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HOST
Richard Ramsden, Goldman Sachs Analyst

SPEAKER
John Gerspach, Citi Chief Financial Officer

QUESTION AND ANSWER

RICHARD RAMSDEN: We're going to start with our next presenter. So, we're delighted to welcome back Citigroup's CFO, John Gerspach. This is John's ninth time presenting at this conference over the last 10 years, and it is also going to be his last time because, as I'm sure as most of you know, John is retiring on March 1 of next year.

JOHN GERSPACH: That's because you told me you were not going to invite me next December, so I had no other choice.

RICHARD RAMSDEN: Well, let's make sure this is your best performance. So, I do think it is fair to say John has been a critical member of the Citigroup team in reshaping the strategy as well as delivering on the results over the last 10 years. So, John, thank you very much for being a very regular attendee. And I'm really looking forward to this.

JOHN GERSPACH: Richard, it is the place to be in December.

RICHARD RAMSDEN: Thank you. So, let's start off with investor sentiment around Citigroup. The sentiment around the stock in particular is very tied to the macro environment. But it's specifically tied to your exposure to emerging markets. And you are very sensitive to headline issues. There's obviously a number of conflicting signals that we're getting from financial markets. There are a number of macro concerns, geopolitical concerns. Can you start off by talking a little bit about how you manage risks across your business? And then, perhaps we can talk about how you see the global economic environment unfolding.

JOHN GERSPACH: Okay, so, you know Richard, when people think about Citi and our footprint, especially the emerging markets and the global network, I think the first thing that they have to focus on is who are we doing business with. And by that, I mean our target client strategy. And you think about – you go back to when we came out of the crisis, we set out a very specific target client strategy.

In ICG, it means doing business with large, multinational corporate and investor clients. And then in Consumer, we're focused on the, call it, the affluent or emerging affluent, urban-based consumer. So, that gives you a little bit of a different flavor for the risk in certain markets. When we look at the way that we've performed, I think that you can see that those types of clients are well reflected in how our credit statistics have been performing over the last several years. If you look at the rate of loss that we've had in either the ICG or Consumer, I think that they've held up very, very well.

So, again, everything, when you think about a risk tolerance, I think it starts with that target client focus. When we look at who we are and where we are, we're not trying to be everything for every client. And that means that we're not trying to compete with local banks on a mass market basis. And again, that is really what's reflected in our results. I think that we've held up really well. When you take a look at the Consumer results, our credit statistics over the last several years have been extremely good. From an ICG point of view, again, we've weathered almost everything that has come to pass, whether it's near Grexit leading up to Brexit, Russia crisis, we've basically have gotten through it all with very – oil patch volatility – with very little impact. So, I think that we do a very good job at managing the risk, starting with

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that target client strategy, going through a risk appetite framework and then looking at everything on a day-to-day basis.

RICHARD RAMSDEN: So, what are you…

JOHN GERSPACH: 98 countries.

RICHARD RAMSDEN: 98 countries. That gives you…

JOHN GERSPACH: But again, when we talk about the 98 countries, I just want to clarify one thing. When you look at some of the Institutional business, in a lot of those countries, our presence there is really just serving as a node in our network. By that, I mean, we're not taking any outsized risk. We're there in those countries just to meet the core banking needs of the subsidiaries of those large multinational clients – cash management, foreign exchange, local currency funding. So, it's a pretty simple business in most of those countries.

RICHARD RAMSDEN: So, what are you seeing across that footprint and what does it tell you about the health of the different regions that you operate in?

JOHN GERSPACH: When we take a look at even the macro environment, the fundamentals still look pretty good. And I think that there is a big disconnect at this point in time between the market technicals and what we're really seeing on the ground. Now, obviously, we're watching everything very, very closely. I would say that, when we look at where the risks are right now, we're looking at in developed countries, we are certainly looking at those countries that have got a high level of debt to GDP, countries where there's probably limited ability for monetary or currency movements and interest rate adjustments. Leading up to Brexit, that certainly is on our radar screen. If you take a look at post-election Mexico, we have a focus there. There's certainly a view towards China as far as whether or not just how off target the GDP growth is. But we're not seeing anything that is terribly disturbing at this point in time.

RICHARD RAMSDEN: So – and that includes obviously the markets here in Asia where there's been a lot of concerns about a slowdown in China and the impact of trade and tariffs. Your view hasn't changed?

JOHN GERSPACH: No, not really. What we've seen in a lot of these cases when – we have seen, on the corporate side, I would say that there's a certain hesitation on the part of corporations right now as they look at the macro environment, but it doesn't mean that they are completely standing still. I'd say that they have gone from a period of confidence following tax reform to one that is still optimistic, but perhaps a bit cautious at this point in time. But we still have a lot of good dialogues going on as far as M&A, the need and the possibility of restructuring supply chains. So, all of these things are conversations that are actually right in our sweet spot.

RICHARD RAMSDEN: Got it. So, let's talk a little bit about some of the growth initiatives that you outlined at the Investor Day. Can you update us on the performance both in the consumer businesses and in the institutional businesses? And perhaps you can talk about how things have trended relative to your initial expectations. So, where would you say you're ahead? Where would you say things are being a bit – been disappointing relative to your expectations two years ago?

JOHN GERSPACH: I would guess, being about half way in, the first thing I would say is obviously we did not get off to a good start in US Branded Cards. Missing the near-term growth projections on the heels of Investor Day was not a good start at all. I think we could have done a much better job at explaining some of the implications of moving towards a promotion balance-based strategy as far as client acquisition in that business especially in a rising rate environment. So, that definitely hurt.

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But as we sit here today, we're seeing a lot of good momentum now building up that – those investments that we've made in cards – US Branded Cards are paying off. And what we're now seeing is we had a – I think a good momentum in the third quarter where we had spread expansion in the third quarter on a sequential basis.

The fourth quarter now, I would say that US Branded Cards we're looking at continued loan growth, spread expansion and there's a possibility of actually having year-over-year revenue growth now in Branded Cards, excluding the impact of the Hilton portfolio sale. So, that business is ramping up nicely. But the tough start that we had put us in a difficult position as far as maintaining positive operating leverage in North America Consumer.

When you think about on the International Consumer side, those businesses have actually been performing pretty close to what our expectations were. We had a little pressure on investment revenues in Asia Consumer last quarter. That continues this quarter just because of the market conditions. But overall, we feel very good about our ability to deliver the 4% revenue growth that we talked about in the Asia Consumer and continuing with positive operating leverage in our international business.

Mexico, we've been performing again right around where we said we were, 9%, 10% revenue growth in Mexico. The underlying fundamentals are good. This quarter could be a little bit of a drag in revenues in Mexico just because we sold our asset management business. So, until we lap that and we begin to ramp up the relationship with BlackRock, there will be a slight drag on revenues in Mexico. But otherwise, that's moving very well.

When you look at the Institutional business I would say that obviously market conditions have put a drag on our Fixed income and Investment Banking revenues. Equities has performed very well. I'd say that we're well on our way to reaching our goal of having a solid number five in that business. If you remember, a couple of years ago, we started out, we had a nine rank in equity markets. We said our goal was to build that up to a number five. We finished last year and we've settled in this year at a solid number six. So, I think those investments are paying off.

And of course, when you take a look at the growth that we've been getting in our accrual businesses, TTS, Securities Services, Private Bank, Corporate Lending, all of that is really offsetting any weakness that we've had in market-sensitive businesses. So, I feel pretty good again about our ability to deliver on those growth prospects in ICG.

RICHARD RAMSDEN: Okay. So, let's talk about the current environment. Obviously, there's been a significant pickup in volatility in pretty much every asset class, every region. How is that impacting the trading side of this business? How are you tracking relative to last year?

JOHN GERSPACH: Well, we certainly have seen a lot of volatility in this quarter. And it's definitely had an impact on our market sensitive revenue. In ICG in markets, going into this quarter, we had anticipated that we would actually see year-over-year revenue growth in Fixed Income and Equity Markets. That's changed. In Fixed Income, again, going into the quarter, we had a really strong third quarter in rates and currencies in particular. And our expectation was that at least some of that momentum would carry through into the fourth quarter. But while we've maintained, I'd say, good engagement with the clients, we just haven't seen that transition into transaction activity at the rate at which we had hoped so – and that's particularly in G10 rates.

RICHARD RAMSDEN: Right.

JOHN GERSPACH: And so, now, as we look at it, our expectation is that Fixed Income revenues may actually be down year-over-year.

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RICHARD RAMSDEN: Okay.

JOHN GERSPACH: Equities, doing very well, continued growth. Obviously, we've got a little bit of an easier comp against prior-year revenues in Equities. But they're continuing to do well. But I would say that combination of Fixed Income and Equity Markets revenues is likely to be slightly lower than we had last year.

RICHARD RAMSDEN: And the impact of the volatility on Investment Banking activity M&A, ECM, DCM?

JOHN GERSPACH: Perfect setup, man. That's exactly where I was going to go next. So, volatility has also had an impact on Investment Banking revenues. M&A continues to perform very, very well; very strong performance in M&A. But we certainly have had a lower amount of investment-grade debt issuance this quarter compared to our expectations. And I'd say that equity underwriting is also under pressure just given the volatility in equity markets. So, while we would still expect Investment Banking revenues to grow sequentially, they are likely also to be down slightly year-over-year.

RICHARD RAMSDEN: Got it. So, let's talk about efficiency…

JOHN GERSPACH: That's a perfect lead because that's exactly where I was going to go next. Let me talk about the efficiency that we've got coming into the fourth quarter. Because when you think about all of that pressure that we've had, it's a much tougher revenue quarter than we would have anticipated and that means that – obviously, we've been working very hard to drive expenses down in order to maintain positive operating leverage at the Citigroup level, and we will certainly be able to do that while maintaining what I would consider to be critical franchise investment. However, given the impact of those lower market-sensitive revenue products, what's likely to happen is that there's a risk that we're going to fall slightly short of our stated goal of achieving 100-basis-point improvement in operating efficiency year-over-year.

We could end up in the 90 basis points, maybe a little bit better range. Continue, though, to see good growth in the accrual businesses. But again, that pressure on those market-sensitive revenues and the tight timeframe of having the ability to react could put us just a little bit short. We do expect to exceed our returns target for the year, should have an RoTCE approaching 11% for 2018. And I think that, that gives us a good trajectory then going into 2019 and our ability to hit the goal of 12% in 2019 and 13.5%-plus in 2020.

RICHARD RAMSDEN: Okay. So, is there anything in the efficiency development this quarter that gets you to change your view around the 400-basis-point improvement that you had forecasted for the next two years?

JOHN GERSPACH: No, no, not at all. The impact this quarter is the – the impact on those market-sensitive revenues is in a really tight timeframe, there's just not enough levers that you can pull over a two-month period to get you to that target. But given the longer period of time, we feel very good about our ability then to hit both the return targets as well as the operating efficiency targets that we've set out.

RICHARD RAMSDEN: Okay. So, perhaps you can talk a little bit about what gives you the confidence about getting to the 400 basis points and maybe you can talk about that in the context of the revenue environment and any potential deterioration and what that could mean around those targets.

JOHN GERSPACH: When we set out for Investor Day – and again, even with – if we miss this year's efficiency target by 8 basis points, 9 basis points, that doesn't take us off our overall plan. The overall plan was laid out over a 3-1/2-year period. We've hit everything that we've said that we were going to do. And so, our ability to invest in that – in the business continues. We've continued to drive forward to that $1.5 billion of investments to yield $2.5 billion worth of expense saves. We actually upped our guidance on

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those expense saves in September and October. We've now said that we've got a clear line of sight driving to $2.8 billion of expense saves. So, we see where we're going to drive the expense efficiency.

And if you look, we've actually been doing, I think, a very excellent job of maintaining that expense base over the last eight quarters. If you look at the last eight quarters on a trailing 12-month basis, our expense base has basically been flat, been in a range of $42 billion to $42.5 billion. And that, again, is the premise of the plan that we put forward, maintaining those flat expenses and driving revenue growth. The ability to generate those additional savings off those investments gives us that confidence that we can continue to drive the investments, grow the revenues, capture the wallet share, and at the same point in time, drive the expense efficiencies that will drive the operating efficiency.

RICHARD RAMSDEN: Okay. So, let's segue to loan growth. Your loan growth this year has actually been very healthy. I think that on a core basis has been running now between 6% to 7%.

JOHN GERSPACH: Correct.

RICHARD RAMSDEN: You're seeing very good growth in the Institutional business actually better than the Consumer businesses.

JOHN GERSPACH: Yes.

RICHARD RAMSDEN: Perhaps you can touch a little bit on how you see the loan growth dynamic today and how you see that evolving as we head into 2019 as well.

JOHN GERSPACH: When you break it down, I'd say – I think that our consumer loans grew at about 3% and the corporate loans have been growing at about 7%. And it's been – it's been on the corporate side, it's been fairly well balanced. Almost every one of our corporate product businesses has been contributing and it's been very well distributed across regions as well. So, again, when we look at our loan growth it isn't that we're trying to grow the loans. It's really reflective of the demand that our target clients have for assistance as they try to grow their business. So we feel very good about that. We're able to work with the clients on areas of trade and vendor finance, supply chain financing.

So again, we feel very good about the loan growth that we've gotten as everything that we do in our book have very high grade credit worthiness on those loans that we feel good about the loan growth that we've had and we still see the loan demand on the part of our clients right now.

RICHARD RAMSDEN: So, deposit outflows, deposit re-pricing got a lot of attention in Q3. Perhaps you can talk a little bit about that. I think what you did say I think on the third quarter call that you did see, for the first time, an impact in the North America Consumer business.

JOHN GERSPACH: Yes.

RICHARD RAMSDEN: How would you characterize the competitive environment of deposits today? And are you still seeing outflows on the non-operational side?

JOHN GERSPACH: The one thing that I want to clarify is, when we talked about the impact in Consumer, it was really on the Commercial deposits that we report as part of U.S. Consumer. So if you look at the overall deposits that we have, there's about $500 billion of deposits in North America and about 60% of that are corporate deposits.

And then within Consumer, we also continue – we also have some Commercial deposits. When you add those into the corporate side, it's only about $150 billion worth of pure retail deposits in our North America

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business, and we really haven't seen repricing action on those deposits as yet. We've seen some mix shift moving to CDs from checking account balances, but no real repricing on those deposits.

The repricing that we referenced was on the Commercial deposits where those deposits basically caught up to the repricing action that we had previously seen on the corporate deposits on TTS. So, again, we feel good. Out of $500 billion of deposits, $350 billion of deposits have already repriced, could be some more to go. But we feel that we've got those up to where the market is, the $150 billion of consumer, pure retail that we really haven't seen much yet in the reprice.

RICHARD RAMSDEN: So the proliferation of online deposit platforms that you're seeing across a multitude of companies, they have not yet had an impact in terms of overall pricing?

JOHN GERSPACH: I'd say this has an impact on our ability to attract new deposits. Very clearly, we have not grown deposits at this point in time, but we have not had to compete to retain as much either.

RICHARD RAMSDEN: Okay. So perhaps let's talk a little bit about the card business, and you referenced obviously the disappointment around the margin in that business post the Investor Day. Obviously, that did start to inflect in the third quarter. Can you update us on the conversion trends that you're seeing as customers roll off the promotional balances and do you think promotional offers are still an attractive strategy in terms of attracting customers today?

JOHN GERSPACH: That business is actually performing very much now in the way that we have modeled it. So as the promotional balances have begun to reach their maturity, they're converting to full-rate revolving balances at just below 50% which is a little bit higher actually than what we had modeled originally. And again, that is exactly what is fueling that growth that we are seeing in full-rate revolving balances.

In the third quarter of last year, we saw our full-rate revolving balances grow 7%, and that was accompanied by spread expansion as well. As you saw, our net interest revenue as a percentage of ANR also grows sequentially. This quarter, we anticipate more of the same. Only this quarter, not only do we anticipate having sequential growth in that NIR statistic but also year-over-year growth. And it's that combination which we believe will also give us a slight growth in year-over-year revenues in Branded Cards, again excluding the impact of the Hilton portfolio sale.

RICHARD RAMSDEN: So how would you characterize the competitive environment for cards today?

JOHN GERSPACH: Cards has been a competitive environment. I guess I first got involved with credit cards in 1992, so for 26 years, it has been a competitive environment, and I anticipate that it's going to remain a competitive environment. I'd say, right now, it's at a reasonable competitive environment. By that I mean you don't see people going out there with offers that you just say, my God, I just can't possibly go anywhere.

We saw that at the end of 2016. That's what caused us to change some of our acquisition strategy going into 2017 when we shifted from a rewards-focused strategy to a promotional balance strategy, focusing on value cards. I don't see that right now, and you'll see us. We will continue to tweak our offers as we find ways of meeting what I'll call client expectations.

We look at how people use our cards and what parts of our value proposition they actually use. So, for instance, last – earlier this year, we changed one card. We took away a fourth night of a hotel where you can stay for free. People weren't using that, and instead we gave people some additional cash rewards offers of an additional 1% on travel and entertainment. These are the things they value.

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RICHARD RAMSDEN: Okay. So one of the other major strategic initiatives that you've been talking about is the digital rollout across North America. Can you update us on how far along you are on rolling that out, what the experience has been?

Obviously, there's a lot of banks now who are talking about doing something similar. Everyone seems to have a different flavor in terms of what they're looking to achieve. So how do you differentiate yourself? It also I think will be useful just to touch a little bit on your experience in Asia and how you think that segues ways into the U.S.? What do you think will be different? What do you think will be similar in terms of the digital?

JOHN GERSPACH: I think the first thing that, since you brought up Asia, the first thing that I should comment on is the way we've changed the organization. And when you look at our North American Consumer organization, we had been still running North America very much on a product basis. And in August, what we announced was that we were bringing Anand Selva who had been our consumer head for Asia to the U.S. and we did that because in Asia, it was very clear that the business that we ran in Asia under Anand's leadership, it was certainly a wealth management focus, but it was really client centric. And by that I meant you weren't running the business in order to maximize the product – the performance of any individual product. It was really being run based upon what the clients wanted and what the client needs were.

And so that's the task that we gave to Anand to run in North America. We needed over a number of years to rebuild that product expertise in North America. But now that we have done that, it's really time to bring those products together in order to really run a business that is just focused on the client. And that's what Anand is doing. Now how does that feed into our view towards expanding our digital capabilities? When we look at our retail banking proposition in the U.S., we've got a heavy physical concentration in six cities they happen to be six very – six cities that are wealth centers, but we've also got a national credit card offering and we've got credit card customers in all 50 states.

Those credit card customers though are not really well penetrated by our retail bank. Rather than go out and build branches in every city in which those clients exist, we feel what we can do is we can bring those clients into the bank through digital means. By that I mean, not just trying to grow deposits which many banks are doing through digital means. People are out there putting out a digital offering just to attract deposits.

Our approach is to look at how clients are using our existing card products, what do they value about those card products. If it's a rewards product, we know that they like airline miles. We can offer a credit cardholder in a city either where we are or a city nearby or even a city that is far away from our nearest branch, we can offer them a script that we know that they value, open an account, get extra airline miles, rewards points, whatever it is that you value. We think that that's a way then of attracting them in and growing a relationship.

Now, we can support that with a national ATM network that we've already built. So, we think that that combination of digital acquisition, customer focused value proposition, and a national ATM network is a way of building a national retail banking offer, not just gathering deposits, but growing and building relationships.

RICHARD RAMSDEN: Okay. So, we got a few minutes left. Let me – I want to ask a couple more questions, and then we'll see if there's anything from the audience. The first is there's been a lot of proposals from Governor Quarles. I appreciate nothing has been finalized yet. But the proposals are quite wide-ranging in terms of impacting capital ratios. You've obviously got a proposal around the Volcker Rule. There's some proposed changes around risk-weighted asset calibration, again taking into account they're not finalized and lots of things could change. But when you look at the proposals, do they have a

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significant impact on how you think about the appropriate level of capital for Citigroup? Or do they have a broader – or do they have an impact on how you think about the overall impact on the bank?

JOHN GERSPACH: The answer to that Richard is going to depend on exactly how they are implemented, but they do have that possibility. And what I liked best about Governor Quarles' speech was not that he necessarily said a lot of things or that they all sounded good, but he recognized that they needed to be implemented in the means of a cohesive framework. And by that I mean in the past when we've had different members of the Fed or different members of other regulatory bodies speak, they were always focused on one thing or another and we needed to implement something on liquidity. We needed to do something on stress capital buffer. We needed to do something on risk-weighted assets.

Each one was a one-off and there was no sense as to figuring out, well, wait a minute, if we implement these, how do they all work together to actually drive a cohesive capital framework that banks could use. Quarles has understood that. And I thought that the most powerful part of his speech was actually his recognition that all of these things needed to be fit together before they were implemented. I think that could be powerful and that, if he's successful, could have a significant impact on how banks are actually run.

RICHARD RAMSDEN: So what specifically do you think that could change?

JOHN GERSPACH: I think it could change the amount of capital that you need. We've now got buffers on top of buffers. And that's because we're not quite sure how CCAR works sometimes. What does CCAR do to you? You're grossing up your balance sheet in stress even though nobody ever thinks that they're really going to gross the balance sheet up in stress and so suddenly, instead having a capital issue just based upon your risk-weighted assets, you actually end up with an SLR issue in stress. He talked about eliminating the SLR in stress. So it was a much – like I said it was a cohesive framework. Will he be successful? I don't know. But I liked what he said.

RICHARD RAMSDEN: In the context obviously that there's a lot of changes happening to CCAR, how are you thinking about capital return? It's obviously been a very important part of the investment thesis in Citigroup. Are you changing your thought process around the calibration between buybacks and dividends at all?

JOHN GERSPACH: Well, the first thing is we're still committed to hitting the $60 billion that we said we're going to do over three CCAR cycles. We're $41 billion into that right now. So, $19 billion to go. So that's priority number one.

Once we think about how to return that capital, I think that you've seen us move our dividend significantly over the last couple of years to get to the point where we're more or less in line with our peers, and we'll continue that process. We want to stay at a healthy dividend rate because we do know that there is a class of investors that value dividends. But as long as the stock is trading below book value as it currently is, I think that you have to lean somewhat heavily towards stock buybacks.

RICHARD RAMSDEN: Okay. Let me see if there's any questions from the audience.

JOHN GERSPACH: Your questions were that good.

RICHARD RAMSDEN: Okay. It doesn't seem like we've got anything. All right I've got time for one last question. So maybe let's just talk about Mexico. Recently, there was some proposals that were put forward that seem pretty far reaching in terms of changing fee structures. How do you calibrate the probability of those changes happening? If they were to happen, what would be the impact on your Mexican franchise?

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JOHN GERSPACH: Well, in the near term, I see little risk of those propositions being enacted. And I think and my basis for that is just a quick reaction of both on the part of the finance minister and then importantly AMLO himself in scaling all of that back and saying wait a minute no, no, no. Not what we're going to do, we need to – if we were going to do that, we would have to work with the industry. It would be a three-year study. I think they walked that back pretty quickly.

As far as the impact on us if it happened, you can look into our supplement our – that was really directed against non-interest revenues or fees that we would get on Consumer banking in Mexico. We generate something just over a billion dollars in those fees. So if it all went away, it would be a billion dollars of revenue. I don't expect it to all go away even if it were enacted. So I'm not exactly worried at this point.

RICHARD RAMSDEN: Okay. With that, we're out of time. So, John, thank you very much for coming along. Thank you.

JOHN GERSPACH: All right.

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