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DRN o/r

Treasury Chambers, Parliament Street, SW1P 3AG

John Mogg Esq
PS/Secretary of State for Trade and Industry
Department of Trade and Industry
1 Victoria Street
LONDON SW1

2 May 1986

Prime Minister 2

Dear John,

To note that it is now proposed
that these markets should continue to
be regulated on a non-statutory basis.
DRN 6/5.

REGULATION OF THE WHOLESALE MONEY, FOREIGN EXCHANGE AND GOLD BULLION MARKETS

The Chancellor wrote to your Secretary of State on 24 February proposing changes to the Financial Services Bill to put the Bank of England's traditional surveillance of these markets on to a statutory basis.

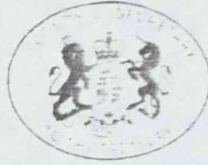
There have subsequently been extensive discussions between officials, involving also the Bank of England and the SIB. As a result the Chancellor and the Governor now accept, reluctantly, that amending the Financial Services Bill in the way suggested would raise too many difficulties, at this stage.

Officials have however agreed on proposals for a more limited set of amendments to the Financial Services Bill, to be introduced at Report Stage. These will provide for the exclusion of these markets from the Bill, giving the Bank of England responsibility to oversee and supervise these markets on a non-statutory basis as at present. The Bank of England would, however, be given a limited statutory power under the Bill to draw up a list of institutions whose wholesale transactions would be excluded from the Financial Services regime.

The Economic Secretary understands that your officials wish to press ahead urgently with consulting interested parties on the details of these amendments, on the basis of the attached draft letter. It will be necessary at the same time to make a statement about the future arrangements for supervision of these markets by the Bank of England; and about our intention to issue a consultative document later in the year about this.

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I attach the draft of a statement which the Economic Secretary plans to make in the form of a Written Answer early next week. It would be helpful if any comments could reach this office by lunchtime on Tuesday 6 May.

I am copying this letter to David Norgrove (No.10), David Morris (Lord Privy Seal's Office), Murdo Maclean (Chief Whip's Office) and John Footman (PS/Governor of the Bank of England).

Yours

A handwritten signature in dark ink, consisting of a series of stylized, overlapping loops and a long horizontal stroke at the end.

M J NEILSON
PRIVATE SECRETARY

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**SUPERVISION OF THE WHOLESALE MONEY, FOREIGN EXCHANGE AND BULLION
MARKETS: DRAFT WRITTEN ANSWER**

The Government has been considering the arrangements for supervision of the wholesale money, foreign exchange and gold bullion markets. These markets have by tradition generally been overseen and supervised by the Bank of England, on a non-statutory basis. The main participants are recognised banks and deposit taking institutions, building societies, and specialised brokers and dealers.

2. Certain transactions in these wholesale markets such as dealings with brokers in certificates of deposit and dealings in currency and gold options and futures, fall within the scope of the Financial Services Bill as at present drafted. Others, such as dealings in commercial bills, and normal spot and forward currency transactions, are excluded. We have concluded that the supervision of each of these wholesale markets should in future be the responsibility of the Bank of England. This supervision will continue to be on a non-statutory basis. The Government will be issuing a consultative document later this year seeking views on the arrangements for future regulation of these markets.

3. To reduce supervisory overlap, the Secretary of State for Trade and Industry will be bringing forward amendments to the Financial Services Bill which will exclude from the definition of carrying on investment business wholesale transactions in these markets if at least one party to the transaction is a recognised bank, licensed deposit taker, building society or an institution on a list to be drawn up by the Bank of England. The Bank's criteria for inclusion on such lists and its arrangements for maintaining them will be subject to the approval of the Treasury. The Department of Trade and Industry will be consulting on detailed amendments. A copy of their letter to interested parties is being placed in the Library of the House.

**FINANCIAL SERVICES BILL: WHOLESALE MONEY, FOREIGN
EXCHANGE AND GOLD BULLION MARKETS**

It has been suggested in comments on the Bill that wholesale transactions in money market instruments and off-exchange deals in foreign exchange options and futures, and gold futures should be excluded from the Bill's definition of carrying on investment business. This is because other transactions in these markets fall outside the Bill's definition of investments. Yet these markets are generally recognised as single markets that should be subject to a single system of supervision. They have for many years been overseen and supervised by the Bank of England on a non-statutory basis. The participants are professional operators, dealing in large amounts. I am writing to you and other interested parties to seek your comments on amendments which the Government intends to make to remove these wholesale markets from the ambit of the Bill, and hence reduce the area of overlapping supervision. These proposals reflect discussions between the DTI, Treasury, Bank of England and SIB.

In formulating the changes, we have sought to avoid loopholes which would enable unscrupulous operators to exploit investors, particularly private investors and the less experienced business and professional investors. The changes are designed to protect the integrity of the markets by ensuring that all the major participants in them, especially market makers, are "fit and proper" to undertake those activities, and are subject

to effective supervision. And they seek to define the exemptions as clearly as possible so that persons dealing in the investments concerned can readily determine whether or not they are subject to the FS Bill.

I attach a note which summarises the proposed changes to the Bill to take certain types of transaction out of investment business as defined in Schedule 1.

The effect of an exemption on the lines proposed in the note would be that a business which dealt only in circumstances covered by the exemption, and which was not otherwise carrying on investment business, would not be subject to authorisation or regulation under the Bill. It would, however, be supervised by the Bank of England. I attach a copy of a written answer given today by the Economic Secretary about the future supervision of these markets.

If a business undertook transactions in other investments subject to the Bill, or dealt in amounts smaller than the suggested limits, or dealt with other persons not covered by the exemption, then authorisation would be required. It would be a criminal offence to undertake such activities by way of business without authorisation and any contracts involved would be unenforceable. Businesses undertaking activities which are defined as investment business under the Bill will be subject to conduct of business rules. The Securities and Investments Board has already made it clear that it recognises that

professional investors do not need the same degree of protection as private investors and that, if it becomes a designated agency, it intends to reflect these distinctions in its rule book. It has also said that it intends, in particular, to make special provision in its rules for money market dealings. More generally the Bank of England, SIB and the SROs concerned will be working closely together as regards both rules and enforcement so as to avoid imposing unnecessary burdens on the businesses concerned.

We would welcome views both on the general approach adopted in the note and on the detailed provisions, especially as regards the investments concerned and the size limitations. The Government would like to put down amendments on this subject in time for Report Stage in the House of Commons, which is now expected to be in early June. Please may I therefore ask you to let me have any comments by 20 May at the latest.

WHOLESALE MARKETS: DETAILS OF PROPOSED AMENDMENT

It is proposed to amend the Bill so as to take out from the area defined in Schedule 1 as carrying on investment business transactions which satisfy all of the following criteria:-

- (i) The transaction consists of the purchase or sale (or any other activity covered by paragraph 12 of Schedule 1), of any of the following investments:-
 - a) A debenture as defined in paragraph 2 which is issued by a recognised bank or licensed institution within the meaning of the Banking Act 1979 or by a building society and which, under the terms of issue, must be repaid not later than 5 years after the date of issue.
 - b) Any other debenture as defined in paragraph 2 which, under the terms of issue, must be repaid not later than one year after the date of issue.
 - c) Local authority negotiable bonds which, under the terms of issue, must be repaid not later than five years after the date of issue.
 - d) Any other investment falling within paragraph 3 (Government and public securities) which, under the terms of issue, must be repaid not later

than one year after the date of issue.

- e) Contracts for differences on currency or interest rates (including forward rate agreements).
- f) Any currency future, or gold future, or interest rate future, falling within paragraph 8 except a contract made, or traded on a recognised investment exchange (including a designated overseas exchange) or a contract on substantially the same terms as contracts made or traded on such an exchange.
- g) An option on currency or interest rates other than an option made or traded on a recognised investment exchange (as above) or on substantially the same terms and option made or traded on such an exchange.

(ii) The size of the transaction exceeds the following limits:-

Money market instruments (a-d above): £100,000

Contracts for differences (e): Value of underlying property (in the case of contracts relating to

currency) or of notional sum (in the case of interest rate contracts) exceeds £500,000.

Currency, gold, and interest rate futures (f): Value of underlying contract exceeds £500,000. Currency Options (g): Gross Value of the option exceeds £500,000.

In all cases, the relevant value is the value at the time the transaction is concluded. For non-sterling transactions, the relevant value is the sterling equivalent at that time.

- (iii) At least one party to the transaction is a recognised bank or licensed institution within the meaning of the Banking Act 1979, or a building society or an institution on a list drawn up by the Bank of England. The list will include only institutions which the Bank are satisfied are "fit and proper" to undertake transactions of the kind which benefit from this exemption. The Bank's criteria for inclusion on the list and its arrangements for addition of institutions to the list and removal from the list will be subject to the approval of the Treasury.

2 There will be a similar exclusion for activities covered by paragraphs 13 and 15 of the Schedule if the person making the arrangements, or giving the advice is an institution covered by

paragraph (iii) above and if the investments concerned are covered by paragraph 1(i) and the size of all transactions exceeds the limits in paragraph 1(ii).

3 Paragraph 17(2) will be extended to apply also to entering into a transaction of a kind covered by this exemption through the agency of an institution covered by paragraph 1(iii) above.

4 Paragraph 18 will be deleted.

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