TRANSCRIPT

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Host
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Speakers
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PRESENTATION

MATT O'CONNOR: Okay. Thanks, everyone. Up next is Citigroup. From our point of view, it seems like management has made a lot of progress the last couple of years, obviously growing capital significantly, lowering the volatility of earnings, regaining some share that they lost in capital markets, and then gaining some share on top of what they had lost a few years ago, and better managing expenses.

But clearly the latest CCAR round and denial of Citi's capital plan has a lot of folks scratching their head as to what more needs to be done before Citi can buy back stock. And I'm thinking there's a good chance that John will address some of these concerns in his presentation.

Just in terms of format, John's going to present for about 30 minutes, and then we're going to open it up right to Q&A from the audience. So please queue up your questions now. And with that, let me turn it over to Citi's CFO, John Gerspach.

JOHN GERSPACH: Thank you. I don't know, Matt, I think you got a much bigger round of applause than I did. So I guess when you're buying lunch for everybody, that kind of goes with the territory. So anyway, thank you all for joining me today. Today, I'd like to cover a few topics including Citi's recent results, the progress we're making on the execution priorities we laid out for you last year, and finally our tangible common equity allocations by business.

While the operating environment has proved challenging over the past year, we have taken significant actions in each of our execution priorities. And importantly, we believe that we can do better. You'll see that our core franchise is actually performing quite well, given the environment, with mid-teens returns on the tangible common equity supporting the operating businesses. Our goal is to better reflect these strong returns at the Citigroup level as we continue to utilize our deferred tax assets, wind down Citi Holdings, and ultimately position the firm for increased return of capital over time.

Turning briefly to our financial results. On slide 3, you'll see the progress that we've made at Citigroup since 2011. Our return on assets has improved steadily from 52 basis points in 2011 to 74 basis points for the most recent 12 months, driven by earnings growth in Citicorp, a significantly reduced drag in Citi Holdings, and a reduced balance sheet.

While we faced revenue pressures over the past year, we have also continued to deepen our relationships with our target clients. And we've taken significant actions to improve the efficiency of how we come to market, simplifying and standardizing our operations and in some areas paring back to focus our resources on a better defined set of activities.

These executions are consistent with the priorities that our CEO, Mike Corbat, laid out for you just about a year ago, with three key areas of focus which remain in place today. First is continuing to improve the efficiency of Citicorp by allocating our resources to the most productive markets, products, and client segments, all while funding growth and absorbing higher regulatory and compliance costs.

Second is driving Citi Holdings closer to break even as we continue to wind down the assets in an economically rational manner and move past our legacy legal issues. And finally, we want to demonstrate a consistent ability to generate regulatory capital through both high-quality earnings and the utilization of our deferred tax assets.

This is a first step. And I believe our progress over the past five quarters is clear. But the real goal, of course, is to be able to return a growing portion of our capital we generate back to our shareholders. The Fed's objection to our 2014 capital plan was a deep disappointment, and we are committed to bringing our capital planning process in line with the highest standards, thereby paving the way for a sustainable return of capital over time.

Let me take a moment to update you on the actions we've taken starting with Citicorp on slide 6. While the revenue environment has been challenging, we have been able to offset much of this pressure with expense discipline, driving the efficiency ratio in Citicorp from 63% in 2011 to 59% over the last 12 months.

At the same time, we've continued to deepen our client relationships with steady growth in loans and deposits across both our consumer and institutional franchise. This progress reflects a better allocation of our resources within Citicorp, optimizing our expense base across markets, further concentrating our efforts on our target client base, and finding ways to simplify and standardize our operations.

I'll start with an update on our markets. Last year, we rolled out a resource allocation framework categorizing each market into one of four buckets. Attractive markets where we had a strong position, good efficiency metrics, and opportunities to expand were characterized as "invest-to-grow" markets, comprising about 30% of Citicorp revenues.

Markets where we had a strong position and good efficiency but where we saw fewer growth opportunities were designated as "stay the course", representing about 5% of revenues. And then about two-thirds of our revenues were in markets where we saw the need to drive better efficiency and returns. "Optimize-then-grow" markets represent about 55% of revenues including large markets in the U.S. and U.K. And "optimize/restructure" markets with 10% of revenues with those with the least attractive efficiency metrics and returns.

Slide 7 shows our Citicorp markets under the same definitions as last year to provide comparability. Some numbers have changed modestly from last year, reflecting the movement of Credicard into discontinued operations as well as some updated cost allocations. But on a comparable basis, you can see the progress we've made in the optimized markets where we've reduced the total efficiency ratio by over 300 basis points from 2012 to 2013.

We've taken additional actions in 2014 including the announced sale of our consumer business in Honduras, which is in the "optimize/restructure" bucket on this slide. While we are pleased with the progress, we are far from satisfied. These optimize markets still create a drag on our overall efficiency, and in order to hit our mid-50%s efficiency ratio target for Citicorp in 2015, there is further work to be done across the consumer and institutional businesses.

Taking each business in turn, slide 8 shows a snapshot of Citi's Global Consumer Bank. We operate roughly 3,600 retail branches across 35 markets, and our goal is to be the preeminent bank for emerging affluent and affluent customers in large urban areas where we can achieve attractive returns.

GCB generated close $38 billion of revenues and over $6.5 billion of net income over the last 12 months, with a return on assets of roughly 170 basis points. Our diversified footprint affords us unique exposure to faster growing regions of the world where we have been successful in growing our loan portfolio with largely stable credit trends. We have unparalleled scale in our cards business as the number one credit card issuer globally by loans; and we tend to serve a consumer base with a higher amount of deposits and investible funds through our Citigold retail franchise – we have $169 billion of assets under management.

With this unique model as a starting point, slide 9 shows the key efficiency priorities for our business. First, as I just mentioned, we are focusing our resources on attractive markets where we have a competitive position. This means not just rationalizing our footprint to focus on the major cities but also transforming our network to leverage branch, digital and other channels.

We're also sharpening our focus on our target client segments, high credit quality customers in the world's top cities, with a somewhat broader reach in cards and certain markets like Mexico. We have a retail banking presence in more than 120 of the world's top cities, where we target clients with very similar banking needs across these markets.

With this footprint and client focus, we believe we can leverage our global scale by driving our business to more common products, processes and platforms. This means strengthening and simplifying our product offerings, standardizing our processes for better efficiency, better controls and better customer service, and driving our 35 markets to a common infrastructure.

To this end, we have taken several actions over the past six quarters. We've exited or announced the sale of six consumer markets across Europe and Latin America. We sold our non-core mass market credit card business in Brazil. We've nearly completed the repositioning of our franchise in Korea, concentrating more of our branch network in the major cities and on our target client base.

We're actively resizing our North America mortgage business for the lower revenue environment. And at the same time, we've been closing or selling branches outside the major cities in North America. Again, focusing our efforts on target markets, where we have a competitive position.

We're continuing to rationalize our number of card products. We were rapidly consolidating support sites for better efficiency. And we remained focused on migrating our 35 markets onto a common technology platform. While we've accomplished a great deal, we are by no means finished, and the statistics on the right side give you an idea of where we expect to end the year on some key expense drivers.

Slide 11 shows the efficiency ratio for Global Consumer Banking on a trailing 12-month basis. Total franchise results are shown on the light blue line, while the dark blue bars represent the efficiency ratio excluding North America mortgage and Korea. As we have discussed in the past, revenues have declined in both North America mortgage and Korea over the past year. And this resulted in a significant drag on our reported operating efficiency.

Outside of these businesses, we have made steady progress, reducing our efficiency ratio from nearly 56% a year ago to just over 54% today, all while continuing to invest in those markets where we see growth opportunities. While we believe the revenues in North America mortgage and Korea have largely stabilized, we will continue to take actions to reduce our cost base and improve efficiency in these businesses, as well as our consumer business more broadly.

Turning to our institutional business, over the past 12 months, ICG generated over $33 billion in revenues and $9.5 billion in net income for a return on assets of 89 basis points. I know from the outside it is difficult to compare one institutional business to another, but it is the global nature of our franchise that really differentiates us from our peers.

We operate the largest proprietary closed loop payment network in the world with direct connectivity to the banking systems in roughly 100 countries. We have trading desks in 80 countries. We have clearing and custody capability in roughly 60 countries. And we facilitate about $3 trillion of transaction flows on a daily basis. This drives significant capital markets activity in areas like foreign exchange as we help our clients grow and transact around the world.

On slide 13, we frame our key execution priorities. First, we are focused on deepening our relationships with our target clients, the world's largest multinational corporations and investors who truly value our global franchise as they grow and operate around the world. In almost every case, we already have a relationship with these companies, and our goal is to serve our clients across more products and more geographies in an integrated manner. And importantly, we are doing so with a keen focus on efficiency and resource allocation given today's cyclical headwinds and the challenging revenue environment.

With these priorities in mind, we've taken several actions over the past year and a half. First, we've gained overall market share with our target clients across many products and regions. This progress has helped us diversify our revenues and grow historically undersized businesses such as our private bank, investment banking, and equities. We've also simplified our organization, removing the management layers in Securities & Banking and Transaction Services to operate in a more integrated manner.

We've rationalized our coverage efforts, better allocating our resources to a defined set of target clients. We reduced capacity in certain areas, and we're focused on improving our back and middle office efficiency. The result of these efforts, as shown on the right side of this slide, is that over the past year and a half, we've diversified our revenues with growth in non-FICC businesses while improving our overall efficiency.

Turning to slide 15, as we have shown in our earnings presentations, on a trailing 12-month basis, we have reduced the operating expense base in ICG in every quarter for over two years, though there is still work to be done for ICG to achieve our 2015 target efficiency ratio of 53% to 57%. Both our efficiency ratio at 59% and our comp ratio at 29% compare favorably to peers today.

Turning briefly now to Citi Holdings. We've made significant progress in reducing the assets in Citi Holdings, down by roughly $700 billion from its peak in early 2008, and by almost $100 billion or 45% over the last two years. Over 60% of the remaining assets are North America mortgages, and we continue to sell those loans opportunistically but do not see an opportunity right now for a larger scale sale at attractive levels.

Beyond mortgages, there are few sizable operating businesses left to sell, with the largest being OneMain with nearly $10 billion of assets. OneMain is a profitable business, with the largest consumer finance distribution network in the United States, offering personal loans through over 1,000 branches. We took a significant step towards an eventual sale of OneMain last month, with the successful $760 million securitization deal that demonstrated its ability to attract third-party funding.

While we remain focused on winding down the assets, it is important to note that Citi Holdings, excluding legacy items, actually generated a small pre-tax profit over the past year. Legacy items, including rep and warranty reserve bills and legal and related cost totaled over $3 billion over the last 12 months. And so the main driver of getting Citi Holdings closer to breakeven is continuing to move beyond our legacy mortgage and securitization related issues. Last quarter, we put a significant item behind us with the settlement of certain private-label securitization repurchase claims. And we remained hopeful that we will have better clarity on the remaining legal issues in Citi Holdings sometime this year.

Turning now to our third execution priority, capital management. Over the last 12 months, we generated roughly $21 billion of regulatory capital, ending the first quarter with $132 billion of Tier 1 common capital under Basel III, or 10.5% of risk-weighted assets. In addition to net income of nearly $14 billion, we generated $3 billion of regulatory capital through the utilization of our deferred tax assets or DTA. And if you look at the components of that DTA utilization, you'll see that Citicorp itself generated earnings enough to support roughly $3.7 billion of DTA usage. We believe this amount is representative of what Citigroup could utilize on a normalized basis once Citi Holdings is closer to breakeven.

Now, I'll turn to the allocation of our tangible common equity. But before I go into detail, I'd like to take a step back and look at a comparison of our capital on a GAAP and regulatory basis so you can better understand our methodology. We ended the first quarter of 2014 with $201 billion of common equity and roughly $171 billion of tangible common equity or TCE. However, a sizable portion of this TCE supports Basel III capital deductions, mainly deferred tax assets which are included in TCE but excluded when calculating our regulatory capital.

Or in other words, today we carry roughly $39 billion of tangible common equity over and above our Basel III Tier 1 common capital. As such, our TCE allocations need to address both our regulatory capital as well as these capital deductions by the businesses.

On slide 21, we summarize our methodology. While we consider lots of factors when allocating capital, including our own internal risk metrics, our methodology is principally based on the Basel III regulatory requirements. First, we allocate what we call base capital. This starts with the amount each business is required to hold as a percentage of its risk-weighted assets. Citicorp businesses are allocated capital equal to 9% of RWA and Citi Holdings capital equals 9.5% of its RWA.

We then allocate additional capital to those Citicorp businesses that employ a disproportionate amount of leverage exposure as defined by the SLR rules. Once this base capital is distributed, we then allocate the amount of TCE which supports the Basel III capital deductions. As I just noted, these capital deductions are mostly comprised of DTA but would also include a portion of our mortgage-servicing rights and minority interests in non-consolidated financial subsidiaries which are allocated to their respective businesses.

Based on this methodology, we set the TCE allocations for each business on an annual basis, as shown on slide 22. At the end of the first quarter, we had just over $171 billion of TCE, with nearly $149 billion of capital allocated to Citicorp and the remainder, or $23 billion, allocated to Citi Holdings. As I just described, these allocations are principally based on the amount of regulatory capital required to support the businesses plus the amount that supports the Basel III capital deductions. Any additional capital generated in 2014 will accrue to the Corporate/Other segment.

Looking at Citicorp, allocated TCE includes nearly $112 billion, which supports the operating businesses, and roughly $37 billion, which supports deferred tax assets that are excluded from Basel III capital. While most of this excluded DTA is embedded in the Corporate/Other segment, we've also allocated some amount for the operating businesses in ICG and the consumer bank based on the amount of DTA that is generated by their ongoing business activities. This sets a somewhat higher bar for these businesses to account for the fact that as an organization, we need to be focused on utilizing DTA and mitigating its impact on our returns.

Turning to our implied returns on slide 23. Over the past 12 months, Citicorp earned just over $15 billion of net income to common shareholders on average TCE of $142 billion for a return of nearly 11%. However, embedded in Citicorp's TCE was an average amount supporting DTA of roughly $39 billion over the same period. This represents a significant amount of capital on which we, in fact, earned no return. Excluding DTA, Citicorp generated a return on equity of nearly 15%.

Turning to Citi Holdings, another $23 billion of capital supports a business which continued to generate losses over the past year. And so when you look at Citigroup in total, the return on average tangible common equity of 8% includes two significant items, the capital supporting DTA and the capital supporting Citi Holdings, which do not represent our core franchise. Our ultimate goal is to better reflect the attractive returns in Citicorp at the Citigroup level as we further reduce the DTA and wind down Citi Holdings, and return excess capital to our shareholders over time.

In summary, our core franchise in Citicorp is well positioned to support and grow with our target clients over time. We are already generating attractive returns in Citicorp excluding the impact of DTA. We continue to make progress in moving past our legacy issues, and we will continue to take actions to improve our efficiency, particularly given the near-term revenue challenges.

Turning to the second quarter. We continue to expect consumer revenues to be roughly flat to the $9.3 billion generated in the first quarter of 2014, while institutional revenues should decline driven by lower trading activity relative to both the prior quarter and the prior year. Historically low volatility and uncertain global macro environment and geopolitical events have all combined to drive volumes lower, particularly in May. And so this quarter's trading results could vary depending on the level of client activity we see over the next five weeks.

We currently expect total trading revenues for equities and fixed income to be down in the range of 20% to 25% year-over-year. In investment banking, revenues should be somewhat higher versus last quarter. And in Treasury and Trade Solutions, we expect revenues to be roughly flat.

At the Citigroup level, core expenses, excluding legal and repositioning costs, should be somewhat lower than the $11 billion recorded in the first quarter, reflecting lower compensation expense in the institutional business and modest sequential improvement in consumer. Legal and repositioning cost, as we've indicated before, should be roughly in line with the $1.1 billion we recorded in the first quarter, albeit with a larger proportion coming from repositioning costs, particularly in Asia consumer.

And with that, I'd be happy to take your questions. Thank you.

QUESTION AND ANSWER

MATT O'CONNOR: For questions, please raise your hand, and we'll get you a mic.

SPEAKER 1: Hi, John. Over here.

JOHN GERSPACH: Hey, Steve. How are you?

SPEAKER 1: Good. Good. So I think probably since the last time you spoke publicly, you received your letter from the Fed, post CCAR, highlighting the deficiencies and maybe more detailed than what was in that initial draft. Can you just talk a little bit about, now that you've received it, your comfort level and the ability to fix them in anticipation of the 2015 CCAR?

JOHN GERSPACH: Yeah. Thanks, Steve. Obviously, I can't comment on the specifics of the letter. However, the letter – the contents of the letter were in line with the conversations that we have been having with the Fed in that interim period between the time that we got the results and then we actually got the letter. So we remain confident that we know what needs to be fixed. And again, it's not about a business model. It's not about a strategy. It's not about the quantitative results. It's really coming up with a better process to gauge what the impact on the firm would be in a severely adverse environment. And it means being more inclusive as far as a business involvement and less top-down driven.

SPEAKER 2: Given your comments about the environment for the quarter, is there any seasonality to the quarter where May is more of the quarter than June, or is it the other way around, or are they even versus April?

JOHN GERSPACH: Well, I think we'd all like to hope that June will be more of the quarter than May was, given the way customer volumes were in May. But when you take a look, normally, there isn't much seasonality difference between May and June, so it's a little hard to say, yes or no, on a seasonable basis, May is always slow or June is always slower or higher. So it's pretty much fairly equal, although, last year, we definitely saw a downturn in June and when the Fed – when we first had the Fed tapering talks, so we'll see.

SPEAKER 3: I have a couple of questions. One, on the loan area, business loans, how do you view the current environment? Is it improving, flat, down? And what's your outlook for – based on your economic intelligence, et cetera, for the next six months?

JOHN GERSPACH: Yeah. I feel the loan demand remains choppy and somewhat inconsistent. We certainly see – we see reasonable growth in trade loans at this point in time, but again nothing that I would constitute as being spectacular. And the overall demand for loans – again, I'm dealing with our target market as opposed to a more general market – loan demand is basically focused where there's perhaps a transaction about to come, but we don't see any just general business demand for loans for expansion purposes at this point in time.

SPEAKER 3: And the second question, going back to trading. Obviously, this is an area that bounces around a lot. Can you compare this with any other period of time in your industry and recent history and whether you see any light at the end of the tunnel there?

JOHN GERSPACH: I think that until there becomes more of a sense of confidence in where the economies are going, we're going to see these types of environments. First quarter was generally okay, though not spectacular. The second quarter, it doesn't quite look like the third quarter of last year, but in some ways, it feels like the third quarter of last year with a general view of investors and a lot of corporates just sitting on the sidelines because no one is really sure about what to do from a position taking point of view; where do they want to put on hedges, what type of economy are they worried about. If you look, right now, we're at historically low levels in volatility, on interest rates and on FX. So those periods, when they happen, are one in usually where you get a revenue market like we're seeing right now.

SPEAKER 4: Hi, John. How are you?

JOHN GERSPACH: Hey, Larry. How are you?

SPEAKER 4: Good, thanks. Why do you think volatility is so low?

JOHN GERSPACH: Larry, if I knew why it was this low, you could probably – maybe you could do something about it, but I think it has to do with just the fact that people don't know – they lack a direction. And so, therefore, there just isn't a lot of direction in the market. People are uncertain. And so there just isn't a lot of movement.

In order to create some level of volatility, there needs to be people on both sides of a view. Right now, I don't think people even know what view to be on either side of. And so it's just a market that has been calm at this point in time. And so there's not a lot going on. And therefore, as I said, we kind of have the market that we've got. I wish I had a better answer for you.

SPEAKER 5: Mr. Gerspach, could you talk a little bit about Mexico? Have we seen the last of this? Are there going to be additional write-downs? What are we looking at as a final number?

JOHN GERSPACH: Are you referring specifically to the fraud that we reported?

SPEAKER 5: Yes.

JOHN GERSPACH: I think we've seen the number at this point in time. There certainly is nothing that in our ongoing reviews that would indicate that the numbers would change at all. We're still hopeful of some level of recovery, but we're not counting on that as yet. So the numbers are the way that we reported it both in adjusting the results for year-end as well as for the first quarter.

SPEAKER 5: And one other question, on the CCAR, do you have to wait until first quarter of next year or is there some process where you can go back after another quarter or two to change things?

JOHN GERSPACH: Well, we do have the option. As a matter of fact, we do have the ability to go back earlier. However, our sense is that we're much better served and our shareholders are much better served if we really focus on improving the qualitative aspects of our process and therefore focus everything on – really focused on the 2015 submission. So at this point in time, we have no plans to put in a submission – an interim submission or a follow-on submission to 2014.

SPEAKER 5: Thank you.

MATT O'CONNOR: Let me just squeeze in an expense question while we get the next question in queue here.

JOHN GERSPACH: Are you just trying to be more efficient?

MATT O'CONNOR: Maybe.

JOHN GERSPACH: Okay.

MATT O'CONNOR: As we think about the regulatory costs, the compliance costs, and CCAR costs, all those in one bucket. You've had – I think the last six quarters you've talked about a big ramp-up already. Based on what you've seen from CCAR, the Banamex fraud, I think there's been a couple of articles on one of the Banamex subs that operates in California although that seems like it's two years old news. Just all that stuff out there that we read about in the papers, does this make you think there's going to be any material increase in regulatory costs, compliance costs from here?

JOHN GERSPACH: Well, we would anticipate that regulatory and compliance costs are going to continue to rise. But that expectation was already built into our target of a mid-50s efficiency ratio for Citicorp. So I'll give you two answers. One is, yes, we see regulatory and compliance costs continuing to rise from here. But we still are very focused on delivering that mid-50s efficiency ratio for Citicorp next year. We don't think that those rising compliance and regulatory costs should get in the way of our ability to achieve that target.

SPEAKER 6: How would you assess your credit metrics at this point in time, in particular, auto, card and maybe certain pockets of C&I? Thanks.

JOHN GERSPACH: Yeah. We're not in auto, I mean, except for a very, very small amount, so I'll put auto aside. Credit card metrics remained very strong, both in our U.S. branded cards business, as well as the retail services business. Delinquency statistics are still – I don't know if I could say that they're at all-time lows, but they're certainly in very favorable territory. And we've got, in general, good credit card statistics and good retail statistics throughout the global consumer business.

We noted that we expect to see a small tick-up in the credit card delinquencies and credit card NCLs in Mexico, which will drive a slightly higher NCL rate in Latin America for the year. But again, everything is still pretty good. And from a C&I point of view, the C&I statistics, we don't see anything – non-accrual loans are still very low. And overall, the credit statistics are looking very, very good.

MATT O'CONNOR: We're actually out of time. So please join me in thanking John.

JOHN GERSPACH: Okay, thank you.

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