

CITY RESEARCH FOCUS

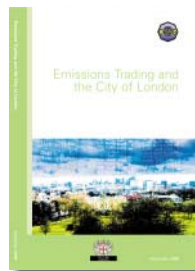


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Emissions Trading and the City of London

PUBLISHED SEPTEMBER 2006



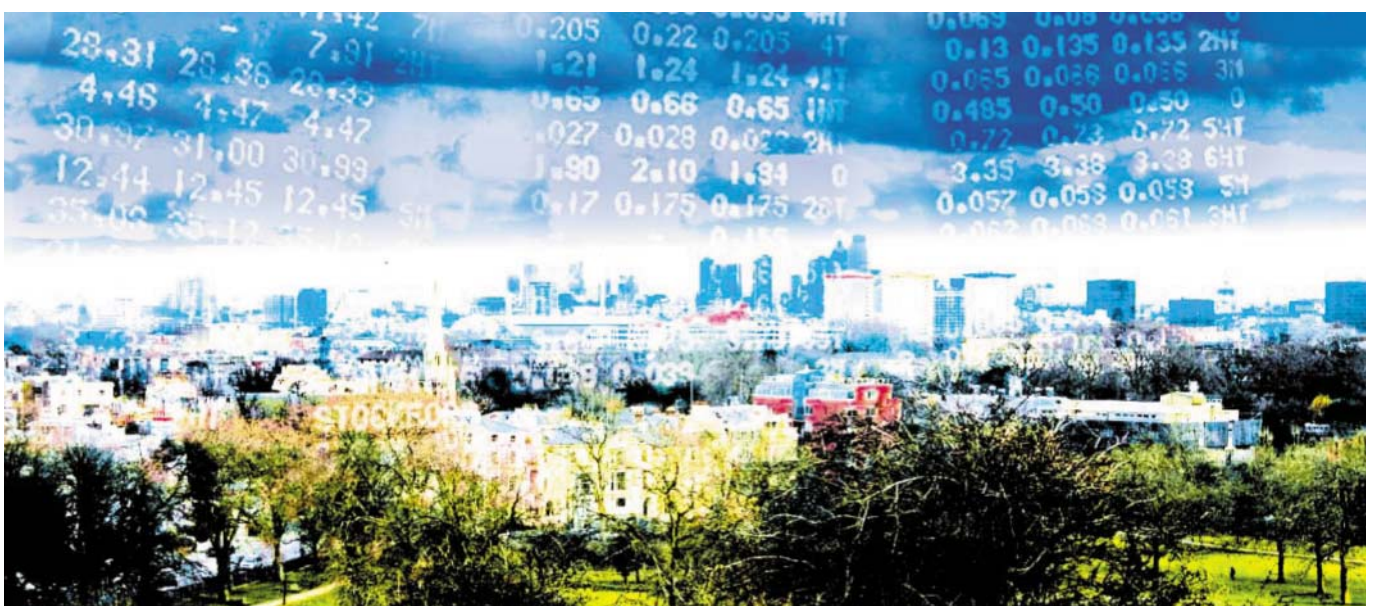
The City of London Corporation is a long-term promoter of the opportunities that the

emissions trading market offers to companies located in the Square Mile. As long ago as January 1999, six years before the European Union Emissions Trading Scheme (EU ETS) was established, we published independent research entitled *Trading Emission Permits: A Business Opportunity for the City?*

Our latest report – *Emissions Trading and the City of London* – answers that key question, ascertains how the structure of the market has subsequently developed and identifies the next generation of emissions trading opportunities on offer to our stakeholders.

The report's authors, Consilience Energy Advisory Group, demonstrate how the City is at the forefront of seeking solutions to the complex problem of climate change. The emissions trading market – a mechanism that harnesses the power of global capital markets to

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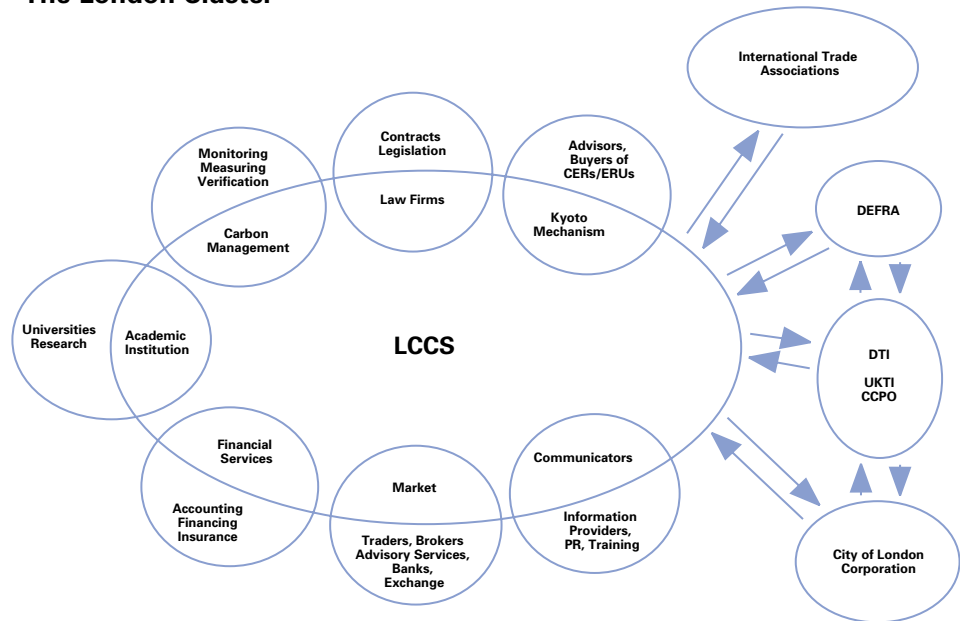


partially offset the consequences of climate change – is now firmly established, with much of the trading infrastructure located in London.

This market promises to be one of the largest markets in the world. Emissions legislation already touches a wide range of industries from the energy sector to heavy engineering to the manufacturing sector at the international level. If the transport sector is included, an idea currently under discussion within the Kyoto framework and in the review of the EU ETS, growth could be exponential. In time it is likely that the emissions market could rival the oil market where many multiples of daily global production is traded each day.

The first phase of the EU ETS has seen a rapid expansion of trade from an almost zero base to €9-10 billion in 2005. This is a small fraction of the growth expected over the next two years in the run-up to the first Kyoto compliance period. Many of the 12,000 installation companies covered by the EU ETS have not yet entered the market partly because of delays to registries. The ability to bank allowances within the three years of the EU ETS Phase 1 meant that installations with a shortfall of allowances to cover 2005 emissions have borrowed 2006 allowances to comply with the first annual EU ETS deadline. Consequently their entry into the market has been deferred. 2006 and 2007 promise a rapid expansion in trade as more installations become familiar with the revenue optimisation opportunities to be had from trading around the compliance timetable.

The London Cluster



Given London’s pool of expertise in financial services, and its reputation as a centre of innovation for trading practices, it is no surprise that the City has become the emissions trading ‘hub’ of Europe. A London cluster servicing this emerging industry has already developed. It is characterised by a close and cooperative relationship between firms offering professional services, as exemplified by the membership of the 68 member London Climate Change Services (LCCS) trade association and government entities.

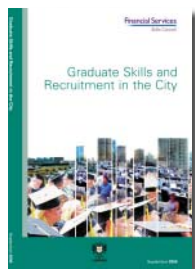
London appears to have captured many first mover advantages by the early implementation of the UK ETS in 2002 and by the vigorous promotion of the EU ETS.

Clearly, if policy makers are to begin to ameliorate the affects of climate change, they need to investigate a wide range of policy tools that can be employed at both global and local levels. This report also investigates how emissions trading could be utilised at the neighbourhood level, with proposals aimed at introducing energy efficiencies in local buildings and transport networks. The nascent buildings and cars schemes, used as illustrative examples in this report, offer a potential first step for local authorities to employ instruments linked to the emissions trading market within their own jurisdictions.

“The most actively traded emissions exchange (‘ECX’) is located and cleared in London, dealing in more than twice the volume of its nearest competitor.”

Graduate Skills and Recruitment in the City

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People are the City's key asset and the competition for the best talent is becoming ever more intense.

Our recent report *The Competitive Position of London as a Global Financial Centre* found that the availability of skilled personnel is the most important competitive factor in the international financial and related business services (FRBS) sector. The City of London and the Financial Services Skills Council jointly sponsored this new independent research on graduate skills and recruitment, written by a consortium of authors led by Alpha Generation Financial Training.

The report, based on a sample of 25 international FRBS companies as well as a selection of 10 UK HEIs, provides an analysis of the perceptions of the skill requirements for graduate entrants, an examination of current recruitment practices, and an assessment of views on the performance of UK Higher Education Institutions (HEIs) as providers of appropriately skilled graduate labour.

There is good evidence of UK HEIs and major international employers working together, but the relationship is not coherent between these two sectors. City employers want deeper relations with universities, with a smooth transfer of academic skills to the work environment. Universities too, want reciprocal dialogue with employers in understanding what their skills needs are. There is an

obvious opportunity for more partnership in this area between employers and HEIs.

The report provides a reliable measure of the size of the City's FRBS graduate recruitment market, in the range of 7,950 – 10,750 per annum. Existing estimates vary depending on what roles are considered to be graduate roles and what is considered to be 'the City'.

A key finding of the report highlights a lack of consensus about how skill sets are defined and interpreted by different stakeholders. There is strong evidence of the use of specific skills-terms in recruitment and selection by FRBS employers. As consensus is lacking in what these terms mean, local interpretations are favoured within organisational frameworks. Lack of clarity confuses the messages being sent to potential graduate employees and to HEIs and makes it difficult to identify exactly what employers want.

There is strong indication that financial and related business services employers tend to target graduates who are not specialised in any particular subject. Most recruiters are more interested in

“City employers want deeper relations with universities, with a smooth transfer of academic skills to the work environment.”

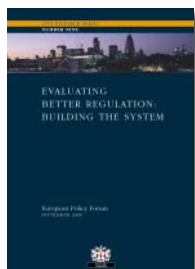
how graduates do things, rather than *what* they have studied. Employers need graduates who can apply their education practically, where there is a widespread perception in the sector that preparing graduates for the world of work should be part of the proper function of UK HEIs.

The FRBS sector is leaning towards increased recruitment of foreign graduates – both of overseas students studying in UK HEIs and students from non-UK HEIs. Both groups are believed to have attributes that UK graduates are perceived to lack. While language skills are an obvious consideration, European graduates are also perceived to have greater maturity and business awareness, relevant 'gap year' or intra-course industry experience. The cultural awareness resulting from an international higher education experience (i.e. studying outside one's home country) is also highly prized by the sector.

These differences partly reflect the structural differences in curricula and course content across major OECD countries, particularly the age at which study is completed and the point at which subject specialisation occurs. The UK system is, however, perceived to produce flexible thinkers, with many UK graduates perceived to be strong at problem solving, thinking creatively and operating a robust level of teamwork. The report makes a number of recommendations outlining steps towards establishing a basis for increased discussion, understanding and collaboration.

Evaluating Better Regulation: Building the System

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Civil servants possess an array of policy tools to reduce the burden of regulation on business. The

increasing use of Regulatory Impact Assessments (RIAs) to determine the quality and effectiveness of proposed legislation is a particularly welcome development. As the National Audit Office's recent *Evaluation of Regulatory Impact Assessments 2005-06* makes clear however, the quality of RIAs produced in the UK is mixed, and existing flaws are often the consequence of a failure to "embed" impact assessments across government departments.

This concern is also apparent within the European Union. The public commitment by European policy makers to establish impact assessments at the heart of proposed legislation cannot be faulted, but there is clearly some way to go before the European Commission, European Parliament and Council of Ministers develop a comparable understanding and coordinated approach to the problem.

In this new report, Graham Mather and Frank Vibert of the European Policy Forum consider how European institutions can coordinate and improve regulatory initiatives. The conclusions are based upon interviews with European institutions, including the Parliament, the Commission, the European Court of Auditors, as well as members of national audit bodies and academic experts.

The task of turning positive policy intentions in the better regulation field into effective results requires a very determined and systematic approach across the EU. The report, therefore, makes specific policy proposals to each of the main EU institutions – the European Commission, the European Parliament and the Council of Ministers. The proposals focus on three areas:

- Measures to strengthen the prior scrutiny of regulatory proposals by bringing Inter Institutional Agreements on better regulation into full effect (prior scrutiny).
- Steps to ensure that individual Integrated Impact Analysis (IIAs), and the systems to support IIAs, comply with best practice (compliance audit).
- Actions needed to get the

evaluation of past regulation off the ground in order to determine whether such regulation has achieved in practise the outcomes originally intended (ex-post evaluation).

The report makes clear that these recommendations should be seen as a package. Indeed, unless each of the institutions develops an analytic culture the efforts of one alone will go to waste. Unless evaluation procedures cover all stages of the process from inception to examining the effects of implementation the necessary lessons about how to improve regulatory processes will not be learnt.

The report also contains a foreword by the Vice President of the European Commission, Günter Verheugen, acknowledging the report's conclusions and highlighting "areas where there is still room for improvement." The City of London looks forward to continuing our dialogue with EU officials on this issue and hope that this report will assist in meeting the dual challenges posed by the better regulation agenda and by the need to do more to meet the Lisbon agenda goals.



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Upcoming Research

Global Financial Centres Competitiveness Index



The City of London is launching an independent Global Financial Centres Competitiveness Index (GFCCI), and has commissioned City-based consultancy Z/Yen to develop and manage the Index. The GFCCI is an 'index of indices', based on a number of existing rankings, in combination with a regular survey of senior industry figures. The Index will be a dynamic product, which will track changing perceptions of cities as financial centres on an ongoing basis.

The GFCCI will build upon previous independent research commissioned by the City of London to evaluate London's relative competitiveness as a financial centre, namely *Sizing up the City – London's Ranking as a Financial Centre* (CSFI, June 2003) and *The Competitive Position of London as a Global Financial*

Centre (Z/Yen, November 2005). These studies identified the key attributes that make a financial centre 'globally competitive' and provided a ranking of such centres.

While both reports showed London and New York as clear leaders, both cities are connected to, are served by, and compete with, a number of national financial centres – e.g. Singapore, Dublin, Geneva as well as Frankfurt and Paris. The GFCCI will provide a more dynamic view of the competitiveness of London vis-à-vis the wide variety of financial centres, a view that responds to rapid changes in the input factors identified in earlier work. The GFCCI builds upon the CSFI / Z/Yen reports and ranks 46 national financial centres around the globe from Athens to Wellington, Amsterdam to Washington.

The GFCCI will rank cities on the basis of their perceived

attractiveness to financial services professionals. It will be based on a 'component factor model' – a statistical model built up with different types of data components or inputs. There will be two specific inputs to the GFCCI: i) individual indices measuring the competitive position of financial centres; ii) responses to a regular survey asking finance professionals to rate centres as locations in which to conduct their business.

The GFCCI will be dynamically updated, permitting, for instance, a recently changed index of office rental costs to adjust the competitiveness of London and the other financial centres. Bi-annually a report on the GFCCI will be released providing an updated view of London's position vis-à-vis other financial centres. The first report will be published early 2007.

See below to participate in the survey or to find out more.

The Global Financial Centres Competitiveness Index (GFCCI)

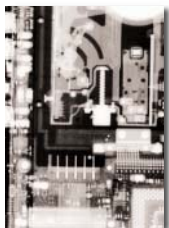


The research for the GFCCI study is now well underway with the survey of industry professionals live now. We would be grateful for your opinions on any financial centres with which you are familiar. Please be assured that answers will be kept confidential, and be used only to compile the GFCCI. The survey should take less than five minutes to complete. We will send you a copy of our report.

To participate in the survey or to find out more about the Index please visit www.cityoflondon.gov.uk/GFCCI

Upcoming Research

The Role of London's Financial Market Infrastructure in its Competitive Position



The Chancellor of the Exchequer recently set up a new high-level group of key participants in

London's financial markets, business services and public authorities to help the Government develop and promote a "single strategy to maintain London's competitiveness" in financial services. This is a recognition that the financial services industry is crucial to the UK economy and that it is a truly global industry, developing at a rapid rate.

Yet the contribution of London's exchanges, clearing houses, settlement organisations and regulators to the City's competitiveness is often taken for granted or misunderstood by market participants and government alike. There is, therefore, the potential for their part in the future strategy for UK's financial services industry to be under-developed in the Treasury's thinking. The proposed merger of the NYSE and Euronext will create a global exchange organisation which will undoubtedly change the market infrastructure landscape in a significant way. It could strengthen London's position in the derivatives industry but

significantly weaken its current leadership of European equity markets.

With this in mind, Bourse Consult has been appointed to analyse the role of financial infrastructure – the exchanges, clearing houses, settlement organisations and regulators – in maintaining London's competitiveness as a financial centre. The research will present an analysis of the infrastructure foundations of each of London's major financial markets – which organisations provide the infrastructure, where they are headquartered and how they are controlled. It will identify areas in which the infrastructure providers' support for London as a financial centre could be improved or is in danger of eroding over time and propose ways in which participants and government could sustain and foster the infrastructure providers' part in London's competitive effort.

In the context of the contribution of the infrastructure providers to the UK financial services industry as a whole, the research will:

- i) identify the key infrastructure providers – whether within or outside the UK – upon which London's financial markets rely;
- ii) analyse the impact of the

financial infrastructure on the development of markets – looking at the creation of new markets and market innovation in general, and the growth of mature markets and iii) analyse the importance of a number of key characteristics of the infrastructure providers to their impact on the London markets in the medium to long term.

Bourse Consult will also assess the competitiveness of London's financial infrastructure relative to global competitors, how competitiveness has changed over time, and whether it is likely to change in the future, particularly as a result of the industry consolidation which is beginning to crystallise.

The research will identify what infrastructure providers believe they need to do to maintain and improve their competitiveness and what support they believe they need from owners, participants and government to do so. The final report will draw conclusions and make recommendations as to what, if anything, needs to be done to ensure that the infrastructure organisations provide the best foundation for the continued development of London as the most important financial centre in the world.

The City of London Residential Population

The usual focus of our statistical pieces is the City's workforce. This is perhaps inevitable given that the workplace population is some 290,000 and the "Square Mile" is the core of the leading international financial centre in the world. By contrast, the City's residential population is small – in fact the smallest of any local authority in England, bar the Isles of Scilly – and has consistently been less than 10,000 since World War II. This indeed makes the City a unique local authority. The City of London has an employee to population ratio of 31.5, the highest in the country, which compares with a ratio of just 0.53 for London as a whole.

The City's residential population should not be ignored, however, not least because of their importance to service delivery plans and spending assessments. This is reinforced by the fact that the residential population has been rising fairly consistently in the last 15 years, but particularly since 1998. The main source of information comes from the census of population, but this is only every ten years, the last having taken place back in 2001. To supplement this, the Office for National Statistics (ONS) provide annual mid-year estimates which are largely based on trends identified from the Census, but also from 1999 onwards incorporate other information. In the case of the City, the National Health Service Register and GP registers of the City and East London Health Authority, as well as the International Passenger Survey and the Home Office

which records asylum seekers, and which help to estimate domestic and international migration, are the main supplementary information. The resident population includes only respondents in the Census who consider their dwelling in the City as their main place of residence. This is important as there are a significant number of residents who live there only during the week. This has implications – and can lead to a potential undercount – for the provision of services. Indeed only the Isles of Scilly and South Hams in Devon have a higher proportion of second homes or holiday accommodation in England – it has been estimated at 27% of the total by a 2004 City of London Corporation study.

The latest ONS mid-year population estimate for 2005 saw the City population leap from 8,600 to 9,200 (figures are rounded to the nearest 100). This represents an increase of 600 or nearly 7% (before rounding) in just one year and comes on a similar increase of 600 or 7.5% the year before. Indeed since 1998, the City population has grown from 5,200 to 9,200 an increase of 77% or average annual increase of 8.5%. The biggest increase in the City population occurred though in 1994 of 1,300 or 33%, but this was due to boundary changes which incorporated the Mansell Street and Golden Lane Estates into the City of London for the first time. The change in population in any one year can be broken down by the ONS into various components – namely births, deaths, net internal

migration and net international migration, although because of the small area concerned they do not meet the stringent requirements of ONS and are not published. Levels of migration are particularly unreliable. It is clear nevertheless from this that most of the population growth in recent years has occurred because of international migration. Thus between 2004 and 2005, the 580 increase in population (before rounding) is broken down as follows and rounded to the nearest 10:

Net international migration	+500
Internal migration	+60
Natural change (births – deaths)	+20

Within the City of London, we can analyse population data from the Census by super output areas (SOAs), which is a new geographic hierarchy introduced by the ONS in 2004 to improve the reporting of small area statistics. They replace the old system of electoral wards, whose boundaries change on a regular basis. The City of London has five SOAs, with the population distributed within these as shown in the table overleaf.

The Greater London Authority produced some projections in 2005 for all the London boroughs based on 2001 data. The projections take into account births, deaths and migration changes, and are linked to an assumed capacity based on housing capacity and an estimate of average household size. The GLA projections show the City population rising from 7,400 in 2001 and reaching 9,026 in 2005,

just below the estimated outturn of 9,200. Thereafter, the population is forecast to steadily increase to 13,494 by 2025. This represents an increase of some 4,500 or 50% compared with 2005, or 2% per annum. This is a considerably faster rate than is expected in London as a whole. For example, some 800 new homes are planned in the Bishopsgate/South Shoreditch area of the City and Hackney by 2016.

The age distribution of the population is heavily skewed to the key 20-60 working age group, making up 72% of the total, with a low proportion of both older and younger people. This compares

Resident Population in the City of London by Super Output Areas

Super Output Area	Corresponding Electoral Wards	Major Populations	Numbers
001A	Aldersgate	Barbican West, Smithfield	1,600
001B	Cripplegate, (south part)	Barbican East	1,470
001C	Cripplegate, (north part)	Golden Lane Estate	1,537
001D	All other wards	Queenhithe	1,505
001E	Portoken	Mansell Street and Middlesex Street Estates	1,073
City of London			7,185

Source: ONS Census 2001

with 60% for London as a whole. By gender, the population is skewed towards males, with a 53% share, compared with 48% for London. Analysis of marital

status, shows that 64% of the population are single (including separated/divorced), compared with a London figure of 41%.



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