Chapter VII

THE STOCK EXCHANGE

In 1914 the Stock Exchange was closed from the 31st July to the 14th September. On the latter date dealings in certain leading stocks were resumed for cash, with fixed minimum prices; and on the 31st October the Government announced a scheme under which the Bank of England would make advances under a government guarantee in respect of account-to-account loans, the amount of which was then about £80 million.

The Exchange re-opened for general business on 4th January 1915, when all dealings were for cash and many minimum prices were fixed. No securities were, however, good delivery unless supported by a declaration by a banker, broker or other responsible party that they had been in the United Kingdom since the 30th September and not in enemy ownership since the outbreak of war. This prevented not only enemy access to the Stock Exchange, but precluded exporters of capital from repatriating securities bought abroad and selling them at a profit. Capital issues were controlled by the Treasury as from the 18th January.

1937

Based on this earlier experience, the Bank's first ideas on Stock Exchange action when another war seemed inevitable were given to the Treasury on the 8th July 1937. They indicated that the closing of the Exchange and perhaps assistance with account-to-account loans would again be necessary. The control of capital issues could, if desired, be effected by the extension of the activities of the Foreign Transactions Advisory Committee. This Committee had been appointed in 1936 with Lord Kennet as Chairman and the Deputy Governor as a member; in fact it became a general Capital Issues Committee at the outbreak of war.

The Treasury (3rd September) thought that the closing of the Exchange should be avoided. It was important to keep the Market open to facilitate the absorption of government issues. Advances, as suggested by the Bank, or some support of the prices of fixed interest securities, would be better than closing the Exchange.

1938

1938

Nothing further happened until April 1938, when the Bank had a conversation with the Deputy Chairman of the Stock Exchange and two other members. They expressed the hope that it might be possible not to close the Exchange at all, or that closing need be for a very short period only. There was now no large contango and loan account open, control of capital issues was already partly in force, the account with the Continent and New York was probably small and the Stock Exchange had had experience of dealing for cash and of certificates of physical possession*.

At the end of May the Bank was still assuming that the Stock Exchange would have to be closed, but that no Government or Bank of England announcement would be called for in the first instance.

On 2nd June the Bank consulted Mullens & Company. Assuming no moratorium, the Bank's Brokers thought immediate closing of the Exchange, by the Government preferably, would be necessary at the outbreak of war; otherwise London would be the target via New York of heavy foreign selling. But outstanding contracts would be the main difficulty, and perhaps the Committee should permit members to postpone settlement for a specified period, renewable if necessary. Probably no Government assistance on loans would be necessary. Dealings on re-opening should be for cash.

The Treasury still hoped that the Exchange would either not be closed or closed only for a very short period, and agreed that the Bank could now consult the Stock Exchange authorities.

A Westminster Bank memorandum about this time gave the Clearing Banks advances to the Stock Exchange in April 1938 as only about £13½ million.

At a meeting with the Clearing Banks on 14th June, the Deputy Governor said that he hoped they would not deal too hardly with Stock Exchange clients in the event of an emergency, and received adequate assurance.

The Chairman

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*Certificates that securities have been in possession of the holder since a certain date, e.g. the beginning of the war.

The Chairman of the Stock Exchange Committee considered that the best way of dealing with maturing contracts would be to amend the Rules and give the Committee power to postpone settlements; this would naturally mean consulting the Committee, which had not yet been brought into the discussion. The Bank informed the Treasury of these views. At a meeting on 29th June the Deputy Chairman had expressed the same views as Mullens & Company and thought that minimum prices might prove necessary; and the Bank asked for a memorandum on this subject as a basis for further discussion. The Treasury agreed that the Committee should be consulted in confidence on the suggested amendment to the Rules and the Committee felt that the Rules should be altered forthwith.

On 18th August the Bank wrote to the Treasury to pass on the assurance of the Chairman of the Stock Exchange that the proposed change in Rule 96* should not excite undue comment; but the Treasury now took the line that the alteration might have a most damaging effect and would be likely to attract the attention of the financial press. On the day after the Munich pact the Treasury, under pressure from the Bank, allowed the alteration. The Rule was changed in December and came into force at the beginning of January 1939.

In the 1914-18 war minimum prices existed for a considerable number of stocks, not only gilt-edged securities, from the re-opening of the Exchange on the 5th January 1915 to the 3rd July 1916 when all minimum prices were removed. In this interval several changes took place, the Stock Exchange sometimes pressing for a reduction in the minima, at which times the Treasury usually seemed to prefer their removal, and at others pressing for removal, when the Treasury opposed it. The final abolition had been urged by the Committee in the spring of 1916. The difficulty then seems always to have been that the minimum prices became too high (as was to be expected with interest rates rising), and the resulting lack of a market if the minima were not lowered was thus likely to be bad for the British Government's credit, to lead to a black market, and to incidental disadvantages.

If securities

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*Rule 96 provided for the fixation, at the first meeting of the Stock Exchange in September each year, of 24 Account Days for the ensuing year.

If securities could not be sold, loans against which they were pledged could not easily be repaid; probate valuations became too high; and selling pressure was unduly diverted to those securities which were not maintained at an artificial level. Borrowers received an artificial sense of protection and lenders an unjustified feeling of security. As a basis for further discussion a comprehensive note on minimum prices in the last war was forwarded by the Chairman to the Bank on the 21st July 1938.

On 26th July the Bank advised the Treasury of the position of the negotiations, and the Treasury gave general approval. As regards an assurance by the Committee that Provincial Stock Exchanges would also be covered, the Treasury thought that, as soon as the need for secrecy had passed, direct contact with these might have to be established. The Bank had no time to give the matter further attention prior to the Munich crisis of September 1938.

Three days before the Munich pact (29th September) the Chairman and Deputy Chairman of the Stock Exchange were asked to call at the Bank. They said that certain nervous members had proposed to them that minimum prices should be introduced and the Stock Exchange closed. The Chairmen and the Bank considered both steps inadvisable. However, with the consent of the Stock Exchange Committee and the prior knowledge of the Government Broker, on 27th September minimum prices were informally fixed by a Gentleman's Agreement, for securities other than those in the Supplementary List. They covered all gilt-edged securities, including Home Municipal Stocks and Dominion & Colonial Government securities. The levels chosen were approximately the lower prices ruling at the close of business on the 26th. This gave the market a steady appearance, but dealing was difficult. Up to the evening of the 28th prices fluctuated a little above the minima. After the Munich pact prices rose and the agreement lapsed.

1939

A sub-committee was set up in March, and with Treasury approval was taken into the Chairman's confidence on the emergency measures which had been discussed with him. Minimum prices were

again

again debated at the end of March, the Stock Exchange pointing out that though they should be limited at first to gilt-edged, selling pressure would spread to other markets. A more general scheme might have to be considered.

On 1st May the Bank told the Chairman that the Treasury were still very nervous about minimum prices and anxious that if they were introduced at all they should be kept extremely flexible and removed at the earliest possible date. A suggestion by the Bank that they should be allowed to fall by a fixed amount daily was rejected as making bear speculation easy. The Bank also said that the Treasury saw no possibility of preventing a black market outside the Stock Exchange. A few days later the Exchange showed some nervousness about loans but found the Bank unwilling to take further steps towards any form of moratorium.

Meanwhile, in April, the Bank had turned their attention to the question of the transfer of inscribed stocks. At a meeting on 31st May between representatives of the Stock Exchange and the Bank it was agreed that the simplest method would be the universal adoption of the common form of transfer deed*.

On the 23rd August the Chairman of the Stock Exchange suggested that registration should be introduced for any Government, Guaranteed and Colonial Stocks which might then be held entirely in bearer form. The Bank promised to consider this in respect of any issue with which they were concerned, a promise which was implemented ~~shortly before the outbreak of war~~ a few days later by the introduction of registration facilities for 1% Treasury Bonds, the only security for which such facilities were not already available.

On the next day (when the Bank Rate was put up to 4% and the Emergency Powers (Defence) Act passed) the Stock Exchange fixed the lower quotations of 23rd August as minimum prices for gilt-edged securities. On the 25th the minimum price of 2½% Conversion Loan was lowered by the amount of the dividend (the Stock being quoted ex-dividend

*For an account of the legislation abolishing Inscribed Stock in respect of Government issues, see chapter on the Chief Accountant's Department.

APPENDIX
~~ANNEX~~ .....I..... (B)

REDEMPTION AND CONVERSION OPERATIONS, INCLUDING ACQUISITION OF SECURITIES BY H.M.TREASURY (UP TO AND INCLUDING 1ST AUGUST 1945)

The following tables give particulars of the redemption, conversion and acquisition operations that took place during the war. In most cases, as will be seen, there was offer of exchange or conversion into a new Security yielding interest at a lower rate; unless a different date is given in the column headed "Conversion", the redemption date was the effective date of conversion. Holdings in respect of which the offer of conversion had not been accepted by the specified closing date were repaid as on the date given in the last column.

In addition to these operations there were the usual drawings in various Securities. New Zealand 3½% Conversion Stock 1939/45 is of interest since a periodic conversion offer was made at each half-yearly drawing; the offer covered drawn or undrawn Stock. Annual drawings of Chinese 4½% Gold Loan 1898 were held and complete and up to date records kept in order that repayment may be made when funds are forthcoming: the drawn Stock is transferable.

Table 1

Title of Security	Approx. No. of Accounts affected: Redemption	Approx. No. of Accounts affected: Conversion	Conversion or Exchange into		Redemption date
Sudan Government 5½% Guaranteed Bonds	720				1 Nov.1939
New Zealand 3½% Consolidated Stock 1940	8,700	3,780	New Zealand 3½% Conversion Stock 1939/45 (5.8.1939)		1 Jan.1940
4½% Conversion Stock 1940/44	51,300	15,640	2% Conversion Stock 1943/45	Special Regulations S.R.& O. 1940 No.49	1 July 1940
Blue Star Line 5% Guaranteed Debenture Stock 1946	300			Special Offer of Repayment	15 Jan.1941
Metropolitan 3% Consolidated Stock 1941	570	1,740	3½% London County Consolidated Stock 1956/68		1 Feb.1941
1% Treasury Bonds 1939/41	220				1 Feb.1941
Blue Star Line 5% Guaranteed Debenture Stock 1946.	450			Final redemption of Stock where holder had not accepted the special offer	15 Mar.1941
5% London County Consolidated Stock 1940/60	8,080				30 Apr.1941
Hull Corporation 5% Redeemable Stock 1941/61	1,020	2,160	Hull Corporation 3½% Redeemable Stock 1960/70		1 Aug.1941
Liverpool Corporation 5% Stock 1941/61	1,710	2,020	Liverpool Corporation 3½% Redeemable Stock 1960/70		1 Aug.1941

1509

dividend on that day). This practice was followed in all cases except that of the 3½% War Loan on 26th October (when the Bank Rate was reduced to 2% and markets were strong) until 15th November. The Governors and the Bank's brokers then agreed there should be no such adjustments in future. In view of the Government's scheme for the evacuation of London the Stock Exchange decided on 31st August to close the House from Friday, 1st September; all bargains were to be for cash. It re-opened on 7th September.

A thaw set in early in October and by the 20th of the month all stocks were well above their minima.

Early in February 1940 the Bank were considering whether the minimum prices should be raised. On the whole the conclusion was in favour of no change unless there were an attempt to make "a reasoned assessment of the value of shorts, mediums and longs, thereby reflecting the Government's determination to maintain their credit on a high level for the duration of the war".

On 18th March minimum prices were revised upwards for some Government loans* and other securities and announced immediately prior to the commencement of dealings in the new 3% War Loan on that day; and on 26th March higher minima were fixed for four groups of Trustee securities. But these changes resulted from the adoption of the policy referred to in the previous paragraph and reflected a comprehensive arrangement for putting Government securities on the following basis -

Up to		5	years	2%
"	"	15	"	2½%
"	"	40	"	3½%

This move was welcomed by the Chancellor as "evincing the desire on the part of the authorities to co-operate in the policy of maintaining interest rates at the present level". No attempt was made to disturb the new basis.

The minimum

*C.T. 13.3.40: The imminence of official dealings in the scrip of the new War Loan raised the question of the revision of minimum prices in the gilt-edged market. It was agreed that these minimum prices ought to be promptly adjusted so as to approximate roughly to current dealing prices, on the levels established by the recent 2% Conversion Loan and 3% War Loan. The objects of such a change would be to give permanent support to H.M.Government's policy of low interest rates during the war, to minimise debt charges and in the event of crises to avoid any material falls in market prices.

The minimum price of "tap" loans was fixed on each occasion at 100 (the price of issue). A price under par seemed undesirable and would have suggested to the public the likelihood that the stock they subscribed for would be marketable only at a discount, and would have thus been detrimental to the success of the issue. The arrangement was simple both for the investor and the banks.

But a change in the minimum prices came in connection with the issue of 2½% National War Bonds 1949/51, on 9th October 1941. If these bonds were issued at 100, it was thought that dealings in the two previous issues, which were on an "accrued interest" basis, might become difficult because of the high rate of income tax (raised to $\overset{s}{8}/\overset{d}{6}$ on 23rd July). To place National War Bonds 1945/47 and 1946/48 on the March basis would have meant a minimum price of about 97. A compromise of 98½ was decided upon and the practices of issuing "tap" loans at 100, and maintaining their minimum price also at 100 while "on tap" were continued. After withdrawal of the issue the minimum price became 98½, the first instances of which were criticised in some quarters as unnecessarily low.

Before the change was made the Treasury seem to have been in some doubt whether minimum prices should be continued at all. The Bank, however, felt throughout that they should remain for the duration of the war, as a safeguard against war reverses, against the possibility of which there could obviously be no assurance. They would also be a useful support in the event of the Government's having to give support to the gilt-edged market~~s~~ after the war, to maintain a cheap money policy in the face of heavy selling for reconstruction and other purposes. The many disadvantages of minimum prices had, of course, always been recognised, and a more or less frozen market for current "tap" loans had sometimes to be accepted as inevitable in these conditions. An arrangement* was, however, made with the Government broker and the National Debt Commissioners to ensure that there should always be a buyer when necessary, for example, in case of forced sales.

<u>Commission</u>

On 22nd September 1941 commission on 2½% National War Bonds was reduced from 1/8% to 1/16% on dealings in amounts of

* Particulars not published.

£50,000

£50,000 and over when shared with agents, and to 1/32% when not so shared.

Thus, after about a year of war things had more or less taken the shape they were to assume until there was a return to something like normal in 1945; and the following few extracts will perhaps serve to indicate the kind of development which occurred in a set of conditions predominantly ~~conducted~~ dictated by the Government's continuous need and pressure to direct every available penny to themselves.

In the first place the following Treasury Committee Minutes seem worth recording -

3rd July 1940 "The recent heavy fall in the industrial market on the Stock Exchange had led to many appeals for intervention in one form or another. The various factors contributing to the depression of this particular market had been fully considered and no special action appeared to be called for at the present time."

14th October 1942 "A protest against the arrangements made for the recent issue of Electricity (Civil Defence) 3% Stock 1955/60 had been lodged formally by the Chairman of the Stock Exchange Committee but on behalf of jobbers in the gilt-edged market who complained that they were not invited to participate. At the request of the Chairman, he had had an unofficial and friendly meeting with representative jobbers; but in his view it was not the function of a jobber to take up stock on condition that he did not part with it for six months at less than the price of issue."

11th August 1943 "The Stock Exchange had recently expressed their dissatisfaction with the limitations now placed on their freedom of action, particularly in the matters of minimum prices and control over the granting of permission to deal. In his view, minimum prices were no impediment to business at current levels; but were still a wise protection to the gilt-edged market in the event of a sudden unfavourable change in prices. Although the control over permission to deal might possibly divert some business from the Stock Exchange their freedom still compared favourably with that of, for instance, the bankers;

and the

and the abolition of this control would both impair the effectiveness of the Capital Issues Committee and tend to develop rival attractions to Government "tap" issues."

In September 1943 the Chairman (Sir Robert Pearson) * and other members of the Stock Exchange Committee called at the Treasury and put forward certain representations concerning permission to deal. Referring to this meeting a Treasury letter (11.10.43) stated "...... since you and your colleagues on the Stock Exchange Committee called last month the Committee's representations about the Treasury's control of permission to deal have been receiving careful consideration. .... In the present instance, however, I regret that we cannot accept your Committee's suggestion and abandon control of the granting of permission to deal and that we must continue to regard it as complementary to the control of capital issues and equally necessary in the public interest."

"The Committee should judge the granting of permission to deal in any given case by the same criterion as they would an application to make an issue. That criterion is whether the marketing of the securities, like an issue, is necessary in the national interest."

In August 1944 the Committee decided that dealings on the Stock Exchange in British Government Stocks should be automatically on a "plus accrued interest" ** basis when the stocks come within five years of their final redemption date (except where notice of repayment at an earlier date is given).

On 11th August 1944 the Deputy Governor, having already spoken to the Chairman of the Stock Exchange Committee about small transactions (£500 or so) where payment had been made in small notes and the securities put in the names of brokers' nominees, wrote to him asking him to warn members against such cash payments unless good reason for them could be produced (with the object, of course, of frustrating black market dealings). At the end of the same month the Stock Exchange Committee issued a notice warning members against accepting payment in notes for the purchase of securities without first making full enquiry into the circumstances.

* 1936-1947.

** For an explanatory note see the Annex to this Chapter.

On the 17th October 1945 the Governor announced in Committee of Treasury that the minimum prices arrangements would shortly be abandoned "as it was now considered that their useful purpose had ended". They were withdrawn on 21st October.

1946 Cash dealings ceased on the 10th December; and fortnightly settlements were reintroduced on the 11th. The first post-war account was in fact a "long" one (3 weeks), to cover Christmas.

Facilities for the postponement of payment for or delivery of stock, in the form of contangos, were re-introduced in April 1949. Continuations between jobbers and between jobber and broker, as before the war, were permitted, but not between broker and broker; and dealings were subject to the £2 stamp duty instead of the 10/-s (privileged) rate for jobbers. Jobbers were required to make returns to the Council showing their "open" position; but the figures were not published. Options, or the right to buy or sell stock at an agreed price over a given period, were not revived.

The Bank and desirable reforms in the Stock Exchange

As early as the summer of 1941 the Stock Exchange were considering reforms, and the Bank had indeed for some years been trying to persuade them to accept new public responsibilities. The Bank, for instance, believed that a fund should be established from which the public could be protected against fraud or misdemeanour on the part of Stock Exchange members.

The Bank also thought that the Stock Exchange should have a single management in place of Trustees who had charge of funds but were removable and a General Purposes Committee who could be easily removed but held no money; and that the Chairmanship should be a full-time paid job. The Bank also advocated a Charter, which, however, had the disadvantages that the expulsion of a member for misbehaviour would be more difficult, whereas no reason for expulsion need be given under existing rules.

Both these reforms were carried out after the war, though no charter was granted. In March 1948 a new constitution of the Stock Exchange provided, under an altered Deed of Settlement, for the powers and duties of the Trustees and of the Managers of the Committee for General Purposes to be merged, and vested in one body - the Council (Chairman, 2 Deputies and 33 other members*).

Guarantee Fund

In March 1950 the Council created, by Trust Deed, a fund to compensate members of the public for possible loss in the future as a result of the failure of Stock Exchange members to meet their obligations, the result of an intensive examination of failures, begun in 1938 but under consideration as early as 1932.

The fund would have an income of about £8,000 (based on membership at the time and the experience of the years 1932-38); but the Council indicated willingness to consider the making of advances should the resources of the fund prove insufficient to meet approved payments of claims arising from losses under four heads:

Securities not delivered;
Securities delivered but not paid for;
Funds in the hands of defaulters -
(a) Awaiting investment, or
(b) Improperly dealt with.

* In 1949; but ordinary members are to be reduced to a maximum of 27

~~Capital~~

ANNEX

"PLUS ACCRUED" DEALINGS AND "FLAT"

1. Dealing "plus accrued" is, of course, only suitable for fixed interest securities, and judging by London's reactions its popularity is in inverse ratio to the complications of ~~the~~ local income tax laws. The fundamental case in support of such dealings must properly be associated with the professional, as the normal private investor regards a deal entirely as a capital transaction and is concerned only with "price" and with a regular sequence of dividends.

2. In London "plus accrued" is important for the Discount Market, who trade on money borrowed from day to day and are therefore vitally concerned to establish from day to day what their borrowed money is earning. In New York dealings in the Bond Market are normally for cash, and there is a very heavy daily carry over on borrowed money, which provides an analogy with our Discount Market, and accordingly a reason why Bond Market prices are quoted in this way. On the Continent Paris deals "flat", but Berlin, Vienna and Amsterdam deal "plus accrued". In all Markets bonds in default are quoted "flat".

3. The London Stock Exchange, which for this purpose means jobbers, are concerned only with profits, which are simply determined by the difference between buying and selling prices. Jobbers are accordingly not interested in voluntarily complicating their own book-keeping, while stockbrokers similarly tend to prefer "flat" quotations as relieving them of the responsibility of explaining a complicated system of "plus accrued" and "minus rebate".

4. The theoretical argument in favour of quoting all fixed interest Stock Exchange prices on a "plus accrued" basis is presumably that the system removes the necessity to obscure prices by arbitrary adjustments o/a dividends, which is sometimes a feature of "flat" prices.

5. The Stock Exchange Rule (138) regarding dealings "plus or minus accrued" reads:-

"Bargains in bonds and debentures include the accrued

interest

> interest in the price, except in the case of British and Colonial Treasury and Exchequer Bonds or Bills, Rupee Paper, Indian Railway Debentures and certain securities of a like character which are dealt in so that the accrued interest up to the date for which the bargain is done is paid by the buyer."

We can trace from our records that this Rule was in existence in 1920 and it is no doubt older. But its rather vague terms reflect the absence of any definite underlying principle.

6. The "plus Accrued" basis, though in operation on the London Stock Exchange before 1914 (e.g. India rupee loans), only came into prominence during the 1914/18 War, when all issues of Exchequer Bonds, Treasury Bonds and National War Bonds were so quoted, irrespective of their currency; cf. the Official List for 1917 o/a Exchequer Bonds redeemable on the 1st January 1930 and for 1920 o/a all series of National War Bonds (the longest maturing in 1929).

7. The fact that this method of quotation, though suited to the convenience of the Discount Market, was not so suited to other types of investor was evidenced by a number of complaints from the public in 1917, who by then had become holders of considerable amounts of Exchequer &c.Bonds. Criticism was directed particularly against the refusal of the Stock Exchange to allow purchasers to deduct income tax from the accrued interest included in the purchase price, notwithstanding that Section 97 of the Income Tax Act of 1842 empowered such action. The Stock Exchange justified their refusal by maintaining that it was their custom to make due allowance for the tax when fixing the price of the Bonds, but a study of market fluctuations over a period failed to support their contention, a fact which they admitted when pressed on the point.

The matter was referred to the Treasury, with whose approval a meeting was arranged early in 1918 at which representatives of the Bank, the Stock Exchange, the Discount Market and the Inland Revenue attended. Though the Bank had earlier taken the view that the proper solution was for the Stock Exchange to restore to purchasers their right to deduct tax on accrued interest, they appear to have been convinced by the

arguments

arguments put forward at the Meeting that, with so many complications in the income tax position, the restoration of such a system would lead to hopeless confusion; at all events, they and all other parties recommended that the particular clause should be repealed. This recommendation was made effective by the terms of the Income Tax Act of 1918, which repealed the whole of the 1842 Act and contained no clause corresponding to Section 97 of the earlier Act.

In the opinion of the Governor (Lord Cunliffe), writing to the Treasury, there remained two possible alternatives:-

(i) having repealed Section 97 of the Act of 1842 to continue the existing method of quotation, leaving buyers to protect themselves by seeing that the liability to tax is properly allowed for in the price;

(ii) to put the quotations for Exchequer Bonds and other short-dated securities on the same basis as those for War Loan (i.e. a "flat" price).

It was fairly clear that the first alternative would do nothing to remove the grievance which had given rise to the discussions. The second, though having much to recommend it from the point of view of the public and the Stock Exchange, was by no means acceptable to the Discount Market, who contended that to add the value of accrued interest to the price of the Bonds would, owing to the impossibility of adjusting prices to accord exactly with the increased amount of interest accruing from day to day, make it necessary to quote wider prices, which would tend to restrict markets to the ultimate disadvantage of the public and the Government. In conveying his views to the Treasury, the Governor expressed the opinion that, whilst there was much to be said on both sides of the question, the ultimate advantage lay in obtaining a closer price, and that he was therefore in favour of leaving things alone.

8. During the recent War "plus accrued" (gross), in association with repeated "tap" loans, minimum prices and high taxation, contributed in some degree to the semi-frozen conditions which have been a feature of the highly controlled New Issue market, since for two months in every half-yearly period a buyer must pay to a seller more (gross) interest than the buyer receives net.

net. On the other hand it enabled some degree of (professional) activity to be maintained at the finest prices in loans even whilst "on tap".

9. In October 1941 an attempt was made to reach agreement with the Market for a settled basis regarding quotations "plus accrued", the question assuming concrete form as a result of the "tap" issue of National War Bonds 1949/51 then current, which was approaching a ten-year maturity. It was finally agreed in January 1942 with all parties, including the Treasury, that thereafter:-

(i) all new issues with a final maturity of five years or less;

and (ii) existing issues when they reach a date five years from the final maturity or when notice of repayment has been given;

should be dealt in "plus accrued" interest as from the 1st February 1942.

That National War Bonds 2½% 1946/48 should continue to be dealt in "plus accrued", though they did not fall into the above category until the following year.

That National War Bonds 2½% 1949/51 should be dealt in "flat" from the 1st February 1942 when the first dividend was payable.

When notice of redemption was given in 1944 to holders of 5% Conversion Loan, the Market asked that the method of quoting this Stock should not be altered because of the controversy which the change would provoke, the difficulty of explaining the need for a change covering only a period of three months and the difficult precedent which would be created, e.g. in the event of War Loan being converted. On the other hand, dealings in 2½% National Defence Bonds 1944/48 were switched to the "plus accrued" basis in September 1943 without difficulty and without attracting adverse comment.

10. Thus it would appear that the agreement of 1942 is fully justified on the grounds that:-

(a) the Discount Market are the main and proper supporters of short-term Government securities and the advantages to them of dealing "plus accrued" are obvious;

(b) there is no good reason for forcing an alteration in the normal method of quoting all other fixed interest securities "flat" which, incidentally, is well suited to the complexities of our income tax system.

(H.B.C.Y.)

24.5.1944

CAPITAL ISSUES CONTROL

Continuously since June 1932 (the time of the 5% War Loan conversion) there has been control to a greater or less degree over Capital Issues in the United Kingdom. The 1932 control and such modifications as were made up to 1939 were without a statutory basis but resulted from public requests by the Chancellor which the various Markets observed.

One of the controls related to issues involving remittances directly or indirectly outside the Empire and it was to advise the Treasury on this restriction that the Foreign Transactions (Advisory) Committee was set up in 1936.

In the discussions prior to August 1939 on emergency measures it was expected that the Foreign Transactions (Advisory) Committee could be turned overnight into a Committee to advise the Treasury on the administration of the statutory control of Capital Issues which was proposed to come into operation at the beginning of the war.

At the outbreak of war the Committee was re-named the Capital Issues Committee; there was no change of membership and the secretarial work continued to be done by staff supplied from or by the Treasury. (The staff had to be augmented because of the greater volume of work which a full control provided as compared with that arising from foreign issues only).

The requirement that Treasury consent was necessary for all Capital Issues (and analogous transactions) was contained in Regulation 6 of the Defence (Finance) Regulations 1939. In order that the Committee and the Treasury should not be overwhelmed by a large number of applications, some covering very small amounts, there was a general exemption in favour of, inter alia, issues not exceeding £5,000 (increased within a few months to £10,000) in any one year, bank borrowing in the ordinary course of the borrower's business and certain other kinds of issues of securities not involving new money.

The general criterion to be adopted by the Committee in considering applications was the advisability of allowing the scheme in the national interest. The position was made clear in a press announcement at the outbreak of war.

The exemption in favour of bank borrowing, while necessary from an administrative point of view, did, however, mean that there was an indeterminate line between operations which in fact might short-circuit Capital Issues control and operations which the exemption was intended to cover, e.g., seasonal financing of raw materials and stocks of goods. The banks were therefore asked by the Chancellor through the Governor of the Bank of England that they should restrict advances during the war to purposes which would assist the war effort or which were otherwise designed to meet national needs; this was thus complementary to the formal control.

Developments in later years may perhaps best be set out chronologically.

1940

A Bill for limitation of dividends was introduced and discussed in Parliament but was discontinued; however, in his Budget speech, the Chancellor said that issues in capitalisation of profits/reserves would not normally receive Treasury consent. The de minimis exemption was not applicable to such issues.

1941

To facilitate conversions of high-interest-bearing stocks of Local Authorities, statutory powers were obtained in the Public Works Loans Act 1941 whereby the Treasury were authorised to underwrite, in effect, such operations through the Local Loans Fund.

1942

To supplement the control of Capital Issues the Stock Exchange, who had agreed from the outbreak of war that they would not give permission to deal in any security the issue of which required Treasury consent, unless that consent had been given, agreed that they would not give permission in respect of any securities, for which permission to deal had not already been granted, unless the Treasury had approved. This covered possible circumvention of the new issue control by the use of certain exemption provisions designed to facilitate Company reorganisations and also controlled the marketing of securities which, for any other reason, e.g., because they were issued before the war, were not subject to the existing control.

It was arranged for Market operations and for private placings that consent should be subject to the terms and timing of the issue being agreed with the Bank of England on behalf of the Treasury.

1944.

Owing to the growth in transactions in securities not quoted on the Stock Exchange, the Stock Exchange and other financial organisations were asked that their members should not deal in such securities unless the Treasury approved in a particular case; this was known as the "Grey Market" restriction.

The exemption limit of £10,000 in any one year having been abused to the extent, in certain instances, of the formation of large groups of small companies each taking advantage of the de minimis exemption, the Statutory provisions were altered whereby no new company could take advantage of the exemption unless the Treasury so directed; and the Treasury were empowered to withdraw the exemption from existing companies. The exemption was not given, or was withdrawn, as the case might be, in a number of instances.

1945

With the conclusion of hostilities, the tests to be applied to Capital Issues applications were necessarily altered and a "Memorandum of Guidance" to the Capital Issues Committee was issued in May; simultaneously the exemption limit was raised from £10,000 to £50,000 in any one year. As regards bank advances, the Chancellor asked, in a similar manner to the 1939 request, that the banks should, as regards advances, continue their co-operation on the new basis notified to the Capital Issues Committee.

At the same time the Treasury's control over permission to deal on the Stock Exchange, and the "Grey Market" arrangement, were discontinued and the 1942 arrangements for agreement of terms, etc., with the Bank of England were restricted to terms and timing for Trustee (and Quasi-Trustee) issues and to timing for other issues (over £100,000).

Under the Local Authorities Loans Act 1945, Local Authorities were, with certain exceptions, required to raise money by borrowing from the Public Works Loans Board, and not on the Market. Conversion of existing stocks could, however, take place and the 1941 Act was extended to cover final maturities as well as stocks for which the borrowers, with Treasury permission, gave notice of redemption.

1946

In order to make permanent provisions for Capital Issues control, the Investment (Control and Guarantees) Bill was introduced and subsequently became the Borrowing (Control and Guarantees) Act 1946.

1947

The above Act was brought into operation as regards borrowing by the Control of Borrowing Order 1947. In effect, previous arrangements were continued by the Act and the Order, although the control was from the angle of borrowing and not, as previously, from that of issue of a security. It had been intended that Treasury control of public offers for sale of existing securities should cease when the 1947 Order came into operation (when Regulation 6 of the Defence (Finance) Regulations was to be entirely discontinued), but it was eventually decided that Regulation 6 could not be dispensed with completely; control of public offers for sale was continued through a modified Regulation 6 in respect of all securities issued less than two years from the date when they were publicly offered.

The Chancellor in his Budget speech stated that he was prepared to allow capitalisations of profits and reserves, but a 10% stamp duty was imposed.

Following the convertibility crisis, the Capital Issues Committee were asked to keep a stricter control on borrowing; and the same request was made to the banks.

1949

The stamp duty on bonus issues was repealed. In October such issues were temporarily stopped, after a considerable number had taken place, and were from December allowed if they were considered to help companies doing a large export trade.

The 1945 and 1947 instructions to the Capital Issues Committee were revised inasmuch as an emphasis was now placed on borrowing to promote and maintain exports and industrial efficiency; again the banks were asked to co-operate.