HOST  
Betsy Graseck, Morgan Stanley Analyst

SPEAKER  
Mark Mason, Citi Chief Financial Officer

QUESTION AND ANSWER

BETSY GRASECK: Good afternoon. And thanks everybody for joining at the MS Virtual Financials Conference. I am pleased to have with me this afternoon, Mark Mason, CFO of Citigroup.

Mark, thanks so much for joining.

MARK MASON: Thanks, Betsy. Thanks for having me. Happy to be here.

BETSY GRASECK: So, I do have a disclosure statement. And then we'll get into the questions. For important disclosures please see Morgan Stanley research disclosure website at morganstanley.com/researchdisclosures. If you have any questions, please reach out to your Morgan Stanley sales representative.

So Mark, just wanted to kick off by asking a bit of an overview question on the kinds of changes that you've seen in your portfolio in the consumer and corporate client behavior, given this work-from-home economy that we’re in right now.

MARK MASON: Sure. Sure. Thanks again, Betsy, for having me. Like most people we’ve been in this work-from-home mode since the middle of March and there are in fact some significant changes that I think we’ve all gone through but certainly our consumer and corporate clients have been experiencing. I think the biggest and clearest takeaway or change that I've seen would have to be characterized as a very, very swift shift towards digitization. And it has become a necessity in light of this shelter-in-place, work-from-home mode that we’ve all found ourselves in.

And in fact, the idea of digitization has played out in everything from how we service clients to how we engage with our clients in order to understand their needs and provide solutions to those needs, to how we acquire new clients or open new accounts. And frankly to how our clients consider new modes for them to go to market or service their different types of customers. And so, it's touched just about every interaction between us and our clients.

If I think about the consumer side, I think about the customer relief programs, forbearances and alike, much of that has been enabled by technology and digital tools and capabilities. If I think about the need that we had to build out digital onboarding for PPP customers, again the importance of that platform, that digital platform in order to enable that activity was critically important.

If I think about our ICG business and the importance of us providing Zoom accounts for all of our client-facing colleagues and I just think back to two weeks ago, we hosted a client call with CFOs from the EMEA region and I was asked by our team members to come and speak to that audience. In a normal environment that would have taken weeks, if not months to schedule and plan. I was asked on a Friday to speak the following Tuesday and I was able to do that and we had full attendance, if you will, in part because of what digitization and technology enables. And so, things like that and things like e-signatures and things of that sort, how our clients go to market and the acceleration and their thinking on providing products directly to consumers and leveraging the capabilities that we have to do that.
So, we've seen a lot of significant changes that are taking hold, most of it in part is an acceleration. We've been making investments as you've heard me talk about in the past in technology and digital for some time now. We've had to make incremental investments to enable this, but we have seen meaningful changes and we've seen frankly some trends start to emerge, so that the first I would say is that idea of digital first customer experiences and the things like the importance of digital onboarding and automation tools. Another one that's interesting that's emerging is supply chain viability and flexibility. So if you think about the shutdown of international borders, which frankly showed how fragile our supply chains are, and the importance of how our clients would think about resiliency of those supply chains in the future and the importance of on-shoring, of manufacturing. All of those factors become important considerations and we're well positioned to assist our clients in that. But there's changes taking place already and I think changes that will continue to emerge.

BETSY GRASECK: Interesting. No. That's great. And especially on the corporate side which we haven't heard much of at least in my sessions. I'm wondering as you go forward from here, are there any investments that you think you need to pursue in order to accelerate that digital adoption you're seeing from clients?

MARK MASON: Yeah. Look, I mean, we've got 80% of our colleagues working remotely and I think we've demonstrated that we can work from home effectively, productively. We can maintain a BAU, business as usual, engagement with our clients and do so while also meeting regulatory demand. And as I mentioned earlier, some of that is on the heels of investments in technology that we've been making over the past few years and if you look back and some of the things we reported at earnings you've seen our digital customers grow, our mobile customer grow north of 24% and 50% respectively versus the 2018 levels. And so, in part we're able to leverage – we were and are able to leverage investments that we've already made. There are additional investments that we've had to make in order to ensure that we can support our clients at the highest levels. They include some of the things that I've mentioned like that PPP digital platform, they include special payments that we've made to employees or the cleaning of branches and buildings and things of that sort. But net-net I do think that over time we will start to see efficiencies if you will, from this move, this acceleration towards digitization.

BETSY GRASECK: And is that efficiency opportunity a function of bringing down commercial real estate cost? Is that the main driver there, or is there anything else beyond that that you would be thinking of?

MARK MASON: Look, I mean it's too soon to tell exactly how it materializes and what the new normal looks like. But I think all of those things will be important things to consider. So, we've seen T&E expenses come down materially because of, for example, how we're engaging with clients, whether that is something that is likely to be a new mode for engaging with clients but certainly not the only mode. And so, there'll be some benefits that come from activities such as that. The continuity of business plans that we've had have often been requiring us to move to other facilities. Well, we've demonstrated that at least in this particular crisis, the continuity of business plan by and large was working remotely. And so maybe that creates real estate opportunities as well. And so, we've got to kind of let some of this play out a bit more to see what the new normal looks like. But we expect there will be some things worthy of considering.

I think the other thing that has been interesting for us is the power of our global model. And what I mean by that is that it's proven to give us flexibility in our operations. And so, one example is in our consumer business where we have obviously a card operation. Our card operations were impacted by lockdowns in India and in the Philippines, and we were able to leverage our global footprint and move critical resources for some of these key processes to the US to ensure that we mitigated risk effectively, right. And there were similar things on the ICG side where India was locked down, we have a global margin operations there. We're able to shift that to parts of Europe and Asia. And so, there are some efficiencies, but there are also some advantages that our global operation brings us in situations like this.
BETSY GRASECK: That's great. While we're on the topic of consumer and card, which you raised from an operational perspective, but it would be good to understand some of the client updates that you're getting some window on here and let's kick off with the US consumer. Your Citi Branded Card and your Retail Services businesses give you a great window on what's going on with the US consumer, what they're thinking, how they're spending. Maybe give us an update on what you're seeing now versus mid-April. And then, talk a little bit about how sustainable you think that could be and how you're preparing for the next couple of quarters here?

MARK MASON: Yeah. Sure. Look, I mean, we've obviously been looking at spend levels. We've been talking about purchase sales volumes coming out of the first quarter and what I'd say is the spend on credit cards has started picking up in certain categories, certainly relative to the depressed levels that we saw through the middle of April, but they're still significantly lower versus a year ago. In the US Cards business, the overall spend started to pick up with May purchase sales down by roughly 20% year-over-year. So still down year-over-year, but better than the mid-30s decline that we were seeing in the middle of April. And you've heard us speak about the idea that there's a great deal of choppiness and significant declines in travel and dining and entertainment, which were down roughly 75% in May. And while the essentials that people continue to obviously need and spend on was tracking above last year's levels, and so there's improvement but still down year-over-year.

And I think a lot of how this, how sustainable it is or how this continues to trend is going to depend on the pace and success of the reopenings which we're starting to see in phased levels and varying degrees across the US. But how customers behave as those restrictions ease and how quickly businesses are able to ramp up, frankly to meet what would then be new demand will be important factors in determining that sustainability, right. And we're watching it carefully to see how our clients who are impacted by the pandemic are able to get back to work and to a more certain future.

So, there are a fair amount of kind of unknowns that still need to play out as we think about that. I mean in our – if I think about the impact that customers have had and now trying to resume some sense of normalcy – in our US consumer business, in that business we've provided assistance and relief to over a 1.5 million consumers. And that's – that represents somewhere between 4% and 5% of our balances across the cards and mortgage portfolio, right. And that includes payment deferrals and late fee waivers and moratoriums on foreclosures and evictions.

I think the hopeful signs that we're seeing, or the hopeful sign that we see is that many of those same customers have continued to make their regular payments, despite having that relief. And that suggests that the government's aid has been effective in helping those that have been hit by the crisis. And we've had a similar practice internationally where we've provided similar programs in line with those local regulatory guidelines. And so, we're now kind of preparing to help our customers as they roll off with those programs and to make sure that we can assist them as appropriate, but lots of moving pieces still, right.

BETSY GRASECK: And on the forbearance that you brought up, how should we be thinking about when those programs end and I'm asking because obviously investors are interested in understanding when we start to see the delinquencies that will come out of this crisis?

MARK MASON: Yeah. Again, it's still early. When I think about kind of reenrollment rates, we're currently running very low in terms of reenrollment rates – some 5% to 7% as a percentage of the accounts that that roll off with some of the broader customer relief programs that we have. But it's still very early and we've got to – we'll watch this as customers kind of lap that 60 days that these – that many of these programs are designed with. So, it's still early days in terms of them rolling off and being able to determine the longer-term impact.
BETSY GRASECK: Okay. Maybe the other window obviously you have a good view on is the corporate – large corporate in particular, and when we look at corporate drawdowns, they were really epic in the first quarter, significant amount of unutilized lines pulled down. How much of that has been paid down, just trying to understand that from a perspective of where the loan balances are likely to go? And do you think the pay downs are going to continue to keep up or have we stabilized on that at this stage or not?

MARK MASON: Yeah, look, I mean like others we saw significant drawdowns in the first quarter in light of how the market evolved through the first quarter, we saw I think was approximately $25 billion or so of draws. But the capital markets are wide open and receptive with significant debt issuance volumes that we're seeing. And I think it's evidence that the measures that have been taken by the Fed have been extraordinary, and it really helped to stabilize the markets, allowing for the strong levels of debt issuances and frankly at tighter spreads. And we've been there, we've been there with our clients kind of through the entire process. We've helped our clients access and raise liquidity as they prepare to deal with a great deal of uncertainty around how long this shutdown would last and the potential for even further market disruption. And as a result of the significant liquidity that our clients have raised, we have not only seen a decline in the pace of new drawdowns but we've also seen some repayments on prior draws on credit lines. And so, frankly, should the capital markets and the overall environment remain constructive, we would expect that draws as well as new loan demands would continue to moderate further. So, it's an interesting dynamic where we're seeing those draws start to abate but more importantly pay downs, given liquidity that's in the market, and new loan volumes abate as well.

BETSY GRASECK: So, how are you thinking about loan growth, given these dynamics on both the consumer and the corporate side?

MARK MASON: Look loan growth is going to be a byproduct of the client and customer demand. As I mentioned earlier, we are seeing on the Consumer side pressure on loan balances, right, as a result of the lower purchase sales really across all the regions. And again, that's driven by the restriction of movement and commercial activity and as a result we'd expect loans to be down in the second quarter, certainly on the Consumer side.

In the US, credit card spend has improved as I mentioned earlier relative to the levels we saw in April, but that's down year-over-year. We expect in Asia to see continued pressure there as countries in the region remain at different points in terms of a trajectory of a recovery. And when we think about Mexico, it's a bit earlier in terms of the stage of recovery relative to other consumer markets.

On the Corporate side, we're continuing to support the liquidity needs of our clients, but as I mentioned they have access to the capital markets to raise liquidity, and we've been working with them on that and we have seen the pace of drawdowns slow and the repayments pick up. And so, while we do continue to see client draws on revolving credit lines, that activity is offset by repayments and we would expect that loan growth in the corporate lending business in the quarter to be impacted by that.

BETSY GRASECK: Okay and when you're talking about the loan growth on the Consumer side you're speaking to an end-of-period concept or more of an average?

MARK MASON: We would expect for it to be down, right, at the end-of-period.

BETSY GRASECK: Okay, got it. All right. And then just on the quarter, moving to the quarter more broadly, maybe you could give us a sense as to some of the trends you're seeing both on the NIR as well as the non-NIR fee side?

MARK MASON: Sure. Yeah. Look, I mean, I think in terms of the second quarter and kind of the outlook and trends we're seeing, it's probably important – let me just kind of put CECL aside for a second, right. So important to point out that since the end of the first quarter, we've seen a deterioration in the macro
backdrop and that's an important factor that we can come back to. At a Citigroup level, to answer your question very directly, we currently expect a decline in the net interest revenue. Now that said, we would expect for that to be more than offset by the non-NIR revenue on a reported basis. So, total revenue should be flat to up slightly in the second quarter and that includes the headwind from the Tradeweb gain that we had last year. We would expect our expenses at this point to be down slightly year-over-year this quarter. And when you put this together, we would suggest that our operating margin will be up a couple of percentage points year-over-year.

When I dig a little bit deeper, take it a little bit deeper in terms of the business specific updates, if we start on the institutional side, our Markets business is seeing continued high volumes and active portfolio repositioning across our entire client franchise. And so today, we expect total trading revenues across both Fixed Income and Equities to be up a similar magnitude to what we saw last quarter on a percentage basis. And so, last quarter we were up close to 40% year-over-year, so we'd expect it to be up on a similar basis to that or similar magnitude to that. And it's really going to be driven more so by Fixed Income. All of that said, as you know Betsy, we still have several days left to the month of June and so we'll see how the remainder of the quarter plays out.

On the Investment Banking side, here too we're seeing good momentum. We expect low double-digit year-over-year growth this quarter. We're continuing to take share. We're fully engaged with our clients. It's really being driven by the debt capital markets per my earlier comments. And so, good momentum in the ICG, particularly Markets, Fixed Income and the Investment Bank.

On the Consumer side, as I mentioned again, pressure on the loan balances are a result of pressure in purchase sales for all the reasons we talked about. In the US, we expect to see a slight reduction in revenues year-over-year given the lower card balances; that's partially offset by stronger mortgage activity given where rates are. And in the international consumer business, we're expecting a more pronounced impact, a decline that's in the mid-teens. With Asia, as you know in Asia, we're focused on the affluent, the emerging affluent customer base and if you think about, for our portfolio, where those customers are geared, they're geared towards more of the sectors that have been most impacted, sectors like travel and hospitality, et cetera and so we're going to see some pressure there. And then, Mexico as I mentioned, in an environment in Mexico where we're seeing decelerating GDP, so an already challenging macro backdrop, we're going to see some pressures there in that market on the revenue line as well.

**BETSY GRASECK:** Okay. So just to make sure I heard you correctly on the Markets by roughly 40% up year-on-year which gets you to maybe a slight down Q-on-Q, but on a year-on-year basis plus 40% and that includes Tradeweb in the base, is that right?

**MARK MASON:** Yeah, plus 40%, yeah.

**BETSY GRASECK:** Okay. And then your NIR which is down year-on-year, that's really mostly a function of the net interest margin is that right given the fact that, or is that more of a function of the loans that you were mentioning earlier?

**MARK MASON:** It's going to be both dynamics playing through, right.

**BETSY GRASECK:** Okay. Maybe we can turn to reserves in the second quarter and talk a little bit about how you think about reserving. I mean, I know you said you were setting aside CECL in the prior comment, we can't do that though going forward...

**MARK MASON:** No, we can't.

**BETSY GRASECK:** Maybe you can help us understand what the major drivers of the CECL reserve are in your opinion and how you see that playing through in 2Q?
MARK MASON: Sure, sure, sure. So look, I mean I think it's important to remember that CECL is a byproduct of the economic outlook and our calculation or estimate for lifetime expected losses. And as we came through the first quarter, we were already seeing at the end of the first quarter a deteriorating outlook for the second quarter. And while we use all types and a large number of variables in these models that we run, we saw it at the end of the first, beginning of the second and still see it in the way of GDP levels, in the way of unemployment in the second quarter expected. And those become important factors in CECL as does the path of a recession and the trajectory of a recovery, as does the probability and loss likelihood and severity of recession models that we all run. So, there are a number of factors that come into play there.

At Citi, we have kind of both a quantitative and qualitative approach to how we do our CECL calculations. We use a single forward-looking macroeconomic forecast, and then that's complemented with a qualitative component to it. When I think about again the magnitude of the view that we had going into the second quarter on a deteriorating environment, I would tell you that we currently expect to see a higher level of reserves in the second quarter, likely a bit above where we were in the first quarter. But clearly we need to see how the remainder of the quarter plays out and how that economic view moves around through the end of the quarter.

That said, based on what we are seeing today and kind of looking into the second half particularly in the US, we are kind of modeling and we do expect an acceleration in GDP growth and a drop in unemployment certainly relative to the second quarter. And so it is likely that that second half looks better, obviously, than the first half, as it relates to these reserves as things start to improve. And that's why the recovery, the trajectory of the recovery, is such an important factor here.

BETSY GRASECK: So, I just want to make sure when you say a higher reserve in 2Q versus 1Q, are you talking about the reserve allowance itself or are you talking about the reserve build?

MARK MASON: I'm talking about the dollar level of reserves. So, we had $4.9 billion of reserves in the first quarter.

BETSY GRASECK: All right. Okay. Yeah. So, you'll be adding to it just from our perspective hard to know if it's going to be a bigger add than first quarter like will the reserve build in 2Q be above 1Q or not, we can't...

MARK MASON: What I'm saying is that it's likely that the build in Q2 is a bit higher than the build we had in Q1.

BETSY GRASECK: Okay. All right. Got it. Yeah. People have been thinking about how high reserve levels could go over time and looking at things like the 2018, 2019 bank-run stress loss. Is that something you think makes sense or is that maybe too high of a level from your perspective?

MARK MASON: Yeah. Look, the regulatory stress tests are an important part of the regulatory framework that we have. But I do think that there are a couple of factors that we have to keep in mind. And one is that it's based on nine quarters, a nine quarter horizon. Two is that it is a reflection of a particular scenario and inherent in that scenario is the trajectory and the magnitude of the downturn as well as the recovery. And we're living through a current crisis that is slightly different from anything that we've forecasted in the past and so that's an important factor. And then the third piece is that, there have been significant Fed actions and fiscal stimulus in the US and there has been stimulus internationally as well and the DFAST scenarios don't contemplate those types of actions. So, I think those three things make it difficult for us to look at that as a point of comparison. Those are pretty significant differences or things right?
BETSY GRASECK: Got it. Okay. No, that's helpful. Okay, so then just wrapping up. I wanted to get a sense, little bit higher level more strategically, how you think about RoTCE. And I know that the goals specifically have been removed given the crisis that we're in right now. But just over time I'm wondering how you think about the strategic actions that Citi could take to drive that RoTCE up over time.

MARK MASON: Yeah. Look I'd kind of point back to – if you think prior to COVID, we'd been on a path of making good steady progress over the past couple of years. And so in 2016, we had an RoTCE of 9% with the extra DTA; in 2017, we had an RoTCE of 9.6%; and in 2018, we were at 10.9% and in 2019, we were at 12.1%. So, we've been on this steady path of improving our return on tangible common equity. And we're now operating in unprecedented times, uncertain times. And as you know, you've heard us say it before, our focus has been on supporting our employees, our customers, our clients, our communities while ensuring that we've got strong liquidity, strong capital position and leveraging that strength to do those things – to be there for our clients in these uncertain times, as they have to manage their businesses and institutions. What I'd say is that we're still in the midst of that, right. So we're still navigating that crisis. We are at the early stages of returning to offices, opening up these cities and states and to some extent testing the resiliency of a return, right. And so, it is I think a bit early for me to call with any degree of precision where our – when and how quickly, we're able to kind of get back to those levels of returns. What I will say is that as we come out of this, we intend to be in a position of strength having been there for our clients, having shored up those relationships and we think that should result in continued share gains and client driven revenue growth with them.

We're going to maintain the resource discipline that we've had. This crisis has required incremental investments, but there have also been offsets and it will likely on the other end of this cause us to reprioritize what we want to invest in because of many of the trends that I referenced earlier. But I think the takeaway is we're going to continue to be focused on client driven revenue growth, a disciplined approach to expenses and capital management and doing that with a very disciplined, strong risk appetite framework and hope to be back on that trajectory as soon as the environment suggests that we get there.

BETSY GRASECK: Well, I think that's a great summary and a great wrap up on how you're approaching not only the short-term, but also the longer term. So, really delighted to have you with us again this year, Mark. And I wish you the same and safety and healthiness for you and your family and all on the call.

MARK MASON: Betsy, thank you very much for having me. And I wish you the same and safety and healthiness for you and your family and all on the call.

BETSY GRASECK: Thank you very much. Take care.

MARK MASON: Bye-bye.

BETSY GRASECK: Bye.