TRANSCRIPT

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SPEAKER
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QUESTION AND ANSWER

SUSAN KATZKE: Okay. We're going to keep going here on the banks. And I am very pleased to have Citigroup with me now, a routine attendee at this conference. This morning, I am joined by outgoing CFO, John Gerspach, outgoing like 10 more days.

JOHN GERSPACH: It's 14 something like that, yeah.

SUSAN KATZKE: Lame duck. Yeah.

JOHN GERSPACH: Exactly.

SUSAN KATZKE: And then I've got the incoming CFO, Mark Mason. Mark debuted publicly on the January earnings call. I think he's up against a tough comparison, but no doubt ready to take on this legacy. So, without further delay, let's start the discussion. John, you're in the hot seat first.

JOHN GERSPACH: Whoa.

SUSAN KATZKE: You've done a lot of heavy lifting over the last few years. You're passing the torch in a few weeks. So, let's start with your assessment of what today works best at Citigroup, where you've made the most progress since the crisis and what do you see is the biggest challenges that Mark will tackle over the next few years?

JOHN GERSPACH: Okay. How long do we have?

SUSAN KATZKE: 28 minutes and 27 seconds.

JOHN GERSPACH: I'll try to leave you some time.

MARK MASON: Thank you, John.

JOHN GERSPACH: When I took over as CFO back in 2009 having worked at Citi for about 20 years at that point in time, I knew that we had a great collection of businesses, with a unique global scale and capability. I had worked in many of them. But quite frankly, pre-crisis, we lost our way in terms of strategy. And when you take a look at it, being big is not a strategy. And that approach led us – it led us to the point where we tried to be too many things to too many clients, and so we needed to return to our core strength.

So I'd say the first big challenge that we had was to put out, to articulate a clear strategy going forward while at the same time dealing with all of our legacy issues and putting them firmly behind us. Now, there was a lot of skepticism about our ability to do that on both counts. And I'd say, quite frankly, it was sometimes difficult for investors to see that we were making progress, even though we were, and we had a lot to deal with. We had to completely refocus and simplify our core businesses in ICG and GCB. We had to navigate through all of the legal issues that were facing the industry at the time. And we had to dispose of $800 billion worth of assets that many had labeled toxic. And I think that was incorrect. I thought it was incorrect then and I think it's been proven they weren't toxic, but still in all, that's where it was.

And we had some stumbles along the way. I think probably most notably in 2014 where we first had the fraud in Mexico and then later we failed CCAR. So you're faced with those two incidents. And both of those, though, were really manifestations of legacy issues and it wasn't really issues with our forward-looking path. But, again, those are things that we had to deal with. And I think that we did. We knew that they weren't fatal to us and what they did was they were distractions. They were very large distractions and they certainly impacted our timeline as far as demonstrating progress.

But if at the end of 2014 I had said to you, said to anybody that over the next four years we should almost double Citi's RoTCE, we should virtually complete the disposition of all the legacy assets, over the next four years we're going to return $60-plus billion of capital to our shareholders and we're going to be the only bank where every resolution plan that we submitted is found credible by both the Fed and the FDIC, I think at that point in time people would have had a great deal of difficulty accepting that as a possibility. But that's what we did. I mean, quite frankly, at the beginning of 2017, most analysts didn't think we'd ever get approval for a capital return that had a 100% payout ratio, and we did that too.

So a lot of heavy lifting. I'd say that I'm proud of our accomplishments and recognize that there's still a good path to go forward. There's a lot to do. And that's really what we're about right now.

When you think about it with Investor Day of 2017, I think that we laid out an incredible path to sustainable improved progress, and that's the path that we're on now. I recognize that when you look at it where we are today, there's still a fair distance to go until we hit the 13.5% RoTCE target that we believe we can achieve for 2020. But at the same point in time, what we've done now is we've cleared a path for being able to invest in our future. We've cleared a path so that we can invest in client relationships, product capabilities, talent and importantly, technology. And as I said, that is something that we recognize going forward.

You take a look at 2018, 11% almost RoTCE, I think that puts us firmly on that path moving forward. We recognize that not every market factor is within our control. So, now our goal is to make sure that we build enough flexibility into multiple levers so that we can continue to demonstrate progress in a range of operating environment.

And I think that's the challenge that Mark faces as he comes into that role. That and the fact that we know the bar just keeps getting higher. Even though we've put out our targets, there's still a material difference between even our targets and where our peers are right now, which means that we just got to continue to demonstrate that steady sustainable progress year in and year out.

So I'd say that I feel good about where we are today. I'm proud of the progress that we've made. I think we're on the right path to generate the type of returns that our investors both expect and deserve. And I'm confident in handing the reins over to Mark. We've got the right guy for the job.

SUSAN KATZKE: Okay, Mark, you're up. So, what do you see as the biggest challenges as you take on this role? The main drivers of continued improvement or really kind of cutting to the chase here, what gives you confidence that you can achieve the RoTCE targets that are laid out both the 12% this year and the 13.5% next?

MARK MASON: Well, thank you, Susan. I think John said it well and I want to reemphasize a couple of points. One is, as I come into the role and certainly having been part of the strategy that we put in place in the Investor Day that we talked about back in 2017, I'm more keenly focused on this 12% return on tangible common equity and the path to 13.5-plus, et cetera, and internally we're focused with a great sense of urgency in delivering on that, obviously, in a responsible fashion. But we recognize that that is yet another proof point on the heels of 2018 in continuing to build credibility with our investors and in the market.

When I think about that, there're obviously some important style points that come along with that. So, last year, we hit, as John mentioned, close to 11% return on tangible common equity, but we recognized that how one achieves that is critically important. That is to say, the underlying earnings momentum of our businesses is ultimately what matters. There are other levers that are important and help us to get there, but demonstrating to ourselves, to the market that the underlying businesses have the propensity to deliver continued earnings growth in the outer years is what we're focused on and how we achieve that return.

When I think about what gives me confidence around that, I can point to a number of things that happened in 2018 that I think demonstrate continued momentum as we go into 2019. So we talked on earnings about the momentum we started to see in US Branded Cards, having made investments in that part of our business and platform. We've seen growth in Mexico that we think is going to continue in light of some of the investments we continue to make there. When you look inside of the ICG, obviously, continued momentum in our TTS business, in our Private Bank, Securities Services. All of those businesses, those accrual-type businesses have shown continued momentum through the years and we think there's promise for more of that as we go into 2019 and beyond.

When we look at the expenses that we have and that we're managing to, we're managing to roughly flat expenses. And you've heard us talk about the idea that our productivity and the efficiencies that we're generating are starting to more than cover the investment dollars that we're putting into the platform. I'd highlight an important point here that as we operate in an uncertain environment, the ability for us to pull levers becomes critically important. And one of the important reasons is because these businesses require investment and we want to be able to protect that investment even in an uncertain environment so that we're not only delivering on that 2019, but also able to hit that 2020 and beyond.

So the underlying strength of the businesses gives me confidence. The levers that we have to pull, whether it's in expenses or balance sheet management, you saw our balance sheet come down at the end of Q4 as revenue softened. And then taxes and other levers there give me the confidence in our ability to get to the 12% and ultimately higher over time.

SUSAN KATZKE: Okay. So let's back up to the present for a minute, talk a little bit about the macro backdrop that you're functioning in today. And we've had market sentiment shifting all over the place between recession fears at year-end, so much optimism prior to that, I'm not sure where we are today. But what are you seeing on the ground right now in terms of client activity, underlying economic conditions? How are the markets?

MARK MASON: It's a good question and on the heels of the fourth quarter in December in particular, you're right, there's a lot of market fears and uncertainty and to some extent that does continue. When we look at some of the underlying fundamentals in the markets and businesses that we participate in, GDP is still solid and growing. We see unemployment still quite low. The credit environment particularly for our target markets is still solid. So we still see good underlying fundamentals that are somewhat disconnected from the market fears that we hear about.

When we think about kind of coming out of that fourth quarter, things are certainly better than they were in December and in the fourth quarter, but we haven't seen from a market point of view a full recovery yet. We feel good about the activity we're seeing with our clients, particularly in some of those stronger performing businesses, that activity has continued, the accrual type businesses. I think the market environment has certainly traded higher and we're hopeful that we start to see some of that play out given the shutdown has kind of been addressed. And so we hope to kind of see more activity as it relates to debt issuances and underwriting and what have you and the M&A pipeline still looks very strong from a market point of view.

SUSAN KATZKE: Great. So, let's step back for a minute. I think one thing that's really not appreciated about Citigroup today is that within your core businesses for the last two years now you have organically generated 2% to 3% revenue growth and Citi is a big ship, so to put up that kind of revenue growth is worthy of mention and reiteration. When I think about the assumptions that were laid out at the July 2017 Investor Day, you've targeted 4% to 5% revenue growth in your core businesses. Can you remind us and maybe we'll put, John, you in the hot seat to begin with on this one, what were the assumptions from a macro backdrop that factored into the 4% to 5%? Does that feel a little bit of a stress today or help me out?

JOHN GERSPACH: When we laid out for the Investor Day, the backdrop was we assumed a global growth rate of around 3% with revenue growing just slightly above that. And when you look at where we're getting the revenue growth today, Mexico is doing what we thought Mexico would do, maybe just a little bit less. Asia, again, revenues are just a little bit off. And we're a year behind in getting the revenue growth out of US Branded Cards that Mark talked about and we now feel the US Branded Cards is really on that upswing.

So, those are three areas that I'd say maybe just slightly underperforming. Yet when you take a look at TTS, Securities Services, much stronger revenue growth quite frankly than we had built into the assumptions going into Investor Day. So, again, 2% to 3% as opposed to 4% to 5% revenue growth is just a little bit light, but that brings into play the other levers that Mark talked about before. So we're by and large on track from an operating efficiency point of view. Let's not talk about 10 basis points off the operating efficiency.

SUSAN KATZKE: You brought it up, not me.

JOHN GERSPACH: I was looking at Dick over here. And then there's the tax rate. There's a continuing good performance coming out of credit, which we think is an important part of the business because it reflects really who we're going after, who we're serving, so much more stability in our cost of credit. So, again, we feel overall good. We put forward what we thought was a balanced view going forward without overreliance on any one geography or any one business. And I'd say it's panning out.

SUSAN KATZKE: Okay. And so I want to pick back up on this idea of flexibility.

MARK MASON: I was just going to comment on that.

SUSAN KATZKE: You read my mind or the question list ahead of time.

MARK MASON: I was going to add to John's point, John's right, when we talked about that 4% to 5% underlying, that was plus or minus 3% or plus 3% in the way of GDP performance, our economy still see growth at around that level. But again, coming out of the fourth quarter, coming out of December, we've approached 2019 in really trying to plan for uncertainty and build in the flexibility around our performance with an eye toward still delivering on that return on tangible common equity of 12%.

And so in doing that, that's where all those levers I mentioned come into play. That's when a hard look at what our plan contains from an expense point of view is what we put to it, a look at what opportunities to generate savings we can pull forward into the year. We're trying to protect the investments that we have built in that plan, but we've certainly taken a harder look at those investments and the payback that we have associated with those. And in what type of environment may make sense to just slow the pace of those. We've looked at obviously the tax rate, which came in lower than what we were expecting last year, and are there more opportunities there.

And so that type of flexibility as we look at 2019 we think is important, particularly given some of the uncertainty. Now, that uncertainty largely has played out in some of our market-sensitive businesses, particularly around Fixed Income. We do see strength and have seen strength in 2018 in our M&A business, in our Equities business. And so we feel good about the performance. The mix may be different from what we originally put out there, but we feel that's one of the benefits of the diversified platform that we have and the mix of businesses that we have.

SUSAN KATZKE: Okay. Flexibility is – I hopefully hear more and more about that over the coming years. So, let's turn to taking a step back and looking at the business model that you're working with. What do you think the most tangible, quantifiable advantage of Citi's footprint with its physical presence in I think it's 98 countries now around the world, what is that benefit? And generally speaking, let's put it into the context of investors considering a fair bit of the EM exposure to have asymmetric risk to the downside. How does that view change over time? Are we missing something and not appreciating the benefits enough because we worry too much about political change in Mexico, for instance?

MARK MASON: I think when we think about that, we certainly look at it through the client lens. So you really have to kind of step back and look at the clients that we're covering from a Citi point of view. Our Institutional clients are large multinational corporate and investor clients. And we serve those clients around the world. And much of the activity that happens in emerging markets is Citi providing our network to those large multinationals and covering their subsidiaries in those countries. And so while people tend to think about the emerging markets as being very risky and highly volatile, the nature of our activity and the clients that we're covering there actually allow for very stable business for us.

So you think of a large multinational corporate that has a subsidiary in a country where they are providing the cash management needs, where they are providing the FX needs that they have, where they are providing the funding – the local funding needs that they have there. They are part of a much larger global company and organization. That has proven to be a very stable part of our platform and client base for us to focus on. That manifest itself not only in the stability of the revenue stream that we have with them, but also as you think about the credit exposure and the risk that we have as an organization. And I think you've seen that kind of over the years and we haven't – as we think about strategy and as strategy has evolved, one thing we haven't done is shifted that focus. We haven't expanded our risk framework to capture lower end, from a risk point of view, type clients. We've been very focused on that strategy, that's what plays to our network in a positive and beneficial way.

JOHN GERSPACH: We mentioned operating in 98 countries around the world, in most of those countries, they really just serve as being nodes in our network. By nodes I mean they're just offering basic core banking products to those subsidiaries of those large multinationals that Mark talked about. So we're not trying to grow a large local business; we're just serving the needs of those large multinationals, which makes it a very, very resilient franchise.

SUSAN KATZKE: Okay. Fair enough. So let's turn to the Consumer business for a minute, and I'm curious where do you think you have competitive advantage today? And in the U.S. specifically, how do you think about what I would call largely the missing piece of your franchise, your retail deposit taking capabilities? How important is it to you to have a low cost core deposit base? And then let's walk through into the national digital bank strategy.

MARK MASON: So, I mean, obviously, we have a global consumer business. If I think about how that business has evolved in many of the international countries, we've always had a client-centric focus. If you think about Asia as a region, it's been a client-centric model for us in Consumer. In the U.S., in particular, historically it's been more product silo. And so what we've shifted to in the U.S. is more of a client-centric model. So we've taken kind of the silos that we've developed in Cards, in Retail Banking, in Mortgages, in Retail Services, et cetera, and we started to look at that through a customer lens.

Now it's obvious that we've got – our physical footprint is very, very small. Right? But that said, we've got a very, very large Cards customer base. We're the second largest card issuer. We've got $400 billon in purchase sales. We got a large customer base here that's available to us. And as we take this customer lens, it affords us an opportunity to tap that asset of ours and develop value propositions that are appealing to that customer.

If you think about our Retail Banking business and banking customers, we've got penetration of about 40% that have credit cards. This is in the U.S. If you kind of turn that on its head, our Card customer, the penetration with Retail Banking products is low-single-digits. Our U.S. Branded Cards customer base is 28 million cardholders. And if we could just penetrate a small percentage of that card base with Retail Banking activities, that we think creates a significant opportunity for us and one we're uniquely positioned to take advantage of. And that's essentially how we're trying to develop our value propositions in our products and how we're going to market and to some extent addressing the lower deposit base that we have or how we grow our deposit base.

So our opportunity there is not how we go out and build new physical branches, but instead how we leverage the investments we've made in digital capabilities, how we leverage the proven model in other countries and other regions and bring that to bear on our existing very large customer base here in the U.S.

I think other unique advantages that we have if you think about it is we've got strong partnerships. So we've got retail service relationships with Costco, with Best Buy, with Home Depot, with American Airlines and again unique customers that we have all within our target segment client base from a credit point of view, we've got a unique lens to that customer profile and what they value, and we think that positions us to create services and solutions that they'll respond.

SUSAN KATZKE: So not to pin you down on timing, but when do you think we can see stronger core deposit inflows in the Retail Bank in the U.S.?

MARK MASON: So I think a couple things. One, when you come to market with new products, new services, it's critically important that you get that right. And so, we've been spending a lot of time and investment dollars in ensuring that the digital platform that we bring to clients, our go-to-market strategy with this consumer-centric focus is going to work and going to work well and successfully.

We've been piloting that. So we're testing kind of a Flex Loan product that's out there that allows for our card customers to convert part of their credit line to fixed interest rate, fixed payment, digitally with kind of pre-populated fields and what have you. We've started to test a high-yield savings product in certain markets. We're in six MSAs, so for this type of product we're targeting customers that are outside of those MSAs so that we're not kind of cannibalizing our own customer base, but instead tapping identified customers that are of a quality profile that would fit within our markets, but exist in our Card customer base. And we're piloting that product and we see good response early on. And so we'll continue that through the course of the year and then we hope to see some of that start to take off more meaningfully.

SUSAN KATZKE: So, tying together the longer-term growth prospects that we hope to see in the Retail Bank in the U.S. and the longer-term aspiration of a 16% return on tangible common equity, how else and how do you see the path from where you are today if we give you the 13.5% next year with your existing business mix? Is it the existing business mix that you believe can get you to the 16% or does that mix need to shift? How do you get to 16% plus?

MARK MASON: Look, it's a fair question. I think that we can all – I look at our business mix and we skew heavily towards or more heavily towards our Institutional businesses than many of our peers. And so, how do we get there, the 13.5%?

Look, about 100 basis points or so we get with the disallowed DTA kind of working itself out over time. So, that would get us to kind of 14.5%. We got another 150 basis points over time to try and achieve. I think that comes through continued momentum that we've seen in part through some of our ICG accrual type businesses, but it also comes from growth in our higher-returning businesses, including on the Consumer side. And so, the continued pickup in Branded Cards and the momentum there, we talked a little bit about Mexico and that momentum, but also the strategy taking hold that we just described in the U.S., this customer-centric focus is going to kick in as well.

So I think over time what you'll see is by definition a business mix shift to some of the faster-growing, higher-returning businesses. That comes as a byproduct of investments that we're making today, but also how we continue to think about the allocation of capital and the resources that we have over time and that allocation has to skew towards higher-growing, higher-returning parts of the franchise, which include the Consumer business.

SUSAN KATZKE: Okay. And I want to circle back to expenses for a minute. And you touched on this in your initial comments, you talked about flat expenses. I like to call them flattish expenses. And I just want to clarify that when you think about where you are going forward in terms of your targets and, let's call, guidance that that's going to be the metrics that you skew towards versus efficiency ratios with maybe the longer-term goal of low-50% still holding intact?

MARK MASON: Look, I mean I think that flattish expenses is certainly what we've seen over the past couple of years. And I think that's a good way to think about the profile that we have going forward. Obviously, the operating efficiency metric includes both the revenue and that expense line, and we just saw in the fourth quarter and last year that there are going to be fluctuations in the markets that impacts that top line.

And so we're not backing away from the operating efficiency target of the low 50s. I still think over time in light of the investments that we've made in digital and automation and technology more broadly that that is the right longer-term target. But I do think that how we get there because of the uncertainty in the market may vary and so that's why I point to a flattish type expense way to think about our business.

I think, again, it points to the focus on return on tangible common equity, which I think is ultimately a primary focus, but it also highlights I think the importance of the other levers that are involved in that. So, to answer your question very specifically, longer-term target for sure, may vary over the years, but that's the way we think about.

SUSAN KATZKE: All right. Fair enough. We are at zero on the clock, but that means I can ask if there are any questions that you want to address in the room. Or let me wrap up with one more question and I'm just curious in terms of tone in DC, CCAR, any thoughts on the scenarios that came out last week? John, you're going to miss this, won't you?

JOHN GERSPACH: Every day. I can't wait.

SUSAN KATZKE: You get up in the morning, you think what are those CCAR scenarios bringing for us.

JOHN GERSPACH: When we take a look at the CCAR scenarios that came out. They quite frankly were not surprising. We knew that they were going to have to get to a 10% unemployment rate. And if you're going to get to a 10% unemployment rate, you're going to have to have some GDP assumptions that match the 10%. So by and large, I'd say that they are modestly favorable compared to last year, slightly favorable compared to last year, but nothing earthshaking and nothing beyond that which we were expecting.

SUSAN KATZKE: Fair enough. And I bet they'll let you come help out with that process if you get bored in your retirement.

JOHN GERSPACH: Trying to figure out a holistic capital framework that actually then incorporates the SCB, Basel IV, there's a lot that has to be thought through. I'm very glad that Governor Quarles has indicated that that is a priority for him and he is not going to rush into anything. And we'll see whether or not I get any calls.

SUSAN KATZKE: Okay. I think Mark can pick up where you left off.

JOHN GERSPACH: No problem.

SUSAN KATZKE: Mark and John, thank you so much.

MARK MASON: Thank you, Susan, for having us. Appreciate it.

JOHN GERSPACH: Thank you, Susan.