



Investment Banking: Rebound Amid a Revolution

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The financial crisis may have left investment banking bruised and embarrassed, but analysts say an industry comeback is on the way, even if it means competing in a dramatically different marketplace.

"I think it's in better shape than the markets perceive," says Dennis Nason, CEO of Nason and Nason, an executive placement firm for the banking industry. "Goldman [Sachs] has always been good and Merrill [now owned by Bofa] is in a lot better shape."

"What I've seen over the last six months for investment banking has been a return in the origination role and more aggressive trading," says Peter Vinella, managing director for global financial services at the consulting firm LEG. "It's a lot more than I thought I'd see coming back."

Experts point to improved market conditions for the rebound. "The government has stabilized the markets somewhat and people are out there now raising capital," Vinella says.

"There's a lot right now going on in the fixed income side," says Gilles Gade, chairman of Cross River Bank in New Jersey. "There's also more activity on the government side for the banks because of TALF [Term Asset-Backed Securities Loan Facility]."

A look at second-quarter profits shows both how far banks have come and still have to go. **Morgan Stanley** announced a loss of \$1.26 billion, but **Goldman Sachs**' profit was \$344 billion, and set aside several billion dollars for compensation and benefits, raising speculation about fat year-end bonuses.

The modern concept of investment banking was created with the Glass-Steagall Act of 1929 that barred commercial banks, investment banks and insurance companies from operating in each other's business.

Most of the industry giants that grew out of that era are gone. Those that weren't consumed by mergers or absorbed by commercial banks following the deregulation of the 1990s became casualties of the financial crisis. **Bear Stearns** was snatched up by **JP Morgan Chase**, **Merrill Lynch** opted to be bought out by **Bank of America** and **Lehman Brothers** went bankrupt. That left Goldman and Morgan Stanley, which quickly sought the safety of bank-holding company status.

The turmoil of 2008 opened the door for the growth of smaller, boutique-type banking firms.

"You now have a slew of small investment banks created by former partners of big firms," says Gade. "The smaller firms are stepping in to service a lot of clientele that has gone undeserved in recent months."

"There's a tremendous flight to boutiques by bankers," says John Rogan, partner and head of global banking and market practice at executive search firm Russell Reynolds Associates. "Look at **Evercore**, **Greenhill** and **Moelis**. They've picked up enormous talent with the collapse of the bigger firms."

Even as boutiques grow in numbers there are still some gaps in the industry, say analysts.

"Early-stage investment banks have all but disappeared," says Leslie N. Bocskor, managing partner at Lenox Hill Partners, a consulting firm that works with small public and private companies in financing and corporate structure. "Entrepreneurs have a much more challenging time gaining access to capital."

Some industry watchers say the current downsizing means less competition.

"The bigger firms will do well, now that Merrill, Lehman and Bear are gone," says Leonard Rosenthal, a professor of business at Bentley University in suburban Boston. "And I expect that some of the newer ones will be acquired or consolidated to become large players themselves."

"I think we are witnessing a seismic shift," says Gade. "On the one hand you have the monsters reigning bigger than before and then you have these small firms. Some are good, some are not so good."

While the industry mix has changed, so has the business model, says Bill Feingold, a former vice president of proprietary convertible trading at Goldman Sachs.

"Capital is far scarcer than it was a couple of years ago," says Feingold. "Investment banks are largely, but not completely, thrust back into their traditional roles of agents [connecting market buyers with sellers], not principals [selling their own products]."

Feingold explains that by returning to the agent role, investment banks don't have the burden of needing reserve capital to sell their own products.

"Big firms like Lehman and Merrill were carrying huge inventories of assets that were designed to be distributed to their clients [mutual funds, pension funds, individuals]. "This had disastrous consequences," Feingold says.

Feingold says that the clients could absorb reasonable losses from the products while many of the banks who held them, couldn't and didn't.

Experts say because of that liquidity problem, investment banks are taking less risk these days.

"The environment, in a regulatory, risk and liability fashion has changed substantially," says Bocskor. "Brokerage firms have switched from a primarily commission-based transactional business to a fee-based offloaded risk based business."

As for the future, some analysts say the restructured industry should work well for both the companies and the financial system.

"What Bofa got was a product," says Nason who has 30 years in the banking industry. "For the most part, commercial banks are sound and when they sell a mutual fund for example, they are using Merrill's distribution network to sell it. As long as they don't over leverage themselves, it should be okay."

With the crisis still fresh in the minds of legislators in Washington, more regulation is on the way. "Some are needed for transparency so investors know what they are getting into and the risks are clear," says Vinella.

Nevertheless, he is among those who say the government should tread lightly.

"If the SEC does its job as it stands, and enforces transparency laws, they can control the excess," says Mark Sunshine, president and COO of Siemens First Capital.

And one analyst says the industry can help itself recover some lost prestige. "There can be a lot more accountability at the top of the investment banks," says Nason "They all can set some standards to follow."

But new regulations or not, experts say the industry will keep making money. "For a while, we may see less innovation when it comes to product," says Rosenthal. "But that will change over time. This has always been a resourceful and inventive business."

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