The banks must be broken apart

Merely ring-fencing the retail and investment sectors doesn't go far enough, argues **Geoffrey Lew**

The recession has not lasted long for the banks. They are back in profit while the rest of the economy is still struggling. This grim irony is bitterly unpopular with people without jobs or who are having to make do with less. Insult is added to injury when they read about the restoration of bank executives' bonuses. But the situation is not wholly unwelcome to the Government. It is keen to see the banks' balance sheets made whole again so that the taxpayers' money can be repaid. Nevertheless, if nothing – or something less than adequate – is done to make real changes to the banking sector, there will surely be another crisis.

What is to be done? The Government has set up an independent banking commission to answer that question. This ought to lead to radical reform when the commission reports next autumn, but will it? Unfortunately, signs of compromise have already appeared. The Government has required the commission to take into account the "competitiveness of the UK's financial sector". This may rule out recommendations such as breaking up the big banks which comprise in one entity a deposit-taking retail business and investment banking.

The big UK banks are indeed big. Six of them hold nearly 90 per cent of all retail deposits, which in the last resort the Government must protect. These banks are coming into profits which owe much to contributions from their investment banking arms. In the current debate, the big composites are being called, variously, "behemoths" or "universal" banks, depending on which side of the argument you are on. The bank "splitters" include Alan Greenspan, the former chairman of the US Federal Reserve. In October 2009, he said; "If the banks are too big to fail, they are too big." This is also the view of Mervyn King, the Governor of the Bank of England. But it is emphatically not the view of those who run the banks themselves, several of them, like Vikram Pandit at Citigroup and Bob Diamond of Barclays, investment bankers themselves. They can be relied on to argue vehemently that breaking up the banks by splitting off their investment banking businesses will make the City less competitive. Alan Greenspan had an answer to that too. "In 1911," he said, "we broke up Standard Oil. So what happened? The individual parts became more valuable than the whole. Maybe that's what we need to do."

Much has been written about the contrasting cultures of retail and investment banking. One is bureaucratic and conservative. The other is entrepreneurial and adventurous, concerned with a relatively small number of large and often innovative deals, whose fees are high, sometimes obscenely so.

The danger is that when the two cultures are housed in the same entity, the activities of the investment bank cannot be policed effectively. This type of failure can lead to the collapse of the composite bank and can endanger other banks as well. Governments are not prepared to see depositors lose their money, so a bailout becomes inevitable. ... way to encourage prudent b... in a risky business like inv... banking is to expose its prac... to the discipline of the ... Counter-parties who are fam... the market are better judge... is a reasonable risk than eith... ulator or a management br... in the traditions of retail ba...

It cannot be emphasised to... ly that regulators can only ... rules. They cannot monitor ... risk-takers behave. The p... made forcibly by Lord Tu... chairman of the FSA, in his ... ber article in the *Financial* ... the regulator's investigation ... collapse of the Royal Bank ... land. "The FSA," he said, "si... not believe our remit inclu... venting the ABN Amro acq...

Faced with the depressi... 1930s, the US President, Fran... sevelt, considered that it wa... sary to separate "good" ba... "bad", and that nothing sho... would do. The Glass-Steag... 1933 did just that. The Hous...

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