

WHY LONDON IS STILL NUMBER

ONE WHEN IT COMES TO THE INTERNATIONAL FINANCIAL SERVICES INDUSTRY, THERE'S STILL PLENTY OF LIFE IN THE OLD CITY YET, SAYS **DUNCAN MCKENZIE** OF IFSAL.

London is a global financial centre and the pre-eminent international financial centre in Europe. While New York and Tokyo source a larger volume of business from their domestic markets, London has the largest share of many international financial markets. London's leading role in the key international financial services industry arises from a long history of openness, with relatively easy access to markets and a tradition of welcoming foreign firms, supporting a trading culture that dates back to the time when the UK was the dominant world trading country over a century ago. The international insurance market, for example, began in London and much of the business there is administered through the Lloyd's market.

London's role as an international financial centre is evidenced in its leading share of many of these markets (see *Table 1*). Cross-border bank lending out of London totalled £1,500bn in September 2002, 19% of the world's total, the turnover for foreign equities of £1,260bn in 2002 accounted for 56% of the world market; and turnover in the foreign exchange (FX) markets in London averaged £302bn a day in April 2001, 36% of global trading.

INTERNATIONAL ACCLAIM. Remarking on London's position as a global financial centre, Alan Greenspan, Chairman of the US Federal Reserve Board, said: "The City has a long tradition of leading the world in FX trading and currently conducts twice the volume of New York despite the US dollar being the leading traded currency by far in FX transactions. London is the world's centre for over-the-counter derivatives trading – again with double the share of the trading in similar instruments conducted in New York. Moreover, a substantial share of the world's securities trading is channelled through the City.

"London has stayed on top in the provision of financial services despite the emergence of the euro, which some expected would divert a significant share of FX trading to a single centre on the Continent. Although financial sector activity in Frankfurt has increased substantially in the past few years, largely reflecting the growing importance of the euro, trading volumes there are still

well below those of London and New York."

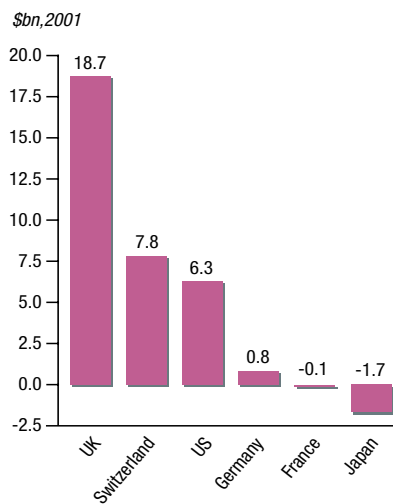
Moreover, trading in the contracts of Eurex, the German/Swiss derivatives exchange, have gravitated steadily to London over the past few years. In 1999, 41% of Eurex contracts traded were originated in Germany, while 25% were from London. However, by the first eight months of 2003, the position had reversed, with Germany's share of contracts halving to 20% and London's share nearly doubling to 46%.

London also remains the leading centre worldwide in the provision of specialist maritime services to the international shipping industry, including a sizeable community, particularly from Greece, which is resident in London. Services provided cover ship broking, legal services, finance, insurance, ship classification, dispute resolution and publishing. Overseas earnings generated by maritime services rose by 16% between 1999 and 2002 to reach £1.1bn, according to IFSAL's recent report on the sector. The £18.7bn trade surplus generated by UK financial services in total in 2001 was by far and away the largest in the world (see *Figure 1*), more than double the next largest surpluses recorded by Switzerland and the US.

WHY LONDON? A range of factors provide support to London's position as an international financial centre. The trading culture favours innovation, which, in its turn, is spurred by the range and depth of expertise and experience available. Key factors include the following:

- There is a concentration of companies in one location contributing to economies of scale, with improved flows of information and greater liquidity and enhanced efficiency in organised markets, and the concentration of support services all helping to reduce costs.
- There is legal, accounting, actuarial, management consultancy and IT support, with five of the six largest law firms in the world being international law firms based in London.
- The City has substantial physical assets, particularly office accommodation and an efficient telecommunications infrastructure.
- The use of English, with businesses also able to access a wide range of other languages in London as required.

**FIGURE 1
FINANCIAL SERVICES TRADE
BALANCE**



Source: International Monetary Fund

**TABLE 1
UK SHARE OF INTERNATIONAL FINANCIAL MARKETS**

% SHARE	UK	US	JAPAN	FRANCE	GERMANY	OTHERS
Cross-border bank lending (December 2002)	19	9	9	6	10	47
Foreign equities turnover (2002)	56	25	–	–	3	16
Foreign exchange dealing (April 2001)	31	16	9	3	5	36
Derivatives turnover						
- exchange-traded (2002)	6	30	3	6	13	42
- over-the-counter (April 2001)	36	18	3	9	13	21
Insurance net premium income (1999)						
- marine	19	13	14	5	12	37
- aviation	39	23	4	13	3	18
International bonds (2002)						
- primary market	60	–	–	–	–	–
- secondary market	70	–	–	–	–	–

Sources: Bank for International Settlements, London Stock Exchange and other Exchanges, Bank of England, Tradedata, Lloyd's, International Securities Market Association, World Federation of Exchanges.

- The perception of a proportionate approach to its regulatory climate, which facilitates innovation, a process facilitated by the establishment of the Financial Services Authority (FSA). The FSA is the single regulator of financial services, the first of its kind in the world and a much-envied model.

Commenting on its role, the FSA said: "Since assuming our full powers we have, with the financial services industry, begun to see the full benefits the government hoped for in establishing integrated regulation. Economies of scale have helped us to keep down our costs and our integrated approach has helped us to focus more clearly on the impact of market factors and industry-wide developments in the financial sector and to act swiftly where necessary."

One indicator of London's continuing influence is the global interest from governments and other organisations in a wide range of international product expertise that can be accessed from London. These products include public private partnerships, pension reform, privatisation, private wealth management and international dispute resolution.

CREATING THE IDEAL PARTNERSHIPS. The UK has pioneered the development of public private partnership (PPP), with the financial and professional service providers having developed unrivalled experience from the 600 signed projects valued at more than £25bn. These have covered a whole variety of activities, such as hospitals, schools, roads and prisons. Many governments are looking for ways of financing their infrastructure without getting heavily into debt, so the UK's experience of PPP is generating considerable interest around the world. IFSL has organised roundtables and seminars for more than 30 governments worldwide to provide an opportunity for them to meet with London-based advisers and find out more about PPP.

The UK's pioneering work in PPP has given a competitive advantage to professional services providers and financiers in the same way as the UK's privatisation programme of the 1980s and

early 1990s created substantial international opportunities to market UK experience and expertise in privatisation. Thousands of privatisations in more than 100 countries have since generated over £600bn in proceeds for governments worldwide.

LEADING IN PENSIONS AND PRIVATE WEALTH MANAGEMENT.

Pension reform is an area where the UK's expertise has developed over a long period, being founded on the development of a large domestic pension industry with funds now valued at some £1,000bn. This experience has given UK-based firms an opportunity to advise other countries that are looking to upgrade pension provision. All private pensions systems, including those in the UK, have faults and loopholes. As the UK pensions community has rectified problems that have arisen, UK practitioners have been able to guide other countries in avoiding flaws that have emerged in the UK system, and also avoid any unintended consequences of both legislation and selling practices.

Another sphere where London's reputation and status has grown is as a centre for international private wealth management. The value of private client securities managed by banks, fund managers and stockbrokers in the UK totalled £360bn in 2002. London's popularity as a forum for international commercial dispute resolution has also grown rapidly. It is regarded as one of the world's principal venues for international arbitration.

The City's leading share in a range of international financial markets demonstrates that in a whole range of services and markets it has the skills, expertise and depth of capital markets to support the business objectives of international business throughout the world.

Duncan McKenzie is Director of Economics at IFSL, with responsibility for reports on financial markets and products which feature analysis of London's competitive position as an international centre and the financial sector's contribution to the UK economy. IFSL reports can be downloaded at www.ifsl.org.uk.

d.mckenzie@ifsl.org.uk