Citi Third Quarter 2012 Earnings Review

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Host
Susan Kendall, Head of Investor Relations

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

PRESENTATION

OPERATOR: Hello and welcome to Citi's third quarter 2012 earnings review with Chief Executive Officer, Vikram Pandit and Chief Financial Officer, John Gerspach. Today's call will be hosted by Susan Kendall, head of Citi Investor Relations. We ask that you please hold all questions until the completion of the formal remarks at which time you will be given instruction 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. Kendall, you may begin.

SUSAN KENDALL: Thank you, operator. Good morning and thank you all for joining us. On our call today our CEO, Vikram Pandit, will speak first. Then John Gerspach, our CFO will take you through the earnings presentation which is available for download on our website, 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 in capital and other financial condition may differ materially from these statements due to a variety of factors, including the precautionary statements referenced in our discussion today and those included in our SEC filings, including without limitation, the risk factors section of our 2011 Form 10-K.

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

VIKRAM PANDIT: Susan, thank you and good morning everyone. Thank you for joining us today. As you know, we reported earnings of $468 million for the third quarter of 2012. Excluding nonoperating items such as the mark on MSSB, CVA and a tax benefit, net income was $3.3 billion, and that amounts to $1.06 per share.

Our businesses gained momentum during the quarter while the impact of Citi Holdings lessened. Loans and deposits increased and in all three of our operating businesses we had positive operating leverage for the third straight quarter. We also had positive operating leverage in Citigroup as a whole. We gained wallet share again in investment banking, while our markets businesses performed very well. Although Transaction Services has been impacted by spread compression, both trade loans and deposits continued to grow and the pipeline appears to be strong.

Our institutional businesses showed growth and resilience in the emerging markets where our unique footprint gives us a meaningful competitive advantage, as we can see by several noteworthy transactions whether they are in China, India, Russia, Mexico, or Brazil. Transactions ranging from the CNOOC-Nexen deal, to the Santander IPO in Mexico are a reflection of our broad and deep capabilities. Net income increased in Global Consumer Banking as the drivers for the business remained strong internationally, especially in emerging markets such as Latin America. North America benefited from increased mortgage refinancing. Overall, these earnings highlight the continued execution of our strategy and show the strength of our core businesses and our diversification, both by product and geography.

We also made progress winding down Citi Holdings. Last month's price agreement on MSSB has given us more certainty on our exit. Citi Holdings assets were reduced by $20 billion in the quarter and now total $171 billion, or 9% of our balance sheet. Holdings assets are down 31% from the end of third quarter of 2011. Citi continues to maintain significant liquidity with roughly $400 billion in highly liquid unencumbered assets, primarily cash and government securities. Our Basel III Tier 1 Common Ratio increased to an estimated 8.6% and is among the highest in the industry.

We continue to generate solid returns for Citicorp and Corp/Other. Excluding CVA/DVA and the sale of minority interests, our year-to-date return on allocated tangible common equity is 17.2%. And return on Basel III Tier 1 common, on a fully implemented 9.5% basis, is 18.7%. For Citigroup as a whole, the year-to-date return on Tangible Common Equity supporting the businesses is 11.8% and return on Basel III on a fully implemented basis is 10.7%.

Regarding the macro picture, market sentiment improved during the quarter as a result of the moves made by the ECB and the Fed. However, GDP growth remains uneven globally, and interest rates remain low.

In the U.S., there are promising signs that more robust economic growth is within reach, assuming the resolution of the fiscal cliff. Lack of a resolution of the cliff situation would be highly disruptive. The housing market has shown improvement, while capital, labor, energy, and technology are all very affordable and in healthy supply.

In Europe, the actions by policy makers appear to have set a path for preserving the Euro, but more needs to be done to create deeper market confidence for a better GDP picture. In the emerging markets, policy makers have been quick to act, and we expect growth there to substantially keep outpacing the developed markets.

In light of these factors, we'll continue to manage our risk carefully, using the deep knowledge we have of the markets where we do business. John Gerspach will go over the slides now and then both of us will come back and we'll be happy to take your questions. John?

JOHN GERSPACH: Thank you Vikram and good morning everyone.

To start, I'd like to highlight some significant items affecting our results this quarter. This would be on slide 3. First, CVA and DVA were a negative $776 million pre-tax and $485 million after-tax in the third quarter, for a negative impact on EPS of $0.16 per share.

Secondly, the loss on Morgan Stanley Smith Barney was $4.7 billion pre-tax and $2.9 billion after-tax, for a negative impact on earnings per share of $0.94. And finally, we recorded a tax benefit of $582 million related to the resolution of certain tax audit items, which had a positive impact on EPS of $0.19. Adjusting for these items we earned $3.3 billion in the third quarter, or $1.06 per share.

Throughout today's earnings presentation, I will be discussing our results on this basis to provide comparability to prior periods. In addition, as shown on slide 4, there are a few other significant items which are included in our third quarter results. First, on the revenue side, in Securities and Banking we recorded losses on hedges related to accrual loans of $252 million this quarter, driven by credit spread tightening in our lending portfolio, compared to gains of $156 million last quarter and over $700 million in the third quarter of last year. On the expense side, legal and related expenses remained elevated at over $500 million in the third quarter, and repositioning charges were nearly $100 million.

On slide 5 we show total Citigroup results. Revenues of $19.4 billion were up 3% from last year, while operating expenses of $12.2 billion declined 2%, resulting in positive operating leverage for Citigroup in total. Credit costs of $2.7 billion were down 20% versus last year. Net credit losses of $4 billion were 12% lower than the prior year, including incremental mortgage charge-offs of approximately $635 million in Citi Holdings in the third quarter of this year. These incremental charge-offs were related to new OCC guidance regarding the treatment of mortgage loans where the borrower has gone through Chapter 7 bankruptcy. The vast majority of these charge-offs were related to loans which were current.

Substantially all of the incremental $635 million of charge-offs were offset by a related reserve release of approximately $600 million this quarter – and so the net impact on earnings was minimal. Excluding these incremental charge-offs, net credit losses would have been down 26% from last year and the net reserve release in the third quarter would have been roughly $900 million, down from $1.4 billion in the prior year.

We earned $3.3 billion of net income in the third quarter, or $1.06 per share, up from $0.84 per share last year on a comparable basis – driven by revenue growth and a decline in both expenses and credit costs. Citigroup end of period loans grew 3% year-over-year, to $658 billion, as loan growth in Citicorp continued to outpace the wind-down of Citi Holdings, and deposits grew 11% to $945 billion.

On slide 6 we show results for Citicorp and Citi Holdings. Citicorp generated third quarter revenues of $18.4 billion and net income of $4.6 billion. Year-over-year, Citicorp revenues grew 5% and expenses declined 2%, and we maintained positive operating leverage in each of our three core businesses. Pre-provision net revenues in Citicorp were $8.1 billion for the quarter, up 15% from last year. And for the seventh consecutive quarter, we grew loans year-over-year in every business in Citicorp. Total Citicorp loans grew 11%, with consumer loans up 5% and corporate loans up 19%.

Citi Holdings had revenues of $971 million and a net loss of $679 million. Citi Holdings ended the quarter with $171 billion of assets, down $20 billion during the quarter and $76 billion, or 31%, year-over-year. At quarter end, Citi Holdings accounted for 9% of total Citigroup assets.

Now, on slide 7 we show a nine quarter trend for Citicorp's results. As I noted, Citicorp's revenues of $18.4 billion were 5% higher than last year and expenses of $10.3 billion were 2% lower year-over-year. Citicorp's net credit losses of $2.2 billion declined 17% from last year, driven by improvement in North America cards. And the net loan loss reserve release in Citicorp was $696 million, down from $887 million last year. This reflected a significant decline in the net reserve release in North America cards, partially offset by a reserve release in the corporate portfolio. Earnings before taxes of $6.6 billion grew 25% versus last year, driven by higher revenues, lower operating expenses and lower credit losses, partially offset by a lower net reserve release.

On slide 8 we show Citicorp's pre-tax earnings by business, excluding the impact of loan loss reserves. On a trailing 12 month basis, earnings grew to $20.2 billion in the third quarter, driven by strong results in Consumer Banking and Securities and Banking.

On slide 9, we show Citicorp's results for the first nine months of the year. Revenues of $55.6 billion grew 4% from the prior year, while expenses declined 1% generating double-digit growth in operating margin.

At the same time, net credit losses improved significantly. Pre-tax earnings, before the impact of loan loss reserves, were $17.9 billion in the first nine months of the year, or 34% higher than last year - reflecting the combination of positive operating leverage in each of our businesses as well as improved credit.

Slide 10 shows the results for North America Consumer Banking. Total revenues of $5.4 billion were up 6% versus last year, largely driven by higher gains on sales of mortgage loans. Total card revenues declined 4% year-over-year. In branded cards, both average loans and spreads declined year-over-year, reflecting consumer de-leveraging and the continued impact of the look-back provisions of the Card Act. In retail services, net interest revenues were stable year-over-year, while non-interest revenues declined, driven by improving credit and its impact on contractual partner payments. On a sequential basis, however, card revenues grew 5% as average loans stabilized and spreads improved in both portfolios.

Total operating expenses of $2.5 billion were up 2% year-over-year, primarily due to higher retail channel mortgage volumes. Credit costs of $852 million declined modestly year-over-year and were up 19% sequentially. Net credit losses continued to decline, by 27% year-over-year, to $1.4 billion, driven by improvement in cards. However, the net loan loss reserve release was significantly lower than prior periods, at $518 million this quarter, compared to $956 million in the prior year and $814 million last quarter. Earnings before tax, excluding the impact of loan loss reserves, nearly doubled from last year to $1.6 billion.

Overall, we continued to see progress in our North America consumer franchise. Average deposits grew for the sixth consecutive quarter, up 6% year-over-year, including double-digit growth in checking account balances. In branded cards, accounts also grew for the sixth consecutive quarter, up 4% year-over-year. And for both card portfolios, net credit margins continued to expand year-over-year.

On slide 11, we show results for international Consumer Banking in constant dollars. On this basis, both revenues and expenses grew 3% year-over-year in the third quarter. Latin America achieved positive operating leverage for the fourth consecutive quarter, with revenue growth of 7% and flat expenses versus last year. And EMEA achieved positive operating leverage as well. Asia, however, had negative operating leverage for the quarter, with revenues down 2% and expenses up 8% in constant dollars, which I'll discuss more in a minute.

Despite some headwinds, most drivers for international Consumer Banking continued to grow in the third quarter, both year-over-year and sequentially. Average loans grew 10% from last year and 2% sequentially. Average deposits grew 4% year-over-year and 1% sequentially. And both card purchase sales and investment sales also grew versus the prior periods.

Credit costs were $722 million in the third quarter, up 8% from last year, as net credit losses grew 6% due to loan growth and there was no material loan loss reserve release this quarter. Earnings before tax, excluding the impact of loan loss reserves, were nearly flat year-over-year at $1.1 billion.

On slide 12, we show our Asia consumer results in more detail. First on revenues, investment sales revenues recovered from the second quarter, however, they remained modestly lower than last year. And our total deposit and lending revenues, including cards, are down modestly from both periods.

Similar to last quarter, most of the pressure on our retail banking business continued to be seen in Korea and Japan. Korea, in particular, reflects the continued impact of regulatory changes – including rate caps and other initiatives intended to slow the growth of consumer credit in that market. At the same time, spreads in several countries have compressed, reflecting a decline in market interest rates.

Despite these headwinds, our franchise in Asia remains strong, and we continued to grow volumes in the third quarter, including average deposits, average retail loans and average card loans. The costs associated with sustaining this volume growth drove a significant portion of the expense increase in the business, both year-over-year and versus last quarter. Third quarter expenses also included nearly $20 million of repositioning charges in Korea, as we began to rationalize our distribution network and re-focus our client segmentation.

While these changes were prompted by the new regulatory environment in Korea, they also simplify the business and align our Korea franchise more closely with the urban-based global strategy we employ in most other markets. We expect to incur additional repositioning charges in the fourth quarter, to complete this effort. Importantly, our overall outlook for Asia remains positive and we currently believe that in this environment, we can grow revenues from our third quarter base at an annual rate of 4% to 6% with a return to positive operating leverage in 2013.

Slide 13 shows our international consumer credit trends, which generally remained stable in the third quarter. For total international Consumer Banking, the NCL rate remained below 2%, and 90+ day delinquencies were stable at just above 90 basis points. In Asia, the NCL rate increased slightly from the first and second quarters, each of which benefited from higher recoveries while delinquencies improved slightly. In Latin America, both the NCL rate and delinquencies remained fairly stable. And in EMEA, the sequential increase in the NCL rate in the third quarter reflects the impact of a recovery in the prior quarter.

Slide 14 shows our Securities and Banking business. Revenues of $5.6 billion grew 15% versus last year and were up 7% from the prior quarter. Investment banking revenues of $926 million grew 26% from the prior year, on stronger debt and equity underwriting activity and higher M&A revenues, while the sequential growth of 8% was driven by debt underwriting.

Overall, our wallet share in investment banking continued to improve year-to-date in all major products. Equity market revenues of $510 million grew 76% from last year, driven by the absence of proprietary trading losses in the prior year, as well as better derivatives performance. Sequentially, equity market revenues were down 7% on lower market volumes.

Fixed income market revenues of $3.7 billion grew 63% from last year, driven by significantly higher revenues in credit-related and securitized products, as well as strong performance in rates and currencies. Sequentially, fixed income revenues were up 31% on strong results across all major products. Lending revenues, excluding the impact of gains and losses on hedges related to accrual loans, were $445 million in the third quarter, up 35% from last year on higher loan volumes and improved spreads, and down slightly sequentially as higher volumes were offset by the absence of gains on asset sales in the prior quarter.

Total operating expenses of $3.5 billion were down 3% from last year, driven by efficiency savings. Credit costs were a benefit of $73 million in the third quarter. And net income grew 67% year-over-year to $1.6 billion.

Moving to Transaction Services on slide 15. Revenues of $2.7 billion were down 2% from last year on a reported basis and up 1% in constant dollars, as continued growth in Treasury and Trade Solutions was mostly offset by a decline in Securities and Fund Services. Treasury and Trade Solutions was up 4% year-over-year in constant dollars, driven by continued growth in deposits and trade loans, partially offset by ongoing spread compression. Securities and Fund Services revenues declined 8% in constant dollars on lower settlement volumes.

The drivers for Transaction Services continued to show strong momentum. End of period trade loans were up over 30% from the prior year, and average deposits were up 17% - both in constant dollars. Expenses of $1.4 billion were down 5% versus last year, driven by efficiency savings.

Slide 16 shows Citi Holdings assets. We ended the quarter with $171 billion in Citi Holdings assets, or roughly 9% of total Citigroup assets. The $20 billion reduction in the third quarter reflected a $12 billion decline in assets related to Morgan Stanley Smith Barney, $4 billion of other asset sales, $3 billion of net pay-downs, and roughly $1 billion of cost of credit.

On slide 17, we show Citi Holdings' financial results for the quarter. Revenues in Brokerage and Asset Management were negative $120 million this quarter, versus $55 million last year, due to a lower equity contribution from Morgan Stanley Smith Barney and lower private equity marks. In Local Consumer Lending, revenues were down 15% versus last year to $1.1 billion, primarily due to declining loan balances. In the Special Asset Pool, revenues were negative $13 million in the third quarter, compared to negative $277 million last year, driven in part by lower funding costs as well as improvement in asset marks.

Citi Holdings expenses were down 21% year-over-year to $1.2 billion, mainly due to declining assets. Credit costs were down 26% year-over-year to $1.2 billion. Total net credit losses were $1.8 billion, including the $635 million of incremental mortgage charge-offs I described earlier.

Excluding these incremental charge-offs, net credit losses in Citi Holdings would have declined 38% year-over-year. As I mentioned, substantially all of the incremental charge-offs were offset by a reserve release of approximately $600 million, so the impact on earnings was minimal.

In total, we released $813 million of net loan loss reserves in Citi Holdings. The net loss in Citi Holdings improved to $679 million in the third quarter. However, this included a tax benefit of nearly $200 million related to the sale of certain assets in the Special Asset Pool.

Looking at the past five quarters of Citi Holdings results on slide 18, rep and warranty reserve builds and legal and related costs continued to weigh on Citi Holdings in the third quarter. These costs have been difficult to predict, and we continue to work to put these issues behind us. On an operating basis, however, excluding these items, we maintained a modest positive operating margin in the third quarter and our goal is to continue to generate positive margin, although there may be quarter-to-quarter fluctuations arising from periodic gains or losses as we continue to wind-down the assets.

Credit trends also remained favorable this quarter with adjusted net credit losses of $1.2 billion declining 12% quarter-over-quarter and mortgage losses comprising over 70% of the total. We ended the quarter with $8.5 billion of loan loss reserves allocated to North America mortgage loans in Citi Holdings, or 30 months of coverage. The decline in North America mortgage reserves from $9.4 billion last quarter to $8.5 billion reflected the $600 million reserve release related to the incremental charge-offs as well as asset sales during the quarter. We continue to watch the housing market carefully, and have taken note of some recent indications that the market may be stabilizing.

On slide 19, we show mortgage loan and adjusted net credit loss trends over the past two years. Since the third quarter of 2010, we have reduced the North America mortgage loans in Citi Holdings by nearly 30%, driven by $20 billion of paydowns, $9 billion of asset sales, and $9 billion of net losses. Of the $9 billion of asset sales over the past two years, approximately $6 billion have been delinquent loans, including the sale of nearly $750 million in delinquent loans in the third quarter.

We have also significantly reduced the quarterly net credit losses on the portfolio - down nearly 40% to $850 million in the third quarter - even while $40 million to $45 million of losses were accelerated into each of the second and third quarters of this year as a result of actions we are taking to fulfill our commitments under the National Mortgage Settlement. Delinquency trends remained favorable through the third quarter, with 90+ day delinquencies improving in both residential first mortgages and home equity loans. Assuming no material deterioration of the economic environment here in the U.S., the net credit losses on these portfolios should generally decline over time as the portfolio continues to shrink.

Slide 20 shows the results for Corporate/Other. Revenues of $33 million were down from the prior year, driven by the impact of hedging activities and lower investment yields. Expenses of $764 million were 47% higher versus last year, mainly due to higher legal and related expenses as well as incremental firm-wide marketing expenses in the third quarter. Assets of $302 billion included approximately $116 billion of cash and cash equivalents, and $130 billion of liquid available for sale securities.

Turning to total Citigroup expenses on slide 21, total operating expenses of $12.2 billion in the third quarter were 2% lower than last year, while core operating expenses, excluding legal and related costs and repositioning charges, declined 1% in constant dollars to $11.6 billion. This core operating expense number is marginally higher than our expectation of $11.5 billion for the quarter, driven by greater than expected volumes in Consumer Banking. As we look to the fourth quarter, we currently believe our core operating expenses should remain roughly in line with the third quarter levels. Additionally, we expect to continue to incur elevated legal and related expenses and repositioning costs in the fourth quarter.

On slide 22, we show our key capital metrics. Under Basel III, our estimated Tier 1 Common Ratio as of the third quarter was 8.6%, up from 7.9% in the second quarter. More than half of the increase was driven by operating earnings; roughly 15 basis points came from the Morgan Stanley Smith Barney transaction; roughly 8 basis points was due to lower risk-weighted assets; and the remainder was driven by changes in other comprehensive income and other items. Our Basel I Tier 1 Common Ratio remained flat as of the third quarter at 12.7%. Adjusting for the final market risk rules that will be effective in January 2013, our Basel I Tier 1 Common Ratio would be approximately 11.5%.

Slide 23 shows the components of our Basel I and estimated Basel III capital ratios. As of the third quarter, our Tier 1 Common capital under Basel I was $124 billion, compared to an estimated $106 billion under Basel III.

Turning to the denominator, our total risk-weighted assets under Basel III were an estimated $1.2 trillion, or 27% higher versus Basel I. The increase from Basel I to Basel III remained very favorable for Citicorp and Corporate/Other, with an increase of only 15%.

Slide 24 shows our returns on capital for the first nine months of 2012. On the lower left we show our average Tangible Common Equity for the period, split between the amount of TCE which supports our deferred tax asset and that which is employed by our businesses. A significant amount of our deferred tax asset is deducted from regulatory capital under Basel III, and therefore, we are required to have a higher absolute level of TCE than would otherwise be needed to support our income-generating businesses.

The $40 billion of TCE that must be retained to support the DTA earns a return through the utilization of this specific asset rather than from the income produced by our businesses. In other words, only $110 billion of our TCE is employed in our income producing operations. On this basis, Citigroup earned nearly a 12% return on the Tangible Common Equity supporting our operating businesses in the first nine months of the year.

Turning to regulatory capital, if we assume Tier 1 Common capital levels of 9.5% of Basel III risk-weighted assets across each business, the return on Basel III capital for Citigroup would have been an estimated 10.7% in the first nine months of the year, including an 18.7% return for our core businesses in Citicorp plus Corporate/Other.

Let me close with a few comments about the outlook. First, Global Consumer Banking - in North America, revenues continued to benefit from strong mortgage refinancing activity, which we currently expect will continue into at least the early part of next year. However, card revenues remain under pressure, with declining average loan balances driven by continued consumer de-leveraging. Additionally, while net credit losses are likely to improve modestly from current levels, we expect loan loss reserve releases to continue to decline in North America, as delinquency trends have stabilized in the card businesses.

In Latin America, we continued to see strong growth in revenues and volumes, driven by market growth and the strength of our franchise in Mexico. Overall credit quality remained stable in the third quarter and we believe this trend will continue.

In Asia, as we discussed earlier, consumer revenue growth has slowed, primarily reflecting headwinds in Korea and Japan. In response to regulatory changes in Korea, we are repositioning that business. We took nearly $20 million of related charges in the third quarter, and we expect to incur additional repositioning costs in the fourth quarter to complete the effort.

Our overall outlook remains positive in Asia, however, as volumes continued to grow in the third quarter. As I noted, we currently believe that in this environment we can grow revenues from our third quarter base at an annual rate of 4% to 6%, with a return to positive operating leverage in 2013.

Transaction Services continued to show positive operating leverage in the third quarter, although overall revenues were down slightly year-over-year reflecting ongoing spread compression, lower settlement volumes and the impact of FX. We continue to believe we can absorb the headwind of a low interest rate environment with additional volumes and new mandates. And while our growth in trade assets slowed in the third quarter, reflecting the market environment, we continue to be well positioned to gain market share in that business.

Securities and Banking results were very strong in the third quarter as a more favorable market environment offset the impact of seasonally slower volumes for many businesses. The strength of our fixed income franchise, in particular, was evident this quarter, with momentum across all products. In equities, our performance continues to demonstrate that the issues of the second half of 2011 are behind us, although we will likely continue to experience low levels of client activity in this macro environment. And finally, we continued to see momentum in investment banking, with wallet share gains in every major product. Importantly, we remained disciplined on expenses in Securities and Banking, with a continued focus on operating at the right size for the opportunities we see in the market.

In Holdings, the wind down of assets will continue, although likely at a slower pace than the third quarter, and our primary focus remains the mortgage portfolio. We continue to watch the mortgage market closely, and while we have noted signs that the housing market may have stabilized, we would like more clarity on economic trends in the U.S. before we can conclude that the housing recovery is sustainable. In the meantime, we are focused on reducing the loan portfolio, mitigating risk and working through the rep and warranty and other issues associated with that business.

Overall, while market sentiment improved in the third quarter, benefitting certain of our businesses, the overall macro environment, including slowing GDP growth in certain countries and a persistent low rate environment, remains an overhang for now.

We continued to make progress, however, in the third quarter, and we remain optimistic about our prospects given our client franchise and unique mix of businesses. Vikram and I will now be happy to answer your questions.

OPERATOR: At this time, if you would like to ask a question simply press star followed by the number one on your telephone keypad. If you would like to withdraw your question, press the pound key. The first question will come from the line of Genn Schorr with Nomura Securities.

GLENN SCHORR: Hi. Thanks. First, a quick one on risk-weighted assets. I noticed there's been no real change for the last four or five quarters. Could you talk through some of the moving parts, the pluses and minuses and what you think might happen over, say, the next four or five quarters?

JOHN GERSPACH: Glenn, are you focused on the risk-weighted assets on a Basel I or a Basel III basis?

GLENN SCHORR: In the slide you give us Basel I, so I guess I'll stay with Basel I just because I noticed the trend.

JOHN GERSPACH: We've also given you Basel III on slide 23. The Basel I risk-weighted assets, as you know, they're not necessarily risk sensitive. They're really linked to the overall size of the GAAP balance sheet. And so with the overall GAAP balance sheet remaining fairly stable, you're not going to get a great deal of up or down movement in the Basel I assets. If you look at Basel III, I think what you'd see over time is continued reductions in the Basel III risk-weighted assets and the rate of risk assets decline in Holdings outpaces any growth that we would otherwise see in Citicorp. And I think you see that reflected in the difference between the two – the multipliers. Where you're looking at the multiplier from Basel I to Basel III for Citicorp and Corporate / Other being about 115%, whereas the Holdings risk-weighted assets are close to 190%.

GLENN SCHORR: That makes sense, okay. That leads to the next one. I think the comment in your outlook was you need sustainable housing improvement to see maybe further releases. Does that mean the releases this quarter were driven by the housing improvement that we've seen? And then that feeds into the model and what spits out is a lower loss rate over the life of those loans?

JOHN GERSPACH: Let me be specific about the mortgage reserve releases that we had in this quarter. There was roughly $600 million that were specifically related to the incremental charge-offs that we had to take on the new OCC guidance related to borrowers that had gone through chapter 7 bankruptcies. So that is merely - we were forced to recognize higher NCLs. We had reserves established against those assets and so we released those reserves. The other change has to do with, as I mentioned, we sold $750 million worth of mortgage loans in the quarter and so, therefore, we took down the reserves that were set aside against those specific loans. So both reserve releases were very specific in nature.

GLENN SCHORR: Got it. I appreciate that. And then on page 10 of the supplement, inside North American Consumer Banking, there is the net servicing and gain on sale. I'm just thinking out loud. This is not necessarily this quarter but it's over the last four quarters, you've seen a big pickup in gain on sale. Obviously, we've seen that trend in the market. I'm curious. It happens when there is no big change in mortgage originations or the servicing portfolio. Is that strictly gain on sale and can we continue to operate at that level?

JOHN GERSPACH: I think that's one of the big questions facing a lot of institutions at this point in time as far as the ongoing pace of mortgage originations. Quarter-on-quarter, we definitely saw an increase in our originations, but a lot of that is clearly being driven by mortgage refinancings. So as I mentioned, we can see the mortgage re-fi's continuing fairly strongly into at least the beginning part of next year but that's about as far as I'm willing to go at this point in time.

GLENN SCHORR: Okay. One last very quickie. The repurchase claims were down 25%. Do you feel like you've been through most of the pipeline? It's definitely a standout versus your peers. Just curious on how you feel on that.

JOHN GERSPACH: When you take a look at the repurchase claim activity, I'd say that we're seeing - we certainly saw in this quarter increased activity on the part of Freddie Mac. I'd say that it's a little difficult to gauge the overall level of claim activity between Fannie and Freddie, and so I would say it's still a little bit volatile in that area and I wouldn't draw any conclusions as yet.

GLENN SCHORR: Okay. Thanks for all your help. Appreciate it.

JOHN GERSPACH: Not a problem, Glenn.

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

JIM MITCHELL: Good morning. Can you hear me?

JOHN GERSPACH: Hi, Jim.

JIM MITCHELL: Hi, John. Just on the deposits, you guys were up $30 billion on a period end basis, sequentially. Can you talk about the drivers? If you think that was sort of end of the quarter issue or if that's pretty sticky? And if that is somewhat sustainable, can we expect to see the long-term debt footprint come down or accelerate, given that deposit growth which helps your margin? I know you don't like to talk about your margin but your margin was up this quarter so maybe you could talk about that interaction.

JOHN GERSPACH: Let me try to address your first question regarding deposits, which again, as you note, they were up fairly strongly, $30 billion quarter-over-quarter. I would say that roughly almost 40% to 50% of that increase I would put on episodic quarter-end deposits.

JIM MITCHELL: Okay.

JOHN GERSPACH: So I wouldn't read that into a continuing trend. However, when we do look at each of our businesses, whether they be Transaction Services on the corporate side, or the consumer businesses, we do continue to see strong momentum in our deposit gathering activities, particularly in what we would refer to as core operating deposits. The deposit franchise is certainly strong, but it was impacted by some episodic growth at quarter end.

JIM MITCHELL: Okay, fair. And should we - could you disclose or give us the benefit from the trust preferred buyback on the margin, and if we can expect to see at least some additional benefit as you pulled back your long-term debt footprint?

JOHN GERSPACH: Yes, if you recall at the end of last quarter, last quarter our NIM I think was 281 basis points. And the guidance that I gave last quarter, which incorporated the retirement of the TruPs, would be that I expect a net interest margin to be flattish, perhaps plus or minus 2 or 3 basis points. So we actually came in a little bit higher than the upper end of my range. We came in about 2 basis points higher than that and that's primarily being driven by lower cost of deposits than what I would have had built into the earlier guidance.

JIM MITCHELL: Okay. Thanks. One last question, switching up on fixed income. You guys - we only have one other comparison but you guys did pretty well relative to one of your other peers. Is it a function of mix in terms of your global footprint or is it - do you think there was some evidence of market share gains or is it hard to say at this point?

JOHN GERSPACH: It's a little hard for me to say - to pin market share gains quarter to quarter. I will say that I do think our results really demonstrate the diversity of our franchise, both from a product offering as well as from a geographic distribution. And our model really is focused on serving our core customers.

JIM MITCHELL: Okay. That's it from me. Thanks, John.

JOHN GERSPACH: Okay.

OPERATOR: Your next call will come from the line of Brennan Hawken with UBS.

BRENNAN HAWKEN: Good morning. Thanks for taking the question. First, on the repo costs. We were just sort of talking about the funding costs, John, I know you mentioned about deposit costs coming down. It also looked like the repo line in your average balance sheet dropped pretty significantly. Was that due to some sort of change in the funding portfolio there - reduction in tenor or something like that?

JOHN GERSPACH: Our tenors have been fairly constant. I think we talked in various calls over the course of the last year as to how we had actually extended some of our repo tenors, I guess going back six to nine months ago. So I wouldn't say that there was any impact this quarter on the extension of tenors. And our repo line tends to move in accordance with our overall customer related business, so I wouldn't draw too much into what's going on on the repo line.

BRENNAN HAWKEN: Okay. So then switching gears a little bit to credit and charge-offs, is there a home price sensitivity for you guys in the charge-off number? And could you maybe help us out a little bit in understanding there and obviously I would think it would be - is there a difference when we think about the LCL book versus the rest of it?

JOHN GERSPACH: Well, I would say that all mortgage charge-off activity has got an element of HPI sensitivity built into it, just based upon the mechanics of what you go through in order to recognize the losses. So when a loan gets to 180 days past due, you take your initial write-down, which of course is influenced by what you think the realizable value of that property is going to be. So there's an HPI component in that charge-off. Then as the loan stays on your books, and with the extension of the foreclosure time line, this is becoming an increasingly longer period of time. You need to go back two or three times a year and reassess where you have that property marked against what your new estimates, as far as realizability, would be. And of course, that is heavily influenced by the expectation of HPI. So when it comes to those severity type of losses, especially the - I'll call it the secondary - the catch-up severity losses on the subsequent write-downs, there we've seen some real improvement.

The overall volume of subsequent write-downs last year was probably running in the $60 million a quarter range. This quarter it dropped down closer to $50 million, a lot of that being driven by volume related - we just have more inventory in our book. But importantly, at least what I'm seeing is that the average subsequent write-down for severity factors year-over-year has probably dropped by a third for each of the properties. So you're starting to see some level of that recovery of HPI enter into the numbers.

BRENNAN HAWKEN: Yes. Sounds like it. While we're on LCL, taking a slightly different tact, when you think about the negative carry that you guys have there - the negative spread - how much rate sensitivity is there in that LCL business? I know that in your disclosures you indicate about a third of your consumer loans float. How many of those are in LCL and how much of a function of the negative spread might be due to low interest rates?

JOHN GERSPACH: Yes, well a lot of it obviously is due to low interest rates. Don't forget, a lot of that LCL portfolio is in our mortgage business. The LCL, we break that out for you on slide 16. The LCL portfolio is about $134 billion, and of that, $95 billion of the $134 billion are U.S. residential mortgages in Holdings.

BRENNAN HAWKEN: Yes.

JOHN GERSPACH: There's not a lot of incremental yield that we're going to get on that portfolio. So it is really dependent on a cost of funds. It's highly rate sensitive from a cost of funds point of view.

BRENNAN HAWKEN: There's not a lot of IO in that mortgage?

JOHN GERSPACH: There certainly isn't a lot of IO that is currently repriced. Don't forget, those resets on the IOs normally have got - they're periodic and so you'll catch up on some of those, but it's highly rate sensitive I would say at this point in time.

BRENNAN HAWKEN: Just on the funding cost side rather than the asset side?

JOHN GERSPACH: Exactly.

BRENNAN HAWKEN: Okay. So the second lien isn't a big factor there either, floating. Okay. Fair enough. And then last one from me. On the LCL business, of the second lien mortgages, the HELOCs, how many of those have started to amortize at this point? Is there any sense we can get on that front?

JOHN GERSPACH: I don't have that in front of me. I can tell you that of the HELOC portfolio, the bigger - we have more targeted to reprice, to reset beginning in like 2015. So we're getting some level of amortization right now, but the bigger step function really starts in 2015.

BRENNAN HAWKEN: Great. Thanks.

JOHN GERSPACH: Okay.

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

MOSHE ORENBUCH: John, you had kind of mentioned some degree of general optimism about seeing growth restart out of the emerging markets. Can you talk a little about where you're likely to see it; which countries and regions; how you're going to see it; how that pattern's going to shake out over the next couple of quarters?

JOHN GERSPACH: I'm not sure I recall saying that it was going to restart. We're seeing growth in the emerging markets today. Vikram, I don't know if you've got -

VIKRAM PANDIT: I think we can break it out in a variety of different ways, Moshe. Obviously we think Mexico is extremely well poised for growth. We've seen that in our numbers. I was just there not too long ago and with the leadership change there, in addition to prospects for reforms and what you're seeing on the ground, that's a high spot definitely. We don't have much of a retail business or a large business in Brazil, so that's less relevant to us. But we're seeing that in Colombia. We're seeing that in Peru. We're seeing that in Chile. If you want to think about it, western coast of Latin America is something we're quite constructive on in terms of growth.

When you get to Asia, as John said, for us there really have been two issues. One is the regulatory changes in Korea which have driven the restructuring of the business and the charge we took there. And I think that's something that's going to continue over the next quarter, at least as John said. And that business is going to grow in line with Korea growing beyond that. But more generally speaking, when you look at the underlying drivers in our consumer businesses, they continue to do well. And they continue to do well in our businesses across Hong Kong, Singapore, India, Southeast Asia, all across there. Based on all the policy decisions that we've seen being taken in these countries, based on my having been there now multiple times in the last couple months, and based on what we're seeing in our own volumes, we think that it's going to lead to revenue growth just the way that John talked about it for next year. From here, about 4% to 6%. That's our current thinking. So we're very much aligned with that growth pattern.

Don't forget, as well, that the emerging markets to us are not only consumer. They run across our entire business line and one place where we really saw it this quarter was in our Securities and Banking business. There's a lot more activity - a lot more activity even on the retail side and on the asset sales side. But across the board there is a lot of activity going on in Asia, as they build up their capital base, but also as Asia looks to the Western world for acquisitions and you saw some of that with Softbank Sprint. We're on the Sprint side on that one, as an example. So when you look at the entire diversified portfolio, what we have, we think that the emerging markets are going to be a bright spot going forward.

MOSHE ORENBUCH: Great. Thanks. Just on a different topic, John, you did say again that you expected kind of slower kind of drawdown of the assets out of Citi Holdings and yet by the same token you also referenced that the mortgage business, to the extent that there's improvement in the housing market you could start to accelerate sales and use the reserve like you did a little bit of this quarter. Could you kind of - how would that take shape in terms of what it might mean for the balances in the local lending business?

JOHN GERSPACH: Well, you know, Moshe, when you take a look at the sales activity, this quarter we were able to conclude $750 million worth of sales. Even in a favorable market with buyers that had access to liquidity, if we doubled that, you'd be looking at $1.5 billion of sales. It's still not likely to be at some sort of an amount that is going to significantly drive the rapid reduction in the real estate loan portfolio.

MOSHE ORENBUCH: Got it. Just the last one from me is that branded cards, particularly in North America, still a little bit sluggish in terms of the overall kind of volume and balances. Revenue was better, but what - are there any kind of things you can highlight, steps you're taking to try and kind of jump start that a little bit?

JOHN GERSPACH: I'm not quite sure you're going to see loan growth in anybody's portfolio because there still is certainly an element of consumer deleveraging going on. I think we do see pockets that consumers are spending. Now, those products in our consumer portfolio where we have already worked through the repositioning of the product, most of our rewards programs, for instance, we are now seeing purchase sales growth year-over-year. But we're working through the entire portfolio at this point in time. So again, that's probably something - don't forget we were a year late than everyone else in repricing the portfolio. So we're still working our way through repositioning each one of our products, simplifying our product offering, retargeting the product offering and re-enhancing as you were the rewards aspect of each of the products.

MOSHE ORENBUCH: Thanks for the answer.

JOHN GERSPACH: We're beginning to see it. Okay.

MOSHE ORENBUCH: Thank you.

OPERATOR: Your next question will come from the line of Jason Goldberg with Barclays.

JASON GOLDBERG: Thanks. John, I thought what you said on the TCE supporting the DTA was interesting. Can you talk about in terms of the time frame of which we can see that DTA come down and that TCE, I guess, get redeployed into obviously much more profitable areas?

JOHN GERSPACH: I think as we said before, the reduction in the DTA is going to be a multiyear project and certainly going to take a multiyear time frame. We had indicated earlier this year that we didn't expect DTA to come down this year and clearly with some of the things we talked about earlier, the loss on the Morgan Stanley Smith Barney JV that has actually caused the DTA to go up. So once we begin to see, I think, a better U.S. economic environment. You'll see growth in our U.S. earnings, and, at that point in time, the DTA will come down. But again, as it starts to come down, it is - it will come down in smaller increments. It's not going to be coming down in big chunks of $8 billion to $10 billion. It will come down related to the size of our North America income. So you need to think about it coming down almost as a paydown of an annuity over several years. I'm not going to give you a range right now, but lower single digits per year would be, I think, the best way to think about it.

JASON GOLDBERG: I guess ultimately if you end up releasing reserves tied to Citi Holdings, the mortgage portfolio, would that, I guess, help the utilization of this?

JOHN GERSPACH: That would definitely have an impact on it, yes.

JASON GOLDBERG: Okay. Then just last thing, remind us where the DTA sits at Q3.

JOHN GERSPACH: Q3 we ended with the DTA at $53.3 billion. And if you think about it, we closed the second quarter DTA was $51 billion. So we've got a $2.3 billion increase. And you basically look at the tax reserve release that we had that added $600 million to the balance. Morgan Stanley Smith Barney, that loss added $1.8 billion to the balance. We had about $200 million worth of FX impact on the balance, and CVA added about $200 million to the balance as well. So overall, the combination of our operations and OCI for the quarter brought it down by about a $0.5 billion, but clearly the pressure was on the upside this quarter.

JASON GOLDBERG: Got it. Thank you.

JOHN GERSPACH: Not a problem.

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

MATT O'CONNOR: Just a follow-up on some of the NIM discussion. Sorry if I missed it. Did you provide an outlook for the net interest margin from here?

JOHN GERSPACH: No, I don't think I did.

MATT O'CONNOR: Do you care to?

JOHN GERSPACH: I'm sorry. I was just playing with you. We're at about 2.86% right now. I would say I still see that yields are going to - loan yields and investment yields - are going to remain under pressure, clearly out into the fourth quarter. And we'll get some offset to that by what I think will be continued improvement in our cost of funds, but as a result of those two factors I think we'll likely see a small reduction in our NIM in the fourth quarter. So I would say it's probably going to be in the upper band of the previous range that I would have given you, so say somewhere in the say 2.82% to 2.84% - just down a couple of basis points from where we are in the third quarter.

MATT O'CONNOR: Bigger picture, as we think about the impact of QE3 on banks, should we think about Citi having less risk since they're not a big agency RMBS buyer or could there be some spillover effects that we're not thinking about globally here.

VIKRAM PANDIT: That's a tough one. Obviously, to the extent that we're a smaller part of the mortgage business, the direct impact is likely to be lower. Having said that, I think the real question to me of QE3 is sort of a bridge to the cliff and we've got to get through the cliff on the other side, and that could start creating the kind of growth that we think is really pent-up in the U.S. And if that happens, anything that happens on the other side of QE3 will be married with a stronger growth rate and better economy. So again, very difficult to predict in any case. Generally, a stronger economy is a good thing for everybody. But for us particularly, given that about half of what we do is in the emerging markets, stronger growth in that part of the world probably dominates for a period of time.

MATT O'CONNOR: Within your securities portfolio you don't have a lot of Agency RMBS. As you look across all the other asset classes you've been buying, it's a little hard for us to track externally. Have you seen as much spread compression there in terms of your reinvestment rates. What they are now versus what they were say in 2Q?

JOHN GERSPACH: We've certainly seen the impact of spread compression on the investment portfolio and it was one of the factors, Matt, that I put into my answer to the question as far as forward NIM guidance. I continue to see the fact that we will have spread pressure, yield pressure on both loans as well as investment securities into the fourth quarter. I don't see that abating.

MATT O'CONNOR: Okay. Just switching gears here. We're a couple of quarters into HARP. I think there's been some changes to the FHA re-fi fees. As you think about that $95 billion of mortgages you have, and I realize some of that's second lien, are there any that could be HARPed or re-fid? Do you literally go kind of loan by loan and proactively try and re-fi? Have you done that or think about doing that?

JOHN GERSPACH: Yes. We are re-financing the loans that are eligible to be re-financed. We've got a lot of the portfolio has already gone through HAMP. That portion of the portfolio that was not eligible for HAMP we're putting through HARP. So we're working our way through the portfolio, as you put it, literally on a loan by loan basis.

MATT O'CONNOR: Do you have any sense of how much of the $60 billion of firsts could be HARPed? Obviously it takes time to figure it out and reach the people.

JOHN GERSPACH: I can't tell you how we're progressing on the HARPing of the U.S. mortgage portfolio in Holdings. I'm sorry.

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

JOHN GERSPACH: Okay.

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

BETSY GRASECK: Hey, good morning. Couple questions. One on the FICC line. I guess I'm just wanting to understand how much of the FICC line was a function of marks that you had, obviously several asset classes that increased in value during the quarter.

JOHN GERSPACH: No, there's not a lot of marks that are impacting the FICC line. It's not like we suddenly had a position that we just took a big mark on and it's going to disappear. It really is being driven by client volume. As I said, I can't remember if I said on this call or some other call, overall I think the market that we encountered in the third quarter was an overall better market. Volumes may have been down slightly, but certainly compared to the markets that we saw last year, we weren't facing a market where every customer was moving in the same direction at the same time. And so that certainly puts you in a better position from a revenue generating capacity. But the business that we're running is really based on client flows.

BETSY GRASECK: Okay. So you also have in the portfolio, in the past, some non-Agency RMBS assets that appreciated significantly in value this past quarter. Would you have taken any gains on those? Would you have sold any of that and realized some benefit? Would that flow through any of the FICC line or the Corporate / Other line?

JOHN GERSPACH: I'm not aware of any out-sized gains, Betsy that would have impacted the FICC line at all.

BETSY GRASECK: Okay.

JOHN GERSPACH: And when it comes to Corporate / Other, almost everything that we have in Corpoate / Other is an AFS security. So to the extent that there were any gains on the securities that we've got in Corporate / Other, it would really be flowing into OCI.

BETSY GRASECK: Right. Okay. And then separately, on the NIM outlook that you discussed. Clearly one of the benefits of the NIM that you had this quarter was the reduction in your long-term debt costs, right?

JOHN GERSPACH: Yes. As I said, that was baked into the guidance that we would have provided you last quarter.

BETSY GRASECK: Right. So I think you've got about $25 billion in long-term debt coming due over the next couple of years. Any color on how much of that debt you'll be refi-ing versus rolling off?

JOHN GERSPACH: We've actually - we certainly haven't gone out a couple of years, Betsy. But I think that we certainly were indicating that this year we would only expect to refinance something less than $15 to $20 billion of the long-term debt that was coming due, and we're on track to be in the lower end of that range at this point in time. We haven't given any guidance yet out to what we might do in 2013.

BETSY GRASECK: Okay. One of the reasons asking the question is there's some discussion and debate among some fixed income investors around the requirements that FDIC and others might have for larger institutions - talking about how much senior debt through equity as a percentage of assets banks might need, the bail-in debt. I know Sheila Bair in the past has asked for 30% senior debt through equity and it sounds like that idea hasn't really gone away yet and wondering if that's factoring into your thought process on how much debt you're going to roll versus not?

JOHN GERSPACH: We still have – if you take a look at our overall capital structure, we've got a reasonable amount of long-term debt remaining. I think we're all trying to await guidance on many of these issues and the topic that you're really getting into is really one that's being driven by the Title II approach to recovery and resolution. So that's something that's being worked through as far as what level of debt you would need. Certainly, the levels of debt that we've got in our forward planning would be such that, again, we think that we would be right in lock step with what we think the requirements of that Title II resolution regime would be.

BETSY GRASECK: Okay. Alright, thanks.

OPERATOR: Next question will come from the line of Ed Najarian with ISI Group.

ED NAJARIAN: Good afternoon, guys. So, you know, in the last couple of calls you've outlined the ROEs coming from Citicorp being quite high and that obviously gets dragged down by Holdings. It kind of begs the question, it's sort of outlined on page 18 of the slide deck where you go through the operating costs of Holdings and especially breaking them into sort of a core number and then a legal related number, any sense of how fast, just thinking about the next couple of years, we can get those operating costs out of Holdings? You've got the assets coming down nicely. But obviously the market's looking for those operating costs to come down in conjunction with that so that we can get closer to the core profitability of Corp. Could you give us a sense of that in any way?

JOHN GERSPACH: Yes. Well, Holdings, I think that we've been pretty true to what we said which was that we would bring down the operating expenses in Holdings in relation to the reduction in assets. Now, if you focus on the operating expenses in Holdings, obviously Holdings is also being impacted by higher amounts of legal and related, put that off to the side so let's just focus on the $1 billion or so of operating expenses that are in Holdings. If you look at it in total right now, those operating expenses are running about 2.3% of the assets this quarter. And that's basically flat to what they would have been last quarter, and it's up just slightly from 2.2% in the fourth quarter of last year. So again, we're pretty much on spot as far as having the operating expenses come down in relation to the assets. Now, at this point in time though, what's going to happen is that operating expenses are going to be impacted now by the mix of the portfolio. The portfolio has shrunk so much that you can now look at it in very bite size chunks.

Obviously, the Specialized Asset Pool assets have the absolute lowest amount of operating expenses associated with them. They're running at about 0.5% or so of assets. So to the extent we can drive down SAP, we drive down the SAP assets but we don't necessarily relieve a lot of the operating expenses. For us, it's really the operating expenses get heavily focused into the LCL assets, and the LCL assets are running at a rate that is certainly higher than the average of 2.3. It's probably closer to 2.6, 2.7 and so that really becomes the area that we're looking to drive down.

Interestingly, it's not concentrated in the U.S. mortgage business. The US mortgage business only constitutes about a third of the operating expenses that are in Citi Holdings. So it really is our ability to drive down, get rid of the assets in LCL outside of the US real estate loans. So there it's the business that's we've got remaining in the international book, and then some of the other businesses that are still in Holdings.

ED NAJARIAN: I guess that's what I'm driving at, though. As those assets come down, do you have a plan or a vision of how those costs will come out in conjunction so that 2.3 number doesn't rise too much? Or conversely are you telling us that it will rise for a while?

JOHN GERSPACH: We are bringing down the expenses as we're bringing down the assets. What I was trying to give you is a flavor of the mix. If you see most of the assets coming down in SAP, you're going to get less of an expense benefit than you would have if we drive down the international assets in Local Consumer Lending. So we are very focused on making sure that as we bring down the assets, we are taking down the operating expenses associated with those assets.

ED NAJARIAN: Okay, thanks. And then to follow up, I think the market is very pleased with clearly the increase in your B3 Tier 1 common equity ratio and overall the increase in your capital ratios in general. And with the stock trading still at a fairly large discount to tangible book, it seems like investors would really love to see more return of capital next year - both a dividend increase and stock buyback. So going into the CCAR with much higher capital ratios this year, would love to hear from Vikram as well, any sense of how you guys are thinking about the CCAR and thinking about capital return for 2013?

VIKRAM PANDIT: Ed, I think the sense we should all have, it's still early. We haven't even seen the scenario yet and we're not going to see it for a year or so - sorry, a month or so. And we'll look at that and then we'll decide what we will request from the regulators on capital. And obviously this is not a question of our ability to generate capital. As you know, we've shown you that. It's now a matter of looking at the full picture which we won't know for a little while.

ED NAJARIAN: We haven't sort of seen the stress scenario yet. Go on a baseline assumption that it's not going to change dramatically from last year's stress scenario, how would you think about that?

VIKRAM PANDIT: Well, you know, I will not presuppose what the stress scenario's going to be. Why don't we wait on that, Ed, if you don't mind? It's not that that far away. We'll get the real scenario and we'll go through it then.

ED NAJARIAN: Okay, alright thanks a lot.

VIKRAM PANDIT: Okay. All right.

OPERATOR: Your next question will come from the line of John McDonald with Sanford Berstein.

JOHN MCDONALD: A couple follow-ups just to what Ed was just asking. John, you kind of crashed through your Basel III 8% target. Do you have a revised outlook for your Basel III capital, Tier 1 capital might get to end of this year or end of next year?

JOHN GERSPACH: I don't think we're going to be publishing any guidance near term. I still feel pretty confident that we'll be above 8% by year end. But, you know, John, if you just take the current consensus estimates for our earnings over the next five quarters, if you just take that level of income, that in and of itself would add roughly 135 basis points to our existing 8.6%. So you could argue that we could be approaching 10% if those estimates came through. Now, obviously there's a lot of other factors that can come into play but subject to all the usual caveats, we should be able to achieve a 9% Basel III Tier 1 Common Ratio sometime next year.

VIKRAM PANDIT: Maybe even 9.5%.

JOHN GERSPACH: What did I say?

VIKRAM PANDIT: You said 9%.

JOHN GERSPACH: 9.5%, sorry.

JOHN MCDONALD: That's just - you're just using a consensus net income. That's not including any additional Smith Barney sales, anything like that.

JOHN GERSPACH: Nothing as far as Smith Barney sales or any other impacts that the additional capital could have on reducing some of the threshold deductions that we're subject to, etc.

JOHN MCDONALD: On the expense drag of Holdings that you were just discussing with Ed, the perception that we've had is that default servicing expenses around U.S. mortgages has been the majority. So it sounds like you say that two-thirds of the kind of expense drag is not in U.S. mortgages that are in Holdings?

JOHN GERSPACH: If you look at the billion dollars of expenses, the operating expenses that we have in Holdings, it's roughly a third of that would be the US residential mortgages.

JOHN MCDONALD: Okay. Just to put a little more tangible sense to it, what are these other kinds of expenses are we talking about, the other two thirds? Is it branches or servicing personnel? What goes away when those other assets go away?

JOHN GERSPACH: The other assets, we've got two consumer operating businesses over in EMEA. We've got a consumer business in Spain. We've got a consumer business in Greece. We've got the continued operations of OneMain Financial, that's an operating business.

JOHN MCDONALD: A lot of branches there.

JOHN GERSPACH: Yes.

JOHN MCDONALD: Okay. Okay. That's helpful. Thanks. And then on the reserve release question in Holdings, John, what specific metrics are you watching when you debate internally about a more general release of reserves? Is it more your delinquency on what you're seeing? Sometimes when you speak about it, it sounds like you're talking about more macro. Is it a combination of your own delinquencies and the macro environment? Can you give us anything there?

JOHN GERSPACH: It's very much a combination of both our delinquencies and the macro environment. So it's both.

JOHN MCDONALD: Okay. And then - but nothing specific you could give us in terms of metrics you're watching?

JOHN GERSPACH: We watch everything from unemployment to the HPI, again, our delinquency statistics, almost anything that you could dream up, we watch.

JOHN MCDONALD: Okay. And the idea, it sounds like you're getting closer to the idea where the models would make you release reserves but you're not quite there yet, you want to see a little more out of the macro before you start doing that. Is that fair?

JOHN GERSPACH: I think it's fair that we want to see, as both I Vikram and I have said, I think the most important thing right now is to get through the fiscal cliff. And then the secondary factor would be that you'd like to see an economy that has got some real legs to it, one that's capable of creating jobs and actually driving down the real unemployment rate. I don't think we're in an economy where you're going to have housing lead the economy. I think you need the economy right now to lead the housing market and I'm not quite sure as to exactly how much of a robust nature we've got at the underlying economy at this point in time.

JOHN MCDONALD: That sounds a little more macro than a couple more quarters of your own delinquencies improving or that kind of thing, but – okay, I think I got it. Just one last thing on international consumer credit. You mentioned the regulatory changes have impacted you in Korea. Are there any signs of increased regulatory scrutiny or changes around consumer lending in Latin America, Brazil or Mexico where you have pretty high yields and everyone has high yields, is there any concern about changes there?

JOHN GERSPACH: Yes, we constantly watch the developments in those markets, especially in Brazil. Brazil has got an active program now with the government encouraging institutions to lower the lending rates. So that's something that we're clearly watching at this point in time. And again, we've repositioned our Brazil franchise so that we think we're appropriately positioned. But it's something that we watch all the time.

JOHN MCDONALD: Okay. Great. Thanks very much.

OPERATOR: Your next question will come from the line of Vivek Juneja with JPMorgan.

VIVEK JUNEJA: Hi, John. Question for you. Couple of questions. Firstly VAR, can you tell us what your VAR was for the quarter?

JOHN GERSPACH: I don't have that with me, Vivek. I'm sorry.

VIVEK JUNEJA: Do you have any sense of up, down, anything?

JOHN GERSPACH: Sorry.

VIVEK JUNEJA: Okay. Second question, 90 plus - did I hear you right? You sold $750 million of delinquent loans from LCL?

JOHN GERSPACH: I believe they were primarily delinquent. There may have been a few non-delinquents but yes, primarily delinquents.

VIVEK JUNEJA: If I adjust for that, your past dues were actually up linked quarter by $300 million or so, assuming whatever that precise number is and that's about 90 plus were up and early delinquencies were also up.

JOHN GERSPACH: When we take - the answer is you're right. They would have been up. Don't forget, you've got a continuing aging book. A lot of those delinquent loans actually came out of the 180 day bucket. I don't have the breakdown in front of me, Vivek, but a lot of the portfolio actually came from loans where we would have already taken the initial write-down and so I'll see what we can do about getting you some more detailed information, but I just don't have the bucket by bucket breakdown of the delinquent loans. But a lot of it, as I said, came out of the 180 day plus bucket.

VIVEK JUNEJA: Okay. And so your point is that the reason the early delinquencies are still going up is it’s just aging of - is this old, these are old borrowers are now falling apart and falling behind.

JOHN GERSPACH: No, actually. The blip that you see is in the 30 to 89 bucket.

VIVEK JUNEJA: Yes.

JOHN GERSPACH: That's actually - that's an internal impact. We've changed some payment schedules and so we got a blip in our early bucket right now. I expect that to dissipate by the time that you see the fourth quarter results. So I wouldn't read too much into that increase in the early bucket delinquencies.

VIVEK JUNEJA: Okay. Thanks.

OPERATOR: Your next question comes from the line of Erica Penala with Bank of America-Merrill Lynch.

ERICA PENALA: Good afternoon. I just had two quick follow-up questions. The first is on capital return. Do you get a sense that the Fed has gotten a better sense of the actual risk profile of your international credit portfolio coming into this year’s? Feels like that's sort of where the difference is with regards to what's actually happening at Citi versus what they were assuming would happen in a stress he scenario.

JOHN GERSPACH: I don't want to say whether or not they've got a better feel for it or better understanding. I mean, what I will say is that since the time of the last CCAR submission, we've spent a lot of time with representatives from the Fed, and importantly, the Fed has been very gracious with their time, allowing us to get some access to the people who actually run the models so that we - I think each side has got a better understanding now of what is driving things and what data is needed. So I'd say it's been a very constructive process that has continued over the course of the last six months or so.

ERICA PENALA: Got it. And my one last follow-up question. I apologize for another Holdings related question. But in terms of your reserving model, on a go-forward basis as you think about new frequency and incremental severity, are your assumptions on a go-forward basis for flat unemployment trends and continued decline in home prices?

JOHN GERSPACH: I'm not going to comment on the individual variables in our assumptions in our various loan loss models but obviously both of those are factors that come into play but I'm not going to comment on exactly how we may be modeling that.

ERICA PENALA: Okay. Thanks for taking my questions.

JOHN GERSPACH: Not a problem.

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

MIKE MAYO: Hi. How much of the $53 billion DTA is for the U.S. only?

JOHN GERSPACH: You know, Mike, I don't have that number in front of me. If you - the last number that I have, and we can follow up with you to get you some more specifics, would be that about roughly $5 billion or so would have been international and then the balance would be both U.S. federal and state and obviously some state and local that comes into play as well.

MIKE MAYO: All right. Well, maybe you could help me with what I'm trying to get to. If the corporate tax rate is reduced, let's say it was reduced by one-fifth, what sort of write-down would you have on your DTA?

JOHN GERSPACH: You know, Mike, as we've discussed in other calls, you've got to break - let's just assume for argument's purposes now that of the 53, roughly 45 is U.S. federal. Okay?

MIKE MAYO: Okay.

JOHN GERSPACH: Then in that U.S. federal of 45, there's a component there that would be tax credits. So foreign tax credits. Most people when they're looking at the prospects for tax reform are the working assumption anyway is that those tax credits would stay in place. You're entitled to those tax credits. That would remove the tax credits from the equation as far as the impact of rate reduction. So there you'd be left with, say, 20 to 25 of federal related DTA that could be subject to tax reform. You then have to think about what year would we have federal tax reform. But if it was at the current point in time and you actually had a 20% reduction, then you would be looking at the FTA would be - the DTA would need to have a valuation or a write-off, actually, of somewhere around $4 to $5 billion.

MIKE MAYO: All right. That was clear. Moving on to the $95 billion of mortgages in Holdings. You said do not expect a rapid reduction in those mortgages. But why not? You said that you feel better about the housing market. You're not willing to call the turn. But if you feel so much better, why not more aggressive sales?

JOHN GERSPACH: The ability to sell requires willing buyers and the buyer - the biggest stumbling block I think that we've got right now from a buyers' point of view would be liquidity. Most of the sales that where people want to buy mortgages are very specific MSAs where you get specialty servicers that are looking to take on some of the delinquent mortgages because they've got a real in-depth understanding of the local market. And so you're looking at sales packages of $200 million, $300 million. It's hard to build that up to some substantial volume where you would see a rapid reduction in the overall mortgage book. There just aren't a great deal of big national buyers in the market right now.

MIKE MAYO: Maybe you could help me connect the theory to the reality. The theory would say simply lower the prices and at a certain price there's always buyers. So what's wrong with that theory?

VIKRAM PANDIT: What's wrong, Mike, is very simply we also have to look at a net present value decision. One of the reasons why you don't have buyers out there is there's still not funding available. You haven't seen a residential securitization market yet. Have you? Not quite. The point on this is a very straightforward one, which is it's the funding that's causing the issue, not necessarily the valuation levels only on the mortgages, and we have to do what's right for our shareholders. We have the funding base. We have a clear perspective on what these assets are worth. We're going to sell them at prices we think are in the interest of our shareholders.

MIKE MAYO: Okay. And then switching gears again. Back to the theory, the theory says slowing economies, therefore more credit concerns and to the extent that Asia is slowing, wouldn't you have more concerns there and you saw a little tick-up in your Citicorp international credit. The NCL ratio went up from 1.8% to 1.9%. Not a big deal. The other metrics are fine. But as you look ahead are you starting to take some extra precaution?

VIKRAM PANDIT: I would tell you again the quality of our portfolio is very strong. We are an urban lender. We have a more affluent portfolio. It's diversified and, yes, there are questions about what rate the growth's going to be at, but the rates are still very significant out there. And so as we look at the situation in Asia, the question to us really is more about what's the rate of revenue growth, not so much issues about the quality of the book that we have.

MIKE MAYO: And then last question. As relates to investigation, last quarter you seemed pretty fine with the question. When do you think you'll hear about the LIBOR investigation? How do you feel today?

VIKRAM PANDIT: I'm going to repeat what I said last time, which is that we're cooperating with the authorities that have asked for information and we'll work on their time line.

MIKE MAYO: And do you have any sense when you'll hear anything?

VIKRAM PANDIT: We will wait to hear from them when they're ready.

MIKE MAYO: All right. Good enough. Thank you.

OPERATOR: Your next question comes from the line of Matt Burnell with Wells Fargo Financial.

MATT BURNELL: Good afternoon. Just a couple of quick questions. John, you mentioned some of the trends in the securities businesses in the third quarter and I realize it's very early in Q4 but I'm curious if you're seeing any reduction in activity levels from clients who might be a little more cautious heading into the election and the fiscal cliff.

JOHN GERSPACH: I don't think I'm going to give a comment on the early stages of the fourth quarter market.

VIKRAM PANDIT: But having said that, there's no question uncertainties are never good for the economy. It's never good for the markets, and at some point it's not about what happens to the cliff, it is leading up to the cliff that can have an impact as well. All of those are uncertainties still ahead of us.

MATT BURNELL: Right. And then just a quick administrative question. John, you had targeted or estimated that the effective tax rate going forward last quarter moving forward would be about 22%. Any change to that guidance?

JOHN GERSPACH: Yes, I would up it probably to 24 right now. You take a look at our tax rate this quarter. It's certainly very noisy, given some of the things that have happened. If you strip out the Morgan Stanley Smith Barney loss and the $580 million tax reserve release, that gives you a rate that's more in line with what would you normally see and you strip out those two and our rate becomes something a shade under 24%. I think it's like 23.6%, 23.7%. So that's just a shade over the guidance that I gave last quarter of about 22%, and I would expect the fourth quarter to be more in line with that 23% to 24% range that you see in the third quarter.

MATT BURNELL: Okay. Thank you very much.

JOHN GERSPACH: Not a problem.

OPERATOR: At this time, there are no further questions.

SUSAN KENDALL: Alright, thank you all for joining us today.

JOHN GERSPACH: Thank you all very much.

OPERATOR: Ladies and gentlemen, this does conclude today's conference. Thank you all for joining and you may now disconnect.