ISSUE 2016/06
MARCH 2016

THE UNITED STATES DOMINATES GLOBAL INVESTMENT BANKING: DOES IT MATTER FOR EUROPE?

CHARLES GOODHART AND DIRK SCHOENMAKER

Highlights

- In the aftermath of the global financial crisis, the market share of US investment banks is increasing, while that of their European counterparts is declining. We present evidence that US investment banks are on the verge of taking over pole position in European investment banking. Meanwhile, since 2015, Chinese investment banks have overtaken American and European investment banks in the Asia-Pacific market.
- Credit rating agencies and investment banks are the gatekeepers of the capital markets. The European supervisory institutions can effectively supervise the European operations of these US-managed players. On the political side, we suggest that the European Commission should continue to view its, albeit declining, banking industry as a strategic sector. The Commission, the European Central Bank and the Bank of England should jointly develop a strategic agenda for the EU-US Regulatory Dialogue.
- Finally, corporates rely on investment banks to issue new securities. We recommend that the big European corporates should cherish the (few) remaining European investment banks, by giving them at least one place in otherwise US-dominated banking syndicates. That could help to avoid complete dependence on US investment banks.

Charles Goodhart is Emeritus Professor at the Financial Markets Group, London School of Economics. **Dirk Schoenmaker** (dirk.schoenmaker@bruegel.org) is a Senior Fellow at Bruegel and Professor of Banking and Finance at Rotterdam School of Management, Erasmus Uni

THE UNITED STATES DOMINATES GLOBAL INVESTMENT BANKING: DOES IT MATTER FOR EUROPE?

CHARLES GOODHART AND DIRK SCHOENMAKER

1 INTRODUCTION

Europe's banks are in retreat from playing a global investment banking role. This should not be a surprise. It is an, often intended, consequence of the regulatory impositions of recent years, notably of the ring-fencing requirements of the Vickers Report (2011) and the ban on proprietary trading by Liikanen (2012), but also including the enhanced capital requirements on trading books and other measures. The main concern is that a medium-sized European country, such as the United Kingdom or Switzerland, or even a larger country like Germany, let alone a tiny country like Iceland or Ireland, would find a global investment bank to be too large and too dangerous to support, should it get into trouble[1]. So, one of the intentions of the new set of regulations was to rein back the scale of European investment banking to a more supportable level.

The European Union, of course, has a much larger scale than its individual member countries. If the key issue is the relative scale of the global (investment) bank and state that might have to support it, could a Europe-based global investment bank be possible[2]? We doubt it, primarily because the EU is not a state. It does not have sufficient fiscal competence. Even with the European banking union and European Stability Mechanism, the limits to the mutualisation of losses, eg via deposit insurance, mean that the bulk of the losses would still fall on the home country (Pisani-Ferry and Wolff, 2012). Moreover, there would be intense rivalry over which country should be its home country, and concerns about state aid and the establishment of a monopolistic institution. While the further unification of the euro area might, in due course, allow a Europe-based global investment bank to emerge endogenously, we do not expect it over the next half-decade or so.

So the withdrawal of European banks from a global investment banking role is likely to continue. That will leave the five US 'bulg

1. See for example commentary by Martin Wolf in the *Financial Times* and other recent coverage: *Financial Times* (2015a, 2015b), Gapper (2015), Oudéa (2015) and *The Economist* (2015).

2. As suggested for example by *Financial Times* (2015a).

3. Governments and other public sector bodies als

Table 1: Market share of investment banks in EMEA (Europe, Middle East and Africa) investment banking (in [illegible])

Investment bank	Region	200	2006	200	200	200	2010	2011	2012	2013	2014	201
1. P Morgan	US	6.5	7	6.4	8.5	8.7	7.9	6.8	7.9	7.3	7.5	7.6
2. Deutsche Bank	Europe	6.2	7.6	7	6.9	7.1	7.4	7.3	7.8	7.8	7.6	6
3. Citigroup	US	8.1	8.1	7.7	5.9	6.6	5.1	5.2	5.9	6.2	6.4	6.7
4. Goldman Sachs	US	4.8	4.7	5.1	5.2	4.9	4.6	5.1	5.3	5.9	5.4	5.9
. Bank of America Merrill L nch	US	4.4	6.9	7.1	6.5	6	5.6	4.8	5.1	5.2	5.8	6.8
6. Barcla s	Europe	6.8	7.2	6.9	6.9	7.1	7.6	6.8	6.7	6.7	6	6.4
. Morgan Stanle	US	4.5	5.1	5.3	5	5.4	4.5	4.2	4.7	5.1	4.9	5.1
. BNP Paribas	Europe	5.4	5	5.2	5.5	5.5	5	5.7	4.5	5.2	4.7	4.4
. Credit Suisse	Swiss	2.3	3.8	3.7	3.8	4.5	4.6	3.7	3.6	3.8	3.7	3.5
10. HSBC Holdings	Europe	4.4	4	3	4.4	5.3	5	5.2	5	4.6	5	5.4
11. UBS	Swiss	2.2	3.9	4.4	4.2	3.8	4.6	4	3.5	1.9	2.1	2.3
12. RBS	Europe	5.3	7.7	8.5	5.7	4.7	4.2	3.7	3.1	2.8	2.5	1.5
13. Societe Generale	Europe	3.5	3.1	2.6	2.7	3.3	3	3.4	2.5	2.8	2.8	2.6
14. Credit Agricole CIB	Europe	3.5	2.7	2.4	3	2.7	2.6	3.2	2.6	2.4	2.7	2.5
1 . Rothschild	Europe	1.7	1.1	1.3	1.3	0.5	0.7	0.9	1	0.7	0.6	1

5. For Citigroup: the Base Prospectus for Citigroup Global Markets Deutschland dated 30 April 2015, and for JP Morgan: additional information from the 2014 Annual Report, to ensure that all the geographic entities in the European Union are included in the dataset.

6. An example of this local hiring policy is the annual International Banking Cycle in the ee FeYFWFdbbNeOW.WUabcFWF n5apFdpbWcXa t

The US investment banks are happy with their current presence in London; HSBC also recently confirmed it would stay in London and not relocate to Hong Kong. The Anglo-Saxon culture, in terms of both the free-market driven business culture and private residence, suits them well. It is no surprise to see that the US investment banks are vocally in favour of the UK staying inside the European Union[7]. In contrast, some London-based hedge funds campaign for Brexit. The volatility following a Brexit could be a fertile trading ground for hedge funds. Moreover, a United Kingdom outside the European Union might be less (over)regulated. These hedge funds perhaps guess, rightly or wrongly, that the United Kingdom will strike a trade deal with U_WXYYFWFd[NwOTXWT]V.WUcWfFWFd[NiOTXWT]V.WUYYW

7. See *Financial Times* (2016a).

8. One of the authors participated in several negotiations on new financial rules in Brussels. He always felt sorry for the EFTA countries, like Norway and Iceland, which were allowed to attend the meetings but had little say and no voting power.

ereignty. Europe's industrial champions will be at a serious disadvantage if they cannot rely on access to capital when their rivals in America and China can."

While this danger exists, it was already present before the withdrawal of European banks from global investment banking. Since the US dollar and US financial markets play the central role in the financial system, the US is in a position to enforce its demands on acceptable counterparty transactions and to dominate, for good or ill, the international monetary policy scene, whether or not the big five US banks are the only glob

Authority (ESMA) has powers under the Regulation on Credit Rating Agencies (EC/1060/2009) to licence and supervise the European operations of the primarily US-based credit rating agencies. Similarly, the relevant directives (Second Banking Directive and Markets in Financial Instruments Directi

The Economist (2015) 'European banks: Banking and nothingness', 17 October

The Five Presidents' Report (2015) *The Five Presidents' Report: Completing Europe's Economic and Monetary Union*, Brussels

Thomson Reuters (2016) 'Global Investment Banking Review, Full Year 2015', T*homson Reuters Deals Business Intelligence*, New York

Veron, N. (2011) 'Keeping the Promise of Global Accounting Standards', *Policy Brief* 2011/05, Bruegel

Vickers Report (2011) *Final Report: Recommendations*, Independent Commission on Banking, London, available at http://bankingcommission.independent.gov.uk/

ANNEX

Table A1: Segmentation of turnover of US investment banks across Europe in 2014						
Belgium	0.00%	0.00%	0.00%	0.28%	0.00%	0.08%
Denmark	0.00%	0.00%	0.00%	0.25%	0.00%	0.07%
France	0.01%	2.41%	0.00%	0.54%	3.86%	1.12%
Germany	1.02%	9.79%	0.70%	2.49%	0.06%	2.19%
Greece	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Irel						