THE CITY REVOLUTION

The City Revolution

Causes and Consequences

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To my darling daughter Alexandra, who perhaps suffered most during my enforced seclusion

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Preface

In July 1983 the UK government reached an agreement with the London Stock Exchange whereby the government agreed to remove the Exchange's rule book from the scrutiny of the Office of Fair Trading and to drop the impending action in the Restrictive Practices Court in return for promises to admit lay members to the Exchange's ruling Council and to abolish fixed commissions by the end of 1986. This event is widely regarded as the event which triggered the reform of the Stock Exchange which culminated in the 'Big Bang' on 27 October 1986. This, however, is not the case. Pressures for reform first surfaced as a result of the demands made by the increasingly important institutional investors during the 1970s. The pressure was intensified in the immediate aftermath of the abolition of exchange controls in October 1979 as the lack of international competitiveness of the domestic securities trading system was finally brought home when little of the resultant business was directed at Exchange member firms. Nor can the 'accord' be held up as the all-important catalyst without which trading practices in the domestic market would never have changed – competitive pressures and straightforward self-interest would have eventually ensured that the market responded to the competitive challenge posed by other international exchanges and financial developments outside the domestic exchange. This is not to deny that the 'accord' might have speeded up the pace of reform – that is a distinct possibility – but rather to indicate that the event should be seen as one of many factors that shaped the programme of reform. This programme, embracing the admission of lay members to the Exchange's ruling Council, the relaxation of ownership rules applied to 'outsiders', the switch to 'dual-capacity' trading, the phasing out of the structure of minimum fixed commissions and the move to limited liability by Exchange members, and the pressures which led to its implementation, form the subject-matter of Chapter 1.

The implications of the changes introduced for the trading systems and techniques adopted in the major financial markets, both domestic and foreign, are the focus of Chapter 2. The 'committed market-maker' trading system to be applied in both the revamped gilts market and the new domestic equity market are clearly explained and the implications for developments in these and the 'global equities' and Euromarkets are closely analysed. The potential benefits and likely 'costs' of the induced structural adjustments and amendments to trading practices are assessed in each case, with the macro-policy implications being explained where relevant.

Chapter 3 is devoted to a description of the changes that have already occurred to the domestic financial landscape and to analysis of the strategies adopted by the different types of financial concerns which have participated in the mad scramble for equity stakes in Exchange member jobbing and broking firms and discount houses in preparation for the 'Big Bang'. The plans, aspirations and dangers facing the clearing, merchant and foreign bank participants (plus others) in this game of musical chairs are scrutinised, as are the arguments presented for and against the process of conglomeration, the current fashion in financial markets. As is demonstrated, the UK financial system in general and the City of London in particular have changed beyond all recognition – truly a 'revolution' – but this may only represent a preliminary 'face-lift': the final landscape will only become clear once the securities battles have been fought and the regulatory authorities are pushed once again into exercising their restraining influences!

The final, and in many ways the most important, chapter assesses the prudential ramifications deriving from the reforms instituted in the UK securities market. The deficiencies of the present supervisory regime, the pressures that led to its reform – notably the Wilson Report, the Gower Report and the reforms undertaken at the London Stock Exchange – and the actual official reform proposals, which culminated in the Financial Services Bill, are analysed in depth. A personal critique of the Bill (as amended during its passage through the House of Commons) is then provided; this highlights its potential merits, but also indicates the broad range of doubts (e.g. concerning the advisability of employing such a high degree of non-statutory regulation within the supervisory process and relying so heavily upon the integrity of practitioners in the use of 'Chinese Walls', etc.) and criticisms that have been expressed in discussions on its proposals. Finally, supervisory issues still giving cause for concern – such as the dangers associated with unfettered conglomeration and possible foreign dominance of the UK securities industry, the problems arising from the slow pace of international supervisory harmonisation, the difficulties experienced in assessing capital adequacy and managerial competence and the lack of a suitable instrument for dealing with systemic problems should they arise as a result of casualties among the securities trading fraternity – are presented for the reader's attention. This material serves to identify the risks that supervisors and regulators are taking in allowing the supervisory network to develop in the manner currently proposed and should always be borne in mind when assessing the potential net benefits of the reform undertaken at the London Stock Exchange. The term 'Big Bang' may prove to be more of an apt description of domestic securities market developments than people even now realise!

MAXIMILIAN HALL

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M.H.