

## Considerations regarding the Indirect Involvement of Banks on Capital Markets

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### Abstract

*Important transformations in the banking sector recorded in the last twenty-five years have been caused by the rapid development of financial markets, marked by the emergence of new financial products, innovative technologies, and geographical and sectoral integration. In the banking sector, financial innovation is manifested in new products (subprime mortgages), services (internet banking) or new tools for processing information (credit scoring), the aim being to reduce costs and risks and to better meet users. Regarding their indirect involvement in capital markets, banks play an important role intermediating transactions for their clients, participating as intermediaries for new issues (initial public offerings - IPOs) or secondary offerings, having the role of depository banks or actively participating in the dynamic process of financial innovation.*

**Key words:** banks, capital market, stock exchanges

**JEL Classification:** G15, G21

### Introduction

The capital market is a complex world with many participants and strict rules. Taking in account the characteristics of this market, in this paper we analyze the activity of the banks as intermediaries on the capital market and the implication of the credit institutions on the financial innovation process.

### Banks as Capital Market Intermediaries

As capital market intermediaries, banks (both commercial and investments banks) are accredited for financial market services, which can be translated as putting into practice their clients' market orders.

In Romania, according to Law number 297/2004 regarding the capital market, financial market investment services can be accomplished only by intermediaries. Capital market intermediaries also include financial institutions and credit institutions which have been authorized by National

Bank of Romania (NBR). Financial institutions are allowed to run capital market investment services, only if they meet the following *criteria*:

- companies are legally organized as joint stock companies;
- their headquarter is located in Romania;
- people that have power of decision in these companies must have high qualification, professional experience and integrity in accordance with Romanian National Securities Commission's (C.N.V.M) regulations;
- the company must have meet the minimum capital requirements;
- a clear business plan, an organizational structure description and internal rules; and also the shareholders` structure must be presented;
- the company must have a contract concluded with a financial auditor, member of the Financial Auditors Chamber of Romania (CAFR) and who meets the common requirements of C.N.V.M and CAFR;
- shareholder structure, the identity and integrity of the significant shareholders.

Investment banks, as well as commercial banks are engaged in numerous activities regarding capital markets, underwriting services representing an important part of these activities. Nowadays, banks offer complete and sophisticated products and services to their clients, and this characteristic of banks leads to a possible conflicts of interest between the two most important activities of banks: lending and underwriting. There are many studies regarding the possible conflicts of interests that may occur in banks' activities. Because USA has an important tradition in bond and stock market financing most of the analysis have been conducted on US commercial banks. Thus, until 1933, U.S commercial banks were allowed o perform underwriting operations with no restrictions. The crisis of 1929 – 1933 has brought under the spotlight a series of questions about possible conflicts of interest arising from banks' involvement both in the capital market and in the banking market, which could raise the risk of financial system. During the 1920s, the number of commercial banks, which directly or through subsidiaries were involved in conducting operations in the U.S. capital market, has known an important increase. As a consequence, the market share held by investment banks performing underwriting operations has suffered a significant decrease. Commercial banks distributed a percentage of 22% of the total bonds issued in the U.S in 1927 and 45% of the total bonds issued in 1929<sup>1</sup>. The number of commercial banks that carry out operations on the capital markets has increased from 10 in 1922 to a peak of 114 in 1931.

The economic crisis between 1929-1933 has brought the necessity of recalculating the position held by commercial banks in capital markets, the idea of separation of commercial banking activities from those of investment banks becoming more and more popular. Thus, since 1933 the Glass-Steagall Act was put into practice in U.S which prohibited banks performing underwriting operations, as well as holding and purchasing (dealing) securities issued by economic agents. To illustrate the potential conflict of interest between the two types of activities performed by banks (capital market activities and banking activities) - the conflict of interest was the main reason that led to the introduction of Glass – Steagall Act – it is often mentioned the case of Fox Motion Picture. In 1929, Chase National Bank financed the acquisition of Fox Company by General Theaters and Equipment (GTE), through a loan worth 15 million dollars. Also, in 1930, Chase National Bank intermediated GTE ordinary shares issuance worth 23 million USD and a 30 million dollars bond issuance, which were later used partly to repay the loan that Chase National Bank has granted to GTE in the previous year. A

<sup>1</sup> Kroszner, S. R., Rajan, G. R., *Organization Structure and Credibility: Evidence form Commercial Banks Securities Activities before Glass-Steagall Act*, <http://faculty.chicagobooth.edu/raghuram.rajan/research/papers/firewall.pdf>

year later, GTE has encountered financial problems, for which Chase Securities intermediated another bond issue worth 30 million dollars. After two years, GTE went bankrupt. Alleged abuse of the Chase National Bank and Chase Securities Company was investigated by Pecora Committee, and it was proved that there was a conflict of interest that led to the issuance of questionable quality shares underwritten by Chase National Bank, information given to investors was incomplete and inconsistent with reality, and funds raised were used to repay the loan that Chase National Bank grant to GTE.

The Glass-Steagall Act remained in force for a period of 60 years, limiting the operations conducted by banks on capital market and prohibiting their holdings in the capital of economic agents. Between 1980 - 1990, U.S. commercial banks were gradually allowed to perform underwriting operations. In 1987, the Federal Reserve (FED) allowed commercial banks to own subsidiaries which could conduct underwriting activities in the capital market, but these were separate affiliates of commercial banks in terms of capital and resources. The Glass-Steagall Act with all restrictions was repealed in November 1999, by adopting the Gramm-Leach-Bliley Act, also known as the Financial Modernization Act.

Currently, U.S. banks can conduct transactions and intermediation in securities distribution (underwriting), becoming major competitors for investment banks. However, although legislation allows commercial banks to perform underwriting operations, experts have divided opinions regarding the additional risk generated by commercial banks' involvement in capital market transactions. There are both advantages and disadvantages of commercial banks involvement in underwriting operations.

The main *advantages* can be summarized as follows:

- compared with investment banks, commercial banks have lower costs of obtaining customer information necessary to conduct underwriting transactions. Due to their involvement in lending, commercial banks have a wide range of information about economic agents obtained from monitoring their loan portfolios;
- commercial banks are considered to provide better certification of companies' value, because they have more information about their customers;
- transactions intermediated by commercial banks involve lower costs than those intermediated by investment banks;
- it is estimated that securities distributed by commercial banks have a higher rate of success and get better prices;
- issuers of securities may obtain better pricing for loans provided by commercial banks, in situations where the same bank deals with the distribution of their shares and/or bonds.

On the other hand, the involvement of commercial banks in underwriting operations can have a number of disadvantages:

- commercial banks may have information on less favorable prospects of the companies, but may decide to support the issuance of securities to protect their own interests; the funds raised from subscriptions can then be used to repay loans granted to those companies;
- commercial banks may require companies that funds lent to those companies to be used for investment in shares and/or bonds issued by other firms and intermediated by the specific banks. In this way, banks may send false information in the market regarding their performance as underwriters;
- commercial banks may require companies to use their underwriting services in order to offer them better loans pricing (lower interest rates, lower charges).

There are numerous specialized studies<sup>2</sup>, examining performance of securities distributed through commercial banks, respectively, of those distributed by investment banks and also the default rate recorded in these two categories of securities, and reaching similar conclusions. Thus, it appears that the securities distributed through commercial banks record similar performance compared to those underwritten by investment banks and conflicts of interest are not dominant in commercial banks' activities.

Banks, as creditors of economic agents, have a very important indirect role in capital markets. Thus, commercial banks have important information about their customers, both obtained from the analysis made at the time of loan granting and in the process of regular monitoring of customer credit, events like credit granting and renewal of facilities providing positive signals in the market for present and future financial performance of their respective companies. For example, the mere granting of a bank loan to a company listed on the stock exchange may increase the price of the shares of that company. Starting from this premise, it appears that shares of companies recorded higher prices at the time of publication of information relating to the granting of loans to these companies, the average increase being 1.93%<sup>3</sup>. In addition, there is a distinction between the announcements of increase and prolongation of existing facilities, and the ones regarding the granting of new loans. In this regard, we note that the market reacts positively especially to announcements regarding extension and increase of existing loans; stock prices increased on average by 1.24%. Information provided by commercial banks in the market come from credit monitoring activity and in a lesser degree from economic analysis made at the time of lending. By further analysis, it appears that positive information offered by banks on smaller and less known companies, have a greater impact in the market than those regarding large companies. Moreover, the information provided by banks is made more valuable and has a greater influence when there is not sufficient information publicly available or when it is unclear. On the other hand, sales of loans by commercial banks provide a negative signal in the market towards the financial performance of issuers of securities.

## Banks' Involvement in the Capital Market Innovation Process

The innovation process characterize not only capital markets, but financial markets as a whole, manifested both by the emergence of new financial products or products designed to cover the risks investors may face, and the emergence of new financing techniques, negotiating new markets or new regulations<sup>4</sup>. In recent years, securities available to investors have significantly widened, reaching a level of complexity that makes their classification difficult, most of them being both capital market products and monetary market products.

Assets securitization was one of the most important financial innovations occurred during the nineties, a technique that has revolutionized the concept of banking intermediation and financing mechanisms. Securitization is a form of financing by which certain financial assets that generate predictable future revenues are pooled and transferred to an entity that finances this acquisition through the issuance of securitized financial instruments (usually bonds), called Asset-Backed Securities (ABS). One characteristic of securitization is that assets underlying this process are banking assets, thus banks turning conventional assets (loans, credit cards, mortgages, etc.) in negotiable assets with a high degree of liquidity. It was found that banks involved in the process of financial innovation through securitization have several common

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<sup>2</sup> Kroszner and Rajan (1994), Roten and Mullineaux (2002), Benzoni and Schenone (2004).

<sup>3</sup> Drucker, S., Puri, M., *Banks in Capital Markets: A Survey*, [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=903819](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=903819)

<sup>4</sup> Cibotariu, I.S., *Financial innovations and their effects on the derivatives markets*, Petroleum and Gas University of Ploiesti Bulletin, economic Sciences Series, vol LX, no. 5A/2008, p. 160

characteristics<sup>5</sup>: (i) there are large banks, able to compete on various financial markets; (ii) there are banks that have significant international activity; (iii) there are banks involved in a greater extent in large transactions, particularly to addressing corporate and government entities.

There are several classes of Asset-Backed Securities (ABS), the most important being the Mortgage-backed Securities (MBS), ABS in the narrow sense (pooled financial assets such as credit cards, consumer credit, future income) and collateralized Debt Obligations (CDOs). Since 1980, mortgage market has suffered major structural transformations, financial innovation leading to new specific tools and to the development of products which use mortgages as collateral grouped according to certain characteristics. These products are called Mortgage-Backed Securities (MBS). Depending on the type of property underlying the issuance of MBSs, they are classified into two *categories*:

- commercial mortgage-backed securities - are based on five types of real estate: office buildings, industrial properties, hotels, retail properties, multifamily apartment buildings;
- residential mortgage-backed securities - based on real estate and single-family homes or apartments.

Also, depending on whether there is or not a guarantee from the Government for these securities, there are two types of MBSs: *agency mortgage-backed securities* – are guaranteed by the U.S. Government and do not receive ratings from international rating agencies and *nonagency mortgage-backed securities* – are not guaranteed by the government.

Through mortgage-backed securities, banking assets with a lower degree of liquidity (mortgage or real estate) become tradable assets, with an increased liquidity. From this point of view, there are three categories of mortgage-backed securities: *mortgage pass-through securities*; *collateralized mortgage obligations* and *stripped mortgage-backed securities*

*Mortgage pass-through securities* are proportionate share of cash flows generated by several mortgages (cash flows consisting of interest and principal, without any bank charges). Financial flows generated by mortgage loans are passed through by the holder of such securities, on a monthly basis, payments made to investors consisting of scheduled principal, interest and any unscheduled repayments of principal resulting from the advance reimbursement or default loans. Mortgage pass-through securities first appeared in 1970 in the U.S. and have been issued by the Government National Mortgage Association (GNMA or "Ginnie Mae"), followed in 1971 by the Federal Home Loan Mortgage Corporation (FHLMC or "Freddie Mae") and later, in 1981, the Federal National Mortgage Association (FNMA or "Fannie Mae"), resulting in the sale of mortgages through bond issuing. For example, suppose that a bank uses 15 mortgages totaling \$ 15 million as collateral to issue a number of 500 bonds, each unit will have the initial value of 30,000 dollars. Therefore, a unit holder will be entitled to 0.2% (1 / 500) of the cash flow generated by such mortgages. Thus, through the purchase of mortgage pass-through securities, investors can have a share of banking assets (mortgage loans) in total amount of \$ 15 million through an investment of much less value, 30,000 dollars, which is translated into an increased liquidity for these products.

Unlike mortgage pass-through securities which are characterized by a proportional distribution of cash flows (principal and interest), for *collateralized mortgage obligations (CMO)* distribution of principal (both scheduled and unscheduled one) has priority in relation to interest distribution. Thus, there are several classes<sup>6</sup> of bonds issued, each of which is characterized by a certain amount and a set of rules which establishes the distribution of principal for each class.

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<sup>5</sup> Silber, W., *Financial Innovation in the Banking Industry: The case of Asset Securitization*, <http://books.google.ro/books>

<sup>6</sup> Fabozzi, J. F., *The Handbook of Fixed Income Securities*, Sixth Edition, McGraw-Hill, New York, 2001, p. 565

Stripped mortgage-backed securities involve the creation of two classes of bonds and uneven distribution of principal and interest between the two classes. Thus, there is the possibility for one class to receive the entire principal, while the second class receives the interest, this being the most common situation. The class of bonds which receives the principal is called principal only (PO class) and class that receives interest is called interest-only (IO class).

One of the most important ABS category is represented by credit card asset backed securities. They have been issued in 1987 and have become the most liquid and the largest sector of ABS market. Thus, since 1990, the annual average value of credit card ABS issuance was approximately USD 31.5 billion, reaching a maximum of 48 billion USD in 1996. The increase of credit card ABS can be explained by the boost of credit card market, the latter becoming a universal means of payment used to purchase a wide range of products and services.

Collateralized debt Obligations (CDOs) represent another category of ABS. CDOs are synthetic securities that include fixed income bonds in their structure and involve financial flows related to the probability of default recorded by a group of several credit products. Credit instruments used are: revolving credit lines (with renewal at maturity), credit instruments issued by companies from emerging countries, debts of various countries, etc.. Depending on the underlying assets, CDO's are classified into two basic categories: *collateralized loan obligations* (CLO) – the underlying asset is mainly represented by credit portfolios; *collateralized bond obligation* (CBO) – the underlying asset consists of various bond types.

Collateralized debt obligations are issued based on loan portfolios and the financial flows they generate are closely related to the repayment of principal and interest on loans or debentures. Consequently, if the underlying asset defaults, this will have a negative impact on the coupon and principal paid for the CDO.

Depending on the purpose for which they are used, CDO's are divided into the following *categories*:

- arbitrage CDOs - are issued by insurance companies, commercial banks and fund managers to take advantage of currency differences between the margins used for securities with greater risk;
- cash flow CLOs - are used to transfer credit risk from banks to investors willing to assume this risk; the loans are subject to these CLOs no longer included in the respective bank balances, as banks with free his ability to use capital and other projects;
- synthetic CDOs - are used for the same purpose as the cash flow CLO, but they use Credit Default Swaps (CDS) for the transfer of risk to an SPV.

Swaps market began to develop in the 1980s, when financial institutions have developed the first non-standard derivative contracts, traded on the Over-the-Counter market (OTC) and used to cover various types of risk, like futures and options contracts traded on commodity and stock exchanges. The first swap contracts transaction belongs to the World Bank, and took place in 1981. It was a currency swap involving the World Bank and IBM company.

A swap contract is an agreement between two parties whereby they undertake to change from time to time (monthly, quarterly, yearly) cash flows resulting from the application of certain prices (or values recorded for rates or interest rates) to a specific notional amount. These contracts are concluded for a time period that usually ranges between 2 and 10 years. Swaps are derivative contracts, and are part of the same class like caps, floors, collars, and swaptions.

Swap contracts are mostly used for hedging, having much the same characteristics as futures contracts: are concluded between two parties, the buyer agrees to pay a fixed price in exchange for risk reduction (price risk, interest rate risk or currency risk). Unlike futures, contracts that are standardized contracts concluded on the stock exchange through a specific mechanism of trading, swaps are not standardized and they are concluded outside the exchange, through direct

negotiation between parties. Depending on the type of risk that financial institutions and businesses may face (the exchange rate, interest rate or price), there are *three types* of swaps:

- Currency Swap (CYSWs) – is an arrangement between two parties to exchange payment obligations denominated in different currencies;
- Interest Rate Swap (IRSWs or plain vanilla swaps) - is defined as an arrangement between two parties to exchange periodic interest payment obligations being calculated by applying different interest rates to a notional amount; it has the largest share in total swap contracts concluded;
- Commodity Swap (CMOs) - is an agreement between two parties to exchange cash flows calculated by applying the prices of certain goods to a certain quantity of those goods.

To provide investors with the possibility of accessing new tools for trading and hedging, exchanges have developed futures contracts based on swap interest rates published by the International Swap and Derivatives Association (ISDA). Thus, Chicago Mercantile Exchange (CME) has introduced futures contracts called swap futures, having as an underlying interest rates for USD swap contracts for 2 years, 5 years, respectively, 10 years.

Innovation in the swaps market has led to the emergence of new categories of swaps like *forward swaps* (allowing parties to enter into a swap at some time in the future), *equity swaps* (financial flows exchanged by the parties are calculated based on the results of some stock indices and by a certain interest rate) or *swaptions*.

Swaption contracts are part of the second generation of derivatives, being representative for the class of innovative derivative financial instruments developed on swap, cap and floor market. Swaptions are options contracts which are based on an interest rate swap. These contracts can take many forms, but most of the times they are encountered as options which gives the holder the right to pay or receive a fixed interest rate, previously established, in return for a future interest rate, London Interbank Offering Rate (LIBOR). In addition, swaption contracts may contain an option to cancel a swap previously contracted, knowing that a swap can be cancelled by initiating an opposite position. So, swaption contracts provide the option buyer the right but not the obligation to initiate a swap at a future date, precisely determined at a specific fixed interest rate.

A swaption contract has the following elements: maturity of the option contract; strike price or exercise price (expressed as an interest rate); payer or beneficiary; option type (American type, European type or Bermuda); notional value.

This category of contracts is used by companies as being an advanced and comprehensive way to manage assets and liabilities. For example, given that the future interest rates' evolution is uncertain, swaption contracts can be used to protect companies against unfavorable evolutions in interest rates, the risk to borrow at higher costs being avoided in this way, but without sacrificing the potential benefits it would entail a lower level of interest rates.

One of the most important and at the same time, the most controversial financial innovations used by banks for credit portfolio management, is the credit default swap contracts or CDS. According to a study published by the British Bankers' Association Credit Derivatives, CDS derivatives dominate the market of credit risk coverage instruments, with over 38%<sup>7</sup> of the total notional value of contracts traded on the market. CDS are contracts between two parties, through which investors buy protection against default risk associated with an asset (bonds, loans, etc.) issued by a reference entity. In contrast, the protection buyer pays a fee to the seller. A CDS may refer to one or more loans; in this case, it is called multi-credit CDS and includes a

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<sup>7</sup> Fabozzi, F., *The Handbook of Fixed Income Securities*, Sixth Edition, McGraw-Hill, New York, 2001

portfolio of loans agreed by the buyer and seller. CDS maturity is between 1 and 10 years, the most commonly used are those with a maturity of five years.

The assets referred to the CDS are issued by a reference entity, which is usually a bank. Another essential element contained in the credit default swap contracts is the event for which the CDS provides protection. Thus, the events (risks) that CDS ensure are: bankruptcy; arrears; default; refusal to pay obligations/moratorium; restructuring. CDS contracts have cash settlement or physical delivery of the underlying asset to the protection seller. These contracts can have multiple uses, the main *practical applications* of CDS are the following:

- hedging - CDS can be used to cover credit risk concentration, being used mostly by banks in order to protect against the risk associated with their loan portfolios. Unlike the sale of loans held by banks, which involves seeking agreement from the borrower or its notification, using CDS allows banks to cover the risk of default, while maintaining a good relationship with their customers.
- investment - can be individually negotiated by the parties, responding to the needs of investors;
- arbitrage/trading – profits can be made from the differences between spot prices and swap market prices.

The credit derivatives market has grown spectacularly in recent years, reaching a maximum of U.S. \$ 16.400 billion, representing the total value of contracts concluded in the first quarter of 2008. With reference to this peak, in the first quarter of 2010, the total value of credit derivatives decreased approximately 13%. Growth rate recorded by these contracts in the period 2003 - 2010 was 100% annually<sup>8</sup>. The largest share of total credit derivatives used for hedging purposes - approximately 97%- is held by credit default swap contracts.

Depending on their type, the structure of credit derivatives is: credit options (0.65%), total return swaps (0.67%), CDS (97.4%), and other credit derivatives (1.28%) In terms of notional value of derivative contracts in which U.S. banks were involved in the first quarter of 2010, it is found that it increased by 3.6 billion dollars, reaching 216.500 billion, 7% higher than in 2009. The largest share of the total notional value of derivative contracts are interest rate contracts (about 84%), followed by foreign exchange derivatives (8%) and credit derivatives (approximately 7%).

The notional values for various types of derivative contracts in the first quarter of 2010 compared to last quarter of 2009, are as follows:

**Table 1.** Notional values for different derivatives contracts

Billion USD	Q1 2010	Q4 2009	Absolute change	Relative change (%)	Share in total derivative contracts (%)
IR (interest rate contracts)	181.981	179.555	2.426	1%	84%
FX (Foreign Exchange) Contracts	17.596	16.553	1.043	6%	8%
Equity contracts	1.571	1.689	-114	-7%	1%
Other derivatives	940	979	-39	-4%	0%
Credit derivatives	14.364	14.036	329	2%	7%
Total	216.452	212.808	3.645	2%	100%

Source: [www.occ.treas.gov](http://www.occ.treas.gov)

<sup>8</sup> <http://www.occ.treas.gov/deriv/deriv.htm>



The largest share of total derivatives contracts concluded by banks, is held by swap contracts, representing about 63% of the total notional value of derivative contracts.

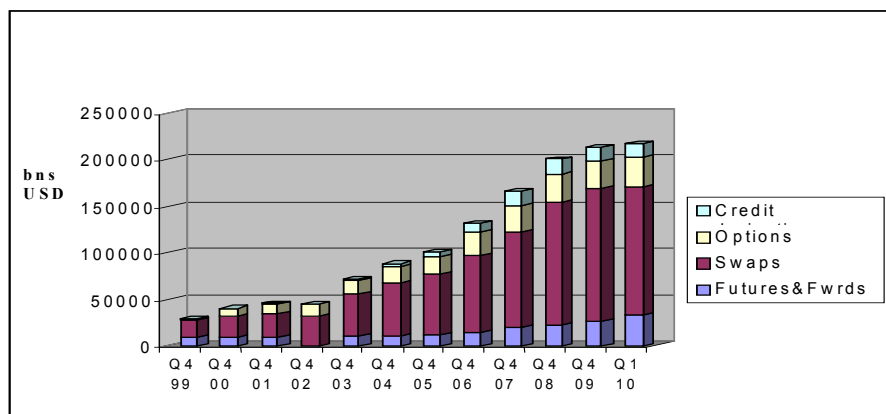
**Table 2.** Notional amounts by type of derivative contracts held by banks

Billion USD	Q1 2010	Q4 2009	Absolute change	Relative change (%)	Share in total derivative contracts (%)
Futures&Forwards	34.094	26.493	7.600	29%	16%
Swaps	136.331	142.011	-5.681	-4%	63%
Options	31.664	30.267	1.396	5%	15%
Credit derivatives	14.364	14.036	329	2%	7%
Total	216.452	212.808	3.645	2%	100%

Source: www.occ.treas.gov

Furthermore, it can be observed that, while swaps are most commonly derivatives used by banks, compared to the last quarter of 2009, in the first quarter of 2010 their notional value has declined by 4%, being the only derivative contracts for which there was a decrease in 2010 compared to 2009.

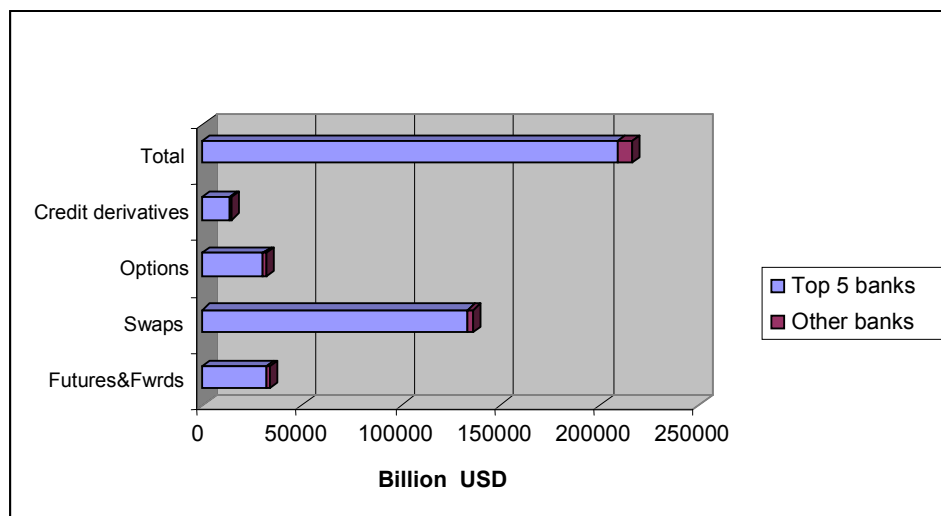
The strong development of derivative contracts used by banks can also be observed from the following chart, as well as their values for the period 1999 – 2009. Thus, we can notice that as in the first quarter of 2010, during the period 1999-2009, the largest share of total derivative contracts used by banks is held by swaps, followed by futures and options contracts.



**Fig. 1.** Types of derivatives and their notional values for the period 1999-2009

Source: www.occ.treas.gov

However, it was found that the overwhelming share of total transactions in derivative contracts made by U.S. banks, is owned by a number of five banks, namely JPMorgan Chase, Bank of America, Citibank, Goldman Sachs, Wells Fargo Bank.



**Fig. 2.** Total amounts of derivatives held by U.S. banks

Source: [www.occ.treas.gov](http://www.occ.treas.gov)

Thus, financial innovation has been and it still is an ongoing concern of banks and other institutions involved in financial markets. Although innovative products have appeared since the 1970s (Mortgage-Backed Securities), 1980s (Interest Rate Swaps, Currency Swaps, collateralized Mortgage Obligations, Asset-Backed Securities), banks had a conservative attitude towards them and didn't use them until 1990s, when the credit risk derivatives market has seen sustained growth.

The use of derivatives makes the banking sector more homogenous, given the fact that differences recorded between banks operating in different regions decrease. It was also noted that the existence of derivatives makes banks invest more in higher risk assets, which increases the overall volatility<sup>9</sup> of the portfolios held by banks.

## Conclusions

As intermediaries, we notice two types of banks that can carry out operations on the capital markets on behalf of their clients: commercial banks and investment banks. They can mediate the distribution of securities owned by corporations, process named underwriting. In the literature, there are a series of discussions on the involvement of commercial banks in underwriting operations for their customers, some experts view that conflicts of interest may arise as a starting point that the two activities that they undertake by commercial banks: the lending and the distribution of securities issued by them. However, most experts consider that this conflict manifests itself only in isolated cases, and there are many advantages in carrying out underwriting transactions by commercial banks: lower costs for customers; easier access to complex information about customers, obtaining better prices for the securities distributed.

As regards the involvement of banks in innovation process, it appears that there are a variety of financial products available to investors, characterized by a high level of complexity; because of that is difficult to allocate them in the capital market products or money market products. The securitization process in which banks are involved, led to the emergence of new financial products such as Asset-Backed Securities, Mortgage-Backed Securities, Collateralized Debt Obligations (CDOs) and Credit Default Swaps (CDS), most of them having as the base the

<sup>9</sup> Kero, A., *Banks Risk taking, Financial Innovation and Macroeconomic Risk*, <http://www.eui.eu>

banking assets. In addition, banks have dramatically increased the holdings of derivatives, in 2006, in the case of JP Morgan Chase, the total value of positions held through CDS was approximately 4.7 times greater than the total amount of the loan portfolio held. From this point of view, many economists regard the CDS as "toxic assets" and some spectacular losses, such as those that led to the collapse of the giant AIG, were related to credit default swaps. Credit default swaps are unstandardized contracts, which are individually negotiated and concluded between the parties and, due to the credits' removal from the balance sheets of banks that buy credit protection, the specialists believe that they contribute to the amplification of invisible debt rate.

Therefore, the implications of the activities of the banks on the capital markets are complex and can be identified both as a direct result of their involvement and as indirect involvement. The research could be continued taking in account the consequences of carrying out transactions involving derivatives on the level of indebtedness of banks and the identification of goals and the extent to which banks use financial derivatives

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## Considerații privind implicarea indirectă a băncilor pe piața de capital

### **Rezumat**

*Transformările importante înregistrate în sectorul bancar în ultimii douăzeci și cinci de ani au fost determinate de evoluția rapidă a piețelor financiare, marcată de apariția unor produse financiare noi, a unor tehnologii inovatoare, precum și de integrarea geografică și sectorială. La nivelul sectorului bancar, inovarea financiară se manifestă prin produse noi (ipotece subprime), servicii (internet banking) sau instrumente noi de procesare a informațiilor (credit scoring), scopul acestora fiind de a diminua costurile și riscurile și de a răspunde mai bine cerințelor utilizatorilor. Din punct de vedere al implicării indirecte pe piața de capital, băncile dețin un rol important, intervenind în calitate de intermediari pentru clienții lor, participând la derularea de oferte publice de vânzare primare sau secundare, având rolul de bănci depozitare sau luând parte la procesul de inovare caracteristic piețelor financiare actuale.*