Big Bang: Two decades on
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Published by
Centre for the Study of Financial Innovation (CSFI)

E-mail: info@csfi.org.uk
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Printed in the United Kingdom by Heron, Dawson & Sawyer

Think-tanks should generally be regarded as a good thing. A think-tank that can encourage another organisation to host a dinner to foster the exchange of ideas on a noteworthy topic is a very good thing. Or so it would seem given the excellent turn-out of people for the CSFI Big Bang 20th Anniversary Dinner which we at Clifford Chance were delighted to host. And a think-tank that has the foresight to plan to publish a report of the exchange of ideas over dinner is definitely to be ranked in the upper quartile of think-tanks. Whether a think-tank that subsequently publishes its report is foolhardy or farsighted is something that I am happy to leave for the readers of this report to decide for themselves.

Tim Plews
Co-Head Financial Services Practice
Clifford Chance LLP
Preface

This note comes out of a dinner held last October to mark the twentieth anniversary of Big Bang. The idea was to pull together a group of City figures who had either participated directly in Big Bang, or whose subsequent careers had been shaped by it. It wasn’t just nostalgia; one of the important sub-themes was whether MiFID will turn out to be a step-change for the City on the same scale as Big Bang. Another was whether the City’s insouciance about ownership of financial institutions in the UK might come to haunt it – particularly in a less benign economic environment, when firms have to draw in their horns.

This was an on-the-record meeting, and I am grateful to Phil Thornton (then at The Independent) for pulling together a narrative from the transcript. It is hard to strike a balance between the flavour of the conversation and the major themes that were discussed, but I think he has succeeded. I am also grateful to the (many) participants who reviewed earlier drafts. In the end, though, the polishing has to stop: warts and all, this is (I hope) a fair reflection of the concerns that were raised.

Obviously, thanks to everyone who participated, particularly to Terry Smith, Stani Yassukovich, Philip Augar, Brian Scott-Quinn and Sir Martin Jacomb, who kicked off the discussion. And, of course, to Tim Plews and Chris Bates, co-heads of Clifford Chance’s Financial Services practices, who hosted the event (and who have made this publication possible).

Andrew Hilton
Director
CSFI

Big Bang: Two decades on
Background

Two decades ago, on October 27, 1986, the old-fashioned gentleman’s club that was the City of London was democratised by a sequence of changes that have come to be known as Big Bang. But that date was neither the beginning nor the end of the process. (Indeed, many believe that MiFID, the dreaded Markets in Financial Instruments Directive, is simply the next stage of Big Bang – just 20 years later.) Many years of earnest debate and political wrangling had led up to that event and several tumultuous years of changes were to follow. While the City has been utterly transformed, the scale of the changes was probably not foreseen on the day of Big Bang – and certainly not by the politicians who put the train of events in motion. Nor is it absolutely clear whether Big Bang was (as conventional wisdom has it) truly revolutionary, or whether it was just one evolutionary step in a process that had begun years earlier in the wholesale markets – and that would have occurred regardless of decisions taken by City grandees in the Stock Exchange’s boardroom.

Whatever, the story of Big Bang probably began in the dying days of the Callaghan government, when the Office of Fair Trading launched an investigation into the restrictive practices of the London Stock Exchange. After the Conservatives’ election victory of 1979, the Thatcher government sat on the issue, which was a political hot potato, until 1984 - when it did a deal with Nicholas (later, Sir Nicholas) Goodison, then LSE chairman, to call off the dogs in exchange for a commitment to wholesale reform.

This meant reforming a number of restrictive practices. In particular, the equity market until then had operated a fixed minimum commission for stockbrokers. In addition, the “single capacity rule” meant that brokers acted on behalf of their clients for that commission, while jobbers “made” the markets and provided liquidity by holding quantities of shares. The two sides of the business were not allowed to combine, and foreign firms were not allowed membership of the stock exchange.

It was decided, as part of a package to get the OFT off the City’s back, that sweeping away these restrictions would take place on one day. It would also change a whole way of life – and not just in the equity markets. Away went a comfortable City lifestyle of getting in late - the gilt market didn’t open until 10am - having a long lunch, and going home early.

In its place, came a highly competitive marketplace. Brokers, jobbers, investment and commercial bankers were given the green light to merge - and a takeover spree ensued. Many (indeed, almost all) of the old well-known City names disappeared as they were subsumed into larger groups and then into foreign banks. Even though several of these mergers failed, a second round of almost entirely foreign-led consolidation began that has largely created the City – and Canary Wharf – that we know today.

Another long-running story – of regulation - emerged at the same time, with the 1986 Financial Services Act. The initial effort to regulate the “new” City was seen as excessively cumbersome – an assertion that will echo for critics of the current 2000 Financial Services and Markets Act and of MiFID. The City is now largely foreign-owned and the threats to its pre-eminence come from other shores, notably the US and Asia. As it moves further into the 21st century, the City needs to absorb the lessons of the last two decades to ensure it can maintain its success over the coming years.
Summary

“Big Bang” – the series of changes (see box on previous page) in the City of London that occurred in 1986 and that was set off by the end of fixed commissions and the so-called “single capacity” system – was, in most people’s eyes, a momentous event which profoundly reshaped UK financial services. At its heart lay reform of the Stock Exchange; but its shock waves reached far into the investment banking industry, shaking up its structures, its technology and its regulation. Inevitably perhaps, memories have dimmed over time. Big Bang was certainly not the solitary event that many people think it was; rather it was only one part (albeit, a big part) of an extended, and perhaps inevitable, process of change that had already had a huge impact, particularly in wholesale markets. While the process was successful overall, opportunities presented by Big Bang were missed and mistakes were made. Now, financial institutions in the UK face a similar problem of preserving the City’s strength in the face of new challenges from rival markets in the US, Asia and Europe – as well as threats posed by domestic tax and regulation and financial directives emanating from Brussels. Do we need a second Big Bang? (And will MiFID provide it?)

Introduction

Do we need a second ‘Big Bang’?

On October 24, 2006, two dozen people – most of whom were centrally involved in Big Bang twenty years before – gathered over dinner to discuss the great event of two decades earlier and to extract its lessons (a list of the participants and their jobs then and now is at the end of this note). The event was organised by the Centre for the Study of Financial Innovation and was hosted by Clifford Chance at its impressive new Canary Wharf headquarters. As Tim Plews, the co-head of the firm’s London Financial Services practice, pointed out, the merger of Clifford Turner and Coward Chance and the existence of Canary Wharf itself can all be traced back to Big Bang – living proof of its lasting legacy. (He also pointed out that a necessary condition for the success of Big Bang was the preceding change in partnership law that made it possible for UK partnerships to have more than twenty partners – the kind of trigger for change that is easy to overlook.)

Andrew Hilton, director of the CSFI, kicked off the discussion by appealing to those around the table to speak their mind. “The questions before us are what drove Big Bang and what did we expect to happen?” he said. “To what extent is the City today the product of Big Bang, and what would have happened if there had been no Big Bang? The ultimate question is what we would have done differently in the light of hindsight.”
Before October 27, 1986, the Square Mile was a very different place – at least for the “traditional” City (which was based around the equity business), Lloyd’s, and the commodity markets. Twenty years later, participants recalled a lost world - a Stock Exchange of bowler hats and fixed commissions, with a “single capacity” rule that separated jobbers and brokers, the market’sdealmakers and agents. Ostensibly, this was to avoid conflicts of interest, but in practice it was simply a restrictive job demarcation. Edward Whitley, for instance, recalled that while posted in Hong Kong, he had arranged a trade in Jardine Matheson shares directly between a buyer and a seller – both English – only to be asked by a querulous manager back in London: “What about the jobber’s turn?”

It was also a City that looked very different. It was a world of open trading floors and, as Nicholas Carn (a “blue button” apprentice on the Exchange at the time) remembered, gents in top hats. And it was relatively unstressful. Since, in practice, all major share trades had to be done by 10am, the rest of the day was available for leisure and long lunches – fostering a tradition for which the City became perhaps too famous.

Behind this now rather ridiculous image, however, the City was already grappling with some serious issues – and, thanks to a group of realistic modernisers, it was changing profoundly, particularly in the wholesale markets. Regulation, and the threat of regulation, also played a big part. In particular, the UK’s Office of Fair Trading had announced as early as 1979 that it had decided to launch an investigation into the restrictive practices of the London Stock Exchange and especially its system of fixed commissions – the bulwark which kept out competition and that enabled nests to be feathered very comfortably. It was recalled by those around the table that Nicholas Goodison, the Exchange’s then-chairman (and one of the key modernisers), had asked the new Conservative government, which came in soon after the OFT’s decision, to call the OFT off in return for a commitment by the LSE to reform itself. Initially, the government refused for fear of a political backlash, but in 1983 then-Trade and Industry Secretary Cecil Parkinson accepted the LSE’s proposal, and agreed to give it three years to get ready. The die was cast.

But, even then, Big Bang was more complex than it seemed.

At the Clifford Chance dinner, Philip Augar – a leading historian of the City – pointed out that what we know as Big Bang was actually made up of four distinct periods. The first was the 1979-1983 “era of uncertainty” in the run-up to the Goodison/Parkinson deal.
But it was what Augar called “Big Bang minus one” – the period from the Goodison/Parkinson deal until Big Bang itself – that was key to how the City developed after 1986. This was when the restrictions on ownership of stock exchange firms were relaxed, allowing banks – both UK and foreign – to buy brokers and jobbers, and to begin putting together their multi-role investment banks. This was one of the most exciting phases of Big Bang (indeed, in the history of the City), with individual banks formulating different strategies and beginning to bid for partners. The fact that there were many eager banks – driven both by ambition and (perhaps even more) by a fear of being left out – and relatively few Stock Exchange firms meant that purchase prices were bid up to what were then seen as astronomical levels, putting enormous pressure on the acquirers to make them a success. And, in the process, making many lucky locals very rich indeed.

Augar pointed out that one of the tightest constraints on Big Bang (and one of the reasons why nemesis followed hubris for many participants) was the shortage of trading skills in the equity market – a reference to the fact that there were only two sizable jobbing firms, Wedd Durlacher and Akroyd & Smithers.

In Augar’s view, only two UK banking houses – Barclays and Warburgs – got it right by acquiring these particular firms. “Everyone else was embarked on a strategy that was far too ambitious for the trading skills available in the City”, Augar said. Neil Collins, then City editor of the Daily Telegraph, agreed – though he added Hoare Govett, which formed one of the earliest Big Bang liaisons, with Security Pacific.

But did anyone really understand what was going on? Augar remembered the period up to Big Bang itself as being “very difficult”. As he put it: “We did not know the way the market would work, what the themes of the organisations would be, and we did not understand the scale of what we were doing.”

1 Augar’s remaining phases were the immediate post-Big Band period and the unease in the City created by Warburg’s unexpected profit warning in 1994 (see below).

2 Brian Scott-Quinn was a wee bit sceptical about including Hoare Govett, since SecPac’s involvement was essentially passive; it was deeply reluctant to compete with the East Coast investment banks – which eventually led to Hoare’s failure.
Collins agreed: “People had very little idea of how it was going to go. At the time, it was stepping off the edge of the cliff – and many had no idea what was going to happen.” But Sir Martin Jacomb, who built BZW (out of de Zoete & Bevan and Wedd Durlacher) for Barclays Bank, was more sanguine: “We in the City knew exactly what was going to happen – at least we thought we did. We knew it could be incendiary and inflammable, but we did not know it was going to be an explosion.”

Was Big Bang a success?

While many of the new business entities created by Big Bang disappeared soon afterwards (leaving a lot of fingers burned, and a lot of former partners feeling very smug and prosperous), the feeling round the table was that Big Bang has been an almost unequivocal success – if not quite in the way that was initially envisaged.

It was a tremendous catalyst for change, and it laid the foundations for the City’s subsequent emergence as the world’s top international financial centre. “We got some things right and some things wrong; we got some things right that turned wrong and some things wrong that turned right”, Sir Martin said. But, on the whole, it worked. In particular, the stock exchange’s new dealing system worked amazingly well, he recalled – even though its £500m Taurus settlement trading system for share trades was a disaster.
Sir Martin also felt that, on a macroeconomic level, the long-term impact of Big Bang to the UK, as a whole, was strongly beneficial. At least a tenth of the UK’s economic wealth now comes from the City, broadly defined as the UK’s financial services sector, and it provides jobs for several hundred thousand people. The tax revenues are vital for the Treasury. “The present situation is an unqualified success”, Sir Martin said. Tim Plews added that “the professional services organisations have also benefited no end – and you can trace that back to Big Bang”.

The main concern – which emerged as a subtext of the dinner, and which is discussed in more detail below – is whether the disappearance of British-owned firms really matters. On this important issue, opinion around the table was decidedly split.

One major benefit to everyone has been the cut in share dealing costs. Before Big Bang, it would have cost £412.50 to trade £25,000 worth of shares, compared to just £7.50 today – at least, according to Gavin Oldham, who was a partner at Wedd Durlacher during Big Bang, and who is now chief executive of The Share Centre. In addition, the volume of available equity research is now enormous, providing investors with a wealth of information that they would not have had before.

Terry Smith – one of the keynote speakers at the dinner, and a City iconoclast even before the days of Big Bang – recalled an incident involving himself that was an early test of the independence of equity research. While an analyst at BZW, he wrote a highly critical note on its parent company Barclays Bank, saying something was wrong in the boardroom. When David Lascelles (also at the dinner), who was the banking editor of the Financial Times at the time, ran the story, Smith recalled that it caused Sir Timothy Bevan, then Barclays chairman, to “blow a gasket”. Sir Martin acknowledged that Bevan wanted Smith’s “head on a plate that evening”. But, he said, he had to explain that times had changed. “We were in an era of Chinese walls, and I had to argue that this was an ideal way to demonstrate that we were independent with our research.” As a result, Smith survived, and thrived.

Could Big Bang have been managed better?

Inevitably, the answer is Yes.

Whether or not it was a true “revolution”, Big Bang was an enormously ambitious project (going even beyond what had happened in New York), so it was inevitable that there would be mistakes of execution if not of conception. Perhaps the most controversial
stemmed from the Bank of England’s belief that British institutions should be encouraged to aim for a size that would enable them to meet the challenge from the US giants – who had gone through their own “bang” in 1975 with the abolition of fixed commissions. Unfortunately, as several participants remembered, by this time, UK houses lacked the capital to compete with the US firms, who had expanded prodigiously since their own Bang. As a result, they too scrambled to buy smaller firms in the hope of cobbling together groups that could compete on a global scale. Inevitably, a lot of money was wasted, and a lot of famous names disappeared.

Despite such unintended side effects, however, Sir Martin Jacomb felt that the Bank had generally played a positive role. He described it as “an incredibly effective but totally discreet helper to the financial sector, and the securities part of it in particular. Help was never blazoned across the headlines, and was not always fully understood by the Treasury. That doesn’t happen now.” Indeed, a concern that was voiced several times at the dinner was that no one now plays the role of City “champion” that the Bank of England used to play.

Nevertheless, some participants wondered whether the Bank had been too eager to encourage British-led institutions to take the plunge into these dangerous waters. After all, as it turned out, few of the British players at the time of Big Bang survived.

David Lascelles remembered it as a time when it was very difficult for anyone (bankers, journalists, even the Bank of England itself) to keep a cool head. It was exciting. There was tremendous competition to buy stock exchange firms, and many banks were panicked into expensive deals. The general feeling was that the City had become a game of musical chairs – and you had to be sure of your place when the music stopped. Sadly, many firms playing the game found that when the music stopped, the “chairs collapsed underneath them”. While the owners of a number of small brokerages were able to fund their early retirement, thanks to the sale of their partnerships, the new owners quickly found themselves nursing heavy losses. The early phase of Big Bang was therefore one of euphoria followed by disaster for many. “Large amounts of money were lost”, admitted David Potter, who had himself helped put Midland Montagu together.

Foreign institutions from the US and Continental Europe – particularly those that had bided their time – were then able to take part in a second wave of post-Big Bang takeovers. As a result, Morgan Grenfell, Kleinwort Benson, the equities side of
BZW, Hoare Govett, and even the one real star of British banking, Warburg, all eventually disappeared inside larger overseas institutions. Of course, history may be kinder than journalists were, in that the City as a whole has thrived in the aftermath of these mergers. But, at the time, the disappearance of household names left a lot of people convinced that Big Bang had been a failure - at least insofar as recognisably British institutions had been concerned.

In Philip Augar’s opinion, the end of what he saw as “Big Bang proper” came with the first profits warning issued by Warburg in 1994. “We knew that this was a very powerful institution that we all admired as a role model for the integrated investment bank and as the one UK institution that could take on the Americans”, he said. “Many people in the City thought ‘if they can’t survive, neither can I’. What happened quite quickly then was that the institutional shareholders of the big British banks exerted severe pressure on the managers of NatWest and Barclays and others – and many firms threw in the towel.”

Maybe. But, according to Sir Martin Jacomb, it wasn’t as simple as that. The indigenous British firms were simply “too timid, as usual” to make the investments needed to thrive – and to survive. “What was wrong was the way that British capital was invested in this enterprise…It was largely very wrongly directed, so, to that extent, Big Bang can’t be called a success”. When Andrew Hilton asked him whether, in his heart, he believed Warburg could have survived, Sir Martin barely hesitated: “Yes”, he said.

Philip Augar took the view that the present absence of UK-owned firms in the City is not healthy, and he wondered whether that might “come back to haunt us”.

Mark Tennant made the point that the weakness of UK-owned institutions was relatively new. Post-WWII, the UK broking market was very strong, relative to that in the US and elsewhere. But British firms failed to capitalise on that strength – particularly as US firms reorganised in the wake of ERISA. “Had one of our institutions taken over, say, a Merrill or Morgan Stanley, the history of Big Bang would have been very different – and the ownership of the City now a very different picture.”

For Stani Yassukovich – the US-born White Weld “gunslinger”, who went on to chair Merrill Lynch (Europe) and to be a pillar of the new City – the biggest lost opportunity at the time of Big Bang was the failure of the London Stock Exchange to “put a terminal on the desk of every trader in the European Union”. Instead, he said, the LSE resisted offering remote access, insisting that all its members had to have an office in London so that it could keep an eye on them. Brian Scott-Quinn agreed - adding that it is also hard to understand why the LSE did not use the opportunity to set up a futures market and why it allowed others to take the initiative instead. Its excuse seemed to be, he said, that these new-fangled contracts were all a bit “complex and difficult”. (This was a surprisingly general complaint; the pre-Big Bang Stock Exchange was a very stuck-in-the-mud institution.) Whatever, it is clear that the London Stock Exchange has suffered; it has not grown as fast in the post-Big Bang era (in terms of business volume, as new markets opened up) as many other institutions.
There was also controversy around the table – just as there has been in the country at large – over the long-term social and political impact of Big Bang.

The Left, which criticised the Goodison/Parkinson deal at the time as a sop to upper class interests, still has concerns over the outcome. *The Guardian*’s Martin Kettle, for instance, argues that it has strengthened the power of an undemocratic City elite, and widened the divide between rich and poor. (Although Kettle was not present, his colleague, Victor Keegan, was). Although practitioners strongly disputed this, the discussion around the table, led at this point mainly by journalists, highlighted the favourable tax treatment given to foreigners who are *resident* in the UK but *non-domiciled* for tax purposes. Peter Wilson-Smith (who was launching *The Independent*, where he was banking editor at the time of Big Bang) said it is an “extraordinary” tax regime that has created a “parallel economy” in London – although he avoided calling for its repeal. Neil Collins went further; it is only fair, he said, that all pay the same tax. But Stani Yassukovich insisted that British nationals benefit from the same tax treatment when working abroad, and asked how the UK would be better off if non-domiciled business people left – an argument Collins described as “moral blackmail”. The group was deeply split on this, with Sir Martin Jacomb (and most of the practitioners) firmly in the Yassukovich corner.

Was Big Bang a trigger for a revolution or just an accelerator?

This turned out to be the most passionate part of the evening’s debate, the issue being essentially whether Big Bang marked the start of a new era, or whether it merely gave an impetus to a process of change that was occurring anyway.

Putting the case for Big Bang as a seminal moment, Iain Saville (then at the Bank of England) said it sent a message to foreign banks to “come to London – you don’t need to go to Frankfurt or Paris”. For Neil Collins it was simple: “Why is it called Big Bang? Because it was the point before which everything was completely irrelevant.” Likewise, Sir Martin Jacomb said: “I thought it was completely fundamental.”

This was also the view of David Lascelles. At that time, he said, the Stock Exchange was truly the heart of the City – cultural, social and historic – and, even if business had increasingly been bypassing it in volume terms (ie through the Euromarkets), the Exchange was the focus of more people’s lives. It also, in his view, affected the UK economy more directly and provided many foreign banks with their only opportunity to get into the equities business.

Would it all have happened anyway?
However the majority (represented in particular by Stani Yassukovich) view around the table moved towards the idea that Big Bang simply crystallised trends that were underway in the City already – and might, as a result, even be described as irrelevant. The presence of US and other international banks in the Square Mile, as a result of the growth of the Eurodollar market and the lifting of UK exchange controls, made change inevitable. Brian Scott-Quinn put it succinctly: “It would not have mattered to London as an international financial centre if Big Bang had not happened.” Mark Loveday agreed: Big Bang was evolutionary, not revolutionary – part of an ongoing process.

It was also pointed out that US firms were never subject to the LSE’s fixed commission system. In addition, their much bigger market capitalisation allowed them to compete with British firms on their home soil – and to offer UK clients the ability to trade in British stocks in the form of American Depository Receipts listed on the New York Stock Exchange. “This was one reason why the Stock Exchange was willing to treat with the government”, Terry Smith said. He added that, while Big Bang changed the way business was done, the developments that occurred would have happened anyway. “It just gave a nitrous oxide injection”, he said.

Yassukovich also disagreed with Collins, insisting that what had gone before Big Bang was highly relevant to the subsequent development of the City. He put it bluntly: “The idea that Big Bang had a major impact and was the driver of the evolution of today’s City is historical nonsense. The stock exchange reforms had absolutely nothing to do with the development of the ‘new’ City. The stock exchange model was already redundant. The process was already well underway.”

Yassukovich insisted that reform would not only have come anyway, but that a “bottom-up” process run by practitioners might have been better than one initiated by the government from on top. Wilson-Smith agreed that there is a lot of misguided nostalgia about Big Bang. Yes, it was significant, but “my conclusion was that by the time of Big Bang, the game was already over”. Banks such as Morgan Stanley, Citibank and Goldman had a vastly greater capital base than their UK competitors such as Warburg, and they had the skills as well. He added that a more important cultural development had occurred some time before, when Morgan Stanley had sent a letter to all its clients effectively repudiating relationship banking. Instead, it said, it would treat its institutional client base as counterparties, to deal with (or not) as business dictated.

That view probably carried the day – albeit with qualifications. One came from Terry Smith, who pointed out that Big Bang was part of a “sequence of events” driven by the reforming zeal of the Thatcher government – albeit it was only possible because of the prior abolition of exchange controls.
Equities or bonds?

One fascinating aspect of the discussion was different perceptions about the relative importance of bonds and equities in the UK market.

Big Bang – in the public eye at least – was certainly a revolution in the way that the man or woman in the street traded shares. As Sir Martin Jacomb pointed out, it had little or no impact on the fastest growing part of the City – the largely invisible (to the man in the street, anyway) Eurobond market, which came to London from New York after the US introduced an interest equalisation tax (a 1970s measure designed to discourage the sale of foreign bonds in the US). Iain Saville agreed, and noted – perhaps tongue in cheek – that the domestic UK bond market, which badly needed reform, was left alone because it was the main source of government funding. As a result, he said, the Bank of England reformed the equity side first to “see if it crashed”. He added: “The gilts market was much too important.” (In fact, as Lascelles pointed out, the gilts market also went through a major restructuring to demystify its workings and to bring it more into line with the US system of recognised market-makers.)

Brian Scott-Quinn pointed out that investment banks still earn most of their profits from the fixed income side rather than cash equities - and, in that sense, Big Bang was of rather marginal importance. Yassukovich went further, insisting that the Eurobond market (international, footloose, essentially unregulated) had always been the best model for the City. Indeed he – and several others around the table – insisted that the London Stock Exchange’s vision of the City was already redundant by the time of Big Bang. He recalled how the leading figures in the equities business, who dominated the LSE’s Council at the time, treated the traded options dealers as little more than “Mafioso” – a class distinction that grated, since the cash market was being rapidly overhauled in terms of volumes traded.

Nevertheless, even though the equities side was less important than the attention it generated would suggest, it was perhaps inevitable in hindsight that the cash equity business should become the flag-carrier for Big Bang.

The reason is that it fitted with the government’s priorities. Just two months later, the Thatcher government privatised British Gas. BT and British Airways had already been privatised, and the water and electricity companies would follow – turning a nation of three million shareholders into one of 13 million. “Privatisation brought equities right into the public arena at the time of Big Bang”, pointed out Philip Augar. Swiftly behind this came the “explosion” in growth of IPOs in New York. For the man in the street – even in Fleet St – “the City” was virtually synonymous with equities.
This has its downside - Terry Smith, for instance, bemoaned the “extraordinary obsession” in the UK with the equities market – even today, it takes up 19 out of the 20 pages of the Companies and Markets section of the Financial Times, leaving a total of one page for the bond, derivatives, currencies and commodities markets, each of which is worth more than the entire equities side. Stani Yassukovich agreed: “When I found myself on the Council of the Stock Exchange, there was one poor fellow who represented the traded options market. Every time this chap got to his feet, the rest of the Council howled him down.”

Mark Boleat, who at the time was head of the Building Societies Association (which was going through a Big Bang of its own), defended this by pointing out that the media demand “personalities” – and that these are more likely to be found at the head of a floated company (whose shares anyone can buy) than in a derivatives dealing room. Oddly enough, no one disagreed with him.

Neil Collins went along with this – adding that Big Bang was important precisely because it had such a huge impact on public consciousness. Members of the public are very likely to shop at M&S or to bank at Barclays, and they, justifiably, want to know what is going on at “their” companies. “Equities impinge directly on people’s lives.” With its emphasis on equities, Big Bang made companies into media stars.

**Threats to the City 20 years on**

The City of London looks very different two decades on. In particular, it has expanded eastwards to Canary Wharf (of which Sir Martin Jacomb is now Chairman). There has also been a technological revolution which few could have foreseen. Foreign banks with head offices elsewhere now dominate the market. Chris Bates observed that London has a tradition of openness – witness the most recent waves of hedge fund and private equity managers setting up here. Markets themselves have become global. How will the City survive in this brave new world?

There was broad acceptance around the table of the view that the City has been very successful, and that it has established itself as one of the world’s top financial centres – ahead, perhaps, even of New York (at least in the international arena). But complacency is always a threat. “Hubris has to be watched out for” Sir Martin noted. “We have to keep competitive. We are not competitive at some things.”

Globalisation (which must be the City’s bread and butter) also seemed to many to be one of the greatest dangers facing the City. With liberal economic policies now shaping markets around the world, and with most barriers to the movement of capital lifted, businesses and people can move freely and easily. There is no reason for them to stay in London if it ceases to be a good place to do business.
New City, new threats...

An economic downturn would also be a challenge for the “new” City. It should not be forgotten that since Black Wednesday (the crash of October 1987), the global economy has enjoyed a uniquely benign period of low inflation and strong growth - notwithstanding the dot.com crash, the awful events of 9/11, the Iraq War and the surge in oil and commodity prices. “That won’t continue”, Sir Martin Jacomb predicted.

The ‘Wimbledon’ effect

In this context, several speakers brought up the so-called “Wimbledon syndrome” – the argument that it doesn’t really matter if none of the top players in the financial services sector are British, as long as they continue to do business in London. The meeting was genuinely split on whether this belief is justified. The problem is whether foreign-owned firms will continue to base their business in the UK if things change. Plus, as Stani Yassukovich observed, if there were a real crash, will there be the political will in the UK to bail out a financial centre that has become largely foreign-owned. Equally, if there were a crash, how interested would the CEOs of American, European and Japanese-owned banks be in saving their office in London at the expense of their Wall Street, Frankfurt or Tokyo operations?

Scott-Quinn described this as “branch office syndrome”. “If they think that things are tight, when decisions are made in New York there’s going be a home country bias,” he said. “No director wants to see his New York empire shrink.” In that sense, the City’s position may be more vulnerable than its lead in many markets would suggest.

Aside from the impact of an economic downturn that the City can do little to avert, top of many people’s list in terms of the City’s long-term health was the issue of regulation.

“Today, I went to see two guys – a Frenchman and an Italian, who are in an office off Savile Row. They had just raised something in the region of US$750m. Twenty years ago, that would have been unthinkable.

“Two fundamental things flow from this. One is about capital. At the time of Big Bang, one of the big issues was that City firms did not have enough capital to support the businesses they were trying to get into – and that is why they were all taken out. Now, people are building very significant businesses using other people’s capital. Something quite fundamental has happened...”

“The other thing is technology... Someone told me that, just after Big Bang, he went to see his firm’s mainframe computer – a humming machine in its own room, maintained by people in white coats. Now, it is possible to rent that process capacity, and for three people in one office to do the work of a major firm. That’s a consequence of Big Bang.”

Peter Thal Larsen

“I am in the camp that says ownership of the London Stock Exchange is as relevant as ownership of Rover...I think that, in the modern world, the idea of national ownership is not relevant.”

Terry Smith
The present Labour Government (particularly through its new City Minister, Ed Balls) has put out a strong message that it will defend the Square Mile against threats from Brussels - such as plans for greater regulation of the LSE’s Alternative Investment Market. The same assurances are now being given about the potential application of US regulations on an extra-territorial basis if Nasdaq and/or the NYSE buy into European stock exchanges. However, many of those around the table remained uneasy about the prospect of government becoming too involved with the City: it has undoubtedly benefited from a hands-off approach over the years, and any kind of government intervention (even well-meaning intervention) is dangerous. As Sir Martin noted (quoting Denis Healey): “I am from the Government and I want to help’. Those are very, very dangerous words.”

While the sense of the discussion was that most people are relatively relaxed about the current level of regulation of UK wholesale markets, there is clearly concern over micro-prudential regulation of retail investment. One speaker said that the volume of rules by itself had put people off making adequate savings for their retirement – and that this is really as major a public policy issue as the low level of savings itself.

Danger of over-regulation

There was also concern at a perceived trend towards re-regulation (or tighter regulation) in the wake of scandals, especially in the US.

Although this currently applies more to Wall Street (after its recent debacles) than to London, it was felt that the City could be vulnerable if it fails to maintain visibly honest markets. It seemed to be accepted that big financial conglomerates are already rife with potentially conflicting interests. This is extremely dangerous, and they must, therefore, be exceptionally careful that those conflicts do not undermine investor confidence.

Stani Yasukovich added a new wrinkle. In his view, the traditional split in the City between principal and agent has been compromised by regulation. “This has corrupted the process of financial intermediation”, he said. But Peter Wilson-Smith felt that one of the most striking consequences of Big Bang has been the proliferation of conflicts of interest within the financial industry. As a result, the tightening of regulation – particularly the separation of research and investment banking – that has occurred since Big Bang was inevitable. “This is the least desirable consequence of Big Bang, and is an issue that is ticking.” Terry Smith went further. He suggested that the increase in regulation (particularly when it comes to investment analysis) means that Big Bang has actually “been repealed”. Nick Carn agreed, pointing out that the City has “reinvented the wheel”.

“I think it is absolutely clear that it doesn’t matter who owns the Stock Exchange. But what does matter from the point of view of London is where the regulator is. That is absolutely crucial because we have the listing rules…We do have to preserve this regulatory environment around listing which makes the market attractive.”

Peter Montagnon
Sir Martin Jacomb also agreed that regulation (or rather over-regulation) is a problem. It is, he said, to blame for driving investors away from the public markets.

This led to a discussion of the growth of private equity – further evidence of Terry Smith’s “enemy within”, which is killing capitalism as we know it. The burgeoning private equity market is a sign that investors are increasingly keen to keep their companies out of the public eye, because of the intrusiveness of regulation. Last year was a third consecutive one of growth in the UK private equity sector, with a record £11.7bn invested. Smith noted that, at the current rate of growth, the private equity sector in the UK will soon become larger than the stock market. “It uses leverage more effectively, accepts failure more readily and is much better at remunerating management.”

John Hitchins added that, in his experience, private equity is able to take a three or four-year time horizon – rather than the three or four months which has become typical of most institutional investors. This permits it to ride out short-term volatility.

Whatever, whether one views it as a good or a bad thing (and views diverged on that), there was agreement that the private equity phenomenon could become a threat to London as a financial centre by removing a lot of business from open markets.

It was also agreed around the table that another threat to the future of the City is the poor quality of the domestic infrastructure – a point made with particular force by Tim Plews.

While bankers from foreign centres such as New York, Frankfurt, Paris and elsewhere enjoy the diversity and multiculturalism of London, they are often taken aback by the appalling transport links. A major priority for the City now ought to be the proposed Crossrail project that would link the City and Canary Wharf with Heathrow Airport. Unfortunately, this scheme is still awaiting parliamentary approval and will not be completed until 2015 at the earliest. As Plews said, the “dithering” by politicians is “a disgrace”. “Either we make the investment, or we (i.e the City) will be on a reversionary lease that will expire.”

Peter Thal Larsen was more optimistic. For him, London’s development has often been more accidental than planned. He pointed out that Canary Wharf has gone bust twice, yet it is now “unthinkable that London could exist as a financial centre without the buildings we see around us”.

“Big Bang, to my mind, was saying to the Americans ‘Come in, we welcome you – and we realise that the future is with you…We don’t want you to go to Paris and we don’t want you to go to Frankfurt.”

Iain Saville
The dog that didn’t really bark was tax (other than the concern about personal taxation if the “non-domicile” status is rescinded). Perhaps because the City has been lobbying so hard for so long for the abolition of Stamp Duty on share transactions, ennui may have set in. Sir Martin noted simply: “We compete on some things – stamp duty is not one of them.” There was a recognition (surprising perhaps) that, whatever damage is inflicted on the City as a result of Stamp Duty, and it may be considerable, any government will be very reluctant to remove it since it is so easy to collect.

Of course, were London to lose ground, the question is which overseas markets would steal its daily bread. There was agreement that some loss of business is inevitable. After all, as Brian Scott-Quinn put it, “London is unlikely to maintain its percentage share of the global market” – if only because emerging markets are developing so fast. The main threats come from East and West – Asia and Wall Street.

Wall Street will obviously continue to challenge London for the title of the world’s largest financial market, largely on the strength of domestic US business. However, there is no doubt that New York is, for now at least, on the back foot because of the Sarbanes-Oxley Act. Many people around the table recalled that the US’s imposition of an interest equalisation tax was a key factor four decades ago in giving birth to the Eurobond market in London. Now, Sarbanes-Oxley is driving business away from the US in the same way. “We always profit by other people’s market restriction mistakes”, said Sir Martin Jacomb.

Thal Larsen was reassuring. In his view, whatever US regulators might want, London will continue to take business away from the US. “The big US banks all realise that the biggest growth is outside the US and they are grappling with where to manage that from...The answer they have come to is that they are starting to move serious numbers of people to London.”

On “non-dom” status… “I was talking to a Treasury adviser the other day, and he said he found himself to the left of Gordon Brown on this issue. It is a fundamental thing, and it has created a parallel economy in London which discriminates against nationals.”

Peter Wilson-Smith

“That’s absolute rubbish...We want these people in the UK because – with their skills, their capital and their business – they bring a great deal of wealth to the country.”

Sir Martin Jacomb
What about Asia? It has, in China and India, two of the fastest growing economies in the world. Indeed, as everyone now appreciates, China is on track to overtake the US by the mid-point of this century as the largest economy in the world. But will China and India convert that raw economic power into a financial market presence? The sense of the meeting was that the growth of the Chinese and Indian economies should bring a parallel growth in their financial markets, but it is unclear how they will develop. Indeed, there are still strong protectionist tendencies in Asian countries that make it hard for them to open up financial markets – to London’s benefit. Reflecting this, Sir Tom Harris warned that: “I can’t see a single financial centre in Asia that has been able to discard this protectionist instinct.”

Protectionism is clearly a big issue – one that involves both the developing and developed worlds, and that could act as a drag on the growth in trade and financial activity. Edward Whitley, for instance, mourned the failure of the latest round of world trade talks, saying that it casts the future of the World Trade Organisation as a multilateral institution into doubt. “We don’t have a WTO that functions, and there is a real risk that a non-functioning trade process could permanently damage attitudes towards free trade in goods and services.” He added that there is a growing pattern of countries starting to “tilt the playing field” away from foreign investors, which he saw as a wider threat. Sir Tom Harris picked up on this – highlighting two recent cases where US political pressure has led to the blocking of takeovers.

These are:

- the planned acquisition of six US ports by Dubai Ports World; and
- the attempted takeover of the Californian oil company, Unocal, by a Chinese rival.

He predicted that the growth in US protectionism (even more likely with a Democratic Congress) will help London by making it the beneficiary of international capital flows that would otherwise have gone to New York. The same analysis applies to financial centres in Asian countries that have not been able to “discard this protectionist mindset”.

Few people appeared worried by the threat from Continental Europe. “I mention Frankfurt and Paris in passing – and I mean in passing”, joked Terry Smith. The small city of Brussels on the other hand poses a major danger in the form of new EU regulation. As Peter Montagnon warned: “The problem for London is that the regulatory initiative has now turned to Europe. While London has the edge in light-

“I think one of the most troublesome things is obviously regulation; there’s a great need to roll back regulation... We may not have SarbOx, but we do have very high taxes and stamp duty and an alarming regulatory system... I think, for goodness sake, let freedom work.”

Sir Martin Jacomb
touch regulation, Europe is now setting the standards and saying it has to be done this way – and that means we go in for gold-plating. One of the risks now is that we will all regulate ourselves out of existence.”

**MiFID**

As indicated at the outset, a particular focus of concern for the City is the Markets in Financial Instruments Directive (MiFID), which is central to the European Commission’s plans to create a single market in financial services. A key provision of this Directive is that Continental stock exchanges will lose their monopoly over trading domestic stocks and shares. Other dealing platforms and in-house securities trading carried out by banks and brokers will be granted equal status. Could this bring about a bigger change than Big Bang on a European scale? Gavin Oldham pointed out that, from November 2007, it will be possible to trade throughout Europe from any EU member country according to that country’s own financial rules. He predicted that this will force national regulators to accept a “lowest common denominator” – or see their companies move elsewhere. If that happens, MiFID could indeed usher in a new Big Bang.

There was a lot of concern that the UK financial media had failed to pick up the enormous importance of MiFID. “MiFID tends to escape us because there are no pictures”, Mark Boleat observed. But it is not just MiFID. David Green highlighted another issue that neither the City nor the press has picked up – the proposed Audit Directive. If implemented, this will require 500 non-EU issuers, predominantly on the London Stock Exchange, to have their auditors regulated out of the UK by 2008. “That’s a major issue that went completely unnoticed…We are working with [Internal Market Commissioner] Charlie McCreevy, but these things continue to go wrong.”

**Recommendations**

Several strong messages came out of the discussion:

- The City must ensure that the Treasury, the Bank of England and the Financial Services Authority all learn the lesson (from the US) that excessively onerous market restrictions simply drive business elsewhere.
There is still a need for the City to have a “champion” (a role that the old Bank of England used to play). But there remains considerable scepticism that (pace Ed Balls) the government could or should play that role.

There was agreement that the classic stock exchange model is increasingly irrelevant and that the future will include “virtual” markets created by banks and independent data providers.

It was accepted that one of the greatest threats to the City comes from MiFID. While this Directive could ultimately prove bigger than Big Bang, there is an even greater threat that it might fail. In that case, pressure for a single European financial regulator could easily become irresistible.

London must continue to be open to foreign ideas, foreign workers and foreign investment. Mistakes made by other governments, such as the SarbOx regime in the US, have helped London in the past – and now. Errors by the UK authorities would do the same for other centres, driving business away.

The City must continue the pressure on government to invest in the London transport network, particularly the proposed Crossrail project.
## Appendix I

### PARTICIPANTS

<table>
<thead>
<tr>
<th>Name</th>
<th>Current position</th>
<th>Role in 1986</th>
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<tbody>
<tr>
<td>Philip Augar</td>
<td>Historian</td>
<td>Analyst, Wood Mackenzie</td>
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<tr>
<td>Chris Bates</td>
<td>Partner, Clifford Chance</td>
<td>Lawyer in Hong Kong</td>
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<tr>
<td>Mark Boleat</td>
<td>Principal, Boleat Consulting</td>
<td>Director General, BSA</td>
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<tr>
<td>Nicholas Carn</td>
<td>Partner, Odey Asset Management</td>
<td>Fund manager</td>
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<tr>
<td>Armel Cates</td>
<td>Retired partner, Clifford Chance</td>
<td>Lawyer, Clifford Turner</td>
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<tr>
<td>David Green</td>
<td>Financial Reporting Council</td>
<td>Bank of England</td>
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<tr>
<td>Sir Tom Harris</td>
<td>Standard Chartered Capital Markets</td>
<td>UK Embassy, Washington</td>
</tr>
<tr>
<td>Andrew Hilton</td>
<td>Director, CSFI</td>
<td>Editor, <em>International Reports</em>, New York</td>
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<tr>
<td>John Hitchens</td>
<td>Head of Banking, PwC</td>
<td>Auditor, PwC</td>
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<tr>
<td>Sir Martin Jacomb</td>
<td>Chairman, Canary Wharf</td>
<td>Chairman, BZW</td>
</tr>
<tr>
<td>David Lascelles</td>
<td>Senior fellow, CSFI</td>
<td>Banking editor, <em>Financial Times</em></td>
</tr>
<tr>
<td>Mark Loveday</td>
<td>Chairman, F&amp;C Investment Trust</td>
<td>Corporate finance partner, Cazenove &amp; Co</td>
</tr>
<tr>
<td>Peter Montagnon</td>
<td>Head of Investment Affairs, ABI</td>
<td>Journalist, <em>Financial Times</em></td>
</tr>
<tr>
<td>Gavin Oldham</td>
<td>CEO, The Share Centre</td>
<td>BZW</td>
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<tr>
<td>Tim Plews</td>
<td>Partner, Clifford Chance</td>
<td>Lawyer, Coward Chance</td>
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<tr>
<td>David Potter</td>
<td>Noble Group</td>
<td>MD, Midland Montagu</td>
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<tr>
<td>Iain Saville</td>
<td>ICMA Centre</td>
<td>Bank of England</td>
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<tr>
<td>Brian Scott-Quinn</td>
<td>Consultant, Börse-Consult</td>
<td>Hoare Govett</td>
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<td>Hugh Simpson</td>
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<tr>
<td>Terry Smith</td>
<td>Chairman, Collins Stewart Tulett</td>
<td>Head of financials desk, BZW</td>
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<tr>
<td>Mark Tennant</td>
<td>Adviser, JP Morgan</td>
<td>Director, Hill Samuel</td>
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<tr>
<td>Peter Thal Larsen</td>
<td>Banking editor, <em>Financial Times</em></td>
<td>Student</td>
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<tr>
<td>Edward Whitley</td>
<td>CEO, IFSL</td>
<td>Hong Kong</td>
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<tr>
<td>Peter Wilson-Smith</td>
<td>Quiller Consultants</td>
<td>Banking editor, <em>The Independent</em></td>
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<tr>
<td>Stani Yassukovich</td>
<td>Arab Banking Corporation</td>
<td>Deputy chairman, LSE</td>
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RECENT CSFI PUBLICATIONS

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