

Supervision of the securities markets: non-statutory aspects

Introduction

1 The system of supervision of the securities markets in the United Kingdom is a blend of statute law and non-statutory regulation. The statutory framework of the system has been described in the Department of Trade's paper *Supervision of the Securities Market: the statutory framework and specific controls* already submitted to the Committee. This paper describes the non-statutory aspects of the supervisory system. Part I deals with the main elements of these as they currently exist. Part II considers recent developments in securities markets and the genesis of the recently formed Council for the Securities Industry.

I The existing system of supervision

2 The securities markets with which this paper is principally concerned are the primary and secondary markets in securities listed on the Stock Exchange. The primary market is where users of long-term capital, such as the Government, the local authorities and public companies, seek to raise funds from investors by the issue and subscription of new securities; the secondary market is where investors are able to buy and sell among themselves securities that have already been issued.

In respect of borrowing by the Government, however, the distinction is not clear cut, since the tap system of issuing new government stock involves using the secondary market for the raising of new funds to the extent that a tap issue is not fully subscribed on its initial appearance.

3 In terms of value, activity in both markets is dominated by transactions in gilt-edged stocks. New issues of British government stock accounted on average for approximately 74% of the gross new money raised in each of the eight years ended 31st December 1977, compared with just under 14% for company issues and about 12% for local authorities and public boards. [1] Similarly, in the secondary market gilt-edged transactions accounted on average for about 70% of total stock exchange turnover in value terms over the same period, [2] compared with about 24% for company securities and 3% for local authority securities.

4 The investors in these markets are private individuals and the institutions through which the savings of millions of individuals are increasingly channelled [according to estimates made by the Royal Commission on the Distribution of Income and Wealth in their second report *Income from companies and its distribution* (July 1975), on the basis of figures up to 1973, nearly eleven million people were members of occupational pension schemes and approximately fourteen million taxpayers saved through life assurance of one kind or another]. The major institutional customers of the securities markets are represented by the National Association of Pension Funds, the British Insurance Association, the Association of Investment Trust Companies and the Unit Trust Association. An important rôle is also played by members of the Issuing Houses

Association, many of whom (particularly members of the Accepting Houses Committee) manage sizable investment funds, and by the major deposit banks, which have traditionally acted as trustees or custodians of personal savings and have recently been expanding the scope of their investment management services, besides operating in a substantial way in the gilt-edged market on their own account.

5 The non-statutory aspects of supervision of the securities markets are centred on the Stock Exchange and the Panel on Take-overs and Mergers, which are involved in day-to-day operational supervision, on the Bank of England with their overall concern for the soundness and effective operation of the markets, and latterly on the Council for the Securities Industry.

The Stock Exchange

6 Historically, the main task of non-statutory regulation of the securities markets has rested with the Stock Exchange. That this should have been so, and that the Stock Exchange should have been able to impose and enforce appropriate ethical standards within a non-statutory framework, is in no small part due to the essentially unified nature of the capital market in the United Kingdom. As was pointed out in the response of the City Capital Markets Committee to the inquiry of the Department of Trade undertaken in 1974:

Under the British system the unified capital market has no effective competitor in its function of providing the mechanism for the marketing and exchange of securities representing share and loan capital. All market practitioners are, for practical purposes, totally dependent on the procedures, forms, rules and regulations of The Stock Exchange. [3]

7 The Stock Exchange's regulatory function has two aspects: the establishment and enforcement of the standards required for the listing of securities, and the control and surveillance of its own members' activities. A description of the way in which these tasks are fulfilled is contained in Appendices A to D of the evidence submitted by the Stock Exchange in connexion with the first stage of the Committee's inquiry, which will doubtless be supplemented in further evidence. For the purposes of this paper certain aspects only require to be emphasised.

8 The standards required for the listing of securities on the Stock Exchange are laid down in the Rules of the Stock Exchange, and in particular the standards for prospectus documents, by means of which information is conveyed to the investing public, in Appendix 34 to those Rules. A prospectus issued under Appendix 34 by a company seeking listing of its securities for the first time is designed to present the record of that company's past history, present situation and future prospects in such a way that no matter relevant to the making of an informed investment decision is omitted. The requirements of Appendix 34 cover the provisions of the Companies Acts regarding prospectuses, but are in several material respects more stringent. Moreover, they are the subject of regular review and, where appropriate, amendment. The 1948 Companies Act itself gives tacit recognition to the prospectus standards imposed by the Stock Exchange by waiving the requirement for

[1] Source: Stock Exchange figures on page 198 of Vol. 3 of *Evidence on the Financing of Industry and Trade* (HM Stationery Office, 1978).

[2] Until March 1973, figures are based on turnover on the London Stock Exchange only; thereafter they embrace all floors of the exchange.

[3] Paragraph 4 of 'Summary of Conclusions', page 2.

a Companies Act prospectus where the Stock Exchange grants a certificate of exemption to a company seeking a listing and publishing a prospectus complying with Appendix 34.

9 The Stock Exchange requirements for listing do not stop with the first issue: they also contain continuing obligations on the issuer to maintain proper standards of disclosure and conduct towards its shareholders for the future. These are stated in the Listing Agreement, which is entered into between the issuing company and the Stock Exchange, and go far beyond those required by the law. It is the Listing Agreement rather than the Companies Act, for instance, which requires half-yearly reports and the prompt publication of details of all major acquisitions and disposals and other price-sensitive information.

10 Compliance with these disclosure requirements is closely monitored by the Stock Exchange's Quotations Department, to which all circulars to be sent to holders of securities must be submitted first for approval. These requirements apply to all companies whose securities are listed on the Stock Exchange, irrespective of their country of domicile or local securities laws (although some relaxation may be permitted in the case of foreign companies). The sanction of the Stock Exchange for breach of the Listing Agreement is the suspension of dealings. While this is a severe sanction, which when applied can affect the interests of investors generally as well as the actions of the directors concerned, the mere threat of its use has in practice proved generally effective. The Stock Exchange's own monitoring is reinforced by advisers and intermediaries in new issues, e.g. members of the Issuing Houses Association, issue brokers, lawyers and accountants involved in the preparation of the necessary documents relating to new issues, all of whom have a professional duty to ensure that all material facts are accurately stated and fully disclosed.

11 The protection of investors against malpractice by stockbrokers and jobbers rests in the control over members' behaviour exercised by the Council of the Stock Exchange by virtue of its Rules and Regulations. Such protection includes specific rules, e.g. the rule that stockbrokers must always act in the best interests of their clients and rules against 'market rigging', and the financial protection afforded by way of supervision of member firms' accounts and the Compensation Fund. The Council can and does impose disciplinary sanctions against members and member firms.

The Bank

12 The Bank have an overall concern that securities markets should operate soundly and effectively. This concern stems partly from their general interest in the health of all financial markets in the United Kingdom, and partly from the scale of their own operations, as agents of government, in the gilt-edged markets, referred to in paragraph 3 above. In order to fulfil their overall responsibility, the Bank seek to enlist the voluntary co-operation of those who operate in the securities markets. This is facilitated by their understanding of the workings of those markets, resulting from their direct operational experience and from their close contacts with the institutions responsible for the day-to-day running of the markets.

13 The Bank's gilt-edged market operations are conducted through the Government Broker, who is in close consultation with the relevant officials in the Bank. With a view to maintaining orderly markets, the Bank, acting as agents of the

Treasury under powers contained in the Control of Borrowing Order, exercise control over the timing of all capital-raising operations for amounts in excess of £3 million through the operation of a queue. This covers both public and private sector issues, and the Bank have certain additional controls over the actual terms of local authority issues.

14 As the securities markets have developed, the Bank have extended the scope and frequency of their contacts with the major institutional groups involved. In some cases, for instance with the Stock Exchange, meetings take place on a regular basis. In others they are arranged *ad hoc*. Throughout, however, the Bank's aim is to act as both the stimulus and monitor of the evolution of the non-statutory side of securities markets supervision. The two most notable examples of this rôle of the Bank have been the creation of the Council for the Securities Industry, which will be discussed in Part II below, and the regulation of take-overs and mergers.

15 In the latter area the Bank's involvement began in 1959 when the Governor of the Bank called into being a Working Party, consisting of representatives of the Issuing Houses Association, the Accepting Houses Committee, the Stock Exchange, the Committee of London Clearing Bankers, the British Insurance Association and the Association of Investment Trusts, with a view to devising procedures which would prevent certain of the methods used by offerors and offerees in take-over situations which were open to justified criticism. The Working Party produced a document entitled *Notes on Amalgamations of British Businesses*, which was in effect the first code of conduct for those concerned with take-overs and mergers; but in the conditions of the time it was not thought necessary to set up arrangements to supervise or monitor its observance.

16 In the face of further undesirable practices in the 1960s, the Governor in 1967 reconvened the Working Party, adding to its membership representatives of the National Association of Pension Funds and of the Confederation of British Industry to take account of the growth of contractual saving and the interests of those whose securities were involved in take-over and merger situations.

17 Their deliberations resulted in the first edition of the City Code on Take-overs and Mergers, issued in March 1968, which dealt with the subject in more precise terms than the *Notes*, embraced most of the matters dealt with in the Licensed Dealers Rules issued by the Board of Trade in 1960 (which had been commended by the 1962 Jenkins Committee on Company Law) and added fresh provisions in the light of recent take-over developments. At the same time the Panel on Take-overs and Mergers was set up to interpret and administer the new Code, with a chairman appointed by the Governor of the Bank and the membership drawn from the organisations represented on the City Working Party. In due course an executive permanent staff was provided under a director-general, the members of which have been drawn from professions involved in the securities markets.

The City Code on Take-overs and Mergers and the Panel

18 The City Code itself does not seek to prescribe the manner in which take-over bids should be conducted. Rather it states certain general principles that should guide the conduct of those involved in such situations and elaborates them in a number of specific rules. The four main principles that underlie

the Code are:

- (i) that shareholders should be given sufficient information to form a judgment on a bid;
- (ii) that directors of an offeree company should act in the best interests of their shareholders and obtain competent independent advice;
- (iii) that all shareholders of the same class should be treated similarly; and
- (iv) that all parties should strive to prevent the creation of a false market in the shares of any company involved.

It is a cardinal tenet of the Code that its spirit should be observed as well as its letter.

19 To take account of changing methods and practices in take-overs, the Code has been revised by the City Working Party on three occasions: in 1969, 1972 and 1976 (when the current edition was issued). Additional amendments of a minor nature were issued in 1970 and 1974, and from time to time the Panel issue Practice Notes which explain the way in which they have interpreted the Rules where difficulties or doubts have arisen. This flexibility and speed of response to often rapidly changing market conditions is an important advantage that non-statutory regulation has over statute.

20 The authority of the Panel was recognised at the outset by the commitment of the bodies sponsoring the Code to engage the support of their membership for the Code and the Panel. In 1973 the Code itself was embodied in the Stock Exchange's rules relating to the 'Admission of Securities to Listing' (although compliance with the Code is not a requirement of the Listing Agreement), as it had been in the guide to Board of Trade practice about mergers published in 1969. The sanctions available to the Panel in the event of a breach of the Code are private or public censure, or the reference of a case to the relevant association of the party concerned for such disciplinary action as they are able to take. Additionally the Panel can deprive an offender, temporarily or permanently, of his ability to enjoy the facilities of the securities markets. Appeals can be made against disciplinary rulings of the Panel to an Appeals Committee, the Chairman of which is currently a retired Lord of Appeal.

21 Some critics of the Panel have argued that its sanctions are ineffective. It is, however, generally agreed that the Code is widely adhered to; and the authority of the Panel has grown and become firmly established over the past decade. The relatively few disciplinary cases that come before the Panel are indicative of the extent of adherence to the Code. There is little doubt that in financial markets where professional integrity is an important ingredient of commercial success the fear of adverse publicity deriving from public censure or expulsion from a professional organisation is an effective deterrent to misconduct.

II Recent developments

22 The foregoing description of the non-statutory aspect of the supervisory system of the securities markets has shown how the traditional mechanism provided essentially by the Stock Exchange was substantially extended in the late 1960s with the creation of the Take-over Code and the Panel to deal with problems arising in the field of take-overs and mergers.

Other developments, however, have been taking place in securities markets, domestically and internationally, over the past ten years or more.

23 The securities markets in the United Kingdom have traditionally been, and still are, substantially a unified market, very largely centralised on the Stock Exchange. Nevertheless, two recent innovations external to the traditional market in domestic securities have been the formation of Automated Real-Time Investments Exchange Limited (ARIEL) and the development of a small market in the securities of unlisted UK companies by M.J.H. Nightingale & Co. Limited. Both these markets could be described as 'over-the-counter' markets.

24 ARIEL is a private company, formed in 1974 and owned by the members of the Accepting Houses Committee, which operates a computer-based system for matching buyers and sellers of securities, whereby buyer and seller deal directly with each other and form the price by negotiation. The Stock Exchange does not permit its members to transact business with or through ARIEL.

25 Subject to certain conditions the Stock Exchange allows its members to deal in unlisted securities under its Rule 163(2). Licensed dealers also deal in unlisted securities. A similar market has recently been developed by M.J.H. Nightingale & Co. Limited, a small investment banking business, whereby firms whose securities are not listed on the Stock Exchange may seek to obtain a degree of marketability for their securities. Like stock exchange members acting within the stock exchange framework, this firm provides a matching service for buyers and sellers and covers at present fifteen securities in twelve companies.

26 Apart from such domestic developments, there has been an increasing internationalisation of securities market activity, arising largely from the attraction of London as an international financial centre. The euro-bond market, in the foundation of which in the mid-1960s British merchant banks were prominent, made London a powerful magnet to foreign brokerage and investment banking houses, trading not only in euro-bonds but in international securities generally. The market is in effect a very large over-the-counter market, operating in a number of international financial centres besides London, important as London is in the overall context. It is also largely a professional market, which, as far as international bonds are concerned, is regulated under the auspices of the Association of International Bond Dealers, a voluntary organisation to which a very large proportion of bond-dealers belongs. United States and British market practices prevail and there is no indication that the public interest is being threatened or damaged by the manner in which the market operates or regulates itself. The British public is largely insulated from this market at the moment by reason of exchange control.

27 British membership of the European Economic Community has also introduced a new factor into the securities markets in the United Kingdom, with the Commission's aim of harmonising rules and laws within the Community as they relate, *inter alia*, to the financial sector. In respect of securities markets, the Commission has proposed draft directives setting a Community standard for prospectuses and aiming at co-ordinating the other conditions governing the admission of securities to quotation. There has also been issued a recommendation concerning a Code of Conduct in stock exchange transactions.

28 All these developments prompted those involved with both the statutory and non-statutory aspects of securities market regulation to consider the scope and adequacy of the existing system and the forms that a more unified and comprehensive supervision of the London markets might take. In 1973 and 1974, on the initiative of the Governor, a number of specialised City committees were formed, providing forums within which interested parties in the City could discuss and formulate views and policy proposals. Those which have been from time to time particularly concerned with matters bearing on the securities markets were the City Capital Markets Committee, the City Company Law Committee and the City EEC Committee. In the course of 1974 a review of the system of supervision of the securities markets was undertaken by the Department of Trade.

29 Following discussions between the Governor and the Secretary of State for Trade, the Secretary of State announced in October 1976 that the review had shown that the existing combination of statutory and non-statutory supervision, although perhaps a great deal more effective than its critics admitted, could with advantage be improved in a number of respects. On the statutory side he proposed new legislation on insider dealing and loans to directors, and a tightening up of the Prevention of Fraud (Investments) Act. As regards the non-statutory system, the Bank undertook to develop their surveillance of the securities industry. In order to provide a more formalised link between those responsible for the statutory and non-statutory elements of securities markets supervision, a Joint Review Body was established, with representation from the Bank and from the Department of Trade, to maintain a continuing review of developments in the industry and the arrangements, both statutory and non-statutory, for its supervision.

The Council for the Securities Industry

30 In developing their surveillance of the securities industry the Bank's aim has been to build on the success of the existing system, particularly as regards the Stock Exchange and in the take-over field, while allowing new arrangements to evolve which will ensure that parties with interests in the development of the securities markets become involved at an early stage and on a regular and formal basis in the formulation of co-ordinated policies to deal with issues that arise. It was felt important that the public interest should also be appropriately represented.

31 A number of discussions among interested City bodies had already been taking place, but following the Secretary of State for Trade's announcement the task of exploring in depth the desirability and feasibility of the formation of a new organisation designed to co-ordinate all the major aspects of the existing non-statutory regulatory machinery was put in hand and entrusted to the Director-General of the Take-over Panel and the Deputy Chief Executive of the Stock Exchange, since both had valuable experience of the working of non-statutory regulation. They consulted representatives of the bodies represented on the Panel and discussions also took place with the Department of Trade, the Institute of Chartered Accountants, the British Bankers' Association, the City Capital Markets Committee and the City Company Law Committee. They reported that a clear consensus had emerged in favour of such a new organisation, although there was less obvious

agreement as to what the scope of its operations should be. Their report nevertheless contained an organisational blueprint for such an entity as a basis for detailed discussion.

32 Since the new body was to be voluntary, it was essential to secure the full agreement of those who would be directly concerned and whose acceptance of the new body's authority was a necessary condition of its creation. Some months were therefore spent by the Bank in seeking and considering the reactions of the different bodies involved to the working party's report and in developing proposals for the organisation of the new body and who should run it. Another high-level working party was formed to revise the original proposals to take account of the views expressed. The Department of Trade was kept continually informed of the progress of the deliberations through *ad hoc* contacts at ministerial and official levels and through the meetings of the Joint Review Body that have taken place since February 1977. Agreement in principle of those concerned was reached in March 1978, and a public announcement about the setting up of the new body, entitled The Council for the Securities Industry (CSI), together with details of its constitution, objectives and coverage, was made on 30th March. The press notice and document circulated to members of constituent organisations for their endorsement are attached as an appendix.

33 The Council held its first meeting on 19th May 1978. Its Chairman is Mr Patrick Neill, QC, Warden of All Souls College, Oxford; Sir Alexander Johnston, GCB, Deputy Chairman of the Take-over Panel (which post he will retain), has agreed to serve as its Deputy Chairman. Both were appointed by the Governor. Council membership consists of the Chairman or a representative of each of the institutional bodies represented on the Take-over Panel; [1] the Chairman of the Panel (The Rt Hon. Lord Shawcross, PC, GBE, QC); the Chairman of the Quotations Committee of the Stock Exchange *ex-officio*; a representative of the foreign banks in London; and three lay members (Dame Elizabeth Ackroyd, Lord Thomson of Montifieth and Sir Edward Singleton) representing the individual investor and the wider public interest, also appointed by the Governor. The Bank themselves have a seat on the Council. The form and extent of any representation of overseas brokers operating in London and of licensed dealers in securities are still under consideration.

34 The new supervisory body is to be built around the existing regulatory machinery of the Stock Exchange and the Take-over Panel. The different bodies involved in the securities markets will maintain their own internal supervisory and regulatory functions. It is envisaged that the work of the Council should broadly fall into two parts: first, the making of rules, and secondly, their interpretation and enforcement. The tasks of framing and amending codes of conduct and considering proposed domestic and EEC legislation of relevance is to be undertaken by a Markets Committee of the Council, which will, *inter alia*, subsume the work of the City Working Party in reviewing and amending the Take-over Code. The Markets Committee will be the body which the Stock Exchange will consult when contemplating major changes in their listing requirements (a rôle undertaken in recent years by the Stock Exchange Liaison Committee).

35 In respect of the Take-over Code, interpretation and enforcement is to remain with the Take-over Panel, which will

[1] These are: the Accepting Houses Committee, the Association of Investment Trust Companies, the British Insurance Association, the Committee of London Clearing Bankers, the Confederation of British Industry, the Issuing Houses Association, the National Association of Pension Funds, the Council of the Stock Exchange, the Unit Trust Association and the Consultative Committee of Accountancy Bodies.

become an arm of the Council but remain constituted and operate essentially as at present. The interpretation and enforcement of any new codes that may be made or practices that may be endorsed may, if appropriate, be entrusted to the Take-over Panel, or other arrangements may be made. In the case of alleged malpractice or misconduct which cannot more appropriately be dealt with under the domestic code of a body represented on the Council, the Council will decide whether any necessary investigation should be entrusted to the Panel or an *ad hoc* investigation panel set up. It is envisaged that the present Appeals Committee of the Panel should continue its existing function in the field of take-overs and mergers and be available to hear appeals on other disciplinary decisions which may be made under the aegis of the Council.

36 The Council is a voluntary body. Its ultimate authority will stem, as in the case of the Panel, from the commitment that has been made by the bodies represented on it to support its activities and its codes and to respect its rulings. The bodies represented on the Council recognise that the Council has the right to make recommendations bearing on any aspect of the activities of their members relating to the securities industry.

These bodies accept that such recommendations, although without legal or binding force, could not in practice be ignored.

Conclusion

37 Like the Panel in its infancy, the CSI will have to prove itself and develop its own *modus operandi*. The Bank believe that its creation marks an important step in the development of the non-statutory aspect of securities market supervision, creating for the first time a forum where parties involved in the securities industry will have the opportunity to make their views heard in the formulation of appropriate policies and practices in the increasingly complex field of securities markets. The Joint Review Body provides the forum at which the authorities concerned, the Department of Trade and the Bank of England, can together monitor the whole field of securities regulation and initiate improvements through either statutory or non-statutory measures as seems most appropriate. In the Bank's view, a continuing amalgam of statutory and non-statutory regulation will provide the combination likely most effectively and economically to promote the success and maintain the efficiency and integrity of the securities markets in London.

Appendix 1

The Council for the Securities Industry

The Bank of England announce that, following extensive consultations with Chairmen and senior representatives of the member organisations of the Take-over Panel [1] and with the Chairman of the Consultative Committee of Accountancy Bodies, general agreement has been reached for the setting up of a new self-regulatory body for the securities industry. The new body will be entitled The Council for the Securities Industry (CSI). A document setting out the constitution, aims and basis of operation of the CSI and the means by which it will be financed is now being circulated to members of constituent organisations for their endorsement. A copy of this document is attached.

Meanwhile the formal establishment of the new Council is in train. Mr Francis Patrick Neill, QC, Warden of All Souls College, has agreed to serve as Chairman of the new Council and Sir Alexander Johnston, GCB,

Bank of England,
30th March 1978

It will be recalled that the Secretary of State announced in the House of Commons in October 1976 that arrangements for improved co-ordination on securities regulation matters had been agreed between the Bank of England and the Department of Trade. The arrangements included the development by the Bank of their surveillance of the securities industry with a view to improving the effectiveness and cohesiveness of the existing self-regulatory machinery. Extensive discussions have been under way now for some time between the Bank and interested parties with this objective in mind.

Recently, following the detailed study by Messrs Macdonald (Director-General of the Take-over Panel) and Knight (Deputy Chief Executive of the Stock Exchange) undertaken early in 1977, a small working party has given further consideration to the non-statutory aspects of securities regulation and has confirmed the desirability of setting up a new supervisory body in which all the major organisations active in the securities industry would participate together with lay members to represent the individual investor and the wider public interest. This new supervisory body would be built around the existing regulatory machinery of the Stock Exchange, as the central market for securities, and of the City Panel on Take-overs and Mergers. The different sectors of the industry would continue to maintain and develop their internal supervisory and regulatory rôles but the new supervisory body would formalise and extend the co-ordination, consultation and co-operation which presently exists between the Stock Exchange and the users of the market with the object of sustaining, in the public interest, proper conduct and high standards in the securities industry.

Title

It is proposed that the new body should be called 'The Council for the Securities Industry'.

Objectives

The principal objectives of the new body would be:

- (a) To maintain the highest ethical standards in the conduct of business within the securities industry.
- (b) To keep under constant review the evolution of the securities industry, market practice and related codes of conduct and to scrutinise the effectiveness of existing forms of regulation and the machinery for their administration.
- (c) To maintain arrangements for the investigation of cases of alleged misconduct within the securities industry and breaches of codes of conduct or best practice and to keep these arrangements under review.
- (d) To initiate new policies and codes as necessary concerning activities in the securities industry other than those properly within the domestic province of each individual constituent member.
- (e) To resolve differences on matters of principle between constituent parts of the securities industry.
- (f) To consider the need for changes in legislation affecting the activities of the securities industry and to examine any proposals for such legislation.
- (g) To ensure liaison with the European Commission on securities industry matters and the implementation of the EEC Capital Markets Code of Conduct.

The Council

The composition of the Council would be as follows:

The Chairman and Deputy Chairman would be appointed by the Governor of the Bank of England. The Chairman of each of the following bodies would be invited to serve on the Council or to nominate an appropriate senior person to represent him.

The Accepting Houses Committee
The Association of Investment Trust Companies
The British Insurance Association
The Consultative Committee of Accountancy Bodies
The Committee of London Clearing Bankers
The Confederation of British Industry
The Issuing Houses Association
The National Association of Pension Funds
The Council of the Stock Exchange
The Unit Trust Association

In addition the Chairman of the Quotations Committee of the Stock Exchange would be an *ex officio* member of the Council; representation would also be invited from the foreign banks in London and from licensed dealers in securities.

The Governor of the Bank would nominate three lay members to the Council as representatives of the individual investor and the wider public interest. The Bank of England would also have a seat on the Council and further members could be co-opted from time to time if that seemed desirable.

[1] See footnote [1] on page 393.

It is anticipated that the Council would meet in full session as often as required, and at least once a quarter on a regular basis.

The detailed work of supervising the securities industry would consist of:

- A the framing and amendment of codes of conduct and the consideration of proposed UK and EEC legislation;
- B the administration and enforcement of (i) the take-over code and (ii) any other codes and practices that may be established.

A For the first of these tasks a *Markets Committee* of the Council would be set up which would subsume the work of the City Working Party in reviewing and drafting take-over codes.

The members of this Committee would be drawn as appropriate from the membership of the Council and might also include other members appointed from the interests represented on the Council. It would meet as required and might from time to time appoint sub-committees, to which experts could be co-opted, to examine specific issues, e.g. proposed new legislation.

The purposes of the Committee would be:

- (i) to prepare as appropriate new or expanded codes of conduct or best practice in the securities industry for consideration by the Council;
- (ii) to keep such codes under detailed review and to recommend to the Council clarifications, modifications and improvements as appropriate;
- (iii) to keep under detailed review existing and proposed legislation affecting the securities industry and to comment to the Council as appropriate;
- (iv) to examine differences on matters of principle between constituent parts of the securities industry, particularly with regard to interpretation of codes of conduct or best practice and to seek to resolve them, referring to the Council in case of need;
- (v) to liaise with the European Commission on detailed matters relating to the implementation of the EEC Capital Markets Code of Conduct and report to the Council as necessary;
- (vi) to keep under review the structure and effective functioning of securities markets and to report to the Council as necessary.

The Markets Committee would be the body which the Stock Exchange would consult when contemplating major changes in the listing requirements (a rôle undertaken in recent years by the Stock Exchange Liaison Committee). The right to grant official listing and permission to deal would remain with the Stock Exchange. Disputes which might arise in connexion with the interpretation of particular stock exchange listing requirements would continue to be settled in accordance with existing arrangements within the Stock Exchange. Where it appeared that a particular ruling carried implications of sufficient substance and general application for the future, it would be open to any organisation on the Council, or a lay member, to raise the principle with the Markets Committee and, if desired, in the Council.

B (i) The interpretation and enforcement of the take-over code would remain with the *Take-over Panel* which would become an arm of the Council but which would be constituted and operate essentially as at present.

The decisions of the Panel on the interpretation of the take-over code would be final and not subject to appeal. The Panel would continue to work closely with the Quotations Committee and the Council of the Stock Exchange. The Quotations Department would continue to undertake preliminary enquiries into circumstances of unusual price movements and into domestic stock exchange matters. When initial enquiries suggested that a breach of the take-over code had occurred, the matter would be referred to the Panel. The Panel would make a quarterly report to the Council on its work and would keep in close touch with the Markets Committee on possible amendments to the code.

(ii) When the Council, in the future, agreed to a new code, or endorsed a practice, arrangements would have to be made for its interpretation and enforcement. This could be entrusted to the Take-over Panel or other arrangements might be made.

If the Council received information which led it to believe that breaches of such a code or cases of alleged malpractice or misconduct had occurred which could not more appropriately be dealt with under domestic codes of individual members of the Council, it would decide whether an investigation should be entrusted to the Panel or whether an *ad hoc* investigation panel should be set up. *Ad hoc* panels set up under this provision would report their findings to the Council.

Appeals

The Appeals Committee of the Panel would continue to hear appeals from decisions of the Panel of a disciplinary nature in the field of take-overs and mergers. The Appeals Committee would also hear appeals on other disciplinary decisions of the Panel or of any other body of like nature that might be established.

Secretariat

A Secretariat would be formed to serve the Council and the Markets Committee and other administrative or investigatory panels as might be set up.

Authority and sanctions of the new body

The Council would be a voluntary body consisting of persons, bodies or associations which had subscribed to the concept of self-regulation. Its authority would stem, as in the case of the Panel, from the commitment of the bodies represented on it to support its activities and its codes and respect its rulings. The bodies represented on the Council would recognise that the Council would have the right to make recommendations bearing on any aspect of the activities of their members relating to the securities industry. These bodies would also publicly recognise that such recommendations, although without legal or binding force, could not in practice be ignored.

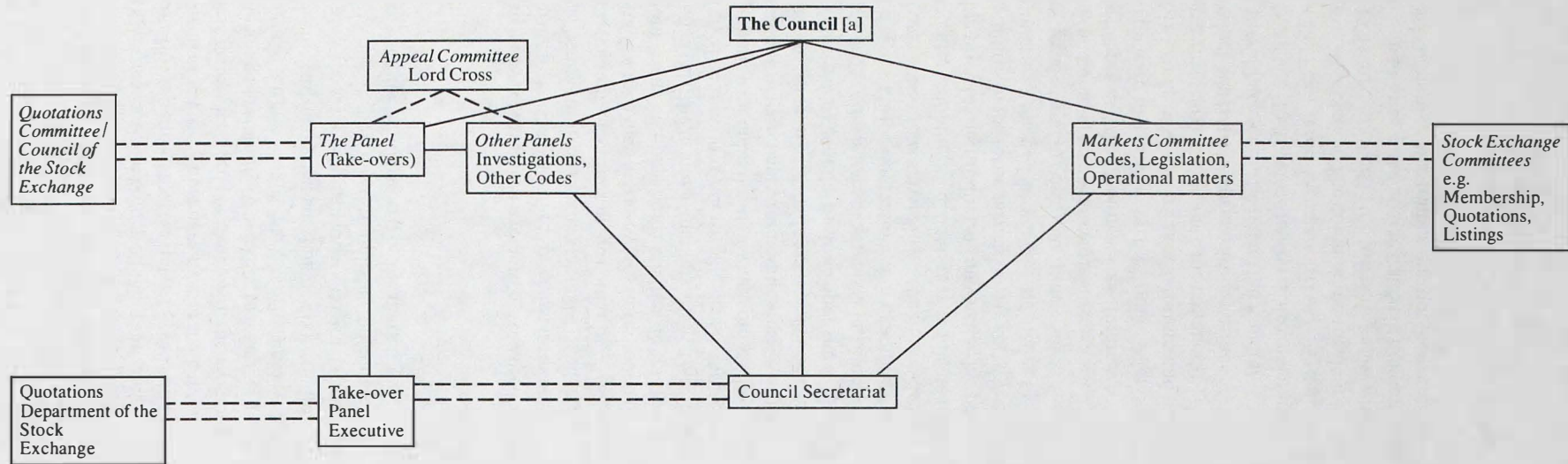
The wide-ranging powers available to the Stock Exchange and the other sanctions which have been so effectively deployed by the Take-over Panel in recent years would remain available for use in appropriate cases. Other organisations represented on the Council would stand ready to examine their own procedures to ensure if necessary that additional action might be taken to assist the Council in making its recommendations effective.

Financing

The new organisation's costs would be met from two sources. In the first place a substantial contribution would be made by the bodies represented on the Council, as has been the case with the Take-over Panel. Secondly, however, partly because it would be impracticable to finance the new Council entirely from contributions from the associations represented on it, it is considered appropriate that some part of the required finance should be drawn from the users of the market and broadly in proportion to the use they make of its facilities. It is proposed, therefore, that a levy, initially set at 60p, should be made on contract notes relating to transactions in UK securities effected both inside and outside the central market. In order to protect the smaller private investor from an increase in costs it is proposed that only transactions above £5,000 consideration money should be chargeable. Stock exchange business would provide the greater part of the levy and most of the costs of collection would thus fall on stock exchange firms. Other associations represented on the Council would seek an undertaking from their members to pay the levy on transactions effected by them.

Examination of the detailed implementation of such a levy is taking place but initially the direct contributions of member bodies would be available so that the new organisation might commence operating without delay.

Council for the Securities Industry



———— Line of authority.
 - - - - Working association.

[a] Membership of the Council

- The Chairman
- The Deputy Chairman
- One representative from each of:
 - Accepting Houses Committee
 - Association of Investment Trust Companies
 - Bank of England
 - British Insurance Association
 - The Consultative Committee of Accountancy Bodies
 - Committee of London Clearing Bankers
 - Confederation of British Industry
 - Foreign banks and Affiliates Association
 - Licensed dealers
 - National Association of Pension Funds
 - Unit Trust Association
- Two from the Stock Exchange
- Three Lay members representing 'public interest' (Governor's nomination).