Citi Second Quarter 2012 Fixed Income Investor Review
TRANSCRIPT
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Host
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Speakers
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PRESENTATION

OPERATOR: Hello and welcome to Citi's Fixed Income Investor Review with Chief Financial Officer, John Gerspach, and Treasurer, Eric Aboaf. Today's call will be hosted by Ilene Fiszel Bieler, Head of Fixed Income 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 question-and-answer session. Also, as a reminder, this conference is being recorded today. If you have any objections please disconnect at this time. Ms. Fiszel Bieler, you may begin.

ILENE FISZEL BIELER: Thank you, operator. Good morning and thank you all for joining us. On our call today, our CFO, John Gerspach, will speak first. Then, Eric Aboaf, our Treasurer, will take you through the Fixed Income investor presentation, which is available for download on our website, www.citigroup.com. Afterwards, we will be happy to take 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, including without limitation the Risk Factors section of our 2011 Form 10-K. With that said, let me turn it over to John.

JOHN GERSPACH: Thank you, Ilene and good morning everyone. We're very pleased to be hosting our Fixed Income Investor Review this quarter. Today we're going to update you on our continued execution and progress in several areas, including the strength of our liquidity and balance sheet as well as our management of each. Eric Aboaf, our Treasurer is going to take you through some specifics on our strong balance sheet, our strong liquidity profile, and our strong capital position, as well as review our recent issuance activity and current funding plans for the year.

Before I turn it over to Eric, however, there are some key points from our second quarter earnings we announced on Monday that I would like to highlight to start us off here on slide 1. As you may know, we reported earnings of $2.9 billion for the second quarter of 2012, and excluding CVA and the loss from the partial sale of our stake in Akbank, net income was $3.1 billion. While the operating environment remained challenging in the second quarter, we've continued to manage our business and our balance sheet carefully, given the macroeconomic uncertainty. Overall, I'm pleased with our performance in light of the economic environment we faced during the quarter.

Loans and deposits in Citicorp had solid growth. Our markets businesses were resilient, despite volatility, and we increased market share in investment banking. Revenue in Transaction Services set another record as we leveraged our unique global footprint, especially in trade finance. While our Consumer businesses were impacted by the slower economy, we still saw positive operating leverage in both Latin America and Asia, excluding Japan. We're managing our expenses closely, and making sure we're right-sized for the environment we anticipate. And net loan loss reserves are down approximately 50% year-over-year, which demonstrates significant improvement in the quality of our earnings this quarter.

Both our capital and liquidity are robust, no matter which measure you use. As of the end of the second quarter, our Tier 1 Common ratio was 12.7% under Basel I, and was an estimated 7.9% under Basel III. We still expect to exceed 8% Tier 1 Common under Basel III later this year. We have ample liquidity with

$413 billion in aggregate liquidity resources and our current Basel III LCR estimate of approximately 118% is comfortably above the 100% proposed requirement. We are seeing continued improvement in credit trends with net credit losses down 31% from a year ago. We are well reserved with loan loss reserves of approximately $28 billion, or 4.3% of Loans. With this strong balance sheet, we have the resources and the capabilities to continue to grow as we help our global clientele navigate the current environment.

Our strategy is showing results and we're executing it diligently. Our focus on capital flows between the world's top 150 cities, on serving multinationals globally as only we can, and on the faster-growing emerging markets, are right for the times and the capabilities of our bank. We are diversified, and while the negatives will pop up here and there, our footprint and strategy will serve us well over time.

Turning to slide 2, I'd like to re-emphasize some of our key earnings results from the second quarter. Citigroup reported net income of $2.9 billion or $0.95 per diluted share. Excluding CVA/DVA, and the loss on Akbank, earnings were $3.1 billion or $1 per diluted share. Revenues of $18.6 billion were down 10% versus the prior year on a reported basis. Excluding CVA/DVA, and the impact of minority investments, revenues were down 7% from last year, as revenue growth in Citicorp was offset by the impact of foreign exchange, and the continued decline in Citi Holdings revenues. Expenses of $12.1 billion were 6% lower than the prior year on a reported basis.

Excluding the impact of foreign exchange and the legal and repositioning charges we incurred during the quarter, core operating expenses declined nearly 3%. Credit costs of $2.8 billion were down 17% versus last year. Net credit losses of $3.6 billion were 31% lower than the prior year and the net reserve release was $984 million, down 50% from last year. Citigroup end of period loans grew 1% year-over-year to $655 billion, as continued loan growth in Citicorp, up 10% year-over-year, outpaced the wind-down of Citi Holdings. And, Citigroup deposits grew 6% to $914 billion.

On slide 3 we show Citicorp's pre-tax earnings by business, excluding CVA/DVA, and the impact of loan loss reserves. As you can see from this chart, our earnings, excluding loan loss reserves, are increasingly steady and are diversified across the franchise, with a growing contribution from Consumer and Transaction Services. On a trailing 12 month basis, through the second quarter, Consumer Banking generated 46% of Citicorp's earnings, and together with Transaction Services, these businesses represented nearly three-quarters of pre-tax profits, a significant increase from where we were two years ago, or even just a year ago.

On slide 4 we show Citicorp's pre-tax earnings, excluding CVA/DVA, and the impact of loan loss reserves for the first half of the year. On this basis, pre-tax earnings increased by 34% from the first half of 2011 driven by lower net credit losses as well as an improved operating margin.

And now, let me turn it over to Eric.

ERIC ABOAF: Thank you, John. Please turn to slide 5. Let me start by describing how we are managing the balance sheet for the current environment and how we are investing to grow the Citicorp Lending businesses. On the left you see assets for Citicorp and Corp/Other, which are up 2% year-over-year, as we continue to expand our franchise and deployed our balance sheet to support our customers over the past year. For example, net loans which is our largest asset category is up approximately $52 billion and approximately $14 billion quarter-over-quarter, as we continue to lend to both consumer and corporate clients in a disciplined manner. And this quarter we've continued to run with healthy levels of trading inventory and reverses, largely in response to customer flows in our rates and currencies businesses around the world.

On the right, you see Citi Holdings' assets, which are down 28% year-over-year as the wind-down continues to free up capital. Our Citicorp, Citi Holdings' strategy continues to provide us the flexibility to redeploy capital and take advantage of growth opportunities, particularly in our lending businesses, while also giving us the ability to size our market-making balance sheet to the current economic environment.

Turning to slide 6, given our strong balance sheet we have been deploying capital in our Citicorp Lending businesses in a disciplined manner as I just mentioned. In Citicorp, loans grew to $527 billion, up 10% year-over-year. As you know, the dollar strengthened, so on an ex-FX basis, we had loan growth of 13%. Lending in our institutional businesses was up 22%, or 24% adjusted for FX. On an ex-FX basis lending increased 48% in Transaction Services from the prior year, driven by trade finance lending in Asia, Latin America, and Europe. And we saw 16% growth ex-FX in our Securities and Banking corporate loan book with increased borrowing across all client segments, in most regions.

International Consumer Banking loan volumes increased 2% year-over-year on a reported basis, and was up 10% ex-FX, led by growth in Asia and Latin America. These trends reflect the economic growth in these regions as well as the results of our investment spending. North America consumer loan volumes were up modestly at 2%, driven by retail banking loans as the cards market continues to reflect both consumer deleveraging as well as CARD Act and other regulatory changes. Overall, ex-FX, full firm loan growth increased 4% year-over-year.

Turning to slide 7, having just discussed the asset side of the balance sheet and loans in particular, let's turn to liabilities and spend a moment to looking at deposits which serve as our primary source of funding. This page shows our deposit growth by region both on a reported basis and adjusted for FX. Similar to our loan trends, deposits were also up. Year-over-year, deposits were up 6%, and when you adjust for the strengthening dollar they were up 9%. Deposits grew across all four regions, Latin America, Asia, Europe, and North America[1], as more and more clients are drawn by our transactional banking offerings, and as they see us as a safe harbor during uncertain economic environment.

Deposit funding costs continued to decline in sync with prevailing interest rates, bringing our average cost of deposits to new low of 72 basis points. Our business model continues to deliver lower price points, notwithstanding that we are seeing competitors selectively bidding up deposit rates, especially in time deposits to secure funding. We'll have more on deposits in subsequent pages.

On slide 8 I want to show you how some of the balance sheet activity that we just reviewed is impacting our net interest margin. This quarter we saw NIM decrease, which was largely due to a few factors. First, we increased our trading book in response to customer flows, and those assets typically come in at lower yields than that of our banking book, effectively depressing NIM. While this impact was expected, it contributed to the sequential NIM decline. Second, overall loan yields were down due to lower market interest rates. And at the same time, as you have heard me say before, we have been focused on reducing our borrowing costs by substituting maturing long-term debt in the bank – which is a more expensive source of funding – with deposits, our lowest cost of funds. This benefit partly offset pressures arising from the lower loan yields. All of these factors were largely taken into account in our NIM expectations.

In addition, however, we also experienced higher than anticipated prepayments in U.S. cards and those higher prepayments were concentrated in our higher rate accounts. And while we believe payment rates have stabilized since April, this had a larger than expected negative impact on NIM in the quarter. Looking forward, absent any other significant changes, our NIM will likely continue to reflect the pressure of a low interest rate environment and subsequent changes in our portfolio. As such, we expect NIM will probably be fairly stable at 2Q levels, give or take several basis points.

Turning to slide 9, looking at Citi Holdings, let me further describe our progress in reducing the amount of our higher risk assets. Holdings assets have declined by 76% from their peak in 2008 to $191 billion, and now stand at approximately 10% of our balance sheet. The $18 billion reduction in the second quarter

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[1] Excluding the impact of foreign exchange translation into U.S. dollars for reporting purposes (FX).

was comprised of roughly $11 billion of asset sales, approximately $6 billion of net runoff and paydowns, and $1 billion of net cost of credit and net asset marks. This slide shows you the key businesses within Citi Holdings where those reductions occurred. Importantly, the two largest components of Citi Holdings, the Special Asset Pool and Local Consumer Lending are down 40% and 26% respectively from the second quarter of 2011.

And as I've said before, our Local Consumer Lending U.S. Mortgage business is a fraction of the size of that of our large U.S. peers. Clearly, we are continuing to make significant progress executing on our Citi Holdings asset reduction strategy. As we have stated, we believe the pace of the reductions will continue at rates similar to those we have seen in recent quarters.

Given the interest in GIIPS countries, we also wanted to update you on our exposures on page 10. At the end of the second quarter Citi's gross funded credit exposure to GIIPS was $20.1 billion, roughly flat to last quarter. Netted against our gross funded credit exposure, we have margin posted under legally enforceable agreements, collateral pledged under bankruptcy remote structures, and purchased credit protection from financial institutions predominantly outside of these five countries. These amounts totaled $14.1 billion. Net of margin, collateral, purchase credit protection, our net current funded exposure to GIIPS at the end of the second quarter was $8.4 billion, which was down slightly from the $9.1 billion last quarter.

You can also see that the majority of our credit exposure in these countries is to corporates, and while our net funded exposure was relatively flat quarter-over-quarter, the mix of that funding is shifting modestly towards corporates. These are our large multinational clients which are often rated higher than their host countries. Very importantly, since the middle of 2011, we have decreased our net current funded GIIPS exposure by approximately 40%, as we continue to carefully manage these positions while serving our most important clients.

Moving to slide 11. Having discussed balance sheet trends in some detail, now let's review Citi's liquidity and funding strategy which has been a cornerstone of strength. Our current strategy is designed to provide ample, high-quality liquidity to make sure that we are well positioned to grow our core businesses and navigate various market conditions. In both the bank and the non-bank, we carry a healthy liquidity buffer which is generally held in cash and highly liquid securities, such as Treasuries and Agencies, and other G7 instruments. We execute on this funding strategy in both our bank and non-bank businesses, by accessing a spectrum of funding sources.

In our bank businesses, our funding is primarily in the form of stable, diversified deposits from around the world, which I discussed earlier and will discuss more in a minute. In our non-bank businesses, we use a modest amount of short-term funding such as repo to finance liquid assets. We then use a range of long-term debt instruments to cover our broader business needs.

On slide 12, you can see the size of our liquidity buffer which is defined as unencumbered cash and highly-liquid securities. It stood at approximately $413 billion at the end of the second quarter. This quarter our high level of bank liquidity is down modestly as we have consciously used cash to pay down long-term debt including TLGP debt and credit card securitizations while being mindful of the economic environment. At the same time, our non-bank liquidity, which supports our broker-dealer, was relatively flat.

It is also worth mentioning that we only include our on-balance sheet liquidity buffer here. As such, this does not include borrowing capacity at the FHLBs, which would increase our liquidity buffer by approximately $22 billion. Nor do we include borrowing capacity at the Fed discount window or international central banks. That capacity is also over and above what you see on this page.

We expect to manage our excess liquidity to somewhat below $400 billion as we continue to pay down our long-term debt. Obviously, we will take market conditions into account as always.

Moving to slide 13. Having discussed the size of our liquidity buffer and our current expectations, let me take a moment to describe the conservative management of our liquidity pool and its governance. To begin with, Citi has a strong governance structure in place. The Asset Liability Management Committee which is comprised of Citi's Senior Management including our President, Chief Risk Officer and Chief Financial Officer, sets the strategy for liquidity portfolio and monitors its performance. Significant changes to portfolio asset allocations need to be approved by this group.

The liquidity pool itself is managed by me directly as Treasurer. Liquidity is managed centrally both by corporate Treasury and by my in-country Treasurers to make sure that our asset/liability profile and liquidity positions are appropriate in every country and throughout the company. Strategically, the liquidity pool is maintained in both cash and a range of highly liquid and high-quality securities to ensure that funding can be made available to meet demand in a stressed situation. As you can see on this page, liquidity pools is conservatively invested, primarily in cash, government securities, including U.S. agency debt and U.S. agency mortgage-backed Securities, and a certain amount of highly-rated investment-grade credit.

Foreign government securities that we hold are largely in support of our local liquidity requirements in our local country franchises. In keeping with our global footprint, these securities principally include government bonds from Japan, Mexico, Korea, Brazil, the U.K., and Singapore. At this time, while we expect the portfolio may fluctuate some in size, we don't expect to see significant changes in asset allocation.

Our funding strategies has served us well over the last few years and has prepared us to meet the proposed Basel III liquidity requirements ahead of schedule as we show on slide 14. The Basel III Liquidity Coverage Ratio or LCR is designed to ensure banks maintain an adequate level of unencumbered cash and highly-liquid securities that can be converted to cash, to meet liquidity needs under an acute 30-day stress scenario. As you are aware, the proposed minimum requirement for the LCR is 100%. The Basel Committee recently disclosed results from its Quantitative Impact Study (QIS) exercise, which was conducted in the second quarter of last year. The weighted average LCR for the large group one banks was 90%, while the European large bank average was only 71%. While we are still waiting final guidance on the Basel III Liquidity Coverage Ratio, we believe that we are already comfortably in compliance, given the proposed rules as we understand them, and with an estimated LCR ratio of approximately 118%.

In keeping with our estimates regarding Citi's excess liquidity that I just shared with you, we currently expect that our LCR will decrease modestly as we manage to a level that is comfortably above the proposed 100% requirement.

In keeping with our discussion of the changing market environment, Citi has significantly shifted its funding mix over the last few years away from short-term sources, to deposits and long-term debt and equity. Slide 15 shows the funding composition that we have for the bank and the non-bank. Within our bank, we view our deposit base as our most stable and lowest-cost funding source. And as you can see, that approximately 81% of our bank is funded by deposits, compared to 78% as of the second quarter of 2011, and 72% at the end of the second quarter of 2010.

In the non-bank businesses, long-term debt represents the most significant component of our liability mix. The vast majority of this funding is comprised of senior term debt along with subordinated instruments and trust preferred securities. As of the second quarter, long-term debt comprised 35% of the funding in the non-bank, compared to 36% in the second quarter of 2011, and 38% as of the second quarter of 2010. While long-term debt was lower over the course of the past year, so was the level of assets, especially illiquid assets it is meant to support. Approximately 30% of our non-bank liabilities are secured financings often referred to as repos, which provide funding in a carefully calibrated manner for liquid securities. And finally, our large base of book equity supports both the bank and non-bank entities.

Turning to slide 16, let's return to our discussion of deposits which is the bulk of the funding for our bank. This quarter, in keeping with our client focused model, we saw healthy deposit growth in Consumer Banking and Transaction Services. Overall, deposits grew 6% year-over-year and were also up quarter-over-quarter. When you factor in the currency movements in the dollar, deposits were actually up 9% on an ex-FX basis.

Turning to slide 17, adjusted for FX, this page shows how we continue to improve the quality of our deposit base. You can see on the page that we have been actively changing the composition of our deposits within both Global Consumer Banking and our Institutional businesses, both Transaction Services and Securities and Banking. Time deposits, where rates are fixed for the terms of the deposit and which have lower margins, are becoming a smaller proportion of our base in both businesses; whereas operating accounts are becoming a larger proportion of our deposits. These checking and savings accounts for individuals, and cash management accounts for corporations, are providing wider margins and have exhibited stickier behavior.

Year-over-year, our deposit mix has shifted positively within each business. Operating accounts are now 76% and 73% of the total for Global Consumer and our Institutional businesses, respectively. On a firm-wide basis, operating accounts now represent 74% of our overall Citicorp deposit base, whereas last year they represented approximately 73%, and two years ago they were at 64%.

On slide 18 let me turn to long-term debt which is the primary source of funding for our non-bank, meaning our broker-dealer and parent Company. The top half of the page shows our long-term debt outstanding by category over time, including senior debt, TLGP, and credit card securitizations. The bottom half of the page segments the amount of long-term debt in the bank and non-bank entities. So, the bottom is just another cut of the top to provide you with some further texture. As you can see here, the long-term debt outstanding has decreased year-over-year in most long-term debt categories, as we have deleveraged the balance sheet.

In the bank, we have consciously reduced debt funding as we have grown our deposit base. Looking at the non-bank at the bottom half of the page, long-term debt has decreased as we have let TLGP roll off, while keeping a healthy amount of funding for our broker-dealer. In the non-bank, assets have been reduced at a corresponding pace, especially as we wind-down Holdings and have taken actions to reduce higher risk, and less liquid Basel III assets in the dealer. As you can see here, with our current estimate for the fourth quarter of 2012, we believe that this trend will continue and expect continued declines in the amount of long-term debt that we have outstanding, particularly in the bank.

Moving on to slide 19, you can see our expected maturities for full year 2012 and also our expected maturities of long-term debt over the next two years. This chart clearly shows the maturities peaked in 2012, and will come down in 2013. As we see in light blue atop of the first column, TLGP debt represents the bulk of the maturities in 2012. As I've said before, for us at Citi, we do not expect to replace TLGP maturities. As we have demonstrated and reviewed in the prior slides the reason is clear, as we continue to reduce our Citi Holdings balance sheet in our bank and non-bank entities, our need for long-term debt is coming down.

During the first half of 2012, we issued approximately $10 billion of long-term structural debt. We issued across multiple tenors in both benchmark and structured notes. As we stated last quarter, we continue to expect to issue approximately $15 billion to $20 billion of long-term debt for the full year of 2012, leaving $5 billion to $10 billion for the second half of this year. At this time, we believe we will be in the low end of this range.

Turning to slide 20, let me review the liability management strategy that we have been executing over the course of the last few years with the objective to lower our cost of funds. For context, we successfully de-risked our balance sheet and reduced Holdings assets, thereby creating ample liquidity. Through selective public tender offers and open market purchases we've bought back outstanding debt, with either excess cash or by replacing it with new issue debt at lower spreads. The chart on the top half of this page shows our quarterly liability management activity. We've been consistently active in the senior benchmark and structured space.

On the bottom of this page you can see that we carefully managed the weighted average maturity of our long-term debt. Over the last two years, WAM increased to approximately 7 years from approximately 6.2 years in 2010. We've used our liability management efforts, coupled with our issuance strategy, to consciously maintain the tenor profile of our debt.

Moving to slide 21. In keeping with our liability management initiatives as part of the CCAR process, Citi received approval to redeem certain series of outstanding trust preferred securities. Our objective was to redeem securities that no longer count under Basel III, as well as to lower our cost of funds. You can see on the bar charts below that we've grouped our outstanding trust preferreds into three categories based on their call features: those that we have redeemed and/or called, those that are currently callable, and those that are not currently callable but will be callable in the future. These securities are ordered in each category by coupon, and the smaller bar shows the notional amount for each security. As you can see, we called the most expensive securities because they had the most significant benefit on our cost of funds.

In June of 2012, Citi, along with many others in the industry, determined that the Federal Reserve's Notice of Proposed Rulemaking, (the NPR), constituted a regulatory capital event and we announced the call of two outstanding issues of our trust preferred securities, the 8.50s and the 8.30s. Those securities have now been redeemed. Most recently on July 12 we also called the 7.250% E-TruPS, and expect to redeem them on August 15.

Turning to slide 22. Let me describe for you the current status of our ratings, a topic we have discussed quite a bit over the last year and a half. As you are aware, S&P and Fitch resolved their industry-wide reviews in the fourth quarter of 2011 and announced their rating changes at that time. We are rated "A/A-1" with S&P at our key operating entities, Citibank N.A., CGMI and CGML, and "A-/A-2" at the Citigroup holding company. We are rated "A/F1" with Fitch at both the operating and holding company levels. And just this week Fitch reviewed and affirmed our ratings. As you're also aware, on June 21st of this year Moody's announced results of its industry-wide rerating of over 130 banks globally. As a result of that review, Citi's ratings are "Baa2/P-2" and "A3/P-2"[2]. This action has had no material impact on our funding, our liquidity, our market-making, or our client activity.

Turning to slide 23. Some of you have asked how the recent Moody's ratings actions on the industry may have impacted our cost of funds. There are of course numerous factors that can affect bond spreads in any given day. But if we isolate the specific days pre- and post-Moody's announcements you can see that the Moody's action appears to have little to no effect on our spreads overall. As you can see on the top half of the page, while spreads widened somewhat after the initial announcement of the Moody's review back in February of this year, Citi's 5-year cash spreads actually tightened post announcement of the ratings actions. Similarly the cost of our deposits were not materially affected; in fact, our deposit rates fell in line with market interest rates.

We believe that our cost of funds were unaffected largely due to the fact that today's market participants have become increasingly sophisticated and are typically assessing bank credit on a large number of indicators, of which ratings may be just one input.

In contrast to the past, today's investors and clients are looking at a variety of metrics to assess bank creditworthiness. These measures include financial metrics such as the bank's equity base, regulatory

[2] For clarity on Citi's Moody's ratings, "Baa2/P-2" is at the Citigroup Inc. holding company level, and "A3/P-2" is the Citibank, N.A. rating.

capital levels, liquidity profile and loan loss reserve; and business metrics such as strategy, geographic diversification, and risk concentrations. We believe that this shift to a more sophisticated approach to credit evaluations by our clients and investors is appropriate in an increasingly complex market environment and we have expanded our disclosures accordingly for you.

So turning to slide 24. Let me talk about capital which continues to be an area of significant strength for us, and supports the lending growth that I described. Our Basel I Tier 1 Common capital stands at $124 billion and our Basel I Total Capital is $173 billion. At the end of the second quarter our Basel I Tier 1 Common ratio was 12.7%, significantly up from a year ago, and also up from the first quarter. Adjusting for the final market risk rules recently adopted by the U.S. regulators that will be effective in January of 2013, our Basel I Tier 1 Common ratio would be approximately 11.3%. You can also see that under Basel III, our estimated Tier 1 Common ratio as of the second quarter was 7.9%, up from 7.2% in the first quarter. These estimates both include the impact of the final market risk rules recently adopted by the U.S. regulators and are based on the proposed “advanced approach” for calculating risk weighted assets under the recent NPR.

As you may be aware, the regulatory proposals also require Citi and other banks to calculate its risk-weighted assets under newly defined “standardized approach” and to use the lower of the two resulting ratios for our reported Basel III Tier 1 Common ratio. We continue to review the implications of the “standardized approach”, but based on preliminary data, our estimated Basel III Tier 1 Common ratio for the second quarter as calculated under the “standardized approach”, approximates the ratio under the advanced calculation. We continue to expect to be above an 8% Basel III Tier 1 Common ratio later this year. Our capital base is one of the strongest in the industry, both as compared to U.S. and international banking peers.

Moving to our last slide. Let me summarize four major points. First, our capital base continues to be one of the strongest in the industry, and this is reflected across every one of our significant capital ratios, including Basel III. Second, we have significantly improved our structural liquidity by increasing our capital base and deposits. We believe we have ample liquidity and our estimated LCR is approximately 118%, which is comfortably above the estimated industry average and the proposed required minimum. Third, we will have significantly lower proportion of wholesale funding going forward. We currently have modest long-term debt issuance planned over the next year. We'll not be replacing maturing TLGP debt. Thus, we expect that our long-term debt outstanding will continue to decline. And fourth, while the environment remains uncertain, we saw continued strength in our core lending and deposit-taken businesses, and good performance in our Markets business.

That concludes our Fixed Income review. John and I would be happy to take your questions.

OPERATOR: (Instructions). Your first question comes from Robert Smalley, UBS.

ROBERT SMALLEY: Hi, thanks very much for taking my question, and for holding the call. Couple of quick questions. First on the TruPS slide, in your resubmission of CCAR, could you go back to the well again and see if you could increase the number of TruPS that you could call this year under CCAR?

ERIC ABOAF: Robert, I think the commentary -- it's Eric, speaking here. The commentary that I gave you the last time is that the Fed gave us approval to call a substantial amount of our TruPS securities and you also know though, that we can't disclose the exact communications that we have with our supervisors. So at this point, we've called about $5.3 billion of securities across three different instruments, and I think at this point I'm going to have to let you conclude whether that's substantial or not, and whether there's a bit more or not to go from there.

ROBERT SMALLEY: Sure. But in the second submission you don't want to say whether or not you went to increase that for this year?

ERIC ABOAF: No. We can't comment on any requests that we've made or not made with our supervisors through the CCAR process.

ROBERT SMALLEY: Okay. That makes sense. Going back to the slides that you talked about – the downgrade and the impact there – you laid out the spread impact pretty well. A competitor yesterday talked about a specific charge they had. They identified a dollar number. Is there a dollar number, one, that you can identify for that? And two, your competitor mentioned that a certain number of clients had kind of stepped back from doing business with them. Did you see that in this process and have you seen those clients step back up now that the Moody's action is over?

JOHN GERSPACH: Robert, its John. Regarding the charge that the other party mentioned, look, to the extent that -- I think that was mostly associated with having to reset contracts where contracts contained ratings agencies triggers; for the most part, we've been able to -- those contracts where we did have such triggers – we've been able to modify the existing contracts with our customers, incurring minimal or no cost. So we really haven't seen anything, any real impact on us.

ROBERT SMALLEY: And post the Moody's action, have you seen customers come back or those who might have been delaying say, okay this is behind us now? And I'm thinking particularly in prime brokerage where that may occur more than in some other parts of the firm.

ERIC ABOAF: Robert, its Eric. We saw very little changes in customer activity during the course of the last couple months, the last six months, through this whole series of events. If you recall, we run, for example in the derivatives side, most of our book, the vast majority of our book, on the bank. Our bank is a $1.2 trillion, $1.3 trillion bank relative to the size of others; that's an order of magnitude larger in some cases. We saw very little pullback or change in their activity that we could note. I think on prime brokerage, I'd say similarly we saw little change in activity, in some cases we actually saw activity come our way during the quarter and the business continued to see very, very nice flows.

ROBERT SMALLEY: Great. Thanks very much.

OPERATOR: Your next question comes from Samuel Crawford, Stone Harbor.

SAMUEL CRAWFORD: Thanks very much. A couple of questions as well, please. First of all, I don't believe I found this in the equity call or in the disclosure but is it possible to get your non-performing assets, not loans, but assets across the group including OREO?

JOHN GERSPACH: Samuel, I do believe that that is in the back of our earnings supplement, the package that we publish, and you'll see the OREO broken out as well as the non-performing assets. It's somewhere back around page, I don't know, 40, 42 of the supplement.

SAMUEL CRAWFORD: Okay. Then I'll go back and fish that out, thanks. The Smith Barney arbitration with Morgan Stanley, is there a clear sort of timing to a decision there?

JOHN GERSPACH: Yes, there is. We laid that out I think in the 8-K that we filed last evening and as I indicated on the call, it's now gone to a third-party appraiser. The third-party appraiser we expect will -- has to conclude its work by August 30, and then the deal should be struck -- it has to close by September 7. So, as I said on Monday, the expectation, and it will be that the process now moves to a third-party appraiser, and each firm now will have to support its valuation to the third-party appraiser, which I guess as you can imagine will create an interesting dynamic.

SAMUEL CRAWFORD: Yes, I'm sure it will. Broader question: curious where you would put your current -- at the margin, your current cost of equity and what you think it means for banks like yourselves to be in sort of a position where they're earning below -- even well below cost of equity on a sustained foreseeable basis.

JOHN GERSPACH: Sam, I think it's a little difficult right now for almost any bank to calculate its cost of equity in the current interest rate environment. I mean, what is a normal return that you would expect a bank to earn in an environment where you've got virtually zero interest rate? So I'm not prepared at this point in time to go forward with an estimate of what our current cost of equity is.

SAMUEL CRAWFORD: Okay. Thanks very much.

OPERATOR: Your next question comes from Ryan O'Connell, Morgan Stanley.

RYAN O'CONNELL: Good morning, John and Eric. Thanks again, very thorough review. I've got two business lines questions if you will. One is the trends we're seeing in the International Consumer Banking; up front, overall looks like a good story, but I just want to get a little bit of clarity on something. Credit provisions went up, this is year-over-year, credit provisions went up about 16%, so [inaudible] went down 12%. And I understand that portfolio growth is driving a lot of this, but here's where I'm getting a little confused. It looks like average loans were up about 4% year-over-year, and when I look back in your deck, slide 33 indicates that for all the major regions the past dues are pretty stable. I'm trying to get a clearer picture of what's going on here.

JOHN GERSPACH: First of all, you've got to adjust for FX movements. We've tried to give you some guidance in the earnings deck that we used on Monday as far as what the impact is of FX on the various loan statistics. You've also seen that when you're comparing year-on-year and some of the figures that you've talked about, you're dealing with a period where in one year we had loan loss reserve releases and now we've got some builds. The builds are associated with the growth in the portfolio. If you take a look at some of the statistics that we've laid out for you in the earnings deck, but also are contained in the supplement, I think that you'll see that the credit trends in our International Consumer business have remained extremely favorable, certainly stable to improving. I think that we quoted on the call, we have loss rates in Asia that are now below 1%, and we've got an NCL right there that is somewhere around 90 basis points. So these are very, very favorable trends that we continue to see throughout the region. In Latin America, the NCL rate has also been declining. So we see favorable trends in the NCL rates. We see favorable trends, or stable trends, in the delinquency statistics in the various portfolios, and to the extent that we feel the need to build loan loss reserves, it really is because the portfolios themselves are growing.

RYAN O'CONNELL: Okay. That makes sense. I saw those credit statistics on your slide 33 which again is what prompted the question. Just so I get it straight, looks like credit quality is stable or even improving. The real difference then is just before you were releasing reserves. Now that's kind of run its course if you will. And so this is ordinary build associated with portfolio growth.

ERIC ABOAF: That's exactly right.

RYAN O'CONNELL: Okay. That's good. One other just business line question. That is equity trading, we've heard the same refrain, tough quarter from everybody. I think what you said on the call is that basically the issues in the equity trading area have been addressed last year. So what have you seen in terms of your market share there, John? And I realize it was a really, really tough quarter for everybody. But maybe if you could do it the last several quarters.

JOHN GERSPACH: I think as we mentioned on the call, the next thing that we've got to focus on in equities is building up the prime brokerage business. Right now, we are much more heavily weighted towards cash equities than perhaps some others. And so therefore you see that impact -- when market volumes trend downward, you tend to see that more apparent in our results than perhaps in others. And so an expansion of the prime brokerage business would probably be the next thing that you'll hear us talking about.

RYAN O'CONNELL: Great. Okay. Thanks a lot.

OPERATOR: Your next question comes from Mark Kehoe, Goldman Sachs.

MARK KEHOE: Just one question. I'm wondering whether you can quantify the Net Stable Funding Ratio (NSFR) number, and also in that regard are you more likely to issue more 30-year debt or even to do it preferred, just given where yields are so low and the shrinkage in the TruPS overall market? Thank you.

ERIC ABOAF: Mark, its Eric. The Basel Committee is still deliberating on the two liquidity ratios, the LCR which is a 30-day stress test, that obviously we've been disclosing here for several quarters, and the NSFR which is the one-year stress test. What we have continued to be told and the industry's been told is that they plan on rewriting the NSFR methods and calculations and definitions, and so we've not spent a lot of time with that measure. We've obviously calculated internally, just to do that and participate in the usual industry studies that they've asked of us, but I think it's so likely to change that it makes more sense to wait for some of those changes, and then once we have better guidance, we would obviously be delighted and we'll share with you the results as soon as it comes out.

I think in terms of implications, the Net Stable Funding Ratio is really a one-year measure. So it's really about having a nice tenor profile of long-term debt. I think we disclosed our long-term debt profile this quarter and last quarter with the weighted average maturities of about seven years. That means we are going to issue across the tenor spectrum, maybe as long as 30s, 10s, 5s, and so forth. I don't think that will change though the nature of our capital structure, if that's what you're asking, between senior and preferreds, or senior and trust and sub debt. I think that will be more determined by just the final Basel III rules and the U.S. version of those and how those play out.

MARK KEHOE: Thank you.

OPERATOR: Your next question comes from Ron Perrotta, Goldman Sachs.

RON PERROTTA: One real quick question. Any color you could give us maybe on the preferred market. We've seen strong demand especially in the retail side of that market and with rates this low, and now we know with the NPR that they should count as capital going forward. Thank you.

JOHN GERSPACH: Ron, I think we're all as banks working through the preferred market and how we want to address that over the next period of time – the next year, two years. Clearly, Basel III has a very long phase-in time period, all the way to 2019. And so many of us are just working through when should we issue preferreds, in what amount, and so on and so forth. I think as we come to a clearer view of that, as we understand some of the requirements a little better, we'll certainly share that with you.

RON PERROTTA: Thank you.

OPERATOR: Your final question comes from David Macgown, Morgan Stanley.

DAVID MACGOWN: Morning, thanks for taking my question. I think this is a quick one. Regarding your deposit composition and the increase in non-interest bearing deposits as you lay out in your supplement, what are your expectations around the elimination of the unlimited insurance at the end of this year, and do you expect to see any significant change in the composition you lay out in the presentation?

ERIC ABOAF: David, its Eric. Good question. We clearly over the last couple of years we've had changes in the deposit insurance framework, and programs that the FDIC has had in the U.S., let alone some of the other governments around the world. They put in place the unlimited insurance. That certainly encouraged folks to leave incremental non-interest bearing deposits in banks. We've certainly got some of those. As that potentially expires at the end of the year, some of those deposits may wash out of the banking system. But in truth I think what we're finding is that investors, corporations, asset managers just don't have very many places to put their excess cash, and so on one hand there's this marginal incentive from the insurance.

On the other hand, there's this need to place cash somewhere and obviously banks are the usual repository of that. And I think what is further factoring into the environment is that there's clearly a differentiation now between the strong banks and the weaker banks. Clearly, there are some around the world that are real challenged with some of the sovereign situations and some of the economic environment, and we don't see any particular concern at our end from the insurance changing or shifting in its nature.

DAVID MACGOWN: Thanks, Eric.

OPERATOR: That concludes the question-and-answer session. Ms. Fiszel Bieler, do you have any closing remarks?

ILENE FISZEL BIELER: Thank you, everyone, for joining our call today. If you have any follow-up questions please don't hesitate to reach out to us in Fixed Income Investor Relations. We'll talk to you again soon.

OPERATOR: Ladies and gentlemen, that does conclude our conference call. Again, thank you for your participation. You may now disconnect.