Investment Banking: Commercial Banks' Inroads

The evolving competition between securities firms and commercial banks has come into increasingly sharp focus in recent years. This article examines some of the historical antecedents and contemporary market forces at work in both the retail and wholesale sectors of the securities business which bear on its interface with commercial banks. This examination leads

Commercial banks and securities firms have invaded each others' turf more and more often in recent years. These incursions strain product limits of the Glass-Steagall Act from both sides.
to some suggestions about possible direction and speed of future competitive change in these market sectors.

**Historical Evolution**

Since 1933, the traditional role of U.S. commercial banks has been reasonably clear; the niches occupied by various groups of securities firms during this period have been less well understood. Some observers see the securities business as a relatively homogeneous activity; others see it as a disparate series of independent, easy-entry “lines of commerce.” Neither of these stereotypes mirrors reality. Instead, competitive factors have divided the business more practically into “retail” investor services and “wholesale” services to corporate, municipal and institutional customers.

Securities firms and deposit-taking commercial banks have undergone separate mutations in response to broader developments in financial services, but the historic routes and influences that have brought them to their current positions have much in common. The post-World War II U.S. commercial and investment banking structure grew out of legislation and regulatory interpretation in the 1930s. The Securities Act of 1933, the so-called Glass-Steagall Act, threw up a Chinese Wall between deposit-taking and securities-dealing firms and thus created an industry structure that is mirrored only in Japan, among industrialized countries.

This structural dichotomy survived for several post-war decades without major challenge, perhaps in part because the United States was enjoying an unprecedented era of secular growth accompanied by relatively high savings, nominal inflation and low interest rates. Each group of financial intermediaries was comfortable, protected, and able to prosper within its assigned niche in the industry structure.

The McFadden Act and the Douglas Amendment protected and nurtured local and regional banks and curbed the money center banks’ market shares in domestic lending and deposit-seeking. But these large banks diversified and grew by following corporate customers into the largely unregulated international arena. Likewise, insurance companies were major beneficiaries of the post-war institutionalization of savings, and thrifts prospered by fueling the growth in home ownership with fixed-rate, long-term mortgages.

On the other side of Glass-Steagall’s Chinese Wall, an ever-expanding base of individual stock ownership and overall market trading volume promoted growth and consolidation within the retail securities sector. Increasing corporate and municipal underwriting volume also yielded attractive profits to the wholesale investment banking sector. Growth in institutional investor demand, which first came into focus in the early 1960s, created yet another dimension for post-war securities industry growth. Over time, that dimension has come to be associated and identified more closely with the wholesale investment banking function.

Meanwhile, beginning in the 1960s, changes in the domestic and world economy conspired to upset the equilibrium in this financial services structure. Several important factors that particularly affected competition between commercial and investment banks were the rise of the Euro-markets, the increasing sophistication of both institutional investors and corporations, and the acceleration of inflation and interest rates in the 1970s, with a consequent realignment of securities values and investor preferences.

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Originally minimized in the mid-1960s as a minor and temporary phenomenon, the Euro-markets’ evolution into a large and permanent “supra-national” market has created an arena outside the jurisdiction of Glass-Steagall where participation is open to diverse financial institutions willing and able to assume the attendant risks. This market, abetted by the advances in—and application of—electronics technology, has spearheaded the rapid evolution toward a global market in money. Linkage of the various national capital markets with the Euro-markets and accompanying aggressive arbitrage on rates and terms have established money as a truly fungible commodity, whose movement across national and currency frontiers is increasingly difficult to control. It has thus become more and more
compelling for U.S. financial service organizations to accommodate this global market.

In the United States, the inexorable institutionalization of savings had, by the beginning of the 1980s, raised the institutional sector share of the New York Stock Exchange equity wealth to 35.4 percent (from 17.2 percent in 1960) and its 1982 share of equity market trading to 83.8 percent (from 24.3 percent in 1960). Money market funds have grown from nothing in the early 1970s to more than $175 billion at the end of 1983. This institutionalization has loosened the commercial banks’ link to the individual saver and focused much of the securities industry’s attention on the large portfolio manager.

Corporations also developed and expanded their internal financial engineering capabilities over this period. The growth of the commercial paper market to a mid-1983 annual rate of $123.7 billion (versus $4 billion in 1960) reflects large companies’ willingness to substitute these less expensive but potentially more volatile short-term funds for traditional commercial bank lines of credit. This development also has diminished an important, moderate-risk revenue stream for the commercial banks and forced them into other, often more risky funds deployments as well as more costly retail lending avenues. After the oil shocks of 1974 and 1979, this redeployment was evidenced by the much greater volumes of foreign, cross-border loans.

Of the forces that increased the pressure on the financial services industry status quo during the 1970s, accelerating inflation and rising interest rates were among the most pervasive. For many years, savings patterns had been fairly stable. Most individual savings were channeled to commercial banks, thrifts and insurance companies in exchange for a modest interest return.

Although earlier flare-ups in interest rates had failed to disrupt this deposit pattern seriously, inflation and interest rate jumps after the first oil price hike in 1973 appear to have precipitated a structural change in retail savings.

On one side of the Glass-Steagall wall, mandated rate differentials were causing commercial banks and other deposit-gathering institutions to lose deposits to money market funds and other intermediaries capable of adjusting more rapidly to changes in prevailing interest rates. Institutions such as thrifts, holding fixed rate instruments with greatly diminished value, suffered from badly mismatched maturity funding sources on the liability side of their balance sheets. As retail deposits deserted them for substantially better returns elsewhere, their options were to turn to the higher-cost wholesale markets for replacement funds or else sell their assets at substantial losses from their original value. Unlike the commercial banks, they had few alternative strategies for survival until passage of the Garn Act in 1982.

On the securities side of the Glass-Steagall wall, higher inflation and interest rates also created serious dislocations. The consequent downward revaluation in the market prices of securities created disaffection among retail and institutional investors and disrupted the markets for new issues of securities as well as for secondary market trading. Concurrently, inflation substantially increased securities firms’ operating costs, especially since their overhead is heavily weighted with the “people” costs and electronics support systems deemed necessary to stay competitive.

**Break with the Status Quo.** These developments have impelled various financial service institutions to seek out new—and hopefully more promising—business niches. On the deposit-accepting side, various legislative and regulatory changes initiated at the behest of industry lobbyists have facilitated this development. De-regulation of the interest payments permitted on deposits (Regulation Q), for instance, has helped spur an intensive competition for retail deposits. While these deposits are more expensive than they were prior to the deregulatory measures, they are seen as a stabilizing counterbalance to the banks’ and thrifts’ mismatched asset maturity structures.

To help attract those deposits and to spread the overhead of the infrastructure and marketing costs, banks and like institutions have sought both to broaden their retail product offerings and to explore alternatives for delivering them, including radically different electronic distribution...
systems. There also has been a more concerted search, particularly by commercial banks, for additional products and services to strengthen relationships with traditional corporate customers.

In building new ties to both the retail saver and the corporate customer, commercial banks and a variety of other nonbank institutions have moved to break through the Glass-Steagall wall to get into new areas of the securities business. They have noted the growth in securities trading volume and the industry's greatly enhanced revenue stream.

Securities firms focusing on individual investors, however, have not themselves been comfortable with their own situation. They recognize that a large part of their profit derives from their role as banker for their customers and that their own historic "deposit base" (free credit balances), like that of the traditional deposit-taking institutions, has come under attack from the money market funds and other higher-yielding instruments. They have responded in part by creating their own in-house savings vehicles to hold those deposits and by creating an even wider variety of products and services both to retain customers and to spread their overhead across a wider base.

A consequence of that deposit-protecting and product diversification strategy has been for securities firms to emulate competing financial intermediaries on the deposit-taking side of the business.

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Glass-Steagall wall. They have initiated moves to break through that wall into the territory of the commercial banks, thrifts and insurance companies by offering de facto checking and savings accounts, consumer loans, home mortgages and various insurance products.

These retail brokerage firms also have sought to combat accelerating overhead and squeezed margins by attempting to integrate backward into the "manufacture" of their financial products. They have created special "think tank" groups to devise new marketable instruments such as unit trust, tax-advantaged investments and various "stripped" securities. It also has propelled them into a more active competition for leadership in new corporate underwritings, thus obtaining securities that are typically attractive products for their retail (and institutional) clientele and whose management and underwriting fees add incremental revenue to the selling commissions they traditionally have received.

Both retail securities firms and commercial banks have noted that wholesale investment firms were not hurt seriously by any of the major international or national money market developments in which their institutional and corporate customers were active during the 1970s and early 1980s. To be sure, the banks often were prodded into making massive incremental investments of people and money to accommodate structural changes in their institutional and corporate markets. But they found ways to cushion their revenues even when the volume of underwritings declined cyclically. The activities and employment within these firms increased dramatically during the 1970s, and profitability held up much better than was true for the retail brokerage firms. Notably, one of the wholesalers' diversifying moves was into the lucrative high-net-worth sector of the retail brokerage business—primarily because it was a profitable exploitation of their in-place research and trading activities rather than as a way of ensuring distribution for their underwritings.

These competitive "migratory" moves are noteworthy. Some of them appear to be in defiance of the spirit, if not the letter, of the 1933 act. Challenges to the long-held interpretation of the limits on business activity imposed by the act surfaced only as a result of economic and competitive forces in a more fragile and volatile environment. Industry competitors began to discover that, like the Wizard of Oz, the Glass-Steagall wall was much more formidable in appearance than in reality. Once tested by restive competitors with inventive legal counsel in an environment generally sympathetic to deregulation, gaps opened up that allowed competitors to cross through the wall in both directions.

It is still too early to predict with confidence the durability or success of many of these competitive moves. Nonetheless, we can learn something about their dynamics by looking at specific market segments. To do that, let us search for likely longer-term competitive patterns in two segments of the securities business.
Retail Discount Brokerage

An industrial organization view of the retail securities sector would depict a number of traditional, full-service brokers in the center, with individual savers on the one hand and the various capital users on the other. Primary and secondary transactions in traditional stocks and bonds have declined in importance as new products, many of them devised by the firms themselves, have grown in variety and volume.

A number of new firms have entered this business in recent years, including wholesale securities firms seeking to skim the cream through appeals to wealthy customers and discount brokers aiming at the price-sensitive, independent investor. Discount brokers emerged after securities commission rates were deregulated on May 1, 1975. In the immediate aftermath, rates on institution-sized transactions fell by almost 50 percent, whereas rates on trades under 200 share actually rose by almost 10 percent.9 During the first couple of years of the negotiated commission era, the retail discounters made little progress, perhaps in part because of inertia or the part of individual investors. The discounters' market share began to grow materially after 1977, however, and by the beginning of 1984 fully 14 percent of the retail trades on the New York Stock Exchange were handled by discount brokers.10

Commercial banks and thrifts moved into discount brokerage beginning in 1982.11 Many leading money center banks have acquired or affiliated with established discount brokerage operations.12 Other banks have set up their own operations but clear the trades through a conventional securities firm.13 In some instances, commercial banks and thrifts have even invited brokerage firms to set up booths on their banking floors, much as Dean Witter is doing within the retail stores of parent Sears, Roebuck.

The number of commercial banks and thrifts offering brokerage services has grown from virtually none in 1981 to an estimated 1,500 at the end of 1983.14 One market observer has predicted that, with the growing participation of the commercial banks, discounters' share of the retail securities market could grow much larger within the next several years.15

With the effective neutralization of the Glass-Steagall legal barrier that had prevented banks from offering brokerage services, the question remains whether economies of scale or other barriers will inhibit the commercial banks, thrifts and others from maintaining a sustained presence in the retail brokerage business.16 In an earlier study, Irwin Friend and Marshall Blume suggested that economies of scale are relatively modest in the brokerage business. Certainly these new bank entrants, whose overhead costs are largely covered by other service activities, appear to enjoy a current price advantage over full-service brokerage firms. That could change as the full-service brokers cut costs and spread their remaining overhead across an ever-broadening array of products and services. It could also be altered if commercial bank entrants move from discount transactions into a more full-service configuration. While trade reports indicate several banks have abandoned brokerage operations because of disappointing profits, the primary motivation for a number of others may be different. If this activity generates incremental retail deposits and other attractive retail "cross-selling" opportunities, it may become a permanent fixture in the banks' product line regardless of its profitability.

Wholesale Services

In contrast to the fluidity of the retail sector, the wholesale securities sector, catering as it does to corporate, municipal and institutional clienteles, is resisting intrusion more effectively. That appears to be the case from the viewpoint of either an aspiring retail securities firm trying to integrate backward into product "manufacture," or a non-traditional intermediary attempting to penetrate the wholesale business.

Competitive patterns in the wholesale sector appear to differ materially from those in the retail sector. A variety of investment banking intermediaries are competing for the business of increasingly sophisticated capital-raising corporate clients on the one hand, and a group of "savers"...
### Table 1. Dollar Revenue Concentration: Combined Negotiated and Competitive Securities
(all $ figures are in millions)

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#### Notes
- The character of innovation has drawn on the secondary market intelligence generated by the wholesalers' trading floors. A number of firms have even moved part of their corporate finance groups down to those trading floors to provide better what their corporate clients identify (and pay for) as “value-added” services.
- Some wholesalers entered the institutional markets seriously in the early 1970s as a defensive move to service their corporate clients better. Others that already had substantial positions in trading used this as a lever to obtain new corporate business. The institutional investors, for their part, have escalated the quid pro quo for their business, so that to be an investment banking participant in the institutional services (and therefore the corporate) sector requires a large commitment of capital and human resources. For some wholesalers the serious commitment to trading was originally a means to an end, but in some instances that activity has become so large that it rivals the firms' corporate finance activities.
- Retail securities firms' efforts to integrate backward into this wholesale sector have been modestly successful at best. The top eight wholesale firms' grip on various parts of the business has, if anything, grown stronger in recent years. This is true in the underwriting of corporate securities, whether one looks at a volume of corporate securities managed or revenues from corporate underwriting activities (see attached exhibit). The same also holds true for municipal finance, for perceived trading competence among institutional clients and for the lucrative merger and acquisition counseling business.
- Several new or potential entrants to the securities market have emerged. They include foreign banks, with their merchant banking skills developed and refined in traditionally integrated heavily dominated by sophisticated institutions investors on the other hand. The growing competences of the traditional corporate clients and the heavily reinforced staffs of the wholesale securities firms have accelerated the pace of "new product" and service innovation.
commercial and investment banking home market settings and in the Euro-markets. They also include a variety of businesses that recently have purchased securities firms with some representation in the wholesale market. Among these are insurance companies (like Prudential), merchandising companies (like Sears), and financial services companies (like American Express). In addition, more and more money center and regional commercial banks have shown interest in parts of the wholesale market which they believe are not closed to them by the Glass-Steagall Act.24

These potential entrants believe they have the regulatory license to compete in a wide range of activities. For the commercial banks, some of the more important include Euro-market foreign exchange hedging, underwriting, lending and trading U.S. government bond underwriting and trading; interest rate futures; general obligation, municipal underwriting and trading; mortgage-backed securities trading; real estate financing; taxable and nontaxable private placements; mergers and acquisitions; venture capital and leveraged buyouts; financial counseling; leasing and portfolio management.

Viewed from a national market perspective, the commercial banking group enjoys major positions in Euromarkets, leasing, and portfolio management.25 Until now, they have been excluded from underwriting corporate securities and severely restricted by Glass-Steagall’s prohibition on revenue bond financing, which in recent years has constituted approximately three-quarters of municipal underwriting volume.26

In the areas of taxable private placements and mergers and acquisition counseling, no legal barriers prevent overt commercial bank competition with securities firms, and yet the results have been disappointing from banks’ perspective. Their penetration in private placements has been quite modest, although growing and their share of mergers and acquisitions assistance at the national level thus far has been nominal. In venture capital, neither commercial banks nor the cadre of leading securities firms have had much impact thus far, although commercial banks have been increasingly active in leveraged buyouts and both groups profess a major interest in venture capital for the future.27

Commercial banks have had a similar record at the regional level. Several regional banks have established “investment banking” or “corporate finance” departments, usually well-separated from commercial lending activities. They offer a variety of services, including private placements, mergers and acquisitions, financial consulting, venture capital, leveraged buyouts, valuations and appraisals, various types of asset-based financing and international financing accommodations. Full-time personnel and revenues tend to be modest; these departments typically have had limited success in mobilizing banks’ resources and momentum on behalf of these investment banking activities.

In sum, despite efforts to penetrate the wholesale securities markets, the commercial banks’ overall record thus far has been unimpressive. In view of their professed interest in wholesale corporate finance, what are the prospects for the future? Aside from the regulatory constraints discussed above, future progress for many commercial banks may hinge in part on their ability to sell corporate customers on the banks’ professional capabilities in providing investment banking services. It also will hinge on banks’ ability to convince themselves that they have those capabilities.

“Corporate underwriting leadership increasingly depends on quick and deep access to institutional investors that can be assured only by a continuous presence in the secondary markets.”

Two important aspects of the wholesale investment banking business seem clear: (1) activities within this sector tend to be interdependent and (2) the successful players in this market have made an important accommodation to the “culture” of investment banking, with its attendant risk and reward structure and high level of personal commitment.

The Interdependent Parts. Many of the key activities in wholesale investment banking are not isolated “lines of commerce” in the classic economic sense but rather “joint product” activities that are, to one degree or another, actually interdependent. A leadership position in the annual underwriting “league tables,” for instance, is
treated by investment bankers as tangible evidence of their market presence and overall corporate finance skill, and is used as a selling tool to convince current and potential corporate clients of their acumen in such areas as financial counseling, private placements and, very lucratively, mergers and acquisitions.

Corporate underwriting leadership increasingly depends on quick and deep access to institutional investors, an access that can be assured only by a continuous presence in the secondary markets. That ongoing market activity, in turn, depends not only on the commitment of people and capital; it also depends on “product” that provides the excuse for securities salesmen to maintain daily contact with institutional portfolio traders and elicit a steady flow of transactions.

Wall Street’s response to the introduction of Rule 415 “shelf” registrations demonstrates that investment bankers understand this interlocking system and act accordingly. When the Securities and Exchange Commission first began “shelf” registrations on a trial basis in March 1982, it expressed hope that the introduction of de facto competitive bidding on these offerings would not only yield savings to corporate issuers but also would boost competition by opening the market to a broader array of competing underwriters.

While corporate issuers have realized significant savings, the leading wholesale firms’ responses have further concentrated, not broadened, the group of competing intermediaries.

These traditional underwriting leaders, as noted, have continued to consider high standings in the annual underwriting “league tables” important in soliciting business in other areas. In addition, because they are continually under pressure to generate adequate volumes of marketable products to feed their institutional trading and distribution networks, the “shelf” registrations, representing well-known credits, are often attractive acquisitions.

Perhaps most important, the traditional underwriting leaders have continued to hold onto their ties with certain corporate clients. They act as though the loss of a client’s “shelf” offering to another investment bank could pose a threat to that relationship, with its prospects for other profitable pieces of business.

Thus, in most instances, these traditional leading wholesale investment banking firms have stepped in and aggressively (and often successfully) bid for their clients’ 415 offerings. Having won the bid, these underwriting firms often have omitted or sharply curtailed the size of the distribution syndicates, thus further concentrating the new issue business. Investment banks’ behavior in connection with “shelf” registrations helps clarify the interlocking nature of the corporate (wholesale) services business as well as the competitive response that leading securities firms could be expected to make to a new group attempting to enter this market.

Commercial banks, which in theory could be serious competitors in the corporate market, are blocked from a more effective challenge, in part because they lack access to some key components in the interlocking portfolio of products and services. They are legally barred not only from corporate underwriting and trading but also from the big volume industrial revenue bond business. This, in turn, has denied them access to other key components of the product and service “system.” The commercial banks cannot aspire to the visibility and stature of a leadership position in corporate underwriting. They cannot benefit from the interaction with corporations that would follow from day-to-day trading in their securities. Absence from the corporate and revenue bond trading markets also can hamper them in providing the latest pricing intelligence to these corporations when new financing strategies are being formulated.

It is not surprising, therefore, that the investment banks have been tenaciously fighting any change in the prohibition on revenue bond underwriting by commercial banks. It probably is not fear of inroads into the profitable revenue bond market that galvanizes investment banks, but rather the specter of commercial banks gaining greater momentum in secondary market trading and then arguing with credibility for authority to apply that acumen to the U.S. corporate securities markets.
competence that could wrest important fee-based corporate business from the current wholesale investment banking leaders.

The Bankers' Mindset. While some commercial bankers believe that the only thing standing between them and the wholesale investment banking business is Glass-Steagall, it is much less certain that commercial banks as a group could penetrate this market rapidly if these regulatory barriers fell. Even putting aside the massive counterattack that leading investment banks could be expected to launch, the traditional "mindset" of commercial banks' management could inhibit successful penetration of investment banking.

While the investment banks talk confidently of their ability to continue fielding the most competent resources in each of their business sectors, they may well fear the trading power that commercial banks might muster. From an initial strategy of "buying" leadership in high volume corporate underwritings such as "shelf" registrations, and by aggressive trading and principal positioning in the "commodity" end of the secondary markets with the help of their huge capitalizations, commercial banks (and certain other non-traditional entrants) subsequently could move into greater value-added products. Like Salomon Brothers, they might parlay that trading initiative into a credible, broad-based corporate finance service business.

Field interviews suggest that commercial banks have found it difficult to link the competence and skills of their investment banking groups with their much larger core of lending officers. Some lending officers' reluctance to become familiar with investment banking product and service possibilities and to promote them to corporate customers may indicate a "mindset" that resists change and fears encroachment by investment banking specialists onto their traditional business "turf."

Envy and resentment at the elite status usually accorded a bank's investment banking personnel also may play a part in some lending officers' unenthusiastic response. These "corporate finance" professionals often are relatively young, deal in what is seen as a more glamorous mix of problems, and have access to the corporate customer group's highest management levels. Lending officers, by contrast, often interact with staff further down the organizational hierarchy. The investment banking staff members usually are paid substantially more than other bank officers, given comparable age, time-in-grade and experience. The managements of some leading money center banks believe they already have crossed the psychological barrier to sharply higher compensation levels for their corporate finance and securities trading professionals. Yet at most banks there has been insufficient experience to predict how well mainstream personnel will react to compensation levels of a half million dollars or more for fast-track corporate finance professionals still in their 30s!

Similarly, commercial bank and other non-traditional entrants into investment banking must be prepared to absorb the vicissitudes of the securities block positioning and trading business. As mentioned earlier, a substantial presence in the institutional trading area has become a sine qua non among serious competitors for corporate service business. Inventory levels have risen dramatically in recent years in the face of increasingly volatile securities markets. While hedging strategies have sought to dampen capital risks considerably, players must be prepared to absorb large, unexpected swings in securities inventory values.

On the positive side, commercial banks can point to gains in trading skills and the assimilation of a supportive culture through participation in several arenas, including the domestic market for U.S. government securities, the Euro-markets, the ongoing management of the banks' liability structure, and the emerging secondary markets for commercial, industrial and foreign loans.

"Changing economic and demographic patterns have broken the longstanding status quo that prevailed in the post-World War II financial services industry."

More than a dozen U.S. money center banks are recognized dealers in government securities. These markets are so large and liquid that they often serve as the benchmark from which securities in other markets are priced, either directly or indirectly. Thus, banks actively participating in these markets have been able to hone their trading skills and related management systems in anticipation of later access to the corporate securities markets.
Euro-markets have offered commercial banks another arena in which to gain securities market experience, and some of the large U.S. multinational banks have become important participants there. While underwriting syndicates have been active in that market since the 1960s, secondary markets in Euro-securities are a relatively recent phenomenon. Nevertheless, several U.S. money center banks have already captured significant positions in these markets. Some U.S. commercial banks have developed impressive worldwide financial networks with which to exploit the evolving global market for money.

As commercial banks and other deposit-taking institutions have moved from primary dependency on savings and demand deposits toward greater reliance on the “wholesale” money markets, they have been propelled into an active trading mode. The constant money-raising efforts of banks’ treasury operations and the increasing use of forward hedges and other sophisticated risk-management techniques to accommodate the gap between asset and liability maturities have fostered skills that find ready application in investment banking.

Similarly, on the asset side of their balance sheets, many commercial banks are moving toward a “transaction” as opposed to a “yield” management philosophy, in which each asset is priced as though it were a candidate for resale. As regulatory pressures have mounted on commercial banks to improve their capital bases relative to loans outstanding, one goal has been to increase the velocity of asset turnover through the temporary or permanent sale of their domestic loans to correspondent bank, and institutional or foreign investors willing to take a slightly smaller spread. Thus, the selling bank is able to reduce its asset base, improve its loan-to-deposit ratio and enhance the return on those assets. It also can foster a transaction orientation among lending officers that supports the development of a trading culture.

Conclusions

Changing economic and demographic patterns have broken the longstanding status quo that prevailed in the post-World War II financial services industry. Each part of that industry has reacted differently to these changes, reflecting competitive dynamics specific to a particular niche. This pattern is mirrored in the intrusion of commercial banks into the securities business. Entry into discount brokerage has been quite rapid because there appear to be few barriers. Penetration of the wholesale investment banking business has been slower and more difficult. Regulatory barriers limit banks’ ability to offer the trading and underwriting services necessary if an institution is to compete successfully in the wholesale securities business. The securities industry has recognized this and has moved in both the markets and the courts to limit banks’ entry. Even removing regulatory barriers would not assure banks of rapid success, however. Despite the experience and success some banks have gained in permitted securities activities, they must learn to manage differences between commercial and investment banking cultures in order to penetrate the wholesale securities market.

—Samuel L. Hayes III

NOTES

10. See various staff reports of the Securities and Exchange Commission based upon “Focus” data supplied by the New York Stock Exchange.
13. Chemical Bank made an earlier abortive attempt to enter the brokerage business in the 1970s.
15. Pershing & Company, a division of Donaldson, Lufkin & Jenrette, provides trading and clearing services to banks as do a number of other securities firms.

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Hummer, in work cited, p. 26. Other estimates range considerably higher than this number.


See results of Greenwich Research surveys, as reported in various issues of the *Wall Street Letter* (published by *Institutions Investor*).


Almost all of the money center banks have at least a corporate finance group. *The United States Commercial Bank Corporate Finance Directory* 1983, compiled by officials at Northwestern National Bank of Minneapolis, lists corporate finance groups for nine New York City banks, thirteen regional money center banks and eight other regional banks.

The American Association of Equipment Lessors reports that, using either equipment cost of $32 billion or total receivables outstanding of $62 billion, commercial banks presently hold approximately 28% of the outstanding, compared to 34% for independent leasing companies and 13% for captive finance companies.


Bankers Trust, however, has recently engineered a "private placement" of a Rule 415 "shelf" registration securities and is being challenged in the courts by the Securities Industry Association for undertaking a de facto corporate underwriting.


See, for instance, *Corporate Financing Week*, Vol. IX, No. 5 (February 7, 1983). In reporting on the top 15 leading intermediaries in private placements it notes that "Bank of America, the only bank on the 1981 list, didn't make it in 1982. No banks made it in the 1982 rankings, but Bankers Trust came the closest, finishing 16th."


See, for instance, hearings before the Securities and Exchange Commission on Rule 415, Jan 28-July 2, 1982.

See, for instance, M. W. Marr and G. R. Thompson, 'Shelf Registration and the Utility Industry,' Virginia Polytechnic Institute and State University, Blacksburg, Virginia, (June 30, 1983).


See *Staff Report on the Securities Industry in 1979*, other years, Securities and Exchange Commission.

The "Recognized Dealers" include: Bank of America, Bankers Trust, Chase Manhattan, Chemical, Citicorp, Continental Illinois, Crocker National, First Interstate, First Chicago, Harris Trust, Morgan Guaranty, Northern Trust, Manufacturers Hanover and Bank of Boston.

There have also been reports of the creation of an informal secondary market for LDC loans, particularly in the case of Mexico. See Gary Hector, "The Banks' Latest Game: Loan Swapping," *Fortune* (December 12, 1983), p. 111.