

CitiFinancial Team Objectives

Background

In November 2000, Citigroup acquired Associates First Capital Corporation (“AFCC”), a subprime lender under investigation by the Federal Trade Commission for potential violations of consumer protection laws. Because AFCC’s three subsidiary banks operated under “nonbank” exclusions to the Bank Holding Company Act,¹ Citigroup, as a financial holding company, was only required to file a post-consummation notice with the Board. Consequently, there was no formal comment period for this highly controversial acquisition.² Subsequent to Citigroup’s acquisition of AFCC, Citigroup applied in February 2001 to acquire European American Bank (“EAB”). This application provided community groups with their first “real” opportunity to comment on the lending practices of AFCC. Commenters raised serious criticisms about the consumer lending and credit insurance practices of certain non-bank subsidiaries of Citigroup, including Associates as well as CitiFinancial Credit Company (“CitiFinancial”) and CitiFinancial Mortgage Company, Inc. (“CFM”), two subprime lenders that assumed most of the business of AFCC. In its July 2001 approval of Citigroup’s acquisition of EAB, the Board undertook a thorough examination of Citigroup’s subprime affiliates, CitiFinancial and CFM in order to assess the effective implementation of certain initiatives and other consumer protection measures adopted by Citigroup to address commenters’ criticisms.

Examiners of the Federal Reserve Bank of New York (“Reserve Bank”), in conjunction with Board staff, commenced the examination in October 2001. While examiners determined that, overall, CitiFinancial substantially implemented the initiatives, examiners found serious concerns with CitiFinancial’s compliance risk management system. Examiners also uncovered poor lending practices that appeared to involve violations of law and regulations by both CitiFinancial and CFM, including requiring cosigners for loans in violation of Equal Credit Opportunity Act and the Board’s Regulation B; approving loan applications on the basis of collateral without sufficient regard for ability to pay in violation of the Truth in Lending Act and the Federal Trade Commission Act; and engaging in misleading practices related to charging and financing points on loans. In addition, there was a concern that employees of CitiFinancial may have made false and misleading statements to Reserve Bank examiners in response to questions relating to the Regulation B issue in violation of section 1001 of Title 18 of the United States Code. In August 2002, the examination was expanded into a formal Board investigation in response to these concerns. The examination and investigation involved coordination between both supervisory and legal staff of the Reserve Bank as well as Board Legal, DCCA and BS&R

¹ Two of AFCC’s three subsidiary banks, Associates National Bank and Hurley State Bank, operated as banks under the Competitive Equality Banking Act of 1987 and were only permitted to engage in credit card lending. The third, Associates Capital Bank, operated as an Industrial Loan Company and engaged in credit card and real estate lending.

² Even though there was no formal comment period, the Board received comments from many community groups, including Matthew Lee/Inner City Press, ACORN, and the Greenlining Institute. Commenters raised serious concerns about alleged subprime and “predatory” lending practices on the part of AFCC. Specifically, commenters alleged that AFCC targeted minority individuals and minority census tracts for high-cost predatory loans.

staff. In May 2004, as a result of the findings of the investigation, the Board issued a consent Order to Cease and Desist and Order of Assessment of Civil Money Penalty against Citigroup and CitiFinancial.

Objective

The CitiFinancial Team's ("Team")³ focus will be to identify areas where the process of examinations and investigations similar to those conducted in connection with CitiFinancial can be improved going forward. The Team will gather information about the way the examination, investigation and subsequent enforcement action were developed and completed and how Reserve Bank and Board staff worked together to accomplish these functions. Based on this information, the Team will try to identify any policy or procedure changes that would be helpful in future similar projects.

Methodology and Product

The Team will review documents and interview Reserve Bank and Board staff who participated in the examination, investigation and subsequent enforcement action. The Team will independently prepare a Report for distribution to the Board's Committee on Supervisory and Regulatory Affairs' members and senior staff of the Reserve Bank and Board Legal, DCCA and BS&R, who will be afforded an opportunity to comment on the Report before it is finalized.

As outlined below, the Team presently plans that the Report will address decision-making processes relating to the scoping and staffing of the examination, investigation and subsequent enforcement action. The Report will also address the communication and coordination among Reserve Bank and Board staff during the examination, investigation and subsequent enforcement action. This outline is preliminary and is subject to modification based on the information gathered by the Team during the course of its review. The Report will not independently assess the quality of the examination and subsequent enforcement action. Rather, the Report will focus on lessons learned by Federal Reserve staff and how the process can be improved for the future.

I. Examination

A. Approach

1. Identify how the determination to conduct the examination was made and the staff who participated in the decision and explain their respective roles;
2. Identify policy issues, if any, raised during or as a result of the examination and how issues were resolved, *e.g.* the examination of non-bank subsidiary;
3. Identify guidelines and/or procedures, if any, applicable to the examination;
4. Identify any new or modified approaches that were implemented during examination and reasons for their implementation; and
5. Identify areas where approach or planning of examination could be improved.

B. Staffing

³ The Team consists of Michael Collins (FRB-Philadelphia), Brad Fleetwood (Board Legal), Phillip Daher (DCCA), and Nina Nichols (BS&R).

1. Identify how examination was staffed and the staff who participated in staffing determinations;
 2. Identify any modifications and/or changes in staffing and the reasons for such modifications and/or changes;
 3. Identify whether staffing was consistent with other or similar examinations of nonblank subsidiaries;
 4. Identify whether there were any knowledge or skill gaps; and
 5. Identify areas, if any, where staffing could be improved.
- C. Scope
1. Identify the scope of the examination, how the scope was determined and the staff who participated in that determination and explain their respective roles;
 2. Identify any modifications or changes to and/or deficiencies in the scope and the reasons for those modifications, changes and/or deficiencies;
 3. Identify any particular difficulties in scoping for non-bank subsidiary; and
 4. Identify areas where scoping of examination could have been improved;
- D. Conduct of Examination
1. Identify whether the conduct of the examination stayed within scope, and if it did not, the reasons why it did not;
 2. Identify whether examination stayed on time schedule, and if it did not, the reasons why it did not;
 3. Identify any barriers that either hindered or delayed the examination including, but not limited to:
 - (a). Unanticipated events;
 - (b). Knowledge or skill gaps;
 - (c). Policy issues;
 - (d). Resource issues;
 - (e). Need for better coordination or collaboration among staff;
 4. Identify the role of attorneys or analysts or other non-examination staff in the conduct of the examination;
 5. Identify the staff who had oversight responsibilities for the examination and what those responsibilities involved; and
 6. Identify the status of the examination immediately prior to the issuance of the order of investigation and what, if any, effect the investigation had on the examination.
- E. Decision-making and Coordination
1. Identify how decisions were made and communicated at various stages of examination;
 2. Identify the coordination of responsibilities between the various Reserve Bank legal and supervisory staff and Board Legal, DCCA and BS&R staff in the conduct of the examination; and
 3. Identify any significant disputes between or among Reserve Bank staff and/or Board staff, to the extent that there were any, and how they were resolved.

II. Investigation

A. Approach

1. Identify how the determination was made to pursue and issue an order of investigation and the staff who participated in the decision and explain their respective roles;
2. Identify policy issues, if any, raised during or as a result of the investigation and how issues were resolved;
3. Identify guidelines and/or procedures, if any, applicable to the investigation;
4. Identify any new or modified approaches that were implemented during the investigation and reasons for their implementation; and
5. Identify areas where the approach to or planning of the investigation could have been improved.

B. Staffing

1. Identify how investigation was staffed and the staff who participated in staffing determinations;
2. Identify whether there were any changes to the examination staff as a result of the investigation and, if yes, the reasons for the changes;
3. Identify any modifications and/or changes in staffing and the reasons for such modifications and/or changes;
4. Identify whether staffing was consistent with other or similar investigation; and
5. Identify areas, if any, where staffing could be improved.

C. Scope

1. Identify the scope of the investigation, how the scope was determined and the staff who participated in that determination and explain their respective roles;
2. Identify whether the scope of the investigation was different from the scope of the examination and, if yes, the reasons for the differences;
3. Identify any modifications or changes to and/or deficiencies in the scope of the investigation and the reasons for those modifications, changes and/or deficiencies; and
4. Identify any particular difficulties in scoping the investigation.

D. Conduct of Investigation

1. Identify whether the conduct of the investigation stayed within scope, and if it did not, the reasons why it did not;
2. Identify whether investigation stayed on time schedule, and if it did not, the reasons why it did not;
3. Identify any barriers that either hindered or delayed the investigation including, but not limited to:
 - (a). Unanticipated events;
 - (b). Knowledge or skill gaps;
 - (c). Policy issues;
 - (d). Resource issues; and
 - (e). Need for better coordination or collaboration among staff;
4. Identify the role of examiners and/or analysts or other non-legal staff in the conduct of the investigation;
5. Identify the staff who had oversight responsibilities for the investigation and what those responsibilities involved; and

6. Identify how the findings of the investigation were reached and the staff who drafted, reviewed and approved the findings.
- E. Decision-making and Coordination
1. Identify how decisions were made and communicated at various stages of investigation;
 2. Identify the coordination of responsibilities between the various Reserve Bank legal and supervisory staff and Board Legal, DCCA and BS&R staff in the conduct of the investigation; and
 3. Identify any significant disputes between or among Reserve Bank staff and/or Board staff, to the extent that there were any, and how they were resolved.
- III. Enforcement Action
- A. Decision-making
1. Identify how decisions were made and communicated in recommending formal enforcement action, including the assessment of CMPs;
 2. Identify how the review and approval process was conducted;
 3. Identify the coordination of responsibilities between the various Reserve Bank legal and supervisory staff and Board Legal, DCCA and BS&R staff in the review and approval of the formal enforcement action; and
 4. Identify any significant disputes between or among Reserve Bank staff and/or Board staff, to the extent that there were any, and how they were resolved.
- B. Drafting
1. Identify the coordination of responsibilities between the various Reserve Bank legal and supervisory staff and Board Legal, DCCA and BS&R in drafting the formal enforcement action;
 2. Identify how the review and approval process was conducted; and
 3. Identify any significant disputes between or among Reserve Bank staff and/or Board staff, to the extent that there were any, and how they were resolved.
- IV. General Coordination
- A. Identify how Reserve Bank legal and supervisory staff and Board Legal, DCCA and BS&R staff understood their role, authority and work responsibilities in connection with each task or phase of the CitiFinancial matter;
 - B. Identify how Reserve Bank legal and supervisory staff and Board Legal, DCCA and BS&R staff understood each other's role, authority and work responsibilities in connection with each task or phase of the CitiFinancial matter;
 - C. Identify what the respective Reserve Bank and Board staff understood of the Board delegations of authority to be in this matter or whether staff felt that the delegations were unclear;
 - D. Identify the Reserve Bank and Board staff views of this project and whether those views were different or viewed in different ways by different staff;
 - E. Identify how Reserve Bank legal and supervisory staff and Board Legal, DCCA and BS&R staff communicated
 1. with each other; and
 2. with senior management;

- F. Identify the timing and format of communications between staff, *e.g.* did they occur on a regular, scheduled basis or were communications more sporadic; and
- G. Identify how significant disputes were resolved among and between Reserve Bank and Board staff, to the extent that there were disputes; and if there were, how consensus was reached.

V. Lessons Learned and Specific Recommendations

- A. Identify what respective Reserve Bank and Board staff believe that it should have done the same or differently;
- B. Identify what respective Reserve Bank and Board staff believe that other staff should have done the same or differently;
- C. Identify areas where there staff believe that problems could have been detected earlier
- D. Identify areas where the Team believes that Reserve Bank and Board staff should have done the same or differently; and
- E. Identify any policy or procedural changes that should be considered.