

Bloomberg comments:

Elizabeth Warren, the freshman Democratic senator from Massachusetts, is leading the charge to split commercial and investment banks. The sound bite she's using to promote the idea: "Banking should be boring."



"Is everything boring enough for you, sir?"

It is an appealing meme. It suggests that if banks are rendered dull once again, we can rest easy and spare the national coffers from another raid in the next financial crisis.

Warren, along with three other senators, has introduced a bill called the 21st Century Glass-Steagall Act, a reference to Depression-era legislation that forced banks to shed their securities and brokerage businesses. The original Glass-Steagall was supplanted by new legislation in 1999, allowing the creation of too-big-to-fail banks such as Citigroup Inc., Bank of America Corp. and their taxpayer-backed brethren.

There are some potentially worthy aspects to Warren's bill, but the idea that banking should be boring doesn't reflect the business that banks are in. For starters, they accept deposits and use the majority of that to make loans, in effect expanding the supply of money. I don't know about you, but creating money sure sounds pretty exciting to me.

And by their nature, banks engage in a very dicey practice. They take a dollar from one person, with a promise to return it at any time, and give it to another person. They hope to get that money back at some point in the uncertain future. For all their troubles, they get a few extra cents with their returned dollar, assuming everything goes well.

If it doesn't, the consequences are brutal. Imagine a bank that lends someone \$100 and, after paying interest to the depositor, has a net profit of \$2. Suppose the borrower stops paying interest and can't repay the loan. To make up the \$100 loss, 50 other similar loans have to keep paying off.

All it takes for a bank to go bust is for a small percentage of its loans to go bad. A rule of thumb, a bank that has 3 percent or 4 percent of its loans in default is in serious trouble; a bank with a 7 percent default rate is dead.

So banking is nerve-wracking business and for most of its history it always has been. The public has long been aware of the precarious balance required of bankers, hence the reason that runs by depositors and other creditors have been a recurring feature in financial history -- at least until the advent of deposit insurance. Absent a government backstop, it is a high risk-low reward business. What Warren is calling boring is the manifestation -- in the past, anyway -- of the restraint and discipline inherent in sound risk management.

It's worth remembering that in the recent financial crisis, most banks got into trouble the old-fashioned way: Too many of their loans went bad and they lacked the capital to absorb the losses. Splitting the investment banking side of their businesses from their commercial lending operations wouldn't have done much -- if anything -- to change that. That's why more capital for banks is so important, as are new tools for preventing banks runs.

What is disturbing, and perhaps this is what Warren is getting at, is that since the financial crisis the risk-reward equation has been flipped. Because of the government's implicit guarantee to rescue banks deemed too big to fail, the risk is low. Meanwhile, the marriage of commercial banks with investment banks has created a compensation environment with high rewards. Much of the fear that should be part of banking has been wrung out of the system.

So how about it, Senator Warren? Instead of making banking boring, how about making it scary again -- for bankers and their shareholders?