Discussion of

"**When the Thin Bench Gets Thinner: Investment Bank Consolidation and Municipal Finance**"

by Renping Li

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Big Picture

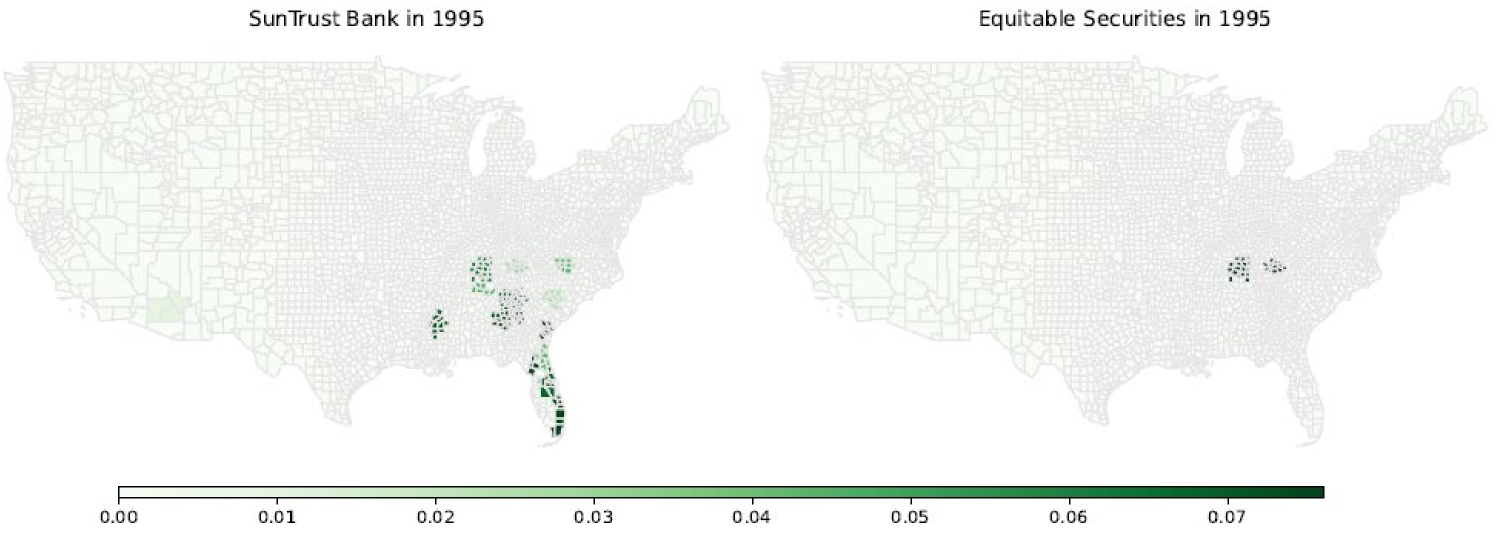
- Financial intermediaries are important for efficiency and stability
- Financial intermediaries might charge high fees
  - IPO 6%, Real Estate 6%, SEOs 5-7%
- Role of intermediaries studied in many markets

Paper

- Setting: Municipal bond market underwriters
- Question: The role of underwriter market concentration in issuance
- Approach: Uses M&A deals between underwriters to link market concentration to underwriter fees

Treatment-Control Approach

Panel A: Example 1, SunTrust Bank and Equitable Securities



Treatment-Control Approach

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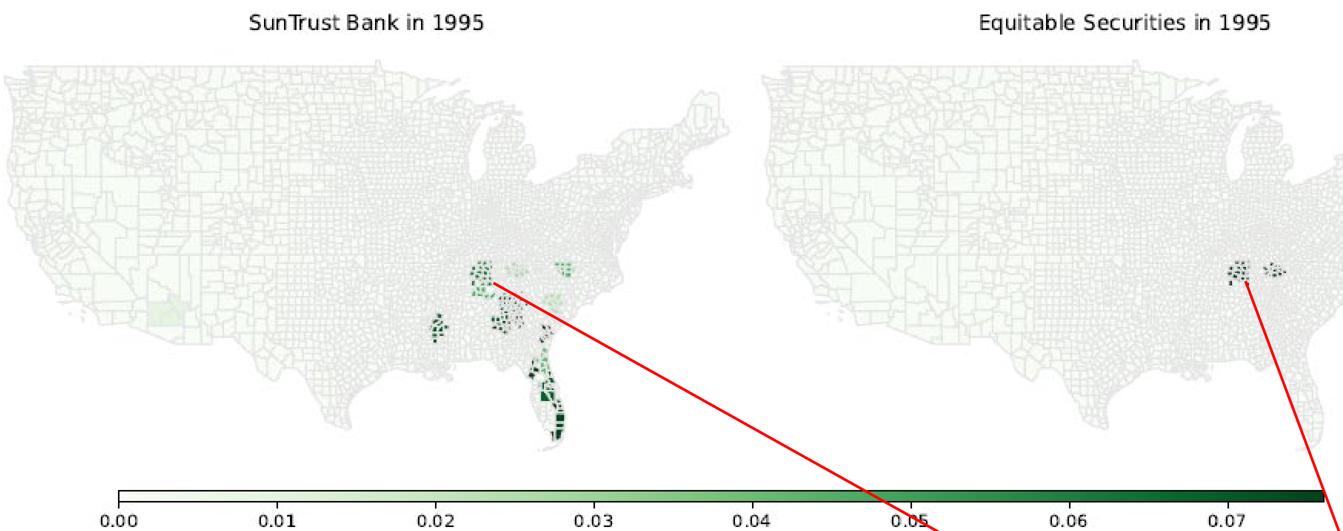
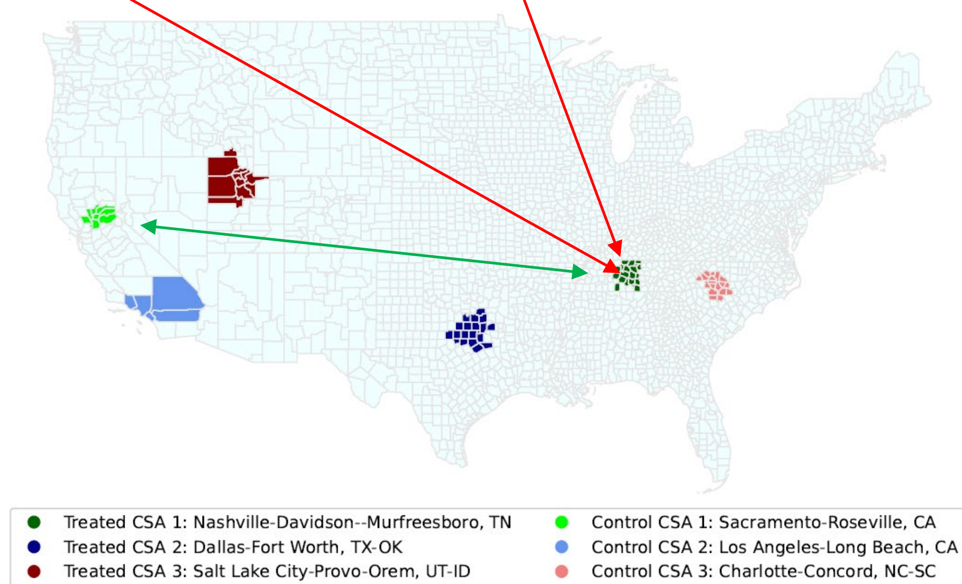


- Nashville treated as M&A increases concentration above a threshold (100 increase in HHI)



Results

- 5 basis points increase in fees when the market concentration increases (relative to 103 bp average)
- 1 basis point decrease in local government budget surplus and 1.4 basis points increase in property tax
- Policy Relevance: Is underwriter concentration a problem?

Policy Relevance: Is underwriter concentration a problem?

When the Thin Bench Gets Thinner: Investment Ban
Consolidation and Municipal Finance *

Renping Li

June 2024

Abstract

Do investment banks possess market power, and does their consolidation have anti-competitive effects? Using the geographically fragmented municipal bond underwriting market as a natural laboratory and a stacked difference-in-differences specification, I find that the underwriting spread rises by 5.3 basis points after within-market M&As from a sample mean of 103.0 basis points. The effects double for more significant M&As and triple in concentrated markets. While issuers become less likely to use

Next

- Industry Trends
- Alternative explanations
- Identification challenges
- Methodology and Suggestions

Industry Background: Fees in Race-to-Bottom?

- Underwriting fees have declined steeply since the 1980s, when negotiated fees were more than $20 per $1,000 of bonds

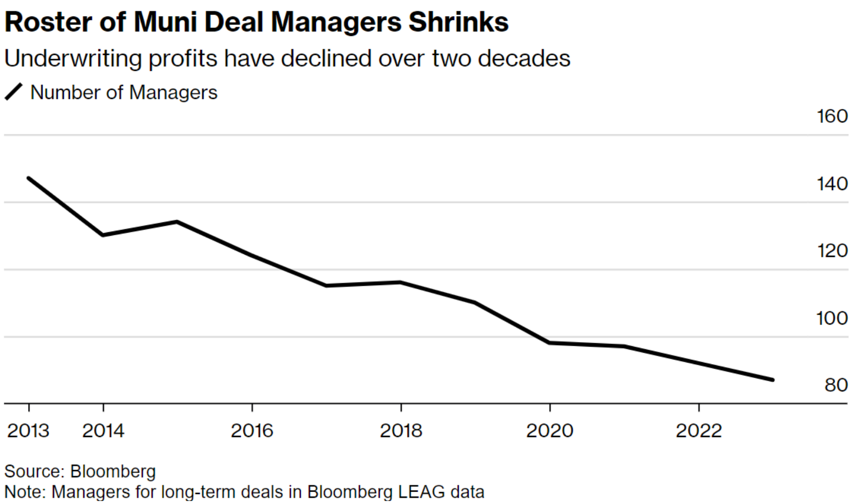
- This year (2021), they're around $5.15 overall, according to data compiled by Bloomberg.

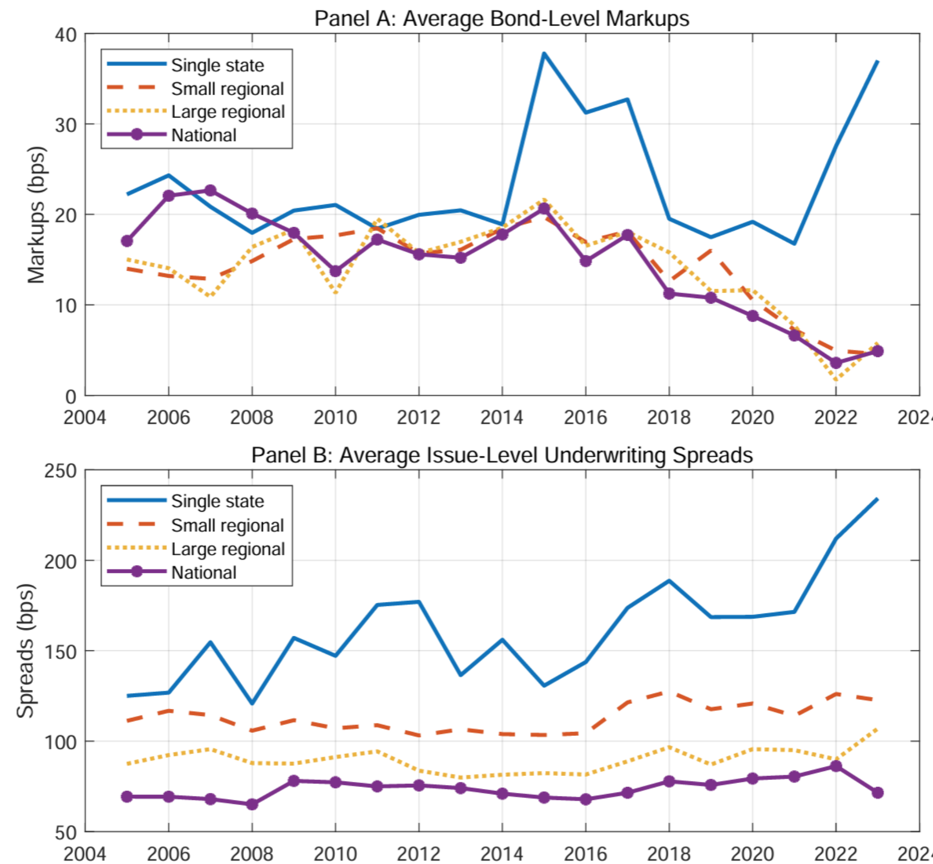
- But for a big-name client like Massachusetts, underwriters, it seems, are willing to work for much less. Sue Perez, the state's Deputy Treasurer for Debt Management, said the takedowns on its bond deals has been in the $2 to $3 range since at least 2014.

- Bank of America Corp., the market's underwriting behemoth, was willing to work for just 50 cents, as was Morgan Stanley, on one-year maturities

- "starting 3-4 years ago firms have stopped even asking for a management fee"

Source: Muni Underwriters Cut Fees in Takedown Race-to-Bottom, Bloomberg, August 24, 2021





Citigroup, UBS Exit Munis After Market's Profits Plummet by 50%

Profits for municipal underwriters fell by 30% to 50% from 2005 to 2023, according to a report to be presented next month at the Brookings Institution's municipal finance conference.

Source: Citigroup, UBS Exit Munis After Market's Profits Plummet by 50%, Bloomberg, June 21, 2024

Alternative Story: Optimal Market Restructuring

- Markups are getting under pressure (and costs increase?)
  - Need to increase price
  - Need to lower costs
  - Or abandon market
- M&A transactions achieve all three?
- Driver is market conditions and not M&A

Identification Challenge 1: Endogenous Choices and Omitted Variables

- Starting market structure is not random
- Smaller regional players studied here choose where to operate
- They also have higher costs
- Treatment is defined as markets that do not have many players (high concentration)

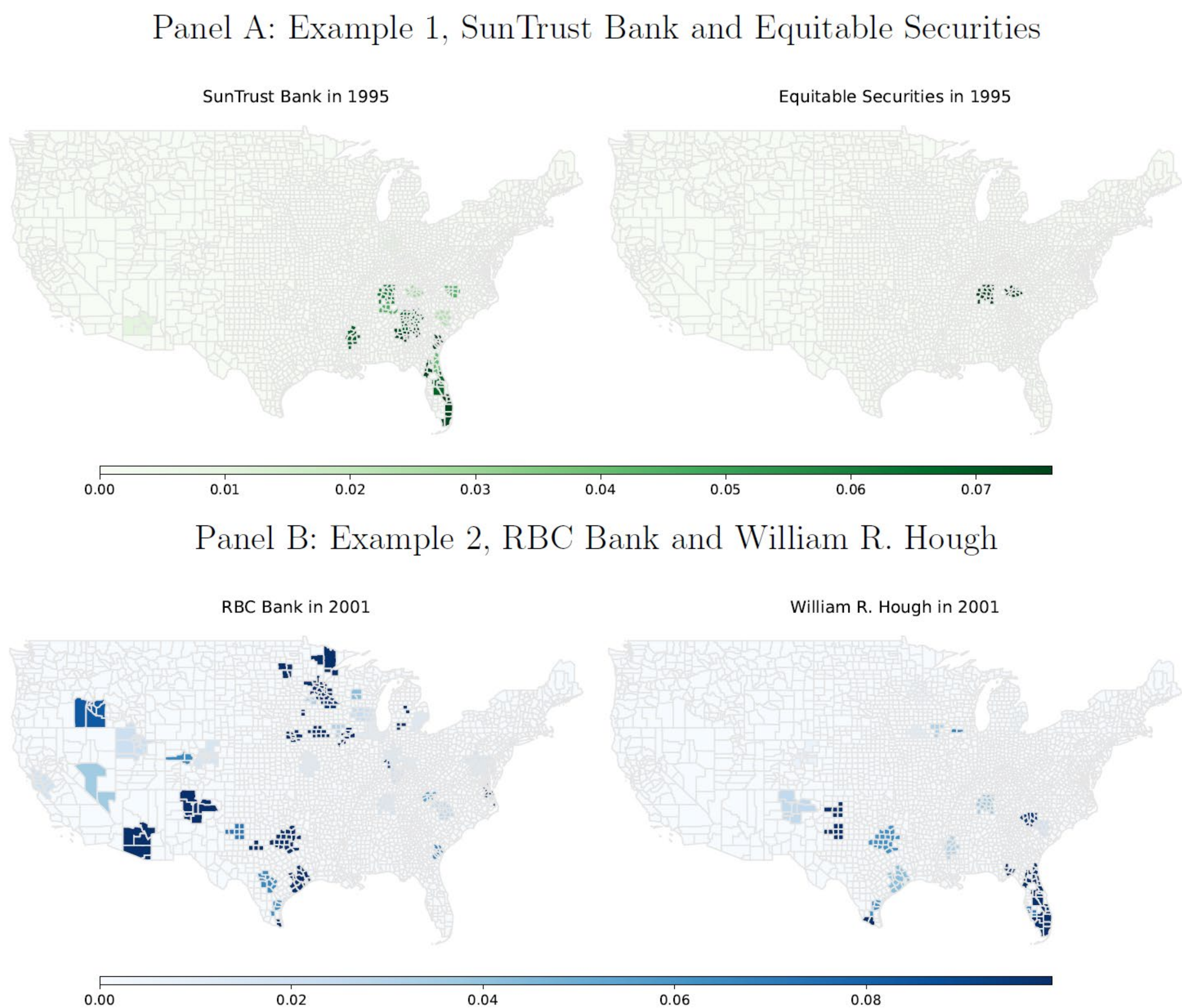
Identification Challenge 2: Reverse Causality

- Decision for M&A depends on future business and markups?
- Decision for M&A depends on cost cutting?

- We regress Deal Characteristics (fees, yield, issuance amounts) on underwriter consolidation
- But underwriter consolidation=f(fees, yield, amount)

If concentration leads to higher profits then why SunTrust bank does not merge with William Hough?

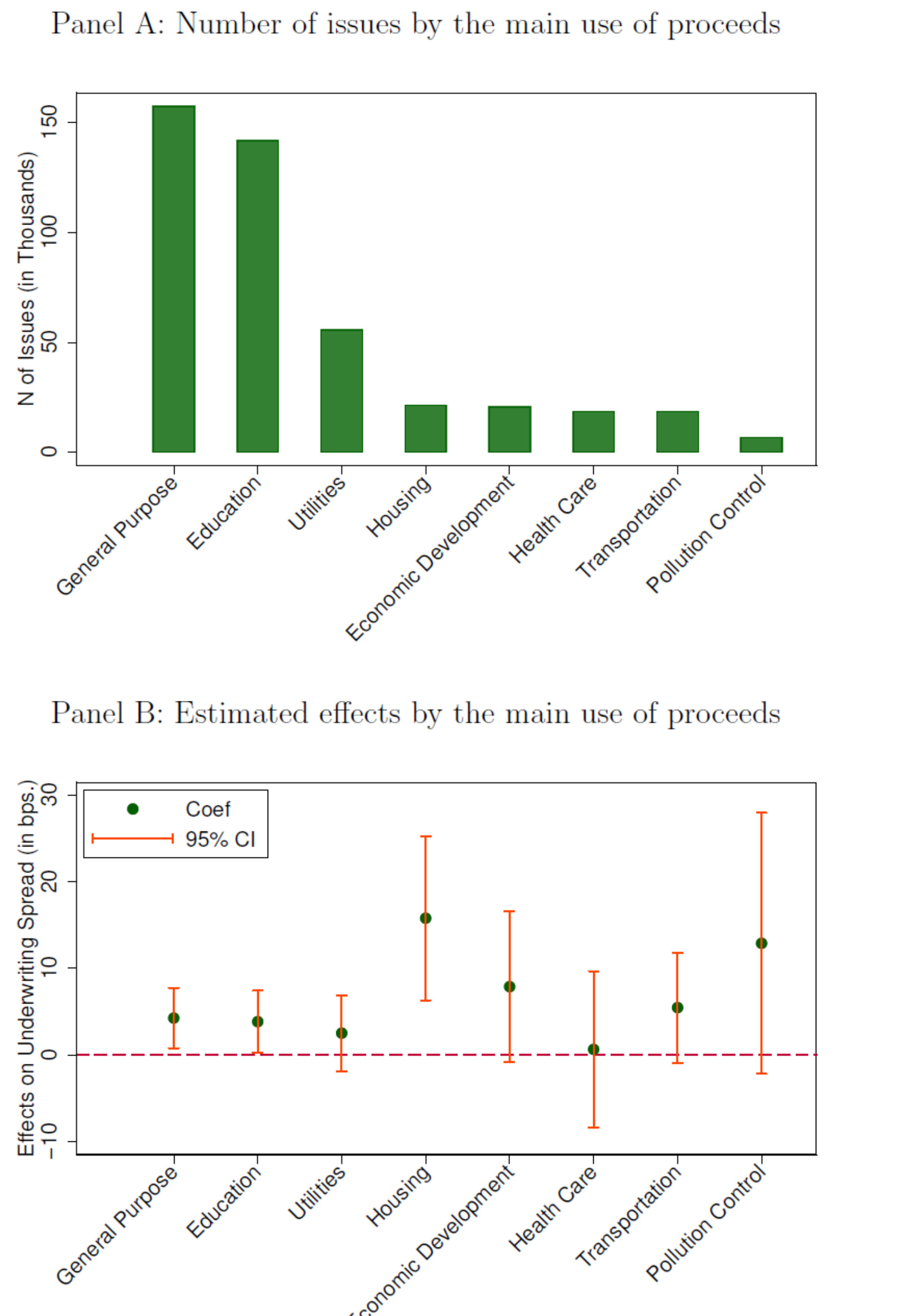
Figure 1: Local Market Shares of Merging Underwriters



Channels

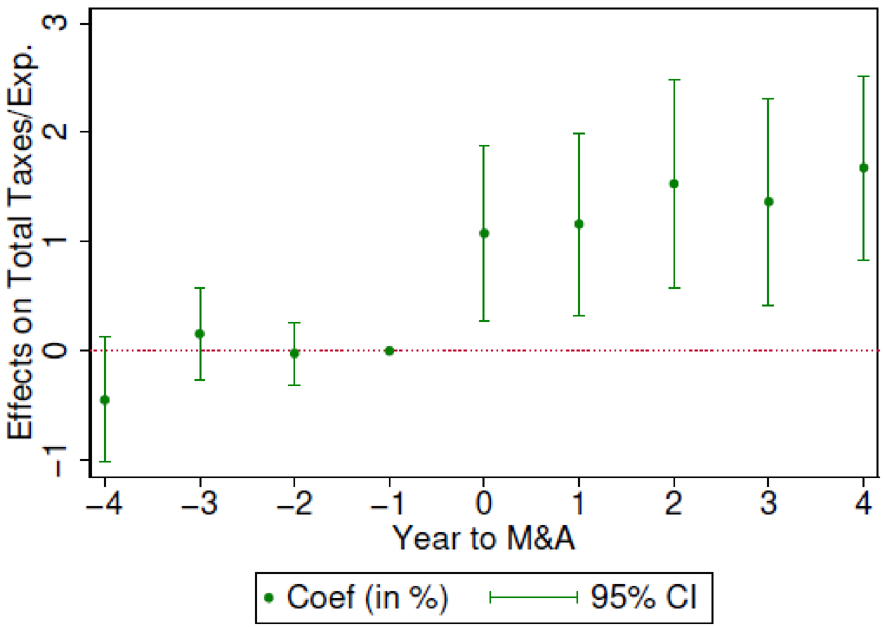
- If story is market power than similar effects in housing vs. education?
- If story is cost cutting, then harder to place issues should see increase in costs?

Figure 4: Effects of M&As on Underwriting Spread by Main Use of Proceed

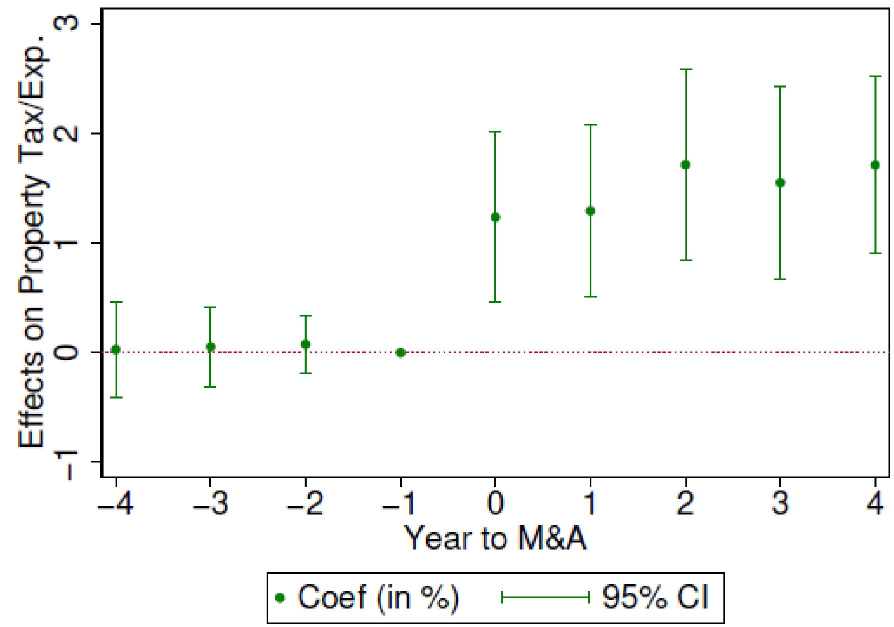


Effects on Local Budgets and Taxes (1 basis point)

Panel D: Total taxes/exp.



Panel E: Property tax/exp.



1 basis point in local taxes adds 45 cents to my house tax bill

Methodology quibbles: Cohort Fixed Effects and Clustering

I run the following regression,

$$y_{d,c} = \beta_1 Treated_{a,c} + \beta_2 Post_{c,t} + \beta_3 Treated_{a,c} \times Post_{c,t} + \theta_i + \theta_t + e_{d,c}. \quad (2)$$

Here d is the subscript for each bond issue, i.e., each deal, a is the subscript for each Combined Statistical Area (CSA), c is the subscript for each cohort of issues in a treated CSA and its matched control CSA, i is the subscript for each issuer, and t is the subscript for the calendar year. *Treated* equals one for issues in treated CSAs and *Post* equals one in the year of the onset of "local M&A episodes" and the four years afterwards. Our methodology of pooling cohorts of treated and control observations together and estimating a difference-in-differences model follows Gormley and Matsa (2011), Gormley and Matsa (2016), and Gormley et al. (2023). Standard errors are clustered at the issuer level.

A few suggestions

- Study withdrawal of Citigroup and UBS as out of sample test? (but need new data)
- Model M&A and concentration as an optimal outcome of shrinking profits (but need model)
- Cluster on time dimension

Conclusion

- Important topic
- Thorough execution
- Results are interesting
- Policy implications hinge on magnitudes and interpretation