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FEDERAL RESERVE BANK OF NEW YORK

NEW YORK, N.Y. 10045-0001

AREA CODE 212-720-5000

April 20, 2004

Ms. Michelle Sims
Board of Governors of the
Federal Reserve System
Division of Banking Supervision
and Regulation
Surveillance Section
Mail Stop 198
Washington, DC 20551



Dear Ms. Sims:

Enclosed are two copies of the following inspection report conducted by examiners for the Federal Reserve Bank of New York:

Name

Start Date

Citigroup Inc.

February 2, 2004

Please acknowledge receipt of these enclosures by signing and returning the attached copy of this letter in the envelope provided.

Sincerely,

A handwritten signature in dark ink, appearing to read "Joan Johnson".

Joan Johnson
Supervisor
Examination Process Support

Enclosures

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**Copy for
Board of Governors of the
Federal Reserve System**

**SUMMARY OF SUPERVISORY
ACTIVITY AND FINDINGS**



Name: CITIGROUP INC.

Period Covered: JANUARY 1, 2003 - DECEMBER 31, 2003

Location: NEW YORK, NEW YORK

RSSD ID Number: 1951350

Start Date: FEBRUARY 2, 2004

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FEDERAL RESERVE BANK OF NEW YORK

NEW YORK, N.Y. 10045-0001

AREA CODE 212-720-2164

April 13, 2004

BY HAND

Board of Directors
Citigroup Inc.
399 Park Avenue
3rd Floor
New York, N.Y. 10043

Enveloped Addressed:
C/O
Mr. Sanford I. Weill
Chairman

Dear Board Members:

Enclosed please find our annual Summary of Supervisory Activity and Findings for Citigroup Inc., presenting our assessment of the company and advising the Board of Directors of significant concerns discovered during the year that need to be addressed.

Our findings confirm that Citigroup Inc. remains in satisfactory condition, but with some noted areas for improvement. This assessment is based on our continuous monitoring efforts, specific target reviews conducted throughout the year, and a review of assessments of primary bank and functional regulators. Accordingly, the firm has been assigned a composite supervisory rating of "2". Organizations so rated are fundamentally sound but with modest weaknesses that are fully correctable in the normal course of business.

The year 2003 signified a year of change for Citigroup, as the firm successfully transitioned its most senior management positions and continued to make progress in further developing its risk management infrastructure. Improvements were noted in risk reporting to Senior Management and the Board of Directors, the establishment of a more independent risk management function, the enhanced stature of the Global Compliance function and the further development of the firm's economic capital framework. However, there are several risk management and control issues that continue to present challenges to the firm and warrant the Board's attention:

- 1) Certain weaknesses in corporate governance were noted during our reviews of Information Security, Business Resiliency and the Global Compliance Function, and enhanced corporate oversight is required to ensure consistency in business unit implementation of policies and procedures, MIS reporting and monitoring and training. Senior management and the Board should continue to focus on these concerns and ensure adequate resources are provided so that project deliverables and corrective measures can be implemented in a timely manner.
- 2) Citigroup has been slow to develop a robust business resiliency strategy relative to other significant firms that are critical to US financial markets. While recent progress has been

Board of Directors
Citigroup Inc.
April 13, 2004

noted, management will need to work diligently to meet internal deadlines and supervisory expectations.

- 3) Past business practices have led to intense regulatory scrutiny and increased reputational and legal risks. As a result, settlements were reached, fines were levied, and Formal Agreements were put in place. Senior management and the Board must continue to focus on improving the Global Compliance function and compliance environment throughout the firm, ensuring sufficient independence and adequate testing of compliance programs.
- 4) The firm has made noteworthy changes in corporate governance and business practices in order to meet appropriate ethical standards. Yet, certain policies and procedures related to structured finance activities and Business Practices Committees need to mature. Senior management and the Board should remain steadfast in its efforts to ensure these cultural changes are institutionalized and embedded throughout the franchise.

COPY

In terms of financial performance, Citigroup Inc. continued to benefit from its diversified business model and the strength of its consumer franchise. The firm posted record results, despite certain headline events, and continued to distinguish itself from its peers in earnings performance and capacity. The diversified revenue stream provides consistent earnings to augment the corporation's capital base and ample liquidity to support global operations. Consolidated credit quality trends are improving, reflective of the early stages of an economic recovery. However, concerns in Latin American emerging markets persist and the Japanese and German consumer businesses continue to show signs of weakness. Moreover, newly acquired consumer businesses require monitoring and need to be fully integrated into Citigroup's processes. Credit risk management remains satisfactory and management should continue its efforts to ensure the operating infrastructure reflects the changes in the company's risk profile.

Representatives of this Bank plan to meet with you on April 19, 2004 to discuss our current evaluation of the firm. After you have had an opportunity to review the report, we would expect to receive a written response to the matters discussed within 60 days of the receipt of this letter.

In closing, please note that this letter contains confidential bank examination material that should be treated accordingly by your organization. As such, the contents of this letter are subject to the rules of the Board of Governors of the Federal Reserve System regarding disclosure of confidential supervisory information.

Sincerely,



Homer C. Hill, III
Vice President and
Central Point of Contact

Enclosures

RSSD No. 1951350RESTRICTED F.R.
12 CFR 261**SUMMARY OF SUPERVISORY
ACTIVITY AND FINDINGS**

<u>Citigroup Inc.</u> Corporate Title	<u>399 Park Avenue</u> Street	<u>New York</u> City
<u>New York</u> County	<u>New York</u> State	<u>10043</u> Zip Code

Homer C. Hill, III
**Federal Reserve Bank of New
York**

<i>TABLE OF CONTENTS</i>

	<u>Page</u>
Risk Management	1
Financial Performance	2
BOPEC Rating	3
Citibank Overseas Investment Corporation CAMEO Rating	4
Appendix:	
Supervisory Activities and Scope of Reviews	A

Inspection Date:	December 31, 2003	Previous Inspection Date:	December 31, 2002
Financial Statements:	December 31, 2003	Financial Statements:	December 31, 2002

RISK MANAGEMENT

EXECUTIVE SUMMARY

Overall, risk management practices are considered effective. Citigroup's risk profile is inherently high reflecting the scale of global operations and product diversification, the reliance on large acquisitions to meet strategic objectives, and corporate governance challenges resulting in part from the integration of systems and businesses. The firm continues to make improvements in its risk aggregation capabilities and risk reporting to senior management and the Board of Directors (Board). Notably, operational risk measurement and reporting has improved markedly and all businesses have embraced the Risk Control Self-Assessment Process (RCSA). We view favorably the elevation of the reporting line for the Senior Risk Officer position and efforts to make the Risk Management function more independent, as well as the Global Compliance Director's enhanced interaction with the Board and senior management which provides for more transparent escalation of compliance issues. Furthermore, we are encouraged that senior management and the businesses have embraced economic capital and are working to incorporate it as a business tool.

Our supervisory concerns relate to certain corporate governance challenges in Business Resiliency, Information Security (IS) and Global Compliance that emanate from Citigroup's historically decentralized organizational structure. Our review of these three areas highlighted the need for enhanced corporate oversight to ensure more consistency in business unit implementation of policies and procedures, MIS reporting and monitoring, and training. Considerable work is required to address gaps in information security, such as completing more thorough risk assessments, better formalization of project plans with milestones, and enhancing resources to assure the full complement needed to complete all projects. Similar to information security, business resiliency is receiving significant attention from senior management and the Board as material shortcomings in current processes exist. The firm continues to build the governance process, assure business unit consistency, and work towards full compliance with the "Interagency White Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System" (Sound Practices). *We expect management and the Board to continue to focus its attention on these efforts to ensure adequate resources are deployed so that timely corrective measures can be implemented.*

Legal and franchise risks remain high given the impact of some of the headline events that have occurred over the past two years. Past business practices have led to increased regulatory scrutiny and resulted in Formal Agreements to enhance controls around the structured finance business and a pending action to improve controls and compliance risk management practices in CitiFinancial. We acknowledge management's efforts to address some of these concerns with the development of the Business Practices Committees throughout the organization, the establishment of the Policy Compliance and Assessment Group (PCAG), and the progress made in strengthening the Global Compliance function. The Director of Compliance has increased staff and budget, improved interaction with business compliance functions, and developed a detailed action plan to be fully implemented by the end of 2004. Nonetheless, enhancement opportunities still exist in the Global Compliance function, and the Business Practices Committees policies and procedures need to mature. *As such, management must continue to set the tone at the top of the organization and make certain that high standards permeate the various businesses in*

RISK MANAGEMENT - CONTINUED

the franchise. Senior management must remain vigilant in carefully evaluating business risks and returns against potential reputational risk issues, given the firm's global presence.

OPERATIONAL RISK

Operational risk is high considering the scale and range of the firm's businesses, but overall we consider Citigroup's activities adequately controlled. Although we continue to assess the firm's management of operational risk as generally effective, supervisory activities over the last year identified the need to improve the way information security and business resiliency are managed throughout the firm. Specifically, areas such as governance, policies and procedures, resource allocation, and consistent business unit implementation need enhancement. Management has recognized the challenge of changing the way the firm conducts business and has taken decisive action to instill new discipline. However, these cultural changes will take time to implement and proper resources will need to be allocated to complete all the tasks that have been identified. The current senior management team has demonstrated a strong commitment to correct identified gaps to bring the firm's practices in line with organizations of similar complexity. While the progress achieved to date on both information security and business resiliency is encouraging, outlined below are issues requiring the Board and senior management's attention to further enhance risk management processes:

- **Information Security:** Management should develop a much broader corporate view of the firm-wide technology strategy that could help clarify the existing information security process, which to date has been confined to each separate business unit. Since management has been focused on business ownership regarding information security over the past six months, we would expect management to shift a certain degree of its attention going forward to execution, process improvement and identification of best practices across the firm. We further encourage senior management to continue the practice of discussing IS issues with its peers and to take full advantage of the assessment of best practices within the organization. This would serve to ensure both consistency and accuracy. Lastly, we encourage senior management to strive to improve performance metrics through the use of robust tracking methods, which will allow management to properly assess results against well-defined criteria and ensure that not only positive results but setbacks as well are being fully disclosed to the board committees.
- **Business Resiliency:** Business Resiliency management was considered minimally satisfactory in our joint target review with the OCC. While we are encouraged by management's diligent efforts in developing a robust business resilience strategy, we do have concerns that internal deadlines may be optimistic. The firm was slow to develop its gap analysis relative to peers and we are monitoring closely the development of the data center plans, which continue to be in the early stages. As such, the final approval by the Board of both plan implementation and the total costs associated with this effort has not occurred, which is also behind other peer organizations. As a result, we see management challenges in 1) finalizing and implementing an appropriate plan for establishing more distant back-up capabilities; 2) management

RISK MANAGEMENT - CONTINUED

remaining focused despite additional distractions due to any potential acquisitions; and, 3) the ability to successfully complete testing with core and significant players. We urge management to continue to work diligently towards finalizing appropriate solutions in order to move closer to full compliance with the Sound Practices. In light of Citigroup's importance to global markets, we expect the firm stay on course with internal timelines in order to provide us a good gauge to measure management's effectiveness in this area. We would expect sufficient board oversight during this process to ensure that these timelines are met.

Any indications that progress is slowing or that management's commitment to correct these issues is waning would lead us to reconsider our overall assessment.

Audit and Risk Review (ARR) and RCSA Process

Despite the aforementioned issues, ARR provides a satisfactory control checkpoint that mitigates overall risk and ensures an acceptable control environment. In late 2003, a joint review conducted with the OCC of ARR confirmed our view that examiners are able to leverage off of ARR results given the effective risk assessment process, the quality of audit work and ancillary processes such as audit tracking and quality assurance. This review was part of our horizontal efforts to look across large complex banking organizations. ARR's overall performance was ranked above peer institutions, with the unit's quality assurance program being identified as a standout process. Given ARR's importance to the firm, management should continue to closely monitor the staffing levels relative to its workload. In addition, the firm's commitment to the RCSA process will add another layer of control. The firm revised its Operational Risk Policy in 2003 and required all businesses to perform control self-assessments utilizing minimum Citigroup standards. As Banamex is the only business not fully incorporating the RCSA process, management is urged to monitor the entity to ensure conformance in a timely manner. While we have not concluded our horizontal assessment of the control self-assessment processes at all the largest firms, early indications are that Citigroup's process is comparable to other peer organizations.

AMA Basel II

The firm continues to implement a comprehensive program to measure and monitor operational risk. We view the inclusion of the RCSA process in the overall operational risk policy back in mid-2003 as a positive result. In addition, we continue to assess the reporting of the operational loss data as an improving trend, as the business line reporting of key risk indicators continues to evolve. Management is encouraged to continue these efforts. In early 2004, we will be conducting, on an interagency basis, a benchmark exercise intended to gather information using the proposed AMA standards. We will provide feedback on our findings and comparability on Citigroup's progress relative to other large firms in late 2004.

RISK MANAGEMENT - CONTINUED**LEGAL AND COMPLIANCE RISK**

Legal and compliance risk continues to be a key focus of management as a result of continuous investigations and considerable pending civil litigation that remains outstanding from prior business activity. The diverse nature of the firm's global businesses in over one hundred countries and the numerous regulators with which Citigroup interacts heightens these risks. Internal controls designed to mitigate legal and compliance risk remain generally effective and have been strengthened over the last year with some key organizational and policy initiatives. Several noteworthy improvements include:

1. The hiring of a new Director of Global Compliance,
2. Substantially increasing Global Compliance and CIB Compliance staff,
3. Establishing "Business Practices" committees at the Corporate and Business unit level,
4. Issuing a new Structured Finance policy and strengthening controls around the Capital Markets Approval Committee process for the review of legal, compliance, and reputational risk,
5. Establishing the Policy Compliance and Assessment Group (PCAG) to review and ensure compliance with five policies issued in 2002 covering Structured Finance, Tax, IPO Allocations, Research, and Anti-Tying; and,
6. Enhancing the Operational Risk policy to require each business to implement the RCSA process, which includes and assessment of legal and compliance risk.

While management has established new policies, procedures, and structures designed to enhance the legal and compliance risk management program, *the Global Compliance function continues to warrant the attention of the Board and Senior Management.*

- Global Compliance Function: The FRBNY and OCC recently completed a review of the compliance risk management programs within the Global Consumer Group (GCG) and Global Compliance function. The GCG compliance program was deemed adequate, while the Global Compliance function was considered minimally satisfactory. Although the Global Compliance function was comparable to other peer organizations based on the FRBNY horizontal reviews, compliance monitoring and testing practices are considered behind peer. A formal independent process to evaluate and test the effectiveness of each business unit's compliance program is a key component of an effective compliance program, and management should ensure that adequate resources are devoted to this effort. Management should also ensure that the independence of the function and compliance officers throughout the firm is clearly delineated in the updated policy manual. Considering the nature and range of Citigroup's business activities, the supervisory expectations are that the firm should operate at a more advanced level (well above peer), particularly in light of recent compliance failures. The Global Compliance function has developed a detailed corrective action plan to address these issues which has been presented to the Audit Committee of the Board. *The implementation plan warrants routine monitoring by the Board and we will review very closely the firm's progress in implementing the plan within established target dates.*

RISK MANAGEMENT - CONTINUED

Compliance with Written Agreement

The FRBNY approved the September 26, 2003 submission by Citigroup Inc. that responds to the Written Agreement ("Agreement") dated July 28, 2003. We have determined that the credit, legal and reputational risk policies, practices, and procedures ("framework") submitted establishes an acceptable basis to address the provisions of the Agreement. However, in three areas, the framework needs further development. The first is in Citigroup's ability to articulate in a structured manner its tolerance for legal and reputational risk, to broadly evaluate these risks, and to communicate risk appetite throughout Citigroup. The second is in management's plans, policies, and practices to evaluate and monitor on an ongoing basis existing customer relationships for legal and reputational risks beyond the approval of individual transactions. The third is to continue to modify and enhance credit risk management systems based on the ongoing review of credit policies. The FRBNY will continue to monitor Citigroup's compliance with the Agreement in coordination with the OCC, where applicable. Therefore, management must ensure ongoing compliance with the Agreement and move forward in developing, implementing, and enhancing the required policies and procedures such that they fully address all of the provisions of the Agreement.

CitiFinancial

The FRBNY and Board of Governors supervisory staffs continue to monitor Citigroup's implementation of consumer compliance risk management practices through the Initiatives and Enhancements quarterly reports filed by CitiFinancial. Although we are encouraged by the information provided in these reports regarding CitiFinancial's status, we will not be able to draw any conclusions until our examiners have had an opportunity to conduct an on-site review to test these measures. We continue to have concerns regarding compliance risk management practices at CitiFinancial and are actively engaged in finalizing our Formal Agreement with the firm to ensure corrective actions are taken.

<i>REPUTATIONAL RISK</i>

Reputational risk has certainly increased over the past two years given the firm's past business practices and issues related to investment banking, consumer compliance, structured finance and most recently asset management. Settlements were made with the SEC and Attorney General on research and structured finance activities and Formal Agreements were entered into with the OCC and FRBNY. *Consequently, the firm's reputation has been tarnished and remains vulnerable to further headline events considering pending civil litigation, as well as pending regulatory actions.*

Executive management has taken several steps to enhance overall corporate governance which should serve to protect the firm's reputation. Specifically, the firm established a Nomination and Governance Committee of the Board, developed policies to comply with the Sarbanes-Oxley Act, and implemented Business Practice Committees at the corporate and business line levels to raise the level of communication and awareness of reputational risk. In addition, management established PCAG to specifically review five internal policies (Structured Finance, Tax, IPO Allocations, Research, and Anti-

RISK MANAGEMENT - CONTINUED

Tying) that were revised after intense regulatory scrutiny and headline events in 2002. The firm also charged the Capital Markets Approval Committee (CMAC) within GCIB with reviewing reputational risk in each transaction. Significant training was conducted throughout 2003 covering the five new policies in addition to policies covering the Code of Conduct, Employee Trading, and Chinese Walls. The effectiveness of these significant changes will need to be thoroughly tested over time. *Management must ensure that these cultural changes take hold in the individual businesses and that the new sound practices are fully institutionalized.*

Anti-Money Laundering (AML)

Considering Citigroup's global operations, compliance with Anti-Money Laundering (AML) and U.S. Patriot Act policies and procedures remains imperative, as control lapses can expose the firm to significant reputational risk. Citigroup's control processes are considered effective and in line with best practices. However, Banamex continues to be an area of supervisory focus as it implements Citigroup's policies and procedures, and we will be reviewing these activities in 2004. Management should continue their proactive efforts to mitigate the potential reputational and legal risk arising from AML and U.S. Patriot Act compliance failures.

CitiFinancial

The issues discussed above regarding CitiFinancial include reputational risks as well as legal risks. While senior management has recently made positive changes in CitiFinancial's culture, the pending regulatory action by the Federal Reserve to address consumer compliance weaknesses found at the 2001-2002 examination will certainly increase reputational risk for Citigroup in the near term. In addition, the recent Washington Mutual Finance acquisition exposes the firm to further headline scrutiny and claims from community activist groups. Management should continue its efforts to improve the compliance and control environment of CitiFinancial.

<i>CREDIT RISK</i>

Risk management practices are sound, controls are sufficient and policies promote a disciplined credit culture. Most noteworthy are the organizational changes that resulted in a greater degree of independence within the risk organization. Specifically, risk managers are reporting directly into the independent risk group in contrast to the previous dual line reporting structure, further strengthening credit risk management. Other positive enhancements include management plans to develop a separate risk infrastructure for the middle market portfolio to better dimension the risk posed by various portfolios throughout the firm. The well-established country risk management process continues to improve and exposure to watch-listed countries is being reduced in accordance with established reduction plans. Additionally, cross-border risk is considered satisfactorily managed.

In the consumer portfolio, acquisitions have increased portfolio risk, and management attention has focused on improving the risk characteristics in the new businesses. In addition, attention remains on

RISK MANAGEMENT - CONTINUED

CitiFinancial Japan's consumer finance business as loss rates remain high; but, we view the structural management changes and collection system enhancements as positive risk management steps to address the credit risk concerns.

Corporate Portfolio

Credit risk is managed through a framework of limits to control risk and maintain a diversified portfolio, although risk concentrations exist in sovereigns (with sizeable exposure to the government of Mexico, for example), financial institutions and investment banks. In the Corporate & Investment Bank, the Global Portfolio Optimization Group continues to develop risk-mitigating techniques to reduce credit concentrations and increase capacity under obligor limits. In the Emerging Markets, a similar initiative was launched that should improve returns and increase portfolio liquidity. Management has also made progress in reducing exposures to stressed industries, most notably telecom, merchant energy and airlines.

Consumer Portfolio

Consumer credit risk is adequately managed. Risk management maintains a well-disciplined, centralized approach to consumer credit risk monitoring by establishing uniform credit policies across consumer businesses and conducting visitations periodically to verify adherence to global policy parameters. Risk managers continue to enhance collection efforts, tighten scorecard criteria and monitor delinquency, bankruptcy and loss rates, particularly in geographies with stressed economies. The consumer credit risk management tools in place -- including MIS, program limits and monitoring, stress testing and periodic reviews -- remain effective in risk mitigation.

The recent portfolio acquisitions of Sears and Home Depot private label/bankcard, and Washington Mutual Finance Corporation's consumer finance business have increased credit risk in the consumer portfolio. Management should remain focused on the continued use of appropriate credit risk management tools to help mitigate the risk inherent in the acquired middle- to lower-end quality assets. We will continue to closely monitor domestic bankcards, including private label, CitiFinancial and international consumer finance, given their higher risk characteristics.

As part of our supervisory program for 2003, several target reviews were conducted to assess the effectiveness of controls, including a horizontal review of credit risk and portfolio management practices. The reviews affirmed that both corporate and consumer credit risk are being satisfactorily managed and controls are operating as intended. The following findings are elevated for management's attention to further enhance risk management practices:

- Allowance for Loan and Lease Losses: The corporate credit ALLL methodology is considered satisfactory. Over the past year, management has continued to improve the level of documentation. However, additional efforts are needed to increase the transparency of the

RISK MANAGEMENT - CONTINUED

process. Specifically, the documentation in the quarterly package should support the judgmental aspects of the reserve process, a repeat recommendation from last year's report. In addition, the quarterly package needs a summary or sufficiently detailed recap reflecting the corporation's methodological construction. Management has started to address these concerns and noted improvement was observed in the fourth quarter 2004 ALLL package.

For CitiFinancial, documentation on the methodology, particularly with respect to the judgmental component, continues to improve. Historically, the straight-rate-to-one methodology was applied to CitiFinancial, which does not account for loans that display elements of high risk or inherent loss within the current bucket. We recommend that straight-rate-to-zero or another appropriate methodology be applied, which management is in the process of addressing.

- **ARR's Credit Risk Review:** The credit review function within ARR is considered effective in identifying and elevating credit risk and control concerns, and compares favorably to other peer institutions with respect to its focus on process and determining underlying causes for risk rating differences. Audits are performed based on well-defined review programs and control test steps are sufficiently rigorous. To further enhance business monitoring practices, we recommend the adoption of a more consistent presentation of business monitoring plans to reflect more clearly that the monitoring is focused on the key business risks and controls.

ECONOMIC CAPITAL FRAMEWORK

In 2003, the firm made several significant advances in economic capital, and senior management clearly acknowledged the usefulness of this business tool. We have been encouraged by the increasing use of economic capital figures in internal management reports, reflecting the acceptance of methodologies and output by senior management and the respective business heads. Likewise, the decision to publish economic capital information for the first quarter of 2004 represents a major step for the firm. Despite this progress, much work remains to be completed before economic capital is embedded in the business as a decision making and risk management tool. We continue to encourage management to foster the use of economic capital in its businesses and to develop a framework that complements its preparations for Basel II.

MARKET RISK

Market risk is managed in a satisfactory manner, reflecting a comprehensive limit structure and adequate price verification, P&L attribution and reserving practices that are comparable to other institutions. In addition, the firm has made considerable progress in strengthening its model review process by addressing prior examination issues. Specifically, management has developed a timetable to validate

RISK MANAGEMENT - CONTINUED

remaining unvalidated models and ensure sufficient expertise and resources to allow for timely validation of all models. The model validation process is now considered in line with peer practices.

The firm's exposure to market risk remains moderate despite the increase in aggregate risk exposure across trading businesses over the last year. While the firm remains principally focused on customer flow trading, management expects proprietary position taking to assume greater importance over the next year to supplement customer flow business. Moreover, recent strategic initiatives to enhance Citigroup's presence in the capital markets, specifically derivatives, highlights management's willingness to further increase the firm's risk appetite. In light of this increasing risk profile, independent market risk management will need to ensure that it has the appropriate level of resources necessary to keep pace with this growth in order to adequately monitor and control risks associated with these initiatives. Based on our reviews and continuous monitoring efforts conducted in 2003, management's attention is drawn to the following areas:

- GMR Integration: While some progress was made in 2003 integrating the remaining trading exposures not captured onto GMR, a few remaining desks are not yet in GMR production resulting in an inability to take full advantage of the benefits associated with aggregating market risk exposures. It has been five years since the integration of Citibank and Solomon Smith Barney began and we expected businesses would have dedicated the appropriate resources needed to resolve these issues in a more timely manner. Management should ensure resources are dedicated to complete the integration of GMR.
- PSE Server Integration & Data Quality: Although the percentage of trades utilizing add-on factors (14%) has been reduced and is currently consistent with peers, aggregate counterparty exposure is distorted by add-on factor measures that are generally more conservative than peers, limiting the usefulness and in some cases the meaningfulness of the potential future exposure measure. We strongly encourage timely completion of scheduled 2004 enhancements to implement new methodologies to incorporate certain products onto the PSE Server and recommend the establishment of a formal project plan with explicit sponsorship to resolve these data quality issues.
- Counterparty Stress Testing: Currently, only five counterparties per year are required to undergo stress tests. Management should implement a "high risk" counterparty identification process that includes identifying potential concentration risk arising from groups of counterparties that are sensitive to common sets of risk factors and/or wrong way risk. Meaningful stress scenarios should be applied, at a minimum, to counterparties for which exposure concentrations are material, highly sensitive to, and/or positively correlated with, default risk, with stress test results presented to senior management on a formal and periodic basis. Peer practices currently range from stress testing the entire portfolio to more tailored stress testing of the largest counterparties and portfolios with specific vulnerabilities (such as hedge funds, emerging markets, energy, etc.) on a formal, periodic basis.

RISK MANAGEMENT - CONTINUED

LIQUIDITY RISK

Liquidity risk management is considered effective. In 2003, Citigroup improved the quality of its liquidity risk management by exerting greater corporate level oversight with the issuance of a liquidity risk management policy that clarifies roles and responsibilities, standardizes data inputs, and allows for greater analysis and discussion of local stress test scenarios. As in 2002 the firm continued to improve its liquidity position by lengthening debt maturities from 4.4 years at year-end 2001 to 5.7 years in 2003, reducing exposure to commercial paper and diversifying funding by currencies and investors in an advantageous capital markets environment. The development of the home equity line of credit securitization program in 2003 and the planned securitization of auto finance loans in 2004 highlight the firm's ability to identify new sources of liquidity. Despite reputational concerns over the past two years, the firm's strong financial position and earnings growth has been recognized by the markets and Citigroup continues to have the ability to access the markets at favorable rates.

Citigroup maintains an effective global contingency funding plan that in some respects exceeds its peers. The automation of previously manual processes and improvements made in the integrity of liquidity MIS further highlights management's commitment to ensuring the firm has ongoing access to the most accurate and timely data for decision making during times of crises.

INSURANCE RISK- LIFE/ANNUITY PRODUCTS

The risk in Travelers Life and Annuity businesses is inherently low with exposure to mortality risk that is well defined and fairly predictable. The FRBNY and functional regulator consider risk management practices to be prudent. Travelers benefited from a relatively benign credit environment and responded to low interest rates and weak equity markets by introducing new guaranteed annuity products and broadening non-proprietary distribution channels. These efforts, while early, are meeting with success and Travelers is maintaining its underwriting discipline to manage its insurance liabilities risk. Risk management processes continue to be strengthened, as Travelers Life and Annuity businesses are further integrated into Citigroup corporate processes. Travelers' progress with control self-assessments, economic capital modeling and credit risk management, while measured, is beginning to display effectiveness.

FINANCIAL PERFORMANCE

Citigroup Inc. exhibited another strong financial performance for the year, benefiting from its diverse product lines and geographical presence. The firm once again distinguished itself as the most profitable financial corporation in 2003. Although Citigroup did not escape headline events in 2003, the financial impact of the Parmalat bankruptcy, regulatory settlements for Enron and Dynegy, and mutual fund issues did not materially affect earnings in this fiscal year, nor did these events erode Citigroup's standing in the capital markets.

EARNINGS

Consolidated earnings for 2003 remain strong. Record net income of \$17.85 billion and strong year-over-year growth of 17% resulted from double-digit income growth in most business lines, even when excluding the December 2002 legal charge. The return on assets, return on equity and net interest margin ratios all exceeded those at comparable domestic institutions as management successfully navigated a lower interest rate environment and held non-interest expense growth to 5% to offset slow revenue growth. Despite the increase in expenses from pension, insurance, options and deferred acquisition costs, Citigroup's efficiency ratio of 55.48% remains below that of its domestic peer group at 58.2% and reflects management's keen focus on controlling expenses.

For the past several years, earnings have been largely dependent on the strength of the Global Consumer business to offset weaknesses in the wholesale markets. Additionally, revenue growth from the legacy businesses has been overshadowed by growth from large-scale acquisitions. As the economic environment is starting to improve, opportunities for growth in other key business lines and their relative contribution to total earnings will be enhanced. The firm's 2004 focus on organic revenue growth in core businesses, supplemented by strategic acquisitions, should provide for an even more stable earnings base for the future.

ASSET QUALITY

Credit quality indicators reflect an improved credit environment and asset quality is considered satisfactory. At year-end 2003, the composition of the corporate portfolio improved, as 85% of outstanding and unused commitments were considered investment grade compared with 79% the prior year, and relative economic capital levels declined. Similarly, there was noted improvement in the levels of net credit losses, non-performing and classified assets. However, there remains the risk that problem credits in stressed industries, such as telecom and merchant energy, may continue to migrate to more severe categories of risk. In emerging markets, Latin America continues to be a primary concern. Argentina and Venezuela are in the more critical risk categories and still pose the potential for further losses.

In consumer credit, portfolio indicators, excluding acquisitions, have been fairly flat during the past year. For the majority of 2003, delinquency and loss rate trends for CitiFinancial improved slightly

FINANCIAL PERFORMANCE - CONTINUED

from 2002 levels, but were mitigated overall in fourth quarter by anticipated higher loss rates in the Cards business line from the Sears/Home Depot portfolio inclusions. Overseas, the consumer finance franchise in Japan, while displaying signs of stabilization, continues to be problematic and is still months away from economic recovery given lags in unemployment and bankruptcy. In Germany, continuing economic issues, including rising unemployment and stagnant growth, will continue to pressure the consumers' repayment capacity and negatively impact the retail bank with extended charge-offs. Management is taking prudent measures to improve collection systems and call strategies to address credit risk concerns in these countries.

CAPITAL

Both Citigroup and Citicorp have maintained regulatory capital ratios throughout 2003 that exceed the guidelines for a "well capitalized" institution. Ratios have also increased slightly from 2002 levels, as has total equity capital, due to strong earnings retention. While Citigroup increased its common dividend twice in 2003 with an overall 94% increase to 0.35 cents, the payout ratio remains prudent and below that of its peer group. Additionally, the insurance and securities subsidiaries continue to exceed the minimum capital standards established by their respective regulators.

PARENT COMPANY LIQUIDITY

Parent Company liquidity remains strong due to the firm's ability to access capital markets flexibly at attractive rates and generate ongoing sources of liquidity from assets. Over the course of 2003 Citigroup continued to actively diversify its investor base and lengthen the weighted average maturity of its debt. Moreover, Citigroup Treasury was able to further reduce its reliance on commercial paper outstanding with an overall decrease of \$1.8 billion during the year.

BOPEC RATING

The Bank Holding Company Performance Rating System currently in use at the Federal Reserve requires an annual rating for Citigroup. The composite and component ratings are reflected in the table below.

BOPEC RATINGS	12/31/03 Citigroup	12/31/02 Citigroup
<i>Bank Holding Company Rating System</i>		
Composite Rating Management	2 Satisfactory	2 Satisfactory
<i>Component Ratings:</i>		
Bank Subsidiaries	2	2
Other Nonbank Subsidiaries	2	2
Parent Company	1	1
Consolidated Earnings	1	1
Consolidated Capital	1	1

BANK SUBSIDIARIES

Overall, banking subsidiaries remain in satisfactory condition as indicated by the examinations conducted by the respective bank regulators. This rating is largely based on the evaluation of Citibank, NA given its asset size. Other banking subsidiaries, namely Citibank (West), FSB, Citibank (Nevada), Citibank (South Dakota), Banamex, Citicorp Trust Bank, fsb, California Commerce Bank, Citibank USA, and Universal Financial Corp are also considered satisfactory. Associates Capital Bank, Citibank Delaware and Citibank, fsb are considered strong.

NONBANK SUBSIDIARIES

The principal nonbank subsidiaries, Citigroup Global Markets, Inc. (CGMI) and the Travelers Insurance Company, remain in satisfactory condition. This evaluation is based on risk reports, meetings with senior management, a review of ARR findings and an assessment of financial performance. In addition to these ongoing monitoring efforts, we also meet with the functional regulators to incorporate their assessments. The satisfactory rating reflects an adequate risk control environment and overall effective risk management practices. In last year's report we noted a need for management attention to improve the compliance function at Citigroup Global Markets, Inc. We are encouraged by the notable improvements realized in 2003, including the hiring of a new general

BOPEC RATING - CONTINUED

counsel and business compliance chief, the significant increase in compliance staff and the implementation of the RCSA process. Management should continue its efforts in further enhancing the compliance environment of CGMI.

We continue to regard CitiFinancial, Citicorp's principal nonbank subsidiary, as only fair given the compliance concerns noted in the prior report. While CitiFinancial has taken significant steps to address some of the control deficiencies and questionable lending and sales practices determined at the 2001-2002 compliance examination, our assessment will remain unchanged until the internal controls and new business practices can be tested.

<i>PARENT COMPANY</i>

The parent company continues to be strong and serve as a source of strength to its subsidiaries. The parent company's double leverage ratio remained stable at 111% and compares favorably to other large complex banking organizations. However, the parent's ability to cover operating expenses and dividends from operating income has deteriorated from 257% at year-end 2002 to 103% at year-end 2003. Despite this decline, our evaluation is based on the compensating factor that the reduction in parent operating income was evidence of acting as a source of strength while a bank subsidiary absorbed an acquisition. Additionally, the parent continues to be well received in the capital markets and has maintained enough liquidity to cover maturing long-term debt and commercial paper without the need to access external funding.

For additional details regarding earnings, capital, and liquidity, please refer to the Financial Performance page 2.

CITIBANK OVERSEAS INVESTMENT CORPORATION

CAMEO RATINGS	12/31/03 COIC	12/31/02 COIC
<i>Composite Rating</i>	2	2
<i>Component Ratings:</i>		
Capital	1	1
Asset Quality	2	2
Management	2	2
Earnings	1	1
Operations/Internal Controls	2	2

COIC's composite rating continues to be satisfactory and now represents approximately 35% of Citibank's assets. The Edge Act Corporation continues to be effectively managed with a strong capital position and earnings performance. Consolidated asset quality remains satisfactory. The significant rise in the level of classified and criticized exposures during 2002 appears to have abated somewhat in 2003, as the assimilation of CitiFinancial/Associates portfolios, as well as those loans absorbed during the Bank Handlowy merger and the Single Europe Program have begun to show signs of stability. In addition, the operations and internal control environment remain satisfactory.

RISK MANAGEMENT

Risk management practices are considered satisfactory. In general, country level management is effective in managing franchise risks in the current global business environment. In particular, the Citigroup Europe Governance Committee (CEGC) has proven to be an appropriate vehicle for corporate oversight and governance relative to the entirety of Citigroup's business activities across Europe. The CEGC committee will be challenged as governance issues in the growing CitiFinancial Europe businesses will be included within their oversight responsibilities. Furthermore, continued vigilance in risk management oversight may be needed as the CEEMEA businesses become combined with EMEA and the integration of legal vehicles and portfolios continue during the completion of the Single Europe Program.

Now that most of the former Associates/CitiFinancial portfolios have been assimilated and housed within COIC vehicles around the world, another key challenge for management will be to appropriately grow the global consumer finance businesses within a strong corporate governance framework that will be mindful of local regulatory concerns. In addition, the acquisition of KorAm Bank will add a significant loan portfolio (\$29 billion) to COIC that will need to be risk-rated, which may influence the

CITIBANK OVERSEAS INVESTMENT CORPORATION - CONTINUED

Edge's overall asset quality assessment. Management should ensure Citigroup's standards are implemented in a timely fashion.

REGULATION K

COIC's internal control processes were reviewed to ensure ongoing compliance with Regulation K limits on the size of individual investments and on aggregate Edge investment activity. The review revealed that the firm has an effective process to monitor Regulation K compliance. The process requires written justification by project sponsors (initiating managers), and sign-off by appropriate parties, including business head, financial control, accounting, legal and regulatory compliance, and risk management. Citibank management is well aware of the Regulation K limits and has put in place internal controls intended to prevent Citibank/COIC from exceeding the limits.

However, compliance with Regulation K is embedded within discrete legal vehicles and businesses, and as such ARR can only audit for Regulation K compliance within the scope of other auditable entities as there is no specific standard audit program (SAP) for Regulation K, as yet. We would encourage ARR management to remain on course with completion of the Regulation K SAP before year-end. In addition, with the increased growth planned for COIC through acquisitions and conversion of Citibank N.A. branches over the next year, we draw compliance management's attention to the need to remain vigilant in ensuring ongoing compliance with not only investment limits associated with Regulation K but permissible activities as well.

COIC SUBSIDIARIES

COIC subsidiaries are effectively managed. This assessment is based primarily on a high level of satisfactory ARR reviews over the last year affecting COIC entities, examiner findings from the continuous monitoring activities of significant COIC subsidiaries and the on-site visitations of two COIC entities (Citibank Privatkunden AG and Citibank Handlowy) in 2003.

SUPERVISORY ACTIVITIES AND SCOPE OF REVIEWS

SUPERVISORY ACTIVITIES

The Federal Reserve's supervisory program is accomplished through a combination of on-site meetings and reviews conducted at Citigroup, and extensive off-site analysis of the company's internal risk management reports, publicly available information, and information from the functional and foreign regulators. The review of internal risk management reports is a critical element of the process.

An important aspect of the supervisory program is reliance to the greatest extent possible on the primary bank and functional regulators. Examination and financial information received from these regulators were reviewed, including reports from the OCC, SEC and the State of Connecticut Insurance Department's (CID). Reviews of business lines, which included the primary bank, functionally and foreign regulated entities, were coordinated with those regulators. Meetings were held with the relevant bank, functional and foreign regulators to communicate the Federal Reserve's supervisory plans, in instances where the corporation's activities involved entities under their jurisdiction.

SCOPE OF REVIEWS

The following on-site reviews were conducted in 2003 and the results of these reviews were conveyed to the corporation.

Operational Risk Reviews

- **Corporate Information Security.** A review of the firm's Information Security (IS) activities was conducted to evaluate the adequacy of the IS program and to determine the effectiveness of management's implementation of the program. We reviewed the IS framework and governance techniques, and assessed business unit implementation of IS processes and practices. We also evaluated policies and standards, risk assessment methodologies, technology initiatives, ethical hacking guidelines, incident response programs, and training and awareness efforts.
- **Internal Audit.** A review of the firm's ARR unit was conducted as part of an overall horizontal assessment process. Our review evaluated the overall effectiveness of internal audit activities and specifically focused on the structure and role of the audit committee, auditor independence, risk assessment processes and planning, the quality of audit work and ancillary processes.
- **Continuity of Business.** The objectives of the review were to evaluate the effectiveness of the Continuity of Business program, review business unit compliance with standards, and assess progress in implementing the Interagency White Paper on Sound Practices. The review evaluated the adequacy and effectiveness of corporate policies and processes. The focus was on corporate management oversight, organizational structure, policies and procedures, MIS reporting, monitoring and staff training.

SUPERVISORY ACTIVITIES AND SCOPE OF REVIEWS - CONTINUED

Legal and Compliance Reviews

- **Global Compliance Function.** This target examination evaluated the adequacy of the compliance risk management program established at the parent company designed to ensure firm-wide compliance with applicable laws and regulations. The examination reviewed the following attributes: Executive Oversight, Organizational Structure, Policies and Procedures, MIS Reporting, Monitoring, Training, and Audit Coverage.
- **Citigroup Global Markets Limited (CGML) - London.** A high-level governance review conducted jointly with the Financial Services Authority to ensure adequate controls had been implemented over conflicts of interest, analyst research activities, and IPO allocations. The review also focused on the established Capital Markets Approval and Commitment Committees.
- **Consumer Compliance Risk Management Program.** Horizontal review of the compliance program administered by GCG North America conducted jointly with the OCC that focused on the following elements: board of directors and senior management oversight, organizational structure of the compliance program, policies and procedures, compliance audits and compliance monitoring, internal controls and compliance training.

Credit Risk Reviews

- **Credit Risk Review.** This review focused on assessing ARR's Credit Risk Review Methodology and to evaluate elements of this process we tested business monitoring practices, key credit risk controls including risk rating assignments, due diligence and problem recognition. In addition, we assessed the independence and competence of staff and the role of the Global Credit Liaison.
- **Allowance for Loan and Lease Losses (ALLL).** A joint review with the OCC was conducted to assess the adequacy of the documentation supporting the corporate credit ALLL, particularly, the FAS 114 reserves and the methodology for the consumer finance business within GCB.
- **Credit Risk Management Processes.** Examiners reviewed the firms' approach to determining credit risk appetite and managing and mitigating concentrations through obligor limit structures and portfolio management techniques. This review was part of a horizontal target across six institutions and at Citigroup; the focus was on CIB, International, the GCB and TL&A businesses.

Economic Capital Reviews

- **Quarterly Management Meetings.** A pilot review was conducted of Citigroup's efforts to date to meet the criteria set forth in the New Basel Accord's Internal Rating Based Approach. The review focused on the firm's risk rating system design, structure and criteria, data maintenance requirements, and the independence and quality of control functions.

SUPERVISORY ACTIVITIES AND SCOPE OF REVIEWS - CONTINUED

Market Risk Reviews

- **Price Verification, P&L Attribution and Market Related Reserving Processes.** The purpose of the review was to evaluate the quality and effectiveness of policies, practices and controls surrounding the aforementioned processes. Specifically, the processes employed by management for the Fixed Income Derivatives and Convertible Debt desks served as a representative sample of GCIB's control activities relating to illiquid and complex instruments.
- **Phibro.** The purpose of the review was to evaluate the effectiveness of the credit, market and operational risk management policies, procedures and systems utilized by Phibro. Also assessed was the unit's compliance with Citigroup corporate standards and applicable regulations, as well as the extent to which Phibro's risk management processes and control systems have been integrated into Citigroup's control processes.
- **Model Validation.** A review of model validation practices was conducted by the OCC with our participation. The purpose of the review was to evaluate the effectiveness of the administration of the new Model Control Policy and whether such efforts adequately addressed priorities, including the model validation backlog and resource requirements.
- **Counterparty Exposure Measurement.** The purpose of the review was to evaluate the underlying methodology and implementation of counterparty exposure measurement techniques, both on the Pre-Settlement Exposure (PSE) Server and outside of the Server in the form of Credit Exposure Factors (CEFs). As part of this evaluation, an assessment was made of the progress to date and future plans for integrating products onto the Server platform. In addition, examiners formally followed-up on an item raised in the 2002 high-risk counterparty examination, which identified the need to incorporate formal and regular stress testing programs within the firm's counterparty credit risk management processes.

International Banking Reviews

- **Banamex.** The review of operational activities at Banamex was performed to evaluate and test selected firmwide operational activities including Information Security Administration, Continuity of Business/Disaster Recovery, and Financial Controls/Reporting. The review also covered an assessment of the new operational risk governance program, and included an update on the progress made in addressing the credit risk management issues raised at the previous review.
- **COIC (*Edge Act Review*).** An examination of Citibank Overseas Investment corporation (COIC), an Edge Act subsidiary of Citibank NA, was conducted and focused on assessing risk management processes, including an analysis of asset quality, as well as a review of internal and external audit coverage and compliance with Regulation K. Additional assessments were also made of certain COIC subsidiaries.

SUPERVISORY ACTIVITIES AND SCOPE OF REVIEWS - CONTINUED

Travelers Life and Annuity Management Reviews

- **Quarterly Management Meetings.** On a quarterly basis, meetings were conducted with Citigroup's management responsible for insurance activities (with the Connecticut Insurance Department in attendance). Each quarter, Travelers' operating performance results were reviewed, and the integration of insurance business risks into Citigroup's firm-wide Operational Risk Management framework and the progress on the Self-Assessment program development were discussed. Other topics covered throughout the year included updates on Patriot Act compliance; legal/legislative/regulatory issues; new product offerings; and overviews of the investment portfolio; Compliance function; new product approval process; Economic Capital framework; international insurance activities/strategies.
- **Connecticut Insurance Department.** In addition, on a semi-annual basis, FRBNY meet separately with officials from the Connecticut Insurance Department to obtain their views on the Travelers insurance companies.

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Supervisory Activities and Scope of Reviews - Continued