NASHVILLE NOTES

Citibank's Upstream Dividend Update

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Jeff Davis is a veteran bank analyst. The views and opinions expressed in this piece are those of the author and do not necessarily represent the views of S&P Global Market Intelligence; Mercer Capital, where Davis is the managing director of the financial institutions group; or StillPoint Capital, where Davis is a registered representative.

Third-quarter earnings season for banks will commence on Oct. 11 with JPMorgan Chase & Co., Wells Fargo & Co. and Bank of New York Mellon Corp. Aside from the usual handful of surprises, the quarter likely will be decidedly uneventful marked likely by flattish net interest margins and somewhat higher classified assets and credit costs.

Citigroup Inc. will release earnings on Oct. 15. I assume most of the focus will be on trading revenues, the booming leverage finance business and credit costs associated with the high-yielding card portfolio. I think analysts would serve their buy-side clients well by exploring upstream dividends declared by subsidiary Citibank NA even though the topic was discussed last quarter following an amendment to an existing regulatory order that gives the Office of the Comptroller of the Currency (OCC) a say in dividends declared by the bank.

> ***The bank's upstream dividends as well as the components of Citigroup's cash flow needs are worth exploring in depth by the equity analyst community.***

I covered the topic in a post this summer because intercompany dividend restrictions matter for parent companies such as Citigroup that are partially or entirely dependent upon upstream dividends from regulated subsidiaries to fund parent debt service and shareholder distributions.

It also matters because enforcement actions apparently can last for years. Wells Fargo Bank NA continues to operate under an OCC cease and desist order from 2018 that arose from the fake account scandal. The order has since been modified to address other shortcomings. As a result, parent Wells Fargo continues to be subject to the $2 trillion asset cap imposed by the Federal Reserve in 2018 on the consolidated company.

On July 9, Citibank consented to an amendment to an October 2020 consent order between Citibank and the OCC that arose from internal control issues. My assumption is that the 2020 order largely had its roots in the botched payment Citibank made as an agent to syndicate lenders to Revlon that resulted in boatloads of bad publicity and litigation in which the bank ultimately prevailed.

No doubt Citigroup, Wells Fargo and other banks are the gifts that keep giving to consulting firms hired to assist in meeting regulatory orders. The 2024 amendment to the 2020 enforcement action against Citibank in bureaucratic verbiage entitled "prioritization of expenditure on remediation" requires Citibank to obtain a "no objection" written response from the OCC's examiner-in-charge to a "Resource Review Plan" detailing how the bank is spending enough money to comply with the consent order. Assuming no objection exists, the bank then must obtain no objection to proposed dividends or other capital distributions.

Citibank is the primary source of cash flow to top-tier parent company Citigroup. The modified order does not prevent the bank from paying dividends to cover Citigroup's debt service obligations, preferred stock dividends and other non-discretionary obligations of the parent company. The not-so-fuzzy area is the OCC say in upstream dividends needed to fund common dividends (~$1 billion quarterly) and buybacks.

Management indicated this past quarter that it expects to repurchase about $1 billion of common shares after having repurchased about $500 million in the first half of the year. The parent company had cash of $4.0 billion as of June 30, while Citibank has declared $3.4 billion of dividends through June 30 (all in the second quarter) following a sizable $16.4 billion dividend in 2023.

The third-quarter dividend declared by the bank will not be disclosed — assuming I have not missed prior guidance — until the bank's Call Report is filed toward the end of the month, unless it becomes an earnings call topic.

I do not think the escalation by the OCC is a here-and-now issue for shareholders, and maybe it never will be if the OCC never objects as long as the consent order as currently modified is in place. Nonetheless, the bank's upstream dividends as well as the components of the parent company's cash flow needs are worth exploring in depth by the equity analyst community. The same idea applies to other banks, especially regional and community banks with levered parent companies.

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