



DEPARTMENT OF TRADE AND INDUSTRY

Room 11.01 Ashdown House 123 Victoria Street SW1E 6RB
Telex 8813148
Telegrams Advantage London SW1
Telephone Direct Line 01-212 3301
Switchboard 01-212 7676

JF4003

PS/Secretary of State for Trade & Industry

22 July 1983

Michael Scholar Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

G
2
Prime Minister

Surprising progress.

But will SE members

accept the Council's

conclusions?

[Handwritten scribble]

MUS 22/7

Dear Michael,

STATEMENT ON THE STOCK EXCHANGE CASE

As agreed at the Prime Minister's meeting on the Stock Exchange case on 20 July, I attach the draft statement my Secretary of State might make to the House of Commons on Wednesday, 27 July. This has been prepared by officials in this Department, in close consultation with the Law Officers' Department and with Mr Alex Fletcher; it has not yet been seen or approved by my Secretary of State or Mr Fletcher.

2 I am copying this letter and the draft statement to the Private Secretaries of the Chancellor of the Exchequer, the Attorney General and the Chancellor of the Duchy of Lancaster; and to Richard Hatfield and Mr Gregson (Cabinet Office).

Yours sincerely, *Ruth Thompson*

RUTH THOMPSON
Private Secretary

Encl



Miss Thompson
PS/Secretary of State for Trade and Industry

cc PS/Mr Fletcher
Sir Anthony Rawlinson
Mr Beckett
Mr Dell
Mr Bovey Sol B3
Mr Wollman Sol A
Mr Lowry CL1
Mr Knight CS2
Mr Monck Treasury
Mr Dawkins Bank of England

I attach a draft statement on the Stock Exchange prepared in the light of events up to Friday afternoon. Sir Nicholas Goodison has just delivered the text of a resolution of the Stock Exchange on the lines that he hoped to produce. The substance is included in the statement with the parts requiring action by the Membership identified.

2 There is some indication that Sir Gordon Borrie will not oppose the adjournment of the case for four months if the Stock Exchange applies for it - as it intends - on July 28. But he has reserved his position as to an adjournment sine die at a later date. Sir Nicholas Goodison is aware of Sir Gordon's position and will probably be content for the statement to be made if we can confirm Sir Gordon Borrie's non-opposition to the first adjournment. But he will have to be given up-to-date information on Monday or Tuesday. The agreement of the Council is formally subject to the case ceasing to be subject to proceedings before the Restrictive Practices Court.

3 Sir Gordon Borrie has received advice that his statutory obligation to proceed against a restrictive trade agreement does not cease because an Order has been made exempting any corresponding agreement post-dating the Order. His strong preference accordingly is for primary legislation which would put beyond doubt the removal of the case from the Court and would emphasise the unique character of the Stock Exchange exemption. It would also protect his personal position against any possible liability stemming from his failure to perform a statutory duty. (The Department's Solicitor considers that any such anxiety is totally misconceived.) Nevertheless the announcement of a Bill would put beyond doubt the Government's ability to deliver its side of the bargain and would ensure that Court proceedings were first adjourned and subsequently dropped. I believe that the Secretary of State is seeing Sir Gordon Borrie on Tuesday. We will of course report any developments before then in his known attitude.

4 As to the substance of the agreement, the phasing out of minimum commissions by the end of 1986 is achieved. The staging is not made precise but the Council has foresworn "unreasonable delay".



5 The Council acknowledges that separate capacity (ie separation of brokers and jobbers) shall continue and that the effectiveness of the separation will be ensured by Statutory Instrument giving effect to EC Directives. Some of the Stock Exchange legal advisers deplore specific reference to the need for an SI on this point but Sir Nicholas Goodison appears to welcome it.

6 The Director General of Fair Trading would have sought the elimination of separate capacity as a restrictive practice, but Ministers firmly decided that it was desirable as a safeguard for investors. The possibility of modification in due course is not ruled out, but it will have to be on terms acceptable to Government.

7 The rules of entry are liberalised by making the unreasonable rejection of an applicant impossible. Any individual qualified by competence, integrity, financial resources and willingness to accept unlimited liability can expect to be elected and has recourse to an appeal body whose members will not be Stock Exchange Members of the Council if he is rejected. (The members may be lay members of the Council). Lay members, comparable to those included in the LLOYD'S Council, are another innovation, and there is a clear implication that they will have a role in the disciplinary appeals committee.

8 The changes to the entry rules do not however alter the fundamental principles that membership of the Stock Exchange is limited to individuals and that it carries unlimited liability. The Director General would have sought the abolition of the rule requiring unlimited liability and if his argument had been accepted, limited companies (eg banks and American broker/dealers) would presumably have become eligible for membership. It was decided not to go for this radical change in the present negotiation though that does not preclude the possibility of pressure being put on the Stock Exchange later if in the light of further research such changes seem desirable.

9 The Stock Exchange themselves - as well as Departments and the Bank of England - attach importance to a continuous process of monitoring that will flow from these arrangements. Whether this is done within formal machinery or otherwise it is clear that Departments (and perhaps the Bank as well) will have a new and easier channel of communication and means of stimulating change. But it will also be a channel through which the Stock Exchange will be free to make representations if in its view the arrangements show signs of disrupting the market or causing other dangers. This is not merely reasonable but in the interest of Departments as well as the Stock Exchange.

10 I understand that you are sending copies of the draft statements to the offices of the other Ministers concerned. I suggest that copies of this minute should go as well since it explains some of the background and reasoning.

M. H. M. Reid

M H M REID
CL
Rm 502 S/B
212 5962

22 July 1983

DRAFT STATEMENT BY THE SECRETARY OF STATE FOR TRADE AND INDUSTRY

I have had discussions in the last few weeks with the Chairman of the Stock Exchange about the case being brought against the Exchange in the Restrictive Practices Court by the Director General of Fair Trading. I have also of course seen the Director General.

The Chairman has told me that his Council is concerned that the processes of the Court might inhibit flexible and constructive development of the Stock Exchange. Changes may become necessary at the Stock Exchange to enable it to compete for business but it is difficult even to consider these while the present rules and practices are before the Court. In reply I have said that if the Stock Exchange is prepared to phase out minimum commissions and to liberalise the rules of entry there would be a basis for discussing whether the case might be stopped. I have made it clear that in the interest of protecting investors I should want the present trading system in which jobbers are separate from brokers to continue at least for the time being. If the Stock Exchange in due course wanted to modify it I should expect to be satisfied that proper safeguards for investors would still be provided.

The Stock Exchange Council has now endorsed the following proposals. It will take action to dismantle by stages and with no unreasonable delay all the rules which at present prescribe minimum scales of commission and complete this dismantling by 31 December 1986.

The Stock Exchange will continue the rules prescribing separation of capacity of brokers and jobbers. Under EC Directives now due to be implemented such rules may well have to be included in statutory regulations if they are to be effective. I have said that I intend to make Regulations under the European Communities Act that will include such a provision if it is found to be necessary.

The Council of the Stock Exchange will recommend to the members proposals which would have the following effects:-

- 1 The introduction of lay members to the Council of the Stock Exchange, the number and the method of their selection to be agreed with the Bank of England.
- 2 The establishment of a new appeal body, independent of Stock Exchange members of the Council, to review and if appropriate over-rule the Council's decision to reject an applicant for membership. In other words lay members of the Council would be eligible for membership of the new appeal body but not Stock Exchange members of the Council.
- 3 The introduction to the Stock Exchange's existing Appeals Committee on disciplinary matters of at least a majority of people who are not Stock Exchange members of the Council.

The Council will introduce rules to permit non-members to serve as non-executive directors of limited corporate members of the Stock Exchange, provided that there is always a majority of directors who are members of the Stock Exchange.

I believe that these changes will be very much in the public interest, and will enable the Stock Exchange to adapt to changing circumstances while continuing to have proper regard to the interests of investors.

I have told the Chairman that if the Membership ratify these proposals in the coming weeks I have it in mind subject to my statutory duty to seek and consider representations, to recommend to Parliament an Order exempting the Rules of the Stock Exchange from the Restrictive Trade Practices Act. I should also make arrangements for the Department of Trade and Industry and the Bank of England to monitor the implementation of these measures with the continuing broad objective of sustaining and promoting the development of the Stock Exchange as an efficient competitive and suitably regulated central market which affords proper protection to investors.

The legislation specifies a period for making representations and the Order is subject to Affirmative Resolution. The House will accordingly have an opportunity to express its opinion of these proposals in the autumn. But it is right that the substance of the discussions between the Stock Exchange and myself should be made known to honourable Members as soon as possible.

I understand that the Stock Exchange will apply for an adjournment of the Court proceedings while the membership is invited to give its endorsement to the changes I have outlined.

[The Director General of Fair Trading has told me that he will not oppose this adjournment].

CONFIDENTIAL

DRAFT QUESTIONS AND ANSWERS

1.Q Is the Government simply letting its friends off lightly so that they will collaborate more readily in its privatisation plans?

1.A There is no question of letting anybody off lightly. The Stock Exchange has offered the abolition of minimum commissions, has rewritten entry rules and provided for appeals from those refused entry. They have also accepted our view on the need for separating brokers and jobbers in the interest of protecting investors. These are significant moves. We are not blessing the status quo. We are giving the Stock Exchange the opportunity to prepare itself for an increasingly competitive existence.

2.Q What is so special about the Stock Exchange that it should be made exempt from the Restrictive Trade Practices Act?

2.A The Stock Exchange is not the only provider of services to which special considerations apply as regards registration of agreements under the Restrictive Trade Practices Act. The professions are exempt under the Act itself. Agreements between various financial institutions, such as insurance companies, unit trusts and institutions active in the money markets are exempt under the Services Order. A common characteristic of exempt agreements is that they are made between institutions which are already subject to statutory regulation. The extent of statutory regulation of the Stock Exchange will inevitably be greatly increased when we implement the 3 EC Stock Exchange Directives. The Stock Exchange is unique in providing a central market for securities dealings. It is in everyone's interest that this market should be sustained and promoted, so long as it remains efficient and competitive.

3.Q What has change so dramatically to justify action at this late stage to remove the case from the Court?

3.A The willingness of the Stock Exchange to commit itself to change has been the most significant change. This willingness may itself reflect a heightened awareness on the part of the Stock Exchange of commercial pressures which are already building up to compel change. We seek to facilitate change, while ensuring that competition is allowed the fullest possible rein.

4.Q Has the Government lost faith in the Restrictive Trade Practices Court?

4.A No. We have great confidence in the Court and in the Director General of Fair Trading. Paradoxically a decision - even one in the Stock Exchange's favour - might limit its ability to adapt flexibly to changing circumstances. Judicial investigation remains a sensible way for determining whether a particular restrictive agreement operates against the public interest. Rules as complex as those of the Stock Exchange are perhaps more appropriate for a different form of examination.

5.Q Is the Government satisfied of the propriety of taking action to remove a case from the jurisdiction of the Court.

5.A Certainly, if Parliament approves. We shall be proposing to ask Parliament for a change in the law by amending The Restrictive Trade Practices (Services) Order 1976 which beyond question is within its competence. It will be for the parties to the case to make representations to the Court in the light of this development. The proposals from the Stock Exchange have altered and the need to implement the EC Directives have altered the circumstances of the case.

6.Q Is the Government satisfied of the efficacy of its action in removing the case from the Court?

6.A That is a matter for the Court.

- 7.Q Has the Government been influenced by Professor Gower's views?
- 7.A I do not know his views on this matter. He tells me that he will report before the end of the year.
- 8.Q Why has the Government not sought wider access to membership and to control of member firms for non-members?
- 8.A The Stock Exchange's proposals would admit outside influence to a much greater extent than at present, and provide for independent review of a refusal to admit to membership. The extent to which fresh sources of capital and innovation should be admitted to the Exchange is a matter to be settled by evolutionary development.
- 9.Q Will the Stock Exchange not use retention of separation of capacity and barriers to entry to resist gradual abolition of commission scales?
- 9.A I do not believe so. They have proposed a firm date for the end of fixed commissions. It is because progress towards this may involve some repercussions for separation of capacity and membership conditions that we welcome the Stock Exchange's proposal for close monitoring of developments.
- 10.Q Is the Government satisfied that the Stock Exchange is sufficiently alive to external competitive challenges to survive as the central market until December 1986?
- 10.A It is the Stock Exchange's awareness of external competition that prompted the Chairman's approach to me.

22 JUL 1983

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