

# lingua business

## The Great Fall of Investment Banking

By Paul Gibson



No pun intended. This fall marks the ETD (estimated time of death) of investment banking. But how on earth can you turn an investment bank back into a traditional so-called universal bank?

First of all, let's get our terms straight. An investment bank takes in money from deposits which they in turn invest in various projects or markets in exchange for a return. Unlike traditional banks that largely make their money on deposits and transaction-fee related revenue, an investment bank is exposed to greater risk.

Assets of an investment bank have to do with the current market value of positions or investments, within an investment portfolio. The value of assets of an investment

bank is estimated using a "Mark-to-Market" (MTM) value. This registers the current share price or stock price of any given security or fund at any given point in time.

So let's say I open an account at Lehman Brothers (recently bankrupt). Lehman takes my money and may invest my money in a big real estate company, a fund, or maybe even a disastrous project like a derivative, like a "mortgage-backed security." My positions inside my portfolio may look like this:

Ferrovial	2.300 euros
MBS	60.000 euros

---

**Net Market Value (NMV) 62.300€**

Now if you are in today's market, that great-looking portfolio of yours may undergo a severe correction in a matter of days if: (1) the real estate market or property values drop - lowering your MBS value because mortgages will not be paid and/or (2) your choice of investment bank goes under because the value of their investments is worthless. Welcome to RIGHT NOW!

Bear Stearns, Lehman Brothers went under, along with other investment banks. The only investment banks that could save themselves like Merrill Lynch fled the scene of the crime and were gobbled up by universal banks.

**Universal banks** are traditional banks, but unlike traditional ones they are also allowed to invest in

certain investment vehicles as of 1999, when they were allowed to offer investments to deposit holders on the primary markets, like the stock exchange. Universal banks have the advantage of escaping the sub prime mortgage debacle, because they still have assets on their books in the form of deposits - not only stock positions.

*Conclusion:* Investment Banks per sé are likely to disappear and you will begin to see a new type of universal bank which combines both commercial and investment banking functions to diversify their risk and adequately leverage their credit risk. Until then, happy investing!

Photo credit:

[http://farm1.static.flickr.com/46/164270827\\_2cccb8e01d.jpg?v=0](http://farm1.static.flickr.com/46/164270827_2cccb8e01d.jpg?v=0)