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PREM 19/2635

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PART 5

CONFIDENTIAL FILING

Gower Report on Investor Protection
The Stock Exchange
Commercial Fraud
The Finance Bill

ECONOMIC POLICY

PT 1: November 1983

PT 5: June 1987

PREM 19/2635

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~16.6.87~~		~~6.7.88~~					
17.6.87		~~20.7.88~~					
~~23.6.87~~		~~21.7.88~~					
~~26.6.87~~		~~27.7.88~~					
~~13.7.87~~		~~10.8.88~~					
~~30.7.87~~		~~15.8.88~~					
~~4.8.87~~		~~17.8.88~~					
~~25.8.87~~		~~23.8.88~~					
~~26.8.87~~		~~6.9.88~~					
~~1.10.87~~		17.8.88					
~~2.10.87~~		~~26.9.88~~					
~~13.10.87~~		~~24.10.88~~					
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~~13.11.87~~		~~14.11.88~~					
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~~19.4.88~~		~~10.1.89~~					
~~27.4.88~~		~~13.1.89~~					
~~10.5.88~~ PA		~~16.1.89~~					
~~13.5.88~~		25.1.89					
~~14.6.88~~		XXX					
~~18.6.88~~		PT 5 ENDS					
~~23.6.88~~		XXX					

PART 5 ends:-

25/1/89. LD. CHAN to PUSS/DT.

Economic Policy PS

Gower Report.

PART 6 begins:-

9/2/89. AT to HMT.

HOUSE OF LORDS.
LONDON SW1A 0PW

25 January 1989

Dear Francis,

Report by Professor A L Diamond: A Review of Security Interests in Property

Thank you for your letter of 19 January informing me of the Parliamentary Question that is proposed for Professor Diamond's Report.

I am content with the arrangements that you outline and I shall be interested to learn how the Report is received upon consultation.

I am copying this letter to the Prime Minister, Nigel Lawson, Peter Fraser, Malcolm Rifkind and Robin Leigh-Pemberton.

Yours ever,

The Hon. Francis Maude MP
Parliamentary Under Secretary of State
for Corporate Affairs
Department of Trade and Industry
1- 19 Victoria Street
London SW1H 0ET

CC PM

Northern Ireland Office
Stormont Castle
Belfast BT4 3ST

NSPM
RACE
25/1

17 January 1989

Rt Hon Francis Maude MP
Department of Trade and Industry
Ashdown House
123 Victoria Street
LONDON
SW1E 6RB

COMPANIES LEGISLATION

Your submission of 5 January to the Prime Minister sets out very fairly the arguments for changing the present basic shape of companies legislation. We have very similar legislation in Northern Ireland and I think that we should want to follow you in any changes on the lines you propose.

I agree however that we should need to have the underlying support of Parliament and perhaps to do some longer term preliminary work, in the course of which my officials could look with yours at any particular Northern Ireland problems, before making any major commitments.

Copies go to recipients of yours.

TK

cc E(A) Members,
Lord President of the Council,
Solicitor General,
First Parliamentary Counsel
Sir Robin Butler
PS/SofS (B&L)
PS/Mr Viggers (B&L)
PS/PUS (B&L)
Mr Fell
Mr McConnell - ESL
Mr Smartt

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

16 January 1989

Dear Jeremy,

COMPANIES LEGISLATION

The Prime Minister was grateful for your Secretary of State's minute of 13 January. She continues to feel, however, that it would be premature for your Secretary of State to make comments in the Second Reading debate today about the possibility of putting more detail into secondary legislation.

I am copying this letter to members of E(A), Alison Smith (Lord President's Office), Michael Saunders (Solicitor General's Office), Brian Shillito (Office of the First Parliamentary Counsel) and Trevor Woolley (Cabinet Office).

Yours,

Paul

Paul Gray

Jeremy Godfrey, Esq.,
Department of Trade and Industry.

PS/D/67

Department of Employment
Caxton House, Tothill Street, London SW1H 9NF

Telephone 01-273 . . 5813 .
Telex 915564 Fax 01-273 5821

Secretary of State

The Rt Hon Francis Maude MP
Parliamentary Under Secretary
of State for Corporate Affairs
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1H 0ET

Dear Francis

13 January

COMPANIES LEGISLATION

In your minute of 5 January to the Prime Minister, copied to E(A) members, you sought agreement to a 'low key' statement proposing that some aspects of company law might be transferred to secondary legislation.

I support this proposal in principle and agree that it would make it easier to keep company law up to date. I note that it is intended to give outside interests enough time to scrutinise proposed regulations; I am sure that this will be welcomed by companies, who might fear that the use of secondary legislation would make it more difficult for them to keep in touch with the updating of company law.

I am copying this letter to the recipients of your minute.

Yours ever

NORMAN FOWLER

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the department for Enterprise

PRIME MINISTER

COMPANIES LEGISLATION

May I comment on your Private Secretary's reply to Francis Maude's minute of 5 January about the possibility of reshaping companies legislation with more of the detail being put into secondary legislation. I have also seen John Belstead's letter of 10 January, and I am grateful for Nigel Lawson's support in his minute of 12 January.

2. I fully agree that we need to approach the subject very cautiously. I do, however, attach considerable importance to finding an effective way of keeping company law up-to-date and enabling us to deal promptly with loopholes and abuses when they come to light. Otherwise business and enterprise will be unnecessarily impeded. What I would like to do, with your agreement, would be to make some general remarks about the problem when opening the Second Reading debate on Monday so as to stimulate discussion about it. I would put forward the idea of putting more detail into secondary legislation merely as a possibility on which I should welcome comment, while making it clear that we would only adopt this approach if it proved to be generally acceptable.

3. I am sure that there are at least some areas of company law which are, at a technical level, susceptible to this new approach. What we do not know is whether it would be accepted by Parliamentary colleagues and by interested parties outside. I am very hesitant about embarking on the considerable programme of work that would be involved in developing the approach without some indication of whether or not it would be politically

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the department for Enterprise

acceptable. The debate on Monday gives us an opportunity to test reactions to the idea without in any way committing us to it. If the idea is generally supported, then I should want to consult colleagues about the particular subjects to be selected for such treatment and on the proper balance between primary and secondary legislation. This could lead to a rolling programme of work over several years although we might consider making a cautious start in the Bill. If, on the other hand, the idea proves to be unacceptable, then we can drop it.

4. I understand that the business managers would have no objection to my saying something on the lines suggested above. I hope, therefore, that you will agree to my raising the subject in the terms of the enclosed draft.

5. I am copying this minute to members of E(A), the Lord President, the Solicitor General, First Parliamentary Counsel and Sir Robin Butler.

D Y

13 January 1989

Department of Trade and Industry

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the department for Enterprise

COMPANIES BILL

DRAFT PASSAGE FOR INCLUSION IN SECOND READING SPEECH

I know that there will be many Noble Lords and other interested parties who will be disappointed that proposals to which they attach importance are not included in the Bill. Unfortunately, there are always far more worthwhile improvements to company law than the legislative timetable permits us to include. Choices have to be made.

There is a very real problem about how best in modern circumstances to keep company law up-to-date in a changing environment, and how to act quickly and effectively when loopholes or abuses become apparent. This is a subject on which I would welcome discussion in the course of this debate. One possibility on which Noble Lords might like to comment is to put more of the detail of company law into secondary legislation, with only the underlying principles and the essential safeguards in each area dealt with in this way laid down in primary legislation. The detail could then be kept up-to-date more easily and, very importantly, practitioners could be given adequate time to see and comment on draft regulations - something which is very difficult to achieve given the pressures of the Parliamentary timetable for primary legislation. A requirement to consult interested parties could indeed be written into the primary legislation.

I realise that this approach is not without difficulties: in particular in achieving the right balance between the framework in primary legislation and the detail to be left to the

regulations. Views are bound to vary on this balance. That is why I am raising the subject in this way. The Bill itself adopts the traditional approach. If the Government were to adopt an alternative approach we would want to do so on the basis of consensus. But there is a major issue about how to ensure that company law provides a fully effective framework for business to operate in, and I hope that we can consider together how best to achieve this aim.

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PRIME MINISTER

COMPANIES LEGISLATION

You saw earlier in the week Francis Maude's minute of 5 December (Flag A) proposing a tentative statement next week that consideration was being given to transferring aspects of company law suitable for detailed regulations to secondary legislation.

You felt there should not be any statement until further work had been done to establish what is possible. I recorded this in my letter of 10 January (Flag B).

Since then the Chancellor has written in support of the DTI (Flag C). And David Young has now minuted you himself (Flag D) urging you to reconsider the idea of his making some general remarks about the problem when he opens the Second Reading debate on the Companies Bill on Monday. He attaches the form of words he would propose to use.

Are you now content for him to speak as he proposes?

Or

Would you still prefer there to be no statement at this stage?

No - We are being criticised totally unjustly for some authoritarian decision. This proposal would lend credence to that criticism.

PRG

(PAUL GRAY)
13 January 1989

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chex.ul/jt.ph/22 **RESTRICTED**

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

PRIME MINISTER

COMPANIES LEGISLATION

I welcome the proposals in Francis Maude's minute of 5 January, and I am grateful that he has carried forward the suggestion I made to David Young on 18 July 1988. I have also seen the letters from John Wakeham and John Belstead, and your Private Secretary's letter of 10 January.

I believe that the transfer of most of the detail of company law to secondary legislation, with appropriate regulation making powers, would be a valuable structural reform.

I understand the delicacy of handling this matter in Parliament in the context of the present Companies Bill. Nevertheless, it would be useful to have this reform in place as soon as practicable.

I am copying this minute to members of E(A), to the Lord President of the Council, to the Solicitor General, to First Parliamentary Counsel, and Sir Robin Butler.

[N.L.]
12 January 1989

Econ BC: Gower

AS

RESTRICTED

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

10 January 1989

Dear Andrew

COMPANIES LEGISLATION

The Prime Minister was grateful for Mr. Maude's minute of 5 January concerning the possibility of re-shaping companies legislation with more of the detail currently in statute being put in secondary legislation.

The Prime Minister does not think a statement such as your Secretary of State envisaged making at Second Reading of the Companies Bill would be appropriate until the necessary work has been done in accordance with the Solicitor-General's advice. She feels that only then shall we know what is possible.

I am copying this letter to the Private Secretaries to members of E(A), Alison Smith (Lord President's Office), Michael Saunders (Solicitor General's Office), Brian Shillito (Office of the First Parliamentary Counsel) and Trevor Woolley (Cabinet Office).

Yours

(PAUL GRAY)

Andrew Heyn, Esq.,
Office of the Hon. Francis Maude,
Department of Trade and Industry.

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PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

10 January 1989

Dear Paul,

COMPANIES LEGISLATION

The Lord President has seen Mr Maude's minute of 5 January to the Prime Minister and is content with the approach it describes to rationalising and simplifying companies legislation.

As the minute says, however, he does believe that the proposal to transfer certain detailed provisions to secondary legislation will require very careful presentation, and he would, therefore, very much like to see in draft the statement which the Trade and Industry Secretary might make at Second Reading of the Companies Bill on 16 January.

I am copying this letter to the Private Secretaries to members of E(A), First Parliamentary Counsel, Justin Greig in the Solicitor General's office, and to Trevor Woolley.

Yours,

Alison

ALISON SMITH
Private Secretary

Paul Gray Esq
PS/Prime Minister
10 Downing Street

PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

10 January 1989

Dear Francis,

COMPANIES LEGISLATION

Thank you for sending me a copy of your minute to the Prime Minister on the future re-shaping of companies legislation.

I am sympathetic with the aims which lie behind your proposals, particularly reducing the burden on Parliament in scrutinising complex legislation. But I also share your assessment that careful handling will be necessary in order to secure the necessary support in Parliament for the regulation making powers which you will need.

As you may know the Government has been criticised in recent years for placing too much reliance on regulation making powers. Such criticisms were frequently voiced during the passage of the Education Reform Bill, for example. Because delegated legislation may not be amended by either House, and because it is not subject to the Parliament Acts, the House of Lords by convention rarely oppose Orders and Regulations and the House, not surprisingly, resents any extension of their application.

The timetable for the Companies Bill is already tight and it would be unfortunate if by seeking order making powers in areas which they might be thought novel or unwelcome we were to become side-tracked into pseudo-constitutional debate. While I have no objection to the suggestion that David Young should make some general remarks at Second Reading, I would be reluctant to try this method out in the context of the present Bill unless we can be assured that our intentions would be well understood, and even welcomed, by the House as a whole.

Careful examination will clearly be needed in order to establish the areas of company law where amendment by regulation is appropriate. For these reasons I find your suggestion that longer term work be set in hand much more appealing.

I am sending a copy of this letter to the Prime Minister, members of E(A), the Solicitor General, First Parliamentary Counsel and to Sir Robin Butler.

Yours sincerely,

BELSTEAD

The Hon. Francis Maude, MP

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the department for Enterprise

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Prime Minister

I think we should not make any statement until the necessary work has been done in accordance with the S-Cs advice. Only then shall we know what is possible and

Content for Lord Young to do a statement on the lines set out in paragraph 5.

PRIME MINISTER

COMPANIES LEGISLATION

Nigel Lawson wrote to David Young on ~~18~~ July expressing the view that primary legislation in the companies field had become too long and unwieldy and represented too great a burden on the time of successive Parliaments. He suggested that, although it might be too late to do anything in the forthcoming Companies Bill, there was a case for moving in the longer term towards a system where only basic powers were set out in primary legislation and the mass of detail currently in statute was put in secondary legislation. Your private secretary wrote to David's on ~~21~~ July indicating that you had some sympathy for the idea of re-shaping companies legislation, whilst noting that it was too late to do anything this time round. David said in reply to the Chancellor on 27 July that he agreed with the desirability of a more suitable framework for companies legislation and intended to provide as much flexibility as possible for the future in areas which the Companies Bill will cover, but that to go further and seek to establish a new basis for company law would be a major task. He said that we would consider his point in taking stock after the Bill had been enacted. David has asked me to write to you in his absence to set out our further thoughts.

I ~~actually~~ said you suggested "this is an area officials might consider for the future".

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2. We have been thinking further about this question, and have obtained the Solicitor General's views on what might be feasible and constitutionally proper. His view is that much could properly be done to rationalise and simplify companies legislation by transferring many of the detailed provisions to secondary legislation. He believes that careful examination is likely to identify many areas of company law suitable for such treatment. He suggests that in an appropriate case a specific provision could be drafted to grant a power to the Secretary of State to repeal the existing legislation and replace it with regulations, perhaps coupled with a general statement of the objectives which the regulation-making power is designed to achieve. There are precedents for taking powers to amend primary legislation in this way.

3. I have discussed the Parliamentary implications of these ideas with John Wakeham, Nick Lyell and First Parliamentary Counsel. The approach described above was seen as having considerable attractions, and was thought able to lead to improved scrutiny of proposed legislation both by Parliament and by outside interests, but it was also thought that there might be difficulties in framing acceptable regulation-making powers and presentation would need very careful handling in order to secure the necessary support in Parliament.

4. We believe that we ought to make it our aim to review company law and, where appropriate, reform it in the way that the Solicitor General suggests. Company law on its present

basis is too cumbersome and too inflexible an instrument for regulating commercial life. Desirable changes - often entirely uncontentious, and technical ones - are not made because other topics of more immediate political moment take precedence. If a substantial part of the law affecting companies can thus be put on a footing which will make it easier to keep it up to date and in good working order, this change should also enable us to quicken the pace of deregulation.

5. We have therefore been considering what David Young might say at Second Reading of the Companies Bill on 16 January. John Wakeham has advised that a low key approach would be most likely to succeed. David would therefore intend to introduce the topics included in the bill very much along traditional lines. He would, however, make some general remarks about the difficulty of making sensible, regular revisions in technical company law areas in order to keep it up-to-date, and of allowing outside practitioners enough time to consider draft legislation in detail, within the procedures which are applied to primary legislation. He might then consider some possible approaches to this problem, and suggest that transferring aspects of company law suitable for detailed regulations to secondary legislation could be a sensible way forward. That would be as far as he would go. It would then be a matter of seeing what degree of support the idea attracted in Parliament. If there was general agreement that this approach was desirable in certain areas, and if it were possible to

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the department for Enterprise

define adequately the principles to which regulation-making powers should be subject and to frame the necessary safeguards in each case, then we would not want to rule out the possibility of handling one or two issues in this way during the passage of the present bill. We would of course seek the agreement of colleagues before taking decisions or making any commitments. Alternatively we might, again with the agreement of colleagues, announce plans to set in hand longer term work along these lines, with a view to seeking a future legislative opportunity, if that seemed more likely to command support.

6. We seek your agreement to making a statement of the sort described in the previous paragraph at second reading, in order to test the water. In view of the imminence of Second Reading, I would be grateful for responses by 12 January.

7. I am copying this minute to members of E(A), to the Lord President of the Council, to the Solicitor General, to First Parliamentary Counsel, and to Sir Robin Butler.

pp Andrew Hayes

FM
5 January 1989

(Approved by the Minister, and signed in his absence)

DEPARTMENT OF TRADE AND INDUSTRY

the Enterprise initiative

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PARLIAMENT : Legislature PT18

Northern Ireland Office
Stormont Castle
Belfast BT4 3ST

The Rt Hon Lord Young of Graffnam
Secretary of State for Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1H 0ET

22 November 1988

Dear David

AMENDMENTS TO THE FINANCIAL SERVICES ACT

I have a copy of your letter of 11 November to the Chancellor.

I see both the difficulties to which s.62 gives rise and the difficulties in defining professional investors in order to exclude them. There is no separate Northern Ireland interest here and I have no objection to offer to your proposal, which I hope will be effective.

Copies of this letter go to recipients of yours.

Yours

TK

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10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

15 November 1988

TRINITY INSURANCE COMPANY

Thank you for your letters of 1 and 11 November. I have noted that you are putting in place monitoring arrangements appropriate to the risk.

(PAUL GRAY)

Jeremy Godfrey, Esq.,
Department of Trade and Industry.

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Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

14 November 1988

Rt Hon Lord Young of Graffham MP
Secretary of State for Trade
and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1H 0ET

Dear Secretary of State,

Thank you for your letter of 11 November proposing an amendment to Section 62 of the Financial Services Act, to remove professional investors from the scope of its application.

I strongly support your proposed approach. I am sure you are right that private investors must continue to be covered by Section 62 but there is a real risk that its application to professionals will lead to excessive litigation, which would be seriously damaging to the flexibility and efficiency of the London markets. Given the difficulty of drawing the boundary between private and professional investors and the sensitivity of this issue, it is clearly sensible to make the definition of excluded categories of investor a matter for subordinate legislation, subject to appropriate consultation. I am pleased to note that you expect to be able to include the necessary change in the Companies Bill on Introduction. I would be grateful if, in due course, your officials would discuss with mine the content of the necessary subordinate legislation.

I look forward to seeing details of the further proposed amendments to the Financial Services Act, to which you refer in your letter, and to which I attach considerable importance.

I am copying this letter to the Prime Minister, all members of EA, James MacKay, John Wakeham, John Belstead and Sir Robin Butler.

Yours sincerely,

Moira Wallace

pp NIGEL LAWSON

(Approved by the Chancellor and signed in his absence)

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10 DOWNING STREET

From the Private Secretary

LONDON SW1A 2AA

14 November 1988

Dear Neil,

DISCLOSURE OF INTERESTS IN SHARES

The Prime Minister has seen your Secretary of State's further minute of 9 November, together with the Governor of the Bank of England's letter of 8 November and the Chancellor's minute of 11 November.

The Prime Minister is now content to agree that the threshold for declarations of shareholdings should be reduced from 5 per cent to 3 per cent. She agrees, however, with the Chancellor that it would not be appropriate for the Government to give public blessing to the further proposals that your Secretary of State has discussed with the Chairman of the Take-over Panel; she has commented that these are matters for the Panel rather than for Government.

I am copying this letter to Alex Allan (H M Treasury), Alison Smith (Lord President's office), John Footman (Bank of England) and Trevor Woolley (Cabinet Office).

Yours,
Paul

PAUL GRAY

Neil Thornton, Esq.,
Department of Trade and Industry

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CF - pc.

PAUL GRAY

Received after Pm left agreed to in 39. proposal. NFA.

14 November 1988

Rec'd 15/11

DISCLOSURE

The DTI, the Bank of England and the Treasury argue for faster disclosure and a reduced percentage threshold. This is not an argument for more Government interference but for more openess by purchasers of shares about their actions. It will always be hard to flush out covert concert parties, including those who practice insider dealing, but a 3% disclosure requirement would help although a 1% level would be better! So would a reduction in the notification period from 5 days to one day, although 2 days as proposed would greatly assist in penetrating skullduggery. The objections of the Financial Services sector that this is all very troublesome is a minor argument compared with the benefit of improved disclosure. Even if these changes are implemented, there is still great potential for malpractice and distortion.

However morally repugnant insider dealing may be, its effects are normally self-limiting in that a few unscrupulous dealers make some ill-gotten gains without affecting the course of history. However, when insider trading leads to significant market destabilisation, as probably happended in the case of Guinness's bid for Distillers, then control of a company can irreversibly change hands without <u>all</u> private shareholders having had a chance to make a truly free commercial decision.

This must be of considerable concern to a Government which has tried to implement a fair regime based on self-regulation under the broad statutory constraints of the Financial Services Act. Furthermore, the Chairman of the Takeover Panel is anxious not to be put under moral pressure to do Government's job. It is therefore no

surprise that not only does he argue for reduced thresholds and notification delays but is willing for the Panel to examine the lowering of the shareholding level at which a full bid has to be made. All these initiatives are intended to protect individual shareholders from the actions of secretive cabals. They should be supported.

GEORGE R GUISE

dti

the department for Enterprise

Cf PPS? NT

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NIT

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

Paul Gray Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1A 2AA

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5424
Our ref PS5BPV
Your ref
Date 11 November 1988

Dear Paul

TRINITY INSURANCE COMPANY

I wrote to you on 1 November about the risk to this company. My Secretary of State, after a very careful review of the case with Francis Maude, has decided not to object to Mr Grant Fowler becoming controller of the company. The company is likely to remain a high risk situation for some time to come and we shall of course put in place monitoring appropriate to the risk.

Yours

Jeremy Godfrey

JEREMY GODFREY
Private Secretary

the Enterprise initiative

My worry is this — we are talking about the introduction of deregulation but we are introducing more and more detailed regulation which lies everywhere up. Why?

PRIME MINISTER

DISCLOSURE OF INTERESTS IN SHARES

When you saw the papers on this last month you were content with the proposal to reduce from 5 days to 2 days the present disclosure period for share holdings above the notifiable level. But you were reluctant to reduce that notifiable level from 5 per cent unless it is absolutely necessary - see my minute of 28 October at Flag A.

I minuted out your views accordingly, and we have now had three further responses:

Flag B: Letter from the Governor strongly urging a reduction in the 5 per cent figure to at least 3 per cent.

Flag C: Supporting minute from Lord Young.

Flag D: Supporting minute from the Chancellor.

I am bound to say I do think there is a strong case for moving to 3 per cent for the reasons set out by the Governor and Lord Young and which have been supported by Lord Alexander, the Chairman of the Takeover Panel.

Lord Young also raises a subsidiary issue. He sees presentational attractions in announcing at the same time as the reduction in the notifiable percentage to 3 per cent that he is inviting the takeover panel to initiate debate on two further detailed matters that fall within Takeover Panel rather than Government jurisdiction. The Chancellor counsels against endorsing these additional proposals, certainly at this stage.

? Right views?

- Are you content to agree to the 3 per cent proposal? Yes

- Agree to discourage Lord Young from publicly inviting the Takeover Panel to initiate debate on further matters within its jurisdiction?

Yes

PAUL GRAY
11 November 1988

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(D) 9CPO

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

PRIME MINISTER

DISCLOSURE OF INTEREST IN SHARES

I have seen the Governor's letter of 8 November and David Young's of 9 November.

I agree with David that the threshold should be reduced to 3 per cent for the reasons he gives. But I would counsel against inviting the Takeover Panel to consider the two proposals mentioned in David's letter. These need more careful consideration before we give them what would undoubtedly be seen as our blessing. Moreover, if any change were to be made, adoption of the US approach might well be more attractive.

I am sending copies of this minute to David Young, John Wakeham, Robin Leigh-Pemberton and Sir Robin Butler.

[N.L.]

11 November 1988

ECON POL: Lower pt 5

dti

the department for Enterprise

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5422
Our ref PB4ADC
Your ref
Date 11 November 1988

Dear Chancellor

AMENDMENTS TO THE FINANCIAL SERVICES ACT

I am writing to seek, simultaneously, policy and drafting clearance from colleagues for a change to the Financial Services Act which has been requested by David Walker, Chairman of the Securities and Investments Board, which I believe could be very helpful in heading off some of the criticism which that Act has attracted since it was passed.

The change proposed is to section 62, which is the provision which provides that a breach of the rules of the SIB, or of SRO rules, gives rise to liability for damages at the suit of an investor who has suffered loss as a result of the breach. You will be aware that much of the complexity of the rules, and the compliance burden which the rules impose, has been blamed on an excessively legalistic approach which, it is claimed, has been fostered by fear of section 62 actions for minor breaches. We did of course defer the implementation of section 62 for some 6 months beyond the commencement of the main provisions of the Act, to allow time for practitioners to become familiar with the rules. However, practitioners are still worried about the prospect of vexatious litigation from professional investors.

I should stress that the problem is not about the principle of section 62 itself. It is widely accepted that where a private investor suffers loss as a result of a breach of the rules he should be able to sue simply on the basis of that breach. The concern is that practitioners in the market may also be able to use this right, or the threat of it, for competitive advantage. SIB have already tried to address this through a

the Enterprise initiative

rule which says that no breach is deemed to have occurred when a firms deals with professional investors if it has used its best endeavours to comply. However, they believe that a better solution would be to amend section 62 to remove the right to sue from such investors altogether. I agree with that view.

In considering what amendment might be made I have been concerned about two points in particular. The first is what right of action should exist between professionals where the misconduct of one has resulted in loss to another. What I propose is that in any such dispute the fact that an act was in breach of the rules should be disregarded by the court. However, this should not prevent an injured party from suing if the act complained of was actionable for some other reason.

The second question is how the classes of investor who will no longer have section 62 rights are to be defined. I am clear that private investors must continue to be covered. However, our experience of both the Act and the rules made under it has shown that it is no straightforward task to define the private investor. Nor can one be certain that a definition which seems appropriate today will still be so next year. I am sure therefore that the amendment of section 62 must include the ability to change, by subordinate legislation, the definitions of the excluded categories of investors. David Walker originally wished SIB to have this power of amendment, but I do not think that this would be acceptable to Parliament. I therefore propose that we should take the power to define the categories of investor by statutory instrument, but to meet David Walker's concerns there should be an explicit consultation obligation before it is exercised. These are precedents for both these mechanisms in the Act already. In spite of these complications, I believe the amendment to section 62 can be kept simple and that it should be possible to include it in the Companies Bill on Introduction without threatening any of the other provisions already agreed.

On timing, SIB are due to issue a consultation document next week on the new, simplified Conduct of Business Rules. I saw David Walker [earlier today] and we agreed that it is highly desirable to announce this proposed change at the same time if at all possible. He has agreed to defer his planned press conference until next Wednesday and I would like to be able to make our announcement by way of an arranged Parliamentary Question on the same day. I should therefore be grateful for clearance by Monday, 14 November.

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I should also mention a second proposed amendment, or rather set of amendments, to the Act which SIB have proposed. These are essentially technical clarifications designed to strengthen SIB's hand when it seeks to negotiate agreements with other regulators (principally those overseas, but also including the Bank) on how firms already authorised by those regulators are to be supervised. This is a technically difficult area, made more awkward because it concerns the positions of the SROs as well as that of SIB. I think we are close to agreeing something which I can put to colleagues, but it is not essential, or even desirable, that it be announced alongside the new SIB rules and I would hope to circulate details shortly. I do not think it will be possible to have these amendments ready by the time of the Companies Bill Introduction. However, I do not expect them to be politically controversial.

I am copying this letter to the Prime Minister, all members of E(A), James Mackay, John Wakeham, John Belstead and to Sir Robin Butler.

Yours sincerely

Jeremy Godfrey
for Lord Young of Graffham

(Approved by the Secretary of State
and signed in his absence)

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the department for Enterprise

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PRIME MINISTER

DISCLOSURE OF SHAREHOLDINGS AND THE TAKEOVER PROCESS

Your Private Secretary's letter of 31 October indicated that you felt a compelling case for change had not yet been made out on the question of reducing the threshold for declaration of shareholdings from 5% to 3%. You will have seen the Governor's further letter to you, strongly urging a reduction, if not to 2% (which he favours) then at least to 3%.

2. The contested takeover mechanism is central not only to the operation of the City but also to the disciplines on company management in this country. No other European country relies on it to any significant extent, and comparison with other European countries is thus beside the point.

3. Because the system is so important, it is essential that it does not fall into disrepute. As a Government we are ourselves vulnerable to criticism whenever a 'dirty' takeover battle takes place: there have been several in the recent past. Presentationally I see nothing but advantage in being seen to do something to tackle this problem.

4. I am satisfied that cutting the threshold to 3% and the time for declaration to two days would be feasible and would not create great problems for shareholders, companies or intermediaries. All parties already have to maintain systems to allow the Panel's requirements to be met immediately a bid is declared - changes in beneficial holdings above 1% to be declared within one working day. The changes I propose in the Companies

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Act requirements (which are acceptable to the Association of British Insurers and the National Association of Pension Funds, representing between them the great bulk of institutional shareholders) should thus not be onerous.

5. The great merit of the changes I propose is that it would become harder for a predator to establish a dominant market position covertly in the pre-bid period. At present, an immensely powerful position can be built up by a single shareholder, acting perhaps within an undisclosed (and therefore illegal but ultimately unprovable) concert party. For example, a predator could jump from an undeclared 4.9% to a much higher figure in the five days permitted before declaration; so could other parties acting with him. The combination of a 3% limit with a two day period would greatly limit the scope for this and increase the number of parties to an undisclosed concert party required to achieve control.

6. You will have seen the recent campaign by the CBI about takeovers. The driving force behind this campaign is protectionist, and we should have no truck with it. But we do need to do everything we can to avoid the justification for our open approach being eroded by abuses of the takeover mechanism. We want the market to decide takeover battles, not political intervention: for example, I do not want to be stampeded into making references to the MMC on grounds of doubts about takeover tactics used, as distinct from competition; or having to take powers to put a block on a takeover during a Companies Act investigation. To be effective, however, the market must be transparent, in particular as regards the accumulation of significant stakes, whether by determined predators or by arbitrageurs 'putting a company in play'. I believe that the

twin actions I propose, cutting the 5% to 3% and the time from five days to two days, would make an important and justified impact in this area without altering the essential balance between predator and pursued.

7. I have discussed the matter with the Chairman of the Takeover Panel, Lord Alexander, who has authorised me to say he personally strongly favours cutting the percentage to 3%. I have also discussed with him two other ideas:

a) that the Panel should reduce the level above which a full bid must be made from 29.9% to some lower figure - perhaps 24.9% or 19.9% ; and

Why?

b) that the Panel should be able to require bidding companies to pay (perhaps on a scale related to the value of the bid) the costs of a successful defence.

Both of these ideas have, of course, been considered before; and both are matters for the Panel rather than the Government. Lord Alexander would be very willing to instigate a debate on the former, whether at the suggestion of the Government or on his own initiative; and if so, would wish himself to open up the latter question for which he considers, as a lawyer, there is a strong case.

8. If we decide to make the changes in the disclosure threshold and time that I recommend, I see some presentational attractions in my announcing at the same time that I have invited the Panel to initiate a debate on these further points - without implying that it is for the Government to decide, or that the

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Government is adopting a position of advocacy. On each of these further points there are considerations both for and against; and I am, as you know, not interested in measures which seek to protect management. But to put these into the public arena at the same time as firm decisions on disclosure would steal the CBI's thunder without impairing the integrity of the market disciplines in the takeover mechanism.

9. I am sending copies of this minute to the Chancellor of the Exchequer, the Lord President of the Council, the Governor of the Bank of England and Sir Robin Butler.

D Y

09 November 1988

Department of Trade and Industry

the Enterprise initiative

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ECON POL: Gower - PES

Bank of England
London EC2R 8AH

The Governor

8 November 1988

The Rt Hon Margaret Thatcher MP
10 Downing Street
London
SW1

Dear Prime Minister,

DISCLOSURE OF INTERESTS IN SHARES

I have seen your Private Secretary's letter of 31 October.

I entirely accept that a strong case has to be made out for reducing disclosure thresholds here below the levels prevailing in many other countries. But I still believe that the arguments for doing so are compelling. Our market system here is more open to takeovers than are those in other European countries; and this does mean that we need to be especially sensitive to the opportunities that purchasers have in our markets to conceal their activities. Historically we have been ahead of other countries in introducing and subsequently in tightening disclosure standards; and the trend elsewhere is to reduce notifiable percentages. In my judgment, we should be ahead of the field.

I think there is a general sense that circumstances have combined now to tilt the balance of advantage in this country rather too much in favour of predators and arbitrageurs. By reducing the notifiable percentage, we would make it more difficult for the predator to pick up shares cheaply before knowledge of his

activities moved the market against him. In many cases, the profit on the secret purchases up to 5% constitute the single largest incentive for a predator or arbitrageur. The longer his activities remain covert, the more existing shareholders are disadvantaged - so early disclosure would not only help to redress the present balance in the predator's favour, but it would also protect the interests of the small shareholders. More generally, a lower threshold for disclosure would be bound to make our markets more transparent, open and efficient.

It is for these reasons that I have urged a reduction in the notifiable percentage to as little as 2% - though I understand the reasons that have led Lord Young to argue for the slightly higher level of 3%. But I do very strongly believe that a reduction from the present 5% is desirable, and I would regard it as a great disappointment if this most significant proposal coming from the DTI's review were to be dropped.

I am sending copies of this letter to the Chancellor of the Exchequer, the Secretary of State for Trade and Industry and the Lord President of the Council.

Yours sincerely

John Footman

Approved by the Governor and signed
in his absence abroad

ECON POL
Gower pt 5

dti

the department for Enterprise

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The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

Paul Gray Esq
Private Secretary
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Direct line 215 5422
Our ref PB2AEA
Your ref
Date 1 November 1988

Dear Paul

I am writing to let you know that a small insurance company Trinity could be at some risk. The company employs about 300 in the Gloucester area. It insures commercial risks, including the general business risks of individuals.

Equiticorp own the company which is in a very weak financial position. An Australian Mr Grant Fowler has decided to buy it subject to the Department not objecting to him on the grounds that he does not appear to be fit and proper. We shall have to make a decision on this by mid-November.

The chances of him putting forward a credible package which we can approve do not appear too good at present. If the Department has to turn him down, it is uncertain whether Equiticorp would then decide to shut the company down or to struggle on in the hope of finding a new buyer. In the former case publicity seems likely.

I will keep you informed of developments.

Yours

Jeremy Godfrey

JEREMY GODFREY
Private Secretary

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10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

31 October 1988

DISCLOSURE OF INTERESTS IN SHARES

Thank you for your letter of 28 October which the Prime Minister has seen. The Prime Minister is reluctant to reduce the 5 per cent threshold for the notifiable percentage unless it is absolutely necessary. She does not think the case for such a change has been made out.

I am copying this letter to Alex Allan (H.M. Treasury), Alison Smith (Lord President's Office), John Footman (Bank of England) and Trevor Woolley (Cabinet Office).

PAUL GRAY

Jeremy Godfrey, Esq.,
Department of Trade and Industry.

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PRIME MINISTER

DISCLOSURE OF INTERESTS IN SHARES

When you saw the papers on this subject last week you agreed to the proposal to reduce from 5 days to 2 days the present disclosure period for shareholdings above the notifiable level. But before reaching a view on proposals to reduce that notifiable percentage from 5 per cent to either 2 or 3 per cent you asked for further information on the rules of other financial centres. (See my earlier minute and letter at Flag A).

The DTI letter at Flag B provides the response. Reducing the threshold below 5 per cent would mean the UK having stricter requirements than most other centres. On the other hand, contested takeover activity is much more prevalent in the UK than elsewhere. My own view is that the disclosure percentage should be viewed more in terms of transparency of markets than as unnecessary regulation.

Only the Governor is arguing to take the figure as low as 2 per cent, so you might like to regard the choice as between leaving things as they stand at 5 per cent or moving to 3 per cent. I would recommend 3 per cent. But which do you prefer?

I am reluctant to move down from 5% and ∴ introduce yet another regulation unless it is absolutely necessary and I do not think the case is made out for this change. Nor do I think is the Chancellor?

PAUL GRAY

28 October 1988

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ECON POL: Govt pt 5.

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the department for Enterprise

CC PU

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

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Prime Minister
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Direct line 215 5424
Our ref PS5BNP
Your ref
Date 28 October 1988

Dear Paul

DISCLOSURE OF INTERESTS IN SHARES

In your letter of 24 October you said that, before reaching her view on the level of the notifiable percentage for the disclosure interest in shares, the Prime Minister would be grateful to know what the comparable arrangements are in other leading financial centres.

... I am enclosing a table which describes the requirements that already exist or are the subject of current proposals in the United States, Australia and eight EC Member States. The momentum in Europe is towards increased disclosure, illustrated by agreement of a Directive on the topic in July this year. This will require all Member States to implement a threshold of at most 10% by the end of 1990.

With a 3% threshold and a two day deadline, the UK would continue to have the strictest requirements applying to all companies (although France has a system where individual companies may choose to impose a level as low as 0.5%). On the other hand, no other European centre has any significant level of contested takeover activity. The threat of takeover is a real discipline on management and it is important that the mechanism does not fall into disrepute. During a bid

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period, the Takeover Panel rules require disclosure of 1% stakes and my Secretary of State considers it is important to improve the transparency of the market in the crucial pre-bid period when stakes are built up but during which the Panel's rules do not apply.

I am copying this letter to Alex Allen (Treasury), Alison Smith (Lord President's Office), John Footman (Bank of England) and Trevor Woolley (Cabinet Office).

Yours

Jeremy Godfrey

JEREMY GODFREY
Private Secretary

the Enterprise initiative

EXISTING DISCLOSURE REQUIREMENTS

Country	Initial threshold	Comments
United States	5%	
Australia	10%	We understand that the Australian Government is considering a reduction to 5%.
France	5%	French companies are able to insist on a level as low as 0.5%. Examples are Paribas (0.5%), St Gobain (1%) and Générale des Eaux (2%).
Italy	2%	30 day deadline. Proposal to raise level to 4% with 48 hour deadline.
Denmark	10%	1 month deadline, but stock exchange code requests immediate disclosure.
Netherlands	20%	Applies only to corporate shareholders, not to individuals.
West Germany	25%	Applies only to corporate shareholders, not to individuals.

PROPOSED DISCLOSURE REQUIREMENTS

Belgium	5%	Legislation currently before Parliament.
Spain	5%	Final decision on threshold not yet taken.
Ireland	5%	Ireland currently legislating on UK model.

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10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

24 October 1988

DISCLOSURE OF INTEREST IN SHARES

The Prime Minister was grateful for your Secretary of State's minute of 10 October. She has also seen the subsequent letter from the Governor of the Bank of England and the minute from the Chancellor of the Exchequer.

The Prime Minister agrees it would be appropriate to reduce the present disclosure period for shareholdings above the notifiable level from five days to two days. On the level of the notifiable percentage itself, she has noted that your Secretary of State favours a reduction to three per cent and the Governor to two per cent; before reaching her own view, she would be grateful to know what the comparable arrangements are in other leading financial centres.

The Prime Minister has noted that there is some difference of view between your Secretary of State and the Chancellor on the handling of the reduction in the minimum waiting period for companies to disenfranchise shares where ultimate beneficial ownership is not known. She hopes that it will be possible to agree a public statement with the Stock Exchange on this issue.

I am copying this letter to Alex Allan (H.M. Treasury), Alison Smith (Lord President's Office), John Footman (Bank of England) and Trevor Woolley (Cabinet Office).

Paul Gray

Neil Thornton, Esq.,
Department of Trade and Industry.

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PRIME MINISTER

DISCLOSURE OF INTEREST IN SHARES

In July you agreed that DTI should issue a consultative document on possible changes to the law on disclosure of interest in shares. The consultation exercise is now complete and the attached papers set out the proposed way forward.

The main paper is Lord Young's minute of 10 October (flag A); there have been subsequent comments from the Governor of the Bank (flag B) and the Chancellor (flag C).

There are three main issues.

What are the rules in other financial centres? We seem to be very very highly regulated

The notifiable percentage

At present shareholdings have to be disclosed when they reach 5 per cent. In the light of the consultation Lord Young suggests reducing this threshold to 3 per cent. The Governor would go a step further and reduce it to 2 per cent, although he is not insisting on this approach. Curiously the Chancellor's minute is silent on the issue; I gather he was advised that moving to 3 per cent was hardly worth the effort and to comment that there was therefore no point in moving from 5 per cent; but then having seen the Governor's preference for going to 2 per cent he decided to offer no comment at all.

My own view is that there is something to be said for a lower disclosure percentage. But I doubt if there is much in the choice between 2 and 3 per cent.

Disclosure period

At present companies have five days in which to disclose that they have acquired interests of 5 per cent or above. In the consultation opinions varied between whether this should be reduced to one, two or three days. Lord Young proposes to

shorten the deadline to two days. He is supported by both the Governor and the Chancellor.

Stock Exchange arrangements

In the consultation there has been support from all parties for the Stock Exchange to relax the rules by which it limits the freedom of listed companies to restrict the rights of shares when companies receive unsatisfactory responses to enquiries about ownership. The Stock Exchange has said it is now considering changes to its rules. But it wants first to consult interested parties and does not expect to have reached a conclusion before the Government introduces the legislative changes in the Companies Bill next session.

There is some difference of view between Lord Young and the Chancellor on how to handle the Stock Exchange. Lord Young wants to tell them that the Government is considering legislation to require the Exchange to reduce to seven days the minimum waiting period for companies to disenfranchise shares where the ownership has not been established; but he does not propose to make this statement public. The Chancellor wants to go further, and to decide now to say publicly when the Companies Bill is published that the Government will take action if the Stock Exchange does not itself do so.

Conclusion

(i) Would you prefer to reduce the disclosure percentage to 3 per cent or 2 per cent? What are the relevant %'s in other financial centres?

(ii) Are you content for the disclosure period to be reduced to two days? Yes

(iii) Do you support the gentler pressure on the Stock Exchange proposed by Lord Young or the tougher approach advocated by the Chancellor? I hope we can agree a public statement with the Stock Exchange on

PAUL GRAY
21 October 1988

chex.ps/nw/59

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

PRIME MINISTER

DISCLOSURE OF INTEREST IN SHARES

I have seen a copy of David Young's letter of 10 October.

I agree with his proposal that the deadline for disclosure of holdings above the notifiable percentage should be reduced to two days. I am also content that no immediate action should be taken on concert parties. It is however important that we do not rule out the option of legislating should the various Court cases currently in train identify significant problems with the concert party provisions.

The bid for Consolidated Goldfields has highlighted the difficulty that companies face in identifying who holds their shares. This is a problem that has concerned me for some time. I agree with David that the best way of solving this problem would be for the Stock Exchange to reduce to seven days the minimum waiting period for companies to disenfranchise shares where ultimate beneficial ownership is not known. But I believe we must make it clear that we shall legislate to this effect if the Stock Exchange fails to make the necessary changes within a reasonable period of time. If the Companies Bill has to be published before the Stock Exchange reaches a decision, we should be prepared to say publicly that we are determined to solve this problem, one way or the other, and the Stock Exchange should be given notice of this intention now.

The other problem shown up by the Consolidated Goldfields bid is that option holdings escape the disclosure net. Dealing with this problem should also be a priority, and I take it that this is what David means when he says there is a case for widening the scope of the types of interest and of equity caught by the provisions.

I am sending a copy of this minute to David Young, John Wakeham, Robin Leigh-Pemberton and Sir Robin Butler.

[N.L.]

ECON FOX' Games pt 5.

ccP

Bank of England
London EC2R 8AH

The Governor

13 October 1988

The Rt Hon Lord Young of Graffham
Secretary of State for Trade & Industry
Department of Trade & Industry
1-19 Victoria Street
London
SW1H OET

Dear David,

Thank you for sending me a copy of your minute to the Prime Minister of 10 October setting out the measures which you propose to improve disclosure of interests in shares.

Although you have not met all of the points we made in our submission to your Department, you have taken those which we consider most desirable and effective - the reduction in the notifiable percentage, reduction in the period within which disclosure must be made, and pressure on the Stock Exchange to relax some of the constraints they place upon application of the Companies Act provisions. I am content, therefore, not to press any further the case for other, less critical, amendments.

I would however like to restate my preference for reducing the notifiable percentage of 2% rather than 3%. The gain in terms of revealing the activities of potential predators earlier would in my view exceed any disadvantage in terms of the marginally greater degree of market exposure and administrative inconvenience for genuine portfolio investors.

I am copy this letter to the Prime Minister, Nigel Lawson, John Wakeham and Sir Robin Butler.

Yours ever, Robin

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the department for Enterprise

PRIME MINISTER

DISCLOSURE OF INTERESTS IN SHARES

1 On 6 July I sent to you a draft consultative document on possible changes to the law on disclosure of interests in shares. Following comments by the Chancellor and the Governor, you agreed on 20 July that the document should be published. You also noted that further consideration would need to be given to the policy considerations when the consultation exercise was completed. We have now received responses to the document, in the light of which I believe we should take the action set out in paragraphs 3 to 5 below.

2 The main specific conclusions from the consultation are as follows:

(a) There is little or no support, even from companies, for the two major possible changes to the law that the document argued against. These were automatic declarations of beneficial ownership of all shares and a change to the statutory power of companies to inquire into their ownership which would have required a registered nominee owner of shares to give details of the ultimate controller. The consultation confirms that we were right to dismiss these proposals as burdensome and unworkable.

(b) There is, likewise, no demand for any changes to the concert party provisions. The large majority of companies and of others who commented on this point were content with the current law. There is, therefore, no case for taking any steps before the law is tested in the Guinness prosecutions.

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(c) There is widespread support among the companies which responded, for a reduction in the 5 day deadline for disclosure of interests of 5% or above. Opinions vary as to whether the deadline should be 1, 2 or 3 days, but most would prefer a short deadline. The financial services sector is divided on the question and most of those who could accept a reduced deadline would prefer 3 days, although a small minority could accept 2 days or even 1 day.

(d) There is similar support from companies for a reduction in the 5% disclosure threshold. Again, opinions vary between 1% and 3% as the ideal threshold. The message from the financial services sector is that it would find this step slightly harder to swallow than a change in the deadline, but one may draw the conclusion from the consultation responses that a 3% threshold would not be unduly burdensome. It is worth noting, that representative bodies of City practitioners and institutional investors would be content with a 3% level.

(e) There is support from all parties for The Stock Exchange to relax the rules by which it limits the freedom of listed companies to take powers in their articles to restrict the rights of shares when companies receive unsatisfactory responses to inquiries into ownership.

(f) There is general support for the minor improvements to the section 212 inquiry procedure outline in the consultative document. There also appears to be a case for widening the scope of the types of interest and of equity caught by the provisions.

3 In its response to the consultative document, The Stock Exchange has said that it is considering changes to its rules, provided adequate safeguards are provided against arbitrary action by company directors restricting shareholders' rights. It

wishes first to consult interested parties and to learn the results of our consultation. Clearly, this process will not have been completed in time for us to take account of The Stock Exchange's eventual decision when introducing our legislative changes in the Companies Bill early next session.

4 I intend, therefore, to apply pressure on The Stock Exchange to change its rules. The Chancellor, in his letter of 18 July, suggested that we tell The Stock Exchange that if it does not act, then we will override it in legislation. In its consultation response, the Exchange itself suggests that if we want listed companies to have stronger powers we could legislate to give them to them. Such legislation would, as the Exchange no doubt knows, be controversial. It might involve limiting the Exchange's freedom as competent authority to make such listing rules as it sees fit. It could only, given the Exchange's timetable, be introduced by an amendment during the passage of the Companies Bill. It would also be seen as a major public rebuff to The Stock Exchange. For these reasons, I would propose that we tell the Exchange that we are considering overriding legislation, but that this should not be made public. We could then reconsider the desirability of such a step if and when the need arose.

5 I believe, nevertheless, that we should take firm action in the Companies Bill to improve disclosure. I believe that a reduction of the notifiable percentage to 3% together with a shortening of the deadline for disclosure to 2 days is now desirable for the following reasons.

(a) It would be consistent with our policy that our role is to ensure that there is proper transparency in the market, leaving the market itself to make decisions without further interference.

(b) If we do not act now to improve disclosure we run the risk of being pressured into taking more interventionist action to regulate hostile takeovers, which might have the result of upsetting the balance of advantage too much in the favour of target companies.

(c) The issue of share purchasing by predators prior to a takeover bid has again attracted public comment with the offer by Minorco for Consolidated Goldfields. There will be considerable advantage in our being seen to take action that deals specifically with such conduct.

(d) The large majority of companies who responded to our consultation argue for reductions in both the threshold for disclosure and the deadline.

(e) While The Stock Exchange wants to see the 5% level maintained, the British Merchant Banking and Securities Houses Association (which represents City practitioners) and the Association of British Insurers and the National Association of Pension Funds (which represent the institutional shareholders) and the CBI either favour or will be content with a reduction to 3%.

(f) The Governor has previously indicated his opinion that the threshold should be reduced. The Bank has now, in its formal response to our consultation presented strong arguments as to why a level even as low as 2% would not create difficulties for the City.

(g) The number of shareholders caught by a 3% level would not be large - typically no more than 10 holdings of such a size would exist in a listed company.

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(h) The Takeover Panel has now operated for some time with a requirement that 1% dealings be disclosed within 1 day during takeovers. The City has not faced any difficulty in complying with this rule.

For these reasons, I would propose to include the reductions in the Companies Bill when it is introduced.

6 I am copying this minute to Nigel Lawson, John Wakeham and to Robin Leigh-Pemberton and Sir Robin Butler.

D Y

10 October 1988

DEPARTMENT OF TRADE AND INDUSTRY

the Enterprise initiative

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Pt 5

PERSONAL

FILE
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10 DOWNING STREET
LONDON SW1A 2AA

From the Principal Private Secretary

26 September 1988

The Prime Minister saw on her return from her visit to Europe your letter of 19 September about the report in The Times concerning two individuals who were paid dividends of £19 million.

The Prime Minister was most grateful for the information in your letter.

N. L. WICKS

The Rt. Hon. Robin Leigh-Pemberton

PERSONAL

PERSONAL

Bank of England
London EC2R 8AH

The Governor

19 September 1988

2
Prime Minister

Nigel Wicks Esq CBE
Principal Private Secretary
to the Prime Minister
10 Downing Street
London
SW1A 2AL

Thanks on me

Dear Nigel,

When we were at Dunphail the Prime Minister drew my attention to a report in the Times of how dividends of £19 million were paid to two individuals; for ease of reference I enclose a photostat of that report. The Prime Minister understandably disapproved of such a level of personal reward but I was unable to tell her anything about the history of the firm.

On investigation it appears that the report in the Times is reasonably full and accurate. What is bad is that two young men, by very aggressive and frankly questionable sales methods, should have been able to make profits on such a scale at the expense of their clients in the futures market; what is better is that the firm has had to improve its methods and standards in order to comply with the Financial Services Act and that, in spite of a sharp fall in profits and the absence of Hughes and Walsh from the management of the firm, it has not yet been accepted by the SRO to which it has applied.

I hope that this is a case in which our new legislation is going to have just the effect intended.

Yours ever,

Robin

THE TIMES

SATURDAY 10 SEPTEMBER

£19m paid to LHW founders

By Lawrence Lever

Dividends of £19 million have been paid to two former directors of LHW Futures, the futures broker that attracted a storm of criticism for its high-pressure selling to private clients.

Mr John Hughes and Mr Jeremy Walsh, both in their 30s, own 83 per cent of the shares in LHW's parent company, although both resigned as directors of LHW Futures some time ago. Their dividend payout from LHW puts them comfortably among Britain's highest earners.

However their shareholdings in LHW will be taken into account by the Association of Futures Brokers and Dealers, the self-regulatory organization (SRO) to which LHW has again applied for membership. The AFBD rejected an application by LHW in 1986.

While Mr Hughes and Mr Walsh were on the board of LHW, the company gained a reputation for charging excessive commissions on futures contracts which were aggressively sold over the telephone to thousands of private clients. Many clients were totally unsuited to the high risks involved in futures dealings and lost thousands of pounds. Moreover, the high commissions LHW charged meant the odds were heavily weighted against their clients making overall profits from their dealings with the firm.

High earners: John Hughes (left) and Jeremy Walsh

LHW's tactics resulted in enormous profits for the company. It made £19.4 million pre-tax profits in the year to March 31, 1986 and £10.6 million the following year. Turnover in those two years was £36.5 million and £26.7 million respectively.

LHW Futures' profits provided most of the profits made by the parent company, LHW Holdings, in 1986 and 1987. In those years LHW Holdings made a total profit before tax of £37.8 million.

The profits enabled it to pay a dividend of £23 million covering both years. Mr Hughes and Mr Walsh, who each own about 40 per cent of the shares in the parent company, picked up £19 million between them. Mr Hughes, who now lives in Switzerland, was one of the founding directors of LHW Futures in 1981 with Mr Walsh.

LHW Futures has had a clean sweep of its management, reduced its staff by two-thirds, slashed its commission rates and made other changes aimed at securing membership of the AFBD. It needs membership of an SRO or the Securities and Investments Board to continue in business.

Mr Brian Edgeley, now chairman of LHW Futures, says Mr Walsh and Mr Hughes "have no executive role in the company at all." He said: "They might from time to time ask us a few questions, but the executive decisions are taken by the existing management".

The days of complaints to the press against LHW appear to be over. However, the changes have also contributed to a drastic reduction in the company's profits. LHW Holdings was itself estimating that profits for the group would be unlikely to exceed £3 million in the financial year to March 1988, compared to £14 million the previous year.

dti

the department for Enterprise

nbpm cc PH

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

The Rt Hon Douglas Hurd CBE MP
The Home Office
Queen Anne's Gate
LONDON
SW1H 9AT

Direct line 215 5422
Our ref LQ4AGT
Your ref
Date 17 August 1988

Dear Douglas,

Thank you for your letter of 11 August 1988, and for your reminder of the pitfalls which may lie ahead when this proposal goes before Parliament.

I am sure we shall hear the arguments you outline when the Bill reaches both Houses: I am confident, however, that we shall be able to rebut them. The fact is that as financial markets become more international the distinction between public benefit in the UK and elsewhere becomes increasingly blurred. Several UK companies are now listed on the New York Stock Exchange, as well as in London: insider dealing in those shares on either market will affect investors in the other market. Actions taking place exclusively in one territory can have a direct affect on investors in the other. In addition, we should remember that we have, as you know, sought to remove barriers to direct investment overseas by persons in the UK. Large amounts of UK funds are invested by individual investors in the UK and by UK business in overseas businesses or overseas markets and it must be in our interest to see crooks who manipulate those markets brought to account. In summary, while we do hope to benefit reciprocally from other countries' assistance, we do not need to rely on that as the only potential benefit to the UK.

On the points you raise about extraterritoriality, I accept that we shall need to continue to be vigilant about overseas

authorities making exorbitant claims of jurisdiction here. Indeed, I am not sure that there are any steps we could take which would ever rule that possibility out entirely. The proposed power would however help in two ways:

(a) Overseas regulators (in particular, the US) who are at present liable to seek to use their compulsory investigation powers extraterritorially will have less cause to do so. The US Securities and Exchange Commission have told us the proposed UK power would help their existing efforts to deflect domestic US pressure on them to use their subpoena powers extraterriotrially. (There would of course be no question of giving overseas regulators "what they choose". In considering their requests, we would consider whether assertion of extraterritorial jurisdiction was intended; and, again, before disclosing information obtained under the powers, ensure that that information was strictly necessary for the stated purpose of the request).

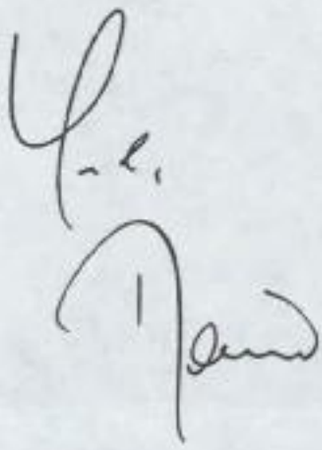
(b) On the subsequent issue of who should initiate proceedings, the proposed power would provide a channel for consultation in those cases where, as often happens, the issue is not so much one of disputed, as of dual jurisdiction.

As you say, the question of how and when to exercise the proposed power will sometimes involve difficult judgments. It is however a burden which we have to accept if international markets are to be properly regulated. One of the safeguards against "fishing expeditions" (about which I share your concern) must be a requirement that overseas regulators specify what information they want, why they want it and the grounds for suspecting an offence or breach of rules. We already impose this requirement on overseas regulators seeking our assistance in making voluntary enquiries, and it has proved an effective discipline.

I agree with you that we need to ensure that your mutual legal assistance legislation and my own proposal are seen as complementary and not conflicting. Here I foresee no particular difficulty. In pursuing investigations in financial services regulation a large amount of information has to be gathered, often across borders, before proceedings can be contemplated. Also, even when proceedings are initiated they can be of a civil rather than criminal nature, although this may not become clear until some way into the investigation. Your officials have already been in touch with mine on the point, and I agree that they should continue to

liaise on how the two systems can complement each other, and on how to ensure that where criminal proceedings are initiated, overseas regulators are not able to play one system off against the other.

I am copying this letter to recipients of my earlier letter.



ECONPOL: Gaman PTS

BANK OF ENGLAND
LONDON EC2R 8AH

THE DEPUTY GOVERNOR

15 August 1988

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry
Department of Trade and Industry
1 Victoria Street
London
SW1H 0ET

Dear Lord Young,

DTI INVESTIGATION POWERS ON BEHALF OF OVERSEAS REGULATORS

In the Governor's absence, I am responding to your recent minute to the Prime Minister on this subject.

As you know from the Governor's letter to you of 21 April, we very much endorse the objective of your proposals. We do, however, have a number of concerns about the detailed arrangements for their implementation, which have been raised in discussions between our respective officials but which are not, I feel, fully addressed in the proposals as they now stand.

My particular concern is that the obligation to involve the relevant UK supervisory authorities should be reflected in statute rather than simply left as an informal commitment. We attach a good deal of importance to our existing relationships with overseas banking supervisors and would prefer that, so far as possible, any new arrangements should build on these relationships and should certainly avoid getting at cross purposes with them. In respect of requests for assistance from our overseas counterparts, therefore, I suggest that they should be lodged initially with the Bank, through the channels which are already open, and that the legislation should enable the Bank then to approach you.

Beyond that, I have a more general worry that the powers envisaged in your proposal are very wide and, at the same time, the criteria for their exercise are rather imprecise. I think it would be helpful if the criteria could be spelt out more clearly. Such clarification would help to avoid a situation in which the UK might lay itself open to a charge of being uncooperative because of refusal to exercise the powers in pursuit of a request which may have seemed perfectly reasonable to the originator whilst appearing excessively intrusive to us.

Econ Pol: Gomez
Pt 5

QUEEN ANNE'S GATE LONDON SWIH 9AT

11 August 1988

Dear Secretary of State,

PROPOSED NEW POWERS OF INVESTIGATION TO ASSIST OVERSEAS REGULATORY AUTHORITIES

Thank you for copying to me your recent minute to the Prime Minister. I do not disagree with your proposal, but I see arguments which you will need to be ready to meet if they are raised in Parliament.

If an overseas regulatory authority wishes to mount an investigation here, and you agree, people and bodies who may be able to cast light on the matters under investigation (who as you say will often have no close links with the real target) will commit criminal offences if they fail to co-operate, or give false information.

Arguably this only slightly extends provisions requiring co-operation in other investigations, for instance, section 105 of the Financial Services Act 1986. But your proposal can be seen to go further because there is no direct public benefit. Instead of dealing with suspected wrongdoing here, we should be dealing with it elsewhere and hoping to benefit reciprocally when we need help with overseas investigations. On this basis we should be applying the criminal law to enforce compliance - which could be quite onerous - by people and bodies whose involvement is incidental and entirely innocent.

I appreciate that being able to co-operate may make it easier to resist or control other countries' claims to exercise extraterritorial jurisdiction here, but it does so at the cost of giving them what they choose, subject to your powers to frame and direct the investigation. I am not sure that Parliament will feel that this is a sufficient safeguard. Nor is it clear that there would be any better control of undesirable extraterritorial activities when you did <u>not</u> exercise your discretion to enable an investigation.

/The worry

The Rt Hon The Lord Young of Graffham

The worry I have is of 'fishing expeditions' unfairly burdening banks, advisers and others in this country. As you will know, I have proposed new arrangements for international mutual assistance in criminal matters, but these turn on criminal proceedings being pending or intended. This ensures a certain minimum procedural correctness, if no more. The safeguard in your scheme is the personal assessment of the Secretary of State in a particular case of a foreign investigator and investigation. That puts quite a difficult burden upon him.

The difficulty I see is that onerous duties mitigated only by your powers will arise on the basis of overseas <u>suspicion</u>; <u>proceedings</u> will (or certainly should) bring the matter within mutual legal assistance provisions and attract arguably more robust judicial safeguards. It may be right that because at an earlier stage matters are speculative rather than substantial the apt safeguard is political, rather than judicial, but I am sure we need to develop a deliberate line on this.

I take it that your considered judgment is that the reciprocal benefits outweigh the misgivings I have canvassed. I am ill placed to weigh the competing claims. I write only to ensure that the issues are fully considered privately before we commit ourselves to public debate.

A copy goes to those who received your minute.

Yours ever

N. Lawson

Approved by the Home Secretary
and signed in his absence.

Econ Pol: Gower
Pt 5

AR.

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

27 July 1988

Dear Neil,

PROPOSED NEW DTI INVESTIGATION POWER TO BE INTRODUCED IN COMPANIES BILL TO ASSIST OVERSEAS REGULATORY AUTHORITIES

The Prime Minister was grateful for your Secretary of State's recent minute. Subject to the views of colleagues, she is content for the proposed power to be included in the forthcoming Companies Bill on the basis of the terms and restrictions described in your Secretary of State's minute.

I am copying this letter to the Private Secretaries to members of E(A), the Home Secretary, the Foreign Secretary, the Law Officers and the Governor of the Bank of England.

Yours,
Paul

(PAUL GRAY)

Neil Thornton, Esq.,
Department of Trade and Industry.

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the department for Enterprise

Prime Minister

You earlier discussion with Lord Young did, I think, ease somewhat your worries about extra-territoriality. Content for him now to provide a power in the Companies Bill subject to the terms and restrictions set out in this note?

PRIME MINISTER

PROPOSED NEW DTI INVESTIGATION POWER TO BE INTRODUCED IN COMPANIES BILL TO ASSIST OVERSEAS REGULATORY AUTHORITIES

I announced on 17 May proposals on DTI investigation powers and said we were considering the introduction of new provisions to enable me to obtain information which could assist investigations being undertaken by overseas regulatory authorities. My memorandum to E(A) of 7 July concerning introduction of the Companies Bill said I would be writing separately on this subject. You had earlier expressed concern about the extra-territoriality implications.

2. I am convinced that it is desirable to have a new power to assist overseas regulators and believe that our proposals will reduce, not increase, the risk of unacceptable extraterritorial activity by foreign regulators. We have outlined our proposals to other Departments at official level and understand that they have no objections (except for some unease in the Scottish Office about the wide scope. I sympathise with this unease but for the reasons given below, the power must be wide if it is to be effective).

3. International co-operation between regulators is becoming increasingly important as markets and business operations become increasingly international. The ability for regulators to exchange information they already hold is not enough; they need also to be able to obtain information on behalf of each other. The SEC is currently seeking such a power to enable them to

PS1BGJ

obtain information domestically which is sought by a foreign supervisor. Provided that suitable safeguards exist, there is much less risk of unacceptable extraterritorial activity by an overseas regulator if there are effective official channels for obtaining the information needed. A power for the Secretary of State to investigate at the request of an overseas regulator would provide such a channel while keeping control of the decision to investigate the conduct of the investigation, and the decision on how much to disclose to the overseas regulator in the hands of the Secretary of State.

4. The attached paper outlines the main features of the proposed new power. Its purpose is to assist overseas regulatory authorities with responsibilities similar to those of the Department, that is to say, those responsible for supervising investment businesses, insurance companies and compliance with company law. It is also proposed, with the agreement of the Treasury and the Bank of England, that the power should be usable to assist foreign banking supervisors. The power should be exercisable only at the request of such an authority, and where we are satisfied that adequate safeguards exist as to the use to which information passed to the authority would be put. The Bank of England would be consulted about requests from foreign banking supervisors. There are already international links between police authorities and we do not therefore think that it is necessary to be able to investigate on behalf of an overseas police authority.

5. I propose that the Secretary of State should have a wide discretion as to whether or not to comply with a particular request to investigate. The identity of the requesting authority and whether it was willing to offer reciprocal

facilities would be relevant factors, but should not necessarily be decisive. The important point is that the decision on whether to investigate in this country will always rest with the Secretary of State and he, not the overseas regulator, will be able to direct the conduct of the investigation.

6. We have considered the scope of such powers and how they might apply. Domestic investigation powers have a specific target (a particular company or dealings in particular shares), and the people who can be required to assist the investigators are defined in relation to that target. This approach will not work for investigations on behalf of overseas regulators. The real targets of the investigation will probably be outside the UK: the purpose of the investigation in the UK will be to get relevant evidence. This might be held by a wide range of people - brokers, merchant banks, creditors, advisers, individual investors - who have no close links with the real target. The power therefore needs to be wide enough to allow the investigators to obtain documents and oral evidence from anyone who can reasonably be expected to be able to help them in their enquiries. The safeguard should be tight terms of reference for investigators and a power for the Secretary of State to give directions to the investigators to ensure that control can be exercised over the scope and direction of the investigation.

7. I should be grateful for your agreement that we should go ahead with including such a power in the forthcoming Companies Bill. We will keep in touch with interested Departments about the details. In particular, officials will discuss further with relevant Departments to what extent search and entry powers might been applied to this new power and whether there should be provisions to protect banking information.

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the department for Enterprise

8. I am copying this minute to the other members of E(A), the Home Secretary and the Foreign Secretary, the Law Officers and the Governor of the Bank of England.

D Y

July 1988

Department of Trade and Industry

PS1BGJ

PROPOSED OUTLINE FOR A NEW DTI OMNIBUS POWER TO INVESTIGATE ON BEHALF OF AN OVERSEAS REGULATOR

1 Purpose of Power

To enable the Secretary of State to institute an investigation to obtain documents or other information from any person in the UK who is, or may be reasonably be expected to be, able to provide information which would assist with an investigation being conducted by an overseas authority in a regulatory field broadly equivalent to those covered by the DTI and its agencies and the banking supervisory field.

2 Criteria for Exercising Power

The Secretary of State would have discretion to investigate at the request of an overseas regulator where it appeared to the Secretary of State that there was a good reason to do so, in order to assist that regulator in enquiries it was making. The power would be exercisable only at the request of a regulator with responsibilities broadly similar to the Secretary of State's regulatory role in the Companies, Financial Services and Insurance fields. Subject to that, the Secretary of State's discretion should be very wide. He should be free to reject any request and to determine what constitutes "good reason". There should be non-statutory guidelines for deciding whether to investigate. These might include:-

i the identity of the overseas regulator requesting assistance. In deciding whether to assist, the responsible conduct of the authority and the ability to offer reciprocal arrangements for the UK are factors which could be taken into consideration, but would not be a pre-condition. The overseas regulatory authority should also not appear to be seeking to assert extraterritorial jurisdiction in an unacceptable way;

ii the nature of the enquiries being made by the requesting authority and the nature and relevance of any information potentially available in the UK. In principle, we would be prepared to assist in the investigation of suspected fraud, misconduct or misfeasance, alleged breaches of relevant regulatory requirements and suspected misconduct by someone authorised to carry out relevant functions subject to a 'fit and proper' requirement. We would not, however, normally investigate before a person was authorised as that could easily become a "fishing expedition".

In deciding whether to investigate, the Secretary of State should not need to consider whether the activity being investigated would give cause for an investigation under our domestic powers.

3 Investigators Appointed

The Secretary of State would have discretion to investigate (using departmental officers) or to appoint 'competent persons' to investigate (these could be inspectors or even overseas regulators staff). The appointment letter to the investigators would set out the terms of reference. Investigations would be

less open ended than domestic investigations and would be confined to obtaining the information specifically sought.

4 Investigators Powers

The investigators should be able to:

i put questions and require documents/papers etc from any person in the UK who could reasonably be expected to have relevant information.

ii take statements on oath.

In some investigations it may be helpful also to require bank account information on similar criteria to those being proposed for Companies Act inspectors. Legal professional privilege should be preserved to the same extent as it is preserved in relation to domestic investigation powers. Search and entry powers would also be helpful, in specific instances where papers have been requested but not produced, or there is danger of them being destroyed. The power for evidence taken to be used against the providers should be included.

5 Sanctions

There should be a criminal penalty for failure to co-operate or provision of false information.

6 Control of Investigators

The Secretary of State should be able (at any time):

i to require the investigators to report to him,

ii to stop or direct the inquiry.

7 Costs

The Secretary of State should be able to recover costs from the requesting overseas regulator in cases where he considers this appropriate.

8 Information Obtained

The information would be restricted, and should be permitted to be disclosed only through the selected gateways set out in the Companies and Financial Services Acts. The Secretary of State should have discretion on whether all or part of the information obtained should be passed on to the overseas regulator. We would seek, in general or ad hoc arrangements with the overseas regulators, to impose conditions on the use of information in order to prevent it being used in the exercise of extraterritorial jurisdiction. The information could be used also for domestic purposes, eg as a basis for seeking a winding up order or disqualifying a director.

9 Reports

The investigators would only report to the Secretary of State, and their reports would not be publishable.

DTI Companies Division
June 1988

ECON POL: Gower pt 5

RESTRICTED

ME SLW
cc BG

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary 20 July 1988

Dear Neil,

DISCLOSURE OF INTERESTS IN SHARES

The Prime Minister was grateful for your Secretary of State's minute of 5 July and the attached draft consultative document. She has now also seen Moira Wallace's letter to me dated 18 July and the Governor of the Bank of England's letter of 19 July. The Prime Minister is content for the consultative document to be issued as your Secretary of State proposes, but has noted that, in the light of the comments by the Chancellor and the Governor, further consideration will need to be given to the policy conclusions when the consultation exercise is complete.

I am copying this letter to Alison Smith (Lord President's Office), Alex Allan (HM Treasury), John Footman (Office of the Governor of the Bank of England) and Trevor Woolley (Cabinet Office).

Yours,
Paul

(PAUL GRAY)

Neil Thornton, Esq.,
Department of Trade and Industry.

RESTRICTED

PRIME MINISTER

DISCLOSURE OF INTERESTS IN SHARES

You saw the weekend before last Lord Young's minute of 5 July and the attached draft consultative document. But you agreed to wait for Treasury and Bank comments before issuing your reaction.

Both the Chancellor (18 July) and the Governor (19 July) have now responded. They both take a more positive view than Lord Young of the case for legislative changes. But neither is pressing for amendments to the consultative document. Instead they reserve the right to argue their views after the consultative period.

Content to agree that the consultative document should be issued, while noting that further policy discussions will be necessary in the light of reactions received?

Yes

PAUL GRAY
19 July 1988

KAYAJE

cc PJL

Bank of England
London EC2R 8AH

The Governor

19 July 1988

The Rt Hon Lord Young of Graffham
Secretary of State for Trade & Industry
Department of Trade of Industry
1-19 Victoria Street
London
SW1H OET

Dear David,

Thank you for sending me the latest draft of the consultative document on the disclosure of interests in shares.

In commenting on an earlier draft we took a more positive view of the advantages of making legislative changes than was reflected then or is reflected now in the paper, or in your covering letter to the Prime Minister of 5 July. I think the paper sets out the issues very well, but I would have preferred it to be more neutral at several points in balancing the advantages and disadvantages of change.

I do agree with you that we should persuade the Stock Exchange to relax the constraints on companies wishing to restrict the rights attached to shares when they have received an unsatisfactory response to enquiries under Companies Act procedures. But on a number of points we would I think see the balance of argument a little differently. I would support more strongly than you the proposal to lower below the present 5% the threshold at which interests in shares must be disclosed. I would see greater possible advantage than you do from requiring automatic declarations of interest in specified situations; and I am less convinced than you that no improvement is possible in concert

party provisions which, if our understanding is correct, have never been successfully enforced in a legal action.

I appreciate the time constraints under which you are operating and rather than seek to prolong discussion now I would be content to reserve the Bank's right to submit our arguments in fuller form during and after the consultation period.

I am copying this letter to the Prime Minister, the Lord President, the Chancellor of the Exchequer and Sir Robin Butler.

Yours ever,

Robin

mjd 3/22m

CONF [redacted]

CCPU

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

18 July 1988

Paul Gray Esq
10 Downing Street
London SW1

Dear Paul,

DISCLOSURE OF INTEREST IN SHARES

The Chancellor has seen a copy of the Secretary of State for Trade and Industry's minute of 6 July to the Prime Minister, and of the Consultative Document which Lord Young proposes to publish.

The Chancellor appreciates that there is no requirement to take policy decisions at this stage and that time is now very short if these consultations are to be reflected in next session's Companies Bill. He notes also that it is in any event likely that the lessons of the Guinness affair will have a significant bearing on the questions of "concert parties" and disclosure of interest in shares with which the Consultative Document deals, so any conclusions at this stage may be provisional. That said, the Chancellor would have preferred the Consultative Document to indicate a rather more positive determination to strengthen the law on "concert parties".

The Chancellor welcomes the proposal to shorten the timescale for the declaration of interests above 5%. And he agrees with Lord Young that pressure should be brought on the Stock Exchange to allow companies to restrict voting rights where a satifactory response to legitimate enquiries by the company is not received within 7 days, as opposed to the present 28 days. If the Stock Exchange is not prepared to do this voluntarily, the Chancellor thinks that it may be necessary to override them in legislation. The message might be put rather more firmly in the consultative document itself, and should certainly be conveyed to the Exchange separately.

However, the Chancellor would not wish to press Lord Young strongly to make further amendments to the Consultative Document at this stage, given the timing constraints and that there will be opportunities to discuss the policy after the consultative period.

I am sending copies of this letter to Alison Smith (Lord President's Office), Neil Thornton (DTI), Trevor Woolley (Sir Robin Butler's Office) and John Footman (Bank).

Yours,
Moira.

MOIRA WALLACE
Private Secretary

Econ Pol: Gowes Pt 5.

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the department for Enterprise

CCJO

Prime Minister

You will probably wish to see Treasury and Bank comments before issuing your reaction. But, if time permits, you may like to take a first look at this over the weekend - I suggest principally the covering note and Chapter 1 and 4.

RRC6
8/7

RESTRICTED

PRIME MINISTER

DISCLOSURE OF INTERESTS IN SHARES

1. In May 1987 Paul Channon announced the outcome of the review of the operations of the Takeover Panel. Among the 24 measures which it identified were 4 dealing with the law on disclosure of interests in shares. Colleagues have agreed that the Companies Bill scheduled for the 1988/89 Session may contain any changes which we decide to make. The announcement said that a consultative document would be published putting forward the DTI's proposals in this area. You asked to see a draft of the document before it was published - this is attached. The draft has been discussed with the Treasury and the Stock Exchange - and shown to the Takeover Panel and the Bank of England - at official level, and although there are differences of emphasis between officials all are agreed that we should now go ahead with publishing the consultation document.

2. The Takeover review put forward its measures in the light of concern about the use of nominees in takeovers and in view of the report of the Trade and Industry Select Committee on the Westland general meetings in 1986. It was never, however, our intention to end the use of nominees by those with a legitimate wish for privacy and whose conduct does not threaten the interests of other shareholders. I do not think that we should support measures which would undermine the legitimate use of nominees unless they offered very clear and necessary benefits to the regulation of takeovers. We must also avoid imposing additional burdens on companies and shareholders which disadvantage the innocent without seriously inconveniencing those who are seeking

to abuse the use of nominees merely in order to be able to claim that we have done something.

3. We have identified three major possible changes to the law which might give effect to the Review's measures. They are described at length in chapter 4 of the document. I do not believe, however, that the arguments for taking these steps are sufficient to outweigh the disadvantages. In brief, the changes and my reaction to them are:

(a) all those controlling voting or disposal rights would be required to make automatic declarations of their interests either at the time of registration or prior to a vote or take-over. This seems to me too drastic as well as still offering potential loopholes. It should be included in the consultative document because it is the sort of system that the Select Committee proposed. But we should be negative about it.

(b) there could be improvements to the powers given to companies under the Companies Act to enquire into beneficial ownership of shares. Any such changes would be fairly complex and unlikely to offer a substantial advance on the present position, and should be presented in discouraging terms.

(c) the existing 5% threshold at which those with interests in shares must disclose them to the company might be reduced: such a proposal was supported by the CBI City Industry Task Force. While simpler and more attractive than the previous two options, the balance of advantage and disadvantage needs to be looked at carefully. But we should positively support a reduction in the timescale for making the disclosure from 5 days to, ideally, one day.

4. I believe that the most important change that can be made is a non legislative one. Companies are not constrained by law from taking powers in their Articles to restrict the rights attached to shares when they receive an unsatisfactory response to an inquiry under Companies Act procedures. The Stock Exchange does, however, prevent listed companies from exercising such powers until 28 days have elapsed. It also does not allow listed companies to restrict disposal rights, which can be crucial in a takeover. I believe that The Stock Exchange should be encouraged to relax these constraints, and the document reflects this view in paragraphs 4.13 to 4.16.

5. There must always be a risk that a further scandal involving the use of nominees will result in criticism that our rejection of major legislative changes shows that we are being soft on the City. But I think it right that the consultative document should be realistic about possible changes, and it may be that the political climate since Paul Channon made his announcement has calmed sufficiently so that a reasonable case for confining ourselves to minor changes will be accepted. If the responses to the consultation exercise suggest that there is, contrary to our present view, a case for legislative measures we shall be able to reconsider our position. The important thing now is for the consultative document to be published without further delay;

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the department for Enterprise

if any changes to the law, whether minor or major, are to be made we must prepare the necessary clauses for inclusion in next session's Companies Bill as soon as possible.

6. I am copying this minute to the Lord President, the Chancellor of the Exchequer, the Governor of the Bank of England, and Sir Robin Butler.

D Y

5th July 1988

DEPARTMENT OF TRADE & INDUSTRY

the Enterprise initiative

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DRAFT

DISCLOSURE OF INTERESTS IN SHARES: A CONSULTATIVE DOCUMENT

CHAPTER 1 : INTRODUCTION

1.1 In May 1987, the Government announced the outcome of a review of the operations of the Panel on Take-overs and Mergers. The review was carried out by officials of the Department of Trade and Industry, the Treasury and the Bank of England together with representatives of the Take-over Panel, the Securities and Investments Board and The Stock Exchange. The review group identified 16 measures designed to strengthen the ability of the Take-over Panel to regulate take-overs. In four of its measures the review group called upon the Department of Trade and Industry, together with The Stock Exchange and the Take-over Panel to undertake further work on the possibility of improving the law on disclosure of interests in shares. The text of the 4 measures can be found at Annex A. This consultative document sets out the results of that work and seeks views on whether improvements to the law are possible or desirable.

1.2 The Government's initial assessment of the work that has been carried out is that the existing provisions for disclosure are satisfactory in most respects. They do not believe that major changes to the system of disclosure under the Companies Act are required. They are concerned that any attempt to replace the provisions with different systems would be largely unsuccessful, while the rights of shareholders might be infringed and unacceptable burdens would be placed upon shareholders and companies alike. The Government wish, however, to know whether those with an interest in this subject agree with their conclusions. They would also welcome comments on whether the existing disclosure provisions might be tightened, eg through a

reduction in the percentage at which interests in shares must be disclosed. This document describes, therefore, the main options for changes to the law, together with an assessment of the advantages and disadvantages that would arise from their implementation. The document also outlines a number of less far-reaching improvements to the law that should, in the Government's opinion, be implemented, together with some non-legislative measures on disclosure.

1.3 The document falls into 5 parts. Chapter 2 sets out the principle behind the disclosure of a company's ownership and summarises the existing disclosure provisions of the Companies Act 1985, the City Code on Take-overs and Mergers, the Rules Governing Substantial Acquisitions of Shares and the listing rules of The International Stock Exchange. Chapter 3 discusses the limitations of these provisions as seen by the Take-over Panel review group. Chapter 4 identifies the main options for change together with other possible improvements. Chapter 5 describes the contents of a proposed EC Directive on disclosure of major shareholdings and considers how the Directive fits in with UK objectives in this area. Chapter 6 summarises the options for change and invites comments on them.

1.4 Comments on the document should be made in writing and addressed to:

The Department of Trade and Industry
Companies Division
Room G21
10-18 Victoria Street
London
SW1P ONN

Comments should be sent to arrive by .

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CHAPTER 2 : THE EXISTING DISCLOSURE PROVISIONS

2.1 It is a long established principle of company law that the recognition of corporate personality should be accompanied by publicity. In accordance with this principle, persons dealing with a company are entitled to see who its members are and what shares they hold. In the case of a public company, it is desirable that interests other than registered ownership in those shares should be known if substantial. This last provision is included because the register of members does not enable the company or anyone else to ascertain more than the identity of the registered proprietors of the shares. The practice of registered shares being held by nominee companies as trustees for the true owners can be highly convenient for the owners, and in many ways desirable. If unchecked, however, it can offer possibilities of abuse by, for example, directors and others who deal in securities on the basis of privileged private knowledge, or by those who may wish secretly to acquire a sizeable holding on which to base a bid for control. Companies are therefore required to keep a register of the beneficial interests of directors in the shares and debentures of a company, and, in the case of public companies, a register of all persons holding individually or in concert a 5% interest in the voting shares of the company. This is intended to enable members and others to determine who controls the company or may be in a position to obtain control of it.

2.2 There are advantages both from the company's and the investor's point of view in restricting the general register to shareholders and not attempting to include all those with beneficial interests. For the investor there is the advantage of privacy. There is also the advantage that investment managers can administer the holdings of a large

number of investors through a single nominee registration in each company in which an investment is made. This can be essential for the efficient management of the accounts of small shareholders. From the company's point of view the advantage is that its obligations to shareholders are fully discharged if they are performed in relation to registered shareholders: it has no obligation to others with beneficial interests, nor need it become involved in disputes about the ownership or exercise of those interests.

2.3 What matters, therefore, is that the controls over disclosure of interests held via nominees are sufficient to regulate possible abuses eg in relation to insider dealing or the acquisition of control or the exercise of substantial voting rights, all of which can involve the exploitation of other shareholders. It is not the aim of the existing disclosure provisions - even if it were thought possible - either to attempt to require that the beneficial owner alone may be the registered member, nor to create a separate register of all beneficial interests. The objective is for beneficial interests to be known or to be ascertainable when they reach critical levels or at critical times, or for effective means to be available at such times to prevent the outcome of crucial issues being determined by the use of shares whose beneficial ownership has not been declared.

THE COMPANIES ACT 1985

Introduction

2.4 Part VI of the Companies Act contains provisions for disclosure of interests in shares other than those

appearing on the ordinary shareholders register. In addition to this Part, sections 442 to 445 provide for investigations by the Secretary of State into the ownership of shares, and Part XV sets out the restrictions on the rights attached to shares that may be imposed when the disclosure requirements are not met.

The obligation of disclosure

2.5 Under sections 198ff in Part VI, a person must notify a public company within 5 business days after acquiring (or becoming aware that he has acquired) an interest in the company's 'relevant share capital' of 5 per cent or more. Any subsequent changes that take the size of the interest through a whole percentage point (6%, 7% and so on) must also be notified. 'Relevant share capital' means issued share capital of a class carrying rights to vote in all circumstances at general meetings. The notifiable percentage may be changed by regulations. The definition of 'interest' is widely drawn, and it requires inter alia notification of beneficial ownership and of control of voting rights. Failure to comply is an offence which may give rise on indictment to imprisonment for 2 years or a fine or both. When there is a conviction under section 210 (but only when), the Secretary of State may direct that the shares be subject to the restrictions in Part XV (these are described in paragraphs 2.14 to 2.16).

Concert parties

2.6 Special provisions (known as the concert party provisions) are designed to prevent avoidance of the obligation of disclosure by groups of persons acting in agreement and holding under 5 per cent individually but 5 per cent or

more collectively. Where there is a concert party agreement (and an interest is acquired pursuant to the agreement) the separate interests of each party are to be attributed to the others for notification purposes. Concert party agreements are subject to these requirements if they contain provision for the acquisition of an interest in shares by any one party and provision as to the use, disposal or retention of such interests. The agreements covered include arrangements that are not legally binding, provided they involve mutuality in the undertakings, expectations or understandings of the parties.

Inquiries by companies

2.7 Besides the requirement for notification by the interested party at the 5% level, the Act, under sections 212ff, gives the company a right to inquire into the beneficial ownership of its shares. It may require a person whom it knows (or has reasonable cause to believe) to be (or to have been within the previous 3 years) interested in its shares to indicate whether that is the case. If the person has (or had) an interest, he can be required to give details of other interests (so far as he knows) subsisting at the same time as his and to give particulars of the identity of the person holding the interest immediately after he ceased to hold it. The company may also ask whether persons interested in the same shares are or were parties to any concert party agreement or to any agreement or arrangement relating to the exercise of any rights conferred by the holding of the shares.

2.8 Failure to comply with a notice issued by a company under s212 or the knowing or reckless giving of false or

misleading information is an offence which may give rise, on indictment, to 2 years imprisonment or a fine or both. In addition, and even where there is no conviction, a company may apply to the court for Part XV restrictions to be applied to shares when a person who is or was interested in the shares fails to give the company any information specified in a section 212 notice within the time specified in the notice. The court may impose such an order notwithstanding any power in the company's articles allowing the company itself to impose similar restrictions.

2.9 It appears that the court procedure for an application for restrictions to be imposed under Part XV of the Companies Act 1985, in circumstances where there had been a failure to provide information under section 212, works reasonably well, with provision for ex parte procedure in appropriate and urgent cases. The case law has elucidated several aspects of sections 212 et seq and Part XV. For example, the cases of House of Fraser plc [1983] S.L.T 500 and Re F. H. Lloyd Holdings plc [1985] BCLC 293 show that where trust property is situated in England and the trustee of the beneficial interest in the shares is resident in England, the shares in question would be susceptible to restrictions under Part XV, although the beneficiaries might be foreign residents. There has not apparently yet been a case where the registered owner of the shares was a foreign resident. Re Geers Gross plc [1987] 1 W.L.R 837 and 1649 is authority for the proposition that the court may refuse an application for leave to sell shares subject to restrictions under Part XV if the information which has been withheld previously has not been disclosed.

Register of interests in shares

2.10 A company must keep a register of interests in shares of 5% or more disclosed under sections 198ff. The register must include details of disclosed concert party agreements. It must also, in a separate part, give details of interests notified in response to section 212 inquiries. Entries must be made within 3 business days of notification. The register must be available for public inspection.

The Secretary of State's powers of investigation

2.11 Under Section 442 the Secretary of State may (or shall on application by a specified minimum number of shareholders or by holders of a specified minimum proportion of the shares) appoint inspectors to report on the membership of a company for the purpose of determining the true persons who are or have been financially interested in the success or failure of the company or able to control or materially influence its policy. The investigation is not limited to voting shares and may extend to debentures. Under s443, the inspectors have wide powers as to the persons from whom they may require information (including any person whom they have reasonable cause to believe possesses relevant information). Sanctions for non-cooperation apply as with other Companies Act investigations.

2.12 The Secretary of State may under s444, when it is unnecessary to appoint inspectors, require any person whom he has reasonable cause to believe to have or to be able to obtain any information as to present and past interests in specified shares or debentures to give any such information to the Secretary of State. Failure to comply is an offence giving rise on indictment to 2 years imprisonment or a fine

or both.

2.13 If, in connection with an investigation under s442 or s444, it appears to the Secretary of State that there is difficulty in finding out the relevant facts about any shares or debentures, he may by order direct that the shares or debentures be subject to Part XV restrictions.

Part XV - Orders imposing restrictions on shares

2.14 Shares may be directed to be subject to Part XV restrictions in three circumstances:

(a) when there has been a conviction under s210 for failure to fulfil the obligation of disclosure (the order to be made by the Secretary of State);

(b) when a person has failed to give information requested by a section 212 notice (the order to be made by the court on application by the company under s216 - there is no need for there to have been a conviction);

(c) when it appears to the Secretary of State that there is difficulty, in connection with an investigation under s442 or s444, in finding out the relevant facts about any shares (the order to be made by the Secretary of State under s445).

2.15 When an order is made the following restrictions apply to the shares in question:

(i) Any transfer of the shares is void.

(ii) No voting rights are exercisable in respect of the

shares.

(iii) No further shares shall be issued in right of them or in pursuance of any offer made to their holder.

(iv) Except in a liquidation, no payment shall be made of any sums due from the company on the shares, whether in respect of capital or otherwise.

In short, the main restrictions are that the shares cannot be sold or voted, they cannot enjoy the benefit of rights issues and they cannot receive dividends. A person is liable to a fine if he purports to exercise the right to dispose of the shares or to vote the shares. He must also inform any person who is entitled to vote the shares that they are subject to the restrictions.

2.16 A person aggrieved may apply to the court for the restrictions to be lifted (having gone to the Secretary of State first if he made the original order). The restrictions may be lifted only if the relevant facts about the shares have been disclosed to the company and no unfair advantage has accrued to any person as a result of the failure to disclose earlier, or if the shares are to be sold and the court (or Secretary of State where appropriate) approves the sale. The Secretary of State (when he has made the original order) or the company (for an order under s216) may apply to the court for the shares to be sold, subject to the court's approval as to the sale. The proceeds of the sale (subject to the deduction of any costs ordered by the court) are held by the court but may be claimed by persons who are beneficially interested in the shares.

DISCLOSURE PROVISIONS OF THE STOCK EXCHANGE LISTING RULES

2.17 Paragraph 16 of the Continuing Obligations of the Yellow Book requires notifications of interests of 5 per cent or more made under the Companies Act to be announced by listed companies immediately to the Stock Exchange Company Announcements Office. Paragraph 21(i) requires annual reports and accounts to be accompanied by a statement of such interests as at a date not more than one month prior to the date of the AGM notice. Paragraph 16 also requires that information obtained pursuant to s212 of the Companies Act be notified as soon as it becomes apparent that a substantial interest (ie 5 per cent or more) exists which has not previously been notified.

2.18 Paragraph 14 of Part 9 of the Yellow Book (Constitution and Documents of Title) states that articles of association must conform with the following provisions:

> "That, where provision is made in the articles to disenfranchise members in cases where there is default in supplying information in compliance with a notice under section 212 of the Companies Act 1985, disenfranchisement will not take effect earlier than 28 days after the service of the notice".

This requirement is a significant restriction, in respect of listed companies, of the ability which all companies have to include provision in their articles for the imposition of restrictions on shares by the company itself (without the need to go to the court) when a response to a s212 notice is unsatisfactory. Moreover, it is Stock Exchange policy not to allow companies to apply the full range of restrictions available under Part XV of the

Companies Act. At present, the SE normally permits restrictions to be applied only to voting rights.

DISCLOSURE PROVISIONS OF THE CITY CODE ON TAKE-OVERS AND MERGERS AND THE RULES GOVERNING SUBSTANTIAL ACQUISITIONS OF SHARES

2.19 The Panel on Take-overs and Mergers administers two sets of rules on disclosure of share dealings. The Rules Governing Substantial Acquisitions of Shares (SARs) apply to acquisitions made prior to the commencement of a formal offer. The Take-over Code contains rules governing disclosure during an offer.

2.20 Subject to certain exceptions, the SARs restrict the speed with which a person (or persons acting by agreement or understanding) may increase his holding of shares and rights over shares to an aggregate of between 15% and 30% of the voting rights of a company. (At 30%, a formal offer would be required under the Take-over Code, and the Code's other provisions would be applicable). SAR 1 prevents a person (or persons acting by agreement or understanding) from, in any period of 7 days, acquiring shares carrying voting rights in a company (or rights over such shares) representing 10% or more of the voting rights, if such acquisition when aggregated with any shares or rights over shares which he already holds, would carry 15% or more but less than 30% of the voting rights of the company. This restriction does not apply to acquisitions (i) from a single shareholder (if that is the only acquisition), (ii) pursuant to a tender offer, or (iii) immediately preceding and conditional upon an announcement of a formal uncontested offer. Under SAR 3, disclosure must be made by noon the following day of acquisitions (and total holdings)

when the resultant holding represents 15% or more of the voting rights in a company. Any percentage changes in the holding must similarly be notified. This is an acceleration of the Companies Act 5 day deadline. SAR 3 does not apply to acquisitions covered by (ii) or (iii) above, although SAR 4.4 requires the results of a tender offer to be announced by 9.00 am on the business day following the close of the tender.

2.21 Rule 8 of the Take-over Code requires, among other things, disclosure by noon the following day of specified dealings during an offer period. The specified dealings are:

(a) those by any person (or persons acting by agreement or understanding) who owns or controls 1% or more of relevant securities of an offeror or offeree, or who will do so as a result of the transaction, and

(b) those by any party to a take-over (and its associates) whether or not they own 1% or more of relevant securities.

Rule 24 requires offer and defence documents to disclose holdings and dealings within the year before the offer announcement (i) by the offeror, its directors and those acting in concert with it in offeree shares and, when there is a securities offer, in offeror shares, (ii) by the offeree in offeror shares, (iii) by offeree directors in offeror and offeree shares and (iv) by the offeree's adviser in offeree shares if the holding is above 10%.

2.22 In addition, there are requirements for disclosure in the offer document and major defence circular.

(i) Rule 24.3 requires that in the offer document the

offeror, its directors, and any person acting in concert disclose their shareholdings in the offeree company and, in the case of a securities exchange offer, their shareholdings in the offeror company, together with a list of dealings by such persons in the twelve months prior to the offer period. Further, persons who give irrevocable commitments to accept the offer or who have any other arrangement with the offeror in relation to relevant securities are required to provide such details.

(ii) Rule 25.3 requires similar details from the offeree company and its directors in the first major circular, namely the shareholdings in the offeree company of its directors, pension funds (including pension funds of subsidiaries) or of its financial or professional advisers and, in the case of a securities exchange offer, such information about holdings and dealings in the offeror. In addition, the holdings in the offeree company and, in the case of a securities exchange offer, in the offeror of any person who has an arrangement with the offeree or certain specified associates must be listed together with any dealings during the offer period (but not before). Finally, any fund manager (other than an exempt fund manager as defined in the Code) connected with the offeree company must disclose its holdings and dealings (during the offer period only) in the offeree company and, in the case of a securities exchange offer, in the offeror.

CHAPTER 3 : POSSIBLE SHORTCOMINGS IN THE EXISTING PROVISIONS

Introduction

3.1 The Take-over Panel review group put forward four groups of suggestions on the law concerning disclosure of interests in shares. These can be found at Annex A. Some of the suggestions were in the form of definite proposals, others simply described problems and recommended further work to identify solutions. When separated into these categories, the definite proposals were:

(a) that the 5 day deadline allowed by the Companies Act for disclosure of interests of five per cent or more should be reduced if practicable;

(b) that the Companies Act provisions on concert parties should be clarified and steps should be taken to ensure that the law is better understood; and

(c) that the Take-over Panel should amend the City Code to make it clear that its provisions on disclosure and in particular concert parties are different from those of the Act and that Panel rulings on the Code do not constitute legal guidance on the interpretation of the Companies Act.

3.2 The areas in which further work was required were as follows:

(i) The Department and The Stock Exchange were to undertake further work to establish ways in which companies could be permitted to prevent the voting at general meetings of shareholdings of which the

ultimate voting control was not disclosed. The Panel was to consider ways in which it might prevent such shareholdings from influencing the outcome of an offer.

(ii) The Panel was to examine whether its disclosure deadline might be reduced for parties to an offer and their close associates.

(iii) Improvements were to be considered to the procedure under section 212 of the Companies Act by which companies have powers to inquire into the ownership of shares.

3.3 It is worthwhile, in this chapter, examining the reasons behind these measures before considering, in the next chapter, what might be done to implement them.

The 5 day deadline (Paragraph 3.1(a) above)

3.4 The review group was concerned that those acquiring an initial stake in a potential offeree company were able to continue purchasing shares during the 5 day deadline before disclosure was required. For example, in the 5 days after going through the Companies Act 5% threshold, a purchaser may increase his stake to as much as 14.9% before having to disclose. Once he reaches 15%, the Rules Governing Substantial Acquisitions of Shares apply, requiring, among other things, accelerated disclosure within one business day. The review group believed that the intention of the Act, disclosure at 5%, was capable of evasion by those taking advantage of the 5 day deadline.

Concert parties (Paragraph 3.1(b) and 3.1(c) above)

3.5 The review group was concerned that there was some confusion among those involved in take-overs as to the application of the Companies Act and City Code provisions on concert parties. The group believed that the concern arose from two sources. First, the Act's provisions are unavoidably complex insofar as they are designed to apply to a wide range of types of agreement, including informal, unwritten understandings or undertakings. Second, the correlation between the Act and the Code was thought by the review group to be unclear. Those with interests in shares might satisfy themselves that they did not offend one set of provisions and, in doing so, might assume incorrectly that there was no need to disclose under the other set either. It was thought particularly important that the different application and separate existence of the Act and Code requirements should be stressed. The Take-over Panel, in the light of this, itself proposed that the Code make the point clear. The necessary amendment has already been made and can be found in the latest edition of the City Code. Proposal 3.1(c) has, therefore, been implemented.

The use of rights of undisclosed shares during votes at general meetings and during take-overs (Paragraph 3.2(i) above)

3.6 The problem of unidentified controllers of shares exercising voting rights at general meetings was examined by the Trade and Industry Select Committee during the inquiries into the events surrounding the restructuring of Westland in 1985. The first part of the measure at 3.2(i) above arose directly as a result of the following recommendation in the Committee's Second Report (HC 176)

Westland Plc.

"We consider that the public interest demands a high degree of transparency in share dealings involving a public limited company and this, of course, is especially so in the case of a company involved in defence contracts. The Westland case has demonstrated the inadequacy of the Stock Exchange Rules to deal with this matter effectively and accordingly we recommend that the Government should introduce early legislation to require prompt disclosure of the identity of those controlling the voting rights in the shares".

This Recommendation itself arose partly from evidence from The Stock Exchange.

3.7 The question of votes at general meetings was not strictly within the terms of reference of the review of the operations of the Take-over Panel. Indeed, the review group took the view that the use of nominee shareholdings to conceal the identity of a person assenting to a take-over (as opposed to other objectives) was not a significant problem. In general, the Panel had sufficient means to identify the controllers of shares when necessary for the purposes of the Code. Nevertheless, the review group thought it sensible that the problem of votes at general meetings should be looked at as part of the follow-up work on disclosure, and that the Panel should carry out similar work in respect of take-overs. As the next chapter makes clear, the recommendation of the Select Committee necessitated an examination of a wide range of possible changes to the Companies Act that went far beyond anything considered by the review group, which had concentrated on possible improvements to the section 212

procedure of inquiries by companies.

Reduction of the City Code's deadline for disclosure by parties to a take-over and close associates

3.8 The Panel thought it sensible, while a reduction in the Companies Act 5 day deadline was being considered, to examine the practicability of reducing its own one business day deadline. The review group had not identified a particular problem. Indeed, the Code's one day deadline precludes the problem of protracted additional acquisitions that exists under the Companies Act. In the event, the Panel has come to the conclusion that it would neither be possible nor helpful to require immediate disclosure of dealings. It would not be possible because those responsible for disclosure might not be immediately aware of all dealings undertaken on their behalf as they happen. It would not be helpful because immediate disclosure would provide the Panel in some circumstances with a number of separate disclosures of small dealings. What was required was a total of shares dealt in any one day in order that the Panel could properly assess whether the dealings gave rise to any consequences under the Code and in order that other shareholders could be aware of the extent of the dealings.

Improvements to the section 212 procedure

3.9 The review group was aware of the concern expressed by some companies that there were shortcomings in the section 212 procedure. In particular, there have been instances in which those with interests in shares have delayed revelation of their identity through the use of a succession of nominee holdings. In such circumstances it

can be necessary for the company to send consecutive section 212 notices over a period of time as each successive nominee is identified. Some nominees can be companies resident overseas. By the time the controller is identified, it may be too late for the information to be of use. For example, he might have exercised his right to vote at a general meeting or he might have built up a significant initial stake in the company. Companies have expressed concern that the procedure of applying to the court for the restriction of rights attached to the shares is not ideal in these circumstances and that the 28 day period imposed by The Stock Exchange before a listed company could itself restrict rights prevents swift action when necessary.

3.10 The possibility of improving the section 212 procedure has been examined by the Department as one of the changes that might be implemented in response to the recommendation of the Trade and Industry Select Committee. The Department has not restricted its work to the specific suggestions for improvement made by the review group.

Conclusion

3.11 The varied nature and scope of the review group's measures have led the Department to undertake a full re-assessment of the existing disclosure provisions, concentrating on possible improvements to the Companies Act. The various options are discussed in the next chapter.

CHAPTER 4 : POSSIBLE IMPROVEMENTS

Introduction

4.1 This chapter describes the options for improvement to the disclosure provisions that have been identified by the Department. As indicated in the previous chapter, they are not restricted to those suggested by the Take-over Panel review. In summary, the types of legislative change that appear possible, and the Government's initial views on them are as follows:

(a) Declarations giving details of ownership (including voting and disposal rights) of all shares in a public company could be required at the time of registration or prior to general meetings or during take-overs. The Government believe that such a system would be difficult to enforce, create unacceptable burdens for shareholders and would also create burdens for companies.

(b) Changes could be made to the section 212 procedure permitting a company to initiate action in the courts to restrict the rights of shares if the registered holder fails to give all the relevant information about ownership. This would amount to a radical restructuring of the section 212 procedure which the Government doubt would be effective. The Government are, however, considering a number of less ambitious improvements to the procedure, described in paragraphs 4.17 and 4.18.

(c) The percentage at which all interests in shares must be disclosed could be reduced from the current 5%. Unlike the previous two options, which amount to the creation of new systems of disclosure, this would build upon an existing, successful, provision. The crucial question is whether the benefits of a reduction would be sufficient to justify the extra burdens.

(d) The 5 day deadline for disclosure of interests of 5% or more could be reduced. The Government believes that a reduction should be implemented.

(e) The Companies Act concert party provisions could be clarified, as suggested by the Take-over Panel review group. The Government are not persuaded that such clarification is necessary or desirable.

Comments would be welcome on any of the options or on any aspects of them.

AUTOMATIC DECLARATIONS OF DETAILS OF OWNERSHIP (INCLUDING VOTING AND DISPOSAL RIGHT)

4.2 There are two possible methods of requiring details of ownership (including voting and disposal rights) of all shares. Both would rely on automatic declarations either by the registered holder or by the person or persons controlling the rights attached to the shares. That is, the declaration would be initiated by the person making it rather than being made in response to an inquiry.

4.3 The first method would be to require all those seeking registration to provide at the time of registration a declaration of the identity of those who owned or controlled the rights in the shares. If the company was not satisfied with the declaration (or if none were forthcoming) it could refuse registration (or, alternatively, restrict the rights attached to the shares). The advantage of this system is that it would give a company comprehensive knowledge of the controllers of its shares at the time of registration. It would also reduce the burden of initiating section 212 inquiries.

4.4 The main disadvantage is that it would all but eliminate the usefulness of nominee accounts, which (as has been noted in paragraph 2.2) are essential if investment managers are to be able to maintain the accounts of small shareholders efficiently. Such managers would have to identify all those clients who had interests in shares in the company. A provision which excluded small holdings on the register would not be of any use, since investment managers' nominee accounts will often be large. There are other disadvantages. There would be a considerable new burden on small shareholders, all of whom would have to disclose even though their interests would be of no significance to the company. The reduced burden for companies of issuing section 212 notices would be replaced by the burden of examining a large number of declarations. It would remain impossible, in the absence of sufficient evidence, to invalidate a false declaration, eg one made by an offshore investment company declaring itself as the controller of all rights attached to the shares. Foreign investors might be discouraged from investing in the UK if there were to be such comprehensive disclosure. Finally, this system would not in itself provide for disclosure

when there was a change in the beneficial ownership of shares but not to the registered holder. Companies would have to rely on disclosure of such changes in much the same way as disclosure is currently made under the Companies Act. The advantage to be gained is, therefore, limited.

4.5 The second method of requiring declaration of details of ownership would be to restrict the requirement to the use of votes on extraordinary and special resolutions and to the giving of assents to take-overs. Since this method would require information only at specific occasions, it has the advantage that it would not be so damaging to the system of nominee holdings as the previous method. Declarations would be required only prior to certain events and by those intending to exercise rights. There would be a complementary reduction of the burden for companies. On the other hand, the problem of validation would remain, and there would be significant difficulty in processing the declarations in the short period before a vote or prior to the closing of an offer. It might also be thought undesirable for a company itself to have the power to restrict rights shortly before a vote or take-over (although the power would be subject to challenge). This power could be given to the courts, but such a solution would provide little benefit over and above that already available under the section 212 procedure. For the purposes of take-overs it might be possible for the Take-over Panel to require, perhaps by way of a condition to be included in all offer documents, that assents in respect of shares where there has been no declaration should be disregarded when assessing whether an offer has gone unconditional. This would address only half the problem, however. It would not provide a

sanction against unidentified controllers of shares who support defences by offeree companies.

IMPROVEMENTS TO THE SECTION 212 PROCEDURE

Compliance by the registered holder

4.6 As indicated in paragraph 3.9 above, the main reason for companies' belief that section 212 inquiries do not give the answer to inadequate disclosure is that successions of nominee holdings can be used to delay disclosure. If a nominee holder is resident abroad it may prove particularly difficult to obtain information about who controls the rights of shares. It might be possible to reduce this problem if the registered holder, when responding to a section 212 notice, were required not simply to furnish the company with such information about ownership that he knows (as at present under the Companies Act) but to give details of ultimate ownership or control of the shares. Failure to do so would lead to a restriction of the rights attached to the shares.

4.7 A broad model for such a requirement may be found in section 178(6) of the Financial Services Act 1986 (penalties for failure to co-operate with insider dealing investigations):

"A person shall not be treated ... as having a reasonable excuse for refusing to comply with a request or answer a question in a case where the contravention or suspected contravention being investigated relates to dealing by him on the instructions or for the account of another person, by reason that at the time of the refusal -

(a) he did not know the identity of that other person; or

(b) he was subject to the law of a country or territory outside the United Kingdom which prohibited him from disclosing information relating to the dealing without the consent of that other person, if he might have obtained that consent or obtained exemption from that law".

In other words, a person answering questions in an investigation is obliged to know or find out the identity of any relevant person for whom he had been dealing. He is subject to heavy sanctions if he does not fulfil this obligation.

4.8 The precise effect of a similar requirement under the s212 procedure would depend upon the information that the registered holder was expected to have. At present, section 212 allows a company to ask questions about any disclosable interests in the shares. But it would not be practicable to require the registered holder to know or to find out details of all the interests that reside in the shares that he holds. These may be numerous and held by a number of different people. They can change hands without the knowledge of the registered holder. Since a company carrying out a s212 inquiry is invariably concerned to discover who controls the voting rights or the disposal rights or both, it would be sensible for the registered holder to be required to have information only about these rights. The proposal might, therefore, be that a company could ask the registered holder to declare that he has sole and unrestricted power to decide how to vote or how and when to dispose of the shares, or that he is subject to the direction of some other named person(s) who either has/have unrestricted power or is/are subject to the direction of some other named person(s) and so on. The

proposal would have to provide for the possibility that different persons might control the voting and disposal rights. It would also have to provide for the possibility that no one person held sole power over either of the rights (eg where the interests in the shares were jointly owned, or where the shares were subject to qualified discretionary control by an investment manager). What is important is that there should be a clear obligation to declare all those persons who have sole or partial voting and disposal rights.

4.9 Although in theory this appears complex and onerous for the registered holder, it would not be so in practice in the vast majority of cases. The fundamental effect would be that it would prevent those who can currently knowingly conceal an interest, or collude in assisting another to conceal an interest, from doing so without fear of suffering sanctions. Those with control over the voting or disposal rights will usually be readily identifiable, and it would be up to those who wished to retain those rights to ensure that the registered holder had the necessary information.

4.10 The major difficulty would be that of validation, as with automatic declarations. For example, a company might be set up by a person who effectively controlled the rights in order to evade the procedure. In such a case, the registered holder could say correctly that XYZ Co. Ltd held unrestricted and sole rights. It might be possible to limit this problem through use of a formula similar to that in section 203 of the Act, where 'effective' control of the rights is deemed to be held by persons with specific powers over companies. Alternatively, the company issuing the section 212 notice could be allowed to

issue a second notice inquiring into the control of the company that was declared as the holder of the rights attached to the shares. When the company was resident abroad, however, it would be difficult to obtain sufficient evidence to invalidate a false declaration of ownership and control of rights by the company.

4.11 The prevention of the use of successive nominee holdings would frustrate any delaying tactics that presently cause difficulties for companies carrying out section 212 inquiries during take-overs or prior to general meetings. It would not of itself, however, be able to cope with all transfers of shares that became known immediately prior to a bid deadline or a general meeting because of the need to allow reasonable time for a response to a company's request for the information. The consequence might be that those wishing to conceal ownership of voting or disposal rights would cease to use nominee holdings for shares bought early during the notice period of a general meeting or during a take-over. Instead, shares might be bought in the market late in the day. This would not be entirely satisfactory for the purchaser, because he could not be sure of his position until the eve of the vote or offer deadline; there would be no guarantee that sufficient shares could be bought in the market and it could often be necessary to pay a premium. An alternative method of evasion could be to purchase options on shares, where the voting or disposal rights would not be transferred to the purchaser until late in the day. It might be necessary, therefore, for control of voting or disposal rights to be defined to include control resulting from the exercise of an option.

4.12 The effectiveness of this proposal could also depend upon the sanctions available against non-compliance, but great care would have to be taken when deciding what sanctions were appropriate. The section 212 procedure currently allows for court orders imposing Part XV restrictions and it is also a criminal offence to fail to comply with a s212 notice or to falsely or recklessly give misleading information. There is a strong argument against maintaining the criminal offence (except in the case of the deliberate giving of false or misleading information) if the duty of compliance is to be placed wholly on the registered holder. Even if the information required were to be narrowed, as suggested, to voting and disposal rights (and perhaps options), it would not be so easily obtainable as that required by section 178(6) of the FS Act. The registered holder would rely on the holder of the rights providing the correct information, and should not be held responsible if a person falsely declares that he controls the rights. Nor could he be expected to be aware at all times of any transfer of the rights (which might be effected as the result of a deal in someone's back garden).

Ability of companies themselves to take powers in their Articles

4.13 However, an alternative and potentially more effective method of improving the ability of companies to inquire into the ownership of their shares would be to widen the scope for listed companies to take the powers in their own articles. As has been noted in paragraph 2.18 above, The Stock Exchange under its current listing rules constrains companies in two respects. First, a period of 28 days must elapse between the issuing of a section 212 notice

and the restriction of rights for the failure to respond. Second, listed companies are not normally permitted to restrict rights other than voting rights. The important sanction of restriction of disposal rights is not available. But for these limitations, listed companies would, like all other companies, be able to take wide powers in their Articles to restrict the rights attached to shares. If the shareholders agreed, they could restrict rights immediately following the issuing of a section 212 notice until such time as a satisfactory response was received.

4.14 There is an argument against the proposal allowing companies greater freedom to take these powers in their Articles. The very effectiveness of the proposal from the companies point of view might be seen as against the interests of those shareholders who were subject to inquiries. Some companies might use their powers indiscriminately, requiring responses within short deadlines that were unreasonable in the circumstances. Small investors might, for example, be unable to respond simply because they were on holiday. Overseas investors might not be given sufficient time to return a reply to the company in the UK. These shareholders, once restrictions were imposed, would normally be able to have them lifted by the company simply by providing an adequate response. If the company proved uncooperative, however, the shareholder would have to initiate action in the courts.

4.15 Other companies might use their powers unfairly. The directors might, prior to an important vote or the closing date of an offer for their company, issue section 212 notices and restrict the rights of the shares concerned in

an attempt to protect their own position. This would be a dangerous step for the directors to take, because, if they used their powers unreasonably, any decision that had been affected by their action could subsequently be declared invalid by the courts. This would be a strong disincentive. Nevertheless, shareholders whose rights were unreasonably restricted would, again, have to initiate action in order to obtain a remedy.

4.16 On balance, the Government believe that companies should be given greater freedom to take powers through their Articles, provided adequate alternative safeguards are imposed. Instead of eliminating the 28 day moratorium altogether, it might be reduced to 7 days. Other possible safeguards are that the full board of the company could be required to agree to the use of its powers and the company could be required to publicly announce its intended action before taking it. Moreover, any company that used its powers indiscriminately or unfairly would do so at its own peril. Investors would be deterred from purchasing shares of a company that had acted unreasonably in the past, or which had unduly harsh provisions in its Articles. These safeguards should ensure a reasonable balance between the interests of the company in finding out who controls its voting rights and the interests of individual shareholders.

Other improvements to the section 212 procedure

4.17 Under s216, a company has grounds to apply to the court if no reply to a s212 notice is received or in the event of a failure by the respondent to give all the information required by the notice. The company is only entitled to such information from the recipient as to interests other

than his own 'so far as lies within his knowledge'. The Secretary of State, however, may restrict rights where 'there is difficulty in finding out the relevant facts about any shares'. A company cannot act if it meets a cut-off created by the fact that the recipient has no knowledge of other interests or does not have sufficient knowledge to point to the next link in the chain. The Secretary of State can. Although it might be rare for a recipient to be able to demonstrate such a deficiency of knowledge (he would be saying something like he was not the sole beneficial owner but did not know of anyone else who had interests in the shares, beneficial or otherwise), the situation might occur. To that extent, it would be useful for the company to be able to apply to the court on the same grounds that the Secretary of State has for restricting rights.

4.18 In certain cases it is thought that a company may have failed to obtain useful responses because of ineffective drafting of its s212 notices. Large companies with experience of the procedure and any company that takes advice from a lawyer experienced in this field should be able to draft their notices correctly and comprehensively. Others might find it of assistance if the DTI were to publish a model form of notice, identifying the questions that can and should be asked and the form that they should take. This would not be a standard form; companies could depart from it in any way that the Act allows, and it could be adapted to meet the particular needs of individual cases. The aim would simply be to give guidance to those who needed it. The argument against publishing a model form is that it might be regarded by some as more definitive than it really was; so that if companies were to see the model as an alternative to

seeking legal advice, the consequence might be to render s212 notices less rather than more effective.

A REDUCTION IN THE NOTIFIABLE PERCENTAGE

4.19 A reduction in the notifiable percentage would require the disclosure of all significant interests (including voting and disposal rights) without the need for the complex arrangements of automatic declarations or the section 212 procedure. It would severely limit the ability of potential offerors secretly to acquire a significant initial stake in a company. If it were combined with a reduction of the current 5 day deadline for disclosure (see paragraph 4.23 below), it would make more difficult the concealment of interests prior to votes or take-overs except by those who purchased shares very late (which would often be an uncertain and expensive process). It would also reduce the attractiveness of the use of concert parties to evade disclosure, since more participants would be necessary to achieve the same effect as under the 5% threshold. (The concert party provisions are discussed in paragraphs 4.26 to 4.28.) Setting the notifiable percentage would need careful judgment. If it were set too low, the burden on shareholders and the financial services industry might be unacceptable. For a large international group, where separate interests may be held in different operating arms, but need to be amalgamated for the purposes of notification, identifying whether or not a disclosable interest is held is already a substantial task: a big reduction in the threshold would have a major impact. On the other hand, if the level remained relatively high, the advantage to be gained would be too small to be of use.

4.20 Although a reduction in the percentage could be put into effect by statutory instrument, it would be desirable to make some amendments to the Companies Act to make it effective. The reduction of the 5 day deadline has already been mentioned. At present, the civil sanction of the restriction of rights can only be applied after a conviction. If greater reliance were to be placed upon a lower notifiable percentage, it would be sensible to allow companies to seek court orders restricting the rights of shares where they believe that disclosure has not been made, even in the absence of a conviction.

4.21 Like the previous options, this suggestion has disadvantages. Those who were prepared to flout the law could fail to disclose or make false disclosures, which would often be difficult to invalidate. While it would reduce the burden for companies of issuing section 212 notices, a lower threshold would create an increased burden for those complying with it. This could be ameliorated to a limited extent by a provision to take shareholders of unlisted public companies and small listed companies out of the regime. Such a provision might state that interests in the shares of such companies continue to be disclosable only at 5% not at the new, lower level. It would be necessary to specify the size of listed company to which the provision would apply (either by reference to nominal share capital or market capitalisation).

4.22 There are two other important possible disadvantages. First, as with automatic declarations, the attractiveness of the UK market to overseas investors might be reduced if they had to disclose at a lower threshold. Second, institutional investors often enter the market with a view to acquiring a significant stake in a company of, say, 3%.

If an institution were required to disclose when its stake reached 1%, the market would be aware that the institution probably intended to increase its stake to a significant level. The price of the shares might rise in anticipation of further buying or as a reaction to the institution's apparent confidence in the company. The institution would face the choice of paying a higher price for the remaining proportion of its investment or deciding to acquire no more shares. The result would be to make it more expensive for an institutional investor to achieve its investment objectives.

A REDUCTION OF THE FIVE DAY DEADLINE

4.23 It has become clear that the 5 business days currently allowed under the Companies Act for disclosure of interest in shares of 5% or above is unnecessarily long. Shareholders have been perfectly able to comply with the one business day deadline for disclosure to be found in the City Code and in the Rules Governing Substantial Acquisitions of Shares (SARs). The Government realise that those with holdings that are disclosable under the Code or the SARs will have been put on alert and will thus be more vigilant in monitoring the relevant holdings than others in their portfolio. It might, therefore, be the case that 1 business day would be too short a time for disclosure under the Companies Act. Comments are invited on whether such a deadline would be appropriate or, if not, what period would be practicable.

4.24 In any event, the Government believe that, once an initial disclosure has been made of a breach of the 5% threshold, subsequent disclosures of percentage changes in the interest should be made within 1 business day. Having

made the initial disclosure, shareholders should be well aware of the need to monitor their interest.

4.25 A simple reduction in the 5 day deadline would not have a conclusive effect. It would have the benefit, which is significant, of limiting the period during which further purchases could be made before disclosure was required. As such, it is a proposal worth consideration on its own merits. But, however short the deadline for disclosure, a shareholder could still purchase beyond 5 per cent in a single transaction or series of simultaneous transactions. In order to be fully effective, the deadline might incorporate a mechanism which restricted purchases in some way once the 5% limit was reached. A person who reached 5% could be precluded from making any additional purchases until disclosure was performed. (Canada has recently adopted a similar requirement.) This would force earlier disclosure from any person wishing to increase his stake further. It would be necessary to specify what constituted 'performance' of disclosure (eg it might be the sending of a notice or its receipt by the company).

CONCERT PARTIES

4.26 The Take-over Panel review group recommended that the provisions on concert parties should be clarified and that steps should be taken to ensure that the law is better understood. The review group was concerned that the complexity of the provisions made it difficult for companies and shareholders to establish beyond doubt when a concert party existed.

4.27 A concert party arises when two or more persons enter an agreement which includes provision for the acquisition of shares by at least one of them and imposes obligations or restrictions on at least one of them with respect to their use. The agreement need not be legally binding - it may include undertakings, expectations or understandings (so long as there is mutuality in them) operative under any arrangement. At least one of the persons must actually acquire shares before disclosure is required.

4.28 As has been noted previously, it would be possible to reduce the reliance placed upon the concert party provisions if the notifiable percentage were to be reduced. If interests held by a single person had to be disclosed at, say, 1% it would be much more difficult to separate a significant stake into a number of smaller interests that would, in the absence of the concert party provisions, not be disclosable. Nevertheless, large concert parties could still enable avoidance of disclosure. It would, therefore, be necessary to retain those provisions even if the notifiable percentage were to be reduced.

4.29 One way of altering the concert party provisions would be to restrict their application to legally binding agreements. Agreements that consisted of unbinding mutual undertakings, expectations or understandings, would not give rise to an obligation of disclosure.

4.30 An alternative approach would be for the category of agreement or arrangement caught to be widened, for instance by removing the need to prove the existence of mutuality in the undertakings, expectations or understandings of the parties to it. Possibly, also, the

need for shares actually to be acquired pursuant to the agreement before disclosure is required might be removed by the elimination of s204(2)(b) of the Companies Act.

4.31 The effect of any widening of the provisions along the lines in the previous paragraph would be to make the need for disclosure apparent at an early stage, and to reduce the number of conditions governing the existence of a concert party. But such a move would also cause a large number of agreements irrelevant to the exercise of control (such as those between existing shareholders to vote against the re-election of a director) to be caught. This would reduce the ability of shareholders to discuss and agree voting tactics in private. It might, therefore, be appropriate to introduce a new form of restriction on the types of agreement caught. One method could be to replace the concept of an agreement with that of a joint or common purpose, for which a favour would have to be performed by one or more parties for the others. Another would be to introduce a purposive criterion, so that the provisions would bite only on agreements made for particular purposes.

4.32 The Government do not, at present, take the view that it has been established that the existing concert party provisions are defective. They are prepared, however, to consider the options described here should it become apparent that action is necessary.

CHAPTER 5 : EUROPEAN COMMUNITY DIRECTIVE ON DISCLOSURE OF MAJOR SHAREHOLDINGS

5.1 In December 1985, the European Commission issued a proposal for a Directive on information to be published when major holdings in the capital of a listed company are acquired or disposed of. At the time of writing, it is expected that the proposal will be adopted during 1988. The Department has consulted interested bodies to obtain their views on the Directive. It is worthwhile, however, setting out its main provisions here and recording how implementation might affect the operation of Part VI of the Companies Act. The original proposal has been amended by the European Parliament and the Council Working Party. The provisions referred to here are those of the text considered by the Internal Market Council of Ministers on 18 December 1987.

5.2 The Directive would require all Member States of the European Community to make rules on disclosure at least as rigorous as the minimum standards laid down in the Directive. The Directive applies only to holdings of voting shares in companies that are both listed on an EC stock exchange and incorporated in a Member State. Any person (or persons acting in concert pursuant to a written agreement) acquiring or disposing of shares in such a company must notify the company within 7 calendar days when their total holding goes through one of a number of thresholds. The basic thresholds set down in the present text of the Directive are 10%, 20%, one-third, 50% and two-thirds, although there are options to accommodate the different needs of Member States (eg the UK's use of whole percentage points rather than fractions).

5.3 When a company has received a notification from a shareholder it must make the information public within 9 calendar days. In practice, companies will be able to satisfy this requirement by notifying the competent authority to be set up under the Directive. The competent authority will then disclose the information. If The Stock Exchange were to be appointed the competent authority in the UK, the existing procedure under paragraph 16 of section 5 ('Continuing Obligations') chapter 2 of 'Admission to Securities for Listing' (The Yellow Book) would apply. Competent authorities would be permitted in exceptional circumstances to exempt companies from the duty to make information public. No such exemptions would be available to shareholders. The Directive does, however, exempt certain 'professional dealers in securities' from its provisions. In the UK, this would include market makers, investment managers and unit trust managers.

5.4 It will be apparent that the Directive will lay down minimum standards that are much less strict than the provisions of the Companies Act. The Act will, therefore, satisfy most of the requirements of the Directive without the need for new legislation. The thresholds required of the UK by the Directive already exist in the Act's 96-point scale of disclosure at 5% and each whole percentage thereafter. Moreover, the definition of disclosable 'interests' in the Act is drawn much wider than required by the Directive. The Directive requires disclosure of simple ownership of shares together with a number of specific types of indirect ownership.

5.5 The Government have supported the principle of the Directive. They have recognised that, while it would have been desirable for the Directive to set higher standards for disclosure (along the lines of the Companies Act), a number of Member States would experience difficulty in implementing a stricter regime.

5.6 There are, however, a number of provisions in the Directive that are not obviously compatible with Part VI of the Companies Act. The lack of provision for exemptions for shareholders other than 'professional dealers in securities' will have the consequence that some of the exemptions in section 209 of the Act will not be allowed in respect of the thresholds imposed by the Directive. The Department has written to exemptees under section 209 and they do not forsee difficulties. There are also a number of technical details of the Directive that would create inconsistencies with the Act. These include the definition of acting in concert and the treatment of nominees who have no interest in shares beyond that of a bare trustee. In view of the limited scope and benefit of the Directive the Department has sought to ensure that its provisions will not compromise the effectiveness of Part VI of the Companies Act.

5.7 As has been noted earlier in this chapter, those likely to be affected by the Directive have already been consulted by the Department. Anybody who would like further information or who would like the opportunity to comment on the Directive should write to the address in chapter 1.

CHAPTER 6: OUTLINE OF POSSIBLE CHANGES

6.1 The outline that follows summarises the possible improvements put forward in this document, together with the Government's current view as to their desirability.

AUTOMATIC DECLARATIONS OF OWNERSHIP (INCLUDING VOTING AND DISPOSAL RIGHTS)

6.2 The document describes two possible methods of automatic declarations of details of ownership or control of rights of all shares in public companies. The first would require a declaration to be made at the time of registration. The second would require a declaration to be made prior to important votes or the giving of assents to take-overs. While these proposals would in principle give more comprehensive information than is available at present, they would be difficult to enforce and would create burdens for shareholders and companies. The Government believes that they should not be adopted. (Paragraphs 4.2 to 4.5).

IMPROVEMENTS TO THE SECTION 212 PROCEDURE

6.3 Interests in shares can be concealed for some time if they are hidden behind a succession of nominee holdings. It might be possible to reduce this problem if the registered holder, when responding to a section 212 notice, were required to give details of ultimate ownership or control of the shares. The Government doubts whether such a proposal would be much more effective than the present system in preventing delaying tactics by respondents. Nor could it address the problem of shares bought just prior to an important vote on the closing date of an offer. (Paragraphs 4.6 to 4.12).

6.4 The freedom of companies to take powers in their Articles to restrict the rights of shares could be increased. The 28 day moratorium before restrictions can be imposed that is laid down in the listing rules could be reduced, and companies could be allowed to restrict rights over and above voting rights. (Paragraphs 4.13 to 4.16).

6.5 A company might be permitted to apply to the court for an order restricting the rights attached to shares on the same grounds that the Secretary of State has for restricting rights. The DTI might publish a model form of section 212 notice. (Paragraphs 4.17 to 4.18).

A REDUCTION IN THE NOTIFIABLE PERCENTAGE

6.6 The percentage in which interests in shares must be disclosed might be reduced from 5%. This would increase the burden of disclosure for shareholders while reducing the need for companies to carry out section 212 inquiries. Views are invited on whether a reduction should be made and, if so, to what percentage level. (Paragraphs 4.19 to 4.22).

A REDUCTION OF THE FIVE DAY DEADLINE

6.7 The Government think that the 5 day deadline for disclosure of interests of 5% or above should be reduced. Views are invited on what would be an appropriate deadline and on the possibility of requiring disclosures made after the initial notification to be made within an even tighter deadline. In addition, a person who reached 5% could be precluded from making further purchases until disclosure was performed. (Paragraphs 4.23 to 4.25).

CONCERT PARTIES

6.8 The application of the concert party provisions might be restricted to legally binding agreements to make it easier to prove offences. This would, however, make avoidance a simple matter. On the other hand, the category of agreement or arrangement caught could be widened. This would run the risk of catching unexceptionable agreements. That risk might be reduced if a purposive criterion were introduced, whereby the provisions bite only on agreements made for particular purposes. The Government do not, at present, take the view that it has been established that the concert party provisions are defective. (Paragraphs 4.26 to 4.32).

MEASURES IDENTIFIED IN THE REVIEW OF THE OPERATIONS OF THE TAKEOVER PANEL

The Companies Act, the Take-over Code and The Stock Exchange listing rules

1 The Stock Exchange and the Department are to undertake further work to establish ways in which companies could be permitted to prevent the voting at general meetings of shareholdings of which the ultimate voting control is not disclosed. The Panel is considering ways in which it might prevent such shareholdings from influencing the outcome of an offer.

2 The five day deadline allowed by the Companies Act for disclosure of interests of five per cent or more should be reduced if consultation confirms it is practicable. The Panel is examining whether the disclosure deadline in the Code should be amended to require parties to the offer and their close associates to disclose dealings immediately in normal circumstances and, in any event, by 9 am the following business day, instead of noon the following business day as at present.

3 A number of improvements might be made to the powers enabling restrictions to be imposed on the exercise of rights attached to shares (including voting and transfer rights) when inquiries by a company into the ownership of the shares under section 212 of the Companies Act prove unsuccessful. These include any necessary clarification of the circumstances in which a company may apply to the court for an order restricting the rights, and the possible inclusion in the Act of a specific deadline for responses to inquiries. For those companies that have taken the power through their articles to restrict rights themselves (without the need to apply to the court) when section 212 inquiries are unsuccessful, The Stock Exchange might reduce the 28 day

period of notice that is required before the rights may be restricted.

4 The Companies Act provisions on concert parties should be clarified and steps shold be taken to ensure that the law is better understood. The Panel proposes to amend the Code to make it clear that its provisions are different from those of the Act and that Panel rulings on the Code do not constitute legal guidance on the interpretation of the Companies Act.

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10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

18 June 1988

Dear Alex.

TOKYO STOCK EXCHANGE

The Prime Minister has considered the Chancellor's minute of 17 June in which he suggests that the Prime Minister might indicate to Mr. Takeshita in Toronto that, in response to adequate assurances he will continue to press the Tokyo Stock Exchange authorities to make more seats available for British firms, she would expect the Bank of England to be telling Namura and Daiwa fairly soon when they will be allowed to open for business as Guild-Edged Market Makers. She thinks this would simply take the pressure off the Japanese and would not be wise in present circumstances. She does not, therefore, prpose to speak in this sense to Mr. Takeshita.

I am copying this letter to Stephen Ratcliffe (Department of Trade and Industry), Lyn Parker (Foreign and Commonwealth Office) and John Footman (Office of the Governor of the Bank of England).

Yours ever,

(C. D. POWELL)

Alex Allan, Esq.,
HM Treasury.

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(1)

No - this would be more where it put me

cc PC

Rice Minister

You are invited to lift the roadblock on Japanese applications for Gilt-Edged Market Maker status here, without any guarantee that we shall get our way in the Tokyo Stock Exchange. I am not sure it is right. CDN 13/6

PRIME MINISTER

TOKYO STOCK EXCHANGE

I understand that you may not be having a special meeting during the Toronto Summit with Prime Minister Takeshita, following your full talks with him here only a few weeks ago. Nevertheless, you will wish to know how matters stand, now that whisky has been settled, on the second of the two bilateral issues you raised with him when he was here. This minute therefore sets out where we stand on the Tokyo Stock Exchange and how I suggest, with the agreement of the Bank of England and DTI, that we should handle this and the related question of applications by two Japanese firms to become Gilt-Edged Market Makers in London.

There has been no real progress in breaking the impasse of the limit on Tokyo Stock Exchange seats to enable BZW to be given a clear prospect of membership within a reasonable time. However it is clear that Prime Minister Takeshita himself has indeed, as he promised you, been actively pressing the Japanese authorities to try to help. We think he will continue to do so and - though we still have no guarantee that he will succeed - it seems right that you should take the opportunity to welcome his efforts and of course urge that he persevere until they do succeed.

Meanwhile, we have the unresolved question of the two outstanding Japanese applicants for GEMM status here. You were careful in your talks with Takeshita last month not to draw any particular link

between the BZW case and GEMM applications, but simply indicated in a general way that delays in Tokyo might result in delays in London also.

We need to handle this carefully. The legal ice is thin. We have already delayed the GEMM applications for many months. For the Bank of England to delay implementation much further might not stand up to judicial review. And I understand that David Young judges that to attempt to use the 'reciprocity powers' in the Financial Services Act would be a mistake: he is inclined to the view - which seems right to me too - that to declare open war in this way on this issue would expose us to risks for other British interests against little chance of success on BZW, so that he could not be satisfied that it was justified in the overall public interest.

My own judgement is that the Japanese would be unlikely to try to test us - they have taken the whole matter quietly so far and would probably reckon that to take issue publicly or legally with HMG on a point which does not matter greatly to them would be disadvantageous to them in the longer term.

But I would not help my opposite number Reagan

Nevertheless, if it would help your relations with Prime Minister Takeshita, and if in other respects they are going well, you might indicate, in response to adequate assurances of his continued efforts, that you would expect the Bank of England to be telling Nomura and Daiwa fairly soon when they will be allowed to open for business as GEMMs.

Our procedure then would be that, fairly soon after the Summit, the Bank would give staged future dates, say 1 August for Nomura and later for Daiwa. The companies would of course have to be free to announce the news as soon as they were told. At the same time we would make it clear again to the Japanese authorities that there could be delays on other matters as long as the British continue to

face delays in Tokyo, and we know that they are concerned about some future questions of more importance to them than the GEMM applications.

We shall of course want, in public answers to questions about this, to be able to indicate that Takeshita has at least renewed his general assurance of willingness to try to find a solution to the Stock Exchange problem.

I am copying this minute to David Young, Geoffrey Howe and the Governor of the Bank of England.

[N.L]
17 June 1988

[Text approved by the Chancellor; signed in his absence]

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10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

10 May 1988

INVESTIGATIONS POLICY STATEMENT

The Prime Minister was most grateful for the further material attached to your letter of 9 May, which she discussed with your Secretary of State this morning. It was agreed that your Secretary of State should proceed with an announcement about the changes proposed. He agreed to take a further look at the detailed drafting of the announcement.

Paul Gray

Stephen Ratcliffe, Esq.,
Department of Trade and Industry.

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the department for Enterprise

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The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

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Our ref DW1ABG
Your ref
Date 9 May 1988

Dear Paul,

INVESTIGATIONS POLICY STATEMENT

We spoke last week about the Prime Minister's concerns on the statement which my Secretary of State proposes to make on Investigations Policy. Lord Young would like to discuss this matter again with the Prime Minister at their bilateral tomorrow with a view to making an announcement later this week.

It might be helpful, in advance of this discussion, for you to have the following papers:

i) A note describing briefly the changes to be announced in the proposed statement, their effects and reasons for them.

ii) A revised draft of the announcement incorporating changes designed to meet the Prime Minister's concerns. The changes are sidelined.

iii) A table describing the various investigation powers and their main features, with changes indicated in red.

Yours ever
Steph Ratcliffe

STEPHEN RATCLIFFE
Private Secretary

the Enterprise initiative

dti

the department for Enterprise

INVESTIGATION POWERS AND POLICY: PROPOSED CHANGES

Objective

To speed up investigations and make them more effective while safeguarding as far as possible the legitimate interests of those involved in investigations.

A. Legislative changes

(i) New power of investigation under the Companies Act.

Present position:

Two main investigation powers under the Companies Act:

Section 432 for large wide-ranging investigations expected to result in a published report. Investigations done by outside inspectors with tough powers to obtain evidence from anyone with relevant information.

Section 447 for relatively quick confidential enquiries into specific matters of concern. Powers are limited and no reports are published but information can be used for prosecution or regulatory action.

Proposal

In some cases, Section 447 powers are inadequate but there is no public interest in being able to publish a report (eg because if the investigation shows something is wrong, the outcome is likely to be prosecution or other regulatory action). Preparing a report for publication is very time consuming due to additional natural justice requirements in relation to those criticised. The proposed change will allow the Section 432 powers to be used in appropriate cases without the obligation to produce a report for publication.

No changes are proposed to the circumstances in which investigations can be undertaken under the Financial Services Act.

(ii) Strengthening various powers

Present position

There are already powers to seek search warrants and obtain information about bank accounts (subject to safeguards) under some investigation powers but not all. Existing provisions concerning the freezing of share dealings by those who fail to co-operate with investigators' requirements for information about ownership of shares have defects in them.

Proposals

To extend existing powers in these areas to all investigation

powers and remedy the defects. No new points of principle are raised.

(iii) Recovering costs of investigations

Present position

Investigation costs can be recovered from persons convicted on a prosecution instituted as the result of a Section 432 investigation.

Proposals

To allow costs to be recovered from persons convicted as a result of any Companies or Financial Services Act investigation. As now, it would be for the court to decide whether to order costs to be met.

(iv) Appointment of outsiders to undertake Section 447 enquiries

Present position

Only officials can undertake Section 447 enquiries. Outsiders can be used for all other Companies and Financial Services Act investigations.

Proposal

To permit outsiders to be used on Section 447 enquiries to supplement DTI resources when particular expertise is required or extra investors are needed.

(v) Simplifying the exchange of information between DTI investigators

Present position:

Information obtained in DTI investigations is confidential and may be disclosed only through specified gateways. These include disclosure for prosecution purposes and to other regulators such as the Bank, SIB, SROs. Disclosure to the Inland Revenue and Customs and Excise is not permitted except for prosecution purposes. Exchange of information between DTI investigators involved in different cases is possible but time consuming and difficult.

Proposal

To make it easier for a DTI investigator in one case to let a DTI investigator in another case have relevant information direct. The draft announcement has been amended to clarify the very limited extent of the proposed changes. There is no proposal to change the circumstances in which information can

be given to the Inland Revenue or Customs and Excise.

? (vi)

(iv) Terminating investigations in specified circumstances

Present position

There is no power to terminate an investigation undertaken by outside inspectors in any circumstances. Investigators are statutorily required to finish their work even if it serves no useful purpose.

Proposals

To enable the Secretary of State to terminate insider dealing investigations if he considers no further purpose would be served by continuing (eg because the information needed for prosecution has already been obtained, or it is clear that there is no prima facie case of wrong doing).

To enable the Secretary of State to terminate Companies Act inspections if it is decided that it would be more appropriate for all further action to be handled by the Serious Fraud Office or, in Scotland, the Lord Advocate. Unless there is a public interest in publishing a report on an investigation, there is no point in continuing two parallel investigations.

(vii) Assistance to overseas regulators

Present position

Information obtained in DTI investigations or held by UK regulators can be passed to overseas regulators exercising similar functions. But investigations cannot be undertaken to obtain information needed by overseas regulators unless the normal criteria are met. In practice, this means that we usually cannot investigate unless wrong doing is suspected in this country, however serious the potential wrong doing overseas. This is inhibiting efforts to improve mutual co-operation with other countries.

Proposal

Consider taking power for the Secretary of State to appoint investigators to obtain information needed by overseas regulators. The proposed power would be subject to important safeguards.

- the Secretary of State would have to be satisfied that relevant evidence would be obtained in the UK which would help an overeseas regulator in a formal investigation into suspected malpractice in the companies or financial services area (ie no fishing expeditions)

- the Secretary of State would have a wide discretion as

to whether or not to use the power in a particular case and to take into account whether reciprocal help was provided by the regulator concerned.

- the investigator would be appointed by the Secretary of State and would be subject to his control.

Departments concerned will be consulted about the proposal in more detail before a final decision is taken.

(viii) Announcements about investigations

Present position

Companies Act: Investigations under Sections 432 and 442 (ownership of shares) into public companies are announced, but such investigations into private companies (rare) are usually not. Section 447 enquiries are not announced and only confirmed if the company has publicly acknowledged them.

Financial Services Act: Insider dealing investigations are not normally announced but there are some important exceptions (details in the attached annex). The criteria for deciding on announcements have not been made public.

Investigations under Section 105 (investment businesses are not announced).

Proposals

Companies Act: To announce all Section 432 and 442 investigations. Otherwise no change.

Financial Services Act: To restrict the exceptions to the policy of not announcing insider dealing investigations (details in annex). The new policy is now being followed. No change on Section 105 investigations.

[redacted]

ANNEX

INSIDER DEALING INSPECTIONS : PUBLICITY

The appointment of inspectors to investigate possible contraventions of the insider dealing legislation is not normally announced (and the criteria for deciding on exceptions have not hitherto been announced). The exceptions to this general rule under the former policy and the new policy have been/will be in the following circumstances:

	Former Regime	New Regime
(a) The employing business or a broker etc has already given clear publicity to a specific transaction	Announce	Do not announce unless, in the public interest and judged less damaging to the individuals and organisations concerned if the existence of an inspection acknowledged, and it is appropriate in the circumstances

	Former Regime	New Regime
(b) The public interest is such that an announcement should be made eg where central or local Government officials are suspected of insider dealing.	Announce	Announce
(c) An individual under investigation is so important to the management of the company employing him that it is more than possible that the fact of the investigation would affect the company's share prices.	Announce	Do not announce

Financial Services Division 5

28 April 1988

R26AAS

DRAFT

Question : To ask the Secretary of State for Trade and Industry what his policy is on investigations under the Companies Act 1985 and the Financial Services Act 1986.

Answer : I have been reviewing the investigation powers and procedures under these Acts in the light of recent experience of operating them.

Fair and efficient markets depend on effective enforcement of the law and of self-regulatory requirements. Investigation powers have a key role to play in this. Their purpose is to discover the facts so that, if there has been misconduct, appropriate prosecution or regulatory action can be taken. The value of the existing powers is demonstrated by the results obtained. In the last 2 years, for example, following investigations under the Companies Act, criminal proceedings were brought in 28 cases involving the management of 47 commpanies and leading to penalties ranging from fines to, in one instance, imprisonment for 15 years. In addition, 61 companies were wound up in the public interest and 9 people were disqualified from acting as directors. In the relatively short time that the Financial Services Act investigation powers have been in force, two people have been convicted of insider dealing as a direct result of investigations by inspectors and legal proceedings are in train in two further cases.

These results demonstrate the contribution which the investigation powers make to the detection of malpractice. But of course, not all investigations reveal malpractice. Their purpose is to find out the facts so that decisions can be taken on whether or not further action is needed. None of the investigation powers can be used unless there is a good reason. Some of the powers have higher thresholds. There is no question of the Secretary of State having the power to undertake "witch hunts", as has been suggested, ~~even if he should wish to do so~~. But when in my judgement the statutory criteria are met, I shall continue to use the powers when circumstances make it appropriate to do so. In exercising my discretion, I shall apply the same broad standards as my predecessors have done.

My Department has recently completed a review of existing investigation powers and procedures with a view to ensuring that investigations are undertaken as effectively and quickly as is compatible with a thorough and fair enquiry.

This review concluded that in general the present range of powers matched the different purposes and circumstances of investigation required in the UK, but that there was a need for more scope and flexibility in the way they could be used and for clarification of some of the provisions to improve efficiency.

Accordingly, it is intended to introduce the proposed changes to the law at the next convenient opportunity:-

(i) enabling the general powers of company investigation under Section 432 of the Companies Act also to be used in certain cases (broadly suspected fraud, misfeasance or misconduct) when the prime purpose is to consider the case for prosecution or regulatory action and there is no intention to publish a report;

(ii) strengthening various powers, including extending the existing powers to seek a search warrant for relevant books and papers and (subject to the Secretary of State's approval) to obtain information about relevant bank accounts, and tidying up the provisions on freezing share dealings;

(iii) extending the existing powers to recover the cost of investigations from persons who are convicted on a prosecution instituted as a result of an investigation;

(iv) enabling the Secretary of State to appoint outsiders to undertake enquiries under Section 447 of the Companies Act;

(v) simplifying the exchange of information between DTI investigators involved in different cases;

(vi) enabling the Secretary of State to terminate insider dealing investigations when no further purpose would be served by continuing and to terminate Companies Act inspections when it is more appropriate for further action to be handled by the Serious Fraud Office or, in Scotland, through the Lord Advocate.

The review also concluded that, because of growing international links in corporate activity, and to help improve mutual co-operation with other countries, it would be helpful if the UK could do more than at present to assist overseas regulators. We are therefore also considering whether to introduce provisions for the Secretary of State to exercise powers to assist overseas regulatory authorities in some situations in which he cannot at present, when he is satisfied there is good reason to do so. We will bring forward proposals in due course if we do decide to proceed.

Additionally, steps will be taken to ensure more guidance and support for outside inspectors, closer working between DTI staff and outside inspectors and more use of criminal lawyers in investigation work.

I have also reviewed the practice on announcing investigations. In the case of major investigations with a wider public

interest, mounted under Sections 432 and 442 of the Companies Act, that normally lead to a published report, it is clearly right to announce these when they are set up. This is existing practice as regards investigations into public companies, and I propose to extend it to such investigations into private companies. Enquiries under Section 447 are much more limited in scope and are intended only to look at the books and papers of a company and seek explanations of them. It has never been the practice to announce these and I am satisfied that this should continue to be the case. Public announcement would undermine the effectiveness of the enquiries and would unduly damage the business of the companies concerned. I would consider confirming the existence of such an enquiry only if it had already been announced by the company concerned and no further prejudicial consequence was involved in such confirmation. The same applies to enquiries under Section 105 of the Financial Services Act.

Insider Dealing investigations under Section 177 of the Financial Services Act involve independent inspectors but the reports are not published. The purpose is to ascertain whether there has been a contravention of the Company Securities (Insider Dealing) Act 1985 and in appropriate cases the investigation may lead to prosecution. I have decided that, in the main, the interests of efficiency and justice are best served by not normally announcing or confirming these investigations. However I will consider making an announcement if it is in the public interest, for example, if public

officials are thought to be involved or if there has already been publicity for an investigation and I judge that it would be less damaging to the individuals or organisations concerned and appropriate in the circumstances if I were to acknowledge the existence of an investigation.

Finally, I have reviewed the resources available within my Department for investigation and related work. Resources have been considerably increased over recent years and the results are now beginning to be seen as staff gain experience. I have concluded that a further increase in resources devoted to this work is needed in order to speed up the handling of the cases. I have also decided that to improve co-ordination, key enforcement activities of the Department should be brought together in one Division. These functions include decisions on cases where it is appropriate to undertake investigations under the powers in the Companies and Financial Services Acts; carrying out investigations under Section 447 of the Companies Act; liaison with outside inspectors; determination of appropriate action when reports are received; and the prosecution of offences for which the Department has particular responsibility, including insider dealing and other offences under the companies legislation, and insolvency offences.

MATRIX COMPARISON OF DTI INVESTIGATION POWERS PROPOSED CHANGES IN RED

APPENDIX 1

ACT	SECTION	ACTION	CAUSE	METHOD	TYPICAL TIMESCALE FOR INVESTIGATIONS	COSTS RECOVERABLE	FOLLOW-UP OPTIONS: MAY REPORT TO SELECTED RECIPIENTS	MAY PUBLISH REPORT	DECIDE TO PROSECUTE	MAY WIND UP	MAY DISQUALIFY DIRECTOR	OTHER	STATUTORY DISCLOSURE RESTRICTION WITH CRIMINAL SANCTION	SUBSIDIARY SUPPORTING POWERS/PROVISIONS: PUT QUESTIONS	SEARCH AND ENTER	STATEMENTS ON OATH	EVIDENCE MAY BE USED AGAINST	SEE DIRECTOR'S BANK ACCOUNT	OTHER	COMMENT
COMPANIES ACT 1985	431	Full inspection of Company affairs	Request by Company or Members	May appoint* outside inspectors	–	Yes	Yes ø *	Yes	Yes	Yes	Yes	S439/460 (civil proceedings or court application)	No	Yes	No	Yes	Yes	Yes	Investigate group companies	Strong public interest
	432	Full inspection of Company affairs	Public concern or Court direction (fraud/misconduct)	May appoint outside inspectors	12 months	Yes	Yes ø *	Yes	Yes	Yes	Yes	"	No	Yes	No	Yes	Yes	Yes	"	
	442	Investigate company ownership (may limit scope)	Good reason to determine who has interests in company (may be member application) MINOR CLARIFICATION	May appoint outside inspectors	12 months	No	Yes ø *	Yes, but may be "edited".	Yes	No	Yes	"	No	Yes	No	Yes	Yes	No	*	
	444	Require information on ownership shares/ debentures	)(alternative power)	DTI officers	few weeks	No	No	No	Yes	No	No	No	No	Yes	No	No	No	No	Impose share dealing restriction To SC T.D.E.D	Discrete fact finding
	446	Investigate share dealings by directors and their families	Circumstances suggesting breach of director's shareholding provisions	May appoint outside inspectors	12 months	No	Yes ø	Yes	Yes*	No	Yes	S438/460	No	Yes	No	Yes	Yes	Yes		Only 3 cases since 1967
	447	Examine records and require explanation	Good reason	DTI officers OR OTHER COMPETENT PERSONS	few weeks	No	No (except for S449 provisions)	No	Yes	Yes	Yes	May use other power (eg S5432 to appoint inspectors) + S438/460	Yes	Only concerning papers	Yes	No	Yes	No		Discrete targetted fact finding – powerful provisions for obtaining papers
FINANCIAL SERVICES ACT 1986	94	Investigate unit trust and collective investment scheme managers and operators	Good reason	May appoint outside inspectors	None yet	No	Yes	Yes	Yes	Yes	Yes	) Measures) may be) taken by S16) and SROs)	Yes	Yes	Yes	Yes	Yes	Yes ≠		
	105/5	Investigate investment businesses	ditto	DTI staff or other competent person	3–6 months	No	No	No	Yes	Yes	Yes		Yes	Yes	Yes	Yes	Yes	Yes	Yes ≠		
	177	Investigate Insider Dealing	Circumstances suggesting insider dealing	May appoint outside inspectors	3–6 months	No	No	No	Yes *	No	Yes		Yes	Yes	Yes	Yes	Yes	Yes	Yes ≠	NEW PROVISION To OBTAIN LIMITED INFORMATION	Investigate with with purpose of seeing if prosecution appropriate.
Insolvency Act 1986	218	Investigate circumstances of winding-up	Possible misconduct reported in voluntary winding-up	May appoint outside inspectors	12	Yes	Yes	No	Yes*	Yes	Yes		No	Yes	No	Yes	Yes	Yes			Must act if prosecuting authority also. SOS discretion on how.
Insurance Companies Act 1982	44	Examine records of authorised insurance company	Public concern on insurance company conduct MINOR CLARIFICATION TO WIDEN CIRCUMSTANCES	DTI staff or other officials	few weeks		No	No	Yes	Yes	No	S460	Yes	Only Concerning papers	No	No	Yes	No			Similar to S447 investigation

ø S437 + 451 apply

* Purpose of power to see if offence committed

≠ may see any related accounts

EXTEND POWERS OF To GOOD REASON INVESTIGATION (WITHOUT REPORT PUBLICATION)

CHANGE TO 'YES'

EXTEND POWERS TO OBTAIN BANK STATEMENTS (VIA SOS)

NEW PROVISIONS TO DIRECT + TERMINATE ENQUIRIES

STREAMLINE PROVISIONS PERMITTING INVESTIGATIONS TO SHARE INFORMATION

010

The Governor

Bank of England
London EC2R 8AH

29 April 1988

The Rt Hon Nigel Lawson
Chancellor of the Exchequer
HM Treasury
Parliament Street
London
SW1P 3AG

CONFIDENTIAL

Dear Nigel,

TOKYO STOCK EXCHANGE

I have seen David Young's letter to you about the appropriate negotiating stance for the Prime Minister to take in her forthcoming meeting with Mr Takeshita on the vexed subject of a seat for Barclays/BZW on the Tokyo Stock Exchange.

We discussed this last week and agreed that we should take stock after the bilateral talks between the UK team led by Geoffrey Littler and the Japanese Ministry of Finance on 21 April. As we expected, these have not changed the essentials of the situation: there is no immediate prospect of further enlargement of the Tokyo Stock Exchange; there would be no official (Ministry of Finance or Tokyo Stock Exchange) objection to the acquisition by BZW of an existing seat if one becomes available, but there is nothing they can do to facilitate the availability of such a seat, which is a commercial matter for BZW to pursue.

David Young suggests that we maintain the linkage between making progress on the BZW front and granting Nomura and Daiwa Gilt-Edged Market Maker (GEMM) status in order to maintain our overall credibility in negotiations with the Japanese on all fronts. He also suggests that with this linkage in place we could continue a

process of mutual liberalisation in other areas, including, apparently, the admission of more Japanese banks in London.

We seriously question whether it would be wise, or in the interests of the British financial community at large, to adopt such a high-profile, confrontational, stance on this particular linkage. The reality is that Nomura and Daiwa have never been especially enthusiastic about GEMM status, approaching it rather as a necessary element in their range of products as a full-service international securities operation. They are very well aware that the GEMMs collectively make persistent losses on the business and they themselves would expect to do so for some period. While, therefore, they would be inconvenienced by what David Young proposes, having already partially geared themselves up to begin operations, it would not be critical to them. Indeed, they have indicated explicitly that they will sacrifice GEMM status rather than make a commitment to help BZW find a seat which they may not be able to deliver. The position in which we could find ourselves, therefore, is that we might provide the Japanese with a relatively painless excuse for continuing to exclude BZW from the TSE and they would be likely to insist that we eventually give way first.

We equally question the realism of the proposition that we could confront the Japanese on the matter of GEMM status and, at the same time, encourage "more Japanese houses and banks in London and more British houses in Tokyo". In the latter case, we would be in the position of appearing willing to contemplate giving the Japanese the things in which they have a greater interest (in particular licences for the regional banks) while withholding the permission to which the Japanese attach a lower priority. This would not seem to us to be a particularly compelling negotiating stance.

My view is that we would do well to avoid a definitive locking of horns on <u>any</u> specific issue, but rather - as the Japanese are inclined to do - to slow down administratively the progress on outstanding issues across the board until we achieve progress on

the particular matter of most concern to us. This would involve not only holding up the GEMM operations for a time, but also dragging our feet in the other fields that have been raised by us until the BZW situation has been resolved.

I am copying this letter to David Young and those to whom his was copied.

Yours ever,

Robin

ph.126

CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

29 April 1988

Charles Powell Esq
No. 10 Downing Street
LONDON SW1

CTBJ 29/4

Dear Charles

VISIT OF MR TAKESHITA: BRIEFING ON TOKYO STOCK EXCHANGE (TSE) MEMBERSHIP

... I attach a briefing note on UK firms' access to the Tokyo Stock Exchange. This has been agreed with the Department of Trade & Industry.

I am copying this letter and enclosure to Robert Culshaw (FCO), and Stephen Ratcliffe (DTI).

Yours sincerely

J M G TAYLOR
Private Secretary

dti

the department for Enterprise

PS/FM
PS/SBH
MR MOUNTFIELD
MR WICLOTT
MR LONG
MISS MORTON
SOLS B
MR FIGGS CP
MR SMITH
FS
MISS STROKES
SOLS/B

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON SW1P 3AG

This will be covered in briefing C80 28/4.

Direct line 215 5422
Our ref DC4AMH
Your ref
Date 29 April 1988

Dear Chancellor,

TOKYO STOCK EXCHANGE

I understand that the question of a seat for Barclays/BZW on the Tokyo Stock Exchange is likely to come up at the meeting between the Prime Minister and Mr Takeshita, despite efforts by Japanese Officials to get it off the agenda. It does seem to me to be a political problem that should not be swept under the carpet, though it is not one that we should let get out of proportion.

I understand that there is some difference of view on the best tactics for carrying this forward. Where we stand at present is that when I was in Tokyo I made it clear, in private, to Mr Takeshita and other Ministers as well as to the Head of the Tokyo Stock Exchange, that, while recognising their own difficulties, progress in granting Nomura and Daiwa Gilt Edged Market Maker (GEMM) status would inevitably parallel progress on the Barclays front. This line was agreed with Geoffrey Howe. The Japanese are now telling us that while they can deliver Ministry of Finance and Tokyo Stock Exchange agreement to a private deal between Barclays and one of the Japanese houses that would give BZW a seat, they are unable to bring about the private sector part of the deal. They have also indicated that Nomura and Daiwa may not be all that interested in GEMM status, since the Gilt Edge market is over populated and unprofitable, with a potential hint that all this may make London less attractive as a centre for these companies. In other words they are seeking to call our bluff.

dti

the department for Enterprise

We have a choice. We can either stick to our guns, maintain the link between BZW and GEMM status but confine the trade-off to that and emphasize to the Japanese that we very much want to maintain warm relations and rapid progress in expanding the access of each others players to our markets. The alternative is to blur the issue, merely defer granting of GEMM status for a little while, but to extend a chill in relations on the financial services and banking front more generally across the board. The argument for the latter course is that this approach has stood us in good stead in the past and that it avoids the potential embarrassment when particular deals come unstuck. I have to say that I do not take this view. I believe that having staked out our position clearly - and the Japanese are under no illusions what the deal was - we should stick to our guns, not so much because this is necessarily the best way of achieving the outcome we want on Barclays' front, but because of our overall credibility in negotiations with the Japanese on other fronts. Moreover, I do not want to see a general chill in relations develop in the Financial Services area. It does not seem to me to be in our best interests and I think we should work hard to make sure that the Japanese understand that we do want more Japanese houses and banks here and more British houses in Tokyo. When the Prime Minister sees Mr Takeshita she should therefore continue to recall the link with GEMM and emphasise our desire for continuing mutual progress on liberalisation.

I am copying this to the Prime Minister, Geoffrey Howe, the Governor and Sir Robin Butler.

Yours sincerely

Stan Ratcliffe

(Approved by Lord Young and
signed in his absence)

the Enterprise Initiative

C15/13/011

CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

29 April 1988

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry
1-19 Victoria Street
LONDON SW1H 0ET

CDO 29/4.

TOKYO STOCK EXCHANGE

Thank you for your letter attached dated 29 April which I received yesterday evening.

I agree entirely that we must not allow the question of a seat for Barclays/BZW on the Tokyo Stock Exchange (TSE) to be swept under the carpet, nor to let it get out of proportion. It is now clearly necessary to defer Nomura and Daiwa's access to GEMM status, originally planned for next month, and the Bank has done this. I do, however, have serious reservations about the tactics you propose.

Our objectives at this stage are threefold; to obtain early progress on the specific BZW issue and in due course on TSE membership for all qualified UK applicants; to ensure that the Japanese do not form the impression that they have called our bluff; and to reduce to the minimum the damage this episode may cause to UK interests already established in Tokyo and to the benefits that the Japanese presence brings to London. I believe we can meet those objectives without establishing an indefinite link between Nomura and Daiwa's progress towards Gilt Edged Market Maker (GEMM) status and BZW's membership of the TSE. Indeed, I feel that other tactics would be more likely to help BZW and less likely to prejudice our other objectives.

First, as you acknowledge, our general approach in dealing with financial services issues with Japan in recent years has been to apply broad and flexible pressure, rather than to become tied down on a series of specific trade-offs. On the whole,

this has worked reasonably well. As you say, there are indications that neither Nomura nor Daiwa are so keen on GEMM membership that they are prepared to take on the task, which may be difficult and expensive, of finding a TSE seat for BZW. There is a risk they will simply withdraw their GEMM applications, leaving us - should we follow the tactics you suggest - without any negotiating lever for BZW and our longer-term TSE candidates, and with an implicit commitment to allow the Japanese to advance on other and more substantial fronts. I have to say also that we cannot exclude the possibility that BZW may lose interest, which would leave us in a most awkward and embarrassing position if we had established a specific link between their TSE membership and particular Japanese objectives in London.

Perhaps more significant, it is clear that the Japanese Government does not consider GEMM status a priority. It has more important objectives in London, specifically banking licences for the regional banks, led by Hokuriku. This ambition could well give us a more effective means of applying pressure.

All this points to maintaining our tried and successful strategy, and going slow on Japanese aspirations across the board, making it clear that this is a response to the Japanese failure to help over the Tokyo Stock Exchange membership problem so far. This would not involve putting up the shutters generally, but delays of uncertain duration on particular cases. I do not think that the Japanese would take this as a sign of weakness. One tactic which is well worth keeping in our armoury is to impose a delay on the first GEMM applicant, and to withhold the second indefinitely (a discrimination which might embarrass the Japanese Government). And we would, of course, continue to press the Japanese to provide whatever help they can for BZW.

I take your point that it is important not to damage relations with Japan generally in the financial services area. But this is a question of degree. I find it difficult to believe that ring-fencing BZW and the GEMMs applications could at the same time be effective as a negotiating tactic and cast no shadow on our willingness to accept new Japanese houses in other markets, whatever we said on the latter. And the Japanese Government are unlikely to be impressed if we give them what they really want and make a stand on refusing them something which they are not particularly anxious to have. It would certainly make us look very foolish indeed.

I would be happy to discuss this further. For the moment, I hope you can agree that it would be sufficient for the Prime Minister to register our concerns about BZW very firmly when

CONFIDENTIAL

she meets Takeshita next week, and to make it clear that there will implications for Japanese ambitions in London, without being drawn on precisely what those implications are. I am sure that this tactic is more likely to achieve the objectives we share.

I am sending copies of this letter to the Prime Minister, Geoffrey Howe, The Governor and Sir Robin Butler.

NIGEL LAWSON

FCS/88/087

SECRETARY OF STATE FOR TRADE & INDUSTRY

Tokyo Stock Exchange

1. I am grateful to you and to Nigel Lawson for copying your letters of 29 April to me.

2. I agree that we must not let this question get out of proportion. When Mr Howard visited Tokyo in April last year, he asked for three seats for British Securities Houses. At that time other British Houses had not shown an interest in obtaining seats. When the Tokyo Stock Exchange (TSE) announced its enlargement in December four British Houses were admitted. The two unsuccessful applicants, BZW and James Capel, were not at the time qualified under the TSE's rules, so this was not a great surprise, although we had lobbied hard for BZW to be given special treatment.

3. We have been right to put a special emphasis on finding a quick way of obtaining a seat for BZW, but we should be careful not to give the Japanese the impression that this is our only objective, and that if a seat is obtained for BZW all problems will be solved. The Japanese are prone to focus on specific requests and to

leave aside broader points of principle. Thus, while pressing for special arrangements for BZW, we should continue to emphasise that what is really needed in the medium term is a more general opening of the Tokyo Stock Market to all qualified applicants. We should note that not only BZW but also James Capel is now qualified.

4. As far as tactics are concerned I am sympathetic to the approach set out in the Chancellor's letter. We should not get ourselves too hooked on one particular linkage though as I have minuted earlier, I agree that our credibility requires that GEMM status for Nomura & Daiwa should be postponed; and we must also make sure that we do not get into a position of using leverage disproportionate to our objectives. It follows that I agree also with the Chancellor that it would be better for the Prime Minister not to make the linkage to gilt-edged market maker status explicit. I would hope, however, that she would also make the general point about the need for completely open entry in the medium term to the Tokyo Market and to financial services generally in Japan, and that she could mention James Capel as well as BZW.

5. I am copying this minute to the Prime Minister, the Chancellor, the Governor of the Bank of England and Sir Robin Butler.

(GEOFFREY HOWE)

dti

the department for Enterprise

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

Peter Barnes Esq
Private Secretary to the
Economic Secretary to the Treasury
HM Treasury
Parliament Street
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Department of
Trade and Industry

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Direct line 215 5422
Our ref
Your ref PS5AOV
Date 22 April 1988

Dear Peter

INVESTIGATION POWERS UNDER THE COMPANIES AND FINANCIAL SERVICES ACTS

Lord Young is grateful to Mr Lilley, and to other colleagues who have written, for their comments on his proposed Parliamentary announcement about investigation powers.

The main issue of substance which has been raised concerns the proposal to announce the intention to seek a new power to investigate within the UK on behalf of overseas regulatory authorities. Lord Young remains convinced that such a power is highly desirable if we are to be able successfully to tackle suspected international fraud and malpractice. Provided that the Secretary of State has a wide discretion as to how and when to use the power, he is sure that we can meet the various concerns that have been expressed. However, in view of the shortage of time before the announcement is made, he is content to accept your suggestion that we should announce at this stage only an intention to consider taking such a power. He would, however, propose to make it clear that the review concluded that this power would be desirable. Otherwise he is happy to incorporate your proposed wording. He hopes that this will also meet the concern expressed by the Prime Minister.

The draft announcement has all been amended to take acount of the other points which you and others have raised. I attach a copy of the revised version.

the Enterprise Initiative

dti

the department for Enterprise

We shall now be going ahead with working out the details of the proposed legislative changes and will be consulting the Treasury and other Departments about the aspects of concern to them.

I am copying this letter to the Private Secretaries to the Prime Minister, the Lord President, the Attorney General, the Home Secretary, the Foreign Secretary, the Lord Advocate, the Secretaries of State for Scotland, Wales and Northern Ireland, the Governor of the Bank of England and Sir Robin Butler.

Yours

Jeremy

JEREMY GODFREY
Private Secretary

DRAFT

Question : To ask the Secretary of State for Trade and Industry what his policy is on investigations under the Companies Act 1985 and the Financial Services Act 1986.

Answer : I have been reviewing the investigation powers and procedures under these Acts in the light of recent experience of operating them.

Fair and efficient markets depend on effective enforcement of the law and of self-regulatory requirements. Investigation powers have a key role to play in this. Their purpose is to discover the facts so that, if there has been misconduct, appropriate prosecution or regulatory action can be taken. The value of the existing powers is demonstrated by the results obtained. In the last 2 years, for example, following investigations under the Companies Act, criminal proceedings were brought in 28 cases involving the management of 47 commpanies and leading to penalties ranging from fines to, in one instance, imprisonment for 15 years. In addition, 61 companies were wound up in the public interest and 9 people were disqualified from acting as directors. In the relatively short time that the Financial Services Act investigation powers have been in force, two people have been convicted of insider dealing as a direct result of investigations by inspectors and legal proceedings are in train in two further cases.

This reply gives the impression that investigation is almost always followed by guilt. But an impression is most unwise and could be very damaging.

These results demonstrate the contribution which the investigation powers make to enforcement. I shall continue to use them whenever in my judgement the statutory criteria are met and circumstances make it appropriate to do so. None of the powers can be used unless there is an objective good reason. Some of the powers have higher thresholds. There is no question of the Secretary of State having the power to undertake "witch hunts", as has been suggested, even if he should wish to do so. In exercising my discretion, I will continue to apply the same broad standards as my predecessors have done. – Surely the discretion itself is within certain limits?

My Department has recently completed a review of existing investigation powers and procedures with a view to ensuring that investigations are undertaken as effectively and quickly as is compatible with a thorough and fair enquiry.

This review concluded that in general the present range of powers matched the different purposes and circumstances of investigation required in the UK, but that there was a need for more scope and flexibility in the way they could be used and for clarification of some of the provisions to improve efficiency.

Accordingly, it is intended to introduce the proposed changes to the law at the next convenient opportunity:-

(i) enabling the general powers of company investigation under Section 432 of the Companies Act also to be used in certain cases (broadly suspected fraud, misfeasance or misconduct) when the prime purpose is to consider the case for prosecution or regulatory action and there is no intention to publish a report;

(ii) strengthening various powers, including extending the existing powers to seek a search warrant for relevant books and papers and (subject to the Secretary of State's approval) to obtain information about relevant bank accounts, and tidying up the provisions on freezing share dealings;

(iii) extending the existing powers to recover the cost of investigations from persons who are convicted on a prosecution instituted as a result of an investigation;

(iv) enabling the Secretary of State to appoint outsiders to undertake enquiries under Section 447 of the Companies Act;

(v) simplifying the exchange of information between investigators; - what effect does this have on information given shortly to one dept. for one purpose only?

(vi) enabling the Secretary of State to terminate insider dealing investigations when no further purpose would be served by continuing and to terminate Companies Act inspections when it is more appropriate for further action to be handled by the Serious Fraud Office or, in Scotland, through the Lord Advocate.

The review also concluded that, because of growing international links in corporate activity, and to help improve mutual co-operation with other countries, it would be helpful if the UK could do more than at present to assist overseas regulators. We are therefore also considering whether to introduce provisions for the Secretary of State to exercise powers to assist overseas regulatory authorities in some situations in which he cannot at present, when he is satisfied there is good reason to do so. We will bring forward proposals in due course if we do decide to proceed.

Additionally, steps will be taken to ensure more guidance and support for outside inspectors, closer working between DTI staff and outside inspectors and more use of criminal lawyers in investigation work.

I have also reviewed the practice on announcing investigations. In the case of major investigations with a wider public interest, mounted under Sections 432 and 442 of the Companies Act, that normally lead to a published report, it is clearly right to announce these when they are set up. This is existing

practice as regards investigations into public companies, and I propose to extend it to such investigations into private companies. Enquiries under Section 447 are much more limited in scope and are intended only to look at the books and papers of a company and seek explanations of them. It has never been the practice to announce these and I am satisfied that this should continue to be the case. Public announcement would undermine the effectiveness of the enquiries and would unduly damage the business of the companies concerned. I would only consider confirming the existence of such an enquiry if it had already been announced by the company concerned and no further prejudicial consequence was involved in such confirmation. The same applies to enquiries under Section 105 of the Financial Services Act.

Insider Dealing investigations under Section 177 of the Financial Services Act involve independent inspectors but the reports are not published. The purpose is to ascertain whether there has been a contravention of the Company Securities (Insider Dealing) Act 1985 and in appropriate cases the investigation may lead to prosecution. I have decided that, in the main, the interests of efficiency and justice are best served by not normally announcing or confirming these investigations. However I will consider making an announcement if it is in the public interest, for example, if public officials are thought to be involved or if there has already been publicity for an investigation and I judge that it would be less damaging to the individuals or organisations concerned

i.e. new rumour?

and appropriate in the circumstances if I were to acknowledge the existence of an investigation.

Finally, I have reviewed the resources available within my Department for investigation and related work. Resources have been considerably increased over recent years and the results are now beginning to be seen as staff gain experience. I have concluded that a further increase in resources devoted to this work is needed in order to speed up the handling of the cases. I have also decided that to improve co-ordination, key enforcement activities of the Department should be brought together in one Division. These functions include decisions on cases where it is appropriate to undertake investigations under the powers in the Companies and Financial Services Acts; carrying out investigations under Section 447 of the Companies Act; liaison with outside inspectors; determination of appropriate action when reports are received; and the prosecution of offences for which the Department has particular responsibility, including insider dealing and other offences under the companies legislation, and insolvency offences.

BON POL' CROWN PTS...

SL3BAW

CONFIDENTIAL

PRIME MINISTER

INVESTIGATION POWERS UNDER THE COMPANIES AND FINANCIAL SERVICES ACTS

You remained uneasy about the arguments in the DTI letter of 20 April and enquired about the Attorney General's views.

DTI tell me that the Attorney General did see the papers at an earlier stage and was content.

As I understand it, your concern is with the proposal that the DTI should use powers on behalf of overseas regulators. There have now been further exchanges over the last 24 hours on this point:

(i) a letter of 21 April from the Governor of the Bank of England expressing the hope that the exercise of such powers would contain appropriate safeguards;

(ii) the letter of 21 April from the Economic Secretary supporting your concerns and suggesting that at this stage Lord Young should indicate he was simply 'considering whether' to introduce provisions to exercise such powers;

(iii) a further DTI letter of 22 April accepting this suggestion and attaching a revised draft written answer.

I think this may meet your concerns. Content for Lord Young now to proceed with the draft Answer attached to the 22 April letter?

RRCG.

It is not SoS's discretion in using the power that is the issue but the power itself. I am far from convinced that such a power is desirable. Please note some other comments on draft answer ref

PAUL GRAY
22 April 1988
SL3BAW

CONFIDENTIAL

Bank of England
London EC2R 8AH

The Governor

21 April 1988

The Rt Hon Lord Young of Graffham
Secretary of State for Trade & Industry
Department of Trade and Industry
1-19 Victoria Street
London
SW1H OET

Dear David,

INVESTIGATION POWERS UNDER THE COMPANIES AND FINANCIAL SERVICES ACTS

Thank you for copying to me your letter of 11 April to the Chancellor of the Exchequer, and the accompanying draft statement.

I very much welcome the general thrust of the various proposals for increasing the scope and flexibility of the investigation powers which have resulted from your review. They should be helpful in reducing the time at present spent in the whole process of instigating, conducting and following through investigations. I also welcome the proposal not normally to announce insider dealing investigations, or enquiries under Section 447 of the Companies Act or under Section 105 of the Financial Services Act. Premature announcement of such enquiries can cause unnecessary and unjustified damage to personal reputations.

I recognise the concern about extra-territoriality expressed by the Prime Minister (reported in Mr Gray's letter to your Private Secretary of 14 April) but would assume that the actual arrangements for the exercise of powers on behalf of overseas regulators will contain appropriate safeguards confining such

occasions to legitimate purposes of international co-operation and leaving an element of discretion to the UK regulators to withhold information in certain cases.

It will, of course, be important for the Bank to keep close to discussions on the detailed implementation of these and other aspects of the proposals (for instance, access to bank accounts). Depending on precisely what is decided, we shall need in due course to consider with Treasury officials the question of related changes to the comparable investigation powers under the Banking Act.

I am copying this letter to the Prime Minister, The Lord President, the Attorney General, the Chancellor of the Exchequer, the Home Secretary, the Foreign Secretary, the Lord Advocate, the Secretary of State for Scotland, the Secretary of State for Wales, the Secretary of State for Northern Ireland and Sir Robin Butler.

Yours ever,

Robin

Economic Policy Pt 9

Gower.

53/2/LPD/3764/033

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cc BG

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Lord Young
Secretary of State for Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1H 0ET

21 April 1988

Dear David

INVESTIGATION POWERS UNDER THE COMPANIES AND FINANCIAL SERVICES ACTS

file with RR

You wrote to Nigel Lawson on 11 April about your proposed Parliamentary announcement outlining your proposals for legislation on investigatory powers in the 1988-89 Companies Bill. I have also seen the letter of 14 April from the Prime Minister's Private Secretary expressing her concern about the possible extraterritorial implications and your Private Secretary's reply of 20 April.

I agree that there are good reasons for tidying up existing Companies Act and Financial Services Act investigatory powers and not normally announcing insider dealing investigations.

In strengthening these investigatory powers we need to make sure that we do not unnecessarily raise concern about threats to privacy. My officials have been in touch with yours about the confidentiality of banking information, where I hope you can agree to provisions similar to those under the Financial Services Act which make access to bank account information subject to approval by the Secretary of State. Perhaps paragraph (ii) on page 3 of your draft might be revised to say "obtain information about relevant bank accounts (subject to the Secretary of State's approval)".

One issue which does give me some concern is the proposal to announce that the Government will be legislating to give you a new power to investigate within the UK on behalf of overseas regulatory authorities. I can see that there is a case for some

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change. It would be useful to increase your ability to assist certain overseas regulators and encourage them to assist us, as long as it is clear that any such investigations within the UK are entirely at your discretion; that it would remain a DTI investigation and you are not delegating your power to an overseas regulator; and that there is therefore no question of extending extraterritorial jurisdiction within the UK.

Your Private Secretary's letter to Paul Gray seems to cover most of these points. However, I remain concerned that the policy details have not yet been discussed outside your department with the other departments with an interest, including the Treasury. Unless we have agreed the underlying policy in more detail, and can explain precisely what we intend to legislate for, we might be in danger of unnecessarily raising alarm about the threat to the confidentiality of banking and other business transactions within the UK and of arousing expectations overseas which we are at present not sure we can, or wish to, meet. We also need to establish whether this will set a precedent we wish to follow in other areas.

If you feel that it is absolutely necessary to say something at this stage I think it would be better not to express it as a definite proposal for Companies Bill legislation. You might consider something along the following lines:

> "The review also concluded that, because of growing international links in corporate activity, and to help improve mutual co-operation with other countries, it might be helpful if the UK could do more than at present to assist overseas regulators. We are therefore also considering whether to introduce provisions for the Secretary of State to exercise powers to assist overseas regulatory authorities in some situations in which he cannot at present, when he is satisfied there is good reason to do so. We will bring forward proposals in due course if we do decide to proceed."

I understand our officials have already discussed the staffing implications of the changes you propose. I see you are proposing to meet any increases in investigation and prosecution costs by reallocating your existing resources. Public expenditure implications are of course a matter for the Chief Secretary. But I know that he would be content provided all the costs arising from the changes you propose are covered in that way. I support your wish to speed up the effective investigation and prosecution of cases and hope that your proposed reorganisation will prove

successful in achieving this. My officials have already confirmed that we are content with your proposals for staff reorganisation at grades 3 and 4 on the basis that this will be reviewed in a year's time.

I am copying this letter to the recipients of yours.

Yours ever

Peter

PETER LILLEY

dti

the department for Enterprise

cc BG

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

The Lord Advocate
Lord Advocate's Chambers
Fielden House
10 Great College Street
LONDON
SW1P 3SL

NBAM
PRCG
22/4

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5422
Our ref PS3AOI
Your ref
Date 21 April 1988

Dear Lord Advocate,

INVESTIGATION POWERS UNDER THE COMPANIES AND FINANCIAL SERVICES ACTS

Thank you for your letter of 14 April drawing attention to the arrangements in Scotland for investigation of serious and complex fraud. I shall ensure that the helpful point you have made is reflected in the announcement of the proposals.

I am copying this letter to all those to whom you sent yours.

Yours

the Enterprise initiative

ECONPOL: Gomez PTS

dti

the department for Enterprise

cc BG

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

Prime Minister
Does this meet your concern?

PRCG
20/4

CONFIDENTIAL
Paul Gray Esq
Private Secretary to the
Prime Minister
No 10 Downing Street
LONDON SW1A 2AA

Department of Trade and Industry
1-19 Victoria Street
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Direct line 215 5422
Our ref DC2ALI
Your ref
Date 20 April 1988

I remain very uneasy about this.
May I see the A-G's views?

Dear Paul,

INVESTIGATION POWERS UNDER THE COMPANIES AND FINANCIAL SERVICES ACTS

Thank you for your letter of 14 April recording the Prime Minister's concern about the extraterritorial aspects of the proposed extension of powers to assist overseas regulators.

The extraterritorial issue was very much in my Secretary of State's mind when he decided that it would be right to seek these powers. The continual internationalisation of the investment business is resulting in a rapidly growing number of complex transactions crossing national frontiers, in some cases as a device for escaping the effective control of national regulators. The first response to this has been to strengthen cooperation between regulators on a reciprocal basis, notably by agreements covering the exchange of information. We ourselves already have bilateral Memoranda of Understanding with US and Japanese authorities and are in the course of extending these to other countries, such as France, Australia and Canada.

Under these arrangements we undertake, on a best endeavours basis, to provide information either already in the hands of UK regulators or which we can obtain voluntarily from other sources. We cannot, however, undertake to use our powers to investigate unless there are domestic reasons for doing so. This has not been a major constraint so far - in those cases which have arisen, there has generally been a related UK concern - but it is a problem that will crystallise in the not too distant future.

This seems reasonable. But it does go beyond the proposals

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The fact is that, in order to unravel a financial mischief, the regulator concerned will generally need to trace its ramifications in all the countries to which it has extended. Depending upon the extent to which those regulators seek to use their powers, for example by attemping to assert compulsory powers in the UK or by asserting their jurisdiction in respect of acts committed in the UK, the jurisdictional problem already exists. The present agreements covering the exchange of information obtained either voluntarily or as a result of domestic investigations are the first step. The ability to use powers on behalf of overseas regulators is a second step, which will make it much easier to control attempts by overseas regulators to secure such information on UK territory. (Indeed, in the US case, the new power would help US regulators in their existing efforts to deflect domestic US pressure to use their sub poena powers extraterritorially). In a case where we do want to help an overseas regulator to track down an offence it is preferable, in extraterritoriality terms, to deny that regulator the right to claim, and purport to exercise, jurisdiction in the UK on the basis that, at our decision, we may choose to use our powers to provide him with the information he is seeking. This structure on the regulatory side is very much parallel to the arrangements being set in place more generally under the proposed Mutual Legal Assistance Treaties covering criminal matters.

Providing such assistance to an overseas regulator does not of itself raise problems of extraterritoriality. The Secretary of State, exercising in the UK powers vested in him by Parliament, would of course not be acting extraterritorially. There is, however, the possibility that overseas regulators, having been passed information obtained by him in the course of investigations conducted on their behalf, may seek subsequently to use that information in furtherance of extraterritorial proceedings. Our view is that the proposed power should give total discretion to the Secretary of State as to whether to exercise it in response to a particular request and, if an investigation has been undertaken, whether to pass on information obtained during the investigation.

We also envisage that our current bilateral arrangements, modified to take account of the new power, would retain the existing provisions restricting the use to which information can be put, and also provide a safety valve for overseas regulators' extraterritorial ambitions by allowing for problems arising from disputed jurisdiction to be resolved by consultation. Similar conditions could be attached to

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requests from other regulators made on an ad hoc basis or under new agreements.

The consultation procedure in the bilateral arrangements is particularly important; because of the transnational nature of much investment business, jurisdiction in the financial services sector may not always be clear-cut. It is worth bearing in mind that our own legislation contains potentially extraterritorial provisions: for example Section 47 of the Financial Services Act makes it a criminal offence to make a false or deliberately misleading statement etc inducing others to trade in investments if the false or misleading impression is created in the United Kingdom, wherever the statement is made.

The proposed move towards taking powers to assist overseas regulators is the general direction in which regulators are moving in order to combine mutual effectiveness with mutual respect of jurisdiction. The French already have such powers, the Australians are taking them. The US and Canadian authorities have recently signed an agreement which commits them to seeking such powers within 12 months. In due course a network of bilateral agreements will develop of which the UK, given the international nature of its securities markets, needs to be a part. It is our contention that reciprocity will be one of the factors to be taken into account by the Secretary of State in deciding whether or not to exercise the new power in any particular case.

The fine details of the proposed power will, of course, be the subject of interdepartmental consultation in the usual way. I hope that the above will however be sufficient to reassure the Prime Minister that the power may help to constrain, rather than abet, extraterritorial action by overseas regulators, and that she will be able to agree that my Secretary of State may make a general reference to the proposed power in the announcement proposed in his letter of 11 April.

I am copying this letter to recipients of yours and to Alex Allan at the Treasury.

Yours sincerely

Stephen Ratcliffe

STEPHEN RATCLIFFE
Private Secretary

the Enterprise initiative

Econ Pol: Gower Pt

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cc BG

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1H OET

NBAM
ARG
19 April 1988

Dear David,

INVESTIGATION POWERS UNDER THE COMPANIES AND FINANCIAL SERVICES ACTS

Hep

Thank you for sending me a copy of your letter of 11 April to Nigel Lawson on this subject.

I am content for my interests with the terms of the draft Written Answer announcing the outcome of your review of the investigation powers under the above Acts.

A copy of this letter goes to the Prime Minister, the Chancellor of the Exchequer, the Lord President, the Attorney General, the Home Secretary, the Foreign Secretary, the Lord Advocate, the Secretary of State for Wales, the Secretary of State for Northern Ireland, the Governor of the Bank of England and Sir Robin Butler.

Yours ever,

MALCOLM RIFKIND

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ITP106F1

ECON PAC: Gowa Pr 5.

CC PS

PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

15 April 1988

NBPM
PRCo
814

Dear Stephen,

INVESTIGATION POWERS UNDER THE COMPANIES AND FINANCIAL SERVICES ACT

The Lord President has seen a copy of your Secretary of State's letter of 14 April to the Chancellor of the Exchequer.

The Lord President is entirely content with the substance of your Secretary of State's proposed announcement. However, he has asked me to say that he thinks it would be preferable to replace the reference (at the top of page 3 of the draft statement) to "the next Companies Bill" with something more generalised such as that it is intended to introduce the proposed changes to the law at the next convenient legislative opportunity. The Lord President believes that a direct reference to the "next Companies Bill" could prompt unhelpful questions about when that particular measure was likely to be forthcoming.

The Lord President understands that the provisions on investigation powers mentioned in the proposed announcement are now thought likely to comprise some 10-15 clauses compared with the estimate of 5-10 clauses given to QL. While the Lord President appreciates the difficulties of making accurate estimates in advance of the provisions being drafted, he has noted that it is already clear that the Bill will be exceptionally long and he has asked me to say that there would be real problems if the Bill were to grow significantly beyond the estimate given to QL and the Cabinet of 160 clauses.

I am copying this letter to the Private Secrertaries of those to whom your Secretary of State's letter was copied.

Yours,
Alison

ALISON SMITH
Private Secretary

Stephen Ratcliffe Esq
PS/ Secretary of State for Trade & Industry
Department of Trade and Industry
Victoria Street
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NJBM
RHC
11/4

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry
Department of Trade and Industry
1 Victoria Street
LONDON SW1H OET

14 April 1988

Dear David

INVESTIGATION POWERS UNDER THE COMPANIES AND FINANCIAL SERVICES ACTS

Thank you for copying to me your letter of 11 April to Nigel Lawson.

I note the proposals you are hoping to implement and for my interest am happy to support them. The only comment I would make in relation to the draft is in connection with point (vi). You will appreciate that the Serious Fraud Office has no jurisdiction in Scotland, nor does it have a direct equivalent in Scotland. However, there is, under my direction in Crown Office, a Serious Fraud Unit which is intended to provide an equivalent degree of expertise and concentration of effort in the investigation of serious and complex fraud. Accordingly I suggest that the Scottish position should be recognised in your explanation of that proposal. The most appropriate way of dealing with this would be to refer to the role of the Lord Advocate in dealing with such cases in Scotland.

I am copying this letter to the Prime Minister, the Lord President, the Attorney General, the Chancellor of the Exchequer, the Home Secretary, the Foreign Secretary, the Secretary of State for Scotland, the Secretary of State for Wales, the Secretary of State for Northern Ireland, the Governor of the Bank of England and Sir Robin Butler.

Yours ever

Kenny

CAMERON OF LOCHBROOM

ECON POL: Gomez pts.

CONFIDENTIAL

File

cc: BG

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

14 April 1988

Dear Stephen,

INVESTIGATION POWERS UNDER THE COMPANIES AND FINANCIAL SERVICES ACTS

The Prime Minister has seen your Secretary of State's letter of 11 April to the Chancellor of the Exchequer and the proposed announcement on 25 April.

The Prime Minister has noted the proposal to widen the powers of investigation so that they could be exercised on behalf of the overseas regulators when there is good reason to do so. She is concerned that this would be a major extension of powers, which would raise the issue of extra-territoriality. She would be grateful if your Secretary of State would reconsider this aspect of the proposals.

I am copying this letter to the Private Secretaries to the Lord President, the Attorney General, the Home Secretary, the Foreign Secretary, the Lord Advocate, the Secretary of State for Scotland, the Secretary of State for Wales, the Secretary of State for Northern Ireland, the Governor of the Bank of England and Sir Robin Butler.

Yours,
Paul

Paul Gray

Stephen Ratcliffe, Esq.,
Department of Trade and Industry.

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the department for Enterprise

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The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
LONDON
SW1P 3AG

Prime Minister
Content to note the proposed announcement and provisions for the Companies Bill.
RRCG
via

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5422
Our ref PS3ANE
Your ref
Date 11 April 1988

Dear Nigel,

INVESTIGATION POWERS UNDER THE COMPANIES AND FINANCIAL SERVICES ACTS

In the light of recent experience of a large number of high profile investigations under both the Companies Act 1985 and the Financial Services Act 1986, I have been reviewing the investigation powers under these Acts, the Department's procedure in using them, our policy on announcing investigations and the resources needed. I have in mind, in particular, that the forthcoming Companies Bill will give us the opportunity to make any necessary changes to the law - investigation powers is one of the subjects which QL agreed should be included.

The review has now been completed, although some details have yet to be settled. There has recently been a great deal of publicity about investigations, much of it ill-informed. I should like to take an early opportunity to put the record straight. In announcing the outcome of the review, I propose therefore to make a more wide ranging statement in the form of a written answer in both Houses and supplemented by a speech. I attach a proposed draft for the Written Answer.

As to the review, the broad thrust was that, although it seemed right to continue with a series of powers having much the present mix, a number of changes should be made to increase their scope and flexibility. It was also concluded that the effectiveness of these powers could be improved by some fine tuning to the provisions which cover the ability to obtain and use information. In conjunction with these changes we also concluded that it would be right to widen the powers so that they could be exercised on behalf of overseas ?

I do NOT like this. It seems a great extension of powers - extra-territoriality?

the Enterprise initiative

dti

the department for Enterprise

regulators when there is good reason to do so. The main components of the changes which will be needed in legislation in order to give effect to these conclusions, are set out in the draft statement. Where appropriate, officials will be consulting on the detail but I hope that colleagues are content for us to include in the statement the broad indication, given in the draft, of the direction in which we are moving.

On announcements, the only significant change is that I propose in future not normally to announce insider dealing investigations unless, in a particular case, an announcement would be in the public interest. Major Companies Act investigations will continue to be announced, but not enquiries under Section 447 of that Act or Section 105 of the Financial Services Act.

As you know, we have over the last few years already increased considerably the resources devoted to investigations and prosecutions. I have nevertheless concluded that a further small increase is needed, partly in the light of the unexpectedly high number of insider dealing investigations and partly to enable us to speed up the investigatory process by avoiding the delays caused by the overloading of existing staff. I can find the necessary resources by re-allocating my existing staff provision, primarily within the regulatory field. I also want to improve co-ordination by bringing together work on Companies Act and insider dealing investigations and on prosecutions into a new Division. My officials are in touch with yours about the new Grade 4 post involved and I hope that agreement can be reached on that quickly.

I should like to announce the outcome of the review on 25 April to enable me to refer to it in my speech that day to the Goldman Sachs International Investment Banking Conference. I should therefore be grateful for any comments on the draft Answer by Wednesday, 20 April.

I am copying this letter to the Prime Minister, the Lord President, the Attorney General, the Home Secretary, the Foreign Secretary, the Lord Advocate, the Secretary of State for Scotland, the Secretary of State for Wales, the Secretary of State for Northern Ireland, the Governor of the Bank of England and Sir Robin Butler.

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DRAFT

Question : To ask the Secretary of State for Trade and Industry what his policy is on investigations under the Companies Act 1985 and the Financial Services Act 1986.

Answer : I have been reviewing the investigation powers and procedures under these Acts in the light of recent experience of operating them.

Fair and efficient markets depend on effective enforcement of the law and of self-regulatory requirements. Investigation powers have a key role to play in this. Their purpose is to discover the facts so that, if there has been misconduct, appropriate prosecution or regulatory action can be taken. The value of the existing powers is demonstrated by the results obtained. In the last 2 years, for example, following investigations under the Companies Act, criminal proceedings were brought in 28 cases involving the management of 47 commpanies and leading to penalties ranging from fines to, in one instance, imprisonment for 15 years. In addition, 61 companies were wound up in the public interest and 9 people were disqualified from acting as directors. In the relatively short time that the Financial Services Act investigation powers have been in force, two people have been convicted of insider dealing as a direct result of investigations by inspectors and legal proceedings are in train in two further cases.

These results demonstrate the contribution which the investigation powers make to enforcement. I shall continue to use them whenever in my judgement the statutory criteria are met and circumstances make it appropriate to do so. Nóne of the powers can be used unless there is an objective good reason. Some of the powers have higher thresholds. There is no question of the Secretary of State having the power to undertake "witch hunts", as has been suggested, even if he should wish to do so. In exercising my discretion, I will continue to apply the same broad standards as my predecessors have done.

My Department has recently completed a review of existing investigation powers and procedures with a view to ensuring that investigations are undertaken as effectively and quickly as is compatible with a thorough and fair enquiry.

This review concluded that in general the present range of powers matched the different purposes and circumstances of investigation required in the UK, but that there was a need for more scope and flexibility in the way they could be used and for clarification of some of the provisions to improve efficiency. It also concluded that in order to reflect the growing international links in corporate activity, and to improve mutual co-operation with other countries, appropriate powers should be exercisable on behalf of overseas regulators.

Accordingly, in the next Companies Bill it is proposed to introduce appropriate changes in the law:-

(i) enabling the general powers of company investigation under Section 432 of the Companies Act also to be used in certain cases (broadly suspected fraud, misfeasance or misconduct) when the prime purpose is to consider the case for prosecution or regulatory action and there is no intention to publish a report;

(ii) strengthening various powers, including extending the existing powers to seek a search warrant for relevant books and papers and obtain information about relevant bank accounts, and tidying up the provisions on freezing share dealings;

(iii) extending the existing powers to recover the cost of investigations from persons who are convicted on a prosecution instituted as a result of an investigation;

(iv) enabling the Secretary of State to appoint outsiders to undertake enquiries under Section 447 of the Companies Act;

(v) simplifying the exchange of information between inspectors and investigators;

(vi) enabling the Secretary of State to terminate insider dealing investigations when no further purpose would be served by continuing and to terminate Companies Act inspections when it is more appropriate for the Serious Fraud Office to handle further action;

(vii) introducing provisions for the Secretary of State to exercise powers on behalf of overseas regulatory authorities when he is satisfied there is good reason to do so.

Additionally, steps will be taken to ensure more guidance and support for outside inspectors, closer working between DTI staff and outside inspectors and more use of criminal lawyers in investigation work.

I have also reviewed the practice on announcing investigations. In the case of major investigations with a wider public interest, mounted under Sections 432 and 442 of the Companies Act, that normally lead to a published report, it is clearly right to announce these when they are set up. This is existing practice as regards investigations into public companies, and I propose to extend it to such investigations into private companies. Enquiries under Section 447 are much more limited in scope and are intended only to look at the books and papers of a company and seek explanations of them. It has never been the practice to announce these and I am satisfied that this should continue to be the case. Public announcement would undermine the

effectiveness of the enquiries and would unduly damage the business of the companies concerned. The same applies to enquiries under Section 105 of the Financial Services Act.

Insider Dealing investigations under Section 177 of the Financial Services Act involve independent inspectors but the reports are not published. The purpose is to ascertain whether there has been a contravention of the Company Securities (Insider Dealing) Act 1985 and in appropriate cases the investigation may lead to prosecution. I have decided that, in the main, the interests of efficiency and justice are best served by not normally announcing or confirming these investigations. However I will consider making an announcement if it is in the public interest, for example, if public officials are thought to be involved or if there has already been publicity for an investigation and I judge that it would be less damaging to the individuals or organisations concerned and appropriate in the circumstances if I were to acknowledge the existence of an investigation.

Finally, I have reviewed the resources available within my Department for investigation and related work. Resources have been considerably increased over recent years and the results are now beginning to be seen as staff gain experience. I have concluded that a further increase in resources devoted to this work is needed in order to speed up the handling of the cases. I have also decided that to improve co-ordination, key enforcement activities of the Department should be brought

together in one Division. These functions include decisions on cases where it is appropriate to undertake investigations under the powers in the Companies and Financial Services Acts; carrying out investigations under Section 447 of the Companies Act; liaison with outside inspectors; determination of appropriate action when reports are received; and the prosecution of offences for which the Department has particular responsibility, including insider dealing and other offences under the companies legislation, and insolvency offences.

CONFIDENTIAL

cc B/G

NORTHERN IRELAND OFFICE
WHITEHALL
LONDON SW1A 2AZ

SECRETARY OF STATE
FOR
NORTHERN IRELAND

The Rt Hon Sir Patrick Mayhew QC MP
Attorney General
Royal Courts of Justice
LONDON
WC2A 2LL

13 November 1987

NBAT

Dear Patrick

SERIOUS FRAUD OFFICE: RECRUITMENT OF LAWYERS

Thank you for copying to me your letter of 1 October to David Young about the recruitment of lawyers for the Serious Fraud Office. I have also seen and read with interest the subsequent correspondence on this matter.

I should perhaps start by recalling that an Assistant Director of the Director of Public Prosecutions (NI) has already been accepted for a post in the Serious Fraud Office. Generally speaking in Northern Ireland, the only source of prosecuting lawyers would be from within the Office of the DPP(NI); these lawyers are members of the Northern Ireland Civil Service and while it is not normal practice to include NICS members in trawls issued by the UK Civil Service Commission, it is, however, open to any NICS lawyer to apply, if they wish to do so, in any subsequent open competition.

I shall of course be looking for similar legal skills in connection with my proposals for an Anti-Rackets Unit for Northern Ireland.

Copies of this letter go to the Prime Minister, Douglas Hurd, David Young and Richard Luce.

Yours ever

TOM KING

CONFIDENTIAL

SMN829

ECON POL: GOMEN PTS

QUEEN ANNE'S GATE
LONDON SW1H 9AT

3 November 1987

Dear David,

SERIOUS FRAUD OFFICE: RECRUITMENT OF LAWYERS

I was disheartened to learn from Patrick Mayhew's letter of 1 October that the Serious Fraud Office is experiencing such difficulty in recruiting experienced prosecuting lawyers from within the Government Legal Service.

We won a good deal of credit for bringing to the statute book before the election the fraud provisions of the Criminal Justice Bill, including those which enable the establishment of the Serious Fraud Office. You will know better than I how damaging it will be if we cannot have a properly staffed office in place in good time, and I very much hope that - acknowledging the recruitment difficulties to which Patrick refers - colleagues will be able to respond constructively to his letter.

Yours,
Douglas.

The Rt Hon The Young of Graffham

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ROYAL COURTS OF JUSTICE
LONDON, WC2A 2LL

nbpn

01 936 6602

The Rt Hon Lord Young of Graffham
Department of Trade & Industry
1 Victoria Street
London SW1

29 October 1987

Dear David:

SERIOUS FRAUD OFFICE
RECRUITMENT OF LAWYERS

Thank you for your letter of 13th October responding to mine of the 1st October. I have also seen a copy of a letter, dated 20th October, from your Principal Establishment and Finance Officer to the First Civil Service Commissioner.

I am grateful to you for your support on the question of lawyers' pay, which is clearly one of the root causes of serious problems within the Government Legal Service at present.

I have carefully noted your comments about the competition for staffing the Serious Fraud Office. In fact, a Competition Notice, inviting applications from in-Service lawyers and accountants for posts in the Serious Fraud Office on promotion or on level transfer, was promulgated by the Civil Service Commission on 9th October. Regrettably I find that there was a delay in the arrival of copies at some departments, including your own.

Although there was a proposal to proceed immediately with an open competition, I believe that in the light of long standing accords with the staff the course we are taking is the right one. You will have seen a copy of the letter, sent to me on 26th October by John Major, outlining the Treasury's support in furtherance of the Government's commitment to the establishment of an effective Serious Fraud Office. I do hope that you, also, will feel able to countenance the release from your Department of a limited number of lawyers who might successfully seek level transfers, given that other hard-pressed departments have agreed to do so. Otherwise the effect will be, I fear, to place a disproportionate burden on those other departments.

I am sending copies of this letter to the Prime Minister, Douglas Hurd, Tom King, John Major and Richard Luce.

Yours ever,

Patrick

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Confer

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CC AG

ATTORNEY GENERAL

ROYAL COURTS OF JUSTICE
LONDON. WC2A 2LL

nbpm

01 936 6602

The Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
London
SW1P 3AG

29 October 1987

Dear John,

SERIOUS FRAUD OFFICE: RECRUITMENT OF LAWYERS

Thank you for your letter of 26th October.

I am extremely grateful to you for your assurances about the release of prosecution lawyers from the Customs and Excise, and your helpful remarks about Revenue lawyers. I am very conscious of the strains the staffing of the SFO might impose on legal departments, and I am anxious that no department should have to suffer a disproportionate loss of valuable legal staff. The numbers you mention in relation to level transfer from Customs and Excise are very much in line with what I had hoped would be achieved.

I am copying this letter to the Prime Minister, Douglas Hurd, David Young, Tom King and Richard Luce.

Yours ever,

Kenneth

ECON POL

GOWER

PT 5

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CCBC

nbpm

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Sir Patrick Mayhew, QC, MP
Attorney General
Royal Courts of Justice
Strand
London
WC2A 2LL

26 October 1987

Dear Patrick,

SERIOUS FRAUD OFFICE: RECRUITMENT OF LAWYERS

Thank you for copying to me your letter of 1 October to David Young about the recruitment of lawyers for the Serious Fraud Office. I have also seen David Young's reply of 13 October.

The importance we attach to the SFO was, of course, reflected in its prominence in the Manifesto. City and other big business fraud is likely to be a controversial subject for some time to come - witness the current publicity about the Guinness and Lloyd's cases - and we need to get the SFO operating effectively next year. Given that we must do what we can to make the SFO a success, I agree that we must be prepared to release staff as necessary, whether lawyers or accountants, from elsewhere within the Civil Service.

I recognise, of course, that this priority must be balanced against others. There is also the difficulty that only a minority of lawyers have the most appropriate background - i.e. in criminal investigation and prosecution - and some departments have few if any of these. However, if the SFO is to be a success we must all be prepared to be flexible about the provision of staff both on level transfer and promotion. Therefore, in respect of the departments for which we are directly responsible and which employ lawyers - i.e. Customs and Excise and Inland Revenue - Nigel Lawson and I are prepared not only to see lawyers transferred on promotion to grades 5 or 6 but also to countenance level transfers.

In practice, Customs and Excise lawyers may prove to be more suitable than Inland Revenue ones, given that a large proportion of Customs' lawyers are involved in prosecutions

whereas the Revenue do not have prosecution lawyers as such. Customs would be willing to consider releasing up to two grade 5s and two grade 6s on level transfer should applicants come forward. But where any Revenue lawyers show an interest the Inland Revenue would look very carefully at each case on its merits. I should add that both departments would also be prepared to consider providing staff on secondment, for example where the SFO was handling a major fraud with particularly serious tax aspects.

In his letter to you of 13 October, David Young linked the current question of staffing the SFO to the level of government lawyers' pay generally. However, the question of lawyers' pay is, as David says, being addressed by an interdepartmental group chaired by the Treasury. We should not delay any longer taking the steps discussed above.

I am copying this letter to the Prime Minister, Douglas Hurd, David Young, Tom King and Richard Luce.

Yours Ever,
John

JOHN MAJOR

ECON POL Gowers PCS.

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

Secretary of State for Trade and Industry

CC BC

nbpm

13 October 1987

The Rt Hon Sir Patrick Mayhew QC MP
Attorney General
Royal Courts of Justice
London WC2A 2LL

Dear Patrick,

SERIOUS FRAUD OFFICE

Thank you for your letter of ~~1~~ 8 October about the staffing of the Serious Fraud Office. I agree that this is a very important matter.

I have been informed of the proposal to have a competition limited to civil servants for a number of senior posts in the SFO. My understanding is that these posts are to be open to people of different disciplines: not only lawyers but also accountants and other people with relevant backgrounds. As far as the accountants and other skills are concerned, I would be ready, recognising the urgent need to staff the office, to see people from this Department, if successful, going on promotion or, to a reasonable extent, on level transfer.

As regards lawyers, however, I have been concerned to hear what is proposed and I do question whether we are on the right track. As the ministerial correspondence earlier in the year showed, there is a serious shortage of lawyers in all parts of the Government legal service. Paul Channon minuted on 15 May last in strong terms on his concern about retention of experienced lawyers in this Department and the drain of experience which has occurred over the last year or so. I more than share his concern.

My understanding is that the First Civil Service Commissioner has in effect, said that, at present rates of pay, the Commission is nowhere near recruiting the numbers of staff needed for the Government legal service; and this is before we contemplate the additional numbers needed for the Serious Fraud Office. I also understand that some weeks ago it had been agreed

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interdepartmentally between officials that there was no point in having a purely internal trawl for lawyers for the Serious Fraud Office. To do so would simply move the available people around, robbing Peter to pay Paul; and in any case a number of Departments had indicated that they were not prepared to release staff on level transfer when they could not adequately staff the work for which they were responsible. The right course was then thought to be an early open competition, at rates of pay which would enable us to attract and hold the staff we need both for the Serious Fraud Office and for the Government legal service generally.

I firmly believe that this is the right course. I understand that the Treasury have already been discussing with Departments the question of lawyers' pay. I consider we should ask for urgent recommendations from officials on this, with a view to going straight to a very early open competition from which the Serious Fraud Office and Departments can draw. It is time that we took action on this problem.

It is not as if lawyers pay, a specialist grade within the Service, can have any effect on the flexibility of Civil Service pay. What is at state is the credibility of the Government in all areas of civil fraud and what is <u>not</u> at risk is the Governments pay policy.

I am sending copies of this letter to the Prime Minister, Douglas Hurd, Tom King, John Major and Richard Luce.

LORD YOUNG OF GRAFFHAM

JG1BMS

ECON POL: Gowen PTS

APPOINTMENTS IN CONFIDENCE

Bank of England

The Governor

London EC2R 8AH

Prime Minister 2
The Treasury slipped me a copy of this.
Parkyn not DLW 8/10.

2 October 1987

The Rt Hon Lord Young of Graffham
Secretary of State for Trade & Industry
Depart of Trade & Industry
1-19 Victoria Street
London
SW1H OET

Dear David,

Thank you for your letter of 29 September, updating me on he meeting which you had with Kenneth Berrill in the middle of last week.

I certainly agree that we should not do anything to endanger the April deadline for implementation of the new system. But at the same time, whatever system is introduced then needs to be acceptable - at least in broad terms - to those who will be regulated under it, and more particularly to those in the SROs who will be putting self-regulation into practice.

In recent weeks, I have seen growing evidence of dissatisfaction with the SIB; the few complaints which have reached the press (for example, Andrew Large's article in the Financial Times on 29 September) represent only the tip of the iceberg. A recurring theme in the criticisms, and particularly in those made privately to me, is that while there is recognition of the enormous scale of what had to be done and of what has been achieved, the task has been made quite needlessly difficult, and the result is far short of what it ought to have been, because of the particular way in

which Kenneth Berrill has chosen to interpret and carry out his task. It was thus with some surprise that I learnt that you had told Berrill that you placed so much importance on his continuation in office until after the 1 April deadline. In my judgment, we may not be able to meet the growing tide of criticism without a speedy announcement of Berrill's successor, an announcement which under the Financial Services Act is the joint responsibility of the two of us.

This of course raises the question of the type of person who should succeed Berrill. I do not know with whom your soundings have been made but my own, from a variety of influential figures in the City, do not square with your conclusion that it is essential for the candidate to be a practitioner, although many undoubtedly feel that this would be a desirable characteristic. Instead, I am told that what is most important is that the new Chairman should listen to advice from practitioners, and should set out the SIB's views in a coherent and persuasive fashion. On this basis, I would see an enhanced role for the practitioners on the Board, who would be able to pass on their expertise to someone who would be prepared to listen to them and act on their views.

I also consider it important that we choose a candidate with the administrative skills necessary for the tasks which fall to the Chairman of the SIB. Many leading practitioners of the first rank are used to taking a firm lead on their own initiative; indeed, this is precisely what makes them such successful businessmen. But our appointee will find his freedom of action circumscribed by the Financial Services Act. What is therefore needed is an individual who understands the nuances of how regulation works in practice, rather than someone who - once asked to operate within a legal framework with which he is unfamiliar - spends his time asking his in-house lawyers for advice. At the same time, the individual concerned will need to have imagination and the ability to take decisions rapidly, and these qualities would come more quickly into play if the new Chairman was already familiar with the subject of regulation. If the candidate had this type of background, were known and respected in the City, and

had a good knowledge of the workings of all types of investment business, I am sure that the appointment would be generally welcomed, whether or not the individual had been a practitioner.

I also think that we should take an early opportunity to rethink the structure and scale of the SIB board. As you may know, I have long felt that it is much too big and all that I hear (including from board members themselves) confirms me in that view. The particular balance that has been struck gives a good deal of weight to lay participation, and I understand why this has been seen as important. But we do, I believe, need to look afresh at the scale and composition of the board in the light of the large job that needs to be done.

I look forward to discussing these matters at more length when we meet next week.

Yours ever,

Robin

nbpm CCB/G

ROYAL COURTS OF JUSTICE
LONDON, WC2A 2LL

01 936 6602

The Rt Hon Lord Young of Graffham
Department of Trade & Industry
1 Victoria Street
London SW1

1 October 1987

Dear David :

SERIOUS FRAUD OFFICE: RECRUITMENT OF LAWYERS

I am writing about the importance I attach to the successful recruitment of lawyers from within the Government Legal Service to the new Serious Fraud Office.

Your predecessor, and colleagues to whom I am copying this letter, have been good enough to take a close and constructive interest in the setting up of the Serious Fraud Office. The Office was created on the advice of the then Chief Secretary's ministerial group, by the Criminal Justice Act 1987. It was clear to me that colleagues set high store by the effectiveness of the SFO as an integral part of our strategy to maintain and increase confidence in the City. It was also clear to me, from the opening Commons Committee Stages of the Criminal Justice Bill which I attended, and from the Official Report of subsequent proceedings, that Parliament expects the Office to be well resourced and to attract high quality staff. I am therefore particularly grateful to my Treasury colleagues for the assistance which has been given in establishing the structure and complement of the SFO.

But there is of course a difference between providing for an adequate number of properly graded posts, and recruiting good people to fill them. A competition notice (limited to Civil Servants) will be issued shortly by the Civil Service Commission, inviting applications for, inter alia, the senior legal posts in the SFO (some 24 in all, at Grades 5 and 6). The posts are open to candidates on promotion or level transfer.

It is, in my view, vital that all Departments who have suitable staff should give SFO recruitment a fair wind. Resources in the Government Legal Service are sorely stretched; no-one is more aware of this than I, in my superintending capacity over the Crown Prosecution Service. But I take the view that, if all those Departments with experienced prosecuting lawyers are prepared to release a very modest number of candidates successful in the limited competition, no single Department will suffer unduly, and the SFO will gain a mix of valuable experience and skills wholly appropriate to its ethos.

I recognise that this in itself may not result in the filling of all legal posts from within the Service, and plans are in hand for an open competition to recruit lawyers from outside. But we must not depend too heavily on this; we know that too few candidates of high quality are presently attracted to the Government Legal Service. This is a matter of serious concern to me, and lies at the heart of our recruitment difficulties. We must, however, go flat out to set the SFO up on the right footing within the constraints we all face. I need hardly add that there would be strong Union resistance to direct recruitment from outside, without SFO opportunities first being made available to lawyers within the Service. The effect of such a resistance would further damage morale within the

Government Legal Service as a whole.

May I therefore ask you, and those copy recipients with prosecuting lawyers in their Departments, to advise me of your policy in relation to the release of lawyers to the SFO who are successful in the open competition either on promotion or on level transfer? I should say at once that I attach particular importance to level transfers, and I would hope that even if the majority of transfers are on promotion, your Department will keep, at least, an open mind on permitting level transfers. The Crown Prosecution Service, which as you know is seriously short of staff, has already given a lead by making a substantial contribution to the SFO. No less than 8 senior legal staff have either already been transferred or have been promised, and all these moves have been on a level transfer basis. These senior and experienced staff the Director could ill-afford to lose, and he now, understandably, is reluctant to release any further staff on level transfer. However, without level transfer from your Department and from other Departments with prosecuting lawyers, the SFO may have to fill a majority of its posts with staff who have been promoted. This is unlikely to yield the quality of legal work essential to the SFO's success.

More generally, a scenario in which the Office cannot start up effectively for lack of staff will surely strike us all as unacceptable.

I am copying this letter to the Prime Minister, Douglas Hurd, Tom King, John Major and Richard Luce.

Yours,

Patrick

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215)
GTN 215) 4417
(Switchboard) 01-215 7877

From the Parliamentary Under Secretary of State
for Corporate and Consumer Affairs

The Hon Francis Maude MP

R27/8

26 August 1987

Dear Prime Minister, 2.

I have today announced the timetable for the implementation of the Financial Services Act. I am concerned that there are still businesses concerned with investment who are unprepared for the Act, and I am writing to seek your help in ensuring that businesses in your constituency are aware of the Act's provisions and of the need for them to take the appropriate action now.

The number of investors has increased dramatically in recent years. About three times as many people own shares today as in 1979. And millions more invest indirectly in unit trusts and life insurance and will soon have the opportunity to do so through personal pension schemes. This Act brings in a tough regime of protection for them.

From the beginning of April next year, anyone carrying on investment business without authorisation will be committing a criminal offence. This applies to life insurance salesman as much as to stockbrokers and merchant bankers. It also applies to many whose investment business is only a sideline to their main business - for instance an estate agent selling endowment mortgages.

In order to avoid the risk of breaking the law such businesses and individuals need to be ready to apply for authorisation by the end of this year. This means they need to be thinking about their applications now. They will need to consider a number of issues. I cannot emphasise too strongly that failure to apply for authorisation by the provisional date, likely to be at the beginning of January, will put at risk their right to carry on in business.

Most businesses will be able to gain the authorisation they need by joining a recognised self-regulating organisation. For most intermediaries dealing with life insurance, this will be FIMBRA. I attach a list of the names and addresses of the organisations which have applied to be recognised, who will I know be happy to answer enquiries from anyone who thinks they might be affected. Alternatively, your constituents might like to seek advice from this Department or from the Securities and Investments Board (addresses attached). Free explanatory booklets are available.

I would be grateful for any help you can give in publicising this important message in your area. It is essential for the protection of the fast-growing body of investors that the new regime is in place at the earliest opportunity; and it is vital for the interests of the myriad businesses active in this field that they respond swiftly to this new system.

Yours ever

Yours.

FRANCIS MAUDE

Securities and Investments Board (SIB)
3 Royal Exchange Buildings
London EC3V 3NL

Telephone: 01-283 2474

Prospective Recognised Self-regulating Organisations (SROs)

Financial Intermediaries, Managers and Brokers
Regulatory Association (FIMBRA)
22 Great Tower Street
London EC3R 5AQ

Telephone: 01-929 2711

The Securities Association (TSA)
The Stock Exchange Building
London EC2N 1EQ

Telephone: 01-588 2355

Investment Management Regulatory Organisation (IMRO)
IMRO Ltd
Centre Point
103 New Oxford Street
London WC1A 1PT

Telephone 01-379 0601

Association of Futures Brokers and Dealers (AFBD)
Cereal House
58 Mark Lane
London EC3R 7NE

Telephone 01-481 2080

Life Assurance and Unit Trust Regulatory Organisation
(LAUTRO)
LAUTRO Ltd
Centre Point
103 New Oxford Street
London WC1A 1QH

Telephone: 01-379 0444

Department of Trade and Industry contact point

Room G07
10-18 Victoria Street
London SW1H ONN

Telephone: 01-215-3065

L30ABE

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215)
GTN 215) 4417
(Switchboard) 01-215 7877

From the Parliamentary Under Secretary of State for Corporate and Consumer Affairs

The Hon Francis Maude MP

Prime Minister.
To note the revised timetable for implementing the FSA.
MEA 25/8

David Norgrave Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

25 August 1987

Dear David,

FINANCIAL SERVICES ACT

Mr Maude has asked me to let you know that he will be announcing at 2.30 pm on 26 August the revised timetable for implementing the ... Financial Services Act. I attach a copy of the Press Notice, which has been discussed in draft with officials from DHSS and Treasury.

Mr Maude will be taking the opportunity to stress that this is still an extremely demanding timetable and that businesses should now be taking the necessary steps to ensure that they can carry on trading legitimately after next April. He sees this announcement as the first stage of a major awareness campaign in the national and local press, as well as in trade journals, which will continue throughout the autumn. He is also writing to Members of Parliament urging them to get the same message over to businesses in their constituencies.

I understand that DHSS are separately issuing a Press Notice about the implications of this announcement for the timing of the introduction of personal pensions.

I am sending copies of this letter to the Private Secretaries to other members of the Cabinet and to Sir Robert Armstrong.

Yours sincerely,

David Roe

DAVID ROE
Private Secretary

J04BTM

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DTI Press Notice

Department of Trade and Industry
1 Victoria Street SW1H 0ET
Press Office: 01-215 4472/4471
Out of hours: 01-215 7877

Number: 87/488

Date: 26 August 1987

TIMETABLE FOR IMPLEMENTATION OF FINANCIAL SERVICES ACT

Francis Maude, Corporate Affairs Minister, today (26 August) urged firms carrying on investment business to be ready to apply for authorisation under the Financial Services Act before the end of the year.

Mr Maude said that it was the Government's intention to implement Section 3 of the Financial Services Act, which will make it a criminal offence to carry on investment business in the United Kingdom unless authorised or exempted, early in 1988.

He said:

"We intend to bring Section 3 into force at the beginning of April. This demanding timetable means that investment businesses must be ready to apply for authorisation by the end of the year, or they risk losing the right to carry on their business.

"That means they need to be thinking about it now: not just the big City firms, but everyone who advises on investments, in every High Street in every town.

"There is much to be done before the new system can be brought fully into force but the Government believes that it is important to press ahead as quickly as possible so that investors can receive the protection afforded by the Act."

The Financial Services Act 1986 is being brought into effect in stages. Four self regulating organisations (SROs) have already applied to the Securities and Investments Board for recognition under the Act and a fifth application is expected shortly.

MORE/...

The Director General of Fair Trading is examining the rules of those organisations which have applied to see whether any are likely to have anti-competitive effects. The Secretary of State, after considering the Director General's reports, will decide whether to give leave for the recognition of the SROs by the Securities and Investments Board. (These procedures are established in the Act.) If so, it is hoped that the five SROs will all be recognised by early December.

The Act provides that a person who has applied for membership of an SRO by a particular date (P-day) and whose application has not been determined by the day on which section 3 comes into force (A-day) will receive interim authorisation for the period until his application is settled. If all the SROs are recognised in early December it should be possible to set P-day for the middle of January and A-day in early April 1988. Any business which needs authorisation and has not applied for it before P-Day is very unlikely to receive it in time to be able legally to carry on investment business after A-Day.

NOTES TO EDITORS

1. The four SROs who have already applied to the SIB for recognition under the Act are the Financial Intermediaries and Brokers Regulatory Association (FIMBRA), The Securities Association (TSA), the Investment Management Regulatory Organisation (IMRO) and the Association of Futures Brokers and Dealers (AFBD). The Life Assurance and Unit Trust Regulatory Organisation (LAUTRO) is expected to apply shortly.

2. Anyone who is uncertain about how the Act affects their activities should contact the SIB or the relevant SRO. A free introductory guide to the Act is also available from the Department of Trade and Industry, Room G07, 10/18 Victoria Street, London SW1H 0NN. Telephone 01-215 3065.

ENDS

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CCBG

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

4 August 1987

The Rt Hon Lord Young of Graffham
Secretary of State for Trade & Industry
1 Victoria Street
LONDON SW1

FINANCIAL SERVICES ACT: TIMETABLE

You wrote to me on 24 July with a copy of your letter to John Moore of 20 July. I have seen John Moore's reply of 31 July.

I accept that some slippage in the timetable for setting up the Financial Services Act machinery is now regrettably inevitable. While any delay in the introduction of personal pensions beyond the date we have already announced is a disappointing development, I see the force of your arguments and I do not dispute the conclusion which you and John Moore have reached. I share John Moore's view that the decision should be announced as soon as possible so as to minimise the disruption to the personal pension industry.

However, I think it would be most unsatisfactory if we announced the postponement of personal pensions without at the same time stating firmly the new date for their introduction. Other considerations apart, silence on this point would undermine the credibility of the revised timetable for the FS Act system generally. I think it essential that we now set a timetable for the FS Act system which we are confident can be achieved, and announce the new personal pensions start date, which the industry needs to know, accordingly.

I am sending copies of this letter to the Prime Minister, to John Moore and to Sir Robert Armstrong.

NIGEL LAWSON

Econ Pol

Gower

PTS

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CQBG

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DEPARTMENT OF HEALTH AND SOCIAL SECURITY

Alexander Fleming House, Elephant & Castle, London SE1 6BY

Telephone 01-407 5522

From the Secretary of State for Social Services

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON SW1

July 1987

NBPM.

IMPLEMENTATION OF THE FINANCIAL SERVICES ACT: IMPACT ON PERSONAL PENSIONS

WILL REQUEST IF REQUIRED

Thank you for your letter of 20 July explaining that it will not be possible for the Financial Services Act machinery to be in place by January 1988. I know you will have reached this conclusion with great reluctance and accordingly, I assume there is no prospect of pressing the SIB and LAUTRO to speed up their procedures so as to meet the original deadline. As you recognise, the delay poses problems for the January start date for personal pensions, and I am grateful for the opportunity to comment before you give your conclusions wider circulation.

I am convinced that we cannot allow people to be persuaded into joining a personal pension scheme to be used in place of SERPS without the benefit of the investor protection measures we all agree are necessary. The political attractions of personal pensions would be negated if people are sold unsuitable pensions contracts because the disciplines of the Financial Services Act cannot be enforced.

Given that starting point, I have two broad options. One is to attempt to implement key elements of the investor protection machinery - for example, product disclosure rules and cancellation rights - in time for a January start. This could be achieved either by making regulations under the Social Security Act 1986 or by a voluntary agreement with the providers. But there are clear drawbacks to this approach, not least the likelihood, as the ABI have pointed out, that substantial numbers of providers would simply not be able to comply with the rules by January. Moreover, the delay in preparing unit trust regulations under the Financial Service Act means that in practice no authorised unit trust personal pension schemes will be available by January. This would not help our objective of increasing competition among pension providers.

E.R.

The other option, which I see as the only viable one, is to defer the start date for personal pensions. You propose a postponement to 6 April 1988, to coincide with the introduction of the changes for occupational pension schemes. I certainly hope that the Financial Services Act machinery will be in operation by then. Yet, given the limits on the influence we have over the SIB and the SROs as well as the ABI's view that some providers may not be able to comply with the full SRO rules until July 1988, I would not propose at this stage to announce a revised start date for personal pensions. There is no need to amend the operative dates of the Social Security Act regulations until later this year, by which time I hope it will be clear whether the Financial Service Act machinery will be effective from April or a later date.

We also need to consider the timing of an announcement that the January start date is to be postponed. I understand your concern to defer an announcement until September so as to keep up the pressure on the SROs. But I am afraid I do not think we can keep pension providers unaware of our intentions for as long as that. If we do not make an early announcement, we will be rightly criticised for allowing the industry to carry on with what might well be abortive work. Moreover, we have to change the timing of our own publicity, which means telling the outside agencies and the Occupational Pensions Board. An early announcement gives us the freedom to present the decision on our terms rather than be forced into responding to rumours.

I hope you will be able to reflect these considerations in the advice you will shortly be putting to colleagues. Subject to their views, we can the agree the exact content and timing of the necessary announcements. I am copying this letter, as you did yours, to the Prime Minister, Nigel Lawson, and to Sir Robert Armstrong.

JOHN MOORE

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cc/84

DEPARTMENT OF TRADE AND INDUSTRY
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SWITCHBOARD 01-215 7877

Secretary of State for Trade and Industry

24 July 1987

The Rt Hon Nigel Lawson
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

Prime Minister 2

The appointed day for implementation of parts 1 of the Financial Services Act has slipped from "the end of this year" to April next year. DRS 24/7

Dear Nigel,

In the context of the introduction of the new personal pension schemes I wrote to John Moore earlier this week to draw to his attention an unavoidable slippage in the timetable for setting up the new regulatory structure under the Financial Services Act.

Once John Moore has had the opportunity to reply I would propose to write to colleagues more generally. But I thought you would also appreciate an early sight of my letter.

I am copying this letter to the Prime Minister, John Moore and Sir Robert Armstrong.

Yours

LORD YOUNG OF GRAFFHAM

DW4CJD

DEPARTMENT OF TRADE AND INDUSTRY
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Secretary of State for Trade and Industry

20 July 1987

The Rt Hon John Moore MP
Secretary of State for Social
Services
Department of Health &
Social Security
Alexander Fleming House
Elephant and Castle
LONDON
SE1 6BY

Dear Secretary of State,

IMPLEMENTATION OF THE FINANCIAL SERVICES ACT

I am writing to draw your attention to what looks like some unavoidable slippage in the timetable for setting up the new regulatory structure under the Financial Services Act.

In May last year my predecessor took the view that it should be possible to bring in the key provisions of the Act, which revolve around the date (the "Appointed Day") on which it becomes an offence to carry on investment business without authorisation, by the end of the year. That timetable was based on assumptions which have already been invalidated. SIB applied for designation in February rather than November as originally envisaged and on the basis of a rule book parts of which had been given only rushed consultation. That caused problems for OFT's consideration and we ourselves were forced to allow an additional consultation period. Accordingly, delegation took place in May, rather than January as initially envisaged. We have, however, continued to aim for the end of the year, in the belief that, provided SROs worked on their application for recognition in parallel with SIB, the ground lost so far could be recovered.

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It is now clear that the SROs have also experienced slippage. Three have only recently made their formal application and submitted their rules. LAUTRO will probably not do so until next month. Moreover, OFT, following their experiences over the SIB rules, are anxious to have sufficient time to look at the rules which will after all be those which apply to the majority of firms. They expect to spend up to four months on The Securities Association rules, which are I understand are quite unlike The Stock Exchange rules, and between two and three months on the others. Given the DGFT's statutory obligations under the Act and the possibility of judicial review, there is little we can do to speed up this process.

Even when recognition is granted - and on the above basis that could be December for the Securities Association - there are further periods we must allow if we are to avoid uproar from the many businesses, large and small, in the financial services sector. First, they must have time to decide which route of authorisation they wish to seek. Second, because the Act provides a mechanism under which firms applying for authorisation but whose application is not determined have interim authorisation, there must be a decent interval to weed out at least some of the obviously undesirable applicants.

The above problems all relate to the authorisation side of the system. I should also add that I am receiving various reports of the difficulties which firms will have in complying with the new SRO or SIB rules if they are introduced at the end of the year. Again, the major problem is that the shape of many of the key SRO rules has until recently remained unknown. There are other ways of dealing with the problem - by transitional arrangements for some rules for instance - but there is a limit to how many rules can be dealt with in this way without making the entire process meaningless.

These various considerations have convinced me that the Appointed Day should be deferred until the beginning of April. I reach this conclusion with very great reluctance. The introduction of an adequate system of investor protection has been an important part of our programme. We have in effect admitted that the present system is unsatisfactory and are vulnerable should there be any failures in the coming months, especially since there is no compensation scheme in place. Nevertheless, we have established a practitioner-based framework at arm's length from Government, and our scope for influencing what SIB, the SROs or the OFT do is very limited. If we were to attempt to commence the central provisions of the Act before the authorisation machinery was functioning, the

result would be that hundreds, perhaps thousands, of firms would be unable to continue carrying on investment business.

I shall be writing to colleagues shortly to inform them of this conclusion, but before doing so I wanted to alert you to the implications for the timing of the introduction of the new personal pensions schemes. Earlier this year we agreed that personal pensions should be allowed to be sold from January 1988. This decision was taken on the basis that the new investor protection framework provided by the Financial Services Act would be in place by then. I know that considerable importance was attached to this. For the new pensions regime to commence without adequate investor protection hardly gives it the best basis for the future.

Given the impossibility of having the FS Act machinery in place, I think we have to decide whether it is preferable to continue with the plans for introducing some personal pensions for those outside occupational schemes without benefit of the FS Act, or whether introduction of such pensions should be delayed until 6 April, the date on which pensions for those inside occupational schemes are introduced and which I propose should also be the day on which the relevant sections of the FS Act are commenced.

I realise that your predecessor laid the relevant commencement order, and that a change may require a further order. I also appreciate the political importance of an early start to personal pensions. However, without the FS Act in place there will be little effective regulation of the marketing of insurance and unit trust based schemes. I understand that there are powers in the Social Security Act which could be used to provide some controls on marketing, but these would certainly fall short of what will be provided by the FSA regime. Moreover, it will be difficult to authorise unit-trust based schemes. This latter problem may tempt a number of practitioners to offer unauthorised schemes. On balance I think it more important that the regime is established on a sound basis, rather than one which could be represented as being open to abuse, and I would therefore favour a deferral. This would give the industry the time it needs to cope with the significant regulatory changes being made and to provide a successful launch to personal pensions.

I think we also need to consider how any announcements on this subject should be handled. I am keen to maintain the pressure on SIB, the SROs and OFT to make better progress than has so far been the case and would prefer to avoid letting them off the hook with an announcement about the Appointed Day at this stage. I realise, however, that would-be providers of personal pensions from 4 January will wish to begin advertising early in the Autumn and we

will presumably need to say something on that account. Unless you believe it would be possible to achieve this without compromising our objective on the FS Act, I think this points to announcement before the middle of September of revisions in both the FS Act and personal pension timetables.

Yours sincerely,

Paul Steeples

pp LORD YOUNG OF GRAFFHAM
(approved by the Secretary of State and signed in his absence)

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PRIME MINISTER

COMPANIES ACT INQUIRIES

On the basis of clear-cut legal advice, Lord Young has decided to institute Section 447 inquiries into Hill Samuel over the AE take-over and into Ansbacher over two take-overs. One of these was the take-over of good relations by Lowe Howard-Spink and Bell. DTI believe that the client may not in this case even be aware of what its adviser was up to.

Section 447 inquiries are not publicised, but can become known.

G. Stevens
Duty Clerk

pp DN

13 July, 1987.

CEBG

CONFIDENTIAL

NORTHERN IRELAND OFFICE
WHITEHALL
LONDON SW1A 2AZ

SECRETARY OF STATE
FOR
NORTHERN IRELAND

The Lord Young
Secretary of State for Trade & Industry
1 Victoria Street
LONDON
SW1

26 June 1987

Dear Secretary of State,

NIBM

FINANCIAL MARKETS BILL

Apart from the Belfast branch of The Stock Exchange Northern Ireland does not have financial markets of the type covered by your memorandum of 15 June 1987 to the Prime Minister. I therefore do not have any specific comment of substance to make on the axiomatic need to ensure continuity of customer confidence in such UK financial institutions. However I do wish to confirm that I am in agreement with the decision in your memorandum that any such measure should be enacted on a United Kingdom wide basis. I also consider that it is important that our officials should continue to liaise on possible implications for Northern Ireland statute law of any changes to the insolvency law as a consequence of the proposed Bill.

I am copying this letter to the members of E(A) Committee and to Sir Robert Armstrong.

Yours sincerely,
Alan Mansfield

for TK
(approved by the Secretary of State and signed in his absence in Northern Ireland)

JLD/3728

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PTS

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PM
cc BG

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

23 June 1987

Dear Paul,

FINANCIAL MARKETS BILL

The Prime Minister has seen your letter of 19 June in answer to mine of 16 June about the possibility of insurance cover to protect market members against each others default. In the light of your explanation, the Prime Minister is now content, subject to the views of colleagues, with the proposed legislation.

I am copying this letter to the Private Secretaries to members of E(A) and to Trevor Woolley (Cabinet Office).

Yours,

David.

D. R. NORGROVE

Paul Steeples, Esq.,
Department of Trade and Industry.

EA

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cc BS

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Secretary of State for Trade and Industry

PS/

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19 June 1987

David Norgrove Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1A 2AA

Papers please.

Prime Minister!
Content now with the proposed legislation to deal with defaults?
DKS 22/6. Yes
Will withdraw

Dear David,

FINANCIAL MARKETS BILL

Thank you for your letter of 16 June.

We had considered whether insurance cover to protect market members against each other's default could solve or ameliorate the problem.

The problem, however, requires instant action (literally within hours) when a market maker or broker on The Stock Exchange or the commodity or futures markets cannot meet his obligations to pay for shares, gilts, commodities futures or options he has bought (or to deliver what he has sold). The Stock Exchange or the clearing house need to be able, without fear of subsequent legal challenge, to use relevant assets to meet his obligations to the other members of the market as far as possible, to forestall a runaway collapse through the market. Procedures differ, but for example they would go into the market place and sell what the member has bought and not paid for (or buy what he has sold but not delivered).

If this could not be done and the market maker or broker had simply to go into liquidation (or seek the appointment of an administrator) the liquidator would have the legal right to repudiate unprofitable contracts and to keep the profits on profitable ones. His duty is to use all the assets for the benefit of all the creditors, not merely for other market members. Not meeting the immediate needs of other creditor market members would have at best a significant effect on the confidence in the market (be it gilts, equities, options or the commodities and futures

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markets) and at worst force other members of the market into liquidation. Depending on the number of firms involved this could lead to a wholesale collapse of the market concerned.

Up until now there has been no challenge to the expectation that an exchange member's assets should be used first to close his positions on the market, and only then be available for external creditors. As my Secretary of State's minute said this existing position can no longer be regarded as safe from legal challenge. That is why we need to change this law.

The difficulties with insurance as an alternative approach to protecting other market members are essentially that it is not available in the sums necessary to ensure that obligations are met. One major Stock Exchange member firm was recently short of £300m overnight; cover is not available in that quantity irrespective of the price and is not sufficiently comprehensive to cover all the circumstances causing insolvency. Even if it were there is the problem of timing. The outstanding positions of a defaulting market member need to be settled immediately to avoid loss of confidence and the creation of a false market; insurance pays out 'after the event' and would not allow immediate settlement.

My Secretary of State has concluded therefore that the only satisfactory approach is to put the legal position beyond doubt in order to ensure that the markets can operate as they have always done free from the fear of legal challenge. Otherwise we risk not only simply a loss of confidence but ultimately disaster.

He welcomes the Chancellor of the Exchequer's support for the Bill.

I am copying this to the Private Secretaries to the members of E(A) and to Trevor Woolley (Cabinet Office).

Yours

Paul

PAUL STEEPLES
Private Secretary

DW4CGK

ECON POL GOMER PTS

ps2/38A

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cc BG

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

PRIME MINISTER

11 BF Friday

FINANCIAL MARKETS (CLEARING ARRANGEMENTS) BILL

I have seen David Young's minute to you of 15 June.

I very much hope that the Financial Markets (Clearing Arrangements) Bill can be included in the 1987-88 legislative programme for the reasons he rehearses. In particular, as paragraph 8 of his minute suggests, the Bill will be a useful vehicle for dealing with the problems connected with the enforceability of the floating charge in the gilts settlement system - not least those caused by the Insolvency Act. This is important for the liquidity of the gilt-edged market, an essential factor in our debt management operations which have been running at £10-15 billion gross sales per annum.

The difficulty which the Bill would deal with concerns the Central Gilts Office assured payments system, which is a central feature of the new settlement arrangements in the gilt-edged market post "Big Bang". In essence this system provides the main participants in the market with an assurance that movements of stock will automatically and simultaneously be matched by movements of cash in the opposite direction. To support this unlimited commitment, the settlement banks (who are responsible for making the "assured payments") have relied principally on a floating charge over their clients' stock. The value of these holdings provides security for any net cash payment due.

The settlement banks have, however, been concerned that in the event of, say, a market maker's insolvency, they may not be able to enforce their charge, or may be able to do so only after unacceptable delay. These concerns have been sharpened by the provisions in the Insolvency Act for the appointment of Administrators, which could threaten further the enforceability of the charge. Until these concerns are allayed, the settlement banks are likely to become increasingly uneasy about the present arrangements and to be reluctant to accept the widening of CGO membership which we would like to promote.

The only solution the Treasury and Bank of England have identified is legislation that will clarify and reinforce the security provided by the floating charge in the context of the CGO, if possible to the extent of giving it formal precedence over any competing charge. My officials are consulting with the Bank and their legal advisers to see how this can most simply be effected.

I am copying this minute to all Cabinet colleagues and to Sir Robert Armstrong.

N.L.

17 June 1987

ECON POL: Gowes pt 5

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10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

16 June 1987

Dear Tim,

FINANCIAL MARKETS BILL

The Prime Minister has seen your Secretary of State's minute of 15 June which sought policy clearance for proposals on clearing arrangements for financial markets.

The Prime Minister will be interested to see the comments of colleagues on the proposed arrangements. She has noted that the procedure would operate to the detriment of other creditors, and has asked whether there are not compulsory insurance schemes which would provide protection in the event of default.

I am copying this letter to the Private Secretaries to members of E(A) and to Trevor Woolley (Cabinet Office).

Yours,
David.

(David Norgrove)

Timothy Walker, Esq.,
Department of Trade and Industry.

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I shall be interested in the comments. Prime Minister! This procedure appears to the detriment of other creditors. Agree to give policy approval to these proposals, subject to the views of colleagues? Is there no compulsory insurance scheme? pse.

PRIME MINISTER

DKV 15/6.

FINANCIAL MARKETS BILL

The Cabinet invited Paul Channon to put forward policy proposals on clearing arrangements for financial markets. This minute seeks E(A)'s agreement today to my policy proposals so that I can seek QL's agreement tomorrow to including them in a Bill in the 1987/88 Session.

2 The problem relates to clearing arrangements on several London financial markets, including The Stock Exchange (gilts, equities and options), the London International Financial Futures Exchange and the commodity exchanges and concerns the procedures for dealing with the default of a member of an exchange.

3 Whilst existing procedures have worked satisfactorily in the past, they are now under threat. The recent changes in insolvency law have clarified, to the disadvantage of the exchanges, the rather murky basis of existing procedures. Moreover, the US legislative system expressly provides for the default procedures of US exchanges; US investment businesses have noted the absence in London of this statutory backing. Given that US business are more litigious there must be a greater risk of them challenging the procedures if an exchange member defaults.

4 Given the risks I am sure we must provide statutory procedures which prevent an exchange member's default causing serious financial loss to other exchange members who in turn could default. My proposed Bill would enable exchanges if a

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member defaulted to appoint an official (usually an exchange or clearing house staff member) to close that member's positions on the exchange. The aim would be to ensure that as many transactions as possible were honoured, thus limiting the impact of the default.

5 To do this the official would have to use some of the defaulter's assets, which under existing insolvency legislation ought to be shared between all the defaulter's creditors. The Bill would determine which assets could be used by the official for the benefit of those of the creditors who were members of the exchange or their customers.

6 When the official has completed his task, any outstanding assets and liabilities will be dealt with according to the normal requirements of insolvency legislation. But the actions of the official will not be subject to challenge.

7 My proposed Bill would give proper statutory backing to the existing procedures of the exchanges. It would not put them in a more privileged position than they currently enjoy in practice. It is essential that we safeguard the integrity of our markets, whether stocks and shares, gilts, commodities or financial futures. It is critical for public confidence, both at home and abroad, in these markets. It is also necessary for the competitive advantage of our markets internationally in facilitating links between our markets and exchanges overseas.

8 My propsed Bill would also deal with a related problem in the gilts market. This involves the security available to certain banks who undertake to make payment as the

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counterpart of transfers of gilt-edged stock between members of the Central Gilts Office settlement system. I would propose to ask my officials, in conjunction with the Treasury and the Bank of England, to examine ways in which these concerns might also be met.

9 My proposals have the broad support of The Stock Exchange, the London International Financial Futures Exchange and the International Commodities Clearing House. If E(A) Committee endorse my proposals, DTI officials will finalise them in consultation with the Treasury, the Bank of England and these bodies.

10 The London financial markets make a vital contribution to UK invisible earnings, and London should be the third major financial centre alongside New York and Tokyo. We need to act quickly in order to prevent potential chaos as a result of a domino effect of a market member's collapse. I therefore invite E(A) Committee's support for my policy proposals.

11 I am copying this to other members of E(A) Committee and to Sir Robert Armstrong.

DY

15 June 1987

DEPARTMENT OF TRADE & INDUSTRY

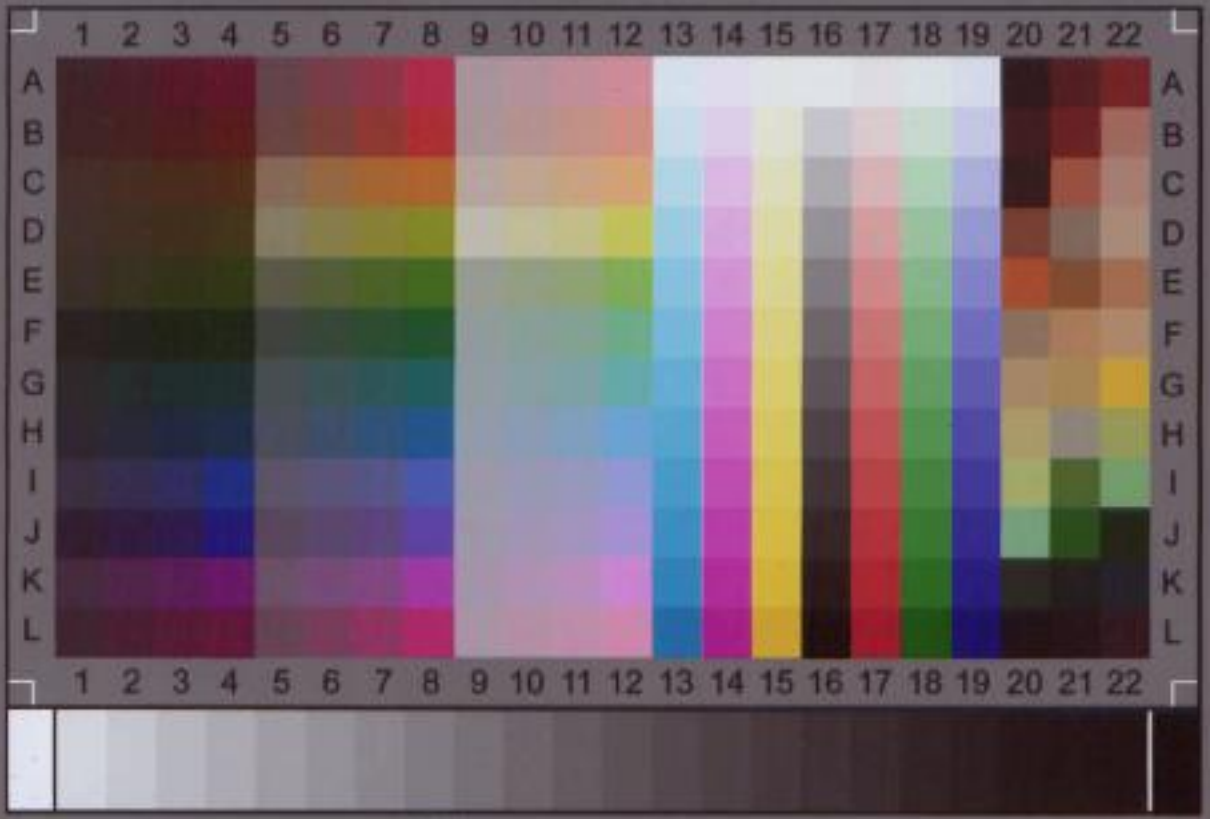
JG1BEQ

PART 4 ends:-

DN to PM. 12.5.87

PART 5 begins:-

SS/DTI to PM 15.6.87.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