Discussion re Citi

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Timeline for Reassessing Rating

- 2nd half Nov 2007: CPC team reassessed need for additional supervisory activities to develop supervisory ratings
  - Will monitor and leverage on work launched by OCC on CDO valuation process
- 1st half Dec 2007: CPC asked that Risk Coordinators prepare for RC "summit" week of Jan 7
- Citi Risk Coordinators & Analyst Meeting Jan 9
  - RCs will prepare written pros/cons of changes to Risk rating broken down by 4 components, for each risk (credit-market-liquidity-operational-compliance-legal/reputational
    - Introduce discipline to properly capture and weigh areas of risk management where things have not gone wrong
  - Assess all continuous monitoring activity & targets
  - Incorporate Senior Supervisors findings
  - Recommend changes to 2008 Sup Plan
  - Analyst to do same re F rating, and individual CAEL components

Timeline (contd)

- CPC to a develop views by Jan 14, with recommendations as to how each component of the rating should change
  - 2006 rating = 212/2 (2)
- Discussion of recommendations with LFIT Week of Jan 14
- Discussion with FRBNY management, week of Jan 14
- Discussion of recommendations with Senior Board staff week of Jan 21

Background for Supervisory Deliberations

- CPC Team focus on risk management issues during the 1st half 2007 included:
  - ALLL methodology
  - Economic Capital horizontal
  - Compliance Monitoring
  - Intraday Liquidity Management horizontal
  - Several Basel Discovery reviews
  - Multi-lateral review Counterparty Credit
  - Auto Finance risk management
  - Energy Commodity trading
  - Internal Audit business monitoring (w/OCC)
- In August, focus shifted heavily toward assessing impact of subprime related market disturbances on various portfolios and the support/treatment of SIVs

Risk Management Considerations

- Almost all Target examinations listed on prior slide resulted in generally satisfactory assessments of the process or business, with improvement needs of low to modest significance identified
- ALLL
  - Focused on BHC and Edge entities, while OCC covered the bank
  - Recommended adjustments to methodology to align with Interagency Policy Statement
  - Management made extensive modifications, and adopted revised methodology firmwide
  - Both agencies reviewed the changes (summer 07)
  - Outcome: Citi management continues to employ its new methodology, but with more aggressive management adjustments, and FRBNY has scheduled a target review of the new ALLL process in first half 2008

Risk Management Considerations

- Risk Aggregation
  - Inadequate orchestration & communication across business lines by the independent Risk function of “top of house” picture of risk
  - Potential magnitude of the credit and market risks assumed in CDO structuring, leveraged lending, and structured conduits were not adequately understood by businesses or independent Risk Function

Risk Mgmt (cont'd)

- Inadequate Risk Tools
  - Inadequate risk metrics.
  - Inadequate stress testing and scenario analysis
  - Macro hedging was not a tool utilized or considered generally available within the Risk function's arsenal
  - Absence of a centralized Treasury encouraged allowing assets to come on the balance sheet without adequate consideration of contingency capital charges
  - Based on results of continuous monitoring, and subject to further validation by OCC exam results, CDO valuation practices were deficient

Supervisory Plan Adjustments

- Follow-up on Action Plan that will be requested of the firm to address risk management weaknesses and capital issues
- Incorporate reviews, via continuous monitoring or formal target exams, of the areas of weakness that have been identified in recent months. These would include:
  - Adjust our planned Price Verification target exam to expand scope to cover all traded and non-traded instruments both on and off-balance sheet, capture all L3 assets, and follow-up on findings of OCC re CDO valuation process
  - Expand scope of planned target on enhancements made to ALLL process to include management adjustment process
  - Add target exam to assess the effectiveness of the changes made by incoming CRO to the Risk function, particularly in whether exposures and limits are more completely defined, and how they are monitored, improvements in stress testing, how differences of opinion between Risk and Business are handled, and how reporting to senior management and BOD have changed
  - Review credit risk monitoring process to ensure effective monitoring and mitigating actions in a deteriorating credit environment
  - Review scope of existing target of readiness for Market Risk amendment
  - Ensure that all 11 Basel related reviews capture the question of applicability of processes and communication of risk firm-wide
  - Examine the strategic budgeting process to better understand how risk adjusted concepts get incorporated
  - Assess how the firm has incorporated risk into its compensation for business heads
  - Assess how the firm is approaching macro-hedging
  - Assess effectiveness of changes made to liquidity management to account for contingencies, and pricing to the business

Financial Condition

- Capital
  - Firm has fallen below internal capital targets but remains "well-capitalized" by regulatory standards; however, firm has dipped below its target TCE/RWMA ratio sought by rating agencies.
  - Firm has demonstrated ability to raise additional capital, most recently $7.5 b in mandatory convertible equity units to a foreign investor, $3.5 b in e-Trups in Dec, and $1.2 b e-Trups in late summer.
  - We have encouraged Citi to continue to seek additional capital in the near future to act as a buffer for future unforeseen events and to lock such equity funding away while general economic & market conditions are still favorable to Citi's story.
  - Citi has responded favorably, now seeking an additional $7b-$10b in convertible preferred via private sources, and considering a further $2b-$5b publicly. Depending on how severe an economic downturn becomes in 2008, the additional capital will significantly improve Citi's capital ratios.
  - Citi has responded by also reducing assets in the third quarter by $100b (despite onboarding of SIVs), decided to reduce the shareholder dividend by 40%, and has identified high probability asset sales that will generate additional capital for TCE purposes.
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Financial (cont'd)

- Asset Quality
  - Although trends for firm are clearly indicating higher levels of NPLs and past due loans at both the consumer and wholesale portfolio, and we are starting to see signs of this overseas (eg Mexico), the quality of the portfolio has not deteriorated below a "satisfactory" assessment.

- Earnings
  - Net income for the firm is significantly down from 2006, only estimated at $4.7b for the year.
  - Projections for 2008 range from $19.2b in a business as usual environment, down to $5.6b in a recession environment (assuming divestitures, dividend cut, and addl capital)
  - Highly dependent on assumptions,
  - Earnings have not been sufficient to generate sufficient capital growth at the firm to weather the volatile market & credit environment.
  - Management strategy of past decade to expand the financial supermarket concept, and then more recently to "catch up" in the international arena to achieve a 60/40 split, has left the firm's shareholders unimpressed, and the firm's ability to weather storms that drain capital, open to question.

- Liquidity
  - Handled the stresses that arose from the events of this summer and Fall satisfactorily.
  - OCC has downgraded the Liquidity rating of the bank to satisfactory from strong.

Supervision Of Edge Act Activities

- COIC is owned by the bank
- Represents significant majority of Citigroup's overseas operations and a large minority portion of the bank's consolidated assets.
  - COIC does not have its own risk management staff or infrastructure
  - In many locations, Edge and bank each conduct activities that are managed under same functional business line and risk management staff.
- Criteria used in deciding which Edge activities to review overseas is risk based, and includes nature of activities, growth patterns, importance of subsidiary's activities to a business line or region, contribution to earnings, problems identified through internal audit, or susceptibility to potential problems (eg AML)
- OCC has participated in examinations of Edge activities abroad when there has also been a business line of the bank active in that same location or region that also spans into the Edge subsidiary.
  - We have invited the OCC, or been open to their suggestions to participate in our exams (Exception: when the exam is focused on an activity solely conducted within the Edge.)
- CPC team dedicated an individual in 2006 to coordinate Edge supervisory activities and interact with our Legal Applications unit.

Edge 2007 Supervisory Cycle

FRBNY Directed Supervisory Activities

ENTITY / SUBJECT	ACTIVITY	SCOPE	FRB Directed	OCC Participated	COIC Specific	COIC Related*
Citi-Japan**	Visitation (Follow-Up)	Compliance, governance, operations, firm-wide	X	X	X	X Governance performed by OCC
Citi-Brazil**	Examination	Consumer CRM, AML, governance	X	X	X	X Asset Quality performed by OCC
ALLL	Examination	Methodology at various entities	X	X		
Citi-Korea	Examination	SME, AML, IT, governance	X	-	X	-
Citi-India	Examination	CRM (retail & SME), IT, operations, AML, governance	X	X	X	X GTS, Non-resident India performed by OCC
Citi-Russia	Desk Review	Credit, AML	X	-	X	-
Citi-Singapore & Citi-Hong Kong	Visitation	Operations, IT, payments/settlement	X	X	X	X Credit wholesale, IT performed by OCC
ICERC	Desk Review	Country risk management, governance, controls	X	X	-	X
Citi-United King.	Examination	Controls, governance, risk management, compliance, CRM	X	X	X	X CitiFinancial performed by OCC
Citi-Poland	Visitation	CRM, Firm-wide, Basel II	X	X	X	X EMEA AML hub performed by OCC

* "COIC Related" refers to supervisory activities that did not target a COIC entity or operation but reviewed operations, business lines, controls, compliance matters, etc. of Citigroup affiliates that touched/encompassed COIC entities.

** Supervisory activities that commenced in late 2006 and concluded in early 2007.

Edge 2008 Supervisory Cycle

FRBNY Directed Supervisory Activities

ENTITY / SUBJECT	ACTIVITY	SCOPE	FRB Directed	OCC Participated	COIC Specific	COIC Related*
Regulation K	Examination	Compliance	X	-	X	-
COIC Edge Subsidiaries	Control Validation	Consumer compliance at Puerto Rican subsidiaries.	X	-	X	-
Regulation W	Discovery	Compliance with inter-affiliate transactions	X	-	X	-
Citi-Poland	Examination	CRM-Wholesale & Commercial, AML, Governance, IT mgmt.	X	X	X	X EMEA AML hub performed by OCC
Citi-Mexico	Examination	CRM (cards, risk modeling, commercial loans), AML, payments/settlement, IT management	X	-	X	-
Cit-Singapore & Malaysia	Examination	CRM (Consumer), AML, IT mgmt, business continuity, payments	X	-	X	-
RCSA	Examination	Risk Control Self-Assessment Process for IT and controls	X	-	-	X
BCP	Examination	Business continuity planning and global data centers.	X	-	-	X
Governance	Examination	Oversight of international operations from results of 2008 exams	X	-	X	-
ALLL	Control Validation	Follow-up to 2007 ALLL review	X	-	-	X

* "COIC Related" refers to supervisory activities that does not target a COIC entity or operation but will review operations, business lines, controls, compliance matters, etc. of Citigroup affiliates that touch/encompass COIC entities.

Enforcement Action

- Substance of EA centered on submission of written action plan, which will address:
  - Strategic Plan
  - Capital
    - Establishing and meeting capital targets
    - Expectation that dividend increases or cash repurchases would be consistent with meeting approved capital targets
  - Risk Management
    - Board/Senior Management Oversight
    - Risk Aggregation/Communication Across Firm
    - Valuation Processes
    - Liquidity/Treasury Management

- Expectation of substantial progress within six-month period

Restricting Acquisitions/Expansion

- Want management to stay focused on realigning the firm's strategy, remediating risk management weaknesses and rebuilding the firm's financial resilience over the coming year
- Mandated written plan for strategy and capital (from EA) as focal point for decisions on acquisitions/expansion
  - Acquisitions/expansionary activities must be consistent with meeting goals agreed to in approved plan
  - During bi-weekly (monthly) discussions with CPC team, firm to provide update on all potential acquisitions
  - For potential acquisitions exceeding a certain threshold (TBD), firm to provide written justification and reconciliation to approved plan
    - Such acquisitions require prior consultation and approval from FRS prior to consummation