

Interview: David Clementi

David Clementi, Deputy Governor of the Bank of England, assesses London's position as a financial centre outside the eurozone. A flexible labour market, low marginal tax rates and light-handed regulation are all more important than membership of the euro, he argues. Interview by Robert Pringle.

Does the Bank of England have a mandate to help develop or foster the City of London as a financial centre?

The Bank has three core purposes - to maintain the integrity and value of the currency, to maintain the stability of the financial system, and to seek to ensure the effectiveness of the UK's financial services. You can see these as separate although they are clearly related. If the UK financial services sector were hopelessly inefficient, not only would it lower the financial standing of London but it might also increase systemic risk. Thus there is considerable overlap between the three core purposes. To answer your question, I would say yes, we do have a duty to promote the competitiveness of the UK financial services.

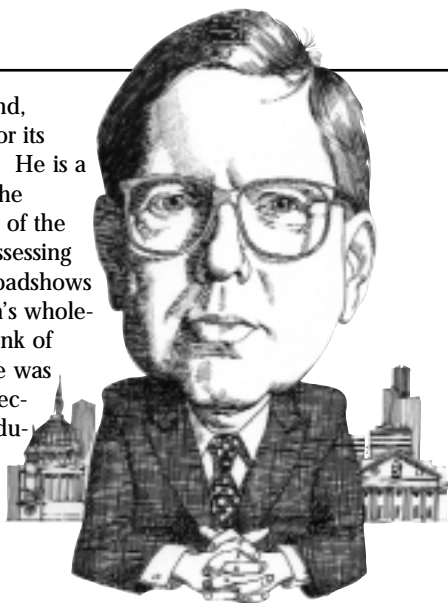
Is this a statutory obligation?

The Bank's core purposes form part of the objectives and strategy that have been set for management by the Court of Directors under Section 2 of the Bank of England Act 1998.

Is this just a monitoring role, or does it extend to active promotion?

Well, we are a central bank and not a trade association. But we do see it as part of our job to worry about a range of issues affecting the standing of the City. We are concerned with the governance of major City institutions, for example. People come and talk to us about what is going on and what concerns them. So you could say that to that extent we do promote the City, but it

David Clementi is deputy governor of the Bank of England, responsible for the bank's day-to-day management and for its mandate to maintain the stability of the financial system. He is a member both of the monetary policy committee and of the financial stability committee (which coordinates the work of the Bank, the Treasury and the Financial Services Authority assessing emerging systemic threats). In 1998 he led a series of roadshows in the major markets to promote the readiness of London's wholesale markets to deal with the euro. Before joining the Bank of England, he spent 22 years at Kleinwort Benson where he was head of the corporate finance division, and later chief executive finally becoming vice chairman in 1997. He was educated at Oxford University and Harvard Business School before qualifying as a chartered accountant with Arthur Andersen. He is married with two children and a former member of the junior international athletics team and an Oxford Blue.



is done against the background of our broad central banking functions rather than from a marketing perspective, as if we were the UK equivalent to *Finanzplatz Frankfurt*.

Are you able to make a preliminary assessment of the impact that the euro is having on the competitive position of London as a financial centre?

There is little doubt that the advent of the Euro did raise the profile of the debate, given that the UK is not in euroland. Our argument was always that London would be ready, and that even though the UK was not in euroland, the City of London was certainly in the euro area. This is true not just in an emotional sense but also because we are linked up to the euro through TARGET, the real time gross settlement system.

We were determined that London banks (irrespective of nationality) would be ready to trade in euros and we are proud that, from the first day, a huge amount of business has been done in London in the euro. London has always been the main centre of the foreign exchange market and its leadership has actually increased, if only because much of the Frankfurt foreign exchange market was always between the lire, French franc, Dutch guilders and the Deutsche mark - currencies now superseded by the euro. Indeed, I know of almost no major bank that is not running its foreign exchange business from London.

Could you indicate how strong London's competitive position is at present in the main sectors, such as foreign exchange, money market dealing derivatives, and bond markets?

We've already touched on the foreign exchange market. A lot of money market dealings are done in Frankfurt and Paris, as they were when the DM was the dominant currency in Europe. In general, many of these changes in markets and institutions are being driven by technology rather than the euro, and this is clearly true of the derivatives market. The short-term interest rate market is still driven by the LIFFE markets. The over-the-counter market is largely in London. The long term bund contract has

moved to Eurex, because of technology. But there again, much of the trading is actually done from London. I am not aware of any firm that has moved its trading desks to Frankfurt or Paris. True, several banks are building up their presence in Frankfurt, but often that is aimed to serve domestic German business, such as mergers and acquisitions. In primary and secondary bond markets, London is still the main trading centre. The gold market is still based in London.

So London has not lost out yet?

No, and in some areas it may have gained through the impetus that the euro has given to greater centralisation of trading operations. With only one currency for the euro area, banks had to centralise international trading, and typically they chose London. London already had critical mass. Many banks which used to trade in several centres knew they could not go on doing that after the coming of the euro and switched most of the business to London. This is true of the foreign exchange markets and may be true of the bond markets as well. The German banks, like others, have been investing very heavily in London.

It is often said that the City would suffer significantly if the UK stayed outside the euro area for a prolonged period. Do you agree with this assessment?

Not entirely. I think that this danger is often overstated. Do not underestimate the amount of yen business, dollar business and so on that is done in London. But nor would I go to the opposite extreme view, that being outside the euro actually helps the City. It is hard to believe that a financial centre does not benefit from having a leading currency as its domestic currency - it's hard to believe that New York does not benefit from the international dominance of the dollar.

So are there any threats to London, or weaknesses?

I will mention three or four key issues. First, the employment market. There is a huge pool of skilled talent in London. More important, London is much less unionised

than Frankfurt; it is just much more flexible. If anything were to damage the flexibility of the London labour market, such as further regulations on working hours and conditions, that might well damage London's position.

Second, the tax regime; any significant

Well, this series in The Financial Regulator will focus on the importance of good regulation, and flexible regulation, to the international standing of a financial centre. So it's good to get your views on this.

Well, it is of critical importance. The situation in the United States is complicated

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increase in the marginal rate of income tax could be a quick way to make the City less attractive: although it is competitive at present in this respect.

The third issue is regulation. A lot of financial institutions have come to London over the years because of what they saw as a benign regulatory system that has created a level playing field. The regulatory role has moved to the Financial Services Authority (FSA). However, many of the people who run the system are the same - honourable and even-handed. One of the advantages of the FSA is that it was really becoming quite irksome for the major players to have to deal with up to five separate regulatory authorities. Each regulator had different rules and regulations; the system had become really very complex. A number of institutions have said to me how convenient it is to fly to London and be able to have only one meeting with one super-regulator. The big, mobile international institutions now have in the UK a regulatory system that actually corresponds to the way they themselves are structured.

Alongside those advantages go potential threats: the FSA might become bureaucratic, difficult, or hide behind its legalistic shell; and a number of people fear it will lose the open approach that traditionally characterised the Bank. But if the FSA can remain approachable, whilst allowing the big organisations to deal with a single regulator, the regulatory system will undoubtedly remain an important advantage for London.

by the different responsibilities of state and federal authorities; and the distinction between investment and commercial banks. Whereas in London, everybody knows what you have to do: you have to go and see Howard Davies and his people at the FSA. You might visit the Bank to talk about more general issues. But the supervisory relationship is with the FSA, where each organisation has an account officer or "point man". If you are a large group, it will be somebody in Oliver Page's team, aptly called the "Complex Group System".

How is the relationship between yourself and Howard Davies at the FSA working out?

The relationship between the Bank and FSA is good. We talk to each other all the time. We have already cooperated closely on a whole range of issues, such as Y2K and the euro. There is overlap, but it is limited. The FSA's responsibilities are day-to-day prudential supervision; we at the Bank are more macro, to do with systemic issues - and the City of London as a whole. I do not get involved at all with individual institutions, except if there was a question whether the demise of a particular institution would cause or might cause problems for the financial system as a whole.

Are there any other threats to London?

Apart from the three I have mentioned, the fourth is transport. London is a good communications hub, but it is a large and not particularly easy City to get in and out

of. The authorities are aware of this, but it is an issue.

And these issues are as important as being in or out of the euro?

Being in or out of the euro is important for some products, but will not make or break the City.

Does the City need to be better organised? Is there a need for a single spokesman?

On the latter question, many who work in the City, but importantly five or six key people, including the Governor of the Bank of England, the Lord Mayor, the City Corporation, the heads of the stock exchange and major banks, all speak for the City. British Invisibles (BI) do a good job to promote invisible exports, pulling people together, mounting overseas and inward missions to “sell” the City’s expertise. I feel that BI are pulling their weight.

The Corporation of London is also sensitive to the issue you refer to.

But does London need an organisation like Finanzplatz Frankfurt?

As I have indicated a number of people speak for the City and help promote its standing. I do not believe that concentration of this function in one organisation, even if it were practicable in a major City like London, would optimise the position.

So it is just not on to have a more organised and focused marketing effort?

Well, one of the strengths of London is its diversity. Many outsiders do not understand this. For instance, occasionally new ministers when they are first appointed will ask; “What is the City’s view?” of this or that issue. But there is rarely one City view. There certainly is not one City view about markets.

One of the strengths of London is its sheer size. Frankfurt is much smaller. It is much easier for small centres to have a single spokesman. London is not dominated by a few big banks. Moreover, one of the exciting things about London is the way in which so many distinguished people who are not

British by nationality choose to make their careers here. We do not ask these people to be quiet and let others promote London’s position. A whole raft of people can make their views known. After all, nobody speaks for New York - or rather, they all do. My conclusion is that large centres are multi-headed and cannot be easily regimented. Their strength lies in diversity.

Thus our view is that a number of people speak for the City, they all point broadly in the same direction, but it would be a mistake to clip their wings and to try to forge them into one single body.

But the reason nobody wants to speak for New York is that there is no money in being a spokesman!

Well, what’s wrong with that? Let us get on with actually providing services. Good quality service speaks for itself.

Finally, do you think there is still sense in the concept of a financial centre, even in this age of the internet?

Yes, there is still meaning in the concept of a centre although it is not as cohesive as it used to be. The trend will be towards further fragmentation because of the ease of remote access. Geographically, also, the City is far more spread out. Fifty years ago, all the major banks were within walking distance of the Bank of England. Now there are important financial institutions based everywhere from Victoria to Canary Wharf, although it is true they are still based largely in London, because that is where the pool of skilled labour is.

So the financial centre is not as cohesive as it was, but nor is it entirely fragmented. People who work in London tend to be recruited from the same labour pool, they read the same newspapers on the way to work, they watch the same TV programmes after they get home. If you fly to Hong Kong you immediately notice the change of atmosphere. There is a different agenda. The topics of conversation are different from those talked about in London. Fly on to Tokyo and the ambiance again changes. Each centre has its own unique flavour.