Research Paper

Should the Services Provided by Investment and Commercial Banks be Separated? If so, why?

Caesar K. Simpson

Swiss Management Centre (SMC) University.

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ABSTRACT

One common debate dating far back the 1930s is whether universal banks should be split into commercial and investment banks, have their scope of operations narrowed, or have their scale reduced. After considering issues of financial stability, economic development, competition among financial institutions, efficiency in the provision of financial services, regulation and supervision, the writer finds that universal banking can provide considerable benefits and would pose few problems for the economy, hence should not be split. It does not follow, though, that specialised providers of financial services should not or would not also exist. Experience and logic indicate that these companies can do many things better than universal banks. In particular, specialised firms are more likely to handle many important aspect of investment banking, for example, takeovers, leverage buyouts, mergers, spin-offs and other capital structuring.

Keywords: *Investment, Commercial Bank.*

1.0 INTRODUCTION

During the past two decades globalization, deregulation and re-regulation, and innovation (including communications technology, computer science, and information technology) have spurred changes in the way banks meet their customers' needs (Ohoukoh, 2011). Fundamentally, a commercial bank is a financial intermediary whose core activity is to take deposits from savers and to pass it on as loans to borrowers (Scott-Quinn, 2012, p.42).

Commercial bank's specific activities listed in the Second Banking Directive of the European Commission (Dermine, 2003) include deposit taking and other forms of borrowing, lending, financial leasing, money transmission services, issuing and administering means of payments (credit cards, travellers' checks, and bankers' drafts), guaranty and commitments, trading for own account or the account of customers in money market instruments, foreign exchange, financial futures and options, exchange and interest rate instruments, securities; participation in share issues and the provision of services related to such issues, money brooking, portfolio management and advice, and safe custody services.

The prominence of commercial banks as financial intermediaries [1] relies on the fact that they bridge the gap between the needs of lenders and borrowers by performing a transformation function. They perform size transformation by collecting small deposits from savers, which are transformed into large amounts of credit to individuals or corporations (Ohoukoh, 2011). Their maturity transformation

[1] Financial institutions that connect surplus and deficit agents (Scott-Quinn, 2012).

function has to do with their ability to give out long-term credit from short-term deposit. Finally, by diversifying their investment, pooling risks, screening and monitoring borrowers, and holding capital and reserves as a buffer, they perform risk transformation.

An investment bank on the other hand is a financial institution that deals with raising capital, trading securities and managing corporate mergers and acquisition. Investment banks raise money through issuing securities in the capital market and insuring bond (selling CDO) as well as providing advice on transactions such as mergers and acquisitions. Investment banking covers all capital market activities, from underwriting [2] and corporate finance to mergers and acquisitions, fund management and venture capital (Ohoukoh, 2011). It also undertakes financial asset structuring (for example securitisation[3]) and provides risk management services through, for example, the creation of, and trading in derivative contracts (Scott-Quinn, 2012, p.43).

Investment banks exist to help large-scale corporations and governments get money. They help these clients invest in financial products that they buy, sell, or create and, hopefully, make a return on the money they invested in the financial vehicles suggested by investment banks (Ellis, Michaely & O'Hara, 2006). Many companies looking to expand or streamline their business will use investment banks for advice on potential targets and/or buyers. This normally will include a full valuation and recommended tactics.

The main difference between investment banks and commercial banks relies on the fact that commercial banks actually risk their own capital whereas investment banks arrange financial transaction and earn fees. When a banking institution performs both commercial and investment bank services it is referred to as a universal bank (Scott-Quinn, 2012). This practice is now a common phenomenon and has come under criticism for a variety of reasons, including perceived conflicts of interest, taking both sides in transactions and many more (Brown, 2005). The question therefore to answer is, should the services provided by investment and commercial banks be separated?

2.0 THE HISTORY OF THE RISE OF UNIVERSAL BANKING

A universal bank participates in many kinds of banking activities and is both a Commercial bank and an Investment bank. The concept is most relevant in the United Kingdom, Germany and the United States (Azadinamin, 2012). According to Casserley, Härle and Macdonald (n.d), the United States (US) has the longest and richest history of debates about universal banking. Prior to the 1933, commercial banks in the US were actively involved in investment banking (Scott-Quinn, 2012, p.59). However, in the wake of the stock market crash and the Depression in the US which started in 1929, many banks collapsed, causing retail depositors to lose their savings (Scott-Quinn, 2012, p.59). Most economists believed that the crash need never have developed into the depression. Some blame the depression on universal banking, largely on conflicts of interest (Benston, 1989). Commercial banks were accused of being too speculative[4] in the pre-Depression era, not only because they were investing their assets but also because they were buying new issues for resale to the public (Calomiris, 2010). Thus, banks became greedy, taking on huge risks in the hope of even bigger rewards. Banking itself became sloppy and objectives became blurred. Unsound loans were issued to companies in which the bank had invested,

[2] The process by which investment bankers raise investment capital from investors on behalf of corporations and governments that are issuing securities (both equity and debt) (Scott-Quinn, 2012).

[3] Securitisation is the process of taking an illiquid asset, or group of assets, and through financial engineering, transforming them into a security (Gallant, 2009).

[4] Exaggerated expectations of future growth, price appreciation, or other events that could cause an increase in asset values (Benston, 1989)

and clients would be encouraged to invest in those same stocks (Casserley, Härle & Macdonald, n.d).

In the period immediately after the depression, the question of what had caused it was central to enacting reforms intended to prevent future crises. This brought into being the famous Glass-Steagall Act[5] (GSA) of 1933 which imposed a strict separation between commercial banking, such as borrowing and lending, and investment banking, such as securities underwriting (Scott-Quinn, 2012, p.59). This was an essential feature of the National Bank Acts of 1863 and 1864 of USA established the principle of the separation of commercial and investment banking (Casserley, Härle & Macdonald, n.d; Grumet, 2009). The Act was passed as an emergency measure to counter the failure of almost 5,000 banks during the Great Depression (Calomiris, 2010). By the Glass-Steagall Act of 1933, banks had to choose whether they wished to accept deposits or deal in securities; they could no longer do both. By and large, the commercial banks got out of the securities business, and the investment banks stopped accepting deposits (Casserley, Härle & Macdonald, n.d; Grumet, 2009).

The restrictions of the GSA on the banking sector sparked a debate over how much restraint is healthy for the industry. Many argued that allowing banks to diversify in moderation offers the banking industry the potential to reduce risk, so the restrictions of the GSA could have actually had an adverse effect, making the banking industry riskier rather than safer. Additionally, big banks are likely to be more transparent, lessening the possibility of assuming too much risk or masking unsound investment decisions. As such, reputation has come to mean everything in today's market, and that could be enough to motivate banks to regulate themselves (Casserley, Härle & Macdonald, n.d).

Subsequently, in November of 1999 Congress repealed the GSA with the establishment of the Gramm-Leach-Bliley Act,[6] which eliminated the GSA restrictions against affiliations between commercial and investment banks (Scott-Quinn, 2012, p.60; Reinholdson & Olsson, 2012). The Gramm-Leach-Bliley Act allows banking institutions to provide a broader range of services, including underwriting and other. Since 1999, however, commercial banks in US were allowed to gradually expand into investment banking and to develop into universal banks that offer a broad range of financial services (Casserley, Härle & Macdonald, n.d).

The UK has had a long history of separated banks, and although there were no legal barriers to universal banking, it was not until the deregulation of the 1980s that this model took hold (Scott-Quinn, 2012, p. 61; Borio & Filosa, 1994). Universal banking was becoming the norm in an increasingly globalized financial world, especially once the UK put an end to its tradition of specialized financial institutions in the mid-1980s. The separation of investment and commercial banking in Britain had always been a matter of convention rather than law. During the 1960s and 1970s the clearing banks started to provide a wider variety of loans than before, moving into consumer finance, mortgages, and medium-term business loans. They also made their first steps into investment banking when Midland bought a 25 percent equity stake in Samuel Montagu and National Westminster set up a merchant-banking subsidiary. The rise of the Eurodollar[7] market in London heralded the arrival of numerous foreign banks and introduced the practice of longer-term loans funded on a revolving basis (Casserley,

[5] The Glass-Steagall Act was sponsored by Senator Carter Glass, a former Treasury secretary, and Senator Henry Steagall, a member of the House of Representatives and chairman of the House Banking and Currency Committee (Grumet, 2009).

[6] The Gramm-Leach-Bliley Act (GLB) is also known as the Financial Services Modernization Act of 1999 (Olsson, 2012).

[7] U.S.-dollar denominated deposits at foreign banks or foreign branches of American banks. By locating outside of the United States, Eurodollars escape regulation by the Federal Reserve Board (Casserley, Härle & Macdonald, n.d).

Härle & Macdonald, n.d; Scott-Quinn, 2012, p.61).

By the 1980s the biggest barrier to the creation of fully integrated banks was posed by the internal rules of the London Stock Exchange. These required members to operate as partnerships specializing either as brokers or as market makers, and prevented outsiders from owning a significant financial interest in member firms. It was the breaking down of these rules in response to a government investigation into restrictive practices and price fixing that opened the door to fully integrated universal banking (Casserley, Härle & Macdonald, n.d).

By the eve of what has become known as Big Bang on 27 October 1986, the four big clearing banks had positioned themselves to become fully integrated banks, and had between them invested close to £1 billion in securities businesses at a time when the capital of the average stockbroker[8] or merchant bank could be measured in tens of millions. These figures were a foretaste of the massively increased scale on which globalized universal banking was to operate in the coming years (Casserley, Härle & Macdonald, n.d).

In the years up to the financial crisis of 2008, British banks enhanced their standing among banks internationally. Commercial banking was a highly profitable business in the UK, and from time to time it gave rise to concerns about the level of competition, especially in retail banking. HSBC and Standard Chartered Bank continued to expand internationally in line with their roots in emerging-market banking. Barclays successfully built an investment bank, and RBS became one of the largest banks in the world through a series of acquisitions and rapid expansion into leveraged lending to corporations and private equity firms (Casserley, Härle & Macdonald, n.d).

By the time of the financial crisis all of them had become universal banks, albeit with very different mixes of commercial and investment banking activities. The post-crisis debate on the merits of separating commercial and investment banking has been more animated in the UK than elsewhere. While moral hazard [9] is seen as the central issue, as it is in the US, those who advocate separation also argue that it could make a material contribution to the stability of the financial system if implemented in conjunction with other measures such as substantially higher capital requirements (Casserley, Härle & Macdonald, n.d).

A counterpoint to the United States can be found in Germany, a country where universal banking has grown up organically and seldom been challenged (Benston, 1994; Casserley, Härle & Macdonald, n.d). In Germany as in most other continental European countries, large banks have traditionally been universal banks, for example Deutsche Bank (Scott-Quinn, 2012, p.60). After unification in 1871, the pace of industrialization accelerated dramatically. The boom of the early 1870s led to the formation of 183 joint-stock banks, while the crash of 1873 prompted successive waves of consolidation that led to the rise of the big Berlin banks. Without any restrictions on branching, the largest banks were able to assume a dominant role in the national economy. By 1913 the three largest German companies were banks (Casserley, Härle & Macdonald, n.d).

The big banks tended to concentrate on providing capital for industrial expansion. In common with the United States, there was a tendency for German companies to form monopolies or cartels [10]

[8] A stockbroker is a regulated professional individual, usually associated with a brokerage firm or broker-dealer, who buys and sells stocks and other securities for both retail and institutional clients, through a stock exchange or over the counter, in return for a fee or commission (Scott-Quinn, 2012).

[9] A situation in which a party is more likely to take risks because the costs that could result will not be borne by the party taking the risk (Scott-Quinn, 2012).

[10] A formal, explicit agreement between a group of producers of a good or service, to regulate supply in an effort to regulate or manipulate prices (Sheffrin, 2003).

so as to avoid what was perceived as fruitless competition. By the early twentieth century the German economy was characterized by networks of dominant corporations financed by a small group of large banks that exercised influence through shareholdings and directorships. For the most part these banks focused on their large corporate clients, and it was not until the 1960s that they entered retail banking. In the meantime, private customers were served by the savings and loan and cooperative sector (Casserley, Härle & Macdonald, n.d).

The German equivalent of America's Louis Brandeis was the Marxist economist Rudolf Hilferding, who published his *Das Finanzkapital* in 1910. He argued that the concentration of business into cartels through bank finance was the ultimate development of capitalism. This analysis led to calls for curbs on the power of banks in some quarters. From a socialist perspective, though, this was a moot point, since the "concentration of economic power in the hands of a few capitalist magnates" was regarded as the result of the fatal inherent contradictions of capitalism and perceived as leading naturally to the concentration of economic power under the dictatorship of the proletariat (Casserley, Härle & Macdonald, n.d).

World War I not only put a stop to questions of banking reform, it also transformed Germany's economic and financial position. The hyperinflation [11] that followed in its wake drastically weakened the banks, reducing their capital to less than a third of its pre-war level in real terms. Ironically, one of the few assets that saved the banks from total insolvency was their holding of industrial shares. After the restoration of monetary stability in 1924, the banks no longer resembled the powerhouses they had been before the war. Their leverage was considerably greater, and they, like the whole German economy, were dependent on inflows of foreign capital (Casserley, Härle & Macdonald, n.d).

3.0 DISCUSSION-THE DEBATE

One of the key questions that the UK government has mandated the Independent Commission on Banking to answer is whether universal banks should be split into commercial and investment banks, have their scope of operations narrowed, or have their scale reduced (Casserley, Härle & Macdonald, n.d). This question is not new, it has been discussed on many different occasions in many countries, whether in response to a banking crisis or not. Although today's banks and financial markets have developed tremendously and become far more complex since the question was last aired, the debate continuous unabated. The writer is therefore of the view that the services provided by investment and commercial banks should not be separated due to the following reasons:

3.1 Universal Banks Decrease the Risk of Financial Instability

One common argument for separation advanced today is that universal banks tend to be large, so large that failure of even one such bank could bring the entire system down or at least cause substantial distress, hence they increase the risk of financial instability (Benston, 1994). In addition, universal banks are said to be particularly vulnerable, because of their close ties to business, particularly their role in underwriting and distributing securities. Francke and Hudson (1984) point out that universal banks often lend to businesses in anticipation of their customers' repaying loans with the proceeds of stock issues that the bank underwrite.

This procedure, they say, "did appear to make the recovery of their liquidity by the banks highly vulnerable to changes in the prevailing sentiment on the stock market and hence to the reception it would give to a flotation. This was even more the case if the bank retained substantial shareholding in the firm even after it has been successfully floated"

[11] Extremely rapid or out of control inflation. Hyperinflation is a situation where the price increases are so out of control that the concept of inflation is meaningless (Benston, 1994).

However, the claim that universal banks are more risky that specialised banks, while plausible in some ways, is not borne out by experience. Most recently specialised US savings and loans banks failed in large numbers because their assets, liabilities and operations were not well diversified [12] (Benston, 1994). Evidence can also be drawn from the experience of the United States in the 1930s. The banks that failed in their droves were not in fact the large national banks with their securities affiliates, but the small "unit" banks. Of the 9,000 banks that failed between 1930 and 1933, very few had securities affiliates. When asked by Senator Glass about the causes of bank failures, the Comptroller of the Currency[13] replied that 90 percent of the banks were "in small rural communities," and that he knew "of no instance where the shrinkage in value of collateral or bank investments as far as national banks are concerned, has been responsible for any bank failure, or very, very few of them (Casserley, Härle & Macdonald, n.d).

As the universal banks "tend to be large" according the argument above, they get diversified. Diversification is a key means of reducing risk (Scott-Quinn, 2012, p.74). Therefore, through diversification universal banks decrease the risk of financial instability. In equity investment, for example, it is a means of exchanging risks amongst a large group of people by each taking a small amount of the risk of each venture. This is simply the practical application of the age-old injunction 'not to put all one's eggs in one basket' (Scott-Quinn, 2012, p.60). Diversification is a 'costless' means of reducing the variance of an investment portfolio. The importance of risk management through diversification is not only that it reduces risk for investors. It is also that, by so doing, it makes risky assets more attractive to investors, thereby raising the price at which they can be sold-thus lowering the cost of capital (Scott-Quinn, 2012, pp.60-61).

3.2 Big universal banks are better for the economy

Sophisticated global economy needs large integrated banks that are able to offer a full range of banking services (Wieandt & Moenninghoff, 2011). It follows that splitting up banks would harm economic growth. This argument was first advanced in the debates of the 1930s. As Alan Pope, a member of the Investment Bankers Association testified to the Senate: "I do not believe that this country could have developed industrially to the extent that it has since the war without the assistance of bank [security] affiliates" (Carosso, 1970, p. 369). A number of studies in the lead-up to the repeal of the Glass-Steagall Act suggested reasons why universal banks foster economic growth. These studies argued that such banks take a longer-term interest in the companies that they finance, and, because they are often shareholders, there are fewer conflicts of interest between borrower and lender. It has also been argued that universal banks can offer economies of scope that enable them to provide investment banking services more cheaply than specialist firms. A study by economist Charles Calomiris of the underwriting fees charged by German banks before 1914 showed that they averaged 3 to 5 percent, compared with up to 20 percent charged by American investment banks. In other words, not only did universal banking bring gains, but those gains accrued to customers (Calomiris, 1995). As money and capital markets become more globalized, universal banking will be increasingly difficult for separated banks to compete with large, international, financial conglomerates [14] for

[12] To distribute (investments) among different companies or securities in order to limit losses in the even to fa fal lin a particular market or industry (Benston, 1994).

[13] The Office of the Comptroller of the Currency (OCC) is an independent bureau within the United States Department of the Treasury that was established by the National Currency Act of 1863 and serves to charter, regulate, and supervise all national banks and thrift institutions and the federal branches and agencies of foreign banks in the United States(Casserley, Härle & Macdonald, n.d).

[14] A corporation that is made up of a number of different, seemingly unrelated businesses. In a conglomerate, one company owns a controlling stake in a number of smaller companies, which conduct business separately (Neely, 1995).

corporate and consumer business. Allowing non-banking firms to own and affiliate with banks will bring additional capital into the banking industry, bolstering its safety and soundness; higher capital, and reduces the probability of bank failure (Neely, 1995).

3.3 Universal banks have a competitive edge

Proponents of separation argument maintain that universal banks have too strong a lobbying influence and have become too powerful leading to monopolistic tendencies. This issue has a clear precedent in the concerns about a money trust in the period before the First World War (Casserley, Härle & Macdonald, n.d). The first lines of Louis Brandeis's *Other People's Money* quoted president-to-be Woodrow Wilson in 1911: "The great monopoly in this country is the money monopoly. So long as that exists, our old variety and freedom and individual energy of development are out of the question. A great industrial nation is controlled by its system of credit. Our system of credit is concentrated. The growth of the nation, therefore, and all our activities are in the hands of a few men, who, even if their actions be honest and intended for the public interest, are necessarily concentrated upon the great undertakings in which their own money is involved and who, necessarily, by every reason of their own limitations, chill and check and destroy genuine economic freedom" (Kelley, 1971, p.1).

In contrast to this argument, it is evidential that universal banks rather have a competitive edge that enables them to provide real benefits to the economy. In the early twentieth century, American banks came under pressure to circumvent the restrictions of the National Bank Act [15] because of competition from unregulated trust companies able to offer a wider variety of services. It is a distinct convenience to most people to have all of their financial business attended to under one roof. The universal banks will not only care for their banking business, but will also receive valuables for safekeeping, care for property, manage their estates temporarily or permanently for them, make investments for them, and give financial and legal advice (Dale, 1992).

Economic progress continues to be associated with the growing importance of larger companies having access to stock and bond markets, there is a strong probability that the commercial loan will decline relatively to other bank assets (Dale, 1992, p.22). The same trends were behind the pressures for American banks to overturn the Glass Steagall Act in the 1980s. More and more companies would be able to finance themselves in the commercial paper[16] market, leaving banks to choose between enduring shrinking profits or raising their levels of risk. In an environment of global competition, rapid financial innovation, and technological change, bankers understandably feel that the old portfolio and affiliate rules and the constraints on permissible activities of affiliates are no longer meaningful and likely to result in a shrinking banking system" (Greenspan, 1990).

3.4 Increased efficiency in the provision of financial services

Another argument in favour of universal banking is the possibility of increased efficiency in the provision of financial services (Neely, 1995). Any cost reductions are likely to result from the presence of economies of scale or economies of scope. Economies of scale are said to exist if average costs fall as output increases; economies of scope exist if the cost of joint production of two or more

[15] The National Banking Acts of 1863 and 1864 were two United States federal banking acts that established a system of national banks for banks, and created the United States National Banking System. They encouraged development of a national currency backed by bank holdings of U.S. (Casserley, Härle & Macdonald, n.d).

[16] An unsecured, short-term debt instrument issued by a corporation, typically for the financing of accounts receivable, inventories and meeting short-term liabilities. Maturities on commercial paper rarely range any longer than 270 days. The debt is usually issued at a discount, reflecting prevailing market interest rates (Scott-Quinn, 2012).

products is less than the costs of separate production. Joint production costs may be lower because inputs like computers and personnel can be shared. If scale or scope economies are present in banking, then policies that would allow banks to become larger or produce additional services would increase efficiency and presumably benefit banks in the form of higher profits and businesses and consumers in the form of lower prices (Neely, 1995).

3.5 Regulation and Supervision

Advocates of separation assert that it is not appropriate for universal banks to make risky bets that are funded at least partly by insured deposits and implicit government guarantees. This is the central moral hazard argument - "if you believe that someone will bail you out, you can take high risks because you are protected from failure" (Casserley, Härle & Macdonald, n.d).

In furtherance, they argue that universal banks are more likely to experience conflicts of interest. The conflicts of interest that were exposed by the Pecora [17] hearings in the US Senate in 1932 were one of the main reasons for the passage of the Glass-Steagall Act. Banks had sold securities to their customers without disclosing their own interests in the transaction, as when National City sold its entire holdings in Anaconda Copper to its customers as soon as the price of copper dropped, while continuing to recommend the stock as a sound investment. Conflicts of interest undermined confidence in banks in general, a factor that was felt to have contributed to the panics of the early 1930s (Casserley, Härle & Macdonald, n.d).

Nevertheless, the moral hazard and conflict of interest alleged on the part of the universal banks cannot be eliminated simply by a mere separation. Better supervision is preferable to drastic structural measures. The question of supervision versus separation was discussed as frequently in the 1930s as it is today (Casserley, Härle & Macdonald, n.d). The current regulatory alternative to splitting up banks - the Basel accords, is a step in the right direction. The Basel Committee on Banking Supervision provides a forum for regular cooperation on banking supervisory matters. It seeks to promote and strengthen supervisory and risk management practices globally. The Committee's members come from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, United Kingdom and United States (Scott-Quinn, 2012).

From its inception in the 1980s, (Basel I) this focused on setting capital requirements as a way of dealing with the growing inherent risk and volatility[18] of the assets held by banks as they move away from traditional commercial banking. Basel I regulatory regimes had mostly tended to focus on liquidity rather than capital, as seen in the reserve ratios established by the National Bank Act of 1864, and after 1913 by the Federal Reserve (Casserley, Härle & Macdonald, n.d). Unlike the previous Basel regulations (Basel I), Basel II uses a methodology which is risk sensitive-thus various asset types are allocated an appropriate risk factor. Basel II also considers not just credit risk but also market risk and operational risk. [19] It also reinforces the importance of supervision -the role of regulators in trying to detect if banks are, in fact following the rules and behaving in an appropriate way. It also tries to use the power of self-interest of various parties by introducing the concept of market discipline

[17] The Pecora Investigation was an inquiry begun on March 4, 1932 by the United States Senate Committee on Banking and Currency to investigate the causes of the Wall Street Crash of 1929. The name refers to the fourth and final chief counsel for the investigation, Ferdinand Pecora (Casserley, Härle & Macdonald, n.d).

[18] A measure for variation of price of a financial instrument over time. Historic volatility is derived from time series of past market prices. An implied volatility is derived from the market price of a market traded derivative (in particular an option) (Neely, 1995).

[19] A form of risk that summarizes the risks a company or firm undertakes when it attempts to operate within a given field or industry. Operational risk is the risk that is not inherent in financial, systematic or market-wide risk. It is the risk remaining after determining financing and systematic risk, and includes risks resulting from breakdowns in internal procedures, people and systems (Scott-Quinn, 2012).

to try to ensure that, for example, counter-parties are aware of the extent of risk-taking by the bank to which they are lending (Scott-Quinn, 2012, p. 388). The Base III: A Global Regulatory Framework for More Resilient Banks and Baking System, which came into effect 2012/13 having a phase-in period up to 2019, has more complex requirements. The Basel I-Basel III is evident enough of continuous commitment of banking regulatory bodies to ensure adequate and efficient supervision and to instill discipline in the banking sector (Scott-Quinn, 2012, p, 398).

4.0 CONCLUDING REMARKS

History does not provide a clear answer to the question whether commercial and investment banking should be separated. For every reason in favour of separation, there is an argument against. Each of these debates has focused on solving the current financial crisis and determining whether it would have happened if different regulation had been in place. The challenge of preventing future crises, possibly of a different nature, has seldom received much attention. It would be unwise to have high expectations of any process of structural reform. The likelihood that it will solve the underlying issues once and for all appears to be slender.

After considering issues of financial stability, economic development, competition among financial institutions, efficiency in the provision of financial services, regulation and supervision, the writer finds that universal banking can provide considerable benefits and would pose few problems for the economy, hence should not be split. This is consistent with Fohlin (2000).

It does not follow, though, that specialised providers of financial services should not or would not also exist. Experience and logic indicate that these companies can do many things better than universal banks. In particular, specialised firms are more likely to handle many important aspect of investment banking, for example, takeovers, leverage buyouts, [20] mergers, spin-offs [21] and other capital structuring (Benston, 1994).

There is a room for disagreement over what form of universal banking makes the most sense for the US. Saunders and Walter (1994) would support the UK model, where securities and other such activities are conducted in separately capitalised subsidiaries banks. The writer agrees that the Glass-Steagall Act's separation of commercial and investment banking and the Bank Holding Company Act's and other legislative restrictions against banks offering full range of financial services should be repealed. Restricting banks' securities activities was either a misguided reaction to the financial crisis of the 1930s or punishing banks at the expense of the general public (Benston, 1994).

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[20] The acquisition of another company using a significant amount of borrowed money (bonds or loans) to meet the cost of acquisition. Often, the assets of the company being acquired are used as collateral for the loans in addition to the assets of the acquiring company. The purpose of leveraged buyouts is to allow companies to make large acquisitions without having to commit a lot of capital (Scott-Quinn, 2012).

[21] The creation of an independent company through the sale or distribution of new shares of an existing business or division of a parent company. A spinoff is a type of divestiture. Businesses wishing to streamline their operations often sell less productive or unrelated subsidiary businesses as spinoffs (Scott-Quinn, 2012).

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