Host
Peter Kapp, Head of Fixed Income Investor Relations

Speakers
John Gerspach, Citi Chief Financial Officer
Eric Aboaf, Citi Treasurer

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 Peter Kapp, 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. Mr. Kapp, you may begin.

PETER KAPP: Thank you, Regina. 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, citigroup.com. Afterwards, we'll be happy to take questions.

Before we get started, I'd 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 2012 Form 10-K. With that said, let me turn it over to John.

JOHN GERSPACH: Okay, thank you, Peter, and good morning, everyone. We're very pleased to be hosting our Fixed Income Investor Review this quarter. Today, we're going to update you on our continued execution and progress in several areas. Eric Aboaf, our Treasurer, is going to review some specifics on our strong balance sheet, liquidity profile, and capital position, as well as review our recent issuance activity and funding plans for the remainder of 2013.

Before I turn it over to Eric, however, there are some key points from our second-quarter results that we announced earlier this week that I would like to highlight to start us off here on slide 2. We reported $4.2 billion of net income for the second quarter of 2013. Excluding CVA and DVA, net income was $3.9 billion or $1.25 per share. Overall, we had strong, high quality earnings, which were well balanced across our products and geographies. As you know, generating such results consistently is one of our top priorities.

We continue to make progress in two critical areas -- reducing the drag on earnings caused by Citi Holdings, and the utilization of our deferred tax asset. We reduced our assets in Citi Holdings by $18 billion in the second quarter. Holdings assets now total $131 billion, and are just under 7% of our GAAP balance sheet. This reduction in assets was driven not only by Morgan Stanley's purchase of the remaining 35% stake of our MSSB joint venture, but also by continued opportunistic sales, including the sale of just over $3 billion of U.S. mortgages. More significantly, the loss in Holdings was reduced to less than $600 million for the quarter. In fact, Holdings actually made a small profit when you exclude the impact of legal, and rep and warranty costs. Associated legal costs will likely remain elevated in the near term, but we took another significant step to get past legacy issues with our rep and warranty agreement with Fannie Mae.

Regarding DTA, we utilized $600 million in the second quarter, bringing the total utilized to $1.3 billion for the first half of the year. Our credit quality continued to perform favorably, with net credit losses down by 25% year-over-year. Our capital position strengthened as our Tier 1 Common ratio increased to an estimated 10% on a Basel III basis. And, based on the current interpretation of the proposed rules, we believe we are well positioned for the regulatory requirements regarding the supplementary leverage ratio, although they've not yet been finalized.

Turning to slide 3, we show Citigroup's results for the quarter. Revenues of $20 billion excluding CVA/DVA grew 8% from last year, while operating expenses of $12.1 billion increased 1%, driven by the higher legal and related costs in Citi Holdings. Excluding legal and related costs, and repositioning charges, core operating expenses were $11.2 billion in the second quarter. Core expenses declined 1% year-over-year in constant dollars, reflecting approximately $200 million of repositioning benefits, partially offset by higher performance-based compensation given stronger revenues.

Credit costs of $2 billion declined 25% year-over-year, driven by net credit losses. We earned $3.9 billion of net income in the second quarter, or $1.25 per share, up from $1 per share last year on a comparable basis, driven by revenue growth and lower net credit losses, partially offset by higher legal and related expenses, and a lower net loan loss reserve release. Our return on assets in the second quarter was again over 80 basis points, as compared with 65 basis points during the second quarter of 2012.

And finally, as Eric will cover in more detail momentarily, Citigroup end-of-period loans declined 1% year-over-year to $644 billion in the second quarter, as growth in Citicorp was more than offset by the continued wind-down of Citi Holdings, and deposits grew 3% to $938 billion. With that, let me turn it over to Eric.

ERIC ABOAF: Thank you, John. I'd like to begin today on slide 4, discussing our continued progress in winding down Citi Holdings. Holdings assets have declined by $18 billion this quarter to $131 billion, and now represent just under 7% of our consolidated balance sheet, and 21% of our estimated Basel III risk-weighted assets. During the second quarter, we achieved meaningful milestones in Holdings in several areas. First, we completed the sale of our remaining 35% stake in MSSB on June 28, which increased our Basel III Tier 1 Common ratio by 47 basis points, and reduced the assets of the *Brokerage and Asset Management* segment by $8 billion.

Second, we reduced the assets in the *Special Asset Pool* by $3 billion, primarily through asset sales. And finally, mortgage assets fell by $6 billion in the quarter, through both runoff and approximately $3 billion of asset sales. Importantly, we put a significant piece of our rep and warranty issues behind us with a Fannie Mae agreement, which covers substantially all potential future repurchase claims from Fannie Mae on loan originations from 2000 to 2012.

We also made progress reducing the earnings drag associated with Holdings, which remains one of our key execution priorities. Pre-tax losses in Holdings have declined from $1.7 billion during the fourth quarter of 2012, and $1.3 billion last quarter, to $900 million this quarter. The earnings improvement over the past few quarters has been driven by credit, as net credit losses continue to decline, and we began utilizing our mortgage loan loss reserves. This quarter, we utilized loan loss reserves to cover 95% of the net credit losses in the North American mortgage portfolio. The decline of these losses in Citi Holdings contributes significantly to our ability to utilize our deferred tax asset.

On slide 5, we show credit trends in our Holdings North American mortgage portfolio. Credit trends continued to be favorable in the second quarter, with net credit losses declining to $553 million, down 37% from last year, and 12% from last quarter. Going forward, assuming the U.S. economic environment remains favorable, we currently expect to continue to utilize reserves to offset nearly all our mortgage net credit losses. Our current reserves against this portfolio are $6.4 billion, representing 35 months of NCL coverage, and 117% of delinquent loans.

We've also witnessed a significant decline in the balances of our delinquencies in this portfolio, with 30-day delinquencies down 36% since last year, and 10% sequentially to $5.5 billion, with improvements across all of our delinquency buckets. The overall delinquency rate continued to downward trend with 30-

day delinquencies down 175 basis points year-over-year to 7.6% of the portfolio, as continued improvements in delinquencies outpaced the decline in the portfolio. The improvement in our delinquency balances reflects both our loan sales and fewer new entries into early delinquency buckets, for both first mortgages and home equity loans. This quarter, we sold $3.1 billion of loans, including $700 million of delinquent mortgages, and $2.4 billion of current re-performing loans.

Turning now to slide 6, let me discuss how we are efficiently using our balance sheet to support our client activities, and achieve our returns targets. Over the last two years, we've managed our balance sheet down from the $2 trillion average balance we had been running, while adding both client loans and deposits in a disciplined manner. This quarter, we again maintained our average and end of period GAAP assets at around $1.9 trillion. We believe that by managing a compact balance sheet, we can focus on our customers' needs, while continuing to improve our profitability, and conforming to the new leverage ratio regulations.

On the asset side, we maintained our cash and investment securities at roughly 25% of the total balance sheet. Year-over-year, total loans declined slightly, but we've continued to shift the mix of loans within our portfolio. Citicorp lending has increased, as we've lent to our core client base. And Citi Holdings loans have shrunk, as we've continued to wind-down those portfolios.

On the liability side, our deposits and equity have grown, while we've continued to reduce our long-term debt, though at a slower pace than last year. Short-term borrowings increased modestly, as we consolidated a trade finance conduit, and also prepared for MSSB deposit outflows. Overall, this balance sheet structure provides a stable funding mix, and allows us to keep our funding costs low.

Turning to slide 7, we have been deploying capital in support of our Citicorp client activities as we grow our loan balances. So let me describe the regional performance of our corporate and consumer loan portfolios for you.

Citigroup loans were down slightly year-over-year, as 4% growth in Citicorp was offset by a decline in Citi Holdings. Excluding FX, in our consumer businesses, we saw growth in all international regions, offset by continued customer deleveraging in North America. *International Consumer Banking* loans increased 6% year-over-year, led by 13% growth in Latam. Later in 2013, when our announced acquisition of the Best Buy portfolio is completed, currently expected in September, we will add approximately $7 billion of receivables to our North American consumer loan balance.

Our corporate lending portfolio grew 8% year-over-year, and 5% quarter-over-quarter, excluding FX. Corporate loans grew year-over-year across all four regions, with Latam up 7%, and Asia up 5%. Much of the international growth came in trade finance. North America experienced 14% growth year-over-year, and 8% quarter-over-quarter, primarily due to the consolidation of $7 billion of previously unconsolidated trade loans. Excluding these additional assets, North American corporate loan growth would have been up 6% year-over-year, and flat sequentially.

Turning to slide 8, let's spend a moment looking at deposits, which serve as our primary source of funding for our bank. Overall, on a constant dollar basis, deposits grew 4% year-over-year, and were up 2% quarter-over-quarter. *Consumer Banking* deposits increased 2% year-over-year, ex-FX, as 8% domestic growth was offset by declines in Asia, as we optimized our high deposit-to-loan ratios in this region by reducing our cost of funds. *Transaction Services* deposits grew by 7% year-over-year, and 4% quarter-over-quarter, primarily as a result of client activity in Latam and EMEA.

Within Holdings, we held $57 billion of MSSB deposits at the end of the second quarter. As I mentioned to you last quarter, following the sale of our remaining JV interest, we will transfer these deposits to Morgan Stanley in stages, starting with approximately $20 billion this month, and then approximately $5 billion per quarter for the next two years. As a result, during the third quarter, we expect a step-down reduction in our deposits before growth in our businesses replaces these outflows. In subsequent quarters, we expect to easily replace these deposits from the natural growth in our *Consumer* and *CTS* businesses.

Our deposit base remains a low cost and flexible source of funds. Our deposit costs have declined significantly from 74 basis points in the second quarter of 2012, to 56 basis points this quarter. In fact, our U.S. deposit costs reached a low with an average cost of 27 basis points in the quarter, and our international deposit costs declined by 21 basis points over the last year to 77 basis points. Both of these are important factors in driving our overall funding costs lower, and maintaining a stable net interest margin.

Now let me turn to slide 9 to describe in more detail our long-term debt, which is the primary source of funding for our parent and dealer subsidiaries, and provides supplemental funding for our banking subsidiaries as well. This chart shows the composition of our long-term debt outstanding over time, with a breakdown of parent company and bank level debt. As you can see, we've reshaped our long-term debt footprint to better match our funding needs, as we deleverage our balance sheet and reduce the size of Citi Holdings. Long-term debt decreased by $84 billion in 2012, and $19 billion year to date to $221 billion. During the remainder of 2013, we expect our long-term debt outstanding will continue to decrease, but at a slower pace. This will also depend on potential new regulatory debt requirements, which I'll discuss more in a minute.

We have maintained our weighted average maturities in the 7-year range to ensure the stability of our longer-term debt funding base. Although we issue the majority of our debt at the parent company, as we will cover shortly, we can use long-term debt as a low cost supplement to our deposit funding at the bank. For example, we issued $2.5 billion of securitizations during the first half of 2013, as compared to $500 million during 2012. We plan to continue to access the securitization market when the right opportunities present themselves, but future balances will remain below our pre-crisis levels.

Slide 10 provides further context for our issuance and buyback plans, as we continue to re-shape the long-term debt footprint of our parent company. In 2012, we significantly reduced our debt outstanding. The $75 billion of maturities were driven by the last of our TLGP bonds coming due, and were complemented by buybacks, tenders, and redemptions. We issued $15 billion of long-term structural debt at our parent company.

Throughout 2013, we expect long-term debt will continue to decline, but at a more moderate pace. This year we expect long-term debt maturities at the parent company of approximately $28 billion, and we are targeting buybacks, tenders, and redemptions of another $12 billion, offset by our expected issuance volume of approximately $20 billion.

During the first half of 2013, we issued approximately $13 billion out of the projected $20 billion for the year, including senior and subordinated long-term debt, for terms of 3, 5 and 10 years, and across a range of currencies. We repaid $15 billion of maturing debt. We redeemed approximately $4 billion of trust preferred securities, not including the $1 billion of TruPS we redeemed this past Monday, and we retired approximately $3 billion of long-term debt through tenders or buybacks.

In addition, while not technically long-term debt, we also consider our issuance of preferred stock in our overall funding plan, as it plays an important role in our capital structure. During the second quarter, we issued $1.25 billion of preferred, and redeemed two older, higher coupon securities, bringing our total preferred outstanding to $4.3 billion. We expect to issue preferred stock over the coming few years, as we ease into the Basel III funding and capital structure requirements.

Turning now to slide 11, I'd like to provide a brief update on the potential regulatory requirements for OLA against the backdrop of our funding and liquidity position. As you know, Title II of Dodd-Frank gives the FDIC the authority to wind-down a failing financial institution. The debt and equity requirements contemplated under the OLA would allow the regulators to re-capitalize a bank via bail-in, eliminating the need for government support. The comments during the Fed's July 2 board meeting began to clarify a potential timetable, but many questions remain about the actual requirements including the types of debt that might be used for bail-in, and the required bail-in capacity relative to our assets – that is, the denominator and the required ratio.

Although we have not received a formal NPR regarding the shape or scope of debt requirements, our illustrative bail-in capacity remains at levels consistent with what we shared last quarter. We operate our business with a significant amount of potential bail-in capacity based upon a few of the ratios calculated by industry analysts, and that we've shown here. Whatever final form the rule takes, we will adjust our capital structure accordingly and over time.

As regulators further clarified how Title II and OLA would function in the event of a market disruption, rating agencies are reassessing the amount of government support included in their current ratings. The agencies have been clear that rating support at the holding company could decrease, while support for the bank or operating subsidiaries is unlikely to change. This distinction is important, especially for our trading counterparties who often face our bank. At the same time, some of the agencies are beginning to recognize improvements in our underlying credit profile, and have commented upon our progress in their most recent credit opinions. We continue to be actively engaged with all of the rating agencies at multiple levels of the organization, as you would expect.

Now that I've covered deposits and long-term debt, on slide 12 I'd like to discuss our liquidity position. We currently have $389 billion of high quality liquid assets, down from $412 billion a year ago, and up from $376 billion last quarter. We size our liquidity resources to ensure we have sufficient liquidity available to meet our operating needs, and to withstand a variety of stressed market conditions.

At the end of the second quarter, our estimated LCR was approximately 110%, representing excess liquidity of roughly $37 billion above the proposed fully phased-in 100% threshold. Approximately 5 percentage points of the decrease in our LCR was driven by MSSB transfers. As previously discussed, we will transfer approximately $20 billion of deposits in July, so at June 30, that outflow was already captured in the 30-day time horizon for the LCR denominator. However, our June 30 HQLA balance still included the $20 billion of cash we needed to fund the transfer. All else being equal, next quarter we would expect our HQLA to decline from this quarter's balance by approximately $20 billion, as we complete the scheduled deposit transfers, but our excess liquidity position and our LCR percentage would be unaffected. As we have said previously, we expect to operate an LCR in the range of 110% going forward, with a potential for some modest variability from quarter to quarter.

On slide 13 you can see how the balance sheet trends that we have reviewed affect our net interest revenue and margin. Net interest revenue of $11.7 billion in the second quarter grew 3% year-over-year, and was up slightly from last quarter. We anticipated that our net interest margin in the second quarter would decrease by 3 basis points to 285 basis points. This decline was driven by lower loan and investment yields, partially offset by an improvement in deposit and long-term debt costs. Looking to the second half of 2013, we expect our net interest margin to stay roughly flat, to perhaps a few basis points lower than in the second quarter. So on a full-year basis, we expect to be slightly above the net interest margin of 282 basis points we achieved last year.

On slide 14, I'd like to discuss the effect of interest rate changes on our net interest revenue. As you can see from this slide, we are generally positioned to benefit from rising rates. The question is how, and when will rates rise. If rates were to rise 100 basis points in a parallel shift across the curve, and across our major currencies, we estimate the increase in the first year would be approximately $1.3 billion, or an 8 basis point improvement in our net interest margin. Under this scenario, our sensitivity to rising rates has increased since the first quarter due to deposit growth, adjustments to our investment portfolios, and increases in our capital base.

In our March 10-Q, we disclosed a number of other interest rate scenarios as well. Perhaps the most currently relevant of the scenarios is number six, which analyzes a steepener environment, where the U.S. 10-year rises 100 basis points, while overnight rates don't change. That is somewhat in line with what we are experiencing now with the 10-year Treasury up by about 65 basis points since the end of March. In this scenario, we estimated as of March, that we would generate an additional $100 million of net interest revenue over the next 12 months. Now, this analysis assumes no change to our portfolio duration as we reinvest, which may or may not reflect our approach at that time. In general, we'd expect that a steepening of the yield curve would have a positive effect on net interest revenue, but it could take several years to develop, depending on our decisions regarding investment duration.

If the steepening that we've recently seen were followed by an eventual rise in the short-term rates, this would result in a flattening of the yield curve. This rise in short-term rates is closer to scenario two from our 10-Q, which we estimate would generate an additional $850 million of net interest revenue. This environment is more conducive to growing net interest revenue over a short time frame, as we would see our floating rate loan yields repriced, and we would expect to generate a wider spread versus our short-term funding costs. So, the combination of a steepening in the yield curve, followed by some flattening, would benefit our net interest revenue and our net interest margin, but the benefits would be realized over a multi-year horizon.

Having discussed the effect of interest rate movements on our earnings, on slide 15 I'd like to discuss how foreign currency rates and interest rates affect our tangible book equity and our regulatory capital ratios. The chart at the top of this page shows the impact that foreign currency and interest rate-related OCI changes have had on our Basel III Tier 1 Common ratio over the past five quarters. The table at the bottom of the page puts these changes into the context of our tangible common equity. The dark blue line represents foreign currency translation impacts, which we manage to keep in a tight band, even when currency movements are significant. During the second quarter, the U.S. dollar appreciated by 3.3% against our major currencies, resulting in a decline in tangible common equity of $1.2 billion. Despite this reduction in our capital, our Basel III Tier 1 Common ratio fell by just 4 basis points in the second quarter due to FX.

Our business model provides a significant natural hedge. As currency movements change the value of our capital denominated in foreign currencies, they also change the value of our risk-weighted assets in that currency. And then as necessary, we further hedge currency fluctuations through forwards and other vanilla instruments. So although our absolute amount of capital may fluctuate due to FX movements, our Basel III Tier 1 Common ratio should not typically move by more than 5 basis points due to FX in a typical quarter.

The light blue dotted line captures the effects of interest rate and other accounting-driven OCI changes on our Basel III capital position, which could be more significant in a rising rate environment. During the quarter, interest rates and other factors reduced our equity by an additional $1.2 billion, primarily driven by the $2.1 billion of unrealized losses on our AFS portfolio, and offset by other OCI movements. In total, these after-tax movements reduced our Basel III Tier 1 Common ratio by 14 basis points. We currently estimate that a 100 basis point parallel shock in rates would reduce our tangible book equity by approximately $2.5 billion after-tax, and our Basel III Tier 1 Common ratio by approximately 35 basis points, including the effects of this OCI movement on a pre-tax basis, given our DTA position. Importantly, given the high quality and relatively short duration of our AFS portfolio, we estimate that the unrealized losses on our AFS portfolio would accrete back over two to three years.

Turning to slide 16, let me summarize our capital trends on a Basel I and Basel III basis, including the supplementary leverage ratio. As of the second quarter, we estimated that our Basel I Tier 1 Common ratio was 12.2%, up from 11.8% last quarter. Under Basel III, our estimated Tier 1 Common ratio increased to 10%, up from 9.3% in the first quarter, driven by retained earnings, DTA utilization, and the sale of our MSSB stake, partially offset by the OCI impacts we just discussed. Our Basel III capital position remains among the strongest in the industry, as compared to both our U.S. and international banking peers.

Turning to the leverage ratio, Citigroup's supplementary leverage ratio, as calculated using the U.S. Basel III NPR, was an estimated 4.9% for the second quarter. Unlike the Tier 1 Common ratio, which is a period-end calculation, the supplementary leverage ratio is the average of the three month-end ratios calculated during the quarter. While our average for the three months was 4.9% for the second quarter, this leverage ratio improved sequentially during the period, with an exit rate of just above 5% in June. We have not yet completed our analysis of the effect of the proposal on Citibank, but based on what we know now, we believe we were around the 6% threshold required as of March 31.

We are still reviewing the final U.S. Basel III rules, but do not believe the rules will have a significant impact on the estimated ratio. As you are all aware, there has been quite a bit of activity in pronouncements relating to the capital requirements of large financial institutions over the past several weeks, and so our estimates are necessarily subject to our continued review and understanding of these recent developments.

Moving to our last slide, let me summarize five major points. First, while the environment remains challenging, on a year-over-year basis, we grew both revenues and net income in the second quarter, and continued to reduce both earnings and the capital drag from Citi Holdings. We also grew Citicorp deposits and loans year-over-year.

Second, our capital base continues to be one of the strongest in the industry. This is reflected across every one of our significant capital ratios, including our estimated Basel III Tier 1 Common, which reached 10% at the end of the second quarter. Our liquidity remained strong, as our estimated liquidity coverage ratio is approximately 110%, comfortably above the proposed minimum.

Third, we're well reserved, and our credit trends remain favorable, reflecting the high quality of both our consumer and corporate portfolios.

Fourth, we are reasonably positioned for rising rates, as I described earlier.

Fifth, and lastly, we've efficiently managed our balance sheet to approximately $1.9 trillion, and continue to expect to run around this level. We reduced our long-term debt footprint substantially in 2012; the 2013 reductions will continue, though at a more measured pace.

That concludes our Fixed Income Review. John and I will be happy to take your questions.

Question and Answer

DAVID KNUTSON: Morning guys. I had a quick question, you talked about Moody's and the potential ratings pressure. Do you perceive a change in Moody's having looked at or provided your second quarter results to them, or how they interpreted the results, or maybe their move on the sovereign? Do you think they're softening a bit their perspective on OLA implementation?

ERIC ABOAF: David, it's Eric Aboaf here. It's really hard to judge. And I always encourage our investors to reach out directly to the rating agencies to get the texture that they need. Moody's clearly summarized our results in their credit opinion. They mentioned it was a credit positive. But it is -- there's obviously a number of different factors that influence their ratings on the standalone ratings, and we're just going to have to see how that evolves during the course of the year. We've clearly continued to reduce our mortgage exposures, our rep and warranty exposures, and have made significant progress on some of our legacy assets, which we obviously continue to share with them.

How they interpret all of that I think is really up to them, and what credit opinions they develop are their own. I think what is clear is that they are doing some reassessment of the government support assumption for the holding company. That's quite clear. It's also quite clear that the bank support is much sturdier. And then as you had mentioned, they continue to re-evaluate our underlying performance, and we're just going to need to see how that plays out.

DAVID KNUTSON: So it certainly is a risk. The subordinated holding company debt would be junk-rated if they would remove a notch of systemic uplift. And I'm curious, what kind of contingency plans, or have you run through a series of ideas of what or how you would mitigate that risk?

ERIC ABOAF: David, it's Eric. There is a potential that the sub debt rating for one of the three agencies falls below investment grade. I don't know that that would be particularly surprising to some market observers. I suspect that it’s partially factored in today, to be honest. It's one of three agencies, so that's a factor. And I think you and others in the investment community do quite a bit of your own credit assessment across a wide variety of financial measures that you assess and evaluate. Not least of which are just some of the current market indicators around CDS and bond spreads, which continue to tighten nicely.

So, very hard to judge a particular agency's effect on our particular long-term debt, especially if it weren't just affecting us, but their opinion tends to affect the other banks as well. I think it's hard to come to the conclusion that it would have a dramatic effect on our debt levels. And clearly, we have an ability to operate in some pretty complicated environments, given the last few years, and I don't see this one as particularly significant.

DAVID KNUTSON: And then Tarullo seemed to suggest that the NPR would be out in the coming months, a few weeks ago. Do you expect then Moody's to take this action on the NPR? So second half, maybe third or fourth quarter this year?

ERIC ABOAF: David, it's Eric. They've been clear in their write-ups that they will conclude their review by the end of the year. I don't think we have any indication one way or another whether it could be sooner or later. So probably best that you just query them.

DAVID KNUTSON: And one last question, and this is in regards to the emerging market performance late in the second quarter. It seems like it's -- the markets have improved a bit. But there was a period of time, and there's still some doubts on Brazil, China, and broadly emerging markets. And I'm wondering, although it didn't really appear in the second quarter results, I'm wondering if the third quarter results are going to be ham strung a bit by weakness in these markets, or do you feel like they're still performing as good as they were in the first part of the quarter?

JOHN GERSPACH: Hi David, it's John. I think if you take a look at the performance that we've generated, not just in the second quarter but over the last several quarters, if not the last several years, we tend to have a pretty well-functioning franchise in the emerging markets. You take a look at the consumer banking results that we've had, the credit performance of those portfolios as we've given you the statistics in the equity investor decks that we use. Very good performance from both an NCL point of view, and a delinquency point of view. Consistent growth in revenues, and that's really because we are focused very much on our designated target market, which is the most credit-worthy customers, set in urban locations and with a global mindset.

If you move over to the corporate side of the business, we've given you a bit more indication on some of the corporate loans in the back of this morning's deck. And that's some place, I think it's on page 32 or 33, it's page 33. And you can see that our corporate portfolio is pretty well geographically distributed as well. I think there's 48% of the loan portfolio that's resident in the emerging markets, and we'd tell you that no country has more than a 5% outstanding as far as our total loan portfolio. When you take a look at the businesses that we operate in the emerging market countries from a *Securities and Banking* point of view, they're very much focused on flow business. And so again, I think it's the type of business franchise that should tend to operate well.

DAVID KNUTSON: Thanks, John.

JOHN GERSPACH: Not a problem.

DAVE MACGOWN: Morning guys. Really appreciate the cap structure detail and the OLA update. And related to some of your measurements that you're looking at on the right side of your balance sheet, the FSB came out with some guidance this week talking about setting up the proper structure for a single point of entry. And specifically mentioned the ability to transmit losses up to the holding company for SPE. Wondering in your discussions with regulators, if you're getting more color around what that might mean for setting up the holding company to do just that, and what it implies around some of the metrics you're looking at towards the total amount of debt you might have up at the holding company? And then secondly, whether you have to recast some of the assets you have up at the holding company, and whether we should be thinking about that as creditors at the holding company.

ERIC ABOAF: Dave, it's Eric here. The FSB has published some materials. The various agencies have obviously published materials over the last few quarters. The FDIC had gone out, for example, and met with a number of investors with some materials. So there's clearly a number of different but fairly overlapping and fairly related perspectives, which obviously means that a single point of entry approach is likely to be the one chosen.

That said, the questions you're asking are specifically the kinds of topics that haven't been really clarified by any of those documents or in any of the real discussions. And I think that's what the Governors of the Federal Reserve Board mentioned, that they were in the process in the next few months of trying to nail that down. And given that, it's just really hard to judge how much debt, how much equity, what the ratio of that will be against GAAP or risk-weighted assets. And to be honest, that's why we've put some of the variety of different ratios on that page that we had for you, page 11, literally because of the uncertainty.

The bottom line is at this point, it's hard with that uncertainty to make any concrete choices or decisions at our end. We wouldn't want to make a decision that would later prove to be unwise given that uncertainty, and so we are monitoring the situation. We're obviously careful about dramatically changing our debt and equity position at the holding company. And obviously, we're also staying in touch with our on-site regulatory team just to make sure that there isn't anything that is particularly pertinent. And all that together really puts us into a wait and see and not try to make any dramatic moves in the interim.

DAVE MCGOWN: Thanks, Eric.

ROBERT SMALLEY: Hi. Good morning, John. Good morning, Eric. Thanks for the call. A couple of quick questions from the slides. First on slide 9, when you talked about long-term debt outstanding, we've had -- you had planned to do $20 billion in issuance this year, so far have done $13 billion. So that's $7 billion outstanding. With the reduction in long-term debt outstanding of $16 billion between now and the end of the year, that leaves me down $23 billion net. Where's that going to come from?

ERIC ABOAF: Rob, it's Eric. I think you can see it from some of the continued -- maybe the best place to look is actually on page 10. You can see some of the year-to-date maturities that we have had. We've had maturities of $15 billion. We've had buybacks, tenders and redemptions of $7 billion.

ROBERT SMALLEY: Right.

ERIC ABOAF: We've got an ongoing program to continue that, and you can see that we were roughly slated to do $40 billion across both of those together. So that would leave another $19 billion, $20 billion of reductions coming through, just as part of the natural balance sheet maturities and our ongoing buybacks. I think which is roughly in line with what we've seen in the first half. You'll see that again in the second half, and that will basically flow through the books and eventually effectively drive the reductions down that you see on page 9.

ROBERT SMALLEY: So the second half mirrors the first half essentially?

ERIC ABOAF: Yes, roughly. It's $40 billion reductions full-year estimate, minus the $21 billion there that you see in the first half is roughly $18 billon, $19 billion the second half, so roughly about the same. Correct.

ROBERT SMALLEY: Okay, great. And staying on slide 10, for 2014 there's no box for buybacks, tenders and redemptions there. Is that something that you'll announce later, or was that intentionally left off?

ERIC ABOAF: Rob, we typically announce that during the third or fourth quarter. Most likely at the end of the year. I think what you should keep in mind is that we've been fairly steady in our approach here over the last couple years as we've adjusted our footprint. You can see the maturities and the buybacks from 2012 put aside the light blue TLGP piece, $31 billion and $17 billion respectively, you see maturities $28 billion and $12 billion in 2013. I don't think there's any significant reason for you to assume they're going to be dramatically different. I think for now, you can assume roughly in line with what we've done in the recent past. And obviously depending on some of the regulatory pronouncements, we'll adjust and we'll make some of those adjustments obviously over time, not necessarily in one particular year, given that most of them have a phased-in and glide path associated with them.

ROBERT SMALLEY: Okay. You had mentioned outflows with MSSB, and that eventually you'll be making them up with other customer deposits. But in the meantime, have -- I know earlier this year we saw a few banks issue senior debt at the bank level. Is that something that you've looked at and might include in part of the funding mix? And what are the pros and cons of that?

ERIC ABOAF: Rob, it's Eric. We've considered over the years, but I'd say lightly considered, the notion of issuing senior debt at the bank level. There are a couple considerations as you think about that. Number one, would it or would it not count for the Orderly Liquidation Authority bail-in debt. Quite uncertain, and it seems like potentially not. So that weighs on you.

You obviously have to consider long-term senior debt at the bank with other bank funding, in particular the closest cousin would be a card securitization or other securitizations, and those tend to be lower cost. So that might be a more natural first choice. You saw we did a little bit of that this quarter, just to diversify our funding mix. And then you ultimately have to compare that to the deposit cost of funds that you're seeing, both across consumer and corporate. So something we'd lightly consider, but I don't think particularly actively right now. And obviously if that changes, we'll share that with you.

ROBERT SMALLEY: Okay. One last question, if I can. A little bit more on strategy, and I'm going back to the deck from a couple of days ago in the appendix, slide 29. It's on the first half '13 returns analysis. Bottom line is that, when we look at average Basel III risk-weighted assets, for *Securities and Banking* they're almost twice as much as they are for the *Global Consumer Bank*, but the returns were only about $700 million more in the first half of the year. Is this the optimal mix for your risk-weighted assets? Are you capping RWAs in the *S&B* division now? How does that play out, and how do you see that going forward?

JOHN GERSPACH: Yes, hi Rob, it's John Gerspach. Good question. We would not put a hard cap on *Securities and Banking* at this point in time. But clearly as we begin to look at capital allocation across the various businesses, the return that we get on those risk-weighted assets weighs heavily as to where we want to put additional capital. I think that we've been fairly clear about this over the past couple of years, that we would expect more growth to be coming from our emerging markets businesses, specifically our emerging markets consumer business. And so you would expect I think to see the risk-weighted assets, all things being equal, risk-weighted assets in the international consumer business grow at a faster pace than you might see the risk-weighted assets in Securities and Banking.

ROBERT SMALLEY: Okay. Great. Thanks very much.

JOHN GERSPACH: Not a problem.

RON PERROTTA: Quick question, on the OLA NPR, any updated thoughts potentially on timing? I know it's a question of potentially second half, couple months, been broader time windows, anything else you guys would be able to share on that or not at this point?

ERIC ABOAF: Ron, you saw the couple months, a couple months we were told two weeks ago. So we're assuming a couple months.

RON PERROTTA: All right. Okay, thanks. And on the trust preferred, done on the Basel requirements now it looks like you're able to get some Tier 2 capital benefit for a period of time for the trust preferreds as they phase out of Tier 1. Did that have any impact on how you think about that part of the capital structure, potentially leaving some of those securities outstanding for longer, anything on that topic?

ERIC ABOAF: Ron, it's Eric. We've always known that TruPS roll into the rest of the capital structure, the Tier 2 capital structure. So, I think what the recent rules might have done, is just clarified exactly the timing and the roll-off. But not significantly different from what we had expected previously. What we have generally done, and I think we'll continue to do, is be reasonably economic about the TruPS. Look at the coupon levels. Look at the economics. And you know we've actually just started with a higher cost TruPS, and we've gone out and tendered or called or bought those back. And we'll continue to do that at a measured pace, just as part of our liability management process.

RON PERROTTA: Okay. And then one final one. I know it's very early days here, but as we look at the new leverage ratio requirements coming into place and some other thoughts on capital requirements potentially on shorter term funding, I know that's not a big part of your funding at this point; but any thoughts just on how you guys are or the industry may start to think about shorter term funding whether it's repo, credit lines, derivatives, and how that could change? Some of these businesses are obviously part of the suite of products that are offered to clients, but what the economics might become once you start layering on additional equity requirements? Any changes that you guys foresee, or how you're thinking about that business going forward?

ERIC ABOAF: Ron, it's Eric. I think it's just so early to really make any real assessments. Obviously, we're devouring the rules, we're understanding them thoroughly, and we want to make sure we understand how they'll work. We need to do our forecast. But you can see we're already at a decent place.

JOHN GERSPACH: You've got to get through a comment period.

ERIC ABOAF: So probably just a little too early to really tell. Maybe we'll know more in the next couple quarters, and as we do I'm sure we'll share that with you. So maybe a good question for upcoming calls.

RON PERROTTA: Okay. Understood. I appreciate that. Thank you.

MICHAEL ROGERS: Yes, a couple of questions. Good morning. Number one, Eric, sitting in your seat, I'm just wanted to flush out if I could how concerned you may be that once indeed when we do get the NPR on OLA, whether or not the probability rises materially that we would be seeing due to supply considerations a material repricing of the market for bank holding company paper. Any thoughts there?

ERIC ABOAF: Mike, it's something that we've considered, and clearly we know that OLA is out there. Clearly we know its implementation is getting further and further along, and we're very supportive of the general single entry process that is being developed. I think in a way that answers the question. I think it's quite clear that most of the investors out there that senior debt is going to have a component in the resolution in the bail-in of future bank failures. Hopefully we won't see any in the short-term, given the environment and everyone's approaches. But that's pretty well publicized. And so we expect that a large part, maybe all, but a large part of that is already baked into credit spread today, both for senior and for the rest of the capital securities.

MICHAEL ROGERS: Okay. And I guess just another more of a blue sky question. It appears now that the honorable folks in Congress are beginning to believe that the improved profits of the banking sector are now being realized by the banking sector, possibly taking too many risks once again and relying on too big to fail subsidies. And I guess I'm curious as to what you gentlemen think of some of the recent rumblings we're hearing in Congress, and whether some of this stuff could end up leading us down a path of more regulation?

JOHN GERSPACH: This is John. I think it's way too early to speculate on that. Those are rumblings, as you say, but there's a long path between rumblings and anything that would be a legislative action or a regulatory rule change. I think if you take a look at the return on equity that most financial institutions are producing these days, there's reason to think that the profitability is really not enough to sustain continued investor involvement.

MICHAEL ROGERS: Thanks very much.

JOHN GERSPACH: Not a problem.

MARK KEHOE: Hello, good morning. And thank you for the quarterly call. I'm just wondering if you could briefly talk about whether the SLR now changes the attractiveness of certain deposits, particularly in the custody area and corporate deposits in particular? And then secondly, if you could handicap whether you think that there would be an exclusion within the SLR for excess reserves. Thank you.

JOHN GERSPACH: Yes, hello. This is John. The one thing that you need to think about, I think whether you're dealing with the SLR, so it's leveraged assets or you've got risk-weighted assets or any one of the other concepts. Every one of these concepts in and of itself is certainly a worthy concept, and plays some role in guarding the overall safety and soundness of the financial system. But in almost every case, it's really a matter of degree and how well all these various elements actually work together, and you note some of the considerations in your question. So I think that when it comes to proposed rules like the SLR or even some of the things that have come out of Basel recently, I think that from our position we just look forward to engaging as usual in a robust, constructive dialogue with the various regulatory bodies on each proposal that they've put forward. And we'll see how all of those dialogues come out.

DAVID JIANG: Hi, I was wondering if you can shed a little light on the supplementary leverage ratio. On the earnings call, you had mentioned that under the BIS framework it might be 40 basis points lower than I think the 4.9% that you've disclosed. And can you shed a little color on how you got to that number? I was a little surprised at how little the impact was, given the add-ons under the BIS.

JOHN GERSPACH: As I said on the call, this is against a proposal that came from the BCBS earlier this month and we've gone through, and done a very preliminary estimate of what the impact is, and you asked how we got that. It was by analyzing the rule, and then trying to estimate as best we could the impact. And the impact that we've come up with is it could be as much as 40 basis points.

DAVID JIANG: With regards to that ratio and in terms of capital planning, do you envision this as incorporated into the whole CCAR process or separate from it?

JOHN GERSPACH: I think that we're very early on in any sort of consideration of the supplementary leverage ratio, given the fact that both the U.S. has just put out an NPR on it. Basel has just put out new considerations. So there are still comment periods to go through, reconsideration. And as I mentioned in response to the earlier questioner, I think that there's a good bit of robust dialogue that we're quite confident will ensue.

DAVID JIANG: Thank you.

JOHN GERSPACH: Okay, not a problem.

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

PETER KAPP: Thank you, everyone, for joining the call today. If you have any follow-up questions please don't hesitate to reach out to us in Investor Relations, and we'll speak to you again soon.

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