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Greed and deception: Is it too late for ethical banking?

As it turns out, Big Bang – the deregulation of stock markets across Europe back in 1986 – really was an event that shook the world. Author and independent stock analyst Cyrus Mewawalla tells INSEAD Knowledge that deregulation, greed and deceit are at the root of today's financial crisis, and suggests ways to return to ethical banking.

"The last 20 years have changed the face of banking," says Cyrus Mewawalla, a leading UK-based research analyst, and author of the fictional financial thriller City of Thieves.

Examples such as using your savings account to invest in mortgage-backed securities, to put a fine point on it. "All bankers need is access to cheap money in order to fill various functions, including trading," says Mewawalla. "And most investment banks, therefore, like to have an arm that has deposit-taking functionalities so they can use these deposits to borrow cheaply."

It's not illegal, but in his book Mewawalla calls it "greed and deception." The garden variety depositor in a retail bank would probably agree. Afterall, who are the bankers representing? "The bigger the institution, the greater the opportunity for conflict," says Mewawalla, who says he saw plenty of that in his career with one of the Big Five accounting firms and as an equity analyst for another mega-firm.

Why doesn't the market work in today's (deregulated) scenario? Because in today's scenario, bankers don't put their clients first; they take advantage of them but they are not penalised by the market. "Clients keep coming back because banking is essentially an oligopoly," says Mewawalla. Take the case of the United States where two big banks failed (Bear Stearns & Lehman Brothers) during the recent crisis and a third bank merged (Merrill Lynch into Bank of America). "If you're a large company looking to do a merger and acquisition (M&A) or a large company looking to do structured debt or a large company looking to expand abroad and raise money in various currencies, you need to go to a big investment bank and there aren't that many of them around."

However, bank-bashing has ineffectually become a worldwide sport, with the players being politicians and policy-makers trying to find the right regulations to impose to prevent another meltdown. Mewawalla says the key is to divide the risk and thereby contain the financial losses inherent in banking.

"Let's segment banks into different kinds of risk – from your basic retail bank all the way to hedge funds – and let's charge a risk premium to each segment based on the risk they pose to the economy," he suggests. "And let's set up an insurance fund to support a bailout in the case of another failure, so the taxpayer doesn't have to pay.

I'd also like to see governments setting out criteria by which they'll save big banks and exactly how they'll do it: will bond holders be protected or not? Will shareholders be wiped out in the way General Motors shareholders were when the car-maker got a US$15 billion federal subsidy?"

Mewawalla says he sees no problem with the "risky bits" of banking moving abroad because "in the long term it may not be worth having those risks in the country. The Anglo-Saxon world wants to be innovators in banking," Mewawalla continues. "They create new products that at first regulators can't understand. And if you take the view that you want that kind of innovation in your country, then you're taking the view that you want a high-risk, high-reward banking culture."

Mewawalla spoke with INSEAD Knowledge in Singapore. He was invited to address MBA students during a business ethics course.

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