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What Bob Diamond really tells us about the City

By John Kay

A widely noted speech last week by Bob Diamond, chief executive of Barclays, coincided with the 25th anniversary of Big Bang, the great shake-up of the structure of the City of London. The transformation of the man – who had told the world the time for remorse was over – into a figure who pleaded for more public understanding of his industry, was widely noted.

But Mr Diamond's emergence as the public face of the City is a measure of another transformation. Britain's indigenous investment banking industry has all but disappeared, while a US investment banker is now in charge of one of its largest retail banks. Investment banks have declined, while investment bankers have grown in power, influence – and remuneration. This is perhaps the most startling of the many consequences of Big Bang.

The changes implemented in and around 1986 involved a mixture of deregulation and reregulation. The conventions that had governed behaviour, largely tacit, were embedded in the English class system that governed recruitment.

But now the informal, value-driven culture, whose ultimate sanction was famously described as the raised eyebrow of the governor of the Bank of England, was replaced by an extensive rule book. The gates of the City were opened to comprehensive school boys, and girls, and to foreigners who might not even recognise the governor, far less appreciate the significance of his raised eyebrow.

Clever graduates and foreigners came in droves. Merchant banks, as they were once called, had always been the aristocrats of the financial system. One by one they were wiped out. US investment banks, now free to expand their London operations, were more professional and more aggressive. Blue-blooded names such as Kleinwort Benson and Morgan Grenfell sought comfort in European retail banks. Barings blew up. Warburg, the meritocratic institution best placed to survive the foreign onslaught, fell into the arms of Swiss Bank Corporation. Of the old names, only firms such as Lazard and Rothschild, which have retreated into niche positions, remain.

Thus US banks came to dominate London's wholesale markets in financial services. Even those activities that were not undertaken by US institutions were conducted in the transactions-oriented style the Americans had developed. But that same aggression and greed created reputational issues that steadily eroded the numbers of US banks. Drexel failed: Salomon, Bankers Trust, CSFB were absorbed into larger institutions. By the beginning of the last decade the number of large independent investment banks worldwide had been reduced to five, all of them American. The crisis of 2008 would claim the scalps of three.

At Big Bang, market makers, brokers, discount houses and asset managers had been acquired by retail banks. These purchases were unsuccessful. Retail banks are necessarily large bureaucracies. Their success depends on processing millions of transactions every day to common standards with a very high degree of accuracy. These requirements fit uneasily with the entrepreneurial buccaneering culture required to trade financial assets.

If investment banks found life tough without the organisational and financial cushion of a retail bank, and retail banks could not control investment banks, the solution was clear: investment bankers would control retail banks. Smarter, greedier and more ambitious than their colleagues who had worked their way through the branch network, investment bankers seized control of conglomerates brought into being by Big Bang, the relaxation and repeal of Glass-Steagall, and the reinvention of continental Europe's universal banks on Anglo-Saxon lines.

In 2011, the chief executives of three of Britain's four large banks, like their counterparts at Citigroup, Deutsche and UBS, are men who have built their careers in investment banking. When António Horta-Osório of Lloyds returns to health, it will be four out of four. When the titans of global finance today exchange reminiscences, only one man has different stories to tell: Brian Moynihan of Bank of America, who was in charge of consumer and small business banking before he assumed the post of chief executive. Would anyone like to take a bet on the likely background of Mr Moynihan's successor?