Change in The Stock Exchange and regulation of the City

An article in the December 1985 Bulletin *described the background to the reforms taking place in The Stock Exchange and in the regulation of the financial services industry. This article*[1] *traces the subsequent progress of those reforms and looks at more recent developments as they affect the structure of The Stock Exchange. The impact of these changes on various characteristics of the equity market, such as liquidity and transactions costs, is also considered. The emerging regulatory framework under the Financial Services Act is described, along with recent initiatives in international regulatory co-operation. The main points are:*

- *Since the package of Big Bang reforms was completed on 27 October 1986, the momentum of change in The Stock Exchange has been sustained by its merger with the International Securities Regulatory Organisation and the inauguration of its third tier equity market;*
- *The Exchange's new rules and the merger with ISRO have transformed its membership, bringing in well-capitalised firms, including British and foreign banks and securities houses, either through participations in existing members or through direct entry;*
- *The evidence so far indicates that the reforms have increased competition in the UK equity market, cut transactions costs and boosted liquidity;*
- *The Financial Services Act reached the statute book in November 1986, and the focus has now switched to the preparation of the detailed rules of the Securities and Investments Board and the regulatory framework forming beneath it;*
- *A high priority now attaches to achieving co-operation between different regulators, both domestically and internationally.*

Restructuring of The Stock Exchange

On 27 October ('Big Bang' day), The Stock Exchange brought into effect the last and major part of the package of reforms to its rules and trading arrangements that arose from its July 1983 agreement with the Government, in return for which the case against the Exchange in the Restrictive Practices Court had been withdrawn. In the event, however, the process of change still has further to go, as the consequences of the Exchange's merger with the International Securities Regulatory Organisation (ISRO) and the introduction of a third tier equity market have yet to be fully absorbed. Although these more recent developments result in part from the momentum of structural change in UK financial markets, they also reflect the influence of the new regulatory framework that is now taking shape. In the slightly longer run, advances in technology will result in further changes in market arrangements, while international linkages, in particular with exchanges in the United States, are likely to increase the range of business that can be conducted through the London Stock Exchange in the future.

The final elements of the Big Bang reforms were the ending of the compulsory distinction between stockbrokers and jobbers (so-called 'single capacity' trading) and the move from fixed to negotiable commissions. The new dual capacity trading system for equities and gilt-edged and other fixed-interest securities, in which market makers and broker-dealers are now able to buy and sell both as principals (that is to deal from their own book) and as agents, and The Stock Exchange's price dissemination system, SEAQ,[2] were described in detail in the earlier article.

As expected, the introduction of the new trading arrangements, and in particular SEAQ, was accompanied by a movement of business away from the Exchange floor to dealing rooms, where transactions are made by telephone on the basis of information carried on screens. Nevertheless, the speed with which the floor has declined in importance was unexpected. Ahead of 27 October, twenty-eight of the firms intending to make markets in equities and gilts decided to maintain a presence on the floor, compared with the nineteen jobbers there previously.

(1) Prepared by D H A Ingram of the Bank's Financial Supervision—General Division.
(2) Stock Exchange Automated Quotations.

Within the first few weeks of trading, it was estimated that as much as three quarters of Exchange business (other than traded options) was being conducted off the floor; by December this figure had risen to perhaps 95% and most market makers had already decided to divert resources to their dealing rooms.

The scale and speed with which The Stock Exchange has been transformed from a traditional floor-based market reflects, in no small part, the confidence shown by traders in the new SEAQ system, in spite of technical difficulties at the outset. Usage of the system by investors and member firms was considerably heavier than the experience of NASDAQ,[1] which SEAQ resembles, had indicated; in particular, the information on the screens was more frequently accessed, and market makers' competing quotes were updated far more often than expected. The system had initial difficulty in handling peaks of demand, but such problems were gradually overcome, and in general large volumes of activity, including the British Gas issue, have been handled successfully. The Exchange plans to increase the overall capacity of SEAQ and its associated systems, notably TOPIC,[2] in the first half of 1987.

In order to allow member firms to organise themselves for dual capacity trading from 27 October, The Stock Exchange had introduced its new membership rules on 1 March 1986. These permitted outsiders to own up to 100% of member firms (removing the earlier ceiling of 29.9%); and allowed limited liability corporate membership for the first time. In the period between July 1983 and the beginning of 1986, a large number of outsiders, including UK and foreign banks, took participations in Stock Exchange member firms in anticipation of the rule change. After 1 March 1986, a large proportion of these deals were completed and the new UK financial conglomerates began to take shape. In addition, further mergers and takeovers involving Stock Exchange firms were announced during the summer and autumn. Table A illustrates the outcome for the original membership of The Stock Exchange.

Out of just over 200 original member firms, most of which were partnerships, more than half have become part of larger groupings. Of the 65 outside entities with stakes in these Stock Exchange firms, more than half are commercial or investment banks, mainly from the United States, the United Kingdom and the rest of Europe. Among the non-banks taking controlling interests, financial services companies are prominent. In a small number of cases, outsiders have taken minority stakes in Stock Exchange firms. The ownership changes sparked off by the opening up of The Stock Exchange have had repercussions across the whole of the UK financial sector, creating groupings which include associated or subsidiary firms active in securities dealing in the United Kingdom and abroad, in commercial and investment banking, in portfolio management, and in the marketing of investment products and property.

Table A
Participations in original Stock Exchange member firms[a]

Outside entities	Number of outside entities	Jobbers	Brokers	Total participations
UK banks	14	9	17(b)	**26**(b)
Other UK financial institutions	16	1	30	**31**
Other UK entities	6	—	9	**9**
US commercial banks	4	1	9	**10**
US investment banks	3	1	2	**3**
European banks	12	3	13(b)	**16**(b)
Other foreign banks	4	—	5	**5**
Other	6(c)	—	6	**6**
Total	65	15	90	**105**

(a) Based on published information. Some outside entities have interests in more than one Stock Exchange firm.

(b) One broker is part-owned by a UK bank and a European bank, and is double-counted in the sub-totals.

(c) Includes, as a single entity, a group of British and foreign financial institutions holding small stakes in a single broker.

In the process of this corporate restructuring, many traditional Stock Exchange firms have lost their original identity. Others have retained their independence, however, including two groupings comprising 14 provincial firms (included in Table A), where capital has been injected by outside interests, but where the firms continue to operate separately, albeit using various common services. In addition, a total of about 100 original Stock Exchange firms, mainly from the provinces, remain independent of outside interests, although a number of these have now switched to corporate membership from their previous unlimited liability partnership status.

In parallel with the ownership changes described above, the Exchange has attracted a number of direct new entrants, among them UK subsidiaries of some of the largest US and Japanese securities houses. By January, membership of the Exchange had increased to about 360, although this figure exaggerates the actual expansion because a number of firms have divided themselves into separate subsidiaries in order to conduct different types of business. In the gilt-edged market, for example, the Bank of England requires market makers, money brokers and inter-dealer brokers (42 firms in total) to be separately capitalised entities; and some Stock Exchange firms have chosen to place activities such as UK equity market making, international equity dealing, agency broking, futures and options, and fund management in subsidiaries.

The Stock Exchange/ISRO merger

By 27 October, The Stock Exchange's membership had already become much more international in character, with about a quarter of member firms being foreign or foreign-controlled. This international element is likely to grow further following the agreement announced in September to merge The Stock Exchange and the International Securities Regulatory Organisation, ISRO.

(1) The National Association of Securities Dealers Automated Quotations market system in the United States.

(2) Teletext Output of Price Information by Computer — the viewdata system that disseminates prices, company news and announcements, and other types of market information.

Close links already existed between Stock Exchange and ISRO members—at the time of the agreement, 56 of the 187 ISRO firms already had Stock Exchange arms or owned members of it. The rationale for this merger was partly commercial, and partly a response to the proposed regulatory framework. ISRO (or more correctly, a formation committee) was established in the latter part of 1985, with a view to providing regulatory cover for the large number of banks and securities firms active in international bond and equity dealing in London which would eventually need to be authorised under the new financial services legislation. Trading in eurobonds has been well established in London for a number of years, for the most part outside organised capital markets such as the Stock Exchange; the emergence of an off-exchange market in international equities in London has been more recent, and has involved trading not only in foreign equities, but also in major UK stocks in both registered and ADR form. Rules to be brought in by the Securities and Investments Board will encourage such bond and equity transactions to be conducted through recognised investment exchanges (RIEs) in the new regulatory framework (discussed in more detail in a later section).

In anticipation of these requirements, ISRO co-operated with the Association of International Bond Dealers (AIBD) in planning an RIE for eurobond trading; and quickly concluded that co-operation with The Stock Exchange offered the most practical route towards creating an RIE for international equities. The Stock Exchange was already developing its own market for international equities through the medium of its SEAQ International system, which began operating in mid-1985, and which now brings together some forty market makers dealing in more than 600 major foreign equities.

In the event, negotiations between The Stock Exchange and ISRO went beyond the creation of a joint exchange for international equities, and agreement was reached on the formation of two joint bodies, both of which would seek recognition under the new legislation: a proposed self-regulating organisation (SRO) covering the activities of their combined memberships (including eurobond traders), and a single investment exchange covering trading in gilt-edged and other fixed-interest securities, domestic and foreign equities, and options. It was also agreed that the AIBD should apply for recognition as a separate RIE for trading in eurobonds.

The proposed SRO is called The Securities Association (TSA); the task of organising its rule books and functions is already under way, and its board has been formed. For the present, this consists of ten practitioners appointed by the outgoing Stock Exchange Council, ten practitioners elected by ISRO members, and a planned total of six lay members, not all of whom are yet in place. Within two years, procedures will be implemented for electing a board. The formation of a single SRO covering a wide range of domestic and international securities-related business should provide firms with more straightforward arrangements for obtaining authorisation than would have been the case if two SROs had emerged, and will simplify firms' subsequent reporting requirements, thus reducing their compliance costs under the new regulatory system. And by building on the Exchange's existing financial surveillance operations, regulation should be achieved more cost-effectively through a single organisation.

The proposed RIE is to be named The International Stock Exchange of the United Kingdom and the Republic of Ireland Limited, but will continue to be known as 'The Stock Exchange'. Following a ballot on the Stock Exchange's Constitution in November, a private limited company was created to form the new RIE, taking over the functions, resources and membership of the old Exchange. ISRO members or their subsidiaries are eligible to join, provided they pass the Exchange's existing tests for fitness and properness and for financial adequacy. Later this year, The Stock Exchange will transfer part of its regulatory responsibilities to TSA as the putative SRO for firms operating in its markets. The new Stock Exchange's initial council consists of fifteen members appointed by the outgoing council, fifteen elected by ISRO; four lay members are in the process of being appointed. In addition, the chief executive of the Exchange and the Government Broker are non-voting members. Again, this council will proceed to elections within two years. Members of the council are to serve on different market committees along with practitioners from the relevant markets. It is intended that these committees should have considerable autonomy for running individual markets within the RIE framework to be approved by the SIB. The creation of a single well-regulated exchange for trading in domestic and international equities should generate economies in the provision of market facilities, boost liquidity and improve the marketability of shares; and should enhance London's prospects as a major centre for trading international securities.

The third market

In May 1986 the Stock Exchange announced proposals to establish a 'third market' to complement its existing markets for listed and unlisted equities.[1] The new market, which opened for business on 26 January, provides access to the organised capital market for a wider range of companies then hitherto; in particular for small, relatively untested companies for which the entry requirements of the USM would be too onerous. Many of the likely entrants to this market will formerly have had their shares traded in the over-the-counter (OTC) market. Others may include shares in mineral companies which are currently traded by Stock Exchange members under Rule 535(3). The third market will form part of The Stock Exchange's application for RIE status under the new regulatory regime, and will have to provide the standards

(1) After wide consultation, the arrangements for the new market were published in *The Third Market:* The Stock Exchange, September 1986.

of investor protection required by the SIB in this area (eg in respect of business conduct rules, market surveillance, record keeping, settlement/clearing etc). Although the shares traded will be high risk investments, the aim of this third tier is to provide investors with a better regulated and more transparent environment than has been available on the OTC market in the past.

Procedures for admission to the third market are relatively simple, with most of the responsibilities falling to a company's sponsoring institution (which has to be a Stock Exchange member). The sponsor needs to assess the suitability of the company to enter the market by reference to various Stock Exchange requirements: for example, in respect of its trading record, the nature of its business, the composition of its board, and its memorandum and articles of association. The sponsor must guide a company's subsequent conduct and see that material information is made available to the market, and must try to ensure that the ownership of its shares is sufficiently well spread to permit a reasonably liquid market. It is also the sponsor's responsibility to arrange for at least two market makers to register to deal in the company's shares, although in certain circumstances this requirement may be relaxed.

Costs of entry to the new market are very low where a company enters by way of an introduction. The main costs are the fees paid to various professional advisers; the Exchange does not charge either initial or annual fees and the minimum requirement for advertising is a single box in a national newspaper, to be published one day before trading commences. Where funds are being raised, the direct costs on the third market are unlikely to be significantly lower than on the USM,[1] but personal investors still qualify for income tax relief under the Business Expansion Scheme (which is not available where shares are quoted on the USM or the main exchange); and, as a result of the third tier's more transparent trading environment, companies can look forward to a more liquid after-market in their shares than in the OTC.

Trading in third market shares is subject to most of the rules and procedures that govern the more senior markets. The intention is to classify most third tier shares as 'gamma' stocks on SEAQ, although at the outset a number may be placed in the least liquid 'delta' category (see following section for discussion of SEAQ categories). Ahead of the opening of the third market, thirty Stock Exchange firms indicated that they intended to act as sponsors, and eight firms as market makers. On 26 January, the shares of eight companies were quoted on the third tier, and the shares of more than sixty were thought to be under consideration by sponsors.

Developments in the equity market since Big Bang

The main force behind the reforms in The Stock Exchange was the need to increase the efficiency and liquidity of its markets—not only to improve the service available to domestic investors and borrowers, but also to enhance the competitiveness of London as an international financial centre. In its previous form, London's main domestic capital market was characterised by transactions costs that were high by international standards, and was dominated by inadequately capitalised securities firms. These features—partly fiscal, partly structural—undermined market liquidity, discouraged investors from trading actively and raised the cost of equity finance to companies.[2] At the same time, Stock Exchange firms lacked the resources to compete in international markets, even where these were located in London; and there were signs that the market in certain leading UK equities was beginning to shift away from the London Exchange.

At this stage it is still too early to be certain about the impact of the new trading arrangements but it is possible to take a broad view of the quality of the equity market since 27 October. This section looks briefly at the market-making capacity now available across the range of equities quoted in the Exchange; at transactions costs and the depth of markets; and at turnover. Use is made of preliminary statistics gathered by The Stock Exchange and of an informal survey carried out by the Bank among a number of fund managers.[3]

Market-making capacity

As described in the earlier article, The Stock Exchange's new dual capacity trading system in the equity market imposes certain obligations upon registered market makers in particular stocks in respect of quote firmness and the reporting and publication of deals. Firms will be able to withdraw from market making in individual stocks at short notice, but will not be able to re-register as market makers in the same stocks for three months. Overall these requirements are intended to ensure a continuous market whatever the state of sentiment.[4] To take account of the different levels of activity in different parts of the market, equities are subdivided into four categories for SEAQ purposes:

- *alpha* stocks are the most actively traded UK equities. Market makers are obliged to maintain continuous, firm two-way prices in a minimum size of 1,000 shares during mandatory SEAQ trading hours (initially 9.00 am to 3.30 pm, extended to 5.00 pm in February). Market makers have the option of posting firm quotes for deals of larger size. Details of all transactions must be reported to the Exchange within five minutes of execution and

(1) The cost of raising funds in the USM and the fully listed market is examined in 'New issue costs and methods in the UK equity market' in the December 1986 *Bulletin*, pages 532–42.

(2) Stamp duty was cut from 2% to 1% following the 1984 Budget, and was cut by a further ½% with effect from 27 October 1986 among measures announced in the 1986 Budget. The impact of stamp duty and other transactions costs on equity markets is discussed in: 'The effects of stamp duty on equity transactions and prices in the UK Stock Exchange' by Mrs P D Jackson and A T O'Donnell, Bank of England ***Discussion paper*** No 25, October 1985.

(3) The Stock Exchange intends to monitor the impact of Big Bang. A benchmark study on the characteristics of markets prior to 27 October, based on surveys carried out in the summer, was provided in *Quality of Markets: First Report*, The Stock Exchange, October 1986.

(4) In December, the Stock Exchange Council proposed various changes to these equity market-making requirements, designed to enhance further the quote information available to users. These changes are likely to be introduced from February onwards.

are published immediately on SEAQ, showing size and price. Trades are also published in the Stock Exchange Daily Official List (SEDOL) the next day;

- *beta* stocks are less actively traded than alphas, although registered market makers must still display continuous, firm quotes for a minimum of 1,000 shares on SEAQ. Details of trades must be reported to the Exchange within five minutes, but are not published on SEAQ. Prices of deals are published the following day in SEDOL;

- for *gamma* stocks, registered market makers are obliged to post only indicative two-way prices on SEAQ but must quote firm prices on enquiry. Trade reporting and publication are the same as for betas;

- *delta* stocks are in the least liquid category. The SEAQ screen does not show quotes for delta shares, but gives information on registered market makers who are committed to quote a price on enquiry, and on accredited dealers.(1) Trade reporting and publication is the same as for betas.

Gilt-edged and other fixed-interest securities form a separate category. Market makers display mid-prices only on SEAQ, although many market makers quote two-way prices on closed user group circuits carried by TOPIC; the prices of trades are published the following day in SEDOL.

Table B
SEAQ classification of UK equities
Number of equities per category

	27 October 1986	end-December 1986
Alpha	62	76
Beta	427	534
Gamma	1,240	1,296
Delta	244	244
Total	**1,973**	**2,150**

Table B shows the initial categorisation of equities. When trading under the new market arrangements began, on 27 October, 62 major UK equities were designated as alphas; they were chosen on the grounds that they each had ten or more registered market makers, market turnover in excess of £195 million in the first half of 1986, and a market capitalisation in excess of £740 million at mid-1986. The stocks represented some 56% of UK equity market capitalisation and about 50% of turnover value. Beta stocks currently have six or more registered market makers, and gammas between two and five. As the trading activity and other characteristics of individual shares change over time, so will their SEAQ classifications. Moreover, new securities are being added to the SEAQ list over time. The Exchange intends to move securities up into the more transparently traded categories as quickly as possible; Table B shows the position at the end of 1986, when both the alpha and beta categories had been expanded. Proposals are also in hand to extend beta status to stocks where four or more market makers (instead of six at present) are prepared to quote firm prices on SEAQ.

A total of 31 firms began trading as equity market makers on 27 October. Previously there had only been thirteen equity jobbers, and, of these, all but five firms were relatively small. Prior to Big Bang, relatively few equities had more than five jobbers; afterwards all alphas and betas (which together account for more than 90% of market turnover) had at least six market makers. An additional feature in the new markets is the preparedness of market makers to quote firm prices on SEAQ in large size. For most alphas, quotes are available for lots of 100,000 shares (and more in some cases) while for betas the vast majority have market makers putting up firm quotes in larger size than the basic 1,000 shares. It is planned that the SEAQ system should soon be amended to permit firms to display quotes up to 900,000 shares. With broker-dealers also prepared to take positions in the more active securities, there seems to be little doubt that the market for alpha and beta equities is much more competitive than before Big Bang.

At the lower end of the scale, earlier concerns that The Stock Exchange's new trading arrangements might divert market-making resources away from the shares of small companies appear to have been misplaced. Market making in gamma equities is proving to be active, to judge from the data on market spreads and turnover discussed below. Delta stocks, normally with nil or only one market maker, are fairly numerous (Table B), but in fact account for less than 1% of the turnover in UK equities. In the past, the jobbers allocated to such inactive shares typically ran little more than an order-matching service, while a number of the companies to which they relate are either highly specialised or can be regarded as moribund. Competition among dealers at the most liquid end of the market is encouraging some market makers to seek a specialist role further down the scale. In addition, the third market is being supported by established Stock Exchange firms as well as new members who have until now specialised in dealing in the shares of small companies on the OTC market and in organising venture capital.

Transactions costs

As expected, transactions costs in the equity market have fallen sharply since Big Bang. In part this reflects the reduction in stamp duty from 1% to ½% on 27 October, as announced in the 1986 Budget. Increased competition has brought commission rates down, and, in many cases, institutional investors now choose to deal direct with firms in the market on a net-of-commission basis. The other main element of transactions costs stems from the spreads between bid and offer prices, and in particular, the market 'touch', which is the difference between the best bid and best offer prices. For the investor purchasing shares, this implicit cost is represented by half of the market touch, that is the difference between the best offer price and the mid-market price. The new market

(1) An accredited dealer (or matching broker) in a particular security is obliged to seek matching counterparties to any business brought to it, but is not required to make firm two-way prices.

arrangements have generated a number of pressures on the touch, in both directions; anecdotal evidence points to a narrowing overall, and available statistics confirm this for betas and gammas, although the picture is less clear for alphas. Other, less obvious, costs have been reduced for the institutional investor since Big Bang. In particular, the combination of considerably improved information on SEAQ and market makers committed to deal at the prices and in the volumes shown on the screen has lowered the costs and possible risks to the investor searching for the best deal.

The Bank's informal survey suggests that, for an equity deal in the range £100,000–£1 million, *commission* rates have fallen from about 0.4%[(1)] to 0.2% since Big Bang. On very large deals, in excess of, say, £2–3 million, rates of 0.125% may be obtained. As noted above, most institutional investors are in fact achieving an even larger saving on pre-Big Bang costs by conducting a substantial part of their equity business on a net-of-commission basis either direct with market makers, or occasionally with broker-dealers who may be prepared to trade on this basis from their own book. Most institutions continue to make sizable use of broking services for dealing in equities, however. In part this may be because they hope to save resources and obtain better prices by using agents to shop around and assemble deals on their behalf. The institutions may also be concerned to maintain access to the research provided by brokers. Although it is difficult to generalise, these factors appear to be reflected in the behaviour of individual institutions. Thus 'client driven' fund managers—such as the accepting houses, with possible access to in-house research—appear to be more inclined to deal on a net-of-commission basis. Some of the very largest institutions have also switched heavily in this direction. By contrast, other pension funds and financial institutions, especially those with limited resources for dealing and research, have continued to use Stock Exchange firms and to pay commission.

Because the costs associated with broking operations tend to be predominantly fixed, the commissions paid on small transactions by individual investors were not expected to fall significantly under the new trading arrangements. In the event, fears that such commissions might even rise do not appear to have been realised; on balance they seem to have fallen slightly. For investors buying, say, £1,000 worth of shares, the commission rate has remained at 1.65% in most cases, the same as that ruling before Big Bang; but a number of firms have cut their rates to 1.5%, and a few are charging as little as 1% for an execution-only service. For the private investor seeking to do a transaction of rather less than £1,000, the picture is less clear-cut, since many brokers maintain minimum charges which have always borne heavily on small deals. Nevertheless, there is evidence that some regional brokers and member firms with retail outlets are competing actively for this type of trade and have lowered their minimum charges. The Stock Exchange is planning to introduce an automatic small order execution system later in 1987, which could reduce transactions costs at this end of the scale in the longer term.

Information on the *market touch* can now be observed on SEAQ screens; as this facility was not available ahead of Big Bang, the Stock Exchange assembled data for comparative purposes through a survey of jobbers' quotations for a sample of equities during a week in July 1986. The results of this limited survey are reported in detail in the Exchange's 'Quality of Markets' study; Table C shows the average touch for the size of transactions in which jobbers would normally make two-way quotations. As might be expected, alphas had the narrowest market touch, averaging 0.8%. In general, the more actively a stock is traded, the narrower will be the touch, because the jobber/market maker will be reasonably confident of being able to reverse a position quickly. More liquid stocks are also ones where hedging devices such as traded options are available. At the same time, however, the touch tends to widen for quotations in larger size, reflecting the risks to the market maker of unbalancing his book. The behaviour of the market touch as quote sizes increase can be taken as an indication of the depth of market liquidity, that is, the less the touch widens, the deeper is the market for the share in question. Again, as expected, The Stock Exchange's pre-Big Bang survey showed alpha stocks to have greater market depth than betas or gammas. Although extra competition and liquidity have put downward pressure on market spreads post-Big Bang, the tendency for a greater proportion of trades to be done on a net-of-commission basis at prices shown on the screen will be working in the opposite direction as market makers seek to protect their profitability.

Table C
Market makers' 'touch' before and after Big Bang[(a)]
Percentage of share price. *Value of average quotation in £ thousands in italics*

Category of stock	Alpha		Beta		Gamma	
Pre-Big-Bang:						
Average touch at normal market size	0.8	*320.8*	1.8	*58.9*	3.4	*15.3*
Post-Big-Bang:						
Average touch at 1,000 shares	0.6	*4.8*	1.4	*2.5*	2.8	*1.9*
Average touch at largest SEAQ quote(b)	0.8	*279.1*	1.7	*83.1*	3.2	*13.9*

(a) Based on Stock Exchange sample surveys.
(b) 100,000 shares for most alphas and a range of sizes for betas up to and including 100,000 shares in some cases.

The structural changes that have taken place mean that direct comparisons of data on the market touch pre and post-Big Bang are rather hazardous. Table C compares the figures from the Exchange's pre-Big Bang survey with those which can now be derived from the SEAQ screen, namely the market touch for the basic 1,000 shares, and also for the largest quotes posted on the screen. These suggest that the touch has narrowed since 27 October for

(1) Scale commission rates were somewhat higher than this (0.58% on £100,000, 0.34% on £1 million) but institutions were able to take advantage of a 'continuation' concession, ie aggregating a series of transactions in the same stock, in order to reduce the average level of commission.

The Financial Services Act

The main features

The Financial Services Act 1986 is the most comprehensive overhaul of legislation regulating the conduct of investment business for over forty years. The Act:

- defines investments and investment business and gives the Secretary of State for Trade and Industry the power to amend these definitions if circumstances require it;
- requires anyone conducting investment business to be authorised and provides for their regulation. The conduct of investment business without authorisation becomes a criminal offence carrying the penalty of fines and imprisonment;
- covers the marketing activities of life insurance companies but without affecting arrangements under the Insurance Companies Act, 1982;
- provides for the authorisation of both the managers and the independent trustees of unit trusts and other collective investment schemes;
- provides for the establishment of an industry-wide compensation scheme;
- consolidates the law on the offering and listing of securities;
- extends earlier legislation on insider dealing, by giving inspectors appointed by the Secretary of State increased powers to question people on oath and to obtain evidence;
- makes provision for exchanges of regulatory information, not only between supervisors within the financial services regime but also between financial services supervisors and those responsible under other legislation (eg the Bank of England, the DTI, the Building Societies Commission), and, in certain circumstances, overseas regulatory authorities;
- enables the Secretary of State (or the Treasury with regard to banking business) to prevent a firm connected with any foreign country from doing investment, banking or insurance business in the United Kingdom if he considers that UK firms do not have access to financial markets in the firm's home country comparable to that available in the United Kingdom (the 'reciprocity' provision).

The framework

The primary objective of the Act is the establishment of a regulatory framework based on the Secretary of State's powers to authorise and regulate investment business. Most of these powers are expected to be delegated to the Securities and Investments Board (SIB), a private sector body. Although the SIB will be able to authorise investment businesses, it is likely that most firms will seek authorisation via membership of one or more of the recognised Self Regulating Organisations (SROs). In order to achieve recognition, an SRO will need to satisfy the SIB that it can regulate its members effectively. SRO requirements will need to be at least as exacting as those facing an institution directly authorised by the SIB. Each SRO will have a 'scope' rule defining the extent of its regulatory competence, and limiting the types of activity that its members can undertake.

Investment businesses have to be fit and proper, and to adhere to conduct of business rules. The Act does not set down detailed conduct of business rules; this task falls to the Secretary of State, and through him, the SIB. SROs must have equivalent rules. The Act establishes the subjects to be covered in the rules, which include: with whom business may be conducted; the manner of market making; the content of advertisements; the disclosure of payments or commissions; Chinese walls; stabilisation of the prices of new issues; arrangements for the settlement of disputes; the keeping of records; capital adequacy. The SIB has the power to direct an SRO to change a rule that is judged not to meet the test of equivalence. Breaches of conduct of business rules and of scope rules are civil, not criminal, offences. The Act does, however, make it a criminal offence for anyone to make a false or misleading statement or to create a deliberately false or misleading impression of the price or value of an investment.

The Act provides for the regulation of the professions, such as accountants and solicitors, who carry out investment business incidental to their main activities. If recognised by the SIB, the various professional bodies will be able to certify their members to carry on investment business. To obtain recognition, these bodies will need to have adequate rules to protect investors.

The legislation also establishes the concept of a recognised investment exchange (RIE). The SIB will be able to recognise an RIE if it is satisfied that the exchange has adequate financial resources and provides a fair and efficient market. Where clearing and settlement arrangements are provided by a separate body, this, too, will need to be recognised. Trading on an RIE will not be obligatory, but the SIB will require comparable investor protection for transactions not conducted through an RIE, which may involve firms in more onerous reporting and disclosure.

The Council of The Stock Exchange will continue to be responsible for admitting securities to listing and making rules on listing. The Act replaces The Stock Exchange (Listing) Regulations 1984, which implemented through statutory instrument the three EC directives on listing. For unlisted securities the Act replaces the prospectus and public offer provisions of the Companies Act 1985 and the Prevention of Fraud (Investments) Act 1958. The Secretary of State, under the Financial Services Act, will be able to make rules governing the information a prospectus must contain and to specify where a prospectus is required. A recognised investment exchange must have rules equivalent to those drawn up by the Secretary of State in respect of offers of unlisted securities.

Certain groups, who might otherwise have been deemed to be undertaking investment business, are excluded from the full scope of the legislation. These include organisations such as the Bank of England, recognised investment exchanges and clearing houses, Lloyd's, and various official bodies. The Act also allows non-investment businesses which are primarily customers of the financial services industry to apply for permission to carry on investment business without authorisation if they can satisfy the SIB that, among other things, their main business is not investment. This category of 'permitted persons' is likely to include corporate treasuries, some of whose activities may resemble investment business. A final exclusion relates to wholesale money markets, and is described in the note on page 63.

quotes in gamma and, to a lesser extent, beta stocks. As far as can be judged, the touch for alphas does not appear to have moved significantly from its pre-Big Bang level. For 1,000 alpha shares the average touch is now about 0.6% on average (concealing a range from as low as zero in a small number of cases to about 1.5%); for larger lots, it widens slightly, but for many individual shares the touch is no larger than for small deals. The figures on SEAQ screens only reveal the touch for quotes up to 100,000 shares—anecdotal evidence suggests that it does not widen significantly for much larger quotes, an indication that there is now greater depth in the market for alpha stocks than before Big Bang. In addition, figures observed on the screens do not give any impression of the volume of business currently being transacted inside the best quotes; there is evidence that some of the bigger institutions are able to deal at better prices, and therefore on narrower spreads, than those shown on the screens.

Table D
Equity transactions costs before and after Big Bang for a liquid alpha stock
Percentage of share price

	Purchase valued at: £1,000		£500,000	
	Before	After	Before	After
Stamp duty	1.0	0.5	1.0	0.5
Commission	1.7(a)	1.5	0.4(a)	0–0.2
Market touch (halved)(b)	0.4	0.3	0.4	0.4
Total	**3.1**	**2.3**	**1.8**	**0.9–1.1**

(a) Based on scale commission rates.
(b) The difference between the best offer price and the mid-market price.

Table D combines the various transactions costs discussed above for the purchase of a typical alpha stock. Two transactions are illustrated, to show the different effects on individual and institutional investors. In both cases, there is a reduction, although it is more marked in the case of the institutional size deal, where the cost of a purchase could be kept below 1% if it were done net of commission. As noted earlier, it might also be possible for the private investor to secure a cheaper deal if he were to shop around.

Market turnover

Lower transactions costs and a more competitive environment have generated increased equity market turnover since Big Bang, although until the TSB and British Gas issues (which generated a large volume of small transactions) have been fully absorbed it will be difficult to establish the underlying picture. Compared with the first ten months of 1986 (ie to 24 October)—already a buoyant period—provisional data indicate that the value of daily turnover in UK and Irish equities (customer trades only) was some 21% higher on average between 27 October and the end of the year. On the same comparison, the number of bargains was up by 40%. These figures include the USM, which was free of the distortions caused by recent big new issues, but it too has shown a healthy advance (21% in value terms, and 22% in volume) on the high rate of activity in the first ten months of 1986. The continuing strength of activity on the USM, coupled

Table E
Stock Exchange turnover: UK and Irish equities(a)

	Average daily turnover (£ millions)	Average daily bargains (thousands)	Average value per bargain (£ thousands)
1980	121.3	16.7	7.3
1981	128.5	15.7	8.2
1982	147.9	15.3	9.6
1983	222.7	18.8	11.9
1984	289.0	19.2	15.1
1985	417.2	22.0	19.0
1986 Q1	710.1	31.4	22.6
Q2	653.2	27.2	24.0
Q3	571.7	21.3	26.8
October(b)	578.8	34.6	19.1
November(c)	774.3	36.4	21.3
December	767.8	40.1	19.1

(a) The data relate to trades for customers throughout. Also include, prior to 27 October 1986, a small volume of transactions in foreign equities. Thereafter such transactions are excluded.
(b) Up to 24 October.
(c) From 27 October to end-November.

Table F
Stock Exchange turnover: unlisted securities market (a)

	Average daily turnover (£ millions)	Average daily bargains (thousands)	Average value per bargain (£ thousands)
1981	1.1	255	4.4
1982	2.4	521	4.7
1983	4.9	1,058	4.6
1984	5.8	1,140	5.1
1985	6.8	1,331	5.1
1986 Q1	9.2	1,684	5.4
Q2	10.4	1,721	6.0
Q3	10.9	1,384	7.9
October(b)	13.7	1,444	9.2
November(c)	14.1	1,849	7.7
December	11.0	2,023	5.4

(a) The data relate to trades for customers throughout.
(b) Up to 24 October.
(c) From 27 October to end-November.

with the steady flow of new entrants and new issues since 27 October, should help dispel earlier fears that the market in the shares of smaller companies would be neglected after Big Bang.

The rise in equity turnover, and in particular the emergence of much more active market making since October, has produced substantial growth in business on the traded options market, no doubt reflecting in part an increase in hedging activity. Again, the British Gas issue will have boosted activity, but in the final two months of 1986 equity options contracts were running at almost 32,000 per day, nearly double the rate in the first ten months of the year.

Regulation of financial services

The Financial Services Act received Royal Assent on 7 November 1986, following almost a year of intensive discussion inside and outside Parliament. Its main features are described in the note on page 60. It is a complex Act, which replaces investor protection legislation that had become inadequate in the new environment. It also extends the scope of formal regulation into areas such as financial and commodities futures and options and the international securities markets in London where supervision has in the past been non-statutory or remote (for example, eurobond activity has not been directly supervised in the past, although most market participants or their parents are subject to some form of regulation by domestic banking or securities supervisors). The Act extends or consolidates other pieces of legislation, for example on insider dealing and on the offering and listing of securities; and it is part of a wide-ranging revision of the legal framework governing the UK financial sector, which also comprises the Building Societies Act 1986 and the updating of the Banking Act 1979 which is taking place during the current parliamentary session.

In spite of extensive amendment during the parliamentary process, the Financial Services Act does not differ greatly in principle from the original draft bill. Among the more significant changes have been those increasing somewhat the powers of the 'designated agency' (now named in the Act as the Securities and Investments Board). For example, it will be possible for the Secretary of State to transfer powers to the SIB concerning the institution of proceedings in respect of offences under the Act. Initially the SIB is likely to be given the authority to prosecute the new criminal offence of carrying on investment business without proper authorisation, but not more serious offences. The SIB's power to order changes to the rules of SROs was also incorporated during the Report Stage in the House of Commons, although the intention is that this power should be held in reserve, and that changes to SRO rules should be achieved through consultation and agreement whenever possible. Finally, the SIB has been accorded legal immunity from suits arising from the exercise of its statutory functions, provided the Board and its officers act in good faith. Similar immunities have subsequently been given to the SROs on the grounds that they would be implementing rules equivalent to those of the SIB, and that on occasion they would need to be able to act quickly and decisively, possibly on the basis of inconclusive evidence. Fear of being sued for damages might have seriously inhibited the effectiveness of SROs, and might have discouraged able practitioners from working on their behalf.

Among other important amendments made by Government in Parliament were those relating to wholesale markets supervision and to compensation. The implications of the first of these is described in detail in the note on page 63. The second set of amendments will enable the SIB to establish a compulsory industry-wide scheme to provide compensation to investors who have suffered loss as a result of a default by an authorised investment business. Draft rules of the scheme were issued by the SIB in December; the details are still under discussion between the SIB and SROs. The scheme will be administered by the SIB in conjunction with a Compensation Board composed of representatives of the SROs. One important aim of the scheme will be to avoid (except in extreme circumstances) cross-subsidisation by SROs with good claims records.

In anticipation of the Act, the SIB and a Marketing of Investments Board Organising Committee, MIBOC (the body responsible for developing proposals covering the marketing of products such as unit trusts and life assurance) were set up in 1985. As foreshadowed in the previous *Bulletin* article, MIBOC was subsequently merged with the SIB (in July 1986) to form a single regulatory authority, the board of which was expanded to include members drawn from the life assurance, banking and unit trust sectors, and two additional lay members.

From mid-1985, SIB and MIBOC began preparing the broad outlines of the new regulatory structure, encouraging the formation of putative SROs, and formulating the rules and regulations that will form the basis of the standards of investor protection to be provided by members of SROs, RIEs, professional bodies, etc. The SIB will also have to be prepared to authorise and monitor firms which may eventually seek direct authorisation, and to be able to exercise supervision over SROs, RIEs and other elements of the new regulatory structure. In the course of 1986, the SIB published in draft form many of its proposed rules and regulations, including those relating to conduct of business, cold calling, segregation of client monies, and authorisation requirements. These are currently being revised in the light of comments received from interested parties.

The machinery of the Financial Services Act is being put into operation in stages. In response to recent cases of alleged insider dealing, a number of sections have already been brought into force, including those in respect of the relevant investigative powers and of exchanges of regulatory information between supervisors, both domestic and foreign. Other provisions, including those dealing with listing requirements, have also been brought into effect. As far as the main structure is concerned, the SIB is expected to apply soon to the government for delegation to it of the main regulatory powers. This application will be accompanied by the SIB's rulebook which must be examined by the Director General of Fair Trading in the light of competition law, and by the Secretary of State, who will need to be satisfied that the rulebook and the SIB's resources are adequate. Provided these tests are satisfied, the Secretary of State is expected to table a delegation order which will have to be approved by both Houses of Parliament. This is likely to take place in the first half of 1987.

The SIB will then be in a position to take applications for recognition from prospective SROs, where it will need to satisfy itself that the SROs have rules which are equivalent to its own, and that their resources are adequate for monitoring and enforcement. SRO rules will also have to be scrutinised by the Director General of Fair Trading. This process is likely to be complete by mid-year. Investment exchanges and professional bodies will also be seeking recognition at this time. In the following months, the SIB and the SROs will need to process applications from those investment businesses that have not by that stage been enlisted. The final element of the Financial Services Act is intended to be activated in the latter part of 1987, when it will become a criminal offence to carry on investment business in the United Kingdom without authorisation.

The future regulation of the wholesale markets in sterling, foreign exchange and bullion

Section 43 of the Financial Services Act provides for the exemption of certain transactions undertaken by particular institutions in an area broadly defining the wholesale markets in sterling, foreign exchange and bullion. The background to and purpose of this exemption, together with the framework of regulation which it is proposed to establish in this area, are set out in a consultative paper, published jointly by HM Treasury and the Bank of England in December 1986: copies are available from the Wholesale Markets Supervision Division of the Bank.

The wholesale money markets are generally recognised as constituting a distinct and coherent area; the main participants are professional operators, typically dealing in large amounts. The Government has decided that, in order to avoid unnecessary duplication of supervision, these markets should in future be subject to a single system of non-statutory regulation, for which the Bank should have responsibility as the natural regulatory authority. The Bank has for many years exercised general oversight over significant parts of these markets; many of the trading institutions involved are banks already supervised by the Bank; and the Bank is itself active in a number of the markets daily and has considerable operational experience and understanding of them.

The wholesale markets are defined in terms of a three-fold classification by the particular instruments, the size of transactions and the institutions involved. By *instrument*, the relevant markets cut across the boundary defining investment business in the Financial Services Act. Thus some wholesale market transactions, for example in Treasury bills, certificates of deposit, commercial paper, short-term local authority paper and financial futures and options, would fall within its scope; but wholesale sterling and currency deposits, foreign exchange and bullion transactions, with which the Bank will also be concerned, would be outside the Act. By *size*, mostly large-scale transactions are involved, with minimum limits of £100,000 (or the currency equivalent) for most cash instruments and £500,000 for those including futures, options or swaps. The *institutions* concerned are either specialist brokers or principals acting on their own account, in a general market-making sense.

Central to the Bank's regulation will be a list of institutions entitled to benefit from the Section 43 exemption. The Bank will need to be satisfied that these institutions satisfy certain criteria, which have to be approved by HM Treasury, as follows:

An applicant will need to satisfy the Bank that it is 'fit and proper', by reason of its capital, managerial and operational resources, its standards of business conduct and its high reputation and standing, to undertake the particular activity. In determining whether an applicant meets this condition, the Bank will therefore take into account the following factors:

(i) that the financial position of the applicant is sound;

(ii) that its ownership structure does not result in any unacceptable conflicts of interest, nor is in any other way a source of potential weakness;

(iii) that its management and staff are of high quality and appropriate experience and that its systems are effective;

(iv) that its reputation in the market place is good; and

(v) that it is able and willing to adhere to an undertaking to observe appropriate Code(s) of Business Conduct, specified by the Bank from time to time.

A firm applying for inclusion on the list will be required to submit a business plan setting out the type or types of activity it intends to undertake, including types of instrument in which it intends to trade. Its permitted scope will be limited to those activities agreed with the Bank, subject to review.

These conditions, together with the arrangements the Bank proposes to make for admission and removal from the list, are spelt out in greater detail in the paper. In particular it is made clear that all listed institutions will need to satisfy capital adequacy tests designed to ensure that the risks they take are not disproportionate to the firm's own resources.

Many listed institutions will already be subject to such tests, set by other regulatory authorities in the United Kingdom or overseas. The Bank itself already monitors the capital of institutions authorised under the Banking Act, as well as the market makers and certain other firms operating in the gilt-edged market. In such cases the tests will already take into account the capital needed to support the firm's wholesale market activity, and no separate tests will be applied. In cases where the tests are set by another supervisor, eg the Building Societies Commission in the case of building societies, the Bank will discuss with that other supervisor how best to reduce unnecessary supervisory overlap and may delegate the assessment of capital adequacy to it.

The paper describes the capital adequacy tests to be applied to those listed institutions not otherwise supervised, whether acting as principals or brokers. Illustrative numbers are provided for non-bank principals' straight open positions, in different classes of asset, distinguished also by maturity. The treatment of matched positions is also discussed.

In addition to the capital adequacy criterion, the Bank will need to be satisfied that sufficient managerial resources are available within each firm to conduct effectively the activity described in its business plan; and that its managers and directors have the knowledge, experience and good reputation necessary for their intended responsibilities. Adequate control systems and accounting records will also need to be maintained. The Bank will also be concerned to ensure that the ownership of listed firms does not represent a source of potential financial weakness nor give rise to unacceptable conflicts of interest.

An annex to the paper sets out a London Code of Conduct, designed to reflect current best market practice for transactions in traditional sterling and foreign exchange instruments. It will be extended to cover trading in the newer instruments, like swaps, FRAs, options and futures; and also the bullion market.

Comments on the paper are invited by end-February: a final paper will be published as soon as possible thereafter and applications then invited from institutions to become listed.

It is now expected that five SROs will seek recognition, compared with the seven that seemed possible a year ago:

- *The Securities Association* (TSA), which, as discussed earlier, is the product of the Stock Exchange/ISRO merger. It intends to provide regulatory cover for firms conducting business in domestic and international equities, UK and Irish gilt-edged securities and company debentures, international bonds (including eurobonds), investment management and advice, corporate finance, and options, financial futures and related products;
- *The Financial Intermediaries, Managers and Brokers Regulatory Association* (FIMBRA), the product of a merger between NASDIM and LUTIRO, [1] members of which will be independent intermediaries advising on and arranging deals in collective investment products, advising on and managing investments for retail customers, and advising on and arranging securities transactions;
- *The Investment Managers Regulatory Organisation* (IMRO), the members of which will have investment management as their main activity, including the management and operation of regulated unit trusts, investment trusts and pension funds;
- *The Association of Futures Brokers and Dealers* (AFBD), covering firms dealing and broking in futures and options and providing related investment management and advice;
- *The Life Assurance and Unit Trust Regulatory Organisation* (LAUTRO), the members of which will be life companies, friendly societies and the operators of regulated collective investment schemes in respect of their retail marketing of life assurance and units.

Candidates for SIB recognition as investment exchanges (RIEs) are: the new Stock Exchange and the eurobond exchange, both of which were described on page 56; and the various UK commodity, financial futures and options exchanges. The RIE concept reflects the view that there are considerable benefits for investors—in terms of both investor protection and best execution—if transactions on their behalf are made through organised exchanges where prices are established in a fair and transparent way, and where deals are effectively monitored, recorded and settled. The Secretary of State will have the power to recognise certain overseas exchanges where he is satisfied that business done for UK investors would be afforded protection at least equivalent to that available in the United Kingdom.

The earlier *Bulletin* article described the problem of overlapping regulatory structures facing diversified financial conglomerates, both within the financial services area (because of the existence of the SIB and several SROs), and between this regime and those covering banking, building societies and insurance. Many firms in London will also be answerable to overseas authorities, through the activities of parent or associated companies abroad. Throughout 1986, discussions took place aimed at ensuring that these overlapping responsibilities did not eventually lead to duplication and inefficiency for the firms being regulated or for the regulators themselves. These discussions were reflected in a number of amendments to the draft legislation, opening up 'gateways' through which information gathered under various statutes (ie the Financial Services, Building Societies, Banking, Insurance and Companies Acts) could be exchanged and shared by the different supervisors, including those from overseas, responsible for the activities of financial conglomerates. This freeing of the movement of information is designed to permit regulators to co-operate, and to co-ordinate their activities. It will also facilitate the 'lead regulator' concept as regards the monitoring of the financial positions of conglomerates: although individual regulators (such as the SROs, or the Bank of England) will retain their statutory responsibilities, which cannot be overridden by other supervisors, the aim is that a lead regulator can be delegated to play a co-ordinating role in the gathering and dissemination of prudential information. When problems are detected, the lead regulator will have the task of promoting a solution which takes account of the interests of the whole college of regulators responsible for a financial conglomerate. Where a conglomerate carries on a significant amount of banking business, the Bank of England will normally be expected to play the role of lead regulator. Discussions are continuing on the mechanics of such co-operation, one focus of which is the desirability of different regulators having the same arrangements for measuring risk and capital adequacy.

International regulatory co-operation

Recent developments in London illustrate the pace at which domestic capital markets are becoming more closely integrated internationally. This process is taking various forms, mainly driven by competitive forces as market participants seek to match the needs of ultimate borrowers and investors; and raises a variety of regulatory questions, especially as international trading in equities becomes more prominent.[2] Securities firms established under one jurisdiction are trading in markets or over-the-counter in other countries, either through branches or subsidiaries: this poses problems for both parent and host regulators, particularly in respect of prudential controls. Securities listed in one centre are being traded simultaneously in other parts of the world; and as internationalisation proceeds, it is also becoming more common for options and futures on such securities to be traded in other markets. In this environment it

(1) The former National Association of Securities Dealers and Investment Managers, and the Life and Unit Trust Intermediaries Regulatory Organisation.

(2) For a fuller discussion of the regulatory issues arising from internationalisation. see the 'concept release' (No 34–21958) by the US Securities and Exchange Commission — 'Request for Comments on Issues Concerning Internationalisation of the World Securities Markets', 1985.

becomes increasingly difficult to be sure that orderly markets in individual securities are being maintained. The Financial Services Act addresses some of the concerns about internationalisation, by extending the scope of the UK regulatory system into London's international markets, and by making provision for exchanging information with overseas supervisors. But these measures are insufficient without effective co-operation between supervisors at an international level. Fundamental differences between institutional, legal and regulatory systems are likely to prevent the early harmonisation of rules and procedures between national securities regulators, although a degree of bilateral co-operation has begun to emerge, notably between US regulators and their foreign counterparts, including those in Switzerland, Japan, Canada and the Cayman Islands.

In September 1986, a UK/US Memorandum of Understanding was concluded between the Department of Trade and Industry on the one hand, and the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) on the other. The memorandum is designed to provide a framework for the exchange of regulatory information on a confidential basis, and each country undertakes to use its best efforts to assist the other to secure compliance with legal requirements in its securities and futures industries. The memorandum is concerned with information relating to insider dealing, misrepresentation (including fraud) and market manipulation on or off exchanges. It is also directed at the conduct, fitness and properness, and financial standing of investment and futures businesses and of clearing/settlement systems in these markets.

Underlying this and the other agreements so far concluded is a recognition that exchanges of information between national regulators are critical to effective enforcement given the ease with which transactions can now be conducted across national boundaries.

When the Financial Services Act comes fully into force the memorandum may need to be revised to take account of the new UK regulatory institutions and the more formal arrangements that will then be in place for exchanging information, including arrangements with overseas supervisors. In the course of this year, it has been agreed that the UK and US governments will begin negotiations on the terms of a treaty covering regulatory questions. The Department of Trade and Industry is now discussing with the Japanese authorities the possible establishment of a co-operative agreement in the securities/futures area. This is likely to be followed by further bilateral agreements involving the United Kingdom. In December, the DTI convened a meeting with regulators from nine other countries with securities industries having important links with UK markets (Australia, Canada, Germany, France, Hong Kong, Japan, the Netherlands, Switzerland, and the United States). Discussions focussed on methods for improving co-operation, within the framework of existing law, between national authorities responsible for preventing and investigating malpractice and for prosecuting offenders. In particular, the talks were aimed at improving existing arrangements for exchanging information relating to the regulation of securities business and markets, and to investor protection generally. A further meeting is likely to be held later this year.