TRANSCRIPT

Citi Third Quarter 2018 Earnings Review

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Host
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Speakers
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John Gerspach, Citi Chief Financial Officer

PRESENTATION

OPERATOR: Hello, and welcome to Citi's Third Quarter 2018 Earnings Review with Chief Executive Officer Mike Corbat, and Chief Financial Officer, John Gerspach. Today's call will be hosted by Susan Kendall, Head of Citi Investor Relations.

We ask that you please hold all questions until the completion of the formal remarks, at which time you will be given instructions for the question-and-answer session. Also as a reminder, this conference is being recorded today. If you have any objections, please disconnect at this time. Ms. Kendall, you may begin.

SUSAN KENDALL: Thank you, Natalia. Good morning and thank you all for joining us. On our call today, our CEO, Mike Corbat, will speak first; then John Gerspach, our CFO, will take you through the earnings presentation, which is available for download on our website, citigroup.com. Afterwards, we'll be happy to take questions.

Before we get started, I would like to remind you that today's presentation may contain forward-looking statements, which are based on management's current expectation and are subject to uncertainty and changes in circumstances. Actual results and capital and other financial condition may differ materially from these statements due to a variety of factors, including the precautionary statements referenced in our discussion today and those included in our SEC filing, including, without limitation, the Risk Factors section of our 2017 Form 10-K.

With that said, let me turn it over to Mike.

MIKE CORBAT: Thank you, Susan, and good morning, everyone.

Earlier today, we reported earnings of $4.6 billion for the third quarter of 2018, or $1.73 per share. We continue to see solid growth this quarter in many areas, including our accrual businesses in ICG, Fixed Income and Mexico Consumer. And despite a drag of net one-time gains that affected our top line comparisons, we still achieved positive operating leverage for the quarter, driving our efficiency ratio down to 56.1%. Loans and deposits both grew year-over-year and our return on assets increased to 95 basis points.

We're on track to achieve our 2018 financial targets. On a year-to-date basis, we've generated 4% underlying growth in aggregate across our Consumer and Institutional businesses. Our efficiency ratio is 57.3% and we achieved a return on tangible common equity of 11.2%, keeping us on track to exceed our original target of 10.5% for the full year.

We returned $6.4 billion of capital to common shareholders through buybacks and dividends during the quarter. And over the past 12 months we've reduced our common shares outstanding by over 200 million or 8%. Combined with our operating performance, our earnings per share were 22% higher than one year ago.

Turning to the businesses, in Global Consumer Banking, we saw solid growth in Mexico, even when you back out the gain on the sale of our asset management business. In Asia, we saw some headwinds in our more market-sensitive investment products, but the remainder of the franchise showed consistent growth.

And in the U.S., we're starting to see the impact of the L.L.Bean portfolio and Retail Services where revenue continued to grow. Branded Cards had sequential revenue growth. And given strong growth in interest-earning balances, we've remained on course to achieve 2% underlying revenue growth for the year.

Our Institutional Clients Group grew by 4%, excluding a one-time gain from last year. Fixed Income and Equities were up 7% in total. And as in the past, our accrual businesses, TTS, Securities Services, Corporate Lending and the Private Bank, all showed strong year-over-year growth.

Investment Banking was down versus last year as continued growth in M&A was more than offset by slower underwriting activity across the industry, but client dialogues remain solid and we feel good about the pipeline and upcoming transactions.

During the quarter, we also made some changes to make certain our structure is completely aligned with our strategic goals. In North America, we shifted to the same regional model we have in Asia and Latin America and have asked Anand Selva to run what is our largest consumer market. His experience in Asia, where we operate a client-centric franchise with strong digital adoption will help us bring North America to where it needs to be as we look to leverage both our brand and our scale in credit cards to drive deeper client relationships nationwide.

In ICG, we're combining Corporate and Investment Banking with Capital Markets Origination. By integrating advisory services with capital raising, we believe we will ensure an even greater focus on our clients. And Paco Ybarra will become Jamie Forese's deputy, giving Paco a platform to focus on technology and capital optimization across our institutional businesses.

And as you know, several senior leaders at our firm have decided to retire, among them John Gerspach. But the good news is this isn't your last call with John since he won't be leaving until we file our 2018 financial statements.

With that, John, I'll turn it over to you to go through the presentation, and then we're happy to take questions.

JOHN GERSPACH: Thanks, Mike, and good morning, everyone.

Starting on slide 3. Net income of $4.6 billion in the third quarter grew 12% from last year, largely driven by a lower effective tax rate. And EPS grew 22% including the impact of an 8% reduction in average diluted shares outstanding. Revenues of $18.4 billion were roughly flat to the prior year reflecting the net impact of one-time gains in the third quarters of both 2017 and 2018, as well as FX translation.

As a reminder, last year, we recorded a gain of approximately $580 million on the sale of a Fixed Income analytics business in ICG. And this year, our results include a gain of roughly $250 million on the sale of our Mexico Asset Management business in Consumer. In constant dollars, total revenues excluding these gains, grew by 4% in the third quarter driven by strong performance in our Institutional franchise. Despite the revenue headwind from net one-time gains, we achieved positive operating leverage this quarter with our efficiency ratio improving year-over-year to 56.1%.

Cost of credit was down slightly versus last year as lower reserve builds in Consumer were largely offset by volume growth and the normalization of credit costs in ICG. And excluding the gains in both periods, pre-tax earnings grew 8% year-over-year. In constant dollars, Citigroup end of period loans grew 4% year-over-year to $675 billion. GCB and ICG loans grew by 6% or $37 billion in total with contribution from every region in Consumer as well as TTS, the Private Bank and traditional Corporate Lending.

Looking at year-to-date results on slide 4, you can see aggregate revenues in our Consumer and Institutional businesses have grown 4% this year, excluding the previously mentioned gains. On an underlying basis, Institutional revenues have grown 4% in line with our medium-term expectations driven by our accrual businesses in Treasury and Trade Solutions, Securities Services, Lending, and the Private Bank.

And Consumer revenues have grown 3% in constant dollars, somewhat below our medium-term goal. Now this is primarily driven by the near-term impact of weaker market sentiment on our Asia wealth management revenues, the impact of partnership terms that came into effect earlier this year in US Branded Cards, which we will lap as we go into 2019, and finally, in US Retail, a drag from lower US mortgage revenues, which should abate going forward, as well as rising deposit sensitivity.

Despite these headwinds, we've made good progress on expenses, bringing our year-to-date efficiency ratio down to 57.3%. Credit quality remains broadly stable across the franchise. And underlying pre-tax earnings grew 5%. EPS grew by 24% including the benefit of share buybacks as well as the lower effective tax rate. And our year-to-date RoTCE is 11.2%, well above our full year target of 10.5%.

Turning now to the third quarter, slide 5 shows the results for Global Consumer Banking in constant dollars. Net income grew 36% in the third quarter largely driven by lower cost of credit, a lower effective tax rate, and the gain on the sale of our Mexico asset management business. Total revenues of $8.7 billion grew 3% year-over-year reflecting the strength in Latin America as well as the one-time gain. And expenses increased by 6% year-over-year, driven by the timing of investment initiatives versus the prior year. On a sequential basis expenses were flat. And year-to-date both revenues and expenses grew 4% versus last year.

Slide 6 shows the results for North America Consumer in more detail. In total, third quarter revenues of $5.1 billion were down 1% from last year. Retail Banking revenues of $1.3 billion declined 3% year-over-year. Mortgage revenues continued to decline mostly reflecting lower origination activity and higher funding costs. Excluding mortgage, Retail Banking revenues grew 1% in the third quarter, a slower pace than we saw in the first half of the year largely reflecting lower episodic transaction activity in commercial banking as well as increasing rate sensitivity. While deposit spreads continued to improve year-over-year, the pace of improvement slowed this quarter led by a deposit mix shift in our commercial portfolio.

Average deposits declined 2% year-over-year, primarily driven by a reduction in money market balances as clients put more money to work in investments. Assets under management grew 9% to $64 billion. In aggregate, deposits and assets under management grew slightly year-over-year as strong growth in Citigold households and balances more than offset other outflows.

Turning to Branded Cards, revenues were down 3% from last year, including the impact of the sale of the Hilton portfolio as well as previously mentioned partnership terms that went into effect earlier this year. Now excluding Hilton, purchase sales grew 11% year-over-year in the quarter and average loans grew 4%, including 7% growth in interest-earning balances as recent vintages continued to mature. This growth in interest earning balances is driving a positive mix shift in our portfolio.

As a result, on a sequential basis, our net interest revenue as a percentage of loans, or net interest revenue percentage, improved, as expected, by over 20 basis points and our net interest revenues grew by 5%. We expect the NIR percentage to continue to improve in the fourth quarter resulting in year-over-year spread expansion that should continue into 2019.

For the full year, we continue to expect reported revenues in Branded Cards to be roughly flat. However, we remain on track to achieve 2% underlying growth. This underlying growth should accelerate and translate into reported growth in 2019, even considering the Hilton and Visa B gains we took earlier this year.

Finally, Retail Services revenues of $1.7 billion grew 2%, driven by organic loan growth as well as the full quarter benefit of the recent acquisition of the L.L.Bean card portfolio, partially offset by higher partner payments.

Total expenses for North America Consumer were up 7%, primarily reflecting the timing of investments versus the prior period. On a sequential basis, expenses were roughly flat and should remain stable into the fourth quarter.

Turning to credit, total credit costs were down 20% year-over-year, primarily due to a lower reserve build in both Branded Cards and Retail Services relative to last year. Our NCL rate in US Branded Cards was 291 basis points, in line with an NCL rate in the range of 3% for 2018. And in Retail Services, our NCL rate was 458 basis points, which is also consistent with our outlook for an NCL rate in the range of 5% for 2018.

On slide 7, we show results for International Consumer Banking in constant dollars. Third quarter revenues of $3.5 billion grew 11%, driven by strength in Latin America as well as the previously mentioned one-time gain. In Latin America, excluding the gain, total Consumer revenues grew 8%, driven by continued volume growth across commercial, mortgage and card loans as well as deposits.

Turning to Asia, Consumer revenues grew 1% year-over-year in the third quarter, as continued growth in deposit, lending and insurance revenues was largely offset by lower investment revenues given a weaker market sentiment. Over the last 12 months, Asia Consumer revenues grew 4%, in line with our medium-term expectations, driven by 5% growth in revenues excluding investment products. While investment product revenues are more market-sensitive and can be variable quarter-to-quarter, we've seen growth over time, consistent with our growth in clients and assets under management. And we are continuing to increase the proportion of more stable, accrual-type investment revenues, as our business in Asia today is more sensitive to upfront transaction fees than in other regions.

In total, operating expenses were up 4% in the third quarter as investment spending and volume-driven growth were partially offset by efficiency savings. And cost of credit grew 17%, reflecting loan growth as well as the impact of a reserve release in Asia in the prior-year period.

Slide 8 shows our Global Consumer credit trends in more detail. Credit remains broadly favorable again this quarter across regions. The sequential increase in the NCL rate in Latin America reflected an episodic commercial charge-off that was fully offset by a related loan loss reserve release and, therefore, neutral to cost of credit.

Turning now to the Institutional Clients Group on slide 9. Excluding the impact of a prior year gain, revenues of $9.2 billion increased 4% in the third quarter and were also up 4% on a year-to-date basis with strength in both Banking and Markets.

Total Banking revenues of $4.9 billion grew 2%. Treasury and Trade Solutions revenues of $2.3 billion were up 4% as reported and 8% in constant dollars, reflecting continued growth in transaction volumes, loans and deposits. Investment Banking revenues of $1.2 billion were down 8% from last year as growth in M&A was more than offset by a decline in underwriting fees, reflecting lower market activity. Private Bank revenues of $849 million grew 7% year-over-year, driven by growth in loans and investments as well as improved deposit spreads. And Corporate Lending revenues of $563 million were up 11%, reflecting loan growth along with lower hedging costs.

Total Markets and Securities Services revenues of $4.5 billion were up 8%, excluding the gain last year. Fixed Income revenues of $3.2 billion increased 9% year-over-year, with contribution from both rates and currencies as well as spread products. Equities revenues were up 1% as strength in prime finance and derivatives was largely offset by lower revenues in cash equities, reflecting a more challenging trading environment and lower commissions. And finally, in Securities Services, revenues were up 11% as reported and 15% in constant dollars, driven by continued growth in client volumes and higher interest revenue.

Total operating expenses of $5.2 billion increased 1% year-over-year, as higher compensation costs, investments and an increase in business volumes were partially offset by efficiency savings. And finally, cost of credit was $71 million this quarter, reflecting loan growth.

Slide 10 shows the results for Corp/Other. Revenues of $494 million declined 5% from last year, driven by the wind down of legacy assets. Expenses were down 44%, also reflecting the wind down as well as lower infrastructure costs. And pre-tax income was $65 million this quarter, better than our outlook, reflecting higher treasury revenues and lower infrastructure expenses relative to our prior expectations.

Looking ahead to the fourth quarter, we expect a modest pre-tax loss in Corp/Other, mostly driven by seasonally higher franchise-wide marketing and regulatory consulting costs relative to the third quarter.

Slide 11 shows our net interest revenue and margin trends. As you can see, total net interest revenue of $11.8 billion this quarter grew roughly 5% from last year, as growth in core accrual net interest revenue was partially offset by lower trading-related net interest revenue as well as the continued wind down of legacy assets in Corp/Other.

Core accrual net interest revenue grew by roughly $970 million year-over-year. And our core accrual net interest margin improved by 12 basis points to 360 basis points, driven by rate increases, loan growth and an improved loan mix versus last year.

On a sequential basis, core accrual revenues grew approximately $270 million, reflecting the benefit of higher rates as well as loan growth, along with the impact of one additional day in the quarter. However, core accrual net interest margin remained flat on a sequential basis as the benefits of higher rates and loan growth were offset by higher average cash balances during the quarter.

Year-to-date, core accrual revenue grew by over $2.7 billion year-over-year. And we expect to see additional growth in the fourth quarter that's roughly in line with the $970 million we saw this quarter. So the growth in our core accrual net interest revenue should approach $3.7 billion for full year 2018.

However, as a reminder, on a full year basis, we expect this increase to be partially offset by a roughly $500 million decline in the net interest revenue generated in the legacy asset wind down portfolio in Corporate/Other. And trading-related net interest revenue will likely continue to face headwinds in a rising rate environment as we've seen year-to-date.

On slide 12, we show our key capital metrics. In the third quarter, our CET1 capital ratio declined sequentially to 11.8% as net income was more than offset by share buybacks and dividends and we saw an increase in risk-weighted assets related to client activity. And our tangible book value per share increased slightly to $61.91.

Before we go to Q&A, let me spend a few minutes on our outlook for the fourth quarter. In ICG, Equity and Fixed Income market revenues should reflect the normal seasonal decline from the third to the fourth quarter. However, we currently expect revenues to be higher on a year-over-year basis.

Turning to Investment Banking, revenues should reflect the overall environment but, given our current backlog, we expect revenues to be up both sequentially and year-over-year. And we expect continued year-over-year growth in our accrual businesses, including Treasury and Trade Solutions, Securities Services, Lending and the Private Bank.

In Consumer, in North America, we expect to see somewhat better growth in Retail Banking excluding mortgage as well as Retail Services. In US Branded Cards, total revenues will continue to reflect the impact of the Hilton sale as well as partnership terms that went into effect earlier this year. However, the net interest revenue percentage should improve both sequentially and year-over-year. And we expect continued year-over-year revenue growth in Asia and Mexico.

Cost of credit should remain fairly stable quarter-over-quarter and we remain on track to achieve roughly 100 basis points of efficiency improvement this year. This would put us at a 57.3% efficiency ratio for the full year. Even though the fourth quarter revenues will likely see some pressure sequentially given a normal seasonal decline in trading revenues, our expenses should also decline modestly on lower compensation costs and better efficiency savings. This should put our efficiency ratio in the fourth quarter roughly in line with our performance year-to-date. And finally, our tax rate should be in the range of 24% to 25%.

And with that, Mike and I are happy to take any questions.

QUESTION AND ANSWER

OPERATOR: Your first question is from the line of John McDonald with Bernstein.

JOHN MCDONALD: Good morning. John, I wanted to – as we look out to your 2020 financial targets, at a high level, you're projecting a widening of the operating leverage jaws next year and acceleration of the efficiency improvement that you're already having. So I guess as we look out in that plan, is it fair that you expect that widening of the operating leverage to be partly driven by stronger revenues and partly by slower expense growth as we look out?

JOHN GERSPACH: I mean, John, I think we're consistent with what we laid out at Investor Day last year and we've been talking about, certainly during the first nine months of this year, which is that we continue to expect revenue growth largely in line with GDP, call that 4% or so revenue growth in our core businesses, so a 3% overall. So we are expecting some degree of revenue growth and basically holding expenses flat over that period.

JOHN MCDONALD: Got you. And then the efficiency improvement, this quarter seemed to be concentrated in the Corp/Other segment. Are we getting to the point where the incremental savings will start being reflected in the core businesses as we look out?

JOHN GERSPACH: You'll see, as we said, consumer expenses staying stable next quarter. But again, last quarter, John, we talked about the fact that from an investment point of view, we were about 50% through our investment spend and at that point in time, about a third of the way through generating the expense efficiency associated with those investments. Both of those have ticked up. We are starting to see that gap begin to close. It's certainly visible to us in the details. I can't say that it's going to be visible to you in the fourth quarter in each of the businesses, but you'll certainly see that in 2019.

JOHN MCDONALD: Got you. Okay. And one more quick follow-up in terms of the card revenues starting to look better next year, it seems like the core revenue growth rate feels like 2% this year and will accelerate next year on a core basis. Is that really driven by the decline in promotional balances and the impact on net interest yields?

JOHN GERSPACH: John, it's two things. We continue, of course, to grow – I think it's more the fact that as those promotional balances run down, we're continuing to convert a lot of those balances into full-rate revolving balances. We talked last quarter about the fact that we saw that conversion rate at something just below 50% and that we continue to see that type of performance.

So you've got that mix of the net interest earning balances growing. I referenced 7% growth in the net interest earning balances this quarter. And then you combine that with the decline in promo balances and that's really what's fuelling that revenue growth that we see going into next year.

So, as we look forward, we expect those interest earning balances to continue to grow and then a larger percentage of that growth gradually comes from the higher margin proprietary product balances. So, promotional rate loans decline, the other balances grow and that's what's driving it. This is all part of what we're trying to achieve by getting the right balance in our U.S. Branded Cards portfolio. We've talked about this in the past.

And I think that what you're going to see is that by the end of 2019, we should have a well-balanced portfolio with the appropriate mix of both interest-bearing and non-interest-bearing receivables. And then importantly, within each of those categories, we will have the right balance of – the interest-earning balance is the right balance between co-brand and proprietary products; and then in the non-interest-bearing, the right mix of promotional and transaction elements. All of that is really what's going to fuel that revenue growth that you're going to see in 2019 and then beyond.

JOHN MCDONALD: Got you. Thank you.

OPERATOR: Your next question is from the line of Jim Mitchell with Buckingham Research.

JIM MITCHELL: Hey, good morning, John.

JOHN GERSPACH: Hi, Jim.

JIM MITCHELL: Maybe just following up on John's prior question on cards. As you noted, the net interest or the NIR percentage grew 23 bps to 8.51%. Where do you see that settling long term? Obviously, prior to all the teaser rate in Costco, teaser rate cards, you were doing north of nine. Is that something where you could get back to? How do we think about that longer term potential revenue yields in the card business?

JOHN GERSPACH: I don't think that we're right in the position now, Jim, to give you a long-term goal on net interest percentage. A lot of that's going to depend on where the interest rate environment settles out and then just how successful we are in driving that right balance. But we certainly see it growing higher in 2019.

JIM MITCHELL: Okay. And do you think the conversion of about a little less than 50%, does that slow loan growth but also help on the credit side? How do we think about that trade-off?

JOHN GERSPACH: Well, it does slow loan growth a little bit. But I think it's – if you're focused on growing loans and only growing loans, we could put out those promotional balances all day long and grow loans. And then you'd be asking me about, well, where's the revenue? And so, again, what you'd do is with those promotional balances, you're hoping that those clients, once they're finished with the promotional period, will like the value proposition that they see based on the card that they've taken and then stick with you and convert to a full-rate revolving loan. And that's exactly what we're seeing. So we're happy to trade off some reduction in the growth of non-interest-bearing loans for faster growth in interest-bearing loans.

JIM MITCHELL: Right. And I was just asking does that help on the credit side as you get rid of those non-interest-bearing loans that roll off, that's all. If you could help with that.

JOHN GERSPACH: You mean as far from an NCL percentage point of view?

JIM MITCHELL: Yeah, reserve building.

JOHN GERSPACH: Yeah, it might. But hopefully, we're getting the right growth elsewhere as well. I wouldn't – I certainly wouldn't ascribe any part of our NCL rate holding in around that 3% to 3.25%, as something to do with the fact that we're quickly running off promotional balances.

JIM MITCHELL: Okay. I mean, that's fine. And just maybe just one other on maybe – forgive me if I missed your comment on FICC trading. But you guys, obviously, at least, so far what we've seen, outperformed, I think, expectations. Is that really largely the EM volatility that we've seen? How do we think about that with respect to FICC and also, I guess, longer term if you're worried about some of these movements in currencies?

JOHN GERSPACH: Actually, when we talk about the strong performance in rates and currencies this quarter, it was really centered more so in G10 rates and G10 FX. And I'd say it's fuelled by a combination of strong corporate client activity and also our ability to navigate a fairly interesting trading environment in the second half of the quarter.

There was a good amount of market volatility in the second half of the quarter due to a combination of U.S. interest rate moves and pressure on the Euro resulting from the situation in Turkey and I think our guys did a great job navigating that environment.

JIM MITCHELL: Okay. Thanks.

OPERATOR: Your next question is from the line of Glenn Schorr with Evercore ISI.

GLENN SCHORR: On Mexico and Asia. Looked good on Mexico, I'm just curious on the removal of the NAFTA headwinds, if that increases your confidence in your 10%-ish growth expectations which has been good. And maybe a flip side question on Asia, good explanation on market-sensitive stuff weighing down decent underlying growth, but in the 4% 2020 target, that's a full package, right? In other words, markets go good and bad, but we're still expecting 4% growth to 2020 targets?

MIKE CORBAT: Yes. So if you'd take each of those pieces. So one is, we like the fact that there's a deal on the table. Obviously, it needs to be ratified by all three governments. Hopefully, we hear back fairly quickly from Mexico and from Canada. We've got a political backdrop. We've got to work our way through the midterms, et cetera, here. But I think the deal that's on the table in getting that behind us would be important.

I would say we stay committed on the 10%. I would argue, Glenn, that kind of near to intermediate term, NAFTA likely has a bigger impact on our institutional flows than our consumer flows. And so when you look there, I think what we've seen is the result of some of the skirmish back and forth. As I think you have seen FDI go down, you've seen more volatility in the currency. I think you've seen U.S. business inbound to Mexico probably more conservative and I think you've seen Mexican businesses more conservative.

So I actually view this is probably having a bigger benefit near to intermediate term for what happens to our institutional business. And I would say from our Consumer business, we're watching longer term the impact of heading into the inauguration, heading into the budget in December, and then kind of watching what comes out in terms of fiscal discipline, social programs, et cetera, and then how that translates domestically into what happens in the economy which will have the bigger impact in our opinion on the consumer business.

I think in Asia, when we look across our Asia franchise, that 4% growth across the footprint in Consumer is, again, to use John's words, is pretty balanced. And as we look into those franchises we see good growth. You saw in this quarter actually pretty good underlying cards growth. You saw pretty good underlying growth everything other than the Wealth Management. And I think as historic and as expected, when we get these periods of heightened volatility, the wealth product tends to pull back. But again, constructively, when you look at what's going on in terms of AUM, we continue to build AUM and provided this isn't some long, prolonged period of extraordinary heightened volatility, we'd expect those Wealth Management revenues to recover and therefore putting us on track for that 4%.

JOHN GERSPACH: Glenn, we actually put a slide in the back of the earnings deck, slide 20, just to sort of make some of the points that Mike is just making. We recognize that right now the franchise is still – it's a little overweight towards Wealth Management, but the Wealth Management revenues is going to give us some volatility. But if you take a look at how it's performed over the past two years, the overall franchise has been growing at about 4%, right in line with where we've targeted out to 2020, and Wealth Management has grown 6%. So it's been performing, but it does give us a little volatility.

Now, we're still, as I said, a bit overweight and we've got several initiatives underway to increase the proportion of what I would call more stable, accrual type revenues and that includes a focus on lending. And if you look at how our loans have been growing, they've been growing at a nice clip. Now, there's a good portion of our loan book in Asia Consumer that we're not looking to grow, mortgages, very low-margin loans. But if you strip out mortgages, the underlying loans, cards, personal installment loans, they've been growing at a rate of about 7% year-to-date.

And even when it comes to investment products, we're changing the fee structure on many of our investment products more towards a trailing fee structure that we have here in the States as opposed to what now is they're very heavily reliant on upfront fees. So that, over time, is going to bring Asia more in line with our fee structure in the U.S. and it will also tend to make the revenues a bit more stable. So we like what's going on in Asia and we're still very comfortable with that 4% growth factor out to 2020.

GLENN SCHORR: Awesome. Thank you.

OPERATOR: Your next question is from the line of Mike Mayo with Wells Fargo Securities.

MIKE MAYO: Hi.

JOHN GERSPACH: Hey, Mike.

MIKE MAYO: My first question is for Mike. Since we talked to you last, you installed a new Head of U.S. Banking. And I guess this person will oversee credit cards and other retail products and distribution. So what are you trying to achieve with that new management change and why now? And what kind of metrics will you monitor to make sure this change will be a success?

MIKE CORBAT: Sure. So as I described in my preamble, really, what we're trying to do here and what we're trying to accomplish in many ways mimics the structure that we already have in Mexico and that we already have in Asia, where we got regional heads who have the ability to view the franchise, where important, to view the customer holistically. And if you go back and think in many ways of the history of Citi, it was CitiCard and CitiMortgage and Citi this and Citi that. And we had a series of bilateral relationships through products with our clients oftentimes not necessarily knowing or understanding the entirety of the relationship.

I think the work that was done in terms of Rainbow and other technology implementations now gives us the ability to view the client holistically. Why now, is because when you go back and look at the work we needed to do from products of getting our card suite built out, of getting contract renegotiations, et cetera, et cetera, we had a lot of work to get done.

And we've now gotten to the place where we feel like we've got the products, we've got the platform, we've seen this work. It's proven successful for us in the other two regions and the time felt right. And with Anand having very successfully driven our business in Asia, we thought, given the things we're trying to accomplish here in a good bench, not just in Asia, but Mexico and other places, that it would be the right time to make this move. So we're excited about it. Anand's pulling the team together. It's early days for him, but he brought a lot of energy to it and we're excited about what's ahead.

MIKE MAYO: And any metrics that you'll monitor to make sure this is successful in terms of profitability or growth?

MIKE CORBAT: Well, I think it will be the combination. So in there, as I said in my preamble, Anand not only brings strong traditional consumer banking, but has really been at the forefront in our firm in terms of the whole digital adoption and the push towards digital, obviously, that's extremely relevant and prevalent in Asia. So one is, we're going to continue to make the push because around the combination of revenue growth, customer satisfaction as well as expense trajectory, digital plays an important part of that. So there'll be digital metrics, some of which we're showing external today.

Obviously, it's the continued growth and continued push around deposit and deposit capture, not just within our traditional physical footprint, but as we talk about on a nationwide basis and what we do there. And then, part of the value proposition that we've talked about in terms of how we do that and how we drive more growth, as an example, is taking advantage of our broad footprint of credit card holders, not just across the U.S., but around the world and using various forms of digital interaction and various types of incentives or rewards to get more out of those relationships. And we'll have metrics against all those.

MIKE MAYO: Great. And last follow-up maybe for you or for John. So you've consolidated the platform, you've consolidated cards, you're in a position where you can do this now. So will you be giving additional disclosure as it relates to North America Consumer, whether it's digital banking or slice and dicing a few different ways for us externally.

JOHN GERSPACH: Mike, when you say additional disclosure, you mean other than the breakouts that we give you right now as far as Branded Cards, Retail Services and Retail Bank, and then adding them all up together to be the North America region?

MIKE MAYO: Or it could relate to more digital banking disclosure, how you're doing with products and customers. Or you have a lot more capability internally, given what you've done with Project Rainbow. And I thought that was a good reference like a decade or two to consolidate all the retail system after all those earlier acquisitions. So now that you have these capabilities to serve customers, maybe you can provide us with more information on any incremental success you're having.

JOHN GERSPACH: Yeah. I mean, we've taken a first stab of that. If you take a look at slide 24 in the appendix, maybe in the future, we can do a little bit more of this on a regional basis. Right now, we're tracking everything globally. So we'll see how we build this into something else.

MIKE MAYO: All right. Thank you.

OPERATOR: Your next question is from the line of Matt O'Connor with Deutsche Bank.

MATT O'CONNOR: Hello.

JOHN GERSPACH: Hi, Matt.

MATT O'CONNOR: Actually, just a follow-up on the last line of thinking here. As you talk about kind of deepening the retail bank relationship, obviously, part of that is going to be the national digital banking effort trying to get deposits. But beyond the card and the deposit gathering, do you think you have the product set and the kind of scale in some other areas? Because I guess, my perception is, you're a lot smaller in mortgage than kind of some peers your size. Auto, I think you either pulled out or you're very small there. Like, are there other areas that you feel like you need to enter or bulk up so you really have the offering for the customer base?

MIKE CORBAT: So one is, Matt, I think when you look at mortgage or you look at auto today, in each of those cases, the predominance of those products, as an example, more than half of mortgages originated in the United States today are originated by non-banks. Over 80% of auto loans originated today are originated by non-banks. And so I think we look to play in our sweet spot in terms of broadly defined payments, so cards, and where payments are headed, Wealth Management and so the combination of then the Citigold type depository and product offering with the combined suite of investment options or opportunities on the back of that.

And so again, we think that that is a good suite. And as we look at consumer preferences, that's probably the tighter bundle that's actually there today. And I think when you look at people, either mortgage shopping or auto loan shopping, you tend to see those as more kind of one-off type transactions. Our approach is more of the relationship approach of trying to broaden some of the products we have.

MATT O'CONNOR: And on the investment in wealth side, I mean, you have some good momentum on the investment sales in terms of the growth rate. Do you think you've got the scale that you need in that area, as you think about going national and trying to really penetrate the card customer base?

MIKE CORBAT: Well, the platform exists and we can – I won't say infinitely scale it, but we can certainly easily scale it. And the platforms, the connectivity, all of that's there. And so, again, whether we do it out of a branch on Fifth Avenue or whether we do it online, we've got the same connectivity to the products.

JOHN GERSPACH: And Matt, again, we've never said that we're never going to build another branch. If – as we show success in penetrating those, especially those card clients that are outside of our six main cities right now – if we start to see concentrations, we'll be looking to build wealth centers around those population areas as well. So to Mike's point, we think that, initially, we can scale off of our mobile and digital platform. And then if required, we're more than willing to scale up physically as well, selectively.

MATT O'CONNOR: And do you think the preference would be to build organically or would you be more open to maybe buying a branch network than you've been in the past?

MIKE CORBAT: I would say it's more likely now to build organically.

MATT O'CONNOR: Okay. And If I could just squeeze in a completely separate question. The charge-offs in Latin America ticked up a bit both linked quarter and year-over-year, but the delinquencies actually went down?

JOHN GERSPACH: We actually tried to make a comment on that focused on slide, I think it's 8, where we give you the credit statistics. And you see that tick up to 4.63% NCL rate in the third quarter. That's really being driven by one commercial credit that went to write-off that we had previously reserved. So it did show the NCL rate tick up and it had absolutely no impact on our cost of credit. And as you so correctly note, it doesn't impact our delinquency statistics at all.

OPERATOR: Your next question is from the line of Ken Usdin with Jefferies.

KEN USDIN: Real quick. Wanted to ask you just about the deposit insurance fund assessment. And can you just kind of walk us through, are you expecting it to be out in the fourth quarter? And since you guys account for it through NII, just what do we need to understand about how that will move through in terms of NIM going forward as well?

JOHN GERSPACH: So you're talking about the surcharge, right?

KEN USDIN: Correct.

JOHN GERSPACH: Yeah. And you're right; we have the surcharge. The surcharge costs us about $140 million a quarter. And the roll-off of that surcharge is not embedded in the guidance that I gave earlier as far as net interest revenues growing by somewhere in that same range as they grew in the third quarter, that $970 million. So if it did roll off in the fourth quarter, that would be some upside.

KEN USDIN: Okay. And then will you – you obviously continued to account for that in NIM going forward. When we think about it on a segment basis, is that spread out everywhere or is it in Corporate/Other? How do we see that come through the segments?

JOHN GERSPACH: No, we actually push it down.

KEN USDIN: Okay. So when it comes out, it will be a nice little helper to both the segment NIMs and also the corporate level.

JOHN GERSPACH: That is correct, sir.

KEN USDIN: Okay, got it, understood. One quick one, just on credit. Latin America losses were up a little bit and I don't know if that was just seasonal versus just any change there. Can you just talk us through if there was any notable change in underlying?

JOHN GERSPACH: No, the tick up in net credit losses in Latin America really stems from one commercial credit that we took to write off this quarter, but we had already fully reserved for it. So it really had no impact on our reported earnings out of Latin America. It just shows up as an increase in the NCL. And then if you look at reserves, it's coming out of the reserves because we obviously released the reserve. And I think importantly, you'll note that our Latin America delinquencies really had no appreciable change. As a matter of fact, they actually went down both sequentially and year-over-year.

KEN USDIN: Okay, all right. Thanks very much, John.

JOHN GERSPACH: No problem at all, Ken.

OPERATOR: Your next question is from the line of Betsy Graseck with Morgan Stanley.

BETSY GRASECK: Hi, good afternoon. A couple of questions. One is just on how the steepening of the yield curve is helping you out and in particular the European yield curve. Because I think there's a little more exposure there than most banks that I cover so I wanted to get an understanding from you as to how it's impacting your forward look.

JOHN GERSPACH: Betsy, we really are still much more exposed to movements on the short end of the curve. And I think you see that in the disclosures that we give you both in the Qs and the Ks. So we really don't have a great deal of exposure on the long end of the curve either in Euro or in U.S.

BETSY GRASECK: Okay. So you go out like two years, is that it or...

JOHN GERSPACH: I'd say when I look at everything, it's more on short rate compared to say three year. Because if you take a look at our investment portfolio, our investment portfolio probably has an average tenure of just below three years, two-seven something like that. So it's really more looking at it on the short rate out to the three year.

BETSY GRASECK: And then separately, could you just walk us through how you're thinking about planning for the potential risk of the Sears bankruptcy. They're filing Chapter 7, Chapter 11, not sure which way it's going to go right now, but seemingly likely to come on Monday. Can you give us update on how you're thinking about your position there?

JOHN GERSPACH: Obviously, we're not in a position to comment on the likelihood that Sears will commence bankruptcy proceedings. But Sears has been a 15-year card partner of Citi Retail Services and the portfolio does continue to deliver strong returns for us. If you do look at the portfolio itself, just to put everything in perspective, the portfolio consists – is primarily MasterCard general purpose accounts. And as we’ve said in the past, over 70% of the customers spend of that portfolio is outside of Sears. That's consistent with what we would consider to be top-of-wallet customer behavior.

And we've seen already that the retailer has already taken actions to close stores and restructure its operations. And that has already been embedded in our financial planning and is embedded in the outlooks that we've given you and the targets that we've set. So, we don't expect a Chapter 11 filing to have an immediate impact on Citi at all.

Now, if the Sears bankruptcy resulted in accelerated store closures, it would likely have the effect of slowing new acquisitions. We'd have to ramp up our engagement with existing cardholders to continue to support spending activity on the predominantly general-purpose MasterCard portfolio but that would be period expenses more so than any individual initial impact.

BETSY GRASECK: Right. And you're facing these customers, obviously, directly. And if I recall correctly the renegotiation that you did earlier this year with Sears gives you a little more flexibility on how you can approach the clients and work with them. Is that right?

JOHN GERSPACH: Yeah. It actually means that we own those portfolios. We have the right to own those portfolios. And so we don't see any impact at all other than the slowing down; that's under Chapter 11. You also asked what I think about a Chapter 7. And, obviously, if for some reason they went down to a full liquidation, that would have a larger impact. There'd be certain accruals that we would need to take. There would be a write-down of the portfolio-related intangibles that remain associated with the contract that we have.

And so that total impact could be $300 million. There would be a $300 million charge that we might have to take if they went Chapter 7. But most of that charge would reflect the acceleration, the write-off of a contract intangible that would otherwise have fully amortized during 2019. So again, not a real significant impact to us over the next 15 months.

BETSY GRASECK: Got it, okay. And then just one follow-up, I think there was a CECL question earlier. But the question I have is I know you put in your commentary back when you did the Investor Day, potentially a 10% to 20% increase in reserve at the point in time when CECL is adopted in 1Q 2020. The question I have is just the composition of that 10% to 20%. Does that include some asset classes where there's a build in some asset classes where there's a release? Just wondered the thinking around that.

JOHN GERSPACH: The way that the math works with some of the models, yes, there are some portfolios where upon the adoption of CECL we'd actually have too much loan loss reserve. And then there are others that would require us to build some additional reserves. All of that is embedded in that 10% to 20% guidance that we've given you. And then we also said that, as we look at it now, it's likely to be that we're on the upper end of that guidance, but we're still within the guidance that we gave.

BETSY GRASECK: Okay. Thank you.

JOHN GERSPACH: No problem, Betsy.

OPERATOR: Your next question is from the line of Saul Martinez with UBS.

SAUL MARTINEZ: Couple of questions, one on the accrual businesses in ICG, you've had a lot of success there, but you did see a slowdown in TTS this quarter. I think growth 4% was down sequentially. Any color there? What's going on and what drove that?

JOHN GERSPACH: Saul, I'd ask you to focus on the constant dollar disclosure that we gave you with TTS only because so many of our revenues in TTS come through outside of the U.S. And on a constant dollar basis, what we told you is that the TTS revenues grew again by 8% this quarter year-over-year. So we think that's been consistent with that growth that you've seen in the past. So we don't see any real slowdown in our TTS business at all.

SAUL MARTINEZ: Okay. So it's just currency then?

JOHN GERSPACH: Correct, Saul.

SAUL MARTINEZ: Okay. Got it. And then just to follow-up on CECL, you highlighted the estimate, but I think perhaps the bigger impact for you and for some of the money centers or GSIBs is the interplay with the CCAR process and interplay with the SCB. But just any comments there, any concerns about whether that CECL's implementation into CCAR could serve as an impediment to your capital optimization plan?

JOHN GERSPACH: Well, there's a lot that we don't know about the future of CCAR and CECL. But the one thing we do know is that the Fed has said that CECL will not be part of the 2019 CCAR cycle. So, therefore, we're not anticipating that CECL will have any impact on our ability to – again, our guidance is that we expect to be able to achieve that $60 billion worth of capital return over those three CCAR cycles. We've done $41 billion through the first two cycles that we referenced. And we don't see CECL as an impediment to us completing them.

MIKE CORBAT: And the other thing we've done is we've tried to emphasize with the Fed that they should be actually taking an aggregated view of the combinations of whatever is to come, whenever it comes in terms of SCB, countercyclical buffer and CECL together to get an aggregate or cumulative view of what impact that may have, not just on us, but on the industry.

JOHN GERSPACH: GSIB recalibration.

MIKE CORBAT: Exactly.

SAUL MARTINEZ: Got it. And I guess, I meant more beyond 2019 just sort of your longer-term capital plan. But, okay, but that's helpful. Thanks so much.

JOHN GERSPACH: Okay.

OPERATOR: Your next question is from the line of Gerard Cassidy with RBC.

GERARD CASSIDY: Mike, I think in your opening comments you mentioned that you felt pretty good about the Investment Banking pipeline and upcoming transactions. Can you compare to us the outlook for that pipeline today for the fourth quarter to what you saw at the end of the second quarter, going into the third quarter? Is it higher than that, the same, lower?

MIKE CORBAT: There's two. One is, there's obviously seasonality to the pipeline kind of depending. So when you look at the numbers today, and John referenced it a bit in there. So we actually had, relatively speaking, fairly strong performance in terms of M&A and we actually had relatively weaker performance in terms of the two capital markets, debt and equities. And when you look at aggregate fees in the third quarter, as an example, you're in a deal or you're out of a deal. That can move the numbers.

And so, traditionally, when we look at – as we go into year-end, at least traditionally, the combination of M&A deals getting closed is fairly strong and then people trying to get in particular prefunding or financings done as we close out the year.

So our expectation, what I would say and I'm not going to get into specific numbers, but I think, John, in what he talked about in the 4Q in terms of Investment Banking, we expect both a sequential and year-over-year increase in there says that we think we've got pretty good visibility to monetizing a fairly strong pipeline.

GERARD CASSIDY: Very good. And, John, you talked about in the ICG group with the equity markets some of the factors that affected the growth in revenues. And you mentioned that there was a challenging trading environment and lower commissions. Can you give us any color on the MiFID II, how that might be affecting your cash business? And can you make any conclusions yet on which way that's going?

JOHN GERSPACH: We don't really see much of an impact coming from MiFID II on our equities business at all. What we have here, Gerard, if you take a look at our equities overall business, we had good growth in derivatives, in prime finance, in Delta One. Those products, combined, were up about 15%, 16% year-over-year.

And so, where we did see this decline was in cash equity. And we just didn't do as good a job navigating the choppy trading environment in cash equities as we did on the other side of the house in G10 rates and in currencies. It’s choppy trading environment. we did really well in one set of products and not so well on the other.

GERARD CASSIDY: Very good. And then, just finally, you mentioned in the ICG group, the Corporate Lending business, revenues were up nicely double-digits year-over-year. Year-to-date, I think they're up almost 17%. Is that coming from what type of corporate loans? Because I noticed the corporate loans year-over-year – when you break it out in slide 21 of the supplement, the Private Bank part is up strong as well as the Markets and Securities Services. So where are you getting that growth? Is it from your large corporate clients or is it from other areas?

JOHN GERSPACH: It’s pretty widespread, Gerard, to be honest with you. And it's pretty widespread both on a geographic basis, as well as on a product basis. I think one area where we didn't see significant loan growth this quarter would have been in trade, and that's just because we deliberately took down our trade loan book in Asia. We just didn't like the spreads.

And so, we went a little bit more on a originate to distribute mode in Asia. And the nice thing is with the franchise that we've built, we've got that ability now to either decide to participate in the market and hold the loan because we think that it's a good spread, or if the spreads are a little bit tighter than we like, we can originate and find other people that we can distribute it to. So I like the overall strength of the franchise right now. It's broad-based. It really is getting deeper in with the clients. And I think that's reflected in the loan growth that you've been seeing in all the regions of ICG.

GERARD CASSIDY: Very good. Thank you.

JOHN GERSPACH: No problem.

OPERATOR: Your final question is from the line of Brian Kleinhanzl with KBW.

JOHN GERSPACH: Hey, Brian.

BRIAN KLEINHANZL: Hey, thanks. Just two quick questions here. One, just focusing on the non-interest revenues in North America for GCB. I mean, those are down again quarter-on-quarter and it's probably like the lowest it's been in 10 years. I mean, I noticed you mentioned that there were some higher partner payments, some additional partner terms going through there, but are we going to take a low watermark for that and if we should inflect from here?

JOHN GERSPACH: Yeah. Brian, it is a noisy line, especially this year. I'll grant you that. Don't forget, earlier in the year, we had some gains that we told you about on the Visa B shares. That is influencing that line. We also did mention the fact that we had some higher partnership terms that kicked in some of our portfolios. And that's going through that line. I think you're going to see improved growth on that line when we get into next year and we get beyond some of these one-off transactions.

If you look at Citi overall right now and you look at our net interest revenue and fees, net interest revenues constitute just over 60% of our revenues, 62%, 63%, something like that, whereas fees are 37%, 38%. And there's just a lot of noise going on in the fee line right now between the gain that we took last year with Yield Book, gain now that we're taking with the asset management, the partnership fees that are rolling in.

But we really think that as we move forward, you're going to see additional fee generation, especially in GCB. The interchange, the annual fees, as we get beyond those partner payments, they will come through. So I think on a go-forward basis, you can think about growth in non-interest revenues for Citi as being at a slightly higher pace than interest revenue.

BRIAN KLEINHANZL: Okay, great. And then just one separate question on the legacy assets and then North America Consumer, looks like the pace of run-off have kind of slowed modestly. I mean, how should we think about that going forward? I know you gave some of your guidance that' it's going to be an offset.

JOHN GERSPACH: The run-off of legacy assets, that's absolutely slowing because we have less legacy assets to run off. And legacy assets now are roughly 1% of our overall GAAP balance sheet. So once we got past our Colombia Consumer business, which we managed to sell earlier this year, there are really no more operating businesses in there. It's really comprised of some of the legacy mortgages and home equity loans. So they'll continue to run off but at a slower pace.

What you will continue to see for at least the next year is some impact on the expense line of the run-off because don't forget, as we sell these businesses, in many cases, we've entered into these transactions support agreements where we continue to support the business for a period of time, could be 12 to 24 months, as the buyer is integrating these operations into their own operation.

So we still expect some benefit coming from the run-down of the asset in the expense line. But you're actually right, you're going to see less of an impact in assets.

BRIAN KLEINHANZL: Great, thanks.

OPERATOR: There are no further questions.

SUSAN KENDALL: Great, thank you all for joining us here today. If you have any follow-up questions, please call me and my team in Investor Relations.

OPERATOR: This concludes today's call. You may now disconnect.