

The Restrictive Trade Practices
(STOCK EXCHANGE)

Bill

Second Reading

Tuesday 22nd November 1983

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1. THE BILL

This two-clause Bill has been introduced to exempt certain agreements relating to The Stock Exchange from the Restrictive Trade Practices Act 1976.

It exempts any agreement between the members of The Stock Exchange which regulates the Exchange, its membership or the activities of members, including the rules, regulations and usages of the Exchange. It also exempts any agreement between The Stock Exchange and the Government or the Bank of England relating to the regulation of the Exchange. Provision is made for the removal from the register of any such agreement which is already registered under the Act and for the termination of any proceedings which are pending. The Bill follows the proposals made by the Chairman of The Stock Exchange after discussion with his Council and announced to Parliament in July. In short these were that:

- the Council would take action to dismantle by stages and with no unreasonable delay all the rules which prescribe minimum scales of commission, completing this by the end of 1986;
- The Stock Exchange continue the rules prescribing the separation of capacity of brokers and jobbers so long as the needs of the investor so require;
- the Council would introduce rules to permit non-members to serve as non-executive directors of limited corporate members of The Stock Exchange ;
- the Council would recommend to the members of The Stock Exchange changes which would:
 - * introduce lay members to the Council;
 - * establish a new appeal body, independent of the Stock Exchange members of the Council, which could review and over-rule any decision to reject an application for membership which complies with the rules of The Stock Exchange;
 - * introduce a majority of people who are not Stock Exchange members of the Council to the existing appeals committee on disciplinary matters.

THE TERMS OF THIS AGREEMENT ARE DISCUSSED IN SECTION 5 ON P.3 BELOW.

2. BACKGROUND: The Restrictive Practices Court and The Stock Exchange.

The Director General of Fair Trading is obliged by law to register agreements containing restrictions and if necessary to refer them to the Restrictive Practices Court. The Court judges whether the restriction operates for or against the public interest. When the Restrictive Trade Practices legislation was extended so as to apply to agreements about services as well as goods, it was recognised that certain bodies and institutions should be exempted. The professions, for example, must have restrictions on entry and controls on what their members may do. The list of exemptions includes the normal services of barristers, accountants and insurance companies. The agreements of trade unions also continue to be effectively exempted.

The Stock Exchange is the sort of body that might have been expected to apply to be exempted, but it did not do so for whatever reason, and so its agreement had to be registered. The OFT put together, over a number of years, a list of the restrictions in the agreement to be referred to the Court.

Ironically one effect of putting this matter before the Court was to make it more difficult for the Stock Exchange to make any changes. The fact that proceedings were pending had the effect of freezing discussion and impeding reform. The Government was concerned about that for several reasons.

3. WHY THE GOVERNMENT ACTED

- First, the securities market is undergoing rapid change and becoming more competitive. Many of the dealings which used to be the preserve of national exchanges, are now being handled internationally. The Stock Exchange must respond competitively with changes of its own if it is not to lose a substantial amount of business to multi-national firms. The Exchange remains central to the working of our economy and is a valuable asset. The Government would not wish to see it hampered from meeting international competition as best it can.
- Second, the Government was concerned that adversarial court proceedings under the Restrictive Trade Practices legislation were not the appropriate way of deciding the future of a self-regulating institution like the Stock Exchange. The Court procedure is a rigid one. Even after the proceedings had ended, all future changes to the Stock Exchange's rules would have to be referred back to the Court. That procedure would not easily accommodate the Stock Exchange's need to adapt and evolve.
- Third, by a decision of the European Court of February 1983, EC directives concerning listing will now have to be reflected in national legislation. This decision is likely to produce a fundamental change in The Stock Exchange's regulatory function, and will inevitably involve the Government in the affairs of The Stock Exchange to a greater degree than before.

4. THE OBJECTIVES OF THE SETTLEMENT

Mr Alex Fletcher, Minister responsible for Consumer Corporate Affairs, outlined the Government's objectives in agreeing this settlement in a speech in New York on October 17th, 1983. He said:

'The....Government's approach to this is guided by two fundamental objectives.

'The first is to maintain and foster a central securities market in Britain which is efficient, comprehensive and competitive both within itself and internationally, and which is responsive to changing conditions and the changing needs both of the providers and of the users of capital.

'The second fundamental objective is that there should be proper protection for the legitimate interests of investors. This is especially important given the Government's commitment to the spread of share ownership in Britain. I believe the day of the small shareholder is returning. That can only be healthy for the British economy. Our policies in relation to the securities market must be wholly consistent with that objective.

'We want to see change - and fairly rapid change. But it must be within the terms of the objectives I have outlined. By taking the

case out of the court we are making possible an evolution, not an instant change',

5. THE TERMS

The possibility of removing the case from the Court had often been mooted before. But The Stock Exchange had not previously come forward with such constructive proposals for change as it did in July. In the Government's view the settlement the Exchange proposed in July constitutes an important reform.

a) The Stock Exchange will abolish, by stages, the minimum commission charged by brokers on stock and share dealings (see Appendix). This will be completed by the end of 1986. Abolishing minimum commissions will be an important step in improving The Stock Exchange's competitiveness, since other markets, like New York, have already done away with them. It will lead to substantial changes. When the New York Stock Exchange took the step in 1975, the ensuing competition obliged a number of firms to amalgamate, and others were forced out of business altogether. The Government wishes to see share ownership widely spread and so thinks it important to give small firms who deal with the small investor every chance to adapt and so to survive. The Government has therefore accepted that the abolition of minimum commissions should be phased in over a maximum of three-and-a-half years. (The New York Securities and Exchange Commission took seventeen years before ordering the abolition of minimum commissions, although once ordered, the abolition was effected rapidly).

b) The Stock Exchange would amend certain rules on entry to the Stock Exchange. Non-members of the Stock Exchange will be included on the Stock Exchange Council and may become directors of member firms. The Appeals Committee of the Stock Exchange concerned with disciplinary matters will be broadened to take in both members of the Stock Exchange who are not members of the Council, and the new lay members of the Council. In addition, applicants for membership of the Stock Exchange who are turned down, will in future be able to appeal to a new appeals body, and it will have the right to reverse the decision.

c) The Stock Exchange will continue the rules prescribing separation of the capacity of jobbers and brokers ('single capacity').

6. 'SINGLE CAPACITY'

When the Government announced the terms of the settlement on July 27th it made clear that it believes that the separation of the two functions of jobber and broker is in the best interests of the investor and should be maintained in its present form for the time being. It prevents a broker deriving any benefit from a transaction other than the commission he gets for effecting it. If the broker could sell stock of his own instead of having to buy it in the market from a jobber he could be tempted to give biased advice and would be able to adjust the price, and benefit unfairly. In the case of Lloyds, Parliament judged it right to require those who arrange insurance (the brokers) to be separate from those who provide it (the underwriters). In the United States, the Securities and Exchange Commission has tried repeatedly over many years to introduce 'single capacity', so far without success.

Members of the Stock Exchange have subsequently argued that single capacity will not be sustainable without minimum commissions. Mr Fletcher said, in his speech in New York that he was:

'ready to be convinced that this is the case, but if the ... Stock Exchange does decide to change its single capacity system, comparable safeguards for investors would have to be introduced'.

It would be for the Stock Exchange to make proposals to provide adequate alternative protection for investors if they feel that the present system of single capacity has, in practice, become outmoded. Mr Fletcher has made it clear that the Government is open to the Stock Exchange's suggestions for this, but he has also said that if a new system to protect the investor depends on electronic equipment, as is the case in New York, then adequate time must be provided for the purchase and installation of this equipment before the present system of 'single capacity' is changed.

In this context it should be noted that Sir Nicholas Goodison, Chairman of the Stock Exchange, was quoted by The Times of 26th October as saying:

'We must not rush our fences or anticipate any changes which might be brought about by the abolition of fixed commissions. We do not intend to push the present system towards destruction. The Stock Exchange Council will pursue a policy to maintain single capacity as long as it is commercially desirable and users want it. I do not detect general pressure to give it up as part of our first thought. We will strengthen the rules to reinforce single capacity'.

7. MINIMUM COMMISSIONS

When it agreed the July settlement the Stock Exchange promised that it would 'take action to dismantle by stages and with no unreasonable delay all the rules which prescribed minimum scales of commission, completing this by 31st December 1986'. The first stage will be the ending of minimum commissions on overseas securities. Since July, however, a debate has developed about whether the remaining commissions should all be deregulated at the same time - in a 'big bang'. This happened in New York, where all minimum commissions were scrapped on May 1st 1975. The Stock Exchange has not yet reached a consensus on this subject. If it does decide that abolition in a single step is preferable the Government will not necessarily object. But it will need to be sure that the 'big bang' will take place at an early and identifiable date and that it will not cause the system of single capacity to break down before a replacement is available.

8. IMPLEMENTATION OF THE AGREEMENT

In July Mr Parkinson said that 'the Government will seek the approval of Parliament for measures to exclude The Stock Exchange from the operation of the Restrictive Trade Practices Act' in order to allow the agreement to be implemented. This, however, would be subject first, to the approval by The Stock Exchange membership of the necessary changes to the Stock Exchange Deed of Settlement and, second, to the establishment of monitoring arrangements involving the Department of Trade and Industry and the Bank of England to oversee reform.

- a) The Stock Exchange. Considerable progress has been made by The Stock Exchange in implementing these proposals. The membership has agreed to the necessary changes to the Deed of Settlement and the Council has agreed in principle that minimum commissions on dealing in overseas securities should be dropped early next year. Decisions covering other types of securities will follow later.

On July 28th, 1983, The Stock Exchange applied for and obtained an adjournment of the Court proceedings. Following meetings of The Stock Exchange Council when rule change proposals were drawn up, an Extraordinary Meeting of Members of The Stock Exchange was held on October 11th. At that meeting changes to the Deed of Settlement were agreed which provide for:

- Lay-members to be admitted to the Council of The Stock Exchange;
- the minimum numbers of the Council to be reduced from 35 to 30 and the maximum limit abolished;
- the number of lay-members of the Council to be limited to 25%;
- the Council to remunerate lay members;
- a majority of laymen to be introduced to a new Disciplinary Appeals Committee of the Council;
- an exclusively lay Membership Appeals Committee;
- the Membership Appeals Committee to override a decision of the Council to reject an applicant for Membership who fulfils the requirements of the rules and
- the Council to appoint non-Council members to its committees and sub-committees.

b) Official Monitoring. Arrangements have now been made by the Department of Trade and Industry and the Bank of England to monitor developments in The Stock Exchange. During the summer a new body was set up to oversee the implementation and effects of the various reforms. The monitoring body, which meets regularly, consists normally of officials from the Department of Trade and Industry, the Bank of England and The Stock Exchange.

Appendix /...

The Fixed Commissions that will goStocks and shares

| <u>Price band (£)</u> | <u>Rate %</u> |
|-----------------------|---------------|
| first 7,000 | 1.65 |
| next 8,000 | 0.55 |
| next 115,000 | 0.5 |
| next 170,000 | 0.4 |
| next 600,000 | 0.3 |
| next 1,100,000 | 0.2 |
| on the excess | 0.125 |

The minimum commission on bargains of £300 or more consideration is £7 for a sold bargain and £10 for a purchase bargain. Bargains with a consideration less than £300 may be charged at discretion.

Long-term gilt-edged stocks

| <u>Price band (£)</u> | <u>Rate %</u> |
|-----------------------|---------------|
| first 2,500 | 0.8 |
| next 15,000 | 0.25 |
| next 982,000 | 0.125 |
| next 3,000,000 | 0.1 |
| next 6,000,000 | 0.05 |
| on the excess | 0.03 |

Debentures

| <u>Price band (£)</u> | <u>Rate %</u> |
|-----------------------|---------------|
| first 5,000 | 0.9 |
| next 5,000 | 0.45 |
| next 40,000 | 0.35 |
| next 20,000 | 0.325 |
| next 770,000 | 0.25 |
| next 1,100,000 | 0.175 |
| on the excess | 0.125 |

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