Break Up the Big Banks

Editorial by Simon Johnson
The New York Times
January 12, 2014

Simon Johnson, former chief economist of the International Monetary Fund, is the Ronald A. Kurtz professor of entrepreneurship at the M.I.T. Sloan School of Management. He is a columnist for Economix.

Our largest banks have grown far beyond the point where things fall apart, repeatedly. They are so big and complex that top management cannot understand, manage and control what is happening

Jamie Dimon, the C.E.O. of JPMorgan Chase, not only had no idea of the highly risky trades engaged in by his firm's so-called London Whale trading – when confronted with the facts in early 2012, he denied this was anything other than a "tempest in teapot." In fact, it amounted to losses of over $6 billion, plus fines and civil lawsuits that will end up being very expensive to shareholders.

Executives like the implicit federal subsidies from being "too big to fail." But smaller banks will be better run and more tightly controlled.

More recently, Dimon and his top management colleagues have apparently persuaded prosecutors that they knew nothing of Bernie Madoff's fraud – information about what was going wrong was ignored or not communicated properly by responsible people.

This was not mismanagement of complex derivatives, but a very straightforward failure of internal anti-money laundering controls, of the kind that have been required since at least 1970.

From October 1986 through December 2008 (when he was arrested), Madoff's Ponzi scheme "was conducted almost exclusively through" JPMorgan Chase Bank. JPMorgan employees in London raised alarms – and filed a report with the U.K. Serious Organized Crime Agency. But the company never reported these concerns to the relevant U.S. authorities.

We have seen exactly this kind of breakdown of policy and internal communication on myriad issues in the past decade within other very large international banks, including Barclays, Citigroup, Deutsche Bank, Goldman Sachs, HSBC, Standard Chartered and UBS. There are still scandals and potential legal settlements as far as the eye can see.

What do these firms have in common? They all got a lot bigger since the early 1990s. JPMorgan, for example, had assets of around $300 billion in 1995 (that's less than $500 billion in today's money); it now has assets valued at more than $2.5 trillion (and nearly $4 trillion by some reasonable measures).

Executives like to operate at this size, in part because it makes their firms "too big to fail" – as was demonstrated by the large rescue packages they received in 2008 and 2009 – and this implies large implicit subsidies from the government.

Force the biggest banks to break up, and you will get better run operations with much tighter control over ethics and business practices.