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Secretary of State for Trade and Industry

PS/

7 May 1986

BF

To hold for meeting later in the month.

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

Dear David,

**BIG BANG**

Your letter of 14 April asks my Secretary of State for a note, in preparation for the Prime Minister's meeting on "Big Bang", on the Financial Services Bill and the state of preparedness of the SIB and other regulatory organisations.

... I attach a note approved by my Secretary of State. You will see that in addition to the Financial Services Bill we also cover the state of preparedness of The Stock Exchange itself on its new rule book and new technology.

I am copying this letter to Tony Kuczys (HM Treasury) and John Footman (Bank of England).

Yours ever,  
Michael

MICHAEL GILBERTSON  
Private Secretary

JF5BDY



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BIG BANG

Financial Services Bill

The Bill is expected to receive Royal Assent in October. It made fast progress in Committee, and has in general received widespread support. The most controversial outstanding issue was the status and powers of the designated agency (expected to be the Securities and Investments Board (SIB)). We have reached agreement with the Government's backbench members of the Committee on this by giving the Board statutory recognition in the Bill and giving it additional powers in relation to investigations and prosecutions. This should substantially ease the remaining stages in the Commons and the passage of the Bill in the Lords.

2 However congestion in the Lords programme means that there is little prospect of the Bill getting Royal Assent in July. The timetable for implementation is little affected by whether Royal Assent is in July or October. SIB is already publishing drafts of its rule book and organising itself to be ready to seek the transfer of powers to it as planned towards the end of 1986.

3 Ministers have made it clear that they welcome comment on the Bill; amendments need to be made to meet the constructive comments received which are mainly of a technical nature. With Report stage in the Commons likely to be agreed for June this will enable DTI Ministers to present the Lords with a Bill which has received extensive support in the House of Commons.



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Securities and Investments Board

4 The timing of the transfer of the Secretary of State's regulatory powers to SIB is in SIB's hands to a large extent. They need a rule book and monitoring and enforcement capability which in the view of the Secretary of State satisfies the criteria in the Financial Services Bill. SIB has published some consultative documents and draft rules for comment by the City and other interested parties; it plans to publish more over the coming months. In addition SIB has started to organise its monitoring, enforcement and computing operations. As of now preparations for the transfer of the Secretary of State's regulatory powers to SIB for early in 1987 are on course.

Self Regulating Organisations

5 Once SIB has received these powers the next step will be the recognition of self-regulating organisations (SROs), membership of which will give authorisation to carry on investment business. Here progress is not so well advanced. Several of the organisations are new and are only now starting to get themselves organised. They have a long way to go to be ready for recognition in the first part of next year. We are urging on them the necessity to make faster progress.

What  
provision can  
we put on  
them?

The Stock Exchange

6 However, The Stock Exchange is much better placed. It already has a well developed rule book and arrangements for monitoring and enforcing it for its present trading system. The rules and enforcement procedures need major amendment to



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cope with the new trading systems, but The Stock Exchange has been planning these for the last three years.

Big Bang

7 Ministers will recall that the "Big Bang" started from the "out of court" settlement of the restrictive trade practices case against The Stock Exchange in July 1983. Whilst The Stock Exchange's contribution to this settlement was then seen by some as rather slight, the proposed abolition of minimum commissions led rapidly to the acceptance of the need for radical changes in the way the equity and gilts markets operated. This will involve abolishing the present separation of jobbers and brokers and introducing dual capacity broker dealers who can deal direct with investors as well as making markets. This in turn has led to the main British participants needing massive injections of capital. Even the largest Stock Exchange firms were tiny by international standards; and the Exchange itself has needed to invest heavily in technology to underpin the new trading system.

8 A number of the reforms planned since July 1983 have already been put into effect; for example, some freeing of commissions, and the appointment of five lay members to the Council. With effect from 1 April, The Stock Exchange firms can be 100 per cent owned by outsiders. Thus, important as are the final unfixing of commissions and the introduction of the new trading system on 27 October 1986 ("Big Bang day"), they are the final stages of a process which has been going on for some time. This process has been monitored by the DTI and the Bank of England. (SIB are now associated with this monitoring.)

With what result?



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Stock Exchange Rule Book

9 This monitoring has been concerned with the amendment of The Stock Exchange's rules and with its new technology. Its rule book needs to be completed before Big Bang and this project is on time; new rules on how to make markets, on coping with what for existing Stock Exchange firms will be new conflicts of interest and on standards of dealing with the public have been drafted and are being considered. The Bank of England have published proposals for regulating the primary market in gilts.

Technology

10 The other main issue is technology. The installation of new technology for dealing and settlement at The Stock Exchange is on schedule - just - but much remains to be done. The last time Mr Howard raised this with Sir Nicholas Goodison (in April) Sir Nicholas assured him yet again that they were on course to meet the Big Bang deadline Sir Nicholas repeated his concerns about the impact on The Exchange's computer systems of the changes proposed in the Budget on stamp duty.

What happens if it's not?

11 For the Exchange to have their new technology up and running by Big Bang may be a near run thing especially on the settlement side given the need to test systems and acclimatise staff to them. The modifications to the settlement system, Talisman, are expected to be in place by end-August (against a target of April) so there is little margin for further slippage. The Exchange also have a programme of system improvement. Where particular changes are likely to be later than Big Bang day The Exchange believes they can make alternative arrangements. The



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Exchange have an independent firm of computer specialists auditing their progress regularly. Some Stock Exchange member firms are behind schedule for the installation of the Big Bang technology and training in their own firms. Four firms are said to be seriously late, one of which is of significant size.

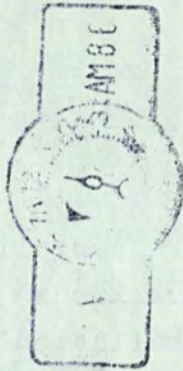
12 Given the extent of the changes at The Stock Exchange it will be most surprising if there are no teething troubles after Big Bang. Systems will not function quite as expected and firms will get things wrong. Any problems would need to be resolved by The Stock Exchange Their first big test is likely to be the British Gas flotation in November.

13 There will be a gap between Big Bang and the coming into force in 1987 of the new regulatory system to be set up by the Financial Services Bill. This gap should not cause undue concern. The Stock Exchange's new rule book will be in force and will be binding on its members. That rule book is being drawn up in the light of the Bill's requirements and SIB's draft rules. The new rule book should, therefore, from the start largely meet the standards which all the SROs will be required to meet in 1987 in order to obtain recognition under the Bill. The Stock Exchange is very mindful of its reputation as a regulatory body and has a large and experienced supervisory staff.

CONCLUSION:

14 Big Bang will entail fundamental changes in the way the equity and gilts markets are organised. Whilst much has been done in preparation for this, much remains to be done. As of now the necessary preparations for Big Bang and the Financial Services Bill are on course.





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