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BANKING 2008

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SUMMARY

This IFSL report gives an overview the UK banking industry and sets out its importance in an international context.

Global capital markets have been affected by a significant re-pricing of credit risk and a liquidity squeeze since the second half of 2007. By end of January 2008, banks around the world have reported losses of around $130bn related to US sub-prime loans. Some estimates indicate that overall losses could reach $450bn in the coming years. In the UK, liquidity pressures and tightening in global money markets has affected banks that are dependent on those markets for finance such as Northern Rock. The Government has published proposals involving reform of banking regulations and introduced legislation in February 2008 to nationalise Northern Rock.

The UK banking industry Assets of the UK banking sector reached £6,964bn at the end of 2007, up 11% on 2007. Foreign banks held 58% of the total. UK bank lending reached £4,127bn at the end of 2007, up 8% from the previous year. As funding pressures increased in the last four months of 2007, market loans of UK resident banks fell £3.4bn while claims under sale and repurchase agreements dropped by £25.2bn (Chart 1). In March 2007 there were 331 banks authorised to conduct business in the UK. The 254 foreign banks physically located in the UK is more than in any other country.

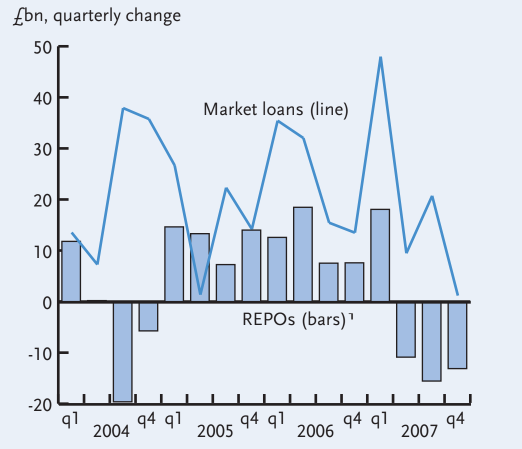
Investment and private banking Global investment banking fee revenue increased 21% in 2007 to a record $84.4bn. Despite record fee income, many investment banks experienced substantial losses related to their US sub-prime securities investments. The US was the primary source of fee income in 2007 with 53% of the total, followed by Europe 32% and Asia 15%. Although the UK was the source of around a quarter of European investment banking fee revenue, around a half of European investment banking activity was conducted through London.

Contribution to the UK economy Net exports of UK banking are expected to reach a record £14bn in 2007, up on £12.1bn in the previous year. The UK banking industry contributed around £50bn to the UK economy in 2005, equivalent to 4.6% of GDP, or over half of the 8.8% generated by the financial sector as a whole. Banks located in the UK provided employment for 432,000 people in 2006.

International comparisons Worldwide assets of the largest 1,000 banks grew 16% in 2006/2007 to reach $74.2 trillion. EU banks held the largest share, 53%, up from 43% in 1999/2000. US banks held 14% while most of the remainder was from Asian and other European countries.

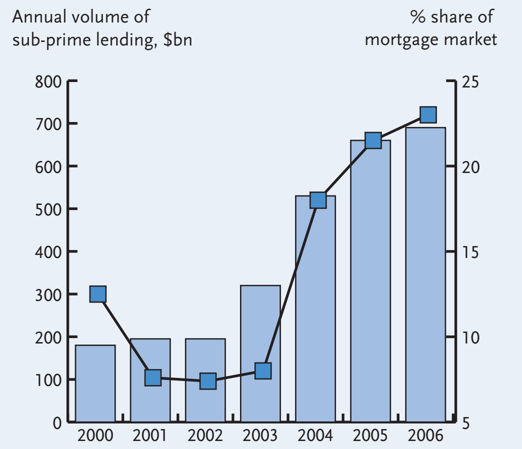
The international position of UK banking is indicated by: deposits being the second largest in the world after the US; the UK is the largest centre for cross-border banking with around 20% of the global total; UK banks have a higher return on capital than most other advanced economies; and the UK is one of the most important centres for private and investment banking.

Chart 1 UK resident banks' interbank lending



¹ Claims under sale and repurchase agreements
Source: Bank of England

Chart 2 Growth of sub-prime lending



Source: Center for Responsible Lending; BBC

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INTERNATIONAL BANKING MARKET

Global capital markets have been affected by a significant re-pricing of credit risk and a liquidity squeeze since the second half of 2007. The credit crisis began with a decline in US house prices and high default rates on "subprime" and other mortgage loans made to customers with weak credit histories or poor creditworthiness (Charts 2 and 3). Traditionally, banks have financed their mortgage lending through deposits they received from their customers. Over the past decade there has been a fundamental change in the way mortgages are funded, with many banks selling on mortgages to the bond markets in order to fund additional lending.

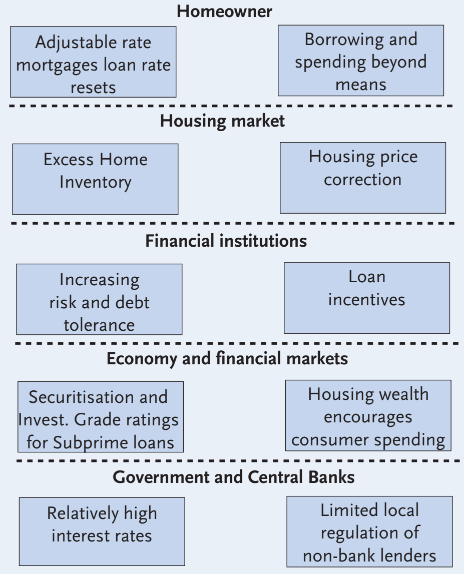
The "sub-prime" crisis Through securitisation (Chart 4), many "subprime" mortgage loans were transferred to mortgage backed securities (MBS). These securities are then rated by rating institutions such as Moody's, S&P, etc. In addition MBS are sold on to investors through collateralised debt obligations and structured investment vehicles. In this way, mortgage lenders had passed the risks of sub-prime lending to third-party investors such as pension funds, hedge funds, investment banks and insurance companies. Although the European market has no direct equivalent to the US "subprime" industry, many European banks have holdings of such securities.

Beginning in late 2006, many "subprime" mortgages in the US became default as homeowners ran into financial difficulties following a series of interest rate rises and a fall in house prices. As borrowers became unable to make payments, there were losses and downgrades on related asset-backed securities and other structured instruments. The value of markets for asset-backed securities fell and wholesale banks became reluctant to grant banks and mortgage providers new loans or did so at much higher interest rates (Chart 5). The bond market for mortgages became less liquid, and the ability of banks to obtain funds through the wholesale market became restricted. In September 2007, the US crisis affecting the global financial sector became even more visible when a major UK mortgage provider, Northern Rock, turned to the UK authorities for liquidity support (see page 11).

The liquidity concerns drove central banks, as the "lenders of last resort", to inject funds into the market to encourage member banks to lend funds and re-invigorate the commercial paper markets. As interest rates on a large number of "subprime" mortgages in the US are due to adjust upward during 2008, banks may be faced with further significant losses. These risks were the primary factors in the decision of the US Federal reserve to cut interest rates early in 2008. Restrictions on lending practices are under consideration in the US and many lenders have cut down or stopped subprime lending.

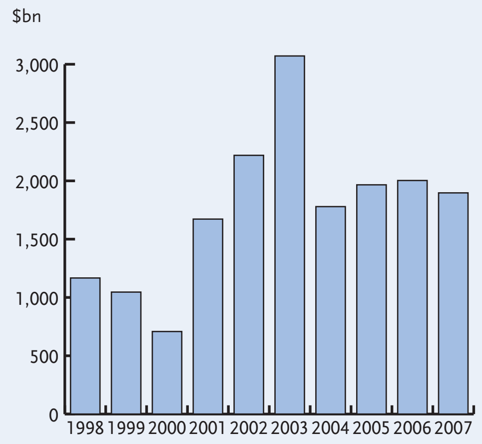
The losses and reduction of liquidity on the wholesale mortgage markets have placed downward pressure on global economic growth. Because of the reduction in willingness of banks to loan funds to other banks and customers, there may be a decrease in investment by businesses and a reduction in consumer spending. The downturn in the housing market may place additional pressure on economic growth.

Chart 3 Causes of US sub-prime crisis



Source: Wikipedia; Contributor Farcaster

Chart 4 Mortgage related securities issuance



Source: SIFMA

Causes of the "sub-prime" crisis

Major contributory factors to the "sub-prime" crisis were poor lending practices and mispricing of risk. A mix of participants were involved in the "sub-prime" crisis:

- Homeowners: Subprime lending has been the major contributor to the increase in home ownership in the US in recent years. Easy to obtain mortgages, combined with the assumption that housing prices would continue to appreciate, encouraged many borrowers to obtain adjustable rate mortgages they could not afford after the initial incentive period. As interest rates went up, many homeowners were forced to default on their mortgages and foreclosures increased significantly in 2006 and 2007.

- Housing market: House prices in the US had been rising consistenly in the decade up to 2006. The housing price correction since then and defaults and foreclosure activity created an excess inventory of homes further contributing to the downturn in the housing market.

- Financial instituitions: Lenders offered an increasing array of higher-risk loans to higher-risk borrowers. The share of subprime mortgages to total originations in the US increased from 9% to 20% in the decade up to 2006. The secondary market for mortgages added to finances available for mortgages. The securitised share of subprime mortgages increased from 54% in 2001 to 75% in 2006.

- Mortgage brokers: do not lend their own money and have big financial incentives for selling riskier loans since they earn higher commissions. In 2006, Mortgage brokers originated 68% of all residential loans in the US, with subprime loans accounting for more than 40% of volume.

- Mortgage underwriters: determine if the risk of lending to a particular borrower is acceptable. In 2007, 40% of all subprime loans were generated by automated underwriting. It is likely that automated controls led them to approve borrowers that under a less-automated system would not have been made.

- Credit rating agencies: In the past five years, the private sector has increased its role in the mortgage market, specialising in higher risk "subprime" mortgages giving these types of securities much higher ratings then they should have, thus encouraging investors to buy into these securities. The market for mortgages had previously been dominated by government sponsored agencies with stricter rating criteria.

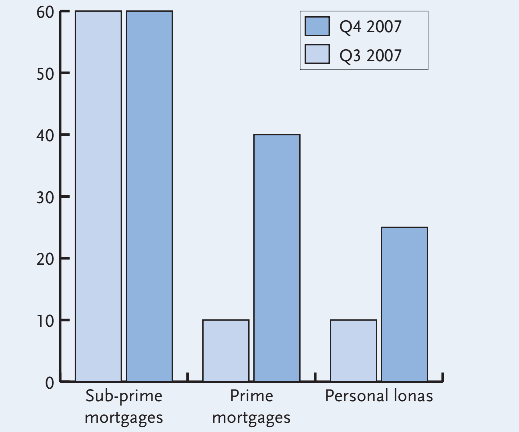
Largest banking centres

The global banking industry experienced strong growth in the last few years. Worldwide assets of the largest 1,000 banks grew 16.3% in 2006/2007 to a record $74.2 trillion (Chart 6). This follows a 5.4% increase in the previous year. EU banks held the largest share, 53% in 2006/2007, up from 43% in 1999/2000. The growth in Europe's share was mostly at the expense of Japanese banks whose share more than halved during this period from 21% to 10%. The share of US banks remained relatively stable at around 14%. Most of the remainder was from other Asian and European countries.

UK banking sector deposits are the third largest in the world and the largest in Europe. According to the latest available international comparisons, UK banks' deposits reached $4.6 trillion at the end of 2005. This was second only to the US with around $5.1 trillion. The UK's strong position is largely a reflection of the international character of its banking industry as more than half of its banking sector assets are foreign owned. Other European countries with substantial deposits include Germany, France, Switzerland and Italy (Chart 7).

Chart 5 Banks tightening standards for loans

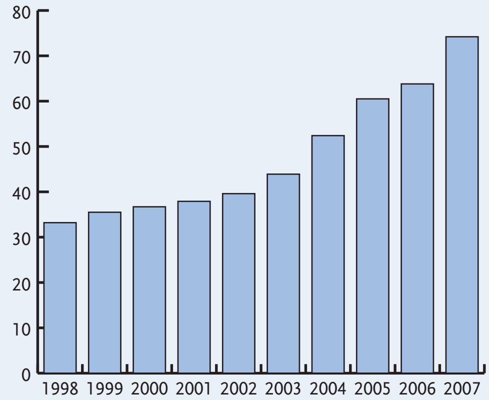
Percentage of banks tightening standards for loans



Source: BBC

Chart 6 Worldwide assets of the banking industry

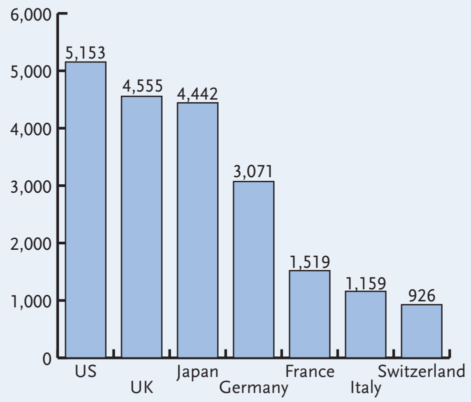
Assets of largest 1,000 banks, $ trillion



Source: The Banker

Chart 7 Largest banking centres

Deposits, $bn, 2005



Source: European Banking Federation, US Federal Reserve, Bank of Japan

The US had by far the most banks and branches in the world (Chart 8). The large number of banks in the US is an indicator of its geographical dispersity and regulatory structure resulting in a large number of small to medium sized institutions in its banking system. In Western Europe, Germany, France and Italy had around 30,000 branches each. This was twice the number of branches in the UK. Germany had the highest number of registered banks and the most employees.

Cross-border banking

International lending and borrowing Statistics on international banking flows collected by the Bank for International Settlements (BIS) show that the UK, with 20% of bank lending in June 2007 (Chart 9), is the world's largest single market for international banking business. BIS figures estimate the total outstanding value of cross-border lending at $29,981bn in June 2007. Germany, with 11%, had the second largest share. Elsewhere, market share remains relatively stable with offshore banking centres retaining around a fifth of banking flows.

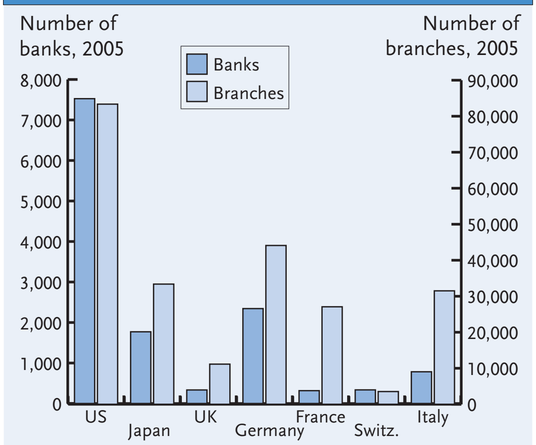
The international character of the UK market for cross border lending is reflected in the range of countries represented there and the spread of currencies. The most active banks in cross border banking located in the UK are British-owned, followed by German, Swiss and US banks. The dominant currencies are the US dollar and euro, each with around 35% of UK-based cross border lending, followed by sterling with 12%. The most important borrowers in the global lending market are industrialised countries. The UK had the largest share with 23% of the total, followed by the US with 13%, and France with 9%.

Number of foreign banks Statistics on the number of foreign banks reveal that London remains the most popular centre with 264 foreign banks located there in March 2005. This next most popular location was New York, which had 228 foreign branches. The smaller number of foreign banks in New York is largely an indicator of the nature of the US banking industry which is more oriented towards serving the domestic market (Chart 10).

Liberalisation There has been a global trend towards autonomous liberalisation in banking and other financial services sectors, particularly in developing country markets. However, numerous barriers to international trade in financial services remain in place in many countries. A sectoral agreement in financial services was concluded in the WTO in 1997 but the liberalisation commitments made by participating countries at that time were based largely on the status quo. That agreement, therefore, did little to ease the restrictions that exist in the financial services sector.

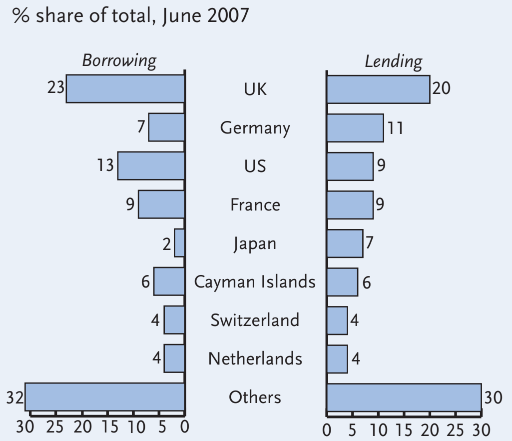
The current round of WTO negotiations was launched at Doha in 2001. It includes negotiations on opening agricultural and manufacturing markets, as well as services and expanded intellectual property regulation. The round was set to be concluded in four years but ran into difficulties regarding opening agriculture markets. A consequence of the slow progress in negotiations was the resurgence of regional trade agreements in the form of free trade

Chart 8 Number of banks and branches in largest banking centres



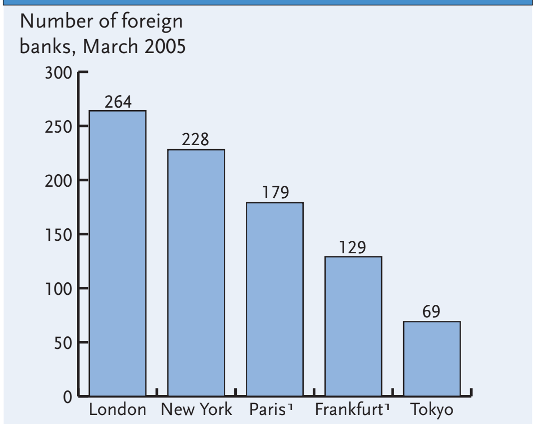
Source: European Banking Federation, US Federal Reserve, Bank of Japan

Chart 9 Origin of cross-border transactions



Source: Bank for International Settlements

Chart 10 Number of foreign banking institutions



[1] March 2003
Source: IFSL, The Banker, BIS, Financial Services Authority, Bank of England

agreements and bilateral trade agreements. Free trade agreements, many of which are bilateral, are arrangements in which countries give each other preferential treatment in trade by eliminating tariffs and other barriers on goods. The EU is pursuing targeted bilateral trade agreements as part of a wider EU strategy centred on the WTO and the multilateral trading system. In 2007, the EU launched negotiations on free trade agreements with Korea, ASEAN countries and India. Since September 2006, the EU has also been in negotiations with China on a new Partnership and Co-operation Agreement.

Comparisons of bank profitability

Pre-tax profits of the world's largest 1,000 banks grew by 22% in 2006/07 to $786.3bn (Chart 11). This was the fourth successive year of growth. Average global return on capital (pre-tax profits to Tier 1 capital) totalled 23.3% in 2006/07, up 3% on the previous year. Factors which contributed to growth in profits during this period included a very positive economic environment in both the major advanced economies and key emerging markets, the expansion in retail banking and advances in technology.

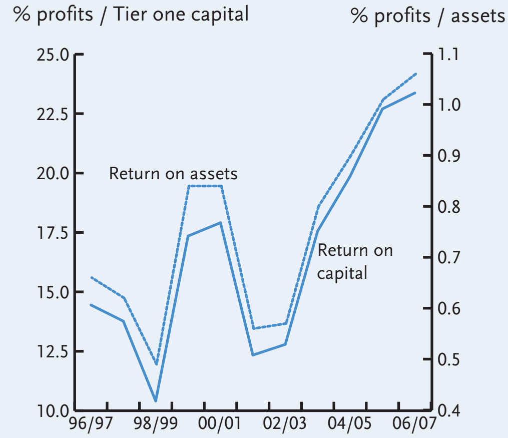
Amongst the major economies, banks in the US achieved the highest return on capital in 2006/07 (22%) and generated the most profits of any single country in the world. This was largely a result of income coming from core commercial and retail activities, such as the mortgage and personal finance sectors. Rates of return in the UK, France and Japan were all in the range between 15% to 20%, with Italian and German banks lagging at around 5%. Japanese banks in particular have posted a significant turnaround in recent years.

Many banks are facing huge losses as a result of the sub-prime crisis. By the end of January 2008, banks around the world have reported losses of approximately $130bn related to sub-prime loans. Some estimates indicate that the overall losses suffered by financial institutions could be between $220bn and $450bn in the coming years. As a result, pre-tax profits of the world's largest banks could halve in 2007/08. Banks which are largely domestic and are less involved in securitised loans related to the "sub-prime" market have been much less affected.

In January, 2008, Société Générale announced that a single futures trader at the bank had fraudulently lost the bank $7.1bn through futures trading. This is the largest such loss in history, much larger than the transactions that brought down Barings Bank. Partly due to the loss, that same day two credit rating agencies reduced the bank's long term debt ratings: from AA to AA- by Fitch, and from Aa1/B to Aa2/B- by Moody's. The bank also wrote off $3bn because of exposure to the US sub-prime market.

The cost/income ratio is an important indicator of banking efficiency, measuring banks' operating costs as a proportion of total income. According to this measure the cost/income ratio in the UK totalled 50.2% in 2006/07 an improvement on the previous year's 53.7%. EU countries and the US both had a cost/income ratio of close to 60% while Japan remained the worst performer of the major economies (Table 1).

Chart 11 Return on capital and assets in all banks



Source: The Banker

Table 1 Return on capital and cost/income ratio

	% profits/ Tier One capital 1999/00	% profits/ Tier One capital 2006/07	Cost/income ratio 2006/07
US	20.4	22.2	59.9
UK	26.1	19.6	50.2
Italy	18.5	6.2	58.3
France	7.6	15.7	63.9
Germany	12.2	4.7	61.5
Japan	3.2	16.2	69.4
Average	**17.9**	**23.3**	**57.5**

Source: The Banker; IFSL estimates

Offshoring involves companies relocating a business process from their home market to another country. This has been a growing trend in recent years. Typically, companies contract with outside sources to handle a business function at a lower cost. As pressures on profit margins have increased over the past few years, banks have placed more focus on managing costs by consolidating business operations. Since the mid-1990s, technological developments and a fall in telecommunications costs have allowed for greater independence of operations from market-place. As a result the range of business processes that may be considered for outsourcing and offshoring has broadened. Functions which are typically offshored include software and hardware development, customer support and IT services. India is the most popular destination for offshoring, with Asia as a whole being the largest regional destination. The offshoring market is dominated by US companies which account for 70% of the market. European and Japanese companies make up most of the remainder, with the UK being a dominant player in Europe.

Largest global banks

Banks' business is becoming more global, facilitated by the reduction in barriers to international trade and technological developments. The distinction between banks and other providers of financial services has narrowed in recent years. As a result of consolidation in the banking sector, the share of assets of the largest ten banks worldwide increased from 14% in 1998/99 to 19% in 2006/07 (Chart 12). The share of the next forty banks also rose during this period, from 35% to 41% while the share of the remaining 950 banks decreased from 51% to 39%. There has been much less merger and acquisition activity in recent years than in the 1990s. However, further consolidation is likely, especially in Continental Europe with the banking sector in Germany, France and Italy being more fragmented than the UK.

In 2006/07, Bank of America Corp was by far the largest bank in the world in terms of Tier 1 capital (Table 2). US banks held three of the top five places with Citigroup second and JP Morgan Chase & Co fifth. UK's HSBC Holdings was third and Credit Agricole Group based in France fourth. Countries with most banks among the Top 1000 were the US (185), Japan (101) and Germany (88) while the UK had 30.

Difficulties in South-East Asia and Japan had a substantial impact on the largest Japanese banks. In the mid 1990s, Japanese banks held the top six places in the rankings of largest banks. In 2006/07, there was only one Japanese bank amongst the largest ten. The number of US and European banks at the top of the rankings has increased during this period. Chinese banks have gained in strength during 2006/2007 with two Chinese banks making the top 10 list for the first time (Table 14).

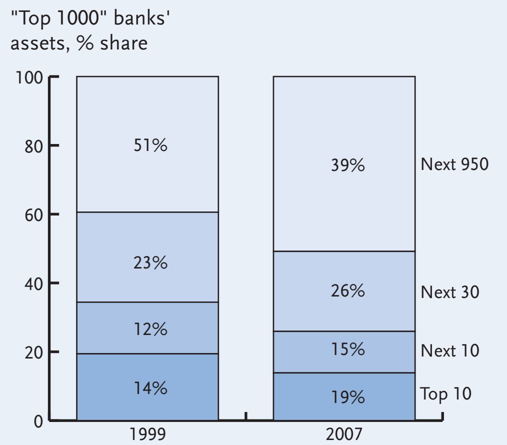
Competition in the banking sector has been intensified by new players such as internet banks and institutions whose parent companies are not part of the traditional banking sector. These include supermarket banks, insurance companies, utilities companies, transportation companies and others. Competition between banks and other financial-service companies in the provision of banking products and services is therefore likely to grow.

Table 2 Largest banks in the world

$bn, 2006/07			Tier One Capital
1	Bank of America Corp	*US*	91.1
2	Citigroup	*US*	90.9
3	HSBC Holdings	*UK*	87.8
4	*Credit Agricole Group*	*France*	84.9
5	JP Morgan Chase & Co	*US*	81.1
6	Mitsubishi UFJ Financial Group	*Japan*	68.5
7	ICBC	*China*	59.2
8	Royal Bank of Scotland	*UK*	59.0
9	Bank of China	*China*	52.5
10	Santander	*Spain*	46.8
11	BNP Paribas	*France*	45.3
12	Barclays Bank	*UK*	45.2
13	HBOS	*UK*	44.0
14	China Construction Bank Corp.	*China*	42.3
15	Mizuho Financial Group	*Japan*	41.9
	Other UK banks in the top 100		
29	Lloyds TSB Group		25.2
56	Standard Chartered		12.8

Source: The Banker

Chart 12 Concentration of global banking



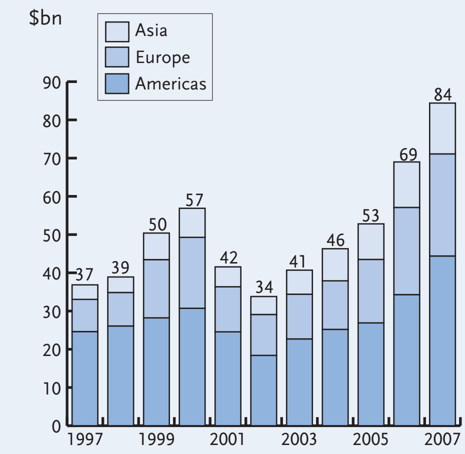
Source: The Banker

INVESTMENT AND PRIVATE BANKING

Size of the investment banking industry

Global investment banking revenue increased for the fifth year running in 2007 to a record $84.3bn (Chart 13). This was up 21% on the previous year and more than double the level in 2003. Despite a record year for fee income, many investment banks have experienced large losses related to their exposure to US sub-prime securities investments (Table 3). Merrill Lynch for example made a overall net loss of $7.8bn in 2007, from a net profit of $7.5bn in 2006. Citigroup posted a $9.8bn loss in the last three months of 2007 and estimate that their exposure to bad mortgage debt is over $18bn. Due to the large losses, both Merrill Lynch and Citigroup have sought new sources of capital from sovereign wealth funds in Asia and the Middle East. Many investment banks are likely to experience further losses in 2008 on their investments in assets backed by sub-prime mortgages.

Chart 13 Global investment banking sources of revenue by region



Source: Freeman & Co

Most of fee income in 2007 came from investment banks' core activities such as mergers and acquisitions business, and debt and equity capital markets underwriting. Fee income in the European investment banking industry was particularly strong in 2007 largely due to strong mergers and acquisitions activity. Commodities trading in emerging markets driven by record oil prices and continuing industrialisation of China and funds coming from Russia and the Middle East were also a major source of income in 2007.

The US accounted for 53% of total investment banking revenue in 2007, a proportion which has remained relatively stable since 2000. Europe (with Middle East and Africa) generated 32% of the total with Asian countries generating the remaining 15%. Over the past decade, fee income from the US increased by 80%. This compares with a 217% increase in Europe and 250% increase in Asia during this period.

Table 3 Sub-prime losses

$bn, January 2008	
Merrill Lynch	22.1
Citigroup	18.0
UBS	13.5
Morgan Stanley	9.4
HSBC	3.4
Bear Stearns	3.2
Deutsche Bank	3.2
Bank of America	3.0
Barclays	2.6
Royal Bank of Scotland	2.6

Source: BBC

Investment banking in the UK History and geography have played an important part in establishing the UK's leading position in Europe and its global importance. But its continued leadership is a function of its trading culture, skills base and language. London can offer greater depth and breadth of expertise than any other financial centre.

Although the UK was the source of 26% of European investment banking fee revenue in 2007, around a half of European investment banking activity was conducted through London. The majority of investment banks are either headquartered or have a major office there. The largest international banks in London each employ several thousand people.

Investment banks' business

Most investment banks' work is undertaken on behalf of large companies, banks and government organisations with some also providing a service to wealthy individuals. A number of investment banks, particularly from the US, have expanded into the retail sector while at the same time some commercial banks through mergers and acquisitions have increased their presence in investment banking.

Investment banks' business can broadly be categorised into: corporate finance and advisory work, treasury dealing, investment management and securities trading. Only a few investment banks provide services in all these areas. Most others tend to specialise to some degree and concentrate on a few product lines. A number of banks have diversified their range of services by developing businesses such as proprietary trading, servicing hedge funds or making private equity investments.

Product breakdown Merger and acquisition (M&A) advisory accounted for 51% of total fee revenue in 2007, with the remainder generated by equity underwriting (30%) and fixed income underwriting (19%) (Chart 14).

M&A advisory has been the main source of fee income since the mid 1990s. Over the past decade it generated more than 40% of investment banking revenue. M&A advisory work accounted for $42.8bn, or 51% of investment banks' fee revenue in 2007 slightly up on its 49% share in the previous year. As shown in Chart 15, M&A advisory work was also the major source of investment banks'business originating from the UK with 59% of the total in 2007.

Corporate merger and acquisition activity increased by a quarter in 2007 to $4.5 trillion. This was the highest level since 2000 (Chart 16). Cross-border activity accounted for a record 47% of global activity in 2007. The US generated 36% of deal volume, down on its 41% share in the previous year. Activity in Europe grew by 26% to $1.8 trillion and surpassed activity in the US for the first time in the past five years. The growth in recent years was across all sectors and was partly driven by emerging European markets such as Russia, Turkey, Eastern and Central Europe. UK activity accounted for a quarter of Europe's share in 2007.

Equity underwriting generated $25.0bn or 30% of investment banks' fee revenue in 2007. The proportion of investment banks' income originating from equity underwriting ranged between 30% and 38% over the past decade.

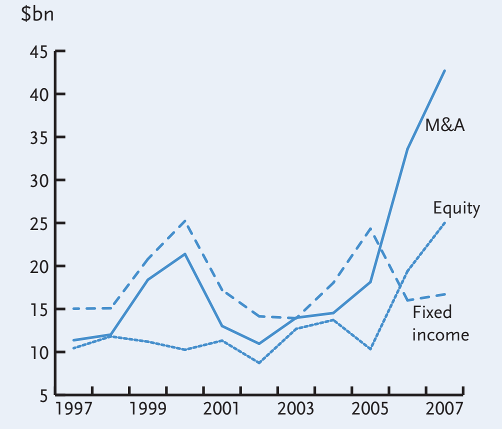
Fixed income underwriting accounted for 19% of total investment banking fee revenue in 2007, down on its 23% share in the previous year. The fall in its share was largely due to the recovery in M&As and equity underwriting income.

Despite a drop in its share to 26% in 2007, the financial sector, with the exception of 2000, was the largest generator of investment banking revenue over the past decade (Chart 17). The importance of technology companies as a source of investment banks' fees declined sharply from their 39% peak share in 2000 to 14% of investment banks fees in 2007. Fee income from the energy sector, particularly oil, gas and power companies, increased markedly over the past decade, having grown more than four-fold. Other fee generating industries include the consumer, healthcare and capital goods sectors.

Largest investment banks

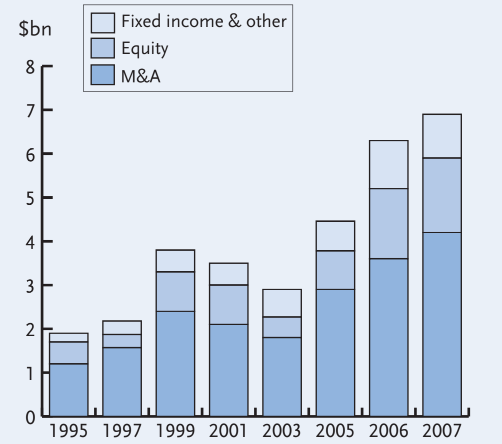
Consolidation in the investment banking sector has created a few global

Chart 14 Global investment banking sources of revenue by product



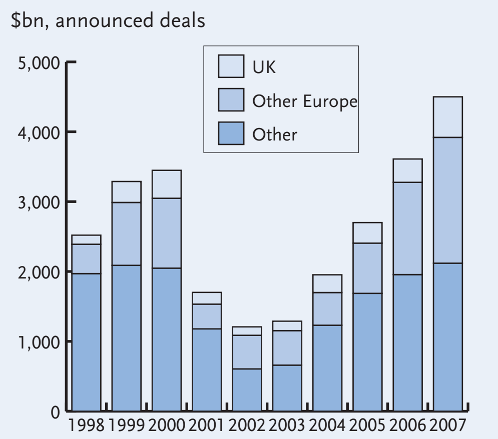
Source: Freeman & Co

Chart 15 UK investment banking sources of revenue by product



Source: Freeman & Co

Chart 16 Global M&A activity



Source: Thomson Financial

companies which dominate the industry. Other investment banks have focused on particular products or regions. In 2007 the top ten European investment banks generated nearly a half of European investment banking revenue. The largest three banks, Deutsche Bank, JP Morgan and UBS between them accounted for nearly a fifth of the income (Table 4). Consolidation in Europe has created larger investment banks, although these are still not as big as their US counterparts, whose capital resources enable them to offer a broad product range supported by strong international distribution networks.

Table 4 Largest European investment banks

	-------- 2007 --------		-------- 2006 --------	
	Revenue, $m	*% share*	Revenue, $m	*% share*
1 Deutsche Bank	2,173	*7.1*	2,031	*6.7*
2 JP Morgan	1,789	*5.8*	1,774	*5.8*
3 UBS	1,724	*5.6*	1,415	*4.7*
4 Morgan Stanley	1,667	*5.4*	1,619	*5.3*
5 Citigroup	1,605	*5.2*	1,780	*5.9*
6 Goldman Sachs	1,493	*4.9*	1,513	*5.0*
7 Credit Suisse	1,435	*4.7*	1,487	*4.9*
8 Merrill Lynch	1,411	*4.6*	1,242	*4.1*
9 BNP Paribas	1,037	*3.4*	1,076	*3.5*
10 ABN Amro	942	*3.1*	---	---
Others	15,424	*50.2*	16,463	*54.2*
Total	**30,700**	**100.0**	**30,400**	**100.0**

Source: Dealogic

Private banking

Private banking institutions showed a strong increase in profits and assets under management in 2006 driven by global equity market growth, new funds and improved efficiencies. According to Scorpio Partnership's annual Private Banking Benchmark study, pre-tax profits of 180 private banks surveyed increased by 24% during the year, while assets under management grew by 14% to $10.8 trillion.

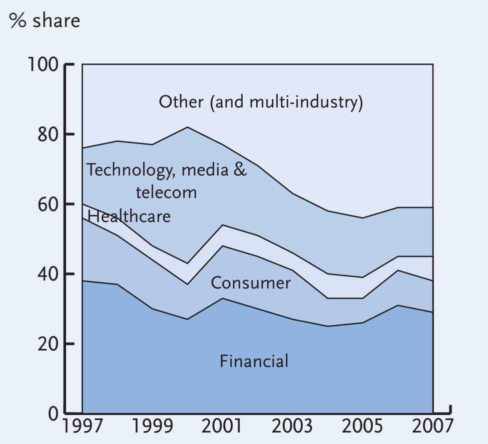
Merrill Lynch/Cap Gemini Ernst & Young's (MLCG) annual *World Wealth Report* 2007 estimated that the value of funds managed on behalf of 9.5 million high net worth individuals (NWIs) with over $1m of investable assets was $37.2 trillion in 2006 (Chart 19). This was 11% up on the previous year. In its annual report *Global Wealth 2006,* BCG (Boston Consulting Group) estimated that the total value of assets managed on behalf of all investors totalled $97.9 trillion at end-2006.

Private banking in the UK London is one of the major onshore centres for private banking along with New York, Tokyo, Singapore and Hong Kong. A major trend in recent years has been the growing attraction of onshore centres. UK offshore locations are also amongst the more important destinations for offshore banking.

Some of the key aspects of London's strong position as an international centre for investment and private banking include its expertise in: asset management and investment advice; emerging market investments; and Islamic financial services. London also has a central position between the US and Asian timezones. The concentration of firms in one location contribute to economies of scale which helps to reduce costs.

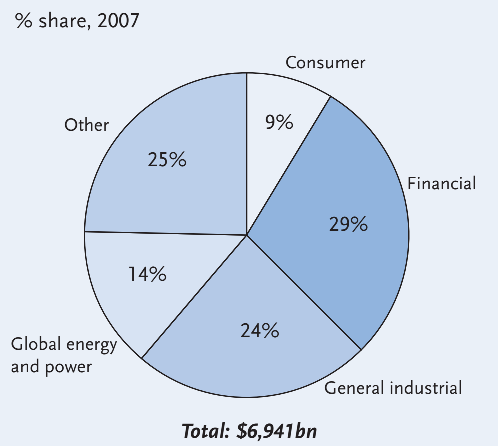
Largest private banks Competition in private banking has expanded in recent years as the number of banks providing private banking services has increased dramatically. The private banking market is relatively fragmented with many medium sized and small players. It is however heavily concentrated at the top end with the largest three private banks accounting for nearly 40% of total assets under management at the end of 2006 (Table 5). Banks from Switzerland and the US feature high in the rankings. UBS and Citigroup had the most assets under management closely followed by Merrill Lynch. HSBC is the only UK bank to feature on this list, although all of the top private banks have a substantial presence in London.

Chart 17 Global investment banking sources of revenue by industry



Source: Freeman & Co

Chart 18 UK investment banking sources of revenue by industry

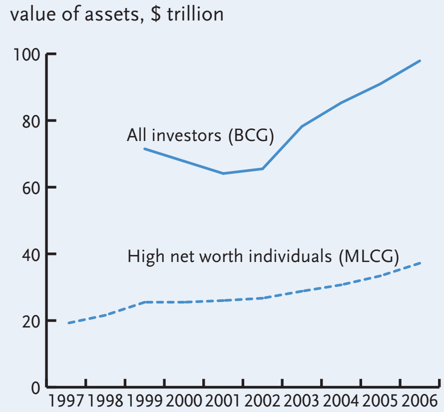


Source: Freeman & Co

Islamic banking

The global market for Islamic financial services, as measured by Sharia compliant assets, is estimated to have reached $531bn at end-2006, having grown by over 10% a year from about $150bn in the mid-1990s (Chart 20). Islamic commercial banks accounted for 75% of the assets $397bn, and investment banks 13%, $66bn. The balance is made up by Sukuk issues $44bn; assets of equity funds and other off-balance sheet investments $14bn and assets of Takaful providers $10bn. Standard & Poor's has estimated that the potential market for Islamic finance could be $4 trillion, over seven times its current size. London has been providing Islamic financial services for 30 years, although it is only in recent years that this sevice has begun to receive greater profile. Over 20 banks in the UK supply Islamic financial services, more than in the rest of Western Europe combined.

Chart 19 Global private wealth



Source: The Boston Consulting Group (BCG) Merrill Lynch Capgemini (MLCG)

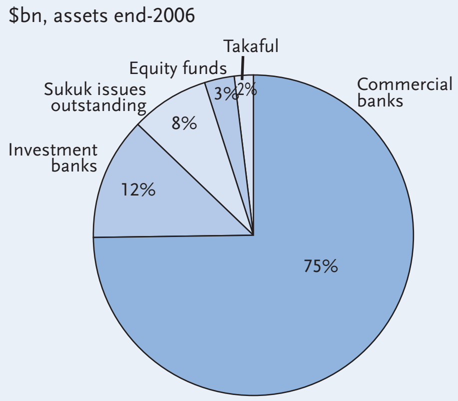
Table 5 Largest private banks

Assets under management, end-2006

	$bn	% share
1 UBS	1,608	14.8
2 Citigroup	1,438	13.3
3 Merrill Lynch	1,209	11.2
4 Credit Suisse	642	5.9
5 JP Morgan	465	4.3
6 Morgan Stanley	450	4.2
7 HSBC	408	3.8
8 Deutsche Bank	249	2.3
9 Wachovia	206	1.9
10 Pictet	192	1.8
Other	6,869	63.4
Total	10,840	100.0

Source: Scorpio Partnership

Chart 20 Islamic finance



Total assets end-2006: $531bn

Source: IFSL estimates based on The Banker, Ernst & Young, World Islamic Funds & Capital Markets Conference

THE UK BANKING INDUSTRY

Assets

Assets of the UK banking sector totalled £6,964bn at the end of 2007, up 11% on the previous year and nearly double the total in 2001. UK-owned banks' assets totalled £2,955bn or 42% of the total (Chart 21). As funding pressures increased in the latter part of 2007 due to the "sub-prime" crisis, banks have been reluctant to commit funding in interbank markets. Market loans of UK resident banks fell £3.4bn in the last four months of 2007, while claims under sale and repurchase agreements dropped by £25.2bn. The corresponding figures in 2006 are increases of £19.2bn and £13.6bn (Chart 22). The liquidity pressures and sharp tightening in money markets, has particularly affected banks that are dependent to a larger extent on those markets for finance such as Northern Rock (see box below).

Northern Rock

Growth in mortgage lending in the UK has steadily been growing over the past decade fulled by rising house prices and a strong economy. Most lenders in the UK operate by lending out the assets they hold for savers and earning a spread on the interest rate they pay savers versus the higher rate they charge borrowers for use of the assets. Some banks however increasingly used wholesale sources to fund customer lending during this period. As the functioning of the interbank market became impaired due to the sub-prime crisis in the US, the banks which were dependent to a larger extent on these markets ran into funding problems.

Northern Rock is one of the top five mortgage lenders in the United Kingdom in terms of gross lending. Over the past eight years it has relied on a growth strategy which has largely been dependent on wholesale credit markets in funding its mortgage lending, three-quarters of its funds coming from this source. During this period it trebled its share of the UK mortgage market. As liquidity in the global asset markets dried up, it was confronted with difficulties in raising funds to replace its maturing money market borrowings. Northern Rock was more vulnerable than most UK banks to the credit crunch.

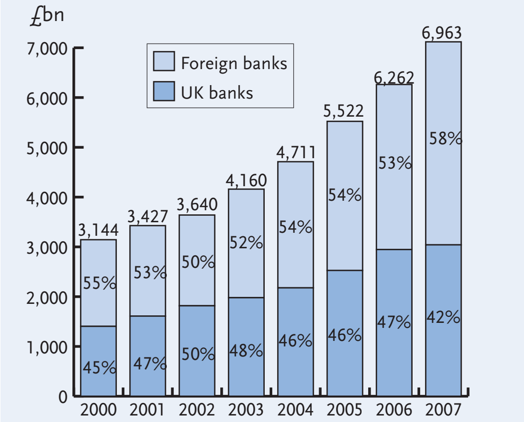
On 13 September 2007, Northern Rock asked the Bank of England for a liquidity support. Bank of England figures indicate that Northern Rock borrowed £3bn from the Bank of England in the following few days of this crisis prompting the first 'run' on a UK bank in more than 150 years. Northern Rock is not the only British bank to have called on the Bank of England for funds since the sub-prime crisis began but is the only one to have had emergency financial support from the Tripartite Authority (The Bank of England, the FSA and HM Treasury). By January 2008, Northern Rock's loan from the Bank of England had grown to £26bn.

The UK government has developed a plan under which Northern Rock would set up a special purpose vehicle and will then sell it a pool of its assets. In order to finance the transaction, it will raise funds on the capital markets by issuing bonds guaranteed by the Government. The net proceeds of the financing will go to the Treasury to repay the Bank of England's loans. The bonds will have a government guarantee, making them in effect, gilt-edged notes. It is thought that the bonds will have several issues with differing dates by which they must be repaid. The government would also continue to guarantee the Bank's liabilities, such as savers' deposits.

In January 2008, The Government proposed that the Bank of England be given powers to offer limited covert bank rescue operations under new plans, to avoid a repeat of the Northern Rock crisis. The Financial Services Authority would also have the right to demand more information from banks about their financial health. A three-month consultation on the proposals, which would see a radical reform of banking regulations has been initiated. Under the proposals the Bank of England would be able to provide emergency covert liquidity support for a "short period". Savers could also get greater protection over their deposits in a potentially pre-funded deposit guarantee scheme.

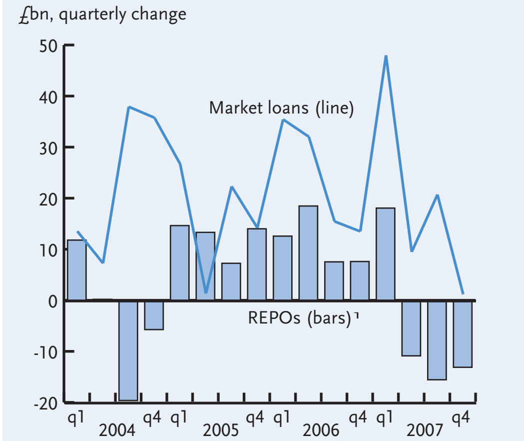
The Office for National Statistics reclassified Northern Rock into a public company in February 2008 due to levels of support and control the Government had over its business. Northern Rock's debt was brought on to Government books increasing its debt burden by around £100bn. The Government introduced legislation mid-February to nationalise Northern Rock.

Chart 21 UK banking sector assets



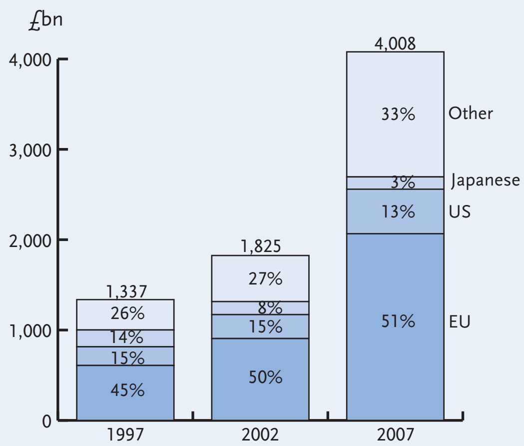
¹ The drop in UK banks' share between 2006 and 2007 is largely due to changes in reporting population
Source: Bank of England, IFSL calculations

Chart 22 UK resident banks' interbank lending



¹ Claims under sale and repurchase agreements
Source: Bank of England

Chart 23 Foreign owned UK banking sector assets by country



Source: Bank of England, IFSL calculations

Foreign banks Foreign banks held the majority (58%) of UK banking sector assets at end-November 2007 or £4,008bn. Major trends during the last decade include (Chart 23):

- Growing presence of banks from the EU, which increased their share of foreign banks' assets from 46% to 51% over the past decade;
- The stability of US banks' position in the past decade whose share fluctuated between 12% and 16%, having previously fallen from 34% in 1980;
- Declining value of Japanese banks' assets and a fall in their share in the ten years up to November 2007 from 21% to 3%. This reversed the 1980's trend when assets of Japanese banks had risen rapidly.
- Increasing share of assets of banks from other areas of the world, rising from 25% to 33% during this period.

Number of banks

The UK banking sector consists of banks incorporated in the UK and foreign banks operating in the UK.

UK incorporated banks The number of UK incorporated banks declined between 1999 and 2007 from 200 to 157 due to a fall in the number of UK-owned banks (Table 6). This was mostly due to mergers and closures of some small institutions. UK incorporated banks consist of UK and foreign owned banks authorised by the Financial Services Authority (FSA) under the Financial Services and Markets Act 2000 (FSMA). These mainly include commercial banks, investment banks, foreign owned banks and banks operated by retail companies.

Foreign banks in the UK London is a major centre for international banking and many foreign banks have located branches and representative offices there. In March 2007 there were 254 foreign banks that were physically located in the UK, with the majority of these located in the City of London. Most of these banks were from Japan, Germany, US, Italy and Switzerland. There are also more than 200 banks from the European Economic Area operating in the UK without an actual physical presence in the UK. This has been facilitated by the Banking Consolidation Directive regulations which provide for home country supervision of branches of EEA incorporated banks throughout the EEA.

Banks' assets and liabilities

Over a half of banks assets are held in lending. Banks' other assets consist of a small amount of cash to meet normal deposit withdrawals; short term or easily realisable bills (both Treasury and commercial), investments, claims under sale and repurchase agreements.

Around 90% of banks' liabilities consist of sight and time deposits. Around a fifth of deposits are held in repos, certificates of deposit, short-term paper and acceptances. The remaining liabilities are primariliy made up of non-deposit funds such as shareholder capital and accumulated reserves.

Table 6 Number of banks in the UK

End- March	1995	1999	2006	2007
Incorporated in the UK	224	200	154	157
UK owned	142	121	73	72
Foreign owned [1]	82	79	81	85
Incorporated outside the UK	257	244	179	179
UK branch of an EEA firm [2]	102	109	94	90
UK service of an EEA firm¹	---	---	5	5
Outside the EEA [3]	155	135	80	79
Total authorised banks	**481**	**444**	**333**	**331**
Foreign banks physically located in the UK [1]+[2]+[3]	339	323	255	254
Channel Islands & Isle of Man²	41	-	-	-

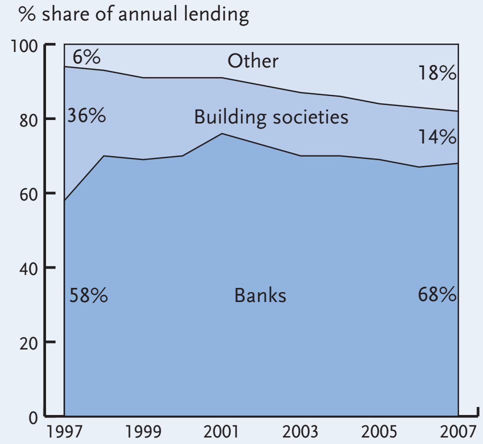
¹ Figures for 'UK service of an EEA firm' only available from 2005
² From Sep-1997 Channel Islands and Isle of Man institutions were no longer considered part of the UK banking sector
Source: Bank of England, Financial Services Authority

Table 7 Largest UK banks

$bn, end-2006	Tier one capital	Assets
1 HSBC Holdings	87.8	1,861
2 Royal Bank of Scotland	59.0	1,711
3 Barclays Bank	45.2	1,957
4 HBOS	44.0	1,160
5 Lloyds TSB Group	25.2	675
6 Standard Chartered	12.8	266
7 Abbey National	9.9	377
8 Northern Rock	5.1	198
9 Alliance & Leicester	5.0	135
10 FCE Bank	4.5	33
11 Clydesdale Bank¹	3.4	54
12 Bradford & Bingley	3.0	89
13 Schroders²	2.3	6
14 The Co-operative Bank³	1.5	26
15 Close Brothers Group⁴	1.0	9

¹ 9/2006; ² 12/2005; ³ 1/2007; ⁴ 7/2006
Source: The Banker

Chart 24 Share of net mortgage lending



Source: Bank of England

Largest UK banks Merger and acquisition activity in the UK banking sector has continued in 2007 with the takeover of ABN Amro by a consortium of three European banks (Royal Bank of Scotland Group, Fortis and Banco Santander) and Barclays banks agreement to purchase Equifirst Corporation from Regions Financial Corporation. The total number of UK incorporated banks has fallen since the mid-1990s (Table 6) despite the conversion of a number of building societies into banks and the increase in the number of new entrants into the market. The scope for further major consolidation within the UK banking sector is probably limited. There is greater scope for small to medium-sized deals and overseas deals. The largest banks in the UK in 2007 were the major high-street banks, namely HSBC Holdings, Royal Bank of Scotland, Barclays Bank, HBOS and Lloyd's TSB Group (Table 7). These banks dominated the UK current account market and accounted for over half of credit cards and personal loans.

Building societies are mutual organisations owned by their members and therefore have no external shareholders. Their main business activity is mortgage finance. At end-2007, there were 59 building societies, down from 80 in 1995 and 167 in 1985. The decline was mainly due to mergers although a number of the larger building societies converted to plc status. In recent years, building societies have accounted for around a fifth of the outstanding value of personal deposits and mortgages and around 15% of net mortgage lending (Chart 24).

Lending and deposits

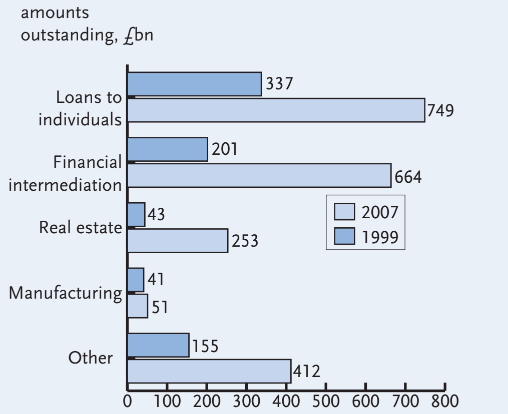
Lending Bank lending can be subdivided into advances, which account for around two-thirds of sterling lending, and market loans which account for most of overseas lending. Around a third of UK bank lending is targeted towards overseas customers partly related to the substantial presence of foreign banks in the UK. Lending reached a record £4,127bn at the end of 2007, more than twice the level a decade earlier.

Personal lending More than a half of UK bank lending is targeted towards domestic customers. A sectoral analysis of trends in lending to UK residents reveals a significant movement away from manufacturing and wholesale and retail trade towards personal lending (Chart 25). The growth in personal lending over the past ten years has complemented wider developments in the economy. There has been substantial growth in financial and business services and an increase in personal income which has made most consumers more creditworthy.

Loans with a maturity over five years accounted for the bulk of personal lending (Chart 26) in 2007. Their share of the total was relatively stable at around three-quarters in recent years. For businesses, overdrafts and lending with maturity under one year accounted for the bulk of loans, accounting for around two-thirds of the total in recent years.

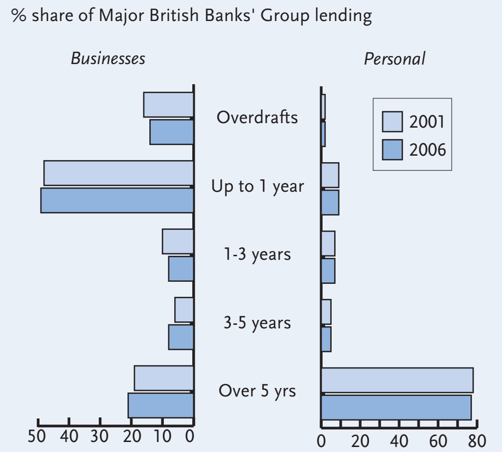
The biggest growth in the past decade was in banks' mortgage lending which increased four-fold to reach around £600bn or 30% of domestic lending outstanding in at the end of 2007. This is related to the growth in house prices over the past decade (Chart 27) which has reduced the affordability of

Chart 25 Sectoral analysis of domestic bank lending



Source: Bank of England, IFSL calculations

Chart 26 Maturity of lending



Source: British Bankers' Association

Table 8 External business of banks operating in the UK

	$bn (claims)		*% share*	
	1999	**Q3-2007**	***1999***	***Q3-2007***
US	336	1,444	*19*	*21*
France	113	683	*11*	*10*
Germany	202	455	*10*	*7*
Japan	181	195	*6*	*3*
Italy	125	225	*7*	*3*
Spain	35	240	*2*	*3*
Other	806	3,699	*45*	*53*
Total	**1,798**	**6,941**	***100***	***100***

Source: Bank for International Settlements housing for first time buyers. As a result, first time buyers' share of annual number of loans fell from 45% to 35% between 2000 and 2007. Difficulties in meeting repayments mean that annual mortgage repossession actions rate increased during this period from 70,430 to 137,605 (Chart 28). This is still only around 1.1% of all mortgages, but a further rise in repossessions is likely in 2008.

Mortgage lending has remained close to record levels in 2007 despite the turbulence in the global credit markets and loss of liquidity in raising mortgage finance (Chart 29). There was however a decrease in lending in the latter part of 2007 compared to the same period in the previous year. Mortgage approvals fell for the seventh month in a row in December 2007 to their lowest level since 1990. Banks ability to raise mortgage finance has become more difficult due to reduced activity on wholesale bond markets, a major source of funds in recent years.

Corporate lending has doubled over the past decade. This was paralleled by a changing pattern in bank lending to companies both in the direction and maturity of lending. Financial services increased its share of bank lending mostly at the expense of manufacturing and wholesale and retail trade while the maturity of lending has shortened in recent years.

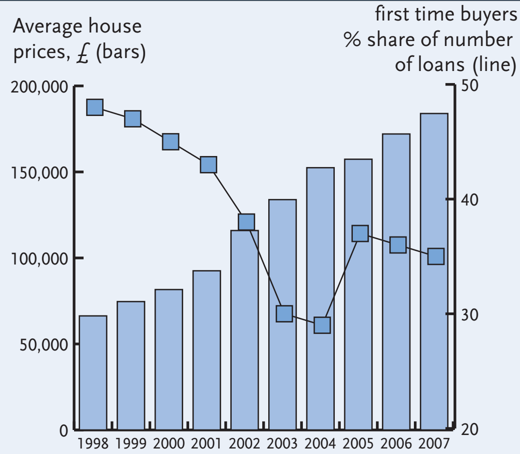
Overseas business Over a third of UK bank lending is targeted towards overseas customers. This is largely due to the substantial presence of foreign banks in the UK and London's role as a major international financial centre. According to the Bank for International Settlements, external business of banks operating in the UK reached $6,941bn in Q3-2007, nearly three times the 1999 total. Four-fifths of this was directed towards industrialised countries. As Table 8 shows, the largest borrowers from banks in the UK were customers in the US with 21% of the total, followed by those in France with 10% and Germany with 7%.

Deposits The outstanding value of deposits in UK banks reached £6,364bn at the end of 2007. This was up 12% on the previous year and 27% up on 2005.

Deposits in domestic banks accounted for 42% of total UK deposits in 2007. The dependence of UK banks on domestic retail and corporate customers means that the majority of their funds are in sterling. Nevertheless, around 39% of domestic banks' assets were held in foreign currency at the end of 2007. This is because a large proportion of funds are handled on behalf of foreign customers through the wholesale markets.

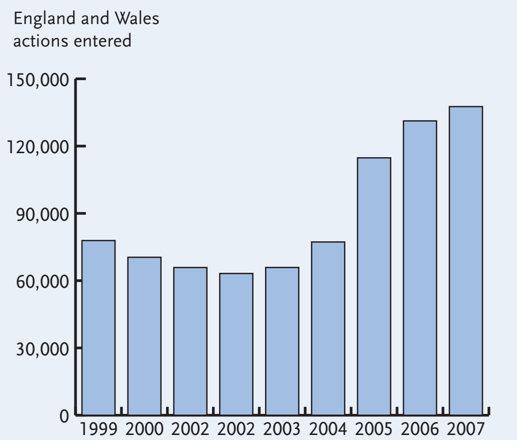
The main source of banks' domestic deposits are personal savings. An analysis of UK residents' deposits shows that personal customers accounted for 39% of the UK residents total. The banks themselves deposit surplus funds with other banks and accounted for around one-fifth of the total although this proportion fell towards the end of 2007 due to the "sub-prime" crisis. Real estate companies, insurance companies, pension funds and manufacturing companies generated most of the remainder (Chart 30). Other deposits, which cannot by their nature be attributed to individual sectors, consisted of certificates of deposit, other short-term paper and acceptances.

Chart 27 UK housing market prices



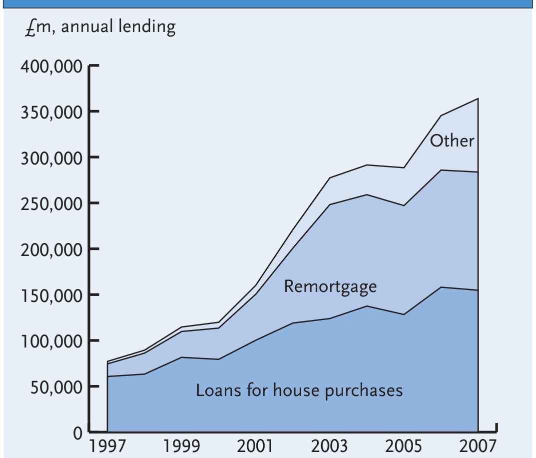
Source: Nationwide; Council of Mortgage Lenders

Chart 28 Mortgage possessions actions



Source: Council of Mortgage Lenders

Chart 29 Gross mortgage lending by type of advance



Source: Council of Mortgage Lenders

Deposits in overseas banks located in the UK accounted for more than half of total UK deposits in 2007. Most of these funds (51%) were deposited with banks from EU countries (mostly Germany, Switzerland and Netherlands). US banks held 12% of the total and Japanese 4%.

Since overseas banks are predominantly serving an overseas customer base only a quarter of their deposits were held in sterling. The composition of foreign currency held by foreign banks in the UK has changed somewhat between 1999 and 2007 as deposits held in euros increased their share of the total from 23% to 31% of total foreign currency deposits (Chart 31).

Distribution

Technology is having a major impact on banking in creating new ways in which banks are delivering services to their customers. Many banks are also seeking to reduce costs through a combination of outsourcing and offshoring.

Branch networks remain an important point of service delivery for banks. The competitive pressures on banks' margins have kept the focus on cost control as a strategic priority. This has resulted in the reduction of the branch network. Operations have in some cases been centralised, allowing lower unit processing costs. Staff numbers have been reduced in some branches and the profile of the work carried out by branch staff has been more oriented towards sales. During the past decade the number of branches in the UK fell by over a quarter, to around 10,500 (Chart 32).

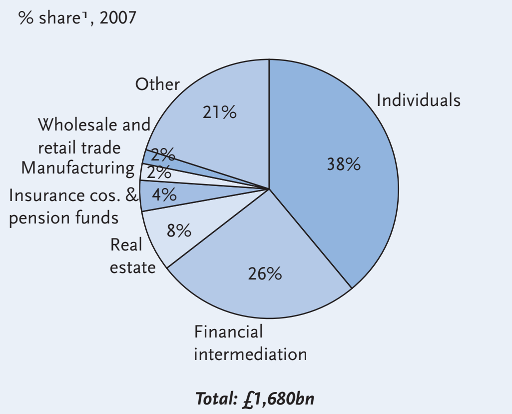
The Post Office role as a banking distribution channel has been expanding given that it is the largest cash handler in the UK. A number of banks have established partnerships with the Post Office, which allow their customers to use these offices for their basic banking needs.

Electronic delivery channels allow for significant cost reduction. They include ATMs, internet banking, corporate electronic banking, interactive TV and mobile telephone banking.

ATMs Parallel with the reduction of the branch network, there has been a steady increase in the importance of the ATM network. In the four years up to end-2007 the ATM network increased from 46,000 to over 60,000. Around a third of ATMs are located in branches, a third in retail outlets, with social and leisure facilities accounting for most of the remaining locations. The extension of the ATM network has helped to fill the gaps created by the closure of some branches.

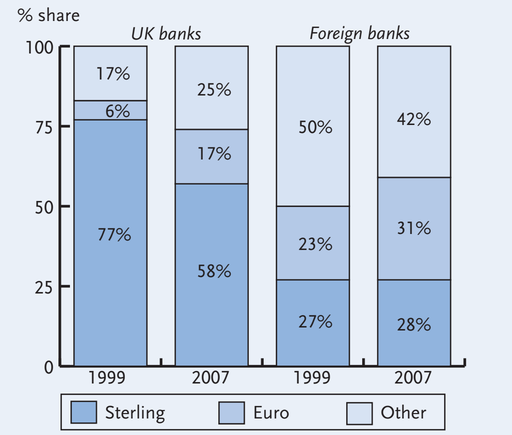
Internet banking On-line banking is growing in popularity as a delivery channel. It is becoming increasingly accessible to the wider market, cheaper and easier to use. The internet provides many advantages such as: removing the need for physical presence in new territories thus eliminating the need for in-country set-up and ongoing infrastructure costs; faster implementation of new products; reduction in marketing costs; and more efficient processing of transactions. This reduces transaction costs and lessens the importance of location.

Chart 30 Industrial breakdown of deposits from UK residents



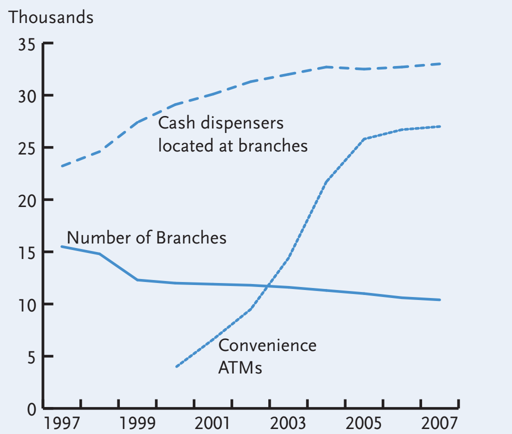
¹ Not seasonally adjusted
Source: Bank of England, IFSL calculations

Chart 31 Deposits of UK/foreign banks breakdown by currency



Source: Bank of England, IFSL calculations

Chart 32 Branches and cash dispensers in the UK



Source: Association for Payment Clearing Services (APACS), BBA IFSL estimates

The UK is the largest market for online banking in Europe. Over 60% of UK households (nearly 15 million) had home internet access at the end of 2007. According to APACS, the number of people using online banking in the UK increased from 6.2m to 17m between 2001 and 2006. During this period the number of people using telephone banking increased 37% while purchases online increased by 157% (Table 9).

Corporate Electronic Banking is similar to internet banking but is more demanding, requiring greater security, involving a heavier volume of transactions and the ability to support multiple users at a single customer site.

Telephone banking remains a key area of service delivery for banks. It includes call centres, call routing, telesales and interactive voice response. Telephone banking can either be used to supplement one of the other channels or as a stand alone, primary delivery channel. Banks in the UK offer telephone banking services primarily to complement their existing activities and this has proven to be a very popular means of service delivery. Even stand-alone internet banks have provided telephone support as it was found that customers preferred telephones as a support channel to the internet.

Payments and settlements systems

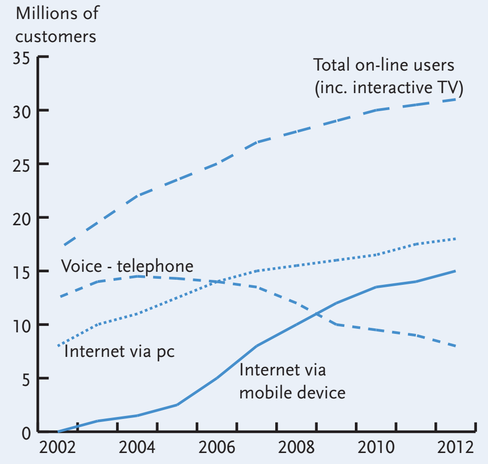
There has been massive growth in the volume and value of financial transactions during the past decade as a result of technological advances, financial innovation, deregulation and competition. The majority of transactions are still made in cash although the proportion is falling steadily. The share of transaction volumes in cash fell from 48% to 38% of the total between 1996 and 2006 (Chart 34). Technology has become increasingly important for the remaining transactions which include cheques, automated payments and plastic cards.

The clearing process involves the transmission and settlement of payments between accounts held at different banks or different branches of the same bank. Payment systems can broadly be divided into clearing networks and plastic card networks. Clearing networks in the UK include: Bankers Automated Clearing Services (BACS) for direct debits, direct credits and standing orders; real time gross settlement which is cleared by the Clearing House Automated Payments Scheme (CHAPS) and the Cheque and Credit Clearing Company (CCCL). Plastic card networks cover debit, credit and ATM cards.

The value of cleared payments increased 13% in 2006 to reach a record £111 trillion. This was over three times the value a decade earlier. During this period there has been a shift from clearing based on cheques and other paper to electronic transactions. Automated payments accounted for over three-quarters of the volume of transactions in 2007, up from around a half a decade earlier. However, such payments accounted for 99% of the value of transactions, up from 95% during this period (Chart 35).

The number of cards in issue by banks totalled nearly 165m at the end of 2006 (Chart 36). Debit cards have become increasingly popular since their launch in 1987, reaching 70m in 2006. Both the number of debit card users

Chart 33 On-line distribution channels in the UK



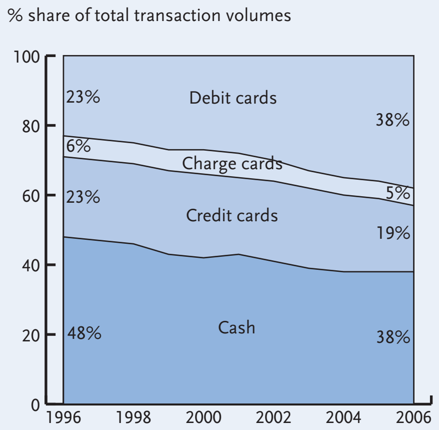
Source: APACS

Table 9 Online banking usage in the UK

	2001 m	2006 m	*Change %*
People using online banking	6.2	17.0	*174*
By age group			
16-24	0.8	1.8	*125*
25-34	2.1	4.1	*95*
35-44	1.4	4.2	*200*
45-54	1.1	3.1	*182*
55-64	0.4	2.1	*425*
65+	0.4	1.5	*275*
People using telephone banking	11.5	15.7	*37*
People shopping online	11.0	28.3	*157*

Source: APACS

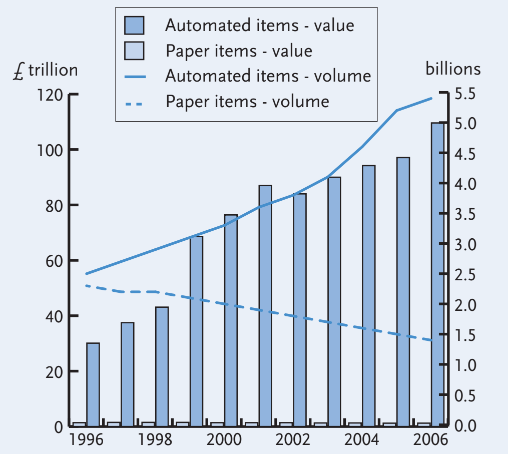
Chart 34 Payment trends in the UK



Source: APACS

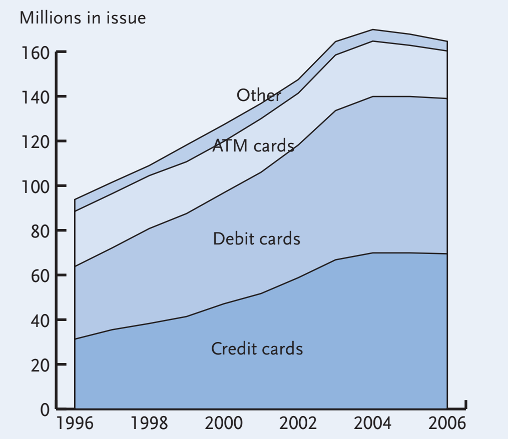
and the number of payments made with each card are expected to grow. The number of credit cards in issue declined in the early 1990s following the introduction of fees and increased use of debit cards, but grew subsequently to 70m in 2006. It is difficult to draw conclusions regarding the number of other cards in issue because of their dual functionality with, for example, many debit cards functioning also in ATMs and for cheque guarantee.

Chart 35 Value and volume of cleared payments in the UK



Source: APACS

Chart 36 Plastic cards



Source: APACS

CONTRIBUTION TO THE UK ECONOMY

The UK banking industry is a crucial and integral part of the UK economy. Its core business of taking deposits from one set of customers and lending to a largely different set provides an essential market mechanism for distributing funds to where they are most required and providing a return to those wishing to hold assets in liquid form. A modern economy could not operate without this mechanism, but its "value" is difficult to measure statistically. This section analyses the more quantifiable contributions of banking to national output, profitability, employment and net exports.

Output

According to the Office for National Statistics, the banking industry contributed around £50bn to UK national output in 2005. This was equivalent to 4.6% of Gross Domestic Product (GDP), or over half of the 8.8% accounted for by the financial sector as a whole.

In the decade up to 2005, the banking sector grew in current prices at an average of around 3.7% a year (Chart 37). This was slower than the increase in GDP (4.3%) partly due to a greater advance in the efficiency of banking compared to some other sectors which had an adverse affect on its contribution to GDP. Activity in the banking sector has been more volatile than other sectors over the past decade, mainly due to the sensitivity of banking profits to the business cycle. The banking sector showed strong growth in recent years due to the recovery of the global economy and capital markets.

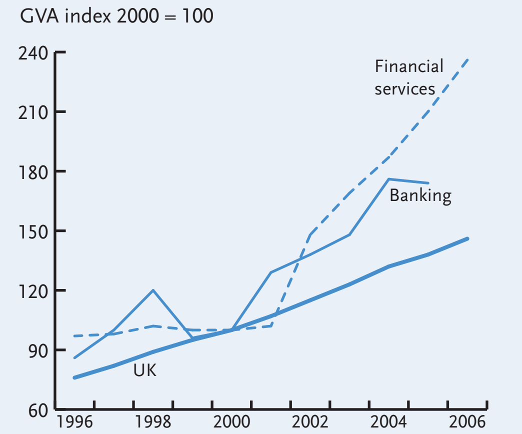
Income

Although no collective data on profits are published for the banking industry as a whole, aggregated data for the MBBG (Major British Banks' Group) provides a good indication of overall trends. Net income, or income after operating expenses of UK banks has risen consistently each year over the past decade to reach £40.6bn in 2006 (Chart 38). Although, these profits are substantial sums, they are equivalent to only about 1% of banks' total assets. UK banks have experienced particularly strong growth in profits since 2002 following a downturn in profits due to the slowdown of the global economy and falls in equity markets in prior years.

Competitive pressures have reduced net interest margins in most banks. Consumers have a wide choice in all product lines as a result of new players entering the market, including non-financial services companies such as retailers and motoring organisations, and overseas firms. Between 1996 and 2006, average net interest margins declined from 2.3% to 1.1% (Chart 39).

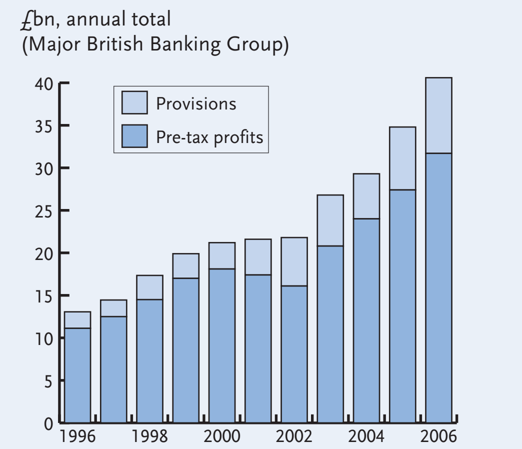
Competition has also resulted in considerable pressure on operating expenses which fell from 2.3% of total assets to 1.5% during this period. Cost reduction has been an important factor in the profit growth of UK banks which are are among the most efficient in Europe. UK banks benefit from a flexible labour market, technology investment, outsourcing and offshoring.

Chart 37 UK output



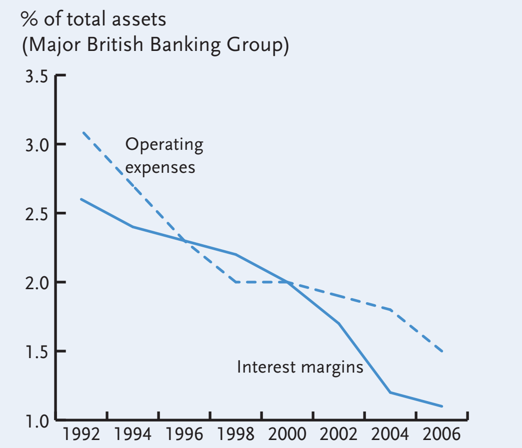
Source: Office for National Statistics

Chart 38 Net income



Source: British Bankers' Association

Chart 39 Interest margins and operating expenses of UK banks



Source: British Bankers' Association

Employment

According to the BBA (British Bankers' Association), the UK banking industry provided employment for 432,000 (Table 10) people at the end of 2006. This represented around 1.5% of total UK employment and around 45% of financial services employment. During the past decade, banks have made considerable efforts to reduce costs including staffing which typically accounts for over half of operating expenses.

Employment in the banking industry gradually declined in the early part of the 1990s to 358,000 in 1996, only to return by the end of this period to levels around 450,000. The large increase in the mid-1990s was due to the conversion of a number of large building societies into banks.

A detailed breakdown of employment statistics in 2006 shows that retail banks accounted for nearly 80% of the 424,400 employed by the Major British Banking Group. Foreign subsidiaries and branches accounted for a further 23,500, global banks for 37,400, investment banks for 4,900 and other domestic banks for 24,500.

Net exports and investment

UK banks' net exports are expected to reach a record £14bn in 2007, up on £12.1bn in the previous year. The latest detailed figures, show that in 2006, spread earnings from securities, derivatives and foreign exchange transactions at £7.0bn accounted for the majority of UK banks' net exports. Derivatives are estimated to account for the lion's share of these spread earnings. Commitment fees totalled £1.5bn; new issues of securities £593m and portfolio management and securities transactions £1.09bn. Other business service exports of banks were £1.6bn in 2006, up from £1.5bn the previous year.

Foreign direct investment Latest available figures show that inward investment or investment into the UK banking sector more than doubled over the past decade to reach £41.3 billion (Chart 41). During this period outward investment grew from £7.2bn to £50.7bn.

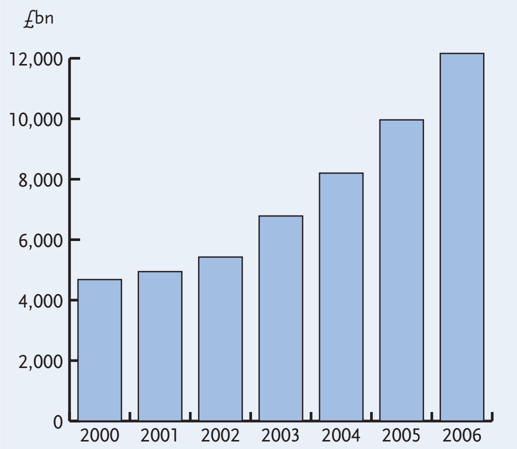
Table 10 UK banking sector employment

Thousands	Major British Banking Group[1]	Other British Banks	TOTAL
2001	321	141	461
2002	323	128	451
2003	327	116	443
2004	331	106	437
2005	330	110	440
2006	321	111	432

[1] MBBG includes The Abbey National Group, Alliance & Leicester Group, The Barclays Group, Bradford & Bingley plc, The HBoS Group, the HSBC Bank Group,, The Lloyd's TSB Group, Northern Rock Group and The Royal Bank of Scotland Group

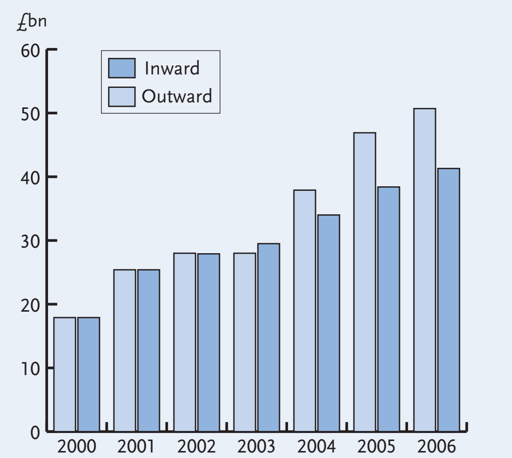
Source: British Bankers' Association

Chart 40 UK banks' net exports



Source: Bank of England

Chart 41 Banks' foreign direct investment



Source: Bank of England

LINKS TO OTHER SOURCES OF INFORMATION

APACS
Yearbook of Payment Statistics
www.apacs.org.uk

Bank for International Settlements
International Banking and Financial Market Developments (Quarterly)
www.bis.org

Bank of England
Finance for Small Firms
Financial Stability Review
Monetary and Financial Statistics
Statistical Abstract
www.bankofengland.co.uk

British Bankers' Association
Annual Abstract
www.bba.org.uk

European Banking Federation
www.fbe.be

Financial Services Authority
www.fsa.gov.uk

Freeman & Co
Investment banking statistics
www.freeman-co.com

Merrill Lynch / Capgemini
World Wealth Report
www.ml.com

The Banker
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Office for National Statistics
UK National Accounts - Blue Book
UK Balance of Payments - Pink Book
www.statistics.gov.uk

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