Another type of â€œtraditionalâ€•

There’s been a reaffirmation of late of the concept of traditional banking. While there’s no official definition of that term, our sense is that it is usually taken to mean the business of raising deposits and using them to make loans. As many people have observed, banking is a fairly simple business. Whether a person is any good at it depends largely on how carefully they lend out the money and how well they manage their cost of funds and operating expenses. It’s more complex in practice, naturally. (The article on interest rate risk, p.28, makes that clear.)

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Then there is nontraditional banking. This is variously labeled “capital markets,” “investment banking,” “Wall Street,” etc. Many players here are not banks at all in the traditional sense. The two bankings are quite distinct, both in function and culture, but they are also intertwined. This was true even when the law kept them apart. Cost of funds and the availability of capital are examples.

Then there is the secondary market, part of nontraditional banking, which has been an integral part of the residential mortgage business for decades. There has been talk about returning to the lend-and-hold model, once the norm. That doesn’t seem too likely or feasible, however, without dismantling the financial system as we know it.

No, we’ve created the modern economic world of which finance is an integral part and we’re stuck with it now. But that doesn’t mean it can’t or shouldn’t be improved. We would be well advised to remember that the “modern worlds” of old—Rome, Greece, Egypt—all thought they were here to stay, and yet they all faded into oblivion.

Recent events in the broader financial world came perilously close to causing a worldwide “economic winter” and, in fact, caused—and continue to cause—untold distress for millions of people.

Given that, the negotiations proceeding (or staggering, depending on when you look) in Washington to address the causes of this near catastrophe are critical, not only for the future of the banking industry—traditional and otherwise—but for the continued growth and stability of modern economies.

That’s a sobering thought considering how politically charged the debate is, and that the outcome is far from clear. That only makes it more urgent for everyone in the industry to think about what needs to change, and to convey their views to Congress and the regulators.

But that’s not all that can be done, nor even the most important thing. Traditional banking doesn’t only mean sticking to a narrowly defined set of activities. We would argue that while some activities may indeed be harmful (even beyond the obvious case of fraud), more often it comes down to how they are used, traditional or not. In making a

loan, for example, not only is there the question of whether the borrower can repay the loan, but also whether the loan is for a good or useful purpose. (Read “Lending ethics beyond the loan policy,” by Ed O’Leary in “Talking Credit” on ababj.com.)

All activities ultimately have an ethical component.

It was not the advance of technology that nearly cratered our financial system. It was the retreat of good judgment and ethics—the ability to distinguish between right and wrong and the conviction that the distinction matters. We’re certain that there is a large core of people in banking who still believe in such a “traditional” concept. Now would be a very good time for them to say so in appropriate forums. â–