

**INTER DEALER BROKER SERVICES**

**PROPOSALS FOLLOWING JOINT  
CONSULTATION BY THE LONDON STOCK  
EXCHANGE AND THE UK DEBT MANAGEMENT  
OFFICE**

**Regulatory Development  
London Stock Exchange**

**March 1999**



## IDB SERVICES CONSULTATION

### Background

1. In June 1998 the London Stock Exchange (“LSE”) and the UK Debt Management Office (“DMO”) issued a joint consultation document, seeking the views of interested parties on the future of the Inter Dealer Broker (“IDB”) services, operated by LSE member firms. The consultation covered these services in both the UK equity market and the gilt-edged and fixed interest market.
2. This document summaries responses to that consultation, sets out proposals for IDB services in the future, and seeks answers to a number of detailed questions as to how those services should be run and regulated.

### Summary of consultation responses

3. Twenty-one responses were received (a full list of respondents is included in Annex A).
4. There was widespread agreement amongst respondents that there was no need for IDBs to be separately capitalised. Consequently, the requirement for gilt IDBs to be separately capitalised will be removed from 29 March, subject to confirmation of Stock Exchange rule changes.
5. In the equity market it was agreed that, following the introduction of the order book there was no particular demand for IDB services dedicated to market makers. The fact that the market in individual smaller companies is not supported by sufficient market makers to warrant an IDB service adds weight to this argument.
6. In the gilt market opinion was split on whether IDBs should be able to extend access to either screen information or trading opportunities to a wider audience. A number of respondents expressed the view that these were commercial decisions for the IDBs to take; they should be free to decide with whom and what business they did. Some felt that a more transparent market and a wider set of trading counterparties would improve liquidity in the market to the benefit of all.
7. Others held the opposing view and indicated that such a move could significantly reduce the attractions of being a liquidity provider with a consequent reduction in the liquidity of the market. Some respondents suggested that GEMMs’ obligations to make a two-way price to counterparties who had access to the IDB screens would need to be reviewed. Others were concerned about the credit worthiness of a potentially wider set of counterparties.

8. As a result of the responses, the Exchange has drawn up the following proposals in relation to the equity and gilt markets. The latter have been drawn up in consultation with the DMO.
9. The aim is to introduce proposals now which will be flexible enough to meet future demands, given that securities markets worldwide are changing rapidly. It is envisaged that the proposals will allow professional market participants to trade with each other in new ways, responding to a changing environment and their changing needs.

## **Proposals**

10. The Exchange proposes to retain core rules for the operation of IDB services by member firms that wish to register as IDBs. The services will continue to be covered by a revised Chapter 7 of the Stock Exchange rulebook and will fall under two categories, as described below. For the purposes of these proposals the services are referred to as Category “A” and Category “B” and the description Inter Dealer Broker (“IDB”) is used. However, the use of these terms is subject to review.
  - Category “A” – Offering an IDB service in gilt-edged securities for registered gilt-edged market makers only.
  - Category “B” – Offering IDB services in any on-Exchange security, including gilts, to a customer group of their choice, which might consist of both Exchange and non-Exchange firms. An IDB should use its own commercial judgement as to the members of its customer group.

### **Price display services**

11. In addition to registered IDB services, a number of other member firms operate price display services as broker dealers.
12. There are currently no specific rules relating to these other operations and use of these services. Under the new proposals, member firms operating such services may continue to operate them as broker dealers and such services may be available to any firm or client of the member firm’s choice. The Exchange does not currently intend to introduce any new regulatory requirements relating to these services.

### **Proposed rules**

13. The following rules will apply to both categories of IDB:
  - i) they will not be permitted to take positions;
  - ii) they must register with the Exchange;

- iii) IDB services must be segregated from the firms other activities and will have to operate under a separate member firm BIC code, although they do not have to be separate member firms; and
  - iv) they must supply the Exchange, and the DMO in the case of gilts, with a copy of their outline customer agreements and service descriptions.
14. The following rules will apply to Category “A” IDBs only and will be optional for category “B” IDBs:
- i) the name of the parties to a trade, or details of an offer to trade via the IDB, must remain anonymous, both pre and post trading;
  - ii) only GEMMs registered in a particular security may trade through the IDB;
  - iv) where the service is screen based, details of all completed trades, whether screen or voice broked, should be published on the screen.
15. It is proposed that Category “B” IDBs must supply a list of users in a customer group to all customers within that group. This is a matter for further discussion. This is not necessary for Category “A” IDBs, since the service is only available to registered market makers.
16. Orders may be either screen broked or voice broked by both categories of IDB.
17. Both Category “A” and Category “B” IDBs will be required to have customer agreements or incorporate service descriptions covering at least the following matters:
- i) whether or not the IDB will accept discretionary or indicative orders;
  - ii) how single orders and contingent orders, if appropriate, will be displayed on screen;
  - iii) the procedures in place to ensure that users do not hit their own orders;
  - iv) minimum order sizes;
  - v) order priority;
  - vi) clearing of orders; and
  - vii) partial delivery.
18. Single member firms will be able to operate both categories of IDB. Discussions are continuing on how the services might need to be segregated within the firm.

## **ANNEX A- List of respondents to consultation document**

**Bank of England  
Barclays Capital  
Cantor Fitzgerald  
Carr Sheppards  
Credit Suisse First Boston (Europe) Limited  
Deutsche Bank  
Dresdner Kleinwort Benson  
Exco WCLK Limited  
Garban Equities Limited  
HSBC Greenwell  
King & Shaxson Bond Brokers Limited  
Merril Lynch International  
Morgan Stanley Securities Limited  
Office of Fair Trading  
Phillips & Drew Fund Management Limited  
Salomon Smith Barney  
Societe Generale  
The Building Societies Association  
Tullett & Tokyo International Securities Ltd (Equity)  
Warburg Dillon Read  
Winterflood Securities Limited**

# LONDON STOCK EXCHANGE AND UK DEBT MANAGEMENT OFFICE MARKET CONSULTATION ON INTER DEALER BROKER SERVICES

## QUESTIONNAIRE - GILTS MARKET ONLY

Please tick box

1. Is there scope for a category B service in the Gilt market?
 

Yes	No
<input type="checkbox"/>	<input type="checkbox"/>
  
2. Should an individual member firm be permitted to operate both categories of service ?
 

Yes	No
<input type="checkbox"/>	<input type="checkbox"/>
  
3. If 'yes', how would these need to be Separated? (Note: They would by rule that they have to have separate trading codes)
 

same office with chinese walls	separate office
<input type="checkbox"/>	<input type="checkbox"/>
  
4. Should a category B firm have to supply a list of users to all users of a specified service?
 

Yes	No
<input type="checkbox"/>	<input type="checkbox"/>
  
5. If 'no' are there any specific types of user that should be entitled to the list above others?
 

Please specify

.....

.....

.....

.....
  
6. Should the Exchange define the type of user e.g. wholesale trader, to which a category B firm can offer its service?
 

Yes	No
<input type="checkbox"/>	<input type="checkbox"/>
  
7. If, yes, please suggest how the definition would be established?
 

.....

.....

.....

.....

8. Could market makers have access to category B services or should they be for non market makers only? Yes No
9. How should category A and Category B be Described ? Category A Yes No  
Retain IDB    
Primary Dealer Broker    
Other (specify .....  
Category B  
Retain IDB    
Wholesale Dealer Broker    
Other (specify).....
10. Could registered market makers using a category B service have obligations to other users of the same service during the mandatory quote period? Yes No
11. Should each category be able to handle orders by screen broking and/or voice broking? Category A  
Screen broking only   
Screen and Voice broking   
Voice broking for complex or contingent orders only   
Category B  
Screen broking only   
Screen and Voice broking   
Voice broking for complex or contingent orders only
12. For screen based services which transactions must be published on screen? Screen broked only   
Voice broked only   
Both
13. Can a firm act on a post trade name give up as part a category B service? Yes No  
   
Category A Category B
14. If yes, would the firm still have to intermediate as principal in those circumstances, to avoid credit exposure issues? Yes No Yes No
15. Should access to screen information be Category A Category B

given to non users of the service?

Yes No Yes No

16. Should registered Market Makers be permitted to see screens for services that they are not users of?

Yes No

17. Should there be a marker against category B orders indicating the type of users inputting the order?

tick box where you believe a marker would be appropriate or no marker.

market maker agency broker

non SE member no markers

18. Given that the Exchange cannot impose rules on non members, should the firm secure undertakings from users not to pass trading information to unauthorised staff?

Yes No

19. Can market makers make screen information available to or give direct access to proprietary trading / swaps desks, within the market maker entity?

Make information available only  
Category A Category B  
Yes No Yes No

Give direct use of the service  
Category A Category B  
Yes No Yes No

Name of Firm..... Date .....

Name of Individual..... Signature.....

Please return the completed questionnaire by 15 April 1999, either by post or fax to:

Reg Dobson  
Market Regulation  
London Stock Exchange  
London  
EC2N 1HP

**Fax 0171 920 4525**