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Introduction

Why is it that some people's bank managers entertain them lavishly, sort out any problems personally and give them generous credit facilities while yours is hard to find, slow to respond and dismayingly tight-fisted? The answer is that you have not yet figured out how banks work and how to get them working for you. There's not a moment to lose.

Are you a company director who can't understand why your business doesn't get the respect it deserves? Perhaps you are a customer frustrated with your personal banking? This book will show you practical ways to get your bank onside.

Obtaining credit facilities from your bank can be challenging in any climate. This book will show you what information the bank needs and how to style it so it is aligned with banks' internal credit reports. That way your proposal becomes a "low-hanging fruit" by saving them time and making it easier for them to arrive at a positive decision.

Meeting your bank manager gives you the best opportunity to develop or destroy the relationship. This book will explain that much of the hard work has to be done before the meeting even takes place. It will also set out the less obvious tell-tale signs the bank managers are looking for and what most irritates them most.

Complaining to the bank and getting compensation is an art form. There will be examples of approaches that maximise the chance of success and those that guarantee failure.

I was a bank manager across three banks and three decades, lending millions but – as I'll share with you in the following pages – not always getting them back. I have seen modern banking in its brash, arrogant heyday and in tatters after the credit crunch. One constant I found over that time, however, was that most of the difficulties and vexations experienced by customers had more to do with a lack of knowledge about how banks work than a lack of money.

So while two-thirds of the book serves as a practical guide, the first third explains how banks work and what makes bank managers tick. This will allow you to build stronger, healthier connections and be one step ahead in your dealings with them.

Misunderstandings about banks are inevitable because they tend to be secretive and guarded. They also operate unlike any other service provider. Why is it for example that none of them want to be seen as the cheapest? Why are they so plagued by errors? Why do they turn away so many borrowing requests when they seemingly couldn't lose money?

A look behind the scenes is long past due. There are plenty of misconceptions to dispel and unexpected perspectives to share.

That's enough introduction. Time – as you'll soon appreciate – is particularly precious in banking. Let's get stuck in.

The Bank Manager as a Species

When two bank managers arrange to meet for the first time in a busy, public place they rarely bother to describe themselves. They know they will easily identify each other. There is a common look, there is a common *type*.

Understanding this type will help us more effectively communicate and deal with bank managers (sometimes called relationship managers – but for the purposes of this book anyone with specific responsibility for your account or lending to you). Personality profiling will naturally involve some generalisation including the use of the masculine pronouns *he*, *his* and *him* for bank managers through most of the book. Of course there are plenty of female bank managers, but they are still fewer than men and numbers matter a lot to a bank manager. Let's use that as our starting point.

Words and Figures Differ

The disparity between an average bank manager's skill with numbers and words is startling. Spreadsheets and cashflows are probably a breeze but writing coherently and grammatically may stump him and everyone in his organisation from chief executive down. One bank I worked in had the word *overdraft* misspelt throughout its website and when this was eventually pointed out the team responsible was surprised anyone cared, since the meaning was surely clear.

Quite simply, numbers assume far more importance than words in a bank. Numbers are solid and unambiguous while words are vague, slippery things that cannot be measured, valued or put on a graph.

This discomfort is often reflected in banks' mission statements. These have usually been crafted by their top executives over a relaxed couple of days on a country estate. Yet the results – such as the following offerings from three different high street banks – have disappointingly little meaning or are simply muddle-headed: *Making a difference together* (an example of increasingly popular post-crash candy floss); *…seize the opportunities that tomorrow will bring* (how about we start with today's?); *Our financial capability shall be continually invigorated to maintain dynamism, growth and stability* (sounds like two violently opposing views thrown together to save space, doesn't it?).

Naturally, the same preference for hard and fast numbers applies when a bank manager reads your communications. Any effort you put into finding the right adjective or subtle balance between humour and directness is largely wasted. By the second paragraph of text his eyes have already glazed over and will only regain focus when they light upon figures. So give them where you can and keep your writing brief and business-like. Adjectives and adverbs do not bring colour to his life; they add woolliness and waffle to his perception of you. Ideally you should follow the principle of leading with numbers and using words to give them context.

Bankers tend to be more numerate than literate. You will be more persuasive in your dealings and communications with banks if you let numbers do most of the talking and keep any written text sharp and to the point.

Respect is Owed

It is up to you to lose your bank manager's respect. His default position is to admire you as a go-getter if you are in business or as a pillar of society if you are getting a mortgage. He does not resent any hard-won successes but instead is likely to be rather proud of you.

In return, bank managers are quite needy when it comes to getting your respect. They occupy a strange position in society's hierarchy, somewhat below professionals even if they have passed banking exams or are earning more. They can be sensitive about this sub-professional status and insinuations that they are corporate drudges, salesmen or mere data imputers to a computer that makes the real decisions.

The easiest way to annoy a bank manager is to talk about the old days when the manager had real authority, did everything on a handshake, had a big, oak-panelled office all to himself and was a real presence in the community. He will not join you in fond reminiscence but will feel unfairly slighted by the comparison. It is not, after all, his ability that is different, but the prevailing system.

He will expect civility however stressful the situation (see the chapter on *How to Complain to Your Bank*) as he does not inhabit an excitable or aggressive world. Two bankers rarely even maintain eye contact for more than a few seconds in case it comes across as threatening. Frowning is rarer yet, while voices raised in anger are in most banks literally unheard of. Therefore your bank manager will find anything resembling aggression deeply disturbing as well as distinctly disrespectful.

Respect is largely a recognition of each other's position. His role naturally prevents him from shouting or being overly rude to you, so if this is what you are doing to him he will resent you for taking an unfair advantage. One of my former customers was a Pall Mall gentlemen's club which had been mildly inconvenienced by a mistake at their local branch. As there had been a few earlier complaints of a similar nature I thought it would be a nice gesture to take the branch manager along so we could apologise in person and work out a way to avoid similar problems in the future.

The club secretary instead used the opportunity to lay into the branch manager, jabbing his finger, showing off about senior directors he knew in our bank and how he could have the branch manager fired. It was an unnecessary humiliation and very uneven as the victim could not of course fight back. Not there and then, anyway. The pattern of complaints after that day suggested that the branch manager was doing everything in his power to frustrate and delay the club's banking operations. Showing such gratuitous disrespect – even if the annoyance that drove it had been justified – provoked a situation that nobody came out of well.

It may look odd to have the word bank and respect in the same sentence. What little reputation the banking industry had was surrendered during the crash of 2008.

However guilty banking was as a sector, it is nonetheless unlikely that your bank manager's fingerprints were anywhere near iffy international derivatives or that his department was involved in dodgy sub-prime securitisations. Resist the temptation to place him at the scene of the crime in order to gain the moral high ground. He will already be bored by clever comments about the evils of banking and if you imply that he or his bank needs to make amends for triggering a world recession he will simply think you do not have a good understanding of the workings of banks and perhaps, by extension, finance as a whole.

Whatever you think of your manager and the bank he represents, a little respect greases the wheels. Don't abuse the fact that you are the client and he cannot speak his mind so freely or he may find a way to even the score in other ways. Recognise that his powers are more limited than in the past but that does not mean his intelligence is.

All Change is Bad

If bank managers were allowed to control their in-trays they would grudgingly allow just enough variety to stave off terminal boredom but would otherwise prefer very little change. Information and requests would flow in a stately and predictable fashion while surprises and anomalies would be ruthlessly filtered out.

More than most humans, a bank manager relies on trends and patterns in order to make sense of his world. He feels safer if he can map ahead how his customers will perform and uses your information and past activity to do so. He hopes that everyone sticks to this predicted path. As it was in the beginning, is now, and ever shall be: world without end.

Unexpected news doesn't even need to be bad to unnerve him. Customers are often amazed that they are asked to justify dramatic upturns as well as dramatic downturns in their accounts. In most banks, however, an alarm is triggered if your account gets substantially more income than usual, requiring your manager to demonstrate that this is not the result of money laundering. In this way, unexpected success is systemically associated with criminality in his mind. Of course your real crime – whether exceeding or undershooting expectations – is that you have cast doubt on your bank manager's ability to make predictions and made the world seem a little less ordered.

By the same token a bank manager can tolerate a lot of bad news as long as it is expected. Customers who exceed their overdrafts regularly on the same day each month tend to get away with far more than those who go into minor excess now and again. If it is a one-off problem, give your manager time to absorb and deal with it. He will have experience of, and probably some sympathy with things not turning out as well as you had hoped. But do not spring it on him. Prepare the ground and involve him in the process. A call or email to say that you are likely to be facing a cash shortfall in three days is infinitely better than calling on the day or waiting for him to stumble across an excess or missed loan repayment.

Have in mind that dramas and surprises are distasteful to your bank manager. They are glimpses of the anarchy he sought to avoid by joining a bank. A sudden request

for the bank's help because your property has been burgled or caught fire would in the circumstances be reasonable and unavoidable. But you have thrown a pebble into his millpond and he cannot help resenting you a little for causing unsightly ripples.

Part of the problem is that a banker is less able to grasp how events can blow your life or your business off course. So while he may have some sympathy, *empathy* may be in short supply. His own career has progressed in steady and unexciting fashion and his monthly salary – even through the crash – has similarly risen steadily and been spent on generally predictable expenses. His employer is too big to be buffeted by a contract falling at the last hurdle, a payment not being received as promised, a flood or partners falling out. He has little or no direct experience of the slings and arrows that small businesses or people with less sheltered existences suffer and this can lead him to respond less generously to unexpected events.

Your bank manager will only relax again once you fall back into step with the financial pattern originally expected of you, or when you have mapped out a new one between you. If your finances have suffered a bout of unsteadiness then let him know how quickly you can return to normality, failing which, establish what the new normality looks like.

Bank managers resent surprises. Prepare them for bad news as far ahead as you can. Because they are more cosseted from unexpected events you may need to explain how events affect you or your business. Show that you have a credible plan to restore your account to the stability they long for.

Expecting the Worst

A bank manager's glass is neither half-full nor half empty but contains a scientifically quantifiable amount of liquid. What makes the glass special is that it might explode in a freak accident, be stolen in the night or spill its contents because of volatility in the immediate environment.

Bank managers are trained to consider the worst possible outcome to every situation. Those that excel at it are sent to work in Credit, where most lending decisions are made (see later chapters). Here their dark imaginings are encouraged until catastrophes of biblical proportions are confidently predicted whenever anyone asks to borrow the bank's money.

This can naturally have a deflating effect on the rest of the population who expect, on the whole, things to sort of muddle through. But bank managers learn early on that there are scant prizes for lending money to a borrower who exceeds expectations but plenty of dire consequences for lending to one who fails to meet them. Over the years some of the borrowers they most admired will have fallen by the wayside. Gradually their expectations lower and pessimism becomes a mindset.

Frustrating though it is that bank manager dwell on the negatives, that is survival instinct kicking in: too many bad loans and they are out of a job. As they list all the ways in which your proposal could go wrong they are not looking for you to cheer them up with your rosier perspective, but to indulge them in their pessimism and work

through their (or their Credit Department's) concerns one by one, however improbable they are.

Bank managers are made gloomy by training and experience. Do not expect to jolly them along. Answer their concerns rationally and you can be optimistic about the outcome.

With a Big and Small C

Bank managers are conservative, yeomen types with a strong regard for the institutions of property and family. They find it hard to trust people who are careless with either. In Britain they are obviously part of a society with a healthy scepticism towards almost any aspect of society and they will also expect a range of viewpoints from their customers. However, there is a limit to how freely you should express any radical or off-the-wall ideas.

A bank would frown upon a manager engaging with you in a political discussion. He will therefore feel constrained or at the very least a little uncomfortable if you bring politics up. But whatever he says or doesn't say, his job would be made rather difficult without capitalism or private ownership of property, so to challenge those would be to question his legitimacy.

Strong opinions against any sector or people would also stand a good chance of unsettling your manager. He has to trust that you will get on with a range of colleagues from the bank and, if you are in business, that you are an equal opportunities employer and not liable to embarrass him by association.

It is surprising how many bank forms ask about marital status even when it has no obvious bearing on what you are requesting. Although your manager's own relationship might have been strained – or even broken – by the bank's challenging work-life balance, he will nonetheless hope that you are happily married. (If not, the dynamics of your relationship are beyond the scope of this book!)

His conservative instincts are at one with a bank's experience: divorced people generally have higher financial commitments and singles are more of a flight risk (able to walk away from commitments without repaying the bank). Your marital statement is what it is, but making disparaging remarks about family or cheerfully declaring that you are on your fourth husband / wife will sound an alarm in your manager's head.

While he is not able to express himself as freely as you, your bank manager is probably conservative in his outlook. Don't come out with extreme ideas as you may be setting up an unnecessary barrier between you. Although he may laugh companionably at your risqué views, you have become diminished in his eyes: a looser, maverick figure whose mind is on things other than your finances. Don't express antipathy or indifference to family members or family as an institution. You may not see a strong link between your personal life and your banking, but in your manager's mind, if you are cavalier with one you may be cavalier with the other.

How Bank Managers Got There in the First Place

The discerning eye may spot a difference between the younger and older bank manager. The effects of short sleep and tall glasses soon play their part in physical appearance, but new recruitment methods and objectives are bringing about more profound change.

Originally, branches were fully functioning and contained not only clerical, but also managerial and executive functions. Distinguished careers could begin, flourish and end in a large branch. In the 1980s and 90s banks started to remove backroom operations from the high street to larger, dedicated service centres which could cover whole towns, cities and regions. Then senior managers were transferred to regional offices, taking the important accounts with them. Branches, which might previously have had a staff of thirty, would now have only half a dozen, focusing on little more than servicing the tills and (these days) selling you products like insurance or credit cards.

Older bank managers may therefore have started as quite junior clerks in a branch after their "O" or "A" levels, worked their way up and then moved across to an office in the great exodus. Instead of a degree they might have got banking qualifications but would anyway have mostly relied on nous and solid experience.

When I first joined the commercial division of my bank we would usually be able to fill any junior roles with the brightest sparks in the branches. Within a few short years, however, the removal of important operations from the high street was effectively complete and the branches had been stripped of their past glory. Many stayed on because they liked the customer contact that a branch allowed, but their career prospects were now much reduced. A vicious circle inevitably kicked in and it became harder to find decent staff who wanted to join the branch network in the first place. This explains why you find it increasingly difficult to meet anyone with authority in your local branch.

Concentrating back-office operations in service centres should have led to greater expertise there, but the same principle applied as with branches: it became more of a dead end than a stepping stone. Through automation and the division of labour some clerical jobs became alarmingly dumbed down.

I learned this early on when I was once asked to investigate why so many mistakes and delays were coming from my bank's regional mandate team. This was a library of every local customer's signature. If a customer went into a branch without any ID or was not recognised, his or her signature was faxed to the mandate centre for comparison with that on an original file. While asking the manager a few questions I noticed a pile of flashcards behind him, similar to those primary school teachers use and bearing simple words like, *fish*, *glove* and *house*. I asked what they were for and he explained that job candidates for his mandate team had to put them in alphabetical order as part of their interview. The worst news was that not everyone passed the test,

but being so short-handed he usually had to recruit them anyway. I didn't need to ask any more questions.

Rather than arriving via branches, younger bank managers will probably have been recruited directly into the offices you find them in, probably at assistant level (see later chapter). They will be more likely to have a degree and this degree is now more likely to be financial. They therefore make up for less initial understanding about core bank operations with a greater knowledge about finance and economics.

Younger managers – or older managers who move banks – will not simply have risen glacially through the ranks but are likely to have been part of a rigorous selection process. Hiring and interviewing techniques change with time and across banks, but the common aim is to find a safe pair of hands and filter out any loose cannons.

First off, the prospective manager will agree to a personal credit check. If this throws up any past or present financial problems the candidate will get no further. This feeds back into the question of empathy that we looked at earlier: your bank manager will have no meaningful blemishes on his personal credit history and neither will any of his thousands of colleagues. He will therefore struggle to understand how you might have failed to pay a bill on time or had a court order made against you.

There will be a test of his credit skills: a discussion of case studies and which if any bank facilities would be appropriate. His ability to generate sales and income will also be examined and he may be asked to give a formal presentation on past deals and successes. Numerical, psychometric, and logic tests also now feature quite commonly, while role-playing in interviews adds a rare dash of drama to bankers' otherwise dry existence.

The interview itself has moved on since the seventies and eighties, when the most important question seemed to be which animal the candidate would choose to be. (The top answer for a building society was *squirrel*, while for an investment bank any blood-crazed predator would do.) These days many banks try to categorise recruits as extroverts or introverts, or in bank parlance *hunters* or *farmers*. The hunters are those with enough aggressive charm to find new business. The farmers then take over the relationship management of the accounts. This is why, when you switch banks, you will often be assigned a different manager from the one you first met.

Bank's staffing policy has changed radically over the past generation. Rather than being apprenticed in branches, banks now often look for their managers of the future to be graduates with financial degrees. This has led to a decline in the quality of staff in back offices and branches and an improvement in bank managers' assistants. Banks may now reel you in with socially-accomplished business development managers and then place you in the hands of gentler relationship managers.

Summary

- You can make general assumptions about your bank manager and use them to improve your interaction with him

- To get your point across to a bank manager focus on relevant numbers rather than well-turned phrases

- Respect – or at least a show of respect – goes a long way

- Avoid surprises when possible and share bad news with your bank early

- Do not be offended if your manager does what he is paid to do and concentrates on what could go wrong with your ideas

- Eccentricities and outspoken views are likely to concern your bank manager

- Knowing how your bank manager was recruited will tell you a lot about his background and skill set

What Banks Do and How They Began

Banks borrow your money, lend it out at a higher rate than they've given you and trouser the difference. This model is so successful that – as this section shows – it has not changed in five thousand years.

This section looks at how banks have developed, the different forms they have evolved into and how they came to shape the economy and even major events in European history.

The First Banks

The priests of ancient Mesopotamia built warehouses to store tithes and religious offerings which were mostly paid in grain. Protected by the gods, these religious sites were seen as superior to ordinary barns, so as an extra service the priests would look after farmers' private wheat and barley. Finding themselves at the hub of agricultural activity, the temple elders realised around 3000 BC that they were well placed to lend their own grain to needy farmers at a profit. The first institutional loan with interest was about to be made.

The charging of interest seems hardwired into everyday transactions, but close-knit tribal groups lend freely or simply give to each other. Interest is only demanded when gatherings of people grow to such a size that – as with the first Sumerian towns in Mesopotamia – there is less familiarity and so less of an emotional bond between the lender and borrower. The Old Testament repeatedly reinforced the distinction between those who should be helped without charge and those to whom there is no such obligation by forbidding the charging of interest to brothers, countrymen and fellow worshipers but allowing it to foreigners.

The words used for interest in ancient civilisations were firmly linked with sheep and cattle breeding, which suggests that the concept was one of a perfectly natural increase in wealth. *Mash* – which one might have guessed to be cockney slang – was actually the Sumerian word for both interest and calves. Likewise *tokos* in Greek (for interest and any kind of birth) and *pecus* in Latin, which accordingly fathers both the word pecuniary and (the sheep's cheese) pecorino. As loans of cattle were not uncommon in ancient societies, repayment "with calves" would perhaps on occasions have been more than just figurative.

Despite the warm imagery, finance was a fraught affair for both lender and borrower. Every few decades on average, in a bid for popularity or to reduce their own liabilities, Mesopotamian rulers would issue a decree commanding that loans to everyone except merchants be cancelled and any security returned. In an early example of the unintended but predictable consequences of government interference, lenders reacted by making loans shorter term and more expensive. Borrowing was also a risky affair: security was often in the form of land and personal freedom, so default could mean destitution and slavery.

Keeping up with the mash would have been challenging: archaeological finds suggest that the most common interest rate was 20%. Loans – which needed to be recorded –

drove the development of writing and number systems. However, transactions would still have needed to be easily understood and communicated. Interest rates were originally quoted as fractions of the principal sum, so perhaps one fifth was favoured because it could conveniently be conveyed as one finger out of five (though it is not hard to imagine an early borrower volunteering that he could just as easily understand a tenth as being one finger out of ten).

Governments and royal houses were from the start very comfortable with the idea of borrowing, especially as they could repay at their discretion or occasionally declare general debt forgiveness. When armies needed to be raised and equipped quickly, loans were more expedient than taxation. By 423 BC finance had clearly started to shape military outcomes. In that year in Persia a mercenary army was created from scratch on the back of a single loan, enabling Darius II to defeat his half-brother and declare himself King of the Earth and King of Kings: perhaps the grandest purpose yet recorded for taking out a loan.

Greeks and Romans developed banking through the finance of overseas trade, exchange of coins (invented by the Greeks around 600 BC), branch networks and cross-border credit transfers. The borrower was no longer allowed to offer servitude as a form of security (although many borrowers then as now probably felt they were still slaves to the bank). Temples continued to play a prominent role as lenders but private banks came to the fore. The fact that banking could now be done better by the lower ranks than by aristocratic priests invited the sneering contempt of the chattering classes. Plato and Aristotle expressed horror at the notion that money could be made from money itself but were perhaps more upset that the likes of Pasion – an ex-slave – could become the wealthiest Athenian of their day by running a bank (which he then bequeathed to his own slave to ensure it would continue to be run properly).

Second Generation

After the fall of the Roman Empire, international trade in Western Europe greatly diminished. Money circulated less and there was no need for large-scale banks, only individual money-lenders (often priests and monks). It was not until commerce began to flourish in later medieval Italy that they would again find a role. That banks had lain dormant for so long is shown by the fact that Italians in the eleventh century still used the ancient Greek word *trapzeza*, sometimes translated via Latin to *banca*. This referred to the bench or table from which the moneylenders would conduct business (and which would be symbolically broken if the lender failed; giving us the term bankrupt). Clearly, what was being revived was an ancient institution.

In 14th century Italy major banks started to emerge, using pan-European networks and double-entry book-keeping to bring the industry into the modern age. The Houses of Peruzzi and Bardi were even larger than the more famous Medici, but both were brought down in part by Edward III of England's failure to repay hefty loans he had taken out to fund his war with France.

Sovereign debt carried high risks then and since. The countries with the most defaults up until the last crash have been: Spain (14 defaults); France (10); Portugal (7) and Germany, Austria and Venezuela with six each. With such a history of failure it is

curious that banks continue to get their fingers burnt lending to kings and states, especially to finance wars that must surely weaken the borrower. Historians cite various reasons including of course the pursuit of profit but also that it gives the lender influence, prestige and trading rights, that large banks eventually outgrow small commercial loans and that – in times of war – there is less trade to finance so it is really the only game in town.

Another problem for medieval banking was that it faced the continued opposition of the church. The theoretically un-Christian activity of money-lending was officially delegated in many European countries to Jews. Highly organised Jewish financial houses were evident in medieval Germany, Italy, The Netherlands and England, where in the twelfth century Aaron of Lincoln was reputed to be the richest man in the country on the back of lending to the crown, the nobility and monasteries. Pogroms, expulsion, heavy taxation and confiscation were a constant threat for medieval Jewish communities and made the establishment of sustainable, inter-generational money-lending enterprises nearly impossible.

Although two of the Medici banking family became popes, usury – lending with interest – had been forbidden since the very first church council in 325 AD and was still being condemned in an encyclical of 1835. Being frequently in hock, the Vatican was well placed to understand the dark side of debt and ironically it was a loan taken out by its archbishop in Magdeburg that irrevocably split the church. To repay the loan the local populace were pressure-sold dubious heavenly rewards: a practice that provoked Luther into launching the Reformation.

Condemned as heretical in southern, Catholic Europe, banking was ready to move north. Protestant England under Henry VIII formally allowed the charging of interest in 1545. Bruges had already liberalised its laws on lending and Amsterdam was close behind. Banking had found a new spiritual home.

Golden Age

Although very little about the actual mechanics of ancient banking would have seemed that strange to us, it was the 16th and 17th century English goldsmiths who made banking something we would more easily recognise today. As they had the second best security and the second strongest vaults people would pay them to look after their gold and silver. (The best security and strongest vaults belonged to The Royal Mint, but the government of Charles I appropriated all the depositors' gold "as a loan" in 1640, thereby destroying any credibility in the state as a safe haven and reinforcing the need for private banks.)

The goldsmith would issue a receipt or a written promise to repay the gold (a promissory note). Because these receipts and notes related to a specified weight of precious metal they were readily accepted as a form of payment for goods in themselves. The notes would circulate in leisurely fashion with nobody in a particular rush to reclaim the gold, so goldsmiths felt safe lending out at interest more notes than could be matched by the gold they safeguarded. Of course, if there was a financial crisis or lack of trust in the goldsmith then there would be a run to cash in the notes

and collect the gold. If the goldsmith could not cover the notes by collecting in his loans, then his by-now-metaphorical bench would be broken.

The concept of paper money was not, however, invented by the goldsmiths. It had first developed in China (first in the 2nd century BC as one square foot patches of leather then in paper form one thousand years later). The first official bank notes in Europe were issued by Stockholms Banco in 1661 to get around their absurd coinage (the Swedish king owned a copper mine so "coins" as heavy as 20kg were developed to help him off-load the metal). The unease about paper money was evident in the fact that each note was hand-signed by up to eight officials. The unease turned out to be well founded – too many notes were circulated and when they could not be honoured the bank crashed. Despite this unpromising start, by the end of the eighteenth century more money was being circulated as notes than in coin form.

Basing paper money on gold restricts economies to what can be dug out of the ground. The British economy unshackled itself from the gold standard in 1931. The USA felt forced to cut the last links in 1970 after a bad experience with Charles de Gaulle, who bad-mouthed the US currency and sent his navy to exchange France's dollar reserves for gold. The task of central banks since ditching gold has been to maintain confidence in their currency in other ways such as controlling inflation.

New Order

A feature of this modern system where money no longer represents anything else such as gold is that banks can and do simply create new money. This is not by printing or minting. Notes and coins only represent 3% of actual money in the economy and the rest is nothing more than entries on banks' books as deposits. Lending is what creates the new money. When a bank makes a loan of £100 it credits the borrower's bank account by that amount. The bank has not unearthed a new nugget of gold or printed two fifty pound notes especially for the occasion. It quite simply and of its own accord taps a few keys and determines that there will now be £100 more money in the world than there was a minute ago.

Something must be stopping the bank from bashing the keys like a child at its first piano lesson. One is that the borrower might withdraw the £100 in cash (requiring the bank to buy currency from the central bank) or purchase goods with a payment that will credit the seller's account at another bank (requiring the lending bank to transfer reserves to cover the payment). Either would have an impact on the lending bank's resources. A second restraint is on the customers rather than the banks themselves: interest rates might be too high to appeal to customers, which is of course how a central bank tempers the economy.

Also, most regulators set a ratio for their respective banks to balance the amount they lend against reserves: either their own shareholders' funds or money held with a central bank. Both types of reserve are the equivalent of the goldsmith keeping something back in the vault as a cushion against losses or against customers wanting their deposits back.

The same tension therefore lies at the heart of banking today as it did with those goldsmiths. Banks and their shareholders instinctively want to lend out as much as possible and keep as small a fraction as possible of that money in reserve (the system we have today is called *fractional reserve banking*). That way they are maximising their income from a minimal investment.

Once banking was no longer restrained by only lending what was held as deposits or what could be backed by gold it started to push against other restrictions. In 1981 The World Bank (WB) favoured borrowing in deutschmarks and Swiss francs for its projects, but the market was running out of appetite for lending to it in those currencies. Instead of recognising its limitations the bank borrowed US dollars which it couldn't use and – in a highly convoluted manoeuvre involving bonds and forward contracts – effectively swapped this debt with computer giant IBM, which did want dollars and also wanted to reduce the currency risk of historic borrowings in Swiss francs and deutschmarks. The swap market was born. Banks soon became addicted to complex financial instruments that overcame market or regulatory constraints but which often baffled even their own executives.

Such complexity helped mask the painful fact that when the credit crunch hit, many banks no longer held enough reserves in their vaults. Governments – the worst defaulters through the ages – reacted with anger. Churches – inventors of institutional lending – reacted with moral outrage. Banks – which have changed far less than either governments or churches over the millennia – took a deep breath and carried on.

Different Types of Banking

Many people lump all banking together as one bad lot, but given its long history it is not surprising that it has evolved into diverse forms. Around ninety-nine percent of adults in the UK (and 47% in the world) now have some sort of access to an account, making banking in its various guises a vital and increasingly global part of the everyday economy.

Retail banking covers financial transactions at their most basic: savings, small borrowings, mortgages, plastic cards and what is left of the legal cash economy. Straightforward personal and small business accounts will fall under this umbrella.

Although these customers may be assigned a specific bank manager with responsibility for their account, most retail needs are comfortably covered by high street branches and the internet. This is the busiest sector of banking and crucial for those financial institutions looking to build up a customer and deposit base. UK banks make £8bn a year from our personal current accounts and £2bn from small-to-medium-sized (SME) business current accounts alone.

Private banking is designed for higher net worth individuals. Services will include wealth and asset management – particularly lucrative areas for a bank. The best known provider in the UK is Coutts, which has been the royal family's bank ever since its rival Drummonds imposed limits on the Prince Regent's expenses two hundred years ago and was never quite forgiven.

Corporate and commercial banking deals with larger businesses and the bigger SMEs. More sophisticated, trade-focused facilities will be offered for these clients. Regular contact between the businesses and the bank is the norm here, so the quality of the working relationship is important.

Wholesale banking handles major corporations, government agencies or other financial institutions who value expertise at cash or currency management as well as lending at higher volumes. The dynamics of the relationship tend to alter at this level and may be between the bank manager and the finance department rather than owners and senior executives.

Investment banking comes into its own for larger clients in raising significant amounts of capital, advising on and lending on mergers and acquisitions and share issues. Merchant banking – the financing of international trade – has now largely been subsumed into investment banking. Goldman Sachs, Morgan Stanley and JPMorgan Chase are the world's biggest investment banks.

Central banking (undertaken for example by the Bank of England and in the USA by the Federal Reserve Bank) theoretically provides stability in the national economy and the supply and circulation of money. Interest rates, inflation, currency flows and exchange, credit supply and the integrity of the wider banking sector are common preoccupations of central banks.