The Securities Industry in New York City

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Highlights

- **The securities industry has been profitable for the past five years, including the three best years on record.**
- **Securities industry profitability declined by 30 percent in 2013 to $16.7 billion because of higher noncompensation expenses, which include settlement costs. The industry earned $8.7 billion in the first half of 2014, 13 percent less than last year, again because of noncompensation expenses.**
- **Employment in the securities industry in New York City is significantly smaller (15 percent) than before the financial crisis. While the banking sector is also smaller (4 percent), it has been slowly adding jobs over the past three years while the securities industry has lost 10,500 jobs.**
- **In 2013, the average bonus grew by 15 percent to $164,530, the largest average bonus since the financial crisis. Bonuses could be even higher in 2014, based on current compensation trends and the continued realization of deferred bonuses.**
- **Salaries (including bonuses) in the securities industry in New York City averaged $355,500 in 2013, five times higher than in the rest of the City's private sector. Industry salaries have remained relatively stable over the past three years.**
- **Even though the securities industry accounted for fewer than 5 percent of New York City's private sector jobs in 2013, it accounted for more than one-fifth of all private sector wages.**
- **An estimated 1 in 9 jobs in the City and 1 in 16 jobs in the State are either directly or indirectly associated with the securities industry.**
- **In fiscal year 2013-14, the industry accounted for about 19 percent of State tax collections and almost 7 percent of City tax collections. In fiscal year 2014-15, the State also expects to receive $4.5 billion in settlement payments.**
- **While more than half of the Dodd-Frank Act rules are completed, many have not yet taken effect.**

Six years after the financial crisis, the securities industry continues to deal with the fallout. Regulatory reforms are changing the way the industry operates by requiring larger reserves, limiting certain activities and imposing other changes intended to reduce unnecessary risk and to enhance transparency.

The six largest bank holding companies in the United States, including their securities operations, have so far agreed to pay an estimated $130 billion to settle legal actions related to the financial crisis. The securities industry, however, does not break out settlement costs from other noncompensation expenses in its public reports. This makes it difficult to measure the impact of settlement costs on profits.

Nevertheless, the industry has been profitable for the past five years, including the three most profitable years on record. In 2013, higher noncompensation costs reduced profits to $16.7 billion (a 30 percent decline), which was still good by historical standards.

Profits totaled $8.7 billion in the first half of 2014, 13 percent less than last year. Noncompensation expenses continued to constrain profits and are likely to do so in the second half as well, given recent settlement announcements. As a result, profits for all of 2014 may not exceed last year's level.

The industry now defers a large share of bonuses to future years to discourage excessive risk-taking. The Office of the State Comptroller (OSC) previously estimated that the average bonus rose by 15 percent in 2013 to the highest level since the financial crisis, and current compensation trends suggest bonuses could increase in 2014 for the third consecutive year.

Employment in the securities industry in New York City continues to decline. The industry is significantly smaller (15 percent) than before the financial crisis, and has not played a role in the City's jobs recovery.

Although smaller and still in transition, the securities industry remains profitable and well compensated. The industry also continues to be a major contributor to State and City tax revenues, as well as an important component of the economy. It remains to be seen how future regulatory changes and higher interest rates will impact the industry.

Regulatory Reforms

Regulators from around the world have adopted reforms to strengthen the financial system and to prevent conditions that could lead to a similar global financial crisis. Although these changes have already altered the way the securities industry operates, it will take years to complete the process.

The Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law in July 2010. According to the Dodd-Frank Progress Report,[1] only a little more than half (55 percent) of the required rules have been finalized, and many of these rules have not yet taken effect.

Section 619 of Dodd-Frank, known as the Volcker Rule, was finalized in December 2013. The Volcker Rule is designed to reduce unnecessary risk by restricting banks from trading on their own accounts (i.e., proprietary trading) and from holding an ownership stake in a hedge fund or private equity fund. Securities firms have until July 21, 2015, to comply with the new rule, but a number of firms have already sold their private equity and hedge funds.

Dodd-Frank also requires certain bank holding companies to create a plan, commonly referred to as a "living will," to liquidate the company without government financial support in the event of the firm's failure. Regulators have found shortcomings in these plans that must be addressed by July 2015.

The Federal Reserve has been conducting stress tests to determine whether the largest banks have enough capital to withstand potential losses resulting from a severe national recession and a global economic slowdown. In the most recent round of stress tests, 5 of the 30 banks required to participate had deficiencies in their capital plans.

Dodd-Frank, the Federal Reserve and certain international agreements require the largest bank holding companies to increase their capital reserves over the next few years. Regulators also recently passed rules that raise the amount of high-quality liquid assets that large banks must hold,[2] and are considering other rules, such as a capital surcharge tied to the level of short-term financing utilized by a bank. Higher reserves and liquidity requirements will increase the stability of the financial system, but could reduce the amount of funds available for investment.

Industry Profitability

The securities industry has had five consecutive years of profitability (including the three best years on record) since the record losses of 2007 and 2008 (see Figure 1). Securities industry profitability is traditionally measured by the pretax profits of the broker/dealer operations of New York Stock Exchange (NYSE) member firms.[3]

The dramatic rebound in profitability in 2009 and 2010 (to the two highest levels on record) primarily reflected the impact of federal government support programs, including an infusion of capital and a reduction in short-term interest rates, which led to a sharp decline in interest costs for the industry.

Profitability was more volatile during 2011. After a strong first half of the year ($12.6 billion in profits), losses mounted during the second half ($4.9 billion) as a result of the growing European sovereign debt crisis and weaker international economic growth. For all of 2011, profits totaled $7.7 billion, the lowest level in nine years except during the crisis.

Securities industry profitability was strong throughout 2012, reaching $23.9 billion (three times higher than the year before, and the third-highest level on record). In 2013, profits fell by 30 percent to $16.7 billion because of a significant increase (19 percent) in noncompensation expenses (excluding interest costs).

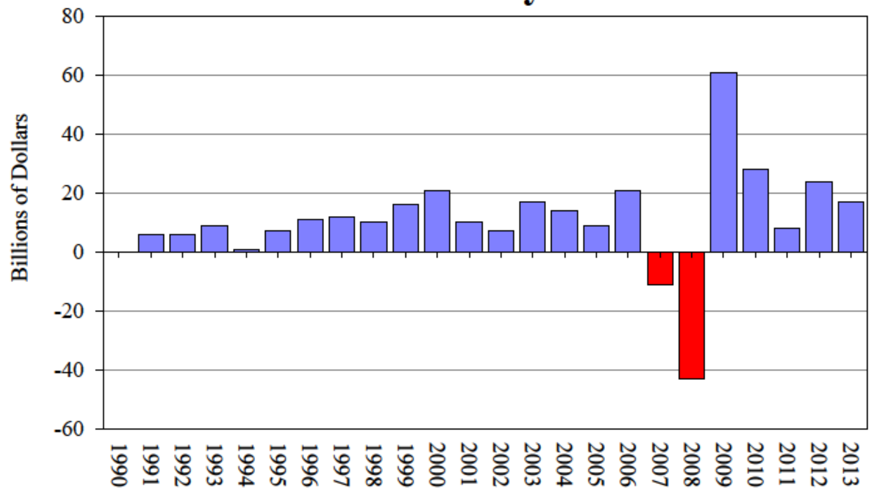
Noncompensation expenses include rent, communications, commissions and the cost of settling legal actions stemming from the financial crisis. The securities industry, however, does not disaggregate settlement costs from other noncompensation expenses, which makes it difficult to measure the impact of settlement costs on profits.

The six largest bank holding companies,[4] including their securities operations, have agreed to pay an estimated $130 billion to settle legal actions stemming from the financial crisis.[5] This estimate includes recent settlements by Bank of America and Goldman Sachs, which will likely be reflected in the results for the second half of 2014. Despite these costs, the six firms have been profitable, in the aggregate, in each of the past five years.

Securities industry profits totaled $8.7 billion during the first half of 2014, which was 13 percent less than the same period last year because of higher

Figure 1

Securities Industry Profits



Note: Results are for broker/dealer operations of New York Stock Exchange member firms.

Sources: Securities Industry and Financial Markets Association; NYSE/Intercontinental Exchange

noncompensation expenses. These expenses are likely to continue to constrain profitability in the second half of 2014 and, as a result, profits for all of 2014 may not exceed last year's level. (New York City's current four-year financial plan assumes that profits will total $14 billion in 2014.) In subsequent years, other factors, such as the pace of rising interest rates and economic growth, will likely have a greater impact on profits.

The Federal Reserve plans to end its bond-buying program, which was designed to hold down long-term interest rates, in October 2014. It has also signaled that it will keep short-term rates near zero until there is further improvement in the labor market as long as inflation remains low. Many economists expect short-term interest rates to begin to rise in mid-2015.

Sources of Revenue

Securities industry revenues have been relatively steady in recent years, although the sources of revenue have changed over time. For example, higher capital and liquidity requirements, limits on proprietary trading, and lower profits from fixed-income investments have reduced the amount of revenue from trading in recent years.

Strong performance in fee-related activities has offset this decline. In recent years, the industry has renewed its focus on wealth management, and revenue from this source increased by more than 73 percent between 2010 and 2013. Fees from underwriting have also been rising (by 20 percent during this period), and reached a record high in 2013. Strong growth has continued in the first half of 2014, with fees from wealth management growing by another 15 percent.

Employment

While the securities industry has been profitable for the past five years, industry employment in New York City continues to decline (see Figure 2). The industry gained jobs during the first part of the recovery, but over the past three years it has lost 10,500 jobs (including 2,600 jobs in the past year), offsetting the earlier gains. As of August 2014, there was a total of 29,000 fewer securities industry jobs in the City than before the financial crisis.

Despite its smaller size, the securities industry remains a critical part of the economies of New York City and New York State. OSC estimates that 1 in 9 jobs in the City and 1 in 16 jobs in the State are either directly or indirectly associated with the securities industry. OSC also estimates that, because of its high salaries, each job gained or lost in the industry leads to the creation or loss of two additional jobs in other industries in the City and one additional job in the rest of the State.

Figure 2 also shows that employment in the City's banking industry experienced a comparable decline during the financial crisis, losing 12,800 jobs. Employment rebounded strongly during the first part of the recovery, just as it did in the securities industry, but employment in the banking sector continued to grow at a slow pace while the securities industry resumed streamlining.

OSC estimates that, as of August 2014, employment in the securities industry in New York City totaled 162,400 jobs. While job losses have slowed in recent months, the industry is now 15 percent smaller than before the financial crisis. OSC estimates employment in the banking industry in New York City totaled 92,500 in August 2014, which is 4 percent smaller than before the crisis.

Although the securities and banking industries are considerably smaller today, other industries in New York City have added jobs since the financial crisis, bringing total employment in the City to a record level of 4.1 million jobs, 262,300 more than before the crisis. Most of the new jobs added during the recovery, however, have been in relatively low-paying industries (i.e., health care, retail trade and tourism), and many new jobs have been part-time.

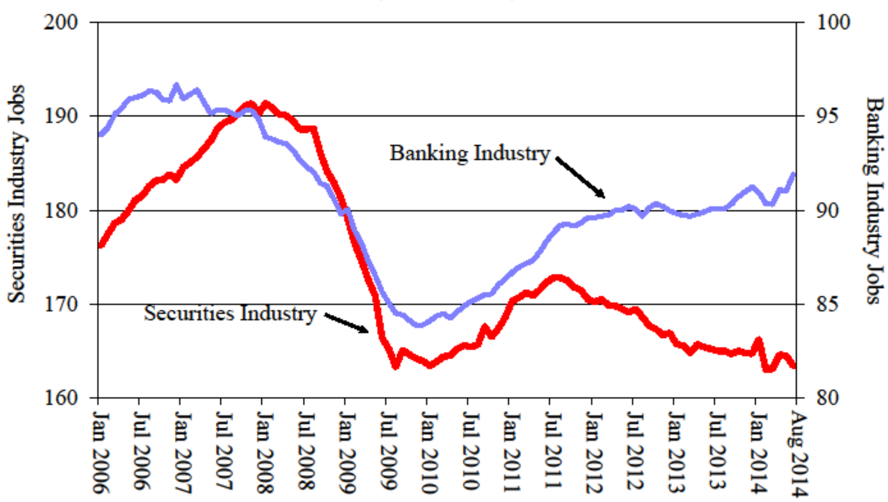
Job growth in the securities industry in New York City has been much weaker during the current economic recovery than it was during past recoveries. So far, the securities industry has not contributed to the City's job growth during the current recovery. During the comparable periods after the 1990-1992 and 2001-2003 recessions, the industry accounted for about 11 percent of private sector job gains.

New York City accounts for nearly 90 percent of all securities industry jobs in New York State, a share that has declined slightly over the past two decades. The securities industry in the rest of the State had a somewhat smaller employment decline than in the City, and has recovered a greater share of the jobs lost (more than one-quarter).

Across the nation, the securities industry has had a stronger recovery than in New York City, regaining almost half of the jobs lost during the recession. As a result, the City's share of national securities employment, which had hovered at slightly more than 20 percent for the past decade, declined slightly to less than 19 percent in the first half of 2014. In 1990, New York City accounted for nearly one-third of all national securities industry employment.

Even after the industry's job losses in recent years, New York State still has many more securities industry jobs than any other state, and twice the number of California, which has the second-highest level of securities industry employment in the nation. Although over time some back-office operations, such as data centers, have moved

Figure 2
Employment in New York City's Financial Industries
(in thousands)



Note: Data are seasonally adjusted.
Sources: NYS Department of Labor; OSC analysis

outside of the City as firms sought geographic diversity and lower costs, many senior and higher-paid positions are still located in New York City.

Compensation

The securities industry's share of private sector wages compared to its share of jobs is a key measure of the industry's importance to New York City's economy. In 2013, total wages paid to employees in the securities industry in New York City ($58 billion) accounted for 20.9 percent of all private sector wages, while securities industry jobs accounted for less than 5 percent of all private sector jobs in the City.

The industry's share of private sector wages has declined in recent years as industry employment has dropped. Prior to the recession, the industry accounted for 28.2 percent of private sector wages and 5.9 percent of private employment. Despite these declines, the industry still accounts for a disproportionate share of wages.

Although compensation costs for the broker/dealer operations of the NYSE member firms increased in 2013, these costs held steady at 47 percent of net revenue in the past two years. Before the financial crisis, compensation traditionally consumed more than 50 percent of industry-wide net revenue.

Bonuses

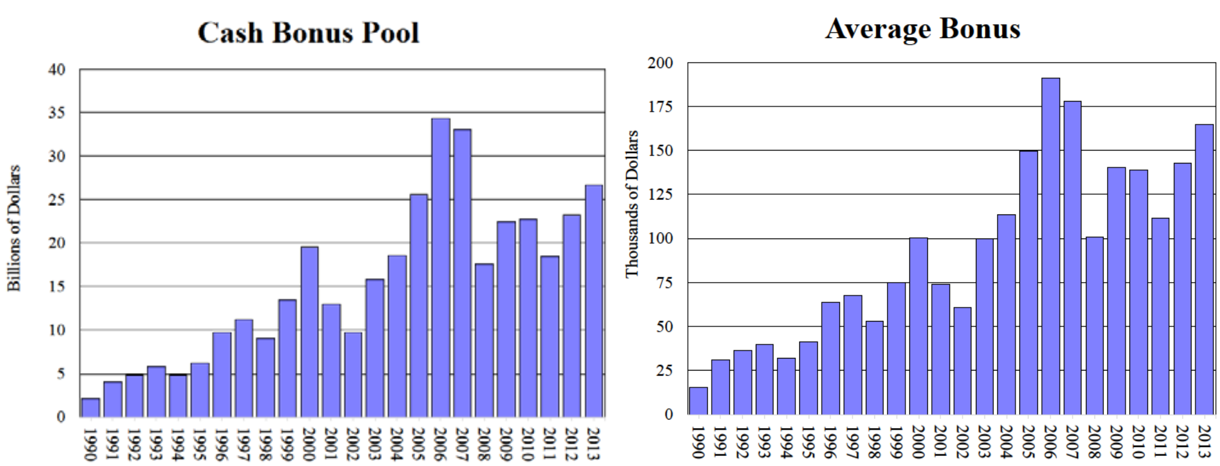
Like most businesses, financial firms report compensation (i.e., base salary, fringe benefits and bonuses, including deferred remuneration) on an accrual basis of accounting. As such, cash bonuses paid in January through March of one calendar year (for work performed during the prior calendar year) are reported in the prior year's financial statements. For example, most of the resources that are being set aside for bonuses in 2014 will be paid out during the first quarter of 2015.

In recent years, the securities industry has changed its compensation practices in response to new regulations and other compensation reforms designed to discourage excessive risk-taking. Firms have raised base salaries for some employees, and now pay a smaller share of bonuses in the current year while a larger share is deferred to future years (usually for a period of three to five years) in the form of cash, stock options or other types of compensation.

In addition, clawback provisions have been adopted,[6] and a larger share of bonuses is now being paid outside the traditional bonus period, making it harder to distinguish bonuses from base salaries. Despite these actions, bonuses remain an important part of total compensation packages paid to securities industry employees.

Figure 3

Securities Industry Bonuses in New York City



Note: Bonuses for securities industry employees who work in New York City.
Estimates include deferred bonuses that have been realized.
Sources: NYS Department of Labor; OSC analysis

In March 2014, OSC estimated that the bonus pool paid to New York City's securities industry employees for work performed in 2013, including bonus payments deferred from prior years, increased by 15 percent to reach $26.7 billion, the third-highest level ever and the highest level since the financial crisis (see Figure 3).

The average bonus paid to securities industry employees in New York City also grew by 15 percent to reach $164,530 in 2013, the largest average bonus since the 2008 financial crisis and the third-highest average bonus on record.

Compensation for the worldwide broker/dealer operations of the NYSE member firms increased by 2 percent in the first half of 2014. Since employment levels have declined globally, this suggests that average compensation, including bonuses, may increase from last year's level. In addition, bonuses will likely be supplemented by compensation deferred from prior years, which has been the case in the past several years.

As a result, OSC expects bonuses to increase in 2014 for the third consecutive year. Since New York City's four-year financial plan assumes that bonuses will decline in 2014, there is a potential for the City to realize some unanticipated revenue.

Average Salaries

The securities industry has the highest average salary of any major industry in New York City. Salaries (including bonuses) in the securities industry averaged $355,500 in 2013, five times higher than in the rest of the City's private sector ($69,700). OSC believes that the large increase in last year's bonuses, most of which was paid in early 2014, will help drive an increase in the industry's average salary in 2014.

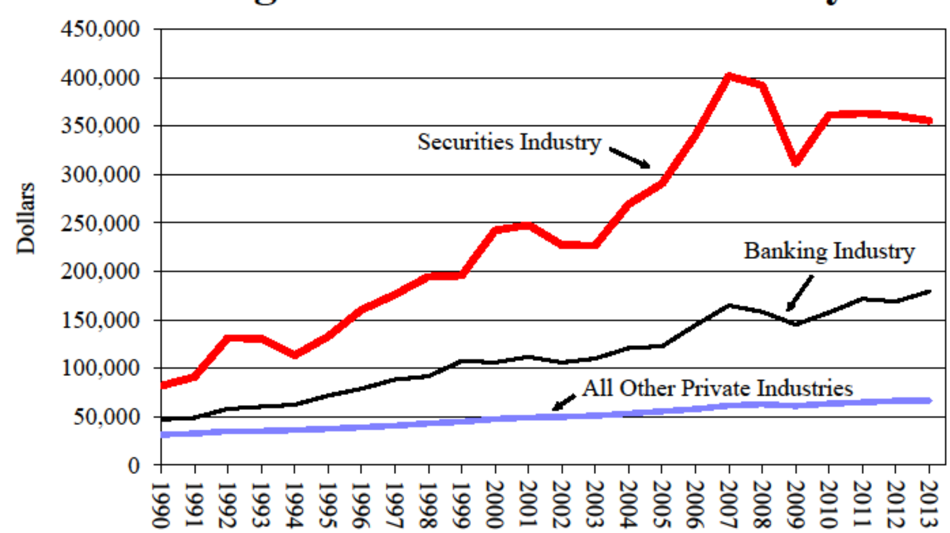
Over the past three years, securities industry salaries have been relatively stable at an average of $360,000 (see Figure 4). Although lower than the peak salaries in 2007 and 2008, this average was higher than in the years leading up to the financial crisis.

In 1981, the average salary in the securities industry was twice as high as the average in the rest of the private sector. By 2007, the disparity between the securities industry and the rest of the City's private sector was the greatest on record. In recent years the gap has narrowed a bit, but the difference remains large.

The banking industry in New York City had the third-highest average salary among large employers ($179,300) in 2013. As shown in

Figure 4

Average Salaries in New York City



Note: 1990-1999 data are on a Standard Industrial Classification basis;
2000-2013 are on a North American Industry Classification System basis.
Sources: NYS Department of Labor; OSC analysis

Figure 4, the average salary in the banking industry is half the average in the securities industry, but it is nearly three times higher than in the rest of the City's private sector.

The average salaries in both the securities and banking industries declined in 2008 and again in 2009. While the average salary in the securities industry rebounded sharply in 2010, it remains lower than the peak in 2007. In contrast, the average salary in the banking sector is higher than ever before.

The average salary of a securities industry employee in New York City ($355,500) was also substantially higher than the average salaries of securities employees in the rest of New York State ($220,300) and in the rest of the nation ($161,100) in 2013. This reflects the concentration in New York City of highly compensated employees, such as chief executives and investment bankers.

Tax Revenues

The securities industry is a major source of tax revenue for both New York City and New York State. Firms pay business taxes pursuant to the State's corporate Article 9A tax and the City's general corporation or unincorporated business tax. In addition, high compensation in the securities industry boosts personal income tax receipts. Capital gains derived from Wall Street's activities are also subject to personal income tax (the Internal Revenue Service reports that securities-related activities generally account for most capital gains).

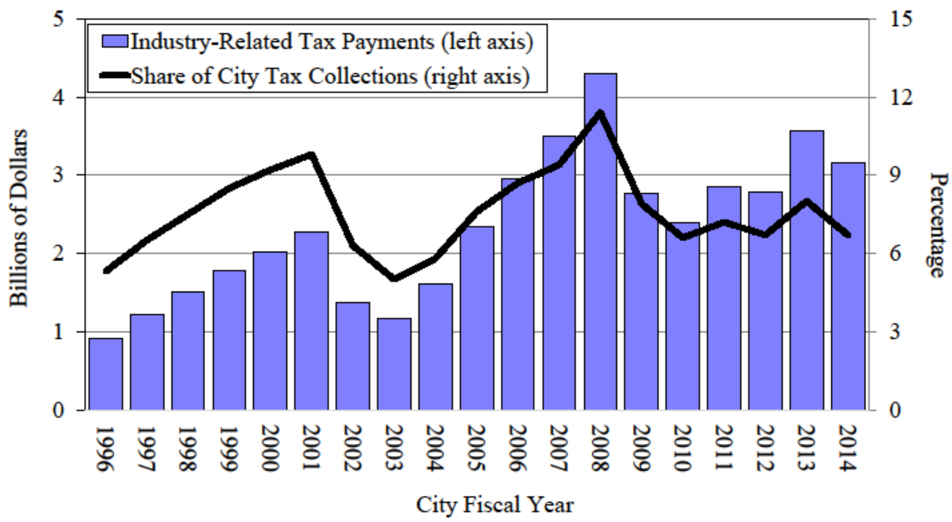
New York City

City tax collections from securities industry-related activities were boosted in City Fiscal Year (CFY) 2013 by a one-time increase in personal income tax revenue. Taxpayers accelerated income (from capital gains on investments such as stocks) into calendar year 2012 to avoid paying higher federal tax rates that became effective in January 2013. The majority of these tax payments were received in April 2013.

OSC estimates that securities-related activities in CFY 2014 generated $3.2 billion, or 6.7 percent of all City tax revenue (see Figure 5). While this is less than the amount collected last year, CFY 2014 still ranks among the best years on record.

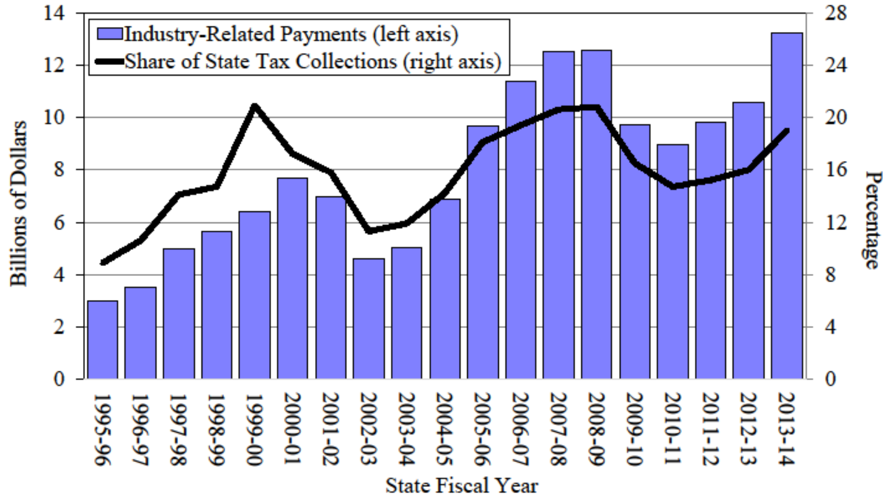
OSC expects securities-related tax collections to increase in CFY 2015. This expectation is based on the assumptions that revenues from capital gains will rise sharply and that bonuses will be higher in 2014.

Figure 5
Securities Industry-Related Tax Payments to New York City



Note: Includes revenue from the personal income, general corporation and unincorporated business taxes. Personal income taxes include capital gains realizations.
Sources: NYC Department of Finance; NYS Department of Taxation and Finance; OSC analysis

Figure 6
Securities Industry-Related Tax Payments to New York State



Note: Includes revenue from the personal income, and corporate Article 9A taxes.
Personal income taxes include capital gains realizations.
Sources: NYS Department of Taxation; OSC analysis

New York State

New York State depends on Wall Street more heavily than New York City does, because the State relies on personal and business taxes to a greater extent. The State also receives tax payments from the many employees in the industry who commute to the City from the surrounding suburbs (including those outside of New York State), and from the larger statewide pool of capital gains realizations.

Because of timing differences between the City and State fiscal years, the higher tax payments from the one-time increase in personal income tax revenue benefited the City in CFY 2013 and benefited the State in State Fiscal Year (SFY) 2013-14.

As a result, OSC estimates that income generated by the securities industry resulted in record tax payments of $13.2 billion in New York State's corporate Article 9A and personal income taxes in SFY 2013-14 (see Figure 6). This accounted for 19 percent of State tax collections in SFY 2013-14, compared to 16 percent in SFY 2012-13. OSC expects securities-related revenue to decline in SFY 2014-15, as taxes from capital gains fall from their elevated levels (similar to the City's experience in CFY 2014).

In addition, the State expects to benefit from $4.5 billion in settlement payments in SFY 2014-15, most of which has not yet been reflected in the State budget. How these new non-recurring resources are to be used has yet to be determined.

[1] The report, which is produced by the law firm of Davis Polk & Wardwell, counts requirements more than once when multiple agencies work on a rule or study. The latest report was issued in October 2014.

[2] The recent rule excluded municipal bonds from the list of approved high-quality liquid assets, which could reduce the demand for these securities thereby possibly raising borrowing costs for state and local governments.

[3] Many of these firms also engage in a broader range of activities beyond broker/dealer operations, such as commercial and retail banking, which are not included in this measure.

[4] The six largest bank holding companies by total assets in the United States are Bank of America Corp., Citigroup Inc., Goldman Sachs Group Inc., JPMorgan Chase & Co., Morgan Stanley and Wells Fargo & Co.

[5] OSC estimates that the six largest bank holding companies have agreed to pay nearly $131 billion (since the start of 2009) to settle legal actions related to the financial crisis. The *Wall Street Journal* estimates that, as of August 31, 2014, these firms have agreed to pay more than $127 billion to settle cases since 2010 (excluding settlements for less than $100 million).

[6] Some clawback provisions require a share of bonuses to be returned if the firm's financial condition weakens or if an executive's investments turn from profits to losses.

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