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HOST
Gerard Cassidy, RBC Analyst

SPEAKER
Mark Mason, Citi Chief Financial Officer

QUESTION AND ANSWER

GERARD CASSIDY: This is the start of the afternoon session. And with us today is Citigroup. As many of you know, we have a new CFO at Citigroup. Mark Mason was officially – taken over the role in end of February...

MARK MASON: Yes, February 23rd.

GERARD CASSIDY:...the 23rd if I recall. John gave him a call.

MARK MASON: 12:02 AM, Saturday morning.

GERARD CASSIDY: Good luck and congratulations, right.

MARK MASON: Thank you, yes, thank you.

GERARD CASSIDY: And Mark has had a number of roles at Citigroup over the years. And most recently, he was the CFO of the Institutional Capital Markets Group. And he's got a great deal of experience working with Citi, being there, 18?

MARK MASON: 18 years.

GERARD CASSIDY: And so with that, thank you again for joining us.

MARK MASON: Thank you, Gerard.

GERARD CASSIDY: I really appreciate it. You guys have been one of the real great supporters, so thank you again.

MARK MASON: Happy to be here. Thank you.

GERARD CASSIDY: Maybe we could start off with some macro questions, and can you talk about what's going on in your world of Citi? There's concerns about global economic slowdowns. You're in many different markets around the world, and you have a different perspective than maybe a regional bank. So maybe you can give us some insights there.

MARK MASON: Absolutely. Gerard, when we look at the factors that potentially impact our business, things look fairly stable. So if you look at kind of global GDP growing, you look at stable unemployment rates, you look at credit trends particularly for the clients that we focus on continue to be favorable, and so we look at those indicators and those indicators look stable to us. That said, the market fears out there seem to suggest a disconnect between the indicators, what we're seeing on the ground and what we're hearing around concerns around just the macro environment, the rate outlook and things of that sort.

When we take a closer look at the overall view of our economist, the view is that global GDP is likely to continue to grow. It's slowing a little bit, but likely to continue to grow at 3% or so, a little bit higher in some of the emerging markets. And when we take a look kind of across the different regions, we've got a pretty close watch on what's going on in developed markets particularly in parts of the world where we have rising debt to GDP and where there may be constraints on the flexibility around monetary policy at this point in the cycle. When we look at EMEA for example, we keep a close eye on what's going on with regard to Brexit and the implications that that will have on the UK and other surrounding countries in that region. We continue to keep a close watch on Mexico given the post-election environment there with Latin America more broadly as well and including Venezuela.

And so we've got a close watch on all of those issues in parts of the world. Things could go positive depending on what happens with regard to U.S. and China trade. But we don't see any particular country or part within the emerging markets that's of particular concern at this point in time. The market overall – our view is that we've started to see markets stabilize and trade higher, but we haven't yet seen kind of a full recovery from a year ago. And so that's kind of the general sense in terms of what we're seeing.

GERARD CASSIDY: As with other conversations, if there are questions from the audience, please raise your hand and we'll get you a microphone. Speaking of emerging markets, can you just share with us and some people know this but not everyone, the quality of the customers that you have in those markets are pretty impressive. And unfortunately, whenever there's a fear of something going on in emerging markets, you guys, your stock gets negatively affected. So maybe just a little more insight there.

MARK MASON: Sure, Gerard. So we're in nearly 100 countries, and a big part of our business and franchise is our TTS, our Treasury and Trade Solutions business. And this is a business within our Institutional Client Group where we focus on large multinational clients, and we partner with those clients to provide them all of the needs they have from a treasury or cash management, supply chain management, liquidity and working capital needs, and those types of issues that they face as companies all around the world.

And so when you really think about our emerging markets presence, you really have to look at it through that target client lens. And so our presence in these emerging markets – our presence is largely there to service these multinational clients, and our presence in the country largely serve as a node on that network to provide the subsidiaries of those multinational clients with what they need in terms of local funding, in terms of working capital, in terms of their treasury needs. And so we look at the emerging markets that we're in and the nature of the clients that we cover, and while others may see it as volatile and potentially of greater risk, for us, it's been quite stable. It's been a high quality client. It's been growing and it's been profitable.

GERARD CASSIDY: Very good. In terms of first quarter outlook, when you look at the operating environment for this quarter, how are the markets business, equities, FICC trading doing, investment banking, how is that holding up? How is it working with expenses as well where we are so far in this quarter?

MARK MASON: So as I said, in terms of our view on the markets, the markets have stabilized. They've traded higher. We don't feel as though the market has fully recovered, although we have seen credit spreads tighten and come in. And so, as we look at our business, I think one of the things we've got to remind ourselves of is that, in the first quarter of last year, we had really strong performance in our equities business and in our Private Bank. As we look at the first quarter thus far, and in particular equities and fixed income markets revenues, we expect that they'll be down year-over-year in the high single-digits. When we look at the corporate banking activity, it was off to a slow start in the first quarter as it relates to industry-wide underwriting. When we look at our investment banking revenues and what we're seeing, and we'd expect that, quarter-over-quarter, they're likely to be down. But year-over-year, we expect them to be higher revenues, particularly in our M&A business, as well as in our investment-grade debt issuance activity.

If I just think more broadly across the business, we expect to see continued strength in our TTS business, in our Securities Services business, in our corporate lending business as well, although you've got to keep in mind that as credit spreads tighten, we generally see losses in our mark-to-market loan hedges, which we have in place in order to manage the risk of our corporate lending book. So that's likely to be a headwind for us as we go through and finish up the quarter.

In terms of total expenses, we're likely to see expenses in the quarter that are down slightly versus the prior year, so that'll likely produce for us some slight improvement in the operating efficiency. When I think more broadly around the year in terms of expenses, I expect the first half to be higher than the second half. Similar to the case in 2018 as we pull – we'll do two things, one, timing and so we tend to have higher incentive compensation in the first quarter, and there have been other things that we've kind of pulled forward in the year which has set us up nicely to show operating efficiency improvement through the year and in total.

GERARD CASSIDY: When you mentioned the investment banking business advisory is going to be decent against last year or sequentially. How is the pipeline? What are you guys – and you guys that are working on the front lines and trying to get deals done this year, is that activity at an elevated pace or lower than last year?

MARK MASON: So we obviously had a slowdown at the beginning of the year particularly with the shutdown that took place and we had a pipeline coming into the year we felt very good about and we've seen that momentum continue with the shutdown being lifted. And so we feel very good about the pipeline that we have and particularly in M&A and in other parts of the franchise, and we see that kind of playing through, through the balance of the quarter and then hopefully through the balance of the year. There are obviously a number of factors, macro factors that are out there that influence this on a regular basis. But from the way we look at things and the way we see things at this point in time, we feel pretty good about that.

GERARD CASSIDY: And you've got a global footprint obviously in this area. Is the U.S. stronger than EMEA or Asia? Where are you guys seeing the better strength?

MARK MASON: We're seeing – just think broadly across the franchise, we're seeing good strength in EMEA. We're seeing good strength in the U.S. as well in terms of momentum and just, if I think outside of corporate banking, if you just look at the performance that we have more broadly across the franchise, good consumer growth in Mexico, good consumer growth if you exclude the investment revenues that have been under pressure in Asia, and so we are seeing kind of the global franchise deliver benefits for us.

GERARD CASSIDY: And this is truly not to pick on any competitors. Coming out of the crisis, a lot of the investment banks were wounded, and it took them a while to get back up to strength. The Europeans maybe were a little slower than the Americans to get up to strength. Are you still finding it advantageous to be stronger than some of the Europeans to gain market share or is that game pretty much over?

MARK MASON: Look, we – it's always advantageous to kind of have a strong position. We think that our – the advantages that we bring in terms of the characteristics of our business are unique and differentiate us particularly in areas like our TTS franchise. And just more broadly, as other players start to retrench, our commitment to our global network and global capabilities, I think position us well to take advantage of that, and we've seen some of those benefits play to our favor.

GERARD CASSIDY: When you guys have put out some targets, return on tangible common equity, for example, this year 12%, next year close to 13.5%. What drivers are you looking for in order to achieve these targets?

MARK MASON: So you're right. At Investor Day, we came out with targets. Last year, as you know, we had a target of a 10.5% RoTCE. We delivered a 10.9% RoTCE. The target this year is 12% as you've stated. When I think about the drivers involved in delivering on that, many of them we've seen start to play out through 2018. So again, go back to the strength and momentum that we've seen in our Treasury and Trade Solutions business and other accrual businesses within the ICG, Securities Services, the Private Bank, corporate lending, we expect that momentum to continue through 2019.

Similarly, if you look at Mexico which I mentioned earlier, good strength that we saw in 2018, we expect to see some continued momentum there in Mexico in our consumer franchise in particular. And we expect to see the continued strength in Asia as well. And then the final point on the consumer side is our branded cards business. And so, in the second half of last year, we really started to see that take up – take off, excuse me, as the investments that we have made in promotional programs started to convert to average interest-earning balances in our business, in our branded card business.

And so we expect that momentum to continue through 2019. Those will all be favorable in terms of revenue growth. I'd also point out a couple of tailwinds that we have playing in our favor. One is the absence of the FDIC surcharge, will be favorable in terms of 2019 performance. We'll see likely less of a drag from some of our legacy and wind down businesses, where we now would have lapped the renewal arrangements we've made with some of our – in some of our card businesses with some of our partners. And so those factors will also aid in delivering that top line growth.

We talk about expenses as being roughly flattish. And we talked last year about the second half where we were able to generate net savings above and beyond the investments that we've been making in our businesses of about $200 million. We expect the productivity benefits and savings to ramp up in 2019 for an incremental $500 million to $600 million or so in 2019 and then again in 2020. And those additional savings should cover the volume or revenue related growth and expenses that you would expect to see.

And so top line revenue growth, expense is roughly flat. We do expect our credit cost to increase modestly. But again, we're not seeing any particular signs or areas of concern there. We'll continue to manage our tax rate effectively, and we feel good at this point about the capital plans that we have. We talked about at Investor Day returning $60 billion of capital. For the first two cycles, we got to about $41 billion. We're obviously in the midst of the CCAR process now, but we feel good about our ability to deliver that 2019, notwithstanding regulatory approval, et cetera.

GERARD CASSIDY: Just touching on that, the capital return, is there a – two questions. Once you complete, let's assume you get approval and you finished your $60 billion three-year CCAR return, do you think you'll do that again, meaning come out and give a two to three-year forecast or will you just go year by year? And then second, when you talk about buying back stock versus dividend, what kind of payout ratio over the long-term do you think is appropriate for Citi to have, a dividend payout ratio?

MARK MASON: Let me I guess kind of take that apart a little bit. So first, let's get through 2019 in terms of delivering the capital there. The way we think about it, if you think about it, we ended 2018 with an 11.9% CET1 ratio. We've talked about our target being roughly at 11.5%, so 40 basis points higher. We managed that in the sense that we saw revenues taper off and we were very disciplined about managing our balance sheet.

I think that sets us up well in 2019 to withstand the output or implications of the scenario that we've got to run which is good. As we get closer to that target, that 11.5% or so, what will determine the amount of capital that we can return will be largely driven by two things. One, the amount of net income we're able to generate, net income to common, as well as, two, the use of the disallowed DTA which has been running somewhere between $1.1 billion and $1.3 billion, offset by other uses internally that we may see for the use of that capital. So that will be an important determinant in terms of how much capital we return. I think over time, to answer the second part of your question, over time, we'll see that ratio, that payout ratio, the dividend ratio likely migrate closer to where competitors are, and we're obviously looking at that and factoring in our view on valuation and all of those important things as we take the decision. But over time, I would expect it to get there.

GERARD CASSIDY: Got you. Regarding – you mentioned earlier that we can't forecast revenues with 100% confidence because the markets change on us and market conditions could go against the industry. Are there any expense levers on top of what you've described that if the industry, if we get into a bear market or something and we just don't see ECM numbers come in and advisory, we can sort of – or just generally a greater slowdown than anyone is expecting, what ability do you have to maneuver?

MARK MASON: So we obviously saw a slowdown in the fourth quarter industry-wide. And we worked to pull all the levers we could pull in order to hit the targets that we'd set. And obviously, I mentioned already we had a 10.9% RoTCE, 40 basis points above the 10.5% target. We did that by pulling some expense levers. But I think what's really important on top of that is we pulled many of the other levers that you'd look for us to try and work and manage to do better than that target. And so those levers obviously include what we can do as it relates to taxes, what we can do as it relates to ensuring we're managing that credit thoughtfully, the discipline around the balance sheet, and it's all those levers that we look to pull at any point in time where we saw that uncertainty. So that's kind of one point.

The second point to answer your question is, yes, we do think we have expense levers that we can pull. There are things that we've looked at already in terms of accelerating to earlier in the year whether it be simplification of our org structure or process improvements that we were planning to make and put in place where we can get the benefits sooner in 2019. And we've accelerated that. But I think what's really important and what I really want to stress is that, we need to be smart about this, right. We have very strong, rapidly growing businesses, many of which I've mentioned already. We're in a very competitive space. Technology is moving very rapidly and they require investment, right.

And we've talked about investments that we're making across the franchise in those businesses and we're balancing the need to make those investments for the longer-term returns of our business against some of these uncertainties and fears that may play themselves out in some of the market-sensitive pieces of our business. And that balance combined with the ability to pull all of those levers, we think is what's important in order to protect the long-term strength and growth opportunities for us.

GERARD CASSIDY: Sure. Good. You mentioned technology. Can you share with us how much your budget is on technology at Citigroup, as well as if you could break it down into the different components? What's for new apps? What's for cybersecurity? What's for your general maintenance? Just to give us a little insight there.

MARK MASON: So we are aggressively investing and going after technology, one, to improve our capabilities; two, to kind of deepen our relationship with our clients; three, to enhance some of our processes and improve our productivity and strengthen our control. So technology is very important as you would imagine to our business and to our forward-look in terms of our growth. That said, about 20% of our total expense base is invested in technology.

About half of that is run the bank and about half of that is build the bank. But I think the real question when I think about it is how technology and operations works together, how they work together. And so we can continue to invest in technology and at the same time bend the curve on our total expenses through an ability to take down cost in our operations. And so, when I think about the digital and technology investments that we're making today, that's happening in parallel with our existing infrastructure, our existing data centers, our existing call centers. But over time, as we kind of move towards more digital and incorporating things like automation and robotics and things of that sort, they will allow for us to reduce our operation costs. And I think that's where a real benefit starts to play itself out.

We've moved the majority of our technology investments on the consumer side towards client-facing initiatives. On the ICG side, we have an industry-leading digital banking platform, and we continue to try and digitize everything that's there in terms of the solutions that we offer clients, enabling clients to do business digitally on iPads, et cetera, et cetera. On the Citi-wide side, so to speak, we continue to invest in the cloud for storage capacity but also in network capabilities and in process improvement technologies and in cybersecurity and information security which is a constant threat for all of us. And I'd say we – similar to some of the larger peers, we invest $600 million to $700 million annually in cyber and information security.

GERARD CASSIDY: Would you want to give us a total number when you think about on the technology spending? How many billions?

MARK MASON: Yeah, so our total expense base is $42-ish billion, $41-ish billion, so about 20% of that.

GERARD CASSIDY: Okay, okay. Got you. I didn't realize that. We're not technology guys in the sense we don't live and breathe it every single day. But when you compare the discussion on technology, say, in banking to 20 years ago, is it more important today? Do you think when you talk to your peers inside the bank because Citi was always on kind of the cutting edge years ago with technology? Or is it just, no, it's always been important, you have to have it?

MARK MASON: I'd say it's always been important. However, I would add one thing to that. One is moving a lot more rapidly than it's ever moved, right. And so the importance of staying on top of that and being forward thinking as it relates to technology is ever more critical than it's ever been before, more critical than it's ever been before. The second thing I'd mention is that technology and our ability to take advantage of it happens in multiple ways. So it happens not only from the innovation in-house that we're able to take advantage of but also in strategic partners with other players. Again, just given some of the advancements that have taken place, you've got – you have to have both. And then there's a third lens to it which is in dealing with our clients. So as our – the business that our clients are in is evolving, and they're seeing technology impact their business model, it's an opportunity for us to, one, partner with them on new solutions; two, to share with them technological advances that we're seeing; and also for them to share with us. And so it's kind of a – it's a catalyst, if you will, since it's touching so many different industries in such a rapid way.

GERARD CASSIDY: Got you. For the – for us outsiders, we hear numbers from you and your peers, billions of dollars spent on technology. What should we look to to see if people are getting the bang for the buck on their spending for technology? Are there any metrics that you guys keep an eye on to say, wow, this was really money well spent, or maybe over here, it wasn't?

MARK MASON: We look at a couple of different things. I mean, on the consumer side, we certainly look at mobile use and digital use from our clients. We look internally in terms of processes that we've been able to automate. We look at kind of the cost to serve and how that varies as we implement new technologies. On the institutional side, particularly in parts of our franchise like TTS, we look at the uses against the different channels that our clients can use to manage their treasury operations, whether that's using – the use of our Citi Velocity or use of CitiDirect and other types of offerings that we have as the uptick if you will. But there are multiple – there's a client use lens to it, and then there's an improvement of our own operations that we manage to and try to track over time.

GERARD CASSIDY: Got you. Speaking of technology and the consumer, how important is it to develop a low cost deposit franchise here in the United States? And assuming it's important, can you do one primarily through the digital channel? Are we there yet where you don't have to have branches in every state to be able to succeed?

MARK MASON: So as you know, we have a small physical footprint in the U.S. We have a little bit under 700 branches. But we happen to have a high deposit-to-branch ratio, if you will. And we also happen to have the largest fee-free ATM network in the country, over 65,000 ATMs that we have available to our customers. When I look at the opportunity for us in terms of the consumer U.S. franchise, I think about the importance of digital there as well. And I think about the strengths that we offer and bring to bear.

And so what I mean by that is aside from that footprint, aside from that ATM network, we also have a large customer – I mean cards business. So we're the number two card issuer, and we do over $400 billion or so in purchase sales. And so, when I think about the opportunity that's in front of us, the opportunity that's in front of us is, for us to actually leverage our advancements we're making in digital, with the card customer base that we have available to us, with value propositions that take advantage of our deeper understanding of those customers and in many instances the relationships we have with other partners like Home Depot, like Best Buy, like American Airlines, like Costco, and develop those value propositions that allow for us to deepen the relationship with those clients, right.

So if I kind of put that in perspective a bit, just take our retail banking customers, 40% of them have a Citi card. When you look at that in reverse, we've got 28 million U.S. branded card customers, and it's low to mid-single-digits in terms of our penetration with retail bank accounts. And so a small percentage change in terms of our penetration with that branded card customer is a big opportunity for us. And we've already, this quarter, started to introduce products that demonstrate our digital capability and test our digital capability. We introduced products like Flex Loan which gives our customers, our consumer customers an opportunity to convert unused balances in credit lines to a fixed rate, fixed term loan. And we're targeting our card customers for a new digital high yield savings account that we've recently launched where they have the opportunity to open an account with a pre-populated, if you will, screen that makes that access quite easy. And we're seeing good uptake as it relates to that product.

And so we're making advancements in terms of that technology and that onboarding of new clients, and we think the combination of digital capabilities, value propositions we're able to create, big consumer card or large consumer card customer base positions us unlike before because of technology to grow in U.S. consumer, and we're looking forward to making progress on that.

GERARD CASSIDY: We've got time for maybe one more question. The branded cards seems to have come the direction in which you obviously had anticipated when you made some purchases a couple years back of different portfolios, Costco, for example. Do you see opportunities for more purchases in the next 12 to 24 months where, if you're interested, you could bid on different portfolios?

MARK MASON: We're always looking at opportunities. They obviously need to make sense. The way I think about this is we want a balanced business in terms of our own proprietary branded cards and the partners that we have. The economics obviously need to make sense for anything that we do. We also focus, as you would imagine, on the higher credit quality type customers across the franchise. We've got a risk appetite framework that we're very disciplined about, but to the extent that there are opportunities that meet the parameters that we set, we certainly look at those, and when they make sense, we go after them.

GERARD CASSIDY: Well, please join me in a round of applause and thanking Mark for being here.

MARK MASON: Thank you. Thank you.

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