The Whitehead Lecture
Chatham House
9th December 2009

Good evening

It's a great honour to be here this evening in this eminent institution for an event that celebrates transatlantic relations.

As you can imagine UK-US relations are close to my heart as the American President of Barclays, a UK based global bank, and as a dual citizen.

Chatham House was created in the 1920s, along with the Council on Foreign Relations in New York,

and these organizations have a very significant role to play in Anglo-American relations.

Barclays Capital is proud to be a supporter of both institutions

and a sponsor of your Director's important new project,

'Rethinking the UK's International Ambitions'.

I've given a lot of thought to what I can best bring to this occasion.

My career in financial services spans 30 years and three different geographies – the US, the UK and Asia

and for me, this is an especially important time to talk about what's happening in the industry,

particularly in respect to regulatory reform.

As regulators around the world formulate their response to the near collapse of the financial system

the potential outcome is so important that I've chosen the title "Too big to get wrong" for my talk this evening

"Too big to get wrong" also symbolizes the purpose of the Whitehead lecture

Transatlantic relations are "too big to get wrong"

Margaret Thatcher once said that "the Anglo-American relationship did more for the defence and future of freedom than any other alliance in the world."

It's a strong assertion and it's underscored by President Obama's reference to "a link and bond that will not break".

Our economies are deeply and closely interlinked:

we each provide the largest source of foreign investment into each other's country,

in trade and finance our relationship is well balanced,

and there are strong cultural connections too:

our fashion, design and music industries are major influences on each other

and globally popular brand names fill each other's stores.

But just as our relationship is "too big to get wrong"

so is the challenge now facing London and New York,

the two largest financial centers in the world.

They have a special interest in getting regulatory reform right.

No city in the world has been more central to international trade flows and trading than London over the centuries

and no city has benefited more than London either, a point which should not be lost in the debate.

But this subject is not just “too big to get wrong” for London and New York

It’s also “too big to get wrong” for the world as a whole.

We need reform that provides a safe and sound financial system - one that people can trust and rely on

but we also need reform that fosters economic growth and job creation

which are the most pressing issues we face today.

Striking that balance is critical for all of us – and I mean for all of us

because a healthy and strong financial sector that’s willing and able to take risk,

in particular cross border risk, is key to trade and economic growth.

The banks have a vital role to play in this.

If we get regulatory reform wrong now – if it stifles the willingness and ability of banks to take risk

it’s not just the UK and US, London and New York, that will suffer:

If we get it wrong, we risk a halt to economic recovery around the world

If we get it wrong, we limit our ability to sustain long term growth.

I know it sounds controversial to suggest banks need to be able and willing to take risk, in the wake of a near collapse of the financial system so let me explain why risk is so important:

Let’s start with what banks do at their most basic

and I make no apologies for starting here, not least because a lot of comment appears to be based on misunderstanding.

Banks hold deposits - $61 trillion of deposits - entrusted to them by consumers and companies worldwide

they put that money to work, helping consumers and businesses invest in new homes or factories they help governments and central banks around the world to earn a safe return and finance their expenditure

they provide domestic and international payment mechanisms, facilitating 730 million non-cash payments every day

and they allow corporates, governments and investors to better manage their risks

by providing products and services which allow the transformation and transfer of that risk.

What does risk taking have to do with this? Let me give you some examples:

Every time a bank lends an individual money to buy a house they're taking risk in a number of ways:

credit risk – will the individual be able to pay it back?

interest rate and duration risk on the loan,

market risk on the value of the property and the economic stability of the community.

Every time a bank lends to a small business that needs capital to grow, they're taking similar risks.

And it's by taking these risks that banks support and encourage business innovation.

It's a similar story when we lend to corporates:

Take the example of one of our clients in the pharmaceutical sector.

We provide loans to the company – but they also need access to the capital markets for more permanent funding,

they raise both debt and equity in multiple locations around the world,

they manufacture and sell in multiple locations,

they buy raw materials in multiple locations, they have to trade across borders - and they have to manage risks associated with borrowing, with foreign exchange rates, and with commodity prices.

The only organization that can help them do all these things is an integrated global bank.

It's also the only organization that can help transform risk for institutional investors.

Let's look at the example of a pension fund:

In an environment where risk free rates are zero or close to zero in most developed countries

pension funds face a choice between no yield

or taking risk in order to deliver the returns they need to manage their liabilities:

in other words to pay savers their pensions.

They can't invest in a single company in order to access credit risk – the risk would be far too concentrated

and we can't pass risk on to them directly from a single corporate issuance

What they need is risk that's diversified by both industry and geography

and that requires credit transformation and structuring that can only be done by a bank.

It's a perfect example of how banks take risk from corporates that need to reduce their exposure

and transform it so it can be distributed to investors who want to increase their exposure.

That is what banks do for their clients and for their customers.

It's not much different with governments:

Barclays today is the Number 1 provider of liquidity to the Government in both the UK and the US there is no solely domestic provider of liquidity and capital to either of these governments

All the top participants are global because you have to have scale, breadth and global reach for this.

When the US government issues bonds, the buyers are not solely in the Unites States

They're in Asia, Europe and the Middle East.

we have to make markets to manage these auctions and in doing so we put our own capital at risk

we also have to ensure that those buyers can sell back when they want – that the market is liquid

and by the way, many buyers want their currency risk managed as well.

If none of this happens, the result is:

an increased cost of borrowing,

higher taxes or lower public spending

and slower economic growth.

So the role of banks is to take risk – to lend to clients - to underwrite their transactions

to help those clients manage risk - by reducing or increasing their exposure depending on their needs

and to do this most efficiently and effectively, they have to operate on a global basis.

This doesn't mean to say that the banks have not made any mistakes

There's no bank and there's no banker that hasn't made mistakes in recent years, including me.

We recognize our responsibility.

There's also no bank that hasn't benefited from fiscal and monetary stimulus and the actions of governments and regulators around the world to mitigate the crisis

even those of us who took no direct government money.

We recognize those benefits and the obligations that go with them.

It's because of that recognition that we've made changes

We're already doing many of the things which regulators are currently looking at:

Since the start of the crisis we've been operating with more capital, less leverage and stronger liquidity buffers

Barclays, for example, has almost doubled its core tier 1 ratio from just under 5% to 9%,

It's brought adjusted leverage ratios down from the high 30's to the low 20's,

and it's liquidity position is significantly stronger now than in 2007.

We're also implementing the G20 guidelines on remuneration.

And Barclays is not alone in taking these actions – in other words - the banks get it.

Our objectives are better aligned with those of consumers, taxpayers and regulators than commentators would have you believe

It's in everyone's interest that we have a safe and sound financial system.

But at the same time we have to recognize that if banks don't take risk they're not doing their job

So risk isn't something to avoid but it does need managing.

That means having a clear understanding of risk appetite across the institution at an aggregate level

whether it's credit risk, market risk or operational risk.

It means having that understanding built into decision making across each of the businesses

It means having a strong risk management function, independent of the businesses, that holds people in the businesses accountable.

It also means having a clear understanding of exposure by geography, by sector, and by asset class.

Most institutions that failed during the crisis, did so as a result of poor risk management.

Let me give you some examples:

HBOS became a forced takeover target because of its over exposure to the property market and its over exposure to single borrowers.

Lending to the property and construction sectors represented almost half its loan book in 2008, for example, compared to a much lower proportion at banks that didn't need government intervention.

Lehman Brothers interestingly was one of the least leveraged banks with some very strong underlying businesses

but they were overexposed - with inappropriate levels of concentration - to commercial property

and to private equity

assets that were not only hard to value but were illiquid and highly capital intensive.

Their private equity business alone would have consumed more capital than many European investments banks.

Northern Rock, the first failed bank in the UK, was a monoline operating in just one market

which depended on capital market securitization for over 40% of its funding

that dependence on the capital markets was ok when funding was available and it was cheap

but it was a huge risk for a business with a narrow range of services operating in just one market.

The fact that some institutions didn't manage their risk well doesn't mean that risk is a bad thing and it doesn't mean that banks shouldn't take any risk.

What it does mean is that banks need to work together with regulators to solve some of the **real** issues.

So in the interests of achieving the right balance between a safe and sound financial system and economic growth, what should regulatory reform look like?

There are four main themes I want to draw out.

My first broad theme is that the rhetoric around trading and capital markets activities - dismissing them as casino banking – is both factually untrue and misses the point.

Research shows that 98% of losses in the last 2 years started with loans and poor risk management and had little to do with trading

Trading didn't cause the near collapse of the financial system

but it does serve an important function

ensuring that banks can make markets for capital and risk to be traded

If trading is penalised, we risk damaging market liquidity and the companies and investors who need it.

Nor can the global economy grow without capital markets activity

Capital markets provided $146 trillion to the public and private sector globally.

That's one and a half times more than the collective assets of the global banking system.

And demand for capital isn't going away:

US Treasury debt raised in the first half of this year was more than the total of the same period for the previous three years combined

so we need deep and liquid capital markets to provide the funding necessary for economic growth.

There's also a view that we should regulate against structured derivatives products but our clients, whether they're corporates, pension funds or governments, continue to need sophisticated derivative products for raising capital and managing their risks

Take one of our utility clients for example:

a company in a highly regulated sector,

one of the first to expand into alternative energy,

and today one of the largest developers of windfarms in the world.

It was only through the use of structured over the counter derivatives that they were able to hedge out and monetise the forward energy prices to fund that investment.

Then take a look at oil prices:

In the last couple of years they've risen to $145 a barrel, crashed back down to $40

and now they're at about $80 a barrel

If you're an oil producing country or an airline how do you manage that kind of volatility?

In the case of the government of Mexico,

helping them to hedge the oil price before it fell

enabled them to preserve their credit rating and their budget,

including their education program.

Of course we need much greater transparency in derivatives markets

so that regulators understand the kinds of instruments being used

and know where there is excessive concentration.

And exchanges have a very important role to play in providing this transparency

but that doesn't mean that we should put all derivatives on exchanges we still need room for customized products that cater for the needs of clients.

That’s why over 35 of our large clients testified to the US Congress, the SEC and the Commodity Futures Trading Commission this year

They wanted to emphasize just how important structured derivatives markets are to them.

In time we expect a similar process to take place in Europe

because these markets are as important for clients as the underlying stock, bond and commodity markets.

This issue goes right to the heart of economic stability and growth.

So our clients need trading, they need access to capital markets and they need structured derivatives

This is not about casino banking.

It’s about enabling clients to access funding and manage risk

in order to run and grow their businesses more effectively.

My second broad theme is that bank’s capital requirements should be set out as part of an agreed and transparent framework

Banks have dramatically increased both the quality and quantity of capital they hold -

as I told you earlier, Barclays has almost doubled its core tier 1 ratio from just under 5 to 9%.

Meanwhile regulators continue to add capital charges on certain trading books and certain asset classes.

New capital directives known as Basel III for example, are due to be implemented in Europe in 2011,

doubling the capital charges on many trading books.

At the same time regulators are redefining what counts as capital.

We have to clearly recognize the cumulative impact of these measures.

Of course we also have to balance the government's call for more banks lending with the regulator's call for banks to hold more capital.

We're managing through this:

gross lending at Barclays in the UK during the first nine months of this year, for example, amounted to £25 billion.

But it's not possible to do both over the medium term

without significantly increasing the cost of credit

and without significantly impacting the prospect of economic growth.

My third broad theme is the need for an international level playing field – with regards to capital, accounting and compensation.

I told you about the Basel changes which double capital charges on many trading books in Europe in 2011

It's not at all clear that this will apply outside Europe

and in fact the US has yet to implement Basel 2 which was introduced here 4 years ago.

Accounting rules also differ:

Mark to market and balance sheet netting are two good examples of this:

banks are required to report gross assets in Europe and net assets in the US.

As a result, if Barclays reported under US GAAP, its balance sheet would be over £500 billion smaller.

Why does a level playing field matter?

Because financial capital and human capital are highly mobile in a global world

so it's in the best interests of everyone that the major economies work in concert.

But it's not just about being able to compete.

It's also about minimising risk

because differences in capital and accounting rules led to the creation of off balance sheet vehicles which fed the bubble in credit assets.

What's more when level playing fields have not been maintained it's led to poor risk management.

Whether you look at the Landesbanks in Germany or federal agencies in the US

the ability to take advantage of cheap, government guaranteed funding

led to sub optimal credit decisions, driven by the desire to deliver returns for shareholders.

A network of single national regulators operating within a consistent global framework can prevent this kind of regulatory arbitrage and provide a level playing field for all.

We've seen a good start with G20 and the Financial Stability Board.

My fourth and final theme is that the notion of breaking up banks that are "Too big to fail" is over simplistic.

The world in which we operate is global

and our clients require and demand global services.

But more than that, it's not appropriate to attack big banks on the basis of size

big banks can have better business models and better risk management than small ones.

130 small federal banks in the US have collapsed this year, for example,

with six additional names confirmed just this past weekend.

In the UK, lots of small building societies have either failed or been forced to merge.

Some of these failures proved to be systemic

so systemic and big are not synonymous.

Nor is it a forgone conclusion that investment banking activities should be separated from retail and commercial banking

and that narrowly defined banks are safer.

We should remember that all the banks I've just mentioned were retail banks

and that Lehman Brothers, Merrill Lynch, and Bear Stearns were all stand alone investment banks.

By contrast the global universal banking model, which integrates retail, commercial and investment banking,

is well diversified by business and by geography,

well diversified by clients and by products,

and it should carry less risk, by virtue of that diversification, if it's well run.

What's more, large universal banks tend to understand the risks they're taking on better because they have broader deeper client relationships across a wider range of services.

This gives them a better understanding of their clients and the issues they face

What's most important of all in this debate is what's required to stimulate economic growth.

We live in a global world and I've given you examples this evening of global clients

who need help from global banks to carry out cross border trading activity and transactions.

But this is not just about generating incremental growth in already wealthy western economies

Banks also play an important role in the development of emerging market economies.

Global trade is the main avenue for countries to emerge from poverty

Global flows of materials, products, and services have the capacity to spur economic growth and there are a number of incredible success stories

where countries have dramatically raised prosperity on the back of an export-led economic model.

This model creates the wealth to invest in infrastructure, health and education

and over time stimulates the development of an attractive domestic market,

both for imports and domestic goods.

We've seen the phenomenon at work in Japan and Korea. Now it's China that benefits:

China today is the third largest exporter in the world, with exports amounting to $1.4 trillion in 2008,

China's also become the fourth largest importer, with the value of imports almost equalling their exports last year.
Stimulating this kind of economic growth also calls for private sector capital, financing and risk management services:

In this context it's interesting that foreign direct investment from the private sector to emerging countries is far larger than development aid from governments and charities.

In 2007, the top 10 emerging market recipients of foreign direct investment received over $300 billion

while the top 10 recipients of development aid received just $30 billion.

For businesses in developing countries, the future for capital formation and growth is largely through banks and the capital markets

For multinationals, being able to hedge their risks allows them to expand into emerging economies and create jobs or provide core services.

So developing countries need global banks that can facilitate cross border trade and investment just as much as our global corporate clients do and if we regulate against large global banks we do so at the risk of damaging world trade and the global economy.

The question then, is not whether we should get rid of large banks that present potential systemic risk

but how we should regulate them to ensure a safe and sound financial system.

What we can and must do is improve the quality of risk management.

We've made a good start with stress testing

which is now an important piece of the regulator's toolkit

and should be a regular part of the supervisory process

And as part of stress testing, of course we should have action plans for how to manage the banks if there are shocks to the financial system.

The reason that regulatory reform is a topic that's "Too big to get wrong" is because the unintended consequences of trying to make the world a safer place could potentially do more harm than good.

Disproportionately penalising capital markets activities could deny clients – whether they're governments, corporates or institutional investors - both funding and the means to manage risk.

A further increase in capital requirements could increase the cost of credit and halt the economic recovery we've seen so far.

The opportunities for creating competitive advantage and disadvantage in different financial centers are huge.

And the break - up of banks that are too big to fail could increase risk rather than decrease it.

The need for global integrated banks to help clients meet their goals and to foster trade and economic growth has never been stronger.

So the onus now is on banks to work in partnership with the regulators

to make sure that we take this opportunity and that we get it right.

And for all of us to benefit, we need an integrated global framework

which balances the need for a safe and sound financial system

with that of economic growth and job creation.

These are the most pressing issues facing the world today

and banks have a vital role to play

because by raising capital and taking risk – well managed risk – and cross border risk – they stimulate and support business innovation and global economic growth.

Thanks - I'd like to throw it open to questions now.