

FOCUS

• THOSE THAT PAY THE FIDDLER . . .

The recent white paper on the policing of the Stock Exchange (*Financial Services in the United Kingdom: a new framework for investor protection*, Cmnd 9432) represents a remarkable achievement for the City of London. After years of unease about its operations and in the face of the most significant changes for generations, the Government is proposing to leave the regulation of the British Stock Exchange and its related businesses in the hands of the City itself.

The white paper is concerned with only one part of the City - the securities industry. This covers all those who deal in, advise on and manage investments. It covers institutions such as the Stock Exchange - the market place in which shares in companies and government stock are bought and sold - and those who use the Stock Exchange - private individuals, pension funds, unit trust companies and the like.

Until now, most of these participants in the stock market have been organisationally distinct. At the centre has been the Stock Exchange, protected by some formidable restrictive practices. The Stock Exchange is effectively the only place where it is possible to deal in the shares of private sector companies and public sector debt. If you, as an individual or as a pension fund for example, want to buy shares, you have to go to a member of the Stock Exchange who is a *broker*. They will charge a fixed price for carrying out your order through a *jobber* - members of the Stock Exchange who make a market in shares. No outside person or organisation is allowed to own shares in a Stock Exchange firm.

Around the Stock Exchange have grown up firms which specialise in managing investments, advising companies on their corporate financial affairs, selling insurance schemes linked to share prices and so on. The walls that divide all these businesses have been under strain for some time, but in the next few years they are going to be knocked down completely. The distinction between jobbers and brokers is going to disappear and, on a scale never seen before, the division between managing funds and making a market in shares is going to disappear. American and British banks are now taking the lead in putting together large financial groups which embrace all these services. The main provocation is defensive - to keep London as one of the world's largest financial

centres in what is becoming an international market in securities. The implications are immense.

The white paper aims to tackle just one implication of the 'securities revolution'. (After all, the present government is unlikely to be concerned about the effect of these developments in driving even further a wedge between the interests of Britain's manufacturing industry and the interests of the City.) But the problem that the white paper tackles is important, nonetheless. Imagine the pension fund of (say) an engineering company in the Midlands is managed by a bank in the City. What guarantee is there that the bank won't spend the fund's money on: shares in a company it is also advising; loans to a company which owes the bank a fortune; shares the bank happens to be stuck with because some deal has gone wrong; and so on.

To deal with such problems the Government is proposing a set of principles by which all business should be conducted, supervised by two regulatory boards. These boards - with the power (which they are expected to use) to delegate responsibilities to self-regulating bodies - will be responsible for authorising investment businesses; the power to withdraw this authorisation will be the ultimate disciplinary sanction.

This system - devised by two committees of City 'practitioners' under the guidance of the Governor of the Bank of England - leaves the responsibility of supervising the City predominantly in the hands of the City. The Governor of the Bank and the financial services industries themselves will have a big say in the membership of these boards. And below them, the self-regulatory bodies will also rely heavily on City practitioners.

The obvious objection to such a system - that insiders may be more sympathetic to the problems of the accused than outsiders - is countered by the Government, who claim that City people will be best equipped to catch offenders. The Government also believes that the best protection is vigorous competition. But perfect competition relies on complete knowledge and with literally tens of thousands of transactions a day and with so much business done verbally, no City practitioner believes this to be possible.

These features of the securities market are also a formidable obstacle to proper policing unless the new boards are well staffed, with an aggressive confrontational approach to their business. But that is not likely to happen. Many seasoned City people privately view the next few years with trepidation, as one scandal after another unfolds. What, I

asked one leading merchant banker, should investors do? 'Put their money in property', he replied.

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