TRANSCRIPT

Citi Second Quarter 2015 Fixed Income Investor Review
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Host
Peter Kapp, Head of Fixed Income Investor Relations

Speaker
John Gerspach, Citi Chief Financial Officer

PRESENTATION

OPERATOR: Hello, and welcome to Citi's Fixed Income Investor Review with Chief Financial Officer John Gerspach. Today's call will be hosted by Peter Kapp, Head of Fixed Income Investor Relations.

Also as a reminder this conference is being recorded today. If you have any objections, please disconnect at this time.

Mr. Kapp, you may begin.

PETER KAPP: Thank you, Brent. Good morning and thank you all for joining us. On our call today, our CFO, John Gerspach, will take you through the fixed income investor presentation, which is available for download on our website, citigroup.com.

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 2014 Form 10-K.

With that said, let me turn it over to John.

JOHN GERSPACH: Thank you, Peter, and good morning, everyone. We're pleased to be hosting our Fixed Income Investor Review this quarter.

I'd like to begin by highlighting some key points from our second quarter 2015 results on slide 2. Last week we reported a strong quarter, earning $4.7 billion while making continued progress on our execution priorities. We saw balanced performance across our institutional and consumer segments. We grew revenues and achieved positive operating leverage in Citicorp. And Citi Holdings was again profitable during the quarter. Holdings assets are down 22% over the past year to $116 billion, and we've signed agreements to sell an additional $32 billion of these assets, virtually all of which we expect to close by year-end. For the first half of the year, Citigroup's efficiency ratio was 56%, our ROA was 103 basis points, and we generated a return on tangible common equity of 10.5%. We utilized $1.5 billion of deferred tax assets through the first half of 2015, contributing to continued strong capital generation.

We have continued to maintain an efficient balance sheet, growing loans and deposits in Citicorp and generating a net interest margin of 295 basis points for the quarter. Credit quality remains strong across our consumer and corporate loan portfolios. We maintained a strong funding profile as our deposit quality continues to improve, and we executed against our debt issuance plans. And our capital, leverage and liquidity ratios remained strong as we generated $3.5 billion of CET1 capital during the quarter.

On slide 3, we show total Citigroup results adjusted for the items noted on the slide. As I noted earlier, during the quarter, we earned $4.7 billion. Net income grew by over $700 million year-over-year, driven by core improvement in Citicorp. Revenues declined on a reported basis to $19.2 billion but increased 3% year-over-year in constant dollars driven by 5% growth in Citicorp. Expenses declined 7% year-over-year and 1% in constant dollars, mostly reflecting the lower legal and repositioning charges. Our second quarter results provide a solid start to 2015, better demonstrating our underlying earnings power and the impact of the actions we've taken to simplify and streamline our operations.

Turning to slide 4, we show trends in our balance sheet. Our discipline in maintaining total assets at approximately $1.8 trillion over the past year and our efforts to improve the efficiency of our balance sheet help us prepare for regulatory requirements and achieve our return targets. On a reported basis, our total assets declined by over $80 billion in the past year, largely as a result of the dollar's appreciation against foreign currencies, especially the euro, Mexican peso, and yen.

To provide more meaningful insights into our underlying business trends, we presented this slide and several others in today's presentation on a constant dollar basis. On this basis, net loans and deposits in Citicorp grew 4% and 3%, respectively, year-over-year across our businesses, offset by the continued wind down of Citi Holdings. We have maintained a liquid balance sheet, with 27% of our assets in cash and investments and approximately half of our balance sheet funded by deposits. We were able to further reduce short-term borrowings by $13 billion in the quarter and $32 billion from last year as a result of growth in high-quality deposits as we managed our liquidity profile.

Slide 5 shows the trends in our loan portfolio. In constant dollars, total Citigroup loans decreased 1% year-over-year as 4% growth in Citicorp was offset by continued significant reductions in Citi Holdings. Consumer loans grew 1% year-over-year, with broad-based growth driving a 3% increase in international consumer loans.

Corporate loans grew 6% year-over-year. Our corporate lending portfolio increased 10% with growth in North America and EMEA as we continued to support our target clients. Private bank volumes increased, particularly in North America. And TTS loans declined 11% as we have maintained our return profile by reducing our balances of trade finance receivables in response to spread compression in certain markets, especially China.

Citi Holdings' loans decreased 33% year-over-year, driven by a $16 billion reduction in North America mortgages as well as the impact of our previously announced agreements to sell OneMain and the Japan credit card business.

On slide 6, we show continued stability in our consumer and corporate credit trends. In the second quarter, consumer credit remained favorable with a net credit loss rate of 224 basis points. In North America and Asia, trends remain broadly stable. And in Latin America, the NCL rate decreased somewhat from last quarter, consistent with delinquency trends.

Our corporate portfolio also continues to see favorable credit performance. Non-accrual loans remain stable at 38 basis points of corporate loans. Latin America declined as we sold a non-accrual loan, and North America increased primarily driven by downgrades in our energy portfolio. We built reserves against our energy exposures by approximately $43 million in the quarter mainly related to our North America E&P exposures. We again realized virtually no NCLs against the energy sector during the quarter. While we are building reserves, we continue to believe that the risk is well contained and we expect any losses we incur to be manageable.

Turning to slide 7, we show our deposit composition. Citicorp deposits grew 3% in constant dollars with continued high-quality deposit flows across our franchise. Consumer deposits increased 3%, with 4% growth in international markets. Corporate deposits increased 8% year-over-year, with a continued focus on growing high-quality deposits and limiting lower quality deposits such as non-operating deposits of financial institutions. Citi Holdings and other deposits declined significantly year-over-year driven by the impact of our agreement to sell the Japan retail business, which resulted in the re-classification of $21 billion of deposits to held-for-sale last year, as well as the continued transfer of MSSB deposits to Morgan Stanley, which has now been completed.

Slide 8 demonstrates the diversity and stability of our deposit franchise. Over 55% of our deposits are outside the U.S., providing local funding for our overseas operations. We run these operations with balance sheets that are largely matched by currency and liquidity characteristics. Overall, Citigroup's deposits have a 74% liquidity value under the LCR, up 100 basis points from last quarter. We expect deposit quality to remain relatively stable at this level based on our current business mix. Each 100 basis point improvement in liquidity value reduces our HQLA requirement by approximately $9 billion.

In our consumer business, our deposits have an 87% LCR liquidity value. Our efforts to deepen our relationships with retail customers, including increasing the penetration of direct deposit and bill pay as well as other products like mortgages and credit card, have also served to increase the stickiness of our deposits. And in the corporate business, we have increased the liquidity value of deposits to approximately 68%. We have reduced non-operating deposits with 100% runoff to $56 billion currently, down by about one-third over the past year. And we continue to work with clients to grow operating accounts while reducing lower LCR liquidity value deposits.

On slide 9, we update our regulatory liquidity metrics. Our LCR under the U.S. rules is 111%, in excess of the 100% minimum requirement and consistent with the levels we have maintained over the past year. Over time, we would expect to manage our LCR in the range of 105% to 110% based on current regulatory requirements. As of June 30, our HQLA was $386 billion, down $15 billion from the prior quarter. Our estimated net outflows under the LCR declined by $14 billion during the quarter, reflecting the improvement in the LCR liquidity value of our deposits as well as the continued reduction of our short-term borrowings. Continued discipline around our funding structure will allow us to maintain an efficient level of liquidity. On the right side, you can see the composition of our HQLA as of the end of the quarter, over 80% of which is in cash and sovereign debt. We continue to expect the U.S. regulators to propose a U.S. version of the Net Stable Funding Ratio sometime during 2015. We believe that our NSFR is in excess of 100% under the international version of the NSFR rule.

On slide 10, we show Citigroup's net interest revenue and margin. Our net interest margin increased sequentially to 295 basis points, driven by a higher than expected contribution from trading NIM, which can fluctuate quarter-to-quarter. Excluding this impact, our net interest margin would have been closer to 291 basis points, and we expect to maintain roughly this level for the third quarter. Looking to the fourth quarter, our results will depend in part on the timing of a number of upcoming actions, including the completion of our OneMain and Japan retail business sales and our planned debt buybacks.

And as you can see on slide 29 in the appendix, we continue to expect a NIM benefit from a rising rate environment consistent with recent quarters. Our estimate of the net interest revenue benefit in a 100-basis point instantaneous rate shock scenario increased modestly to $2 billion, of which $1.4 billion reflects the impact of U.S. rates. In managing our interest rate risk, we routinely consider the impact of many scenarios, including a range of market and macroeconomic conditions as well as the expected behavior of our clients.

On slide 11, we show the composition of our long-term debt outstanding. During the quarter, our long-term debt increased slightly to $212 billion. Bank issued debt declined $2 billion as we reduced our reliance on credit card securitizations in anticipation of the potential impact of TLAC. Parent company debt increased by $3 billion during the quarter to $155 billion. We currently expect to end the year with total parent company long-term debt of roughly $160 billion. Our weighted average maturity fell to 6.7 years due in part to the repurchase of some longer-dated securities during the quarter. Over time, we intend to maintain our WAM at around seven years. And our total preferred stock stands at $14 billion, providing nearly 110 basis points of additional Tier-1 capital.

On slide 12, we update our issuance and redemption expectations for long-term debt in 2015. For the full year 2015, we expect to issue approximately $25 billion of benchmark debt. We issued nearly $16 billion of senior and subordinated debt during the first half of the year, including offerings in dollars, euros, and

Canadian dollars. For the remainder of the year, we expect to issue approximately $10 billion of benchmark debt.

Year-to-date, in addition to $10 billion of maturities, we have reduced long-term debt by an additional $11 billion including $6 billion of buybacks. For the balance of the year, we expect additional repurchases of $4 billion to $5 billion of benchmark debt. As previously indicated, we expect to buy back some of our higher cost debt in connection with the completion of our sale of OneMain. Consistent with our prior debt buybacks, these will be NPV-positive and will help us lower our cost of funds.

In the first half of 2015, we issued $3.5 billion of preferred stock. We will remain opportunistic around market conditions, and currently expect to issue an additional $2 billion or so of preferred in the second half of 2015, as we continue to build towards 150 basis points of Additional Tier 1 capital.

On slide 13, we update our estimates of our total loss-absorbing capacity based on the FSB's November 2014 consultative document and our ongoing discussions with regulators and other industry participants. We have yet to see any formal proposals or feedback from our regulators, although we continue to expect something this year. Accordingly, consistent with our prior estimates, we include CET1 capital, preferred stock, and unsecured parent-issued senior and subordinated debt with at least one year remaining until maturity, as well as a small portion of our customer-related debt, in our estimates of TLAC.

We estimate Citigroup's total loss-absorbing capacity increased to $273 billion, or 21.3% of our risk-weighted assets, and 11.4% of our total leverage exposure. We calibrate this 21.3% against potential requirements of 22% to 26% depending upon the base TLAC requirement of 16% to 20% and a 3.5% GSIB surcharge – I'll discuss the Fed's final GSIB rules more in a minute. This range translates to $282 billion to $333 billion of required TLAC, or $9 billion to $60 billion more than our current TLAC estimate.

We have identified a number of sources with which to meet this incremental TLAC need, as necessary. As we have previously communicated, we already expect to issue $4 billion to $6 billion of preferred stock, as well as net issuance of $6 billion to $8 billion of subordinated debt to meet our other existing regulatory capital requirements.

Then to the extent that additional TLAC is required, we estimate approximately $10 billion of existing principal protected notes within our customer-related debt may become eligible under the final rules. And an additional $10 billion of customer-related debt could possibly be included with some structural changes to our issuance program. These sources alone total nearly $35 billion of potential TLAC eligible funding. Beyond that, if necessary, we would look to issue incremental senior debt to replace non-TLAC eligible funding, including non-eligible customer-related debt, securitizations and repo financing. So we have multiple ways of addressing our potential TLAC requirements based on proposals to date, but we continue to await formal regulatory guidance or rules.

Turning to slide 14, let me summarize our capital position, which remains among the strongest in the industry. During the quarter, our fully phased-in CET1 capital ratio increased approximately 30 basis points to 11.4%, driven by our retained earnings and DTA utilization, and after returning $1.7 billion to shareholders through share repurchases and common stock dividends. Risk-weighted assets under Advanced Approaches also decreased $5 billion to $1.279 trillion. Under transition agreements, our CET1 capital ratio increased by 50 basis points to 13.8%. Our supplementary leverage ratio grew to 6.7% driven by the strong capital generation and $2 billion of preferred stock issuance, as well as a decline in our leverage exposure. Citibank's SLR also increased 10 basis points in the quarter to 6.7%.

On slide 15, let me address the final U.S. GSIB surcharge rule released yesterday. Our review of the rule is ongoing. With that said, I'd like to make several observations about our current understanding.

While in many ways the final rule is consistent with the December proposal, it does include several important changes. First, the final rule determines the GSIB surcharge based on fixed aggregate measures of systemic importance rather than the relative measures used in the proposed rule. Second, it replaces a spot FX rate with the three-year average of daily exchange rates. And third, it better recognizes the regulatory treatment of certain types of short-term wholesale funding. Most notably, it reduces the penalty for holding non-operational deposits, which have been addressed separately through the LCR.

Under the original proposal, we estimated that we would be subject to a 4% GSIB surcharge. We now expect a 3.5% surcharge based on our current interpretation of the final rule, consistent with the Fed's estimate. While this final rule did not go as far as we would have liked, especially with respect to the treatment of deposits, it is clearly a move in the right direction. As described, this rule affirmatively allows the industry to better measure the impact of specific actions on each firm's GSIB surcharge, consistent with the Fed's policy objectives.

Moving to our last slide, let me summarize four major points. First, we reported solid results in the second quarter with revenue growth and positive operating leverage in Citicorp, lower legal and repositioning expenses and continued favorable credit trends, and we utilized $1.5 billion of DTAs in the first half.

Second, we have actively managed our balance sheet, maintaining total assets around $1.8 trillion and optimizing our assets and liabilities to support client needs and improve returns. Credit trends remain favorable across both our consumer and corporate portfolios, and we have maintained a stable net interest margin.

Third, our deposit base remains a key strength as we continue to improve the liquidity value of our deposits. Our 2015 issuance plans are on track, including preparations for formal guidance related to TLAC.

And lastly, we have continued to prepare our business and balance sheet for the ongoing evolution of the regulatory environment. Our capital and liquidity remain strong.

This concludes our Fixed Income Review. I'll now be happy to take your questions.

QUESTION AND ANSWER

OPERATOR: Your first question comes from the line of Ryan O'Connell with Morgan Stanley. Please go ahead.

RYAN O'CONNELL: Thank you very much, and John, a very helpful presentation as usual. I'd like to talk about two areas, and one is just to clarify some things about Holdings. You've mentioned that there are $32 billion of sales in the pipeline. I guess I'd like to know how much of that is actually reflected in the numbers already. Or let's put it another way. Once those sales are completed, which I think you've indicated might be by year-end, what would be ballpark the level of assets and holdings?

JOHN GERSPACH: Well, it's kind of simple. If you just did those $32 billion, the $116 billion, if all $32 billion closed, would drop down to $84 billion. Now, of course, we'll also have other activities during the third and the fourth quarter, but all $32 billion that I mentioned are contained in the $116 billion.

RYAN O'CONNELL: Okay, great. And then on the earnings call, I think what you said is that the target was to operate Holdings at breakeven – I wasn't sure if it was into next year or through next year?

JOHN GERSPACH: Our goal is to operate Holdings at breakeven through next year.

RYAN O'CONNELL: Okay, great. Second area is on North America cards. Just if we could talk about some of the trends there. If I look at the Branded Cards, purchase sales are up 5%, so that's good. But if we look at the revenues, accounts, loans, they're all down about, let's say, 4% or 5%, and at least one of your competitors, J.P., cards are up about 1%, and sales are up about 7%. So I know you said in the call that Branded Cards is an area for investment, but I wondered if you could share a little bit more color on how you plan to restore growth in that business?

JOHN GERSPACH: That's exactly where the investments would be targeted, Ryan. I think one of the things that we did coming out of the crisis – and certainly during the crisis, we had slowed down investments, as you can imagine in virtually all of our products – coming out of the crisis, we did ramp up marketing spend in Branded Cards if you go back to 2010, 2011, but we really got substandard results from that marketing spend simply because it was really our product array that needed work. So we've been – Jud Linville and his team have been hard at work over the last couple of years to really improve our product offerings, and I think they've done a great job standardizing the product offering on a couple of common platforms. And now that we've got the product array in place, what we believe is our next thing is we need to once again then begin to lift the level of marketing spend that we have in our cards business. So that is something that you will be seeing during the second half of this year and then clearly into 2016.

RYAN O'CONNELL: Okay. Great. Thanks very much.

JOHN GERSPACH: Not a problem, Ryan.

OPERATOR: Your next question comes from the line of Robert Smalley with UBS. Please go ahead.

ROBERT SMALLEY: Hi. Good morning, Peter. Good morning, John. Thanks for doing the call.

JOHN GERSPACH: Hi, Robert.

ROBERT SMALLEY: I had a couple of questions, one on metals and mining exposure, and then just a couple of questions on issuance around TLAC. First, on the metals and mining, could you talk about your exposure to coal, iron ore and copper? Specifically, I'm interested in if you can provide any numbers, but also I know that there has been a lot of reports about regulators clamping down or criticizing more assets in oil and gas. I'm wondering if the same thing has happened in coal and what your experience has been with the portfolio there as we're starting to see some of these companies file or try and restructure their outstanding debt.

JOHN GERSPACH: Robert, I'm sorry. I'm not prepared to talk about anything to do with the metals and mining exposure on this call simply because, quite frankly, as we were preparing for subjects that we thought might be of interest, we didn't see anything in our portfolio that looked like it was going to draw questions.

ROBERT SMALLEY: That answers a lot of that question right there, then. So if we could shift over to a couple of the questions around slides 12 and 13. John, you had mentioned that – and I'm talking about slide 13 here – on potential TLAC requirements, two things you had mentioned: potentially $10 billion in principal protected notes that might be included, and then $10 billion with some structural changes. I believe last time you had alluded to making some modifications in structured notes, but has there been any change, or why did you identify the principal-protected notes as well? Have you gotten any guidance along those lines?

JOHN GERSPACH: No. I think we're just using maybe slightly different words to describe what was essentially the same as last year. The only thing I think we've noted is that we do think now there is probably two groups of $10 billion as opposed to one group of $10 billion. We are getting some feedback that there could be some change in the definitions of the customer-related debt that would be included, and therefore, it is possible that roughly $10 billion of those principal-protected notes might then therefore become TLAC eligible. And then there is also the other $10 billion that we think we could get to TLAC eligibility with some structural change. But all of that is going to be dependent on exactly how the final rule comes out and the specifics that would be contained therein.

ROBERT SMALLEY: Okay. That's helpful. And then finally on page 12, you had mentioned about $10 billion left to do in benchmark issuance this year. So far, I think you've done about $11.5 billion senior, $4 billion subordinated. Will that upcoming $10 billion be in the same proportion senior to sub, or have you fulfilled the sub requirement for 2015?

JOHN GERSPACH: No, I'm not going to address the mix that we might do towards the end of the year. But again, we are focused on doing $10 billion of the benchmark debt, but I really can't give you specific guidance as to what percentage might be or might not be in either of those categories.

ROBERT SMALLEY: Okay. Thanks very much. And thanks for doing the call.

JOHN GERSPACH: I appreciate it. That's okay.

OPERATOR: Your next question comes from the line of David Knutson with Legal & General. Please go ahead.

DAVID KNUTSON: Hi guys. Thanks for doing the call. Couple of questions have been answered, but I wanted to ask a broader question about your emerging market exposures. The outlook, at least I think you talked about Asia being optimistic or optimistic on Asia, but Latin America seems to be struggling. It's a core part of the business. How does – how patient will the bank be with some of the franchises throughout the region as it goes through maybe a cyclical or a structural decline?

JOHN GERSPACH: Yes, David, interesting question. But the good thing is what we have is really – what we've built is truly a client-focused business. We're in these regions to support our clients, and when we take a look at whether it's some of the headline countries that are either in Latin America or Asia or anywhere in the world, for the most part, the business that we do in those countries, certainly on the corporate side – our institutional business – is really focused, for the most part, on the subs of multinational clients that we bank around the world. So we feel very good about the credit quality of those relationships. We're not in those countries competing with the local banks for local businesses.

We're either serving, as I said, the subs of those multinational clients or in certain instances, we'll be serving very large local multinationals. But we tend to focus our business on that specific client segment, and then to the extent we're in those countries with our consumer business, for the most part, our consumer business is really focused on what I'll call the mass affluent customer base. And again, that's largely an urban-based customer segment. And I think you've seen the results of how our credit performance has held up over time in the consumer business. Clearly in Asia, even with everything that had gone on in Korea and to a certain extent still goes on within Korea, our NCL rate in Asia has hovered somewhere between 80 and 96 or 95 basis points. So we think that we're focused on certainly the right customer segment for us, and it's something that we are very vigilant about.

DAVID KNUTSON: The – your comment regarding no increase of NCLs from energy sector exposures, I appreciate. I imagine they flow in over time. Do you have an expectation of when broadly speaking analysts or we should start to expect to see energy companies crack? I guess people have made a lot of noise when the oil price first dropped, but I imagine it takes time for companies to recognize –

JOHN GERSPACH: David, if you think, on a public call, I'm going to tell you the timing of when energy companies are going to crack, come on.

DAVID KNUTSON: All right. So maybe from a different perspective, I'm expecting the losses to come in over time. There shouldn't be any particular quarter. Or is there something about your energy exposures which would lump a loss recognition?

JOHN GERSPACH: I don't think that you should be looking at any lumpy loss recognition. We've built the reserves. We'd like to think that we could manage through this without taking any significant NCLs. During the quarter, as I think I mentioned on last week's call, we did increase our overall exposure to energy and energy-related businesses by $1 billion and $1.5 billion. But importantly, we reduced our exposure to what might be considered to be the riskiest element of that business, which would be the E&P segment. That actually came down. So the E&P segment now represents, I think, something like 27% of our energy portfolio. That's down from north of 30% where it would've been last quarter. So again, this is all part of active management of the portfolio as you would expect us to do.

DAVID KNUTSON: All right. And the last question, it's regarding TLAC. What you laid out, and when you think about the expected timetable to comply with it, it doesn't look to be that punitive unless all the big banks will rush to comply like they have with some of the other rules that have come out. In my mind, this is something that doesn't prohibit capital distributions or some other thing that would encourage management teams to rush to implement it quickly. Is that the right way to think about a TLAC requirement, that the full implementation time period will be used instead of everyone rushing over the next two, three quarters to finish it?

JOHN GERSPACH: That would certainly be my view of it. I can't speak for others, but that's clearly my view.

DAVID KNUTSON: Okay. Thanks very much guys. I appreciate the call.

JOHN GERSPACH: Not a problem.

OPERATOR: Your next question comes from the line of David Jiang with Prudential. Please go ahead.

DAVID JIANG: Hi, John.

JOHN GERSPACH: How are you doing?

DAVID JIANG: A question about – good, thanks. A question about your fully implemented Basel III RWAs. How much of that is operational risk RWAs? And if you could break it down between what's in Holdings and at the Corp.

JOHN GERSPACH: Yes, the overall RWA – the op risk RWA that is in the $1.279 trillion – I think I might have said billion during the call, but I should have said $1.279 trillion – there is $325 billion of op risk RWA in the $1.279 trillion. Within the $1.279 trillion, we've got $169 billion of risk-weighted assets associated with Holdings. And then within that $169 billion, $49 billion of that is op risk.

DAVID JIANG: So $49 billion of the $325 billion is in Holdings?

JOHN GERSPACH: Yes. Exactly.

DAVID JIANG: Okay. How do you think about how that rolls off? Is there a way to think about, as time passes on, that the models will incorporate less of that? Or is parts of it going to go away quicker like Citi Holdings versus Citicorp?

JOHN GERSPACH: No. I would say that in both cases, you're looking at multiple years before you're going to see a meaningful reduction in that amount, even as we continue to sell businesses in Holdings. Just the way the op risk models work and the way, certainly the supervisory guidance that we get indicate that it's the passage of time that ultimately – the passage of time and the non-occurrence of similar events that ultimately then will allow you to begin to take down that exposure. That's why as we think in terms of that $169 billion of risk-weighted assets associated with Holdings, the $120 billion of that that's associated with either credit or market risk, that, as we sell the assets we'll get out of immediately. But that last $49 billion is something that is going to trail out over a number of years.

DAVID JIANG: Got it. Second question I had was, there has been some press reports about potentially selling Banamex USA, and I was wondering if that would – would that change any of the strategy for the Banamex Mexico, the core unit?

JOHN GERSPACH: One, I'm not going to make any comment on anything that could be in the papers, and certainly we don't comment on any sales activities or purchase activities on these types of calls until we're ready to announce something. But BUSA – Banamex USA and Banamex are two separate entities.

DAVID JIANG: All right. Okay. Thank you.

JOHN GERSPACH: Not a problem.

OPERATOR: Your next question comes from the line of Michael Rogers with Conning & Company. Please go ahead.

MICHAEL ROGERS: Yes. Good morning, John. Just a question for you on your Standard & Poor's rating. I'm just wondering, they remain out there with a negative outlook on the holding company as they've been for some time, seemingly awaiting clarity on the TLAC rules. Do you get any sense from them that the solid performance that you folks have certainly put on the board in recent quarters could be increasingly sufficient enough of an offset to save the A-minus holding company rating?

JOHN GERSPACH: Well, that's obviously something that they'll have to determine on their own. I can't speak for them. I know that they're aware of our performance, and I'm sure they'll take everything into consideration.

MICHAEL ROGERS: Okay. Thank you.

JOHN GERSPACH: All right.

OPERATOR: Your next question comes from the line of Louise Pitt with Goldman Sachs. Please go ahead.

LOUISE PITT: Hi. Good morning, guys. Thank you again for holding the call every quarter. It's really helpful. Most of my questions have been answered, but I just have a quick question with respect to the redemption. So that number changed slightly in the slides this quarter, I think. Could you just walk us through what, if any, are your primary drivers about how you're looking at redemptions at this point? Is it currency? Is it maturities? Is it coupon? Is it all of the above?

JOHN GERSPACH: Well, it's really all of that. Some of what we do is we look at individual debt issues that could be trading at wider spreads than what our current secondary trading levels would be. So that provides an opportunity. And it's something that we look at on an issue-by-issue basis, is about all I can tell you, Louise. We look for those inefficiencies and try to address them.

LOUISE PITT: Okay. That's helpful. Just a follow-up question similarly related, but can you just clarify what approvals are needed and what the process for that is with respect to redemption of capital securities – so either Tier 1 qualifying or Tier 2 qualifying securities? Do you have to formally request that from the Fed or is it just a phone call that you make ahead of taking those out?

JOHN GERSPACH: No. Those are all included in the capital plan that we would submit to the Fed, so that would all be part of our CCAR submission.

LOUISE PITT: So that's more of a long-term planning rather than a pure market trading level on those securities in terms of redemption?

JOHN GERSPACH: It's something we certainly need to contemplate in advance.

LOUISE PITT: Okay. That's helpful. Thank you.

JOHN GERSPACH: Not a problem.

OPERATOR: Your next question comes from the line of Arnold Kakuda with Bloomberg Intelligence. Please go head.

ARNOLD KAKUDA: Once again, thanks a lot guys, for having this quarterly call. Really helpful.

JOHN GERSPACH: Our pleasure.

ARNOLD KAKUDA: A quick question on – you talked about the portfolio's sensitivity to interest rates, and I think you mentioned that you slightly increased the sensitivity to rates this quarter. And I just want to contrast that with – I think a peer talked about increasing duration on its balance sheet, and they sort of swapped floating rate instruments for fixed. So I just wanted to see how – what you guys did with the balance sheet versus a peer's comments.

JOHN GERSPACH: The increase that we had, as I said, was fairly slight. I think it went from $1.9 billion to $2 billion. So it doesn't really reflect a significant shift, nor does it reflect any sort of significant change in our overall balance sheet management approach.

ARNOLD KAKUDA: Okay. Got it. Thank you. And then on the GSIB surcharge, clearly, 3.5% surcharge better than the 4% that you expected. But how sticky is that 3.5%? Are there certain things that you can do to mitigate it down to maybe potentially a 3% bucket? And with some of the wind-downs and Citi Holdings for the rest of this year, would that incrementally potentially move you from a 3.5% bucket down to a lower one?

JOHN GERSPACH: Well, even within these buckets, don't forget there are ranges, and so when you look at the buckets, the range at least in the buckets that we would be looking at is, basically it's about 100 points that are in there. So the Fed I think published that we had a score of 714. Our own calculations came out with 715. So we're pretty close to where the Fed was. That – in order to move down to the 3% bucket, we'd have to get under 630. So that would be an 85 basis point move, which is not to say that it's impossible to do, but it's not necessarily something that you're going to be able to do in a short timeframe. And we've had the final rule now for something less than 24 hours.

So it's a little early for us to comment as to the feasibility or the desirability of putting together an active program to move down. The one thing you can say – we have been saying – is we will do everything to continue to make this institution safer and stronger. And simpler and smaller seem to be the order of the day, and it's something that we've been actively looking to do. So we will continue to do everything we can to drive those four things to be simpler, smaller, safer and stronger and still be able to serve our clients. And if that enables us – if we can do that by being in a 3% bucket, then that is exactly what we will do.

ARNOLD KAKUDA: Got it. And then lastly another question on ratings, but more from the Moody's side. You benefited from a notch upgrade on the methodology, but just in light of kind of the stronger earnings that you guys have had in the past few quarters, 9% return on equity for the first half of the year, yet you're still ranked at Baa1 on the senior HoldCo, a notch below others at A3. So I just want to see if you guys are having updated conversations with Moody's and getting their thoughts on your fundamental improvements there.

JOHN GERSPACH: Yes, no, we have conversations with each of the rating agencies on a very regular basis, so they are fully aware of the progress that we have made, and we're very hopeful that at the appropriate time, they'll – each one of them will recognize the progress that we think is evident, in not just our net income performance, but in the construct and the management of our balance sheet.

ARNOLD KAKUDA: Great. Thank you very much.

JOHN GERSPACH: Not a problem.

OPERATOR: Your next question comes from the line of Michael Rogers with Conning & Company. Please go ahead.

MICHAEL ROGERS: Yes, John. Just a follow-up. These have been awful good times in lending for quite a period of time now. And I just wanted to get your bigger picture view as to where you may see excesses developing in lending that Citi has or will make a conscious effort to pull back from.

JOHN GERSPACH: Well, again, we try to be – we try to look very closely at every one of the activities that we're involved in. I think you'll note that we have been steadily moving down the league tables when it comes to leveraged finance, and so that might give you some indication of one of the areas at least that we would look at with somewhat less enthusiasm than others.

MICHAEL ROGERS: Okay. Thank you very much.

JOHN GERSPACH: Not a problem.

OPERATOR: Okay. Your next question comes from the line of Scott Cavanagh with APG. Please go ahead.

SCOTT CAVANAGH: Thanks guys. I really do appreciate you doing this call every quarter. It's clearly a star performer in the industry on this perspective. I have a question on regulatory updates – could you hear me?

JOHN GERSPACH: Yes, I just said thank you.

SCOTT CAVANAGH: Sorry about that. Okay. So I just have a question on upcoming regulatory rulings or potential rulings. When we think about the single credit counterparty limit, how does this impact you and what are you guys expecting?

JOHN GERSPACH: I'm sorry, Scott. That's one area that I just don't have anything prepared on that one. I haven't looked at that in the last couple of days, and I'm sorry. I just can't.

SCOTT CAVANAGH: I had to try. I had to try. And again, thank you very much for the call.

JOHN GERSPACH: Yes, you got me. Not a problem.

OPERATOR: Thank you. That concludes the question-and-answer session. Mr. Kapp, do you have any closing remarks?

PETER KAPP: Thank you everyone for joining the call today. If you have follow-up questions, please don't hesitate to reach out to us at Investor Relations. We'll talk to you again next quarter.

OPERATOR: Thank you. This concludes today's conference call. You may now disconnect.

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