The FSA may be no easy pushover for Nasdaq

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The watchdog has the power to say no

A conspicuous "for sale" sign is permanently on display over the UK's quoted corporate sector. I am no protectionist but this makes me uneasy on two grounds.

First, the lack of reciprocity, especially in continental Europe. Second, the danger that important utilities are being exposed to potentially destabilising ownership in highly leveraged foreign bids. These issues were raised over the bid by Ferrovial of Spain for BAA. They could now be raised again with Nasdaq's tilt at the London Stock Exchange.

To date, most of the concern expressed about the LSE has focused on the extra-territorial reach of US regulation. Yet there are grounds for questioning a Nasdaq business model that entails exceptionally high leverage in a bid that comes before the structural revolution in the European securities industry prompted by the Markets In Financial Instruments Directive (Mifid).

Project Turquoise, the proposal by leading investment banks that could throw up a trading platform to compete directly with existing stock exchanges, is a clear threat to the exchanges' profits. It could be the first of many such threats. The one certainty about Mifid is that competition will increase -- and it would be all too easy to paint a scenario where the LSE, with little cushion of profitability from clearing and settlement, might be badly hit.

The interesting question is what the Financial Services Authority feels about this because Nasdaq would have to meet its recognition requirements on a transfer of ownership. These include a requirement that a bidder for the LSE should have sufficient financial resources for the proper performance of its functions as a recognised investment exchange.

Subjective judgment enters into this, since the rules permit the FSA to have regard to "the operational and other risks to which the UK recognised body is exposed". It also looks at the capital and liquid assets of the exchange under new ownership.

Nasdaq has embarked on its bid with its eyes open in relation to Mifid. It will no doubt put a powerful case to the FSA -- and with ready access to the debt markets, the US exchange will have no difficulty finding the resources to capitalise the LSE at the level necessary to satisfy the FSA.

At the same time the FSA's instincts under Sir Callum McCarthy have been liberal -- witness Santander's takeover of Abbey. Yet it strikes me that the watchdog might nonetheless worry about a

potentially unstable ownership for what remains, for the moment, a vital part London's financial infrastructure. Whether the hedge funds that are piling into the LSE have factored this into their equation is an intriguing question.

Shareholder rights

My colleague Tony Jackson, writing in the latest issue of *Financial World*, argues that the US has had more corporate scandals than the UK because its corporate governance standards are weaker.

There is a risk that the merits of UK governance are currently being oversold. However, I think he has a point -- witness the Securities and Exchange Commission's decision to postpone the discussion billed for this week on proxy access, which is shorthand for shareholder democracy.

Most of the corporate scandals arose -- with the notable exception of Enron -- at companies where the roles of the chief executive and chairman were combined. The imperial CEOs accountability to shareholders is weak. Huge stock option grants, which provided these individuals with an increased incentive to cook the books, were not subject to a UK-style shareholder vote. Meanwhile, a new Harvard paper by Lucian Bebchuk, Yaniv Grinstein and Urs Peyer tells us that lucky grantsof backdated options were more likely when the company lacked a majority of independent directors and/or the CEO had longer tenure -- factors both associated with increased influence of the CEO on pay-setting and board decision-making.

Not all the news is bad, though. The Scott Committee on capital markets regulation last week retracted its endorsement of ballot stuffing by brokers in director elections, under pressure from its more shareholder-friendly members. And its other proposals on shareholder rights will be hard to ignore.

Nutty dividend

I commented recently on the practice of paying dividends in kindin Romania. I now discover that it goes back as far as the Dutch East India Company. In a splendid new book* Stephen Davis, Jon Lukomnik and David Pitt-Watson point out that it was prone, in the early days, to pay dividends in bags of nutmeg instead of cash. Those were the days.

**The New Capitalists: How Citizen Investors Are Reshaping The Corporate Agenda*, Harvard Business School Press.