

Research @ Citi Podcast, Episode 36: Beyond the Basics in Financial Services

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Host: Anne Malone, Head of North America Equity Research, Citi

Guest: Keith Horowitz, U.S. Large Cap Bank Analyst, Citi

Transcript:

Keith Horowitz (00:00)

Generally, I think there's way too much hype on the benefits of deregulation for the banks. When you think about where there is some benefit, it's primarily on capital, and I would focus on two things. It would be GSIP reform and SLR reform.

Anne Malone (00:14)

Hello, and welcome to Research @ Citi Podcast. Today, I'll be speaking with Keith Horowitz, our U.S. Large Cap Banks analyst. I'm Anne Malone, head of North America Equity Research here at Citi. We're all back from Napa, where we held our Beyond the Basics Conference, which brings together experts in the financial-services space.

But before we dig into what came from that, let's talk about this conference and its format a bit. Keith, what makes it unique, in your mind?

Keith Horowitz (00:40)

Yeah, thanks, Anne. So, we kind of came up with this idea a long time ago because a lot of the conferences are very focused on what's happening near-term. It's an opportunity for banks to provide guidance on next quarter's earnings and really kind of focus more on the immediate term.

And what we really wanted to do was to be able to sit back and focus and kind of think about more of the intermediate strategic themes for the financial-services industry. And so that's what this conference has been about. So, we change the speaker lineup depending on what the key themes are of the day every year, and we try to get speakers people have not seen, with some really insightful insights to help people kind of think through what some of these key issues are.

And so this year was no exception. We had an exceptional lineup of speakers and a lot of great content.

Anne Malone (01:31)

So, I think of the agenda as very curated. And is that canvassing clients, talking to the other financial analysts that we have here? How do you go about setting up that agenda?

Keith Horowitz (01:43)

Yeah, so we're limited in terms of the spots. So, we try to be very selective when we think about it because we only really have spots for 14 speakers.

So, when you're limited by that, you have to be really thoughtful in terms of which ideas or themes that you want to focus on, and then you really need to kind of zero in. Also, when we send out the invites about six months in advance, we will also canvass people and ask them, you know, what would you like to see?

Obviously, you know, being in the space, we're kind of aware of what some of the key themes are. And we kind of think about this, all through the year. So now that Napa 25 is over, we think about some good speakers for 2026. So, what I tell my partners is we want to shoot for the really high-value speakers. So, you know, people who might have a low probability of coming, but that's exactly what we want.

So, we start early and we go after those targeted speakers, and that's how we kind of curate what I think is an exceptional list for people. And then the benefit also is that, we're there to moderate for the sessions, but the beauty is that because of the people that this conference attracts, generally the very intellectually curious, the audience kind of takes over and asks a lot of questions.

Anne Malone (02:52)

All right, Keith, I'll save any comments about how fabulous the weather was in Napa for the end of this. But I noticed your note is talking about disruptive trends. So why don't we start there? What did you pick up from the conference that talked about disruption for the banks or financial services?

Keith Horowitz (03:10)

Yeah. So, when you're trying to, like I said, we had 14 key speakers, also a keynote address, and you're trying to kind of think through what's the best way to kind of communicate what happened. The best way to kind of think about it was, in terms of disruptive threats for the banks that we heard.

Number one, there's a lot of concern about the payments franchise for the banks. When you think about the banks, payments is one of the highest-returning businesses for the banks, but they have some particular pain points in terms of the legacy infrastructure that it's built on as not necessarily a real-time system. That results in some potential pain points for customers and opens them up to disruption risk.

The second was a theme that came across in almost every session, which was the growth in the private credit markets, where historically banks have had a very, very large share of credit, and they've been losing some share over the years, largely to private credit, and so that was addressed as well.

Anne Malone (04:01)

So, payments, though, that must be a consistent theme, right, that we've had for years now. Is private credit the newer of those two, if you think?

Keith Horowitz (04:10)

Yeah, so I mean, historically, private credit really started, I would say, post the Global Financial Crisis, and the growth was mostly, I would say, in kind of non-investment grade loans to middle-market companies that the banks simply really didn't want to do. So it wasn't that much of an issue.

More recently, though, you've seen alternatives. There's a shift to investment-grade credit, largely due to the growth in the insurance platforms. And they've been focusing on traditional areas where the banks have been, such as asset-backed finance, such as aircraft leasing, and more recently, I would say on the corporate side for private investment grade to fund like large investments such as AI infrastructure, which a lot of times now are being done off-balance-sheet through off-balance-sheet instruments.

However, we don't view this as an existential risk to the banks. It definitely is taking on the margin some commercial lending share away from the banks. But when you think about the overall bank stocks, you know, returns is what drives it. And returns on commercial lending on a standalone basis are typically just above the cost of capital as the spreads are pretty thin and right now we've got just a lot of capital out there.

And so the beauty of this right now is that some of this is being moved off the banks, but the real disruptive risk would be if the banks were not able to maintain the operating deposits and the fee revenues, which is where they get the juice to returns.

But so far right now, the focus has really just been on the lending side, and so the bank's been able to kind of, maintain a lot of the key drivers to the higher returns.

Anne Malone (05:42)

OK. So good conversation on it, but in your mind, not the biggest risk. You said it was mentioned often on the payments franchise as well. Was there a consensus on that one?

Keith Horowitz (05:53)

So, it was a fairly technical discussion from a company called Finality. Basically, you've got the traditional banks, which people typically talk to as TradFi, and then you also have DeFi, which is basically new up-and-coming technology companies which have a more modern technology stack.

And the key, is that you want to build a model which is real time and it's 24/7. And that can happen within borders. But when you get across border, it gets a little bit complicated, especially for wholesale payments, and it could be a real pain point for customers.

And what we've seen, we've done a lot of work in the past on blockchain. Goes back to, say, 2016, and at that point, banks started to make their own investments in their own internal blockchains in terms of building their own coins.

But the problem is that it's not what we call an interoperable solution because XYZ bank who has a coin can't move that coin to another bank. What Fidelity has done is that they have built a model, I would say like a financial utility, where they sit with an account at the central bank, and they can actually act as an intermediary between the banks.

So, you can effectively create a 24/7 real-time cross-border settlement for wholesale payments with the benefits of central-bank cash. It provides a much better product for the customers, but also for the banks – you know, leverages their existing investments. It can lower their capital and liquidity requirements. And it was just a fascinating discussion.

I just want to stress that this is a wholesale payment solution on the large corporate side. That's very, very different than what we're talking about with stablecoins, which Fidelity views as more of a retail-focused solution, and that would include things like individuals moving money to say, Mexico.

Anne Malone (07:42)

OK. So, a better mousetrap to some extent.

Keith Horowitz (07:45)

A better mousetrap, but it's a way to kind of bridge that gap from everyone focuses on the banks with this legacy infrastructure and they're not going to be able to deliver 24/7 real-time cross-border settlement, but this is a mousetrap that can actually leverage the banks and provide that.

Anne Malone (08:02)

OK. From disruption to I'll call it, maybe the more mundane or the more typical of what we think about. So, I can't help but think regulation . . . deposits . . . M&A . . . had to have been discussion points. So, pick from that list to start.

Keith Horowitz (08:10)

Sure. So, look, a lot of hype on the benefits of deregulation. Myself and our partners here in research — we did a big report on it. Generally, I think there's way too much hype on the benefits of deregulation for the banks. When you think about where there is some benefit, it's primarily on capital, and I would focus on two things. It would be GSIP reform and SLR reform.

Basically, the way the rules were constructed is they're static and so, basically as banks grow, some of the larger GSIP banks grow, it leads to more and more capital. So, banks are hoping that they can fix that and calibrate those GSIP scores to move in line with

GDP. So, there's some hope there that's really sitting just with the Fed, so it's not really a complicated solution here is something that should be a relatively easy fix.

One example that JPMorgan gave during their presentation about how inefficient the process is, is it's one trade with an overseas hedge fund would have added 1.5 points to their GSIP score and would have added \$8 billion dollars of capital, which is crazy.

The other issue is SLR reform. There's a general view that if you have SLR reform — which is more of a backstop measure, I would say for the banks, there's only one real bank in our coverage who's really constrained by SLR. But one view is that SLR is going to enable banks to start buying a lot of U.S. Treasurys. I highly doubt that would happen. I think the real benefit from SLR reform is that in terms of times of stress, I think it's going to grease the wheels in terms of the ability for them to market make, in terms of trading for U.S. Treasurys, which would help the banks and the exchanges.

So that would be a benefit. But in terms of people looking for SLR reform to lead to additional bank buying of U.S. Treasurys to help push down yields, I think that's highly unlikely. And I would just say if banks wanted to buy U.S. Treasurys today, there's literally no capital charge as only one bank is constrained by SLR. And so, we don't necessarily agree with that.

The second thing I would say is just improvement on bank supervision. Basically, the ask from the banks is pretty simple. They just want greater transparency in their communications with the regulators, especially with respect to potential issues that can lead to enforcement actions down the road.

Anne Malone (10:34)

OK. Deposits had to have come up?

Keith Horowitz (10:37)

Yeah. So, deposits are the key lifeblood for the banks. It's really interesting in terms of we had some great presentations from Bank of America who we think is probably, best in class in terms of their deposit franchise, and they showed some fantastic stats.

But we also got some really good stats from a consultant called Curinos, who gave a very detailed presentation, and if people want, they could reach out to me for their slide presentations, we can send it to them.

But you know basically, what Curinos does is they see, they have relationships with the banks, and they can see account-level data on a weekly basis for over \$8 trillion in deposits. So, they can see exactly what's going on in terms of the ability for banks to kind of reprice deposits, in terms of how much ability they have. They can see where new accounts are being opened. They can look at things like M&A in terms of how much attrition there is in M&A. So, it was absolutely a fascinating discussion. And again, if people are interested, please reach out and I can send you the slides.

Anne Malone (11:35)

Great. I believe, Keith, there were a couple of exchanges that attended Napa this year. What did they have to say?

Keith Horowitz (11:42)

I think both CME and ICE really gave a pretty bullish update. They're both benefiting from the recent market volatility. CME actually noted about some positive tailwinds on the rate business.

And also, like we're talking before about SLR and in times of stress, how it can really kind of help grease the wheels for you know, additional activity, they would also benefit from that with their dealer relationships.

So overall, I would say a very constructive outlook.

Anne Malone (12:09)

OK. We probably have time for one more topic. What else stands out to you? It doesn't have to be banks-confined because I know you had a broad swath on the agenda.

Keith Horowitz (12:18)

I guess I have to go with M&A because that was one of the bigger takeaways. We had an investment banker from another firm come and talk about small-bank M&A. It was extremely bullish. The takeaway was that there's more sellers than buyers right now.

I would say, though, he also noted that the expectation is that in the past, we've seen premiums of 25% to 30% in prior cycles. This cycle, he expects the premiums to be lower.

And you know, with the new administration, there's an expectation that the approval time for these deals is likely to be coming down, which also should help accelerate some deal activity. The only thing, though, is for the large banks, M&A, I don't really expect that to really pick up. I think this is primarily mostly for smaller banks under \$100 billion in assets.

Anne Malone (13:01)

OK. We've probably eaten up the time, so we can't talk about how good the weather was out there. But why don't we wrap it up there. I really appreciate your time, and I thank everyone for joining today. This podcast was recorded on May 29th, 2025. Be sure to join us for our Research @ Citi podcast which will feature Veronica Clark, from our U.S. Economics team providing insights on fiscal policy, tariffs and lingering summer uncertainty. Something you don't want to miss. Thanks so much, everyone.

Disclaimer (13:29)

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