

HOW INVESTMENT BANK WORKS IN ENGLAND

Name

Instructor

Course

Institution

Date

Investment banking attracts considerable controversy because of its ability to make large amounts of money within a short period of time. In England, investment banks may either deal directly in financial markets for their own account or perform the traditional "investment banking" role of financial advisory work. This paper provides a brief review of investment banks in England.

An example of advisory work is a scenario in which a bank, a solicitor, or an accountant helps a big corporation in decisions that involve the bond market, stock market, or issuance of securities (Morrison and Wilhelm, 2007, p. 9). In contrast, a bank may deal directly with financial markets for their monetary benefit through the purchase of financial assets from one customer, and then sell them to another. Investment banks often have several departments, which perform an exclusive function that facilitates the moneymaking ventures of a bank and manage risk. Investment banks are imperative in capital markets and ensure the proficient performance of financial markets. Even so, the multifaceted and interrelated nature of their activities creates and spreads risks in the financial system as seen in the recent financial crisis.

Investment banks associate the financial system and the real economy in their dealings. Securities, such as government bonds, provide investment banks with more money than they do by directly traded shares (Bird, 2015, p. 1). Investment banks in England provide direct services to other financial markets and financial institutions such as insurers, hedge funds, retail banks, and pension funds. They facilitate capital provision, risk management and insurance, institutional design, infrastructure provision, and funding and liquidity. Direct services to the real economy include assistance to government agencies, non-financial companies, and households. The investment banks achieve this through the provision of risk management and insurance, payment services, and provision of credit and capital. Even so, Bird (2015) iterates that investment banks

normally do not offer households direct services. Most of their money comes from services from the financial sector, while only about 25% of that comes from “direct service provision to the real economy”.

Investment banks have seen several changes in recent years. Unlike in previous years where they floated securities on behalf of their customer to earn a partial commission, contemporary banks are full-service firms that trade businesses in a more professional manner. Several forces shape and impact on investment banks because they often involve complex deals (Morrison and Wilhelm, 2007, p. 8). There are so many risks involved, and this calls for stringent regulations in the investment banking industry. The Bank of England’s Prudential Regulation Authority (PRA) regulates investment banks to guarantee the stability of the country’s and UK’s financial system. The Financial Policy Committee (FPC) at the Bank of England monitors, reduces and removes systematic risks that investment banks propagate (Balluck, 2015, p. 2).

Apart from investment banking activities, banks in England also provide other retail and corporate services. They offer loans, accept deposits, and facilitate payments. Global systemically important banks (G-SIBs) are also entitled to access the Bank of England’s liquidity services through the Sterling Monetary Framework. Despite this advantage, the status of such banks subjects them to higher care and forethought. For instance, they must have greater amounts of capital (Morrison and Wilhelm, 2007, p. 9). These conditions are set to lessen their probability of failure and safeguard the United Kingdom’s financial system.

In the primary capital markets, investment banks help their clients, companies, and banks to minimize systematic risks through underwriting and securitization services. They provide bankrolling services and purchase securities not taken up by investors. In consequence, they

facilitate access to finance through capital markets. They serve both small and large companies and investors and provide them with 'leveraged loans' for acquisitions and small projects (Balluck, 2015, p. 3). In case of transactions of lump sum amounts of money, banks coordinate their efforts through a 'syndicate', which helps them split the total amount underwritten, and hence, spread and share associated risks.

Apart from their underwriting services, investment banks in England are also 'book runners' as they conduct a 'book building' process. They link clients with investors who can purchase securities. For instance, they provide a platform for investors to make bids on securities and determine the best deal for their clients. In lieu of this, they conduct a 'due diligence' process to ensure an efficient process for both their clients and investors. They help clients put in order legal documents and review a company's operations to ensure that they represent their investors appropriately. Investors are the providers of capital and credit, and they must have pertinent information that promotes fluency in services. Similarly, investment banks link clients with the most appropriate investors who can issue them capital or credit (Balluck, 2015, p. 3). Through this, they facilitate equity and debt issuance and promote services in the financial market.

Securitization is another important function of investment banks. Securitization repackages loans into 'asset-backed securities (ABS)' to allow investors to trade easily. It supports the real economy through the provision of credit through the accumulation of an assortment of debt such as credit card loans, mortgages, student finances, or profit-oriented real estate lending. The investment banks move such loans to a special purpose vehicle (SPV), which is a separate legal unit. After that, they follow up on the primary and interest repayments of the finances to which links to the securities and ensure returns on these securities. In a securitization, banks arrange the transaction process by structuring the securitization into different 'tranches' or

portions. These portions categorize risks and securities into separate branches that depend on the repayment of investors based on the loan portfolio (Balluck, 2015, p. 9). As a whole, they offer managerial support services such as cash organization.

Investment banks also serve the secondary market and derivatives. They are 'market makers' because they assist clients to buy and sell existing monetary instruments in the secondary markets. They promote market liquidity because they provide opportunities and facilitate interactions between buyers and sellers in the market (Morrison and Wilhelm, 2007, p. 10). They facilitate the trading of corporate bonds that are not traded on the London Stock Exchange, but as an alternative, investors have to contact the investment banks. Banks advise clients on the length of time to hold securities and manage their large cash pools. In addition, through derivative with their clients they are can hedge risks.

In conclusion, investment banks in England have a myriad of roles that underlie their functions. Their roles in the primary capital market and secondary markets are indispensable in the normal functioning of the financial market. They engage in propriety trading, securities, financing and provision of infrastructure, and provide beneficial linkages to both the financial system and the real economy. The Bank of England supervises and minimizes risks in various transactions and helps clients and companies to survive shocks, e.g. the recent financial crisis.

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