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INSIDE OUTSIDE LEAVE ME ALONE: DOMESTIC AND EC-MOTIVATED REFORM IN THE UK SECURITIES INDUSTRY

PATRICK M. CREAVER

INTRODUCTION

The United Kingdom ("U.K.") securities market has undergone extensive changes in the past decade. These changes have resulted from both internal reforms and from external European Community ("EC") mandates.

In the past, the U.K. investment industry was primarily self-regulated, with little governmental interference. This scheme of regulation was turned upside-down in the mid-1980s with extensive deregulation, referred to as the "Big Bang."¹ In addition to the Big Bang, the Financial Services Act of 1986 ("FSA") created a new set of rules that replaced the prior system.² These new rules emphasized a move away from complete self-regulation, yet the drafters made a conscious effort to avoid agency regulation modeled after the United States Securities and Exchange Commission ("SEC").³

Further changes in the U.K. securities industry were, and continue to be, implemented by the EC Directives concerning the securities and banking industries.⁴ These Directives are aimed at creating a single mar-

1. See 10 International Capital Markets and Securities Regulation § 6A.01 (H. Bloomenthal rev. ed. 1990) [hereinafter H. Bloomenthal]; N. Poser, International Securities Regulation: London's "Big Bang" and the European Securities Markets xv (1991).

2. See N. Poser, *supra* note 1, at 81-82.

3. See H. Bloomenthal, *supra* note 1, § 6A.01. The language used to describe these events can be somewhat confusing. As one commentator has stated, "the much heralded 'deregulation' of the London market . . . involved as much regulation as deregulation." Peters, *Overview of International Securities Regulation*, 6 Int'l Tax & Bus. Law. 229, 239 (1988).

The Big Bang was a "deregulation," in the sense that it removed the scattered rules and barriers to investment activity. The FSA "re-regulation" was an attempt to use one statute to cover the area of market governance. The U.K. chose to continue the tradition of "self-regulation" under the FSA, but with more government participation than existed prior to the Big Bang. For a discussion of the misleading use of the word "deregulation," see Address by R.B. Jack, A Review of the Legal Problems, *reprinted in* Financial Deregulation 51 (R. Dale ed. 1986).

The type of deregulation that has occurred in the U.K., and other markets, has been referred to by some as "access deregulation." See Warren, *Global Harmonization of Securities Laws: The Achievements of the European Communities*, 31 Harv. Int'l L.J. 185, 187 (1990). This deregulation involves the lessening of regulatory barriers such as exchange controls with an eye towards increasing the international activity of the particular market. See *id.* The Big Bang is referred to in the context of access deregulation. See *id.* The kind of re-regulation under the FSA has been termed "prudential re-regulation," which refers to the kind of "legislative activity undertaken to address the perceived shortcomings of regulatory systems in the aftermath of deregulation." *Id.* at 188. This form of re-regulation creates a system of regulation under which internationally accessible markets may grow while investors are adequately protected. See *id.* at 188-89.

4. This Note covers banking issues in a very limited context. For more information

ket in securities across the EC.⁵ Some of the earlier directives have already been incorporated into U.K. law and the conduct-of-business rules governing trading within the U.K. securities markets.⁶ Other directives are still under consideration by the EC.⁷

Finally, the adoption of a real-time automated stock quotation system is of major concern for both the U.K. securities industry and the various EC securities markets. The adoption of such a system is a practical necessity toward the achievement of the EC single market. Toward this end, the U.K. would like to see its Stock Exchange Automated Quotations ("SEAQ") system simply extended to all EC exchanges.⁸ There is some disagreement among EC members, however, as to what system should eventually be implemented.

This Note examines both the changes in the U.K. securities industry and related EC issues. Part I discusses the internal deregulation and re-regulation of the U.K. securities industry in the 1980s resulting from the Big Bang and the FSA. Part II examines the present and proposed EC Directives that, as an external force, have created change in the U.K. securities industry, and the EC as a whole. Part III then explores the problems encountered by the EC in implementing a community-wide computerized quotations system, as well as the U.K. interest in expanding SEAQ across the EC. This Note concludes that despite what may be well-founded British skepticism of the EC goals, the expected changes will likely strengthen the U.K.'s role in the international securities markets and promote economic growth across the EC.

I: THE BIG BANG AND THE FINANCIAL SERVICES ACT OF 1986

The year 1986 was one of great change for the British capital markets and for British securities regulation.⁹ Two separate events—the Big Bang and the adoption of the FSA—occurred at that time, changing the system of securities regulation and the conduct of business within the U.K.¹⁰

The Big Bang grew out of fears that the U.K. stock exchanges were too restrictive in comparison to the exchanges of other countries. The FSA arose in response to the continuing abuses resulting from the form of self-regulation existing in the industry at that time. The consequence

on EC banking, see Note, *Banking on Europe: 1992 and EMU*, in *Annual Survey of Institutions and Regulations, Transnational Financial Services in the 1990s*, 60 *Fordham L. Rev.* S395 (1992).

5. See S.J. Berwin & Co., *Company Law and Competition* 3 (1989) [hereinafter *Company Law*]. The single market will help European companies expand within the EC, allow American and Japanese companies to aid in European development, and give the EC as a whole greater international bargaining power. See Warren, *supra* note 3, at 196.

6. See *infra* notes 118-62 and accompanying text.

7. See *infra* notes 163-249 and accompanying text.

8. See *infra* notes 250-74 and accompanying text.

9. See H. Bloomenthal, *supra* note 1, § 6A.01.

10. See *id.*

of these changes was a market more attractive to foreign investors because it was both more accessible and provided greater investor protection.

A. *The Big Bang*

In 1986, the British government prodded the former London Stock Exchange ("Exchange"), today called the International Stock Exchange ("ISE"), to enact major reforms which have been called, collectively, the Big Bang.¹¹ Reforms included the elimination of fixed commission rates,¹² which led to another more significant reform—the elimination of the "single capacity system" of the Exchange.¹³ The single capacity system had prevented brokers from simultaneously trading stock issues and "market making," the process of determining stock prices.¹⁴

At this time the U.K. also switched from limited floor trading to SEAQ—an automated and computerized system of quotations patterned after the United States NASDAQ system. This switch to SEAQ, coupled with the elimination of the single capacity system, created a market with much more liquidity.¹⁵ Some have compared these changes to similar events in the United States, such as the 1975 unfixing of commission rates, called "Mayday," and the introduction of NASDAQ.¹⁶

These British reforms arose after a lawsuit, brought against the Exchange following a six-year investigation by the Office of Fair Trading into the practices of the Exchange, concluded that the restrictive nature of the Exchange dealings violated the Restrictive Practices Act 1976.¹⁷ The action was settled when the Exchange promised the British Government to reform itself.¹⁸ Some U.K. authorities involved in the lawsuit,

11. See Peters, *The Changing Structure of the Financial Services Industry and the Implications for International Securities Regulation*, 46 Wash. & Lee L. Rev. 525, 530 (1989). The words "Big Bang" are indeed appropriate to describe the reforms and changes in the U.K. markets. See Address by Philip Wilkinson, Preparing for the Big Bang, reprinted in *Financial Deregulation* 22 (R. Dale ed. 1986).

12. See Peters, *supra* note 11, at 530. For a discussion on how commission rates were fixed, why they were fixed, and the complexities leading to the need for reform, see N. Poser, *supra* note 1, at 13.

13. See Peters, *supra* note 11, at 530. The prohibition of fixed commission rates made the single-capacity system untenable. See N. Poser, *supra* note 1, at 37. See generally *id.* (discussing the seven part "link argument" put forth by the Exchange which details why single-capacity could not survive the unfixing of commission rates).

14. See H. Bloomenthal, *supra* note 1, § 6A.01.

15. See *id.*; see also Miller, *Regulating Financial Services in the United Kingdom—An American Perspective*, 44 Bus. Law. 323, 326 (1989) (SEAQ is a major advancement because brokers can now access stock prices at will, as opposed to making many individual requests to a market maker).

16. See Miller, *supra* note 15, at 325; see also N. Poser, *supra* note 1, at 14-17 (discussing U.S. "Mayday" reforms).

17. See N. Poser, *supra* note 1, at 25-26.

18. See Miller, *supra* note 15, at 325; Wilkinson, *supra* note 11, at 22. See generally Jack, *supra* note 3, at 49 (discussing this settlement between the Exchange and the British Government).

however, were unhappy with the settlement. They believed that if the suit had gone to completion it "would have brought out all the various public interest issues, the advantages of competition, the needs of investor protection, [and] the imperatives of international competitiveness"¹⁹

While the Office of Fair Trading lawsuit prompted reforms, fear was the real driving force behind the more extreme changes. The U.K. was particularly concerned that other exchanges around the world would eventually trade more U.K. stock issues and other foreign issues than the U.K. exchanges themselves.²⁰ If that were to occur, London would lose its role as an international securities leader.

As foreign markets incorporated technological advancements and made other efforts to become attractive to foreign investors, domestic markets in general had to act to become more competitive.²¹ Furthermore, the global "trend towards financial deregulation and greater competitive freedom has prompted governments and supervisory authorities to review their arrangements for regulating the financial services industry."²² The U.K. system especially needed to revitalize because, as one commentator noted, "[t]he London Stock Exchange was becoming like a last outpost in a faraway colonial possession."²³ Thus, the changes were a means to increase the U.K.'s role in global securities markets²⁴ and to

19. Jack, *supra* note 3, at 50 (quoting the Director General of Fair Trading).

20. There was little choice but to reform. The London Stock Exchange had trouble competing on an international level, and also lost business trading domestic U.K. shares. See N. Poser, *supra* note 1, at 29; see also *id.* at 17 ("internationalization of the markets (i.e., increased competition among the markets of the world, at least in securities of international interest)" was the underlying cause of British market reform); Address by Andrew Buxton, *Financial Deregulation: The Opportunities and Some of the Dangers*, reprinted in *Financial Deregulation* 15 (R. Dale ed. 1986) (deregulation of the Exchange would have occurred despite the Office of Fair Trading lawsuit because of foreign competition taking U.K. business).

21. See Peters, *supra* note 11, at 528. Globalization of securities markets has made offshore exchanges more accessible, and markets have been "streamlining themselves" to remain competitive. *Id.* See also Peters & Feldman, *The Changing Structure of the Securities Markets and the Securities Industry: Implications for International Securities Regulation*, 9 Mich. Y.B. Int'l Legal Stud. 19, 25 (1988) (the U.K. reforms enacted, so as to allow its domestic market to remain competitive, are the most "dramatic" to date); Address by Richard Dale, Introduction, reprinted in *Financial Deregulation* xi (R. Dale ed. 1986) ("[t]his review [of existing financial regulation] has been most far reaching in the UK").

22. Dale, *supra* note 21, at xi.

23. Miller, *supra* note 15, at 325 (quoting I. Kerr, *Big Bang* 10 (1986)); see also N. Poser, *supra* note 1, at 19 (single capacity had been in use since 1847).

24. See Miller, *supra* note 15, at 326. One commentator suggests that as a result of technology, market liberalization, and greater investor sophistication, there is a movement toward one global securities market comprised of the New York, Tokyo, and London exchanges. See Wilkinson, *supra* note 11, at 23. Another commentator has stated, "[d]evelopments in communications technology and the general mobility of capital and persons have all irresistibly contributed to a highly interdependent world economy, with truly international markets." Rider, *Policing the International Financial Markets: An English Perspective*, 16 Brooklyn J. Int'l L. 179, 180 (1990). For a discus-

maintain London's position as a leading international financial center.²⁵

B. *The Financial Services Act*

Prior to Big Bang, there was a statutory system of securities regulation in the U.K., but it was not faithfully enforced and did not cover all areas of the industry.²⁶ In fact, the U.K. investment industry was heavily self-regulated; the Exchange itself handled oversight of the investment industry.²⁷ The FSA, enacted shortly after the Big Bang, replaced the prior system of regulation,²⁸ and as such was a major vehicle for U.K. securities regulation reform.

The FSA attempted to encapsulate the various provisions of British securities law under a single act.²⁹ Thus, the FSA encompasses much of the substance of the prior law governing the securities market, such as is found in the Companies Act and Prevention of Frauds (Investment) Act. In addition, the FSA contains new provisions for civil liability that were not contained in any prior statute.³⁰

Although the FSA provided for continued self-regulation of the industry, it included provisions for stronger government guidance than in the pre-Big Bang era.³¹ FSA regulation thus represents a middle-ground be-

sion evidencing the globalization of securities markets, particularly in regard to the linkages of the ISE to investment mechanisms in the United States, see Becker, *Global Securities Markets*, 6 Int'l Tax & Bus. Law. 242, 247, 249, 255 (1988).

25. See Miller, *supra* note 15, at 329. It should be noted that, while the Big Bang was intended to enliven the U.K. securities markets, "[i]ts primary importance to the rest of the world was its effect on the international securities markets, not the domestic British market." N. Poser, *supra* note 1, at 27.

26. See N. Poser, *supra* note 1, at 82.

27. See generally *id.* at 84 (discussing pre-FSA self-regulation by the London Stock Exchange).

28. Forbes-Cockell, *Financial Services Regulation in the United Kingdom*, Prac. L. Inst., Mar. 15, 1990, available in WESTLAW, International Library, Text & Periodicals File, at *1. The origin of the FSA is in the "White Paper," which is patterned after reports written by L.C.B. Gower. See *id.* Gower was an expert on British corporate law, and was hired by the Department of Trade and Industry to advise on new securities legislation. See N. Poser, *supra* note 1, at 85.

29. See H. Bloomenthal, *supra* note 1, § 6A.02; see also Forbes-Cockell, *supra* note 28, at *1 (notably, the Gower report, as one of the bases of the FSA, called for a single statute encompassing securities regulation laws).

30. See H. Bloomenthal, *supra* note 1, at § 6A.02; see also Halloran & Scudellari, *Securities Offerings Abroad by Domestic Issuers, Both Public and Private*, 6 Int'l Tax & Bus. Law. 262, 292 (1988) (the Companies Act of 1985 was a major source of regulation over the U.K. securities industry prior to the FSA); Miller, *supra* note 15, at 331 (the Prevention of Frauds (Investment) Act, which was replaced by the FSA, "was the primary legislation affecting the investment industry in the U.K."); Rider, *supra* note 24, at 189 ("Prior to the FSA . . . there were certain statutory provisions regulating the investment industry . . . under the Companies Act and the Prevention of Fraud (Investments) Act 1958."). For discussion of FSA imposition of civil liability, see *infra* notes 80-96 and accompanying text. For a limited discussion of the relationship of the FSA to prior U.K. laws governing the securities industry, see Note, *International Financial Markets and Regulation of Trading of International Equities*, 19 Cal. W. Int'l L.J. 327, 351-53 (1989).

31. See H. Bloomenthal, *supra* note 1, § 6A.02; Forbes-Cockell, *supra* note 28, at *1. The Gower report notably recommended a continuation of the prior self-regulatory na-

tween full agency regulation and earlier complete self-regulation.³²

The easing of certain restrictions under the Big Bang had reduced confidence in the self-regulating structure, and the need for change became evident.³³ The U.K. had "long prided itself on a system of securities regulation with a minimal statutory basis," but "given the nature of the changes taking place at the Exchange (particularly the conflicts of interest inherent in integrating market making and [trading] of securities), it [was] inevitable that a more formal regulatory structure be adopted."³⁴ Furthermore, sizeable pre-FSA scandals involving Lloyd's of London dramatically illustrated the problems linked to self-regulation.³⁵ These scandals involved the misappropriation of vast amounts of money by Lloyd's of London professionals.³⁶

Today, while there is still self-regulation, it operates under the statutory framework of the FSA, which is intended to curb abuses and rebuild public confidence in the financial services industry by providing more governmental oversight.³⁷ In this regard, the FSA, in conjunction with Big Bang reforms, has kept the U.K. market competitive on a global scale while also serving to protect the interests of the individual investor.³⁸

ture of the securities industry. *See id.* at *1. Referring to the content of the Gower report, "[t]he statutory framework would be based so far as possible on self-regulation, but the self-regulation would be subject to governmental supervision." N. Poser, *supra* note 1, at 86. This increased governmental oversight under the FSA has been felt especially by securities firms. *See Riley, London May Face Challenge*, *Fin. Times*, Nov. 17, 1988, Survey sec., at XII, cols. 1, 3-4.

32. "What the Government is attempting to do in the Financial Services [Act] is . . . to encourage self-regulation within a statutory framework." Jack, *supra* note 3, at 51.

33. *See H. Bloomenthal, supra* note 1, § 6A.01. Changes in the U.K. securities industry after World War II rendered the traditional self-regulatory system ineffective to guard "against the incompetent, let alone fraudulent." Rider, *supra* note 24, at 184.

34. H. Bloomenthal, *supra* note 1, at § 6A.01.

35. *See Miller, supra* note 15, at 330 & n.35. A call for new regulation occurred after other instances of fraud by investment firms upon their customers, involving the misappropriation of funds. *See id.* at 330. It became obvious that the existing self-regulatory structure could not cope with the problem of fraud. *See Rider, supra* note 24, at 189.

36. *See Nader Accuses Lloyd's of London of Destabilizing American Market*, 55 *Antitrust & Trade Reg. Rep. (BNA)* No. 1374, at 58 (July 14, 1988); Moore, *Howden Makes £13.4m Offer to Lloyd's Members*, *Fin. Times*, Dec. 18, 1985, § 1, at 8, cols. 1, 1-2. The problems at Lloyd's of London have continued. Between 1983 and 1986 seventeen disciplinary cases were completed by Lloyd's internal disciplinary committees. *See Lloyd's of London Report May Calm Regulatory Fears*, *Reuters*, Jan. 21, 1987, available in LEXIS, Nexis Library, Omni File, at *1.

37. *See Miller, supra* note 15, at 360; *see also Halloran & Scudellari, supra* note 30, at 292 (noting that the FSA was "an attempt to restore investor confidence in the U.K. securities market," which had deteriorated as a result of the scandals under the prior self-regulatory system); Rider, *supra* note 24, at 185 (noting DTI view that the primary purpose of the FSA is to increase investor confidence).

38. *See H. Bloomenthal, supra* note 1, § 6A.01 n.6.

C. *Regulatory Structure of the U.K. Securities Market under the FSA*³⁹

The FSA requires one to be "authorized" in order to engage in investment business in the U.K., unless a statutory exemption applies.⁴⁰ Any unauthorized person or firm conducting securities or investment business may be criminally prosecuted.⁴¹

This "authorization" can be obtained in several ways under the FSA. The Securities and Investment Board ("SIB") can directly authorize the person. Membership in an SIB-recognized Self-Regulating Organization ("SRO") or Recognized Professional Body ("RPB") are alternate routes for authorization.⁴² The SIB also acknowledges Recognized Investment Exchanges ("RIEs"), although membership in an RIE is insufficient in and of itself to entitle someone to legally engage in investment business.⁴³

1. The Securities and Investment Board

The FSA gave power of investment and securities regulation to the Secretary of State of the Department of Trade and Industry ("DTI"), and allowed the Secretary to delegate that power to a private sector "Designated Agency," which is the SIB.⁴⁴ The SIB is comprised of various staff members and a chairperson, all of whom are appointed jointly by the Secretary of State for Trade and Industry and the Governor of the Bank of England. Despite these appointments, the SIB is considered a private agency.⁴⁵

The objectives of the SIB are two-fold. It is designed to head "a system of effective investor protection across the UK markets and, at the same time, to ensure that those markets develop efficiently and competitively."⁴⁶ Towards the achievement of these objectives, the SIB has fairly

39. The FSA is a very complicated document. It covers everything from public offerings to collective investment schemes (mutual funds). See Poser, *supra* note 1, at 91. The focus of this part of the Note will be limited to the regulatory framework devised under the FSA. While only part of the mass of information in the FSA, it is within this framework and structure that the rulemaking bodies under the FSA create most of the regulations governing the U.K. securities industry.

40. See Financial Services Act, 1986, § 3 (Eng.); Forbes-Cockell, *supra* note 28, at *1. See generally Miller, *supra* note 15, at 334 (discussing people and activities excluded from FSA coverage). For a list of entities exempted from FSA coverage, see Financial Services Act, 1986, §§ 35-45 (Eng.).

41. See N. Poser, *supra* note 1, at 91; Financial Services Act, 1986, § 4 (Eng.).

42. See Financial Services Act, 1986, §§ 25, 7, & 15 (Eng.); H. Bloomenthal, *supra* note 1, § 6A.02.

43. See H. Bloomenthal, *supra* note 1, § 6A.02. Once an RIE is recognized by the SIB it is actually exempted from authorization. See N. Poser, *supra* note 1, at 103. Nonetheless, it must meet certain conditions in order to conduct investment business. *Id.*

44. See Financial Services Act, 1986, § 114 (Eng.); Miller, *supra* note 15, at 335. For FSA requirements imposed on the Designated Agency/SIB, see Financial Services Act, 1986, §§ 114-18 & sched. 7 (Eng.).

45. See N. Poser, *supra* note 1, at 92-93.

46. Address by Sir Kenneth Berrill, The Securities and Investment Board: Its Objectives and Expectations, *reprinted in* Financial Deregulation 18 (R. Dale ed. 1986).

broad powers, including the ability to criminally prosecute those who engage in investment business without proper authorization.⁴⁷ The SIB may also directly authorize an individual to engage in investment activities and can regulate those activities, as well as authorize the existence of SROs and RPBs. It also has power to approve the rulebooks of the self-regulating bodies, and to seek compliance orders against them.⁴⁸ While the SIB has the power to directly authorize individuals and firms to engage in securities transactions, it has expressed the desire that most seek authorization under an SRO.⁴⁹

The SIB rules, known as the "SIB rulebook," initially served as a model for the rules promulgated by an SRO or RPB.⁵⁰ The DTI, however, must be satisfied that the SIB rules themselves provide an adequate level of investor protection and comport with objectives of the FSA.⁵¹ If the DTI is not satisfied that the SIB is operating satisfactorily, or finds that its rules are inadequate or overly anti-competitive, it may reclaim SIB rule-making functions.⁵² The DTI's ability to revoke the SIB's power is an instance of potential governmental intervention in this primarily self-regulated industry.⁵³

2. Self-Regulating Organizations

As the FSA intended, SROs assume the majority of the self-regulation in the U.K. investment industry. Once the SIB recognizes an SRO, that SRO has regulatory power over its members.⁵⁴ The requirements for SRO recognition by the SIB are as follows: its rules must provide ade-

47. See Berrill, *supra* note 46, at 20. This is "a particularly unusual function for a private [sector organization]." *Id.* However, this makes perfect sense in the case of the SIB because it does operate and oversee the authorization process. *See id.*

48. See Miller, *supra* note 15, at 335; H. Bloomenthal, *supra* note 1, § 6A.02; *see also* Financial Services Act, 1986, §§ 25-28 (Eng.) (SIB direct authorization); §§ 9-10 (Eng.) (SIB authorization of SROs); §§ 17-18 (Eng.) (SIB authorization of RPBs); §§ 10(3), 18(3) (Eng.) (SIB approval of rulebooks); §§ 12, 20 (Eng.) (compliance orders); *see generally* Forbes-Cockell, *supra* note 28, at *4 (the SIB has three tasks: recognizing SROs and RPBs, drawing up its own rulebook, and overseeing the regulatory system).

49. See Miller, *supra* note 15, at 337. In theory a person or firm can choose to be authorized by the SIB or an SRO, but "[t]he SIB has discouraged direct [SIB] authorization." N. Poser, *supra* note 1, at 93.

50. See H. Bloomenthal, *supra* note 1, § 6A.03. For discussion concerning the detailed SIB rulebook, see Forbes-Cockell, *supra* note 28, at *4. Note that "equivalency" essentially called for SRO and RPB rulebooks to be almost identical to the SIB rulebook. *See id.*; *see also infra* notes 80-96 and accompanying text (discussing the problem of damages for breach of such rules, and subsequent amendment of the FSA to do away with "equivalency").

51. See Financial Services Act, 1986, § 114(9) (Eng.); H. Bloomenthal, *supra* note 1, § 6A.02 n.1.

52. See Financial Services Act, 1986, § 115 (Eng.); H. Bloomenthal, *supra* note 1, § 6A.02 n.1.

53. "Even though the Secretary of State [through the DTI] has delegated most of these regulatory powers to the Designated Agency [the SIB], this Agency is under the control of the DTI." Miller, *supra* note 15, at 336.

54. *See id.* at 337.

quate investor protection; it must see to enforcement of its rules; its governance must be representative of the public; it must be able to investigate complaints; it must be able to advance fairness and integrity; and it must be willing to provide information to the SIB and the DTI.⁵⁵

The general functions of an SRO are to decide whether members are "fit and proper" to engage in the specific investment business covered by the SRO, to devise adequate means to enforce the rules relating to the investment business of its members, and to create fair procedures regarding admission and punishment of members.⁵⁶

The SROs, among themselves, differ widely in character and each SRO usually covers a distinct area of the investment business. For example, one SRO regulates those who deal with private investors, while another covers those who engage in the marketing of securities. This division of authority creates regulatory separation among the various areas of the investment industry.⁵⁷

Initially, each SRO was required to have rules that afforded a level of protection to investors equivalent to the protection provided pursuant to the SIB rules.⁵⁸ Amendments to the FSA, however, eventually abolished the equivalency requirement in favor of broader SIB guidelines that emphasized investor protection.⁵⁹ The SIB, however, still maintains power to review the particular rules of an SRO.⁶⁰ Moreover, the SIB must be satisfied with the rules, and can still impose individual mandatory rules.⁶¹

3. Recognized Professional Bodies

A person who is a member of an RPB that is recognized by the SIB is authorized to conduct securities and investment business in the U.K.⁶² An RPB operates similarly to an SRO, and as such is subject to SIB and DTI guidelines and oversight in order to protect investors.⁶³

Unlike an SRO, an RPB's members are professional people, such as accountants and solicitors, who wish to carry out investment business

55. See Financial Services Act, 1986, sched. 2 (Eng.); N. Poser, *supra* note 1, at 94.

56. See Miller, *supra* note 15, at 337-38.

57. See *id.* at 338; H. Bloomenthal, *supra* note 1, § 6A.03; see also Miller, *supra* note 15, at 339-41 (overview of present SROs and specific functions they cover); N. Poser, *supra* note 1, at 94-95 (same).

58. See H. Bloomenthal, *supra* note 1, § 6A.03.

59. See *infra* notes 80-85 and accompanying text for more on the problem of equivalency and why it led to amendment of the FSA.

60. See Financial Services Act, 1986, § 13 (Eng.).

61. See *id.*; Forbes-Cockell, *supra* note 28, at *6; *infra* note 95 and accompanying text.

62. See H. Bloomenthal, *supra* note 1, § 6A.03.

63. See Miller, *supra* note 15, at 342. See generally Berrill, *supra* note 46, at 20 (discussing the early concerns of RPBs about having to adjust their rules according to the SIB guidelines). For discussion of SIB and DTI oversight, see *supra* notes 46-53 and accompanying text.

"incidental" to their particular profession.⁶⁴ Thus, RPB members are not primarily concerned with the investment business. There is then the risk that their rulebooks, supervisory systems, and disciplinary procedures regarding investment ventures may be inadequate.⁶⁵ Consequently, the rules of the RPB must explicitly restrict members to investment activities "incidental" to their profession.⁶⁶

D. Criticisms of the Big Bang and the FSA

1. Big Bang

It has been several years since the reforms of the Big Bang. Although the Big Bang has given the U.K. the lead in the Euromarkets, the reforms have occasionally been criticized. For instance, some critics believe that the former single-capacity system actually enhanced investor protection by keeping brokers and market-makers (price-setters) separate, thus reducing the risk of conflicts of interest inherent when those who sell shares also determine the price of those shares.⁶⁷ While a dual-capacity system is not required today, the lifting of its prohibition coupled with the unfixing of commission rates (two Big Bang reforms) made single capacity unprofitable⁶⁸ and impossible.⁶⁹ Thus, the increased risk due to potential conflicts of interest must be weighed against theoretical benefits of increased competition from the unfixing of commission rates.

In addition, some critics have noted that the "touch"—the difference between the selling and buying prices of stock—has increased since the Big Bang to the detriment of the small investor. Some view this increase primarily as a result of SEAQ, whose quote-driven market-making fosters this price differential.⁷⁰ Large institutional investors, however, can avoid the touch by shopping around, off SEAQ, for a better price.⁷¹ Unlike their institutional counterparts, small investors do not have this opportunity and must use SEAQ.⁷²

A criticism related to the widening of the touch is that commission rates for small deals have actually risen. Thus, the supposed increased competition among brokers after the unfixing of commission rates has

64. See Miller, *supra* note 15, at 342.

65. See Berrill, *supra* note 46, at 20.

66. See Miller, *supra* note 15, at 342.

67. See *Five Years Since Big Bang—After the Earthquake*, Economist, Oct. 26, 1991, at 23, 23 [hereinafter *Five Years*]. "[T]he end of the single-capacity system has created new conflicts of interest that may reduce investors' confidence in the integrity of the markets." N. Poser, *supra* note 1, at 75.

68. See *Five Years*, *supra* note 67, at 23.

69. For a discussion on the impossibility of maintaining the single capacity system once rates were unfixed, see *supra* notes 12-13 and accompanying text.

70. See *Five Years*, *supra* note 67, at 24. See also N. Poser, *supra* note 1, at 48-50 (the "transparency" of SEAQ causes this problem).

71. See N. Poser, *supra* note 1, at 50. Institutional investors could "save money by dealing directly with one another between the published" stock quotes. *Id.*

72. See *Five Years*, *supra* note 67, at 24.

not created a benefit for the small trader.⁷³ Furthermore, higher commission rates and the wider SEAQ touch have resulted in a decrease in the volume of trading.⁷⁴

Finally, since the Big Bang, critics argue that the securities market has been concentrated in larger firms.⁷⁵ This has supposedly occurred because many firms entered the U.K. hoping to reap the benefits of Big Bang deregulation and the anticipated increased trading.⁷⁶ When lower commission rates for institutional trades and lost revenues were compounded by a sharp decline in trading following the 1987 market crash, firms began to abandon the London securities market.⁷⁷ As a result, only "very large firms and specialty firms" have survived in this atmosphere.⁷⁸ The risk today is that the remaining firms will "flex[] their competitive muscles" and drive smaller entities out of business, collapsing the market further into an already tight circle of conglomerates.⁷⁹

2. The FSA

Criticisms of the FSA are more substantial than those lodged at the Big Bang, and have actually led to an amendment of the statute. Much criticism has been levelled against the imposition of civil liability under Section 62 of the FSA, in conjunction with the "equivalency standard" for SRO and RPB rulebooks.⁸⁰

Section 62 of the FSA allowed for the imposition of damages for losses

73. *See id.* at 24. Small sized trades of shares were not any cheaper after the Big Bang. *See* N. Poser, *supra* note 1, at 54-55.

74. *See Five Years, supra* note 67, at 24. Of 2,100 shares listed in June 1991, 1,300 were not traded at all during the month. *See id.* *But see id.* at 26 (SEAQ has generally worked well, albeit at times at the expense of the small investor, and SEAQ International has been dominating cross-border trading).

75. *See* N. Poser, *supra* note 1, at 74. For an early prediction of the present concentrated state of the U.K. investment industry, drawn from the U.S. experience following the 1975 "Mayday" reforms, *see* Wilkinson, *supra* note 11, at 25.

76. *See* N. Poser, *supra* note 1, at 72. *See also* Buxton, *supra* note 20, at 15 (large banks availed themselves of the deregulated U.K. securities market, so as to increase their services provision business).

77. *See* N. Poser, *supra* note 1, at 72. This was especially true of foreign firms operating in London. *See id.* at 72-73. *See also* Buxton, *supra* note 20, at 16 (discussing early concerns that banks providing investment services were entering the U.K. market at the height of competition, which was dangerous because market returns might not justify the risk of such moves); Wilkinson, *supra* note 11, at 27 (expressing early belief that institutions entering the post-Big Bang market were exposing themselves to risks from an extremely competitive market).

78. N. Poser, *supra* note 1, at 72. "There will . . . be a place for the specialist, since experience . . . shows that there is always a market for skill and specialisation." Buxton, *supra* note 20, at 16. Large firms are able to function because they are capitalized at a greater level and can compete in the global securities market. *See* Panel Discussion, *reprinted in* Financial Deregulation 81 (R. Dale ed. 1986). *See generally* N. Poser, *supra* note 1, at 74 (for discussion of the firms that dominate the U.K. securities industry).

79. N. Poser, *supra* note 1, at 74.

80. *See* Forbes-Cockell, *supra* note 28, at *4. For discussion and meaning of "equivalency," *see supra* note 50 and accompanying text.

stemming from violation of an SRO's rules.⁸¹ The equivalency standard necessitated an almost line-by-line adoption of the SIB rulebook by SROs and RPBs,⁸² but the complicated SIB provisions led to small differences in SRO/RPB equivalent adaptation.⁸³ This, in turn, led to "entirely different answers . . . to quite simple questions."⁸⁴

SROs were thus concerned that the rules they were drafting were leaving uncertainty about their legal duties under Section 62. Therefore, overly detailed rules emerged that were legalistic and obscure.⁸⁵ Eventually the SIB realized that SROs needed a simpler and more flexible approach to rulemaking.⁸⁶ This simplified approach is contained in what is known as the "1989 Proposal," devised and eventually adopted by the SIB.⁸⁷ The Companies Act of 1989, which amended the FSA, enacted the new system into law.⁸⁸

The SIB can now promulgate necessary "principles" to be incorporated by SROs into their own rulebooks.⁸⁹ An SRO can then adapt these principles with some flexibility, as opposed to complying with the previously extensive list of SIB rules.⁹⁰ The SIB can still review the SRO/RPB rules to ensure that the principles it set out have been followed. Now, however, the SIB evaluates rules under the more subjective standard of "adequacy of investor protection," as opposed to the prior objective "equivalence" standard.⁹¹

Violation by an SRO of its own rules based on SIB principles may still lead to common law civil liability under contract or tort principles,⁹² but the violation does not of itself lead to an express right to a civil suit by an investor under the FSA.⁹³ Nevertheless, failure to comply with broad SIB principles can be grounds for disciplinary action.⁹⁴

Additionally, the SIB can still impose mandatory rules under the 1989

81. See Forbes-Cockell, *supra* note 28, at *4; see generally Rider, *supra* note 24, at 194-200 (discussing the benefits of civil enforcement of U.K. securities law). It is worthwhile to note that the EC has dealt with this area under a proposed Directive, making the supplier of a service liable for damages for the faulty provision of that service. See Harris, *Damaging Advice and Services—EC Proposals*, 135 *Solic. J.* 318, 318-19 (1991).

82. See *supra* note 50 and accompanying text.

83. See Forbes-Cockell, *supra* note 28, at *4.

84. *Id.* at *4.

85. See *id.* at *4.

86. See *id.* at *5.

87. See N. Poser, *supra* note 1, at 127.

88. See Forbes-Cockell, *supra* note 28, at *5.

89. See *id.* at *5. The "principles" represent broad standards of conduct that all SROs and RPBs must follow. See *id.* The 1989 Proposal advanced this "general" approach, with the SIB's broad principles as a guide under which SROs were to make their rules. See generally N. Poser, *supra* note 1, at 127-29 (for discussion of these principles, known as the "10 Commandments").

90. See Forbes-Cockell, *supra* note 28, at *6.

91. See *id.*

92. See *id.* at *5; N. Poser, *supra* note 1, at 132.

93. See Forbes-Cockell, *supra* note 28, at *5; N. Poser, *supra* note 1, at 132.

94. See N. Poser, *supra* note 1, at 132.

Proposal, but these may simply be followed by an SRO without any need for incorporation into a rulebook. This should eliminate inherent differences and problems in creating "substantially equivalent" precepts based on these rules.⁹⁵ SRO violation of such SIB-designated rules would be grounds for a civil action by an investor under Section 62.⁹⁶

In addition to the equivalency standard criticism, the FSA also poses problems in that it requires firms with a range of investment activities to become members of several SROs, because each SRO is limited to authorize only certain investment activities.⁹⁷ Larger firms are concerned about the awkwardness and expense of these multiple, overlapping SRO registrations.⁹⁸ Further, such multiple SRO coverage is likely to lead to gaps in regulation and to confuse people and firms trying to meet varying standards of investor protection.⁹⁹

Furthermore, since SRO members cannot be authorized to engage in activities outside the scope of the particular SRO's authority, there will be undue delays in authorization if a new investment activity arises. Investors will have to wait until a new SRO is formed for purposes of authorization or until an existing one is expanded.¹⁰⁰

There are two additional criticisms of the FSA. First, the FSA has weak enforcement provisions. It allows for the SIB to prosecute violators, but in the late 1980s there were only several SIB junior investigators.¹⁰¹ While the SIB has improved somewhat in this area, the low priority on enforcement is still evidenced by the SIB's reliance upon outside investigators and the inexperience of its own personnel.¹⁰² Second, the whole FSA system of self-regulation is suspect because of the problems demonstrated by the only other example of self-regulation—Lloyd's of London insurance.¹⁰³ Further, the post-FSA scandal involving Guinness casts doubt on the success of continued self-regulation.¹⁰⁴ Guinness, while in competition with another company to acquire Distill-

95. See *id.* See generally Forbes-Cockell, *supra* note 28, at *7 (discussing these "core" or "designated" SIB rules); N. Poser, *supra* note 1, at 129-30 (same). The rules left to be formulated by the SROs are referred to as "sub-rules." See Forbes, *supra* note 28, at *7. Note that these SIB core rules are an instance of increased interference in the self-regulatory structure of the U.K. investment business.

96. See N. Poser, *supra* note 1, at 129-30.

97. See Miller, *supra* note 15, at 361. The origin of this SRO limitation is in the Gower report, which called for self-regulation along "functional . . . lines," with each SRO "responsible for a different part of the investment business." N. Poser, *supra* note 1, at 86.

98. See Miller, *supra* note 15, at 362.

99. See *id.* at 361. Miller refers to this problem as "gaps and overlaps." *Id.*

100. See *id.* at 363.

101. See *id.* at 362 & n.218.

102. See Rider, *supra* note 24, at 191.

103. See Miller, *supra* note 15, at 363. The author is skeptical of the FSA scheme of regulation, stating that "in the long run it [regulation by a government body] may be viewed as more desirable." *Id.* at 361. For a discussion of the Lloyd's of London scandals, see *supra* note 36 and accompanying text.

104. See Miller, *supra* note 15, at 331.

ers Co., drove up the price of its shares. It did so because Guinness shares were included in its offer to shareholders of Distillers Co., and a higher market price for Guinness stock would make the offer more attractive.¹⁰⁵

II: EUROPEAN COMMUNITY DIRECTIVES CREATING CHANGE IN THE INVESTMENT INDUSTRY AND THEIR EFFECT ON THE U.K. SYSTEM

The EC has enacted many Directives¹⁰⁶ that have affected the EC investment industry, all intended to aid movement towards the "single market"¹⁰⁷ envisioned by the 1957 Treaty of Rome.¹⁰⁸ Furthermore, the Directives aid in the ability of a Member State, as well as other foreign issuers, to offer securities across the entire EC.¹⁰⁹ The Directives have had a major impact upon U.K. securities regulation because, as a member of the EC, the U.K. is obligated to incorporate the substance of a Directive into domestic law.¹¹⁰ While a Member State must meet the minimum requirements called for by a Directive, there is no prohibition on that State enacting more stringent securities rules for entities originat-

105. See N. Poser, *supra* note 1, at 271.

106. See generally Morris, *The Direct Effect of Directives—Some Recent Developments in the European Court—I*, 1989 J. Bus. L. 233, 233-34 (1989) (defining a Directive and its usage by the EC).

107. For a discussion of the EC single market, see *supra* note 5.

108. See A. Swan & J. Murphy, *Cases and Materials on the Regulation of International Business and Economic Relations* 286-89 (MB) (1991). The Single European Act, adopted in 1986, furthered the EC efforts to create the single market by calling for integration by December 31, 1992. See *id.* at 287.

The UCITS Directive, Council Directive 85/611, 1985 O.J. (L 375) 3, as amended by Council Directive 88/220, 1988 O.J. (L 100) 31, relates to the harmonization of national law and increased investor protection as to "collective investment" schemes (ie. mutual funds). See Council Directive 85/611, para. 2, 1985 O.J. (L 375) 3, 3. This Note is concerned with basic issues of stock and, to a lesser extent, with debt securities. As such, the UCITS Directive is beyond the scope of this discussion. This Directive, however, is important because "it shows, in microcosm, the nature of the present strategy for completing the internal market in financial services. In a sense, therefore, it has something of the character of a pathfinder Directive." Blair, *Europe 1992 and the Harmonisation of Standards for the Regulation of Financial Institutions*, 16 Can. Bus. L. J. 97, 103 (1990).

The UCITS Directive "proceeds by three fundamental propositions" that become "the core of the subsequent Community initiatives." *Id.* at 104. The three elements are (1) the requirement of authorization in one State that is valid in all the others, called "home State authorisation," (2) "host State" control over matters affecting users in that State of home State authorized services, and (3) "harmonisation and minimum standards." *Id.* at 104-05.

109. See Halloran & Scudellari, *supra* note 30, at 299; see generally *id.* at 292-99 (discussing the offering of securities in the U.K. under the FSA and the ISE rules).

110. Directives are not directly applicable to Member States. They are binding upon the States, however, as to the final objective of the Directive. See Steiner, *Coming to Terms with EEC Directives*, 106 L. Q. Rev. 144, 145 (1990). Thus, Member States are obligated "to implement measures to achieve the prescribed results." *Id.* See generally *id.* at 149-59 (examining the approaches taken by the U.K. courts in implementing Directives).

ing in that State.¹¹¹

One goal of the EC is "harmonization" of the various member states' laws, in order to provide equivalent safeguards across the EC.¹¹² The Directives effect such harmonization, which was originally understood to mean that the various Member States had leeway in implementing the goals of a particular Directive.¹¹³ As to general "company law," however, scholars have argued that the EC Directives effectively result in a unification of member states' law, leaving only the details to be sorted out by each Member State.¹¹⁴ This argument is evidenced by the "far-reaching changes" initiated by the Directives on British company law.¹¹⁵

Furthermore, there are difficulties in regard to the safeguarding objectives of company-law harmonization in the EC. First, there is the problem of discerning which provisions of domestic company law are indeed safeguards, and thus targets for harmonization. Second, and compounding the first problem, is the interdependence among domestic company-law provisions. Finally, assuming harmonization in this area is directed at the correct national laws, it will nonetheless be difficult to determine whether an adequate level of equivalency has been achieved among domestic laws.¹¹⁶

The next section explores some of the Directives, past and present, that affect EC securities law¹¹⁷ and the U.K. securities system.

A. Past Directives

Two Directives previously devised by the EC and incorporated into U.K. domestic law, the Admissions Directive and the Listing Particulars Directive, illustrate the EC move toward the single market. These Directives also show the effect Directives have had on national law, and illustrate the particular concerns of the U.K. in trying to meet Directive obligations.

111. See Halloran & Scudellari, *supra* note 30, at 299.

112. See Morris, *supra* note 106, at 242. Harmonization is also closely related to the concepts of deregulation and re-regulation of domestic securities markets. See Warren, *supra* note 3, at 190. While deregulation makes markets more accessible, and re-regulation allows for both the growth of those markets and increased investor protection, harmonization reduces the differences between domestic regulatory schemes. See *id.* This is viewed as a method of achieving greater protection because regulatory variations could otherwise lead to abuses. See *id.*

113. See Morris, *supra* note 106, at 242. See generally *Company Law*, *supra* note 5, at 16-22 (discussing harmonization and related principles).

114. See Morris, *supra* note 106, at 242.

115. *Id.*

116. See F. Wooldridge, *Company Law in the United Kingdom and the European Community: Its Harmonization and Unification* 4 (1991).

117. Directives in the area of securities law show the premium the EC has placed on the disclosure of information. See Warren, *supra* note 3, at 209 & n.144.

1. The Admissions Directive

The Admissions Directive¹¹⁸ sets out the minimum conditions a company and its stock (and issuers of debt securities) must meet in order for an issue to gain admission to a Member State stock exchange. The continuing obligations the issuer of the stock (and debt securities) must meet are also stated in this Directive.¹¹⁹

The coordination of conditions for admission of securities to Member State stock exchanges was intended to accomplish several goals. First, the Directive provided increased protection to the investor by virtue of EC-wide uniformity in the area. Second, it facilitated admission of securities across the EC and among EC exchanges. Third, it allowed increased "interpenetration of national securities markets" by Member States to aid the establishment of the single European market.¹²⁰

Under this Directive certain *conditions* must be met before an issue will be admitted to the official listing on a Member exchange. In the case of shares, the conditions extend to both the issuing company and the shares themselves. In the case of debt securities, the conditions apply to both those issued by a private undertaking and those issued by a State.¹²¹

Furthermore, admission is subject to the issuers of the securities meeting specific *obligations*.¹²² Where the obligations require that an issuer make certain information public, the issuer must publish this information in newspapers with wide circulation, or publish notice in such newspapers that the information is available in writing at indicated places.¹²³ Although Member States are required to meet the minimum standards set out by the Directive, they are free to impose some stricter conditions and obligations as long as they apply to all parties seeking admission to listing on an exchange.¹²⁴

118. Council Directive 79/279, 1979 O.J. (L 66) 21 [hereinafter Admissions Directive].

119. See Reid & Ballheimer, *The Legal Framework of the Securities Industry in the European Community Under the 1992 Program*, 29 Colum. J. Transnat'l L. 103, 124-25 (1991); Company Law, *supra* note 5, at 36.

120. See Admissions Directive, *supra* note 118, para. 1. This Directive makes note that "partial coordination of the conditions for admission to official listing constitutes a first step towards subsequent closer alignment of the rules of Member States in this field." *Id.* para. 6.

121. *Id.* art. 4(1). Article 4(1) of the Directive imposes the conditions, which are listed in Schedule A of the Admissions Directive for shares, and in Schedule B of the Admissions Directive for debt securities.

122. See *id.* art. 4(2). Obligations are set out in Schedule C for companies issuing shares. See *id.* at 30, sched. C. Schedule D sets out obligations for an undertaking which issues debt securities. See *id.* at 31, sched. D(A). Also in Schedule D are the obligations of a State issuing debt securities. See *id.* at 32, sched. D(B).

123. See *id.* art. 17.

124. See *id.* art. 5(1). Note that Article 5(4) specifically allows Member States to subject issuers to national rules requiring regular release to the public of financial positions and course of business. See *id.* art. 5(4). Note also that the Directive prohibits stricter requirements. See generally *id.* art. 6 (prohibition on a Member State conditioning admission of another Member's securities to its exchange on those securities already having gained admittance to another EC exchange).

The drafters of the Admissions Directive placed an obvious premium on investor protection. The Directive allows a Member State to reject an application for the admission of a security to an exchange if the State believes such admission would harm investors.¹²⁵ It also allows a State to impose "special conditions" on the admission of a particular security if it is in the interest of investor protection.¹²⁶ Further, an issuer who has securities admitted to listing in a State must provide any information to its authorities that is needed to protect investors.¹²⁷ The authorities may also suspend the listing where investor or market protection so requires.¹²⁸

The Directive also sets up a Contact Committee. The Committee will facilitate implementation of the Directive, and aid harmonization of both the minimum standards and the permissible more stringent national standards.¹²⁹

2. The Listing Particulars Directive

The Listing Particulars Directive¹³⁰ is almost a companion piece of EC legislation with the Admissions Directive.¹³¹ This Directive sets the minimum requirements that must be met for the listing particulars to be published when an issuer seeks admission of its shares (or debt securities) to an EC exchange.¹³² Further, it seeks to harmonize these disclosure requirements.¹³³ Member states are charged with enforcing this Directive, and no particulars can be published without approval. Moreover, the approval must be in accord with the Directive mandates.¹³⁴

Listing particulars are a means of investor protection because they provide objective information about the financial condition of the issuer and about the security for which admission is sought.¹³⁵ Prior to the enactment of the Listing Particulars Directive, however, the existence of varying sets of such safeguards among different EC Member States created problems. First, issuers found it more difficult to obtain listings on several EC exchanges because each Member State required something

125. *See id.* art. 9(3).

126. *Id.* art. 10. Note that this is a derogation from Article 5, which allows extra conditions only where applicable to all.

127. *See id.* art. 13.

128. *See id.* art. 14(1).

129. *See id.* art. 20.

130. Council Directive 80/390, 1980 O.J. (L 100) 1 [hereinafter Listing Directive].

131. As evidence of this, the Admissions Directive allowed Member States to delay its adoption until they adopted the Listing Particulars Directive. *See Admissions Directive, supra* note 118, art. 22; *see also* Listing Directive, *supra* note 130, art. 26 (the Contact Committee set out by the Admissions Directive is also authorized to handle harmonization problems that arise from the Listing Particulars Directive).

132. Admission of securities to a member exchange is conditioned on publication of the listing particulars. *See Listing Directive, supra* note 130, art. 3.

133. *See Company Law, supra* note 5, at 36-37.

134. *See Listing Directive, supra* note 130, art. 18 (1)(2)(3).

135. *See id.* para. 2.

different in the particulars. Second, investors were discouraged from buying securities across the EC because of varying levels of disclosure requirements. Consequently, the overall financing of EC projects was inhibited.¹³⁶ To offset these problems, the goals of this Directive were two-fold: to achieve adequate equivalence of safeguards by eliminating different listing requirements among Member States, and to ensure that sufficient and objective information is released to investors.¹³⁷

In general, the Listing Particulars Directive requires that the set of particulars contain the information necessary for investors or their advisors to assess the "assets and liabilities, financial position, profits and losses, and prospects of the issuer and of the rights attaching to such securities."¹³⁸ Furthermore, the Directive requires that the particulars include extensive specific information. Schedules A, B, and C of the Directive, referred to in Article 5(1),¹³⁹ indicate the specific information that generally must be included in a listing.

Schedule A sets out the particulars required where the admission of shares of stock is involved.¹⁴⁰ Schedule B sets out the listing particulars required where debt securities are involved.¹⁴¹ Schedule C sets out the requirements where "certificates representing shares" are sought to be admitted to listing on an exchange.¹⁴² Where an issuer falls outside the scope of Schedules A, B, and C, the listing must nevertheless contain equivalent information.¹⁴³ The Directive also provides an extensive list of exemptions under which there may be no obligation to publish listing particulars. For example, a Member State may exempt publication of listing particulars for securities which have been issued in connection with a takeover or a merger, or for shares of stock given at no cost to prior holders of the same stock.¹⁴⁴

The Directive also provides a considerable roll of "specific cases." Under each specific case, the precise information to be included in the listing is set out, often with detailed references to sections of the Schedules.¹⁴⁵ Thus, depending on the kind of security involved, there are differing amounts of required information to be disclosed. Each security sought to be admitted is not required to have all the information contained in a particular Schedule.

The listing particulars must be published either in a newspaper in the State where admission to listing is sought, or in a free brochure available

136. *See id.* para. 3.

137. *See id.* para. 4.

138. *Id.* art. 4.

139. *See id.* art. 5.

140. *See id.* at 11, sched. A.

141. *See id.* at 19, sched. B.

142. *See id.* at 25, sched. C.

143. *See id.* art. 5(3).

144. *See id.* art. 6.

145. *See id.* arts. 8-17.

at certain mandatory sites.¹⁴⁶ These sites include the stock exchange where listing was sought, the office of the issuer, and the offices of the issuer's agent in the Member State where admission was sought.¹⁴⁷ Further, either the whole of the particulars, or a notice stating where it has been published by the issuer (or where it can be obtained) must be set out in a publication designated by the Member State itself.¹⁴⁸ In addition, any new and relevant information must be set out in a supplement to those particulars already published.¹⁴⁹

Where various States and their exchanges receive admission applications, the States are to use "best efforts" to coordinate listing particular requirements and to agree on a single set of particulars.¹⁵⁰ To this extent, where securities have been listed in another Member State within the previous six months, the State to whom application is made shall exempt the issuer from preparing another prospectus.¹⁵¹

3. The Past Effect of the Admissions and Listing Particulars Directives on U.K. Securities Regulation and Conduct of Business

These two Directives, adopted by the EC Council prior to the Big Bang, were eventually incorporated by the U.K. into the FSA and other securities conduct-of-business rules.¹⁵² The Directives had their greatest impact on the "Third Market," a former U.K. exchange that was phased out of existence.¹⁵³ The Third Market was a limited exchange, dealing primarily with companies incorporated in the U.K. and mineral exploration companies incorporated in Ireland.¹⁵⁴

The demise of the Third Market resulted from a condition that the Admissions Directive imposed on companies seeking to have shares admitted for listing. This condition required that "[a] company must have published or filed its annual accounts . . . for the *three* financial years

146. *See id.* art. 20(1).

147. *See id.* art. 20(1).

148. *See id.* art. 20(2).

149. *See id.* art. 23. The supplement is also subject to the requirements of this Directive. *See id.*

150. *See id.* art. 24(1).

151. *See id.* art. 24(2).

152. The Admissions Directive requirements were included in U.K. domestic regulations under the FSA. *See* Company Law, *supra* note 5, at 36. The Listing Particulars requirements are embodied in U.K. law via Part IV of the FSA, and in the structure of the U.K. securities industry via the "yellowbook" (the ISE rulebook). *See The Likelihood of a Simplified Route to Public Listing Remains Elusive*, Fin. Times, Mar. 28, 1991, § 1, at 31, col. 1, 1; *see also* Note, *Survey of Registration and Disclosure Requirements in International Securities Markets*, 9 Mich. Y.B. Int'l Legal Stud. 243, 244-247 (1988) (summarizing the U.K. regulatory scheme governing the admission to listing of securities on the ISE and particulars requirements); Bloomenthal, *supra* note 1, § 1.08(2)(c) (same).

153. *See* Fitzsimons, *EC Directives Change Securities Markets*, Fin. Times, Feb. 15, 1990, available in LEXIS, Nexis Library, Omni File, at *1 [hereinafter *Directives Change Securities*].

154. *See* H. Bloomenthal, *supra* note 1, § 1.08(2)(a).

preceding the application for official listing."¹⁵⁵ The ISE requirement, however, was five years. The Unlisted Securities Market ("USM"), the second largest exchange in the U.K., had a three-year requirement, while the Third Market had a one-year requirement.¹⁵⁶ When the ISE dropped its requirement to three years,¹⁵⁷ the USM dropped its requirement to two years. The Third Market, with its one-year requirement, simply became unnecessary.¹⁵⁸ Since January 11, 1990 new companies have not been admitted to the Third Market,¹⁵⁹ and companies presently on that exchange will have the opportunity to be admitted on the USM.¹⁶⁰

In contrast to the lowering of some U.K. exchanges' admission standards, the overall level of information to be disclosed under these Directives has increased.¹⁶¹ This is viewed as largely the result of both the general and ongoing disclosure requirements of the Listing Particulars Directive.¹⁶²

B. Proposed Directives

A primary goal of the EC in creating the single market is for financial services to be offered freely across the EC, in a manner that both promotes the financial system and protects investors.¹⁶³ While the Proposed Investment Services Directive and the Proposed Capital Adequacy Directive represent the major efforts of the EC in this area, the U.K. has

155. Admissions Directive, *supra* note 118, at 26, sched. A(I)(3).

156. See generally H. Bloomenthal, *supra* note 1, § 1.08 (discussing the prior trading requirement of these three U.K. exchanges).

157. The five year ISE prior trading requirement would put the ISE at a competitive disadvantage compared to other EC exchanges in attracting foreign companies to list on the ISE. See *ISE Proposes Restructuring of Primary Markets*, Fin. Reg. Rep., Nov. 1989, available in LEXIS, Nexis Library, Omni File, at *2 [hereinafter *ISE Proposes Restructuring*]; see also *Directives Change Securities*, *supra* note 153, at *2 ("the [ISE] would need to move from a five-year [trading] history requirement to a three-year history requirement in order to remain competitive in attracting foreign companies with Stock Exchanges in other countries"). This drop in prior trading history was also grounded in fairness reasons. U.K. domestic companies were still required to meet the ISE five-year requirement, while other EC companies could attain an ISE listing after only three years. See *id.*

158. This was not necessarily an onerous result. The Third Market, unlike the USM, is considered a failure as a market. See Waters, *Misgivings on USM Entry Changes*, Fin. Times, Nov. 1, 1989, § 1, at 12, col. 4, 4 [hereinafter *Misgivings*]; see also *ISE Proposes Restructuring*, *supra* note 157, at *3 (discussing the various proposals entertained by the Committee on Quotations of the ISE on how to resolve the USM/Third Market prior year requirement problem).

159. See *Directives Change Securities*, *supra* note 153, at *3.

160. See *Misgivings*, *supra* note 158, § 1, at 12, col. 5; *ISE Proposes Restructuring*, *supra* note 157, at *4.

161. See Reid & Ballheimer, *supra* note 119, at 126.

162. Article 4 of the Listing Particulars Directive sets the general requirements and Article 23 requires the ongoing disclosure of new information. See *id.*; see also *supra* notes 138 & 149 and accompanying text (discussing Articles 4 and 23 of the Listing Particulars Directive).

163. See Redhead, *Liberalization of the European Community's Financial Services Sector*, 12 Whittier L. Rev. 185, 186 (1991).

identified several potential problems if the Directives are adopted as written.

1. The Proposed Investment Services Directive ("ISD")

a. Goals of the ISD

The Second Banking Directive specifically allows EC-based banks (credit institutions)—but not investment firms—to provide certain securities-related services across the EC. The EC Council designed the Investment Services Directive¹⁶⁴ primarily to afford pure, non-bank investment companies the same "single passport"¹⁶⁵ to provide securities and investment services¹⁶⁶ to EC Member States.¹⁶⁷ It was somewhat anomalous and unfair to allow banks to engage freely in cross-border securities transactions, and not to specifically allow investment firms to do the same.¹⁶⁸ Another purpose of the ISD is to aid the EC in forging the single market in financial services.¹⁶⁹ In this regard, a related objective is the liberalization of stock markets and options markets,¹⁷⁰ which would

164. Amended Council Proposal for an Investment Services Directive, 1990 O.J. (C 42/06) 7 [hereinafter ISD].

165. The "single passport" is the term used to describe the ability granted an EC firm in one Member State to carry on investment services in any other Member State. See R. Cranston, *The Single Market and the Law of Banking* 116-17 (1991).

166. The following investment services fall under the ISD: brokerage, dealing as principal, market making, portfolio management, underwriting services with respect to transferrable securities only and subsequent distribution thereof, professional investment advice, and safekeeping and administration. See ISD, *supra* note 164, at 18, annex sec. A. Unless otherwise noted above, all of the following instruments/securities can be subject to the ISD services: transferrable securities, money market instruments including certificates of deposit and "Eurocommercial paper," financial futures and options, and exchange/interest rate instruments. See *id.* at 18, annex sec. B.

167. It is interesting to note that while the ISD specifically creates the single passport for investment firms, their freedom to engage in cross border business in the EC already exists under the Treaty of Rome. In this regard the ISD is unnecessary. See R. Cranston, *supra* note 165, at 116. The ISD, however, will prove greatly helpful because it represents a specific EC-wide agreement not to obstruct the ability to provide such services. See *id.* Thus, "[t]he ISD is an expression by Member States of a willingness to comply with obligations already imposed upon them by the Treaty [of Rome] and to give effect to freedoms which already exist under the Treaty." *Id.*

168. The ISD is "necessary for reasons of fair competition, to ensure that non-bank investment firms benefit from similar freedom to create branches and provide services across frontiers as that provided for by the [Second Banking Directive]." ISD, *supra* note 164, para. 3; see generally Redhead, *supra* note 163, at 190-96 (discussing the provisions of the Second Banking Directive).

169. See ISD, *supra* note 164, para. 1.

170. In order for EC firms authorized by their "home state" to conduct a Community-wide business, access to "host-state" stock exchanges (and options markets) should be liberalized. See *id.* para. 5. The terms "home state" and "host state" are used extensively in the ISD and need to be defined. "Home state" means the EC Member State in which the investment firm has its principal place of business (if firm is a natural person), or its registered office/head office (if firm is a legal person). See *id.* art. 1(4)(a)(b). "Host state" means the EC Member in which the investment firm has a branch, or in which it supplies services. See *id.* art. 1(5).

allow EC firms broad access to investment exchanges.¹⁷¹

b. "Home-State" Authorization

Under the ISD, the "home state"¹⁷² is charged with both authorizing a firm to engage in investment services, and supervising the firm to ensure its financial soundness.¹⁷³ Home-state authorization may not issue unless the investment firm has sufficient capital¹⁷⁴ and those who operate the firm are "of sufficiently good repute and experience."¹⁷⁵ Further, home states must require the applicant firm to include in its application information about the kinds of business it will conduct as well as the structure of the firm.¹⁷⁶ Additionally, the home state cannot grant authorization without knowing the identities of all members of the firm possessing qualified holdings, or if it is not satisfied that those with qualified holdings will further the careful management of the firm.¹⁷⁷

Mutual recognition by EC host states of a particular EC home state's authorization of an investment firm will enable that firm to conduct investment activities across the entire Community, without the need to obtain new authorization in each new host state.¹⁷⁸ Mutual recognition of home-state authorization is achieved by ISD harmonization of the various EC Member State standards for authorization,¹⁷⁹ thereby making it unnecessary for the host state to impose its own investment rules.¹⁸⁰

A Member state may impose stricter rules for firms it authorizes while acting as a home state.¹⁸¹ In most cases, however, those same rules will not apply to firms authorized elsewhere, because of the policy of mutual recognition.¹⁸²

171. See R. Cranston, *supra* note 165, at 132.

172. For the definition of "home state" and related terms, see *supra* note 170.

173. See ISD, *supra* note 164, para. 6; art. 3(1).

174. See *id.* art. 3(2). This capital amount is to be determined according to the nature of the service to be provided, and will be specifically referenced under the Capital Adequacy Directive. See *id.*; see also *infra* notes 231-43 and accompanying text (for analysis of capital requirements under the Capital Adequacy Directive).

175. ISD, *supra* note 164, art. 3(2).

176. See *id.* art. 3(3).

177. See *id.* art. 4. A qualified holding is defined as 10% or greater of the capital or voting rights in the firm, or a holding in the firm that allows the exercise of significant influence over its management. See *id.* art. 1(7).

178. See *id.* paras. 2 & 8.

179. See *id.* para. 2.

180. See *id.*; see also *supra* notes 112-13 and accompanying text (discussing harmonization, which bears on the EC objective that home-state authorization will be acceptable to host states).

181. See ISD, *supra* note 164, para. 7. This is so because the EC "Commission's approach [under the ISD] is one of 'minimum harmonisation,'" which allows the home state to "impose prudential rules [on its own firms] which are stricter than those laid down by the ISD." R. Cranston, *supra* note 165, at 117.

182. Host states cannot make home-state authorized firms "subject to an authorization requirement or to a requirement to provide endowment capital or any measure having equivalent effect." ISD, *supra* note 164, art. 12(2). In general, under the ISD the host

c. *Instances of "Host-State" Control*

Nevertheless, there are several instances under the ISD where host-state rules and authority apply to a home-state-authorized firm conducting investment business within the host-state borders. In those situations the policy of mutual recognition does not apply.

Article 16(2) of the ISD makes a broad reference to "the legal provisions adopted in [the host] State pursuant to the provisions of this Directive involving powers of the host Member State."¹⁸³ The first of these host-state powers allows the host state to require compliance with its own laws in two cases: (1) where a firm is not authorized as an investment firm in its home state, and (2) where investment activities that fall outside the ISD are conducted by the firm, even if the firm has home-state authorization.¹⁸⁴ However, such host-state power exists only if host laws are compatible with Community law and protect the general good, and if there are no equivalent rules over these firms or activities in the home state.¹⁸⁵ A second host-state power over a home-state-authorized investment firm allows the host Member State to verify that the firm conforms with its laws and principles as to administrative and accounting procedures, and that it exercises sufficient internal control.¹⁸⁶

A third source of rule-making authority for the host state over the home-state-authorized investment firm is found in Article 11 of the ISD.¹⁸⁷ The tenor of Article 11 is an order to home-state authorities to devise prudential rules that must be followed by all investment firms they authorize, whether the firm is to be a branch in the host state or will only provide services into the host state.¹⁸⁸ One such required rule regards compensation schemes for investors.¹⁸⁹ In the case of a branch established in the host state, however, the branch must follow the host-state rules as to compensation schemes until the substance of such schemes can be harmonized.¹⁹⁰

Article 13(2) is a fourth instance of host-state control over investment firms authorized elsewhere in the EC.¹⁹¹ Article 13(1) obligates host

state's ability to impose rules on home-state authorized firms is very limited. See R. Cranston, *supra* note 165, at 117.

183. ISD, *supra* note 164, art. 16(2).

184. See *id.* para. 10. The language here first appears to indicate that such host-state laws or regulations have to be followed only if the firm is *neither* authorized in the home state nor engaging in activities beyond the ISD. However, the phrase "such firms or such activities" appears later in the same provision. *Id.* This lends credence to the view that the words "such activities" refer to authorized firms as well as unauthorized firms.

185. See *id.*

186. See *id.* para. 15.

187. See *id.* art. 11.

188. See *id.* art. 11(1), indents 1-7. Note that this is an example of an effort to harmonize in the area of financial services; the aim here is to have all EC Member States force the firms they authorize to comply with these specific mandates.

189. See *id.* art. 11(1), indent 4.

190. See *id.*

191. See *id.* art. 13(2).

states to open membership in their stock exchanges, securities markets, and settlement systems to home-state-authorized firms allowed to engage in brokering, dealing, or market-making.¹⁹² In this context, membership "shall be on the basis that the rules governing the structure and organization of the relevant host stock exchange or organized securities market and clearing and settlement systems are complied with."¹⁹³

A fifth source of host-state power over home-state-authorized firms is in the area of advertising. The investment firm is subject to any host-state rules concerning the form and the content of advertising. Such rules, however, must be enacted in the interest of the general good.¹⁹⁴

Finally, the ISD allows the host state to exercise authority in circumstances involving the "general good." While the standard of mutual recognition of home-state authorization requires that host states not interfere with authorized activities, this is only to the extent that the activities are not counter to host-state legal provisions that protect the general good.¹⁹⁵

Further, Article 16 of the ISD affords a remedy for the host state when an investment firm, whether having a branch in the state or merely providing services into the state, fails to comply with ISD-sanctioned host-state rules. Article 16(2) of the ISD states that the host state "shall require the investment firm concerned to put an end to the irregular situation."¹⁹⁶ If the firm fails to comply, the host state must then inform the authorities in the firm's home state of the firm's failure to comply. Thereafter, the home state must ensure that the firm complies with the host-state rule.¹⁹⁷ If the firm continues to violate the rules of the host state, the host state can, upon notice to the home state, take action to punish the firm and prevent it from engaging in any further business.¹⁹⁸ The foregoing procedure need not be followed, however, where the investment firm is in violation of host-state rules designed to protect the general good, or in the case of an emergency where action must be taken to protect investors. In these cases the host state may take whatever measures are needed to prevent the violations or to protect investors.¹⁹⁹

192. *See id.* art. 13(1).

193. *Id.* art. 13(2).

194. *Id.* art. 16(10).

195. *See id.* para. 11. A particular instance of this broad power is found in Article 14(4) where, in the interest of the "general good" the host state may impose conditions upon the branch of a home-state authorized investment firm. *See id.* art. 14(4).

196. *Id.* art. 16(2).

197. *See id.* art. 16(3).

198. *See id.* art. 16(4). Note that the investment firm must be notified of any sanction exacted on it, and the sanction must be explained. Further, the firm may appeal any sanction to the courts of the Member State that imposed it. *See id.* art. 16(6).

199. *See id.* art. 16(5)(7).

d. *“Home-State” Imposition of Conditions on Authorized Investment Firms*

Under the ISD, the home state is charged with ensuring that the firms it has authorized comply with several conditions. One such condition is contained in Article 8, which specifies that an authorized firm’s initial required capital not fall below the amount required for authorization.²⁰⁰ The home state, however, may allow time for a firm that falls below its required amount to increase its capital to an acceptable level.²⁰¹ A second condition is simply that the firm must continue to comply with those standards needed for initial authorization—namely, sufficient capital as per the services provided, and the good repute of the firm’s directors.²⁰²

A third condition under the ISD regards qualified holdings. The home state must require that prior notice be given to the competent authorities by a natural or legal person any time that person hopes to: (1) gain a qualified holding in a firm; (2) increase an existent qualified holding in a firm;²⁰³ or (3) dispose of or decrease a qualified holding.²⁰⁴ Furthermore, the firm itself must give the home state notice of changes in qualified holdings as soon as it becomes aware of such changes. It must also supply the names of those natural or legal persons with qualified holdings, and the sizes of the holdings, on a yearly basis.²⁰⁵

The home state must also draw up “prudential rules” that authorized firms must follow. These rules relate to: administration and accounting, separation of investors’ securities and money from that of the firm, compensation in case of firm bankruptcy or default, provision of information upon home-state demand, record-keeping, and conflicts of interest.²⁰⁶

e. *Requirements upon “Host States”*

Once a firm is authorized by its home state, the host state must ensure that the firm may freely provide services within its borders, whether through a branch located in the host state or through provision of services into the state.²⁰⁷ As noted above, the host state cannot impose any additional authorization requirements.²⁰⁸ Also, as described above, there is a broad mandate that duly authorized firms be allowed equal access to the various financial markets and exchanges within the host state to

200. *See id.* art. 8(1)(2) & (4).

201. *See id.* art. 8(5).

202. *See id.* art. 9. These requirements are set out initially in Article 3(2).

203. *See id.* art. 10(1).

204. *See id.* art. 10(3).

205. *See id.* art. 10(4).

206. *See id.* art. 11(1). Note that the home state may choose not to apply some of these rules when a firm deals with professional investors, or where the firm will not handle the money or securities of its client. *See id.* art. 11(2).

207. *See id.* art. 12(1).

208. *See id.* art. 12(2); *see also supra* note 182 (discussing this general requirement).

which domestic firms have access.²⁰⁹

f. *Branching of Authorized Firms*

Under the ISD a distinction is made between an EC home-state-authorized firm that merely provides services into the host state, and a firm that is operating as a branch in the host state.²¹⁰ There is a definite procedure under the ISD that must be followed in order for an authorized firm to branch.²¹¹ First, the firm must notify its home state that it wishes to branch into another EC nation.²¹² When providing such notice, the firm must include information regarding the target host state, the type of business to be undertaken, the organization of the branch, its address in the host state, and the names of the branch managers.²¹³ The home state then has three months in which to decide whether to convey this information, plus information as to the amount of funds in the investment firm, to the host state. If it decides that the financial and administrative capacities of the firm are inadequate, however, it need not do so.²¹⁴ In the event of refusal—which operates as a denial to branch into the host state—the home state must explain to the firm within those three months the reason(s) why the information was not forwarded.²¹⁵

Once the information is conveyed to the host state, the host state has two months to: (1) prepare for the supervision of the firm, according to the extent of its ability to impose conditions under the ISD;²¹⁶ and (2) indicate the conditions devised in regard to the public good that it will impose on the branch.²¹⁷ The firm may establish the branch upon notice from the host state, or upon expiration of the two-month period, whichever occurs first.²¹⁸

g. *Value of the ISD to the U.K.*

The ISD is of great importance to the U.K. because the British securities service industry is comprised of many pure investment firms.

209. See ISD, *supra* note 164, art. 13. See generally R. Cranston, *supra* note 165, at 132 (discussing ISD ordered access to stock exchanges and other securities markets).

210. A branch is defined as "a place of business which forms a legally dependent part of an investment firm and which provides an investment service for which the investment firm has been authorized." ISD, *supra* note 164, art. 1(6).

211. The procedure involved where an investment firm authorized in the home state merely wants to provide services into the host state is far simpler. See R. Cranston, *supra* note 165, at 134. In these cases the firm must notify the home state of the services it hopes to provide, and the home state has one month to send that notification on to the host state. See ISD, *supra* note 164, art. 15.

212. See ISD, *supra* note 164, art. 14(1).

213. See *id.* art. 14(2).

214. See *id.* art. 14(3).

215. See *id.* The firm may have recourse in the home-state courts upon the home state's refusal or failure to notify. See *id.*

216. See *id.* art. 14(4). See generally *supra* notes 183-95 and accompanying text (for listing of the powers afforded the host state over home-state authorized firms).

217. See ISD, *supra* note 164, art. 14(4).

218. See *id.* art. 14(5).

Whereas other EC states rely on banks for investment services, which obtain their "single passport" via the Second Banking Directive, the U.K. industry derives cross-border trading benefits primarily from the ISD.²¹⁹ This aspect of the ISD responds to the U.K.'s concern that allowing other EC banks access to U.K. securities business, while not permitting U.K. securities firms to solicit business in other EC states, would be grossly unfair and destructive to the U.K. investment industry.²²⁰

h. *U.K. Concerns About the ISD*

While the ISD will likely equalize pure investment firms with banks in the EC investment services market, the U.K. is nevertheless troubled that its own national firms will remain at a competitive disadvantage in comparison to other EC firms. This is the result of relatively strict U.K. conduct-of-business rules under the FSA that apply to U.K. "home-state" firms, regardless of the EC state in which they seek to do business.²²¹ Compounding this adverse effect on U.K.-authorized firms is the fact that EC firms operating in the U.K. itself will not be subject to many of these rules because they operate under their home-state requirements, which are likely to be less exacting. Thus U.K. firms are also at a competitive disadvantage within the U.K. itself.²²²

Yet another misgiving is that U.K. firms, and other foreign firms, will relocate to Member States with comparatively less demanding investment rules. Thus, the EC harmonization in the area of financial services may lead to a decrease in regulatory standards rather than an increase in the effectiveness of regulation.²²³

219. See Blair, *supra* note 108, at 113-14. "Many . . . large securities businesses in Germany and France are bank owned, so they will get their passport from the second banking directive. But in the UK many securities firms are not bank owned and so need the investment services passport before they can sell their services elsewhere in the EC." *Inside the City: EC Threat to UK Financial Services Firms*, Independent, Sept. 17, 1990, available in LEXIS, Nexis Library, Omni File, at *1 [hereinafter *EC Threat*].

220. See *EC Threat*, *supra* note 219, at *1.

221. See Company Law, *supra* note 5, at 20; Reid & Ballheimer, *supra* note 119, at 116.

222. See Company Law, *supra* note 5, at 20. Some feel, however, that such a disadvantage to any Member State firm will not be that taxing. "It is probable that some Member States will have rules which are stricter than the minimum required [under the ISD], but competitive forces will probably lead to pressure for change upon those states which are . . . overly restrictive." R. Cranston, *supra* note 165, at 117.

223. See Rider, *supra* note 24, at 186-87. The fear is that there could be a proliferation of "investment firms in Member States with the least strict conduct of business rules and least strict prudential controls." Reid & Ballheimer, *supra* note 119, at 116. This fear may be countered somewhat by the ISD, however, which requires that authorization be denied to a firm where it is clear that it has chosen the legal system of another Member State simply because it is less stringent than the state where it intends to conduct most of its business. See ISD, *supra* note 164, para. 4.

2. The Proposed Capital Adequacy Directive ("CAD")

a. *Goals of the CAD*

The Capital Adequacy Directive²²⁴ is intended almost as a corollary to the ISD.²²⁵ While the ISD coordinated and harmonized rules regarding investment services, it left coordination of capital requirements of those firms to another Directive.²²⁶ The CAD harmonizes the minimum capital reserves that an investment firm must maintain in order to engage in cross-border securities business.²²⁷ As such, some believe capital adequacy to be the crucial element in actually gaining a single EC market in investment services.²²⁸ In order for such capital adequacy requirements to effectively protect investors, however, the regulations must broadly cover all the risks associated with the industry.²²⁹

Towards the formation of the single financial market within the EC, this Directive has several objectives: (1) to establish uniform amounts of initial capital; (2) to harmonize standards for the "own funds" of investment firms; and (3) to harmonize standards for monitoring market risks.²³⁰

b. *Initial Capital Required for Investment Firms*

The initial capital required of investment firms under the CAD is ECU 500,000.²³¹ This amount drops to ECU 100,000 for investment firms

224. See Commission Proposal for a Council Directive on Capital Adequacy of Investment Firms and Credit Institutions, 1990 O.J. (C 152/6) 12 [hereinafter, Capital Adequacy]. Note that some provisions of this Directive apply to credit institutions as well as investment firms. Such aspects of the Directive have been left out of the following analysis, as matters relating to credit institutions are beyond the scope of this discussion.

225. See *EC Pressed on Capital Adequacy*, Independent, Feb. 19, 1990, available in LEXIS, Nexis Library, Omni File, at *1 [hereinafter *EC Pressed*]. The Capital Adequacy Directive makes specific reference to the ISD in several of its provisions. See Capital Adequacy, *supra* note 224, paras. 1 & 2.

226. See *id.* paras. 1 & 2.

227. See Reid & Ballheimer, *supra* note 119, at 117. "In the proposed Capital Adequacy Directive, the Commission intends that capital adequacy requirements for firms covered by the proposed Investment Services Directive be harmonized." *Id.*

228. See Ewing, *The Single Market of 1992: Implications for Banking and Investment Services in the EC*, 13 *Hastings Int'l & Comp. L. Rev.* 453, 465 (1990).

229. See Dale, *supra* note 21, at xii.

230. See Capital Adequacy *supra* note 224, para. 3. "Own funds" under the Capital Adequacy Directive can be defined in two ways for investment firms: the definition in the Own Funds Directive, Council Directive 89/299, 1989 O.J. (L 124) 16, or the definition contained in the Capital Adequacy Directive itself, found in annex VI(4). See *id.* art. 2, indent 16. A useful definition is "the . . . institution's own capital, including items which may be treated as capital under national rules." Reid & Ballheimer, *supra* note 119, at 106 n.20 (citing the First Banking Directive, Council Directive 77/780, 1977 O.J. (L 322) 30).

231. See Capital Adequacy, *supra* note 224, art. 3(2). See generally Spicers Centre for Europe, *Opportunities in European Financial Services: 1992 and Beyond* xiii (P. Quantock ed. 1990) [hereinafter 1992 and Beyond] (discussing initial capital requirements).

Note that the firms covered by this article of the CAD are those that are not credit

that hold customers' securities or funds while acting as agents, but that do not hold trading positions.²³² The amount drops further, to ECU 50,000, for firms that are not authorized by their home state to hold customers' securities or funds, to act as market makers, or to underwrite. This amount is also applied to firms that underwrite, but only to the extent that they distribute issues on "a best efforts basis."²³³

There are two exceptions to the initial capital requirements. First, firms existing prior to the implementation of the CAD may continue to be authorized by the home state even if their own funds do not meet the required initial capital amounts.²³⁴ This, however, is subject to limitations. The firm's own funds²³⁵ at the time this Directive is implemented cannot fall below the highest amount recorded after that time.²³⁶ Further, the exception does not apply where the control of the firm changes hands, other than through an inheritance.²³⁷

The second exception to the initial capital requirements under this Directive is for mergers of investment firms. The resulting firm's exemption, however, is subject to approval of the home-state authorities.²³⁸ Note that the own funds of the new firm cannot fall below the highest amount achieved after the merger.²³⁹

There is a general prohibition under the CAD that a firm's own funds not fall below its initial capital requirement. If own funds do fall below the required amount, the home-state authorities may choose to give the firm time to raise the funds back to a sufficient level. If it fails to do so within that time, the firm must cease conducting business.²⁴⁰

c. "Own Funds" and Market Risks

Under the CAD, investment firms are required to maintain their own funds at a level adequate to cover the market risks associated with vari-

institutions, those whose business is not confined to the giving investment advice, and those that are not "local firms." See Capital Adequacy, *supra* note 224, art. 3(1). A local firm is a firm that deals "only for its own account on a financial futures or options exchange." *Id.* art. 2, indent 13.

"ECU" stands for European currency unit. The ECU is the "denominator . . . for the [European Monetary System] exchange rate mechanism." A. Swan & J. Murphy, *supra* note 108, at 842. Under this system, each Member State agrees to set an official rate for its currency, and to maintain that rate within a narrow range by participation in the exchange market. Thus the European Monetary System achieves the close monetary cooperation within the EC and, in conjunction with the ECU, has stabilized intra-EC exchange rates. This is viewed as essential to the formation of the EC single market. See *id.*

232. See Capital Adequacy, *supra* note 224, art. 3(4).

233. See *id.* art. 3(3).

234. See *id.* art. 3(5).

235. For a definition of the own funds requirement, see *supra* note 230.

236. See Capital Adequacy, *supra* note 224, art. 3(5).

237. See *id.* art. 3(6).

238. See *id.* art. 3(7).

239. See *id.*

240. See *id.* art. 3(8).

ous investment activities.²⁴¹ The sum of the amounts of own funds to be devoted to particular risks is the overall own-funds requirement for that firm. The firm must ensure that this required amount is less than, or equal to, the own funds in its possession.²⁴² Furthermore, home-state authorities must require investment firms to maintain own-funds levels necessary to counter the risks associated with activities that are permitted by the ISD, but not covered by the CAD. Risk from activities not covered by the ISD must also be covered by the firm's own funds.²⁴³

d. *Reporting Requirements*

Investment firms shall provide all the information that the home-state authorities need to determine whether the firm is complying with the terms of the CAD.²⁴⁴ Furthermore, there is a specific timetable under which such information is to be supplied. Firms that are authorized by the home state to act as principals must report to the home-state authorities at least once each month. For firms that act as agents or portfolio managers, the reporting period is no less than once every three months. Firms that are not authorized to retain customers' securities or funds, to act as market makers, or to engage in underwriting must report to the home-state authorities at least once each year. Finally, firms that underwrite, but do so only for a distribution of issues on a "best efforts basis," are also subject to the yearly reporting requirement.²⁴⁵

e. *U.K. Concerns About the CAD*

The U.K. anxiety here is that the minimum amounts set out under the CAD for investment firms are higher than the U.K. domestic requirement. U.K. firms would have to either meet the higher standard under the Directive or go out of business, because they cannot engage in investment business if they fail to maintain adequate capital.²⁴⁶ This concern is especially significant in light of the fact that the Big Bang and the adoption of the FSA created an environment that fostered the birth of many firms.²⁴⁷ The U.K. is also troubled that the levels of required capital will

241. *See id.* art. 4(1). The risks are set out in annexes I-IV. *See id.* at 12-16. *See generally* Reid & Ballheimer, *supra* note 119, at 118 (discussing the four types of risks set out in the Proposed Capital Adequacy Directive).

242. *See* Capital Adequacy, *supra* note 224, art. 4(1).

243. *See id.* art. 4(2).

244. *See id.* art. 6(1).

245. *See id.* art. 6(2).

246. *See EC Pressed*, *supra* note 225, at *1. Proposed levels were far too high according to Lord Elton, Chairman of the Financial Intermediaries, Managers and Brokers Regulatory Association, and other securities officials in the U.K.. *See id.* *But see* Capital Adequacy, *supra* note 224, art. 3(5) (firms in existence prior to the Capital Adequacy Directive may be authorized by the home state even if they fail to meet the minimum capital amounts).

247. *See* Solomon & Corso, *The Impact of Technology on the Trading of Securities: The Emerging Global Market and the Implications for Regulation*, 24 J. Marshall L. Rev. 299, 315-16 (1991).

cause a loss in international securities trading in the EC as a whole,²⁴⁸ as EC firms would be required to meet greater capital levels than competing investment firms outside the EC.²⁴⁹

III: SEAQ AND THE EC EFFORTS TO DEVISE A UNIFIED STOCK QUOTATIONS SYSTEM

SEAQ, as a means of trading securities, was itself a reform of the Big Bang intended to increase liquidity in the U.K. markets.²⁵⁰ SEAQ was also designed to put London in the forefront of cross-border trading in securities.²⁵¹ As one expert has noted, a computerized, automated, and "screen based system [of trading] . . . which did not depend on the geographical location of the members using it (as did any system that depended on [a] trading floor) held an enormous potential advantage for the [London Stock Exchange] . . . to establish itself as the premier stock exchange for the trading of international securities."²⁵²

While there have been certain criticisms of the system,²⁵³ it has put the ISE and London far ahead of the competition in the global securities market.²⁵⁴ In regard to the EC attempt to forge a single market in securities, other EC states are concerned about this U.K.-SEAQ dominance in international securities trading.²⁵⁵

One such effort to create a single EC securities market was called "Euroquote," an EC-backed idea for a Community-wide real-time stock quotations system to which all EC States could have access.²⁵⁶ However,

248. See Reid & Ballheimer, *supra* note 119, at 117. In regard to the Capital Adequacy Directive, "[t]he United Kingdom's government expressed the fear that international securities trading would be driven outside the Community as a result of an earlier proposal by the European Commission, which, by . . . favoring universal banks, could have discriminated against firms that conduct securities business in separate companies." *Id.*

249. See 1992 and Beyond, *supra* note 231, at 140.

250. See *supra* note 15 and accompanying text. See generally N. Poser, *supra* note 1, at 43 (for how stocks are traded and priced through SEAQ).

251. See N. Poser, *supra* note 1, at 42.

252. *Id.*

253. See *supra* notes 70-74 and accompanying text.

254. See *Five Years*, *supra* note 67, at 26. SEAQ International handles "up to half the turnover in big French and Italian shares and a quarter of . . . big German shares." *Id.* Further, because of SEAQ, "London now accounts for some 90% of all global cross-border share deals." *Id.*

255. See *Inside the City: Secure Future for SEAQ is Vital to City's Well-Being*, Independent, Dec. 3, 1990, available in LEXIS, Nexis Library, Omni File, at *1 [hereinafter *Secure Future*]. SEAQ's "success has not gone unnoticed by London's rivals, such as Paris, led by Regis Rousselle, president of the Societe des Bourses Francaises and Frankfurt, where Rudiger von Rosen is vice-chairman of the Federation of German Stock Exchanges." *Id.*

256. See generally *European Update: Main Text Banking and Financial Services*, 1991 WL 11696, available in WESTLAW, International Library, Eurupdate File, § 6.6.2. [hereinafter 1991 WL 11696] (describing Euroquote).

the idea has been abandoned by the EC.²⁵⁷ Euroquote was actually a Brussels company²⁵⁸ charged with implementing the project, which involved linking together EC states' computerized trading systems.²⁵⁹ It was intended to be "the vehicle for a comprehensive European trading system."²⁶⁰ Moreover, it was also to carry information about companies to be listed on EC exchanges.²⁶¹

The value of a unified system is obvious: the EC is moving towards the single market, and a system such as Euroquote would enable Member States to obtain the same information at the same time. Furthermore, a unified quotation system for the single market will likely increase international investing in the EC markets.²⁶² A single EC market for securities, and a unified stock market, will also likely increase infusion of foreign capital into the EC.²⁶³

Within the framework of the Euroquote system, the U.K. wanted to extend SEAQ to all Member States. Thus the U.K. system would become the EC single market quotations system.²⁶⁴ SEAQ International already handles a global business and has an international trading capacity, and the U.K. does not want to lose this growing business.²⁶⁵

France and other EC States, however, were hesitant to allow the U.K. system to branch out in such a manner.²⁶⁶ Therefore, the French posed

257. See *European Bourses Slowly Forging Closer Links*, Reuters, Nov. 20, 1991, available in LEXIS, Nexis Library, Omni File, at *1 [hereinafter *Closer Links*].

258. See *Secure Future*, *supra* note 255, at *2.

259. See 1991 WL 11696, *supra* note 256, at § 6.6.2..

260. *Secure Future*, *supra* note 255, at *1 (quoting the Federation of German Stock Exchanges).

261. See *id.* at *2. This aspect of Euroquote was subject to EC dispute. The executive vice-chairman of the Federation of German Stock Exchanges stated that there was no German demand for Euroquote to carry only information. See Waters, *Securities Chiefs Split as Deadline Looms*, Fin. Times, Apr. 23, 1991, § 1, at 29, col. 5, 5 [hereinafter *Securities Chiefs*]. In his opinion, "the obvious need remains for a European settlement system." *Id.* (quoting Rudiger von Rosen, executive vice-chairman of the Federation of German Stock Exchanges).

262. See *Frustration, Confusion Reign as Policy Deadline Nears*, Int'l Sec. Reg. Rep., June 17, 1991, at 5 [hereinafter *Policy Deadline*]. The disparity between the EC markets, including trading practices and settlement procedures, actually drives away potential investors. See *id.* (citing view of Andrew Hugh Smith, chairman of the ISE).

263. See *id.* at 5; 1991 WL 11696, *supra* note 256, at § 6.6.1..

264. See *Secure Future*, *supra* note 255, at *2. "If a commercial case is made for making Euroquote into a trading system it could possibly incorporate S[EAQ] International." *Id.* This is in keeping with the original goals in implementing SEAQ. See N. Poser, *supra* note 1, at 42. The U.K. recognized that such an option would be confronted by political barriers, because SEAQ is fully an English operation. See *Secure Future*, *supra* note 255, at *2.

265. See generally *Secure Future*, *supra* note 255, at *1-*2 (for discussion on importance of SEAQ to U.K. securities industry and fear of losing business as a result of other options being adopted for the Euroquote Project). See also *Five Years*, *supra* note 67, at 26 (highlighting amount of international securities trading done through SEAQ).

266. Some say that the U.K. was not so concerned with the unified market as it was with advancing SEAQ. See 1991 WL 11696, *supra* note 256, at § 6.6.2.. But see *Policy Deadline*, *supra* note 262, at 5 (in regard to the EC forging a single stock quotations system and securities market, the SEAQ system is "an excellent base from which to

an alternative plan of their own called "Eurolist,"²⁶⁷ which, after the failure of Euroquote, has become the focus of EC efforts in this area.²⁶⁸ This system would allow EC exchanges to have their own quotations system, with foreign companies listed on them as well.²⁶⁹ Thus, all EC exchanges could share in the trading of each company's stock,²⁷⁰ while "remain[ing] the main centre of liquidity in its own domestic shares."²⁷¹ A further benefit to this system is that local investors would be able to conduct international securities transactions within a familiar system.²⁷² A drawback to Eurolist, however, is that it will not carry news about listed companies—a feature previously planned for Euroquote.²⁷³

Despite the dissolution of Euroquote, implementing the U.K. SEAQ system in some capacity might allow the EC to avoid spending funds on an entirely new system,²⁷⁴ and the cost of expanding SEAQ might justifiably fall on the U.K., which has the most to gain from its acceptance. On the other hand, while France's Eurolist concept comports more with the EC policy of Community-wide participation, its reliance on national trading systems appears to be adverse to the EC objective of a single securities market.

CONCLUSION

The U.K. implemented sweeping domestic changes in its securities industry via the Big Bang and the FSA. The EC Directives regarding securities, designed to move the EC toward the single market planned for 1992, have fostered additional changes in the U.K. investment sector.

Previous Directives have required adjustment of the laws and conduct-of-business rules in the markets of EC Member States, specifically effect-

start. The statistics show that [U.K.] markets transact around 90 percent of all cross-border business in the European Community. . . . Around two-thirds of business done on SEAQ International is in European shares. This success is due to the liquidity offered to investors, usually much greater than is available in European national markets. This attracts business which would never be done in the absence of this kind of liquidity'") (citing Andrew Hugh Smith, chairman of the ISE).

267. See 1991 WL 11696, *supra* note 256, at § 6.6.3..

268. See *European Bourses Study New Euro Trading System*, Reuters, Aug. 21, 1991, available in LEXIS, Nexis Library, Omni File, at *1 [hereinafter *New Euro Trading System*].

269. See 1991 WL 11696, *supra* note 256, at § 6.6.3.; see also *Closer Links*, *supra* note 257, at *1 (" 'Eurolist' [will] facilitate multiple share listings on EC bourses for big European companies").

270. See 1991 WL 11696, *supra* note 256, at § 6.6.3..

271. *Securities Chiefs*, *supra* note 261, § 1, at 30, col. 7 (citing view of Jean-Francois Theodore, chairman and chief executive of the Paris Bourse).

272. See 1991 WL 11696, *supra* note 256, at § 6.6.3.. But see *Financial Services and the Single Market: A UK View*, Fin. Reg. Rep., Sept. 1989, available in LEXIS, Nexis Library, Omni File, at *2 [hereinafter *UK View*] (the U.K. has noted that consumer preference for local firms and systems is a barrier to formation of the single market).

273. See *New Euro Trading System*, *supra* note 268, at *1.

274. For example, if the EC had decided on Euroquote, and wanted a completely new computerized trading system under that format, the cost would have been approximately ECU 15 million. See *Secure Future*, *supra* note 255, at *2.

ing the exchange structure and disclosure requirements in the U.K.. Present Directives will likely necessitate further changes. The U.K. has concluded that change, with movement toward a successful single EC market, will be of national benefit.²⁷⁵

If the U.K. can move beyond current misgivings generated by the newer Directives,²⁷⁶ and if some accord can be reached among the EC as to a unified quotation system, all Members should experience an increase in cross-border investment. Furthermore, investment in both U.K. and other Members' issues by non-EC investors will likely increase when securities and financial markets are fully harmonized.²⁷⁷

275. See *UK View*, *supra* note 272, at *1. This was the conclusion of the all-party Committee of the House of Commons Trade and Industry. See *id.* Such change, however, is likely a necessity. U.K. cooperation with other EC markets, as well as cooperation with other foreign exchanges and markets, is vital as securities markets continue to engage in transnational business. See Note, *supra* note 30, at 382.

276. See *supra* notes 221-23 & 246-49 and accompanying text. Note that there are various other obstacles standing in the way of the single market that need to be overcome by both the EC and the U.K.. These include exchange controls, domestic regulations concerning financial services, tax and currency variations, consumer preferences for local firms, takeover protection, and the EC merger policy. See *UK View*, *supra* note 272, at *2-*3.

277. The ISE Chairman himself has stressed increased unity among EC states, so as to attract those foreign customers that are likely avoiding investment in the Euromarkets because of the variations among trading practices and markets. See *Policy Deadline*, *supra* note 262, at 5.