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Deregulation in investment banking: Industry concentration following Rule 415

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Abstract

This paper examines activity in the investment banking industry around the passage of Rule 415 (the 'shelf registration regulation'). Our empirical results document that corporations that issued securities via shelf registrations chose to do so using significantly fewer and more prestigious underwriters per issue than corporations that issued securities prior to Rule 415. Although the trend toward fewer underwriters occurred for both shelf and non-shelf registrations, it is more pronounced for the shelf registered issues. Further, we show that stockholders of small, less prestigious underwriters experienced significantly larger stock price decreases than stockholders of larger, more prestigious underwriters during the period in which Rule 415 was passed.

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The decade of the 1980's produced significant changes and challenges for participants in the investment banking industry. Events occurring during this period include the growth of the high-yield debt market, mortgage-backed and asset-backed debt financing, the introduction of shelf registration, rapid growth in corporate control transactions, mergers of scope and scale in the investment

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banking industry, and increased foreign competition in underwriting. A consequence of these innovations has been an unprecedented increase in competition for underwriting business. Even as the industry is experiencing some of its greatest revenues ever [1], various underwriters find themselves pitted against one another for business. [2]

One of the more hotly debated events of the 1980's, in terms of the potential impact on competition in the investment banking industry, was the introduction of shelf registration of new securities. After several decades of debate (Hodes, 1963), a nine month trial period plus an extension, and a formal hearing process, the Securities and Exchange Commission (SEC) put Rule 415, the so-called 'shelf registration' regulation, on the books in late 1983. The basic premise of Rule 415 is to streamline the system by which some firms take new security issues to the market. Under Rule 415, firms already in compliance with the information disclosure rules of the Security Exchange Act of 1934 [3] do not need to repeat and release this information prior to a primary security sale (Banoff, 1984). This regulation permits large corporations to file a registration statement with the SEC and to subsequently issue the securities anytime during a period of up to two years. The company can file a short form statement as an update immediately before the security offering. Thus, the timing of issuance of the security that is shelf registered is in the hands of the issuing corporation and is not subject to the typical delay associated with an SEC review of a non-shelf registered security.

Competition and concentration in the underwriting industry around the passage of Rule 415 has yet to be extensively documented. Rogowski and Sorensen (1985) examine some industry trends which occurred during the Rule 415 experimental period. They document declines in underwriter spreads, in returns to underwriting banks, and in combined market share of the top ten underwriting firms during the experimental period relative to a period prior to the passage of Rule 415. Foster (1989) also examines industry trends during the experimental period and finds evidence that is consistent with higher operating costs and/or market power for underwriting syndicates. Marr et al. (1993) examine the effect of shelf registration on the distribution of underwriting revenues of broker/dealers beyond the experi-

[1] As reported in the *Wall Street Journal* (October 1, 1991, p. C1), 'the third quarter (of 1991) was the second-best ever in volume of new stock and bond offerings, trailing only the record second quarter' of 1991; and (July 1, 1993, p. C1), 'Corporate America's sales of new stocks and bonds soared 19% in the first half, breaking a record ...'.

[2] It is not uncommon to find articles in the *Wall Street Journal* that discuss the market power and/or prestige of various investment banks. See for example, 'Merrill Strengthens Underwriting Lead, As Salomon Stumbles in Rankings' (October 1, 1991, p. C1) or 'Municipal Bond Issuance Leaps Despite Investigations' (July 1, 1993, p. C14).

[3] The stated goal of the Security Exchange Act of 1934 is that adequate and timely disclosure is necessary so that investors may make informed decisions. The SEC has consistently attempted to uphold disclosure requirements, and in the primary market this due diligence caused significant delays between the registration and sale of securities.

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