Near East University

THE INVESTMENT FUNCTION IN BANKING AND FINANCIAL SERVICES MANAGEMENT

An investment officer of a large money-centre bank was once overhead to say: ‘There is no way I can win!. I am either buying bonds when their prices are the highest or selling bonds when their prices are the lowest. Who would want this kind of a job?’.

So lets discover exactly what that bank officer really meant?

Keep in mind that primary function of most banks and many of their closest competitors is not to buy and sell bonds, but rather to make loans to businesses amd individuals. İn a financial crise situation is important for the companies for them to keep liquid assets with in order to cover their lost. For all these reasons, commercial banks and thrift institutions, for example, have learned to devote a significant portion of their asset portfolios – usually somwhere between a fifth to a third of all assets.

A major category of earning assets can be discovered as investment in securities. Now the question is..

WHAT ARE THE INVESTMENT INSTRUMENTS AVAILABLE TO BANKS AND OTHER FINANCIAL FIRMS.

1. Money market instruments
2. Capital market instruments

INVESTMENT SECURITY PORTFOLIOS HELP TO;

a. Stabilize income: when loan revenues fall, income from investment securities may rise.
b. Provide geographic diversification: securities often come from different regoins that the sourcesof loans , helping diversify a financial firm's sources of income.
c. Provide a backup source of liquidity: beause secuirities can be sold to raise needed cash or used as collateral for borrowing additional funds.
d. Provide flexibility: in a financial firm's asset portfolio because investment securities, unlike most oans, can be bought and sold quickly to restructure assets.

FACTORS AFFECTING CHOICE OF INVESTMENT SECURITIES

The investment officer of a bank or other institution must consider several factors in deciding whifch investment securities to buy, sell, or hold. The major factors which should be considered when choosing an investment security as follows;

a. Expected rate of return
b. Tax exposure
c. Interest rate risk (how to measure: YTM)
d. Credit risk
e. Business Risk
f. Liquisity risk
g. Call risk
h. Prepaymemt risk
i. Inflation risk
j. Pledging requirements

Source: Rose, P. S. & Hudgins S. C. (2005) *Bank Management & Financial Services,*6th ed., McGraw-Hill, NY.