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HAND DELIVERED

Mr. George Schleier
Deputy Controller
Citigroup Inc.
153 East 53rd Street
21st Floor/Zone 4
New York, NY 10043

Copy for
Board of Governors of the
Federal Reserve System

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Dear Mr. Schleier:

Examiners representing the Federal Reserve Bank of New York, with participation of the Office of the Comptroller of the Currency, completed a review of the use of the Special Purpose Entities ("SPE") at Citigroup as of September 16, 2002. The objective of the review was to evaluate the firm's controls surrounding SPE governance and accounting policy in relation to other large and complex banking organizations in the second Federal Reserve District, and gain an overall cross-institutional perspective on SPE management. Specifically, the review focused on the oversight and control processes employed throughout the SPE process from creation to dissolution.

Overall, we found Citigroup's managerial oversight of SPEs to be adequate. Our review confirmed the institution's ability to capture exposures and manage the risks emanating from SPE activity. Key control functions are deemed adequate enabling senior management to monitor the creation, modification or growth of SPEs. In addition, Citigroup has instituted several enhancements to effectively manage the SPEs. Most notably, Citigroup formalized the legal vehicle approval process and created an SPE specific database. We also noted that the strengthened Accounting Policy Group, through its expanded role and responsibilities, is in line with the best practices identified at the other institutions.

As part of the review, we observed a variety of different processes and controls to mitigate the risks involved with SPE transactions. At Citigroup, the following sound practices were observed:

- Citigroup's new policy requiring greater transparency in their clients' disclosures of complex transaction for determining client motivation helps support the due diligence process.

- The use of Financial Reporting Developments (FREDS) to document the detailed accounting analysis performed by Accounting Policy is an effective practice.

- The Accounting Policy Group has been proactive in assessing potential exposure from the FASB rule changes and in keeping abreast of industry discussions on the issue. Citigroup was one of only two institutions that were able to provide impact analysis from the proposed accounting changes.

- Citigroup's integrated risk management and business line meetings serve as a good forum for discussing risks associated with structure transactions.

In our cross-institutional reviews, we observed a heightened awareness of reputational risk across the industry. A good reputational risk management framework is a high-level evaluative process, recognized within the firm, and defined as to what the process is meant to accomplish. We recognize that the Capital Markets Approval Committee in the Global Corporate and Investment Bank considers reputational risk when it reviews proposed new business initiatives and understand that Citigroup is establishing a new Business Practices Committee to also address reputational risk issues. The challenge will be to evaluate the effectiveness of the process going forward. We encourage management's efforts in this regard.

While overall management of risks associated with SPEs is considered effective, the following recommendations would further enhance governance and control processes:

- Identify and report the interest rate risk emanating from retained interest in certain SPE transactions, outside of the business line. In our review, we noticed that the Market Risk function did not capture basis risk arising from the Conduits Business, although the business line, itself, did measure the exposure. We understand that Market Risk Management is currently reviewing the exposure to determine its significance.

- Consider defining alternative exit strategies for SPEs in the case of a trigger event. We observed this practice in one institution and believe it is effective.

- Formalize the Post Implementation Review process for significant transactions to extend beyond operational systems and validate that executed transactions mirror transaction approvals and met expectations (i.e., risk management assumptions) as outlined in the New Product Approval process.

- Consider implementing a portfolio management approach over retained interest exposures, including a report of aggregated exposures across business lines. We observed this to be amongst best practices in the industry.

Within 45 days of the receipt of this letter, we would appreciate a written response to the matters discussed above. In closing, please note that this letter contains confidential bank examination material and 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. If you have any specific questions or comments, please feel free to contact Laura Braverman at (212) 720-2764 or myself at (212) 720-2164.

Sincerely,

Homer C. Hill, III
Assistant Vice President

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