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Host
Betsy Graseck, Morgan Stanley Analyst

Speaker
Jamie Forese, Citigroup President and Chief Executive Officer of the Institutional Clients Group

BETSY GRASECK: So we'll get kicked off here. We are delighted to be joined today by James Forese, President of Citigroup and Head of Institutional Securities. James was recently appointed President of Citigroup. Is that right?

JAMIE FORESE: That's correct.

BETSY GRASECK: And he is also, two hats, CEO of Citi's Institutional Clients Group, right, which is something you have been doing for a while now – and never gets boring.

JAMIE FORESE: No. I wish it would get boring. That would be my dream come true, but it doesn't seem like that's going to happen anytime soon.

BETSY GRASECK: We'd be bored if it was boring, so it's better to be excited.

Okay, we're going to kick off here with a couple of questions. This is really related to Citi as a stock more than your business, but just let's power through this. What do you think will be the biggest driver for Citigroup shares over the next two years? A, B, C or D: Accelerating capital return; B, expense management; C, stronger capital markets growth; D, exiting Citi Holdings; and E, stronger emerging markets growth.

So these questions are really for John Gerspach sitting in front row. John, maybe you're taking notes. Can I see which one you are picking? Okay. And the answer from the group is very interesting. So accelerating capital return, A, but we have some strong showings here from expense management and exiting Citi Holdings, so that's good.

All right. Next question is going to be what gross total payout ratio do you think Citigroup can achieve in the 2016 CCAR? Because I know you wouldn't answer this, John, so we figured we'd get an answer from the audience. What do you guys expect Citi can achieve in the 2016 CCAR? – A, below 45%; B, 45% to 50%; C, 50% to 65%; D, 65% to 80%; and E, above 80%. So 2016 is next year. What do you think Citigroup can achieve. Partly a question for how you think the regulators would behave obviously, but – all right, 50% to 65%. It's a nice bell curve with its skew, you know. Skew makes it easier for you. Okay. Mark your calendars for, what is that? We get that June, right? June, next year.

All right let's flip to the next – thank you. Okay, now we have the background slide that is more appealing for John to look at here. All right. Thank you. James, thank you so much for joining us today.

JAMIE FORESE: Sure.

BETSY GRASECK: And I just want to remind everybody, we will have a breakout session afterwards. So if you're shy – I know a lot of you have been shy today. If you are shy, you can save your questions for the breakout which is going to be in the Norse, N-O-R-S-E Room.

Let's kick off with ICG strategy. Okay, really the basic question here is, how are you taking advantage of what's going on in the business today? You've got some major banks that are retrenching globally. You've got folks that are kind of moving back to their historical strengths, their historical footprints, and are backing away from areas of relative weakness. How does Citi differentiate itself in this environment?

JAMIE FORESE: Well, I think we did the same thing that many other banks did a few years ago or are doing now. And just post the crisis, we thought about what it is that we were distinctively good at. What were our core strengths? And in the ICG we evaluated our business along really three different axes: one was our geographic footprint; two was our product spectrum; and the third was our client base, our target client base. And first, with respect to the geographic footprint of the firm, which is very pronounced – we are in 101 countries, and even as we've retreated somewhat in the consumer space, we've stayed – we consciously decided to remain a very diffuse footprint in the institutional business. And in part, that is one of our core strengths: being able to serve clients around the world in all of the emerging markets in which they operate is core to one of – it's one of Citi's unique attributes. So we consciously decided to keep that.

We looked at the product spectrum too, and we had products back post the crisis, some of which are industry-leading with great margins and great returns and some of which lag that where the performance isn't as we'd like it to be. And we decided not to make any broad product exits either, product retreats. We decided that we were better off, in a world where our overhead is getting bigger and bigger – overhead costs are getting bigger and bigger – that we really needed to improve any underperforming or less well-positioned businesses rather than exit them. And when we looked at the analysis around exiting certain businesses, it just didn't make economic sense to our shareholders given the cost of doing that, given the stranded costs that we'd be left with. It was very obvious that what we needed to do is strengthen and invest in some of those product areas. So we decided to be a full product invested business across the entire wholesale product spectrum – we should say products and services really.

And then last was with the clients that we serve, and that actually, where we did make – we did shrink our client focus. We looked at – we tried to define the type of client that was really well-suited to being covered by Citi and when we added all those up, we got to about 15,000 clients. When we looked at the number of clients that we did business with, we had 32,000 clients that we did business with. So we were doing business with far more clients than we really felt that we could provide any distinctive services with. So we began to narrow our focus, again by serving clients all over the world and trying to deliver that full product spectrum to them on an integrated basis, but in a narrow set of clients.

BETSY GRASECK: Okay.

JAMIE FORESE: So that's been what's been behind our performance over the last several years. It's been work all focused on trying to execute on that.

BETSY GRASECK: And so, how has that driven wallet share of the clients that you have identified?

JAMIE FORESE: Well, we've seen a nice improvement. We've really been targeting at that was to try to improve the return on capital in the business. And you all know we've got lots of ways that we have to measure capital today, several regulatory ways, but one of the things most important to you is our return on tangible – allocated tangible common equity within the company overall. And we're focusing on that simple return equation along all the variables; how can we improve revenues, how can we do so with less cost and how do we be disciplined around capital?

In the revenue side, we haven't had an environment where there has been robust, industry-wide revenue pool growth. And so, we've been really focused on how do we take share and grow our share of wallet in that targeted client segment and that's accounted for about half of the revenue growth that we've seen over the last few years. It's been us taking share of the revenue pool or taking share of wallet from our clients as opposed to just seeing a rising tide that's lifting us and all the other banks.

So we've been focused on return on equity. Again, the focus on the revenue side has really been one about share of wallet because we don't control what makes the tide go up and down, and then, of course focusing on expenses and capital discipline as well – that's helped us deliver improved returns in segments as well.

BETSY GRASECK: And anything you can point to specifically around the share of wallet increase? Has it been more skewed towards things like underwriting, towards cash management, towards lending?

JAMIE FORESE: We've generally seen share of wallet improve across everything. But it's probably been more pronounced in the investment banking suite – debt capital raising, equity capital raising and M&A – and in the FICC wallet as well. We've seen, even while the wallet for FICC has declined, by our estimates, more than 30% since 2010, we've picked up share within FICC. And it's been pretty straightforward blocking and tackling; it's a lot of planning, a lot of good coordination internally and trying to be a little bit more integrated in the delivery of our products and services to the clients.

BETSY GRASECK: We had a couple announcements this week, at least one major institution pulling back from the capital markets, HSBC. I mean is there – you guys have some overlap with them, just being global institutions.

JAMIE FORESE: That's definitely a tailwind for us. In fixed income in particular, I think has seen the most pronounced capacity retreat and capacity that hasn't been filled in. In the past when there's been capacity shrinkage in the industry, someone else has always filled it in. But, I think here in FICC, that isn't what we're seeing now; we're seeing genuine retreats. And for those firms that have chosen to stay invested in FICC, those retreats have been positive impacts for them to allow us to gain some – one of the reasons why we've been able to gain wallet share in FICC is because others are now stepping back. And that's been helpful to us as well as some of the other larger FICC franchises.

BETSY GRASECK: So now, is there more opportunity to do more cross-sell and deepen wallet penetration in things like cash management, or is that something that is tapped out?

JAMIE FORESE: No, I don't think it's tapped out, but we hesitate to use the word – we don't like to use the word 'cross-sell'.

BETSY GRASECK: Okay. My word, not yours.

JAMIE FORESE: Because it’s almost definition, it's an unnatural thing. It means I'm trying to sell something that I'm not supposed to sell, I don't really know how to sell, so I'm going to 'cross-sell' it. But our opportunity isn't so much in asking a cash management specialist to sell foreign exchange, or a foreign exchange specialist to sell interest rate hedging strategies. It's in an integrated delivery of solutions to clients coordinated by a relationship manager overall.

So where we think we have more opportunity is to deliver solutions that involve multiple product building blocks to clients. And cash management is a good example, because quite often with a payment instruction that a client – cross-border payment instruction that a client's making, they also, at some point in the company, they have to do a foreign exchange trade as well.

And so we don't ask our cash management people to also sell in foreign exchange; we ask our cash management people to try to come up with a solution for the client that allows them to instruct the payment and do the foreign exchange at once. And obviously, we need systems to support that as well. So that's really what we're trying to deliver. And again, we hesitate to call it ‘cross-selling’; it's just selling. It's trying to sell the full product spectrum from things that are highly transactional and executed every day to things that are strategic and episodic and executed infrequently and all of the stuff in the middle and how it connects to a client's business.

BETSY GRASECK: Can we talk a little bit about Citigroup's capital position and how that can be an advantage for you? Obviously Citigroup has a very robust capital position and nice SLR. And so I would think that that would give you some advantage relative to peers in some of the businesses that you're on.

JAMIE FORESE: Yeah. Well first of all, I'd say that overall, our strong capital position is an advantage to the bank overall and what it fundamentally means is that we have plenty of capital to support client needs. So as our clients require more capital, we've got it, and we will deploy it provided that we can meet threshold returns in our activities. And that's not just an advantage to ICG; that's an advantage to the consumer business as well. And to the extent we have – as you well know, the extent we feel we have excess capital, more than we can realistically deploy now and to the near future, we'd like to return that. We think that – we agree that that's a big driver of shareholder value, is being able to accelerate our capital return program.

As it relates to ICG, given that the SLR is one of our least binding constraints in our own capital, it means that we can use SLR where we have good businesses on a risk-adjusted basis. We have good uses for capital on a risk-adjusted basis that may not be good uses on an SLR basis. We have the luxury of being able to do that. And so that does help in a few things that we are trying to develop: the prime finance business, the equity finance business overall, the set of delta one activities in equities. Those are good returns on risk-adjusted capital but not great returns on SLR. So, if SLR were our binding constraint, and it is for some firms, they are going to be pressuring those activities, whereas for us, because we have SLR capacity so to speak, we can deploy a little bit more balance sheet in the area and generate attractive returns on equity for shareholders.

BETSY GRASECK: Sure.

JAMIE FORESE: So it is, I think on a – there's lots of challenges when you try to invest, but that is a little bit of an advantage for us, yes.

BETSY GRASECK: You brought up equities, and I think recently, your European head of equities, Tim Gately, said that he thought 1Q wasn't just a blip for the industry and we should see strength continue, right? And I guess the question is, how are you thinking about your equities business? There's been some volatility there, and I know that you guys have been working on driving to more consistent earnings, so you could explain what kind of is behind that thought process?

JAMIE FORESE: Equities is one of those businesses, when I was talking before about the review we did several years ago about our product spectrum, equities was one of those businesses that is – we're amongst the very smallest of the global equity houses in terms of revenues. And we looked at it to see, is this something we should stay in, should we exit it, or what are we going to do about it? And we, again, consciously made the decision that we should invest in it, make it more efficient and make it more profitable. And we did that. That is core. Generating profitability is now a foundation of being able to grow it.

And while we've improved the equities business, we still have some things we are working on. One is, it's still a little inconsistent from one quarter to the next. We can have some decent solid quarters, and then we seem to disappoint a little bit. We're really trying to see what we can do to steady out the performance.

One of the things that is underlying that is to be stronger in prime finance and delta one products. The reported equities segment is made up of a number of things: the cash equities business, which is both high-touch, low-touch, or medium-touch execution business; there's the traditional derivatives business; then you have the whole broad category of delta one businesses, then equity and prime finance.

That equity and prime finance business, the delta one category are more recurrent types of businesses. And so when you build a franchise there and you have revenue in one quarter, you're more likely to generate it again the second quarter. Yes, there's some volatility too, but it's not as volatile as traditional derivatives for the cash business. And so, one of the things that we're looking at doing now that we've got into levels of profitability that we do think are extremely competitive now compared to the industry overall is to look where we can invest in the business, and particularly in things like equities to try to build that franchise up. And again, we have realistic goals there. We are not going to set a silly, unrealistic goal of trying to be in the top three in 12 months' time. That's not credible. But we do think that we can move from our current position just gradually up with some solid, steady investment in the business.

BETSY GRASECK: And you have some nice things to offer to the Street, in particular the global nature of your business.

JAMIE FORESE: Yes. Again, the globality is something that distinguishes – we really feel distinguishes Citi in any number, or almost in every way.

BETSY GRASECK: Can we talk a little bit about FX and rates globally and how you think about resource allocation? I mean, you're a leader in both of those. So is there anything left to do in those two areas? Or are you really thinking in the FICC space of building up some of the other parts?

JAMIE FORESE: Well, you're right. In contrast to the equities business, our rates and currencies business is one of the leading businesses in the industry overall. And there we have to make sure that we invest to sustain leadership. We're by no means going to be complacent there. But it's easier to defend the leadership position than it is to move into one. So that will consume plenty of attention and planning, but not necessarily as much investment as equities or some of the other parts of FICC that we're trying to build out, where we are more in the, say the middle of the industry dynamic.

The one element of FICC overall that has been growing nicely for us has been commodities. And commodities has been a relatively turbulent space for banks just given the pressure under which we're operating and capital rules around some of the activities within commodities. We've been treating commodities as just like any other asset class that our clients trade or hedge. And so just like we help our multinational clients hedge foreign exchange risk or interest rate risk, we do the same things with those that have commodities as inputs or outputs to their business; we help them hedge those exposures. We finance using commodities as collateral, but we don't own any capital-unfriendly commodity, physical assets like refineries or shipping or warehouses or the like. So our business has been able to grow into that. It's generally been a regulatorily – if that's a word – favorable activity. Or I just would say maybe they're going to look beyond that as opposed to some of those other things with commodities.

BETSY GRASECK: And you are everywhere you want to be in commodities, or there's still a few more verticals to fill out?

JAMIE FORESE: We have – we don't have any growth. So we don't have to – we're in metals, we're in energy and power and we're in that regionally as well. We just need to get stronger in some of those areas.

BETSY GRASECK: Okay. Got it. And while we're on the topic of trading, just can you give us some color on what you're seeing so far Q-to-date? Any update on how trading has been trending?

JAMIE FORESE: I think overall for the markets type businesses, equities and fixed income combined, it's the quarter that we're experiencing looks a lot like the quarter of a year ago. Equities is probably a little bit better. FICC, probably a small decline with the spread products underperforming the macro products within the FICC mix.

BETSY GRASECK: Got it. Okay. Yes. We had some comments after last week from the NFP that kind of gave a little bit more volatility to the rates space. So I was just wondering on that front.

JAMIE FORESE: The last week or so has been – we've seen some better activity, but we still have – and no one I think wants to project that out for the remainder of the quarter. So, we'll see. We've got two-plus weeks to go still.

BETSY GRASECK: Exactly. So, just last thing on FICC in general, in trading. You recently received a one notch upgrade from Moody's, right? So I was just wondering – I'm sure John's very happy with that – and wondering how you think about that and how you can utilize that?

JAMIE FORESE: Well, we're very happy to be upgraded, but it hasn't had any practical consequence to our business. In a way it's I think a little bit of a lagging move relative to the way financing markets have already adjusted or already been anticipating things of what's been happening around the company. So it really didn't change anything. Our spreads, our financing costs didn't move on the news. And largely, it was just very discounted already for us and the industry.

BETSY GRASECK: Okay. All right. And then just lastly on the ROTCE, you mentioned that's really a critical driver of how you think about the business and your success in running it. You've got 13% return on tangible capital if we calculated it correctly, and you are contributing 60% to Citicorp's earnings. So a big number in both ways. I guess I'm just wondering, do you feel like there is room to move up that 13% or is that the kind of steady state and you've gotten it already to that very high best-in-class ratio?

JAMIE FORESE: Well, again, so there's three principal levers to improve the return. On the revenue side, find a way to make them go higher; the expense side, find a way to make them go lower or deploy less capital in the denominator. I think on the expense side, when you look at our operating efficiency and if we stay on course to hit our target for 2015, that is going to be an extremely competitive, if not industry-leading operating efficiency for the segment amongst our peers. And there's only – there's a limitation to just how competitive you can be with your operating efficiency because improvements in operating efficiency tend to come only because you're not investing enough in the future or you may not be paying your people competitively enough too, which has the long-term effect of hollowing out your talent. So those aren't ways in which we want to improve the efficiency ratio further.

So having done a good job I think over the last few years on expenses, we're not done in finding productivity enhancements and gains, but it is coming to an end. The story is not going to be as good going forward.

So, we need to grow the revenue line to improve, which we think, if we can get a higher-rate environment, and we've – John and others, Mike, have spoken publicly about the benefit that that has to the bank in a higher-rate environment and I think it's somewhat reflected in today's – the moves in bank pricing today as we start to anticipate higher rates. So that will be a boost as well, and I think that's largely a pretty efficient boost to the bottom line too, because we don't necessarily have a lot of expenses that correspond to that increase. So, and again, we're still very focused on growing share of wallet in our segment too. So that hasn't come to an end, and even though it may be easier in some product areas to grow wallet share than in others where we are more saturated, that's still a focus of the bank.

BETSY GRASECK: M&A has been a great example of how you've been investing and driving improving wallet share. And it moved from – I think it was number eight to number five in a very short period of time over last year or so. Is there more to do there as well?

JAMIE FORESE: Yeah. We don't really try to isolate just M&A, and I think what you are describing is volume ranking, or announced or closed M&A. Again, we are much more share of wallet focused than looking at the total wallet. We do want to compete for the largest share of the investment banking wallet of our clients, which would be the equity capital raising, debt capital raising and the M&A, the advisory wallet. And again, all part of our planning, we've been able to do that. And you've seen an improvement in our equity capital markets ranking. Our debt capital markets which has always been pretty strong, has remained pretty steady, and we've seen an improvement in the M&A ranking as well.

I do think there's more to do. If you look at our penetration in investment banking wallet, it's a little inconsistent. We are really strong in some franchises and weaker in others and we're focused on the weaker franchises and trying to do better there. It's a combination of planning and improving talent and getting more focused and being more consistent in front of the client. But it's a formula that we're familiar with now, and given more time we think we can succeed in that too.

BETSY GRASECK: I'll just pause and see if there's any questions from the audience for James on the ICG business at Citigroup. We do have a breakout session afterwards, so if you are too shy to raise your hand, you can save your questions for the breakout.

Okay. So I just have a few other questions on my list here, if you don't mind.

JAMIE FORESE: Okay. Sure.

BETSY GRASECK: One is, competing with institutions that don't have to face the same kind of SIFI rules and rules and regs that we have here in the U.S. And I'm thinking about some of the folks in Europe, but also in Asia and Latin America. Maybe you could give us a sense as to how you are able to compete effectively, be it either on own price or in how you hit your hurdle rates?

JAMIE FORESE: Well, so we compete with a lot of banks all over the world because we are the most global bank, if that's good grammar. We not only compete with the typical global peers in your coverage universe or your European peer colleagues' coverage universe, we also compete with a lot of local banks in the markets, in the 101 markets in which we operate. But we don't necessarily compete directly with them for the same clients, nor for the same type of business with the clients which overlap with us.

Remember that we are generally trying to do the international business, the cross border business of, say, an emerging markets customer. So if we're competing in Thailand with a Thai bank that isn't subject to global SIFI standards, we may cover the same large multinational Thai company, but we are trying to do their international business which that Thai bank is not well positioned to do. They don't have an expansive global network, and so they are not able to service that client internationally; they service them domestically, where we don't really try to compete with them, and we're just trying to do the international business. Likewise, if General Motors is – when General Motors or Nestlé is doing business in Thailand, we're covering their subsidiary very actively for their domestic activities. The Thai bank could do that, but that would be the only activity they would be doing with General Motors or Nestlé and we're doing their business covering them all over the world and providing integrated solutions.

So we do compete ostensibly with those banks, but we don't compete for the same things. And so we can then – we do still have pricing power to charge for the things that we do uniquely well with the kind of returns that we want.

BETSY GRASECK: Okay.

JAMIE FORESE: So it's not as big of a challenge for us because we're just not trying to match – trying to compete for the same business that they do with those clients.

BETSY GRASECK: Got it. And then other thing, as you are managing your business and thinking about some of the risks. One of the questions I get from folks is cyber threats and risks like that, how are you addressing that kind of challenge in an organization that touches more countries than anybody else?

JAMIE FORESE: Well, there is two – you can imagine I spend a fair bit, as does the entire management team spends a fair bit of time on risk management. But we're spending a lot of time today on two risk categories that have existed for some time now, but we never spent as much a portion of our time as we do today. One is cybersecurity or information security in general and the other is conduct risk. The conduct of our employees or the misconduct of some of our employees has been hugely painful to the institution and to shareholders. I would estimate that the value that we generated from the illegal conduct in foreign exchange was order of magnitude about $1 million. We paid about $2.5 billion of fines and penalties in foreign exchange. So the misconduct of one or a small number of employees is incredibly damaging and costly. And so, we're spending a lot of time on improving the conduct of our employees and making sure that they perform.

And the other then would be cybersecurity as well. And then there, we are trying to stay as current as we can. We spend a lot of money, but it's – you can also waste a lot of money around cyber, but we stay as current as we can in working with industry bodies, working with the government to stay abreast of current threats and the threats come from all over the place. So it not only incorporates a big program of keeping people out, it's also monitoring the systems inside to see if anyone did get in, can we detect them and halt it from there. So that's a field that we could spend all afternoon on it with – and we should, probably with our experts – not with me, but with our experts in the field.

BETSY GRASECK: But it should be a calling card for you with your clients relative to some of the local competitors that you're dealing with in these various countries.

JAMIE FORESE: Yes. I think we can hopefully earn the trust of clients that we are going to protect better their information, protect the identities of individuals better and put more resources at it than some of the smaller firms.

BETSY GRASECK: So last question while we're on the subject of risk management, just on the Greek exit. I know it's been discussed and debated for a very, very long period of time, but we still get questions on it. How do you protect yourself?

JAMIE FORESE: Well, Greece isn't new. And so we've been concerned with it for a while. We've been trying to keep our exposures to Greece directly – our primary exposures to Greece as low as we possibly can while still being able to serve our core clients that are doing business in Greece. You'll recall too that we sold our consumer operations in Greece. So we just operate the ICG in Greece today. And we believe we have our exposures as small as we can to still be able to serve clients in Greece. We also are – while we are hopeful that a compromise will be struck here in the coming weeks, we can't be assured of that. So we've been thinking about what might come next by way of possible capital controls in Greece or potentially even a redenomination. So we've focused on ensuring that our local balance sheet is as balanced as we can make it between the assets and the liabilities so that we're not exposed to a redenomination mismatch there.

And so I think we feel that we can survive. We don't want it as an outcome, but we will comfortably survive – with a little pain we'll comfortably survive something in Greece at least in its primary effects. But I think the real worry that most people would probably express about Greece would be the secondary-order effects or the tertiary effects of what happens to someone and how does that – what does that mean for someone else and what does that mean then for you as that trickles through the system. But Greece is a well-known issue and been out there for a while, so hopefully the whole system has been able to make adjustments. And we will see minimal secondary impacts as well.

BETSY GRASECK: And with your strong capital liquidity, SLR, you're in as good a spot as any.

JAMIE FORESE: We are ready to fight. We're ready to fight.

BETSY GRASECK: Okay, great. All right, well, thank you very much, James, for joining us today.

JAMIE FORESE: Thank you.

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