

Revamping the economic model of Corporate and Investment Banks

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The investment banking field today finds itself under pitiless scrutiny in a setting of emotions flailing between dark doom and indignant mistrust, and shrill calls for complete dismantling. Indulging in emotional extremes, however, is entirely counterproductive. In order to find a way out cool heads must prevail - we must pause, breathe in with full chest, and start building a new solid footing.

From Here to Healthy

This time however we let the common sense drive. We build a coherent plan first, instead of blindly diving into a race for mere conformity to regulatory requirements or for the most esoteric trading strategy. Then we get the right people to implement the plan in an organized manner.

Such plan in fact exists. It is a logical set of changes and adjustments that is easy to initiate and that can produce results promptly.

The plan addresses several fundamental shortcomings of the corporate and investment banking business that led to the quaking observed today.

Right the Boat First!

First and foremost the plan mandates a thorough understanding of the production process. Actually, the CIB production process is an inverted one. Lack of awareness and control of the total costs spawned between the point of product conception and its delivery to the end client led to the ballooning balance sheet sizes across the industry. The production process needs to be reengineered according to a healthy, transparent and coherent standard that takes all process inputs – the multitude of by-products by means of which the end product and its constituent processes are hedged - into consideration of the total value.

From Back-Pocket Snapshots to 360° Views

Risk management needs to be expanded from an aggregation of short-term snapshots (10 days VaR) to a comprehensive multi-horizon coverage. The product life cycle management needs not only stress testing but also a multi-horizon norm of risks.

Such expansion will be most successful when led by experts who are well-versed in all the existing varieties of risk.

Cultural (R)evolution

The plan also covers the so much needed change in the culture. The post Glass-Steagal Act explosion of corporate and investment banking activity led to a massive industrialization of the business, leaving many of those employed in the support of the industry reduced to mere factory tools, while their Front Office counterparts were raised by the wave of gasping fascination and lavish remuneration, both of which were caused in their turn by the size of the deals. That the size of the deals was often accompanied by the proliferation of costs and a slur of hedges, hedges on hedges and mushrooming of counterparties was ignored at the time. It is now time to build a healthier and balanced incentive and remuneration scheme for everyone involved, a scheme that is rooted in the adequate cost and contribution accounting. It is also time to acknowledge the contribution of the teams involved and reintroduce full accountability.

There is More in the Toolkit

These changes are accompanied by others: proper decentralization methods, upgrading concepts of governance to more modern and innovative levels, establishing models for future development and strategic positioning. The plan is elaborated upon in full detail in the working paper [Reinventing the Corporate and Investment Banking Model](#) we offer to your attention on our website.

The Need for Reinvention

Our analysis presented in this document demonstrates that investment banking is not doomed to disappear as a business and that its value added within the financial and economic system remains indispensable. To that end however, we believe it is necessary to redefine the business itself, and to put forward organizational changes that would enable and sustain it.