London The International Financial Centre

The title of this conference is “Competition and Innovation within a Global Context”. That is an appropriate title for a conference, which is taking place in the heart of global business. There are a large number of statistics which indicate that firstly London is an international centre and secondly that it is the international centre of finance in the world. 481 foreign banks operate in the United Kingdom, the vast majority of those in London. That compares to 287 in the whole of the United States, 242 in Germany and only 92 in Japan. Around one-third of global foreign exchange is done daily in London, determining exchange rates across the globe.

In the insurance sector, the volume of insurance business generated in the United Kingdom is the third largest in the world, exceeded only by the United States and Japan. However, London is exceeded by the US and Japan only because of the size of their domestic market. London represents the world’s largest international insurance market and had the largest share of net premiums in the world for marine insurance and for aviation insurance.

In securities dealing there are 501 foreign companies listed in London more than on any other exchange in the world. Record turnover in foreign equities of £3trillion520billion sterling was booked at the London Stock Exchange in 2000, an increase of 45% over the previous year. Trading in the international Bond market, 70% of which is based in London, increased 7 fold over the last decade to reach $19,000billion in 1999.
Those are pure statistics and there are lots more of them to show the size and the depth of the international financial market in London. Of course, that market brings great benefits to the United Kingdom. The financial services industry directly employs 1 million people on salaries, which are above average for the United Kingdom economy. The financial services sector as a whole pays one-third of all United Kingdom corporation tax. The City of London alone accounts for between two-and-half and three percent of UK GDP.

London’s position owes much to its history of openness in terms of welcoming foreign firms and, as a result, external economies of scale, such as the mutual advantages that are gained from the concentration of financial firms in one location. That history goes back to the early 1700s when, largely as a result of war, the financial centre of Europe moved from Amsterdam to London. That was about the time the Bank of England was founded and several of the main British banks can trace their history back to that time. The open London markets have over the years encouraged both competition and innovation. Indeed there have been times in the banking industry when it was foreign banks who were making all the running in the market and even now foreign banks account for 55% of total assets in the London market with the British domestic banks accounting for 45%. The most obvious sign of the openness of the London market is the way the investment banking market is now dominated by foreign firms.

It is interesting to look at the way in which the growth of electronic markets is making redundant the reasoning for the geographical attributes of markets. Indeed that has been one of the reasons why London has gained as an
international centre. International dealers like dealing with the skilled centres of the world and electronic communication has enabled them to do that. No longer, for instance, does a centre like Riyadh or Athens need to have its own foreign exchange market because, provided that the London market is open, both those centres can deal electronically into London. Theoretically, with the advent of virtual markets with remote membership, a financial institution does not necessarily need to be based in Frankfurt, London or Paris, but in fact, the skilled financial population of London is an advantage even if its costs are relatively high. It will be interesting to see the aspirations of Euro-next, the amalgamation of the French, Belgium and Netherlands Stock Exchanges, which has recently bought the London International Financial Futures Exchange, because in theory there is no reason to have any more than one Stock Exchange in the time zone of Europe although I am sure that small regional Stock Exchanges would still exist. I fully expect Euro-next to have the aspiration of being that Stock Exchange.

The regulation of that large international market in London is extremely important, not just the words of the regulation, but the way in which it is carried out. The London market has had self regulation through a series of self regulating organisations coordinated by the Securities & Investment Board. That was all swept away with the formation of the Financial Services Authority and the move of financial supervision away from the Bank of England. That is a move that the financial services industry welcomed, because it meant a unified supervising authority. It was also inevitable that regulation would become more rule based than it was, but in becoming more rule based we must ensure that we do not lose the
advantages of the previous system which encouraged a close working relationship between supervisor and supervised. Strict rule based supervision raises costs and widens the gap between supervisor and supervised if it is not based on good common sense. Regulation is routine for financial institutions covering nearly all aspects of their businesses, but since the mid 1990s the volume and intrusiveness of regulation has risen remorselessly – in stark contrast to the benefits generated. Regulation is there to provide consumer protection and market stability, to combat money laundering and promote open and transparent markets. There have been a number of cases in the past where the market has not achieved these desirable outcomes and government regulation has been necessary to bring them about. There is, however, a balance to be struck between benefits and costs and in recent years there has been a plethora of government initiatives in addition to the work of the FSA and its predecessor regulators, creating a wall of new proposals and regulation. Banks are deeply concerned at the volume of government initiatives to micro regulate the key features of many financial products. The amount of this regulation, the lack of co-ordination, the costs, and above all direct intervention to fix prices and supply are potentially damaging to customers and markets alike. This concern is beginning to transmit itself to international banks working here in London, which can see the way in which government, through the Financial Services Authority, and through other investigations, such as that conducted by Cruickshank, is trying to increase its hold on an important strategic industry.

Last week I was talking to a small group of City Executives who have broken away to form their own financial services advisory company. The FSA’s guidelines on regulation now runs to 4,000 pages. It is difficult for a
small group to cope with that and we have to be careful that regulation does not actually drive away business.

In Europe as a whole we must create an open market, properly regulated, that actually encourages business. In the majority of countries in the European Union, and certainly in the single currency area, different regulators are handling different parts of the financial service business but more importantly different member states have different regulatory systems and different cultures of regulation. The first thing to do is to actually recognise the differences that exist. There are currently numerous regulatory and other impediments to the creation of a genuine single financial services market and it is difficult, sometimes impossible, to develop standard, Pan European products and services. The European Central Bank has control of liquidity but supervision rests with national authorities. The first step is to encourage national regimes to move to a consolidated domestic regulator and then subsequently to have a common regulatory approach throughout Europe which will ultimately result in one regulator.

In that context the current World Trade Organisation talks are important to Europe just as they are to the developing world. Some people may think the WTO negotiations are all about agriculture and textiles, but actually the largest sector under negotiation is services. It just happens to be the sector on which there is most agreement so it does not hit the headlines. 67% of GDP in the United Kingdom is represented by services. In France it is 71%. In most European countries it is between 65% and 70%. Even in the developing world the service sector is now the largest sector in most developing countries and in the majority of developing countries is over
50% of GDP. Incidentally, that compares in Europe with agriculture, which gets a huge amount of attention, but is only 2% of GDP. There is one basic difference between service industries and agriculture. Agriculture is better organised and controls more votes. Service industries do not make their voice heard although they are the most important sector in the economy. It is important that our European negotiators and European politicians recognise that Europe is the largest exporter of services in the world accounting for 26% of total global services transactions and for more than 40% in terms of balance of payments. The EU is also the largest investor in services worldwide and accounts for 60% of foreign direct investment in services. Nevertheless, there are plenty of examples in the European Union where protectionism is alive and well just as there are in other developed economies of the world and I am not just talking about agriculture.

London, and Europe, will only flourish in the financial market if there is sensible regulation, which encourages transparency, fairness and competition and if legislation encourages an open liberalised market. Although London is the leading financial centre in Europe and is the leading international financial centre in the world, it will be permanently in competition with other centres and the main competition is almost bound to come from the United States. This is not a competition in which European centres are slugging it out; it is a competition in which world centres are slugging it out and in theory, at least, electronic global trading needs only one main centre in the world. Of course, I am biased and I hope that will continue to be London.