When the Thin Bench Gets Thinner: The Effects of Investment Bank Consolidation on Municipal Finance

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Motivation

- Concerns regarding the structure of the American banking system and concentrated financial power have recently taken center stage (Grischkan, 2024)
- Antitrust regulations traditionally focused on commercial banking activities
- Investment banking activities are often overlooked

- Does the consolidation of investment banks have anti-competitive effects?

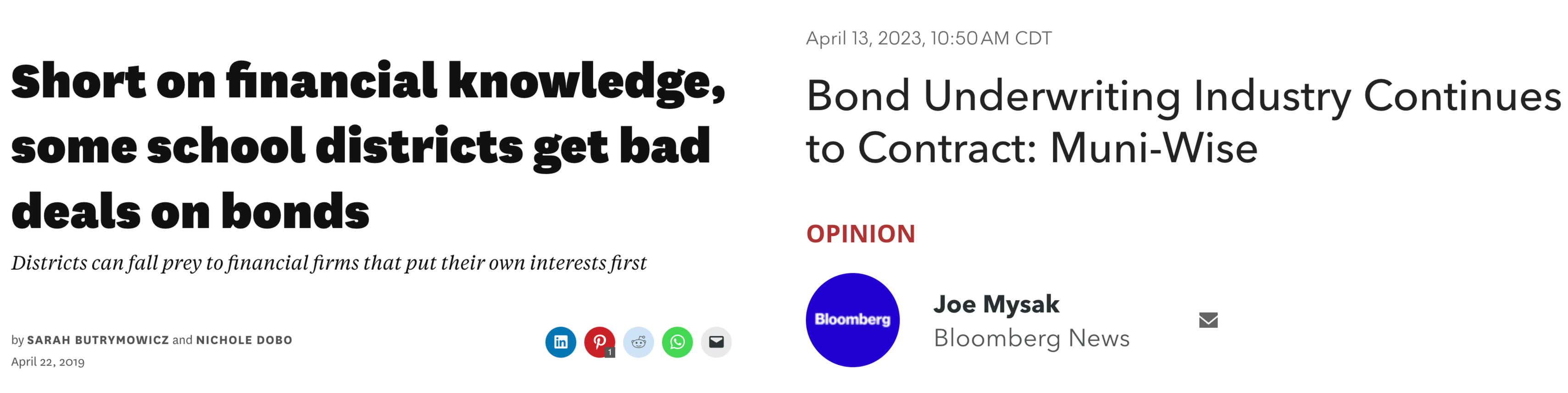


Figure A. News reports on the state of the municipal bond underwriting market

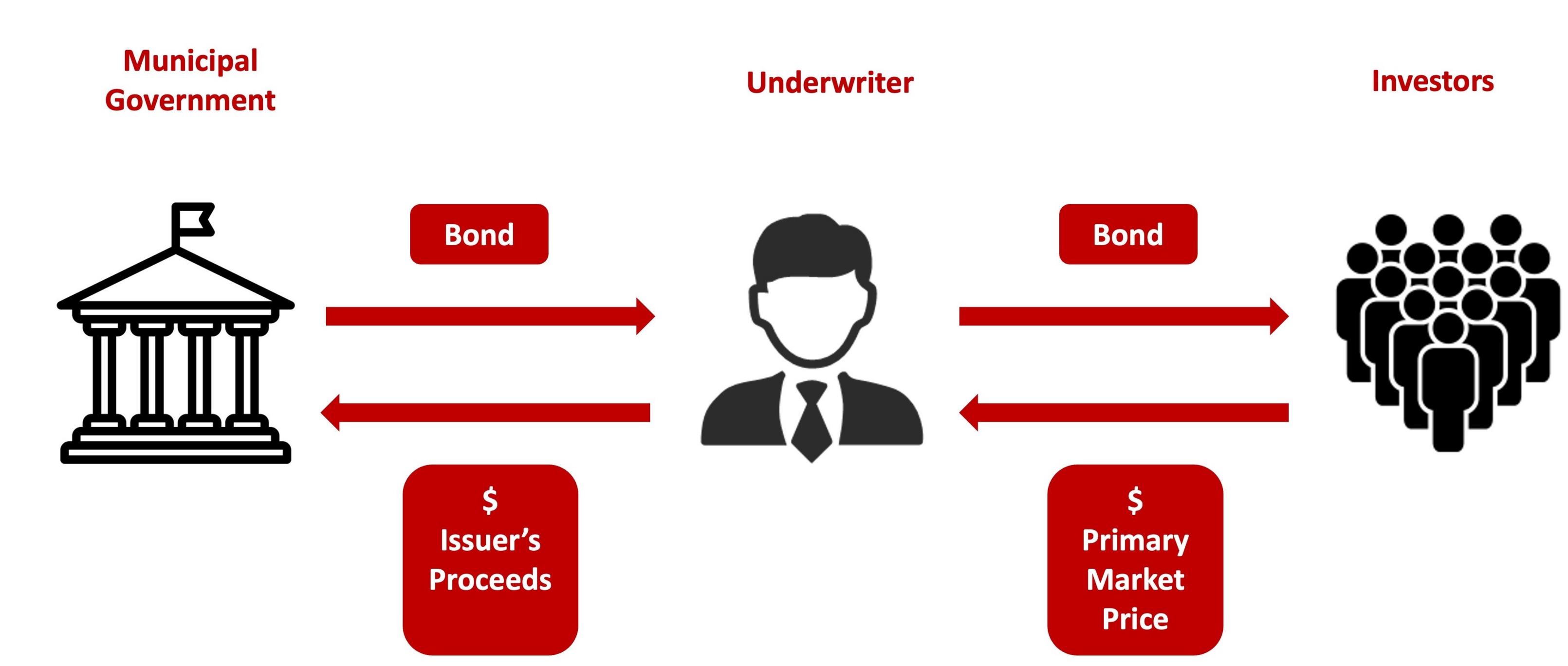
Empirical Setting

- I study the M&As of municipal bond underwriters. Why this market?
  - Large: $410B issuance in 2022 ($883B/102B for corporate bond/equity)
  - Local governments are vulnerable to powerful underwriters
  - Many heterogeneous issuers and stable issuance flows
  - High geographical fragmentation (Butler, 2008; Babina et al., 2020)
  - Significant consolidation over the past several decades

- I hand-collect a sample of M&As among municipal bond underwriters
  - 256 deals during 1970-2022, 162 with overlapping geographic operations

- I assemble a treated-control matched sample
  - Market = CSA (metropolitan area), 181 in total
  - Treated = Experiencing within-market consolidation
  - Control = Non-treated and closest match in terms of income and population

- Main outcome variable: Underwriting spread



Underwriting Spread ($) = Primary Market Price – Issuer's Proceeds

Figure B. Illustration of the issuing procedure

Summary of Findings

1. The underwriting spread rises by ≈ 5% of the sample mean after M&As
2. Consistent with an enhanced market power interpretation, effects double for larger deals and in more concentrated markets
3. Examinations of M&As less likely to be influenced by local economic conditions, combined with three placebo tests, help establish causality
4. Efficiency gains, if any, are too small to offset the rise in the underwriting spread
5. Using Census data, I validate my prior findings and show a reduction in new issuance

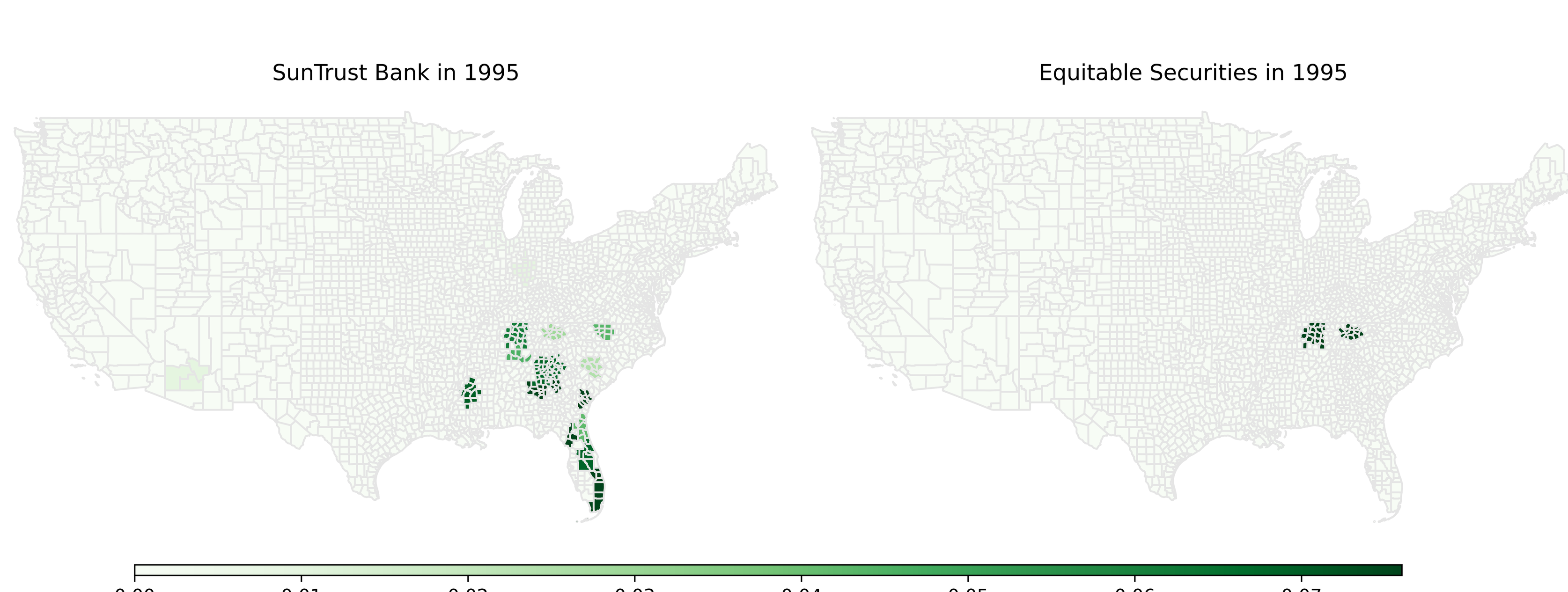


Figure C. Example of municipal bond underwriter M&A

Findings #1: Underwriting spread ⇧

- The underwriting spread increase by 5.0 bps from a sample mean of 103.0 bps following M&As
- An average CSA issues $1,312 million annually ⇨ $653,989 greater burden
- Effects double for: (1) bigger M&A deals (2) in already concentrated markets

$$y_{d,c} = \beta_1 Post_{c,t} + \beta_2 Treated_{a,c} \times Post_{c,t} + \theta_{i,c} + \theta_t + e_{d,c}$$

Equation 1. Stacked difference-in-differences specification

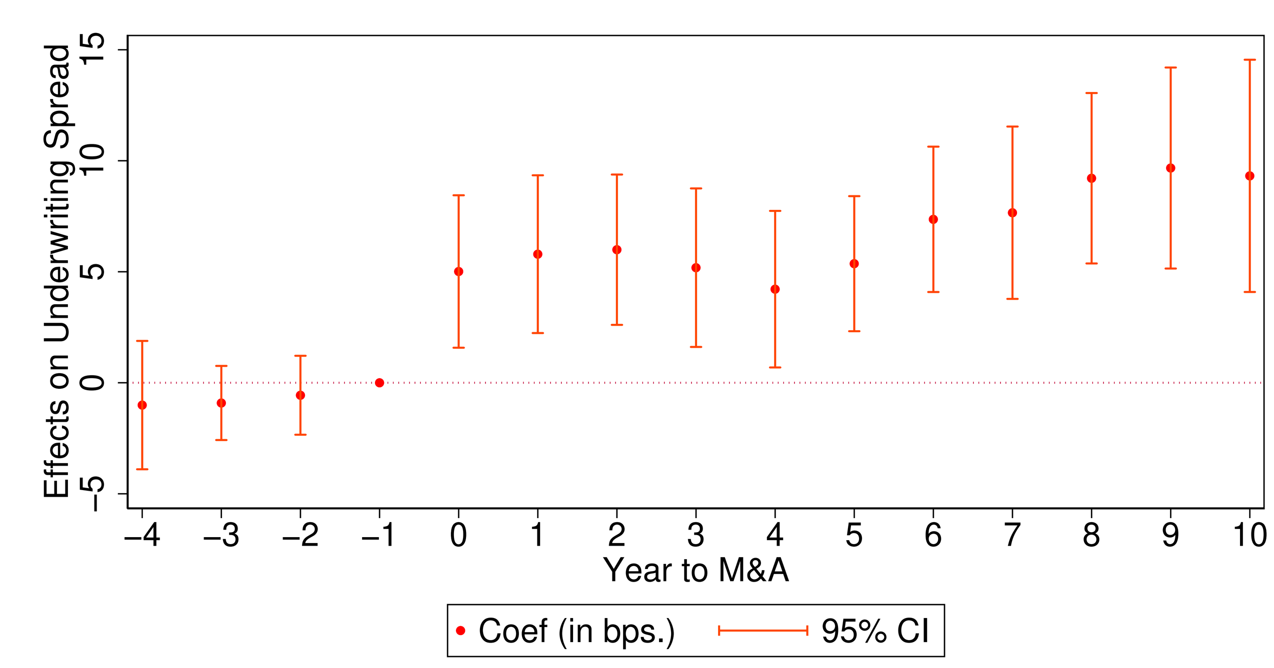


Figure D. Dynamics of the underwriting spread around underwriter consolidation

Findings #2: Offsetting efficiency gains?

- Do issuers benefit from lower bond yield at initial offering? No
- Do issuers benefit from less usage of other issuer paid services? No
  - I look at credit ratings, bond insurance, and financial advisors
- An "all-inclusive" measure confirms that issuers are overall hurt

Findings #3: Quantity ⇩ in Census data

- Based on Census data
  - New issuance drops by $178.9 per student per year for school districts
  - Consistent with findings from bond issuances, there is an increase in financing costs for issuers in affected markets

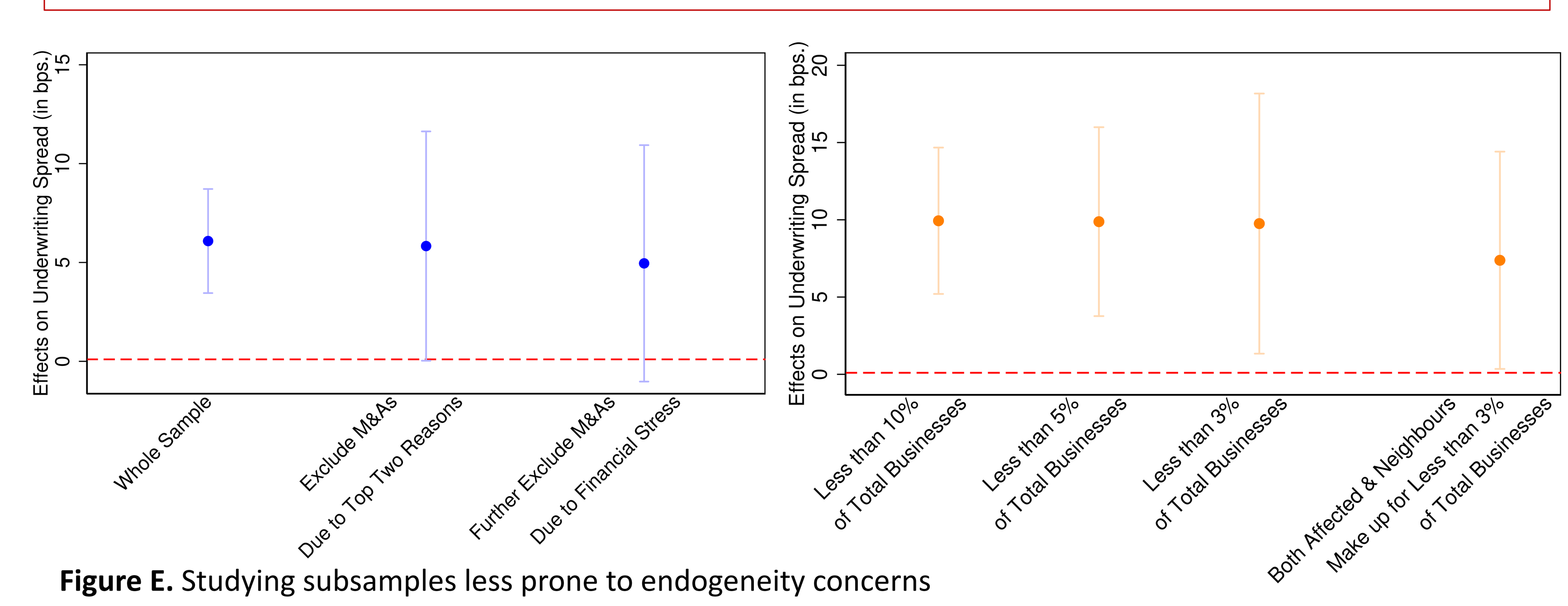


Figure E. Studying subsamples less prone to endogeneity concerns

Causality?

- Findings hold when focusing on M&As for which the reported rationales in news articles are likely unrelated to local economic conditions
  - The narrative approach (Romer and Romer, 2010)

- Findings hold when focusing on scenarios where the affected markets account for a small fraction of the merging underwriters' businesses

- Findings are absent in three placebo tests:
  - Cross-market M&As without overlapping geographic operations
  - (Purely) commercial bank M&As
  - Withdrawn M&As

Policy Implications

a) Investment banking activities warrant antitrust regulatory attention
b) Regulators should consider more narrowly defined markets when geographic fragmentation and entry barriers exist (Wollmann 2019, 2023)
c) A simple rule based on pre-consolidation market share and *predicted* increase in HHI can identify scenarios where price effects are stronger
d) Evaluation of both costs and benefits from M&As requires an evidence-based approach

Contact

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