



HOST

Betsy Graseck, Morgan Stanley Analyst

SPEAKER

John Gerspach, Citi Chief Financial Officer

QUESTION AND ANSWER

BETSY GRASECK: All right. Thanks, everybody, very much. We're going to get started here. We're pleased to have with us, John Gerspach, CFO of Citigroup. I think you all know John's been CFO of Citigroup since 2009, is it?

JOHN GERSPACH: Exactly – July 9, 2009.

BETSY GRASECK: Oh, I remember. I remember that well. Okay. Let's go to a couple of polling questions, warm the room up on Citigroup. Okay, number one, other than capital return, what do you think will be the biggest driver for Citi shares over the next two years? You've got consumer revenue growth, institutional corporate revenue growth, emerging markets growth or expense management. Choose your answer, A through D. And, okay, pretty even split; interesting. You've got something to talk about there? We have a few questions on that.

JOHN GERSPACH: I actually think that they're closely aligned. So, when you think about it, I think one of the big drivers of our value is actually going to be improvement in ROE over the next several years. Our ability to drive ROE is really going to be driven by the ability of our Consumer business to improve its performance. One of the big drivers in Consumer is both the revenue as well as the ability to deliver on the expense saves that we built into the Investor Day presentation. So, I actually think that those things are linked, and they tie back to the Investor Day presentation we did last year.

BETSY GRASECK: People are listening.

JOHN GERSPACH: Absolutely. Susan, you're doing a great job.

BETSY GRASECK: There you go. Let's flip to the next question. How high do you think Citi's gross payout ratio will go with the upcoming 2018 CCAR? A, less than 100%; B, 100% to 120%; C, 120% to 140%; and D, 140% plus. Are we going to get a response from you on this one? Come on. You can start the shot clock. Thank you. Oh, there you go. All right. Oh, that's a consensus view.

JOHN GERSPACH: That's pretty – yeah, I'd say that's a pretty solid consensus right there.

BETSY GRASECK: Let's talk a little bit about what we were just discussing. Investor Day presentation, you highlighted some of the outlook for expenses in particular. And you've got some reinvestment going on, \$1.5 billion, is that right, annual reinvestment in digital cards, retail banking, across the board, TTS, Equities, IBD, check, I don't think I left anything out there. But since your Investor Day, we've had tax reform, rates are higher, Asia's growing quicker...

JOHN GERSPACH: Life goes on.

BETSY GRASECK: Yeah. So, Branded Cards, a little slower, maybe. Maybe you can...

JOHN GERSPACH: Well, yes.

BETSY GRASECK: ...a little bit, right?



JOHN GERSPACH: Yes.

BETSY GRASECK: Has that at all changed the plan and the priority of your reinvestments that you're making?

JOHN GERSPACH: Betsy, when we – we did Investor Day last July, right? So, last July, I look at Investor Day, we laid out a series of strategic priorities in other areas that were really going to be guiding to form the basis for our investment program in the near term. And when you think about that, investment program was really centered around, I'd say, two things. One is the basis for the whole strategy is to drive the generation of client-led revenue growth and that's there. And secondly is, we wanted to be able to leverage our scale and leverage these investments that we're making in technology both to deepen the client relationships, improve the client experience, and also drive efficiencies. So, those things stay intact.

As you mentioned, since Investor Day, life goes on. We've got some businesses that are growing a little faster, and some businesses that are growing a little bit slower than what our medium-term expectations were. But the strategic priorities, they stay in place as does the investment plan. So, what are we doing? We're continuing to invest in some businesses where we're trying to build on advantages that we have. We've got some industry-leading franchises, TTS, Cards, Mexico, Asia Wealth Management. Those are all areas of strength that we're continuing to invest in. And then, we're investing in other areas where we're trying to improve our capabilities. We called out Equities. These are probably areas that you'd say that we're currently punching below our weight, Equities and U.S. Retail, especially in Wealth Management. Those investment programs go on. So, I'd say, we're getting good results out of those.

Tax reform. In response to tax reform, we did raise the RoTCE targets that we had put out at Investor Day. So, we talked about raising those targets by about 200 basis points. That's there, and we'll continue. But – so, no investment plan is set in stone. We've tweaked certain areas of investment. We probably have leaned in a little bit more, say, to digital investments in Mexico, because we've seen the uptake of digital be much stronger in Mexico than we had thought. But by and large, the large – the strategy stays in place.

BETSY GRASECK: What about on the cost save side? You have – flip side of the question, but \$2.5 billion in cost saves that you've outlined by 2020. So, I know it's about a year in. Can you give us a sense of an update how that's going?

JOHN GERSPACH: So, in Investor Day, we laid out, as you said, we said we'd get \$2.5 billion worth of cost saves by 2020. About \$1.5 billion of that was concentrated in Consumer. But we had other cost saves coming out of Institutional – ICG, other cost saves coming out of Corporate functions. So, everybody was expected to contribute to that. As I mentioned, life goes on, things change, but by and large, from what we have seen so far, I'd say that the cost saves are on pace. Now, again, when we laid out the cost save, the expectation was that the pace of the cost saves, we get some of them in 2018, but they'd be more heavily concentrated in 2019 and 2020. And that's because the pace of the investment spend was going to be higher in 2018 than the pace that we were seeing from the cost saves. So, 2019 and 2020 is when you're really going to see those benefits, but from what I can see right now, we are on track. As a matter of fact, in some of the areas like in Consumer, I think that there's likely to be some upside.

BETSY GRASECK: Upside in the form of?

JOHN GERSPACH: Higher saves than what we had originally talked about.

BETSY GRASECK: In 2018?

JOHN GERSPACH: In 2019 and 2020.



BETSY GRASECK: 2019 and 2020, okay. And that's driven by...

JOHN GERSPACH: We're getting – the investments where we're putting the money in mobile and digital technology, they are really driving the way that we're serving the customers, they're lowering our service costs and the uptake on these mobile technologies is, as I said, it's greater than what we had anticipated.

BETSY GRASECK: Interesting. We had some conversations yesterday. One CEO mentioned that he thought that, due to mobile, that you've had more change in the past year in banking than the prior, I don't know, 20 years or something...

JOHN GERSPACH: I don't know. I don't know what he's been doing for the last 20 years, but I've seen a lot of change in 20 years.

BETSY GRASECK: But your point on – the uptake is faster than...

JOHN GERSPACH: It is, because more and more customers, they really want to interact with us digitally from mobile platforms. You think about it, we talk a lot about consumer, right, as far as everybody now, they reach into their pocket, they do all their banking on one of these, but corporations, when you think about the ICG, we have, I think, an industry-leading digital banking platform that we use to serve our ICG customers. Last year, we moved \$2 trillion worth of transactions on mobile devices of corporate treasurers. So, the uplift, even in digital technology among corporate treasurers, is just fantastic.

BETSY GRASECK: And that's on their personal phones?

JOHN GERSPACH: Well, we do have some encryption, of course, that we insist on, so.

BETSY GRASECK: Okay. So, let's get back to that in a minute. Just to wrap up the expense discussion, your expense ratio targeting around 57% for this year, 2018?

JOHN GERSPACH: Yeah. I mean, obviously, from Investor Day, what we said was, we're going to, by 2020, get the efficiency ratio down to the low 50s.

BETSY GRASECK: Right.

JOHN GERSPACH: We said the pacing would be such that it would be a slower pace in the first couple of years and then pick up. Last year, we delivered 100 basis points improvement in operating efficiency. We said, this year, we would do another 100 basis points in operating efficiency. So, last year, we finished the year just slightly above 58%. So, we should be just at or slightly above 57% for this year. And then, over the next two years, we would expect to get 200 basis points in each of those years as those expense efficiencies that we talked about really kick in. So, the pacing, we're on track, we can see it in the forecast that we're doing. And as I said, we like the returns that we're getting off those investments right now.

BETSY GRASECK: And are rising rates in the U.S. or the tax benefit, is that a bit of a tailwind that potentially gives you even more opportunity there?

JOHN GERSPACH: I'd say that, with tax reform, that's something that we have yet to see play out. When I say play out, conversations are good, the dialogue that we've got – that we see with our corporate clients is robust. But I don't think that you've seen the full impact of tax reform yet as far as with corporations actually doing implementations of their strategies. And I've said this before, in past, when we've had some sort of massive tax reform, it has taken shape over 6, 9, 12 months. So, companies have had a lot of time to think about what they're going to do as these plans are taking shape. This tax reform got passed in December. And I'd say there was six weeks as opposed to six months. So, companies did

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not have a chance to actually put plans in place prior to the enactment of tax reform. Most of us didn't get a chance to really look at the details until the bill actually got signed. So, that does not give you a great deal of advanced planning.

I think that what you've seen is, in the first quarter, there's been a lot of good talk. That talk continues into the second quarter. I do think that that pace of change then, you'll see it in the second half of this year and into 2019. And I do think that that provides a good backdrop for some potential uplift overall.

BETSY GRASECK: Okay. I do want to dig into some of the topics that we touched on before regarding technology and digital. But before we go there, let's just spend a little bit of time on 2Q. Just want to make sure how you're thinking about 2Q. We only have a couple weeks left of the quarter. And maybe you can give us some update on what you're seeing in trading revenues and M&A underwriting, that kind of thing.

JOHN GERSPACH: Sure. From a trading revenue point of view, at the end of the first quarter, what we had indicated was that we would expect a normal seasonal slowdown in the second quarter. I'd say that that is exactly what we're seeing right now in the results. That should mean then that we'll basically have flattish trading revenues, both FICC and Equities second quarter year-over-year. And I'd say that within there, Equities is probably stronger certainly than FICC right now. I'd say that you're going to see some strength coming out of Equities as we continue to see a favorable trading environment in Equities, and we're also still building out our capabilities in Equities. So, I feel good about the Equities results, but that's probably going to be offset by some lower revenues than we have in FICC.

BETSY GRASECK: And I mean EM has been a bit of a challenge for some folks. You've got some EM exposure. Is that one of the things you're thinking about?

JOHN GERSPACH: I'd say that it's hard to pinpoint EM. I'd say EM is, it's not an area of strength for us this particular quarter, although again in Equities, in equity derivatives, in particular, we're doing quite well, but FICC is just an overall slowdown.

BETSY GRASECK: Okay. What about in terms of corporate confidence? Anything there that you're seeing, is it translating at all into M&A or underwriting?

JOHN GERSPACH: I'd say that the dialogue with – as I said before, the dialogue with our corporate clients is robust. We've got a good M&A pipeline. I always say, Susan, I'll never use that word pipeline in public, and now I just did, okay. But we've got a good backlog coming in there.

BETSY GRASECK: What's the difference between pipeline and backlog?

JOHN GERSPACH: No, I – people always talk about their backlog. And it's like dude, the backlog doesn't mean anything, unless you actually can close the deal. So, I do feel good about the conversations that we're having and the indications. What we said is that, this quarter, we should have a pickup from the first quarter. We had some deals that got delayed out of the first quarter into the second quarter. So, that should be a pickup. But we did have a very strong M&A quarter last – investment banking quarter in the second quarter of last year. And so, year-over-year, we'll probably have a slight decline.

BETSY GRASECK: Okay. Just a few comments on regulation would be helpful. I mean we've had some signs of change coming through the pipeline, right, including the potential for Volcker Rule to change. How do you see that impacting what you can do at Citi?

JOHN GERSPACH: The Volcker is – frankly, the changes that we've seen so far in Volcker have not been meaningful, I would say. One, we've always been a proponent of the basic thesis behind Volcker, which is banks shouldn't engage in proprietary trading. Proprietary trading is not part of our strategy going forward. And so, that's not something that we're looking to get relief off of. What we've said is that we would like relief from some of the burden, the regulatory burden. And there's indications that the current



administration is looking to enact some reductions. Certainly taking – giving one agency the lead would be nice to have one definition of what all this stuff means.

But as you look at some of the things that have been proposed, there's indications that some of the burden imposed on the reasonably expected near-term demand analysis would go away, but then you see other things where some of the record keeping on individual gains and losses on – market gains and losses on positions, that just adds more burden. So, I'm not quite sure that we're going to get much relief out of this, but it's a proposal and we'll be active commentators on the proposal and, hopefully, we'll be able to get something that I think we'd all be – we'd all find useful.

BETSY GRASECK: On the administration side really is what you're talking about?

JOHN GERSPACH: Yeah.

BETSY GRASECK: Okay. What about just on things like the eSLR that's come through?

JOHN GERSPACH: Again, interesting, SLR – it wasn't a binding constraint for us and so we're not – it's not as though we're suddenly going to have some great capital relief coming from it. I do think that the proposal makes more sense. SLR was always meant to be not – it certainly wasn't meant to be the binding constraint, but more of a backstop. And so, I'd say that the changes that they've proposed so far on the eSLR makes sense in moving it more back towards that backstop type of approach.

BETSY GRASECK: Right, okay. And then, maybe to touch base on CECL...

JOHN GERSPACH: Sure.

BETSY GRASECK: So, you have indicated in your filings that your expectation at least at this stage is, what, reserves go up by another 10% to 20% or so?

JOHN GERSPACH: Yeah. That's what we've said.

BETSY GRASECK: Can you just help us understand how you're thinking through that? Just what type of assumptions you have to use to get to those numbers? I mean really the question has to do with the book of business you've got and which portfolios are being more and less impacted?

JOHN GERSPACH: As you can imagine, there's a whole series of assumptions that go into that. That's one of the reasons why we've laid out such a wide band. And I recognize we're the only institution that's really put out an estimate. That was really again driven by Investor Day last year. I didn't feel that we could go into an Investor Day and talk about 2020 and some of our capital return aspirations without at least being able to give some response as to, well, wait a minute, how much could this be impacted by CECL. So that's why we wanted to go out there with those estimates.

Now, when you look at it, I said 10% to 20%. If you think about being on the high end of that range, that would give us an impact on an after-tax basis of about \$2 billion. So, that's manageable within our current capital. Plus, from a Fed point of view, again in some of the proposals that have been put out, we'd have a three-year transition period on feathering that in. So, we think that it's very manageable. As to whether or not it comes out to be exactly somewhere in that range or a little bit above or towards the high end, there are still a lot of unknowns. I'll grant you that. I think the biggest unknown, whether it is – it has to do with the estimates around the lifetime of revolving debt. And I know that's where we're still having a lot of discussions.

BETSY GRASECK: Okay. And so, more of an impact or point for credit card business. C&I, I would assume, as well.

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JOHN GERSPACH: C&I, I think we got a pretty good handle on that at this point in time. Where – for us, and I assume for almost anyone, it's on the consumer lending and it's what is the right way to think about the payment hierarchy and the application of payments and what are the implications, therefore, for those assumptions on the lifetime estimates for a particular instrument of debt. And since you're trying to estimate lifetime losses, the actual life expectancy of an individual debt instrument becomes important.

BETSY GRASECK: Sure. No, I just brought up C&I, because it's a revolver, but maybe there's...

JOHN GERSPACH: But for the most part, the C&I loans, they don't revolve for as long – I mean they all have terms for the most part.

BETSY GRASECK: Okay. Right, the tenor of the loan. Okay. And 10% to 20% increase in reserve, rough estimate right now today, does that impact how you think about capital returns?

JOHN GERSPACH: No. As I said, when I think about it, one of the reasons why we wanted to at least put out an estimate, not just for your benefit, but for our benefit is to actually think about, well, wait a minute, if and when we do implement CECL, when we implement CECL, what would be the impact on some of those capital return aspirations that we had. And at \$2 billion, and now with the Fed talking about a three-year phase-in, and the Fed has also said that they don't anticipate CECL being included in the 2019 CCAR, we think it's very manageable, and it doesn't impact any of the numbers that we've put out.

BETSY GRASECK: Okay. Let's turn to Consumer. You talked about digital. You talked about the uptick in usage of the digital applications that you've got on the mobile phone. You're also talking a bit about launching a national digital banking strategy in the U.S. Could you just give us a sense of your plans around that? And what is going to constitute success for that strategy?

JOHN GERSPACH: Sure. Sure. National digital banking for us, it's sort of like the next logical step, right? For almost the last five to six years, we've talked about how branches are going to be less important going forward. Still need branches, still a lot of value in branches, but as we think about the future of banking, we always said, branches, while they're going to be important, there's going to be less of them. They're going to be smaller. And they're really going to need to be in areas of great impact. So, you want them in impactful areas.

So, that's what's been driving our strategy for the last five years as we have honed our branch footprint throughout the states. And even overseas, we've drastically cut back on branches. We have concentrated them into the larger metropolitan areas where they're more impactful. And you've seen that – as we've rolled out the new branches, they are smaller, because we've asked the branches to leverage more technology. So, less investment in physical footprint, more investment now in digital capabilities. As we continue to roll out digital banking and we've put much more of an emphasis on being mobile-first. So, if anybody who's a client of Citi has seen the pace of change, the pace of new features on our various mobile banking platforms increase dramatically over the past 12 to 18 months.

And so, now that we've got these digital capabilities and we're continuing to roll out more, almost every other week, not every quarter, but weekly, now that gives us the basis to leverage those existing capabilities and begin to offer those banking services, taking advantage of our national ATM network and our national credit card distribution. Now, we can offer the same banking services to a wider array of customers.

BETSY GRASECK: And do you price the deposits the same in the national bank as you do where you have branches?

JOHN GERSPACH: Well, we're certainly – I think you've heard Stephen Bird talk about this. We're not looking as though we're going to lead by raising rates on deposits. What we're looking to do, as I said, is actually build deeper relationships with existing credit card customers and people that know us already.

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We like to think that we know what they value and there's other things that they value beyond interest rates.

BETSY GRASECK: So, in building out the national bank or the digital bank, sorry, or any of the other efforts that you've got...

JOHN GERSPACH: National digital banking.

BETSY GRASECK: National digital banking.

JOHN GERSPACH: We get upset when somebody calls it a bank because then people think of it as a legal entity. It's a service.

BETSY GRASECK: Banking. The I-N-G is the important part there.

JOHN GERSPACH: Exactly.

BETSY GRASECK: Okay. So, as you're building that out and some of the other things that you're working on, I'm just wondering how you're tracking in terms of efficiency goals for the year and is there anything in the quarter that you might – that we should be aware of or any other guidance that you might have on that.

JOHN GERSPACH: Well, I'm not going to get into specific consumer guidance. For the quarter, what we said, overall, again, this quarter we would expect to get another 100 basis point improvement in operating efficiency from where we were in the second quarter last year.

BETSY GRASECK: Right, year-on-year.

JOHN GERSPACH: So, we're on pace for delivering that 100 basis point improvement in the quarter. And that includes all of the investments that we're making in the national digital banking capabilities, because those capabilities are nothing more than the capabilities that we're putting in place for our existing banking customers anyway.

BETSY GRASECK: Right. Okay. And when we say banking, are you highlighting that you can do this nationwide without having to get specific licenses from different states? Is that the point?

JOHN GERSPACH: We feel that we can roll this out as is where is. And so, again, for us, it gives us the ability to add clients, to actually have client acquisitions done through a mobile platform. So, you acquire customers, you engage and service customers all through mobile and digital technology.

BETSY GRASECK: Right. And do you enhance it all with a branch or two or video ATMs or...

JOHN GERSPACH: ATM network, we feel that we've got in place right now. As to whether or not we would add in branches, I'd say that, if we see areas of concentration, new areas of concentration building up, we would certainly augment that probably with some sort of wealth management center, but that would be something for another day.

BETSY GRASECK: Okay. I'll just see if there's any questions from the floor. There's one up upfront.

SPEAKER #1: Hi. So, historically, global or multinational banks haven't delivered the synergies you might expect from that model, whether it's because they were running multiple core systems, multiple regulatory jurisdictions or extra layers of management. Do you think technological change actually makes that multinational model easier to derive cross boarder synergies whether it's because of more standardized IT or APIs or mobile applications?



JOHN GERSPACH: Actually, that's a great question. And I'd say it's all of that, because – and I say that – when I was working in our transaction service business, the forerunner of what is now Treasury and Trade Solutions, back in 2000, 2001, that's when we first introduced CitiDirect, which was the first real mobile Internet-based platform. And what we had to convince various country management teams at that point in time was the advantages of actually having one global banking platform. And that was difficult because everyone wanted to do it their own way, based upon their own needs, in their jurisdiction. And we had to convince people that, no, the real benefit was being able to serve large multinational clients seamlessly around the world, no matter where they were, no matter where their subsidiaries were. And as we drove that standardization of platforms, you then drive the standardization of process along with it. That drives the standardization of data, and it does, therefore, help to deliver the efficiencies and the other things that you were talking about. So, I think that technology can be one of those wedges that you use that forces management to change itself that it actually delivers on the promise.

BETSY GRASECK: Is there more you can do there on a global TTS business?

JOHN GERSPACH: Absolutely. Take a look at where we're getting the growth right now. One of the things, we barely touch and talked a little bit about, M&A, but we really like the fact that the ICG, the bulk of the growth is actually coming in, what I would call, the core accrual businesses, TTS, Security Services, Private Bank. These are areas that have continued to grow and grow nicely. And I think a lot of that is because of the standardization of the platform, the focus on our target clients, which are these large multinationals, and we're able to deliver a consistency of service wherever they are around the world.

BETSY GRASECK: Perfect. Thanks so much, John.

JOHN GERSPACH: Thank you.

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