

**Citi Second Quarter 2020 Fixed Income Review**

Wednesday, July 29, 2020



**Host**

Tom Rogers, Head of Fixed Income Investor Relations

**Speakers**

Mark Mason, Citi Chief Financial Officer

Mike Verdeschi, Citi Treasurer

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**PRESENTATION**

**OPERATOR:** Hello and welcome to Citi's Fixed Income Investor Review with 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 will 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 in 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 2019 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 half of 2020. 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 second quarter and first half of 2020. In the first half of the year, we reported net income of \$3.8 billion, which included a \$10.5 billion increase in credit reserves under the CECL framework, primarily reflecting a deterioration in the economic outlook since the beginning of the year as well as downgrades in the corporate loan portfolio.

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 16% over the last year, as we continued to support our consumer and institutional clients as they manage through the COVID-19 health crisis while also maintaining a strong balance sheet. We saw strong growth in deposits across both GCB and ICG. Loans grew, driven by our institutional business. Trading-related assets and liabilities grew, reflecting a continuation of the heightened client activity we saw in the first quarter, and long-term debt increased as we built liquidity to support our clients and maintain the firm's robust liquidity profile.

Slide 5 presents trends in our loan portfolio on an average basis in constant dollars. Total Citigroup loans increased 5% year over year. In our Consumer franchise, average loans declined 1% year over year, reflecting the impact of lower consumer spending activity in our Cards business across regions. In our Institutional franchise, average loans grew 11% year over year. Average loans in Corporate Lending grew

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21%, as we continued to provide new loans and facilitate additional draws for clients looking to bolster liquidity. However, on an end-of-period basis, loans in Corporate Lending declined 12% from the first quarter, reflecting significant repayments, as we assisted our clients in accessing the capital markets. 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 loss rates generally trended upward this quarter as a result of the macroeconomic slowdown, though this was much more a function of the lower loan balances, as it is still too early to see a pronounced impact from COVID-19 on our net credit losses. In ICG, non-accrual loans increased \$1.5 billion sequentially, reflecting the current environment, with roughly half of the increase coming from smaller sized exposures. However, on a relative basis, NALs remained low at 99 basis points of total corporate loans.

Turning to slide 7, we show trends in average deposits over the past five quarters in constant dollars. Total deposits increased 21% from the prior-year period, reflecting client engagement and a flight to quality, so to speak, across both our Institutional and Consumer businesses. In our Consumer business, deposit growth accelerated to 12%, with strong growth across all regions. In North America, deposits grew 14%, driven by a combination of factors, including the delay of tax payments, stimulus payments and a reduction in overall spending, as well as our continued strategic efforts to drive organic growth. In our Institutional business, deposits grew 25% on an average basis, primarily driven by 30% growth in TTS as well as continued growth in Private Bank and Securities Services.

Now let me cover our parent benchmark debt issuance program on slide 8. So far this year, we have issued approximately \$18 billion of parent-level benchmark debt across a variety of tenors. Going forward, we'll continue to maintain the flexibility to issue a mix of tenors, currencies and structures, as we prudently manage the liquidity profile of the firm and support our clients.

On slide 9, let me cover our issuance, maturity and redemption expectations. In 2020, we continue to expect gross issuance of approximately \$25 billion, inclusive of our parent benchmark and bank-level programs, including the roughly \$18 billion we've issued so far this year. Given the strong deposit growth we've seen at the bank, we expect the majority, if not all, of our second half issuance to be out of the parent. And we will continue to be flexible around optimizing our funding through opportunistic redemptions.

On slide 10, we show the composition of our long-term debt outstanding. During the second quarter, our total long-term debt increased by approximately \$14 billion to \$280 billion, driven by parent benchmark and customer-related debt issuance, as our bank-level debt declined, given strong deposit growth.

On slide 11, we provide an update of our LCR metrics and drivers. Our average LCR increased modestly to 117% this quarter.

Turning to slide 12, let me summarize our key regulatory capital metrics. Our CET1 capital ratio increased to 11.5%, primarily reflecting a decline in risk-weighted assets, and our SLRs were 6.7% and 6.6% for Citigroup and Citibank, respectively.

Moving to our last slide, let me summarize several key points. The franchise performed well through the first half of the year. We earned \$3.8 billion of net income year-to-date, including a \$10.5 billion increase in credit reserves. We maintained a strong capital position with a CET1 capital ratio of 11.5%, an SLR of 6.7% and a surplus above our TLAC requirement. And we also maintained a strong liquidity position with an average LCR of 117%, \$900 billion of available liquidity resources and we expect to be in compliance with the NSFR when the rule is effective.

It's this strong capital and liquidity that positions us well for a range of scenarios, from a persistent downturn to a stronger than expected recovery. And we have the flexibility to deploy these resources in ways that deepen and expand our client relationships and support the broader recovery.



Before we move on to Q&A, let me touch briefly on LIBOR. Broadly speaking, we are continuing to prepare for the transition away from LIBOR by the end of 2021 by working with our regulators and various industry working groups as well as through the work streams we've established within Citi. With regard to the unique language in the subset of our preferred securities, while we are continuing to make progress in evaluating alternatives, we are not yet in a position to speak to a specific transaction or timing.

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

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## QUESTION AND ANSWER

**OPERATOR:** Your first question is from the line of Arnold Kakuda with Bloomberg Intelligence.

**ARNOLD KAKUDA:** Hey, Mark, Mike, Tom. Thanks for holding the call, always helpful as usual.

**MARK MASON:** Good morning.

**MIKE VERDESCHI:** Hi, Arnold.

**ARNOLD KAKUDA:** Hi. So Citigroup, you've been a stress test winner this year, congratulations. Many years of hard work, and I think maybe this is one of the first times that I think your losses were less than peers. So it seems like the trading losses especially were better than peers. And you had targeted an SCB of 3%, and since you did so well, the SCB actually is 2.5%. So you have that on the one hand, and then yet your bonds trade on the wider end of peers. So what do you think may be underappreciated by the market compared to the hard work that you've done with the Fed and how you've done in the stress tests this year?

**MARK MASON:** Arnold, first of all, thank you and good morning. Look, I appreciate the commentary around the performance. The SCB did come in, as you pointed out, at about 2.5%, and that puts us when you look at our CET1 ratio at about a 10% minimum. And as we've stated before, we're running currently, for the second quarter, at 11.5%. There's a lot that goes into the scenario, but we think that certainly is a good and favorable outcome.

There's still a lot of uncertainty in the market more broadly as it relates to the crisis that we're managing through. And I think that uncertainty plays straight across the board, from this being a health crisis and there being a lack of clarity as to when a vaccine and a resolution comes into play, to what is the ultimate impact on losses as we all build lifetime reserves for the first time with this new accounting change. And so, I think part of the uncertainty that's out there that relates to us is investors seeing how we manage through this particular crisis.

With that said, as you point out, I feel good about our capital position. I feel good about our liquidity position. I feel good about the performance that we've demonstrated through the half and being able to support our clients through this crisis. The level of engagement that we have with clients has been very strong.

We're a very different firm than we were during the last crisis, and you can see that when you look at the mix of our credit card portfolio. You could see that with the discipline that we've managed in terms of our focus on our corporate clients. And while we won't be without losses through this crisis, we feel good about the forward look and our ability to continue to manage it in a responsible way and to be there for our clients. And hopefully, when that all plays through, there will be greater transparency and understanding of the strength of the franchise and the discipline that we've demonstrated. Mike, I don't know if you want to add anything to that.

**MIKE VERDESCHI:** No, Mark. I think that's it. Obviously, we've been continuing to issue well. And I know there's a comment on the bond spreads, but good sponsorship from the investment community around that.



**MARK MASON:** Yeah, yeah.

**ARNOLD KAKUDA:** Okay, great. And then talking about the uncertainty ahead, and you've had a strong reserve build, \$10.5 billion over the first half of the year. And then I guess in the first quarter it was more on the Consumer side and the Cards, second quarter it was more tilted towards ICG. But going forward, I guess nobody has a crystal ball, but consumer or wholesale, which one do you think might be more of a problem area going forward, or is it all kind of dependent on the stimulus and path of the pandemic? Do you have a thought in terms of which one I guess might be more of a concern in your eyes?

**MARK MASON:** Look, as you would imagine, we're focused on our entire portfolio and exposures on both the Consumer side as well as the Institutional side. Our reserves today sit at \$28.5 billion. They've doubled since the end of 2019. We did see, as you point out, an increase on the corporate side. And frankly, as we've seen the crisis continue to evolve through and into the second quarter, that's really, in a way, a byproduct of that evolution and downgrades and the like, putting us in a position to increase the reserves on the corporate side.

With that said, as you know, this is tied to our economic outlook and forecast for how this continues to play out and what the pace of recovery looks like. And that's going to be an important factor as to how those reserves evolve, and frankly how losses play through the P&L in the subsequent quarters. And so we're focused on it. We feel good about the reserve levels that we have to date. We feel good about the exposures we have given the discipline around how we've underwritten our corporate client exposures and the focus that we have on the higher-quality Consumer portfolio. And subject to how the economic forecast plays out, that will be an important determinant in how the evolution of reserves and losses evolve.

**ARNOLD KAKUDA:** Great, thank you.

**MARK MASON:** Yeah.

**OPERATOR:** Your next question is from the line of Nikhil Khosla with JPMorgan.

**NIKHIL KHOSLA:** Thank you. Good morning and thanks for doing the call.

**MARK MASON:** Good morning.

**NIKHIL KHOSLA:** I hope everyone there is staying safe. Two questions. First on the GSIB scores, clearly the balance sheet has shown substantial growth. And reading the last regulatory filings, all the derivatives across jurisdictional exposures, Level 3 assets, seem to be going up across the industry, so I just wanted to understand. Could you just talk to managing or balancing client needs versus a potential increase in the GSIB surcharge, and thus being at the lower end of the SCB scale, so good job there, afford you a little more headroom maybe on the GSIB side?

**MARK MASON:** Yes, sure. So look, we all have to remind each other, and that's probably not hard to do, that we're managing through a crisis. And as we're doing that, as you would have heard me say before, it's important for us to continue to demonstrate balance sheet strength, both as it relates to liquidity as well as, as it relates to our capital. And there is a lot of liquidity that's in the market at this point as firms have shored up their liquidity positions, but also as consumers have seen the impact of stimulus and forbearance and the like. And so as a result, we have seen our balance sheet grow.

Mike would have mentioned in his prepared remarks the growth in the deposit levels that we've seen through the quarter and through the half, and we have seen pressure on that GSIB score. We've seen pressure in the past. I think the industry has. I think we'll have to manage through the balance of this year, and we're constantly looking at the drivers of that. We'll continue to focus on complexity, which is an important factor, size, and across jurisdictional components of the score, and manage that, particularly

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through size and mix of our balance sheet with an emphasis on deposits and trading assets. But again, we're focused on the safety and soundness. We're focused on being there for our clients.

And the final point I'd make on this is one you alluded to. When you look at our CET1 stack, as was already pointed out, we have a 2.5% stress capital buffer at this point. We were estimating for another 50 basis points, and so there is a little bit of room and latitude there. But again, we'll deal with that as we need to. In the meantime, we're focused on all the things that I've mentioned through the course of the remainder of the year.

**NIKHIL KHOSLA:** Great, thank you, and a follow-up on the card portfolio. Are you seeing any discernible changes in customer behavior this time around versus say the 2008 crisis or prior recessions, maybe customers choosing to pay down card balances over some other loans or borrowings as cards probably are more important today in this digital world, any comments there?

**MARK MASON:** What I'd say there is I'd point back to one of my earlier comments in that we're in many ways a very different firm than we were as we've come through this crisis versus the prior. And that is particularly the case when you look at both our Consumer as well as our Institutional portfolio. And I've spoken before around how the mix of our Cards portfolio in the way of FICO scores has evolved since the prior crisis. So you've got a different portfolio, so to speak, in terms of the quality of it, combined with a different crisis.

And this crisis for all the reasons we've pointed to already is quite different from the last. It started as a health crisis. It's evolved certainly to an economic crisis, but there's also the stimulus and the forbearance actions and all of those types of relief that have played into it, and we have to see how that evolves and plays out over time. And there's talk of even yet incremental relief as we're currently managing through it. That has caused different behaviors.

And so you've heard me reference the number of customers who have opted into some of these forbearance programs. You've heard me reference kind of half of them coming off, particularly in the US, and 80% of them still making payments. And so those types of behaviors in some ways are different from prior crises. This one is far from being over, and as I've mentioned, there remains uncertainty. And so we'll have to see whether those positive signs, how they ultimately play out, but we are seeing some different behaviors given it is a different crisis and we do have a different portfolio, and some of that has been certainly positive signs.

**NIKHIL KHOSLA:** Great, thank you.

**MARK MASON:** You're welcome.

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

**HIMA INGUVA:** Great, thanks for taking my questions, for doing the call, for all the disclosures, Mark, Mike, and Tom. Thank you again.

**MARK MASON:** Sure, good morning.

**HIMA INGUVA:** Good morning. So my first question is basically on pref issuance and redemptions considering your SCB results that came out. I just wanted to know, considering everything, how you're thinking about that for this year and then going forward, and then I'll follow up with another question.

**MIKE VERDESCHI:** Sure, Hima. So no real change in how we approach the pref question. We're running close to that 150 basis points of RWA that I've talked about in the past, so that level remains relevant, in addition to other factors, such as how our balance sheet may evolve and taking into account the environment that we're operating in. Then we'll evaluate those calls that are coming due first based on the



need for that capital. And assuming that we did need it, then we'll look at the economics associated with simply leaving that security outstanding versus calling it and then replacing it. So the very same approach that we've been talking about, but I think obviously as Mark talked about, a period of uncertainty, we do have to evaluate how that balance sheet may evolve over time.

**HIMA INGUVA:** Okay. Great, got it. And then the next one is on subordinated debt, and I know I've been asking this question many times on the call. The reason I'm asking it again is because we are living in a very different environment, and considering your macroeconomic outlook, any risks there if you see a change in the way you think about need for issuing subordinated debt?

**MARK MASON:** I'm sorry, Hima. I couldn't make out the last part of your question. Can you repeat it, please?

**HIMA INGUVA:** I'm sorry. The question is around need to issue sub debt, if you see a reason or opportunity to issue subordinated debt going forward. Sorry. Was that clear?

**MIKE VERDESCHI:** Hima, so yeah, that's clear. Even there I talked about a level of around 200 basis points of RWA, and we've been running well in excess of that level. And even when you look at the breakdown of that, it is something that we've been paying attention to. The sub debt securities alone have us a bit over that 200 basis points. But as we've added reserves, that's now added another, call it, 40 basis points or so. So we're well in excess of the level that we had targeted.

So I would still say same answer, that there's really no need for that additional issuance at this time. But again, we never want to say never. We'll always talk about remaining opportunistic and evaluating where there is opportunity, but I would note that we're well in excess of that targeted range.

**HIMA INGUVA:** Great, thank you very much.

**MIKE VERDESCHI:** Thanks, Hima.

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

**ROBERT SMALLEY:** Hi, good morning. Thanks for doing the call, a couple questions on issuance also. You said you've done 18 to 25, the majority, if not the remainder, from the HoldCo. When I look back last year versus this year, you're running about a \$9 billion surplus – excuse me, increase to the surplus that you ran last year. Is there a reason for that? When I'm looking at TLAC that's coming off, I'm seeing maturities from the second half of next year coming into this year – coming in now. So there's a lot of disqualification, but I really don't see a lot of callable debt between now and the end of the year. So does that inform your thinking at all?

And I also just wanted to ask on a separate note, if you could talk a little bit about what's going on in Mexico in terms of the economy, how that's impacting your portfolio, and how that stands out versus the general economy in Mexico and what you're doing to insulate yourselves there.

**MIKE VERDESCHI:** Sure, so I'll take that first question around the issuance. And just to give some broader perspective on it, first, starting with the bank, if you go back to the beginning of the year, our expectation was that we would be in and around \$25 billion of issuance in some combination of bank and non-bank. And of course, with the great deposit growth that we've seen, over and above what we've needed for loans, we've just not had that need to issue out of the bank at this point. And so, as you noted, we definitely weighted it towards the non-bank issuance.

And when you think about that non-bank issuance, we're in a good position right now. We've seen an increase in our LCR, our TLAC buffer. I've talked about a range of \$7 billion to \$8 billion. Even as we went

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into the year, that was probably double that targeted range in terms of what we had as a surplus, and now of course we're looking at \$30 billion-plus of that TLAC surplus.

So one of the things that we're looking at, we're obviously going to be mindful that TLAC will decay and call it maybe \$10 billion over the remainder of the year. Another thing I'll be looking at is that leverage relief that will be expiring at the end of the first quarter, and again, these things are out there a bit. We certainly have some time, so we do have the flexibility around our issuance program. But that being said, we've always talked about being opportunistic. We'll evaluate what our investor preferences are. We'll be evaluating how spreads are performing. And so we certainly leave ourselves room to continue to issue despite being in a favorable position from that TLAC as well as from that liquidity perspective. Mark, maybe on the...

**ROBERT SMALLEY:** Before the next question, just a quick follow-up. Any reason that you haven't done a 30-year lately like most of your peers have?

**MIKE VERDESCHI:** No. You know what, I think there's no real reason for that. I think clearly, what you saw us do early in the crisis is we did issue longer-term. We did that 20-year transaction. That really was a function of the front end of the curve being dislocated. So we did have a preference to issue further out on the curve as we did 10 and 20-year. But really it's just going to be a function of what our needs are and where our investor demand is. So we'll always look at the 30-year as well and see if there's a need out there and what that client, what that investor preference may be. But hard to know exactly what those plans may be over the rest of the year. We'll be evaluating opportunities, as I mentioned earlier.

**ROBERT SMALLEY:** Okay, sorry to interrupt on the Mexico.

**MARK MASON:** No, that's quite all right. And I think, Mike, I was going to add one point. I think Mike hit it, which is this is obviously an ongoing assessment of our needs, and we try to be opportunistic as it makes sense to do so.

With regard to Mexico, let me make a couple comments. One, I just would point out that we have a very strong franchise and position in Mexico. Across many products that we offer, we're number one or number two, whether you look at deposits or lending products, et cetera, et cetera. And we've been very disciplined around the target market client that we've been focused on. And as you know, we've made a considerable amount of investment into our franchise over the past couple of years, and that's investment in kind of building out some of our branches, but equally important kind of enhancing our digital capability and our mobile offering, which in a time like this is certainly proving to pay dividends.

As you point out, there's certainly GDP contraction that's going on in Mexico. It's undeniable. There's a slowdown in industry volumes that in many ways are exacerbated by the COVID-19 situation, and we're seeing cases grow, and unemployment is likely to increase. And so as a result, we're watching the macro very closely. We've put assistance programs in place for our cards customers, for our mortgage customers, for our personal loan and payroll loan customers, as well as small business banking. And those include deferrals of minimum payments and temporary rate reductions and fee waivers and the like.

I'd point you to we are seeing kind of a flight to quality as it relates to deposits. Our deposits have grown in Mexico, both on the Consumer side, which are up about 9%, as well as the Institutional side, which deposits there are up about 20%. And so continued client engagement, which I think is very important, but we've seen that through this crisis.

And then I'd also mention that when you look at our exposure in Mexico, it's important to put that in context. And so we've got about \$31 billion of kind of funded exposure as of the end of the second quarter across both the GCB and the ICG. That's call it roughly 5 percentage points, if you will, of our total loans. About \$13 billion of that are consumer loans, about \$18 billion are corporate loans.



And when we look at the consumer loans, 56% is in cards and personal loans. And there we're targeting a higher-quality customer segment, certainly higher than many of our local peers, and they're priced accordingly, and a higher percentage of transactor clients. And 80% of our payroll loans are concentrated in sectors that have a lower risk of layoffs. So think about government employees and pensioners and think about that in the context of my earlier point around rising unemployment. And another 25% of the portfolio is in mortgages, for example. And in our mortgage portfolio there's an average LTV of less than 50%. So again, focused on high-quality customers, but also structuring the portfolio to manage the risk accordingly.

On the corporate side at \$18 billion, roughly half of those loans are basically a traditional corporate lending book. And so those are the large Mexican companies and subsidiaries of large multinationals that domicile outside of Mexico. So again, staying core and true to our strategy, a large percentage being investment-grade, and roughly 40% of the corporate loan portfolio has a maturity that's less than a year.

And so I highlight those dynamics to not only support the idea that we do have a strong franchise but we have a high-quality franchise. That doesn't mean that it's not without or that it's without risk, but we feel good about the reserve levels that we've built, and we'll continue to kind of manage that very closely. And our view is that longer term, we continue to be optimistic about the opportunities in Mexico just given competitive labor markets, given the continued expansion of its middle class, given the under-penetrated banking sector, and in particular our corporate clients as they begin to reevaluate and reposition their supply chains coming out of this crisis. And so I think there are a number of things to highlight there, which I feel like I've done, but it's not without risk but we're managing that very, very closely.

**ROBERT SMALLEY:** Thank you. That level of detail is greatly appreciated. That's very helpful.

**MARK MASON:** You're welcome.

**ROBERT SMALLEY:** And thanks for doing the call again.

**MARK MASON:** You bet.

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

**BRIAN MONTELEONE:** Hey, good morning.

**MARK MASON:** Hi, Brian.

**BRIAN MONTELEONE:** If I could follow up on the preferred question, so when I think about – there are a couple of preferreds that come up for first call later this year, with the resets of LIBOR-plus somewhere between 400 and 450 basis points, which in the current context of the market seems neutral to marginally expensive. Can you talk about like how you think about evaluating economics? But also are there any other factors such as what's going on with LIBOR going away or anything else that will kind of factor into that economic decision when it comes?

**MIKE VERDESCHI:** Brian, so really those are the types of things we'll evaluate. Certainly the economics, as you point out, the spread, we know spreads have moved out quite wide across the industry and across all issuers, for that matter. And while we've seen with the Fed's actions to add liquidity to the system and introduce new facilities, that has been a big contributor to spreads coming in, but they are still widened. And so you're right, when we look at the prefs and the opportunity to call, we will be doing, as you indicate, looking at the spreads on the existing structures and evaluating, if we wanted to maintain them, what it would cost to replace. And to the extent things are wide, that will be certainly a key factor.

The other point is yes, is that we'll be looking at other factors like LIBOR transition and fallback language, and that would be another consideration. And keep in mind that these calls they're quarterly, so there's a call that would be coming up. And then obviously, if we decided to not call, there would still be opportunities



to call in the future. So I think you described it well. There are the economics and then there are other factors too that we would always be looking at.

**BRIAN MONTELEONE:** Great, thanks, Mike. And then I appreciate all the kind of color and detail around the business in Mexico. Do you guys have what credit losses to loans are in Mexico versus maybe other books, maybe like versus the US book or the aggregate credit loss to loans across the business?

**MARK MASON:** Look, in Mexico we have, let's take the cards portfolio for example. The Mexico cards portfolio, we have reserves against balances that are roughly plus 20%, so 23% or so in terms of the reserve levels. And in a way, that is tied to kind of the structural losses that we tend to see in Mexico. And frankly, the margins and the pricing around that also kind of correlates with the structure of performance that we see there. So reserve levels or reserves to balances are higher certainly for the Cards portfolio in Mexico relative to what we show in the US.

**BRIAN MONTELEONE:** Got it. Thanks, Mark. I appreciate it.

**MARK MASON:** Yes

**OPERATOR:** Your next question is from the line of Gary Kessler with Goldman Sachs Asset Management.

**GARY KESSLER:** Good morning, thanks again for hosting the call.

**MARK MASON:** Good morning.

**GARY KESSLER:** Another follow-up on preferreds. Related to structure and as you think about accessing this market again, so far you've issued a SOFR reset and given the market has moved more towards this five-year CMT structure, is there anything that would make you hesitant to issuing that structure just in light of ARRC committee obligations or any other focus on the SOFR as a replacement benchmark, or would you consider kind of going with an industry norm?

**MIKE VERDESCHI:** Sure, thanks for the question. As I said before, when we've done these structures and issuance in general, there are a couple of factors that we consider. Certainly, the LIBOR transition and being supportive of the new benchmarks that have been established, so that has been a factor. But of course, we're going to be responsive to what our investor needs are and what they're looking for. And we recognize with SOFR moving lower that there may be some preference for CMT. That's certainly something we would consider in our structures going forward. So we want to be supportive of that LIBOR transition, but at the same time we're going to be responsive to our investor appetite as well.

**GARY KESSLER:** Great. And I had one other question, and this is around CCAR and the resubmission process, and what would you comment on, if you can, on anything? We've got maybe a few blurbs on the timing, but any other thoughts on your approach to resubmission, what you're focused on? Anything related to capital returns, or do you think that is just completely off the table until next summer?

**MARK MASON:** Sure. Why don't I take that. So there isn't a lot of new information beyond what's out there publicly in terms of the timing. So as we currently know it, we would expect to get scenarios by the end of September and have some 45 days or so to respond from when we do get those scenarios. And that the balance sheet data is likely to be as of the end of June, so June 30 I think is what's been stated. I would imagine that the stress scenario would be more reflective of the current environment we're managing through and the stresses associated with this crisis. And we will obviously work to prepare to make sure that we can adhere to all of the submission requirements.

I think what I'd say is I kind of go back to the first question. Just as I look at our position going into it, I feel good about our position going in. We've got an 11.5% CET1 ratio. If you look at kind of, we added a page, I think it's page 30 in the back of the deck, that kind of just shows how that compares relative to the minimum

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requirements. In the case of a standardized approach, we're 170 basis points above that minimum, 150 basis points on an advanced basis. That's another \$19 billion of capital above the binding requirement. And we feel good about the balance sheet that we have kind of going into the scenarios. And even when you look at the last submission and what's been reported publicly, while our SCB was at 2.5%, that was the floor. We got floored at that level.

And so when you look at the peak-to-trough losses plus dividends, it was closer to 1.9%, suggesting that there's room there to absorb lower PPNR or higher stressed losses before we would have gotten to that 2.5% floor. Now all of that said, hard to know exactly what those scenarios will look like that we get at the end of September, but we feel good about where we stand going into it.

In terms of the latter part of your question on capital returns, as we've stated before, we're managing through a crisis. We're managing through an uncertain period of time. The industry took some actions earlier in the year as it relates to buybacks. We've been very clear of our intent to continue to pay dividends. And we feel as though we've demonstrated performance through this crisis that supports that. And we expect to continue to do so, obviously subject to board approval.

**GARY KESSLER:** Great, thank you so much.

**MARK MASON:** Thank you.

**OPERATOR:** Your next question is from the line of Scott Cavanagh with APG.

**SCOTT CAVANAGH:** Thanks, guys, for having the call. It's always greatly appreciated. I just wanted to circle back onto the cards. So just for comparison versus your peers, could you further break out your macro assumptions for CECL, going beyond fourth quarter, so unemployment for fourth quarter? And then fourth quarter of the next year and the following year, just so we can kind of get a sense of how you guys are positioned in your outlook versus others?

And then looking at the experience in your Branded versus Retail Cards, can you just delineate what you're seeing in the difference there? And then on the retail side, given all the distress with retailer distress and the advent of CECL, how are the conversations going with these retailers? And are there any big retailers' portfolios that are up for bid in the near term?

**MARK MASON:** Okay, you'll certainly remind me if I don't get everything there. Okay, so thank you. So first let me start with the scenario, which as you know is critically important to forecasting the CECL reserves, but is also something that certainly moved a great deal through the first quarter and continues to evolve given we're still managing through this crisis. What we've assumed as we look at the scenario is the second quarter, we kind of assumed unemployment peaking at about 15%, GDP falling 35-plus percent quarter over quarter.

And as I've said before, what's important from here is the shape and the pace of the recovery, and obviously how significant a second wave is, and all of those things come into play. As I look at our base scenario, we have GDP recovering sequentially in the third quarter. And so call it full year 2020 down 5%, and unemployment recovering to under 10% by the fourth quarter of 2020, and down to a level of 7% by the fourth quarter of 2021. Now, that assumes that any potential second wave is well-controlled, that there's an appropriate fiscal response if needed to maintain kind of a healthy pace of recovery.

I think the important thing, as I mentioned earlier, is there continues to be a significant amount of uncertainty. In our approach to CECL, we consider the probability of alternative downside scenarios, and we build additional reserves as appropriate. And so in the case of the \$28.5 billion that we have in allowance for credit losses that I referenced earlier, that includes \$2.2 billion to account for – \$2.3 billion roughly to account for the possibility of a more adverse outcome. And so hopefully, that gives you a sense. We have



a scenario. We realize that it's hard to forecast with precision. So we look at alternative scenarios and come up with an estimate for the uncertainty, and then we build on top of that.

In terms of your question around the Retail performance versus the Branded performance, I'd make a couple of comments I guess. One is that again, the quality of those books has evolved certainly since the last crisis. And again, we focus on some of the higher FICO scored customers.

Similarly, the important driver, probably one of the most important variables on the Consumer side is what we're seeing in the way of unemployment. In this particular case, as you know, we have additional factors such as the stimulus and the forbearance plans that we put in place, and those will impact how things move through the delinquency buckets. And so we're not seeing in either of those portfolios increases in our 30 to 89-day buckets as people have – are benefiting from the forbearance activity that is there. We are seeing people continue to pay that are part of those relief programs, and we're seeing people as they come out of those relief programs continue to pay. I mentioned earlier that 80% of those that have come out of the programs are continuing to pay.

What I would highlight in addition to that is on the Retail Services partner side, it's important to remind ourselves that the nature of those relationships are – we're not only partners but we work very closely with these corporate partners in how they're running their businesses. And so through this crisis, we've been very engaged on how they think about things such as their digital online offerings and the like. And they've been different for different partners who have – some of whom have continued to operate as they've been declared essential, others of whom have worked on strategies where they've had pickups as the stores manage through closures, and we've been part of that dialogue.

I think the other important thing is that there's sharing that goes on with these partners, and that flows through the economics and P&L that we reflect in. That sharing also pertains to losses. And so while we build these reserves for our Retail Service partner programs, the ultimate losses that play through, we share with those partners. And that sharing flows through on an adjustment to the revenue sharing that we would make. And so think about the reserves associated with the Retail Services program as being roughly 35% to 40% of what ultimately played out in the way of NCLs would be picked up by the partner. And so hopefully that gives you a little bit of a sense. I'm not sure if I missed any components of your question, but I'm happy to address it if I did.

**SCOTT CAVANAGH:** No, no, that's perfect, and I really appreciate the additional disclosure this quarter and color. It's very helpful. One thing I'd note that others have been putting out, the payment trends looking across their portfolios. That might be a helpful addition to your presentation just to give a sense given you're such a big credit card player, there just to see what trends you're seeing. That would be helpful for us.

**MARK MASON:** Yeah, let me comment on that because we have talked to that in the earnings call just in terms of purchase sales activity. I'm sorry, you were referencing payment trends...

**SCOTT CAVANAGH:** All of the above.

**MARK MASON:** All of the above. So just first on purchase sale activity, we've referenced how we've seen that trend go from the high 30s, if you will, across the entire portfolio in April, that is to say down as much as 30-plus percent in terms of purchase sale activity to end of June and through July kind of being in the low to mid-teens. And so we are seeing good traction there. We'll see how it plays out as spikes tend to occur or are starting to occur in certain parts of the US, but we have seen a positive trend there.

The point that I'd make on your payment question is that there too, I think I've pointed to the idea that, or the fact that, we are seeing continued payments of people that are both on the forbearance programs, as well as as they've come off. And so people – customers who are not contractually obligated are continuing to pay. And we've seen 40% to 60% of customers enrolled in consumer relief programs across the globe continue to make payments. So almost 50% of our Branded Cards and 40% of Retail Services, almost 60%



of Mexico card customers, more than 40% of our Asia-Pac card customers, 50% of our mortgage customers. So a high percentage of customers that have signed up for these programs continuing to make payment, which again, we think is a good sign as we sit here today. So hopefully that helps.

**SCOTT CAVANAGH:** Very much so. Thanks again, I appreciate it.

**MARK MASON:** You're welcome.

**OPERATOR:** Your next question is from the line of Mark Kehoe with MacKay Shields.

**MARK KEHOE:** Hi, good morning. I just had two questions, one rather vague. I just wondered whether you could comment on, given the unprecedented liquidity injections by the Fed and the use of the banks to provide that kind of liquidity to the economy. What do you think regulators going forward look more on liquidity regulations and supercharge those rather than look at capital for recognizing kind of the role of banks has changed post this crisis? Thank you.

**MIKE VERDESCHI:** Mark. Look, I think it's hard to say how their views may evolve. I think when I think about the pre-financial crisis and post-financial crisis, the amount of work that's gone into, both internally and sort of from a regulatory perspective, building metrics-based frameworks that are rolled out broadly, I think that's really so well embedded in the financial institutions and how they operate today, both again informed by regulation and of our own standards that it's hard to see how that evolves.

Clearly, you raise a good point where there's a lot of liquidity that's been put into the system, and you could see we're running quite high on deposits, and a lot of that liquidity has been either left at the central bank account or used to purchase securities. And so very high liquidity cushions, but at the same time there's going to be a focus on how we manage those capital levels and then how we think about how that capital performs in stress, as informed by CCAR and of our own evaluation. So I think side-by-side, it's going to remain critical that we evaluate both. I expect our regulators to continue to evaluate both quite carefully. So I think that's going to be very much a continued focus.

**MARK MASON:** I think that's right, Mike. I think that – look, there will be a lot of lessons learned when we do get out of this crisis. I'm encouraged by the fact that the industry came into this crisis in a much stronger position than we went into the last one, and I certainly feel that way about our firm. That has allowed for us, I think, to be helpful in shoring up the economy and importantly working very closely with our clients, working with our clients as they manage their uncertainty and shore up liquidity, but not just with our balance sheet but also in facilitating their access to the markets.

That's also allowed for us to work closely with the regulators as they've provided liquidity into the markets and have made appropriate adjustments to some of the regulations to ensure that there can be a collaborative effort to shore things up. And I would imagine coming out of that, as I mentioned, there will be lessons and adjustments and different ways that we want to think about how we manage the capital markets and the impact that it can have on the global economy. But it's premature to speculate how that will ultimately play out.

**MARK KEHOE:** And just lastly then, have you mentioned your macro assumptions for both Mexico and Latin America in terms of the GDP decline expectations you have for the reserve build?

**MARK MASON:** I have not. I did not mention that and do not intend to at this point. Obviously, there's pressure, as I mentioned, that continues to exist there. But that's all factored into the reserve levels that we talked to.

**MARK KEHOE:** Great, thank you.

**MARK MASON:** Yes.



**OPERATOR:** Your final question comes from the line of Jeff Bernstein with Insight Investment.

**JEFF BERNSTEIN:** Hi, just a short question. Most of my questions have been asked and answered. Regarding your macro assumptions for reserving, what did you assume for the stimulus that's expiring in a few days?

**MARK MASON:** So we didn't have an explicit assumption around that. But as I mentioned, we assumed that there would be continued support in order to ensure a smooth recovery, if you will. And so that is to suggest that if there was a need, which obviously there is or it's been determined that there is, then we would have accounted for it. But we didn't explicitly have an assumption around more stimulus activity.

**JEFF BERNSTEIN:** Thank you. And lastly, I realize that CECL wasn't designed to have macro assumption changes every quarter, and this is an unusual time. But as things hopefully settle down, even if your macro assumption should change, not you but everyone's macro assumption should change up or down slightly, is that going to change reserves on a quarter-by-quarter basis?

**MARK MASON:** Let me try to answer your question. And again, if I don't, just ask me again. So the way I think about this is that you're right, I don't think we contemplated significant moves in these assumptions quarter to quarter. And to the extent that the forecast that we have for the economic scenario and the variables here play out as we have forecasted them, you would expect that the reserve levels would move in tandem with the NCLs. So with the losses that start to play out, with probably the one exception, one important exception, which is how balances change.

So to the extent that we start to build new loans, there obviously would be new lifetime reserves that get established for that new lending activity. But all other things being equal, you wouldn't expect significant movement in the reserve levels. Now as we saw in the second quarter, if those variables move or the view of that outlook deteriorates, that ends up with a different outcome. So hopefully that addresses your question.

**JEFF BERNSTEIN:** It does, thank you very much.

**MARK MASON:** Great.

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

**TOM ROGERS:** I'd just like to thank everyone for joining the call today. And of course, if you have follow-up questions, feel free to reach out to us in Investor Relations. Thanks.

**OPERATOR:** Thank you for your participation. At this time, please disconnect.

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