Big Bang 20 years on

New challenges facing the financial services sector

COLLECTED ESSAYS

WITH A FOREWORD BY NIGEL LAWSON

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FOREWORD

NIGEL LAWSON

THE 20TH ANNIVERSARY of the radical reform of the London Stock Exchange that came to be known as 'Big Bang' thoroughly deserves the thoughtful celebration this collection of essays provides. Without that reform, it is doubtful if London would have retained its place as Europe's pre-eminent financial centre, and certain that it would not have become the foremost truly international financial centre of the modern globalised economy that it is today, to the great benefit of the British economy as a whole.

As I well recall, the story began shortly before the advent of the Thatcher Government in 1979, when the Office of Fair Trading decided to launch an investigation into the restrictive practices of the London Stock Exchange, in particular the system of fixed minimum commissions. The extremely able Chairman of the LSE, Nicholas Goodison, fearful both of the cost of a long drawn-out investigation and subsequent case before the Restrictive Practices Court, and of the nature of the remedies that might be imposed once the case was lost, as it was bound to be, asked the new Government to call off the OFT in return for a promise that the Stock Exchange would reform itself.

Whatever the practical merits of this proposal, which had the backing of the Bank of England, it was hardly a politically attractive one, and the Government refused to play ball. Four years later, in June 1983, we were returned with an increased majority, and I became Chancellor and Cecil Parkinson Trade and Industry

Secretary. By that time, the matter had become more urgent, with the first hearing of the OFT's action against the stock exchange scheduled for January 1984. Cecil and I concluded that, provided the reform promised by Goodison was genuine and adequate, we should – at this eleventh hour – reverse our previous position and accept his proposal. At a difficult meeting in her room in the House of Commons, and against considerable opposition, notably from Willie Whitelaw, we were able to persuade an apprehensive Margaret Thatcher to go along with this.

For my own part, I had come to know the old, clubby, City pretty well, as a City journalist from 1956 to 1963 – first on the *Financial Times* and then as city editor of the *Sunday Telegraph* – well before I entered politics. I had come to respect its achievements, its expertise, and its generally high standard of integrity, and to warm to the value of what has nowadays come to be known as fraternity which it notably embodied.

The problem, as I saw it, was not merely the restrictive practices themselves: in addition to fixed minimum commissions, these included the 'single capacity' rule, which enforced a separation between brokers acting as agents for their clients on commission and jobbers who made the markets and theoretically provided liquidity by holding lines of stocks and shares on their books; the requirement that both brokers and jobbers should be independent and not part of any wider financial group; and the exclusion of all foreigners from stock exchange membership. The problem was that these restrictions in practice ensured that the stock exchange was woefully under-capitalised. As a result, while the City remained one of the world leaders, if not *the* world leader, across a whole range of financial markets, such as the foreign exchange market, in the securities market it was in danger of becoming a backwater. And there was no way in which London could remain a world-class financial centre without a world-class securities business. So the sooner genuine reform came, the better.

Once the decision had been made and announced, to predictable outrage from the Labour Party, the question arose as to whether the various reforms required should be phased in over a reasonable period or whether everything should happen at once, on a single day. This became known internally as the choice between the gradualist and the big bang approaches. Goodison felt that it was only by introducing all the changes in full overnight that he could be confident of securing his members' agreement – which was essential. The Government concurred, and the chosen date was 27 October 1986 – subsequently to become known more widely as 'Big Bang', a name which was then attached to the package of reforms itself and to the far-reaching changes which these reforms set in train.

Twenty years on, it is clear that the reforms triumphantly succeeded in achieving their objective, although not without setbacks along the way. The first such setback caused great *angst* at the time, but in practice has proved to be of little importance. The Bank of England went to great lengths to encourage mergers between brokers, jobbers, UK investment banks and commercial banks, in order to ensure a fair number of substantial British-owned players in the new London marketplace. For one reason or another, it did not prove particularly successful, and Wimbledonisation has ensued.

The second setback threatened to become much more serious. The old Stock Exchange regulated itself; but it was clear that, following Big Bang, the case for a new and improved statutory regulatory framework, covering all aspects of the savings and investment industry, could no longer be gainsaid. The Government sought the advice of Professor Gower, whose report on investor protection was published in January 1984. The Professor wisely observed that the level of supervision should not "seek to achieve the impossible task of protecting fools from their own folly", but should rather "be no greater than is necessary to protect reasonable people from being made fools of" – a rubric

that is too often overlooked. He also recommended that practitioners should play a large part in devising the detailed regulations required.

Greatly influenced by the Gower Report, the Government duly brought into being the 1986 Financial Services Act, and all the agencies set up under that Act. But the regulatory system that emerged was far more cumbersome and bureaucratic than any of us in government had envisaged. Paradoxically, the involvement of practitioners in the regulatory process, which was intended to avoid this, probably exacerbated it. Not only do poachers frequently make over-zealous gamekeepers, but Adam Smith's celebrated observation that "people of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices" is relevant here. In general, transparency is always preferable to regulation as a means of protecting the public; but transparency is not always the first choice of the practitioners.

Changes since 1986 – not least in the regulatory personnel – have improved the system, but in a number of areas regulation remains excessive, and in some it is arguably getting worse. As a number of contributors to this volume point out, regulation with a light touch is essential to London's continuing pre-eminence as an international financial centre. The danger comes not only from the natural tendency of any bureaucratic system to proliferate, but also – and more specifically – from overseas, whether it is the migration of the damaging Sarbanes-Oxley rules as a result of growing US ownership of the London Stock Exchange, or the European Commission's desire to increase EU competence in this area, leading to a single EU regulator. Both these threats need resolutely to be resisted. So far as Europe is concerned, it is not sufficiently recognised that healthy competition in regulatory systems is as beneficial as it is elsewhere.

Another threat to London identified by a number of contributors to this volume is the level and complexity of taxation. Over the past ten years both the burden and the complexity have greatly increased – the latter mind-bogglingly so. This process badly needs to be reversed.

It is far less difficult to maintain pre-eminence than it is to achieve it. There is no reason why London should not remain the world's premier truly international financial centre. But the overriding characteristic of the global economy in which we now live and work is that it is unforgivingly competitive, and with the emergence of the new economic giants of the East set to become increasingly so. It is Britain's good fortune that its most successful industry is one of the fastest growing on the planet. But it is also one of the most mobile. We need to learn the lessons of the past 20 years since Big Bang and, while celebrating a notable British success, take care not to take it for granted.

Nigel Lawson
October 2006

ONE

THE CHALLENGES AHEAD

MICHAEL SNYDER*

Synopsis: The City of London is a global powerhouse, and a vital asset to the British and European economies. The reforms of Big Bang played a key part in bringing this about. However, the challenges which will face UK based financial services over the coming years must be confronted. These include ensuring a competitive and business-friendly tax and regulatory system; providing high quality infrastructure (which entails greatly improving the transport network and supporting Crossrail in particular); and making available a labour force with the right skills. If these and other challenges are met, globalisation is not a threat but a great opportunity for both the City and the country as a whole.

HAVING WORKED IN THE SQUARE MILE since the late 1960s, I have witnessed the City environment both pre- and post-Big Bang. It is no exaggeration to say that Big Bang marked the beginning of the modern City.

On 27 October 1986, a series of reforms swept through the London Stock Exchange – banks, brokers and jobbers merged; trading moved off the market floor; and new measures were brought in to oversee a thoroughly modernised industry. Deregulation allowed UK commercial or retail banks to become

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involved in the City markets. The removal of restrictions on membership also allowed the entry of the most innovative firms and practices from around the globe, and from the late 1980s, the City became home to the major players in the international financial markets.

There were many who thought Big Bang would spell disaster. But, two decades on, no one would now claim that it was a mistake. It worked. Big Bang was truly momentous for the Square Mile.

Over the past 20 years, the City of London has flourished, and today – in no small part due to the reforms of Big Bang – it is firmly positioned as the world's leading international financial and business centre. The City of London Corporation, including the Lord Mayor, as our Ambassador for UK Financial Services, works tirelessly to ensure that this remains the case.

Today, firms from all over the world are attracted to London by the presence of the full range of financial and professional services. Everything global financiers need to do business is to be found on their doorstep. It is this range of business, and its high concentration into such a small area, which makes the Square Mile unique, and which puts it ahead of financial rivals such as New York and Tokyo. Our markets are innovative, competitive and highly liquid, and this brings the City great success in a wide range of international financial markets.

The City is a success story. But we must always look to the future – and the Square Mile's continued prosperity affects us all. While the City's reach is truly global in nature, it is of course extremely important to the UK economy. In 2004, financial and professional business services made a net contribution to the UK's current account of £19 billion – a significant amount of which was generated within the Square Mile. Furthermore, as Europe's financial capital, the City is also vital to its neighbours. It is estimated that without London, around 100,000 financial services jobs would be lost across the EU.

For these reasons and more, we can never be complacent about London's position. Other cities would love to steal our crown as the global leader in financial services. New challenges and demands are constantly arising which must be faced to ensure that the City stays competitive. It is a much-used analogy, but we must not kill the goose that lays the UK's and Europe's financial golden eggs.

Over the next 20 years or so, three major issues will deserve our particular attention: tax and regulation; infrastructure; and the availability of a labour force with the right skills.

Tax and regulation

In a global economy, it is easy for financial services firms to relocate. For this reason, both the tax and regulatory environment must remain attractive, so that businesses do not move out to competing financial centres – to the fiscal detriment of London, and indeed the UK and EU as a whole.

On taxation, politicians must be ever-mindful of the direct and serious impact that tax issues have on London's ability to compete, to attract investment and to create new jobs. While the Government has acknowledged the need to cut red tape for business – and this is most welcome – the sheer magnitude and complexity of the current UK tax system remains difficult and costly to navigate for businesses. Alternative approaches must be sought for those aspects of the current tax system which are most damaging to the UK as a competitive business location; these include, for example, the negative consequences of driving non-domiciled residents overseas, and the effects of stamp duty on share transactions.

More needs to be done to make our tax regime clearer and simpler. This would make is easier for businesses to administer, and ultimately, easier for them to compete in the global economy. We cannot afford for our long-held competitive advantage on tax to be eroded.

On regulation, nothing must be done to risk our light-touch, risk-based regulatory regime. London's regulatory framework for its financial markets is widely regarded as the best in the world and it has been emulated by other advanced economies. To date we have avoided, and indeed gained competitive advantage from, the over-prescriptive US Sarbanes-Oxley Act and its resultant manifestations. Such pitfalls, or knee-jerk reactions, must be avoided at all costs. One of the chief attractions of doing business in London has always been that it is well-regulated, but not over-regulated. It is vital that this remains the case.

The leadership of our regulator, the FSA is vital. The fact that its current Chairman Sir Callum McCarthy, was previously a practitioner is important. He has the right experience on which to form judgments on what regulation we need and what is unnecessary and harmful. But there is always the challenge to keep everyone, in any organisation, in tune with the top. This is why the current review of the performance, efficiency and value for money of the FSA is so vital.

Of course, with regulation, we are not just dealing with a national framework. Currently, the majority of measures emanate from Brussels, and the legislative power of the European Union is one of the key backdrops to all areas of City business. Given the accelerating pace of change in the EU financial services sector, the City Corporation devotes substantial resources to EU issues, at a political and operational level. As well as European officers based in London, we also have a City Office in Brussels which represents UK-based financial services, and acts as our "early warning radar".

At present, we are seeking to ensure that the EU's Financial Services Action Plan is properly implemented and enforced, but more broadly, that all future EU legislation is proportionate, and adopted under the better regulation approach. This means improved consultation; the use of cost-benefit analysis; and regulatory impact assessments, at the earliest stage of policy development. Then, once EU legislation has been passed, its

transposition into domestic law must take place in the most cost-effective manner possible. In the past, EU regulations have been implemented in drastically different ways in the various member states, and the UK has stood accused by business of 'gold-plating' regulations. This is being addressed, but we must remain on our guard.

Business has no problem with complying with the law, but it does have a problem if it is made to comply more rigidly than its competitors. There must be a level playing field.

We will also continue to oppose any move towards the centralisation of regulation at an EU level, and the creation of a single European regulator. A 'super-regulator' would be too distant from the markets, and with the need to deal with 25 different legal systems, it would have a near impossible job. Fortunately such a move is not currently on the agenda, and we hope this will remain the case for the foreseeable future.

Infrastructure

The second big issue for the City's future success is infrastructure. This covers all manner of things, from telecommunications to high-quality office accommodation and perhaps most vitally, transport.

Over 90% of the City's 320,000 workers use public transport to travel to and from the office. They should be entitled to expect a comfortable journey. However, the frequent transport delays they face due to lack of capacity and the unreliability of the system is conservatively estimated to cost £230 million a year. This is equivalent to about £1 million per business day for the City as a whole. This is unacceptable and unsustainable.

No surprise then that transport is consistently identified by City business leaders as their greatest concern, and a major threat to London's competitive position. Urgent action is required. Improvements to the existing network must continue apace, along with progress on vital new projects such as Crossrail.

We are delighted that the Crossrail Bill is progressing well through the House of Commons, and at the time of writing is in Committee. The City of London Corporation has already appeared before the Committee to confirm our long-standing support for the scheme. Finding the money for Crossrail has been a major stumbling block for some time, and government, business and commuters all have a part to play in the solution.

A combination of monies from the Department for Transport; a precept of the non-domestic business rate; and revenues from fares ought to be enough to see Crossrail through to completion. The City – and in fact the whole of London – needs Crossrail. It is the only project available for the significant, or 'step change', increase in capacity that is required, particularly for the regeneration of the Thames Gateway. It is *long* overdue.

The skilled labour force

The third key issue is the maintenance of a labour force with the right skills. At present, one of London's attractions as a destination for major firms is its highly skilled workforce. We must continue to foster this environment, and to raise the aspirations of more and more school and college leavers to wish to work in the Square Mile.

This has been one of my key priorities as Chairman of Policy, as part of our important work to look beyond the City boundaries and to be a good neighbour to our surrounding boroughs. We have been involved in a number of initiatives, over many years, which encourage City firms to look to local communities to meet their recruitment needs – for example the Business Traineeship Scheme. This scheme brings together school and college leavers with an interest in City employment – including finance, ICT, insurance and administration – with City firms seeking their services. The scheme organises short-term work placements, with the aim of encouraging trainees to seek employment in the City in

the future. This mutually beneficial scheme has now been running for over ten years. Long may it continue.

Our work to improve skills, also extends into the education sector. The City of London Corporation is responsible for some of the best performing independent schools in the country and, over the last few years, we have extended our education activity into the state sector. We are one of only a handful of local government bodies to be involved in Academy sponsorship. We are the sole sponsor of the City of London Academy in Southwark, which specialises in business and enterprise, and we have now agreed to sponsor jointly new Academies in both Islington and Hackney with the City University and KPMG respectively. By assisting in the provision of Academies, we hope to help raise standards of education and improve the skills of Londoners. This is good for individuals and communities, and of course for business. We must not allow ourselves to lag behind in the global educational league tables.

Security

These three key issues – of tax and regulation; infrastructure; and skills – will not be our only issues of concern over the coming years. Issues also featuring highly on our agenda include security and the challenges of globalisation.

Security has been a high priority in the City for many years, and will remain so. As a major centre of global finance, the Square Mile has become a particular target, and while every effort is made to prevent and detect terrorism, the City came under attack with bombs detonated at Bishopsgate and St Mary Axe in the early 1990s; and more recently on 7 July 2005, with one of the suicide bombs exploding at Aldgate. In August 2006, the issue of security has once again been uppermost in our minds, with the successfully foiled attempts to bomb passenger planes.

As the local Police Authority for the Square Mile, security is high on our agenda – as it is on the agendas of City firms.

In 2003, we took the significant step of levying a premium on the national business rate, to pay for extra security measures. Among other things, this has allowed a substantial number of new police officers to be recruited, and for an extension of the 'ring of steel' which has brought tens of thousands of staff and hundreds of businesses into the zone patrolled by the City Police.

The new funds available have also allowed the City Police to work even more closely with firms to help them with their emergency planning activities. One very successful example of this is Project Griffin, which was launched jointly with the Metropolitan Police in 2004.

Project Griffin trains security officers from firms in the City, and also from Westminster and Canary Wharf so that these staff are better equipped to be able to work alongside police officers, for example on cordon control, in the event of a major incident. This initiative has been so successful that it is now being rolled out across the country. It has also generated interest overseas, particularly in the US.

Of course, the City is affected by what goes on around it, so we are also closely integrated with many other pan-London emergency planning activities. We work in close partnership with the Metropolitan Police – Project Griffin is just one example. This is a partnership that can and should be developed further. However, both we, and more importantly City businesses, believe that the City's interests are best served by the City Police remaining as a specialist Force for a special and unique area. With its expertise in security and civil protection, and combating economic and financial crime, the City Police is a key factor in keeping international business confidence in the City. Over the coming years, we will endeavour to maintain and improve still further our excellent service, and to retain the City Police as an independent force.

The challenges of globalisation

Along with security, the subject of globalisation continues to provoke much debate. While many feared that global integration would undermine London's historic position as a world financial centre, in fact the opposite is true. The City remains the most international of all the world's financial and business centres, where our truly open market places show the success globalisation can bring. To us, globalisation is not a threat. Rather, it is a great opportunity.

The City is internationally-owned; internationally-managed; and internationally-staffed. It depends on international business, and on talented individuals from around the world. This is why we are reaching out, in particular to China and India, with their vast populations and potential for growth. We now have City of London representation in Beijing, Shanghai and Shenzhen, and plans for similar representation in Mumbai are progressing.

In today's world, we need to face outward to gain inward investment and prosperity. This is why the role of my colleague, the Lord Mayor of the City of London, is so important. As Ambassador for UK-based financial services, the Lord Mayor travels more than 80 days a year, criss-crossing the globe, accompanied by strong business delegations. His visits aim to develop business opportunities for UK companies, by enthusing those he meets with the potential of investing in Britain. Managed well, globalisation can work in our favour, and the Lord Mayor's promotional work is absolutely key.

The City of London is a global powerhouse, and a vital asset to the British and European economies – and the reforms of Big Bang played a key part in bringing this about.

However, we must continue to look to the future, and be bold enough to confront the challenges that will face UK-based financial services over the coming years. The City of London Corporation is dedicated to tackling these challenges in partnership with the business community, with other London

Boroughs, and with politicians both on the national and European stages. By working together, we can complement each other's activities, as we seek to encourage investment and business growth prospects, as well as tackling legislative, regulatory or fiscal challenges to the competitive environment. We will take every opportunity to ensure that UK based financial services continue to flourish – as they have done ever since Big Bang – and that the City continues to thrive as the world's leading international financial and business centre, and Europe's financial capital.

TWO

THE IMPORTANCE OF THE CITY OF LONDON TO THE UK ECONOMY

DOUGLAS McWILLIAMS AND JONATHAN SAID*

Synopsis: The City of London is the single most important element in the UK economy, contributing disproportionately to exports, GDP and productivity and – through its fiscal contribution – to financing a substantial proportion of UK public sector activity.

Key facts about the City economy

- 702,000 jobs in London – 18% of the total – exist as a result of London's ability to act as an internationally competitive business 'cluster'.
- Direct employment in 'City-type' financial jobs in London is lower than this, although still substantial, at 325,000 in early 2006.
- Demand from other countries in the European Union supports 22% of London's City-type activity, or 72,000 jobs. The ten countries that joined the European Union in May 2004 are responsible for supporting just 2,500 City-type jobs in London. As these economies mature, their international

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financial services are forecast to grow extremely rapidly, reaching 20 times their size in 2004 by 2010.

- London's output share, of £40 billion per year, is equivalent to 41% of all City-type financial services activity in the European Union.
- If London ceased being an international financial centre, it is estimated that UK GDP would be £20 billion lower – a reduction of 1.8%
- If London ceased being an international financial centre, it is estimated that the UK would lose 188,000 jobs
- The costs of financial services would rise by an estimated 16% in Europe if London were to cease being an international centre. Multinational firms would be likely to transfer operations to New York or Tokyo.
- London has a dominant international market share in six out of the eight major international financial product areas, including foreign exchange, cross-border bank lending, foreign equities and marine and aviation insurance.
- London's share of world hedge fund assets under management is forecast to grow from 14% in 2004 to 20% by 2010. In addition, London's over-the-counter derivatives activity is projected roughly to double by 2008.
- City-type activities in the UK are forecast to grow by 5.1% a year between now and 2015.

The London economy compared to the rest of the UK

The greatest differences in the economic structures of London and the United Kingdom lie in the shares of output accounted for by utilities, manufacturing, finance and business services. 40% of the capital's gross value added (GVA) is accounted for by finance and business services compared to 24% for the country as a whole. By contrast, utilities and manufacturing account for just 17% of the capital's GVA but 36.5% of the UK's.[1]

Regional accounts data from the Office for National Statistics showed that 'financial intermediation' accounted for 11.2% of London's GDP in 2001. For the UK, the sector contributed just 4.8% of national income[2]. Similarly, financial services' jobs accounted for 5.6% of London employment in 2003,[3] compared to an average of 3.2% for the UK.

Through the mid- to late-1990s, London's economy outperformed other regions of the UK. However, in the early years of this millennium, manufacturing and financial services struggled throughout the country while consumer spending was rampant; the structure of London's economy meant that the capital experienced unbalanced and relatively slow growth, so that other regions of the UK started to close the gap.

This sectoral imbalance eased in the first few years of this decade: the dotcom bubble burst slowing the finance sector, the manufacturing sector restructured itself and government spending boosted consumer spending. However since then, the financial and business services sector in London has outgrown the rest of the economy, tipping London to becoming more of a services specialist centred around the financial markets. This sector's buoyancy has in turn spurred the housing market and consumer spending in the capital. To a certain extent, it has also supported the manufacturing

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1 Office for National Statistics; **cebr,** *London Business Services Jobs Briefing,* October 2004.

2 *Blue Book 2004,* Table 2.3.

3 *Annual Business Inquiry*, National Statistics, 2003

sector with high-tech industries such as pharmaceuticals benefiting from London's global status. London's prospects for the next few years are positive, as it continues to benefit from being a world leader in the provision of finance and business services. This degree of specialisation makes it more vulnerable to possible downturns in the global economy and the financial markets — although these are likely to be undone nearly as quickly as they are caused.

London cluster activities

'London cluster activities' are classified as those which exist and are concentrated in London; and whose level of specialisation and scale are not matched elsewhere in the UK, if not elsewhere in Europe or the world.

These activities are typically higher value and highly specialised, and have located in London to benefit from the synergies which result from close proximity to customers, suppliers, employees and competitors. Customers tend to be organisations rather than individuals, markets are national or global, rather than local, and the scale of individual and total transactions is considerably larger, permitting greater employee specialisation.

The definition of London cluster activities requires some judgement but includes, for example, investment banking, maritime and aviation insurance, fund management and wholesale foreign exchange trading. It also covers central government, the headquarters operations of large corporate organisations and the higher value specialist business services that provide for central government, corporate headquarters and the finance sector.

Much of London's economy would continue regardless of the existence of London's specific clusters. These are classified as 'non-London clusters'. They are characteristically domestic, retail and lower in value. These activities are located in London to serve local markets rather than to benefit from the presence of specialist business clusters. While some of these businesses will benefit from

London's specialist clusters, they will be organisations that could locate close to any cluster throughout the UK — they are not linked to London's specialist activities *per se*.

	Examples of Non-London cluster activities	**Examples of London Cluster activities – or dependent on the London Cluster**
Finance	High street banking	City-type financial intermediation incl. commercial banking, international banking, specialist private & corporate banking, London branch operations of foreign banks, activities in foreign exchange, securities, commodities, derivatives markets, fund management, corporate finance
Insurance	High street/retail insurance	Commercial insurance, specialist insurance
Maritime	Port of London activities, water transport activities	Ship owners, charterers and cargo interests, ship brokers, maritime governance and regulation
Corporate headquarters		Corporate headquarters, centralised functions and functions dealing with the City
Public services	Local health and education	Central banking and financial regulation incl. Bank of England, FSA and other London cluster central government and policy activity
Higher value services*	Local services, found dispersed throughout country	London cluster business services serving above activities
Lower value services†	Local services, found dispersed throughout country	Lower value business services serving above activities
Other	Local activity, not serving or part of the London cluster	

* For example, accountancy, law, marketing, PR, Trade bodies etc.

† For example, cleaning, office supplies etc.

Having differentiated between London cluster and non-London cluster, the London cluster activities can be further divided into 'City-type' and the remainder, 'non-City-type'.

City-type activities are those of the London cluster that are typical of the City of London — including international and wholesale finance, insurance and maritime support. In some cases the distinction between what is 'City-type' and what is not is obvious: for example, a foreign exchange trader in London is clearly involved in 'City-type' activity, whereas a *bureau de change*, even if based in the City, is not. The distinction is less clear for other activities; for example, many accountants in the City are involved in 'City-type' activities while others, even those based in the City, are not.

Sizing the London cluster

London's jobs can be classified in four ways, according to:

- **Their location within London**: City of London; Westminster; Tower Hamlets; or elsewhere
- **Business sector**: finance; insurance; maritime services; corporate headquarters; public services; higher value business services (e.g. accountancy, IT, HR, law); lower value business services (e.g. cleaning, office supplies); and other activities
- whether or not they are part of the **London cluster activities** (or dependent upon them)
- whether or not they are **City-type activities**

Our calculations, using the ABI but adjusting for measurement problems with the official data, show that:[4]

- 702,000 jobs in London – 18% of the total – exist as a result of London's ability to act as an internationally competitive business 'cluster'.

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[4] See the Appendix for an explanation of the technical issues in enumerating employment levels.

- Direct employment in 'City-type' financial jobs in London is lower than this, although still substantial, at 317,000 in 2003.
- 'City-type' jobs in London saw a 1% increase in 2003. This followed two years of decline from the peak in the annual average number of jobs that was seen in 2000.

Employment by category in London by location, 2003

	Non-cluster		Cluster or dependent on cluster	
Finance	City:	1,800	City:	109,510
	Tower Hamlets:	3,070	Tower Hamlets:	29,780
	Westminster:	3,980	Westminster:	27,760
	Other London:	51,210	Other London:	29,090
Insurance	City:	3,880	City:	34,930
	Tower Hamlets:	2,610	Tower Hamlets:	2,610
	Westminster:	2,150	Westminster:	320
	Other London:	25,440	Other London:	4,450
Maritime	City:	0	City:	560
	Tower Hamlets:	60	Tower Hamlets:	520
	Westminster:	160	Westminster:	1,470
	Other London:	7,640	Other London:	5,110
Corporate HQs			City:	13,010
			Tower Hamlets:	8,000
			Westminster:	52,800
			Other London:	45,170
Public services	City:	7,790	City:	6,230
	Tower Hamlets:	18,760	Tower Hamlets:	5,150
	Westminster:	45,420	Westminster:	42,760
	Other London:	564,900	Other London:	85,390
Higher value business services	City:	18,890	City:	63,060
	Tower Hamlets:	6,510	Tower Hamlets:	4,920
	Westminster:	58,220	Westminster:	41,470
	Other London:	272,110	Other London:	35,440
Lower value businesses	City:	3,380	City:	10,930
	Tower Hamlets:	9,600	Tower Hamlets:	6,160
	Westminster:	23,450	Westminster:	12,730
	Other London:	253,670	Other London:	22,230
Other	City:	75,590		
	Tower Hamlets:	57,960		
	Westminster:	238,470		
	Other London:	1,533,140		

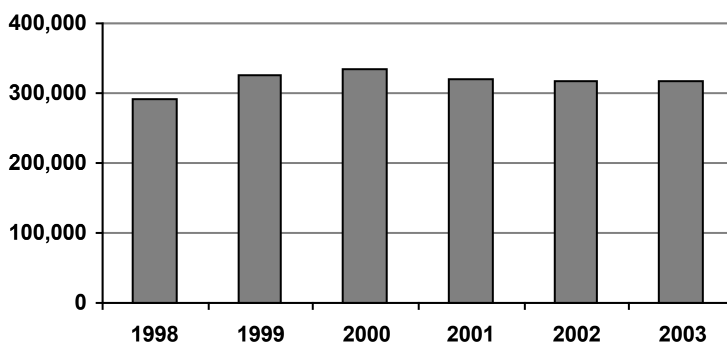
Source: cebr calculations using ABI data.

Employment in London by category, 2003

	Non cluster		Cluster – or dependent on cluster	
	Number	**Share of London Employment (%)**	**Number**	**Share of London Employment (%)**
Finance	60,050	2	196,140	5
Insurance	34,070	1	42,300	1
Maritime	7,870	0	7,660	0
Corporate HQs			118,980	3
Public services	636,870	16	139,530	3
High value services	355,730	9	144,870	4
Low value services	290,090	7	52,050	1
Other	1,905,150	48	0	0
Totals	**3,289,820**	**82**	**701,520**	**18**

Source: cebr calculations using ABI data

cebr estimates of London's 'City-type' jobs for each year from 1998 to 2003 inclusive, thousands



Source: cebr calculations

Summary of 'City-type' employment, 2003

	City-type employment by area		City-type employment totals
Finance	City:	138,500	238,700
	Tower Hamlets:	32,350	
	Westminster:	34,180	
	Other London	33,630	
Insurance	City:	44,180	52,500
	Tower Hamlets:	2,830	
	Westminster:	390	
	Other London:	5,140	
Maritime	City:	710	9,000
	Tower Hamlets:	570	
	Westminster:	1,810	
	Other London:	5,900	
Public services	City:	2,150	4,400
	Tower Hamlets:	2,250	
	Westminster:	0	
	Other London:	0	
High value business services	City:	10,280	13,100
	Tower Hamlets:	260	
	Westminster:	1,580	
	Other London:	940	
Total 2003			**317,700**
Total 2004 Estimate*			**318,650**
Total 2005 Estimate*			**325,980**

Source: cebr calculations using ABI data

* Calculated using annual growth rates from cebr's *Quarterly Business Forecasts, London*

The above estimates of London cluster employment are as reliable as it is possible to be.[5] However, it should be recognised that existing official statistics when sectioning on the capital's economy are weak. In particular, the current *Standard Industrial Classification* fails to identify properly the different business activities that occur in the London cluster.

[5] See the Appendix for comparisons with other available employment estimates.

Comparison of trends

The trend over time in estimates for total employment in London, London cluster jobs and City-type jobs against other information sources can also be estimated.

The transport authorities provide a consistent source of trend information. According to TfL, Central London arrivals in the morning peak three hours have fluctuated around the one million mark for several years.[6] A peak was reached in 2000, with over 1.1 million arrivals. Since then, a period of accelerating decline occurred until 2003 – the last year for which we have data. Arrivals fell by 1.4 per cent in 2001, by 2.3% in 2002 and by 3.7% in 2003.

Comparison of central London arrivals data and employment data, millions

Source: *Annual Business Inquiry* and Transport for London

The ABI data shows a similar peak in 2000, although the profile of employment decline is different; the decline in employment since 2000 has decelerated, rather than accelerated. The largest fall in jobs was between 2000 and 2001 while the largest fall in central London arrivals was between 2002 and 2003.

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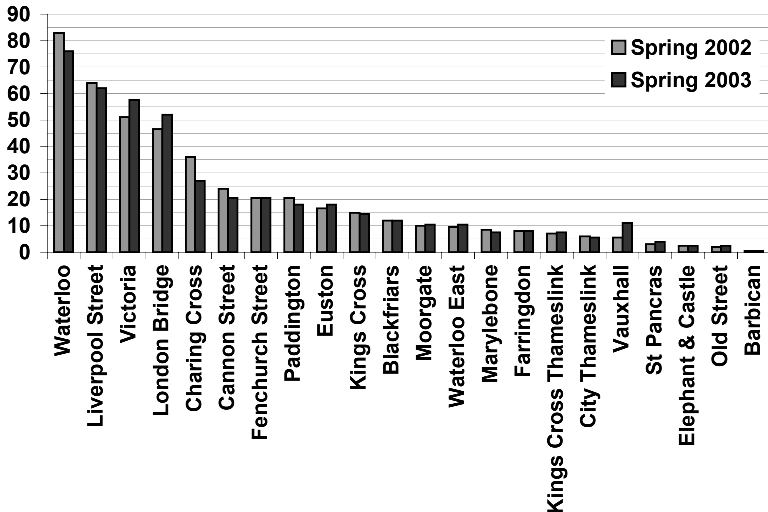
6 Transport for London, *London Travel Section 2004,* 2004

cebr estimates again follow the same trend. The absolute number lies between ABI estimates and numbers from transport data, as would be expected.

Arrivals at London mainline rail stations fell 0.8% between the cordon counts conducted in Spring 2002 and Spring 2003, exactly matching the decline in employment in the City of London and Westminster measured by the ABI data. The largest falls were at Waterloo and Charing Cross stations. However, it has historically been the case that rail passenger volumes are highly geared to central London employment. Econometric studies have shown that if central London employment increases by 10%, rail passenger numbers increase by 13% – due to restricted parking, new employees are more likely to catch the train and rail's mode share increases. The fall in rail arrivals is therefore likely to be larger than the fall in employment.

Arrivals at central London rail termini between 0700 and 0959 AM, thousands



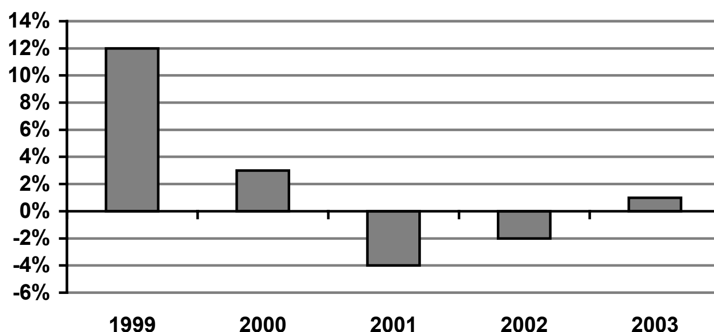
Source: Strategic Rail Authority cordon count surveys, Spring 2002 and Spring 2003

Those stations which directly serve the City of London without interchange — namely Liverpool Street, London Bridge, Cannon Street, Fenchurch, Blackfriars, Moorgate, City Thameslink, Old Street and Barbican – show a negligible change in arrivals. In both 2002 and 2003, 186,000 people alighted at these stations in the morning peak. Employment in the City of London fell by under 0.1% during the same period according to the ABI.

Between 2002 and 2003 the number of AM peak trips to the Isle of Dogs (including the Canary Wharf estate) rose by 5,000 to 53,000.[7] This compares with estimated employment of 73,000 in 2003 and a period of strong growth in jobs.

The ONS data from *Employee jobs estimates* show employment levels in the 'financial intermediation' categories. These can be compared to the trends in the above estimates. The first chart illustrates the year on year growth in cebr estimates for City-type employment throughout London. The second shows year on year growth for London as a whole in the ONS categories which are closest to City-type employment — 'financial intermediation' and 'pensions and insurance' categories.

Year on year growth in London's 'City-type' employment



Source: cebr calculations

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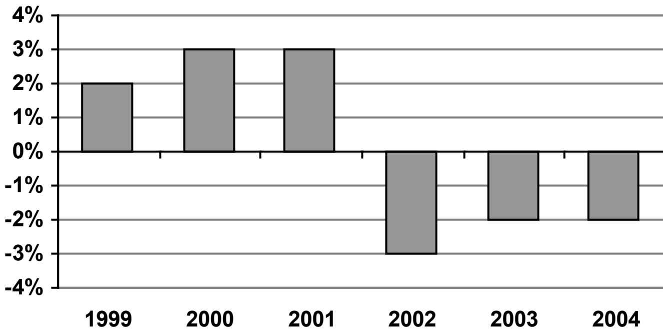
[7] Transport for London, *London Travel Section 2004,* 2004

A comparison of cebr results with the ONS data shows a similar trend exists, although timings differ somewhat. Both estimates show growth from 1998 into 1999, growth of approximately 2% in 2000. According to the ONS' *employee jobs estimates*, employment in London's financial sector continued to grow in 2001, while cebr estimates a slight fall. The two estimates seem to follow a similar trend but the ONS data lags cebr estimates. This may be explained by our adjustment for employment through agencies which may mean that our estimates react more quickly to changing circumstances.

Year on year growth in London employment in financial intermediation, pensions and insurance



Source: ONS Employee Jobs Estimates

Note that the above chart includes data for September 2004. This suggests a further decrease in employment in 2004.

Conclusion

The City of London is a major contributor to the UK economy in terms of employment and GDP. Moreover, it is especially important for UK growth, especially for exports and other sources of overseas credits. It is therefore critical that the City is permitted to continue to prosper. Without this, the knock on effect on the rest of the UK, let alone the total UK economy, would be potentially disastrous.

THREE

ALL REGULATION IS BAD

ANDREW HILTON*

Synopsis: It would be all too easy for politicians or regulators to damage the City throughout heavy-handed regulation. To say regulation is bad is not to say it is never justified. But it can only be justified if a greater good comes out of it. And regulation is expensive (particularly in compliance terms); favours the big companies to the detriment of the small; inhibits innovation; undermines the principle of caveat emptor*; reduces the returns to consumers; and is by its nature likely to spread into markets where it is not necessary.*

THAT SHOULD NOT BE A CONTENTIOUS STATEMENT – particularly for those of a free market persuasion. Unfortunately, it is the kind of truth that, if expressed aloud, causes people to move away and roll their eyes. But it still needs saying.

To say regulation is bad is not to say it is never justified. But it can *only* be justified if a greater good comes out of it. Of course, sometimes it is hard to measure either the burden of regulation or the greater good – in financial services or elsewhere. How many broken limbs before Health & Safety should crack down on travelling fairgrounds (the semi-shambolic nature of which is part of their charm, and why they are a more attractive feature of British life than an ersatz Disneyworld like Chessington)? How many upset tummies before the last kebab house gives way to the

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billionth McDonald's? But the *principle* ought to be clear: regulation carries a price, and there is no moral virtue in regulation as such.

In that sense, the UK financial services sector is just like any other. It is there to do a job, and regulation makes that job more difficult – even if regulation is sometimes (demonstrably) necessary.

Some definitions

What is the financial services sector? And what is it supposed to do?

These are questions that are seldom asked – and they turn out to be rather difficult to answer. What the financial services sector *is* is everything from banks (commercial, retail, investment, private) to brokers (stocks, commodities, money) to insurers (general, life, reinsurance) to consumer credit companies (credit card issuers, pawnbrokers, doorstep lenders) to markets (cash, futures, pork bellies, derivatives) to asset managers (active, passive, closet trackers) to clearing and settlement systems, to payment systems, to deal makers (M&A shops, advisory boutiques) to venture capitalists, to regulators, to central banks and to all the hangers-on (the IT shops, the media, the accountants, lawyers, rating companies and so on). According to recent work for the City Corporation, all of that accounts for around 7% of UK GDP – but anyone who has anything to do with the City knows that is a gross underestimate. 20% could be considered a minimum in terms of the sector's contribution to UK plc. Whatever, it is estimated that its contribution to the UK's balance of payments is a surplus of US $35 billion – almost three times the surplus that Switzerland's financial sector generates.

So what does it *do*?

That's no easier. Indeed, it may be more difficult because the UK financial services sector serves two masters: the UK market place (ie you and me); and the international market place (ie them).

Some of what the sector does is geared to the needs of the UK market: that includes most High Street banking, for instance, most

life and general insurance and most stockbroking. But much else – such as investment banking – is truly "weightless". It goes where the global winds blow it, and it can move.

As far as the domestic financial services sector is concerned, it is "mature"; the UK is over-banked, it has more fund managers selling more savings and investment products in the UK than the US (with a population four times as large), and we (almost) all carry huge amounts of insurance – life, house, car, travel, health. And – the best sign of all that an industry is mature – no one is satisfied with the service he or she gets. If it isn't outrageous bank charges, it is Indian call centres, the closure of rural branches, underperforming with-profits funds and so on.

All the while, however, the "weightless", stateless, "Alex & Clive" part of the sector seems to go from strength to strength. London is the centre of the Eurodollar market, the centre of the "euro-euro" market, the centre of the OTC derivatives, hedge fund and private equity businesses. One third of global foreign exchange trading is done through London; and more equity trading (for large and small firms) gets done through London than anywhere outside New York.

It is an enormous success.

The UK economy is (depending on who adds up the figures) the fourth, fifth or sixth biggest in the world, but the UK financial services sector is No 2. It is streets ahead of any of our Continental or Asian rivals. We are to international financial services what the French are to wine, the Germans to automobiles and the Swiss to cuckoo clocks – best of breed.

The point is that the UK has a responsibility for the health of a sector that is overwhelmingly more important than our comparatively weak domestic economy would warrant. And we mustn't screw it up.

Don't think that we can't screw it up

The reason the Euromarkets developed in London was because the US imposed an interest equalisation tax that forced US banks to hold dollars abroad. Those dollars started to be lent offshore – and most have never been back home. That business was lost to New York in a twinkling – as was London's dominance of the German *bund* market, when Frankfurt leapfrogged us with better technology. Tax (personal as well as corporate) is also an issue: the global shipping market came to London because of a peculiar quirk in our tax laws that enabled residents to declare a foreign domicile. That doesn't help Americans (who are taxed on their worldwide income in the US), but it has been a godsend for Greeks, Italians, Spanish and others who have flocked to London in droves. Change that rule (as Labour perennially threatens) and watch business melt away.

So there is something to lose. Even if our High Street banks will probably have to grin and bear it if politicians decide they need a good thrashing, the same is not true for two-thirds of the cross-border financial business that is done in the UK. It can move.

Wimbledonisation

There is a lot of talk in the financial services industry of the "Wimbledon effect". The UK allegedly holds the best tennis tournament in the world, but hasn't produced a British winner in almost 70 years.

There is more truth in this analogy than people realise. Wimbledon's hold on the global consciousness is as much myth as fact, and most top players would just as soon give the grass a miss. Hence, the LTA must flatter and cajole; it can never crack the whip for fear that Nadal *et al* will choose to stay home for two weeks' R&R.

Surprisingly, the "blazered buffoons" of SW19 seem to have got that message quicker than those who control the destiny of the City.

Why regulation is bad

First, it is not a free good – something that seems to slip the minds of most consumer activists. Indeed, it is very expensive. It is not just the fees that are payable by regulated institutions to their regulator. Indeed, those have been fairly stable since the Financial Services Authority was set up, at least in real terms. (This was one of the more disingenuous assurances given by the FSA's first chairman, Howard Davies). It is also:

- the fines that are imposed, often for quite trivial "offences" that are often brought to the attention of the regulator by the firms themselves; and more important,
- the incremental cost of compliance with FSA-mandated regulations.

Compliance is a bottomless pit. The compliance function is the fastest growing part of the UK financial services industry – but it is slippery. How many of those compliance officers (and lawyers) does a firm *really* need? And how many are foist on it by otiose regulation? The FSA (which commissioned a study on this from Deloitte) hasn't really been able to answer the question yet. Depending on the sector, it could be anything from 5% of total costs to 37% – which is too broad a spread to be helpful. And don't expect the firms to volunteer the information either. After all, it is not in a compliance officer's professional best interest to badmouth his own job. Quite the contrary: compliance officers beget more compliance officers, who beget more lawyers, unto the end of time.

The same is, of course, true of the regulators themselves.

No regulators, at any level, have ever felt that their careers would be enhanced by having a firm go belly-up on their watch. This means that – although the FSA has said all the right things about not operating a "zero-failure regime" – the reality is that line regulators want to make sure nothing happens that can reflect badly

on them. And that means a general disposition in favour of more micro-prudential regulation, more regulators and less forgiveness.

It gets worse. While everyone accepts that, in principle, a regulatory regime in which there were no failures would be a disaster, there isn't a politician or journalist in the land who could resist the temptation to dump on the FSA if, say, another Leeson were discovered beavering away in the bowels of one of our biggest banks.

And don't expect the banks to fight this. The reason is that, for them, regulation is another row of bricks on the wall that protects them from the healthy wind of competition.

At least for institutions that face the UK or European markets, the cost of regulation can be passed on to customers – while the regulations themselves are a massive barrier to entry, jacking up the entry fee for anyone who wants to challenge incumbents.

The second reason why all regulation is bad is that it also favours the big and discriminates against the small. Most of the costs of regulation are fixed, and can be spread more thinly over a larger customer base. For smaller institutions (essential to a healthy, growing financial sector), the unit cost of regulation is much higher.

This may not matter on the upswing of the business/banking cycle. But cycles turn; and when profits are lower, smaller institutions will really find the burden of regulation, in terms of fixed costs, a major problem. Many will go to the wall – driven there, ironically, by regulations intended to protect them.

Thirdly, regulation inhibits innovation. This is not quite as straightforward as it sounds, since it is possible to argue that:

- what the UK financial sector (and, in particular, the financial consumer) suffers from is too *much* innovation, not too *little*; and,
- this is one of very few industries where the consumer interest would be best served by less competition, not more.

Nevertheless, it seems axiomatic that putting every new financial product (at least in the retail area) through endless regulatory hoops means that some good ideas will be strangled at birth. One example is wealth management for the middle classes: the need is pressing but compliance costs and a threat of mis-selling means that no one yet offers such a service at a competitive price.

Fourthly, from the point of view of the consumer, regulation has two negative consequences:

- It undermines the principle of *caveat emptor* – it encourages the negligent to exploit protections that were aimed at the vulnerable, and to reach for their lawyers at the slightest provocation. The result is to make an already litigious industry even more so.

- It reduces the return on the savings or investment products. That may not matter so much for, say, one-time travel insurance. But many savings products have 20 or 30 year lives – and the return is cut every year by the cost of regulation. At a time of low inflation and (relatively) low interest rates and equity returns, that can be devastating to long-term returns – and, hence, to dreams of a prosperous retirement.

Fifthly, regulation also migrates. Regulation may be an unavoidable necessity as far as many retail financial products are concerned – though not all, since there are plenty of products (most forms of general insurance, current accounts, some very simple types of savings product) that could be sold simply on the basis of standard consumer protection legislation. If they don't do "what it says on the tin", sue the buggers. However, for most savings products – those that will be with you for a decade or more – some degree of regulation is inevitable. The problem is that, within a bureaucracy (particularly a soup-to-nuts

bureaucracy like the FSA), there is what one might call "regulatory drift".

What this means is that rules that may be justifiable in one market or for one product (ie for individual customers in the retail market) start to be applied across the board. This means that they start to be applied in wholesale markets, in inter-professional markets, in markets where both sides of a deal know how to look after themselves. Where everyone is (as they say) a consenting adult.

This may be counter-intuitive. There is a temptation to say that, if it is right to regulate the doorstep lending market (which is pretty small beer), it must *a fortiori* be even righter to regulate the FX market, which shifts trillions of dollars a day through the market. Not so: the regulatory spend should be focussed on those who cannot look after themselves, not those who can.

That does not mean that malefactors in the inter-professional markets should go unpunished. Fraud and theft are criminal offences. Plus these are markets that lend themselves to self-regulation – which can be devastating since it means that industry bodies can (often with less proof than a statutory body like the FSA would require) exclude individuals from practising their profession. But it does mean that professional markets do not need anything like the same degree of micro-regulation as retail markets – not least because, if we do, they will move. And there is some evidence that the hedge fund managers of Curzon Street are starting to pack their bags as they see the FSA's regulatory net about to be cast over them.

The message is simple and clear: be careful. It would be all too easy for politicians or regulators to kill the Golden Goose that is the City. There is no reason why the cluster of skills that is the City should remain with us forever. Finance is essentially weightless, and it can go where it likes – driven by a combination of tax and regulatory arbitrage, the prevailing political climate, and even whether the trains run on time.

FOUR

THE CITY AND THE EU

MALCOLM LEVITT*

Synopsis: EU regulation is becoming increasingly important. However, long-term success will depend upon overcoming economic nationalism; settling differences in Europe over market openness, regulatory philosophies, expertise and practice; understanding of and priorities attached to international financial markets; the success with which British governments fight our corner; the avoidance of self-inflicted tax and regulatory wounds; and the rise of financial centres elsewhere in the World.

A benign domestic environment for business

The City, including Canary Wharf, is Europe's premier international wholesale financial centre. It embraces a huge cluster of international highly skilled intellectual capital, financial institutions, and professional service; deep pools of liquidity; and global markets: all are mobile but have chosen to locate here. This cluster has grown organically, through a self-reinforcing dynamic process, not as a result of government blueprint.

This growth has been facilitated by:

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- a tradition of openness[8], and
- intelligent regulation.[9]

Historically, both have been relatively rare in Europe.

The City's dynamic business development meant that regulators have had to familiarise themselves with international financial markets to a breadth and depth unknown in many other financial centres. Its long-term prospects have to be seen within the context of EU regulatory initiatives, business developments, and the economic environment. Challenges to the City can arise from any of these factors.

EU regulatory/supervisory challenges and opportunities

The main impetus behind the raft of European legislation over the past 20 years is the laudable aim of creating a financial "single" market – supported by successive British Governments and the City, as well as European visionaries seeking monetary and economic integration. But the process been much more complex than originally envisaged. Moreover national safeguards or derogations, appeals to consumer protection with the effect (if not the intention) of protecting domestic suppliers, and failures of implementation and enforcement have impeded the project.

The basic challenge is to overcome economic nationalism on the part of some countries. This embraces suspicion of foreign

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8 Symbolised by Magna Carta: " All merchants shall have safe and secure exit from England, and entry to England, with the right to tarry there and to move about as well by land as by water, for buying and selling by the ancient and right customs, quit from all evil tolls, except in time of war".

9 Especially in the wholesale markets, where regulation has largely avoided interference in the absence of significant market failure, has aimed to be proportionate and risk-based (thereby distinguishing between the professional and retail markets), transparent and developed via consultation with market practitioners, and open to financial innovation,

firms and investors; a presumption that the authorities should determine business structures and even the decisions of individual firms; suspicion of markets and rejection of their role in allocating resources efficiently; and susceptibility to pressures from special interests masquerading as the general interest.

Such a philosophical approach is wholly at odds with that which has underpinned the City's success and finds outlet in some national positions taken on EU legislative proposals, especially on points of detail wherein the devil lies.

Fortunately it is not a view of the world be found in the Commission's 2005 Financial Services White Paper. This is not a zero-sum game. Much of the international financial business conducted in the City is not open for "repatriation" to Member States because it never was done elsewhere in Europe in the first place. And if not done here it would be driven outside Europe.

What needs to be accepted by all players over the long term is a shared vision of a Europe where suppliers of financial services and their customers or counterparties can transact across borders, with remote access to necessary infrastructures on a remote basis if they so choose, subject only to essential, proportionate regulation, and that the City cluster is an asset for Europe.

Recent legislative and regulatory problems and the prognosis

A number of EU legislative proposals have threatened either to

- raise compliance costs with little or no offsetting gain, and/or
- damage business, possibly driving it offshore.

Although the underlying driver behind some of these disputes is economic nationalism, other more direct causes can sometimes be identified.

Varied experience
Unlike the UK, many Member States had:

- a less developed regulatory framework for their domestic financial markets (e.g. over insider trading); insofar as it differed from that already in place here, higher compliance costs were an inevitable result;
- less familiarity with modern international wholesale financial markets (e.g. listing of overseas wholesale debt issues, which meant that negotiations over the prospectus Directive were less well informed and the outcome harder to implement). This might change as European regulators working together through the Committee of European Securities Regulators (CESR) gain broader knowledge of the international dimension.

At the same time it must be recognised that protection of retail investors has been a higher priority in some countries than was the case in the UK until recently. The challenge is to avoid carrying over rules appropriate to retail into wholesale markets.

The degree of harmonisation
Open access, from which the City benefits, requires some degree of similarity of rules. A regular feature of disputes has been over the extent to which such rules should be identical. International firms face lower compliance costs when the rules are the same in each jurisdiction. But identical rules threaten innovation and where they differ from our own, domestic compliance costs rise. So far no satisfactory process for resolving the question has emerged and it will be an ongoing challenge for the City.

Poor quality legislation
Many of the problems faced by City – and other European – financial institutions reflect poor standards of legislative development. It has often been characterised by the absence of

rigorous tests of: clarity of the definition of the intended outcome; evidence of market failure; assessment of non-legislative alternatives; evidence that benefits would exceed costs; proportionality regarding the problem to be tackled; sufficient and timely consultation with practitioners; and regard to implications for global competitiveness of those affected. Also and importantly, there has been inconsistent implementation and enforcement by national authorities together with inadequate resourcing of enforcement action by the Commission.

The case for improving the consistency of national implementation and enforcement, plus the enhancement of co-operation and convergence of approaches by national financial authorities over the long term, is unanswerable. These issues are being addressed in part by the committees established following acceptance of the recommendations of the Lamfalussy Committee of Wise Men.

As to the problem of the quality EU legislation and regulation, the current Commissioner and the Directorate General responsible for financial service legislation have clearly listened to the criticisms. Their 2005 Financial Services White Paper, together with the Commission's "Better Regulation" agenda, provide a welcome response. However it is essential that this mind-set becomes firmly embedded within the Commission and the other key European institutions, supported by appropriate monitoring, evaluation and reporting systems. Changing the culture from less to better – and better implemented and enforced – regulation will be a long term challenge.

The Commission needs to take a more proactive approach towards more enforcement and should reallocate internal resources to it away from drafting yet more rules. Evidence of such a reallocation will be the acid test of its "Better regulation" credentials. It has not emerged publicly yet.

The global context

Too often, recognition of the global competitive environment has been missing from EU proposals. Some – such as the Taxation of interest on savings Directive, the Prospectus Directive and the Transparency Directive – have in their original form posed a threat to City business, making investments or capital issues less attractive relative to some non-EU locations.

Partly this reflects the relatively low priority attached to the international context in other Member States, with their lower familiarity with and involvement in international financial markets. It also resulted from the Commission's own lack of awareness of what was at stake. Fortunately the international competitive dimension of Commission proposals was recognised as a priority in its 2005 Financial Services White Paper. The challenge is for the City and Government to ensure that that this remains a Commission priority when it frames future proposals and when they are negotiated with Parliament and in Council.

Regulation

Regulation is an important factor affecting decisions on where to locate or transact business. It is an over-simplification to describe the FSA as having a "light touch". One experienced practitioner told me that "the FSA asks more focussed and probing questions than many of their peers in other countries but they work with the grain of market developments". City practitioners are now increasingly concerned by that the threat of a heavier hand is emerging.

There are increasing pressures in some quarters to create a single EU regulator. They include the concerns of some authorities with the spread of cross-border business; some political ambition to bring the City under EU control; and the desire of some international financial institutions who prefer to deal with fewer regulators. Insofar as the UK regulatory "brand" is a factor in the City's success, such pressure is of concern.

These pressures are at least premature and misguided at worst. Such centralising pressures are to be resisted unless and until the following criteria are met:

- national authorities have a common regulatory philosophy, common high quality experience of, and internal expertise on, international financial markets;
- fundamental questions of accountability to national Parliaments and finance ministries are resolved;
- and there is a solution to the question of who bears the bill when taxpayers have to fund a rescue.

The way ahead for the EU is that set out by the Lamfalussy Report: improvements to co-operation and convergence of standards and practices among national authorities, in a flexible evolutionary process.

The domestic dimension to EU policies

A somewhat different concern arises over allegations that the UK regulatory authorities "gold plate" EU legislation, adding a layer of complexity and additional compliance costs, and thereby reducing the City's competitiveness. At the same time, the London Stock Exchange is a magnet for international IPOs partly because of the perception of higher standards than elsewhere. Similarly, the UK's approach to corporate governance is internationally respected. UK listed companies lead in disclosure, (such as price sensitive information). This gives confidence to UK and overseas investors. One report suggests that investors pay a premium for the cachet of investing in LSE listed shares, to the benefit of issuers. In short, while vigilance over UK additions to EU legislation which damage City business is .necessary, over-simplification of the issues can also be damaging.

For the longer term, it is to be hoped that the Government's awareness of the gold plating problem, as demonstrated by the

Davidson Review of UK implementation of EU legislation, will bear fruit.

Often in the past, there was little discernible evidence that the City commanded a priority in governments' EU policies to match its contribution to the UK economy. There have been exceptions to this generalisation: support in the 1980s for the Commission's ambition to create a single market by 1992 and, later, for the Financial Services Action Plan were in part motivated by hopes that it would greatly benefit the City; the current Government fought a successful campaign against the original proposal for the Directive on Interest on Savings, which threatened the wholesale bond market business. But the City could hardly be said to command a consistently high level support comparable to that enjoyed, say, by agriculture in France.

Moreover, stamp duty on share transactions remains a self-inflicted wound. Over the long term, it is essential to avoid further tax damage, e.g. any which threatens the attractiveness of the City to the highly mobile talent working here, whether as a result of mistaken domestic policy or any emanating from the EU. In the same vein of argument, domestic and EU immigration laws could conceivably inflict damage to the openness of the City to global talent.

However, in recent times the Treasury has carefully consulted with City practitioners over EU developments. The City is a public priority.

Business Developments

A key driver of business development is technology. It opens up new opportunities for reaping economies of scale, the centralisation of functions, and the extension of the geographic scope of business operations, especially the outsourcing and off-shoring of back office operations. These are elements in the consolidation of institutions and infrastructures globally. In this

context a specific "European" dimension to business development can be hard to isolate – except perhaps as a compliance matter.

Several instances of consolidation of financial institutions have emerged in recent years, creating large Austrian, Dutch, Italian and Spanish institutions, not to mention the established large German institutions, with pan-European and overseas ambitions. (The recent Breugel Report shows how the largest European firms derive a rising share of their income and employment from outside their "home" country).

From a City perspective the issue is: where will they undertake their capital market activity? Will it be in their home country, where the pool of talent and liquidity available in London cannot easily be replicated? Or here? Will British based institutions themselves, as they derive a rising share of their income overseas, undertake more of their *additional foreign* business overseas instead of here?

A clear trend is for the out-sourcing and off-shoring of lower value support functions overseas to lower cost locations. The long term challenge is for the City to retain and grow its share of high value added business. A favourable regulatory and fiscal environment are clearly necessary but, by themselves, insufficient. Market operators also need confidence that the pools of talent and liquidity available here will remain. Hitherto the City has benefited from a virtuous circle of a growing influx of institutions, people, transactions and liquidity within a benign regulatory environment. A major potential threat will be from the growth of financial centres outside Europe.

The EU economic environment

Europe faces a major economic challenge over the longer term from faster economic growth in other continents. Over time, major European financial institutions will derive a growing share of profits and will devote a rising share of their investment to those more economically attractive regions. Those regions have

their own ambitions for creating major financial centres. Provided that they can create appropriately prudent but flexible regulatory regimes they will succeed over the long run (although no doubt scandals and crashes will occur).

This would be at the expense of the City in the sense of an opportunity foregone. Avoiding such an outcome will be a major challenge.

Conclusions

Long term challenges will continue to arise from:

- differences in Europe over market openness; regulatory philosophies, expertise and practice; understanding of and priorities attached to international financial markets;
- the success with which British governments fight our corner;
- the avoidance of self-inflicted tax and regulatory wounds;
- and the rise of financial centres elsewhere in the World.

But the City has risen to successive challenges over its history, while Europe and the World offer major opportunities on which it thrives.

FIVE

THE CHALLENGES FACING INVESTMENT BANKING IN THE UK

ALAN YARROW*

Synopsis: London's advantages are not necessarily everlasting. It is essential that the regulatory environment (and the FSAP) is framed and implemented in a way which ensures that we remain internationally competitive. This entails overcoming the complexity of regulation itself; ensuring that it is efficiently maintained and flexibly implemented; and balancing out a perceived lack of market influence in its preparation. Finally, with an ageing population, a changing society and the pressures of globalisation, the investment banking community must continue to satisfy the needs of clients, new and old, if it is to survive.

'Big Bang' was a shorthand term for a series of inter-connected reforms, implemented between 1984 and 1986, which focussed on the equities and fixed income businesses; parallel developments in international securities and derivatives also played their part. These reforms responded to the tensions appearing in the City in the early 1980s and have laid an important part of the foundations for London's extraordinary international success.

My family's firm abandoned London as the base for its shipbuilding business in the late 19th century, because they could not see how they could remain competitive on costs, particularly

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labour costs; so I am well aware of two important lessons: first, that there is a financial services industry in the UK outside London and, secondly, that London's advantages are not everlasting.

The background to Big Bang, the elements of the reform package and the consequences – intended and unintended – all contribute to the challenges we face today.

Four drivers of Big Bang are particularly relevant today. First, the abolition of exchange control in 1979 and the increasing volume of international business done in London had intensified the pressure for markets here to become internationally competitive. The need to allow a fusion of international capital and London expertise arose both from the desire of internationally active banks to own London-based firms and from the fact that those firms needed to have access to additional external capital in order to exploit the opportunities arising from the development of the international securities markets in London.

Second, the need for the London marketplace to provide a platform for market participants to compete more fiercely with one another had become clear: the spark for reform was the need to do away with price fixing and exclusion. Before Big Bang, the London Stock Exchange had individual members; only these members could be partners in, or owners of, firms which carried on business at the exchange. Broadly, brokers could deal only as agent; dealers/jobbers could deal only as principal and only with brokers or other jobbers; and all brokers charged the same fixed commission rates. There were also limitations on the form which a business could take. Brokers also had to operate as partnerships, with unlimited liability; jobbers, who had to have bigger balance sheets, had been allowed to incorporate some years before.

Third, an emphasis that clients must come first was increasingly apparent. In the debates over Big Bang, it was generally agreed that whatever the reform was to be, and over however long a period, client service remained central.

Fourth, the need for continuous technological innovation was becoming more pressing. At the same time as completing a structural reform, the London Stock Exchange delivered a major market automation project: the provision of 'live', dealable prices electronically over the Stock Exchange Automated Quotations system (SEAQ). SEAQ was supplemented by SEQUAL, a trade confirmation and matching service. Settlement was carried out through TALISMAN, which also required upgrading to support the new market structure.

The reform programme was designed to respond to these forces, among others. The Big Bang reforms included changes to the rules of the London Stock Exchange, introduced in two phases, as well as legislative change and reforms to the structure of the markets. The reforms addressed four related areas: competition policy concerns arising from price fixing and exclusion; liberalisation – anyone could now own a dealing (market-making) or broking firm, which in turn provided those firms with access to capital to modernise and to take bigger risks; the introduction of electronic trading tools displaying real-time prices (automatic execution was still some way off); and the need for regulatory reform, set out in the Gower report which called for self-regulation on a statutory basis.

These measures did not tackle all of the issues. For example, clearing and settlement was left till later. It turned out to be awkward, expensive and time-consuming to fix. And some of the measures taken created further challenges.

The arrangements which were swept away in Big Bang were originally intended to manage conflicts of interest largely through separation between broker and dealer and between the broker-dealer sector and the rest of the financial services industry: banks, insurance companies, pension funds and their professional investment managers. As a consequence of Big Bang, firms needed to evolve new ways of dealing with conflicts of interest.

Progress in all of these areas is never complete. Developments in the world in which the markets operate the way in which the markets themselves evolve and changes in public expectations all demand constant innovation in response. In 2006, looking forward to 2026, all these issues are still central, even if the particular form they take has changed.

Competition policy

At the detailed level, the focus of competition policy has moved away from broker-dealers to the exchanges themselves. The exchanges have ceased to be owned by their members; they are, mostly, quoted companies, with outside shareholders. In turn, this has raised the question of how best to develop mechanisms to protect the users' interest. As profit-maximising businesses, blessed with a central position in the markets they serve, they pursue ever higher returns for their owners, reluctant to share the benefits of falling unit costs with the users. Their managements are now considering consolidation, both within Europe and across the Atlantic. Once more the UK is in the lead; the competition policy concerns raised by the prospect of a major European merger were thoroughly analysed by the UK Competition Commission in 2005. Their report still frames that debate.

Liberalisation

More generally, the banner of liberalisation is being carried forward in Europe by Commissioner McCreevy. His handling of a number of issues, including cross-border bank mergers and the question of how best to modernise European clearing and settlement arrangements, suggests that the Commission of which he forms part is determined to improve Europe's chances in a competitive, global market place. The completion of the legislative stage of the Financial Services Action Plan is a significant step. The journey is not over; but we know where we are and how far we have come.

Population

At a more general level, wider changes in society present an enormous challenge for Europe – and an opportunity. As fertility rates in the EU continue to decline, so the average age of the population is rising rapidly. In the EU as a whole, UN statistics project a median age rising from 38 to 49 years by 2050. In comparison, the median age in the US will move from 35 to 38 years; in other words, we will be an average of 11 years older on this side of the Atlantic. Our ageing population will have potentially serious consequences: not just on the dependency ratio and pensions, but on the risk appetite of investors, managers and entrepreneurs. At the same time, explosive GDP growth in the near and Far East will mean that European competitiveness and relative growth rates will remain under pressure. Even if we can grow at a little over 2% a year for the next 44 years, the European share of global GDP is set to shrink from 18% in 2000 to 10% in 2050.

Regulation

To help meet these challenges, Europe – and particularly financial Europe – must remain attractive for business.

Even if the FSAP measures achieve their objective within the EU – to provide a workable, integrated, securities market – it is essential that they are framed and implemented in a way which ensures that we remain internationally competitive. This means:

- Surmounting the very complexity of regulation itself;
- Ensuring that it is efficiently maintained and flexibly implemented; and
- Balancing out a perceived lack of market influence in its preparation.

The reasons for the complexity are easy to understand. The price of securing the agreement of the many and varied members of the EU to any given piece of financial regulation is recourse to

great detail and at great length. But there are also signs that the new four-level machinery for handling the detail, together with new process disciplines like cost-benefit analysis and regulatory impact assessments are beginning to help the EU reach agreement more readily.

When it comes to flexibility, these new methods of policy development came too late to keep much of the detail out of the key FSAP directives. Yet in a competitive, dynamic, global marketplace, we have to move faster than before, and to be able to modify regulations – substantially, quickly and frequently on occasions.

EU directives can, however, only be revised infrequently, and the legislative process is now set to be hard to control. So EU regulations risk becoming obsolete relatively swiftly, particularly those that are inappropriately detailed; and risk remaining unchanged for long periods. But the analogous regulations produced by our competitors are likely to be adjusted more quickly and frequently to the changing conditions in their markets.

The regulatory raw material is highly technical, as are the markets to which it applies. This demands that market participants, professionals and experts should play a major role in shaping it, particularly in working out the detail. Nowadays the markets are consulted more seriously and comprehensively than was the case five years ago. Nevertheless, further progress is essential in three areas: – developing the better regulation agenda, debating the role of self-regulation, and finding a place for industry initiatives. The development of the tools to be used in the fight against money laundering in the UK gives us hope that these matters are on the authorities' agenda.

The debate about the desirability of a single European regulator for financial services has not died down. The main question is: will the regulators remain knowledgeable and responsive? The calibre and motivation of the regulators themselves is a challenge too. It remains to be seen whether the structure now in place will endure.

Capital market infrastructure

Another concern is about the capacity of Europe to generate and sustain sensible capital market infrastructures. Electronic trading has begun to live up to its potential, and we are discovering again that market automation means that we have to get *clearing and settlement* right. In 2006, the challenge is pan-European rather than merely national – and the infrastructure and incentives which can promote or hinder reform are correspondingly more complex.

Over the last few years, we have spent a great deal of time grappling with the unintended consequences of demutualisation in relation to the post-trading market infrastructure and in the context of exchanges more generally. It is clear that we did not get it quite right. There are clearly some areas where one wishes to see more competition; others where market participants have clearly expressed a wish to see a move towards a well-structured utility-type natural monopoly. However, in both cases investment banks, both as market users and as the intermediaries representing the wider world, urgently need structures which are properly responsive to the interests of users.

The question of how to build a platform to provide clearing and settlement services for a greatly enlarged, pan-European market has been the subject of a long-running debate. The latest development is an initiative by the European Commission which is important for two reasons. First, it applies the analytical tools of competition policy to the provision of clearing and settlement services. Secondly, it has explicitly been described as an alternative to legislative intervention.

Challenges of reform

The challenges of reform are always with us. The effects on morale should not be underestimated, as Petronius reminds us:[10]

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[10] Caius Petronius, Roman Consul, 66 AD, quoted in Petronius Arbiter, *Satyricon*

> *"…it seemed every time we were beginning to form up into teams, we would be reorganised. I was to learn later in life that we tend to meet any new situation by reorganising, and a wonderful method it can be for creating the illusion of progress while producing confusion, inefficiency and demoralisation."*

At the same time, constant debate and a constant striving for new solutions, whether the problems are new or enduring, is a sign of health. Genuine, innovative responses to new challenges will be required from regulators and market participants alike. The challenges are highlighted in these concluding themes.

The financial services industry does not exist in a bubble. Some social questions will affect the way the industry evolves. Clients, of course, come first. It may be that the age of institutionalised saving is over, and that we are beginning to return to the world of individual accounts and individual accountability for decisions. Or it may be that new institutional arrangements are developing in response to an analysis of the shortcomings of the old. Hedge funds and private equity are not wholly new – but their influence in the financial markets has grown rapidly over the last few years.

There will be a natural default to higher risk aversion arising from the change in the age structure of the population. Will the generation born between 1965 and 1985 have different attitudes to risk and investment decisions, as the generation born between 1945 and 1965? Will they take decisions over the same time horizon? The experiences of the two generations have been very different in relation to major economic variables and in financial awareness. In particular, changes in the cost of capital, and fluctuations in the price level have been markedly different between 1965 and 1985 and since 1985.

Our clients, collectively and individually, are also constantly reinventing themselves. The client base today differs significantly in its profile and risk appetite from our clients at the time of Big Bang. Today's clients want different products and services. The arrival of

new fund managers, operating different business models, developing new investment techniques or applying existing techniques in new ways demonstrates low barriers to entry. The changes in investment fashions and different attitudes to risk continue to assist in the progressive development of the markets.

Finally, the iconoclastic question about the future of investment banks': will the integrated model survive? The short answer must be: if it satisfies the needs of clients, new and old. A longer answer would take account of the human and organisational strains and costs imposed by the integrated model. One of the advantages of low barriers to entry is that people who have a different view of how the industry will develop can set up businesses and discover whether or not sufficient clients share that view to enable them to make a living and grow their businesses.

London's development as an international financial centre has not come from securities trading alone, important though that has been. We can now see that the success of London and the UK has come from the interweaving of different trades and services in the cluster: professional investment managers, advisory businesses, lawyers, accountants, actuaries and so on. We neglect the wider world at our peril. We have taken advantage of conditions all over the world and in China, India and Russia in particular; Asian countries, together with South America, will play a larger part in shaping the future of the world than they have for many years.

At its most fundamental, the City will remain and even grow in importance if it concentrates on "getting the product right", which is a combination of the above. We know to our cost as residents that marketing alone cannot deliver and "spin" is a pejorative noun for "hot air".

SIX

WEALTH MANAGEMENT: LONDON, A GLOBAL CENTRE

ANGELA KNIGHT*

Synopsis: There is about £320 billion of private client business under management in London with about 4½ million client accounts. It is a highly competitive market and one which is rapidly growing (more millionaires and multi-millionaires have been created over the last 15 years than over the previous 150 years). London is the global leader. But it faces three challenges: the danger of a heavy-handed regulatory environment being introduced under the FSAP (which could both increase costs and restrict some of the more innovative investments); a tax system which is seen to be unstable, unfair and too high; and an infrastructure which needs great improvement (not least in transport).

Looking after individuals' investments is a global business and the UK is one of the largest centres in the world for personal wealth management.

This term 'wealth management' however is a broad one, ranging from the individual who chooses to buy and sell some shares without advice on an internet site or at their bank, through to advice-based portfolio management of all sizes and types and on to the very specialised services for wealthy individuals.

The majority of private clients are looked after by the specialist private client stockbroking firms, private client investment

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management firms, and private banks who are members of APCIMS. Looking at the statistics, these firms operate on more than 500 sites primarily in the UK, the Channel Isles and Isle of Man; last year they undertook 18.6 million trades in UK equities for their clients; and they have under management for them in the region of £320 billion. Although this in itself is a lot of money, this is an understatement because wealth management for high net worth individuals is by its nature a private affair.

It is also difficult to be exact as to how big the pool of clients actually is. Individuals tend to use more than one firm, so the actual number of clients is difficult to accurately assess. The latest information though tells us that the UK private client firms have around 4½ million client accounts of which 1.1 million are portfolio-managed. This latter number is increasing.

There are a number of reasons why the UK is so strong in this business. First, the UK has been undertaking wealth management for a very long time and is a centre of global renown for financial expertise. While there are a number of strong competitors in centres such as, most obviously, New York and Switzerland, the UK not only has the largest financial centre in Europe, it also has one of the largest stock exchanges in the world, a legal profession which in itself is one of our great export successes, a depth in finance second to none which, coupled with a well-rated financial regulatory environment and that British sense of "fair play" means that whatever business it is that an individual or a firm wants to do, then as long as it is legal you can get it done in the UK and done well.

Meanwhile the world is getting richer and more individuals are creating their own wealth through entrepreneurship rather than inheriting it from previous generations. The combination of moving through a substantial technological revolution and the former communist countries getting to grips with more sensible economics and business management has meant that it is now

estimated that more millionaires and multi-millionaires have been created over the last 15 years than over the previous 150 years.

North America still has the largest concentration of wealthy people and an ethos which requires individuals to provide for themselves much more than is the case for the social regimes of Europe. However, the inexorable rise of the new economies to the east presents the future opportunities. The next decade of growth for the private client business is not one for North America, nor particularly one for Europe; rather it is likely to be dominated by countries of the Russian Federation, of China and of South East Asia.

The appropriate regulatory environment

The opportunities abound. But there are concerns. The UK prides itself on providing a good regulatory environment for everyone and everything that operates within the financial market. Concerns though are being raised in respect of the degree of regulatory change, both home-grown and from the EU.

Regulators are there to regulate and not to de-regulate – this might be stating the obvious but the Financial Services Authority now employs some 2,500 people and not only is a very substantial organisation in its own right but in terms of what it covers, is the most all-embracing regulator there is. Also it is one that believes in exercising its powers too, and that includes its power to fine firms should they make a mistake, its powers to require firms to make compensation, and its powers to publicise this widely in the media with the consequent damage to a firm's reputation.

The wholesale business is lightly regulated and rightly so, as it is after all "consenting adult to consenting adult". But in the retail sector regulatory tensions increasingly arise. However, print out the FSA rulebook and it stands around six foot tall of which about four foot of rules are retail.

There remains a notable absence in all regulatory pages of a section tailored to wealth management. The result is that a firm

which has long-term relationships with its clients, who manages for these clients wide-ranging portfolios of investments running to many millions of pounds, is regulated as if it were a firm selling to an individual on a one-off basis a financial product such as a simple unit trust. The result is that the regulation does not "fit" either with the firm or the client; and that there are too many rules and too much cost. Unless we tailor the regulatory framework in the UK to make it a better fit for wealth management, then we risk losing this business to our competitor countries, and maybe particularly to Switzerland.

The Financial Services Action Plan

Next is the European Commission which, through the FSAP, is seeking to bring about a greater degree of harmony and fewer barriers to cross border business across the 25 countries of the EU. This is a commendable policy but it is also one that is fraught with difficulties – difficulties in terms of the extent and detail of the changes that need to be made.

Firms, regardless of whether they are doing cross-border business or not, are finding themselves having to alter almost every action and activity they currently undertake, from how they trade to whom they trade with and from what they can offer their clients to the actual client agreement responsibilities themselves. The Financial Services Action Plan affects both wholesale firms and retail firms, private banks, stockbroking firms, investment managers and many more. It will, to a certain extent, restrict some of the more innovative investments that it is now possible for a firm to offer their client. It also changes how an individual can buy what they wish to buy without advice.

Such extensive change inevitably carries with it substantial cost. Unfortunately, no cost estimates were made in advance of finalising the Directives under this Action Plan. The most important are arguably the Market in Financial Instruments Directive (MiFID) and its associated Directive, the Capital

Requirements Directive (CRD). The CRD implements the Basel II capital regime designed for banks to around 6,000 or so non-banks across Europe. It has to be in place before MiFID and will change the way that firms have to calculate how much capital they are required to hold to be in business.

The market for looking after the affairs of the high net worth individual is highly competitive. Costs are important. Just because an individual is rich it does not mean that they do not look at the price of the goods or services that they are buying (indeed one can argue that one of the reasons that they are rich is that they do pay attention to costs and make sure they get value for money). Thus, while good regulation is clearly an attraction, too much regulation is not. At some point this equation needs to be calculated properly by not just the industry but the regulators and policymakers alike. Tip it one way and the calibre of London as a centre for personal wealth management is reduced. But tip it the other way and it simply becomes too costly when compared with other international centres of substance.

Tax

Tax is also important.

The message that individuals are receiving is that taxes are increasing; that tax relief of savings is reducing; that tax changes are adversely impacting their pensions; that when their savings increase, capital gains tax kicks in; that they are increasingly restricted on what they can pass on to their children on death.

Resentment on the part of prudent individuals towards the current tax regime is growing fast. If savings are to be encouraged in the UK, then “a joined-up view” must be taken. For example, the amount that an individual can save in a PEP or ISA should be increased substantially. Capital gains tax thresholds could be doubled and no CGT returns necessary unless an individual has made disposables greater than £20,000 in any year. Inheritance tax thresholds should also at least be doubled.

These reforms would not be cheap. But when individuals consider that a tax that they have to pay is unfair, then they will do everything they can to find legitimate ways of not paying it. In addition, when Nigel Lawson substantially *reduced* capital gains tax rates in the 1990s, the result was an *increase* in the amount of revenue collected from CGT.

The second point is this. The UK used to pride itself on being one of the low tax countries in Europe. That is now no longer the case. Importantly our tax regime affects the entrepreneurs, the wealth creators and the leaders of our business and industry. Unless we keep them here, we will lose the drive, spirit and leadership and the employment that go with them. What is more, as business location is nothing like as important now as 20 years ago with so much more being undertaken remotely and electronically both in business, retail, finance and travel, it is now good business practice to locate operations in the most tax efficient jurisdiction. It is also considered by the customer base to be perfectly acceptable – not least because they will get their goods or services cheaper. Never before has it been so important to foster the tax regime such that companies and individuals feel that what they are being asked to pay is fair.

Infrastructure

Tax infrastructure comes in three parts. Firstly, it is the way that firms get their clients' business done. In the past, the infrastructure changes in the UK have been undertaken for the wholesale business (which is a perfectly reasonable thing to do) without true and proper attention being paid to the consequence for the individual investor. An example of this is a firm buying or selling shares for the individual: it will not do so directly on the London Stock Exchange as it will cost more than if the trade is undertaken through a specialist market maker. The reason is that the London Stock Exchange's infrastructure requires them to use the clearing system which in turn is set up to operate

advantageously for the large institutional trades and not for private client business. Although ways have been constructed to get around this problem, nevertheless it is an ever-present irritant and one that can be easily repeated a second, if not a third time. This could be exacerbated should the London Stock Exchange join in some form with other European exchanges or particularly with a US exchange.

Although a tie-up between UK and US exchanges has evident business advantages, for this to be successful there also has to be a structure that prevents US requirements creeping into the UK market. This has to be thought through first and not after the event.

A second kind of infrastructure point relates to what happens to individual investors when companies merge or undertake corporate reconstruction. Investor pressure from institutions for their agendas is strong, and it has tended to crowd out private investor issues. For example individuals increasingly hold their shares electronically in nominees yet in corporate actions such as acquisitions, mergers or even just handing back money to shareholders, too often shareholders in nominees are not considered as entities in their own right, resulting in them failing to have a choice of, for example, selling shares or taking the money should that be on offer and for all individuals, sadly the tax efficient option is not offered. There are now some legal changes underway which better enfranchise these nominees shareholders (who after all have paid exactly the same amount of money for a share as those who retain certificates) but the corporate advisers have not yet fully stepped up to the plate on these matters.

The third infrastructure point is communications. It remains difficult to travel across London, either over-ground or underground. The investment in the transport system that connects our major airports to the centre of London compares badly with our nearby competitors such as Frankfurt, Geneva or Amsterdam. The attractions of a country to business of any type is

a mixture of parts: if that business is about personal relationships and client service – as is the case in wealth management – and if our transport links make it difficult, then we are adversely impacting that business.

In conclusion, the UK today is one of the largest centres in the world for personal wealth management. But it is a fiercely competitive market. Others want what we have got. Effective, careful regulation is vital. Tax has to be fair, sensible, stable; and coherent. Infrastructure needs to be regularly renewed, reviewed and updated from the perspective of those who use it and not just from those who provide it.

In each of these three areas, Government has a strong role to play.

SEVEN

UK PRIVATE EQUITY – A UK SUCCESS STORY

PETER LINTHWAITE*

Synopsis: London is the established centre for the European private equity and venture capital industry. Private-equity backed companies are a great benefit to the UK economy, creating jobs at a considerably faster rate than other private sector companies (over the five years to 2004/5, the number of people employed by private equity backed companies increased by an average of 14% a year) and increasing sales and profitability faster than average. To continue to prosper, effective, careful regulation is vital. And tax has to be fair, sensible, stable; and coherent.

London is the established centre for the European private equity and venture capital industry. It has the most mature and developed European private equity and venture capital industry. The UK currently accounts for over 50% of that market.

Key attractions include a developed legal and regulatory regime, a good pool of domestic investment opportunities, established and liquid stock markets, access to a highly developed network of accountants, lawyers, bankers and other advisors with experience of and knowledge about the industry, consistent political support from the Government and Opposition parties,

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and good communications with other regions of the UK, continental Europe and the wider world.

London and the UK currently benefit from a tax regime that supports the venture capital industry and is attractive to a flow of highly-skilled and experienced private equity practitioners who come from around the world to work in the UK. Attracting and then retaining this talent is vital to the continued success of the UK industry. The industry is invested in all sectors of the UK and global economy, and across all regions of the country and around the world.

In the UK, continental Europe and much of the rest of the world, 'private equity' means the equity financing of unquoted companies at many stages in the life of a company from start-up to expansion, or even management buy-outs or buy-ins of established companies. 'Venture capital' is a subset of private equity, covering the seed to expansion stages of investment. Where this article uses the term 'private equity', it is taken to include 'venture capital.'

Why the private equity model is so successful

Private equity is successful because of the clear alignment of interest between the shareholder and management. Private equity investment brings concentrated management experience and a focussed approach to the achievement of specific corporate objectives to achieve value enhancement to the business. In doing so, private equity is able to deliver consistently superior returns.

Private equity investment generally means focussing closely on ensuring that real value is created in an investee company. This is principally achieved by active ownership techniques, rather than just relying on financial engineering.

Another strength of private equity firms has been the identification of strong growth opportunities, whether it be the roll-out of an existing platform, a consolidation opportunity, or backing a company that is well positioned in a growth market.

The management team and the private equity firm need to be fully focused on implementing the strategic plan set out at the time of the deal. A key element of this includes the incentivisation of management teams to achieve such strategic goals. This is where the feature of alignment of interests is so important. All parties should be incetivised and focussed on the same goal: optimising shareholder value through long-term sustainable value creation.

Economic impact of private equity on the UK economy

The economic impact of the private equity industry on the UK is profound and continues to grow. Private equity-backed companies provide a substantial impetus to the economic performance and competitiveness of the UK.

This impact can be seen both in terms of the effects on the economy of companies that are backed by private equity, as well as the importance of the industry as a key component of the UK's successful and vital financial services sector.

Private-equity backed companies create jobs at a considerably faster rate than other private sector companies. Over the five years to 2004/5, it is estimated that the number of people employed in the UK by companies that have received private equity backing increased by an average of 14% a year against a national private sector employment growth rate of 0.3%. It is also estimated that companies that have received private equity investment account for the employment of around 2.9 million people in the UK.

The performance of private equity-backed companies significantly strengthens the UK economy and improves its international competitiveness. Over the five years to 2004-05, on average private equity-backed companies' sales rose by an estimated 20% a year – more than twice that achieved by FTSE-100 and FTSE Mid-250 companies. Exports grew by an estimated 27% a year, compared with a national growth rate of just 3.9%; investment rose by 14% a year compared with a national increase of 3%. It is estimated that companies that have been private equity

backed generated total sales of £233 billion and contributed £29 billion in taxes.

It is not just the companies backed by UK private equity houses that have had a positive impact on the broader UK economy; the UK private equity community itself is a significant contributor to our financial services sector and to the economy as a whole. The industry represents a vital source of fees and income for a broad range of businesses across the entire UK market. Indeed, advisory support alone for private equity deals netted an estimated £1 billion of income in 2005. Income from other sources, such as interest paid to banks, represent even greater sources of revenue for the UK financial services industry.

The private equity industry has spawned an infrastructure of support services around it. These range from legal and accountancy personnel to dedicated specialists in diverse fields like insurance, environmental consultants, recruitment specialists; business processing outsourcers. In this way, the private equity industry has contributed significantly both in terms of revenues (and taxes) to the UK and also through the development of a cadre of highly skilled professional services workers.

Investment activity – worldwide and UK

Worldwide investment by BVCA members increased by 21% in 2005 to an unprecedented £11,676 million. UK private equity firms' investment remits are becoming increasingly international, with investment in overseas companies growing for the third consecutive year in 2005 to £4,863 million. Investment in continental Europe increased to its highest ever level in 2005, totalling £3,858 million.

Despite the increasingly global reach of UK private equity firms, domestic opportunities remain a key source of deal flow and accounted for 58% of all companies backed in 2005. The number of investments in UK companies during the last year remained relatively stable at around 1,300, although the amount

of capital invested increased by 28% to £6,813 million, representing the fourth consecutive year of growth.

The smaller, entrepreneurial end of the market is a key driver of economic growth in the UK and is an important area of focus. Over 200 early stage businesses attracted private equity funding to the tune of £380m in 2005, a 35% increase on 2004 levels.

Regional investment across the UK

The UK private equity industry has well established and highly networked regional markets, helping to ensure that companies across the country have access to equity funding.

Investment by region

	Amount invested (£m)		% of amount invested	
	2005	2004	2005	2004
South East	578	1,552	9	29
London	2,417	1,423	35	27
South East & London	2,995	2,975	44	56
South West	448	265	7	5
East of England	636	232	9	4
West Midlands	271	335	4	6
East Midlands	1,122	111	16	2
Yorkshire & Humber	243	314	4	6
North West	426	654	6	12
North East	85	90	1	2
Scotland	114	176	2	3
Wales	461	99	7	2
Northern Ireland	12	85	-	2
Total	6,813	5,336	100	100

Source: figures taken from BVCA Report on Investment Activity 2005

Sources of private equity

Funds raised by BVCA members increased more than eight-fold in 2005 to £27,314 million, reflecting the growing appetite among international institutions for private equity fund investment opportunities. This success was largely due to the completion of several large fundraisings from international buyout houses.

The UK private equity market has attracted strong support from overseas investors, which contributed almost 80% of funds raised in 2005. For the ninth year running, overseas investors have contributed significantly more to UK private equity funds than their UK counterparts.

North America was the largest contributor at 45%, accounting for £12,218 million of UK funds raised, compared to its 41% share in 2004. Continental Europe collectively accounted for 22% of the total at £5,905 million, while the UK and Asia accounted for 21% and 7% respectively.

Pension funds were again the largest UK source of funds raised, contributing 5% of the total in 2005 (£1,502 million). Overseas pension funds were the largest single source of funds raised, contributing £7,175 million, representing 26% of funds raised in 2005 compared to 15% in 2004. Overseas funds of funds contributed 12% of the total raised (£3,244 million), compared to 15% in 2004, being the second largest contributor by category to funds raised after overseas pension funds. Overseas government agencies substantially increased their allocation to £3,196 million in 2005.

Performance of UK private equity

2005 results show that UK private equity has continued to outperform Total UK Pension Funds Assets and the FTSE 100 and FTSE All-Share over the medium to long term. The net returns of UK private equity funds raised between 1980 and 2005 measured to the end of December 2005 were:

- Over three years: 21.1% a year;

- Over five years: 11.9% a year;
- Over ten years: 16 .4% a year;

These fund-level performance statistics reflect the success of the private equity model in creating sustainable growth businesses. This view is further supported by the fact that private equity backed businesses outperform other IPOs post-flotation.

IPOs of UK companies that had been private equity backed outperform other IPOs, generating returns of 15.2% (unweighted) and 13.8% (weighted), over the course of the year after flotation, compared with 6.1% and –1.9% for other IPOs. These findings support the view that private equity backed businesses tend to be robust, well-managed and in good operational shape, representing an attractive opportunity for public market investors.

The potential for the continued expansion of the industry is vast. Were every OECD country's private equity industry to reach the comparatively modest benchmark of 1% of GDP, another $200 billion of capital would be added to the global investment total.

The supply of capital to the private equity industry continues to grow, as institutional appetite for the asset class increases and access to individual funds continues to improve through the development of new and innovative fund structures and product offerings.

Demand for private equity is also growing. The profile of private equity as a source of funding has improved as management teams increasingly recognise the advantages of private ownership.

The importance of tax

The immediate term challenge is to ensure that government and regulators continue to recognise the importance of a vibrant and dynamic private equity and venture capital industry to the UK economy. That means a competitive tax regime and an appropriate regulatory regime.

Only a relatively small worsening in the overall burden of taxation borne by the industry could put the UK industry at a competitive disadvantage with continental Europe. In particular, as France and German tax rates are moving closer to current UK levels making those countries increasingly attractive to private equity firms. These two countries have recently enacted specific legislation to provide their private equity and venture capital industries with favourable taxation regimes, and it is believed Portugal is shortly to follow a similar path.

Other challenges ahead include:

- At the industry level, increase scrutiny from regulators and investors in areas such as levels of disclosure and approaches to valuation are likely.
- At the operational level, increasing competition will mean that value-creation will be vital for if the industry is to maintain its track record of superior returns.
- At the smaller, more entrepreneurial level the BVCA would like to see greater success in the exploitation and development of spin-outs from universities. To that end we conducted and published recently a report looking at this area, *Creating Success from University Spin-outs*, which contained recommendations for the Government, the industry and the higher education sector.

There is also a major initiative central government could take to help support this higher risk end of the market. Government is a major procurer of goods and services. Could a specific programme of dedicated procurement by government help stimulate and support the smaller more entrepreneurial end of the market? France is looking to place some form of "social commitment" to support SMEs. Whether rules or regulations need change is open to debate. It would certainly require a change in the culture and practice of government procurement. It

would also require a level of cross-party political support and consensus about the value and importance of such an initiative.

The industry is well placed to take advantage of investment opportunities in the UK and increasingly across Europe and around the world. We attract significant investment into London and the UK from around the world, principally the United States. To maintain our leading position in Europe essentially our message is simple and clear: as light a burden of taxation as possible and as sensitive a regulatory regime as possible.

TECHNICAL ISSUES IN CALCUATING EMPLOYMENT DATA IN THE CITY OF LONDON*

The primary source of employment data is the government's *Annual Business Inquiry* (ABI), which is the most detailed survey of employment available. It provides a high level of industrial and geographical detail on a workplace basis. Another government survey, the *Labour Force Survey* (LFS), is carried out on a quarterly basis. However, this survey is residence-based and uses a smaller sample; consequently the results may be less detailed or robust.

However, the ABI alone is not adequate; there are three key issues.

- First, although the ABI allocates every job to a specific business sector in accordance with the *Standard Industrial Classification*, the SIC sector often fails to distinguish between London cluster and non-London cluster activities.

- Second, the ABI categorises 'agency staff' and 'temps' – who are paid by and under contract to a human resources agency, but work for the agency's clients – as if they were working for the agency.

- Third, the ABI provides information on the business sector, and not the function within the business — so it does not distinguish between, for example, employment in headquarters and jobs in a branch plant.

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* This Appendix details some of the issues discussed in Chapter Two.

The categorisation of jobs within the ABI does not distinguish between what are defined as 'London cluster' and 'non-London cluster' activities. For example, the government's financial intermediation classification combines the full range of banking and financial services. Crucially, government statisticians combine domestic retail banking and insurance, such as are found on any high street, with international wholesale banking, insurance and financial trading which are the hallmark of the City. The data has been split to estimate those activities which are specialist and those which could be carried out at any location.[11]

The ABI includes agency staff and temps within the 'Labour recruitment and provision of personnel' sector rather than the business area in which they are actually working.

Agency staff are no longer only the cleaners, security, manual and administrative workers. There has been an increase in the number of specialist agencies, including small City boutiques, setting up to provide City firms with a new source of labour. It is now common for not just IT staff, but some traders and analysts in large investment houses to be agency staff. When combined with the general trends in outsourcing, there is a significant risk of underestimating employment in the London cluster by failing to include these employees in the sectors in which they are actually working.

Those jobs in 'Labour recruitment and provision of personnel' have been reallocated where they are not associated with

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[11] From the government's categorisation, we extract those services which are core to London's specialist activities and those which would exist anywhere. We use regional data on employment in monetary intermediation and compare this to regional population levels. We generate an estimated ratio of retail banking employment to population, and adjust this with an efficiency ratio to account for the savings generated from operating within a City. This enables us to identify the share of London's commercial banking which would exist on any high street and that share which is present due to the City's financial cluster. We include only specialist services that have located in London in order to benefit from the clustering effects and serve international markets.

providing recruitment services but are instead agency staff working in other sectors.[12]

Many company headquarters are located in London. The categorisation within the ABI does not distinguish between employees working in local branches, factories or offices and those involved in headquarter activities. We have therefore adjusted the data to estimate the share of employment in all sectors which is accounted for by headquarter activity[13].

Comparison of estimates

The ABI is the primary source for the above employment data. It has been with other information providers and adjusted where necessary.

There are a number of trade bodies, research groups and other organisations that produce estimates of the number of workers in specific London cluster sectors:

- The most recent measure of employment in fund management appeared in the 2003 survey undertaken by the Investment Management Association[14]. The estimate covers 51 firms which accounted for the majority of institutional funds under

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[12] We have analysed regional data on employment in the 'Labour recruitment and provision of personnel category', to estimate the share of these employees that are working directly in labour recruitment and the share that are subcontracted to work in other areas. Having established estimates for additional subcontracted workers in both London and the South East, we estimate the shares which will be employed in London, and allocate these across the business sectors in each London borough.

[13] In order to estimate employment in company headquarters we looked at London's employment in all categories. For each category we estimated the share of employment in the sector which is accounted for by local activity. We then allocated the remaining employment to headquarter activity. Within this headquarter activity, we allocate back office and support employment to non-core activity and the remainder to core activity.

[14] Investment Management Association, *Asset Management Survey*, 2004, p9.

management. The survey estimated total employment of the United Kingdom's fund management industry at 23,300 in June 2003. Estimating that 80 per cent of these are located in London, this gives a total of 18,640 jobs. The latest estimates for employment in smaller firms and those dealing with retail business are from the International Financial Services London (IFSL). They estimated that over 29,000 people were employed in these sectors throughout the United Kingdom in 2003. If 70% of these jobs are in London, this gives an estimate of 20,300 jobs[15].

- The latest data on security broking comes from IFSL's *Securities Dealing 2003* publication.[16] This estimates a total of 58,000 employees were authorised to conduct securities dealers business in the United Kingdom in 2001. We estimate that 65% of these are based in London.

- Combining the above two estimates gives a total of approximately 76,500 employed in stock broking and fund management in London. This compares with the cebr estimate for all security broking and fund management of 71,000.

- According to its annual section, the Bank of England employed 1,908 people at the end of February 2004.[17] Some of these employees are based in Debden: it is estimated that 1,700 are based in London.

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[15] International Financial Services London, *City Business Series 2003, Fund Management,* May 2003, p.14-15.

[16] International Financial Services London, *City Business Series 2003, Securities Dealing,* July 2003, p.28.

[17] Bank of England, *Bank of England Annual Section 2004*, May 2004, p. 21.

- The Financial Services Authority sections that it employed 2,303 people in 2003/4[18]. We estimate that 2,070 are based within Tower Hamlets.

- The London Market for insurance supports 50,000 jobs in the United Kingdom, according to IFSL[19]. Of these, 40,000 are believed to be located in London. This compares to the cebr estimate of just over 42,000 employees in City-type insurance business.

- In the City of London Corporation's recent section, it was estimated that maritime services and the relevant support activities account for 14,000 jobs in London.[20] We estimate 7,700 employees are employed in pure maritime services. Once the support services such as insurance and law are included, this grows to just over 13,000.

Unfortunately, these data from trade bodies and other non-governmental organisations do not provide a comprehensive alternative source of information on employment in London — as they do not cover the entire London cluster, nor do they provide estimates for consistent time periods or for consistent definitions of employment. For example, many of the professional membership organisations section the numbers of people with accreditation to practice — but not how many actually practice.

Transport authorities provide another source of corroboratory evidence.

Transport for London statistics show that 1,028,000 people arrived in central London in the three hour morning peak on a typical working day in 2003.[21] The *Annual Business Inquiry* shows a

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[18] Financial Services Authority, *Annual Section 2003/04,* 2004, p. 57.

[19] International Financial Services London, *City Business Series 2003, Insurance,* January 2004, p.20.

[20] Fisher Associates for the Corporation of London, *The Future of London's maritime Services cluster: A Call for Action,* August 2004, p. 30.

[21] Transport for London, *London Travel Section 2004,* 2004

total of 860,000 employees working in the City of London and Westminster during that year. The cebr estimates, using the ABI but adjusting for its weaknesses, are that 900,690 employees worked in these areas.

The difference between the transport statistics and the estimates are not unexpected. More people arrive in central London in the morning peak than there are employees there, as a significant minority of people will be travelling for leisure, education or other personal reasons, or on business but not to their normal place of work.

Meanwhile, special workplace statistics are collated as part of the government's 2001 census. These data cover a 10% sample of respondents to identify their travel to work patterns and main location of employment.

The cebr estimates for total employment using the 2001 ABI are slightly higher than the results of the government census would suggest. Part of this might be explained by the timing of the census, which related to one day, 29 April 2001. As the *Labour Force Survey* data presented in the next section suggests, employment in London saw a decline in the first quarter of 2001; employment in April 2001 may therefore have been below the annual average.

To add to the myriad of employment statistics, the Office for National Statistics also produce *Employee jobs estimates* which, although heavily based on the ABI, are separate from them. These enable us to look in more detail at employment in financial intermediation, insurance and pensions. The *Employee jobs estimates* show that 335,795 workers were employed in financial intermediation (including insurance and pensions) throughout London in 2003 compared with 323,291 from the ABI and the cebr's own estimate of 332,567.

The City of London Corporation provides local government services for the Square Mile, the financial and commercial heart of the UK.

The City of London is committed to maintaining and enhancing the status of the Square Mile as the world's leading international financial and business centre through the policies it pursues and the high standards of service it provides. The City sustains the Square Mile's role in finance and related business services, which include law, accountancy, regulation, business education and many other areas.

Its promotional work supports the City's international business community, helping to develop business opportunities for it and establishing contacts with decision-makers and people of influence worldwide. Its responsibilities also extend far beyond its boundaries: it provides a host of additional facilities for the benefit of the nation, ranging from open spaces such as Epping Forest and Hampstead Heath to the famous Barbican Centre.

In addition to local authority services, such as town planning, housing, education, social services, environmental health and waste management, the City of London performs a number of

very special functions. It runs its own police force and the nation's Central Criminal Court at the Old Bailey. It runs the internationally recognised Guildhall School of Music and Drama. It provides five Thames bridges, the Animal Reception Centre at Heathrow Airport and is the Port Health Authority for the whole of the Thames tidal estuary. Three premier wholesale food markets, Billingsgate, Spitalfields and Smithfield, also belong to the Corporation.

Many of these services are funded from the Corporation's own investments at no cost to the public. Among local authorities the City of London is unique; not only is it the oldest in the country, it operates on a non-party political basis through the Lord Mayor, Aldermen and Members of the Court of Common Council. The City of London combines its ancient traditions and ceremonial functions with the role of a modern and efficient local authority, dedicated to the needs of its residents, businesses and the hundreds of thousands of people who come to work in the City every day.

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HANDLE WITH CARE: an investigation into the care system

Harriet Sergeant

Harriet Sergeant describes the horror of what is happening to the most vulnerable children in our country today. It describes, in the children's own language, the true extent of a problem which has for too long been hidden: the catastrophic failure of our care system. About 6,000 young people emerge from the care of the state every year. 4,500 of them will leave with no educational qualifications whatsoever. Within two years of leaving care 3,000 will be unemployed, 2,100 will be mothers or pregnant and 1,200 will be homeless. Out of the 6,000, just 60 will make it to university. It is not just a tragedy for the individual. A successful system of care would transform this country, empty a third of our prisons and shift half of all prisoners under the age of 25 out of the criminal justice system. It would halve the number of prostitutes and homeless, and remove 80% of *Big Issue* sellers from our street corners.

The Government is passing Acts, proposing initiatives and spending money (it costs an average of £40,000 for each child in care). Yet its best efforts are failing to address the deep-rooted problems in the system. Why, despite generous funding and good intentions, does the care system fail so badly?

"…a devastating report" – James Naughtie on *Today*

"THE BETRAYAL OF 60,000 CHILDREN" – front page headline in *The Daily Mail*

"About one in six young people in Centrepoint services have experience of the care system, which backs up Harriet Sergeant's report on the complete failure of the care system." – Balbir Chatrik (policy and communications director, Centrepoint) in a letter to *Young People Now*

RECENT PUBLICATIONS FROM THE CPS

FROM PRINCIPLES TO POLICY: what an alternative manifesto should say

Norman Blackwell and Ruth Lea

The principles on which the CPS has developed its policies include the beliefs that the individual and the family should have freedom to determine how they want to live their lives and take responsibility for their destiny; that the size of the state should be constrained in order to ensure that government is the servant of the people, not its master; and that individual and national prosperity will flourish with a low overall tax burden and limited regulation. From these principles flow several keystone policies: growing public spending less rapidly than overall economic growth; true independence for schools and hospitals; and support for the traditional family.

"…a radical agenda with the abolition of inheritance tax, capital gains tax and stamp duty" – Daily Telegraph

LEVIATHAN STILL AT LARGE: An open letter to Mr John Tiner, Chief Executive of the FSA

The FSA is one of the most powerful and least accountable institutions in the UK. This report, based on interviews with leading City figures reveals that its lack of accountability has nurtured a sense of disengagement and growing disillusionment within the financial services industry. Today, the FSA is seen as vulnerable to political direction and influence; and as being unable to defend the industry it is intended to support against political or public criticism. London's pre-eminence as a leader in the world's financial markets will be under threat if the concerns of leading practitioners are not heeded.

"The honeymoon is well and truly over for the FSA… The latest broadside comes from the Centre for Policy Studies" – leading article in *The Financial Times*