**TRANSCRIPT**

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**HOST**
Gerard Cassidy, RBC Analyst

**SPEAKER**
John Gerspach, Citi Chief Financial Officer

## PRESENTATION

**GERARD CASSIDY:** Welcome to our fireside chat with John Gerspach, who is the CFO of Citigroup. John has been with Citigroup since 1990 and was appointed CFO – we were just chatting – in 2009. As some of you may know, today is the day in 2009 that the S&P bottomed at 666 and has obviously soared up since that time. Not to say that this will be a day of infamy but...

**JOHN GERSPACH:** Let's not go back to 2009, all right?

**GERARD CASSIDY:** No, that's true. Those were difficult times and, in fact, it's just the opposite, as you know, John, that everything seems to be going very well with the economy in the U.S., particularly with the tax reform, and maybe we could start off in your Investor Day. You laid out some guidelines and since then we had tax reform, of course, and possibly you could just remind us what some of the profitability and return targets will look like now that tax reform is in place.

**JOHN GERSPACH:** Yeah, sure. Thanks, Gerard. So you may remember when we did the earnings release, we talked about some of the impacts on tax reform and since then, we've upped the impact of tax reform slightly when we filed our 10-K 10 days ago. So tax reform cost us about $22.6 billion one-time, non-cash charge, but obviously the impact on our capital was much more modest and very manageable at about $6 billion. So the benefits of tax reform, of course, to us would mean that we're going to have a lower effective tax rate. What we've said is, for 2018, we expect a 25% effective tax rate and we've got line of sight to something lower than that, call it 24%, over the course of the next two years.

Now, against the Investor Day targets, if you take a look at some of the numbers that we've put out there for 2020, we had assumed a 33% effective tax rate in those numbers. So, tax reform saves us about 900 basis points on an effective tax rate out to 2020. We've talked about, therefore, tax reform, since it will lower our tax expense, improving our ROE by about 200 basis points, and of course, if you actually do the math on 900 basis points against some of the targets we've put out there for 2020, it's actually on a straight numbers basis probably something closer to a 300 basis point increase in ROE, but we want to leave ourselves some room to think in terms of how much of that benefit do we really want to reinvest in the business. Are there additional market programs? Are there additional product development programs? Technology expenses that we want to move forward?

So there's a series of things that we'll be looking at over the course of the next several months, and we'll give you further guidance, but right now, I'd say the best thing is assume about a 200 basis point increment over the numbers that we had put out. This year, we've put out a very specific target, 10.5% ROTCE is our target for 2018 and then 2020, at Investor Day, we said about 11%. Now we're thinking more in terms of 13%.

**GERARD CASSIDY:** And similar to other meetings and conversations, if there are questions from the audience, please raise your hand. John, with these profitability targets embedded and this is your efficiency ratio dropping down into the low 50% range by 2020, what are the biggest drivers of that and could it actually be accelerated?

**JOHN GERSPACH:** Good question. When we take a look at the efficiency ratio, I think what we demonstrated last year is a pretty good summation of how we intend to approach it: a combination of some revenue growth, additional efficiency saves covering investment expenses and then the continued wind-down of legacy assets. If you take a look at what we did last year, last year we generated about 150 basis point improvement on our efficiency ratio. And then we targeted about another 100 basis points this year.

Last year, we had revenue growth in our core businesses of about 6%. We continue to invest in those businesses, but efficiency savings, by and large, offset the impact of those investments. And then, we had the wind-down of the legacy asset, so when you look at it, it netted out to be about a 2% all-in revenue growth because as you wind down legacy assets, you certainly have a runoff in both revenue and expenses, so 2% all-in revenue growth and virtually flat expenses.

This year, I'm not saying that we're going to repeat exactly that, but again it would be the same type of formula. Some revenue growth, we'll continue to manage the expenses closely, and we'll continue to wind down the legacy assets and that is really the formula that we put in place for the Investor Day looking forward. We had about a 4% compound growth rate in revenues, and then, again, it's continuing to make those investments in the digital capabilities, continuing to build scale, continuing to invest in cloud computing, all of these things that should then enable us to drive the efficiency ratios down to the low-50s.

**GERARD CASSIDY:** Yeah. When we look at the Investor Day, you'd mentioned also a CET1 target ratio of about 11.5%. You've also in the past talked about the binding constraint being the CCAR process on the capital. Do you anticipate any changes to that targeted ratio with the new regulators coming in, any relief or should we still keep that 11.5% as kind of the target?

**JOHN GERSPACH:** I'd say the 11.5% is still the target for now. We certainly haven't seen anything concrete coming out of the regulators at this point in time. We're hopeful that there'll be some improvements made in the overall CCAR process but nothing just as yet. So for now, the 11.5% is, I think, a good target.

**GERARD CASSIDY:** Now that we've had some weeks to look at the CCAR scenarios that have been put out there, can you give us your take on what you guys are seeing in those scenarios and how it might impact you guys?

**JOHN GERSPACH:** Yeah, certainly a little bit tougher than we had thought that we would be presented with. Certainly a little bit tougher than what we would have hoped. But we're still on target to deliver the $60 billion worth of capital return to the shareholders that we talked about over three CCAR cycles. So when we did Investor Day, we said over the 2017, 2018 and 2019 CCAR cycles, we felt we had the capacity to deliver $60 billion worth of capital return to the shareholders. $19 billion got approved in the last CCAR cycle, so that leaves us around $40 billion yet to go. And we still think that that we've got a pathway to get there. But the scenarios were a little tougher than we had thought they might be.

**GERARD CASSIDY:** Yes, we agree.

**JOHN GERSPACH:** And I don't think we're alone, yeah.

**GERARD CASSIDY:** When you look at dividends and dividend payout ratios, when you and Mike talk to the board, can you kind of talk to us as you get through the excess capital phases over the next two or three years, what do you see reasonable dividend payout ratios being for Citigroup?

**JOHN GERSPACH:** Yeah. There's obviously – at least the Fed right now is still talking in terms of a 30% or so payout cap on dividends. I don't know how firm that's going to be going forward and so we'll see what happens. But I think the important thing when it comes to the Fed is they've always said there's no – as far as what they said to us – there's no cap on capital returns. That's going to be just based upon a firm's ability to generate capital and what capital they need and how they perform in stress scenarios.

 

So you saw that last year we were able to actually return – a lot of people look at it as far as a payout ratio on net income, we were well above 100%. We were above 100% of the capital that we generated last year. So we think we've got ample room to continue to return capital. When we take a look at dividends, I'd say that for us in the near term what we're focused on is having a dividend percentage equal to about 2% to 2.5%. So that's kind of dividend yield that we would be targeting. And that's kind of what we're using in as guidance right now.

**GERARD CASSIDY:** Got you. Speaking of the regulators, I don't know if you had a chance yesterday, but Vice Chairman Quarles was out talking about maybe changes to the Volcker Rule and reporting. Can you give us your thoughts on just how you're seeing the regulatory environment evolve as the administration has changed, new people have come in? Are they more receptive in talking to you guys about making it more efficient and more optimal?

**JOHN GERSPACH:** Well, certainly, what we've heard – I think what everyone has heard being said publicly is indicative of the fact that they would like to make some changes, not necessarily large-scale changes, but even some of the things that Quarles was talking about yesterday, and which others have talked about in the past, would have a positive impact. Again, it's not as though they're taking away regulation, but we've all mentioned over the last several years, does it really make sense to have five different agencies administering adherence with the Volcker Rule? You've got five different interpretations.

For us, we've got three different agencies that regulate us on Volcker. So that's three different sets of eyes, three different conversations, in some cases, three different data sets that you've got to provide them with. So having one common definition administered by maybe one agency per bank, that would be welcomed.

**GERARD CASSIDY:** When we look at your capital markets business, your Investment Banking area, you guys have made really good strides in the last three, four, five years of taking market share. What do you see on the horizon for that? Can you continue with that path? Is it hiring more people to generate that market share gain in addition to the guys you have in-house winning new business?

**JOHN GERSPACH:** Yeah. I'd say it's a combination of factors, Gerard. One, going back to 2009, when we really thought through the strategy of Citi, and we refined the strategy, so that from an ICG point of view, we decided to focus just on large multinational clients, just serving the needs of large multinational clients. That's enabled us to really cut down our client list dramatically. We've cut down our client list from about 30,000 down to 12,000 at this point in time, 12,500. So we've been able to focus on clients.

You combine that intense focus with doing some key hires and we invested in Investment Banking teams back in 2014, 2015, it takes a while for that to come together. But I think what you're seeing now is a result of that combination of deciding to focus on a very specific set of clients and then building up the capability that you need in order to do that and it's having the result that we thought it would have. And so you're starting to see those wallet share gains build and we've had a nice run. I'm not going to say that we're going to get the same result every year, but it's working.

**GERARD CASSIDY:** Geographically, are you finding better opportunities, whether it's EMEA, Asia or U.S.?

**JOHN GERSPACH:** Well, most of the Investment Banking activity is still in the U.S. and Europe. Asia is wonderful. We're doing fine there, but where we're really gaining the wallet share is in the more traditional markets.

**GERARD CASSIDY:** Got you. Moving on to markets in general, how is it going this quarter in terms of more volatility? Everybody is hopefully benefiting from the volatility in terms of versus last year, but maybe if you could give us some color on what you guys are seeing?

**JOHN GERSPACH:** Yeah. I mean, definitely, there certainly has been a pickup in volatility in the first quarter and by and large, that's positive. It's probably had some impacts on more products than others and we still have seen some periods of time when the volatility has gotten a bit steep, it spiked or when it's become particularly erratic that we've had some of our investor clients move to the sidelines.

But by and large, I'd say that the products that have benefited the most from the volatility this quarter would have been our FX product. And that's in both the G10 markets as well as the emerging markets. So we've had really good activity in FX and Equities. Equities has done pretty well this quarter. We have a shot at getting to $1 billion of revenues this quarter in Equities. And volatility, I would say has had less of a benefit on rates and spread products.

So all in all, a good environment. I'd say that if you look at it a combination of our Equities and Fixed Income markets products, I'd expect the revenues to be up low-to-mid single-digits this quarter over a fairly strong first quarter last year. And we had an especially strong March last year.

And then we've got good momentum continuing in TTS, in Private Banking, Corporate Lending, Securities Services. So even though Investment Banking may be down a bit this quarter compared to last year, still a lot of good momentum across the place.

**GERARD CASSIDY:** You mentioned TTS, which is a real crown jewel for you guys in moving money around the world. Rising rates traditionally have benefited I think that business. Can you share with us some of the innovations? I think at your Investor Day, you guys identified that clients are moving more money through the iPads and iPhones and how important is technology?

**JOHN GERSPACH:** Well, technology is incredibly important and we continue to invest in technology. I mean one of the things – talking about some of the good things that from a revenue momentum in the first quarter, you'll likely see – and like I said we'll have good revenue momentum. We'll do fine. We will still hit our target for efficiency ratio for the full year. But the efficiency ratio will likely be in the first quarter about flat to last year. And that's because with all of the positive momentum, we're leaning in from an investment point of view.

And so, when you think in terms of TTS, TTS really is a technology business and it's been that way – I worked in our TTS business back in 2000-2001 when we first implemented Citi Direct and that was a big investment program then and we continue to pile more money into that technology platform. As you said, we're now expanding into where treasurers can move money just using mobile tablets. So we moved $2 trillion last year just on tablets or mobile phones, smartphones. So, it's great.

The rates aspect of TTS, definitely there, but where we're really gaining revenue is more on volumes. We continue to gain wallet share, whether you measure that through SWIFT volumes or some of the other things. And with TTS, we've also now introduced our Corporate Card and that is becoming a real revenue-generating machine and we like that product a lot.

**GERARD CASSIDY:** Speaking of cards, maybe you can kind of pivot into the consumer side of the business. Obviously, the big Costco acquisition is behind you now. What are you guys seeing in that business? Is it still a promotional rate business that is very competitive or where do you see that going?

**JOHN GERSPACH:** Yeah, good engagement. When you think in terms of the U.S. Cards business, purchase sales I think we've had up like 10% last year. We grew receivables by about 6%. Importantly, even with the – and we did make a pivot during the year to be a little bit more focused on some of the promotional balances – the interest-bearing balances in that book grew by about 4% last year. And so that's important because that means that the earlier vintages that we invested in back in 2015, 2016, they are now generating the interest-bearing receivables that we thought. So as people come out of the promotional period, we're getting that flipping behavior that we wanted. So we like the way that that business is performing.

As I mentioned last year, we talked about it in our third quarter earnings call. We had gone into the year expecting to be a bit more heavily invested in rewards products for last year – didn't like the way the competitive environment was shaking out from a rewards point of view. So we shifted a little bit more into the value products, which are much more leaning on promotional balances. That gave us some revenue headwinds last year. Those revenue headwinds will probably be there again this year. But importantly, the underlying book is performing really well. The promotional balances are moving into revolving balances as we modeled. So it'll be okay, but it probably delays the overall growth in that business by about a year.

**GERARD CASSIDY:** Okay. Are there any questions from the audience? Yeah.

**SPEAKER #1:** I have a question for you. You've analyzed the bank at book value. Will they ever achieve peer group book value that J.P. Morgan has?

**GERARD CASSIDY:** I'm sorry. Will it ever achieve in terms of price to book?

**SPEAKER #1:** Price to book. On that basis, when can you achieve that?

**GERARD CASSIDY:** Right. Right. Right. No, I would say we've always been big price to book and price to tangible book investors. The value in it is driven, we believe, not necessarily by growth but by profitability. And there's a great correlation, as we all know, between ROE and price to book, and whether we all agree that cost of capital is around 10%, that could be debated, but the higher the ROE, and if Citi can deliver, as John just mentioned, on the profitability, then the price to book will definitely increase.

**JOHN GERSPACH:** When we take a look, we recognize that against peer institutions right now, certainly against some of the larger peers, our ROE trails them. And that's why we're really focused on doing two things. One is continuing to improve that return – those profitability metrics on the base business and that includes the revenue growth, the continued expense discipline and credit discipline that I think you should see building in the business.

But importantly, that also means continuing to deal with our denominator. And we've been running – we closed last year 12.4% CET1 ratio, even after the write-offs of tax reform. Our target is to run the place at 11.5%, which means that we have capital that should be returned to the shareholders. And that's why the annual CCAR cycle as we go through the capital planning process is important and that's why we've targeted over at least the next two CCAR cycles returning $40 billion to the shareholders.

It's capital that we'll generate. Importantly, that level of capital return should enable us to get that CET1 ratio down from that 12.4% closer to that 11.5% and also, therefore, benefit our ROTCE by lowering the denominator. So we talk about it as both improving the return on and the return of capital and that's how we think we get the price to book where it should be.

**GERARD CASSIDY:** John, is there any possibility – we're not expecting great regulatory relief for the big guys. There will be some, but if there's better transparency in CCAR where both the regulators and the banks can come to some sort of understanding that the gaming of the system they feared doesn't happen. Could you actually lower the targeted CET1 ratio to something – once you know there are no surprises in CCAR?

**JOHN GERSPACH:** Look, it certainly is a possibility. We had that conversation a couple of minutes ago where I said I think 11.5% is still the right target now, but there's a lot of things on the table that I think are ripe for discussion. What's the treatment of the GSIB buffer in CCAR? Are they going to implement an SCB, right? What happens in the future – one of the assumptions that's in the CCAR process right now is the assumption that institutions will continue to buy back shares of stock even in a crisis period. There's an assumption when the Fed runs its severely adverse scenario that says that assets will grow during a crisis. You tell me a crisis when banks have actually grown their assets. But anyway, if those things change, then maybe the target can go down as well.

**GERARD CASSIDY:** In looking at tax reform, obviously, the economy has picked up some momentum. Globally, it feels the OECD countries are all positively growing today. What are you guys seeing on commercial and corporate loan demand? Has it started to pick up yet? If not, is it later in the year possibly?

**JOHN GERSPACH:** I'd say that when you think about the globe, right now people have used the term synchronous growth and it's real. It's real. I was in Asia last week and you can feel it in Asia. You can certainly feel it in client conversations in the States. So I'd say that whole thing about synchronous growth is a reality. It is translating into loan growth in selected areas now. I'd say that when it comes to tax reform, most companies, not all companies, but most companies are just working through that strategic planning process now.

Most times, when you get something as significant as the U.S. package that just got put through tax reform, you've got months where you're thinking about what they're talking about and how that might impact you. Tax reform happened fairly quickly. The reality of it crystallized in a matter of weeks, not months. And so I don't think it's unusual for companies to take some period of time in order to make some very big decisions as to where they want to invest, how they want to invest. So I do think you're going to see a lot of that over the next six months.

**GERARD CASSIDY:** When we look at the globalization, obviously, you guys have been in Mexico for some time. Can you share with us – and you've committed to Mexico, you're investing in Mexico in the Banamex brand down there with the Citi name.

**JOHN GERSPACH:** Well, it's Citibanamex.

**GERARD CASSIDY:** There you go, Citibanamex. What are the guys on the frontlines telling you about their concerns of NAFTA changes or these tariffs now that we're hearing about? I know it's real time on the tariffs, but what are your guys telling you about how they're feeling about what's going on?

**JOHN GERSPACH:** Look, we certainly hope that people stay at the table. I think there's constant threats about the U.S. saying it's going to withdraw from NAFTA. There's a lot of good in NAFTA and we would certainly hope that people stay at the table and work it through. There's a lot of constructive ideas that have been put forward. Hopefully, some of those come to fruition.

To the extent that the U.S. would adopt a much more protectionist view, that's going to serve to add operations costs to the U.S. manufacturing. From a Mexico point of view, to the extent that this uncertainty lingers, it has the real possibility of reducing foreign investment into Mexico and that could certainly have a negative impact on the Mexico GDP.

However, if something does happen and there's less trade flow, Mexico's labor is fairly competitive and I would think that also their competitive stance would be benefited by a reduction in the value of their currency. So it'll take them some time to reestablish some new trade corridors. But we have no doubt that they'll be successful in there.

**GERARD CASSIDY:** Coming back to digitalization, obviously, it's moving very quickly into the banking industry. Some of the smaller regional banks – or not smaller – but regional banks have taken a national approach to consumer lending through digitalization. Obviously, you have Branded Cards, which is more than national. It's global. Is there any thoughts about other products that can be marketed nationwide through a digital channel?

**JOHN GERSPACH:** Well, when you think about all the capabilities that we're building now on our retail bank, so we're moving more and more things onto mobile devices. We're coming up with new ways of serving our clients digitally. We're coming up with new ways of onboarding clients digitally. So I'd say that we really are laying the groundwork for having a national digital bank at some point in time.

**GERARD CASSIDY:** Right. Do you sense that that's three years away, five years away?

**JOHN GERSPACH:** I think that's something that is much closer than that. Again, you'd want to make sure – you would not want to announce that we're now having a national digital bank until you were really sure that you could onboard and service your clients with great experience – I mean with great service digitally. We're close. But I'm not making an announcement right now. But I'd be really disappointed if it was anything close to being three years away.

**GERARD CASSIDY:** We were talking earlier about how strong the U.S. economy is and the global economy. Is there any metrics that you watch carefully to see if things are starting to slow down or credit at your organization is starting to show a crack?

**JOHN GERSPACH:** We take a look at both metrics that pertain specific to us as far as daily metrics on payment rates, delinquency statistics, purchase sales, all of that, all of which look really good and as well as drivers that you would think about as far as the larger economy.

**GERARD CASSIDY:** Right. It looks like we got the red light, so we're out of time. So, John, thank you so much for coming.

**JOHN GERSPACH:** No, my pleasure, my pleasure.

**GERARD CASSIDY:** I really appreciate it and thank you, everybody, for joining us. Please join in on our applause.