrepancy when the question when members were asked whether the system was self regulatory. For the question "it is self regulatory" there was an increase between those who felt that this characteristic should be important and those who felt that the system actually was self regulatory . This means that some respondents that considered it to be of little importance, or unimportant, did feel that the system possessed this characteristic. This means that something they were neutral about was nevertheless, a part of the regulatory system. Clearly this is not a particularly significant disparity but it does show that members could feel that their own priorities were not reflected in how the system operated.

This fact becomes more clear when looking at two other characteristics. For " it does not lead to litigation" a clear majority, 61.2% felt that this was important or very important. But only slightly more than a third, 38.1%, agreed or strongly agreed that this system actually possessed this characteristic. This shows that members were not satisfied with how the system was working. However, it should be noted that nearly half, 47.8%, of respondents replied "don't know" when asked if the system actually did lead to litigation. This high proportion of unsure responses obviously casts some doubt on any conclusions drawn as to members views on the subject.

The next characteristic, " it is simple to understand" does not however have such a problem. It shows an even greater disparity between what members thought should be important and how they thought the system actually operated. For this feature there was near unanimous agreement, 97.1%, that it was important or very important. Indeed over two thirds of respondents, 67.1% felt that it was very important. But this consensus was not shared when members indicated the extent to which they thought the system actually was "simple to understand". Here a majority, 52.1% disagreed that the system was simple to understand, only 41.1% agreed or strongly agreed that it was. Thus, the importance given to this characteristic by FIMBRA members was not they felt reflected in how the system actually operated. This is clearly illustrated by the fact that while 67.1% felt it was <u>very</u> important that the system should be simple to understand, only 5.5% <u>strongly</u> agreed that it actually was.

Therefore, it is clear that there was a divergence of views amongst FIMBRA members when it came to the need for regulatory change. Certainly many felt that change was unnecessary because FIMBRA was operating well. This is borne out by the qualitative and quantitative data in the questionnaire, and would mean that there was a legitimacy problem concerning the Clucas Reports recommendations. It adds weight to the idea that the Report recommended change without proper practitioner input, as witnessed by the limited consultation which took place. But the quantitative data make it clear that FIMBRA members did not feel that some aspects of the regulatory system were operating satisfactorily. In particular a majority did not feel that it was a "simple to understand". This shows that not all members shared the view expressed in the above quotations, that FIMBRA and LAUTRO had established a good system. Indeed this disquiet about the system had already been emphasised by the earlier conclusion that FIMBRA members did not feel that their priorities were reflected in their own SRO's operations.

It is not possible therefore, to conclude that the call for change in the retail sector lacked support. This means that the Clucas Report's recommendations were in line with at least some FIMBRA practitioners, and that the "self" element of self regulation was not being totally abandoned. Indeed it must be remembered that FIMBRA members were not the only practitioners involved in this area. Even their unanimous opposition would not mean that practitioners had no input. Other practitioners, the Life Companies and Banks in particular, are large players in the retail sector. For any change to be seen as legitimate in terms of practitioner input, their views must also have been considered. The views of these companies is therefore very important. However, the particular focus of this thesis is upon FIMBRA members, because as heterogeneous group consisting of small firms they are the ones most likely to be sidelined in any policy making process. Yet, as practitioners their input as well as the larger product providers, is needed for the FSA self regulatory system to be considered legitimate. There is a distinct danger that the product providers will be better organised and so more influential, at the expense of the IFAs. Policy making based on such influence would have practitioner input, but its narrow nature would meant it could not be seen as fully legitimate.

It is therefore necessary to consider the debate which followed the Clucas Report and resulted in the PIA becoming the new retail regulator. This analysis shows that the idea of practitioner input, of various types, was crucial to the eventual outcome. It also highlights the concern that one group of practitioners would be able to dominate.

However, as I shall show, the second legitimating device of self regulation, effective investor protection, also figured highly as an issue, something which was often seen as conflicting with practitioner input.

From Clucas to the Personal Investment Authority.

The time from the publication of the Clucas Report, March 1992, to the publication of the PIA prospectus, April 1994, saw much debate and considerable changes. While the PIA formation committee was quickly established, in June 1992 (Financial Services Law Letter 1992b), it was at once beset by opposition which seemed likely to thwart Clucas' recommendations. Almost all sections of the retail industry were opposed to the establishment of the PIA, at some point in time, and practitioners played a considerable role in altering the form that the SRO eventually took. The PIA debate highlights the legitimacy that comes from practitioner input, but once again raises concerns that one section was too dominant, that a limited section of the industry was able to capture the regulatory system. Moreover, the PIA establishment debate shows that the need for investor protection was also important in determining regulatory forms. Indeed, as I shall show, the whole rationale of self regulation (that practitioner input means effective investor protection) was often questioned. However, it is still the case that practitioners play a considerable role in regulation, and so this involvement needs some in-depth consideration.

The initial reaction to the Clucas Report was generally favourable (Financial Services Law Letter 1992a, Hall 1994), with the SIB backing the call for a new SRO by establishing a formation committee. This committee had representatives of all sections of the retail industry as well as public interest members. Its remit was to consult and to develop proposals for the formation of the new body.

However, support for a new SRO was not unreserved. It soon became clear that while many backed a new regulator, exactly what this meant varied considerably. For example, IMRO's response to the Clucas report was to welcome the idea of a new SRO, to replace FIMBRA and LAUTRO (Freshfields 1992), but it rejected the idea that IMRO members who also dealt mainly with the public, should leave it and join the new body. IMRO argued that it had been effective in regulating those advising the public, and that members should therefore not have to move regulator. This was in opposition to the Clucas recommendation for a new SRO encompassing all those advising the public.

The PIA formation committee soon published plans, in June 1992, which generally followed the Clucas reports recommendations (Financial Services Law 1992d). It proposed a board with a majority of practitioners, and only one quarter of independent public interest members. It said that membership of the new body would not require a new application, but rather would follow from previous SRO membership. Likewise, firms would follow the previous SRO s rules until the PIA could develop a common system for all members. These initial proposals were certainly designed to minimise disruption and extra costs, something which practitioners had complained about. But, it was not the case that this minimalist approach gained approval from inside or outside the industry.

The danger that the PIA would simply represent a continuation of the old regulatory system, except with a formalised product providers financial support for IFAs, was opposed by many industry players. Life companies, regulated by LAUTRO, feared that in a joint SRO they would be forced to finance the IFAs. They argued (Financial Services Law Letter 1992d) that unless the Banks and Building Societies, who were regulated by the SIB, also joined the PIA, this would but them at a disadvantage. However, the Banks and Building Societies were not convinced by the proposed new SRO.

For example, the British Bankers Association, while recognising that it was up to individual banks to decide on membership, said (Financial Services Law Letter 1993a) that it could see few benefits to consumers of merging all retail financial regulators. Without advantages it could not see how the extra costs of the PIA could be justified. However, it can be argued that cost was not the only reason behind the Banking sectors opposition. The IFA sector had been badly damaged by its dominance in the ICS figures, and it can be argued (Bosworth-Davies 1993b) that larger companies did not want to be associated with a sector of the industry perceived as consisting of untrustworthy firms. Indeed this seems to have been behind the original decision by the Building Societies, who offered independent advice, not to join FIMBRA but to be directly regulated by the SIB (Bosworth-Davies 1993b).

It was clear, therefore, that the formation of a new regulator would not be a straightforward exercise, due to opposition from several sectors. I noted above that the FSA did not contain provisions which could be used to force a firm to join a particular regulator. Firms were free to choose a regulator, or direct regulation by the SIB. This meant that the opposition of the Banks and therefore the Life companies, to the PIA had to be accommodated if the regulator was to be formed. The weak financial base of FIMBRA ruled out an IFA only SRO.

The SIB did suggest (Financial Services Law Letter 1993b) seeking the power to compel a firm to join a particular regulator. But whilst a Treasury Minister, Andrew Nelson, did seem to support this (Financial Services Law Letter 1993b) the fact that such a power would require legislation made it unlikely. The SIB was forced to act within the statutory framework if it was to get the PIA into operation.

The SIB chairman, Andrew Large, made this clear in a report entitled "Financial Services Regulation: Making the Two Tier System Work", published in May 1993 (Large 1993a). He again reiterated the

> "desirability of SIB being able to decline to grant or continue direct authorization to any firm where a satisfactory SRO option is open to it" (Large 1993a:74),

The report concluded that the present two tier system should continue, albeit with the SIB moving from direct regulation to a more strategic role (Hall 1994).

This report made it clear to those opposing the PIA that the FSA system was unlikely to change. This meant that the problem of FIMBRA members regulation could only be solved by some form of SRO, with the PIA being the SIBs favoured option.

However, while this suggests that practitioner concerns were not being heeded in the regulatory change, other moves by Large show clearly that industry opposition to the

PIA was being accommodated. In January 1993, Large wrote to the PIA chairman, Gordon Downey, setting out the standards the SIB would require before the PIA could be recognised. This letter called for a "step change" in regulation, meaning a step up in regulatory practice (Financial Services Law Letter 1993d). It made it clear that the original proposal, that the PIA would largely continue with previous SRO practice would not be enough to secure recognition for the new body. This can be seen as a reaction to the industry pressure for tighter controls on IFAs, which lay behind the banks reluctance to join the PIA. Practitioner input was having some effect, the danger was that this was only one sector of the industry.

However, it was not just practitioner pressure which lay behind the SIBs demand for the PIA to be a new and tougher regime. The main legitimacy requirement for the regulatory system was investor protection. The danger was that too much practitioner involvement would mean the PIA would develop rules to favour them rather than the investing public. The issue of the composition of the PIA Board came to be seen as crucial in ensuring that the 'public interest' was not subsumed by industry concerns (see Treasury and Civil Service Select Committee 1993/94 para 38:51). In his January 1993 letter, Andrew Large, said that the PIA board should contain a majority of public interest members. As with the higher regulatory standards the PIA did eventually accept this, with its final board having equal numbers of practitioners and public interest directors. The balance was held by the Chief Executive. This person was technically a practitioner, although the SIB chairman claimed in his evidence to the Treasury Committee that the Chief Executive represented "the regulator and public interest".

Whatever the technical position, the PIA was clearly moving to have more public interest directors than the regulators it replaced. For example LAUTRO had only seven out of a board of eighteen. This was seen as an abandonment of self regulation by many in the industry. One board member, Jim Stratton managing director of Standard Life, resigned in protest at the fact that practitioners would not have a majority on the board (Financial Services Law Letter 1994d). Another leading industry figure, Sir Nicholas Goodison of the TSB, argued that the FSA system of active practitioner involvement providing good investor protection, was being abandoned. He said, in evidence to the Treasury Committee:

> "the best, the most responsible, practitioners will take customers interests, the public interest, in mind anyway" (Treasury and Civil Service Select Committee 236 1993-4, para 43).

Moreover, both FIMBRA and LAUTRO made it clear that they opposed the move to lessen practitioner input on the new SROs board. They argued in their Committee evidence that the two tier system was designed to allow greater practitioner involvement at SRO level, while the SIB had more public interest representation. Moving to have public interest dominance at SRO level seemed to be an abandonment of the two tier system, and a weakening of the idea of self regulation.

It is clear then that industry concerns about some aspects of the PIA had an influence on the SRO's formation process, whilst others did not. The concern of the larger companies, over the standard of their fellow members seemed to be reflected in the SIB insistence that the PIA be a 'step change' in regulation. Such influence certainly adds legitimacy to the self regulatory system, based as it is on the premise of practitioner involvement and input. However, the debate over the PIA board shows that the other legitimating device of the system, investor protection, was also important.

The question of practitioner input is difficult to assess however, particularly in the retail sector. The formation of the PIA brought together a variety of firms, of different size and approach. Assessing the influence of all these firms is problematic. The focus of this thesis is upon FIMBRA members, because as small and largely unorganised firms these are likely to have difficulties in exerting influence upon their external environment. Therefore, the empirical study provides important evidence of the extent of practitioner input into the formation of the PIA, and whether the perceived influence extended to smaller firms.

FIMBRA Members Views on the PIA.

The questionnaire was completed by respondents at the time, that the PIA became fully operational, summer 1994. It provided an excellent opportunity to canvass the views of FIMBRA members on this change. It seems likely that the topicality of the issues raised in the questionnaire certainly help to explain the high response rate. The questionnaire canvassed views on the PIA in several ways. I have already discussed the mixed conclusions derived from questions 22 and 23 (appendix two) as to whether members favoured any change. But the questionnaire was also designed to consider members' views on the PIA as a particular form of regulatory change. There is no necessary link between members favouring change, and supporting the formation of the PIA. Other regulatory changes may have been favoured in opposition to the PIA.

The questionnaire provided much data with which to consider these issues. It asked directly whether members favoured the formation of the PIA (question 25, appendix two). But this rather blunt question was followed by a request for members to give reasons for their views. Many respondents took this opportunity, and so there was also much qualitative evidence of member's views on the PIA. This qualitative data allows a more sophisticated analysis of the quantitative data.

The hypothesis is that, as small and diverse businesses, this group will have been relatively unsuccessful in influencing its regulatory environment. As I shall discuss, the evidence does not support such a simple conclusion, clearly showing that IFAs had some influence over the eventual form of the PIA. However, the fact that these firms were not a homogenous group does make any conclusion problematic. But before discussing the eventual form of the PIA I want to analyse the views of FIMBRA members on the PIA's formation.

A narrow majority, 51.3%, of respondents said that they did not favour the establishment of the PIA (question 25, appendix two). This shows that at the crucial time, just before and after it became operational the PIA had still not won over most FIMBRA regulatees. The lack of active support is emphasised by the fact that nearly a fifth of all respondents, 19.7%, replied 'don't know'. Only 29.1% actively said they did support the PIA's formation. The reasons given for this support also cast doubt on how favourably the new SRO was received. While some respondents made it clear they supported its establishment, others gave only reluctant support. This suggests that the figure for those positively in favour of the PIA was even lower than the simple statistics suggest.

Nevertheless, several respondents who did support the new SRO expanded on why in the questionnaire. Several reasons can be deduced from these comments. One reason given was the welcome reduction in the number of regulators, which would simplify the system and save money. For example, one said, in welcoming the PIA:

> "regulatory application appears to have been inconsistent across different sectors of the industry multiple regulatory bodies with different compensation and investigative rules confuses public"

Likewise another suggested that the PIA would reduce costs, he said:

> "Industry regulated by one body, eventually it should result less expensive for the companies and investors"

Both these members therefore saw a reduction in the number of regulations as advantageous to industry and its regulation as a whole. These comments are supported by others who whilst less detailed also welcome the PIA for the improvements it would bring. For example one member said he favoured the PIA because:

> "the industry needs strict regulation".

While another gave his reasons as:

> "to give investors better protection"

But it was not just the general improvement that caused FIMBRA members to support the PIA. Some believed that the new SRO would be particularly advantageous to the IFA sector. One commented:

> "at last bank and building societies will be regulated and commission disclosure should show IFAs can offer a better deal"

This belief was echoed by another member who said that the PIA

> "will help public awareness of true independent advice"

It is clear that some FIMBRA members saw the establishment of the PIA as a positive step, something which would lead to better regulation, and benefit both practitioners and investors.

However, many of those who said they favoured the establishment of the PIA, gave reasons which suggest less than full support. Some expressed reservations as to whether the PIA could deliver improvements. And in contrast to those who saw it as an opportunity for IFAs, other supporters feared that this sector would lose influence in a new combined SRO. Moreover, some respondents gave only grudging support for what they saw as a temporary solution.

The following quotations highlight the reservations expressed by those who claimed to support the formation of the PIA. They cast doubt on the real support FIMBRA members gave the formation of the PIA. For example, one member hoped the PIA would be successful, but doubted if it really could be. He said

> "in the best of all possible worlds this should be the answer to all the regulatory problems we have experienced. Unfortunately too much bureaucratic and impractical input from the likes of SIB have produced the proverbial horse designed by a committee - a camel."

Another saw the PIA as potentially damaging to the IFA sector in particular. He said he favoured its establishment:

> "provided it doesn't become a vehicle for the direct sales operators to squeeze out independents"

The fact that FIMBRA members were giving only reserved support for the PIA is made even more clear in the following two quotations. Both give support for the PIA, but hope that its existence would be short lived. The first FIMBRA member said of the PIA:

> "it has happened, so we have to make the best of it. I suspect that it will change greatly over the next 2-3 years and hopefully end up an improvement on current arrangements"

The second respondent while welcoming the new regulator said:

> "within the present structure of self regulation this is a good move. We would however prefer direct government regulation, with minimum academic standards etc."

Therefore, while nearly a third of FIMBRA members said they welcomed the PIA, it is the case that some of this support was given with reservations, reservations as to how effective the new body would be, and as to how long it would actually last. These reservations, combined with the fact that a majority did not favour the PIA at all, means that there is considerable doubt as to the legitimacy of the formation of the PIA. It is clear that for one group of practitioners, FIMBRA members, the theory of self regulation involving practitioner input was not being realised in practice. The comments given by those who opposed the formation of the PIA emphasise that this group of practitioners had many concerns which they did not feel the PIA was addressing.

Many respondents opposed the PIA because they feared that their particular concerns, as IFAs would be swamped as part of a single retail SRO. They feared that the large product providers would have too much influence in the new body. The danger to polarisation, and the whole concept of independent advice was a particular concern. Others failed to endorse the new SRO because they felt it would not solve the basic problems of the regulatory system, that is, that a plethora of regulatory bodies would still exist so that all the PIA achieved was higher costs for little gains. There was considerable disquiet amongst FIMBRA members as to the purpose and effectiveness of the PIA.

The belief that the PIA, as sole retail regulator, would inevitably undermine polarisation can be seen in the following comments. Giving reasons for opposing the PIA one FIMBRA member said:

> "it will further blur the distinction between independents and tied when all belong to the same body. It will further reduce the numbers of independent firms. Both results will militate against the public interest"

Another echoed the belief that the public would be confused by tied and independent firms being in the same SRO. He gave the following as his reason for opposing this move:

> "misleading the public i.e. no differentiation between independent and tied advisors"

In a similar vein a third FIMBRA member said:

> "we are small IFAs our voice will be lost within the PIA. At present the general public identify independence with FIMBRA and having one regulator will cause confusion and we will be associated with the bad practice of tied and direct salesmen"

But, it was not just public confusion that caused opposition. Several felt that effective regulation would be undermined by a new all encompassing SRO. These respondents felt that the difference in business approach required different regulators. For example, one said:

> "..The role of the IFA is obviously different from tied agents and the rest, therefore in my mind a specific regulatory body makes more sense. The PIA will find it difficult to ensure that not only IFAs but tied agents, life companies and bancassurers all comply with one rule book"

This was echoed by another who commented:

> "I do not agree that all retailers of financial services should be regulated by the same body. Independent financial advisers are completely different to providers of financial products and should be regulated by different body."

These themes, of weaker regulation and less IFA input, were present in the reasons given by many members who based their opposition to the PIA on the belief that large companies would dominate the regulator. The idea that the large product providers, and their tied salesforces, would dominate at the expense of both IFAs and the investing public was expressed by many. For example, two respondents put it bluntly as follows:

> "it appears that it will be dominated by companies with large direct salesforces and cynics would say that the rules reflect this!"

> "the vested interest of the life assurance industry are setting the agenda. No one puts the investor first"

Other members commented at length expressing the same worries. For example:

> "the direct salesman as well as the independent adviser are now authorised under one umbrella. The worry is that again banking power will eventually take control of the PIA. The question of polarisation is a contentious argument and note the divisions to which the bankasurers have created because of their power in the monetary system. Banks should be banks and not try to be all things to all classes of the public"

and

> "I feel that the PIA is attempting to over regulate the investment sector but not controlling banks and insurance companies whose membership has gone through 'on the nod' despite horrendous compliance failures. Whereas the independent sectors is being torn apart to find things that do not exist. Long term the investor will lose as preference is give to supposedly more professional 'bancassurers' who in reality are anything but"

However, it should be noted that it was not just product providers who were seen as dominating the new SRO. Some respondents combined this fear, with a belief that consumers, and their representatives, had too much influence. The following express this belief:

> "heavily loaded in favour of consumers and large bank assurers"

and

> "the spirit of self regulation has been abandoned. To much control in the hands of the large institutions and public interest representation."

The concern for IFA influence was expressed in a more extreme form by other respondents. These felt that the PIA would inevitably undermine independent advice altogether. This view can be seen in the following quotations:

> "the PIA appears to have been established to make regulation simple by wiping out smaller IFAs leaving only the large organisations & agents of insurance companies. Capital adequacy is a prime example of the restrictions and rulings which will be enforced on IFAs but <u>not</u> tied agents-doe the public realise that their choice of IFA will be restricted by the PIA?"

> "At least FIMBRA was for IFAs only. Now we are all mixed up together in the PIA IFAs are a vanishing breed as figures are proving. IFAs are not getting enough representation for themselves under the PIA, the bank insurance industry is slowly squeezing them out with all the regulations, cost, and other problems such as commission disclosure which we have to face in the future. I am firmly convinced that this was the original reason for the financial services act, to push the small man out and reduce the power of the insurance industry in favour of the bank assurers"

A third was clear, if brief, when he said:

> "there is some speculation as to whether the PIA really wants small IFAs to survive"

It is clear therefore that the opposition to the PIA, felt by the majority of the respondents was largely based on a feeling that IFA input would be undermined, or lost altogether. Respondents feared that their particular concerns, as a distinct group of practitioners, would be lost, and even deliberately harmed, by inclusion in a single retail regulator. In terms of legitimacy this view contradicts the idea that a self regulatory system is based, in part, on practitioner input. This self regulatory system, the PIA, was not reflecting the views of one group of practitioners, and therefore it legitimacy is weakened.

Moreover, the second legitimating idea of the FSA regime, effective regulation with good investor protection, was also seen as lacking by FIMBRA members. This group opposed the formation of the PIA because they did not feel it would improve regulation. I have already discussed how regulatory arbitrage had weakened FIMBRA's position, and how Clucas proposed a new SRO as a solution to this problem. But several respondents argued that the PIA would not overcome the problem of overlapping regulators, and therefore was not worth implementing. This is shown in the following three quotations:

> "fails to simplify system-RPBs still exist-consumers will still be confused as to type of advice. Disproportionate costs and additional paperwork without any effect-does not increase investor protection"

> "it does not really make much of a difference their are still several alternatives available i.e. IMRO, IBRC, SIB so it still is not level playing field"

> "the concept of one regulator has been lost i.e. the PIA will not regulate the investment activities of insurance brokers, solicitors, accountants" (483)

It is the case that the PIA operated within the existing FSA system, and that therefore it was unable to fully overcome the many problems which had already developed in this regime. The existence of RPBs could not be altered without new legislation, and so the PIA could not overcome the difficulties their existence had caused. This leads to a further reason why a majority of FIMBRA members opposed the PIA. The failure to tackle basic regulating problems emphasises that some felt only major regulatory change would solve the sectors problems. This represented itself in a call for more government regulation, and an end to self regulation which the PIA represented. One member said

> "in an industry where products are very personal and money orientated pure self regulation should not be permitted. The government has an interest in many areas (e.g. pension provision) and should be more closely involved.

There are, therefore, two interlinked causes behind the opposition to the PIA. One rests on concerns of practitioner input, and the fear that IFAs would be sidelined, that practitioners input would in effect mean input, and control, by larger product providers. Secondly, FIMBRA members were opposed to the PIA because they felt it would not lead to better regulation.

Despite these criticisms and opposition to the PIA, it was established and most FIMBRA members joined. This suggests a considerable gap in terms of practitioner influence on, and therefore legitimacy of, the new SRO. However, an analysis of the events which led to the recognition of the PIA show that some concerns of the IFA sector were acted upon by the new body, and that it is too simplistic to rule out practitioner input altogether. But, it also highlights the fact that the nature and size of the IFA sector severely weakened its influence, and made opposition to the PIA ultimately ineffective.

Recognition of the Personal Investment Authority.

The empirical study, and other data, make it clear that the PIA was not welcomed by most FIMBRA members. They doubted its effectiveness, and the future which IFAs would have under its regulation. This opposition suggests that they had little influence on their regulatory environment as it was the PIA that became the sole SRO for the retail sector in 1994. A discussion of the events which preceded this illuminates the extent of IFA practitioner input into the new SRO. This analysis casts further doubts on the legitimacy of the PIA in terms of practitioner support. But it also shows that the importance of practitioner input was being down graded as investor protection and tight control came to dominate the agenda for financial services regulation. This creates a legitimacy deficit for the hybrid bodies which operate under the FSA.

Before discussing the eventual form the PIA took I want to highlight the role which FIMBRA members and their concerns, played in its formation. Throughout it will be shown how they, and the people who supported them, were largely ineffective in causing change in the regulatory structure. I have already discussed how the SIB chairman, Andrew Large, had written to the PIA saying that the new SRO must bring a "step change" in regulation. This was seen as a response to the fears of product providers that they would be forced to finance untrustworthy IFAs. The larger companies wanted these IFAs excluded, by an application procedure, before the single SRO was established. This perception of product providers dominance was heightened by a change of PIA chairman.

On 22 September 1993 Gordon Downey resigned (see Financial Times 23 September 1993) and was replaced by Joe Palmer. Partly this was explained by the slow progress made in launching the new body (Financial Times 24 September 1993) but this lack of speed reflected the reluctance of one particular section of the industry. It was the life companies and banks who had been reluctant to join the PIA, and the appointment of Palmer was designed to encourage this group to join. Downey had been a former chairman of FIMBRA, and was seen as a supporter of its IFA members. Palmer, in contrast, had spent his career in the insurance industry before joining the SIB as a board member. Indeed Downey said that his reason for resigning was that he had not been able to secure the support of all industry practitioners, and that in order to encourage the banks to join a chairman from a large institution had been sought. (Independent 13 May 1994; Financial Adviser 19 May 1994).

The belief that Palmer would favour one section of the industry was denied by him and by SIB chairman Andrew Large (Financial Times 24 September 1993) and there is naturally a difference between encouraging the product providers to join, and altering rules to their favour.

However, the fact is that after Palmer became chairman the move to make the PIA a tougher regulator than previous SROs was accelerated. This move saw the implementation of new requirements, most of which were seen by IFAs as particularly harmful to them. An example, of this was the capital adequacy rule. In October 1993 (Financial Times 2 October 1993) the PIA Board adopted a rule that all advisers must have at least £10,000 minimum capital before they could join the SRO. This was implemented in the Prospectus (Personal Investment Authority 1994:28), but was seen by IFAs as particularly harmful to them (Financial Times 26 November 1993; Money Marketing 2 June 1994;). The large product providers would be unaffected by this requirement, but many small IFAs did not have this amount of reserves. Up to twenty five percent according to one survey (Money Marketing 9 June 1994:22) could not meet this rule. The capital requirements seemed designed to limit the number of IFAs joining the PIA, and to allay the fears of product providers that they would have to pay if IFAs went into default. This represents practitioner input, but only by one section of the industry.

The weakening of IFA influence was further evidenced when the former FIMBRA chief executive, Godfrey Jillings, was removed from his position in charge of the PIA admissions procedure (Financial Times 11 March 1994:7; Money Marketing 17 March 1994:104). He was replaced by the PIA chief executive, Colette Bowe. Jillings had been at FIMBRA at a time when it face severe financial problems, something which he had helped partly overcome. He was seen as a strong advocate of the IFA concerns, and his removal suggested that these concerns would not be fully listened too. One IFA said of his removal:

> "there was a psychological advantage for IFAs in having Godfrey Jillings as head of the admissions' process, even though he was likely to be just as tough. There is a feeling that he is one of us" (Michael Bryant quoted in Money Marketing 17 March 1994:104).

It is clear therefore that those which the IFAs saw as understanding and representing their views were sidelined from the important positions in the PIA formation process. The capital adequacy rule seemed to confirm that the PIA was adopting policies which hindered IFAs compared to other industry sectors. This discontent was translated into out right opposition to the new regulator.

Early in 1994 an IFA trade body, the National Federation of Independent Financial Advisers (NFIFA) indicated that it was unconvinced by the PIA (Financial Times 22 Jan 1994:5). This position was strengthened when, just days before the 5 April deadline for applications, the NFIFA called on members to complete, but not to send off their application forms (Financial Times 29 March 1994:11). This was justified because the PIA was considered to have a very uncertain future. The chief executive of NFIFA, Gary heath, said:

> "In light of this uncertainty we see no reason why IFAs should rush to join the PIA. If you had recommended to your clients that they placed their futures in such a shaky enterprise, you would quite rightly have been disciplined" (Financial Times 29 March 1994:11).

However, whilst this may look like reservations rather than opposition, it is obvious that if NFIFA had considered the PIA to be a good option for IFAs they would not have been reluctant to recommend that members join. Indeed the recommendation to delay application seems to have been based around some specific policies of the PIA, and to have been used as a bargaining tool to alter policies seen as unfavourable to IFAs.

The capital adequacy rule was the main point of opposition, with a NFIFA survey showing that 25-30% of IFAs would have difficulty meeting the £10,000 minimum requirement. Gary Heath said (Money Marketing 9 June 1994:22) that the capital requirement was "a measure with no regulatory value" and that it could present continuing problems for IFAs, thus threatening their very future. It is clear that many IFAs did not support the PIA, and were not keen to join the organisation because it would not serve their best interests.

Nevertheless, most IFAs did join the new regulatory body, and the trade associations dropped their opposition and recommended joining. If the PIA was gaining legitimacy from practitioner input this change would have been because the regulator responded to practitioner concerns and altered policy accordingly. This does not however seem to have been the case. While the PIA did respond to one concern of IFAs, namely professional indemnity insurance (Money Marketing 16 June 1994:1) giving a delay before its much criticised scheme was introduced, the majority of IFA concerns were not fully addressed. Negotiations did take place between the trade associations and the PIA which resulted in the trade associations dropping their boycott of the regulator (Financial Adviser 30 June 1994), but it is questionable how much these achieved for IFAs. One trade association official claimed that "significant progress" had been made in relation to IFA concerns during these meeting. But the PIA did not significantly alter its plans in relation to polarisation and pension compensation which had been raised as issues by IFAs. Moreover the capital adequacy requirement was implemented unaltered at £10,000.

It appears that the reservations which IFAs, and their advocates, expressed in relation to the PIA, as shown in the above discussion of the questionnaire data in particular, were not instrumental in altering PIA policy. The practitioner input, which would give the PIA formation the legitimacy in terms of self regulation cannot be found for this sector of the industry. It seems that once the Office of Fair Trading (OFT) had approved the PIA rulebook (Financial Times 1 June 1994, Financial Adviser 9 June 1994) there was little IFAs could do to prevent the new regulator becoming operational. The OFT decided that none of the PIA rules would significantly affect competition, although it did say that the capital adequacy rule could potentially hinder competition. This was a blow to the views of the IFA trade association (as shown by Gary heath (Money Marketing 9 June 1994)) which saw no purpose to the capital requirement, other that to hinder IFAs.

Once the PIA rulebook had been approved by the OFT, IFA had little choice but to join the new regulator. I have already shown how FIMBRA was no longer financially viable, and with the SIB strongly backing the PIA (Financial Times 5 may 1994), it is not clear what alternative IFAs had. In this light the change of position by the IFA trade bodies, from calling on members to boycott to advising them to join, can be seen as an inevitable move from a position of weakness. The changes in policy which the PIA did implement, such as over professional indemnity insurance and by establishing a small practitioner panel to consider their views in policy making, are only minor alterations when the whole regulator picture is considered. IFAs did not have considerable input into how the PIA was formed and were not significantly able to alter policy to their own particular needs.

While this conclusion is encouraging in terms of the lack of agency capture, it is less so when it is remembered that the PIA was, and is, a hybrid body. As such it should gain legitimacy from both good investor protection and practitioner input. The later is supposed to result in the former as policy is made by those with more knowledge and experience of the industry and its practices. The alienation of one group of practitioners from the PIA, and its initial policy making, therefore means that the regulator lacks legitimacy. While investor protection may have been the PIAs main concern, the divorce of this from practitioner input (at least in terms of IFA input) means that the PIA is operating in a governmental bureaucratic way without the controls which exist on such governmental action (i.e. Parliament). Indeed the PIA is structure in a hybrid way, without the controls, i.e. practitioner input, which operate on such bodies. Its legitimacy is lacking on both fronts.

Chapter Six: Conclusions

Having considered the PIA formation, and FIMBRA operations, it is now possible to draw conclusions about how the regulation of the financial services industry, under the Financial Services Act 1986, is operating. The objectives of this thesis were to highlight the hybrid nature of this system of regulation, and to consider how legitimate it was in operation. This has been done with particular focus on independent financial advisers and their regulators. It was clear from the literature, (see chapter two) that many hybrid bodies were taking on public roles, and that whilst this may have been in the name of efficiency and effectiveness, it did create legitimacy problems. The accountability of these bodies, and the participation of actors in their decision making, needed consideration to discover if hybrid bodies could be considered to be acting legitimately.

Regulation under the Financial Services Act 1986 appeared to be a clear example of hybrid policy making. The advocates of the Act claimed it to be a system of "self regulation", and those being regulated (the financial services industry) were brought directly into the system via memberships of the self regulatory organisation (SRO). As I showed in chapter three, these bodies were the direct regulators for most industry players, and were supposed to set their rules after consultation and input from members. This input should have ensured that policy making and rules where legitimate in two complementary ways: firstly, via greater participation in policy making which would, secondly, lead to greater effectiveness. Practitioner input would ensure that rules where effective, above all in protecting investors, because those with the most knowledge and experience would be involved in drafting them. This would be more effective than rule making by a government bureaucracy which lacks the real details and knowledge experience of how rules affected the industry. Greater effectiveness is at the heart of possible advantages of hybrid policy making but the way that this is to be achieved is also crucial. The participation of those being regulated raises the possibility that they will be able to influence policy to serve their own narrow interests, rather than the wider public interests of the investing public or the public at large. This danger, of agency capture, has been central to the debate around the working of the FSA since its inception. It has been the need to strike a balance, between regulatee input and capture, which has caused many difficulties for the operation of the FSA system.

I have shown how the FSA system has been criticised from both sides, for being over responsive to regulatees, and also for not responding to their concerns. The initial reaction to the SIB and SRO rule books, from the industry, was generally unfavourable (see chapter three). Practitioners saw them as too legalistic and prescriptive, and therefore as an unnecessary hindrance to business, particularly the development of new products. The idea of self regulation is to avoid exactly this occurrence. The involvement of practitioners should ensure that policy is made which takes account of the realties of the marketplace and which does not stifle business. The original response to the FSA leads to the conclusion, therefore, that whilst the system may have been hybrid, in terms of both public and private actors being involved in policy making, it was not truly self regulation, because many practitioners felt alienated from the process and that inappropriate rules were being imposed upon them.

This conclusion is particularly problematic in terms of the legitimacy of the system. Hybrid policy making represents a shift away from traditional legitimacy devices, centered around elections, ministers and accountability to Parliament, in favour of alternative legitimacy based on participation of those most directly affected and the effectiveness this brings. It is clear that the original system under the FSA was not gaining legitimacy in terms of practitioner involvement or effectiveness. This is emphasised by the 'new settlement' which attempted to allow for greater flexibility in SRO rule books (see chapter three).

The new settlement changes accepted the industry arguments that rules were too prescriptive and attempted to allow individual SROs to develop specific rules, which would be more appropriate to their particular area. Primarily this was done by altering the requirement as to the standard of investor protection SRO rule books must provide, under s10 and schedule 2 of the Financial Services Act. This was amended, by s203(1) of the Companies Act 1989, from 'equivalent' to an 'adequate' level of investor protection. The original wording, had meant that SRO must provide the equivalent protection to the SIB's own rules, as a direct regulator, and had been interpreted by the SIB to mean that almost identical rules would be needed. However, whilst the new wording was designed to give SROs more room for manoeuvre, it still fell to the SIB to decide what was an 'adequate' level of investor protection. As I discussed above this meant that in practice SROs did not have the greater freedom that had been envisaged.

However, the new settlement does show that the industry was able to influence policy making and its regulatory environment. It shows that the FSA system was truly hybrid with rules being altered due to the concerns of private actors. The controversy over whether this is desirable or not is highlighted by other changes introduced by the Companies Act 1989. This also altered s62 of the FSA, the section which allowed civil actions to be taken by investors who had suffered due to a firm breaching the regulatory rules. A new section, s62A, was inserted which restricted the ability to bring such an action to 'private investors' only. The industry had argued that the previously wider drafting of this section, which allowed any investors to sue, opened the way for considerable litigation and was therefore undesirable. They feared that civil actions would be used by disgruntled clients, and that combined with the sanctions available to regulators, this would lead to unnecessary delay and complication. The industry argued that civil actions could be used, particularly by large clients, as an integral part of business dealings, with the threat of bringing an action being used as a bargaining device. Hence the move to restrict such actions to only small investors, which severally limited the scope for their use.

However, as I showed above, it is debatable if this restriction was really justified or desirable. There is little evidence of civil actions being used by investors, and the considerable restriction that s62A represents has many potential drawbacks. The reason for creating a civil liability for rule breaches can be seen as twofold, firstly, to encourage rule compliance by firms, because they would be civilly liable, and secondly, to empower investors irrespective of the failings of a regulator. The restriction to only 'private investors' means that the affect of this provision is greatly reduced, because those clients most likely and able to bring actions, larger professional investors, are now excluded from doing so. Small investors lack the resources, and knowledge, to be likely to bring a civil action and this means the potential advantages of in terms of rule compliance and gains for investors has effectively been lost.

Therefore, the fact that the industry was successful in changing policy in this area, whilst emphasising the hybrid nature of rule making, raises the danger of capture, with rules being made to favour the regulatees rather than for effective regulation, and investor protection. In order to explore the workings of hybrid policy making, to discover if it was operating in the public interest, one regulator (FIMBRA) and its regulatees (IFAs) were chosen for in depth and original consideration. The questionnaire sent to FIMBRA members allowed analysis of the regulators working practices and of the input members had into their SRO. It also provided the basis for a consideration of the relative input of various industry actors into the wider regulatory change which occurred in the retail sector.

It was shown above, in chapter four, how FIMBRA had been criticised for being too responsive to its membership. The abandonment of the professional indemnity insurance scheme and the subsequent resignation of Lord Elton as chairman, were cited as examples of the membership having influence over the policy of the SRO. Perhaps of more concern was the predominance of FIMBRA regulatees in the list of firms going into default, and requiring their clients to be compensated from the Investors Compensation Scheme. This appeared to show that FIMBRA was not a thorough enough regulator, because it failed to uncover malpractice in a firm via its compliance and monitoring work. I discussed above how this was often also cited as an example of agency capture, with FIMBRA inadequacies attributed to the influence of its members.

The original data from the questionnaire supports the secondary data in this area, but casts doubt on the conclusions to be drawn from FIMBRA firms prominence in the ICS figures. The questionnaire data concerning the FIMBRA compliance visit was discussed at some length. The fact that visits were of only short duration, and normally preceded by notice, cast serious doubt on their potential as a regulatory and compliance check. It seems clear that a compliance visit which lasted longer and was unannounced could be more in depth, and avoid any possibility of records being manipulated to indicate false compliance. There is certainly more that FIMBRA could have done to make its compliance checks more thorough and therefore to have uncovered problem firms which subsequently caused investors to rely on the ICS.

However, the fact that FIMBRA did not operate as effective compliance visits as could have been hoped does not automatically lead to the conclusion that it was captured by its members. While the examples of the PI scheme and Lord Elton's removal do show that members had considerable influence, the data from the questionnaire suggests that this may have been restricted to the early years of FIMBRA's operations. By the time the questionnaire was completed FIMBRA had been operating as a regulator for over six year, and at this time there was little evidence from which too conclude that members had a close relationship with the SRO from which to influence its operations. The questionnaire showed that members did not feel that they had an input into FIMBRA operations, with a majority saying they had did not have either formal or informal input, and that they had not been consulted by their regulator on any issue. While some had been proactive in contacting the SRO about an issue of concern, the lack of input raises severe doubts about how the members could have been able to capture the regulator. One possible reason for this lack of interaction between regulator and regulatee could be that members already felt that FIMBRA was operating in their best interests, and that therefore they did not need to attempt to alter policy, because it already served their own wishes. The questionnaire again allowed consideration of this possibility.

The comparison of how members judged FIMBRAs operation, on certain issues, and their own priorities (question 20 and questions 21) while showing some correlation between priorities and operations, generally leads to the conclusion that FIMBRA members did not feel that their concerns where being reflected in how FIMBRA actually operated. This is particularly true for the representative role FIMBRA could play, vis-à-vis the public and the government, where a majority of members felt the SRO was of marginal effect or positively ineffective. This is therefore further evidence that FIMBRA was not captured by its regulatees.

In terms of the working of self regulation this conclusion is to some extent encouraging, because it suggests that the danger of too much regulatee influence did not occur in practice. However, one of the prerequisites of a legitimate self regulatory system is that those most closely involved in the area have an input into policy making. This would create a more pluralist decision making process and this greater participation would compensate for the fact that the traditional legitimating devices, in particular of ministerial responsibility, is being sidelined. Therefore, while too much regulatee influence is undesirable, a complete lack of membership input is also problematic. There needs to be a balance of influence, so that hybrid policy making can use both private and public actors to create the most legitimate and effective system. The example of FIMBRA suggests that while the FSA system was hybrid it failed to strike this balance. The initial lack of practitioner input, led to rule books being heavily criticised as too long and too legalistic. In FIMBRA's case there was then considerable practitioner influence over the policy and leadership of the SRO. But the questionnaire shows that as time progressed the FIMBRA was once again considered remote from its membership. They had little input, of whatever form, into its workings, and were not satisfied with how it operated on many important issues.

This is of particular concern because the SROs were intended to be responsive the their memberships, as front line regulators. It was SROs which would bring ordinary practitioners into the regulatory system. The SIB which was designed to be a more public dominated body, having as it does a leadership chosen by the Chancellor and the Governor of the Bank of England, and a board which has equal numbers of practitioner and public interest members. The SROs should have provided an input for practitioners by their close relationship with members, which could then be channeled up, to the overall regulatory system.

But it is clear that this was not occurring under FIMBRA, and this is reinforced in the working of the PIA. The PIA, had a greatly reduced practitioner input on its governing body, with an equal number of public interest and practitioner members. The changes in the way the FSA regulatory system operated was reflected in the October 1995, Treasury and Civil Service Select Committee Report (1995/6). In this report the Members of Parliament argued that the SROs had developed into strong public interest regulators, and where not dominated by their members. The Report says:

> "From being the apparent creatures of their client industries the so-called Self-Regulatory Organisations established under the Financial Services Act have developed into self-confident regulatory organisations with objectives transcending the particular interests of the industries and asserting the public interest over the particular interests of their members." (1995/6: para 102).

From this finding the MPs concluded that self regulation was "dying a natural death" (para 103), and that this was to be welcomed as a desirable move.

However, it still remains the case that the regulators, under the FSA, are hybrid bodies. They are private companies, privately financed and are not directly responsible to Parliament for their actions. It is the governing bodies themselves (at least as far as the SROs are concerned) who choose the public representatives on their governing bodies. The MPs are correct to argue that domination by members interests alone is undesirable, but without members input there is a distinct lack of legitimacy for these hybrid bodies. Moreover, given the ineffectiveness and reduction in the role of Parliament, as the public and private realms compenetrate, it is important that the opportunities for greater participation and accountability offered by hybrid policy making is realised if legitimacy is to occur. The concept of self regulation is desirable, although the actual working of the concept has not resulted in all the possible gains which could occur.

The Future: the Financial Services Authority.

The regulation of the financial services industry is however, again undergoing a period of change. The Labour Government, elected in May 1997, has put forward proposals to replace the FSA regime with a new system. In a statement on the future of the Bank of England (20 May 1997) the Chancellor, Gordon Brown (Brown 1997), announced that the SIB would be transformed into the single regulator for the industry, covering not only the areas under the FSA but also the regulatory role of the Bank of England. He argued that this move would replace the system of self regulation with what he called a "new fully statutory system". This was needed because self regulation had failed. He said

> "It has long been apparent that the regulatory structure introduced by the Financial Services Act 1986 (FSA) is not delivering the standard of supervision and investor protection that the industry and the public have the right to expect" (Brown 1997)

As part of this announcement, the Chancellor asked the SIB to develop proposals for this new system. The SIB, in consultation with the SROs produced its report in July 1997 (Securities and Investment Board 1997). This formed the basis for detailed proposals, and consultative documents issued in October 1997 (Financial Services Authority 1997a,b,c). During this process the SIB was renamed the Financial Services Authority (Financial Services Authority 1997d) in preparation for taking on its new expanded role.

The documents issued in October 1997 make it clear that the regulatory system will undergo considerable change in the coming years. The new Authority will be responsible for regulating all financial firms, expanding its role into banking and friendly societies which were not covered by the 1986 Act. It will also be the direct regulator for all firms. The SROs will be abolished, as will the role played by RPBs in giving authorisation to carry on investment business. This will remove the main channels for practitioner input into the regulatory system, and is clearly a move away from self regulation. This is re-enforced by the plans to for the authority's governing body to be appointed by the Treasury, and for the people appointed to be representatives of the public interest, not any section of the industry.

However, I would argue that the proposals will result in a continuation of hybrid policy making. The new Financial Services Authority is like the SIB it replaces, a private company which will continue to be privately financed. The compensation scheme will also continue to be financed by the industry rather than the taxpayer. Moreover, the

Authority has published a consultative document on practitioner involvement which makes it clear that the industry will still play an important role in the regulatory system. The Chancellor in his original statement stressed that one of the beneficial aspects of the FSA system was practitioner input and that this should be maintained in the new system. The consultative document goes on to give several reasons why practitioner involvement is seen as desirable (Financial Services Authority 1997b:5). As well as ensuring that the Authority is 'market aware', practitioner involvement is said to be needed to help the Authority formulate sensible and efficient policies which do not hinder innovation, whilst maintaining practitioner confidence and support. In order to achieve these objective two practitioner bodies are proposed. One is a "high level practitioner group" which would advise the Board on cost and competition implications of regulation. The other is a "small business panel". This builds on the PIA's small business practitioner panel, which advisers on the particular problems small firms face from regulation.

The exact form of these bodies, and their roles, is not yet determined. The time for consultation does not end until 30 January 1998. However, it is clear that the new system will not exclude practitioners in favour of a regulatory system simply imposed by a government bureaucracy. Indeed it will not be a government department which regulates this area, but a private company (albeit with powers delegated by Parliament) and the views of practitioners are seen as important for effective regulation. Funding, which will still come from the industry, is likely to ensure that practitioners are keen to influence how the new authority works.

Conclusions.

These proposed changes emphasise again that hybrid policy making is an integral part of the modern state. Even changes which purport to move away from self regulation seek to include private actors. Whilst this is often justified on effectiveness and efficiency grounds, it is often virtually impossible to say if it has achieved these successes. Hybrid policy making does however provide an opportunity to revitalise legitimacy in decision making, with more actors actively participating, and with decision makers being accountable to a wider audience. These can provide a much more meaningful process that the ineffective checks offered by Parliament over hybrid policy making. There is an inherent danger that private actors will subvert the process, and capture it to their own ends. But the opportunity for this will be greatly reduced if the system is open and accountable.

Indeed the evidence from this research is that some private actors (i.e. IFAs) seem to have very little influence over policy which affects them. Formal systems to ensure all private actors can play a full role seems to be one lesson of regulation under the Financial Services Act 1986.

The history of the FSA regime is therefore a mixed one. Certainly private actors had a great influence, but in terms of IFAs this seemed to wane considerably after the first few years. By the demise of FIMBRA they seemed to have little contact with, and influence over, their regulator. With the loss of the SROs this seems likely to increase. Only a recognition, by governments and politicians, that hybrid policy making is here to stay, and that no system of financial services regulation can be without practitioner input, will result in the formal system which build in practitioner input, and therefore legitimacy into policy making. It does not seem that the new Financial Services Authority will lead to this desirable outcome.

Appendices

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Appendix One: Research Methodology And Analysis.

The basis for the empirical contribution of this thesis is a postal questionnaire sent to FIMBRA members in the summer of 1994. This was designed (see appendix two) to provide detailed quantitative data on their views and experience of FIMBRA and its operations. It also provided space for more open ended qualitative comments to be included, and many respondents took this opportunity. For example, 179 gave reasons for their views on the PIA (question 25a).

The original pilot questionnaire was sent during January 1994, to a randomly selected national sample of twenty FIMBRA firms. These firms were chosen from the yellow pages phone directory, and did not form part of the sample for the questionnaire itself. This pilot received an acceptable response rate of twenty five percent which showed that the questionnaire would need much revision. These changes centered around the questions (20-24) which asked for members views on certain roles and features of FIMBRA and the regulatory system. The pilot questionnaire asked respondents to rank these features, from 1 as 'most important' to 5 for 'least important'. This was intended to provide an insight into how respondents viewed the characteristics relative to each other. However, most respondents in the pilot, graded all (or nearly all) of the characteristics and features as "1", presumably because they viewed them all as very important. They did not rank the features relative to each other. Rather they seemed to be giving a general view of how they viewed each one irrespective of the importance they attached to the others.

Therefore, following the pilot, major changes were necessary in the questionnaire. Those question which sought views on several characteristics, were altered so that each one could be graded independently from the others, from very important to unimportant. There were also other minor changes following the pilot to take into account the extra knowledge about FIMBRA firms, and FIMBRA operations it provided. For example, question two on the original draft of the questionnaire (how many FIMBRA authorised adviser do you employ?) had contained possible responses which started at 'less than five'. All the respondents ticked this box, and so the questionnaire was altered to include each figure up to five, in order to provide details that were lacking in the pilot. The same was done for question three (how many principals does the firm have?) because the pilot indicated that this was likely to be below five. For similar reasons questions 9,12 and 13 were amended in order to reflect the details, in terms of length of time taken and notice given, about FIMBRA visits which respondent to the pilot gave.

The pilot therefore provided much information which allowed the questionnaire to be improved before the main sample was dispatched. It ensured that the questionnaire accurately reflected the actual characteristics, and experiences, of FIMBRA members.

The questionnaire was amended and the main sample was sent in July 1994. The delay between the pilot and the main sample partly reflects the changes which occurred in the questionnaire but was also due to the need to obtain an accurate list of all FIMBRA members. This had to be purchased from a marketing company. The questionnaire was sent to 554 FIMBRA members, which represented one in ten of the membership as contained on the list provided. The firms were chosen at random. The first was chosen by the role of a dice, and then every tenth firm was selected. The firms which had formed the pilot sample were highlighted on the list, but there was no need to specifically exclude them from the new sample because they never occurred at this tenth position.

The questionnaire was sent with a covering letter (see appendix three) and a reply paid envelope for responses. The letter indicated a date, by which respondents were asked to reply. This was some four weeks after the questionnaire should have been received by the firm. After this time had elapsed (September 1994) a follow up was sent to those firms which had not replied. This contained a new letter (appendix four), which again gave details of the research, a further copy of the questionnaire and a new reply paid envelope. Again, a requested reply date of four weeks was indicated.

Of the sample of 554, replies of some sort were received from 272. However this included twenty nine which could not form part of the empirical work. These were mostly from firms which had stopped trading, or were still trading but were no longer FIMBRA members. They also included two who returned the questionnaire indicating that they were not willing to complete it, and a further two who sent detailed letters in reply (expressing their views and giving details of their particular working practices) but did not complete the questionnaire. Finally there was a reply from a firm on the Channel Islands who indicated that, whilst they were regulated by FIMBRA, they conducted specialised business which was outside the scope of the questionnaire.

Therefore, there where 243 responses which could be used for this thesis. The computer package SPSS for window was used to analyse the responses to the questionnaire. Once the data had been inputted, this provided a quick and easy way of producing statistical data.

Not all of these respondents completed the questionnaire in all respects. Some only completed certain sections of it. This is reflected in the "valid cases" and "missing case" for each question in appendix two. Valid cases is the number of respondents who completed this particular question. Missing cases gives the number that failed to give a response to this particular question. However, the vast majority of respondents did complete virtually all the questions.

The exception to this was the questions (the 'a' parts of 14-19,25 and question 26) which asked for respondents to expand on previous responses. With the exception of question 26 these question were only to be completed by those who had answered 'yes' to the preceding question. Naturally therefore the response rates for these were much reduced compared to the majority of questions.

Appendix Two: Questionnaire Sent To FIMBRA Members

☐☐☐☐

FINANCIAL SERVICES REGULATION.
FIMBRA Members Questionnaire.

This questionnaire is attempting to elicit your views on F.I.M.B.R.A., and financial services regulation in general. Please tick all the options in each question you feel appropriate. Please do not hesitate to include any other options. You may feel that these simplified questions are inadequate to express your views and I would draw your attention to the space at the end of the questionnaire that is available for you to expand on any points you wish.

Section One: About your firm.

This section asks for some basic background information about your firm to help us draw some statistical conclusions.

---

1. When was the firm established ?

   prior to 1980 ☐
   1980-1987 ☐
   1988-1990 ☐
   after 1990 ☐

2. How many F.I.M.B.R.A. authorised advisers does the firm employ ?

   One ☐
   Two ☐
   Three ☐
   Four ☐
   Five ☐
   more than five: please specify.............................

3. How many principals does the firm have ? (i.e. directors, partners etc.)

   One ☐
   Two ☐
   Three ☐
   Four ☐
   Five ☐
   more than five: please specify....................

4. Within which fee category for F.I.M.B.R.A. subscriptions is your firm placed ?

Category One: ☐

Category Two ☐

Category Three ☐

5. When was the firm fully authorised ?

month... year:......

6. What basis is used by your firm for charging clients ?

commission only ☐
predominately commission with some fees ☐
predominately fees with some commission ☐
fees only ☐

Section Two: F.I.M.B.R.A.'s compliance visit.

This section asks for details about F.I.M.B.R.A.'s compliance visits, and in particular how the most recent one was conducted.

---

7. How many times has the firm been visited by F.I.M.B.R.A. compliance officers since 1988 ?

never ☐ if never please go to Section Three..
Once ☐
Twice ☐
Three times ☐
Four times ☐
Five times ☐
more than five times: please specify.....

8. when was the last such visit?

month:......... year:.....

9. How long did this visit take ?

completed in one day ☐
1-2 days ☐
3-5 days ☐
more than five days: please specify..................

10. From your firms point of view do you consider that the time taken for this visit was:

too much ☐

about right ☐

too little. ☐

11. With regard to the visit would you say that the amount of documentation requested by F.I.M.B.R.A. was:

adequate for review ☐

too little ☐

more than necessary for review ☐

12. How much notice did your firm get of this visit ?

no notice ☐

less than a week ☐

1-2 weeks ☐

3-4 weeks ☐

more than four weeks: please specify. ....

13. How many staff days did it take to prepare for this visit ?

no preparation was involved ☐

less than a day ☐

1-2 days ☐

3-5 days ☐

more than five days: please specify..................................

14. After this visit did F.I.M.B.R.A. request that the firm alter any working practices ?

yes ☐ no ☐ don't know ☐

14a) ***If yes***: Please give details of the area involved.

....

....

....

....

....

....

15. After this visit did the firm alter any <u>other</u> working practices ?

yes ☐ no ☐ don't know ☐

15a) ***if yes***: Please give a brief outline of the area involved and why alteration took place.

....

....

....

....

16 Overall in respect of the firms business did you feel the visit was

- helpful ☐
- neither helpful nor unhelpful ☐
- unhelpful ☐

16a) Please elaborate on your views.

....

....

....

....

....

....

<u>Section Three: F.I.M.B.R.A.</u>

This Section attempts to gauge your feelings about F.I.M.B.R.A.. How effectively you perceive it to be working, and how you may like to see its operations altered.

---

17 Have you attended any internal F.I.M.B.R.A. meetings e.g. AGM ?

yes ☐ no ☐

17a) ***<u>if yes:</u>*** please specify which and when...

....

....

....

....

18. Has F.I.M.B.R.A. made any ***<u>formal</u>*** (e.g. written) requests for your views on its operations ?

yes ☐ no ☐

18a) ***<u>if yes</u>*** please specify the nature of the request and outline the nature of your response ?

....

....

....

....

....

....

19. Have you, via ***<u>informal</u>*** channels (e.g. meetings with officials), made your views known to F.I.M.B.R.A. in respect of its operations ?

yes ☐ no ☐

19a) ***<u>if yes</u>*** please specify the nature of the informal channel and the nature of your input.

....

....

....

20. Given below are some of the many possible roles which F.I.M.B.R.A could fulfill. Please indicate how important you feel each one should be in F.I.M.B.R.A.'s operations

	very important	important	of little importance	of no importance
a) regulating member firms	☐	☐	☐	☐
b) preventing fraud	☐	☐	☐	☐
c) co-ordinating compensation	☐	☐	☐	☐
d) representing members vis-à-vis Government	☐	☐	☐	☐
e) representing members vis-à-vis the public	☐	☐	☐	☐
f) other: please specify	☐	☐	☐	☐

21. Given this please say how effective you feel F.I.M.B.R.A. has been in fulfilling the following roles:

	very effective	effective	marginal effect	ineffective
a) regulating member firms	☐	☐	☐	☐
b) preventing fraud	☐	☐	☐	☐
*c)*co-ordinating compensation	☐	☐	☐	☐
d) representing members vis-à-vis Government	☐	☐	☐	☐
e) representing members vis-à-vis the public	☐	☐	☐	☐
f) other: please specify.............	☐	☐	☐	☐

Section Four: Regulation and the Financial Services Act.

This section asks some general questions about regulation under the Financial Services Act. This covers not only the present structure, but also the proposals for reform around the establishment of the Personal Investment Authority.

22. The following are some of the main possible features of a regulatory system. Please indicate how important you feel they **should** be in an ideal system.

	very important	important	of little importance	unimportant
a) it is self regulatory	☐	☐	☐	☐
*b)*it provides good investor protection	☐	☐	☐	☐
c) it has different regulators for different types of firms	☐	☐	☐	☐
d) it does not lead to litigation	☐	☐	☐	☐
e) it is simple to understand	☐	☐	☐	☐
f) other: please specify............	☐	☐	☐	☐

23. In relation to this please indicate to what extent you agree with the suggestion that the present system (i.e. prior to operation of P.I.A.) actually possesses the following characteristics.

	strongly agree	agree	don't know	disagree.
a) it is self regulatory	☐	☐	☐	☐
b) it provides good investor protection	☐	☐	☐	☐
c) it organises a good compensation scheme	☐	☐	☐	☐
d) it does not lead to litigation	☐	☐	☐	☐
e) it is simple to understand	☐	☐	☐	☐
f) other: please specify	☐	☐	☐	☐

24. Given that change does seem likely how important do you feel the following characteristics **should** be in planning reform

	very important	important	of little importance	unimportant
a) fewer regulatory bodies	☐	☐	☐	☐
b) common training requirements for all advisers to the public	☐	☐	☐	☐
c) common compliance requirements for all advisers to the public	☐	☐	☐	☐
d) the maintenance of polarisation	☐	☐	☐	☐
e) more Government involvement in regulation	☐	☐	☐	☐
f) other: please specify.......	☐	☐	☐	☐

25. Do you favour the establishment of the Personal Investment Authority ?

yes ☐ no ☐ don't know ☐

25a) Please give reasons for your answer. ....

....

....

....

....

....

....

26. Thank-you for taking the time to complete this questionnaire. The following space is left blank for you to include further information, or include any personal views.

....

....

....

....

....

....

....

The next stage of the Financial Services Regulation Research project requires that some F.I.M.B.R.A. members should be interviewed in order to obtain, in more depth, their views about the issues covered in this questionnaire. If you are willing to participate in this exercise please include a contact name and address. Thank-you.

Name:

Firm:

Address:

....

....

....

....

....

....

Tel...

Once again thank-you for completing this questionnaire. When completed please return (in the reply paid envelope) by 30th September 1994, to :

Nick Lynch

School of Financial Studies and Law

Sheffield Hallam University

City Campus

Pond Street

Sheffield

S1 1WB

If you have any queries please phone 0742-533688.

Appendix Three: Covering Letter Sent With Questionnaire

Dear Compliance Officer,

<u>Re: F.I.M.B.R.A. Members Questionnaire.</u>

I am a researcher at Sheffield Hallam University, currently undertaking a research project in to the regulation of the financial services industry. The purposes of this project are; to establish an in-depth understanding of how the system is, and is perceived to be, currently operating, and also to appraise future change.

To this end I am sending the enclosed questionnaire to a nation-wide sample of F.I.M.B.R.A. members, and your firm has been selected as a representative of this group. Obviously the success of this aspect of the project is largely reliant on your goodwill and co-operation and I would be most grateful if you are able to find the time too complete and return (in the reply paid envelope) this questionnaire by 5th August. I appreciate that there are many demands on your time, and I can assure you that the content of the questionnaire has been kept to a minimum.

Moreover, I would stress that all information will be treated in the strictest confidence, and that firms will not be identified in any research findings. If you have any queries about the questionnaire, or the research in general, do not hesitate to contact me on 0742 533 688.

I would like to take this opportunity to thank you for your help, and I look forward to receiving your reply,

Yours faithfully,

Nick Lynch
Researcher in Law.

Appendix Four: Covering Letter Sent With Second Copy Of Questionnaire

Dear Compliance Officer,

<u>**Re: F.I.M.B.R.A. Members Questionnaire.**</u>

Recently I sent your company a copy of the above Questionnaire, and my records indicate that I have not yet received a reply. As I explained in my previous letter I am currently engaged on a research project into the changes in the retail Financial Services industry and I am attempting to gauge the views of F.I.M.B.R.A. members, and now with the establishment of the P.I.A, ex-F.I.M.B.R.A. members. Your firm has been chosen as a representative of this group.

I feel that it is particularly important that this section of the industry is fully represented in the research findings; as larger financial institutions often have less difficulty in making their views known. Moreover, I see this as a particularly fruitful way for the section of the industry which has, perhaps, come under the closest regulatory and public scrutiny to fully air their views on past, present and future regulation and indeed changes in the industry in general.

I appreciate that you have many demands on your time, but I would stress that the more complete the response rate the better I will be able to represent the views of firms like yours. I have enclosed a further copy of the Questionnaire (with a reply paid envelope for your response). Whilst I realise that the change anticipated in the questionnaire has now taken place (i.e. the P.I.A. has been established) I hope you will still be able to give me your views on how F.I.M.B.R.A. performed as a regulator and whether we should have changed to the P.I.A. at all.

Finally, do not hesitate to contact me, on 0742 533688, if you have any questions about the questionnaire or the research in general.

I look forward to receiving your reply,

Yours faithfully,

Nick Lynch
Researcher in Law.

enc.

Appendix Five: Results Of Questionnaire.

Question 1.
When was the firm established ?

	Number of Responses.	Percent
prior to 1980	61	25.1
1980-87	110	45.3
1988-1990	32	13.2
after 1990	40	16.5
Valid case 243	Missing cases	0

Question Two.
How many FIMBRA authorised advisers does the firm employ ?

Number of Adviser	Number of Responses.	Percent
1	85	35.1
2	69	28.5
3	32	13.2
4	21	8.7
5	9	3.7
6	6	2.5
7	2	0.8
8	2	0.8
9	5	2.1
10	1	0.4
11	1	0.4
16	1	0.4
17	1	0.4
18	2	0.8
20	1	0.4
22	2	0.8
32	1	0.4
65	1	0.4
Valid cases 242	Missing cases	1

Question 3: How many principals doe the firm have ? (i.e. directors, partners etc.)

Number or Principals	Number of Responses	Percentage
1	98	40.5
2	90	37.2
3	33	13.6
4	10	4.1
5	4	1.7
7	2	0.8
8	2	0.8
9	2	0.8
10	1	0.4
Valid case 242	Missing cases 1	

Question 4: Within which fee category for FIMBRA subscriptions is your firm placed ?

	Number of Responses	Percentage
Category One	4	1.7
Category Two	27	11.2
Category Three	211	87.2
Valid cases 24	Missing cases 1	

Question 5: When was the firm fully authorised ? Year.

Year	Number of Responses	Percentage
1984	2	1
1985	4	2
1986	15	7.4
1987	47	23
1988	71	34.8
1989	8	3.9
1990	14	6.9
1991	13	6.4
1992	13	6.4
1993	15	7.4
1994	2	1
Valid cases 204	Missing case 39	

Question 6: What basis is used by your firm for charging clients ?

	Number of Responses	Percentage
commission only	77	32
predominately commission with some fees	146	60.6
predominately fees with some commission	10	4.1
fees only	8	3.3
Valid cases 241	Missing cases 2	

Question 7: How many time has the firm been visited by FIMBRA compliance officers since 1988 ?

Number of visits	Number of Responses	Percent
never	3	1.2
Once	50	20.6
Twice	113	46.5
Three times	52	21.4
Four times	14	5.8
Five times	6	2.5
More than five times	4	1.6
Valid cases 243	Missing cases 0	

Question 8: When was the last such visit ? Year.

Year	Number of Responses	Percentage
1983	7	3
1988	1	0.4
1990	1	0.4
1991	18	7.8
1992	66	28.4
1993	118	50.9
1994	21	9.1
Valid cases 232	Missing case 11	

Question 9: How long did the visit take ?

Length of Visit	Number of Responses	Percent
less than a day	207	85.5
1-2 days	35	14.5
Valid cases 242	Missing cases 1	

Question 10: From your firms point of view do you consider that the time taken for this visit was:

	Number of Responses	Percent
too much	23	9.5
about right	217	90
too little	1	0.4
Valid cases 241	Missing case 2	

Question 11: With regard to the visit would you say that the amount of documentation requested by FIMBRA was:

	Number of Responses	Percent
adequate for review	203	84.6
too little	13	5.4
more than necessary	21	8.8
Valid Cases 235	Missing Cases 6	

Question 12: How much notice did your firm get of this visit ?

	Number of Responses	Percent
no notice	2	0.8
less than a day	19	8
1-2 days	121	51.1
3-5 days	78	32.9
more than five days	17	7.2
Valid cases 23	Missing cases 6	

Question 13: How many staff days did it take to prepare for this visit ?

		Number of Responses		Percent
no preparation involved		42		17.4
less than a day		95		39.4
1-2 days		82		34
3-5 days		22		9.1
Valid cases	241	Missing case		2

Question 14: After this visit did FIMBRA request that the firm alter any working practices ?

		Number of Responses		Percent
yes		132		55
no		104		43.3
don't know		4		1.7
Valid cases	240	Missing case	3	

Question 14a: If yes, please give details of the area involved.

	Number of responses	Percent
no response given	110	45.8%
response given	129	53.8%

Question 15: After this visit did the firm alter any <u>other</u> working practices ?

		number of Responses		Percent
yes		171		26.1
no		5		71.8
don't know		62		2.1
Valid cases	238	Missing cases	5	

Question 15a: if yes, please give a brief outline of the area involved and why alteration took place

	Number Of Responses	Percent
no response given	184	76.7
response given	55	22.9

Question 16: Overall in respect of the firms business did you feel the visit was ?

		Number of Responses		Percent
helpful		146		60.6
neither helpful nor		85		35.3
unhelpful		10		4.1
Valid cases	241	Missing case	2	

Question 16a: Please elaborate on your views

	Number Of Responses	Percent
no response given	118	49.2
response given	121	50.4

Question 17: Have you attended any internal FIMBRA meetings e.g. AGM ?

		Number of Responses		Percent
yes		39		16.1
no		203		83.9
Valid cases	242	Missing case		1

Question 17a: Please specify which and when

	Number of Responses	Percent
no response given	201	83.8
response given	37	15.4

Question 18: Has FIMBRA made any **formal** (e.g. written) requests for your views on its operations ?

		Number of Responses		Percent
yes		10		4.1
no		232		95.9
Valid cases	242	Missing case	1	

Question 18a: if yes please specify the nature of the request and outline the nature of your response

	Number of Responses	Percent
no response given	232	96.7
response given	7	2.9

Question 19: Have you, via **informal** channels (e.g. meetings with officials) made your views known to FIMBRA in respect of its operations ?

		Number of Responses		Percent
yes		48		20
no		192		80
Valid cases	240	Missing case	3	

Question 19a: if yes please specify the nature of the informal channel and the nature of your input

	Number of Responses	Percent
no response given	193	80.4
response given	47	19.6

Question 20: Given below are some of the many possible roles which FIMBRA could fulfill. Please indicate how important you feel each one should be in FIMBRAs operations

Possible Role	*very important*	*important*	*of little importance*	*of no importance*	*Total*
Regulating member firms	170 (70.2%)	66 (27.3%)	3 (1.2%)	3 (1.2%)	242
preventing fraud	211 (87.2%)	25 (10.3%)	3 (1.2%)	3 (1.2%)	242
co-ordinating compensations	57 (23.8%)	136 (56.9%)	33 (13.8%)	13 (5.4%)	239
representing members vis-à-vis the Government	103 (42.7%)	85 (35.3%)	32 (13.3%)	21 (8.7%)	241
representing members vis-à-vis the public	81 (33.6%)	110 (45.6%)	28 (11.6%)	22 (9.1%)	241

Question 21: Given this please say how effective you feel FIMBRA has been in fulfilling the following roles :

Possible Role	*very effective*	*effective*	*marginal effect*	*ineffective*	*Total*
Regulating member firms	23 (9.5%)	155 (64%)	53 (21.9%)	11 (4.5%)	242
preventing fraud	6 (2.5%)	85 (35.7%)	102 (42.9%)	45 (18.9%)	238
co-ordinating compensations	8 (3.6%)	97 (43.1%)	98 (43.5%)	22 (9.8%)	225
representing members vis-à-vis the Government	3 (1.3%)	43 (18.3%)	101 (43%)	88 (37.4%)	235
representing members vis-à-vis the public	2 (0.9%)	62 (26.4%)	104 (44.3%)	67 (28.5%)	235

Question 22: The following are some of the main possible features of a regulatory system. Please indicate how important you feel they should be in an ideal system.

	Very important	*important*	*of little importance*	*unimportant*	
It is self regulatory	93 (38.8%)	76 (31.7%)	44 (18.3%)	27 (11.3%)	240
it provides good investor protection	174 (72.2%)	54 (22.4%)	11 (4.6%)	2 (0.8%)	241
it has different regulators for different types of firms	64 (26.9%)	74 (31.1%)	65 (27.3%)	35 (14.7%)	238
it does not lead to litigation	43 (18.5%)	99 (42.7%)	64 (27.6%)	25 (10.8%)	232
it is simple to understand	161 (67.1%)	72 (30%)	6 (2.5%)	1 (0.4%)	240

Question 23: In relation to this please indicate to what extent you agree with the suggestion that the present system (i.e. prior to operation of PIA) actually possesses the following characteristics.

	Strongly agree	*agree*	*don't know*	*disagree*	*total*
It is self regulatory	65 (27.7%)	139 (59.1%)	10 (4.3%)	21 (8.9%)	235
it provides good investor protection	24 (10.3%)	132 (56.4%)	31 (13.2%)	47 (20.1%)	234
it organises a good compensation scheme	13 (5.5%)	124 (52.8%)	59 (25.1%)	39 (16.6%)	235
it does not lead to litigation	8 (3.5%)	79 (34.6%)	109 (47.8%)	32 (14%)	228
it is simple to understand	13 (5.5%)	84 (35.6%)	16 (6.8%)	123 (52.1%)	236

Question 24: Given that change does seem likely how important do you feel the following characteristics should be in planning reform.

	Very important	*important*	*of little importance*	*unimportant*	*total*
Fewer regulatory bodies	73 (31.1%)	86 (36.6%)	56 (23.8%)	20 (8.5%)	235
common training requirements for all advisers to the public	128 (54%)	87 (36.7%)	14 (5.9%)	8 (3.4%)	237
common compliance requirements for all advisers to the public	141 (59.7%)	83 (35.2%)	10 (4.2%)	2 (0.8%)	236
the maintenance of polarisation	150 (64.4%)	64 (27.5%)	16 (6.9%)	3 (1.3%)	233
more government involvement in regulation	33 (14.2%)	53 (22.7%)	95 (40.8%)	52 (22.3%)	233

Question 25: Do you favour the establishment of the Personal Investment Authority ?

	number of responses	Percent
yes	68	29.1
no	120	51.3
don't know	46	19.7
Valid cases 23 Missing cases		9

Question 25a: Please give reasons for your answer.

	Number of Responses	Percent
No response given	63	25.9
response given	179	73.7

Question 26: Space for further information and personal views.

	Number of Responses	Percent
No extra comments	155	63.8
Extra comments given	88	36.2

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