TRANSCRIPT

Citi First Quarter 2019 Fixed Income Review
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Host
Tom Rogers, Head of Fixed Income Investor Relations

Speakers
Mark Mason, Citi Chief Financial Officer
Mike Verdeschi, Citi Treasurer

PRESENTATION

OPERATOR: Hello and welcome to Citi's Fixed Income Investor Review with the Chief Financial Officer, Mark Mason, and Treasurer, Mike Verdeschi. Today's call will be hosted by Tom Rogers, Head of Fixed Income Investor Relations. We ask that you please hold all questions until the completion of the formal remarks, at which time you'll 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.

Mr. Rogers, you may begin.

TOM ROGERS: Thank you, Natalia. Good morning, and thank you all for joining us. As Natalia mentioned, I'm joined this morning by our Chief Financial Officer, Mark Mason, and our Treasurer, Mike Verdeschi. In a moment, Mike will take you through the fixed income investor presentation, which is available for download on our website, citigroup.com. Afterwards, Mark and Mike will be happy to answer your questions.

Before we get started, I'd like to remind you that today's presentation may contain forward-looking statements, which are based on management's current expectations and are subject to uncertainty and changes in circumstances. Actual results and capital and other financial conditions 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 filings including, without limitation, the Risk Factors section of our 2018 Form 10-K.

With that said let me turn it over to Mike.

MIKE VERDESCHI: Thank you, Tom, and good morning, everyone. On today's call, I will cover a number of topics. First, I'll briefly discuss our operating results for the first quarter 2019. Second, I will cover recent balance sheet trends including growth in loans and deposits. Third, I'll review our issuance program. And finally, I'll discuss our continued strong liquidity and capital position.

Slide 3 summarizes our results for the first quarter 2019. In the first quarter, we reported net income of $4.7 billion, achieved positive operating leverage for the 10th consecutive quarter, and increased our RoTCE to 11.9%.

On slide 4, we show average balance sheet trends over the past five quarters in constant dollars. On this basis, we have grown our balance sheet by approximately 4% over the last year. We saw strong growth in both ICG and GCB loans. We continued to leverage our global footprint to raise high-quality deposits and we issued debt opportunistically across a diversified set of programs. This included the establishment of a commercial paper program out of our broker-dealer entity this quarter, as we continue to utilize different levers to efficiently fund growth in our various entities. Finally, total cash and investments increased modestly year-over-year, but declined sequentially again this quarter as we continue to deploy cash to support client activity.

Slide 5 presents trends in our loan portfolio on an average basis in constant dollars. Total Citigroup loans increased 4% year-over-year and 5% in aggregate across our consumer and institutional businesses. In our consumer business, average loans grew 3% year-over-year, driven by continued growth in North America and Asia. Average loans in Mexico remained flat year-over-year, reflecting a slowdown in activity in our commercial banking franchise where client sentiment has become more cautious under the new administration.

On the institutional side, loans grew 7% year-over-year as a modest decline in TTS loans was more than offset by continued growth in the rest of our franchise. In TTS, we saw strong growth in origination volumes. However, loans declined 1% as we utilized our distribution capabilities to optimize the balance sheet and drive returns.

Corporate Lending growth moderated to 4% this quarter, reflecting the episodic nature of our clients' strategic financing needs as well as an active quarter in debt capital markets origination. Private Bank loans increased 10%, driven by both new client on-boarding as well as the deepening of relationships with existing high net worth clients.

Finally, continued strong year-over-year markets loan growth was driven primarily by real estate-related warehouse lending activities, and loans included in Corp/Other continued to decline driven by the wind-down of legacy assets.

On slide 6, we show credit quality trends in our GCB and ICG loan portfolios. In GCB, credit remained broadly favorable again this quarter, with stable delinquency trends across regions. In North America, the NCL rate increased sequentially mostly reflecting seasonality in cards. And in Mexico, the NCL rate reflects continued seasoning in the cards portfolio as well as the impact of overall lower volume growth.

In ICG, total non-accrual loans increased sequentially, but declined on a year-over-year basis, and remained low at 41 basis points of total corporate loans. In North America, NALs increase to 51 basis points, driven primarily by a few idiosyncratic downgrades. In Asia, NALs declined to just 3 basis points, driven by the repayment of a single name.

Turning to slide 7, we show trends in average deposits over the past five quarters in constant dollars. Total deposits increased 6% from the prior year period. In our consumer business, deposits increased 2%, driven by growth across all regions.

In North America, deposits increased 1%, reflecting growth in both branch-based deposits as well as through digital channels as we continue to enhance our digital capabilities and launch new products to lay the foundation for a more integrated multi-product relationship model. In our institutional business, deposits grew 9%, primarily driven by continued high-quality deposit growth in TTS.

Now, let me highlight our parent benchmark debt issuance program on slide 8. So far this year, we have issued approximately $9 billion of parent level benchmark debt across a variety of tenors, currencies and structures, including our issuances early this month. Going forward, we'll continue to maintain the flexibility to issue a mix of tenors, currencies and structures.

On slide 9, let me cover our bank level issuance. So far in 2019, we have issued approximately $5 billion of bank level debt. This includes $1 billion of SOFR-based bank notes, which marked our first transaction using this rate, as we look to support the continued development of the market and ensure our operational capabilities. Going forward, we will continue to maintain the flexibility to issue across a variety of tenors, structures and currencies as we drive the efficiency of our funding sources.

On slide 10, let me cover our issuance, maturity and redemption expectations. In 2019, we continue to expect total gross issuance of $30 billion to $35 billion, roughly evenly split across both our parent level benchmark debt and our bank level programs. This includes the $9 billion of parent benchmark and the $5 billion of bank level debt we have issued so far this year.

At the parent level, we have contractual maturities of $14 billion and potential buybacks of approximately $1 billion, and continue to expect net parent benchmark issuance to be roughly flat in 2019. At the bank level, we have contractual maturities of $12 billion and continue to expect a modest amount of net issuance for the year.

On slide 11, we show the composition of our long-term debt outstanding. During the quarter, our total long-term debt increased by approximately $12 billion to $244 billion. At the parent, senior benchmark debt increased by approximately $5 billion as we issued opportunistically in a more favorable market environment after not issuing in the fourth quarter of last year.

However, as I noted earlier, we continue to expect net parent benchmark issuance to be roughly flat for the year with the increase in senior benchmark debt this quarter reflecting the timing of our issuance relative to maturities. And as markets stabilize during the quarter, we also saw strong demand for our customer-related debt which drove a $5 billion increase in customer-related debt this quarter.

On slide 12, we provide an update of our LCR metrics and drivers. Our average LCR declined to 119% this quarter as a modest reduction in HQLA outpaced a slight decline in modeled net outflows.

Turning to slide 13, let me summarize our key regulatory capital metrics. Our CET1 capital ratio remained stable at 11.9% as net income was offset by $5.1 billion of total common share buybacks and dividends. And our SLRs were 6.4% and 6.9% for Citigroup and Citibank, respectively.

Moving to our last slide, let me summarize several key points. First, we earned $4.7 billion of net income, achieved positive operating leverage for the 10th consecutive quarter, and increased our RoTCE to 11.9%.

Second, we maintain a strong capital and liquidity position with a CET1 capital ratio of 11.9%, and an SLR of 6.4%, an average LCR of 119%, and an estimated NSFR of greater than 100%, and we maintain a surplus above our TLAC requirement. Finally, we continue to further diversify and optimize our liquidity resources.

Before we move on to Q&A, let me touch briefly on a couple of topics related to the transition away from LIBOR. As I referenced on last quarter's call, we are evaluating alternatives to address the language in a subset of our preferred securities. And while we continue to make progress, we do not yet have a chosen path or an update with respect to timing. Going forward, we will continue to keep you posted on this topic.

Now, more broadly, we've been taking a number of steps to prepare ourselves for the transition away from LIBOR. Within Citi, we've established the governance structure and work streams which focus on several areas including the impact to our clients, operational capabilities and legal and financial contracts among other areas.

We are also continuing to work with our regulators and participating in the Alternative Reference Rate Committee as well as other industry working groups. And lastly, as I mentioned earlier, we issued our first SOFR-based benchmark note this quarter to ensure our operational capabilities and further support transition efforts.

And with that, Mark and I will be happy to answer your questions.

QUESTION AND ANSWER

OPERATOR: Your first question is from the line of Scott Cavanagh with APG Asset Management.

SCOTT CAVANAGH: Good morning, guys. Thanks for holding the call, much appreciate it.

MIKE VERDESCHI: Good morning.

SCOTT CAVANAGH: Good morning. So, just on the regulatory front, we saw there was an NPR on the cross holding of G-SIB debt. Could you give me your thoughts on that? And then also on the FINRA proposal on the pilot program to change the corporate bond block trade dissemination?

MIKE VERDESCHI: Sure, Scott. First of all, to your first question, the proposal was not unexpected, and this first came up during the TLAC proposal. And we were happy to see certain comments on the Fed's earlier proposal reflected such as including the market making exemption for holdings of the covered debt. And while we continue to go through the proposal, based on our initial read and if finalized as proposed, we don't believe it will have any material impact at all on our capital requirements.

Your second question, I believe you're discussing the FINRA comment related to block trades. This was just issued last week. I believe the comment period will run into June, so very early stages. And I would just say that we certainly support efforts to further study changes that have potential to improve liquidity in the fixed income markets, but very early stages and we're looking forward to evaluating that.

SCOTT CAVANAGH: Okay. So for with the first proposal and arguably probably the second, are you worried about – we're in a very favorable environment, are you worried about in a less favorable market in how the liquidity for the G-SIB debts and how it will trade? Is there any concerns about that?

MIKE VERDESCHI: Again, this is something that – there is an exemption within that proposal. So, again, we just don't think this is at all going to have a material impact. So I can't say we're really worried about that at all.

SCOTT CAVANAGH: Okay. And then transitioning over to cards, so two notables; on the CECL, I appreciate you guys giving the updated guidance on the initial call. How should we think about where you're going to ultimately target your CET1 ratio? We know the CCAR, the regulations on that and phasing it in, but how should we ultimately think of where you think that's going to be an appropriate level?

MARK MASON: Hey, Scott. This is Mark Mason. So, thanks for your question. As we have talked about before, we ended the quarter at about 11.9% CET1 ratio. We ended the year at about 11.9% CET1 ratio. When we look out in terms of the target that we think is appropriate, we think that's about an 11.5% CET1 ratio, and we've kind of gone through the mix of that including the minimum requirement, the estimate around G-SIB, the estimate around the stress capital buffer, et cetera.

And so, we're still comfortable that around that 11.5% is the right target for us to manage to. And as we've thought about the longer-term implications of CECL, recognizing that we're still modeling and still working through that, we think that we've factored in for consideration the impact of the ongoing or the ongoing impact of CECL.

SCOTT CAVANAGH: Okay. And then lastly for me, there was an FT article on end of March talking about the Head of Consumer, and the assertions that the company was going to miss the 2020 targets. I know this was talked about also in the initial call, but could you guys flesh that out, how should we think be thinking about it? It's rare that we see such disclosures on senior management?

MARK MASON: I'd make a couple of comments. One, as I mentioned on the earnings call, we remain committed and focused to delivering on our RoTCE target for 2019 of 12% and getting to our 2020 target of 13.5% or so. We actually saw, I think, very solid momentum in the first quarter here with the 11.9% RoTCE number. If you look at consumer, in particular, we had strong, I would say, strong North America growth of about 4% if you exclude the Hilton gain of about $150 million. Within that, you see U.S. branded cards grew at about 5% excluding that Hilton gain.

As we've talked about before, we made investments in promotional activity in prior years and we've seen those promotional balances convert into interest-earning balances and generating an NIR percentage of

9% or plus in the quarter. And that's what we've been talking about in terms of starting to see momentum in U.S. branded cards.

We also saw, I think, some strength in our Retail Banking, specifically, with digital balances and the growth in digital deposits; again, a byproduct of what we've said in the past in terms of investing in our digital capabilities, the on-boarding of clients, new products being offered to clients. We grew digital deposits by $1 billion in the first quarter, which is more than we did in all of last year.

And so I highlight those examples including strength in retail services of about 3% or so as examples of the consumer business really starting to demonstrate the solid performance that we referenced at Investor Day. And we're pleased with the progress that's being made against that, with the team that's executing against the strategy there.

SCOTT CAVANAGH: Thank you very much.

MARK MASON: Welcome.

MIKE VERDESCHI: Thanks, Scott.

OPERATOR: Your next question is from the line of Hima Inguva with the Bank of America.

HIMA INGUVA: Great. Mark, Mike and Tom, thank you for doing the call.

MARK MASON: Thank you.

HIMA INGUVA: I really appreciate all the disclosures and colors as always. Since Scott asked the proposal question, I'm just going to – if I could follow-up on that to get a better understanding of your views on if you see any differential between trading bank's own debt in terms of regulatory capital treatment of holdings of covered debt instrument that is versus trading other G-SIBs. And then if you could also comment on the thinking around need for sub debt on the back of this or just the distinction between current treatment of G-SIBs common – trading of G-SIBs common stock plus subs, anything along those lines. Any observations would be great.

MIKE VERDESCHI: Again, it is early stages. And I would say that it's something that is not a surprise to the industry. I just don't think this is going to have a meaningful impact. I think what's important was that there was an acknowledgment that there should be some kind of consideration for market making to ensure liquidity in those products. And that market making exemption seems to be fairly adequate. So, I just don't see this proposal having a meaningful impact in terms of the performance of those bonds. And for us, again, because we don't believe it's going to have a meaningful impact, we're not looking at changing anything the way we conduct our business today either at an issuance level or how we view our market making activities.

HIMA INGUVA: Yeah. That's fair and helpful. Thank you. Just my other question is on, if you could share your latest thinking and perspective around plans for Citigroup Capital XIII as you take a fresh look at these securities.

MARK MASON: Hi, Hima. This is Mark. Thanks for your question. At this point, there's no change to our thinking around those securities.

HIMA INGUVA: So, if I recall correctly, Mark, last time management basically said that if it makes sense economics-wise, then Citigroup would call these, otherwise keep them outstanding. Is that correct?

MARK MASON: Yeah. We continue to kind of assess the situation. But, yes, that's generally correct.

HIMA INGUVA: Great. Appreciate it. I'm good. Thank you very much.

MARK MASON: Thank you.

MIKE VERDESCHI: Thanks, Hima.

OPERATOR: Your next question is from the line of Brian Monteleone with Barclays.

BRIAN MONTELEONE: Hey. Good morning. A question on the...

MARK MASON: Good morning.

BRIAN MONTELEONE: I think towards the beginning of the call you guys mentioned the establishment of a CP program out of the broker-dealer. Can you talk a little bit more about what that's funding, what funding that's replacing and kind of how big that could grow to be?

MIKE VERDESCHI: Sure. It's Mike. So, just to give you a little bit of background on our thinking for this, when you go back over time and when we met our liquidity obligations, whether related to resolution planning and our liquidity needs there, our TLAC requirements, we've talked about after that really having greater flexibility to think about optimizing our funding, and we've done that by introducing the bank program.

We've talked about issuing both secured and unsecured. And we've also talked about issuing short-end paper as well as long-end. So, this is a program that is available in our non-bank. Obviously, it's short-term. And when I think about the non-bank, we obviously have our parent benchmark program. But with us running a sufficient TLAC buffer at this point, we certainly can look at other alternatives.

We have – our repo financing is also an option for us. But, even there recently, we've seen some spikes in repo financing in terms of cost. And this simply provides us a complement to those funding alternatives. And so, it's a short-term program, unsecured. The size of the program, we're going to keep it fairly modest. Again, this is something that is meant to serve as a complement. So in the area of $4 billion to $6 billion seems a reasonable start. We certainly have flexibility to probably take it higher. But I would tell you, initially, we want to keep it fairly modest and around the range I mentioned.

BRIAN MONTELEONE: Great. Thanks, Michael. And then a follow-up on a couple of the questions around the TLAC deduction proposal. The market making exemption, I believe, only exists for other G-SIB TLAC you own and won't exist for your own TLAC. So, I guess, how do you think about that part of the proposal?

And I guess, as you think about the charge down to the business for risk, is there any difference in the way the business gets charged today for sub debt versus senior debt because sub debt's already exempted – net long investments and sub debt's already exempted, whereas senior debt's not in terms of your own. So is there anything that will change internally in terms of how you think about risk if the proposal goes through as it is?

MIKE VERDESCHI: So, to your first question, yes, there's – when you think about the market making activity, the exemption where it applies and where it does not apply, again, I still think it's a reasonable exemption that it's large enough that it's not going to disrupt how we make markets today whether that's for other paper or even our own paper.

So I just don't think that our activity today is really going to be impacted by this rule. Again, this is something that the Street has been aware of. So, again, that exemption I think is favorable. We're happy it's part of what's being proposed and we do think it's ample to not impact our current activities.

BRIAN MONTELEONE: Okay. And then maybe a question for Mark; just a follow-up on Hima's question. I guess are there specific things around that security that could – I guess when you talk about the economics today versus what the economics would need to change to make sense to call that security, can you provide any insight into what you're thinking about that could change that would make it more likely that a call would occur?

MARK MASON: No, as I mentioned earlier, we – as you would imagine, with things like this, we look at them with regularity. We factor in the environment we're in. We factor in the financial state of play so to speak. We factor in all the things that would impact an economic decision and we act accordingly. And as we've looked at this, our thinking right now just hasn't changed around those securities. And so we don't anticipate any action at this point.

BRIAN MONTELEONE: Great. Makes sense. I think just one last one for me. Corporate non-accrual loans ticked up a little bit this quarter for yourselves as well as some others. I know you mentioned in the prepared remarks that there were few idiosyncratic downgrades. I guess the range over the last year or so has been around $1.3 billion to $1.5 billion or $1.6 billion. And I think back in 2015, 2016 it kind of had a peak around $2.5 billion. Should we expect non-accrual loans to kind of bounce around, around this range where they've been over the last year absent any kind of material change in the economic environment?

MARK MASON: This is Mark. What I tend to look at is everything. But one thing that does jump out is the ratio of non-accrual to total loans and that remains at about 41 basis points. And if I kind of look back over that period of time, the past number of quarters, it's roughly been in that range. And so, while you're right in terms of the absolute dollar and there being an uptick, we don't see any systemic issues or concerns at this point in time around the portfolio. And that will likely be the range that you'd expect to see in and around that number going forward.

BRIAN MONTELEONE: Great. Thanks Mark. Thanks Michael.

MARK MASON: Yeah.

MIKE VERDESCHI: Thank you.

OPERATOR: Your next question is from the line of Robert Smalley with UBS.

ROBERT SMALLEY: Hi. Good morning and thanks for doing the call.

MARK MASON: Good morning.

ROBERT SMALLEY: A couple of questions. One on deposit gathering, one on Flex Loan, and then I wanted a follow-up on one of Brian's points, if that's okay. On the earlier call, referencing digital deposit gathering, said that two-thirds were new to the Retail Bank and a third was outside of the branch footprint. So was this increase due to an increase in rate, an increase due to marketing penetration? Are you offering something different? Is it sustainable? And what's the marginal impact to the margin for these deposits that you gathered through this channel?

MARK MASON: So what we referenced obviously was the $1 billion in digital deposit growth. It was a combination of both in-market through branches, but also outside of kind of the core six markets that we operate in. And if you think about the consumer strategy and the idea of targeting customers that we have with the bank, but who may not have existing retail banking relationships, and based on our understanding of that customer and creating value proposition that they're likely to respond to.

And so, some of this deposit gathering was exactly that, kind of looking at some of our card customer base outside of our six core markets, and crafting offerings and marketing to them that they're likely to be responsive to and we saw some good uptake in that. So some of it is marketing, some of it is – there is at least one product that we've got out there outside of our six markets that is a high yield savings account product. And so there's an element of that that is price as well.

But, again, I push that a little bit or push the thinking around that a little bit to say, we're being very targeted in the clients that we're making these offers to. So, clients that we can see inside of our card portfolio, we understand their behaviors. We understand where they have other accounts. We're able to set up digital capabilities that allow for them to on-board with ease, that allow for them to move moneys from other accounts with ease. And so, yes, it's product capability. Yes, it's marketing. Yes, there is some price element to some of it and it's coming through multiple channels.

And we do expect that growth to continue in the outer quarters of the year as we continue to execute against the strategy. The on-boarding there, I can't speak specifically to the margin impact, but the cost of acquisition is lower. And so there's certainly some advantages to that. And so we're pleased with the progress to-date, but we certainly expect more.

ROBERT SMALLEY: That's very helpful. Thanks. And moving to Flex Loan, so we're taking a product and then making a longer-term client commitment. On one hand, that's a good thing in terms of how you can leverage that within the bank. On the other hand, as a credit person, I say to myself is this somebody who couldn't pay their credit card bill, and probably the reality is all of those and somewhere in between.

So could you tell me a little bit about the credit assumptions that you're making with the product, what you're looking for delinquencies and charge-offs and, overall, how do you view that? And then, is this a more CECL friendly product because it's an amortizing product not a revolving product. So, does that help you with a little bit of capital relief?

MARK MASON: So there's a lot in there, I'll try to get at as much of it as I can. So, I'd start with, we launched Flex Loan; the Flex Loan product allows for customers to access funds by converting a portion of their existing credit line into a fixed interest and fixed payment personal loan. And the idea there is, in many ways, to target – and again, this gets back to the earlier point, but to target transactor-type customers. So it's not an effort in any way to cannibalize our existing revolver client customer base, but instead, customers who are making a purchase, they're more likely to be a transactor, that's a unique purchase outside of what they might normally do. And they see an advantage to converting that into a fixed rate, fixed payment type of product.

I will tell you this, that while it's still early days, we've seen good initial engagement, both in terms of the FICO quality, the average loan size, as well as the average APR and term around the activity. And so, I don't think it's a situation where we are compromising the quality of the activity that we do with our customers in any way for that matter just given what we're seeing at this initial engagement.

ROBERT SMALLEY: Okay. So, can you share – that's great. Can you share some of the overall credit assumptions? Or are what you're using for this really what you have baked into similar products?

MARK MASON: We're not acting – we're certainly not acting outside of any of the risk parameters that we would set for similar products. As you know, we tend to have higher-quality from a FICO score point of view customer base. But I don't have specifics that I can – that I would be comfortable to share or can share at this point in time.

ROBERT SMALLEY: Okay. Okay. Last question a follow-up on Brian's point on funding from the non-bank. And I know it's a little early with the program, but just interested to know where you see issuance levels versus some of your existing debt. Obviously, you'd like it to come flat to issuing out of the bank, but it's got to come with some additional yield given the difference in the issuance entities. So, how do you look at that? What kind of numbers make sense to you non-bank versus bank issuance with respect to issuing levels and yields? And what have you modelled internally?

MIKE VERDESCHI: So, with a program this size, our focus is going to be having another liquidity lever, broadening our investor base. And so, in terms of what you're paying though, you are going to see a modest premium in the non-bank relative to the bank. And obviously, the further you go out on the curve that could have more impact. But, in the short-term program, again, we're going to be benchmarking to a short-term rate and you'll be a very modest spread above LIBOR in some of these – in the non-bank program.

But, again, these are not meaningful differences than where you're tracking sort of a similar type of program whether you have a CD program or some other type of wholesale funding in the bank. So I would say, for a modest amount, this is really about creating flexibility. It's about creating broader investors. And so, a slight premium is something that is not worrying to us.

ROBERT SMALLEY: And just would you put a little flesh on the bone around what you consider slight? Is that single digits or kind of 10 to 15 basis points in the year type of maturity?

MIKE VERDESCHI: Yeah, we're talking single digits.

ROBERT SMALLEY: Okay.

MIKE VERDESCHI: Single digits, yeah. Very modest.

ROBERT SMALLEY: All right. That's great. Thank you for all the answers. It's very helpful and thanks again for doing the call.

MARK MASON: Thank you.

MIKE VERDESCHI: Sure.

OPERATOR: That concludes the question-and-answer session. Mr. Rogers do you have any closing remarks?

TOM ROGERS: Thanks, everyone, for attending the call today. And of course, if you have any follow-up questions, please feel free to contact us at Investor Relations. Thank you.

OPERATOR: This concludes today's Fixed Income Investor Review. Thank you for your participation. You may now disconnect.