

NASHVILLE NOTES

Apollo Swaps Out the Banks

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By Jeff K. Davis

Jeff Davis is a veteran bank analyst. The views and opinions expressed in this piece are those of the author and do not necessarily represent the views of S&P Global Market Intelligence; Mercer Capital, where Davis is the managing director of the financial institutions group; or StillPoint Capital, where Davis is a registered representative.

A few weeks ago on the Street Talk podcast, [Keefe Bruyette & Woods Inc.](#) CEO Tom Michaud [noted a power shift](#) in US capital markets in which some nonbanks have grown at the expense of traditional banks. [Apollo Global Management Inc.](#) recently was added to the S&P 500, and Michaud speculated that [Coinbase Global Inc.](#) might be the next financial company addition.

The shuffling last summer included the addition of [KKR & Co. Inc.](#) into the index and the demotion of regional bank [Comerica Inc.](#) to the S&P 600 SmallCap. Comerica has since been promoted to the S&P 400 MidCap given the fantastic rally in bank stocks during the second half of 2024.

Based solely on market capitalization, the S&P committee probably did not deliberate very long. Comerica's market cap at the time of its demotion was around \$6 billion, versus \$87 billion for KKR and \$100 billion for Apollo when they were added. The addition of \$70 billion Coinbase might coincide with the demotion of a lower-market-cap regional, such as \$19 billion [KeyCorp](#).

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There is nothing new about private credit; it has existed since man began to barter. And disintermediation of "traditional" commercial banks has been a long-running theme.

In the 1970s, the development by Merrill Lynch of the cash management account, the predecessor to the ubiquitous money market account today, siphoned deposits from the banking system. My experience with [The Charles Schwab Corp.](#) is a microcosm of the dynamic: Idle funds earn a nominal rate until they are transferred by me to a money market that pays something close to a T-bill rate.

The rise of cash management accounts not only affected deposit franchises, but also contributed to a loss of lending to blue chip companies in the 1970s and 1980s, as more companies tapped the burgeoning commercial paper market. Aside from T-bills, high-quality commercial paper is a prime money market investment.

When the Fed approved a [Section 20 exemption](#) in 1987 for Bankers Trust (now part of Deutsche Bank), J.P. Morgan and Citicorp to engage in securities underwriting, among the first powers granted was to underwrite commercial paper. In 1989, corporate debt and equities were added, and Chemical's application was approved around the same time.

While the Section 20 exemptions were cumbersome, they allowed the Wall Street banks to operate in the more efficient capital markets. Eventually, the need for exemption relief was rendered moot by financial modernization in 1999 that

entailed the legislative repeal of Glass-Steagall.

The rise of the leveraged loan market in the past 30 years has been a testament to the banks' successful response to a changing market. Banks were able to convert leveraged lending into a capital markets model in which loans are originated, distributed to investors (technically lenders) and traded in the secondary market. Issuers and investors pick their preference between floating-rate loans and fixed-rate bonds, while banks generate fees to underwrite both.

Now the leveraged loan (and high-yield bond) franchises are under intense pressure from the rise of private credit, and it is not clear to me how the challenge will be met, other than by ceding more market share or by accepting tighter lending spreads.

Now, the leveraged loan and high-yield bond franchises are under intense pressure from the rise of private credit, and it is not clear to me how the challenge will be met.

Yes, the Trump Administration will loosen regulations, but private credit represents a high-return-on-capital model that does not rely upon government subsidized deposit insurance and is not heavily regulated. Private credit has little or no liquidity risk because the backbone of funding is long-term capital commitments from investors, and there is little asset-liability management risk because both sides of the balance sheet are mostly variable-rate.

Whereas banks obtained regulatory and eventually legislative relief in the 1980s and 1990s, the reverse has occurred in a sense during the past 15 years, aiding private credit. The post-2008 financial reforms that limited bank involvement with highly levered companies were one aspect of that. Another is the Fed's zero-interest-rate policy. Institutional capital raised its allocation to private capital to obtain better yields, a decision that proved to be prescient or lucky once the Fed raised rates.

Private credit probably would add that it can move faster than banks with price certainty, and it is easier to deal with when the borrower has issues. Hence, it can obtain somewhat higher rates from borrowers who opt for speed and flexibility.

Apollo CEO Marc Rowan offered his perspective on the competition when he was [quoted recently](#) as saying, "We do not want their clients. All we want is the asset." The good news in that statement is that the key asset for a bank is technically a liability: core deposits, which are not in the private credit wheelhouse.

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