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Investment Exchanges & Clearing Houses Bill

Bill 4 2006/07

This Bill gives the Financial Services Authority, the chief financial regulator, in the UK an overarching power to prevent recognised investment exchanges and clearing houses from introducing new, additional, regulatory procedures because of a takeover by an overseas body subject to its own domestic legislation.

Timothy Edmonds

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Summary of main points

This Bill deals with a hypothetical problem. If a UK exchange, such as the London Stock Exchange, or a clearing house, for example CrestCo the company responsible for the Crest settlement system for shares in the UK, was taken over by a foreign company, that company might want, or might be forced, to apply its own domestic regulation system onto the UK institution.

The UK government and financial community feel that the UK's system of 'light touch', principles-based, regulation gives the City an advantage over other jurisdictions in terms of compliance costs.

The Bill gives the chief financial services regulator in the UK, the Financial Services Authority, the power to veto rules applied to UK institutions, or indeed rules introduced by new domestic bodies, that are deemed excessive for the regulatory benefits they secure.

The current take-over bid by the American NASDAQ corporation for the London Stock Exchange, and concerns in this country and in America about the burden and scope of recent US corporate legislation, is the backdrop to this Bill.

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I Introduction

This Bill is the result of three developments coming together. First, the flotation of the London Stock Exchange (LSE) opened up the possibility of it being taken over by, crucially, a foreign buyer. Secondly, the introduction of significantly more onerous audit and accounting regulations on companies listed in the United States regardless of where their main business areas are. Thirdly, the perceived tendency of US law, especially business law, to be applied across national borders. The Bill is an attempt to stop the last occurrence in the case of the first.

II Ownership of the London Stock Exchange

It is important to recall that the LSE is a business in its own right. The decision to become a public company and to raise outside capital was taken because, in the words of Clara Furse, LSE Chief Executive, speaking on flotation day:

> This is an important milestone in our commercial development. Full listing gives us the flexibility we need to exploit strategic business opportunities. We have a growing business and are in a strong position to achieve our strategic vision and objectives.[1]

Of equal long term importance was the decision by the then membership of the LSE, on 19 July 2001, to end the cap (previously 4.9%) on individual stakes of ownership of the LSE. Thus from day one of becoming a public company the LSE opened up the possibility that it could be bought by an overseas bidder. Rumours of mergers, alliances and bids did not take long to emerge.

In December 2004, Deutsche Bourse offered 530p per LSE share, valuing it at £1.3 billion. The offer was rejected and in the following March, withdrew its offer after it failed to win a positive recommendation from either LSE management or its own shareholders. On 15 December 2005, the LSE Board rejected an unsolicited offer from the Macquarie Consortium[2] of 580p per share as “derisory”. In March 2006, the Board received a pre-conditional proposal from the American NASDAQ Stock Market Inc. ("NASDAQ”) with a view to NASDAQ making an offer to acquire the LSE for 950p per share in cash. Under the terms of the Takeover Code[3] NASDAQ has been able to revive its bid since October, but only at the price of the last shares it bought. It had been thought that since the LSE share price had declined since the previous offer (from about 1243 to 1230) that NASDAQ would delay making a further bid until May 2007 when it could bid again at any price. However, on 20 November 2006 it repeated its former bid at 1243p a share and increased its stake in the LSE to 28.75%.

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1 London Stock Exchange Website 20 July 2001, http://web.archive.org/web/20080229004819/http://www.londonstockexchange.com/NR/exeres/957DA60C-0B16-49A5-B8A0-06D8D4D45EE4.htm

2 An Australian financial services consortium

3 Often called the City Code, this sets out the rules and principles governing conduct in takeover situations.

III Regulation in the United States

The second of the trio of causal factors behind this Bill is new legislation surrounding the audit of US companies, here defined as companies listed on a US stock market. The new law is the Sarbanes Oxley law, commonly called Sarbox.

The Sarbanes-Oxley Act was brought into force on 30 July 2002 as the main US response to a series of corporate financial scandals, which included Enron and WorldCom. It deals with the oversight of accountancy firms that provide audit services to companies that are quoted on a US market and governance requirements for those companies.

The Act introduced new requirements in a number of areas:

1. Accountants and auditors

- The Act creates a new accounting regulator, the Public Company Accounting Oversight Board (PCAOB), under the aegis of the Securities and Exchange Commission (SEC). Accountancy firms that audit US-quoted companies ('issuers') have to register with the Board and thereafter will be under an obligation to comply with the Board's requests for information and assistance. The Board will set a range of standards for preparers of audit reports and will inspect firms on a regular basis.

- Audit firms are required to rotate the lead audit partner and audit reviewer every five years.[4] They are not be allowed to provide audit services to companies if key personnel at the company were recently employed by the auditing firm.[5]

- Controls on the provision of non-audit services to a company by its auditor prohibit absolutely the supply of specified services that could conflict with the independence of the audit (including actuarial services, internal audit services and legal services).[6] Other non-audit work (including tax advice) may be provided but only after prior approval from the audit committee.[7]

2. Audit committees

- Companies are required to establish an audit committee, made up of independent members, one of whom is expected to be a financial expert. (Strictly, firms are only required to state whether one of the audit committee's members is a financial expert.)[8] The audit committee manages the relationship with the company's auditors, including determining their remuneration and giving prior

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[4] Sec. 203

[5] Sec. 206

[6] Sec. 201

[7] It had been feared at one point that auditors would be barred from giving tax advice; accountancy companies lobbied hard against the proposal

[8] Sec. 301. Some exemptions from the details of this rule have been made for non-US issuers by the SEC

approval to the purchase of both audit and non-audit services. The audit committee has to set up systems to allow it to act as a conduit for whistleblowing reports by employees on auditing and accounting matters. Whistleblowers are given additional protections from discrimination.[9]

3. Directors and officers

- The Chief Executive Officer (CEO) and Chief Financial Officer (CFO) are obliged to certify that they have reviewed the annual and quarterly financial reports and that to their knowledge they are materially accurate and show the financial and operational state of the company.[10] A second certification requirement imposes criminal liability on CEOs and CFOs if they certify a 'periodic' report as complying with SEC requirements when they know that it does not.[11]

- Companies will be prohibited from making loans or extending credit to their directors and executives (subject to some exceptions for certain types of credit).[12] While there is an exemption from the prohibition for US-authorised banks (which are subject to other controls on lending to staff), non-US banks have argued that they are unfairly discriminated against in not being covered by that exemption.

- If a company is required to re-state its financial reports because of non-compliance with US reporting requirements (due to misconduct), the CEO and CFO have to repay to the company any bonus or incentive they received in remuneration for the year following the issue of the defective report.

- Directors and officers can be disqualified by the federal courts from holding office on the basis of their 'unfitness' to act rather than the current standard of 'substantial unfitness'.[13] The SEC will also be able to disqualify directors on grounds of unfitness.[14]

- Companies will need to consider adopting a code of ethics for their senior financial officers.[15] Any changes or waivers to such codes have to be notified to the SEC. It is not an absolute requirement to implement such a code: companies are required merely to disclose whether they have adopted a code.

4. Lawyers

- Corporate lawyers will be placed under a duty to report breaches of US securities laws to the company's CEO or chief legal counsel, and thereafter to the audit

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9 Sec. 806
10 Sec. 302
11 Sec. 906
12 Sec. 402
13 Sec. 305
14 Sec. 1105
15 Sec. 406; Non-US issuers have to make the code disclosure but are not obliged to disclose changes to their codes immediately

committee or full board if appropriate action is not taken.[16] Some commentators foresee problems with this obligation since the requirements of securities law may not always be clear-cut.

5. Financial disclosures

- Companies are obliged to disclose off-balance sheet transactions and obligations with unconsolidated entities that could materially affect the company.[17] This addresses an issue highlighted in the collapse of Enron.

- When companies present financial data in standardised or 'normalised' ways ('pro-forma') they are under an obligation to make sure that it is not misleading and must reconcile the pro-forma information with the financial condition of the company as it would be presented using normal accounting principles.[18] This addresses a trend in the US to present headline financial data to investors in a sanitised manner that tends to emphasise growth and stability by stripping out as 'one-off' or 'exceptional' items that would distort that picture.

- Companies have to include an assessment of their internal controls in their annual reports and make a declaration that management takes responsibility for internal financial controls.[19] Their auditors will in addition have to report on these assessments.

- Companies are expected to report material changes in their financial condition on a 'rapid and current' basis, in plain English.[20] This is designed to encourage faster or 'real-time' reporting of significant corporate news which investors would want to know.

6. Criminal offences

- In addition to the criminal offences of knowingly providing false financial information to the markets (see 'Directors and officers' above), the Act also introduces stiff criminal penalties for knowingly altering and destroying corporate documents in the context of a federal investigation or insolvency, taking steps which make documents unavailable for official proceedings and for taking retaliation against whistleblowers.[21]

UK and EU regulatory and professional bodies have reacted with particular concern to the extra costs implied by the law and the fact that European auditors of companies with a US listing would have to comply with US regulations, despite the fact that the head

[16] Sec. 307
[17] Sec. 401
[18] Sec. 401. Non-US issuers have been partially exempted from this rule for disclosures which are primarily made outside the US.
[19] Sec. 404
[20] Sec. 409
[21] Secs 802, 1102, and 1107

office or main activity might be within Europe. There is no doubt that SARBOX has had a huge impact. The UK/US law firm, Mayer, Brown, Rowe and Maw described the Act as:

> signalling the most intense scrutiny of public companies and [effecting] the most dramatic changes in the US federal securities laws since the adoption of the Securities Exchange Act of 1934.[22]

In a prophetic statement, the US branch of corporate law firm Clifford Chance argued instead that, while significant, the obligations of the new Act would be manageable:

> It will be many months before it is clear which of the changes effected by the SOX Act will and will not apply to non-US companies. However, there is little doubt that, just as the SOX Act will be an inconvenience, but not a serious problem, to the vast majority of US publicly traded companies, the burdens it imposes on non-US companies will be real, but will not be overwhelming. They will simply be part of the price of accessing US public capital.[23]

It is the last line in this quote that is so pertinent. Increasingly, companies have decided that the price of SARBOX is simply too high. The financial press has been full of rumours about companies thinking of delisting from US exchanges. More tellingly, new issues (initial public offerings or IPOs), particularly major overseas new issues, have chosen to list on non-US exchanges. This has been very good news for the LSE. An LSE press release tells its own story:

> RECORD YEAR FOR INTERNATIONAL LISTINGS
>
> In 2005 the London Stock Exchange attracted a record 129 international companies, from 29 countries, to its Main Market and AIM – an increase of 82 per cent on 2004. International companies raised a total of £5.9 Billion in new issues on the Exchange's markets, the highest value since 2000.
>
> An Exchange survey of the 80 international companies that conducted an IPO on its markets has revealed that, for more than three quarters of respondents (77 per cent), access to capital was the principal reason for their decision to go public. 89 per cent of the companies surveyed said they were satisfied with the price they achieved on flotation.
>
> According to the survey, 27 per cent of respondents identified London's liquid international trading market as the most important factor in their company's decision to float on the Exchange's markets. This was closely followed by the UK's standards of regulation and corporate governance (25 per cent), analyst coverage (25 per cent) and access to emerging market institutional investors (23 per cent).
>
> Of those companies that considered listing on an US exchange, 90 per cent felt that the demands of Sarbanes Oxley made listing in London more attractive.

[22] Hermsen, Niehoff and Uhrynuk (of Mayer Brown), 'An extraordinary expansion', *Accountancy*, October 2002

[23] Clifford Chance US LLP, *Application of the Sarbanes-Oxley Act to non-US companies*, September 2002

> More than half of the international companies appointed a UK based non-executive director in preparation for their London listing.

This trend has continued. A press release in August 2006 barely conceals the LSE's glee:

> LONDON STOCK EXCHANGE WELCOMES FIRST US-INCORPORATED COMPANY TO IPO ON THE MAIN MARKET
>
> The London Stock Exchange today welcomed California-based Napo Pharmaceuticals Inc to its Main Market. Napo Pharmaceuticals, which raised a total of £11.9 million on admission, is the first US incorporated company to have its sole listing on the Main Market.
>
> […]
>
> Tracey Pierce, Head of Global Business Development at the London Stock Exchange, said: "We are delighted to welcome Napo Pharmaceuticals to our Main Market. As the first US incorporated company to IPO exclusively on London's Main Market, Napo Pharmaceutical's admission underlines the increasing attractiveness of the London Stock Exchange's markets to companies from across the globe."
>
> In the six months to the end of June 2006, the Exchange attracted 50 international IPOs to the Main Market and AIM, drawing companies from 15 different countries, and raising a total of £4.5 Billion. By comparison, during the period from January to May this year, there were 15 international IPOs on the New York Stock Exchange and NASDAQ combined.
>
> There are currently 52 US based or incorporated companies quoted on AIM, the Exchange's international market for smaller, growing companies. 14 of these companies have joined during the course of 2006, and have raised £503.8 million between them. There are 41 US incorporated companies listed on the Main Market.[24]

In November 2006, the LSE announced that:

> A total of £3.5 Billion was raised by companies undertaking an IPO on the London Stock Exchange's markets in October, up 40 per cent on the same month last year. This takes the total money raised through IPOs on the Exchange's market to £22.3 Billion so far this year, more than any other exchange in the world.[25]

A recent study into the relative efficiency of world exchanges specifically blames SARBOX for higher costs:

> A newly published report, commissioned by the City of London and The London Stock Exchange, has demonstrated that the cost of capital at both IPO stage and

[24] LSE website 2 August 2006

[25] ibid, November 2006

> beyond is lower in London than in other major European and US financial centres.
>
> […]
>
> The report finds that the London markets are cheaper than NYSE and NASDAQ with respect to both underwriting fees and other direct IPO costs. […] Other direct IPO costs, such as legal and auditing costs, are also reported to be lower in London than in the US, largely due to the costs of complying with Sarbanes-Oxley. Despite the additional costs associated with a US listing, the report finds no evidence that Sarbanes-Oxley has delivered any significant regulatory benefits not already available under the UK corporate governance regime, enabling London to maintain its lead in this area. [26]

Figures for new listings on the LSE and American exchanges are shown below:

UK and US Stock Exchange Listings 2003-06

	LSE				NASDAQ		NYSE	
	Mainmarket		AIM					
	New	*Total*	*New*	*Total*	*New*	*Total*	*New*	*Total*
2003	39	1,938	162	754	134	3,333	107	2,561
2004	68	1,816	355	1,021	260	3,271	165	2,618
2005	105	1,692	519	1,399	269	3,208	192	2,672
YTD Oct 2006	75	1,610	371	1,582	229	3,200	..	..

Note: Data is taken from the websites of each individual exchange
Total listed relates to end December
New listings include IPOs and introductions
NYSE/NASDAQ data includes closed end funds and exchange traded funds

Sources: LSE Main market: http://www.londonstockexchange.com/en-gb/pricesnews/statistics/factsheets/mmfs.htm
LSE AIM: http://www.londonstockexchange.com/NR/rdonlyres/74ED73E6-8462-441E-8CD4-1BB1194CAEF8/0/AIMFactsheetOctober2006.pdf
NASDAQ: http://www.nasdaq.com/newsroom/stats/documents/2006_Download.xls
NYSE: 2005 annual report: http://ccbn.mobular.net/ccbn/7/1552/1714/
NYSE: 2003 figures taken from facts and figures tables: http://www.nysedata.com/factbook

IV Extra-territorial application of US law

The last of the three elements driving the Bill is that there has recently been considerable interest and uncertainty over the extent to which US commercial law extends to people and actions outside the US. The experience of former NatWest bank employees facing trial in US courts for actions committed in this country, but not thought appropriate for legal action here, caused widespread concern in the City and in the House.[27] A director of an online gambling group BetonSports that operated out of Antigua and Costa Rica, from where bets were taken from US citizens, was arrested as he changed planes in Dallas, Texas and remains under house arrest in St Louis, Missouri. In such an

[26] ibid, 29 June 2006

[27] See for example "Lords lose battle over 'fast-track' extradition", *Daily Telegraph* 8 November 2006

atmosphere, and with the clear indication that SARBOX regulation has cost NASDAQ business in the last few years, it is not surprising that there has been speculation that a NASDAQ takeover might be followed by the LSE's regulatory advantage being extinguished as a result of US legislation being applied to the LSE.

Comments from American executives of US exchanges added weight to such supposition when they talked about SARBOX driving "a global race to the bottom with respect to regulatory standards".[28]

V The Bill

1. Introduction

Despite everything written above in this Paper concerning the real-world background, it is very important to say about the Bill that:

- the Bill is *not* aimed at a particular takeover possibility;
- there is *no* proof that any of the conceivable courses of events would happen in the event of a takeover by NASDAQ; and
- the Bill does *not* try to prevent the LSE from being bought by NASDAQ or by any other foreign company or group.

A Treasury press release puts it well when it says, "the new power [in the Bill] would be a right of veto and provide a backstop" to undesirable developments, whatever they might be. Significantly the LSE has made no proactive public statement in respect of the Bill although, privately, it is 'supportive' of this measure.

Advance warning of impending legislation came in a written Ministerial Statement by the Economic Secretary, Ed Balls, in September 2006:

> Concerns have been expressed to the Government about the effects of a possible takeover of the LSE by a company based outside the UK on the LSE's rules, in particular the rules applying to those companies whose securities are traded on the LSE's markets. This is a concern that the Government shares. In this statement I set out our approach.
>
> The Government is neutral as to the nationality of the owners of Recognised Bodies (RBs) . Of the current RBs, five are subsidiaries of overseas based companies. Openness to overseas investment has been an important part of the success of the City in recent years and will continue to be in the future.
>
> The Government would also not seek to intervene in the independent judgements of the Financial Services Authority (FSA) and the competition authorities in respect of any changes of ownership of RBs. The FSA and the competition authorities have specific tasks to perform on an independent basis within clear

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[28] Bob Greifeld (NASDAQ chief Executive) quoted in the *Independent* 14 November 2006

legislative frameworks set out by Parliament. Independence and indifference to nationality are key elements of the UK's regulatory regime.

Investors, issuers of securities, and members of RBs all have an interest in RBs having rules which strike a balance appropriate to that body between the benefits of the restrictions, particularly in terms of investor protection and the impacts on issuers, members and other stakeholders. Such a balance is vital to ensuring exchanges play their role in creating deep and liquid capital markets which promote economic growth. In this respect, the Government believes it is essential that changes of ownership of RBs should not put at risk the achievement of such a balance by RBs.

Our current regulatory regime for RBs is based on high-level legislative principles supplemented by FSA guidance. Within this framework, RBs have the freedom to develop their own rule books in consultation with their members.

I have discussed these issues widely in recent months and made clear that I would expect any potential new owners of the LSE to want to provide certainty and reassurance to the exchange's stakeholders. I welcome the statement which the US's Securities and Exchange Commission issued on 16 June. This provided a helpful clarification of how the SEC sees the current position in respect of the scope of US securities laws.

However, as the FSA pointed out in its statement of 12 June, there is a degree of uncertainty about how overseas ownership of the LSE would affect its regulatory regime. It depends on exactly how any owner would attempt to integrate the LSE with its existing business and the legal framework in other countries – both of which can be subject to change. It is important that there is certainty that the rules of RBs in the UK will continue to be proportionate, balancing the benefits of restrictions with the impacts on stakeholders.

The Government will now legislate to enhance the FSA's powers in this area. This will confer power on the FSA to veto changes to the rules of an RBs in defined circumstances. The aim would be to enable the FSA to stop RBs making rule changes whose effects on issuers and others were likely to be disproportionate to the public benefits. The Government will provide further details in due course.

The purpose of such a change to legislation is not to involve the FSA in the day-today commercial judgements of the RBs. The power will be a right of veto and not a right of approval of rule changes. It will provide a back stop to ensure that the RBs stakeholders can be certain about the proportionality of the rules of the RBs going forward.

This new provision will ensure that UK RBs remain open to overseas ownership. It makes the permissible outer limits of the RB's rules blind to the nationality of their ownership by entrenching better regulation principles in respect of those rules. It should also be clear that we will not allow this legislation to be evaded through abuse of our Recognised Overseas Investment Exchange and Clearing House regimes.[29]

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[29] HC Deb 13 September 2006, C125 -6WS

2. Financial Regulation: continuing responsibilities

The main legislation governing financial services in the UK is the *Financial Services and Markets Act 2000,* and the main regulator the Financial Services Authority (FSA). Under the Act, recognised 'investment exchanges and clearing houses' are substantially self-regulating, but the FSA has an overarching responsibility in certain respects. In a speech on 4 February 2005, the Chairman of the FSA, Callum McCarthy, outlined these responsibilities. He said:

> If the LSE remains a UK exchange under a new parent it will continue to be subject to FSA regulation as a Recognised Investment Exchange (RIE).
>
> "This will require the FSA to be satisfied that, inter alia:
>
> - the governance arrangements of the exchange are such that the exchange is a "fit and proper" person to perform its functions;
> - the UK entity has sufficient financial resources to ensure that, in the event of the need arising, its business could be wound down in an orderly fashion;
> - the exchange's systems, including satisfactory clearing and settlement arrangements, work and offer adequate protection to investors; and
> - the exchange's risk management and internal and external audit procedures are robust.[30]

3. The Bill

The Bill, if passed, will add a significant power to the responsibilities outlined in the section above. It is a short, five clause, Bill, clause 1 of which is the main measure. It states:

> Power of FSA to disallow excessive regulatory provision
>
> In Part 18 of the Financial Services and Markets Act 2000 (c. 8) (recognised investment exchanges and clearing houses), after section 300 insert—
> *"Power to disallow excessive regulatory provision*
>
> 300A Power of Authority to disallow excessive regulatory provision
> (1) This section applies where a recognised body proposes to make any regulatory provision in connection with its business as an investment exchange or the provision by it of clearing services.
> (2) If it appears to the Authority—
> (a) that the proposed provision will impose a requirement on persons affected (directly or indirectly) by it, and
> (b) that the requirement is excessive,
> the Authority may direct that the proposed provision must not be made.
> (3) A requirement is excessive if—

30 FSA press notice, FSA/PN/015/2005, 4 February 2005

> (a) it is not required under Community law or any enactment or rule of law in the United Kingdom, and
> (b) either—
> (i) it is not justified as pursuing a reasonable regulatory objective, or
> (ii) it is disproportionate to the end to be achieved.
> (4) In considering whether a requirement is excessive the Authority must have regard to all the relevant circumstances, including—
> (a) the effect of existing legal and other requirements,
> (b) the global character of financial services and markets and the international mobility of activity,
> (c) the desirability of facilitating innovation, and
> (d) the impact of the proposed provision on market confidence.
> (5) In this section "requirement" includes any obligation or burden.
> (6) Any provision made in contravention of a direction under this section is of no effect.".

The effect of this clause is to confer on the FSA a new power such that it can disallow any regulatory provisions imposed by a recognised exchange or investment house if it deems them excessive. The basic framework of regulation of an exchange remains. The explanatory notes set out the reasoning behind the position taken in the Bill:

> The recognition requirements for UK recognised bodies are currently framed in terms of the objective to be achieved or the minimum standards which the body has to meet. It would be difficult to reformulate the recognition requirements in ways which set both minimum and maximum standards (i.e. the standards beyond which any regulatory provision might be considered to be excessive) without making the recognition requirements much more detailed and specific. Such an approach might be unduly restrictive on the ability of UK recognised bodies to devise regulatory provision appropriate for the markets they serve and which meets the needs of their own customers. In addition, if it were a recognition requirement that a body did not adopt excessive regulatory provision, the only remedies available to the FSA would be withdrawal of the recognition or the making of a direction to the recognised body to take specified steps to secure its compliance with the recognition requirements, whereas the scheme provided for in the Bill allows the FSA to veto excessive provision without a body's recognition status being affected.[31]

Clause 2 sets out 'procedural and other provisions':

- exchanges will be required to notify the FSA of changes to their rulebooks (except for types of change to be exempted from notification requirements)
- the FSA will be given 30 days in which to consider the proposal or to allow for consultation on it; and
- sets out the procedure if the FSA decides that a proposed change requires further consideration.

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[31] Bill 4 Explanatory notes,:

http://web.archive.org/web/20061122015616/http://www.publications.parliament.uk/pa/cm200607/cmbills/004/en/07004x--.htm

The FSA will produce rules under the Bill setting out their criteria for actions and decisions. Between the date of the Bill becoming an Act and publication of these rules, interim provisions apply – as set out in clause 3.

Clause 4 establishes that a new body applying for recognition may be refused if its rules "imposes or will impose an excessive requirement on the persons affected (directly or indirectly) by it". Clause 5 establishes that the Act will come into force on the day that it is passed.

Appendix 1: Financial regulation and Stock Exchange ownership

Speech by FSA Chairman Callum McCarthy, to encourage discussion of the potential longer term implications of any change of ownership of a UK Recognised Investment Exchange.[32]

> The FSA in discharging its responsibilities will always seek to be neutral concerning the nationality of the management or ownership of the entities it regulates. We recognise the benefits that this policy has brought to the UK in assisting in it becoming one of the most international capital markets in Europe and worldwide. We made this policy clear in our public statement of 4 February 2005 on the potential longer term implications of any change of ownership of the London Stock Exchange plc (LSE)1 or its ultimate holding company.
>
> "Against this background, we maintain the same approach in respect of the LSE or any other UK Recognised Investment Exchange (UK RIE): as long as it remains a UK exchange the FSA will continue to require that it meets its regulatory obligations as set by us under the Financial Services and Markets Act (FSMA). As we mentioned in our February 2005 statement these relate, inter alia, to sufficient financial resources, appropriate governance arrangements, and robust trading technology and strong internal risk management systems and controls. In respect of Euronext.Liffe2, another UK RIE, the same considerations apply and we are working with our fellow regulators in the Euronext Regulatory College3 to consider the issues raised by the proposed transaction between the Euronext group and the New York Stock Exchange.
>
> "As set out in our February 2005 statement, we consider a takeover of the LSE might have wider and longer-term implications, including where the regulation of the LSE's markets would take place. In making our statement then our intention was to ensure that the market and all the LSE's stakeholders were fully aware of these implications and could carefully consider how bidders address these potential issues. We believe it helpful to make a comparable statement now, in light of developments over the last three months.
>
> "We note that the Nasdaq Stock market, Inc. (NASDAQ) in its public announcement of 10 March 2006, stated that following any acquisition the LSE would continue to be a RIE regulated by the FSA and that it was committed to preserving an FSA regulated Main Market and AIM. While Nasdaq has withdrawn its indicative offer, it has subsequently acquired 25.1 per cent of the issued share capital of the LSE and has stated its desire to work constructively with the LSE as its major shareholder. If a bid for the LSE should progress, we would expect the bidder to make clear its intentions in respect of maintenance of the UK RIE. We note that no bid may be forthcoming and that any bid may or may not be accepted by shareholders. This is a matter for the management and shareholders concerned.

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[32] FSA/PN/055/2006 12th June 2006

"The possibility of ownership of the LSE by a US entity has raised questions about whether, and to what extent, US law and regulation might impinge on the operation of the exchange and its markets and the companies listed on them. We would expect any bidder to make clear whether its proposals might lead to such a possibility. Any such implications would need to be considered by all stakeholders.

"For our part, we have been discussing with the relevant authorities in the United States the regulatory issues raised by combined groups operating exchanges in the UK and the US, with a view to considering for example whether arrangements to exchange information or strengthen cooperation in the oversight of such groups are necessary.

"In respect of the LSE, neither the FSA nor the Securities and Exchange Commission (SEC) consider that US ownership of the LSE, in and of itself, would result in US regulations, including Sarbanes-Oxley, applying to companies listed or quoted on its markets or member firms of the LSE. As is currently the case, some companies on the Exchange's markets may have - or choose to seek - registration with the SEC.

"Over time, a combined group, although continuing to operate separate subsidiary exchanges, may seek to harmonise aspects of both markets in respect of its trading platform, rules, membership arrangements and listings of companies. Certain aspects of integration, such as the development of a common trading platform technology, would be relatively straightforward from a regulatory standpoint. However, harmonisation of listing and membership would present greater regulatory issues between jurisdictions.

"A common trading platform technology could be developed and operated by the respective exchanges. This would need to comply with existing regulations to ensure that the systems were adequate and that reliable and appropriate controls were in place. Further integration steps could lead to the creation of a single market, covering all the securities of both exchanges with access by common members serving investors in both jurisdictions. This would require compliance with the rules of both jurisdictions unless the differing regulatory frameworks were to be aligned, including consideration of whether standards could be deemed equivalent and whether legislative change is required.

"Harmonisation of trading rules would need to be consistent with US and UK standards, including those required by the Markets in Financial Instruments Directive - to be effective by November 2007. Securities admitted to a regulated market in the EU would require compliance with European Directives such as the Prospectus, Transparency and Market Abuse Directives. In addition, a UK exchange could choose to have issuers meet additional requirements on its markets, for example for a dual UK/US listing. Member firms of a UK exchange undertaking a regulated activity in the UK would need to be authorised by the FSA or fit within a relevant exclusion. The provision of trading screens in the US by a UK exchange would require its registration as a US National Securities Exchange and consequent registration of all issuers.

"However, we believe that there could be circumstances where a more complex regulatory position might arise. Theoretically, in the longer term, a new entity might seek to achieve further benefits from rationalisation of its regulatory structure. This could at the extreme involve the LSE no longer being subject to

UK regulation as an RIE. Its services might be provided from outside the UK, either from the US, another EU member state or an alternative location, through the provision of trading screens in the UK and with securities admitted to trading on the market operated from elsewhere. Such a move, were it to occur, would potentially have significant implications for various aspects of the wider regulatory regime as indicated in our February 2005 statement. If such a market were to be operated from the US it would require member firms and issuers to be registered with the SEC and subject to its oversight.

"We have sought to set out in this note some of the potential longer term implications of ownership of a UK Recognised Investment Exchange by a US entity to ensure that all stakeholders, including the exchanges' users, members and issuers, can consider these implications. For its part the FSA will continue to explore the regulatory implications of any such proposals, in conjunction with other regulatory authorities such as the SEC, the Commodities and Futures Trading Commission and the Euronext Regulatory College."

Appendix 2: List of UK recognised investment exchanges and clearing houses.

Recognised Investment Exchanges

EDX London Ltd
LIFFE Administration and Management
London Stock Exchange plc
NYMEX Europe limited
The London Metal Exchange Limited
virt-x Exchange Limited

Recognised Clearing Houses

Crestco Limited
LCH. Clearnet Limited

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