THE VOICE OF BUSINESS

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-- CHECK AGAINST DELIVERY --

Good evening ladies and gentlemen. Thank you for asking me to address your annual dinner.

On the day in which 10 European countries, but not the UK, have announced their intention of going ahead with a Common Financial Transactions Tax, I am pleased to have the opportunity to link the needs of British business with your vital contribution, and comment upon some of the challenges which wholesale financial markets face.

My job is to secure private sector growth here in Britain.

Recent experience has shown even some of the most cautious growth estimates have proven wide of the mark.

Not so long ago, consensus economic opinion was the UK would grow by around two per cent this year, before picking up further in 2013.

This, many acknowledged, was low by the standards of previous recoveries, but not unexpected given the particularly deep effects of the financial crisis.

Well, times change, but what doesn't is the essential wisdom of JK Galbraith's famous claim that "The only function of economic forecasting is to make astrology look respectable".

Yet again reasonable expectations of growth have been disappointed by uncertainty – primarily but not exclusively the black clouds of the Eurozone crisis.

We have not yet grown at all in 2012. I believe that the best way to sum up the economy today, balancing out challenged construction companies and successful exporters is flat. Flat but not negative, and on this basis I still believe that growth is a reasonable expectation for 2013.

What I'm in the fortunate position to be able to hear about is conditions on the ground – what business leaders from companies small, medium and large tell me about the state of their operations, and in their sector.

These observations reveal what the backward-looking data can't, which is what sentiment about the future is like.

Generally speaking, a significant majority tell me that, economic conditions notwithstanding, they are doing okay. They're remaining competitive, they're taking market share in new areas and they're innovating. Put simply, they're doing what businesses exist to do – including creating jobs.

At the risk of oversimplification I believe that this growth will come primarily from two sources – growing our medium sized sector and getting them to export to emerging economies on the one hand, and getting larger companies investing in Britain's infrastructure on the other.

That's what I have been campaigning on this year, but neither of these sources of growth can be leveraged without a greater role for wholesale financial markets in financing growth.

A lesson from the financial crisis is that the UK was over-reliant on bank finance. In the US, for example, roughly two-thirds of business financing is from equity, and one-third from debt. In the UK the opposite is true.

Let's start with mid-caps. These high-growth potential firms disproportionately cite access to finance as a barrier to growth. And they are heavily reliant on bank finance – driven by a lack of alternatives to bank finance at the smaller end of the scale. They need patient capital.

But currently only around 5% of MSBs are able to access debt capital markets.

The CBI has been heavily involved in the work taken forward by Tim Breedon on boosting alternative sources of finance to address this. In particular, we'd like to see retail bond products to support the deepening of the UK corporate bond market.

We have recommended that the government should look again at retail bond investment incentives to help maximise this important source of debt finance.

Because those companies, the UK Mittelstand, are the engines of growth, of job creation and of the export revolution which we need. And currently we don't have enough 'gazelles' growing as fast as we need.
There's more to do on infrastructure too. Of the £250bn investment required to 2015 and beyond, at least £170bn will need to come from the private sector.

Balance sheets of infrastructure providers, such as the major energy companies, alone are not big enough to stand this.

There are a number of risks to cover off, including political & regulatory risks, procurement risks and construction risks.

But the fundamental proposition seems a good fit with those seeking long-term, stable returns – such as pension funds and other long-term investors.

We need to see more investment into existing assets, and there's already some movement here with pension funds investing in the likes of Gatwick Airport and Northumbrian Water. But we also need the money going into new assets, such as new build power stations and our roads infrastructure.

How can the government help make this happen? Providing the right funding wrapper to make it a viable proposition, whether that be through UK guarantees or a recast PFI would help, as would sorting out regulations on capital in CRD IV and Solvency 2 so they aren't prejudiced against long-term investments.

And investment in infrastructure is the best way to get growth moving, enhancing short term demand and the long term capability of the economy.

So whether it be growing the mittelstand or rebuilding Britain's infrastructure your businesses and your interests are vital, in my judgement, to getting business growing.

Because for business, you provide funding for growth and enable companies to manage risk and their capital.

If we’re to achieve a breakaway from an over-reliance on traditional bank funding, investment banks and the wholesale markets have an important role to play.

Managing risk is important to getting the economy growing again, particularly if we are to up our game on exports. And companies can insulate themselves against these risks by ‘hedging’ the price.

For the economy more broadly, self-evidently wholesale financial markets enable banks to borrow from each other to support so-called ‘maturity transformation’ where they borrow for short periods of time to enable long-term lending to customers for products such as mortgages. Ensuring a balanced portfolio of assets to support pension fund investment is another critical role wholesale financial markets play.

In these and other ways you are important as an agent of growth. And you are important to the economy in your own right.
London’s wholesale financial markets employee 350,000 people and pay 40% of the £63 billion raised in taxes from financial services.
You know this stuff as well as I: I rest my case.

So much for the opportunities – what of the challenges?

It must therefore be a cause for concern for all us championing growth that financial markets are so much under challenge.

We know why, and much of it is, frankly inevitable and some of it justified.

But what do we do about it?

Well, first of all there is the reputational challenge to financial services, especially since the Libor scandal blew.

In recent months, much of the political focus has been on culture and standards in banking.

Much of the political flak has gone in the direction of the high street banks.

But the regulatory fall-out from Libor and other scandals could have major consequences for investment banks and the wholesale financial markets.

The key threat is a re-opening of the debate about bank structures which goes to the heart of the business model for these businesses.

In the past ten days, Andrew Tyrie's Commission has debated whether the Vickers "ring-fence" should be tightened so that no derivatives sit within the retail bank. It has heard evidence from Paul Volcker on his preference for a hard-split on retail and investment banking. And it has heard from Erkki Liikanen on the European variant for a ring-fence, but based on a trading threshold. All of this will play out in the UK through the Banking Bill currently before Parliament.

But for me culture change lies at the heart of this whole agenda. This must be led by banks themselves, with a desire to put customers at the heart of the business.

The question is how we can nudge things along.

Well first, by having reforms aimed at reinforcing culture change in banks:

- strengthening corporate governance, risk management and internal controls, all with more supervisory emphasis on them;
- pay reward that has a greater emphasis on behaviours and non-financial performance; a continuation of the trend towards long-term performance measures; and performance incentive triggers to be based on organisation-wide performance;
- and a change in managing customer relationships, through a renewed emphasis on relationship banking.

Second, we need to have reforms which are aimed at strengthening individual accountability:

- that means introducing a new professional code to underpin ethical standards, and one which carries real teeth with the threat of being 'struck off';
- this could be supported by an extension of the FSA 'approved persons regime';
- and the banking sector could learn from other professions and require employees to undertake a minimum specified amount of professional development training annually.

These are the measures which I think could make a difference.

I don't believe that further industry-wide structural reforms are the best way to drive culture change.

That said, some of the reforms already in train through the Vickers ring-fencing proposals with separate governance requirements will be helpful.
If reputational challenges weren't enough to keep us busy we also have regulatory ones.

As a first rank global financial centre London benefits hugely from being a bridge to service Europe and good parts of the rest of the world, certainly from a US perspective.

So top of the list of concerns for many people I speak to in the City right now is how Britain plays its hand in the debate about a European Banking Union for the Eurozone.

Most accept that it's not in the UK's wider economic interest to have any form of fiscal exposure to euro zone banks by backing a common deposit guarantee or resolution fund, and that has to be the right call.

But it's the prospect of being on the outside of the tent for rule-making on financial services, which could be shaped by euro zone member states to the detriment of the UK, which is causing the most headaches.

The main action at last week's European Council was essentially a Franco-German debate about the nature and scope of supervision.

For the UK, the critical issue is how the ECB relates to the European Banking Authority, and to ensure that the latter has primacy on the single financial market of the 27.

And this boils down to technicalities over the voting structures. The UK government is aiming for a simple majority vote taken by both the 'in' countries and 'out' countries of the common supervisory system in order for decisions to get the go ahead at the EBA. It looks ambitious, but if it can pull it off that might just be about the best result for London in what is undoubtedly a minefield to negotiate.

But as we know the regulatory challenge goes much further than the implications of banking union.

There are other areas just as challenging for financial markets to help fund growth – regulations on derivatives, short selling and third country access to name but a few – all material issues which we must get right.

So, ladies and gentlemen, to sum up.

I am a cheerleader for growth. I can see a way to rebalance the UK economy.

To do that I need Britain's Wall Street working for Britain's main street. And I can't do it without wholesale financial markets and services – without you.

I am asking more of this industry at just the moment that it is under reputational and regulatory challenge.

And there lies the conundrum. We need funding for growth, and we need to rebuild our financial services. And we need both at the same time.

No pressure then!

Thank you very much.

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