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Citigroup’s Muni-Market Exit Sows Fears of a Wall Street Retreat.

- **Bank shuts down businesses, seeing it as a drag on growth**
- **Follows UBS, steady disappearance of local investment banks**

For years, small investment banks have been pulling out of the business of underwriting municipal bonds, leaving the job of raising money for US state and local governments dominated by Wall Street’s giants.

Now, there’s concerns that the big banks may start dropping away, too.

Citigroup Inc.’s announcement Thursday that it is shutting down its municipal-bond division highlighted the pressures on a corner of finance contending with diminished fees, a debt-sales slowdown and pushback from local Republican politicians intent on drawing banks into America’s culture wars. Chief Executive Officer Jane Fraser indicated that underwriting state and local debt was, effectively, too big a drag on the bottom line, unable to compete with more lucrative lines of work. UBS Group AG made a similar decision in October.

Citigroup’s departure is unlikely to have any immediate repercussions, since others will almost certainly fill the void, at least temporarily.

But it underscores the steady shift of capital away from the business. That’s raised concerns that a further retreat could make it more costly for local governments to finance infrastructure or increase the risk of a liquidity squeeze as big banks that backstop the market pull out. Broker dealers have already retreated sharply from that role as buyer of last resort, reducing their holdings of state and local government bonds sharply since the 2008 credit crisis.

“Over the next five to seven years, we are going to need more firms, not fewer, just to process all the bonds,” said Matt Fabian, a partner at Municipal Market Analytics, predicting that debt sales will rise as interest rates slide and governments step up borrowing for public works. “Citi leaving now is not just that firm walking away from this business upside – it also means the incremental cost to borrowers in the future will be higher.”

A spokesperson for Citigroup referred Bloomberg to the memo released on Thursday.

Citigroup has been a major force in the municipal-bond market and as recently as 2021 was the second-biggest underwriter, accounting for roughly 10% off all the new securities that were sold. It worked on landmark projects including the rebuilding of the World Trade Center site and the installation of 65,000 streetlights around the city of Detroit and was the envy of rivals.

But its longtime chief, Ward Marsh, left in 2019. Layoffs, retirements, and other departures shrank the public finance department to about 120 people, down from around 400 employees at one point, according to two former employees who declined to be identified. As the Fed’s rate hikes depressed debt sales, it continued to lose market share, sliding to the seventh biggest this year.

Still, the decision to shut down the business completely was a surprise, given its still prominent role. In 2022, it underwrote nearly $27 billion of long-term municipal bonds.

Washington State Treasurer Mike Pellicciotti said in a statement that the bank's departure was unfortunate. "We've particularly appreciated Citi's dependable participation in our competitive sales, where they have frequently provided the best bid," he said.

The bank has also long been revered for its trading arm and its willingness to take risks during market dislocations.

"Citi has historically been a huge liquidity provider for a lot of the names that have shown up in headlines over the last ten or twenty years," said Nicholos Venditti, senior portfolio manager at Allspring Global Investments. "It's difficult to imagine that any combination of regional broker dealers, even cumulated, would have the same balance sheet power that Citi has."

The decision comes as underwriting fees have been under continued pressure and banks have pulled back from trading in the securities.

While banks have often utilized their role in financing public-works projects to deflect criticism of casino capitalism, Republicans more recently have seized on it to drawn them into America's culture wars.

Citigroup was banned from working on muni deals by Texas Attorney General Ken Paxton, who said the bank's policies ran afoul of its law barring work with those who are hostile to the gun industry. Due to its fast-growing population, Texas is the biggest source of new municipal bonds, accounting for 16% of overall issuance in 2023.

Even though it's exiting the underwriting business, Citigroup will still be a buyer of municipal bonds, like other banks who invest in the securities. The Wall Street giant holds nearly $10 billion of state and municipal debt securities, according to regulatory filings. The vast majority of that is classified as held-to-maturity.

But the expectation on muni desks is that Citigroup will unload the inventory it holds as a broker-dealer. That won't likely have a major impact, since such dealers have steadily cut back their holdings and support of the market after the financial crisis ushered in new regulations.

Still, Citigroup still served as an important liquidity provider and was "one of our first phone calls when we were doing business," said Jason Appleson, head of municipals at PGIM Fixed Income.

"It's going to hurt," Appleson said. "People will step up and fill the void in some way, but I don't think it's going to be fully plugged."

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