Letters

On India, Moravia, Iraq, Taiwan, banking, voting, the finger

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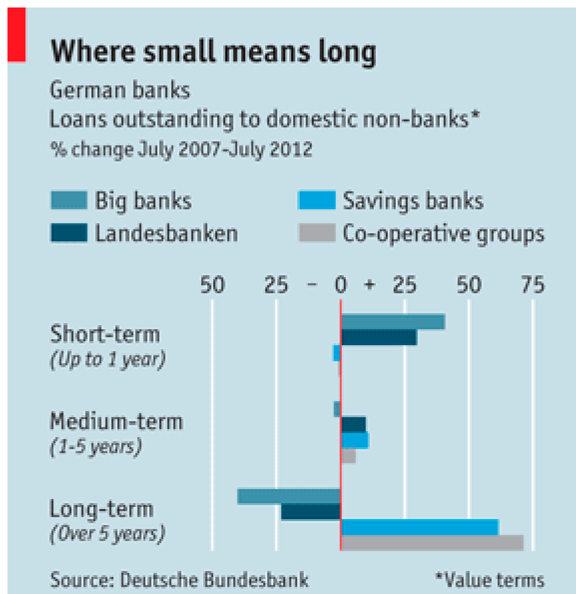
Ring-fencing the banks

* SIR – Your article on German banks ("Old-fashioned but in favour", November 10th) mentioned that officials are wary of proposals to ring-fence the banks' riskier activities as that may increase the cost of their stand-alone funding. That is precisely the rationale of such proposals.

Thanks to their franchise value and implicit government support banks can borrow cheaply and use those funds to trade in the market. Since funding is cheap, trading is naturally skewed towards high-volume low-margin strategies, such as carry trade. These often exhibit a heavy possibility of rare but dramatic losses. At the same time, bank trading is inherently difficult to supervise or risk manage, as exposures can change rapidly. Correcting or liquidating large-volume positions moves markets and is costly.



Segregating market-based operations improves market discipline. It forces banks to focus their trading on margin rather than volume. It offers some protection for the banks' core operations (deposit-taking and lending) from freak losses in side activities.

During the crisis, numerous large, systemic banks experienced losses on market-based operations. These compromised financial stability, and often necessitated fiscal support. Without policy action, catastrophic losses in banks' trading will remain a probabilistic process, an accident waiting to happen. Those who oppose segregation are playing Russian roulette.

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