Gerard Cassidy, RBC Analyst

John Gerspach, Citi Chief Financial Officer

QUESTION AND ANSWER

GERARD CASSIDY: I'd like to thank everybody for joining us for this fireside chat with Citigroup. With us is John Gerspach, who is the CFO of Citigroup, which he has been CFO since 2009. John joined Citigroup back in 1990 and he has worked in the accounting area and treasury functions, controllers area, throughout Citigroup, and has been a good friend to RBC and joining us today. So, thank you, John.

JOHN GERSPACH: Thank you, Gerard. Thank you very much. Yeah, I've been thrown out of more businesses at Citigroup than most people have, having moved around there quite a bit, so.

GERARD CASSIDY: I see. Maybe we could kick it off with – we're in the third month of the quarter.

JOHN GERSPACH: Yeah

GERARD CASSIDY: Maybe you could share with us how the quarter is going relative to expectations and give us maybe some color on what you're seeing?

JOHN GERSPACH: Sure. Sure. Sure. Sure. So, the first thing I'd say is that the businesses are largely performing in line with our expectations. If we want to start with Consumer. In North American Consumer, as we indicated during our fourth quarter earnings call, most of the growth this quarter is going to be really coming from inorganic items, primarily the addition of the Costco portfolio. And those revenues will be offset by lower revenues in mortgages and the absence of some asset sale gains that we had in the first quarter in last year in Retail Services. And that's pretty much in line with what we had laid out at the fourth quarter call. Moving on to International Consumer, we continue to see modest revenue growth in the regions. And that's accompanied by positive operating leverage in both Asia as well as in Mexico. So, that's kind of Consumer.

Moving on to ICG, well, one thing I would say is that the environment that we see in the first quarter of this year is a lot more favorable than the environment that we saw in the first quarter of last year, so that's a plus. Investment Banking, first quarter revenues in Investment Banking are tracking pretty much in line with our fourth quarter revenues, which means that if you take a look at year-over-year that should generate a fairly significant increase year-over-year for Investment Banking. And then, the total of Fixed Income Markets and Equity Markets, I'd say, they're also doing well. I'd say that's a strong performance there. And I'd say that we're – right now, the expectations would be something like low-double-digit revenue growth in Fixed Income and Equity combined. And then, of course, staying with ICG, we continue to see gains in revenues in the accrual businesses, Treasury and Trade Solutions and the Private Bank.

And then the only thing I'd add is that we did have one significant event that we announced earlier this quarter, which was the sale of our mortgage servicing business. And in connection with that sale we will incur, as we announced earlier, about a $400 million loss associated with that sale. And we should be able to make up maybe about half of that through other asset sale gains that are going to be in Corporate/Other. So that's pretty much where we see things right now.

GERARD CASSIDY: And regarding the FICC and the equity trading, if I heard you correctly, the growth you've referred to is year-over-year growth, right?

JOHN GERSPACH: Year-over-year growth. Low double-digits
GERARD CASSIDY: Yes. John, there's always been some talk about a secular decline in FICC trading versus a cyclical decline.

JOHN GERSPACH: Yeah.

GERARD CASSIDY: Can you share with us your color on – do you think a secular decline is bottomed, or were we in one in the first place I guess, but can you share with us what you guys are thinking about those trends?

JOHN GERSPACH: Well, you certainly have seen – the longer-term trend in FICC has been down over the years. I'd say last year, I think, if you take a look at all the data, it rebounded by single-digits, maybe in the 5% range. So, as to whether or not that is a new base or that's a bounce off of something, it's hard to say. What I think last year does point out though is that when you talk about what is the single largest driver on FICC, it's the macro environment. And last year, there was a lot of things going on in the macro environment that caused corporations and investors to look back and say, well, gee, I need to position my balance sheet this way. I think this is going to happen. And that gave us a good opportunity. I think the other thing that still holds true with FICC is that it's a scale game. And I'd say we demonstrated that again last year. Last year, overall, our FICC revenues were up 15%. So we're up 15% in a market where the revenues were up 5%.

You take a look at rates and currencies. Rates and currencies, we were up 30% last year. And there is probably nothing more scale in the scale business than rates and currencies. And that means that – I think that's going to be a continuing trend. What you're looking for are companies that have got the staying power to make the investments that need to be made. And we've done a lot of that as far as moving to more electronic trading, you capture those volumes, and then you have to have the balance sheet to actually put to work. Especially in the rates business. And we've made the investments. We've got the staying power. We've got the balance sheet to put to work when you look at the Supplemental Leverage Ratio that we're currently operating with at 7.2%. And then you combine that with the global network that we have which plays out well against our target client base, which are the large multinationals. And our Treasury and Trade Solutions business gives us a nice opportunity then to have great conversations with those clients as how to manage their working capital. And that leads to a fairly successful FICC franchise, which I know did not answer directly your question as to whether or not we've hit a new secular low. But I'm staying with that answer.

GERARD CASSIDY: Okay. And as in the past, folks -

JOHN GERSPACH: I mean, we're going to do fine. As long as there is a FICC market, we are going to get our share.

GERARD CASSIDY: Yeah. That's good. And if there's questions from the audience, please feel free to ask them. You mentioned Investment Banking. Is it more the debt capital markets because we've heard January was a very strong month for DCM? Is that where the strength is in? And, geographically, is there any areas, because obviously you're global – where is some of the strength on a global basis?

JOHN GERSPACH: What I'd say is – so two answers to your questions. DCM is definitely strong. ECM definitely has rebounded off of last year, which, God, it had to, right? But it's not quite – the levels that we're seeing in the ECM space are not quite back to what you would consider to be the three-year average. But they're approaching that.

And I don't think that there's any real area of strength. What we've seen is a lot of the larger deals that have got regulatory concerns. They're still being either delayed or you're seeing some that have been pulled, but they've been nicely replaced with a whole series of small to medium sized deals which have just sort of popped up and closed fairly well. And I'd say that we've seen them in virtually every geography in which we operate.
GERARD CASSIDY: Great. Yes?

SPEAKER #1: Is the Equities business as much of a scale business as FICC and if so how does that influence your decision to invest in the Equities business?

JOHN GERSPACH: Yeah. That's an interesting question. I don't think it's quite as scale-driven as FICC, but just by a little bit. Equities – for us, what we're trying to do is we want to size our Equities business appropriate with our client base. And, again, it means that you need to be able to put balance sheet to work, you need to be able to make the technology investments that you need to make, but we're not looking in Equities to be number one, two or three. That's just not going to fit because we don't want to go for the same broad market that you'd need to have in order to get into that one, two or three level.

If we look at sort of where we play out overall from an ECM point of view right now, we kind of sit nicely in a number five or a number six range. And if we take a look at our Equity Trading business, which is really where we've made those investments, there we're more down on the eight and nine range. So, for us, it's not about trying to build out scale, so that we can challenge for a number one or number two, but we do think that it would be very natural for us to be able to grow our Equity Trading business from being number eight or nine to be more in line with our ECM at five or six. It's as simple as that.

GERARD CASSIDY: John, maybe you can share with us – obviously CCAR applications is going to be submitted in the next three weeks or four weeks.

JOHN GERSPACH: I've heard.

GERARD CASSIDY: Maybe you can share with us how you're approaching it this year versus last year? Are there any changes and what could we maybe expect?

JOHN GERSPACH: Yeah, I'd say no changes other than, of course, we've continued to make improvements to our process which is something that you always need to be able to evidence. But no other change in approach. There is no new rules that are out there. So we'll continue to work through the process going through our stress case and we'll see where we end up. I mean I think the biggest change that we made would have been two years ago when we really decided that rather than trying to have a separate CCAR process completely divorced from the way we would operate on a business as usual point of view, and we just decided that what we really needed to address was the fact that we needed to have a continuous capital planning cycle. And I think that that served us well, because it means that as we get into those discussions in the fall and we give the businesses – here are the assumptions that we see in the environment for the next three years, let's go out and build the budgets. Businesses use that information, those assumptions in the models that they use every day. They produce a budget. We then go through a whole series of challenges to that budget and eventually produce something that goes to the board and gets approved then that's our operating plan.

When it comes to CCAR, just as it comes to any sort of stress testing, then all we need to do is change the assumptions. Now you've got a whole series of stressed assumptions, goes back to those same businesses using those same models, and now we get the stress results. And then we get learnings off of that as to gee what does this mean as far as businesses that are performing well and it's just part of a continuing cycle. It's the same thing – resolution is just an even more dire set of assumptions than the stress test. So it's all just part of the way that we approach things. And no, I'm not going to tell you the dollar amount that we're going to ask for.

GERARD CASSIDY: Okay. When you look at the capital levels of your organization obviously very well capitalized. What is an ideal optimal level that – once we get the final rules kind of set maybe in the next year or two years, the Fed has changed leadership, of course, and they give you guys all the final rule, where do you guys feel comfortable at?
JOHN GERSPACH: I'd say that we should settle – it's going to depend a little bit on whether or not we actually do have something like the stress capital buffer, the SCB. But something in the 11% to 11.5% range. You know, if there is an SCB, maybe it leans up to the 11.5% and that would be with an appropriate buffer that we would put on top of whatever the regulatory requirements are. So it's something in that 11% to 11.5% range, I think is, where we should settle out.

GERARD CASSIDY: As we look into the future, as you generate capital at a faster rate due to better profitability, is there an idea of giving back 100% of earnings at some point or how do you manage that number – or is there growth opportunities where you can manage it that way?

JOHN GERSPACH: Yeah. Mike and I have said that we really feel that, where we have got to get, in a fairly near-term basis, would be a capital distribution of something in the order of $15 billion to $18 billion a year. And that's not a number that we pluck from the air. $15 billion to $18 billion basically would represent, I think, exactly where you were going. It would be the capital that we generate through earnings in any given year less whatever capital we need to retain in the business for growth opportunities, like a Costco. But then added to that would be the capital that we free up from utilizing the DTA and the capital that we free up from continuing to wind down Holdings. And then, as we look longer term, I think, we should be able to operate at a capital level of 11.5%, we're now at 12.5%. So there is an adjustment that needs to be made there. And it's all those things that will go in ultimately to the amount of capital that we should be able to return on an annual basis.

GERARD CASSIDY: Got you. Yes. Over here.

SPEAKER #2: Citibank Global Consumer business used to be its most profitable business and yet you've been selling it, Argentinia recently, other countries before that. Are you selling the crown jewels to keep the regulators happy or have the dynamics changed or is the franchise eroded from where it used to be so great?

JOHN GERSPACH: No. I'd say that the strength of the franchise is where it is right now and that's kind of the strength where it's always been. I'd say there's two aspects of that. One is coming – or going into the crisis, we had a Consumer business, depending upon how you count countries like a Guam, anywhere to say a mid-40s, 43, 45 different countries. But the profitability in those countries was not equal and the prospects for those countries were not equal. One of the first decisions that we made was to exit the Consumer business in Western Europe. That had been profitable in the past, but we didn't think that given where we saw Europe going that it was a place where we wanted to be, that we thought we could get adequate returns. And that started then our journey on really looking at where do we want to concentrate our Consumer business given the strategy that we want to employ.

And that strategy really is around, for the most part, serving an affluent or emerging affluent customer base that really would benefit then from a Global Institution. And that means people that live in cities, because we're not going to be competing everywhere with a mass branch bank offering. So, when you start refining your strategy that way, it started with Western Europe just didn't make any sense, and I think we definitely made the right decision in exiting Western Europe back in 2008, 2009.

And then it became a series of taking a look at individual countries where we felt that we had the opportunity to really generate adequate returns. And so now, we're down to 19 countries, it's the U.S., Mexico and then a series of countries in Asia with Poland and Russia, sort of, added on to that and the UAE. And that strikes us as being the right place to be. We like the customer base. We like the cities that we're in there. And we feel that the cities that we're located in there give us the right economic coverage for a country. It's where the people with the money live and we feel pretty good about our ability then to generate good returns going forward. What we've said is even with that type of country array, we should be able then to get that Consumer business back to earning a 20% ROTCE. And that's what we're targeting and that's where we're headed.

SPEAKER #2: Does that apply to the credit card business? Are you in more than 19 countries?
JOHN GERSPACH: No, we're in the credit card business in the countries where we have a Consumer offering.

GERARD CASSIDY: John, sticking with the Consumer, we all know here in the States how important the digital channel is to service the Consumer. Can you share with us how important is it in those other countries around the world and can you give us an update on just where you stand in the digital channel and steering your customers that way?

JOHN GERSPACH: Sure. I'd say that we're most advanced in digital right now in Asia, as you might suspect. And Asia kind of leads the U.S., and the U.S. certainly leads Mexico. So we've got a lot of investments going on right now in enhancing our digital capabilities both through our abilities to acquire customers digitally, but also our ability to service those customers digitally. And that serves a couple of purposes. One is it's the way most of our clients want to do business right now. In Asia, if you didn't have a great digital offering, you'd be dead.

And, clearly, the way the U.S. is going, that's the same way it is. We just announced our new mobile application here in the U.S. and I'd say it's met with a very good reviews so far. And it gives you the ability, not just to 'Gee, what is my balance?' but you can lock your credit card; you can unlock your credit card. If you're a Citigold client, you've got instant access to your relationship manager; you've got access to investment and trading products all on that phone. And that's some of the investments that we intend to make into Mexico as well. A differential between the U.S. and Mexico, we get more than half of our new credit card customers through digital channels in the U.S. In Mexico, it's less than 10%. So, a tremendous opportunity as that market moves to more of a mobile offering to really capture additional business in Mexico.

GERARD CASSIDY: Speaking of Mexico, do the customers just not have access to digital devices, is it more that, or just culturally they just don't do banking there?

JOHN GERSPACH: Certainly the smartphone penetration is making – it's growing. It's definitely growing, but in Mexico, it's more of a cultural thing. People still like to do business in the branches. And we think though that if we offer them attractive, easy to use digital channels, there is no reason to think that they won't move onto those channels. And, as I mentioned to you, this move to digital is a double-edged benefit. One is it makes it much easier to acquire customers. And then from a customer service point of view, it makes it easier to service those customers and give them a great experience at lower cost. So, it really is a win, win, win.

SPEAKER #3: Would you just talk about your U.S. footprint. If you look yourself versus your larger peers, you're reasonably subscale and you're concentrated in certain MSAs. When you think about having such a large credit card business there's an opportunity to provide other products but without a regional footprint along those markets, do you feel that's a weakness? If you think, like, scale will go to the Chases of the world that will have six or seven or eight products, how do you feel Citi works in there?

JOHN GERSPACH: So I'd say that we've got scale in Cards and we've got scale in Retail Banking in the cities in which we choose to operate. So we don't choose to have – I'm going to annoy somebody from various states – but there are states and locations that we don't have branches. You're not going to find a branch of ours in Wyoming. Love Wyoming, great place to visit, but we don't have branches in Wyoming and we're not going to start by opening one branch in Wyoming and then try to, on an organic basis, grow at a branch network that's just not us. We're located in six key cities in the U.S. that constitute a good portion of the wealth of the U.S.

And, again, that fits perfectly with our Retail Banking model, which is much more of a wealth management offering. We don't need to be in individual cities in order to have a very good card offering. We're doing great with Costco. And if you take a look at Costco, we don't have branches everywhere there's a Costco store. But that card operates in every one of those stores and gets you that same, fabulous value.
proposition that it offers no matter where you are. So, I think, credit cards, we've got scale and Retail Banking we've got scale where we want it.

GERARD CASSIDY: Speaking of Cards and the Costco, can you share with us — you have seen some real good success with that product. Can you just expand upon what you're seeing there and what the year looks like for the credit cards?

JOHN GERSPACH: Well, let's start with Costco. Costco, as you said, it's an unqualified success. I think that's a win for us. It's also a big testament to Costco itself. It's great to have a partner like them and I hope they feel the same way about us. Tremendous success. We bought that portfolio, 11 million card members, had a receivable of $10.6 billion. We closed out the year $17 billion worth of receivables on our books, $52 billion worth of purchase sales. So, we think that's headed in the right direction.

But, as we said when we bought Costco, the Costco portfolio, it would not be accretive to earnings for the first 12 months – that's just the way purchase accounting works. So, we've seen the revenues. We've had the expense. We've had to build up a whole cost of credit. The second half of this year should be when we start to see some of that earnings power really kick in and that's coincident with, you know, we began to make an investment in our proprietary cards portfolio about midway through 2015. And we said this is going to take 24 to 30 months before you really start to see the earnings power of these investments. 24 months coincides, again, with mid this year. So, in the back half of this year, we feel really good about the profitability that we should be able to show in our U.S. Branded Cards business as both of those key investments mature.

SPEAKER #4: On the Costco part, Amex said 70% of their – was outside the warehouse. What's your percentage in the first nine months or whatever of –

JOHN GERSPACH: We've said it's over 70%. Yeah.

SPEAKER #4: Outside of warehouse?

JOHN GERSPACH: Yes.

SPEAKER #5: We haven't heard a lot about FinTech today. So, which are the businesses which are vulnerable to FinTech in the next three years and which ones are vulnerable for five plus years? Is it payments or what are the areas there?

JOHN GERSPACH: I'd say the way that we look at it is every business is vulnerable to disruptive technology. And, whether it's a three-year or five-year timeframe, we're busy looking – making investments and doing proofs of concept in those businesses in order to protect it. Near-term I'd be more – we're more concerned with payments. And so, we certainly are doing that both on the corporate and the consumer point of view. It's one of the reasons why we're moving to more digital means to deal with our clients.

But, when we approach digital we do it in a variety of fashions. We're making investments ourselves. We make investments in other companies through our Citi Ventures firm, which is located out in Palo Alto. So we have investments in startup companies, just to make sure we stay current. And then we also engage the programming community by giving them access to dummy data but on active websites of ours that allow, then, people to come up with new applications. And we've introduced several of things that we've gotten through those types of efforts, most notably in Asia. So we think we've got at least a three-prong attack to make sure that we are staying awake and countering that risk of being disrupted.

SPEAKER #5: Would someone like U.S. Bancorp who makes 30% of their money in payments not more vulnerable than most? I mean they're the highest multiple in the banks stocks.

JOHN GERSPACH: I can't speak to U.S. Bancorp.
GERARD CASSIDY: The bad news is we have to end the session, but the good news is there is a breakout session, which you go pass the coat room, it's on the left. Please join me in a round of applause thanking John.

JOHN GERSPACH: Thank you, guys.