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Libor pains

"It was when Nick Clegg joined the campaign against Bob Diamond that I started to feel a sliver of sympathy for the now former-boss of Barclays. Not very much sympathy, mind. Just a tiny bit. But put yourself in Bob Diamond's hand-made crocodile-skin loafers for a moment. You build a business from scratch (Barclays Capital), you dodge the worst of the financial crisis that took down your rivals, you become top-man at Barclays and then you end up being lectured by the leader of the Lib Dems."

- Iain Martin in The Daily Telegraph.

"With one in ten of the nation's workforce currently conducting, the subject of, or reporting on a judicial review, several companies are setting up public inquiry call centres in the north of England.

"Centre supervisor Tom Logan said: "We offer a bespoke service with everything from a quick brush under the carpet to a complete three-ring circus that takes so long everybody gets completely bored by the whole thing and forgets what it was about, leaving you to carry on as before."

- From 'UK to become inquiry-based economy' in The Daily Mash.

While everyone has been fixated on whether Barclays (along with numerous other banks) tried to manipulate Libor, nobody seems to be particularly bothered that UK base rates have been routinely manipulated by the Bank of England for years. And when the Bank has not been formally responsible for the base rate, the Government of the day (or its Chancellor) has. Headline policy interest rates have always been a political plaything, nudged higher or lower as "required", which normally means lower ahead of an election.

We have been used to this political interference for so long that we take it for granted. So there is mass hysteria over the shock revelation that banks are self-interested rent-seekers, and none whatsoever over the fundamentally distorted monetary infrastructure that underpins the interest rate-setting process in the first place. Interest rates are not set by any free market in any remote sense of the word, they are a tool of Government. But when our banks have blown themselves up, the manipulation of interest rates (to 300 year lows) effectively becomes a tool that forcibly impoverishes savers in order to perpetuate a broken banking system.

When even meaningful sums of capital end up earning zero percent interest on deposit at the bank, it becomes difficult to remember that that capital is still at risk. Depositors may be earning zero compensation for putting their money in jeopardy as unsecured creditors to the bank in question, but the bank is still free to lend on at profit (or, as seems to be the prevailing case, to park that money with the central bank instead, or put it to work in the sterile investment of government bonds). The outgoing head of retail at RBS – a bank so bad that it blew up a country – suggested that regulators and politicians should end free banking. What he possibly meant to say and certainly should have done was that regulators and politicians should stop taxpayers and depositors providing free money for banks. Apparently he went to Australia – long a favoured UK government destination for repatriating undesirables. We would add that the lending of demand deposits, or the lending of time deposits for a term longer than their own duration, amounts to fraud, and should be prohibited.

For five long years now, we have watched with increasing disbelief as the banks' chickens flew noisily home to roost, and have been met with a political response ranging from ignorant apathy through denial to sudden panic and its associated haemorrhaging from the public purse. Britain's banks have been through a degree of recapitalisation relative to their euro zone peers, but neither British nor European banks look particularly healthy and if they dare to suggest as much, how can we possibly believe them now ?

As coincidence would have it, while Barclays / the Bank of England / the FSA were loudly defenestrating Bob Diamond last week, we were guests of Anthemis Group and Hogan Lovells at the 'Innovation Playground for Financial Services' – in essence, a day of debate and presentations on the topic of the future of finance. Amongst Anthemis' portfolio of investments in "digitally native finance" companies:

- Fidor Bank, which received its banking licence in 2009 and now offers a banking service "uniquely adapted for e-commerce, mobile and the social web";
- The Climate Corporation, which enables farmers to access real-time pricing and provision of customisable weather insurance using proprietary weather simulation modelling;
- The Currency Cloud, a foreign exchange payments automation service facilitating payments in 140 currencies across 200 countries;
- MoBank Group, which creates and operates transactional systems for mobile commerce and banking.

Amidst a global banking crisis (which has lately involved systems outages and a catastrophic breakdown of trust on the part of the incumbents), it was a breath of fresh air to see solutions, rather than just another endless sequence of problems, emerging from the ground up. As Anthemis founder Sean Park suggested during his keynote address,

"The pessimists write the headlines and the optimists make the money." (James Altucher).

This was a sentiment echoed by Luke Johnson in his weekly piece for The Financial Times ('Ignore the delusional prophets of doom') wherein he observed that at a recent Founders Forum, a meeting of entrepreneurs,

"The place is bursting with confidence. I invariably leave with an overwhelming sense that mankind's combined ingenuity can solve any challenge, if sufficient brainpower and the right incentives are applied. The occasion was all about invention and action, unlike political conferences, which tend to be dominated by complaint, dispute and an obsession with legislation."

Sean also quoted writer and new media consultant Clay Shirky:

"Institutions will try to preserve the problem to which they are the solution."

Having sat and watched on the sidelines as our banks drown in a mire of their own making (and having religiously advised clients against making any investments whatsoever in the listed banking sector), we are now willing to see some light at the end of the tunnel. But the light is being created not by the incumbents, whom we view as a lost cause, but by the insurgents. As Sean hinted, the FSA (for example) ought to be supportive of competition in the UK banking sector. But it is difficult to encourage competition when getting a UK banking licence is a) grotesquely expensive and b) effectively impossible. So no surprise that a concentrated oligopoly helped by a well-funded lobbying base clings on grimly to its market share despite any obvious ability variously to a) provide value (or any return on capital placed riskily on deposit !); b) provide functioning systems or c) behave like something other than a bunch of crooks.

It will doubtless take time for some of these new "digital natives" to seize market share from the banking incumbents, and doubtless some of them will fail spectacularly, just as some of them will achieve spectacular success. But as James Altucher also said recently, in quoting from the film 'Margin Call',

"There are three ways to make a living: be first; be smarter; or cheat."

If we were to put any money to work in the banking sector as an investment, you can rest assured we would only have interest in supporting entrepreneurs pursuing the first two objectives. There is enough passive money out there resignedly supporting the third.

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