



BANK OF ENGLAND

News release

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Quarterly Bulletin pre-release article: ‘Investment banking: linkages to the real economy and the financial system’

All of the largest global investment banks have operations in London. This article explains what investment banks do – and attempts to help the reader understand some of the jargon used in relation to investment banking. The functions of investment banks are typically less well understood than those of retail or “high street” banks. Two key functions are: helping large organisations, such as companies and government agencies, to raise finance through capital markets; and trading in a wide range of financial instruments, mainly on behalf of a bank’s clients, which include large corporations, other banks, insurance companies, pension funds and hedge funds. Both of these functions can help financial markets to function effectively and serve the real economy.

However, investment banks can also be a source of risk to the financial system. Drawing on an internationally agreed framework for assessing systemic risks, this article highlights the following factors:

- **The size of investment banks:** following losses incurred during the recent crisis, investment banks have reduced their trading activities: for instance the amount of debt securities held by the major global investment banks fell by over 40% between 2008 and 2013. Even so, the trading assets of the ten largest banks sum to more than £5 trillion, so the sheer scale of these banks’ operations means that distress or failure of an investment bank can have a large systemic impact.
- **Interconnectedness:** the web of interconnections between investment banks and other financial institutions can act as a channel for the transmission of losses throughout the system.
- **Complexity:** the risks associated with holding some investment banking products, particularly the more esoteric structured products, can be poorly understood. As the recent financial crisis demonstrated, this can contribute significantly to risks in the global financial system.

Many of these risks crystallised during the recent global financial crisis. At that time, some of the largest global investment banks were either taken over, bailed out using public funds, or forced to declare bankruptcy after facing distress.

A number of regulatory initiatives globally have been implemented since the onset of the global financial crisis to mitigate these risks, and to build a safer, more resilient financial system that continues to serve the real economy. Some of these key initiatives are discussed in the article. The Bank of England has a key role to play in working with other regulatory bodies globally to fully implement these initiatives and ensure that investment banking activities are conducted in a way that is safe and sound. The agreement of these standards for banks is substantially complete, but it is important to ensure that they are implemented fully, to monitor new risks, build mutual trust and further facilitate international co-operation.

The URL for the article (which will be live from 14.00hrs (GMT) Monday 9 March) will be:

http://www.bankofengland.co.uk/publications/Pages/quarterlybulletin/2015/q1prerelease_2.aspx

The rest of the Q1 edition of the *Bulletin* will be published at 00:05hrs (GMT) on 12 March 2015.

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Note to Editors

Copies of the *Quarterly Bulletin* are available from:

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