JASON GOLDBERG: Good morning, and welcome to the third and final day of our Global Financial Services Conference. We have a jammed packed morning, I think, we have seven banks in a row, large cap banks in a row in this room. But I couldn't think of a better bank to have kick off today's session than Citigroup, the most global bank that we cover.

And with that, I'll turn over to John Gerspach, Chief Financial Officer.

JOHN GERSPACH: Good morning Jason, and thank you all for joining us. To begin, let me spend a few moments on our recent results. We earned $4 billion in the second quarter of 2016, a material improvement over the first quarter as we saw sequential consumer growth in North America Branded Cards, Asia and Mexico.

We acquired the Costco portfolio and renewed key partnership agreements in North America Cards. And we also saw a rebound in Markets and Investment Banking revenues in the second quarter, while large franchises like Treasury and Trade Solutions, and Rates and Currencies continued to show momentum. These growth trends demonstrate the strength of our franchise. While the overall environment remains challenging. We are open for business and able to support our clients as they grow and transact in any region around the world. We're diversified by business, product and geography with a well-defined high-quality target client strategy. And we're playing from a position of strength in capital and liquidity, giving us the capacity to support our clients without facing regulatory constraints.

After several years of restructuring and exiting assets that were either low return or off strategy, today we're pivoting to growth in our core franchise. And we remain focused on optimizing our capital base, utilizing our deferred tax assets and putting the firm in a position to return greater amounts of capital to our shareholders.

Our path to improved RoTCE is centered on three themes of investment, DTA utilization and capital optimization. Our first execution priority is to improve returns on the capital deployed in our operating businesses, generating consistent high-quality earnings in line with our strategy and target client segments. We're investing to grow higher return franchises while maintaining our expense and credit disciplines. And we continue to wind down Citi Holdings, with a minimal impact on total Citigroup earnings.

Second, we continue to utilize our deferred tax assets, thereby shrinking the amount of TCE required to support the DTA. More than half of our total DTA is disallowed, or deducted, when calculating our CET1 capital. The capital supporting this disallowed DTA cannot be deployed in our businesses and, therefore, cannot earn a return.

As the disallowed DTA is reduced, this benefits CET1 and enables us to generate total regulatory capital in excess of earnings on an annual basis.

And finally, our goal is to return to our shareholders all the regulatory capital we generate each year above the amount needed to prudently operate and invest in our businesses. So our path to improved RoTCE is twofold. We're focused on the return on capital deployed in the businesses as well as the return of capital generated through both earnings and DTA utilization.
On slide four, we show more detail on our returns. In total, we generated $7 billion of net income after preferred dividends in the first half of 2016, on average tangible common equity of $182 billion for an RoTCE of 7.7%. However, embedded in our TCE was an average of $29 billion supporting disallowed DTA on which we earned no income and, therefore, a 0% return. Excluding the capital supporting the DTA, we had $153 billion of TCE deployed across GCB, ICG, Corp/Other and Holdings at an RoTCE of 9.2%. Our goal is to improve upon the 9.2% we're currently generating in the businesses, while shrinking the capital supporting the DTA and therefore mitigating the 150 basis point drag on our returns.

On slide five, I'd like to spend a little more time on our first execution priority, which is to improve returns on the capital deployed in our operating businesses today. Starting with our consumer franchise, we see good opportunities to accelerate growth in our key regions, the U.S., Mexico and Asia, where we have a high relative market share, competitive strength and a deep history. Within these markets, we're investing to grow higher-return businesses, most notably Cards and Wealth Management, with a consistent focus on high-quality consumer segments and we continue to enhance our digital capabilities across the franchise to deliver a more consistent, convenient and differentiated consumer experience. Over time, we should drive efficiency benefits by further rationalizing and repositioning our branch network and expanding digital channels to better acquire, service and engage with our customers.

Turning to the Institutional side, our strategy starts with our target clients, the world's largest multinational corporations and investors, who truly value our global franchise. Our goal is to deepen these existing relationships, serving our clients' needs with more products and more markets as they grow and transact around the world. We're leveraging our scale advantages and the power of our global network in businesses like Treasury and Trade Solutions and Fixed Income. And we're focused on gaining wallet share in areas such as equities, banking and securities services, all while maintaining our expense discipline.

For the remainder of our businesses, Corporate Other and Citi Holdings, the return story is driven more by optimization on the allocated capital. Our goal is to continue to operate Citi Holdings at or around breakeven going forward, and we will continue to drive efficiencies in our global functions. But, the more meaningful driver of the improved returns will be the release of capital currently supporting assets in Citi Holdings and the disallowed DTA, which I'll discuss more in a minute.

Let me share some more detail on our businesses, starting with Consumer on slide six and in particular, the progress we're seeing on investments we are making in our U.S. Branded Cards franchise. For the past several years, we've been working to transform the Cards business, and we are seeing significant momentum today as we continue to position Cards for growth. Here in the U.S., you saw us ramp up our new account acquisitions beginning in the second half of last year, which is paying off with growth in purchase sales and average loans at an improving year-over-year revenue trend even before the benefit of the Costco portfolio acquisition last quarter.

Turning to International GCB, in Asia, we've continued to manage through the economic environment, which has seen slower overall market activity, and we'll also continue to move past the regulatory headwinds that have become a significant factor in that region for several years now. As a result, looking ahead, we expect Asia Consumer revenues to return to growth in the second half of 2016, resulting in positive operating leverage year-over-year for the back half of this year. And in Mexico, we're seeing growth accelerate as well. With momentum in retail banking, and a recovery in Cards, expected to drive continued top line growth and positive operating leverage in the future.

Turning now to the Institutional Clients Group on slide seven. Our business today reflects an ongoing transformation that began several years ago. We started by sharpening our client focus, rationalizing our client base to focus on a target set of multinational corporations and investors. These actions enabled us to grow our wallet share with our target clients while diversifying our revenue base and coming to market more efficiently.
Today, we benefit from scale advantages in businesses like Treasury and Trade Solutions and Rates and Currencies, where we are consolidating industry volumes. We continue to invest in these businesses, as well as other attractive areas, where we believe we are undersized relative to our natural share in wallet with our target clients. These include Equities, Private Bank, Investment Banking and Securities Services, where we believe the stability of our platform, our global network, and our strong capital position are differentiating us from our peers. So today, it’s really about continuing on this path, deepening our relationships with our target clients and growing wallet share with a focus on overall client profitability, efficiency and returns.

Now I’d like to spend some time on what we can do to mitigate the drag on returns from Corporate Other and Citi Holdings on slide eight. As we mentioned at the start of the year, we will no longer report Citi Holdings as a separate segment after 2016. So, Citi Holdings and Corp/Other are shown here on a combined basis. Our goal is to operate Citi Holdings at or around breakeven going forward. And while we will continue to drive operating efficiencies in Corp/Other, the real key to mitigating the drag from these segments is to optimize their allocated capital.

Looking at the $66 billion in total TCE allocated to Corporate Other and Citi Holdings. We have $9 billion in TCE supporting Operational Risk RWA, which is likely to remain with us in the intermediate term as the industry works to address the issue of how Op Risk RWA can be reduced over time. And we have another $5 billion in TCE supporting Credit and Market Risk RWA in Corp/Other that is also likely to remain fairly stable.

But the $8 billion in TCE supporting Credit and Market Risk RWA in Citi Holdings should continue to decline as we wind down the portfolio. As seen on the slide, we have reduced total Credit and Market Risk RWA in these segments by almost 30% since last year, largely driven by Holdings. And then we have another $26 billion opportunity in the form of the TCE supporting the disallowed DTA, which should also decline as we continue to utilize the deferred tax assets. Together, these two potential sources of excess capital represent over half of the total TCE currently allocated to Citi Holdings and Corp/Other.

And finally, we have $18 billion in Other at the top of the stack, which largely represents the amount of capital we hold in excess of our target capital ratios today, or roughly 1.5% of firm-wide Risk-Weighted Assets. However, when thinking about this $18 billion in potential excess capital, it’s important to note that we have yet to receive details on how the G-SIB surcharge may be incorporated into the CCAR process in the future, which will inform our ultimate capital requirements.

We'll go into more detail on the DTA on slide 9. If you look at the top line or total DTA, you can see that we’ve utilized roughly $10 billion of DTA since the end of 2012, bringing our total balance from $55 billion to $45 billion at the end of the second quarter. And at the same time, as our capital base has grown, we’ve also expanded the amount of DTA that can be included in our CET1 capital. As a result, we’ve been able to reduce the amount of TCE supporting disallowed DTA by over $15 billion.

Slide 10 shows the power of the DTA impact on our CET1 capital generation. Since 2012, our TCE has grown 5% annually, but our regulatory capital has grown over twice as fast, as we’ve reduced the drag from the unproductive capital supporting the disallowed DTA.

Which brings me to our final goal, to return to our shareholders all the regulatory capital we generate each year, above the amount needed to prudently operate and invest in our businesses. We feel good about the significant progress we have made over the last two CCAR cycles in terms of our ability to return capital to shareholders. In 2015, we increased our total capital return to $6.8 billion, representing over 40% of the capital we generated through earnings and DTA utilization from third quarter 2015 through second quarter 2016. And, earlier this year, we got another positive result in CCAR, enabling us to increase our planned capital return to $10.4 billion.
For illustrative purposes, using consensus net income expectations for the next four quarters and assuming $2 billion in DTA utilization offset by preferred dividends, this would equate to roughly 65% of total capital generated. And while this puts our capital return more in line with our peers, we're still a fair amount away from our ultimate goal, which is to return all the excess capital that we generate each year, whether through earnings, DTA utilization or other sources.

As the market gains confidence in viewing the DTA as essentially an annuity source of capital return, we believe it has powerful implications for valuation, as we illustrate on slide 12. On the left side of the slide, we show a sensitivity analysis on the present value of returning all the capital currently supporting disallowed DTA back to our shareholders. And for illustrative purposes, on the right side of slide, we show the impact of separately valuing the capital deployed in the businesses and this annuity stream from DTA. At the end of the second quarter, we had roughly $157 billion of tangible common capital deployed in our businesses, which represents nearly $54 per share at an illustrative one-time multiple. And, assuming $2 billion in annual return of DTA-related capital over the next 14 years at a 10% discount rate, this equates to over $5 of additional value per share. Together, this valuation of nearly $59 per share represents clear and significant upside from where we trade today.

While I've covered many topics here today, I want to leave you with a few key thoughts. Our path to improved RoTCE is twofold, focused on the return on capital deployed in the businesses, as well as the return of capital generated through both earnings and DTA utilization. We're working to grow higher return businesses while maintaining discipline around our strategy, expenses and risk appetite. And I believe our recent results demonstrate good progress even in a continued challenging environment.

On this note, I'd like to make a few comments on the current outlook for the third quarter. On the Institutional side, Markets revenues are performing above our expectations for the third quarter, still down sequentially, but up around mid-single digits from last year, with continued strength in our Rates and Currencies franchise. However, Investment Banking is a little lighter than we had estimated as M&A revenues should continue to recover sequentially, but not enough to offset the comparison to a very strong second quarter in debt capital markets.

And finally, we would expect to see some mark-to-market losses on our loan hedges this quarter given spread tightening around the market. So, there are some puts and takes, but in total, the current ICG revenue trend looks consistent with the favorable outlook we described on our second quarter earnings call.

Turning to Consumer, we remain very encouraged by the progress we're seeing in both North America Cards and the International franchise. In North America, the Costco portfolio continues to exceed our expectations for customer engagement and new account acquisitions, and revenue trends are above our expectations on an organic basis driven by strong volumes on our existing U.S. Card portfolios.

And finally, in Asia and Mexico, our outlook remains the same. Revenue should improve modestly from the last quarter, resulting in year-over-year growth and positive operating leverage in both regions.

On the expense side, we expect core expenses to be slightly higher quarter-over-quarter in Citicorp, that's up from our prior guidance of being slightly down given the volume growth in U.S. Cards and Costco in particular, as well as additional costs related to the Costco conversion.

Finally, on Citicorp credit, overall credit quality and loss rates remain favorable. However, as a reminder, we expect to incur roughly $150 million of LLR build this quarter related to the acquisition of the Costco portfolio. And we should see additional LLR builds by volume growth as well. And we continue to expect Citi Holdings to operate right at breakeven this quarter.

And with that, I'm happy to address any of your questions. So, thank you.
QUESTION AND ANSWER

JASON GOLDBERG: A lot in there, John. I guess a couple of questions, and then we'll do some from the audience. But you talked about returning 65% this year of the capital generated with a target of 100%. Can you maybe talk to how we get from that 65% number to 100% number? Is it just kind of stair stepping a little bit each year with CCAR? Is it waiting for how the GSIB gets calculated and maybe thoughts in terms of that this year, next year and how that influences your thinking as well?

JOHN GERSPACH: Well, obviously Jason, it is going to depend a lot on what the rules are going to be for 2017. We don't know those rules as yet, we'll have to see. However, we have continued to increase that level of capital return each year. And so our goal would be to continue that trend. I can't tell you that we're going to be able to get from 65% to 100% in one step or two steps. But, again, our goal is, in the fairly near term, to get to that 100% as quickly as possible.

JASON GOLDBERG: And then maybe another one on that is, in your illustration, you used a $2 billion DTA utilization level each year. Is that kind of how we should think about going forward or is there a way to maybe accelerate that?

JOHN GERSPACH: Well, there's a lot of things that impact DTA, obviously. In the past, we've benefited a little bit from what I'm going to call bucket expansion, as we've grown our CET1 capital, more of the DTA has been allowed. That's therefore reduced the amount of disallowed DTA and the capital supporting that.

However, our goal is not to continue necessarily to increase that CET1 capital. We want to be able to return the capital to the shareholders, and therefore, I don't want to rely on bucket expansion to increase that level of DTA. And of course, DTA is also going to be impacted by the impact of other comprehensive income which can benefit us in some years and be a slight hurt in others. But we think $2 billion is a good average rate to think about.

JASON GOLDBERG: And maybe we'll go one ARS question and then we'll look to the audience for questions. If you don't own the shares of Citi or underweight the stock, which one of the following will most likely change your mind? One, higher rates; two, increased capital return; three, acceleration of growth in EM; four, more certain outlook for cap markets; five, DTA utilization; and six, getting rid of Citi Holdings.

JASON GOLDBERG: Pretty evenly dispersed.

JOHN GERSPACH: Yeah. When you think about it, actually six drives two.

JASON GOLDBERG: Right.

JOHN GERSPACH: So, hopefully, as we continue to wind down those assets, that is yet another source of capital then that we can return to the shareholders.

JASON GOLDBERG: I want to look to the audience for any questions. I see one.

SPEAKER #1: Hi.

JOHN GERSPACH: Hi.

SPEAKER #1: One of your peers yesterday said that C&I in the U.S. slowed recently. I was wondering if you saw the same thing and, if so, what's driving it?

JOHN GERSPACH: I'm sorry, they said that...
SPEAKER #1: C&I has been slowing recently.

JOHN GERSPACH: I don't think we're seeing that same impact. So, I don't know how to respond to that, sorry.

SPEAKER #2: Now, kind of staying on the capital type of conversation, when you are involved in CCAR, is the DTA at all considered that you know of in the CCAR and the expectations of the roll down of the DTA?

And then along with that, you mentioned obviously the RWAs for Operational risk. And obviously, you had a little insight to say this is going to take a while to come down, but any talks or anything again with the Fed on the RWAs, the Operational risk, and how long is that runway going to be for that, because obviously it's a huge carry?

JOHN GERSPACH: You're absolutely right. Let me take the first question first. There's two aspects, of course, to CCAR, there is the quantitative and the qualitative. In the quantitative aspect of CCAR, DTA utilization does not really come into play. Obviously, the fact that you have DTA will cause you therefore to perhaps have higher losses because you can't use offsetting tax benefits. But that's in the quantitative.

In the qualitative aspects of CCAR, as we're presenting our capital plan, DTA is very much a focal point. So, to the extent that we can continue to utilize that DTA, continue to drive down the amount of capital that we need to hold to support the DTA, it very much gives us the ability then to look to increasing the level of capital that we can return to shareholders. So it has a very direct impact on our capital planning, which is what the Fed reviews as part of CCAR.

When it comes to Operational Risk, I think we're all focused right now on the next round of potential changes. You've heard them refer to as Basel IV that are potentially coming. We know that something is coming, we're just not sure when or where. I think as the various regulatory bodies focus on, whether you call it Basel IV or you call it enhancements to Basel III, it's going to be hard to get a resolution on exactly how everyone should be viewing our Risk-Weighted Assets supporting the Operational Risk under the advanced approaches which is really what's hitting us in the slide that I put up.

So there just is not a clear pathway right now. Right now, when you incur an operational loss, it has got a Plutonium-238 half-life at this point in time. And so it's just something that we all know we need to address. But I can't tell you that there is a clear path forward.

SPEAKER #3: Outside of the card area where you're growing nicely, will we see other expense growth or the cost savings or the restructuring charges we've seen still flowing through?

JOHN GERSPACH: I think what you'll see is expenses matching various avenues of revenue. Obviously, to the extent that we've got revenue growth in some of our institutional businesses, you should expect that there'll be some higher levels of compensation associated with that revenue. That will be mitigated by some of the cost savings that we have built in, but I can't tell you that it's going to be completely offset. But overall, I think that when we talked about maintaining that expense discipline, the target that we've put out for the year is in an efficiency ratio for Citicorp, around 58% for the full year, and that's still where we're targeting.

SPEAKER #4: Are you going to issue new targets as you did a few years ago? Are you going to update those and issue new targets, and when would you do that?

JOHN GERSPACH: Yeah, Mike talked about that during the second quarter earnings call. And so, probably at the end of this year, we'll be updating the targets. I can't give you an exact timeframe, but think about it as being something associated with our fourth quarter earnings release.
JASON GOLDBERG: Other questions for John? Maybe we'll go another polling question given you guys are a little bit shy. This is kind of similar to the first one, but what do you believe the biggest catalyst for Citi is going forward?

Increased dividends and share repurchase or accelerating revenue growth. I think we'll just going to go to the question, then we'll ask a follow-up because I think this will help frame it. Which of the business segments do you believe still has the most potential over time? International Consumer Banking, North America Consumer Banking, Markets and Securities Services, Investment Banking, and Treasury and Trade Solutions?

By far International Consumer Banking was the first choice, which is interesting because that's one of the businesses where you've been kind of doing the most kind of refocusing and scaling back. John, maybe just to address how you feel about your current footprint, is that kind of it and then where do you see the bin with the biggest growth opportunities?

JOHN GERSPACH: So, from a footprint point of view, I'd say that we're essentially done. Although, like with any other strategy, it's something that you revisit every year at least. So I wouldn't say that now that we're in 19 countries from a consumer point of view, it's always going to be 19 countries. But we're comfortable with those 19 countries right now. The second was, where do we see the growth coming?

JASON GOLDBERG: Yes, yes.

JOHN GERSPACH: Okay. So which countries have got the largest growth potential? And again, I'll stay on the International side of things. But clearly, we're very constructive about Mexico. We're in the processes of shedding our consumer businesses in every other Latin America country, but we're very constructive about Mexico. We still think that that has got tremendous untapped potential, our franchise in Mexico.

And so we're very focused on making the right investments there. We're going to do it slowly. We're going to do it over time. You've already seen where we've been reshaping the card portfolio in Mexico. That has given us some revenue headwinds, which we've been able to overcome by the strong growth on our retail banking franchise in Mexico. But even with that, we do see that Mexico is going to be a source of revenue growth and, as we said, positive operating leverage for the future. We'll have it in the second half of this year and continuing into next year. So, again, very constructive on Mexico.

JASON GOLDBERG: I see a question, third row, stage left. The question was just why so constructive on Mexico?

JOHN GERSPACH: When you look at the advantages that Mexico, has being with the proximity to the U.S., the chance to really participate with the U.S. economy, the workforce in Mexico, there is just a lot of growth that can yet be coming from Mexico. They're in the process of making, I think, the right reforms. You haven't seen the full benefit of those reforms as yet, but there's a lot of potential yet in Mexico. And they should benefit then as the U.S. continues to recover. It's got a good workforce, it's got a good wage setup. So we just think that it's a country that is still on the come.

SPEAKER #5: Any indication the Fed would relax the 30% or 35% dividend payout ratio and would you consider making that a bigger part of the mix going forward since it seems as though the banks aren't getting credit for the total return they're giving to shareholders might they be more dividend, please? Thanks.

JOHN GERSPACH: Yeah, I don't know what the Fed is going to do. Obviously, they've promised that they're going to issue some new guidelines related to CCAR. There could be some changes in their construct towards that 30% to 35% dividend cap. I remember even that is somewhat of a soft cap. So, I
think that if you have the right program in place, there could be some play there even under the existing rules.

For us, you saw that we made a significant increase in our dividend in this last cycle. And we recognize the importance of increasing dividend. At the same point in time, when your stock is trading at the discount to book that we're currently trading at, you do want to put the bulk of your capital return doing share buybacks. I think that that is going to be accretive to the share price in the longer term even if we're not necessarily getting full credit for it right now.

But the power of that share buyback is still pretty impressive. However, we'd recognize the fact that we have investors that want a combination of dividends and share buybacks. And that is exactly what we're trying to come to a good balance between in looking at the right mix of that $10.4 billion return that we're currently doing. And we'll continue to explore changes in that mix as we move forward.

JASON GOLDBERG: John, when you gave your outlook, you mentioned revenues higher than expected. It's on the Costco revenues running better than expected, but also costs running better than expected. Is that increased cost more tied to better volume growth or more tied to just difficulties in conversion? Maybe just kind of flesh out in terms of kind of where we are on the Costco purchase a few months in and then maybe appetite or the environment for additional purchases.

JOHN GERSPACH: Yeah, From a Costco point of view, from a revenue where we're seeing sales exceeding our expectations, new account growth is exceeding our expectations. We're on target with our mix between in-store and out-of-store spend. So all of that is positive. Obviously, as you bring on even higher amounts of new accounts, you're not going to get revenue off of those new accounts immediately, but that is going to have some impact on your expense base, and that's what we're seeing.

We're also, I don't think it's a big state secret, we had some difficulties in the Costco conversion. We needed to put some additional costs in that first month in order to make sure that we were servicing customers the way that we feel that they needed to be served and the way the customers deserve to be served. So you'll see some of that expense pressure, but again, overall, from a growth point of view, from a franchise point of view, the Costco portfolio is quite good, quite good.

JASON GOLDBERG: Time for one quick last question, if there is one. If not, please join me in thanking John for his presentation this morning.

JOHN GERSPACH: Thank you very much.

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