TRANSCRIPT

Citi Third Quarter 2011 Fixed Income Investor Review
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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 your conference.

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 2010 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. Last quarter we discussed some of our key accomplishments, particularly our strong capital position, robust structural liquidity, and disciplined balance sheet management. Today we're going to update you on our continued execution and progress in those areas. Eric Aboaf, our Treasurer is going to take you through specifics on credit fundamentals, balance sheet progress, our liquidity profile, our capital position, as well as provide a review of our recent issuance activity and our current funding plans for the current year.

Many of you may have joined us for Monday's earnings call and there are some key points from that call that I would like to re-emphasize to start us off here on slide 1. We announced net income of $3.8 billion or $1.23 per share for the third quarter. When you exclude CVA and focus on our operating results, we earned $2.6 billion or $0.84 per share. These are solid results, particularly in a macro environment in which economic and political uncertainty created a lot of market volatility.

Over the past few years we have methodically positioned Citi for the trends and opportunities we see in the world. We built substantial financial strength, de-risked our balance sheet, and re-oriented our business back to what we do best and what's in Citi's DNA: being a uniquely global bank focused on capital flows and global trade, with a particular focus on the emerging markets.

I believe that Citi's performance during this quarter shows the significant progress that we have made in improving our risk management. We have completely revamped our risk profile, risk approach, and most importantly, our risk culture. We put in place robust practices in the businesses and regions to integrate risk analysis into decision-making.

More than 18 months ago we recognized the potential for Greece's sovereign debt issues to impact other countries in the Euro zone. Since then we have reduced our exposures where needed, while continuing to serve our clients diligently. As you will see, we have continued to closely manage our trading and AFS portfolios in the GIIPS, France and Belgium and currently have no material net exposure to sovereign debt securities in those countries. Eric will go into further detail on our enhanced risk management and update you on our European exposures later during the call.

We continue to be very transparent about our U.S. mortgage exposure. We have a smaller owned mortgage portfolio than any peer. Because of our aggressive risk mitigation efforts which include selling mortgages, our portfolio has shrunk faster than any peer, and in a period of uncertainty, we believe that we hold the largest reserves against that portfolio.

We have the smallest servicing portfolio and the smallest securitization portfolio of any peer. While we continue to focus on the risk of the mortgage portfolio, particularly if the economy were to weaken, we feel very good about all the steps we have taken and how we are positioned today.

Regarding Citi Holdings we decided to move the vast majority of our Retail Partner Card business to Citicorp. We have made a lot of progress in strengthening this portfolio including shedding some assets and re-underwriting the portfolio to much higher credit standards. The portfolio is now two-thirds of its size at its peak with an average balance weighted FICO of more than 700.

As importantly, the Credit Card business and the availability of credit have changed since the enactment of the Card Act. Consumer behavior has also changed as branded cards carry smaller open lines, consumers would rather use retail cards to preserve and protect their open lines of credit with banks. With this transfer, pro forma Holdings assets will total about $250 billion or 13% of Citi's balance sheet. Although we continue to analyze the Holdings portfolio, we don't expect any other transfers of this magnitude and our goal is to get Holdings below 10% of the balance sheet in the near future.

Next, Citi has built unquestionable financial strength over the past several years. At the end of the third quarter our Tier 1 Common ratio was 11.7% and we had approximately $145 billion in tangible common equity. Almost 25% of our balance sheet is cash or liquid securities. We have enough liquidity that we could operate without issuing long-term debt for a couple of years. Although we still plan to participate in the debt markets. And as we have been saying for the better part of a year, we expect to end 2012 with an 8% to 9% Basel III Tier 1 Common ratio and, subject to regulatory approval, we plan to begin returning capital to shareholders next year.

Turning to slide 2, I would like to highlight some of our key earnings results from the third quarter. Citigroup reported third quarter net income of $3.8 billion or $1.23 per diluted share. This quarter's results included significant CVA of $1.9 billion driven by Citi's credit spreads widening. Excluding CVA, earnings were $2.6 billion or $0.84 cents per share in the third quarter.

Revenues of $20.8 billion were roughly flat versus the prior year on a reported basis. Excluding CVA from both periods, revenues were down 8% as continued strong growth in International Consumer Banking and Transaction Services was more than offset by lower revenues in Citi Holdings, Securities & Banking, and North America Consumer Banking.

Expenses of $12.5 billion were up 8% year-over-year and down 4% from last quarter. Year-over-year roughly three-quarters of increase was driven by the impact of foreign exchange, higher legal and related costs, and the absence of one-time benefits in the prior period. Excluding these items, operating expenses grew 2% year-over-year in the third quarter driven by higher investments, partially offset by productivity savings, and other expense reductions.

Cost of credit continued to improve year-over-year, down 43% to $3.4 billion. Sequentially, end of period loans declined 2% for Citigroup, however, reported loans included a net negative impact from foreign exchange in the third quarter. On a constant dollar basis, total Citigroup loans were up 1% sequentially as loan growth in Citicorp more than offset the decline in Citi Holdings. And now let me turn it over to Eric.

ERIC W. ABOAF: Thank you, John. This quarter we continued to build a foundation for growth. Our results demonstrate this clearly as you can see here on page 3. Both our capital and liquidity are robust no matter which measure you use.

We continue to make progress in de-risking the balance sheet, which provides us with ample capital and liquidity to strategically invest in the future. Holdings assets have declined by more than 65% from their peak in 2008 to $289 billion and now stand at just 15% of our balance sheet. We are seeing continued improvement in credit trends with net credit losses in the third quarter down 41% from a year ago, and non-accrual assets down 44% year-over-year. We are well reserved with loan loss reserves of more than $32 billion or 5.1% of loans.

With this strong balance sheet, we have the resources and the capabilities to help our global clientele navigate the current market environment, and we are well positioned to capitalize on our significant presence in emerging markets. As an example, for the fifth consecutive quarter we grew total loans in Citicorp.

Let me start out by taking you through our credit trends, which show continued improvement for the ninth consecutive quarter. Slide 4 shows total Citigroup net credit losses and loan loss reserves. NCLs continued to improve in the second quarter, down 12% sequentially to $4.5 billion, and the net LLR release was $1.4 billion versus $2 billion in the prior quarter.

Let me describe our credit trends in two broad buckets: corporate and consumer. The first major area is corporate credit, which you see at the top right. Corporate credit costs were $86 million in the third quarter, compared to a benefit of $104 million last quarter. Corporate net credit losses were down 22% sequentially to $272 million. We had a small reserve release, as a release in Citi Holdings this quarter was partially offset by a modest build in Citicorp to reflect the continued growth in corporate loans and commitments. Corporate non-accrual loans of $4.2 billion were down 14% versus the prior quarter.

At the bottom right of the page you can see the second major area, consumer credit. Consumer NCLs declined 12% sequentially to $4.2 billion, and we released $1.2 billion in net loan loss reserves. Along the bottom of the slide you can see that we ended the quarter with $32.1 billion of total loan loss reserves or 5.1% of loans.

On slide 5 we have an overview of our credit trends in North American cards and mortgages. The top half of slide 5 shows our North American cards portfolios. Credit trends for both Citi-Branded cards and Retail Partner Cards continued to improve. In Citi-Branded cards, NCLs declined for the sixth consecutive quarter. NCLs decrease by 11% sequentially to $1.1 billion, and 90-day plus delinquencies were down 13% to $1.1 billion as well. In Retail Partner Cards, NCLs were down for the eighth consecutive quarter. NCLs decreased by 19% sequentially to $0.8 billion, and 90-day plus delinquencies declined by 4% to $1 billion.

Given investor interest in mortgages in general, I wanted to spend a moment reviewing our North American consumer mortgage portfolio, notwithstanding that our portfolio is significantly smaller than that of other large U.S. banks. To be clear, as we did last quarter, we are including Citicorp and Citi Holdings consumer mortgage portfolios together in this presentation. For the combined portfolio, NCLs and 90-day delinquencies continued to improve in both residential first mortgages and home equity in the third quarter.

With respect to our first mortgages in Citi Holdings, in recent quarters both asset sales and the pace of modifications of these mortgages have slowed as we have a smaller pool of eligible delinquent loans to sell or modify. At the same time, our early bucket delinquencies are beginning to increase, reflecting re-defaults of previously modified mortgages. As a result of these converging trends, we could begin to see increasing delinquencies and net credit losses in the first mortgage portfolio within Citi Holdings.

However, expectations for re-defaults, and a resulting increase in net credit losses, are already factored into our net loan loss reserve balance. In fact, for our total North American consumer mortgage portfolio, our reserves currently cover over 30 months of NCLs.

The last part of our credit portfolio is International Consumer. Credit trends remain stable in Asia and continue to improve in Latin America. You can find additional details on International Consumer credit in the appendix of the presentation.

Turning to slide 6, now that I've covered our credit trends in both Corporate and Consumer, let me describe our progress in investing to grow Citicorp, which includes our Regional Consumer Bank, Global Transaction Services and Securities & Banking businesses. This is especially pertinent now that Citicorp and Corp/Other together represent 85% of our balance sheet.

On the left you see Citicorp and Corp/Other, which is up 5% year-over-year as we continue to reinvest in the franchise. Here you can see how we have deployed our balance sheet to support our customers over the past year in Citicorp. For example, net loans, which is our largest asset category, is up approximately $55 billion year-over-year as we continue to lend to both consumer and corporate clients. The combination of trading assets and secured lending is up approximately $44 billion, as we have ample market-making capacity to facilitate transactions to support both our investor and corporate clients around the world. On the right, you see Citi Holdings assets, which are down 31% year-over-year, and which I will come back to in a moment. Our Citicorp, Citi Holdings strategy continues to provide us the flexibility to re-deploy our capital and take advantage of growth opportunities around the world.

Turning to slide 7, looking at Citi Holdings in more detail, let me further describe our progress in reducing the amount of higher-risk assets. The sequential $19 billion reduction of Holdings assets occurred across many portfolios and businesses and was comprised of roughly $10 billion of asset sales and business dispositions, approximately $7 billion of net run-off and paydown, and roughly $2 billion of 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 53% and 27% respectively, from the third quarter of 2010.

As John mentioned earlier, we decided to move the vast majority of our Retail Partner Card business to Citicorp. We've made a lot of progress in strengthening this portfolio, including shedding some assets and re-underwriting the portfolio to much higher credit standards. The portfolio is now two-thirds of its size at its peak and with an average balance weighted FICO of more than 700. Clearly we are continuing to make significant progress executing on our Citi Holdings asset reduction strategy, although, as we have stated, we believe the pace of reductions will continue to moderate.

Turning to slide 8, given our healthier balance sheet, as I just explained, we have been deploying capital in our Citicorp businesses. So let me describe what we are seeing in loan volumes. In Citicorp, loans grew to $444 billion, up 13% year-over-year, including 6% growth in Consumer and 21% growth in Corporate loans. This quarter's results represented the fifth consecutive quarter of Citicorp loan growth.

In our institutional businesses, lending increased more than 41%, in Global Transaction Services from the prior year driven by trade finance lending in Asia, Latin America and EMEA. And we saw 15% growth in our Securities & Banking corporate loan book with increased borrowing across all major client segments.

International Consumer Banking loan volumes increased 8% year-over-year led by Asia and Latin America. These trends reflect the economic growth in these regions as well as the results of our investment spending. North American Consumer loan volumes were up slightly driven by Retail Banking loans as the cards market continues to adapt to the CARD Act and other regulatory changes. Overall, we are reaching an inflection point which is most evident when you adjust for the currency swings which you can see along the bottom of the page. In fact, Citigroup loans have been growing quarter-over-quarter since the beginning of this year, as Citicorp loan growth has outpaced the reduction of loans in Citi Holdings.

Turning to slide 9, having covered loans in some detail I wanted to take a moment to discuss some key indicators of customer activity around the world. In addition to loan volumes we are also seeing results from our investments in Citicorp across major business drivers, including higher deposits and cards purchase sales volume. And in particular, Citicorp continues to benefit from a strong emerging markets franchise.

On the right-hand side for example, looking at Asia, and Latin America, we are seeing momentum from past investments. Both regions are demonstrating consistent strength with continued loan growth in all businesses as well as cards purchase sales increases of 8%, and 18%, respectively. This strength in customer activity has helped us achieve positive operating leverage in Asia this quarter, and sets us up for a positive operating leverage in both Asia and Latin America next quarter. As you have heard us say before, our investments skew towards those businesses that give us a good rate of return, and as a result, we are on track to deliver on these investments.

Turning to slide 10, this page shows how we are also improving the quality of our deposits as we build the base. You can see on the chart that we are actively changing the composition of our deposits. Time deposits, where rates are fixed for the term of the deposit and which have lower margins are becoming a smaller proportion of our base, whereas operating accounts are becoming a larger proportion of our deposits. These checking and saving accounts for individuals and cash management accounts for corporations provide wider margins and have exhibited stickier behavior. Year-over-year our deposit mix has shifted significantly. Operating accounts now represent 74% of our overall Citicorp deposit base, where last year they represented approximately 66%.

This quarter, in keeping with our client-focused model, we saw operating deposit growth across almost all our deposit-taking businesses, including Retail, Private Bank and Global Transaction Services. We continue to see inflows based on the strength of our product and service offerings as well as due to the highly liquid position many corporate clients find themselves in.

In summary, we continue to focus our pricing strategy to minimize our borrowing costs and believe we have a high-quality diversified and stable deposit base across our businesses and around the world.

On Slide 11, I want to show you how some of the drivers we have just reviewed are contributing to our net interest margin. This quarter we saw the rate of NIM decline starting to moderate. This was due to a few factors including a shift in the mix of our balance sheet. On the asset side, as Citi Holdings continues to shrink, some our higher-yielding loans are running off. That NIM pressure is somewhat offset by growth in Citicorp's loan portfolio. Loans, adjusted for currency translation grew slightly quarter-over-quarter and have become a larger proportion of our balance sheet over time as you can see on the bottom of the page.

On the liability side we have been focused on reducing our borrowing costs. In the bank, we have been substituting maturing long-term debt – which is a more expensive source of funding – with deposits. And as you have heard me say deposits are our lowest cost source of funds. This has a positive impact on our NIM. In addition this quarter, our NIM was positively impacted by the absence of certain borrowing costs that we had in the second quarter in our trading businesses. As those positions rolled off in the third quarter, we had a one-time improvement in our NIM.

Looking forward, absent any other significant changes, our NIM is going to continue to reflect the pressure of a low interest rate environment and subsequent changes in our portfolio. As such, we expect NIM could continue to come down a couple of basis points each quarter.

Moving to slide 12, having discussed credit and balance sheet trends, now let's review Citi's liquidity and funding strategy, which has been a cornerstone in our efforts to re-shape the balance sheet. 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 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 G-7 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 globally diversified deposits. In our non-bank businesses we use a modest amount of short-term funding, such as repos, to fund liquid assets. We then use a range of long-term debt instruments to cover our broader business needs.

On slide 13, you can see the size of our liquidity buffer, which is defined as cash and highly liquidity securities. It stood at approximately $300 billion at the end of the third quarter. This quarter our high level of bank liquidity is down modestly as we have consciously deployed some of the excess into loan growth in Citicorp, as well as paying down long-term debt. At the same time we have increased our non-bank liquidity to support our broker-dealer and continue to believe that this range is proportionally calibrated to the size of our balance sheet and current market conditions.

In addition to these high levels of liquidity, let me refine remind you of the fungibility of our liquidity at Citi. In general, Citigroup can freely fund legal entities within our bank vehicles. In addition, under section 23A of the Federal Reserve Act, our bank can fund our non-bank entities with as much as $22 billion, as long as it is collateralized appropriately. And finally, it is also worth mentioning that we only include our on balance sheet liquidity buffer her; as such, we don't include borrowing capacity at the Fed Discount Window, or with the FHLBs, as part of our aggregate liquidity resources. That capacity is over and above what you see on this page.

On slide 14, given the recent market disruptions in the funding market, I would like to spend a moment discussing how we think about the appropriate level of liquidity resources that we hold at the parent company level and our broker-dealer subsidiaries. We use a variety of metrics and stress tests to determine the appropriate amounts of liquidity resources. These include internal stress tests as well as the Basel III Liquidity Coverage Ratio which, as I have said before, we are already in compliance, with even though those requirements are not scheduled to come into effect until 2015.

You can see on the left-hand side of the page that we have $100 billion in non-bank aggregate liquid resources. As I just mentioned, we have been purposely running with additional excess liquidity outside the bank given current market conditions. Just to the right of the bar you can see that we had commercial paper of approximately $9 billion at the end of the third quarter and that it would take 8 quarters for approximately $80 billion of non-bank long-term debt to mature. This means that we have enough liquidity that we could operate without issuing long-term debt for more than a couple of years, although we still plan to participate in the debt markets.

Turning to slide 15, let's review our long-term debt trends and our liability management initiatives. 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 de-leveraged the balance sheet, especially in the bank. In the bank, in fact, we have consciously reduced debt funding as we have grown our deposit base. We also let an additional $2 billion of TLGP debt run off in the bank in 2010, and another $10 billion will mature during 2011.

Looking at the non-bank at the bottom half of the page, long-term debt has decreased modestly as we have let TLGP roll off while keeping a healthy amount of funding for our broker-dealer. In the non-bank, approximately $5 billion of TLGP debt matured in 2010 and approximately another $11 billion is maturing in 2011. We have not, and will not, replace this TLGP debt. As you can see here with our current estimate for year-end 2011, 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 16, you can see our actual maturities for the nine months of 2011 and expected maturities of long-term debt over the next two years. This chart clearly shows that maturities peak in 2012, and come down in 2013. As we see in light blue atop the first two column columns, TLGP debt represents a significant amount of maturities in 2011 and 2012. Many industry observers have noted that this wave of maturities is an industry-wide situation which came about as many banks issued TLGP and other government guaranteed debt in 2008 and 2009. As I have said before, for us at Citi, we do not expect to replace TLGP maturities. As we have demonstrated and reviewed on prior slides, the reason is clear: as we continue to reduce and de-risk our Citi Holdings balance sheet in both our bank and non-bank entities, our need for long-term debt is coming down.

During the first nine months of 2011 we issued approximately 12 billion of long-term debt. We issued a across multiple tenors and currencies in both benchmark and structured notes. We are revising down our expected full year forecast from approximately $20 billion to approximately $15 billion as our non-bank liquidity levels continue to come in ahead of forecast. This leaves approximately $3 billion of issuance left for the rest of 2011 which puts us in a position to issue opportunistically in the fourth quarter.

Turning to slide 17, we continue to issue the majority of our long-term debt as benchmark transactions. The broad-based issuance franchises that we have built over time provides us access to reliable and diversified funding sources. These include issuing in multiple currencies including U.S. dollar, Euro, Japanese Yen and Sterling; issuing across tenors including 2s, 3s 5s, 10s and 30s; and satisfying demand across a broad spectrum of investor segments.

However, we have seen favorable market conditions in investor demand for structured long-term debt this past quarter. As many of you know, structured debt is sold through high-net-worth, institutional and other channels. The ability to customize issuances to investor preferences at favorable funding levels for Citi has increased the attractiveness of structured notes for us over the past quarter. These notes are typically linked to currencies, equities and commodities. We will continue to issue a mix of funding, of course, and expect benchmark debt to continue as an important funding source.

Turning to slide 18, let me describe for you the current status of our ratings, a topic we have discussed quite a bit over the last year. On the top half of the chart you see our senior debt and commercial paper ratings for Citigroup and on the bottom half are long-term and short-term ratings for Citibank. In recognition of our progress, our unsupported ratings have been improved at all three major agencies – Fitch, S&P and Moody's – over the past year and a half or so, thereby narrowing the gap between our supported and unsupported ratings.

Fitch has indicated that regardless of possible future lowering of government support from our ratings, as long as our credit profile remains stable or improves, we would retain our long-term rating in the ‘A’ category and short-term rating of at least ‘F-1’. And just last week in fact Fitch placed the unsupported standalone ratings of eight large banks on negative watch. Citi was not included in that negative review.

Also recently, S&P announced that they are finalizing their new bank rating methodology, and are expected to publish the final criteria first and make any associated recalibrations in the fourth quarter of 2011. As you are all aware on September 21, 2011, Moody's upgraded our unsupported ratings and affirmed our long-term debt rating at the bank and holding company levels. At the same time, however, as a result of an alignment to its rating methodology, Moody's changed the short-term rating of Citigroup, the holding company from ‘P-2’ to ‘P-1’. This has had no material impact on our funding profile or our business.

So turning to slide 19, let me talk about capital which continues to be an area of significant strength for us and supports the lending growth that I have previously described. At the end of the third quarter our Tier 1 and Tier 1 Common ratios were 13.5% and 11.7% respectively, up from a year ago and flat to the second quarter. Our GAAP assets increased 2% year-over-year, our risk-weighted assets stand at $982 billion, and Citi Holdings now represents approximately 27% of the total. As you know, our capital base is one of the strongest in the industry.

Moving to slide 20, we show more detailed capital walks, quarter-over-quarter and year-over-year. During both time periods we had growth in our capital ratios. On a quarter-over-quarter basis however, you can see that while our Tier 1 Common capital ratios increased, our absolute level of Tier 1 Common capital was roughly flat. Let me give you a bit more detail on the drivers.

We started the quarter with $115 billion of Tier 1 Common capital. Net income excluding CVA on Citi's fair value option debt contributed $2.8 billion of capital, and we raised an additional $1.9 billion through the conversion of equity units during the quarter. Our capital has also been reduced by a net $3.6 billion, driven by the strengthening dollar in the last few weeks of September. This cumulative translation adjustment – net of related FX changes in goodwill and other intangibles – arises from the translation of non-dollar denominated capital into U.S. dollars for reporting purposes. All other capital movements were a net negative of roughly $1.1 billion and included cash flow hedges, AFS, changes in the DTA allowed, pensions and so forth.

While the absolute level of capital this quarter was impacted by foreign exchange swings, we proactively mitigate this impact by hedging our capital ratios, which is why they still rose. We do this by partially hedging the movement in capital balances and intangibles in line with the expected currency translation of the risk-weighted assets. In the third quarter, our risk-weighted assets were reduced by the strengthening dollar by approximately $27 billion, which would offset the capital translation adjustment after hedging.
In addition, however, our risk-weighted assets increased, excluding the effect of foreign exchange, by approximately $16 billion due to a modest expansion in our loan book and higher market volatility factors flowing through the risk weighted asset calculations in our trading book. These changes were in line with expectations. As Vikram reiterated on Monday, we expect to end 2012 with 8% to 9% Basel III Tier 1 Common ratio, and subject to regulatory approval we plan to begin returning capital to shareholders next year.

Moving over to slide 21, a number of you have asked for more information regarding risk management at Citi. This slide provides an overview of some of the structural changes we have made in risk management in the past few years as well as specifics on how we manage risk day-to-day. On the top half of the page, we have outlined some of the fundamental organizational changes, as well as enhancements in risk identification, and our processes to measure and report risk. Citi's risk culture is now based on managing and taking intelligent risk which means balancing the earnings capacity of a business, relative to the deep downside tail risk. The risk management organization establishes the policies and guidelines for risk assessment and management and ensures the appropriate controls and tools are in place to manage, measure, and actively mitigate risks taken. While many of these actions are responsive to the type and scale of losses seen in 2007 to 2009, more importantly, they greatly improve our ability to identify and manage all types of risks.

The bottom half of the page describes how we actively manage market, credit, operational and franchise risks in a matter consistent with Citi's risk appetite on a day-to-day basis. For example, within products, businesses, and geographies, we employ concentration and counterparty limits at multiple levels. We adjust these as necessary based on the market environment and with our strategic intent. Our day-to-day risk management is dynamic, and provides key early warnings with the goal to protect and build shareholder's equity.

Having provided you with some texture around how we manage risk, slide 22 is a specific and timely example. More than 18 months ago we recognized the potential for Greece's sovereign debt issues to impact other countries in the Euro zone. Since then we have reduced our exposures where needed, while continuing to serve our clients. At the end of the third quarter, Citi's gross funded exposures to GIIPS was $20.6 billion, and our combined gross funded exposure to France and Belgium was $14.4 billion. Netted against our gross funded exposure, we have margin posted under legally enforceable margin agreements, collateral pledged under bankruptcy remote structures and purchased credit protection from financial institutions. These amounts total $13.5 billion for GIIPS and $12.4 billion for France and Belgium. Credit protection has been purchased from high quality financial institutions, predominantly outside of these seven countries.

Net of margin, collateral and credit protection, our net current funded exposure to GIIPS at the end of the third quarter was $7.1 billion. And our net funded exposure to France and Belgium was $2 billion. We also hold collateral totaling $4.4 billion for GIIPS and $4.1 billion for France and Belgium, which have not been netted from these amounts. We continue to carefully manage these exposures while serving our important clients in these countries.

Moving to our last slide, let me summarize four major points. First, we see continued strength in our core businesses. We believe these trends position us for sustained growth in our three core businesses: Securities & Banking, Global Transaction Services, and Regional Consumer Banking. And as I stated earlier, we achieved positive operating leverage in our Asia Regional Consumer Banking business this quarter, and expect to do the same in Latin America Regional Consumer Banking during the fourth quarter of this year.

Second, we have significantly improved our structural liquidity over the last three years by increasing our capital base in deposits, and by reducing assets. We believe we have ample liquidity as you saw, and our lending activities declines continue to increase. We continue to believe the company will continue to exhibit quarter-over-quarter loan growth.

Third, we will have a significant lower proportion of our wholesale funding going forward. We currently have modest long-term debt reissuance plans for the next two years. We will not be replacing the maturing TLGP debt and so we expect that our long-term debt outstanding will continue to decline.

And fourth, 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.

That concludes our fixed income review. John and I would be happy to take your questions.

OPERATOR: [Operator Instructions]. Your first question comes from the line of Ryan O'Connell with Morgan Stanley.

RYAN O'CONNELL: Thank you very much. First of all, John and Eric, I want to thank you for all the additional detail on the International Consumer loans, that's very, very helpful. And my question is on the Latin American operations. I'm just – I'm trying to get a clearer picture of the outlook for it because on the one hand you're getting good loan growth, delinquencies are going down, and yet the profits have been going down for the last couple of quarters. Now, it looks to me it's because you're now starting to build reserves rather than release reserves. So I guess two questions. One, are you starting to build reserves because you have any concern for the credit quality of the books, or is it that you're just getting back to a more if you will normal level of provisioning and reserve build?

JOHN C. GERSPACH: It's John, Ryan. Good question and I think you pretty much have answered it. When you take a look at Latin America – one of the reasons why in every one of those businesses, if you look at the investor deck that we used on Monday, we give you a pre-tax income excluding loan loss reserves, so that you can actually see the continued momentum in the business from what we would consider to be pure operating results and taking out the variability that comes from reserve releases and builds.

The other thing with Latin America – especially this quarter – the peso devalued about 15% this quarter against the dollar. Rather sharp movement and so obviously as you're doing quarter-to-quarter comparisons, you're going to have a significant impact on the reported results just from the change in FX. It's one of the reasons why we have given you a lot of the information in a constant dollar format. So you can help that.

And then finally to your last point on reserve builds. As your portfolios build, even if your credit quality is improving, you reach a point where you just can't release reserves any more and you need to get back into some reserve build. This quarter's reserve build in Latin America though, it was impacted by a couple of specific credits in our local commercial book and so it was perhaps a little bit larger than you would have otherwise expected it to be just because of the portfolio growth. But in general, we're very comfortable with the underlying credit of that portfolio and in particular, we continue to see the credit quality improving in the credit card book in Mexico.

RYAN O'CONNELL: Thank you very much.

JOHN C. GERSPACH: Okay.

OPERATOR: Your next question comes from the line of Mark Kehoe with GSAM.

MARK KEHOE: Good morning, just a question in terms of the composition of the debt that you may issue into the rest of the year. Can you talk about whether it would be – kind of the tenor and whether it would be structured notes or institutional deal or even a $25 par deal? Thank you.

ERIC W. ABOAF: Mark, it's Eric Aboaf. As you imagine, we are constantly out there thinking about what are the best funding opportunities for us, right? So we're certainly looking across the mix of maturities, right? You saw us earlier in the year issue quite a bit of 2s and 3s. The market was particularly attractive for those. We've issued 5s before, 10s before and obviously we will continue to look across that spectrum. And obviously we also need a certain weighted-average-maturity in our book to keep the funding profile healthy. So we need to issue across the tenor buckets.

In terms of benchmark debt versus structured debt, I think it's really going to be a mix. Part of the reason we showed that extra decomposition this quarter for you, as well as the history, just to give you a sense that there is some moving up and down in the different categories, and that's because of some market factors that we see where we sometimes get better pricing and better – well, literally better pricing and good volumes in the categories, and those tend to swing around based on investor demand, market conditions, what's going on in different parts of the world. And obviously from a shareholder perspective, we want to optimize the lowest-cost funding source, so we'll continue to look across and find those unique opportunities.

That said, we'd like to – we will be – always maintaining the strength of our benchmark program, and we want to also maintain the strength of our structured note program, so you'll see a mix of both.

MARK KEHOE: Great. Then the last question I have, we've seen some strong deposit growth at some of your peers, maybe less so for you. Is there any reason for that?

ERIC W. ABOAF: It's a good question, right? Clearly with the market uncertainty there is deposits from corporations, let's say, are maybe being pulled out of some of the regions of the world or countries where there are some concerns. I think what you have to ask yourself is, are the flows that folks are seeing, are they really long-term, sticky operating account deposits? Or are they just the hotter money, time deposit, price-sensitive balances that are sloshing around the world? Because, I think as you saw on our page 10, we're very focused on those operating balances. It's checking and savings for consumers. It's embedded cash management for multinationals, because that's really sticky deposits, and low-cost deposits. And that's where we're focused on building our book. You see this quarter we've adjusted for the currency translation, we've continued to build that book. And I think you just have to, as you analyze us and other peers, you actually have to get to that level of detail to understand what they're really picking up and the value of those balances.

MARK KEHOE: Great. Thank you.

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

ROBERT SMALLEY: Hi, thanks very much. Three quick questions, if I can. First on 23A, you had mentioned this last time in the call, too, as an alternative with respect to moving around liquidity. My question is, with respect to B of A we saw in the past couple of days a lot of blow-back from the market when they moved various things around between the holding company and the bank. Is this something that you still look at, or are you reconsidering this as an alternative? And is there a Plan B beyond 23A?

ERIC W. ABOAF: Robert, it's Eric here. I'm not very familiar with some of the changes you mentioned at some of the peers. What I can tell you about 23A is that it is a facility that's available to us. It's there as part of our contingency funding plans, which you know we review in detail internally with everyone through the senior management and the Board, and we also review with our regulators. So it's absolutely an arrow in the quiver, from a liquidity management standpoint, and is a good arrow in that quiver. I mean, it is also, though, not the kind of liquidity access that you start with. We have a large number of other opportunities to build liquidity, maintain liquidity, enhance liquidity during crises, that we would prefer to start with, and obviously we do start with and have started with before. And so it's one that you get to eventually, but certainly not up front.

ROBERT SMALLEY: So it's fair to say that for you that's a Plan B, Plan C, et cetera, type of move?

ERIC W. ABOAF: Yeah. I don't like to categorize things in letters from my school days but, yeah, it's further down the list, absolutely.

ROBERT SMALLEY: Okay. Second, on – and I just want to touch on this briefly. You talked about returning capital to shareholders. I know we've talked about in the past the FDIC-held TruPS. Will some kind of different solution, negotiation, around those occur as part of next year's comprehensive capital review, or is it something you're looking at between now and that time?

JOHN C. GERSPACH: It's John. The FDIC holding of the TruPS, that's separate from anything to do with our submission of capital plans. The capital plan, the CCAR, and I'm going to assume that they're going to call it CCAR again, that's a program administered by the Fed. Any discussions that would be happening with the FDIC regarding their TruPS would be outside of that process.

ROBERT SMALLEY: Okay. But I think my understanding was that you needed to take care of one in order to do the other.

JOHN C. GERSPACH: No. I think we've addressed this on other calls. The FDIC, as part of holding those TruPS, needs to approve – it doesn't say that we can't return capital. It's just that we need to go through the FDIC. And when you think about it, when the Fed takes a look at the CCAR submissions – and I'm searching for the right term – they don't approve but they – when they issue their "Don't Object" or their "Object," they involve the other agencies in that process anyway. I think that was fairly clear in the letters that the Fed issued last year. So the FDIC is part of the CCAR process in any event.

ROBERT SMALLEY: Okay. Thanks. And last one, just in terms of long-term capital and Holdings, a lot of European banks now have announced pretty aggressive asset disposition plans. You're obviously well, well on your way there. But do you look at things that you have for sale now and say gee, the market is now getting virtually flooded with bank-held assets, maybe we slow down the pace of dispositions, or in some case maybe we just bring them back out of Holdings, and is there any kind of capital implication for that?

JOHN C. GERSPACH: As we've said, bringing things out of Holdings is not a matter of do we like the yield on an asset or not. We have to satisfy ourselves that any movement out of Holdings into Citicorp is something that actually fits in with the Citicorp strategy. And that was very much a part of the consideration that went into our decision to move the vast majority of the Retail Partner Cards book out of Holdings into Citicorp. And from our administration of the Holdings portfolio, one of the things that we've said all along is that we're looking at the wind-down and the decision to sell or just wind-down assets in that portfolio on an economically rational basis. So we've always taken a look at what various asset actions mean to us, both from a P&L point of view but more importantly from an overall capital point of view, and so all of those things weigh into our decisions regarding any sort of dispositions or other asset sales out of the Holdings portfolio.

ROBERT SMALLEY: I guess what I'm trying to say is, the potential bid for some of these assets or the prices may have gone down, because of the availability of alternatives now. So how does that come into the thinking at all?

JOHN C. GERSPACH: We've had markets that have been favorable and markets that have been unfavorable over the three-plus years now that we've been dealing with Holdings. And we've continued to work our way out of those assets.

ROBERT SMALLEY: Okay. Great. Thanks.

OPERATOR: Your next question comes from the line of Barry Cohen with Knott Partners.

BARRY COHEN: Good morning, thanks for taking the call. Just a couple of questions. Could you kind of help us understand maybe as you move the private label business back into the main operating entity, how that business is funded today versus how you'll be funding it in its new configuration on a pro forma basis?

ERIC W. ABOAF: Barry, it's Eric. That move won't change dramatically how the business is funded. Right now it's funded through a mix of card securitizations and deposits. I think you have seen – and I was pretty explicit on some of the debt charts. I was describing to you how there's not a need for large scale securitizations on the bank given our deposit-focused model and our strength in deposits. Over time it will become more and more deposit-funded. But that would have happened with or without the move that we've talked about.

BARRY COHEN: And then just two questions, one is kind of a big macro question for you, sorry to do that I know how everybody hates those. So in this earnings season, there's been some interesting trends that have come around. One is that, on the margin, banks have slowed their reserve releases. And probably, on the margin, their return of capital in various formats has kind of been a little bit less than the market, right or wrong, had anticipated. I was wondering if you might be able to opine a little bit about what it is that you think is going through the minds of senior managers, yourself and your peers, given what we have seen? That would be my being big macro question and I have just one more quick follow-up after that if I could.

JOHN C. GERSPACH: Barry, what was the second part of your big macro? Was it...?

BARRY COHEN: Well, if you looked at what's happened on people's balance sheets this quarter, you have seen that pretty consistent improvement in credit still. Different companies and different levels but generally the trend has been still very favorable but the reserve release has been slowing. The second is that there's a number of companies that actually have the ability to repurchase shares and do higher dividend levels. You have actually seen, to a certain extent, a more muted follow-through on that capacity. And I was wondering if you had some maybe big picture thoughts as a leading player in the market.

JOHN C. GERSPACH: Well, on the first when it comes to credit, I assume everybody does what we do, which is you look at – it's not just the published improvements in either NCL rates or delinquency. You want to make sure that you've got adequate reserves to cover the losses that are embedded in your portfolio. So you can see in some cases, we actually started to build the reserves a year before the crisis back in '08, because we could see that in some of our earlier buckets and even in the portfolio itself, there was some underlying credit trends that just didn't feel right.

So when you're taking a look at reserve levels, it's not just about the losses that are there today, it's really about the losses that you expect to be happening tomorrow. In similar fashion then, when you're releasing reserves, a lot of times you're releasing the reserves not necessarily because you necessarily feel differently about the losses that are in the early buckets, but because you're actually incurring the losses that you had expected to incur, and therefore, you're releasing the reserves against that. I kind of laugh sometimes when people say, "They're just releasing reserves." So they take that out of your net income. Well, many times – most of the times when we're releasing reserves it's because the NCLs that we expected to incur are now happening, and I kind of go back to the old matching principle: it's nice when you release the reserve that you set up for the loss that you're now incurring. So there is a certain amount of that.

As far as the second aspect, I can't comment on what other institutions may or may not be doing with their capital repurchases or how they're talking about it. That, again, I think is an institution by institution view of things and not necessarily something that I would terribly think about as being systemic.

BARRY COHEN: I guess the reason why I ask is the two theses that are out there in the marketplace are that the slowing of reserves may have to do with the fact that with mortgages, which you have opined that you're a little concerned about, people are concerned that people aren't releasing those reserves as quickly because there's more to come on the home equity side and a lot of people are making comments about the AG settlement, like will you have write-downs in home equity that you haven't seen, so that's why you're not seeing the reserve releases. And on the capital side, there's a discussion that the regulators at least in the U.S. are going to accelerate the timeframe by which companies have to achieve the Basel III requirements, even though they're written out in a way that you have a long period of time to do it. That's the reason I was basically asking.

JOHN C. GERSPACH: Yeah, well, regarding each of those topics – mortgages, you're quite right. Mortgages are something that we've been concerned about for a long time. And we're pretty public as far as our view, as far as the fact that the mortgages represent the single largest risk I think that a U.S. bank has on its books right now. And that's for a variety of reasons. I mean, even aside from some of the other things that you mention as far as AG discussions and everything else, mortgages are just a very different asset than a credit card, and that risk of loss stays on your books for years, especially in a cycle now where normally if you were thinking about foreclosures taking six to nine months to get through, now you're looking at 24, 30 months. There's some states where we haven't seen a foreclosure processed in almost a year, so it just means you're exposed to the severity of those properties continuing to decline while you hold them on your balance sheet.

BARRY COHEN: With that in mind, if I could ask, then, as you transfer out the lion's share of the credit card business out of your LCL portion of your business, when we look at your segmented earnings that you provide us, obviously that's an enormously large percentage of at least what the current earnings are there. Can you kind of help us understand how your comfort level is given the size of the real estate holdings that are going to be left in LLC versus let's say those current earnings support that the credit card business was providing?

JOHN C. GERSPACH: I think what you're asking, I just want to make sure, we've been stating for some time now that our view in the LCL business is that the cumulative PPNR that we would – the pre-provision net revenues that we would earn on the portfolio, plus our existing reserves would cover the losses that we would expect to incur in that portfolio over time. Right?

BARRY COHEN: That's correct. But you're moving a fairly substantial portion of your operating profit away from the LCL with the transfer of the credit card business.

JOHN C. GERSPACH: And obviously that would eat into some of the cushion that we had in that business, but as we look at the remaining assets in that portfolio, and again, taking a look at our existing reserve levels, we're still comfortable with making that same statement.

BARRY COHEN: Okay. I appreciate it. Thank you very much.

JOHN C. GERSPACH: Okay, not a problem.

OPERATOR: Your next question comes from the line of Michael Rogers with Conning Asset Management in Hartford.

MICHAEL ROGERS: Yes, good morning, two questions. Do you have any update if you could on when you expect to see a Notice of Proposed Rulemaking out of regulators with respect to capital issues? And how that could affect your ability to par call some trust preferreds? And secondly, I'd be very interested in your views on the potential impact of Dodd-Frank – on the Volcker amendment of Dodd-Frank as that is currently proposed, if you can share some views there.

ERIC W. ABOAF: Michael, it's Eric. On the first, we had – I think many in the industry had anticipated seeing a notice of proposed rulemaking sometime this fall or winter. But I really don't have any other more specifics than that, to be honest. So that's what we had anticipated.

MICHAEL ROGERS: Okay.

JOHN C. GERSPACH: Do you mean winter beginning December 21, or winter...?

ERIC W. ABOAF: Winter stretches through February or March, right?

JOHN C. GERSPACH: Yeah, yeah, yeah. So I mean that's fine – again, on the second, this is John now. Look, the Volcker rule as it's currently proposed, the two hundred and what is it – ninety-eight pages? And the 300-some odd questions that need to be – I just think there's a lot more that needs to be vetted through before anyone's going to be able to give you a very clear answer to your question. I mean, the only thing you can say right now would be that certainly the record-keeping requirements in its current proposal are somewhat daunting, is about the way I would put it.

MICHAEL ROGERS: Okay. I appreciate that. One last thing, John. The tremendous amount of volatility in the third quarter – I'm sure you get this question a lot. But what is your chief worry right now as you look out on the fourth quarter and then into the new 2012 year?

JOHN C. GERSPACH: Well, near term, from a markets point of view, I think it's all about Europe. And maybe it's about how France and Germany decide to deal with Europe, but it's basically Europe becomes the single largest driver of market volatility right now. And so as we progress over the next couple of weeks or a month, we'll learn a lot more then about whether or not that volatility will begin to settle down or it's going to remain with us for a bit more.

MICHAEL ROGERS: Thank you very much.

JOHN C. GERSPACH: Okay, not a problem.

OPERATOR: And your final question comes from the line of David Jiang with Prudential Financial.

DAVID JIANG: Hi, John and Eric. I had a question on page 40 of the slide deck, the reps and warranties. Can you give any underlying trends as to the unresolved claim pool and how that's progressing? I mean, it seems to be still mostly GSE. I'm wondering if there are any vintages that may have surprised you this quarter. And also on the reserve balance it seems to be that you're still kind of building reserves. And when do you think or how far along do you think we are with at least some of the GSE claims?

JOHN C. GERSPACH: Yeah, it's John, David. You know, claims, we're continuing to revise the model that we've got as far as our expectation as to when claims will peak. And we've obviously moved that out just a wee bit now. And that's one of the reasons why the reserve balance has grown again this quarter. We're dealing with a – what we're putting up here is our attempt to put up a lifetime reserve on this issue. And as we get more data points, we certainly reflect that in the reserve balances.

I'd say that the agencies have stepped up their game a little bit as far as putting in claims. Our rescission rate, though, is still staying just a little bit north of 50%. So, we feel good about that. I'd love to be able to tell you that we're in the seventh inning or we're in the fifth inning or the ninth inning. I just don't know. I'd say we're somewhere in the middle part of this thing, but with each quarter, things become just a little bit more clear as to where the claims are coming from.

You had one specific part of the question as far as any vintages. The vintages that are most impacted by the claims process are the ones that I think you would expect to be, it's – it would be mortgages that were originated in '07 and '08. And those are still the ones that get most focus.

DAVID JIANG: Got you. At this point are you putting up any reserves for private investors? Or is everything just still mainly for GSEs?

JOHN C. GERSPACH: There are some reserves, and we do get repurchase claims in from private investors, and that would be reflected in these balances; but to date, the repurchase requests from the private investors are really not significant. And as I think we have indicated in the past, what we would expect is that most of that private label litigation – private label securitization is going to be handled through litigation. That's one of the reasons why we provided you with more detail regarding the level of private label securitizations that we did of mortgages in that '05 to '08 vintage both out of our mortgage subsidiary CMI and our Securities & Banking business and also tried to provide you with cumulative losses to date, as well as the delinquency percentage of the remaining outstandings.

DAVID JIANG: Great. My last question is on page 22, the GIIPS country risk exposure. I think the net number is $7.1 billion this quarter. Does that correlate to the $13 billion that was last quarter?

JOHN C. GERSPACH: Yes, it does.

DAVID JIANG: Okay. Can you explain how you were able to cut this exposure in half? I mean, is it mostly from purchased credit protection or just taking down the gross funded number?

JOHN C. GERSPACH: The – when you think about the $6 billion or thereabouts of reduction, it's one-third reduction of the – I'll call it the gross exposure, and two-thirds additional credit protection and margin.

DAVID JIANG: Okay. Great. Thank you.

JOHN C. GERSPACH: Okay.

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 the call today. If you have follow-up questions please don't hesitate to reach out to us in Fixed Income Investor Relations. We'll talk to you again soon.