TRANSCRIPT

Citi Fourth Quarter 2020 Fixed Income Review

Friday, January 29, 2021

On February 26, 2021, Citi announced that, as a result of new information Citi received subsequent to December 31, 2020, it adjusted downward its fourth quarter 2020 financial results, from those previously reported on January 15, 2021, due to a $390 million increase in operating expenses ($323 million after-tax) recorded within Institutional Clients Group, resulting from operational losses related to certain legal matters. The financial impact of this adjustment lowered Citi's fourth quarter 2020 net income from $4.6 billion to $4.3 billion and earnings per diluted share from $2.08 to $1.92. The financial impact of this adjustment is **not** reflected in this fourth quarter 2020 fixed income investor review transcript, dated January 29, 2021. For additional information, including Citi's fourth quarter and full year 2020 results of operations including this adjustment, see Citi's Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission on February 26, 2021.

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 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. We ask that you please limit questions to one question and one related follow-up. 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 take a variety of factors, including the cautionary 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.

Before I turn it over to Mike to walk through the presentation, I'd like to make a few comments about the frequency of the Fixed Income investor reviews going forward. First, I would say that we truly value the engagement of our Fixed Income investors, both during the Fixed Income Investor Reviews and outside of the reviews. And while we feel the investor review calls are a great opportunity for our investors to engage with us in a public forum, at this point we believe hosting the call two times a year is most appropriate. So going forward, we would envision one call occurring after fourth quarter earnings and one call after second quarter earnings. However, we would, of course, host a call outside of this schedule if there are updates that we believe our investors would benefit from. Again, we value the engagement and do not plan to be any less engaged with our investors, though the nature and timing of that engagement will continue to evolve.

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 2020 operating results. Second, I will cover recent balance sheet trends. Third, I'll review our issuance programs. And finally, I'll discuss our continued strong liquidity and capital position.

Slide 3 summarizes our results for the fourth quarter and full year 2020. In 2020, we reported net income of $11.4 billion, even as we increased our reserves by roughly $10 billion under the CECL framework.

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 15% 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.

In the fourth quarter, deposits grew in line with recent trends, with continued momentum in consumer and continued client engagement in our institutional business. Loans declined, reflecting lower levels of consumer and corporate activity. Trading-related assets and liabilities grew, reflecting a continuation of heightened client activity relative to the prior year. And long-term debt increased year over year but decreased sequentially, as we maintained our robust liquidity profile and optimized our funding, given our strong deposit growth.

Slide 5 presents trends in our loan portfolio on an average basis in constant dollars. Total Citigroup loans decreased 4% year over year. In our consumer franchise, average loans declined 6% year over year, primarily reflecting the impact of lower consumer spending in our Cards business and higher payments by customers given high levels of liquidity due to fiscal stimulus.

In our institutional franchise, average loans decreased 3% year over year. Breaking that down by business, average loans in Corporate Lending decreased 6% year over year, reflecting net repayments as we continued to assist our clients in accessing the capital markets. Private Bank loans increased 6%, largely driven by secured lending to our high net worth clients, including residential real estate lending. TTS loans decreased 10%, reflecting softness in underlying trade flows and the continued low level of spend in commercial cards. 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 ICG, credit quality remained broadly stable. In the fourth quarter, non-accrual loans declined sequentially to $3.5 billion or 91 basis points of total loans, reflecting write-offs and repayments across the portfolio. In GCB, credit trends remained broadly stable to improving this quarter, given high levels of liquidity in the US, lower spending, and the benefits of relief programs.

While we do expect losses to begin to rise in 2021, given today's delinquency trends and the expected impact of recent stimulus, we now expect peak loss rates to be pushed out for the first half of 2022, with losses in Asia and Mexico peaking earlier than in the US. That said, with credit reserves of $27.8 billion, we believe we are well prepared for expected credit losses across both our consumer and institutional portfolios.

Turning to slide 7, we show trends in average deposits over the past five quarters in constant dollars. Total average deposits increased 19% from the prior-year period, reflecting continued client engagement as well as the elevated level of liquidity in the system.

Now, let me cover our parent benchmark debt issuance program on slide 8. In 2020, we issued approximately $20 billion of parent-level benchmark debt across a variety of tenors, including the issuance of our inaugural $2.5 billion Affordable Housing bond. So far in 2021, we issued roughly $2.5 billion. 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. As I just mentioned, in 2020 we issued approximately $20 billion of parent benchmark debt with $20 billion of maturities. Looking to 2021, we expect gross issuance of roughly $15 billion to $20 billion. And we will maintain the flexibility to optimize our funding through opportunistic redemptions.

On slide 10, we show the composition of all long-term debt outstanding. During the fourth quarter, our total long- term debt declined by approximately $1 billion to $272 billion, as we allowed our bank debt to mature, given strong deposit growth.

On slide 11, we provide an update of our LCR metrics and drivers. Our average LCR was unchanged at 118% this quarter.

Turning to slide 12, let me summarize our key regulatory capital metrics. Our CET1 capital ratio increased to 11.8%. And our SLRs were 7% and 6.7% for Citigroup and Citibank respectively.

Moving to our last slide, let me summarize several key points. In 2020, we demonstrated the significant earnings power and resilience of the franchise. We earned over $11 billion of net income, even as we increased credit reserves by roughly $10 billion. We maintained a strong capital position with a CET1 capital ratio of 11.8%, 180 basis points above our regulatory minimum requirement, an SLR of 7%, and a surplus above our TLAC requirement.

And we also maintained a strong liquidity position with an average LCR of 118%, over $970 billion of available liquidity resources. And we expect to be in compliance with the NSFR when the rule is effective. Our capital and liquidity profile remains strong and well positioned to withstand potential pressure if economic conditions deteriorate. And we continue to 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. As many of you on this call are aware, there have been some additional developments since the third quarter Fixed Income investor call. Subject to the results of the IBA consultation, it appears likely that most US dollar LIBOR tenors will continue to be published through June 2023. At Citi, while we are continuing to work with our regulators and various industry working groups, including the Alternative Reference Rate Committee, to ensure a smooth and timely transition, we do appreciate the flexibility this affords.

With regard to the subset of our preferreds, which we have mentioned on previous calls, while we are continuing to evaluate alternatives, we don't have any further updates at this time.

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 Hima Inguva with Bank of America.

HIMA INGUVA: Great, good morning and Happy New Year.

MARK MASON: Good morning.

MIKE VERDESCHI: Good morning, Hima.

HIMA INGUVA: Good morning and thank you for hosting the call, Mark. Good morning again, Mark, Mike, and Tom. I really appreciate the disclosures and the opportunity to have the dialogue.

I'm going to start off with SLR. So when we are thinking about SLR and how moving from a backstop to being a binding measure, would that impact the way you think about capital returns? And then in line with what your peers have commented on, just maybe if you could give us some color on if you see retaining more equity or maybe issuing more debt or perhaps. And also if you could please suggest if TLAC would be more binding that SLR in that case. So if you could kind of help us parse it out, that would be great.

MIKE VERDESCHI: Sure, Hima. Thanks for the question. Certainly an area of focus, given SLR and TLAC exemption for reserves and Treasuries are set to expire at the end of 1Q. The short answer is that SLR would not become binding for us, and so will not impact our capital return or even the prefs at this time.

For SLR, the exemption is worth roughly 110 basis points. So all things equal, that 7% SLR would come down to 5.9%, so still 90 basis points above our regulatory minimum. And we are assuming our continued growth of the balance sheet, driven by deposits, but that 90 basis points of room gives us an opportunity to continue to grow.

In terms of TLAC, again with the exemption ending at 1Q, our binding constraint would flip from RWA to leverage. And in leverage, as of 4Q, we have a TLAC surplus of $32 billion. So that exemption is worth roughly $20 billion. So if it does expire, that surplus comes down from $32 billion down to $12 billion, which is still above our $7 billion to $8 billion targeted range. So our issuance plans do assume that exemption ends at 1Q. And the issuance plans also consider the balance sheet growth that we expect to see in supporting our clients. So the impact on TLAC, of course, is something that we'll be focused on, and hopefully that gives you a sense of the implications.

But taking a step back, just a few other thoughts. The Fed appropriately reintroduced quantitative easing measures as COVID unfolded early last year. At that time, the QE actions were meant to add liquidity to address the market dislocation at that time. The Fed of course has maintained QE after markets have even stabilized and shifted that focus to using the accommodative stance to support employment and inflation goals. The byproduct of these policy actions is that liquidity in the system has grown and will remain elevated.

So giving you some context, the Fed grew its balance sheet by about $3.2 trillion in 2020, which drove industry deposit growth of about $2.8 trillion or a little over 20%. So that kind of deposit growth has implications on leverage and those key measures such as SLR and the G-SIB score as well. So with monetary policy remaining accommodative, the exemption of reserves and Treasuries would still very much make sense given where so much of this liquidity is being deployed.

MARK MASON: Mike, I'd add one point to that, which is I think, one, we still feel good about the ability to continue to return capital, so I would make that point. And then two, I think the Fed has been, as you described, Mike, very thoughtful and constructive about providing this relief. And I would hope that they give additional consideration around extending it or even making it permanent, and also taking a look at the G-SIB score, given the amount of liquidity impacts that score as well.

HIMA INGUVA: Great, I appreciate it. I also want to recognize all the efforts that you're doing in terms of diversity and inclusion, and it's very good to see all that in the news. So I appreciate that. With that, I'm going to pass it on.

MARK MASON: Thank you, Hima. I appreciate it.

MIKE VERDESCHI: Thanks, Hima.

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

SCOTT CAVANAGH: Good morning, guys. Thanks for the call. Before going to the questions, I just wanted on your announcement about moving to two calls per year, I would say that we very much appreciate your industry-leading outreach with Fixed Income investors, particularly these quarterly updates and presentations. And I would encourage the continuation or at least keeping up the overall high level of engagement because I think it pays benefits even with current spread levels being so tight.

Going on to questions, perhaps we can dive into looking at the overall health of the consumer, particularly in the credit card portfolio. Could you give us your expectations for net charge-offs on both the retail and branded card portfolios for 2021 and 2022? And then could you dovetail that into what are you seeing as far as differentiation across the FICO bands in these portfolios? I'm really trying to get at, is there a differentiation between higher scores and lower scores? And given the expected runoff of a lot of the COVID relief efforts and the pending eventual having to pay rent again for some people and then having to pay student loans again, is there kind of a risk for a cliff effect there and impact on net charge-offs?

MARK MASON: Thank you, Scott. Why don't I take that. First of all, I would say that we very much value the engagement with you all as investors as well, and so we look forward to continuing that.

Secondly, with regard to the consumer, it's interesting. The consumer, again, has proven to be incredibly resilient through this, and obviously the stimulus that's been provided has been helping to bridge consumers in a substantive way. When we look at the performance that we've seen through the fourth quarter, we continue to see payment rates run at a very good level. We saw a pickup in purchase sale activity, or certainly not down nearly as much as it was earlier in the year. And that's really across both portfolios, both the branded cards as well as the retail services portfolio, so not a lot of distinction between the two in terms of that positive activity.

As you would have seen in some of the cost of credit information, we've also seen delinquencies remain quite low in the portfolio. And it's really the signs that we're seeing there of consumers' continued ability to pay and lower delinquencies that lead us to believe that we're more likely to see losses peak, no longer in 2021, but more likely in 2022, just speaking more broadly around the portfolio. That's going to vary depending on region. But for the US portfolio, that's been pushed out more likely to 2022.

Now, the reality is that there is continued talk of an additional stimulus. And to the extent that additional stimulus are put out there, that is likely to have a continued impact. The good news with the additional stimulus, assuming similar behavior, is that payments continue. The downside to that is that puts pressure on loan volume. And so net-net, we think losses more likely in 2022 at this point. Additional stimulus could impact that. And in fact, additional stimulus could end up not only delaying peak losses, but also deflating peak losses. And so we kind of have to see how some of that plays out, but thus far we feel very good about what we're seeing and in fact continue to look at these behaviors for signs for when we should enter or reenter the markets, so to speak, with marketing and programs that lead towards acquisition… at least for our card customers.

SCOTT CAVANAGH: That's very helpful. On the funding side, could you give us some guidance on what your expectations for potential additional green or social bond issuance, and then where you stand on the investments for the recent Affordable Housing bond issuance?

MIKE VERDESCHI: Sure. So, Scott, it's Mike. I think on that, we were very happy with the two green bond issuances that we've done, again, starting in 2019 and then following up with the dollar-based green bond in 2020. Of course, we wanted to expand beyond that, and so we introduced the Affordable Housing bond last year. And so we do very much want to remain active in this space of ESG, and so we'll look at other structures. We'll look at the potential to come back and tie the green bonds or for another social as well. So this is very much something that will be a focus of ours.

Of course, when we look at this issuance, we look at this issuance in the context of the broader needs. Obviously, we're going to be taking legal entities into account, tenor into account, investor demand, but it is something that we want to continue to stay active in. And so with the housing bond, of course the proceeds for the transaction finances construction, rehabilitation, or preservation of quality affordable housing for low and moderate income populations in the US. So that's where the proceeds are used. And of course, as I mentioned, we want to remain active in the space of issuance.

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

GARY KESSLER: Hi, thanks. Thanks for taking my question.
MARK MASON: Good morning.

GARY KESSLER: I appreciate the call as always. Good morning.

MIKE VERDESCHI: Hi, Gary.

GARY KESSLER: I just wanted to touch on the prefs again. So you guys have – not LIBOR, I think we all bought ourselves a little bit of time there, but more on some of the decision-making. And it was helpful to get the conversation on the SLR, thinking about the 2020 December CCAR and the redeem-without-replace option. And it looks like with what you did issuance-wise in December and what you're calling out, it looks like maybe you'll go a little bit below 1.5%. And sort of what's the target there in light of the CET1 cushion as well as other constraints?

And when you think about the refinancing decision, when you look at the two callable pieces of paper that you have left on the institutional side, those are both – economically could be refinanced. And so should we be thinking about, purely about the reset? And when you think about replacing, potentially re-fi and different structures, do you think more, when you think about say a non-call 5-year versus a non-call 10-year, do you care more about coupon optionality, the back end? How should we be thinking about these things?

MIKE VERDESCHI: Sure, thanks for the question. In the past, we've talked about a target of roughly 150 basis points. And so where we end the quarter, we're probably more like 160 basis points. So that range, that target of 150 basis points is still something that we do think about. And as you point out, obviously we issued late last year, and use that as an opportunity to call structures. That was an economic decision. And as we look at our structures, as we've talked about in the past, as they become callable, we'll continue to first look at the need for maintaining that capital outstanding. And if so, we'll look at the economics associated with leaving that structure outstanding versus calling it and replacing it with a new structure.

In terms of the structure itself, as you said, the tenor of that call or even the back end setting that we embed, it's really going to be a function of where that investor demand is. So we want to keep a good dialogue and understand where there may be preferences. Of course, you've seen so far in the past as part of that transition away from LIBOR, but more recently CMT, and again that's a function of where perhaps some of the preferences are, obviously with rates very low and some steepness in that yield curve that that five-year CMT seemed to make sense.

So you're likely to see us continue with that same practice of that targeted range of 150 basis points, the evaluation of the economics as well as other factors. And then in terms of structure, we're going to continue to maintain that good dialogue with the investors on what may be preferable.

GARY KESSLER: Great, that’s helpful. Thank you.

MIKE VERDESCHI: Sure.

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

BRIAN MONTELEONE: Hey. Good morning, guys.

MARK MASON: Good morning.

MIKE VERDESCHI: Hi, Brian.

BRIAN MONTELEONE: So it was positive development in New York about moving forward with a LIBOR solution via the legislative route. I was wondering if you could talk a little bit about specifically in New York, if that becomes law, fixing that kind of fallback language, where specifically that helps? And then maybe what other parts of your capital structure might need, something in Delaware, something similar in Delaware, like I think some of the preferreds are covered by Delaware law?

MIKE VERDESCHI: Sure, Brian. It's Mike. In terms of that legislation, I think I've said this in the past. The LIBOR transition, it's certainly a complex transition, and the recognition of coming up with some legislative solutions we think is a very positive development. And you talked about New York, and the prefs would be more applicable to Delaware. But I would say just getting started on a framework for legislation in terms of how that would apply, what is the scope of it, I think is a positive development. Certainly could you see states following once there is a precedent and a framework?

The other thing I would point out too, is there more – is there a development in the federal space as well around legislation? So I think these are the types of developments that are encouraging, and New York on its own may not solve some of the things that we're focused on, on its own. We still think it's a positive development as well as that potential for legislation, the federal legislation as well.

BRIAN MONTELEONE: Thanks, and then maybe a question for Mark. Any thoughts you can give us around the timing of the review that you and Jane are going through around all the different businesses and how you think about investment, et cetera, going forward?

MARK MASON: Sure. Brian, you came across a little bit muffled but I think you were asking about the timing in terms of the strategy for me and Jane. Is that right? Did I get that right?

BRIAN MONTELEONE: Correct. Correct. Yes.

MARK MASON: So look, you obviously heard Jane on the earnings call. She takes the seat end of February, first of March, and so certainly want to give her time to get squarely in the CEO seat. And as she mentioned, we're spending time now and we'll spend some period of time thereafter to really try and do a thorough kind of review.

What I would say, though, is that in some ways you can look at some of the announcements that we put out already and see that we're not waiting when things make sense. So we recently announced the creation of a new Wealth Management unit, which really brings together our Private Bank and our Consumer Wealth organization, which includes the International Personal Bank and the Citi Personal Wealth Management business. It brings all of that together and really moves to create a single integrated platform to serve our clients, clients everywhere from the affluent level straight up to the ultra-high net worth client.

And I simply highlight that to say that while we're working on taking a look at the strategy, as Jane suggested, we're not waiting where things make sense to kind of get off the ground. And so stay tuned. We'll continue to work through it, and it's obviously an imperative for the entire leadership team, with Jane driving it.

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

ARNOLD KAKUDA: Hey, Mark, Mike, and Tom. I appreciate the call. It's always very helpful. So compared to peers, your 11.5% CET1 target seems very conservative. It's 150 basis points above your 10% requirement, and that compares with peers that are maybe looking at a 50 to 100 basis point excess target. So you've done well on the past few stress tests. You talked about this reevaluation process. I think simplification was a word I heard. So is there a chance to evaluate the CET1 target as well going forward?

MARK MASON: So what I'd say is look, we're still – as you know, Arnold, we're still kind of managing through a crisis with some uncertainty that's still out there. And so as I sit here today, I continue to feel good about the 11.5%. When we established that, as you know, we were looking and still had uncertainty around things like the stress capital buffer and how that would play out. We've now seen that both at the 2.5% from the initial submission and an increase of about 10 basis points in the most recent, although that's not being applied.

There's still movement obviously with the G-SIB score that I referenced earlier, which is at 3% for us now, but with the increase in deposits where we're currently running a bit higher than that. And so I feel good about the 11.5%, and we'll continue to look at that as things continue to normalize. But at this stage, that's where we are.

Now, I would remind you or continue to point out that we ended the fourth quarter at 11.8%, which obviously is above that target that we have. And I think we've had a pretty good run rate leading into this crisis of being thoughtful about returning capital at a reasonable pace. And we'll continue to do that, particularly given that the Fed has reinstated the ability to do that in Q1 here. And so we're looking forward to that.

ARNOLD KAKUDA: Great, thanks for that. And then shifting to deposits, the classic teachings I guess are that deposits are good. But in this low rate world where there is lots of liquidity and low loan demand, have deposits become a burden in a sense? Or is there something – is it just the stage of the cycle where demand is low for loans that you want to take on an extra I guess relationship? So are deposits a burden right now?

MARK MASON: I can start and then, Mike, you may want to chime in. What I'd say is we obviously talk to some of the deposit momentum or growth that we've seen across the franchise. And I think there are probably a couple of lenses through which one can look at that. One is, it obviously is a lower cost of funding than some of the other alternatives that one would have. But two is, I think if you look at the nature of the growth that we've had, take for example the US Consumer, it really leverages or demonstrates the payoff, if you will, from the investments we've been making in our digital capability and helps to expand our customer footprint beyond just where we have branches, and so that's good. And as you know, we look to use that to expand our wallet share with those customers.

And the third thing I'd point to is even as we look on the institutional side, where we've had good deposit growth with our TTS clients, it really is and does create a foray to expand the nature of those relationships as well, as they've opened new digital accounts with us and expanded the dialogue to include conversation around their supply chain and things of that sort.

Now, the reality is also the other factor that comes into play here is what you suggested, which is that there is low loan demand, and that is something that we continue to watch and monitor. And the deposits do put pressure on the G-SIB score, and we just talked a little about the SLR as well. And so we'll have to continue to manage that and monitor that, and hopefully we end up with relief as it relates to things like G-SIB. But we're approaching this from a relationship point of view, and we think that's pretty important. Mike, I don't know if you want to add anything to that.

MIKE VERDESCHI: No, nothing to add, Mark.

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

ROBERT SMALLEY: Hi, thanks a lot and good morning, Mark, Mike, and Tom.

MARK MASON: Good morning.

ROBERT SMALLEY: A lot of questions asked and answered, so a couple of follow-ups. On Scott's question on consumers, given that you're seeing in the US probably credit peaking in the first half of next year, will the allowance for loan loss reserves there just remain static for the rest of the year, or could you see releasing some of those reserves as you get a better handle on that? And maybe there are some CECL implications in there that you could talk about.
Second question I had was on slide 22, and it relates to your comments on the rest of the world, Latin American 90 days past dues picking up to 2.5%. Is that what you're seeing and that's why you're saying that peak there will be in the second half of this year? And then I had a question on the IB.

MARK MASON: Sure. Why don't I start with your question with regard to consumer reserves and what could impact that going forward? I guess there are a couple of things that factor into the reserving actions that we take. And so one would certainly be changes in the portfolio, and that is to say recovery in spend, an increase in loan volumes, or even customer behavior and mix. Those things will factor what happens with – factor into what happens with the reserve levels.

The second is kind of the base scenario or even the two scenarios that we look at, so the base scenario, which will reflect the shape and the pace of recovery. And to the extent that we continue to see improvements in that base scenario, with the assumptions GDP, unemployment, et cetera, that will have an impact on our estimate for the lifetime reserves, in this case associated with the Consumer portfolio.

The third would be how we look at the downside scenario. And obviously, to the extent that it's more severe or a higher probability of a downside or a lower probability of a downside, that will factor into how we think about that EUMA, that management adjustment that we've talked about before. And then losses obviously play in as well. As we see those losses materialize, all things being equal, we'd be releasing reserves. So there are a number of factors that will come into play as we see reserves move around in the coming quarters.

What I would say or the final point I'd make on this is that even as we sit here now relative to the assumptions we had for many of those variables when we ended the year, many of them have moved in a positive direction, have improved. And so not to repeat it all again, but that becomes a factor, that shape and pace of a recovery is factored in there. And as I said on the earnings call, I do expect that we'll see improved profitability in 2021, and we're more likely to see releases.

In terms of – and your second question was with regard to Latin America. And what I'd say here is – and I'm looking at kind of the trend that we saw in both NCLs as well as delinquencies. And in the earnings deck, we showed that delinquencies were coming down in the fourth quarter and that our – I'm sorry, that losses were coming down in the fourth quarter, excuse me, and that delinquencies were picking up a bit. And what I'd highlight there is the difference between customers that are on the relief program and coming off versus customers that were never on that relief program. And so what we're seeing in the delinquencies that are on that chart reflects the fact that customers coming off the relief program are starting to flow through those delinquency buckets. What we're seeing in the lower net credit losses represents favorable performance from customers that were not on the relief program.

So hopefully that gives you a little bit of that dynamic. But to answer your question more specifically, it is that trend in delinquencies that give us a view that we are likely to see losses for Latin America, in this example, peak in the first half of 2021.

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

NIKHIL KHOSLA: Good morning and thank you for hosting the call, two things, one a follow-up on Brian's question on the preferred side. Given that there is a legislative solution out there and to your point if it extends to Delaware and there's a federal angle to it, if that were to happen, would it preclude the exchange or consent path that you've been talking about on previous calls? So if there is a legislative solution, would you not go down the exchange and consent because you can essentially – you have a fallback language through a legislative growth path?

MIKE VERDESCHI: We would have to see, of course, what that solution would entail. It's a good question because I think when you think about the complexity of the transition, when you have things like preferreds, you would put that in the category of some of these structures certainly that remain fixed or even ones that are float that would essentially convert to fixed. Those are the types of things that are complicated. And so I do think legislation is one of those areas that could provide a solution, but I do think it's going to be a consideration for what's included in that legislation. We've talked about an amendment. We've talked about an exchange. We will continue to evaluate the various alternatives to make sure we're ready to deal with any of those options when the timing is right.

NIKHIL KHOSLA: Great, thank you for that, and a follow-up to the peak losses and to your guidance around peak losses in the US now in the first half of next year. How should we think about delinquencies trending there? And when should delinquencies, very similar to what we're seeing in Latin America now where people coming out of relief programs are flowing into the higher delinquency buckets, when will that happen in the US given the TDR relief, I believe, has been extended until the end of 2021? So just trying to kind of triangulate, are you using that TDR relief of people coming off forbearance now flowing into delinquency buckets, or when should we see that happening in the US?

MARK MASON: Sure. So I guess I'd make a couple points. One, I'd like to correct. I think I may have said that peak losses in Mexico would be in the second half. I meant that they would peak in the first half of 2021. So I just wanted to correct myself on that.

In terms of kind of US peak losses, again, there are a number of factors that come into play there, including kind of how the stimulus continues to evolve and how much more stimulus is introduced. And so while that is the current timing and the view, that stimulus response as well as the behavior from consumers will be a major factor as to what peak levels look like and the timing of them. So I mentioned earlier the idea of delaying or deflating.

In terms of TDRs, which I think was the other part of your question, we really don't expect to see a material impact. We had limited usage of this relief kind of outside of the programs. And to some extent, even within the programs, the usage has been limited. So again, I would say that any relief really didn't have a significant impact on many of the important factors and variables, and I don't think that that will have a material impact kind of playing into losses in 2021.

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

MARK KEHOE: Good morning, just two quick questions. It sounds like there are some New York tech exception firms looking toward their banks for additional lending to avoid a kind of final round of equity financing before the IPO or do a SPAC. Can you just talk about how you manage the credit risk of lending to those firms, particularly if they need to be on the IPO docket? Thank you.

MARK MASON: I'm sorry – I had a hard time hearing your question. Would you mind repeating it?

MARK KEHOE: Yes, sure, sorry. It sounds like some of the New York tech firms are looking towards their banks for additional lending so as to avoid a final round of equity funding before IPO-ing or going to a SPAC structure. I'm just wondering how you are managing the credit risk of potentially lending to those firms in a debt capacity but also needs to be on the IPO mandate?

MARK MASON: Sure, yes. So again, and I think you know this about our kind of risk framework and how we think about our credit profile. We tend to focus predominantly on our large multinational clients that are predominantly investment grade, which stick to kind of sectors that – or clients that are strongest in their sectors and that we have longstanding relationships with. That said, we have been very active from an investment banking point of view in the SPAC space and certainly have seen that play out in our equity capital markets performance through the year.

As it relates to credit risk related to that, we obviously have a robust framework and infrastructure around that. And we set credit limits across different risk parameters for clients, and this would not be any exception to that in terms of not only monitoring the profile of those clients but making sure that we're operating inside of limits that make sense for the type of exposure that we want to take on.

MARK KEHOE: Okay, thank you. And just my second question, it sounds like you're kind of waiting for a lot of external factors around the G-SIB buffer and the SLR. But is there any further optimization, both on the asset and liability side of your balance sheet, that you can do just given the elevated deposit trends that are likely to exist for the near future?

MIKE VERDESCHI: Sorry, Mark. Are you asking what other things can we do on balance sheet sort of in the deployment of those deposits?

MARK KEHOE: Yes, or even kind of around the asset side as well.

MIKE VERDESCHI: Sure. As we look at the balance sheet and we think about that deposit growth, last year obviously you did see a surge in that lending activity as there were client draws. But given the amount of liquidity in the system, we saw those loans repaid as we were supporting clients who accessed the markets at that time.

When we think about this year, that liquidity in the system remains, so that's still very much dynamic. And when you think about what we could do on balance sheet, maybe just starting on the liability side, that deposit growth does give us an opportunity to reduce some of the wholesale funding that we would have had, and what I mean by that in particular, things like FHLB, so we can reduce that short term, long term. That makes room for us to take in those deposits and support our clients. Of course, we'll always be looking at the callable structures as well and whether we do need that liquidity or whether we should call it. So there's always going to be a set of liability optimization that we'll be thinking about.

On the asset side, of course I'll mention lending in a minute. But even in the investment portfolio, over the past year we grew that investment portfolio close to $80 billion. And the vast majority of that went into US Treasuries, but we also invested in non-dollar sovereigns and agency MBS as well. So that will be something that we continue to evaluate and deploy investments to.

Certainly, as we've seen some steepening of the yield curve and 10-year rates popping above 1%, that we are looking at. And of course, if that yield curve continues to steepen, which we think it could, that will continue to provide an opportunity there. And of course, we'll be evaluating how that lending activity evolves over the course of the year, but that would be of course the more traditional deployment of those deposits. But the combination of looking at managing the liability side as well as deployment into securities, those are all things that we will be looking at to optimize.

MARK MASON: I think that's right, Mike. We're going to actively manage all of this. We can't forget the increased liquidity that we've seen on the heels of some of the Fed monetary actions are a byproduct of this COVID-19 pandemic crisis that we're managing through and that we're not entirely through yet. And so we're going to continue to look at the balance sheet, both liabilities as well as assets, and try to manage that actively with client focus in mind and certainly keeping in mind the capital implications. But what we really need to do is ensure that we get through all of this and get back to some level of normalcy as it relates to all of these things.

OPERATOR: Your next question is from the line of Kevin Maloney with BlackRock.

KEVIN MALONEY: Thanks, guys. As the loss curve keeps getting pushed out and cards to 2022 and spend is recovering, how are you thinking about the Card portfolio? Are you increasing marketing spend maybe to get transactors, or are you changing any credit adjustments, or are you just trying to stay cautious?

MARK MASON: Look, it's the right question. And when I think back to the last crisis, we learned that that timing is critically important, the timing for which you put mitigating risk management in place as well as the timing for which you decide to reenter the market.

We've taken several actions while continuing to serve clients, including pausing certain marketing programs and balance consolidation offers, pausing proactive credit limit increases and reducing the size of introductory lines. We've tightened the parameters around some of the digital lending activity that we've done. We've tightened parameters around some of our customers. And so we've done a whole host of things in order to ensure that we've been managing the risk through this environment.

Those actions obviously have an impact on interest-bearing balance growth and therefore on revenues. So it's going to be important for us to reenter the market with client offers, given – or when the environment kind of supports that. And to that end, we have been testing target market reentry. That's included sequential increases in advertising quarter over quarter and marketing spend in the fourth quarter. In Asia in markets where the pandemic is more controlled, we've initiated kind of the unwind of some of our credit tightening actions, and we're looking to ensure that we can take advantage of the turn in customer interest when that starts to play out. In the US and Mexico, expansion frankly has been a little bit more limited to date, and over time we will again look for the right timing to leg in more meaningfully.

KEVIN MALONEY: Great answer, thank you. Lastly, a number of FinTechs and non-bank financials have entered the consumer lending space including, I guess, buy-now/pay-later guys. Is that a competitive threat to the card market, or is it too small to even think about?

MARK MASON: I'm sorry, I just couldn't make out – the connection here is bad.

KEVIN MALONEY: Sure. A number of non-bank and FinTech financials entered the consumer lending space, including buy-now/pay-later concepts. Is that a threat to the card market, or is it just too small think about at this point?

MARK MASON: Look, we don't take any of kind of the new FinTech strategies for granted. But what I would say is that those are small efforts. We do have, I think, a meaningful scale in our Cards business, and we've got I think a very good risk framework for how we assess new and existing customers and manage our exposure in a fashion that allows for us to get returns that make good sense.

And so on top of that, our strategy involves how we expand the offering that we have with these clients and how we serve them with enhanced digital capabilities. And I think the combination of continuing to evolve our solutions, new channels for accessing clients like our Google relationship, as well as enhanced servicing play to ensure that we kind of continue to capture growth when the market kind of stabilizes. And we'll watch many of those other players entering the market, but in the meantime we're staying engaged with our customer base here.

OPERATOR: Your final question is from the line of Ryan Butkus with Lord, Abbett.

RYAN BUTKUS: Hi, thanks for hosting the call again. Just a follow-on from Mark's earlier question on slide 11 as it relates to the high-quality liquid assets, so year over year this is up 24%. Available cash is at 56% versus 37% a year ago. And you have things like Level 2 assets at 7% versus 14% a year ago now. So I was wondering maybe if you could talk a little bit more about the pace and the categories that you could potentially consider redeploying some of the available cash. Obviously, there's an element of conservatism here just given the background that you're operating in, but I think it's just an interesting market dynamic to consider.

MIKE VERDESCHI: It's Mike. I do think you raise a good point. So we do have ample space in that Level 2. As I talked about over the past year, we really did deploy to I would say the vast majority of that portfolio that we hold, which is going to be highly liquid product. Over time, we do typically look at spread products as well. We have deployed the spread products in the past. Given the amount of surplus liquidity in the system today, spreads have come in. So we do want to look at all the asset classes and evaluate the opportunity. But we are – if we're going to deploy to less liquid, we are going to look at the returns on capital as well, so we want to be focused on the economics too.

So I didn't mean to rule out that we would look at those categories, but again, it's a portfolio that we're going to maintain good liquidity in, and so the vast majority would continue to be into those more liquid products such as Treasuries, agency mortgages. But at the right time, we will look to continue to expand spread products as those opportunities arise.

RYAN BUTKUS: Thank you.

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

TOM ROGERS: I would just like to thank everyone for attending the call this morning. And of course, if you have any follow-up questions please feel free to reach out to us in Investor Relations. Thanks.

OPERATOR: This concludes the fourth quarter Fixed Income investor review. Thank you for your participation. At this time, please disconnect.