UK International Financial Services – the future

Introduction

Thank you and good morning Ladies and Gentlemen. It is an honour to be here today.

I have been asked to comment on Sir Win Bischoff's report on the competitiveness and future of the UK Financial Services Industry. I will divide my talk into 3 sections: First I will look at what has enabled the UK to become and remain the world's leading financial centre - what is at the heart of the UK's competitive strength?; Second, I will focus on a couple of key findings of Sir Win Bischoff's report; and Third, I will look at some of the future challenges & opportunities for the UK as an international financial centre. You should be aware that my lens on these issues is from a banking perspective

The UK's competitive advantage

Looking at what makes the UK international financial services sector competitive I think our business allows me an insight into what is good about the UK financial services sector.

Standard Chartered is a truly international bank with over 150 years banking experience. This year we celebrate our 150th anniversary in Hong Kong and last year celebrated 150 years in India and China. We operate in over 70 markets – in over 70 different regulatory jurisdictions - predominantly across Asia, Africa and the Middle East and employ over 70,000 staff across 150 different nationalities. We are listed in both the UK and Hong Kong, rank among the top 20 companies in the FTSE 100 in terms of market capitalization and are actively exploring listings in India and Shanghai. In many ways we are the quintessential international bank.

Despite the crisis, we have performed well recording 26 per cent profit growth in 2008 and have just announced record income and profits for the first 5 months of the year. We are strongly capitalised, strongly liquid and conservatively funded.

Asia is by far the largest contributor to our revenue stream, accounting for over 70 per cent of Group Income. Yet, we remain headquartered in the UK, lead regulated by the FSA.

Why? It's simple, the UK historically possess many of the strengths that a Banking group like ours looks for in order to create a foundation of tradition, trust and confidence:

– long term stability and predictability of legal, political and tax regimes
– An established open market economy
– A skilled labour force, which has been supported by open and balanced immigration policy
– A regulatory framework which whilst subject to significant questions now, still retains a leadership position. Interacting with 70 plus regulators across our franchise generates a complicated regulatory mosaic but one which is made much easier by the fact that our lead regulator - the FSA – has been at the forefront of regulatory thinking.
– Access to and depth of liquidity and capital markets
– World renowned financial infrastructure: accountants; insurers; auditors; financial analysts, lawyers et al.
– A critical mass of financial and corporate institutions, globally and regionally headquartered in the UK, means it's important for many companies to be located here from a relationship management perspective, Standard Chartered included. From our perspective, the UK acts as a key originator and enabler of business. Without our base in the UK we would miss out on revenue opportunities in the order of US$1bn throughout our network.
– Use of English as a business language
– Culture, conventions and behaviours. Our democracy, our free press reinforce trust and confidence.

When thinking about the UK financial sector from a historical perspective there is therefore much to be confident about. It's important that we do not lose sight of these historical competitive advantages when we focus on the outlook for its international importance.

We should also not forget, parts of the sector continue to perform well, for example insurance – not everything needs fixing.

Nevertheless, there is no doubt that the global economic and financial crisis has severely damaged public confidence and trust in the banking sector as a whole, and the UK banking sector in particular.

Turning now to the crisis and the findings of Sir Win Bischoff's report

Whilst attention grabbing headlines and accusations of an 'Anglo Saxon' problem' are not factually correct or helpful, we as an industry, along with regulators and government must acknowledge that a huge amount was wrong. Taking business models first – skewed and overly dependent funding profiles/ aggressive balance sheets where poorer quality assets were booked for apparent return and complex investment banking trading activities. Then there is model blindness, the size of bank trading books, a dysfunctional relationship between accounting standard setters and regulators, regulatory failings including the tripartite system, short term financial architecture, a focus on capital not liquidity and on the wrong type of capital and skewed incentives of a scale disproportionate to real value created, some of which was based on "illusory profits".

We also need to acknowledge that there are some lessons to be learned from those countries that survived the crisis in better shape, many of which were in Asia. Whether it is regulatory caps on LTVs or the proactive management of vulnerable parts of their economies e.g. the issuance of credit guarantees to the SME sector, this is an opportunity for us to learn from them.

This crisis has taught us all (business leaders, regulators and government) a valuable lesson, when the banks stop functioning, the broader economy ceases to function properly. Without a good banking system you can't have a good economy, right now the priority is to get the banking sector functioning properly again. Longer-term we need to put in place an effective and efficient regulatory system that enables the UK international financial services sector to prosper, to retain its position as the world's leading financial centre, that way we can guarantee the future and success of the broader UK economy.

The UK faces three key challenges: it must restore public confidence and trust in the banking sector; it must reaffirm the strengths that I talked about earlier; and at the same time it must also determine how it intends to compete, and more importantly retain its competitive advantage, in the very different world of global financial services 10 years from now. In doing so it must present a cogent regulatory framework and set of proposals.

Sir Win Bischoff's report into the competitiveness of the UK Financial Services Industry and its future, commissioned by the Chancellor, addresses the key issues.

We at Standard Chartered agree with the broad findings of the report. I do not want to discuss each in detail, but will focus on two keys areas - ,a). Partnership and cooperation and b). Reaffirming the UK financial sector's reputation – as I consider these critical to the future success of the UK financial services industry.

(a) Partnership and cooperation

Partnership and cooperation are key to retaining and enhancing the UK's position as a leader in Financial Services. By this I mean partnership with the wider UK economy, between government and industry and most importantly engagement and cooperation with the international financial centres of Europe and the Emerging markets.

Engagement with the emerging markets financial centres will become increasingly important given global economic dynamics.

It is clear that economic power is shifting from the West to the East. In 2000, developing countries accounted for 37 per cent of world output, last year that share had risen to 45 per cent. Almost 60 per cent of the increase in global output that occurred between 2000 and 2008 happened in developing countries, half of it in the BRICS alone. The growing importance of the G20 as opposed to the G7 is one testament to this trend.

This shift is likely to have many facets to it: higher growth rates; bigger services sectors, much stronger financial sectors.

The UK and the West have to acknowledge this large scale shift in economic power and must work with this trend rather than against it, looking to stimulating international growth and development rather than focusing inward. At this critical juncture, we in the UK need to reposition ourselves to look to Asia and other emerging economies as partners in the international financial arena.

Partnership and cooperation should extend to

– cooperation between regulators on a Global level, especially opening up the discourse with Asian regulators – they have much to teach particularly on liquidity regulation. This is vital to ensure a level playing field for local and international banks and to avoid potentially destabilising regulatory arbitrage, which is not in anyone's interest. The global perspective is especially important as historically, European regulators have tended towards a very G7 centric view, with little regard to how non-OECD markets operate, with potentially negative repercussions for international banks with large operations in non-OECD countries.
– the development of common approaches to address the issues of the day, be they alignment of accounting standards, auditing standards or the regulatory framework.
– dialogue with the investor community both locally and globally. Investors have to some degree been absent from the debate between policy makers and bankers. There is a need for a strong third party voice, which will help alter the dynamic and hopefully result in better long term decisions. We would expect Investors to be actively engaged when it comes to decisions around the exclusion of subordinated debt from the capital equation.
– working with and supporting International banks in their vital role of facilitating trade and cross-border investment. If the real world is going to get ever more independent and global – with increasingly international supply chains, with technology making more goods and services tradeable and with new multinationals emerging from the new economic powers in the world, such as China and India – if we are going to see all this, and I hope we do, then International banks will need to be there to enable and support these trends in the real economy.
– sharing ideas, skills and knowledge more generally e.g. with other emerging financial centers

This type of cooperation will be critical as trade flows shift and the balance of economic power changes. It is this lack of partnership that has to some degree perpetuated, if not exacerbated, the current crisis. One of the positive features of the crisis has been the realisation that international cooperation on financial services regulation must now include such economies as China, India, Saudi Arabia and Brazil. The G20 decision to enlarge the membership of the new Financial Stability Board and the Basel Committee to include these major emerging markets should be warmly welcomed. Another impressive achievement has been the degree of collaboration among regulators and central banks on financial system regulation – indeed sometimes it seems easier to cooperate across boarders than within them!

It's not just about economic power though it's also about population dynamics and human resources. The number of graduates from the emerging markets (specifically India and China) already far outstrips those in the 'West'. The UK financial services sector needs to work out how to tap this skills/knowledge base. International banks like ourselves have a role to play, through IG programmes, secondments, a policy of geographic role mobility etc.

(b) <u>Reaffirming the UK financial sector's reputation for competence, responsibility and trustworthiness</u>

Now more than ever the UK must demonstrate its leadership credentials.

In the current climate there are numerous issues where we need to ensure we have a loud voice on the global stage, commensurate with the historic position of the UK and commensurate with a leadership position for London and the UK.

In my opinion the most important and far reaching are:

(i) Regulation and the way forward: there are some critical tenets with matter hugely if the UK is to maintain its long run reputation – openness vs protectionist tendencies, we are seeing impediments to the flow of capital creeping in, many wrapped as technical regulations designed to ensure stability. Its harder to spot than trade tariffs, but just as pernicious – ambiguities over home vs host regulation need attention – formation and consistent implementation of a set of international regulatory standards - periodic "fit for purpose" reviews of regulatory structures e.g. tripartite - increasing dialogue/partnership between regulators and industry

(ii) The sheer level of complexity inherent in the system – both of a financial and regulatory nature. From a financial perspective we have overly complex products teamed with overly complex accounting.

From a regulatory perspective the industry is grappling with the complicated, model driven Basel II IRB approach. Looking forward we are faced with the potential for significant further complexity with the unilateral introduction of new liquidity frameworks, leverage ratios and counter-cyclical rules. While these proposals might be sensible, we have yet to see any suggestion that anything material will be taken out of the regulatory framework. If simplicity is the key to better regulation, which I believe is the case, we need to go through an exercise to remove some of the existing less effective rules otherwise we simply layer complexity on complexity. Historically we have tended to regulate quantum. We should also regulate complexity.

(iii) Reconciling accounting and regulation – currently we have an “unmanaged” set of interactions between accounting standards and regulatory rules that has resulted in significant duplication, inefficiency and ineffectiveness, as well as contributing to pro-cyclicality. The complex interaction between different sets of accounting standards and different sets of regulatory rules across multiple countries is little considered by the standard setters.

(iv) Incentivisation – how should we balance risks and remuneration?

(v) Managed exit of governmental capital and perhaps more importantly the plethora of liquidity support offered to the Banking system - without market discipline, we will eventually end up with a new crisis. So we do need to work out how to take the industry off the life support system. Repaying capital is the easy bit unwinding guarantees and tightening liquidity will be far harder.

(vi) Addressing the current financial architecture. Have markets become too short term?

Inherent in this is the need to address the global issues of the day – climate change and carbon markets, poverty – the whole sustainability agenda.

The UK is making progress in this space - take the recent announcement that Lord Turner is to chair the FSB’s Supervisory and Regulatory Cooperation standing committee. This is an important signal which recognises the ongoing role and contribution of key UK policy makers. But more needs to be done.

So, what is the outlook for the UK international financial services sector?

When thinking about what the future looks like for the UK financial services sector we need to mindful of what underpinned our previous success, those historical advantages that I talked about earlier that enabled the UK to build a foundation of tradition, trust and confidence. They are strongly rooted but we cannot take them for granted.

One of the key challenges for the UK is to ensure we participate in and influence the international debate, to ensure that we do not dilute our message/influence and that the UK international financial services sector remains at the heart of the global financial community.

As someone who currently faces a plethora of competing consultation papers, new codes, conflicting regulatory views and separate lobby groups, I firmly believe that the UK should focus its promotional resources on a single body. Today, we have far too many – IFCR; IFSL; UKTI; CSFI; BBA; and City of London Corporation. We need to bring together these resources from both public and private sectors to ensure that our message/influence is not diluted. Public squabbles are not helpful. The current reporting of turf battles damage our reputation internationally and distracts the debate away from the all important content towards “personalities”. What we need is one UK wide, practitioner led, independent, politically neutral, strategic and cross-sectoral body to represent us on the global stage. Without this there is a real risk of the UK becoming side-lined in the international debate.

We need to ensure that the UK’s current heady mix of politics and regulation does not hinder the future development and success of the UK’s international financial services sector.

The size of the public deficit poses a further challenge. Government borrowings aren’t expected to fall back to 40%, the previous fiscal rule, until 2035! The UK government whilst handling a steepening debt burden must ensure that measures to contain the deficit do not drive out business from the UK. Now more than ever the UK should maintain a predictable and competitive tax regime. The UK financial services sector workforce is extremely mobile, financial institutions can and will walk away if pushed. An increasing number of UK domiciled companies (not just in the financial services sector) are actively considering following in the footsteps of WPP and Shire. Whilst some of the noise maybe no more than headline grabbing, the UK government cannot ignore it and must ensure its macro-economic policies do not work against the financial services sector.

Attracting and retaining the best talent is also critical to the future success of the UK financial services sector. Politicians must ignore the short term public noise around unemployment and maintain an open and balanced immigration policy.

The UK must also work hard to ensure that unilateral action by individual jurisdictions does not jeopardize either the UK financial services sector or the global financial sector. Banking is a global, cross-border business and it is vital to the effectiveness of its supervision, that international agreement is reached and local protectionist measures avoided. Fragmenting the world's financial system into a set of supposedly "self-sufficient" markets in which "self-sufficient" entities operate may give an illusion of greater stability from the perspective of the individual policy-maker, but it is far from clear that the global system will be more resilient to shock. It is going to be a difficult balancing act with multiple complex relationships and far too many commentators. In light of the FSA signalling that it will take unilateral action in the absence of international agreement on the application of local liquidity requirements, it's a point worth making….and making loudly!

Conclusion

UK international financial services are at the heart of global finance and it is in the UK's long term and strategic interests to ensure the financial services sector is improved and strengthened.

The strengths that have created this enviable position still hold true even after the financial crisis.

It is clear that some remedial work needs to be done to ensure the UK's reputation is rebuilt if not strengthened. Sir Win Bischoff's report provides insights into where we the business, as well as regulators and politicians, must focus.

Not everything is broken, but the work that needs to be done should involve demonstrating the UK's leadership credentials by addressing – I admit a lengthy - shopping-list, as well as embracing and partnering with other emerging financial centres.

It's imperative that we get this right: that we learn the lessons.

Thank you

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