TRANSCRIPT

Citi Second Quarter 2021 Fixed Income Review

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Host
Thomas Rogers, Head of Fixed Income Investor Relations

Speakers
Mark Mason, Citi Chief Financial Officer
Michael Verdeschi, 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 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.

THOMAS ROGERS: Thank you, Shelby. Good afternoon and thank you all for joining us. As Shelby mentioned, I'm joined this afternoon 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 cautionary statements referenced in our discussion today and as included in our SEC filings, including without limitation, the Risk Factors section of our 2020 Form 10-K.

With that said, let me turn it over to Mike.

MICHAEL VERDESCHI: Thank you, Tom, and good afternoon, everyone. On today's call, I will cover a number of topics. First, I'll briefly discuss our first half 2021 operating results. Second, I will cover recent balance sheet trends. 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 2021. In the second quarter, we reported net income of $6.2 billion. And for the half, we reported $14.1 billion, both higher than comparable periods in 2020, driven by significant reserve releases.

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 1% 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 second quarter, deposits continued to grow, reflecting continued engagement with our consumer and corporate clients in a period of elevated liquidity. Loans increased sequentially, driven by growth in ICG, while consumer loans remained under pressure, driven by elevated payment rates.

Trading-related assets and liabilities grew, reflecting a continuation of strong client engagement. And long-term debt decreased, as we continued to optimize our balance sheet, given our strong liquidity position and deposit growth.

Slide 5 presents trends in our loan portfolio on an average basis in constant dollars. Total Citigroup loans decreased 7% year over year. In our consumer franchise, average loans declined 4% year over year, as high levels of liquidity continued to drive elevated payment rates.

In our institutional franchise, average loans decreased 8% year over year, as strong growth in Markets and Private Bank was offset by repayments and reduced demand for loans in Corporate Lending. Sequentially, total loans grew in TTS markets and the Private Bank, and Corporate Lending repayments slowed.

On slide 6, we show credit quality trends in our GCB and ICG loan portfolios. In ICG, credit quality remained broadly stable. In the second quarter, non-accrual loans declined sequentially to $2.6 billion, or 64 basis points of total loans, reflecting portfolio upgrades and repayments.

In GCB, overall credit trends improved, given high levels of liquidity in the US and improvements in international consumer credit performance after losses peaked in the first quarter. And with credit reserves of $21.5 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 5% from the prior-year period, reflecting continued client engagement in a period of elevated liquidity.

Now let me cover our Parent Benchmark Debt Issuance Program on slide 8. So far this year, we have issued roughly $11 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. We previously expected issuance of $15 billion to $20 billion, but we now expect issuance at the low end of that range, all in our Parent Benchmark program, as we see elevated levels of liquidity in the bank. And we will maintain the flexibility to optimize 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 $9 billion to roughly $265 billion, reflecting an increase in non-bank debt, partly offset by a continued reduction in bank debt.

On slide 11, we provide an update of our LCR metrics and drivers. Our average LCR decreased modestly to 113% this quarter.

Turning to slide 12, let me summarize our key regulatory capital metrics. Our CET1 capital ratio increased modestly to 11.9%, with net income largely offset by buybacks and dividends.

And our SLRs were 5.9% and 6.8% for Citigroup and Citibank, respectively. The decline in Citigroup's SLR from the prior quarter was largely driven by the expiration of the temporary SLR relief.

Moving to our last slide, let me summarize several key points. The franchise continued to perform well through the pandemic. We earned over $14 billion of net income in the first half, including a credit reserve release of roughly $6 billion.

We maintained a strong capital position with a CET1 capital ratio of 11.9%, an SLR of 5.9% and a surplus above our TLAC requirement. We also maintain a strong liquidity position with an average LCR of 113%, over $970 billion of available liquidity resources, and we are comfortably in compliance with the NSFR rule, which became effective on July 1.

While we expect continued macroeconomic improvement, our capital and liquidity position us well for a range of scenarios. 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. We appreciate the flexibility afforded by the IBA in their extension of most tenors of US dollar LIBOR until mid-2023. As it relates to a legislative solution, the recently enacted New York State law to address the phase-out of LIBOR as a benchmark rate is clearly a positive development, as is the similar proposed federal legislation.

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.

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

QUESTION AND ANSWER

OPERATOR: Your first question is Scott Cavanagh of APG.

SCOTT CAVANAGH: Good afternoon, guys. Thanks once again for having the call, two questions for you. First, looking at overall asset quality and earnings momentum, we've seen, as you and your peers said, the improvement in the economy, the ongoing strength in credit quality has definitely been a tailwind for bottom line earnings. But when we think about the second half and going into next year, how should we think about the potential continued benefit from reserve releases given your second quarter levels were still elevated to the day one, albeit lower than the first quarter of 2020?

MARK MASON: Scott, good afternoon. You broke up a little bit. You said how should we think about in the second half what, just repeat that part again, please?

SCOTT CAVANAGH: Sorry, potential future benefit of reserve releases given the ongoing improvement in the economy, given the absolute levels are still elevated to day one, there's the possibility that we go – the correct levels are below that, so how should we think about that?

MARK MASON: Got it, great question. And look, you're right, we have seen – on the heels of 2020, we have seen the economy and the outlook improve, and that's been an important factor through quarter one and quarter two as we've seen reserve releases play through. We've also, by the way, continued to have very strong client engagement and strong underlying indicators around the prospect for a strong recovery that we feel good about.

As it relates to your question specifically on additional reserve releases, there are a number of factors that come into play there. So one is the continued outlook for the macroeconomic indicators, how GDP, how unemployment is likely to evolve. The second is how the portfolio mix changes. And as you know, we are starting to invest in bringing on or acquiring new customer accounts and reactivating card activity with customers, and so that's going to be a factor as loan balances begin to build. And then the last factor would be kind of the downside scenario that we assume as we run these different CECL models that we have. And so hard to say with precision where this ends up for the year. The way the indicators have been evolving, I would expect that we would see additional reserve releases, but hard to call that precisely.

In terms of where we started on day one, whether that's the long-term level, those factors come into play again, so what the portfolio looks like relative to what it looked like then, the outlook on the economy, et cetera, et cetera.

SCOTT CAVANAGH: Okay. And my follow-up question is on the issuance front. What are your current plans for future agreements? You entered the affordable housing bond with great success. And then could you elaborate on the recent ICMA debate about looking at the lookback period that's commonplace in the US green and sustainable bonds and the potential for rolling your long-term assets within that?

MICHAEL VERDESCHI: Sure, Scott. Hi there. It's Mike. Look, so we were happy with the programs that we brought in ESG, both green and affordable housing. That's an area that's obviously important to the firm. We're going to continue to explore opportunities to issue in that space. Of course, as I think about the issuance for the year and what we've done so far and what we have left to do, it's a limited amount, but of course, we'll continue to explore opportunities, talk with our investors, and really determining what the need is, both across tenors, currencies, as well as types, including ESG.

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

HIMA INGUVA: Great, thank you very much. And as usual, Mark, Mike, and Tom, thanks a lot for doing the call.

MARK MASON: Sure.

HIMA INGUVA: We appreciate it. So my first question is around China, with all the regulatory crackdowns that are being talked about. If you could, maybe elaborate a little bit on exposure in China, considering you've announced plans to exit Retail Banking in Asia. That would be very helpful.

MARK MASON: Sure. Hi, Hima. How are you? Thanks for joining. Look, as you would imagine, we continue to monitor that situation very closely.

While we have announced that we're exiting Retail Banking in Asia, we are continuing our very strong performance in our ICG businesses around the world. We're not exiting any countries out of our ICG business.

And as such, we continue to serve our multinational companies and our local champions through this ICG business that we have. And we don't anticipate any impact from some of the Chinese regulatory crackdowns, as you characterize them, that have been in the press as of late.

Our total exposure in China, which we do disclose in our 10-Q, so it's out there in our first quarter 10-Q, is approximately $20 billion. And that includes about $12 billion of funded loans and about $3.5 billion of funded loans out of our consumer business.

HIMA INGUVA: Got it, thank you very much for clarifying that. And the second question is around your perhaps issuance needs. Maybe if you could elaborate on how we should think about it, remainder of the year, considering all the changes that were made this year.

MICHAEL VERDESCHI: Sure. Hi, Hima. So no immediate need. As you know, we would typically, depending on market conditions, get out in front of the call opportunities that we have, if it was economical. But we don't have calls for quite some time.

So it's really now about how our balance sheet evolves. And that of course is going to be a function of overall economic activity. And then of course, markets are favorable, so we will consider that too.

So as always, we leave ourselves room to be opportunistic, and we'll take that into account and look at how the balance sheet evolves. But again, nothing that's going to be driven by calls, just given we don't have anything in the near future here.

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

ARNOLD KAKUDA: Great, thanks for holding the call, guys. Really appreciate it. So it seems like – reading from the press, it seems like you've reinstated a mask mandate in the US. So just curious in terms of if you have maybe some more insights from your global footprint where there's been – the Delta variant has kind of been more of an issue versus the US. So is that kind of what you guys are seeing? Or is it just more response to the CDC updated guidance?

MARK MASON: Yeah, sure, Arnold, good to hear from you. We obviously have a global footprint, and frankly we are handling this pandemic as the local environments that we operate in would require. And so every market, every country we handle uniquely, based on the data and not on any targeted date for when we want to get back into the office or when you should or shouldn't wear a mask.

And so in the case of what you've read recently, it is in response to what everyone's seeing come out of the CDC. We obviously want to adhere to the guidance that they provide. And what's most important is ensuring the safety of our employee base. And so we'll continue to be led by data, whether it's data around returning to the office or data around wearing face mask or whatever, because that's the right thing to do.

ARNOLD KAKUDA: Got it, thank you. And then moving on to issuance, so it seems like you're lower than peer issuance has helped your bonds outperform peers this year. And then you further kind of moved your target to the lower end of the range.

So I'm just curious in terms of we've seen some of your peers have elevated issuance. If I can put it into two buckets, one, maybe where the balance sheet expanded a lot during the pandemic, and so maybe with the SLR relief going away, then you'd issue some other. In other cases, an opportunity opening up in prime brokerage, so peers aggressively going after that market share.

So where do you guys kind of fit within that? Are there other things that you guys are able to do to kind of offset some of these increased issuance pressures that maybe others have had?

MICHAEL VERDESCHI: Sure, Arnold. So when we think about issuance, and we've always talked about this, we like to maintain a lot of flexibility. And we do that by ensuring we have multiple funding levers at our disposal, both in the bank and in the non-bank.

Just starting off with the bank, clearly we've seen deposit growth over the past year. And so the need for any bank issuance really is diminished, just given that good deposit growth that we've seen. And obviously, that's an activity where it's a funding source, but it's also accommodating our client need.

When you think about the non-bank, it's similar that we have different funding sources. Of course, we have financing activities, but we also maintain a commercial paper program. We have our client note program in addition to of course our Parent Benchmark.

Now, in terms of need, as you've seen with TLAC, even after the expiration of the temporary relief, we end the quarter roughly $16 billion, which is just about double where our targeted range had been. And if you look at our liquidity levels, we've maintained good liquidity levels as well.

And so when you think about the need that we've had and how we've been funding, especially our non-bank positions, we did use some of that liquidity in the quarter to fund that need, but at the same time, we saw good client engagement in our note program. And keep in mind, that note program is really a client facilitation activity, so it has the benefit of meeting our client needs while at the same time providing us funding, which is attractive because it's a diverse investor base. It's retail and high net worth clients. And again, it's a diversification from our Parent Benchmark program, and of course we still over the course of the year and in the quarter did come to the market for that Parent program. And so really, it's about having the flexibility to source funding from different avenues. And as I said, we've been in a good liquidity position, same with TLAC, and so that has afforded us the flexibility to really optimize our sources of funding while meeting our client needs.

You mentioned Prime Brokerage, and of course, obviously our resources are going to be supporting our clients. And of course we then turn to what is the most optimal way to fund those positions, and that's of course what I just described.

MARK MASON: The only thing I'd add obviously is in the equities space in particular, we've seen very good progress straight through the second quarter here. We're focused on getting the most out of the resources that we've dedicated to the business. Overall, we're up almost 40% versus the second quarter last year, and Prime and Delta One are up similar levels. And so good strength there, good client balanced growth there, and as Mike suggests, we're well positioned to fund the opportunities as they present themselves as we do more with our clients.

OPERATOR: Your final question is from Robert Smalley of UBS.

ROBERT SMALLEY: Hi, thanks very much for taking my questions and thanks for doing the call, two different questions. First on asset quality, we're all waiting for loan growth. We're starting to see some of the beginnings of it. But number one, are you concerned about the competitive environment at all? And number two, given that corporations and consumers need to be in relatively good shape, are we setting ourselves up for an adverse selection type of scenario where the first borrowers are the ones that really have needs?

Second question on deposits, you had big deposit growth last year, not so much in the first half. Could you break that down a little bit, corporate versus consumer, what you're doing there to put a lid on deposit growth? And are you doing that with a view toward the SLR? Or is the SLR just a coincidental indicator off the back of that?

MARK MASON: Sure. So why don't I get started on the loans piece, Robert? Thanks for the question. And then I'll touch on the deposit question, and I'm sure Mike will want to add in on that as well.

So look, in the second quarter, we did return to sequential growth. And we saw that particularly in the ICG business, in the Private Bank, in our trade loans – or with our trade loans in TTS and parts of our Markets business. And we started to see as well increased spend in our North America Branded Cards business. And feel pretty good about growth in loans playing out toward the end of the year as it relates to the Cards business.

And in part, that's because of what we're seeing in the way of the trend in payment rates. While they're still high, we think they're going to trend in the direction that would support some loan growth at the end of the year. But also the activity that we're ginning up with the marketing dollars that we're putting to work around bringing on or acquiring new balances. And so we feel good about the prospect of loan growth toward the end of the year.

We also feel good about the underwriting that we've done. Many of these customers we've had for a long time. We know the behavior patterns of those customers. We know that we have customers that are in a temporary transactor state, so to speak.

And so as the stimulus starts to wind down, we would expect they will revert back to revolving activity, and that will drive those loan balances. And this is a portfolio, both on the Branded Cards business as well as the Retail Services business, and I stress that, because you have a mix of behavior that plays out when you have a portfolio of the size that we have.

And so we do feel good about the prospect of loan growth. Obviously, the recovery and the pacing of that will be an important factor. But the trends we're seeing in GDP forecast, the trends we're seeing in unemployment forecasts all support that that should play through and that we should be well positioned to capture the benefit of that loan growth.

MICHAEL VERDESCHI: Sure. And on deposits, clearly we saw, as the Federal Reserve putting a lot of liquidity in the system, the industry deposit rates growing quite rapidly.

But from our perspective, clearly we have ample deposits to fund our growth just based on what our need is. Now obviously, we've been deploying some of that excess liquidity into securities. But also I'd say it's not about the absolute level of deposits. We're working with our clients in meeting their needs as well as looking at the value of those deposits and looking at the returns as well as the liquidity value associated with that activity.

If I think about consumer, we saw strong deposit growth there, particularly in the US, which allows us to continue to execute on our strategy. Our overall consumer deposits were up 14% on the year. And when you look at North America consumer, that was up 18%. And within that, checking balances were up 24%.

So we're very much focused on the types of deposits that we're taking in as well. And if you look at our broader businesses and our institutional business, we continue to grow deposits there as well. Securities Services, again, that's been driven by higher assets under custody. And if you look at Private Banking, we continued to grow and deepen those relationships as well.

In TTS, down slightly, but that is also a function of optimizing that deposit base in the context of the overall client relationship.

So it's really about focusing on meeting our client needs and really being thoughtful about how we take in those deposits and the value of those deposits in terms of their deployment.

MARK MASON: The only thing I'd add to that, Mike, is that – so you're right, relationship being the key word there. And that's how we think about managing the deposit growth and momentum that we've seen. And that's critically important.

The deposit levels – to the other part of your question, the deposit levels do put pressure on the G-SIB score. They do put pressure on SLR. And the regulators have referenced the importance of maintaining capital levels throughout the industry, so to speak.

And so we're hopeful that their continued focus on the implications of this excess liquidity that's in the market and these deposit levels and what they mean for these important factors that they continue to focus on that and that that plays out in a way that allows them to maintain their objective of balanced or maintain capital levels.

ROBERT SMALLEY: That's great. That's very helpful. Thank you and thanks for doing the call.

MARK MASON: Thank you.

OPERATOR: We did have another question come in from Kevin Maloney of BlackRock.

KEVIN MALONEY: Thanks for having this call, guys. It's greatly appreciated. On the Card portfolio, have you increased marketing expenses or developed new programs? It seems like some of your competitors are beginning to go that route.

And also, the corporate card, which I believe is mostly in Asia, is that going to be sold when you sell the businesses?

And lastly, I think there's about $16 billion of loans in Asia in the Card portfolio. Can I just assume that's all going to go away when the business is sold?

MARK MASON: Sure, so let me try and take those. So first, we have increased our marketing and acquisition spend as it relates to Cards as we see the recovery start to take hold, and you can see that referenced in our supplement, which speaks to that expense very explicitly. We've also kind of looked at and launched, I should say, additional products. Our cash-back card is out there to attract new customers that kind of respond to those types of rewards, but we've also kind of continued our efforts around Flex Pay and Flex Loan, which also will generate interest almost immediately as those balances grow. And so we are actively engaged with acquiring new balances, as I mentioned earlier.

In terms of the corporate card, which I think was your second question, the corporate card is part of our TTS platform, which is part of our ICG business. And so as I mentioned earlier, while we're exiting Asia consumer businesses or markets, we're not exiting any of our ICG business activity in Asia, and that would include our commercial card activity, which is part of that TTS franchise.

KEVIN MALONEY: Okay, good. So the $16 billion that's in Asia, some of that will obviously be retained. Is that the takeaway I should get from that?

MARK MASON: So as I mentioned earlier, I gave China as an example. There are Consumer loans of about $3.5 billion that we have funded there. That would be part of whatever exits we make out of that market, and that would be true for the consumer balances that we have in the other countries, the other 13 markets that we've referenced. And so that's kind of as those exits occur over time, we would expect that to move along with it.

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

THOMAS ROGERS: I'd just like to thank everyone for attending the call. And of course, if you have any follow-up questions, please reach out to us in Investor Relations. Thank you.

OPERATOR: Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.