



# The Securities Industry in New York City

**Thomas P. DiNapoli**  
New York State Comptroller

**Kenneth B. Bleiwas**  
Deputy Comptroller

Report 10-2011

November 2010

## Highlights

- Wall Street earned \$14.1 billion in the first half of 2010—61 percent less than in the same period last year—and revenues were down by 26.8 percent.
- Wall Street profits could total \$19 billion for all of 2010—or 69 percent less than last year's super-sized record (\$61.4 billion), which was fueled by federal assistance and low interest rates.
- Despite the sharp drop in profitability, 2010 could still be Wall Street's fourth most profitable year in absolute dollars and the sixth best year (in at least 30 years) on an inflation-adjusted basis.
- One of every six jobs lost in New York City during the recession was in the securities industry. Job losses in the securities industry could reach 38,000 before employment growth resumes.
- Total wages paid to securities industry employees who work in New York City fell by 28.5 percent in 2009 (the largest decline in at least 30 years), reflecting layoffs and much smaller cash bonuses paid at the beginning of 2009 for work performed in 2008, which registered record losses.
- The average wage in the securities industry in New York City fell by a record 20.5 percent in 2009 to \$311,330—still 4.9 times higher than the average in the rest of the private sector (\$63,650).
- While the cash bonus pool for 2010 may be smaller than last year—as revenues, profits, and compensation have trended downward this year—the average bonus may be larger, given job losses.
- Household wealth fell from \$65.8 trillion before the recession to \$48.8 trillion in the first quarter of 2009, but then rebounded to \$53.5 trillion in the second quarter of 2010.
- The delinquency rate for residential mortgages exceeded 11 percent in the first half of 2010, compared with 2 percent before the recession.
- Consumers are paying down debt and saving more as they repair their personal finances. The savings rate has risen to about 6 percent of disposable income in the spring of 2010—triple the rate in the summer of 2007.

The recent financial crisis, which was precipitated by excessive risk-taking, began in the United States but quickly spread across the globe and caused the worst recession since the Great Depression. Two years ago, Lehman Brothers, one of Wall Street's historic institutions, filed for bankruptcy—the largest bankruptcy in American history.

The fallout led to bank failures, consolidations, and regulatory reforms that have changed the way the securities industry operates. New regulations will require increased capital reserves, limits on some activities, and compensation practices that reward long-term performance rather than short-term gains.

Wall Street's broker/dealer operations lost a record \$54 billion during 2007 and 2008, but, with the help of federal bailouts and low interest rates, the industry quickly returned to profitability. In 2009, Wall Street earned \$61.4 billion—nearly three times more than in 2006, and an extraordinary record unlikely to be matched in the foreseeable future.

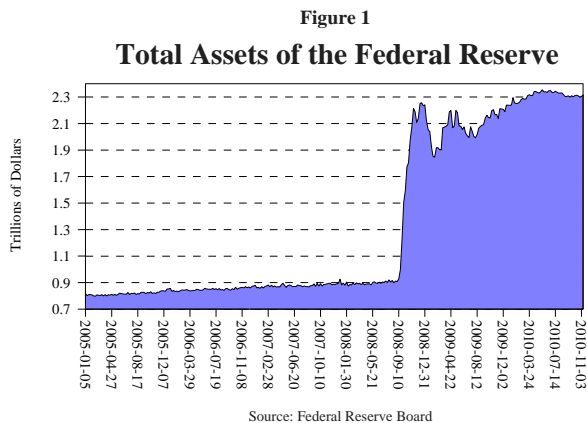
The first quarter of 2010 was among the most profitable on record (\$10.3 billion), but in the second quarter profits eased (to \$3.8 billion) and were more in line with pre-crisis levels. It appears that profits were relatively modest in the third quarter as well, but 2010 could still be the fourth most profitable year for the securities industry in New York City.

Despite strong profits since the beginning of 2009, the securities industry in New York City continues to downsize as it adapts to changes in its economic and regulatory environment. The amount of funds set aside for compensation, including bonuses, has declined during 2010 as revenues and profits have trended downward.

The securities industry remains New York City's economic engine, but it has not been the driving force behind the economic recovery. While other sectors were adding jobs, the securities industry was shedding jobs. Even when job growth resumes, the resulting tax revenue will be insufficient to solve the budget problems facing New York City and New York State, whose budget is even more dependent than the City's on tax revenue from Wall Street.

## Financial Market Conditions

Since the financial crisis, the Federal Reserve has expanded existing lending programs and implemented new ones, including the purchase of Treasury and mortgage-backed securities, to improve liquidity, reduce interest rates, and support the financial system. These efforts rapidly increased the size of the Federal Reserve’s balance sheet and changed its composition. The Federal Reserve’s balance sheet grew from \$926 billion in January 2008 to over \$2.3 trillion by March 2010, and has remained at that level (see Figure 1).

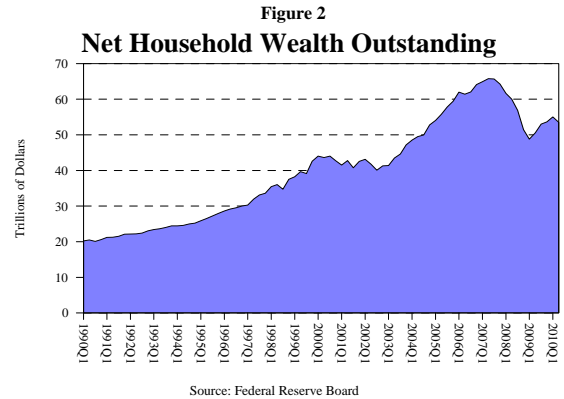


Although many of the lending programs have expired or have been terminated, the Federal Reserve’s balance sheet is expected to expand. At the conclusion of its November 2010 meeting, the Federal Open Market Committee (FOMC), which makes decisions regarding interest rates and the growth of the U.S. money supply, announced that it intends to purchase an additional \$600 billion of longer-term securities through the second quarter of 2011, and intends to continue to reinvest principal from maturing securities in long-term Treasury securities. The FOMC is planning to take these actions in an effort to “promote a stronger pace of economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate.”

Other factors that could affect Wall Street include legal issues related to processing home foreclosures, currency devaluation, and the run-up in commodity prices.

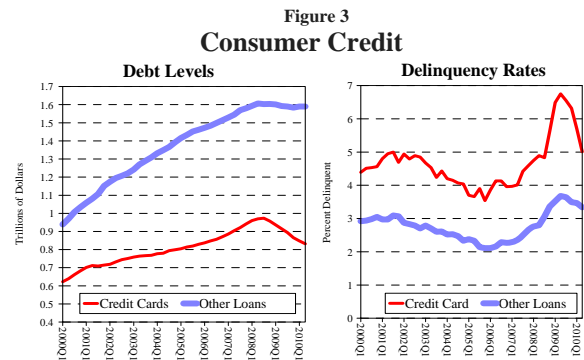
## Household Wealth

During the recession, household wealth declined from a peak of \$65.8 trillion in the second quarter of 2007 to \$48.8 billion in the first quarter of 2009 (see Figure 2), a loss of 25.8 percent. The decline was much more severe in the current recession than it was in the recessions of the early 1990s (1.8 percent) and the early 2000s (9 percent). While household wealth has begun to recover, it remains—at \$53.5 trillion in the second quarter of 2010—far lower than it was before the recession.



## Consumer Debt

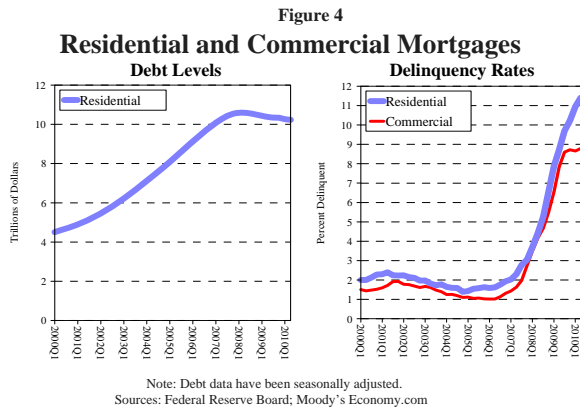
Total consumer debt (excluding mortgages) has fallen by 6.1 percent (\$156 billion) from its peak in 2008, to \$2.4 trillion. Revolving debt (primarily credit card debt) has fallen by 14.5 percent (see Figure 3). The decline in credit card debt is attributed both to consumers cutting back on spending and to banks writing off losses. Non-revolving debt (e.g., car loans) has also declined, but at a slower pace. Consumer credit delinquency rates rose sharply during the recession, but have begun to fall in the past year (see Figure 3).



### Residential and Commercial Mortgages

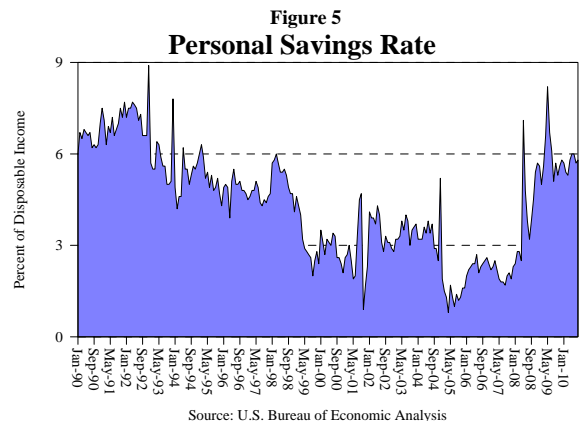
Residential mortgages peaked at \$10.6 trillion in the second quarter of 2008, but then declined by \$355.5 billion (3.4 percent) over the following two years (see Figure 4). The reduction reflects both bank write-offs and consumers' efforts to pay down debt. Delinquencies continue to rise, and exceeded 11 percent in the second quarter of 2010, compared with 2 percent before the recession.

Commercial real estate loans peaked at \$1.7 trillion in the fourth quarter of 2008, but declined by \$137.1 billion (8 percent) through the second quarter of 2010. Commercial real estate delinquencies, which surged during 2009, remain much higher (8.8 percent) than they were before the recession (see Figure 4).



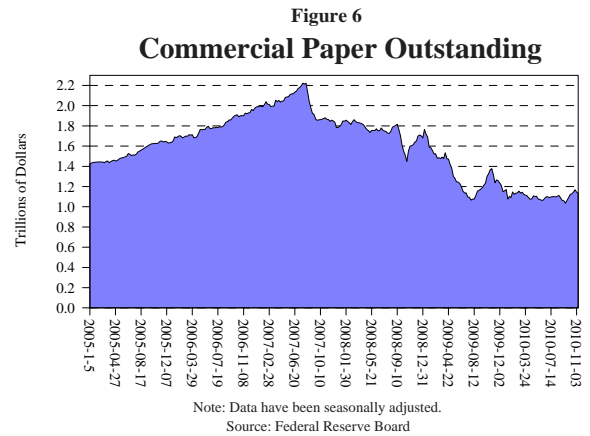
### Savings Rate

Consumers are saving more as they repair their personal finances. The savings rate had risen to about 6 percent of disposable income in the spring of 2010—triple the rate in the summer of 2007, and about the same rate as in the early 1990s (see Figure 5). The savings rate has since eased, but remains higher than it has for many years.



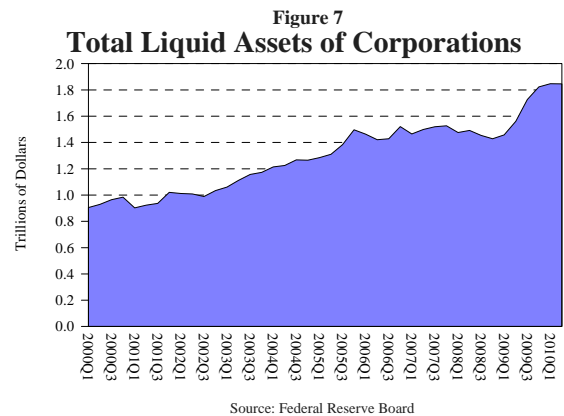
### Commercial Paper

The domestic commercial paper market remains depressed—through November 10, 2010, the level of outstanding commercial paper had been cut in half from its peak in July 2007 (see Figure 6).



### Business Cash Holdings

Some businesses are hoarding cash in response to economic uncertainties, and have been reluctant to expand or make capital investments. Cash balances rose by nearly 28 percent during 2009, and now exceed \$1.8 trillion (see Figure 7).



### Business Loans

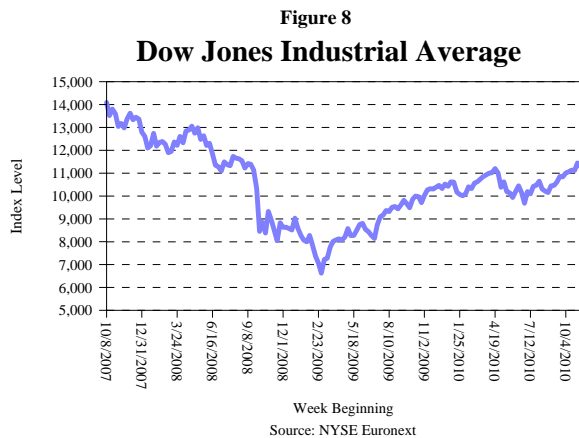
Other businesses have had difficulties obtaining bank loans as a result of stricter lending standards. Domestic commercial and industrial loans peaked in the fourth quarter of 2008; by the second quarter of 2010, the volume of these loans had fallen by 23.6 percent, or \$384.6 billion. The delinquency rate rose from 1.2 percent at the beginning of 2007 to nearly 4.4 percent (slightly higher than during the last recession) by the end of 2009, but since then the rate has begun to ease.

### Commercial Bond Issuances

Issuances of investment grade bonds (\$561.7 billion) are at about the same level as in the prior two years, and still below pre-crisis levels. Domestic issuances of high-risk, high-yield bonds (i.e., junk bonds) totaled \$172.3 billion through September 2010, far more than the total issued in all of 2006 (\$146.4 billion). Worldwide issuances through September 2010 totaled a record \$275 million.

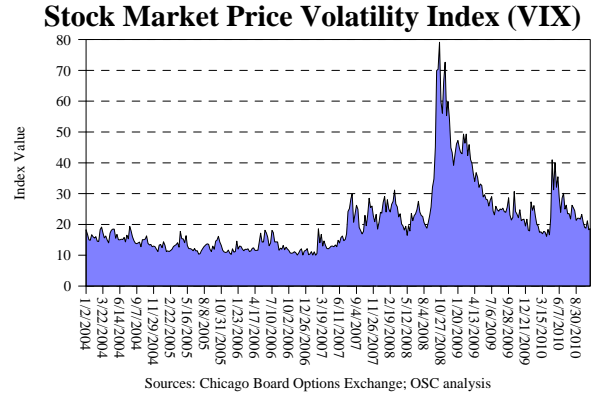
### Equity Markets

The Dow Jones Industrial Average reached a record high of 14,164 on October 9, 2007, but then declined by 53.8 percent over the following 17 months to 6,547 on March 9, 2009 (see Figure 8). Through most of 2009 and early 2010, stock values rose sharply from their financial crisis lows. Concerns over the European credit crisis and the “flash crash” in May 2010, however, then led to a correction in the markets. By late August, the stock markets began to rally again, with the Dow Jones Industrial Average reaching 11,444 on November 5, 2010—its highest close since before the bankruptcy of Lehman Brothers. At that point, the Dow Jones Industrial Average had recovered about two-thirds of its losses. Through November 12, 2010, stock prices then retreated slightly on trade and currency concerns.



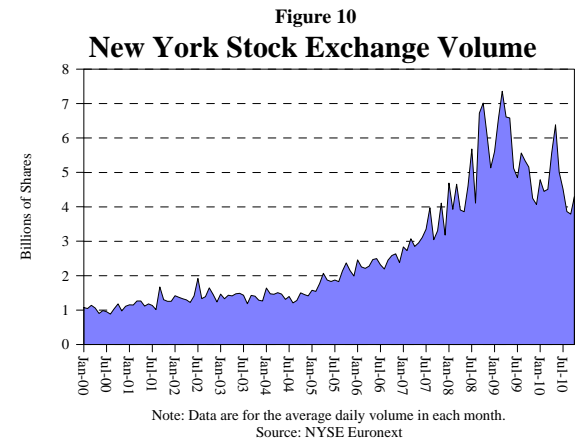
During the peak of the financial crisis, the Chicago Board Options Exchange Volatility Index (VIX) reached as high as 79 points (see Figure 9). The intervention of the Federal Reserve and other federal initiatives helped calm the roiling markets. Although the VIX declined to pre-recession levels (less than 20 points) by March 2010, it spiked in the late spring in response to the European debt crisis; since then, the index has declined.

Figure 9



### Trading Volume

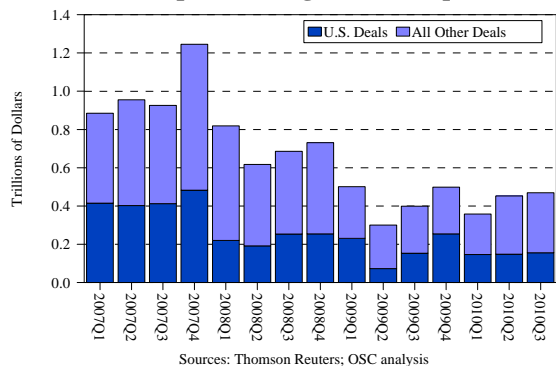
Trading volume on the New York Stock Exchange has moderated in recent months, following surges associated with the financial crisis and the more recent “flash crash” in May 2010 (see Figure 10). These surges had helped fuel trading-related revenue growth at financial firms. While average daily volume remains high relative to pre-crisis levels, the slowdown has put pressure on firm revenues.



### Mergers and Acquisitions

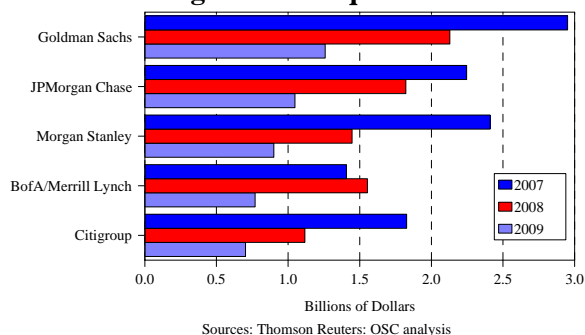
Mergers and acquisitions activity remains subdued, especially in the United States. Although the value of transactions worldwide (\$1.3 trillion) rose by 6.7 percent through the first nine months of 2010 compared with one year earlier, it remained 53.7 percent lower than three years earlier (see Figure 11).

**Figure 11**  
**Value of Completed Mergers and Acquisitions**



Mergers and acquisitions activity was stronger in the rest of the world than in the United States during the first nine months of 2010. During this period, the value of U.S. transactions fell by 1.4 percent while activity in the rest of the world rose by 11.7 percent, boosted by transactions in Asia, primarily in China and Hong Kong.

**Figure 12**  
**Imputed Fees from Worldwide Mergers and Acquisitions**



Fees associated with mergers and acquisitions are an important source of revenue for Wall Street firms. Before the crisis, fees totaled \$10.8 billion for the five largest firms in 2007, but over the next two years fees fell by 56.8 percent (see Figure 12).<sup>1</sup> While fees have begun to rise again—growing by more than 60 percent during the first nine months of 2010 compared to the same period in 2009—they are still significantly below pre-crisis levels.

<sup>1</sup> The investment banking operations of Wells Fargo, the nation's sixth-largest bank holding company, were not among the top ten investment banking firms for which Thomson Reuters reported imputed fees.

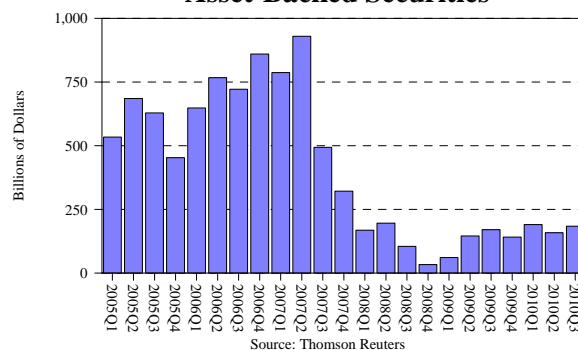
*Equity and Debt Underwriting*

Worldwide equity underwriting totaled \$507 billion during the first nine months of 2010, 9.2 percent less than the same period in 2009. If this trend continues through the end of the year, 2010 will be the third consecutive year that worldwide equity underwriting has declined. In the United States, the rate of decline during the first nine months of 2010 was even higher (31 percent).

Although equity underwriting declined worldwide, the decline was tempered by an increase in initial public offerings (IPOs). During the first nine months of 2010, the value of IPOs rose by \$4 billion in the United States, but grew by \$91 billion in the rest of the world, with more than half of the increase in Asia (excluding Japan).

The market for long-term asset-backed securities, in particular mortgage-backed securities, collapsed during the financial crisis and is not expected to return to pre-crisis levels. Worldwide quarterly issuances regularly exceeded \$500 billion prior to the crisis—and approached \$1 trillion in 2007—but fell to \$33 billion during the fourth quarter of 2008 (see Figure 13). Although U.S. issuances are now far lower than the levels reached prior to the financial crisis, they have averaged more than \$165 billion over the past six quarters.

**Figure 13**  
**Value of Worldwide Issuances of Asset-Backed Securities**

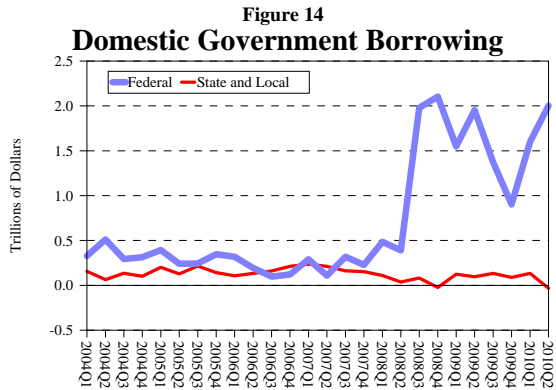


Federal reforms enacted last summer gave the Securities and Exchange Commission (SEC) the authority to require that new issuances of asset-backed securities show the ratings assigned by the rating agencies. The rating agencies, however, would not allow their opinions to be used because of concerns over potential liability, which caused a halt in new issuances. The SEC has allowed issuances without ratings for the rest of 2010 while regulatory revisions are being considered.



## Government Debt Issuances

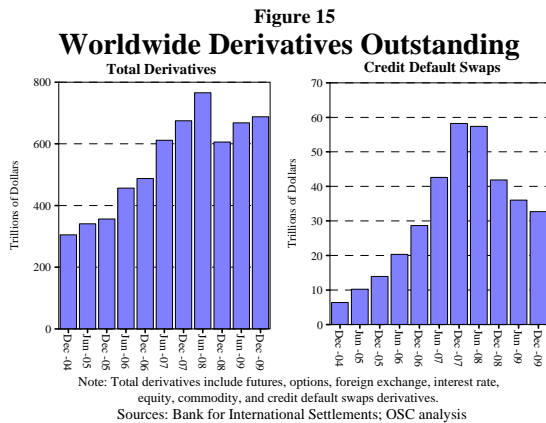
Federal government borrowing surged in mid-2008 (see Figure 14), reflecting stimulus and bailout efforts to support the economy. Although municipal bond issuances have increased because of low interest rates, most of this activity reflects refundings; net borrowing has actually declined.



Note: Seasonally adjusted data are the net of new issuances, refundings, and retirements.  
Source: Federal Reserve Board

## Derivatives

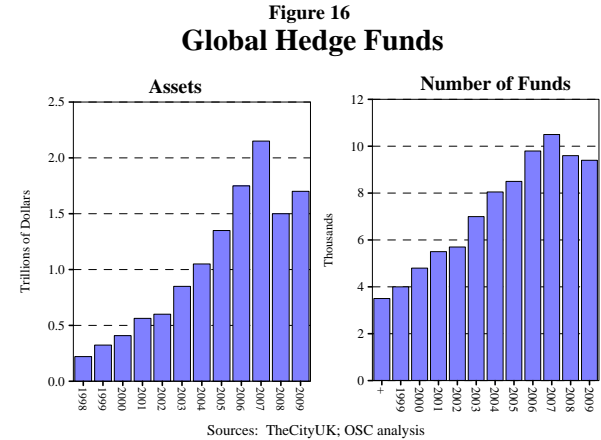
Derivatives are financial contracts whose prices depend on the values of other underlying financial instruments. They are often used to hedge risk, but can also be used for speculative purposes. Derivatives played a major role in the financial crisis and have been a focus of new regulations.



Outstanding derivatives fell from \$766 trillion in June 2008 to \$606 trillion in December 2008 (see Figure 15), a decline of 21 percent. Credit default swaps—essentially, insurance against a default by the issuer of an underlying financial instrument—fell by 27 percent during this period. Since then, the value of all derivatives has slowly begun to rise, reaching \$688 trillion by the end of 2009. The growth reflects the increased use of other types of derivatives, most notably interest rate swaps.

## Alternative Investments

Global assets under management by hedge funds fell by \$650 billion in 2008 (30 percent), and 900 funds closed in that year (8.6 percent). In 2009 another 200 hedge funds closed, but assets rose by 13 percent to reach \$1.7 trillion (see Figure 16), approaching the 2006 level.



Private equity is an important source of funds for leveraged buyouts and venture capital, and for firms in financial distress. Worldwide investments by private equity firms in 2009 (\$91 billion) were a fraction of the record \$309 billion invested in 2007. Investments in the first half of 2010 (\$55 billion) show only a modest gain.

## Financial Regulation

The federal government has implemented reforms with the aim of preventing similar conditions that could lead to another financial crisis. The Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted in July 2010, will improve transparency, provide consumer protections, and begin to address the “too big to fail” issue, but it may take years to be fully implemented.

The Dodd-Frank Act enhances the oversight of derivatives, and requires financial firms to trade most routine contracts on public exchanges and to process them through clearinghouses. Riskier customized derivatives (such as credit default swaps based upon mortgages) can be completed outside of an exchange if done through a separately financed subsidiary. Firms engaged in derivatives trading will also be subject to new capital and reporting requirements.

The new law also creates the Consumer Financial Protection Bureau within the Federal Reserve to oversee certain financial products, including

mortgages and credit cards, and the Financial Stability Oversight Council, headed by the Secretary of the Treasury, to identify, monitor, and address systemic risks to the financial system.

The law also consolidates and enhances the Federal Reserve's regulatory authority, including the assumption of the duties of the Office of Thrift Supervision. Regulators now have the authority to liquidate failing institutions whose demise would affect the broader markets, and to impose restrictions on troubled companies. In the event of liquidations, the government could recoup its costs by levying an assessment on large financial firms. Hedge funds and private equity funds are now required to register with the SEC.

Bank accounts will remain insured up to \$250,000, making permanent the increase enacted by the Federal Deposit Insurance Corporation to allay fears during the height of the financial crisis. Financial firms will be required to retain an interest when selling complex financial instruments, and investors will be able to sue credit rating agencies, which will be subject to oversight by the SEC.

The legislation also addresses concerns related to proprietary trading. Bank investments in private equity and hedge funds will be limited to 3 percent or less of the firm's capital (the "Volcker Rule"). These requirements will not take effect for at least three years, but some banks have already taken actions to comply with the law. Goldman Sachs has closed its Principal Strategies business; some of the affected traders are joining KKR (Kohlberg Kravis Roberts & Co.). JPMorgan Chase will close some of its proprietary trading units and shift other units to its asset management group, where they will trade for clients. The press also reported that Bank of America/Merrill Lynch will lay off proprietary traders as it shrinks that business.

European nations have taken steps to reduce future risks in their banking systems, and other international efforts are also taking place. In September 2010, regulators of 27 nations met in Switzerland and tentatively approved the Basel III accord, designed to enhance stability, transparency, and accountability in the world's financial system. The G-20, comprising representatives from 20 industrialized and developing countries, adopted the Basel III accord at their November 2010 meeting.

The Basel III agreement will increase banks' liquidity and capital requirements. Implementation will begin on January 1, 2013, and be fully phased in by January 1, 2019. Banks that fail to meet the new requirements will face restrictions on dividend payouts, bonuses, and share buybacks.

The financial crisis also focused attention on compensation practices that reward excessive risk-taking. In June 2010, the Federal Reserve issued guidelines aimed at senior executives, employees with oversight responsibilities, and employees whose activities may expose firms to material risk. Under the guidelines, firms are discouraged from providing incentives to employees for activities that encourage excessive risk-taking beyond the firm's ability to identify and handle risk.

The Dodd-Frank Act also includes provisions related to compensation and corporate governance. For example, companies will be required to hold shareholder advisory votes on executive compensation and golden parachutes, disclose additional information regarding compensation practices, and implement compensation clawback policies. In addition, firms will be required to comply with new federal regulations, currently being drafted, that will restrict firms from rewarding excessive risk-taking.

Earlier in the summer, the European Parliament passed compensation rules affecting banks in its 27 member nations. Beginning in January 2011, the cash portion of a bonus cannot exceed 30 percent. Another 40 percent to 60 percent of a bonus must be deferred for at least three years, with clawback provisions if the firm's financial condition weakens or if the executive's investments turn from profits to losses.

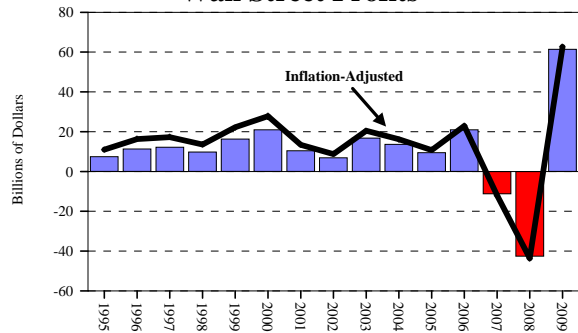
Regulatory reforms may trim profits in the near term, but could diminish high-risk practices that destabilized the financial system and resulted in historic losses for the industry. As long as other international financial centers play by similar rules, New York City will retain its leadership position in the securities industry.

## **Wall Street Profits**

The securities industry made a remarkable return to profitability in 2009, helped by federal government bailouts, the Federal Reserve's low interest rate policy, and changes in accounting rules. The profits of the broker/dealer operations

of New York Stock Exchange member firms, the traditional measure of Wall Street profitability, reached a record \$61.4 billion—almost triple the 2006 level (see Figure 17). Profits were fueled by large revenue gains, particularly from proprietary trading. The gains also exceeded the \$54 billion in cumulative losses incurred in 2007 and 2008.

**Figure 17**  
**Wall Street Profits**



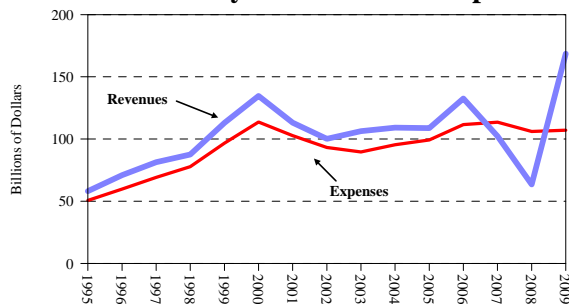
Note: Profits are for broker/dealer operations of NYSE member firms.

Sources: New York Stock Exchange; Securities Industry and Financial Markets Association

Profitability returned in 2009 because revenues rose quickly while expenses remained level (see Figure 18). Net revenues rose by 165 percent in 2009 to a record \$168.6 billion, following a nearly 38 percent decline in 2008. Much of the revenue swing reflects sizable gains from proprietary trading, but it also reflects the Federal Reserve’s low interest rate policies. Interest expenses totaled \$19.5 billion in 2009—far less than the \$114.5 billion incurred in 2008.

**Figure 18**

**Securities Industry Revenues and Expenses**



Note: Data from the broker/dealer operations of New York Stock Exchange member firms. Revenues exclude interest expense.

Sources: Securities Industry and Financial Markets Association; NYSE Euronext; OSC analysis

Profits totaled \$10.3 billion in the first quarter of 2010—among the highest levels on record—but eased to \$3.8 billion in the second quarter, in line with the quarterly average for the 2002-2006 period. The slowdown primarily reflects lower revenues from proprietary trading and investment banking. These trends, coupled with changes

being implemented by securities firms in advance of regulatory reforms, will trim profits in 2010. The Office of the State Comptroller estimates that profits will total about \$19 billion in 2010, 69 percent less than last year’s record, but still the fourth-highest in absolute dollars and the sixth-highest, in at least 30 years, on an inflation-adjusted basis.

In contrast, the nation’s six largest bank holding companies, which are more diversified than traditional broker/dealer firms and which include investment, commercial, and retail banking, earned \$58.9 billion through the third quarter of 2010—compared with \$51.3 billion at that point last year—based on improvements in the profitability of their traditional bank operations.

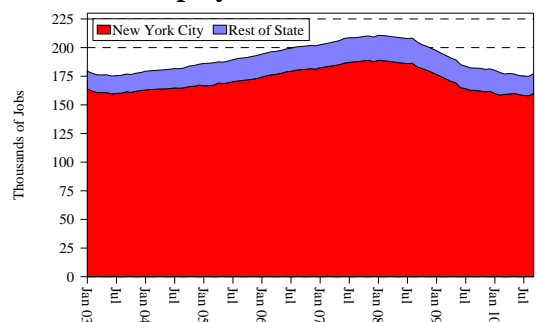
**Employment**

Employment in the securities industry in the City peaked at 200,600 jobs (seasonally adjusted) in December 2000. The industry lost 41,100 jobs during the dot-com bust that began in 2000, but regained 72 percent of those jobs by January 2008, when employment reached 189,000 jobs.

Between January 2008 and August 2010, the securities industry in New York City lost 31,000 jobs (see Figure 19). This represents a decline of 16.4 percent, or four times the rate of total job loss in New York City. Preliminary data suggest that the industry added 2,000 jobs in September 2010, but the unexpected gain was most likely due to a statistical anomaly rather than job creation, and we expect the gains to dissipate as the industry continues to restructure and downsize in response to changes in business conditions.

**Figure 19**

**Securities Employment in New York State**



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



Even though the securities industry has returned to profitability, the industry continues to restructure and downsize as it adapts to changes in its economic and regulatory environment. In each of the past two downturns, the securities industry in New York City contracted by about 20 percent. If the industry contracts at a similar historical rate during this downturn, job losses in New York City could reach 38,000 before the industry begins to add jobs on a sustained basis.

Other regions in New York State, which account for less than 10 percent of the securities industry statewide, experienced an even larger decline than the City on a percentage basis (20 percent), but lost a smaller number of jobs (4,300).

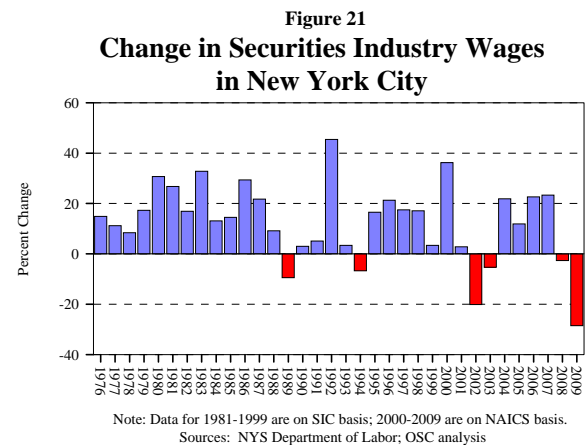
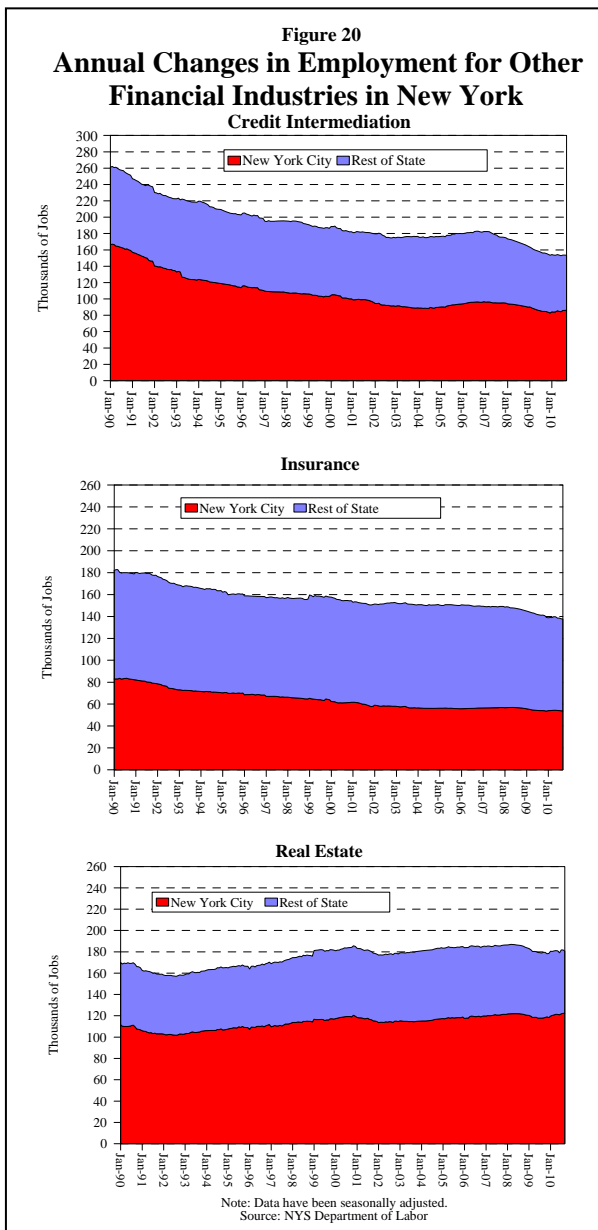
Employment in the three other activities that constitute the financial services sector (i.e., credit intermediation, insurance, and real estate) has been declining in both New York State and New York City since 1990, with losses in credit intermediation and insurance offsetting modest job gains in the real estate industry (see Figure 20).

Credit intermediation, insurance, and real estate lost a net of 18,600 jobs in the City and 46,200 jobs in the rest of the State during the three years leading up to December 2009. As of September 2010, employment in these activities had grown by 7,800 jobs in the City (3.1 percent) and declined by 6,800 jobs (3.1 percent) elsewhere in the State.

## Compensation

Personal income in New York State fell by 3.1 percent in 2009—the first annual decline in 70 years. The decline was due in large part to a steep drop in employment and cash bonuses in the securities industry.

Wages (i.e., base salary and bonuses realized during the calendar year) make up the largest portion of personal income. Wages paid to securities industry employees who work in New York City fell by 28.5 percent in 2009 (\$20.5 billion), the largest decline in at least 30 years (see Figure 21). This drop represents 64.3 percent of the total decline in wages that occurred in New York City in that year. The large decline reflects employment losses and a steep drop in cash bonuses for work performed in 2008, most of which were paid during the first few months of calendar year 2009.



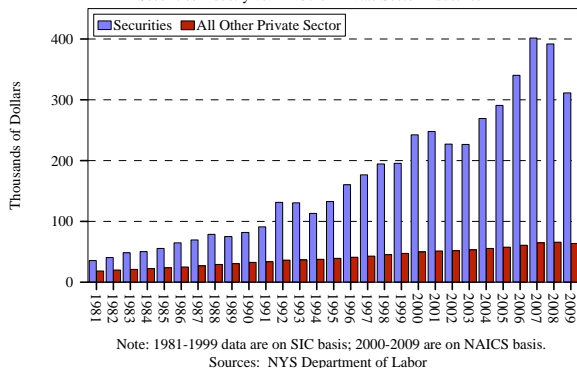
Overall, the securities industry accounts for a disproportionate share of wages paid in New York City. Although the industry accounted for only 4.6 percent of all jobs in New York City in 2009, it accounted for 19.5 percent of all wages. The industry accounted for more than 25 percent of wages in 2007.

The average wage in the securities industry in New York City posted a record decline in 2009, falling by 20.5 percent to \$311,330. Average wages in the securities industry in other parts of New York State and in the rest of the nation (\$202,000 and \$141,980, respectively) were much lower than the average in New York City, because New York City is home to some of the most highly compensated positions in the industry, such as chief executives and investment bankers.

Securities industry wages rose by 18.5 percent in the first quarter of 2010, reflecting an increase in cash bonuses for work done in 2009, when the industry reported extraordinary record profits. Since about 30 percent of all industry wages are generally paid in the first quarter of the year, this strong gain will likely boost wages for all of 2010.

The disparity in pay between the securities industry and other private sector jobs has generally widened over the past three decades (see Figure 22). In 1981, the average wage in the securities industry was nearly twice as high as other private sector jobs, but by 2007 it was 6.2 times higher. Although the average wage in the securities industry in New York City contracted sharply in 2009, it was still 4.9 times higher than the average for all other private sector jobs in New York City (\$63,650).

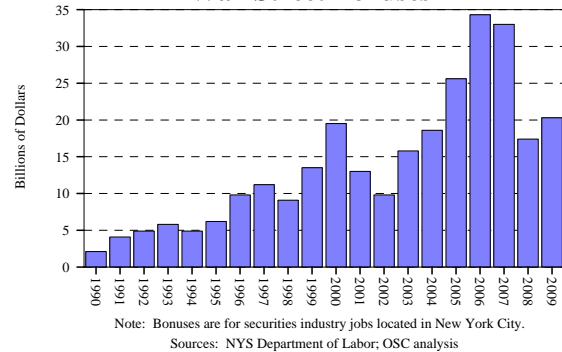
**Figure 22**  
**Average Wages in New York City**  
Securities Industry vs. All Other Private Sector Industries



### Wall Street Bonuses

The Office of the State Comptroller estimated that cash bonuses paid to securities industry employees located in New York City for work performed in 2009 grew by 17 percent to \$20.3 billion (see Figure 23), following a 47 percent decline in 2008.<sup>2</sup> Despite record profits, the growth in the 2009 cash bonus pool was restrained by federal intervention and the public's outcry over the industry's compensation practices.

**Figure 23**  
**Wall Street Bonuses**



Changes in compensation practices have slowed the growth in cash bonuses, with a greater share of bonuses deferred to the future. According to a global study conducted by Mercer earlier this year, many of the 61 financial firms surveyed have begun to replace cash bonuses with increased base salaries and deferred compensation.

Financial firms, like many other businesses, report compensation (i.e., base salaries, fringe benefits, and bonuses, including deferred remuneration) on an accrual basis of accounting. As such, cash bonuses paid in January and February of one year, for work performed during the prior calendar year, are reported in the prior year's financial statements. Tracking the compensation trends of firms during the year provides insight into the size of the bonus pool, much of which will be paid out at the beginning of the following year. For example, most of the resources that were set aside by financial firms for cash bonuses during 2010 will be paid out in January and February of 2011.

The amount of revenue set aside by member firms of the New York Stock Exchange to fund compensation was down by only 4.4 percent in the first half of 2010, even though net revenues and

<sup>2</sup> Estimates reflect cash payments and deferred compensation for which taxes have been prepaid, but exclude unrealized stock options and other forms of deferred compensation.

profits were down sharply (by 26.8 percent and 61.1 percent, respectively).<sup>3</sup> Compensation may have fallen further in the third quarter. In the aggregate, Goldman Sachs, JPMorgan Chase Investment Bank, and Morgan Stanley reported a 7.1 percent reduction in compensation through the third quarter of 2010.

The securities industry has reported declines in revenues, profits, and compensation as 2010 has progressed, and compensation was down compared to one year ago. While it appears that the cash bonus pool will be smaller than last year, the average bonus paid to employees in the securities industry in New York City may be a bit larger, since the pool will be divided among fewer workers given continued staff reductions. It is difficult to predict, however, the impact of regulatory reforms (both enacted and anticipated) on compensation practices, which could result in the deferral of a larger share of bonuses. An analysis of personal income tax withholding patterns, beginning in late December 2010, will clarify the change in the cash bonus pool.

## **Economic Multiplier**

The economic benefits of Wall Street ripple through the rest of New York City's economy. High levels of profitability and compensation in the industry result in additional job and wage gains in other industries, through either business-to-business transactions or consumption by employees' households. The Office of the State Comptroller estimates that each new job in the securities industry leads to the creation of two additional jobs in other industries in the City.<sup>4</sup>

The Office of the State Comptroller further estimates that each new Wall Street job creates one additional job elsewhere in New York State, mostly in the City's suburbs. Many of Wall Street's employees are commuters who spend in their home communities, thereby supporting local businesses and generating jobs. Based on these multipliers and the current level of securities industry employment, 1 in 7 jobs in the City and 1 in 13 jobs in the State are either directly or indirectly associated with Wall Street.

<sup>3</sup> In response to a decline in revenue, member firms set aside a larger share of net revenue to fund compensation in the first half of 2010 compared with last year, so as to prevent a larger reduction in compensation.

<sup>4</sup> We used the IMPLAN input-output models to model the effects of regional economic changes.

During the recession, Wall Street's multiplier impact worked in reverse, leading to job losses in the rest of the City's economy. Between August 2008 and December 2009, the City lost 169,800 jobs in the private sector. Wall Street directly and indirectly accounted for about 44 percent of all jobs lost in the City. During the same time period, the State lost 330,400 jobs in the private sector, of which Wall Street directly and indirectly accounted for 30 percent.

While the recently enacted financial regulation bill aims to increase the long-term stability and prosperity of Wall Street, in the near term it will have an adverse impact on profitability and the associated multiplier effects as the industry realigns itself. Many measures, such as policy restrictions on proprietary trading, derivatives trading, and compensation, may alter the industry's productivity and thus alter the multiplier effects. Though the magnitude of the impact is hard to gauge at this time, the State Comptroller estimates that the multiplier could be meaningfully reduced if the industry's total sales fall by more than 20 percent over a sustained period of time.

Such a potential decline would have a large impact on businesses that depend on spending by industry employees, such as retail stores, restaurants, and real estate services. At the same time, some businesses, such as law and accounting firms, may benefit from increased demand that could arise from the new regulations. As Wall Street adjusts to the changes and creates new products and services, the multiplier should stabilize.

## **Tax Revenues**

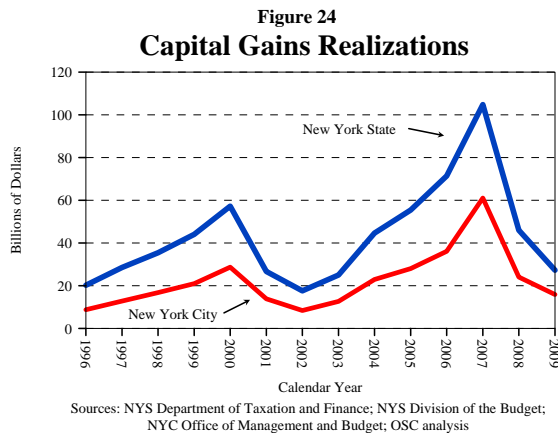
Wall Street activity has traditionally generated a disproportionate share of State and City tax revenues because of high levels of compensation, profitability, and capital gains. During the mid-2000s, tax revenues from the securities industry—payments of general corporation, unincorporated business, and personal income taxes, including payments on realized capital gains<sup>5</sup>—grew rapidly and helped to fill the State and City coffers. Wall Street's share of City tax revenues fell from 13 percent before the financial crisis to about 7 percent in City fiscal year (CFY) 2010.

<sup>5</sup> The Internal Revenue Service reports that securities-related activities generally account for most capital gains.

New York State depends on Wall Street even more than New York City does, because the State relies more heavily on personal and business taxes. (The City also levies property taxes.) In addition, the State receives tax revenues from the many industry employees who commute from the suburbs outside of New York City, and from the larger statewide pool of capital gains realizations. Wall Street's share of State tax revenues fell from 20 percent before the financial crisis to nearly 15 percent in State fiscal year (SFY) 2009-2010.

The financial crisis severely curtailed the flow of revenue from securities industry-related activities. For example, cash bonuses were cut in half between 2006 and 2008, and while growth resumed in 2009, bonuses were still more than 40 percent below the pre-crisis peak.

In addition, the Office of the State Comptroller estimates that between 2007 and 2009, capital gains realizations fell by about 74 percent in the City and the State (see Figure 24).

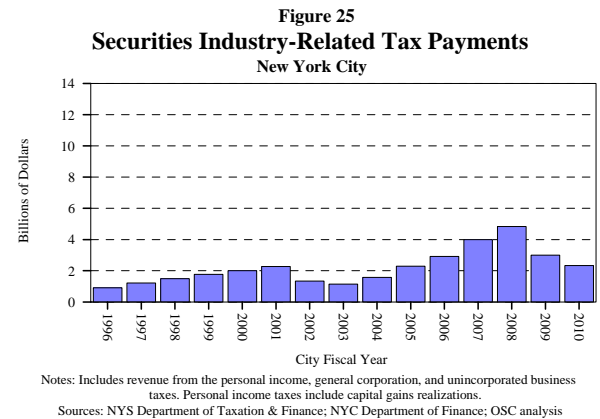


The Office of the State Comptroller estimates that between CFY 2003 and CFY 2008, personal income taxes and business taxes related to the securities industry more than tripled, to \$4.8 billion (see Figure 25).<sup>6</sup> Collections declined by more than half between CFY 2008 and CFY 2010 (falling by \$2.5 billion), reflecting historic losses.

We estimate that industry-related tax revenues could rise by \$300 million in CFY 2011, which appears to be reflected in the City's July forecasts. A portion of the additional revenue could be

<sup>6</sup> Excluding revenue from real property or transaction taxes, and sales taxes on industry purchases.

deferred if the Bush tax cuts do not expire as assumed in the City's budget.



The Office of the State Comptroller estimates that between SFY 2002-2003 and SFY 2008-2009, personal income and business tax collections from Wall Street-related activities almost tripled, from \$4.5 billion to \$12.3 billion (see Figure 26). In SFY 2008-2009, tax collections held steady, despite a large decline in bonuses, as a result of strong capital gains realizations from 2007. Last year, Wall Street-related tax collections declined by 29.7 percent (\$3.6 billion), despite an increase in personal income tax rates for upper-income taxpayers, because of a steep falloff in capital gains realizations from 2008.

We estimate that industry-related tax collections could decline by about \$775 million in SFY 2010-2011—about \$275 million more than assumed in the State budget because of our lower bonus estimate. Tax collections from capital gains could be further reduced if the Bush tax cuts are extended rather than permitted to expire as assumed in the State's financial plan.

