TRANSCRIPT

Citi Second Quarter 2011 Earnings Review
July 15, 2011

Host
John Andrews, Head of Investor Relations

Speakers
Vikram Pandit, Citi Chief Executive Officer
John Gerspach, Citi Chief Financial Officer

PRESENTATION

OPERATOR: Hello and welcome to Citi's Second Quarter 2011 Earnings Review with Chief Executive Officer, Vikram Pandit and Chief Financial Officer John Gerspach. Today's call will be hosted by John Andrews, head of Citi Investor Relations. We ask that you please hold all questions until the completion of the formal remarks, at which time you will be given instructions for the Q&A session. Also as a reminder, this conference is being recorded today. If you have any objections, please disconnect at this time. Mr. Andrews, you may begin.

JOHN ANDREWS: Sarah, thank you very much, and good morning to everybody. Thank you for joining us this morning. On our call today, we'll start off with Vikram, our CEO, who will give you an overview of the quarter. And then John Gerspach, our CFO, will take you through the earnings presentation, which is available for download on our website, www.citigroup.com. Afterwards, we will be happy to take your questions. Before we get started, I would like to remind you that today's presentation may contain forward-looking statements which are based on management's current expectations, and are subject to uncertainty and changes in circumstances. Actual results and capital and other financial condition may differ materially from these statements due to a variety of factors, including the precautionary statements referenced in our discussion today and those included in our SEC filings, and including, without limitation, the risk factors section of our 2010 Form 10-K. With that out of the way, now let me turn it over to Vikram.

VIKRAM PANDIT: John, thank you, and good morning everybody. Thank you for joining us today. We announced earnings of $3.3 billion for the second quarter, which brings our total net income for the first half to $6.3 billion. This was another solid quarter of operating performance as we continued to execute our strategy and invest in our franchise.

Loans grew throughout our core businesses in the second quarter at a level that more than offset the reduction in Citi Holdings. The revenues from our International Consumer Banking operations increased from the previous quarter and year, as did the net income from the North American Consumer Bank. In our institutional businesses, investment, corporate and private banking revenues improved. Global Transaction Services performed very well as net income increased from the previous quarter despite continued low interest rates. However, our markets business was clearly impacted by the trading environment.

In Citi Holdings, we continued the reduction of assets in an economically rational manner. Our Holdings assets were reduced by $29 billion during the quarter, from $337 billion to $308 billion, and now make up less than 16% of Citigroup's balance sheet.

We remain on track to meet the Basel III capital requirements through both the optimization of our assets and the generation of capital. We continue to expect that Citi will be in a position to return capital to shareholders in 2012, and still have a 8% to 9% Basel III Tier 1 Common capital ratio at the end of that year. As we'll show later in the presentation, and John Gerspach will take you through this, our earnings and utilization of deferred tax assets create a “multiplier effect” on regulatory capital formation. In the first half of this year, this generated $9 billion of Basel III regulatory capital on $6.3 billion of earnings and $1.5 of DTA utilization. Looking forward, while we are comfortable with the broader macro economic trends that underpin our strategy, we are concerned with the impact the near-term economic environment will have on the industry for the second half of the year. But that said, we are consistently profitable and remain focused on growing responsibly. Let me turn it over to John, who will take you through our presentation, and then we'll come back to the Q&A later.

JOHN GERSPACH: Thank you, Vikram. Good morning everyone. Starting on Slide 2, Citigroup reported second quarter net income of $3.3 billion or $1.09 per diluted share versus $0.90 per share in the second quarter of 2010. Revenues of $20.6 billion were down 7% versus the prior year, as strong growth in International Consumer Banking and Transaction Services was more than offset by lower revenues in Citi Holdings, Securities and Banking, and North America Consumer Banking. Expenses were up 9% year-over-year to $12.9 billion. But excluding the U.K. bonus tax of roughly $400 million in the second quarter of 2010, expenses were up nearly 13%. Approximately one third of this 13% increase resulted from the impact of foreign exchange, and another third was related to higher legal and related costs. The remaining third was driven by the net impact of investment spending, partially offset by ongoing productivity savings. All other expense increases, such as higher volume-related costs in Citicorp, were largely offset by a reduction in Citi Holdings expenses. Net credit losses declined again in the second quarter to $5.1 billion, 35% lower than the second quarter of 2010. We also released $2 billion of net loan loss reserves compared to a $1.5 billion net release last year and a $3.3 billion in the first quarter. On a sequential basis, end-of-period loans grew 2% for Citigroup, as strong loan growth in Citicorp more than offset the decline in Citi Holdings.

Turning now to Citicorp and Citi Holdings on Slide 3, Citicorp reported revenues of $16.3 billion and net income of $3.7 billion in the second quarter, down slightly versus last year. Sequentially, we grew end-of-period loans in every business in every region in Citicorp, and the same holds true year-over-year with the exception of North America branded cards. Versus last year, Citicorp loans grew 16%, including 11% growth in consumer and 22% growth in corporate loans. Citi Holdings reported revenues of $4 billion and a net loss of $218 million, which included over a half billion dollars of pretax realized gains on the sale of assets transferred out of held-to-maturity in the Special Asset Pool in the first quarter. Citi Holdings ended the quarter with $308 billion of assets, down $29 billion during the quarter and $157 billion year-over-year.

Now on Slide 4, we show a nine quarter trend for Citicorp's results. Excluding CVA, Citicorp's revenues of $16.2 billion in the second quarter were flat versus the prior year. Sequentially, revenues were down 3% as growth in Regional Consumer Banking and Transaction Services was more than offset by lower revenues in Securities and Banking. Operating expenses of $10.1 billion were up 10% versus the prior year. But again, excluding the U.K. bonus tax in the second quarter of 2010, expenses were up 14%. Over one quarter of this 14% increase resulted from the impact of foreign exchange. The remainder was primarily driven by investment spending. All other expense increases, such as higher volume-related costs, were largely offset by ongoing productivity savings. Citicorp's net credit losses were $2.2 billion, down 27% from the prior year, driven by Citi-branded cards in North America. We released $914 million in net loan loss reserves, up from $665 million last year, due to higher net releases in Citi-branded cards, partially offset by lower releases in International Consumer Banking and the corporate portfolio. Excluding CVA, earnings before taxes of $4.9 billion were up 3% year-over-year as lower credit costs more than offset higher operating expenses.

Emerging markets continued to be a significant driver of Citicorp results, as shown on Slide 5. Excluding CVA, emerging markets contributed nearly half of Citicorp's revenues and over 60% of earnings before taxes in the second quarter. Emerging markets revenues have grown year-over-year for five consecutive quarters, driven by both our consumer and institutional businesses. This growth reflects consistent strength in underlying business drivers, with average deposits up 13% year-over-year and loans up 27%.

Slide 6 shows results for our North America Consumer Banking business. Revenues of $3.4 billion were down 9% versus last year, mainly due to a decline in average card loans, lower mortgage revenues, and the impact of CARD Act. Sequentially, revenues were up 1%. Expenses of $1.8 billion were up 17% year-over-year and 5% sequentially as we continued to increase investments largely through higher marketing and technology spending. Credit costs declined 74% from last year to $552 million. Net credit losses were down 39% to $1.3 billion, driven by Citi-branded cards and the reserve release was $757 million this quarter. Net credit margin grew by 32% year-over-year to $2.1 billion. Sequentially, we grew both end-of-period retail and card loans, although average card loans declined modestly. On a year-over-year basis, purchase sales grew 2% while card accounts were roughly flat.

Turning to our International Consumer Banking businesses on Slide 7, international revenues were $4.8 billion in the second quarter, up 12% year-over-year with growth in all regions. Revenue growth reflects continued improvement in underlying drivers as well as the benefit from foreign exchange, partially offset by spread compression. Year-over-year, average deposits and loans grew by 17% and 20% respectively. Investment sales were up 5% versus last year, and card purchases grew 28%. Expenses were $3 billion in the second quarter, up 19% versus last year, with over a third of the increase due to the impact of foreign exchange. The remainder primarily reflects higher investment spending and volume-related costs, partially offset by continued productivity savings. A lower net reserve release resulted in an increase in credit costs, up 52% year-over-year to $629 million. Net credit losses declined 12% to $697 million, while the net loan loss reserve release was $90 million this quarter versus $403 million in the prior year. Higher revenues and lower net credit losses resulted in net credit margin expansion, up 17% year-over-year to $4.1 billion.

On Slide 8, we show growth trends for International Consumer Banking in more detail. International growth reflects both the economic environment in these markets as well as the results of our investment spending. Sequentially, we have grown average loans and deposits every quarter for over two years, and card purchase sales have increased year-over-year for seven quarters. We have also increased our net credit margin and our earnings-before-taxes, excluding the impact of loan loss reserves, year-over-year for seven consecutive quarters.

Slide 9 shows our Securities and Banking business. Excluding CVA, revenues of $5.3 billion were down 7% from last year and down 15% versus the prior quarter. In investment banking, revenues of $1.1 billion were up 27% sequentially, with strength in both advisory and underwriting activities. Ex-CVA, equity market revenues of $776 million were down 30% sequentially, mainly due to lower market volumes and a challenging trading environment, particularly in derivatives. Fixed income market revenues ex-CVA were down 27% sequentially to $2.9 billion, driven by credit-related and securitized products. Our rates and currencies business showed a much smaller revenue decline as lower G10 revenues were partially offset by growth in emerging markets. Lending revenues were $346 million, up from $244 million last quarter due to lower hedge losses. Private Bank revenues, excluding CVA, were up 7% sequentially to $555 million. Total operating expenses of $3.9 billion were down 1% from the second quarter of 2010. Excluding the impact of the U.K. bonus tax last year, expenses were up 9%, mainly due to investment spending, partially offset by productivity savings. Credit costs were $59 million in the second quarter compared to a benefit in the prior year period.

Now moving to Transaction Services on Slide 10, revenues of $2.7 billion were up 6% from the second quarter of last year, driven by growth in the emerging markets. Treasury and Trade Solutions was up 6%, primarily due to higher trade revenues and increased deposits, partially offset by spread compression. Securities and Fund Services grew 6% year-over-year, driven by strong growth in custody and securities lending on new client mandates as well as market activity. Transaction volumes and new mandates continued to show momentum in both businesses. Asset growth was driven by trade loans, with average trade assets up 70% from last year. Average deposits grew 14% year-over-year to $365 billion with a favorable shift towards core operating balances. Assets under custody were up 19% to $13.5 trillion as a result of market and client activity. Expenses of $1.4 billion were up 18% versus last year, reflecting higher volumes and continued investments, partially offset by productivity savings.

On Slide 11, we show a nine-quarter trend for Citi Holdings. The loss in Citi Holdings narrowed to $218 million in the second quarter, which included over $500 million of realized pretax gains on the sale of assets transferred out of held-to-maturity in the Special Asset Pool in the first quarter. Revenues were down 18% year-over-year to $4 billion due primarily to lower assets. While expenses of $2.2 billion were down 9% versus last year, sequentially, costs were up $185 million primarily due to higher legal and related costs. Total credit costs were down by more than half to $2.1 billion.

Looking at Citi Holdings in more detail on Slide 12, revenues in Brokerage and Asset Management were $47 million this quarter, down from the second quarter of 2010, reflecting a lower contribution from the Morgan Stanley Smith Barney JV. In Local Consumer Lending, revenues were down 30% versus last year to $2.9 billion, driven by declining loan balances. In the Special Asset Pool, revenues were $1 billion in the second quarter, reflecting the previously mentioned realized gains on the sale of assets transferred out of held-to-maturity last quarter, as well as realized gains on other asset dispositions. Credit costs were down by more than half year-over-year to $2.1 billion, as credit trends continued to improve in both the consumer and corporate portfolios. Total net credit losses were down 40% to $3 billion, and we released $1.1 billion of net loan loss reserves in Citi Holdings.

Slide 13 shows the Citi Holdings assets. We ended the quarter with $308 billion in Citi Holdings, or 16% of total Citigroup assets. The $29 billion reduction in the second quarter was comprised of nearly $21 billion of asset sales and business dispositions, over $7 billion of net run-off and paydowns, and roughly $1 billion of net cost of credit and net asset marks.

On Slide 14, we show the drivers of Citi Holdings' wind-down over the past ten quarters. Net credit cost and net asset marks are down dramatically since early 2009, representing only $2 billion of net decline in the first half of 2011. The next largest component is net run-off and paydowns, which have gradually declined as the remaining portfolio has gotten smaller. Finally, the most significant driver has been asset sales and business dispositions. As we have discussed previously, there is a smaller pool of assets available for sale today than in prior periods. Additionally, there are only a few remaining businesses of significant size, and future sales activity would depend on both attractive terms and a favorable funding environment.

Moving to Slide 15, we take a closer look at the remaining assets in Citi Holdings. Brokerage and Asset Management is mostly related to the Morgan Stanley Smith Barney JV. Morgan Stanley has calls to purchase our stake in the JV in three tranches beginning in 2012, and either party has the right to cause an IPO after 2015. We have also roughly $12 billion of margin loans and other assets, the majority of which should transfer to the JV by the end of 2012. Local Consumer Lending is a mix of operating businesses and run-off portfolios. Two sizable operating businesses remain: first is Retail Partner Cards with $45 billion of assets; second is Citi Financial with $32 billion of assets, including both the One Main business and Citi Financial Servicing. On Slide 15, these assets are included in both mortgages and personal loans. The majority of assets in Local Consumer Lending will either run-off or be reduced by smaller sales. Over half of the assets are mortgages, with a roughly six-year expected average life. The Special Asset Pool consists of securities, loans and other assets. Roughly $19 billion are trading assets or available-for-sale; $13 billion are held-to-maturity securities with an expected average life of seven years; $7 billion are loans and leases which we currently expect to reduce significantly by the end of next year; and the remainder is other assets, including private equity positions, targeted for sale.

Slide 16 shows the results of the Corporate Other segment. Here, revenues declined by $400 million versus last year, reflecting lower investment yields and the impact of hedging activities, partially offset by the gain on sale of a portion of our stake in HDFC this quarter. Net income also reflects higher operating expenses during the quarter. Expenses were up by $415 million versus last year, mainly due to legal and related costs. Assets of $269 billion include approximately $78 billion of cash and cash equivalents, and $130 billion of liquid available-for-sale securities.

Slide 17 shows total Citigroup net credit losses and loan loss reserves. NCLs continued to improve in the second quarter, down 18% sequentially to $5.1 billion, and the net LLR release was $2 billion versus $3.3 billion in the prior quarter. We ended the quarter with $34.4 billion of total loan loss reserves and our LLR ratio was 5.4%. Consumer NCLs declined 11% sequentially to $4.8 billion, and we released $1.5 billion in net loan loss reserves. Corporate credit was a benefit of $107 million in the second quarter compared to $520 million last quarter. Corporate net credit losses were down 59% sequentially to $349 million, driven in part by lower cost of loan sales. We released $456 million of net corporate loan loss reserves, down from $1.4 billion in the first quarter. Corporate non-accrual loans of $4.8 billion were down 12% versus the prior quarter.

Slide 18 shows our international consumer credit trends. In Citicorp, as our loan portfolios grew, dollar NCLs were up modestly from the first quarter in Asia and Latin America, but remain stable-to-improving on a rate basis. Ninety-plus-day delinquencies also increased sequentially in dollar terms in Asia and Latin America, but remained fairly stable as a percentage of loans. We also saw a continued improvement in international consumer credit in Citi Holdings.

On Slide 19, we show North America Citi-branded cards in Citicorp and Retail Partner Cards in Citi Holdings. Credit trends for both portfolios continued to improve. In Citi-branded cards, NCLs decreased by 9% sequentially to $1.2 billion, and 90+ day delinquencies were down 16% to $1.2 billion. In Retail Partner Cards, NCLs decreased by 14% sequentially to $956 million, and 90+ day delinquencies declined by 18% to $1.1 billion. For both portfolios, early stage delinquencies also showed improvement on both a dollar and a rate basis.

On Slide 20, we show the North America mortgage portfolio in Citi Holdings, split between residential first mortgages and home equity loans. NCLs and 90+ day delinquencies improved in both portfolios in the second quarter. In residential first mortgages, we ended the second quarter with $73 billion of loans, down 19% from a year ago. Sequentially, 90+ day delinquencies declined by 13% to $3.9 billion and were down more than 50% from last year. Net credit losses were down 17% sequentially to $461 million. The sequential decline in first mortgage delinquencies again was primarily due to continued asset sales, as we sold nearly $800 million in delinquent mortgages in the quarter.

Regarding modification activity, over the past nine quarters, we have converted $5.7 billion of trial mods to permanent modifications. More than three quarters of these modifications were HAMP, and we continue to experience re-default rates on HAMP-modified loans of less than 15%. The remainder were modified under other Citi programs, and to date, the re-default rate on these modifications has been less than 25%. In recent quarters, the pace of our modification activity has slowed. Going forward, we expect fewer new modifications, while some portion of our previous modifications will re-default. As a result, delinquency trends may deteriorate. However, this is already factored into our net loan loss reserve balances.

In the second quarter, we recorded a modest increase in our net loan loss reserves primarily related to home equity loans. We ended the quarter with roughly $10 billion of our total loan loss reserves allocated to North America real estate lending in Citi Holdings, or over 27 months of coincident NCL coverage. Now for our total North America consumer mortgage portfolio, including Citi Holdings as well as $27 billion of residential first mortgage and home equity loans in Citicorp, our reserves also cover over 27 months of NCLs.

Slide 21 shows the trend in our key capital metrics. We ended the quarter with a Tier 1 Capital ratio of 13.6% and a Tier 1 Common ratio of 11.6%. Our total risk-weighted assets were $992 billion, with roughly 28% attributable to Citi Holdings.

Looking at risk-weighted assets in more detail on Slide 22, over the past few quarters, Citigroup's risk-weighted assets, as reported under Basel I, have been fairly constant as growth in Citicorp has been offset by a significant reduction in Citi Holdings. We currently expect risk-weighted assets under Basel I to grow slightly, by low single digits, as of the end of 2012.

Based on our initial analysis, last year we estimated that Basel III would result in an increase in risk-weighted assets in Citicorp of approximately 30% to 35%. Today we believe the increase in risk-weighted assets for total Citigroup will be in the range of 35%, with Citicorp's risk-weighted assets increasing in the range of 20%. The refinement in our estimate of the risk-weighted asset impact is based on several factors, including greater experience with Basel III risk models and key drivers, and more clarity on the impact of mitigating actions. We believe our businesses in Citicorp are inherently Basel III-friendly.

For Regional Consumer Banking and Transaction Services, we expect only a slight increase in risk-weighted assets under Basel III. In Regional Consumer Banking, we serve a customer base with generally higher credit quality, which positively affects our risk weightings. Transaction Services is an asset-like business with relatively little credit risk. As expected, the greatest impact of Basel III will be on our risk-weighted assets in Securities and Banking. Of course, we will continue to refine our estimates of risk-weighted assets under Basel III as additional clarity and guidance becomes available.

Turning to capital generation on Slide 23, in the first half of 2011, Citigroup earned a total of $6.3 billion in net income. We also utilized $1.5 billion of DTA. Under Basel III, we deduct a significant portion of our DTA from our equity when calculating Tier 1 Common capital. Therefore, utilizing DTA generates regulatory capital by reducing the size of the DTA, and hence its deduction from equity. In addition, both earnings and the DTA usage also create a “multiplier effect “on the growth of regulatory capital. Under Basel III the inclusion of DTA, mortgage servicing rights, and unconsolidated investments and financial subsidiaries is subject to limitation based on a percentage of Tier 1 Common capital. Therefore, any growth in Tier 1 Common capital results in a larger portion of these assets being included in Basel III regulatory capital. The combined impact of earnings, DTA usage, and the "multiplier effect" generated $9 billion of Basel III Tier 1 Common capital in the first half of 2011. Additionally, over time, we expect to continue to generate capital from the wind-down of Citi Holdings as well as other mitigating actions. We expect to end 2012 with an 8% to 9% Tier 1 Common ratio under Basel III as fully implemented, including the impact of returning capital to shareholders during the year. In summary, we continued to execute our strategy in the second quarter.

Now, I'd like to discuss some factors which may affect our results in the second half of 2011. In North America Consumer Banking, we expect revenues to continue to stabilize in the second half of the year, while net credit losses should continue to improve. We will also continue to invest in the business. In International Consumer Banking, our investment spending should continue to generate revenue growth. We currently expect both Asia and Latin America Consumer Banking to achieve positive operating leverage in the fourth quarter of this year. International credit costs are likely to continue to increase in the second half of the year, reflecting a growing loan portfolio. In our institutional businesses, Securities and Banking results will continue to reflect trends and client activity, global market conditions, and seasonal factors. Transaction Services should continue to benefit from increased volumes and the globalization of trade and capital flows, partially offset by continued spread compression. Corporate credit costs are expected to increase, reflecting growth in corporate loans. In Local Consumer Lending in Citi Holdings, revenues should continue to decline, given a shrinking loan balance resulting from paydowns and continued asset sales.

Regarding operating expenses, the impact of the weakening U.S. dollar, as well as higher legal and related costs, total roughly $1.6 billion out of the $1.9 billion increase in our expense base in the first half of 2011 as compared to the first half of last year. These factors will likely continue to affect our expenses in the second half of this year and will remain difficult to predict. Therefore, we expect operating expenses to remain elevated for the remainder of the year. As a result, our full year operating expenses will likely exceed the $48 billion to $50 billion guidance that we had communicated previously.

That concludes our review of the quarter, and Vikram and I will now open up the line for questions.

OPERATOR: At this time, ladies and gentlemen, if you would like to ask a question, please press star and the number 1 on your telephone keypad. Your first question comes from the line of Glenn Schorr with Nomura.

GLENN SCHORR: Hi there. First question is combining the Slides 14 and 22, and I just want to make sure I'm reading it correct. If you look and see the recent run rate of, call it, $40 billion to $50 billion of organic paydown and run-off in Holdings, and combine that with the 1.75 multiplier -- I just want to make sure -- that looks like you can get anywhere from $70 billion to $100 billion of risk-weighted assets in natural run-off on an annual basis. I'm reading that correct?

JOHN GERSPACH: You know, I haven't done that math, Glenn, I have to admit. But if you take a look at the way the assets are declining, again, the way we look at the asset decline, we would expect the Basel III "multiplier effect" on those remaining Holdings assets to be about 1.75x at the end of next year. And how you get to that 1.75, or how you think of terms of where we end up in assets, is also going to depend on where you think we end up in total asset mix of Citi Holdings' assets.

GLENN SCHORR: Right. Right, right. And I guess I can't get a comment on progress on Citi Financial and private label cards, because that's kind of in motion. Is that fair?

JOHN GERSPACH: That's fair…fair that you can't get a comment.

GLENN SCHORR: I understand. Slide 26, on your exposure to the GIPSIs, formally known as the PIIGS, I just want to make sure I'm reading this correct also. Of the $13 billion in net exposure, only $1 billion is to sovereigns -- or a little more than $1 billion -- and that next comment is what I want clarification on. Is 70% of the $6 billion to financial institutions subs that are non-GIPSI subs to outside the GIPSI region, right?

JOHN GERSPACH: Let me give you an example of something that might be contemplated by that comment, all right? Say that we had a deposit in a branch, a separately capitalized sub of one of the GIIPS banks, offshore, out of the GIIPS zone, but that deposit was guaranteed by the parent company in one of the GIIPS countries. We would count that in the $6 billion as being part of the exposure merely because it's covered by a parent company guarantee.

GLENN SCHORR: Got it. Okay. And then the net takeaway of Slide 26 is that you feel like you're in pretty good shape, and you've been preparing for this, and netting your exposure, right -- even your unfunded exposures, the large multinationals? That's the net takeaway we're supposed to take away, correct?

JOHN GERSPACH: Well, you can draw your own conclusion, but obviously, we've been telling you that we thought the exposure was manageable. Now we've provided you more detail. And it's obviously been something that we've been working for a long time. And above that, Glenn, we think that this exposure as it is today, it's an appropriate number given our size, our stature, and our business model.

VIKRAM PANDIT: But let me add one thing to that. I think what Glenn's talking about is in some ways getting a handle on, is this appropriate business? And what is appropriate business? And that's exactly the reason, Glenn, that we have provided you with the appropriate amount of transparency to sort of get beyond the headline numbers. And so for example, you talked about the sovereign exposure a little bit more than $1 billion, well that number has come down a lot over time, and we've gone through that process over the last few quarters. On the other hand, you asked about the financials. That's an interesting one, because let me tell you what we did last quarter. We worked with some of the financial institutions in the region to create lending that is collateralized and secured and in other subsidiaries in other parts of the world. Now that is the right thing and the right kind of business. It's right for our clients. It's right for our investors. It's right for our shareholders. And there are going to be other great opportunities that are considered by us to be appropriate business, but that will get picked up in some of these numbers, which is why differentiation and transparency is important as well here. And we've also given you, as you know, a breakdown between funded and unfunded lines. You know very well the conditions that are required to be met by borrowers before they draw unfunded lines. And as you can see, a lot of that exposure is to multinational clients as well. So differentiation is important. I think the question you've asked is important, and that's why we've given you this kind of transparency, and I really think that's the kind of transparency you should expect.

GLENN SCHORR: Okay, and just a quick one to wrap up. Vikram, you've mentioned you're concerned about the economic impact on the industry for the second half. Maybe just a little clarification to spoon feed -- how could that manifest itself to the industry? It just means slower growth for everybody. Is that your point?

VIKRAM PANDIT: Well it's uncertain growth, is what the notion is, and you watch what's going on around the world as well as anybody else on this call. There is just a lot of uncertainty out there. It may not be uncertainty that leads to any kind of crisis, but it is a kind of uncertainty that can affect people's confidence and can affect trading volumes in the market. It can affect how spreads go on. And we think it's that kind of uncertainty, while we all hope gets resolved soon, is likely to last through the rest of the year. And that doesn't necessarily affect all the underlying trends in terms of the emerging market consumer. All of the underlying themes are still intact, but near-term, we just think there's a lot of uncertainty that could undermine confidence and affect volumes and affect the kind of growth one could see. Now that could turn too. If you had more certainty in certain aspects of the world, you could see the risk rate on as well. So that's really the point.

GLENN SCHORR: Got it. Thank you very much.

OPERATOR: Your next question comes from the line of Jason Goldberg with Barclays Capital.

JASON GOLDBERG: Thank you. Just, I guess, a follow-up. I thought the disclosure of 14 and 15 on the Citi Holdings run-off was helpful, and I guess you commented that it slowed. It looks like it's kind of now down to like the high, single-digit-type, billion-dollar, per-quarter, run-off pace. Is that kind of what we should expect going forward, just from paydowns and losses?

JOHN GERSPACH: Well, I think as the portfolio continues to shrink, the paydowns will reduce as well, as a percentage. So again, we've tried to give you enough on page 14 and page 15 that you can kind of conduct your own analysis.

JASON GOLDBERG: Okay. And then you gave us the denominator, but I guess on the numerator on Basel III, where would you peg Tier 1 Common today on a dollar basis versus where you would see it under Basel III? -- And maybe just some similar color there.

JOHN GERSPACH: Yeah, and what we said there, Jason, is that, as we've been saying, we intend to operate at an 8% to 9% Tier 1 Common range under Basel III by the end of next year. That's our target. That's been our target for the last nine months, and we've been consistent with that because we think that that's the right level of capital for us to have. And that's what we're working towards for next year.

JASON GOLDBERG: Got it. And then just lastly, you commented about the operating expenses being above your prior guidance. Would you care to put a new bracketed range on that?

JOHN GERSPACH: I'll tell you, Jason, given the continued weakening of the dollar and the uncertainty surrounding the industry regarding litigation matters, I would say that what you should do is take a look at where we are today and figure that we're going to be around those levels going forward, subject again to whatever might happen with the dollar and those litigation matters.

JASON GOLDBERG: Got it. Thank you.

OPERATOR: Your next question comes from the line of Jim Mitchell with Buckingham Research.

JIM MITCHELL: Hey, good morning. Quick question on the Basel III target. You mentioned that's inclusive of buybacks or dividends or both. Can you give any kind of indication of what that magnitude is that is contemplated in that target, or is it mostly buyback?

JOHN GERSPACH: We're not going to get ahead of ourselves here. We're looking to, as we said, we expect to be able to return capital to shareholders next year, but we're not going to start to comment yet as to what the size or the timing of that may be.

JIM MITCHELL: Fair enough. But do you think, is it mostly buyback-oriented or dividend-oriented, do you think?

JOHN GERSPACH: Same comment. I think we're a little early in trying to structure how that divide might work. Obviously, given where our stock is trading, when you have stock trading below book value, below tangible book value, that would certainly color your thinking.

JIM MITCHELL: Yep. Fair enough. And then maybe on the assets in Holdings, it was helpful in terms of the table and how to think about the wind-down. Can you maybe give some help on how to think about the risk-weighted assets? What is heavier, I guess, in Citi Holdings, in terms of the risk-weighted assets under Basel III versus what is lighter? So is it mortgages that are the biggest hit, or is it the Special Asset Pool? And we can kind of draw our own conclusions on the pace of run-off on the individual assets.

JOHN GERSPACH: Well, Basel III certainly puts a premium on any type of asset that's resulting from a securitization. And so that would sort of draw your attention to more of assets that are in Special Asset Pool.

JIM MITCHELL: Right. So to the extent that you can move those down more quickly, that could be helpful?

JOHN GERSPACH: That would be the logical conclusion, yes.

JIM MITCHELL: Right. Okay, and one last question on the legal expenses. Can you give us a sense of what that might have been in the quarter so we can just sort of make our own projections on how to think about what's kind of the run rate? And then on top of that, what's the legal expenses in 2Q?

JOHN GERSPACH: Again, I think what we're talking about is the growth in the legal expenses year-on-year. As we've said, the litigation and related matters added roughly $900 million to our expense base in the first half of this year compared to the first half of last year. And so that's about the level that we're looking at.

JIM MITCHELL: But we don't know what it was last year, so we don't know the absolute number.

JOHN GERSPACH: No, and I'm not going to go into exactly what we had baked into what last year was.

JIM MITCHELL: Okay. All right. Well, thanks a lot.

OPERATOR: Our next question comes from the line of Guy Moszkowski with Bank of America.

GUY MOSZKOWSKI: Good morning.

JOHN GERSPACH: Hi, Guy.

GUY MOSZKOWSKI: On some of those expenses, I think I heard you say that basically all of the increase in Citi Holdings' quarterly expense, which was about $200 million up from last quarter, was due to those legal expenses. Is that right?

JOHN GERSPACH: That's what we said, yes.

GUY MOSZKOWSKI: Okay. And you think that we should run that forward at around that level for the remainder of the year. Is that right?

JOHN GERSPACH: No, I'm not going to say that you should run those Citi Holdings expenses, at least that level of litigation in Citi Holdings.

GUY MOSZKOWSKI: And are you going to be trying to -- do you think you will be able to achieve any reductions in the underlying operating expense in Citi Holdings over the remainder of the year? Because it looked like there was pretty good progress in the earlier part of this year there, and then obviously, you've kind of given some of that up with these legal expenses.

JOHN GERSPACH: Yes, and we continue to drive down the Citi Holdings' expenses as we drive down assets. And I think we do have a pretty good track record, and you should assume that as we continue to drive down the assets in Citi Holdings, we will get expense saves coming out of the business. That is clearly the way that we are operating Citi Holdings. And to your point, we had a little bit of a bump on the road this quarter due to some legal and related costs.

GUY MOSZKOWSKI: Okay. In Citicorp, in Securities and Banking, obviously we don't get a lot of color on what the expenses are. But it looks like overall, your expense load went up about $100 million, even though your revenues fell sequentially by about $500 million. What's going on there? Have you added fixed costs? Were there some one-time items there that we should be thinking about?

JOHN GERSPACH: No. There's no significant one-time item that I can recall hitting Securities and Banking, and what we've said is we are continuing to build out the banking franchise, so there was some add there. I'd say that we're roughly two-thirds through what we want to accomplish as far as building out the banking franchise. And that's about it, as far as anything significant that would have gone into Securities and Banking.

GUY MOSZKOWSKI: Okay, fair enough. The Brokerage and Asset Management unit, obviously mostly driven by Morgan Stanley Smith Barney, was the decline that we saw there really largely revenue and volume-related? Was there anything with respect to sort of an expense share between yourselves and Morgan Stanley, which I know sometimes has bumped the numbers around? Or was this really just the underlying environment?

JOHN GERSPACH: No. It's a little bit of the underlying environment, but don't forget that because of the way the JV works, there are certain deposits that feed the JV, and then with the increase overall in FDIC assessment, that also works its way through the JV. And so that did have an impact on it as well.

GUY MOSZKOWSKI: Okay, that helps. Now in Citi Holdings, the net interest revenue went negative. Is that sort of an anomaly with respect to the asset sales that took place or something? Or in fact, with the asset sales that have taken place, should we now expect that maybe that's a permanent fixture of that business, that negative carry?

JOHN GERSPACH: Yeah, that's a great question. Obviously, as we continue to drive down yielding assets in Citi Holdings, and in this quarter, as you said, we got rid of that $13 billion of securities that we had in the held-to-maturity. That is certainly going to impact the net interest income coming out of both the Special Asset Pool as well as Citi Holdings in total.

GUY MOSZKOWSKI: So should we think that that's a sort of a negative carry going forward, or was that somewhat anomalous, but we should obviously take into account that with assets lowered, net interest income will be lower no matter what. What's the best way to look at it?

JOHN GERSPACH: Again, I'm not going to get into exactly how you should be taking a look at your model. But yes, net interest revenue out of Citi Holdings will be under pressure.

GUY MOSZKOWSKI: And you alluded to the asset sale, which appears to have been very beneficial in terms of gains. But what was the RWA reduction that, maybe on a current or a Basel III basis, would even be more helpful that you achieved by getting rid of those assets in the quarter?

JOHN GERSPACH: Well, we haven't directly commented on that, but I've seen analysts' reports that have estimated that the $12.7 billion of securities could have generated as much of $100 billion of risk-weighted assets under Basel III, and we haven't challenged any of those estimates.

GUY MOSZKOWSKI: Okay, fair enough. And then I just have one more question about the foreclosure issues that are obviously in the midst of negotiations, so we don't have a settlement yet. But I seem to remember that Citi had undertaken a review of foreclosure procedures before the whole thing really started blowing up last September, and the sense I had was that your procedures were more compliant with what's needed than at some other places. Do you expect to get the benefit of that in terms of how much of the industry foreclosure settlement you might have to shoulder yourselves?

JOHN GERSPACH: As you said, it's unclear as to exactly where these talks are headed at this point in time. And we would expect that if it's possible, we'd like to work with the other banks to structure a settlement that is both fair and reasonable, and would take into account all pertinent factors.

GUY MOSZKOWSKI: And do you think that it's a pertinent factor that you had undertaken that review and would appear to have had a somewhat different procedure for foreclosures?

JOHN GERSPACH: What do you think?

GUY MOSZKOWSKI: Well, I would think it would matter, but we never really got a lot of color on the degree to which it reduced robo-signing issues and the like.

JOHN GERSPACH: And I guess, as with any set of discussions, along with amount, there will be discussions as far as how those amounts get apportioned and how those amounts get structured. And so I'd say all of that is in the mix right now.

GUY MOSZKOWSKI: Okay, that’s great. Thank you very much for taking my questions.

JOHN GERSPACH: Not a problem.

OPERATOR: Your next question comes from the line of Betsy Graseck with Morgan Stanley.

BETSY GRASECK: Hi. Good morning. John, you talked a little bit about the FX impact on expenses. Could you give us some color on the FX impact on revenues?

JOHN GERSPACH: Yes, sure, Betsy. FX impacts, foreign exchange impacts, not just expense, but also revenues and net credit losses. Last quarter, I think we said that for the firm as a whole, when you looked at the impact of FX on those three components, it was basically a zero for the entire corporation. This quarter, when you take a look at the impact on revenues, expenses, and net credit losses, it's roughly about $100 million positive. So the total impact of FX roughly adds about $100 million to our pretax income.

BETSY GRASECK: Okay. So you should have some areas, obviously, where you're getting a little bit of positive operating leverage, I would expect, from the FX itself. Is that right?

JOHN GERSPACH: That's fair that the FX impact would -- again, it has different impact on different parts of the businesses. But there would be some that the benefit on the revenues would certainly outweigh the benefit of the expenses, yes.

BETSY GRASECK: And obviously, there's a little bit of angst around the expectation that the expenses in total are going to be above the $48 to $50 that you talked about at the beginning of the year. Can you talk through what you're doing to keep a tight lid on expenses in areas where you're not investing? Have you done as much as you can there? Is there any opportunities to increase expense saves in areas you're not investing in?

JOHN GERSPACH: Yes. And I think we're attacking that pretty hard. I mean look, we don't like the idea that our expenses are going to be above the guidance any more than anybody else does. When you're faced with $700 million impact in the first half due to foreign exchange, and say roughly $900 million due to the increase in legal and related expenses, you've got two decisions to make. You can either manage back down to the guidance by cutting your investment programs, or you can agree that you're going to press on, but as we've always said, continue to find reductions in your base. And don't forget, we've targeted -- our basic operating mantra is that every business should be able to find approximately 3% to 5% of productivity saves every year. And that's actually the way that we have been operating and we will continue to operate. So if you think about the first half of the year, we talked about $1.6 billion worth of impact due to foreign exchange and legal and related. During that time, the impact of investments is a little bit north of $1.5 billion. So we've made about $1.5 billion of investments, and we've had roughly 50% of those investment dollars covered by productivity saves in the business. And so we're continuing to actively manage our expense base. Again, we're very conscious of -- you guys are very focused on expenses. I got to tell you, so are we. But we're also trying to make sure that we're putting the right expense dollars into the businesses to grow operating margin. We think that that's what you want us to do, and that's really what we're doing. Now, we began investing last year. We called out the fact that we were beginning to invest in our consumer businesses in Asia and Latin America. When you start investing in your consumer businesses, you've got roughly a 12 to 18 month lead time before you really begin to see something positive in operating leverage coming out of those investments. And in both of those geographies, as we said on the call, our expectation is that, beginning in the fourth quarter of this year, you will see positive operating leverage in both the Regional Consumer Banking businesses in Asia and in Latin America. Now that's pretty much on schedule. Subsequently now, we've begun investing, just this quarter, really putting investment dollars behind the North America Consumer Bank. That is going to follow the same rough pacing as our investments in Asia and Latin America. So again, it's going to be a second half of 2012 story as far as gaining positive operating leverage out of the North America Consumer Bank. In similar fashion, we're continuing to make investments in Transaction Services this year. That's a business that you can starve in investments for a very short period of time, but then you need to catch up. We're making those investments now. The expectation would be, again, that sometime in 2012 -- I'm not going to give you an exact quarter -- we should start to see, again, positive operating leverage coming out of Transaction Banking. And that might happen even sooner if we get a rise in interest rates. So we've got plans in place for every one of our Citicorp businesses. And I left out Securities and Banking and I didn't mean to, but obviously we've been focused on rebuilding the banking platform in Securities and Banking. And as I think I mentioned during the call, we think we're about two-thirds of the way through that build-out program. You start to see this quarter, we had some nice results coming out of the investment banking group. That's something that we hope we can build on into the future. But every business has got a targeted investment program, and I think for the purposes of this question, maybe more importantly, a very targeted re-engineering program that is really focused on driving those 3% to 5% productivity saves out of each of the businesses, as well as the corporate staff units.

BETSY GRASECK: So are we at a point where that $1.5 billion gross pre the offsets that you have, that $1.5 billion gross investment spend is stabilizing in the second half, or moving up as Asia and LatAm are? I don't know if they're on a run rate. And you're increasing in the U.S.

JOHN GERSPACH: Yeah, I would say that you should still consider the second half of this year to be dominated by those three factors. Again, FX and legal, I don't know how to forecast. But clearly, we're going to stay in an investing mode in those businesses. But again, you should start to see the revenues outpace the investment spend in both Asia and in Latin America in the fourth quarter.

BETSY GRASECK: Right. And I guess just my basic question was does the investment -- you're ramping up investment spend in the U.S. -- is that offset by pulling back on the investments in Asia and Latin America because you've done what you need to do, or does that $1.5 billion go up a little bit, offset by the operating leverage that you expect to get in 4Q and on in the Latin America and Asia regions?

JOHN GERSPACH: Well, just because of the lapping of the expense growth, you should start to see moderating levels of expense increase coming out of both Latin America and Asia.

BETSY GRASECK: All right. Okay. Thank you.

OPERATOR: Your next question comes from the line of John McDonald with Sanford Bernstein.

JOHN MCDONALD: Hi. John, in terms of the positive refinement of the Citicorp RWA inflation, can you share any color on which areas were refined in your analysis?

JOHN GERSPACH: It's basically every one of them. As you work through the models -- I may have mentioned this in other calls -- don't forget the U.S. never moved to Basel II. So really, it's only been since everyone has gotten tremendously focused on Basel III that we've actually really spent a lot of time, on a daily operating basis, working through what are the impacts of various calculations. And everything on Basel III is model-driven, and I've made this comment before. Basel III turns your regulatory balance sheet into one giant Level 3 asset, and so it's working with every one of the models in every one of the businesses. That just provides you some greater clarity.

JOHN MCDONALD: Okay. And are the numbers you were giving us as the multipliers in the year-end '12, are those fully mitigated, or would you have more mitigation that can be done beyond 2012 at Corp and Holdings?

JOHN GERSPACH: Well, I wouldn't say that mitigation would be completed, but we certainly believe that by the end of 2012, we'll certainly get through the bulk of the mitigating actions. However, as in anything else, the more you work on it, the more you learn. And so it may very well be that as we continue to work, we'll find even more mitigating actions that we can do.

JOHN MCDONALD: Okay. And then in terms of the numerator side of Basel III, those deductions are scheduled to phase in over many years, not starting until 2014. Have you been told by regulators that you and other banks may need to meet the Basel requirements on an accelerated basis? Or is it your sense that the banks will just need to meet the requirements according to the timeline that's been set forth by the Basel Committee?

JOHN GERSPACH: I don't believe that we're going to be required to meet the Basel III requirements any earlier than whatever the U.S. rules. Again, I don't know what the U.S. rules are going to say, but assuming they somewhat track the language that has been passed by the Basel Committee, I don't expect us to be held to a higher standard any earlier. But I do believe that one of the things that the regulatory bodies will look for is a credible path to get to those Basel III requirements. And I think that is what the financial institutions will need to demonstrate.

JOHN MCDONALD: Um-hum. But your 8% to 9%, just to be clear, that you're talking about being at next year -- that kind of conservatively fast-forwards those deductions, right? That includes those deductions that technically don't start till 2014. Is that right?

JOHN GERSPACH: That's correct.

JOHN MCDONALD: Okay. And then the last question is on the net interest margin. At the top of the house, I think you talked a little bit about NII at Holdings. Just how do you see, what are the kind of puts-and-takes for your NIM and net interest income, all in at Citicorp and Citigroup, for the next couple of quarters?

JOHN GERSPACH: Okay, let's start with this quarter. So we had about a 6 basis point decline in NIM quarter-on-quarter. And there's roughly, say five factors that drove NIM decline first quarter to second quarter. Number one would have to be the FDIC assessment. The increase in the FDIC tax cost us about 4 basis points of NIM in the quarter. The second factor would be loans. The combination of those higher-yielding loans running off in Citi Holdings combined with the somewhat lower-yielding net loan growth in Citicorp, that had about a 9 basis point impact, a negative impact, on our NIM. The third factor, we had some additional borrowing costs in some of our trading businesses to fund some client positions that was a little bit higher than the first quarter. That was 3 basis points. So those are the bad guys. And then on the good guy side, this quarter, we didn't have the reserve build in Citi Financial in Japan that we had in the first quarter. So that was 7 basis points to the good. And then as we begin to roll that, run down our long-term debt, that added about a 3 basis point positive to our NIM. So I think I've got the math right, that should net out to roughly 6 basis points. So as you think going forward, the FDIC now should be behind us. That's kind of baked in. And it's going to be that combination of what happens with the run-off in loans in Holdings, the loan growth in Citi, the impact of the continued run-off in the long-term debt. And so I'd say over the next two quarters, absent some significant portfolio sale coming out of Holdings, you should probably see NIM be plus or minus 1 or 2 basis points from where we are right now.

JOHN MCDONALD: Okay. Is the magnitude of the roll-off of long-term debt similar going forward to what we saw this quarter?

JOHN GERSPACH: It'll be a little bit less. Don't forget, this quarter about $8 billion of the run-off was due to debt buybacks that we did in the quarter. So I think absent the debt buyback, it'd be about $16 billion of a decrease, and that's probably more indicative of what you could expect in the next couple of quarters.

JOHN MCDONALD: Okay. And then in terms of the interest-earning assets, there was a little bit of growth. You had a little bit of loan growth net and then also some, it looks like increasing in liquidity still. Is that preparing for regulatory, or is that just the positive inflows and nothing else to do with the money?

JOHN GERSPACH: Well, we do continue to build up cash. Now we actually drove the cash down quarter-on-quarter. That was primarily, we used the cash to buy back debt. So we're at somewhat of an equilibrium right now as far as loan reductions and asset run-off which generates cash, and then the use of cash as far as funding loans.

JOHN MCDONALD: Okay. Thank you.

OPERATOR: Your next question comes from the line of Ron Mandle with GIC.

RON MANDLE: Hi. Thank you. I have a couple of things. One, I was wondering about the tax rate, down from the first quarter -- if this is a good level to think about for the second half of the year, or how should we think about that.

JOHN GERSPACH: Ron, the short answer is yes, it is. Again, this certainly reflects where we think the business mix is. Now when I say a good level, you need to look at the level for the first half of the year.

Don't forget, at the end of every quarter, what we do is we reassess the mix of our earnings for the remainder of the year and then adjust the tax rate. So if you look at the tax rate for the first half of the year, it's probably somewhere in the neighborhood of say, 25%, and that's because that reflects where we believe our tax rate will be for the entirety of 2011. So we had a slightly higher tax rate in the first quarter, and now, we've actually, by lowering the tax rate to 22% or whatever it was in the second quarter, it gets us down to a first half tax rate of 25%, and that's our view of the rest of the year. Now again, that's also going to depend upon how the mix in our earnings streams run in actual for the second half of the year. But that's where we think we are right now.

RON MANDLE: Okay. And would we say a little creep upward next year, at this point?

JOHN GERSPACH: Well we've always said, Ron, that we actually think the normal tax rate for us is going to be something in the 28%, 29%, maybe as high as 30% range. But if you want to stay in the range of 29%, that pretty much has been our thinking and continues to be our thinking as to where we end up a little bit longer term.

RON MANDLE: Right. Okay, thanks. And then a question about the legal -- one aspect was you mentioned that the Holdings expenses were up $185 million mainly due to legal. But with the assets down, ex-legal expenses would likely have been down. So I guess my conclusion is that you actually provided considerably more than the $185 million for incremental legal expenses for Holdings.

JOHN GERSPACH: I wouldn't challenge your analysis, Ron.

RON MANDLE: Thank you. And I guess where I'm going with that is, could you discuss some of the legal issues in a little bit more detail? -- GSE put-back, private label put-back, maybe what some of the other legal issues are?

JOHN GERSPACH: Well, we don't comment specifically on litigation matters. But don't forget the put-back, certainly the repurchase, that doesn't go through litigation. That's actually a charge against revenue.

RON MANDLE: Right. And how much was that in the quarter?

JOHN GERSPACH: We provided an additional $224 million to the reserve in the quarter, and I believe that's laid out actually on a schedule in the Appendix of the Investor Deck.

RON MANDLE: Okay, thanks. Thanks very much.

JOHN GERSPACH: You're welcome, sir.

OPERATOR: Your next question comes from the line of Matt O'Connor with Deutsche Bank.

MATT O'CONNOR: Hi, guys.

JOHN GERSPACH: Hi, Matt. How are you?

MATT O'CONNOR: Good, thanks. Two separate follow-ups to topics that have come up. On the FX revenue impact, it's helpful to, again, broadly speak of the numbers of maybe $500 million or $600 million -- from a geographic point of view, does it show up in net interest income and fees, a combination?

JOHN GERSPACH: I'm sorry?

MATT O'CONNOR: The FX revenue boost -- does that show up evenly in net interest income and fees, or one more than the other?

JOHN GERSPACH: I can't answer that, I'm sorry. It certainly impacts every one of our revenue lines. It depends upon, obviously, the denomination of the currency that the different revenues are booked in. And I'm sorry, I just don't have that breakout in front of me between interest and non-interest.

MATT O'CONNOR: Okay. And then separately just a follow-up on, I think, John's question about the margin and the net interest income dollars going forward. If the NIM is relatively stable from here, obviously the positive loan growth that you saw this quarter is very good and it sounds like it's sustainable. So should we expect net interest income dollars to continue to rise off the second quarter level?

JOHN GERSPACH: Again, certainly from a Citicorp perspective, that is what we would expect. The Citi Holdings is going to be dependent upon what assets run-off and the timing of those run-offs as well.

MATT O'CONNOR: Okay. But I guess as we think about loan growth overall -- absent large asset sales out of Citi Holdings -- it seems like you should be able to generate net loan growth for the overall company from here.

JOHN GERSPACH: Yeah. If you look at, on a sequential basis, we had positive loan growth for the firm as a whole, second quarter compared to first quarter. Year-on-year, Citicorp loans grew 16%, Citi Holdings declined 35%. I think that you should expect that either by the end of this year or at the very early of next year, we should, on a year-on-year basis, see positive loan growth.

MATT O'CONNOR: Okay. All right. Thank you.

OPERATOR: Your next question comes from the line of Ed Najarian with ISI Group.

ED NAJARIAN: Yeah, good afternoon. I guess most of my questions have been answered, but one quick one. You're seeing credit losses decline very rapidly in the Partner Cards business, I think down more than 50% over the last five quarters. Any thoughts of retaining that business? -- And I know you've been running it as an operating business and potentially moving it over to Corp from Holdings?

JOHN GERSPACH: Yeah, and as we've said before, putting the Retail Partner Cards business in Holdings was not because we ever thought it was a bad business, it just didn't seem to fit the Citicorp strategy when we laid that out. Now we have been running the Partner Cards business as an operating entity. We've done a lot of work to restructure the business. But the ultimate question that we'd have to answer, as far as whether or not it goes back, is, does it fit the Citicorp strategy? And that's just not a determination that we've made as of yet.

ED NAJARIAN: Are you doing any kind of analysis or thinking about trying to reevaluate that, or has your thinking remained unchanged since you made the decision to put it in Holdings a while ago?

JOHN GERSPACH: No. We look at the businesses in Holdings from a periodic basis. You may recall at the beginning of last year, we actually moved some loans and other things out of Holdings back into Citicorp exactly because of that type of review. So we look at it all the time, and if and when we conclude on any of that analysis, we'll certainly let you know.

ED NAJARIAN: You may or may not be willing to answer this one. Obviously, that particular business is not broken out as part of Holdings. Now with credit losses running at these lower levels, has it become significantly profitable again?

JOHN GERSPACH: Actually, there's a slide in the Appendix to the Investor Deck, Slide 35. If you take a look at Slide 35, Retail Partner Cards actually generated earnings before tax of $769 million in this quarter, and $697 million of pretax in the first quarter as well.

ED NAJARIAN: Okay, great. Thank you very much.

JOHN GERSPACH: All right? Not a problem.

OPERATOR: Your next question comes from the line of Gerard Cassidy with RBC.

GERARD CASSIDY: Thank you. Good afternoon. The question I had was on the Citi-brand branded cards. Your net credit losses have been steadily declining, which obviously is quite positive for the business. Do you guys have a sense of how low the net credit losses could go? It looks like they were 6.2% for the total Regional Consumer Bank under their Citi-branded cards. Can we see that get into the 3% to 4% range?

JOHN GERSPACH: I think 3% to 4% may be -- never say never -- but doubtful. But I think what you will see is, I'm going to call it an overshooting, especially when you look at it on a rate basis. Don't forget, on a rate basis, you've got both a numerator and a denominator effect. We are in the process of rebuilding the cards portfolio in North America. We mentioned the fact that on a sequential basis, loans increased slightly. And so that should begin to help grow. The growth in the denominator, as that numerator continues to shrink, you're likely to get a very low NCL rate at some point in time. I don't know if it's going to get down with the 3 handle, but you may get a quarter where it has a 4 handle. But that's only because the loans that we'd be putting on the books now haven't seasoned yet, and therefore, as those loans season, I think you're likely then to rebuild back up to a more normal NCL rate, something in the 5% range.

GERARD CASSIDY: Do you guys feel that you've turned the corner in terms of building the portfolio? Obviously, the end-of-period loans in this area grew this quarter versus the first quarter. Do you think you're now on a growth trajectory for this business?

JOHN GERSPACH: Well, I'm cautious by nature. I'd like to see a couple of quarters of growth before I say that we've actually turned a corner. But it is good to see at least that first quarter where you've got some small amount of sequential growth.

GERARD CASSIDY: Okay. Coming back to the expenses, I know you don't want to get into the details on the legal expenses, but were any of those expenses for building up a litigation reserve for potential settlements in the future?

JOHN GERSPACH: I would say that you can take a look at our legal and related expenses as being a combination of both expenses incurred and settlements that have already been made, and as well as in anticipation of settlements that have yet to be made.

GERARD CASSIDY: Okay, good. And then just finally, on the foreign exchange on the expense side, what's driving -- you mentioned, I think it was $700 million of elevated expenses due to foreign exchange. Can you share with us some color on what caused that?

JOHN GERSPACH: Well, it's the weakening of the dollar. Don't forget, roughly 50% of our expense base is denominated in currencies other than the U.S. dollar. So as the dollar weakens or those currencies strengthen, it causes additions to our expense base. The dollar has weakened against almost every major currency during the last year, and that's just put a real strain on the expense base. It's weakened against the euro. It's weakened against the British pound. It's weakened against the Mexican peso. And those are all significant contributors to our expense base.

GERARD CASSIDY: And I guess then, the revenues in those respective areas were not as positively impacted then by the weakening dollar to offset the expenses?

JOHN GERSPACH: No, no, no, and I'm sorry. I thought I indicated earlier that those same moves did obviously cause revenues to grow. They also caused net credit losses to increase as well. And when you look at the net impact of foreign exchange movements on our results for the entire quarter for the entire Firm, it had a net benefit of $100 million pretax. So all of those currency movements added about, again roughly, $100 million pretax income to Citigroup.

GERARD CASSIDY: Oh, good. Thank you for clearing that up. Thank you.

JOHN GERSPACH: Okay. I'm sorry. Thanks.

OPERATOR: Your next question comes from the line of Moshe Orenbuch with Credit Suisse.

MOSHE ORENBUCH: Hey, good afternoon John. I promise I won't ask about FX, the NIM, or expenses, actually. So the first thing is, you mentioned the 27 months --

JOHN GERSPACH: Moshe, you can ask anything you want. You know that.

MOSHE ORENBUCH: All right. I think we've hit those topics. You mentioned 27 months coverage on the mortgage reserve, both in Holdings and in aggregate. Could you talk a little bit about what you'd have to see in order to bring that down? Or do you expect the charge-offs to increase? I mean, how do we think about that?

JOHN GERSPACH: Well, I'd say the whole subject of mortgages right now is -- I think everyone's waiting to see what happens coming out of these negotiations, quite frankly. We've got excellent trends building up in delinquency statistics, but there is the specter of forced write-downs and knock-on effects that that could have. And so you want to be cautious.

MOSHE ORENBUCH: I understand caution, but obviously, given that the trends are improving, in other words that should tell you that, all other things being equal, you would need less reserves as opposed to more, right? I mean, isn't that correct?

JOHN GERSPACH: No, that's absolutely right. Now the one thing though, and I don't want to get preachy about this, but mortgages are really different than credit cards. Your risk on mortgages, it just hangs around for a long time because those mortgages sit in inventory once they get past the 180 days, and so you still have a great deal of severity risk that can impact you. Until housing prices begin to rise and until you can start clearing out some of your foreclosures and process inventory, you've got an elongated period of time where you're going to have elevated credit losses. That's one of the reasons why we have been such active sellers of delinquent mortgages, because we just don't want to start building up a lot of mortgages that are sitting on our books that are more than 180 days past due.

MOSHE ORENBUCH: Right. And to the extent that you have extra severity risk, I guess, as home prices decline, you're saying essentially that's partially mitigated by the fact that your delinquency trends have been better.

JOHN GERSPACH: Delinquency trends certainly help, but once those mortgages get past that 180 days -- and like I say, that's why we manage that very, very closely -- that's when your severity risk really really kicks in.

MOSHE ORENBUCH: Right. Kind of on the comment that you made of running the capital levels at 8% to 9%, I think that's very helpful kind of guidance for us. One of your competitors, JPMorgan, spoke yesterday, and they mentioned they're planning to run at 7.5%. Is the 8% to 9% basically kind of an internal classification? I mean, how should we think about how you arrived at that?

JOHN GERSPACH: Well, we arrived at that, and I think we tried to describe the thought process in I think it was the third quarter of last year. And we just believe that given our mix of business and where we are, and recognizing inter-connectiveness and everything else, we think that's the right level of capital for us to operate. I think others at that point in time were saying that they were at 7%, and they thought that 7% was it, and they weren't going to run it a dollar more than 7%. We've always been targeted at this 8% to 9% level. We've tried to be very consistent with that, and that's the way we've have been managing the place now for going on a year.

MOSHE ORENBUCH: Okay, great. Very last quick one-- in terms of the Partner Card business, you've talked about that a lot, but it's not really just one kind of block of business, right? I mean, there's different partners, and is it probable or possible that some of those partners would be more consistent with your customer franchise, and maybe others less so?

JOHN GERSPACH: That is certainly a possibility. I certainly would not deny that.

MOSHE ORENBUCH: All right. Thanks a lot.

JOHN GERSPACH: Not a problem.

OPERATOR: Your next question comes from the line of Peter Ganucheau with Carlson Capital.

PETER GANUCHEAU: Hey guys, thanks for taking my call.

JOHN GERSPACH: Not a problem, Peter.

PETER GANUCHEAU: There's been a lot of discussion on the FX issue. I just want to get a conclusion. You're basically saying that most of the P&L impact would be hedged naturally or explicitly, so I'm trying to get comfort with thinking that the FX volatility won't move the needle in the bottom line on the P&L. Is that fair?

JOHN GERSPACH: Basically, it's self-hedged. When you take a look at the impact on our revenue and our expense and the cost of credit, the business is basically self-hedged against FX exposure. So depending upon how the dollar moves, we'll get either a very small impact, or a positive or negative, on the bottom line. But it does have an impact on the individual lines, and that's why when people look at expenses -- just separate out just their view on expenses -- that's going to color your view on expenses.

PETER GANUCHEAU: So maybe just think about expense as ex-FX? I mean, I don't know. Okay, and then the second one is a mathematical --

JOHN GERSPACH: That would clearly be a way to look at it.

PETER GANUCHEAU: Okay. And the second point I have is the question on some math. I've got $992 billion of risk-weighted assets, 72% you said is Citicorp. That's $714 billion. Now your old guidance on the risk-weighted asset inflation would have been 35%. The new guidance is 20%. Do a little math, I won't take you through it, but the delta is $108 billion in risk-weighted assets. At 9.5% Tier 1 Common, let's say it's the 7% plus the 250bps G-SIFI that's $11.3 billion in incremental excess capital that's freed up. And that's 10% of your market cap and the stock is flat, so I must be doing my math wrong. So what am I doing wrong?

JOHN GERSPACH: The only thing that struck me as you went through that is that by the end of 2012, we would certainly expect to have some growth in our Citicorp assets, because we are growing that business.

PETER GANUCHEAU: Okay. Fair enough. You mean, Holdings is there, but it's running off, right? But even if you include the increased inflation on Holdings, it would cut the effect in half. -- But it's still noticeable. Okay, thank you.

JOHN GERSPACH: Okay, Peter.

OPERATOR: Your next question comes from the line of Mike Mayo with CLSA.

MIKE MAYO: Hi. I know we've been through expenses a lot, and you said the net effect is the positive $100 million on income. But what is the revenue number? You said the weaker dollar contributed $1.6 billion to $1.9 billion increase in the first half versus the prior year. How much did the weaker dollar add to the revenue line item?

JOHN GERSPACH: I don't have that for you, Michael. I'm sorry. As I said, the net impact for the full Firm is roughly $100 million pretax.

MIKE MAYO: Okay. Linked quarter, your revenues were down $500 million and your expenses were up $500 million. Now, FX is going to impact both. You said legal hurts that some. But it still looks like it's going to be negative operating leverage. And you said you're doing a degree of investment spending that should pay off for Asia in the fourth quarter, and Transaction Services next year, and U.S. Consumer Bank second half to next year. But of what you can control in expenses, where do you think you need to do better than you've been doing? Or is it that's just the way it's going to be, because you're in an investment mode?

JOHN GERSPACH: Well, we are clearly in an investment mode and we -- look, I think you can always do things better. But we're definitely focused on driving those productivity saves, and so we're very focused on managing the business as we go forward.

MIKE MAYO: You gave us an isolation where each segment should turn to a positive operating leverage mode. When do you think the overall firm would be in a positive operating leverage status? Is that the end of this year, next year, 2013?

JOHN GERSPACH: I'm sorry, Michael, but when you consider with Holdings and everything else, I'm not prepared to pick a time-frame.

MIKE MAYO: Okay, sure. Let me shift gears. The net $13 billion of exposure to the European countries identified, what is the gross number and what's the difference between the gross and the net?

JOHN GERSPACH: I don't think that the gross number is relevant. I mean, again, we're taking a look at the net exposure after hedges and appropriate risk management approaches.

MIKE MAYO: Okay. So after collateral, and what else would be included in risk management?

JOHN GERSPACH: Hedges, collateral, outside guarantees. I mean, I'm just trying to kind of run through an inventory.

MIKE MAYO: Okay. And having gone through the crisis and having seen a lot of outside guarantees and hedges not working, how comfortable are you that you have the right hedges and risk management in place?

VIKRAM PANDIT: Well, it's reported. And if we report it as net exposure, it's based on our confidence that we consider these to be true hedges. By the way, the only thing I'd add is -- John Gerspach talked about its net of collateral -- there are types of collateral that don't get netted. Suppose if you had a loan in one of these countries and the collateral was a lot of, let's say, U.S. corporate bonds. That's not a qualified hedge, necessarily. It doesn't come through the numbers. So we do have collateral of that sort too in some of these financial institutions numbers.

MIKE MAYO: Okay. And then lastly, I saw that Jerry Grundhofer stepped off the board three weeks ago after having pretty recently been renominated. Can you add any color to what was said in some of the public statements? I mean, he was in charge of the Risk Committee as I understand it. Who's the new head of the Risk Committee, and why did he leave?

VIKRAM PANDIT: We will make those announcements in terms of changes post our Board meeting that's coming up. So that's in process. We are delighted with the Board that we have. We have enormous amount of depth, both on the financial services side and the risk side, and Jerry was very clear, and our press releases were very clear in terms of his reasons for choosing what he wanted to do. We really think that we all have come a very long way. He made substantial contributions, and the Board is in good shape going forward.

MIKE MAYO: All right, thank you.

OPERATOR: Your next question comes from the line of Meredith Whitney from Meredith Whitney Advisors.

JOHN DUNN: Good afternoon. This is John Dunn, actually. Just one last question on expenses. Can you give us a breakout of the comp versus non-comp in the Investment Bank, and just a sense of how that compares to last quarter on last year?

JOHN GERSPACH: No. We don't disclose comp versus non-comp in the Investment Bank.

JOHN DUNN: Okay. Yeah, I just wanted to take a chance. Thanks.

JOHN GERSPACH: All right. Thanks.

OPERATOR: Your last question comes from the line of Mike Holton with The Boston Company.

MIKE HOLTON: Okay, I'm going use this opportunity to ask two quick ones. The first one's really easy. You mentioned there's a gain from the sale of HDFC. Approximately how much was that?

JOHN GERSPACH: Pretax, it was roughly $200 million.

MIKE HOLTON: Okay. And then I'm just going to follow up on Mike Mayo's question about the gross PIIGS exposure. I understand the reasons why you guys don't want to disclose it, but having seen the movie before, if Europe turns into a real problem, the net exposure guidance or disclosure you gave isn't going to give investors any comfort whatsoever. So I would encourage you guys to give the gross exposure at some point if you're not going to do it today.

JOHN GERSPACH: Okay, thank you.

OPERATOR: There are no further questions at this time. Presenters, do you have any closing remark?

JOHN ANDREWS: Yeah, it's John Andrews. Thank you for those of you who just managed to stay on for this lengthy call. The replay will be available later this afternoon on the website, and we'll all talk to you later. Thanks.

Certain statements in this document are “forward-looking statements” within the meaning of the rules and regulations of the U.S. Securities and Exchange Commission. These statements are based on management’s current expectations and are subject to uncertainty and changes in circumstances. Actual results and capital and other financial condition may differ materially from those included in these statements due to a variety of factors, including the precautionary statements included in this document and those contained in Citigroup’s filings with the U.S. Securities and Exchange Commission, including without limitation the “Risk Factors” section of Citigroup’s Annual Report on Form 10-K.