

## Conclusions and recommendations

### I The 'conditions'

87. In considering whether the 'conditions' to which the 1948 Act (as amended and extended)<sup>1</sup> applies prevail we are required by our terms of reference to limit consideration to 'conditions which prevail or may prevail by virtue of arrangements or practices (falling within section 2(4) of the Act of 1965) whereby two or more persons supplying the relevant services accept restrictions on the advertising of such services'. This means that we can find the 'conditions' to prevail if we are satisfied that the supply of stockbrokers' services in the United Kingdom is, to the extent of at least one third, by or for two or more persons who, whether voluntarily or not, and whether by agreement or arrangement or not, accept restrictions on the advertising of such services and thereby so conduct their respective affairs as in any way to prevent or restrict competition in connection with the supply of stockbrokers' services (whether or not they themselves are affected by the competition and whether the competition is between persons interested as persons by whom, or as persons to whom, services are supplied).

88. We have described in chapter 2 the restrictions on advertising which members of the Stock Exchange are required to observe under the rules and regulations of the Stock Exchange. We are satisfied that in general all stockbroker members in the United Kingdom, that is to say all suppliers of stockbrokers' services in the United Kingdom as defined in the terms of reference (see paragraph 8), accept these restrictions on advertising. The restrictions prevent every stockbroker from using certain forms of advertising at all (eg radio and television advertising), severely limit the content of press advertising and the extent to which it may be used to obtain business, and prevent the use of circulars as a means of obtaining business from any investors other than existing clients; these restrictions as a whole place strict limits upon the use of advertising as a form of competition to obtain business. It can hardly be denied that the use, if they were available, of the forbidden kinds of advertising as a form of competition could be expected to result in some shift of business from one stockbroker to another. For immediate purposes, we are not concerned with the question whether the kind of competition that would arise in that event would be desirable or undesirable. We are satisfied that the restrictions on advertising of stockbrokers' services must have some restrictive effect on competition among the suppliers of those services.

89. We conclude therefore that the 'conditions' prevail as respects the supply in the United Kingdom of stockbrokers' services by virtue of arrangements or practices of the kinds specified in the reference, as described in paragraph 87 above.

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<sup>1</sup>Since the reference was made before the commencement of the Fair Trading Act 1973, we are required (by paragraph 7 of Schedule 11 to that Act) to make our report in accordance with the enactments under which it was made, ie the 1948 Act as amended and extended.

## II The public interest

90. The matters on which we are required to form a judgment as to their effects upon the public interest are limited to those of which we have taken account in reaching our conclusion as to the prevalence of the 'conditions'. In other words, in considering whether the conditions, or any things which are done by the parties concerned as a result of or for the purpose of preserving those conditions, operate or may be expected to operate against the public interest, we are required to limit our judgment to the effects on the public interest of the arrangements or practices restricting the advertising of stockbrokers' services. In forming our judgment, however, we are entitled to take account of the general context in which these services are supplied.

91. The number of stockbroking firms in the United Kingdom<sup>1</sup> (ie United Kingdom stockbroking member firms of the Stock Exchange, including corporate members—see paragraph 19) has been diminishing over the years and is now under 300. There are some small stockbroking firms which mostly serve local clients, but the larger firms operate on a national or international scale, and institutional investors are among their most important clients.

92. Institutional and other large investors have a wide choice of brokers. The small investor who wishes to deal direct with a broker also has a wide choice if he is in the London area, although some large brokers do not encourage small business; outside London his choice may be more restricted if he wants to use a local broker. But in fact a large proportion of small business reaches brokers through the clearing banks and other agents, most of whom would have a wide choice of brokers.

93. The nature and regularity of the services rendered by stockbrokers differ according to the type of investor concerned. Institutional and other large investors may use the services of a broker, or of several brokers, to buy and sell securities on a more or less continual basis. Brokers normally also provide an advisory service to such clients without making a specific charge for it. Some medium-sized investors may also use the brokers' investment advice or portfolio management services on a regular basis. At the other end of the scale, a small investor may use a stockbroker's services only to buy or sell securities on rare occasions, perhaps seeking his advice in the process.

94. The Prevention of Fraud (Investments) Act 1958 prohibits dealing in securities, except by certain persons and classes of persons specified in the Act, including members of the Stock Exchange, and by such persons as may be licensed or otherwise authorised by the Department of Trade (see paragraph 24). Under the rules of the Stock Exchange only its members or their appointed dealers have access, as dealers, to the floors of the Stock Exchange, which are the principal organised markets where potential buyers and sellers of securities

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<sup>1</sup>Although other persons can describe themselves as stockbrokers, we use the expressions 'stockbroker' and 'stockbroking' in this chapter to refer to the stockbroking members of the Stock Exchange with whose services our reference is concerned. (The membership of the Stock Exchange includes jobbers as well as stockbrokers, but the services of jobbers are not covered by our terms of reference—see paragraph 9.)

are brought together<sup>1</sup>. Other persons authorised under the Act to deal in securities can only do business in a stock exchange through a broker member of the Stock Exchange.

95. Thus dealing in securities in the capacity of a stockbroker is a function which is effectively protected against competition from any person not a member of the Stock Exchange. Neither the law nor the Stock Exchange's own rules place any limit upon the number of persons who may be admitted as members. The number of applicants seeking membership at any time is, no doubt, affected by the conditions of membership, including the examination and financial requirements (see paragraph 17), and also by the state of the financial market.

96. Among the conditions required of a stockbroker if he is to remain a member of the Stock Exchange is observance of the rules and regulations, including those on advertising. The basic rule in this respect is that which prohibits advertising (including, subject to certain permitted exceptions, the issue of circulars or business communications other than to existing clients) for stock exchange business by a member or member firm, with the exception that, subject to the prior consent of the Council, advertisements may be placed in newspapers, periodicals or books of reference<sup>2</sup>. It is clear from the explanatory notice issued by the Council to the members<sup>3</sup> and from the Stock Exchange's evidence to us<sup>4</sup> that prior consent to an advertisement is not given unless, in the Council's judgment, it fulfills certain conditions. A fundamental condition is that it must not advertise individual securities (ie it must not 'tip' shares)<sup>5</sup>. In addition, it must be made in good faith and must not confuse, mislead or offend, it must be capable of substantiation, it must not attack or discredit other firms and institutions directly or by implication, it must be distinguishable from editorial contents, it must convey that the advertiser is a member of the Stock Exchange, it must be clearly worded, and (where appropriate) it must distinguish between branch offices and correspondents. Apart from the basic rule referred to there are provisions prohibiting members from having an interest in concerns which advertise for stock exchange business, regulating the appearance of a broker's name in certain prospectuses<sup>6</sup>, requiring the Council's permission for press contributions on financial matters, and requiring agents to observe the advertising restrictions<sup>7</sup>.

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<sup>1</sup> ARIEL is a newly established organisation for bringing institutional buyers and sellers together without the intervention of a dealer. Other authorised dealers have access to limited or specialised markets (see paragraph 26).

<sup>2</sup> Rule 78(1)—see Appendix 1.

<sup>3</sup> Permanent Notice C-4—see Appendix 2.

<sup>4</sup> See paragraphs 66 to 73.

<sup>5</sup> See paragraph 40. Although the prohibition of tipping of shares is not mentioned in rule 78(1) and is given little prominence in the explanatory notice to members, this, the Stock Exchange informs us, is because it is taken for granted by members and hardly needs to be mentioned.

<sup>6</sup> It is an accepted convention that companies may give the names of their brokers in their annual reports.

<sup>7</sup> Rules 78(2) and (3), 93 and 212 (2)(a) with Appendix 49—see Appendix 1.

## **Advertising and the stockbroker's responsibilities**

97. At the time (8 August 1973) when the reference was made and until November 1973, the Stock Exchange's rules prohibited virtually any advertising in the United Kingdom by members. One of the main grounds for this prohibition was the view that 'the real purpose of advertising must be to promote sale of stock to the public and that the interest of the client may thereby become subordinate to the interest of the advertiser'. The Stock Exchange has now modified this prohibition to the extent of permitting press advertising on the strictly regulated basis described in paragraph 96 above. It says that 'the relaxation of the advertising rules must be seen as a recognition of the need to remove any barrier which might be thought to prevent member firms from effectively meeting the competition they face (in particular by enabling them to make known the increasingly specialist services which they offer) while at the same time continuing to safeguard the interests of the investing public'. The Stock Exchange justifies the existing restrictions on advertising principally on the ground that stockbrokers are expected to accept a special responsibility to protect the interests of the investing public generally, but also on the ground that stockbrokers, like members of other professions, regard themselves as in a position of trust in relation to their clients. The stockbroker's ability to carry out both of these responsibilities would, it is argued, be at risk if there were no restrictions.

98. The main questions for us that emerge from these arguments are: (1) Do the suppliers of stockbrokers' services assume special responsibilities, and is it desirable that they should do so? (2) If special responsibilities are assumed and it is desirable that they should be assumed, would freedom to advertise be likely to have adverse effects on the suppliers' ability to carry out these responsibilities?

99. With regard to (1) of paragraph 98, the stockbroker, as we have said, assumes both that he is in a position of trust in relation to his client and that he has an overriding responsibility to protect the interests of the investing public. So far as the client's interest is concerned, there is in the first place a fiduciary element of a particular kind, inasmuch as the stockbroker's service may involve holding clients' monies and securities in trust. We do not regard the advertising restrictions as a safeguard in this respect. As to the question of quality of service, the ability of a buyer to judge the quality of the goods and services he is offered varies greatly according to the nature of the goods and services concerned. He has to buy some goods and services largely on trust. In some of these cases it may be possible subsequently to identify defects and hold the supplier responsible; but in other cases this can be much more difficult, even when the consumer is vigilant and takes advantage of the protection increasingly given to consumers by legislation and otherwise. To the extent that the service rendered by the stockbroker is the implementation of buying or selling orders on behalf of clients and the subsequent delivery of stock, we doubt whether this is a consideration of much importance. Large private and institutional investors should be fully capable of judging the quality of the services rendered to them in these respects, though this may be less true of the small investor. When the stockbroker's service also involves giving advice on

investment, however, quality of service can assume greater importance and also be more difficult for investors to judge. It is desirable that a stockbroker's advice should be considered and objective; it should always be in the client's interest and not be influenced by the desire to create commission-bearing business. We accept, therefore, that it is in the interest of users of their services that stockbrokers should recognise a special responsibility for giving considered and objective advice on investment.

100. In the Stock Exchange's view, a principal element of the stockbroker's responsibility to protect the interests of the investing public arises from the danger of 'false markets'. A 'false market' according to the Stock Exchange's own definition<sup>1</sup> means 'a market in which a movement of the price of a share is brought about or sought to be brought about by contrived factors, such as the operation of buyers and sellers acting in collaboration with each other, calculated to create a movement of price which is not justified by assets, earnings or prospects'. We accept that creation of false markets, as described above, is undesirable, as indeed is any action on the part of stockbrokers which could have the effect, whether deliberately intended or not, of misleading investors or prospective investors. We accept, therefore, that it is desirable that stockbrokers should assume the responsibility of avoiding such action so far as this is possible in the circumstances of the stock market.

101. With regard to (2) of paragraph 98, a principal purpose of the Stock Exchange's rules on advertising is to restrict the promotion of individual securities (or share tipping) by stockbrokers. 'Share tipping', as we understand the term, need not involve any 'contrived factors' of the kind referred to in the Stock Exchange's definition of a 'false market'. It can occur without any intention of creating a false market, and stockbrokers do in fact recommend individual securities in circulars to their clients because they believe that purchase at the current price would be 'justified by assets, earnings or prospects'. The Stock Exchange rules, as implemented by the Council, however, prohibit share tipping of any kind in press advertisements or in circulars to non-clients. The Stock Exchange says that this serves two purposes. In the first place it may be against the interest of the investor to have shares recommended to him without regard to his particular financial circumstances; the broker is therefore prohibited from making such recommendations except (by circular) to his clients, whose circumstances should be known to him. Secondly, widespread tipping of shares through press advertising or indiscriminate circularisation could not only have the effect of causing 'a very wide move in the price', but could also 'put temptation in the way of individuals to secure for themselves a line of securities before they started the advertising campaign and to sell these at a profit to the unwilling recipients of the advertisement'.

102. So far as circulars to clients are concerned, a stockbroker can, no doubt, discriminate to some extent among his clients when deciding to whom they should be distributed. But a circular is a document produced in quantity and it seems unlikely that advice given to clients by this means can ever prove to be tailor-made for each recipient. Furthermore, the contents of brokers'

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<sup>1</sup>Rule 73b(2)—see Appendix 1.

circulars to clients frequently find their way into the financial press, sometimes with explicit attribution to the broker concerned. In such a case the broker's recommendations are, in effect, made known indiscriminately to investors. We think that the prohibition of circulars to non-clients stems partly at least from the concept, common to many professions, that a supplier of the relevant service should never attempt to 'supplant' a fellow supplier by deliberately attracting the custom of his clients. The Stock Exchange, while denying that it has any desire to stifle or restrict competition between stockbroking firms, acknowledges that its rules are intended to prevent 'soliciting for business'. We think that the distinction between what may be said to clients and to non-clients derives from this concept as well as from the need to protect the investing public generally. The Stock Exchange says that it would not be administratively practicable to apply a prior 'vetting' procedure to circulars, and this is one of the reasons why circulars to non-clients are prohibited (with some strictly limited exceptions). But the Stock Exchange permits the issue of circulars to clients without prior approval although, for reasons explained in this and paragraphs 103 and 104, it seems to us that, if the Stock Exchange's anxieties about abuses which might flow from unvetted advertisements and circulars to non-clients were justified, they ought to have similar anxieties about unvetted circulars to clients.

103. As to false markets, the Stock Exchange's rules provide that 'no member shall knowingly or without due care deal in such a manner as shall promote or assist in the promotion of a false market'<sup>1</sup>. Strict enforcement of the rules on press advertisements and circulars to non-clients is, no doubt, effective in preventing a member from using them as a method of promoting a false market. But it seems to us that any stockbroker who at present might be tempted to infringe the rule on false markets could find ways and means of doing so and would be very little impeded by the advertising rules. Even if he were free to recommend particular securities in an advertisement it seems unlikely that such a stockbroker would use this as his main method of creating a false market, since he could not rely on the effects of one particular advertisement in a market in which many other brokers would be openly recommending shares; it would, moreover, be more difficult to conceal inaccuracies or omissions in advice given in advertisements than if it were given more covertly. It is much more probable, therefore, that he would use a word-of-mouth approach to individuals whose interest he wished to arouse, including financial journalists; he might also, though less probably, use circulars to clients for the purpose. Where methods other than press advertising or circulars are used, the rule against the promotion of false markets obviously cannot always be strictly enforced; apart from the general difficulty of establishing that the broker concerned knew that he was helping to establish a false market it may not be possible to establish the fact that he tipped the shares. Stockbrokers cannot use press advertising or circulars to non-clients to promote false markets because the Stock Exchange's rules prohibit them from recommending individual securities at all by those methods. But as regards other methods of promoting false markets, the rules, in effect, put brokers on their honour not to make use of them and cannot necessarily be easily enforced against the dishonourable

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<sup>1</sup>Rule 73(b)—see Appendix 1.

exception. As for unwitting connivance in promoting false markets through lack of care in passing on recommendations, it appears to us that this is no more likely to occur in circulars to non-clients than in circulars to clients.

104. The separation of the broking and jobbing functions is intended to ensure that the broker's advice shall not be influenced by his own commitments to the shares in which he deals. The Stock Exchange evidently regards this as a sufficient safeguard of the broker's integrity *vis-a-vis* his clients, and it therefore does not attempt to control the advice he may give to them. If the separation of functions and the provisions of section 13 of the Prevention of Fraud (Investments) Act 1958<sup>1</sup>, together with the professional standards of ethics which all members of the Stock Exchange are expected and undertake to observe, provide a sufficient safeguard of the broker's integrity when dealing with clients, we do not see why the Stock Exchange should take a quite different attitude when there is a question of brokers communicating openly with investors and prospective investors who have not so far been their clients. For the reasons given in paragraph 102 above, we think that the distinction between client and non-client does not result in the broker's advice being confined to those for whom it is tailor-made. And for the reasons given in paragraph 103 above, we doubt whether the present rules can provide any additional safeguard against misleading the investor or prospective investor or against the promotion of false markets. The cautious approach of the Stock Exchange to the question of relaxing advertising rules appears to reflect partly the fact that the members, or many of them, are reluctant to accept that an individual broking firm should invite custom not only from existing clients but also from those who are not its clients, including those who are the clients of other broking firms.

105. We do not regard the present advertising rules as a necessary supporting safeguard against false markets. We accept, however, that the Stock Exchange is properly concerned to maintain confidence among members as to mutual integrity and confidence on the part of the public in the integrity of the profession as a whole. This is of importance, particularly because business is transacted on an oral basis. We accept that some kinds of advertising could, if permitted, seriously mislead some investors or have harmful effects on confidence within the profession and on the public's confidence in the profession; and loss of confidence can itself help to create conditions in which a loss of integrity becomes more likely. But in our view the Stock Exchange's present restrictions on advertising are not necessary for the avoidance of these harmful effects.

106. It is not our purpose to pronounce upon the advantages and disadvantages of advertising in the field of goods and services as a whole. We can hardly arrive at a judgment on the effects of restrictions on advertising in one small part of that field, however, without taking account of the fact that freedom to advertise to the extent that it exists at present over the greater part of that field is not universally regarded as being without some disadvantageous consequences.

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<sup>1</sup>See paragraph 29.

107. The Stock Exchange has suggested that promotional advertising could lead to the interest of the client becoming subordinate to the interest of the advertiser (see paragraph 97). But every advertiser must, if he is to attract demand, try to take some account of the interests of the potential purchasers; and in this sense it is a function of advertising to promote the interests of consumers as well as that of the advertiser. There remains, certainly, a recognised risk that the advertiser may mislead the consumer. In the field of goods and non-professional services this is regarded as an acceptable risk because of potential counter-balancing advantages to the consumer and the public interest, though some attempt is made to minimise the risk by applying general controls (eg by legislation or by other means of regulation or restraint). We express no view as to the desirability of tighter control of advertising in general. Two points that seem to us relevant to the present inquiry, however, are, first that the present controls on advertising by stockbrokers, though less severe than in some professions, are nevertheless fairly stringent, and secondly, that the stockbrokers seem to us to ignore the extent to which the interests of the investing public might be served by their own advertisements.

108. In the light of paragraphs 97 to 107 above our position so far may be summed up as follows. We accept that stockbrokers have a special responsibility to their clients and to the investing public. So far as that responsibility relates to avoiding the misleading of investors and avoiding false markets, we do not think the present restrictions on advertising are necessary to provide an effective additional safeguard. We accept, however, that there are some kinds of advertising which, if permitted and indulged in, could seriously mislead some investors or could lead to a significant deterioration in confidence within the profession, in the public's confidence in the profession, and therefore in the profession's ability to carry out those special responsibilities which it is in the public interest that it should assume. There is, therefore, a case for the continuance of a degree of restriction of the advertising of stockbrokers' services. But it does not follow that the kinds of advertising that we think should be avoided are those at present forbidden to stockbrokers.

### **Possible disadvantages of advertising restrictions**

109. The principal possible objections to the restrictions on advertising observed in the stockbroking profession appear to us to be that (1) they deprive users and potential users of helpful information which might otherwise be available to them; (2) they reduce the stimulus to efficiency, to cost-saving, to innovation, to new entry to practice and the setting up of new practices, and to competition amongst stockbrokers; and (3) by limiting the use of an overt method of stating competitive claims they enhance the more undesirable effects of less open methods of self-promotion. In the following paragraphs we consider what weight needs to be given to these objections in the actual context in which members of the profession offer their services and having regard also to the fact that in this profession the existing restrictions are such as to permit some forms of advertising. We bear in mind in this connection that the number of stockbroking firms is small and tending to diminish (see paragraph 91 above), that dealing in securities is a function protected by law, and that though members of the Stock Exchange are not the only beneficiaries of that

protection they are the only dealers with direct access to the principal organised markets for dealing in securities (see paragraphs 94 and 95 above).

### **Effects on information to the public**

110. With regard to (1) of paragraph 109, it might be said that, even if the Stock Exchange was open to criticism in the past for prohibiting its members from giving the public information about their services, this criticism is no longer valid because any stockbroker can now publicise in press advertisements the existence of his practice and is not precluded from claiming special areas of expertise if these are considered by the Council of the Stock Exchange to be justified. The stockbroking profession is still regarded, however, by some sections of the public as somewhat remote and incomprehensible, and we therefore think it necessary to consider briefly how far the restrictions on advertising may be relevant to this state of affairs.

111. We do not think that the advertising restrictions deprive institutional and other large investors of any information they require. Such investors often have their regular brokers and, in any event, would have no difficulty in finding a broker to transact their business. They are likely to be well-informed about any special areas of expertise of particular brokers.

112. Although the Stock Exchange has made useful efforts to improve public understanding of its members' services (eg by opening a visitors gallery, by corporate publicity through films, by participating in educational projects), many small investors, particularly those investing for the first time, would have little idea of how to approach any stockbroker, still less of which stockbroker might best suit their purpose. In a small neighbourhood the 'yellow pages' might provide a small investor with a list of local brokers from whom he could make a choice; this could be a short list in some neighbourhoods or a much longer one if he were in the London area, but in either case none of the names might mean anything to him. If he should think of approaching the Stock Exchange itself, he would be given a short list of member firms willing to deal with small investors (see paragraph 80). In practice, a great many investors do not try to approach a broker directly but go for advice to a bank manager, solicitor or accountant, who then, as an agent, deals with the broker on his behalf.

113. We doubt whether the present restrictions on advertising have much to do with this state of affairs. Since November 1973 it has been open to any stockbroker to place approved advertisements in the press publicising his willingness to do business for small investors. Only a minority of brokers have taken advantage of the relaxation of the former rule, and of these only a very small number indeed have indicated that they welcome small investors' business. The condition of the financial market over the last eighteen months may have deterred some brokers who might otherwise have advertised. But however this may be, any failure by brokers to give small investors information about the services they could offer must now be a result of their individual decisions. The broker's commission is based upon the value of the transaction and not upon the amount of work performed; and this may be a reason why

some brokers prefer to concentrate on large orders. Although the Stock Exchange asserts that there are, nevertheless, many brokers who are anxious to obtain small investors' business there is little evidence that even these brokers wish to invite a direct approach by small investors. It appears to us that many of them are content to obtain small business through banks or other agents; the agent in such a case takes 20 per cent, or in the case of an agent included in the register of banks 25 per cent, of the broker's commission on the transaction but performs some of the necessary work. This is not necessarily against the interest of small investors, many of whom may prefer to deal through a bank or other agent. But, in any event, if there is any detriment to their interest by way of a failure on the part of stockbrokers to provide information about the existence of their services and their areas of special expertise, we do not think this is a consequence of the restrictions on advertising imposed by the present rules of the Stock Exchange.

114. Although, in the light of what has been said in paragraphs 110 to 113, we think the advertising restrictions have little or no effect on the ability of investors to find a stockbroker, these restrictions do, nevertheless, deprive members of the investing public of useful information which might otherwise be available to them. A stockbroker may make recommendations about individual securities to a client but he may not draw the attention of non-clients to individual securities. For the reasons given in paragraphs 101 and 102 we do not accept that this distinction helps to protect the public against the creation of false markets. Making recommendations about individual securities involves giving advice as well as information. There may be a case for saying that recommendations should not be given indiscriminately in advertisements because the limitations of space prevent the formulation of advice in detail, and investors could be seriously misled by simple recommendations. Such limitations do not apply to circulars; and we think it is a significant disadvantage of the existing restrictions on the advertising of stockbrokers' services that a stockbroker who might wish to do so is precluded from imparting to other members of the investing public by means of circulars the information and advice which he is allowed to make available in this way to a minority, namely, his existing clients.

#### **Effects on efficiency and the competitive situation**

115. With regard to (2) of paragraph 109, the possible objections to the restrictions in this respect are that, to the extent that they prohibit the use of some kinds of advertising, they deprive the more efficient firms of something which might help them to expand at the expense of the less efficient, and that, by depriving new entrants and firms which wish to introduce new methods or new kinds of service of some part of their means of attracting demand, they discourage both new entry and innovation; more generally, insofar as vigorous competition among suppliers may be expected to stimulate efficiency and so contribute to cost reduction, any inhibition on overt competition may be expected to produce contrary, disadvantageous effects.

116. The Stock Exchange says that (a) member firms 'have been in the van of progress in developing new computerised data retrieval systems, research

programmes and computerised office procedures'; (b) they have consistently sought higher efficiencies in their business; (c) the compulsion to such innovation and increased efficiency comes, first, from the 'intense competition' to which they are subject, from each other and from outside the Stock Exchange, and, secondly, from increased costs of operation; and (d) 'in this context the role of advertising is largely irrelevant'.

117. We know of no method of making any quantitative comparison between the present state of efficiency of stockbroking firms and their hypothetical state of efficiency if advertising were less restricted than it is. Competition from outside the Stock Exchange, whether in transferring ownership of existing Stock Exchange securities, in facilitating the raising of finance for new capital for industry or to meet the borrowing needs of the Government or other public authorities, or in the provision of investment advice, takes a number of forms, as described in paragraph 26. Such competition no doubt sets up some pressure upon all stockbrokers to improve their efficiency and minimise their costs; though it may be noted that stockbrokers do not seek to meet it by varying the price for the major service which they perform, since they are committed to minimum rates of commission on the purchase and sale of securities and in practice treat these rates as standard rates except on small transactions. We agree that freedom for stockbrokers to use forms of advertising which are at present prohibited would be unlikely to have much, if any, effect upon the large investors or raisers of capital whose decisions must account for the greater part of the business which thus by-passes the Stock Exchange. It might, however, have some effect upon the decisions of small investors who at present invest otherwise than in Stock Exchange securities (eg in national savings, building societies, etc). More importantly, the present advertising rules must have some inhibiting effect on competition among stockbrokers. For example, they prohibit any direct distribution (eg by means of circulars) to non-clients of material relating to particular securities which might attract the interest of investors generally or of some classes of investors, or even of material indicating a stockbroker's willingness to offer them advice and assistance on investment in Stock Exchange securities.

118. So long as minimum rates of commission are prescribed on the purchase and sale of securities<sup>1</sup>, there can be little possibility of price competition among stockbrokers. There are, however, no prescribed fees for giving investment advice, and, in practice, a great deal of such advice is given to clients at present without additional charge. Willingness to give advice free of charge or on a specific charge basis might be an aspect of service which a stockbroker would wish to advertise.

119. With regard to innovation, we think it desirable that individual stockbroking practices should not be discouraged from introducing new and better methods and types of service. So far as these may call for increased investment of capital in the stockbroker's practice, it may be essential that he should have the prospect of attracting increased business to justify the risk. Under the present advertising rules he should normally be able to publicise his

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<sup>1</sup>The rules governing rates of commission are not covered by our terms of reference.

innovations in press advertisements but, again, may not make any direct approach to non-clients. The rules may discourage or delay the introduction of innovations in such circumstances.

120. With regard to new entry to practice as a stockbroker, the number of firms has been diminishing over the years and the tendency is for newly admitted members to join existing firms rather than set up new firms. We do not think either the past or the present advertising rules have contributed materially to this situation. Nevertheless in a changed climate the inability of a new firm to approach potential clients direct might restrict possibilities of expansion which would otherwise be open to it, and to this extent the restrictions could act as a deterrent to new entry.

121. In paragraphs 117 and 118 we have explained why the advertising rules seem likely to have some inhibiting effects on competition among stockbrokers and, to a lesser extent, on the competitive position of the Stock Exchange as a whole. To the extent that competition is so inhibited, the effectiveness of one potential stimulus to efficiency is reduced. In a profession in which there is little scope for competition in price, it is all the more important that the competitive stimulus should be enhanced by other means rather than reduced. We think that it is a significant disadvantage of the existing restrictions on the advertising of stockbrokers' services that they are likely to have inhibiting effects on the competitiveness of the profession generally. They are also likely to have some effect in delaying the introduction of innovatory methods and services (see paragraph 119) and in some circumstances could act as a deterrent to new entry (see paragraph 120), with further consequential disadvantageous effects on competitiveness and efficiency.

### **Effects on the public attitude to the profession**

122. With regard to (3) of paragraph 109, there is scope for suppliers of many kinds of services to attract customers by hints or by more explicit 'touting'. Or a supplier may think it worth his while to establish a reputation in public affairs because this may indirectly recommend him to numbers of potential customers. Such methods can vary from the honourable to the disreputable. The scope for using such methods would appear to be greatest where the service is based on esoteric skills and is normally supplied by individuals in business on their own or in partnership rather than by large corporations. This is not to suggest that we believe disreputable methods to be in common use within the stockbrokers' profession; but this profession, like other professions, is aware that no rules can ensure that they will never be used by any of its members.

123. The argument against restrictions on advertising in this connection is not that their removal could be expected to eliminate these other methods of attracting custom. Rather the argument is, in the first place that a limitation on the use of explicit challengeable claims in advertisements may enhance the influence upon clients and potential clients of hints of claims that are hardly open to challenge and may have little bearing upon the client's real need. Secondly, it is that, if the suppliers of a service are known to deny themselves the use of overt advertising but are believed by the public, whether rightly or

wrongly, to be willing to promote their businesses by backstair methods, the public may be more sceptical of their integrity than they would otherwise be, with effects which are detrimental to public confidence in the profession and ultimately to the public interest. The stockbrokers' profession, unlike some other professions, does not now completely deny itself the use of advertising. But it continues to draw a sharp distinction between what may be said to clients and to non-clients, and thus to a large extent denies itself the use of advertising as a means of promoting business by attracting new clients. Although this distinction derives in part from the concept of a special responsibility to avoid misleading investors, it seems to us to be based also upon the belief that a stockbroker should not be seen to be seeking to attract another stockbroker's client (see paragraph 102). Stockbrokers are all in business to earn a living by supplying their service, and the Stock Exchange itself says that they are subject to 'intense competition' from each other. We see no reason why, in these circumstances, stockbrokers should not seek clients wherever they can find them, including the clients of other stockbrokers. We think that if the members of the profession were more frank with each other and with the public in acknowledging the personal interest in conducting a successful and remunerative business, relations within the profession would not suffer while the public might be more rather than less ready to recognise that this personal interest did not mean that other interests were disregarded.

124. For the reasons given in paragraphs 122 and 123, we conclude that an additional significant disadvantageous effect of the existing restrictions on the advertising of stockbrokers' services is that they may enhance the influence of other, less desirable, methods of attracting custom, and tend to create a false image of the profession which is harmful to public confidence and to relations between the profession and the public.

### **Conclusions on the public interest**

125. We have found that the existing restrictions on the advertising of stockbrokers' services result in significant disadvantages to the public interest. We conclude, therefore, that:

- (a) The 'conditions' which we have found to prevail (paragraph 89) operate and may be expected to operate against the public interest because the restrictions on advertising by virtue of which those conditions prevail (i) unduly deprive members of the investing public of useful information which might otherwise be available to them (paragraph 114), (ii) are likely to have disadvantageous effects on the competitiveness and efficiency of the profession generally and on the introduction of innovatory methods and services and in some circumstances could act as a deterrent to new entry to practice (paragraph 121), and (iii) may enhance the influence upon the public of other, less desirable, methods of attracting custom and tend to create a false image of the profession which is harmful to public confidence and to relations between the profession and the public (paragraph 124);
- (b) There are no things done by the parties concerned as a result of, or for the purpose of preserving, the 'conditions' which operate or may be expected to operate against the public interest.

### III Recommendations

126. It does not follow from our conclusion in paragraph 125 about the disadvantageous effects of the existing advertising restrictions upon the public interest that we think stockbrokers should henceforth be allowed to advertise without any restrictions. We have made it clear that in our view there is a case for the continuance of a degree of restriction of the advertising of stockbrokers' services because some kinds of advertising could seriously mislead investors or could lead to a significant deterioration in confidence within the profession, in the public's confidence in the profession, and therefore in the profession's ability to carry out those special responsibilities which it is in the public interest that it should assume (paragraph 108). The Stock Exchange, having given serious consideration to the question for several years, concluded in November 1973 that promotional advertising, until then forbidden in any form, was acceptable for stockbrokers provided restrictions were applied to its use. We agree with this in principle, but disagree as to the restrictions which should be applied. We see no value in the rigid distinction drawn between what may be said to clients and to non-clients, and do not regard the restrictions applied to communication with non-clients as providing an effective additional safeguard against the misleading of investors and the creation of false markets. Our main objection is, therefore, that the existing form of restriction, while depriving some of the investing public of access to information which they might otherwise have, does not provide any additional protection of their interests. We accept, nevertheless, that there are some kinds of advertising which, if permitted and indulged in, could have harmful effects in the context of the stockbrokers' profession and its services, and that there should continue to be a safeguard against the risk that individual stockbroking firms might bring disrepute upon the whole profession by the methods or matter of their publicity. But we think that, for these purposes, the line does not have to be drawn where the Stock Exchange now draws it, and that a new approach, providing wider scope for advertising than at present, is required. In paragraphs 127 et seq we describe the arrangements which would, in our view, substantially remedy the adverse effects, as summarised in paragraph 125, of the present restrictions while providing the necessary safeguards.

127. Subject to certain specific restraints (see paragraph 128), we would see nothing improper or harmful to the relations between the profession and the public in allowing any individual stockbroking firm to advertise to the extent and by the methods it thinks fit and without any requirement of prior approval by the Stock Exchange. Such publicity could include any of the features which are at present permitted in press advertisements. Nor would we see any objection to the firm, should it think this appropriate, drawing attention to any other features, eg the convenience of its location, its expedition in dealing with clients' affairs or the level of its charges. Further, provided the form of publicity is suitable for giving advice in detail (see paragraph 128(3) below) we see no objection to stockbroking firms recommending particular securities without restriction as to the persons to whom such advice is given. Stockbrokers who advertise under the present rules are, though in somewhat muted fashion, inviting custom, including the custom of other stockbrokers' clients. We do not think that the public will be surprised or shocked if members of the profession invite custom somewhat more explicitly and informatively. Nor, given the

appropriate restraints, do we think that such advertising will be likely to create any serious new risk of misleading the investing public or creating false markets. We would expect on the other hand that the increased freedom to advertise would be conducive to improvements in communication and relations between the public and the profession (including the wider dissemination of investment advice) and in the general efficiency of the profession, to the introduction of new methods and, possibly, to the facilitation of new entry to practice.

128. The basic rule on advertising is the Stock Exchange's rule 78(1), which is supported by an explanatory notice to members (see paragraph 96). The general effect of these is to prohibit all forms of promotional advertising and publicity, except that circulars to existing clients are uncontrolled and that press advertising is permitted subject to strict conditions and prior approval. We consider that these provisions should be terminated and replaced by a rule which, subject always to any material statutory provisions, would permit any stockbroking firm of the Stock Exchange in the United Kingdom to use, whenever it thinks fit, such methods of publicity as it thinks fit, provided that:

- (1) No advertisement, circular or other form of publicity used by a stockbroking firm should claim for that firm superiority in any respect over any or all other stockbroking firms.
- (2) Such publicity should not contain any inaccuracies.
- (3) Recommendations about particular securities should not be made in any advertisement in the press or other news media, but should be confined to circulars to specific addressees in which the reasons for making the recommendations are explained in detail.
- (4) Whenever a stockbroking firm makes recommendations about particular securities in circulars, it should make it clear that individual investors who might contemplate taking action as a result of such recommendations would need to have regard to their own particular circumstances.
- (5) While advertisements, circulars and other publicity may make clear the intention of the firm to seek custom, they should not be of a character that could reasonably be regarded as likely to bring the profession into disrepute.

129. Since we do not agree with the ways in which the stockbroking profession, through the Stock Exchange, has exercised its power to regulate advertising, we have considered whether it might be advisable that some independent representation of the public interest should be introduced to play a part in the formulation or enforcement of the advertising code of the profession. For various reasons we have reached the conclusion that this is not practicable. Provided the basic changes we regard as necessary are made in the present code, we see no need for modification of the present disciplinary arrangements within the profession. The restraints proposed in paragraph 128 should, therefore, be enforceable through the Stock Exchange's existing disciplinary processes.

130. Although we have outlined the substance of the general rule on advertising which we propose, we think that there should be consultation between the Stock Exchange and the appropriate authorities under the Fair

Trading Act before the rule is formulated in precise terms. As regards other rules which have a bearing upon advertising (see paragraph 96), we doubt whether rules prohibiting members from having an interest in concerns which advertise for stock exchange business or regulating the appearance of brokers' names in prospectuses or any separate rule on press contributions would be necessary. The consultation referred to above could cover all these matters and also the question how far the suggested general rule for stockbrokers should also be applied to those included in the registers of agents<sup>1</sup>, having regard among other things to the bearing of the Prevention of Fraud (Investments) Act 1958 upon the activities of those persons. It may also be necessary to bear in mind that the Stock Exchange's present rules on advertising apply to some stockbrokers outside the United Kingdom and to jobbers and that the services provided by such members are not covered by our reference.

131. When formulated in more precise terms, a rule such as we have outlined need be neither vague nor unenforceable. The Stock Exchange's disciplinary powers will remain intact; it will still, ultimately, be for the Council to determine whether a member has violated this or any other rule and, if necessary, to apply the appropriate penalties, which can include suspension or expulsion. The Council indeed has general powers to penalise members for 'dishonourable, disgraceful or discreditable conduct' or for acting 'in a manner detrimental to the interests of the Stock Exchange or unbecoming the character of a member'. Our recommendation is made in the expectation that the Council will accept that advertising, subject to the conditions we propose, will not henceforth be regarded as in any way improper for stockbroking member firms in the United Kingdom. It is in this expectation that we have said, in paragraph 129, that we see no need for modification of the present disciplinary arrangements.

ASHTON ROSKILL (*Chairman*)  
ROGER FALK  
MARGARET HALL  
E L RICHARDS  
S A ROBINSON  
HARRY STREET  
B S YAMEY

E L PHILLIPS (*Consultant*)

25 June 1975

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<sup>1</sup>Our reference covers 'services ordinarily provided, in the course of their professional practice by members of the Stock Exchange'. To the best of our understanding, the agents in question are not agents of stockbrokers. We do not regard the services supplied by these agents, or the advertising of such services as being within our terms of reference.