For example:

- On December 11, 2006, as part of a required, regular report to the Audit Committee on Special Purpose Entities, Hans Morris, then-Chief Financial Officer of the Corporate and Investment Bank, addressed CDO transactions, describing them as "[l]ow risk" and stating that Citi's "retained interests tend to be AAA." (Exhibit 33 (Special Purpose Entities – Corporate and Investment Banking Update (Dec. 11, 2006)).)

- On January 16, 2007, Mr. Bushnell provided the Board with an overview of developments in structured credit products, such as synthetic CDOs with cash-flow waterfalls and leveraged super-senior swaps. (*See* exhibit 34 (Citigroup Board of Directors Risk Overview (Jan. 16, 2007)).) The next day, Lewis Alexander, Citigroup's chief economist, addressed the Board and advised that he saw the housing decline as reaching its bottom. (*See* exhibit 35 (Minutes of Citigroup Inc. Board of Directors (Jan. 17, 2007)).)

- Also on January 16, 2007, in response to a request from the Consumer Subcommittee, Steven Freiberg addressed the quality of Citi's own loan portfolio and potential exposure to the weakening housing market. (*See* exhibit 36 (Consumer Lending Group: Real Estate Update (Jan. 16, 2007)).)

- On January 17, 2007, following discussion and debate, directors approved Citi's proposed acquisition of ABN AMRO Bank's U.S. residential-mortgage business. (*See* exhibit 35 (Minutes of Citigroup Inc. Board of Directors (Jan. 17, 2007)).)

- At the end of February 2007, Mr. Armstrong requested that the Audit Committee be presented information on Citi's subprime-related exposures; in response, on March 19, 2007, Mr. Bushnell provided the Audit Committee with a briefing concerning the Company's exposures to subprime mortgages through consumer lending, securitizations, and extensions of credit to originators. (*See* exhibit 30 (Risk and Compliance Update: Sub-Prime Mortgages (Mar. 19, 2007)).). In addition, prior to the March 19 subprime briefing, Mr. Armstrong requested specific information regarding the impact of Citi's subprime holdings on the Company's portfolio and reserves. (*See* exhibit 37 (E-mail from C. Michael Armstrong to Bonnie Howard (Mar. 18, 2007)).)

- On April 16, 2007, Mr. Bushnell followed up on his March 19 report to the Audit Committee and was pressed at the Board meeting about Citi's subprime portfolio. (*See* exhibit 31 (Risk and Compliance Update: Non-Prime and Sub-Prime Exposures (Apr. 16, 2007)).) Directors specifically asked Mr. Bushnell about potential subprime contagion on Citi's other business activities.

- On July 26, 2007, Mr. Bushnell again updated the Audit Committee on Citi's subprime and other credit exposures. Audit Committee members discussed with Mr. Bushnell the subprime impact within Citi Markets and Banking and the projected future impact both on that business and on other businesses within Citi. (*See* exhibit 32 (Risk and Compliance Update: Non-Prime and Sub-Prime Exposures (July 26, 2007)).).

- Also during the July 26 meeting, Mr. Armstrong questioned whether management's second-half forecast was achievable in light of current market conditions. Specifically, Mr. Armstrong inquired about the Company's loan loss reserves and rapid build up of leveraged loans, among other issues, and suggesting that the Company consider instituting a hiring freeze, re-evaluating the second-half budget, and adopting other measures to control costs. In response, management noted the strength of the Company's distribution model in the leveraged lending area—the area that, at that time, appeared to face vulnerabilities, given the tightening of credit markets. More generally, management assured the Audit Committee that it was monitoring developments in the credit and subprime markets, and was positioned to handle potential adverse market developments in the second half of 2007.

- On September 17, 2007, Board members received a tutorial from Gary Crittenden on the relationship between subprime mortgages and various aspects of Citi's business, including CDOs and SIVs. (*See* exhibit 38 (Review of the Current Environment (Sept. 17, 2007)).)

- Also on September 17, 2007, Mr. Bushnell presented the Audit Committee with a risk tutorial on Allowance for Credit Losses, during which he described the assignment of risk ratings, expected loss calculations, the role of Citi historical data, the management adjustment process, and enhancements in the methodologies that management plans to adopt in response to regulatory concerns. (*See* exhibit 39 (Allowance for Credit Losses Tutorial Presentation (Sept. 17, 2007)).)

- More generally, the Board regularly received written and oral updates on the economy and housing markets from Citi's chief economist, Lew Alexander, to ensure that it was apprised of overarching market trends. (*See* exhibits 40 (Lewis Alexander, Economic & Market Analysis, Prospects for Financial Markets (Nov. 22, 2006)); 41 (Lewis Alexander, Economic & Market Analysis, Economics/Strategy (Mar. 1, 2007)); 42 (Resurgence of Volatility (Mar. 2007)); and 43 (Lewis Alexander, Economic & Market Analysis, Citi Markets and Banking (Oct. 2007)); *see* *also* exhibits 35 (Minutes of Citigroup Inc. Board of Directors (Jan. 17, 2007)); 44 (Minutes of Citigroup Inc. Board of Directors (Mar. 19, 2007)); and 45 (Minutes of Citigroup Inc. Board of Directors (Oct. 15, 2007)).)

3. ***Directors are not routinely provided peer information, so the extent to which they were aware of Citigroup's relative capital position is unclear.*** (Letter at 3.)

The Company's directors routinely are provided with detailed peer information, including specifically information concerning the Company's relative capital position.

For instance:

- On a monthly basis, the Board receives an Investor Relations Newsletter, which includes peer data on price-earnings ratios and implied-growth rates. (*See* exhibit 46 (Investor Relations Newsletters (2007)).)
- Earnings reviews presented to the Board include peer information, such as comparative total stock return, payout and dividend yield, dividend changes, and valuation. (*See* exhibit 47 (4Q06 Earnings Review (Jan. 16, 2007)).)
- In a March 19, 2007 presentation, the Audit Committee was provided with a competitor comparison of loan loss reserve trends, which reflected that "[t]he Citi trend and overall level in 'Loan Loss Reserve as a % of Total Loans' is consistent with that of other large banks/bank holding companies." (*See* exhibit 48 at 4 (Risk and Compliance Update: Loan Loss Reserve Trends (Mar. 19, 2007)).)
- At a July 2007 Strategy Offsite, the Board discussed Citi's shareholder return and strategic steps that could be taken to enhance market value. The Board focused on comparative peer information, including data reflecting the return above cost of capital and the price-to-book ratio of the largest financial services companies. (*See* exhibit 49 (Drivers of Value Memo).)
- During a September 17, 2007 Audit Committee tutorial, the Audit Committee was provided with peer information showing that "Citi's credit reserve-to-loans ratio is comparable to its competitors." (*See* exhibit 39 (Allowance for Credit Losses Tutorial Presentation (Sept. 17, 2007)).)
- In an October 15, 2007 presentation, the Corporate Audit and Risk Management Subcommittee was provided with peer comparative data reflecting holdings of Level 3 inventory. (*See* exhibit 50 (CMB – Unverified Inventory (Oct. 15, 2007)).)

- Also on October 15, 2007, the Board received a "Credit and Markets Discussion" presentation, which included a summary of how Citi's losses compared to those of its competitors. Peer data presented included, among other metrics, EPS growth (comparing Q307 vs. Q306), third-quarter operating income losses, and historic consumer cost of credit versus that of Citi's competitors. (*See* exhibit 51 (Credit and Markets Discussion (Oct. 15, 2007)).)

- On October 31, 2007, the Board received a presentation that discussed the October market dislocations. This presentation discussed Merrill Lynch's CDO and subprime-related write-downs and its super-senior valuation methodology, and data reflecting issuance of ABS CDOs by major market participants. (*See* exhibit 52 (Discussion of October CMB Performance (Oct. 31, 2007)).)

- More generally, the Audit Committee and, in particular, Mr. Armstrong routinely requested analyses of key capital ratios, including peer comparisons. (*See, e.g.*, exhibit 53 (E-mail from Bonnie Howard to C. Michael Armstrong (Mar. 13, 2007) attaching Tier 1 Capital (as of Dec. 31, 2006)).)

C. <u>Risk Management and Business Related Matters</u>

1. ***Independent risk management needs to have the same level of authority and influence as the business units. To date that has not been the case. Our review indicated that independent risk management had insufficient authority and/or failed to exercise its authority to restrain the business. While the desk level market risk management staff seemed to appropriately escalate issues, decisions on risk were routinely deferred to the senior business unit management's wishes. For example, when the Asset Backed Securities (ABS) Correlation desk asked independent risk management for new limits to support their shift in business strategy, risk "stood down" when senior business management was in support of the increase. Additionally, senior management needs to ensure that independent control groups—specifically, independent risk management and product control—have the requisite staff, analytics, and expertise to understand and monitor the business.*** (Letter at 4.)

We agree that senior management and independent risk should have the same level of authority and influence within the Company. That said, the Letter draws certain conclusions with which we disagree.

Taking the specific example cited, we believe the Letter is mistaken concerning the role played by risk in the shift in business strategy by the ABS correlation desk. Specifically, the Letter appears to overlook both the development of structuring activity on the ABS Correlation desk and the purpose served by establishing limits.

As the ABS Correlation desk moved into the structuring business during 2006, market risk, in fact, did review limit requests and set limits related to the warehousing activity necessary to accommodate the expanding business. As this business developed, independent risk determined that it was not necessary to set limits on the ABS Correlation desk for its super-senior exposure. Market risk establishes limits based on the specific goals of the business and evaluates those decisions as the business develops and matures. When the business indicated an interest in expanding its structured-finance activity in late 2006, market risk determined that a super-senior limit for the ABS Correlation desk was not necessary in the early stages of the business, based on risk's experience with super-senior positions. This decision did not reflect lack of risk oversight; nor does it indicate that risk "stood down" in the face of pressure from the business. Rather, this decision reflects a considered judgment by risk based on the nature of the business and its understanding of super-senior risk.

There are other examples in which limit requests were rejected or approved only after modification, and where risk overrode the wishes of the business.

For example:

- In 2006, the business requested an AAA/AA warehouse limit increase from \$5 billion to \$7.5 billion, and a \$5 billion par put limit. Risk questioned the need for these limit increases and sought further information before approving the warehouse limit increase, and ultimately proposed a "more modest limit" of \$2 billion for the par put limit. (*See* exhibit 54 (E-mail from Murray Barnes to Nestor Dominguez and Andy Feigenberg (Apr. 12, 2006)).)

- In January 2007, the US Cash CDO business requested a \$60 billion super-senior limit. (*See* exhibit 55 (E-mail from Nestor Dominguez to Murray Barnes, et al. (Jan. 11, 2007) attaching 2007 CDO Limit Increase Request).) This request was verbally denied by risk, and substantially lower temporary exceptions of \$40 billion (net) and \$45 billion (gross) were subsequently provided. (*See* exhibit 56 (E-mail from Murray Barnes to Jason Alfano and Michael Silvestri (Feb. 27, 2008)).)

- In the third quarter 2007, based in part on its ongoing discussions with the OCC regarding Citi's loan loss reserve processes and methodology, risk management determined to increase Citi's ALLL by almost \$1 billion. Despite opposition by some business managers, independent risk management held its ground because it perceived the increase to be warranted in light of new acquisitions, deterioration in the credit markets, and other trends. (*See* exhibits 57 (Minutes of Citigroup Audit and Risk

Management Committee (July 26, 2007)); and 58 (Risk and Compliance Update: Loan Loss Reserve (July 26, 2007)).)

- In October 2007, the business sought a $14 billion to $16 billion financing of a basket of financial stocks. Risk denied the request and said that it would entertain a request for only a $3 billion non-recourse facility. (*See* exhibit 59 (E-mail from Ramesh Gupta to Jason Alfano (Feb. 22, 2008)).) The business's proposal for the $3 billion facility ultimately was not approved by risk.

Risk continually monitored the business and elevated issues in light of market developments. For example, Risk Manager Estimates ("RMEs") that stressed the CDO and other businesses with subprime exposures increased significantly in the first quarter of 2007. Those RMEs were brought to the attention of the CMB risk management committee. The businesses put in place efforts to reduce risk, not just in mortgages as the OCC references, but also in the structuring business. To that end, no new warehouses were opened for mezzanine-level deals after February 2007 and the business aggressively sought to shed lower-rated exposure by actively distributing deals in the marketplace. As a result, subprime exposure (excluding super seniors) decreased materially through the first half of 2007 and the quality of the retained CDO tranches improved materially with the overwhelming majority of the retained CDO exposure by July being rated AA or better.

It also is important in this context to consider the appropriate relationship between risk and business. Independent risk does not set the risk appetite for the Company; nor ultimately does it run the business. Risk management engages in a dialogue with the business to understand its goals, it sets limits and monitors risk within those constructs, and it escalates issues as they arise and as deemed necessary in the independent judgment of risk management personnel. Independent risk reviewed structured-credit exposures within the framework set by the business—a framework in which the business wished to expand its market share.

In September 2007, risk expressed a preference for using a collateral/correlation-based approach to value the Company's super-senior positions rather than an intrinsic cash-flow model. After representatives of risk, finance and the business discussed the matter at length, finance and the business, which had responsibility for valuing the positions, decided to use the cash-flow model.

The Letter cites no instance in which independent risk "stood down" when it believed it should "stand up," and no such instances were ever reported to the Audit Committee by independent risk or anyone else. At all critical junctures—including at times when the business requested limit increases and when illiquid exposures needed to be valued—risk voiced its perspective and engaged in a dialogue with the business. In certain instances, the business prevailed; in others, risk prevailed. But consistently, there was a candid, constructive dialogue between independent risk and business management.

> 2. ***Directors do not appear to have been informed or questioned the impact of market indications of weaknesses in subprime mortgages on other aspects of the company's business or Citibank. . . . By focusing on a specific sector (consumer) as opposed to overall risk levels in the corporation, the Board was not provided a sense of the full exposure to subprime real estate until very recently.*** (Letter at 3.)

As detailed *supra* in Section II.B, it is not correct that directors were not informed of, and did not question, subprime-related market weaknesses, or how market developments might affect the Company's businesses or the Bank. Nor is it accurate that reports to the Board and Audit Committee were focused solely on the Consumer business. The Audit Committee was updated on both Consumer-side and Corporate-side subprime exposures, and risk reviews presented to the Corporate Subcommittee included subprime updates at every meeting in 2007. The focus of these updates and reports was not on a particular sector, but rather on those areas that were considered the most significant.

Thus:

- In January 2007, Ms. Bebe Duke, co-Head of Risk Management of Corporate and Investment Banking, informed the Corporate Subcommittee of significant declines in the ABX indices. (*See* exhibit 21 (Risk Management Review (Jan. 16, 2007)).)

- On March 19, 2007, Mr. Bushnell presented to the Audit Committee a risk and compliance update on subprime mortgages, in which he reported nonprime and subprime exposures in both the Consumer and Corporate businesses. (*See* exhibit 30 (Risk and Compliance Update: Sub-Prime Mortgages (Mar. 19, 2007)).) The report of subprime exposure on the Corporate side focused on exposure arising out of the securitization of interest-only and negative-amortization mortgages originated by third parties.

- At the next Audit Committee meeting, on April 16, 2007, Mr. Bushnell again presented an update on subprime exposures, both in Consumer and Corporate. (*See* exhibit 31 (Risk and Compliance Update: Non-Prime and Sub-Prime Exposures (Apr. 16, 2007)).) A $2 billion increase in exposure on the Corporate side was reported, attributable to Citi's financing of Ameriquest. Also on April 16, 2007, Ms. Duke updated the Corporate Subcommittee on credit and market risks associated with subprime and noted that Citigroup had escaped significant losses in the bankruptcy of New Century, a leading subprime mortgage originator to which it had exposure. (*See* exhibit 22 (Risk Management Review (Apr. 16, 2007)).)

- In July 2007, as broader potential subprime exposure on the Corporate side first began to emerge, Mr. Bushnell's regular update on subprime exposures included discussion of Citi's exposure to the Bear Stearns hedge funds through the Company's financing desk and through positions in ABS CDOs. By July, Corporate's counterparty exposure had been actively managed downward, from $4.2 billion to $0.6 billion. (*See* exhibit 32 (Risk and Compliance Update: Non-Prime and Sub-Prime Exposures (July 26, 2007)).)

- In August 2007, in a letter accompanying July materials circulated to the Board, former-CEO Charles O. Prince discussed credit market dislocations, including subprime, which he described as likely to "play out over a broader set of participants and over an extended period of time." Mr. Prince went on to explain that while "we consciously did not originate these aggressive products in our U.S. Consumer Group," Citi did have some exposure due to portfolio acquisitions and underwriting of RMBS collateralized by subprime products originated by third parties. (*See* exhibit 60 (Letter from Charles O. Prince to Franklin A. Thomas (Aug. 15, 2007)).)

As can be seen, the updates to the Board followed the arc of the developing subprime story. In response to requests from the Board for updates on Citigroup's subprime exposure, management focused on those areas that it believed were most risky. Indeed, while the Board tasked management relatively early on with identifying the Company's subprime exposures, this was no simple task. For example, CDO subprime exposure was not readily ascertainable in part because of the product's inherent structural protections, and in part because CDOs include a variety of different asset-backed securities, including prime and subprime ABS, and cannot, therefore, be defined simply as "subprime." (*See* exhibits 61 at 2 (Memorandum regarding September 30, 2007 Valuation of Super Senior Tranches of CDOs); and 62 at 2 (William Bozarth, December 31, 2007 Valuation of Super Senior Tranches of CDOs (Jan. 25, 2008)).))

Thus, in the early part of 2007, management briefed the Board on the most direct exposure to subprime borrowers, either through Citi's own loan portfolio in its Consumer business or as a result of financing activities in the Corporate business of subprime mortgage originators. Later updates focused on exposure to counterparties with significant subprime exposure and CDO tranches below super senior in the structured-credit business.

It is true that the Board was not provided with information about potential risks to it's super-senior positions as a result of the subprime market weakening until much later. Throughout the first half of 2007, independent risk and business management genuinely believed that the Company's super-senior positions were safer and more secure than AAA structured-credit exposures. Contemporaneous documents corroborate the Company's state of mind. In June 2007, as part of its Consolidated Supervised Entity presentation to the SEC, the Company presented its "Overall CDO Business and Subprime Exposure." (*See* exhibit 63 (Presentation to the Securities and

Exchange Commission Regarding Overall CDO Business and Subprime Exposure (June 2007)).) In that presentation, the Company referenced its super-senior "book," but stated that "[d]ue to the extremely small probability of default, this exposure has been excluded" from the Company's overall subprime-exposure evaluation. (*Id.* at 11.)

Likewise, the majority of Citi's super-senior exposure arises from its so-called liquidity-put agreements with CDO entities that financed their super-senior positions with asset-backed commercial paper. That ABCP had successfully rolled as late as July 2007 and an analysis by the business determined in late 2006 that it would take more than a five-standard-deviation event for the ABCP market to become sufficiently stressed to cause spreads on the ABCP to hit the liquidity-put triggers.

As the above facts demonstrate, risk and business management promptly elevated subprime-related exposures as they surfaced, and actively managed those exposures in a prompt and diligent manner.

3. ***[W]ith the removal of formal and informal agreements, the previous focus on risk and compliance gave way to business expansion and profits.*** (Letter at 2.)

As set forth above, Citi has maintained a strong, independent risk function. Following implementation of the formal and informal 2003 agreements to which the Letter refers—agreements that had the effect of temporarily constraining the Company's mergers-and-acquisitions activity—the Company enhanced its risk and compliance infrastructure. The Letter's suggestion that, with the lifting of the restrictions on Citi's business activities, the Company abandoned its focus on risk and instead began to pursue riskier business activities with the sole goal of enhancing profits, is in error.

As described in detail above, the Company made several strategic business decisions prior to the market dislocations to enhance its presence in certain markets, including leveraged lending and structured finance. In making those business decisions, the Company carefully evaluated the risks associated with expanding those areas of its operations. In the end, and with its eyes wide open, the Company made an informed decision to expand these businesses—a decision that was made with full consideration of the attendant risks and rewards as they were then understood by experienced management. Contrary to the implication in the Letter, the Company did not move forward with these business activities in response to the lifting of any restrictions on the Company's activities.

In fact, many of the transactions that led to the recent write-downs were implemented prior to and during the time when those formal and informal agreements were in place. (*See, e.g.*, exhibits 64 (Grenadier Funding Indenture (July 14, 2003)); 65 (Klio Funding Indenture (Apr. 16, 2004)); and 66 (Klio III Funding Indenture (Oct. 24, 2005)).) Additionally, the Company's current challenges do not relate in any way to the types of transactions that Citi agreed to forgo or constrain as a result of the 2003 agreements. The recent write-downs by the Company were caused by the unprecedented credit and subprime crises that arose suddenly in the latter part of 2007. There is simply no connection between the 2003 agreements and the credit and subprime crises that led to write-downs by Citi (and by all other market participants).

D. **Valuation-Related Matters**

1. ***While the current valuation method is broadly within the range of current market practice, collateral-based valuation results need to be factored into this analysis. . . .***

   An alternative method that starts by valuing collateral and then building up to CDO value, using a correlation model for some positions, has proponents within the bank and would have led to larger write-downs. It is more of a market-based approach and better aligns with how risk is hedged. It also involves substantial judgment, since the market for the instruments is not trading. However, it is consistent with current marking procedures for the collateral. Collateral based valuation results should be part of regular reporting and factored into the assessment of final value. This includes use of the correlation model, an important analytical tool even if its results are not used for official valuation. (Letter at 5–6.)

As the Letter acknowledges, "events during the year produced tremendous pressure on the business to deploy a new valuation model on short notice." The Company first employed a model to mark its super-senior book for the close of the third quarter. At that time, and based on then-available valuation tools, the Company concluded that the intrinsic cash-flow model developed by the Fixed Income Research group was the most appropriate valuation method, given the lack of market observables.

The Company has so far determined that a collateral-based approach would not fairly reflect the value of its super-senior exposures. (*See* exhibit 61 (Memorandum regarding September 30, 2007 Valuation of Super Senior Tranches of CDOs).) Among other reasons, the values for the underlying collateral (more than 8,000 distinct CUSIPs) are based on *subjective* trader judgments—not market observables—and thus are not independently verifiable. This is not to say, however, that Citi made no use of the collateral-value approach. In arriving at the write-down estimates reflected in the Company's 8-K filed on November 5, 2007, the Company employed a collateral-based approach to calculate the high end of the range, reflected in that announcement. (*See* exhibit 67 (Memorandum from Paul Smith to Files (Nov. 26, 2007)).)

Since November 2007, the Company has continued to refine its valuation methodology. Thus, in marking its super-senior positions for year-end 2007, the Company employed a more sophisticated model that had been in development for approximately a year. (*See* exhibit 62 (William Bozarth, December 31, 2007 Valuation of Super Senior Tranches of CDOs (Jan. 25, 2008)).) This model, known as the Default model, reflected a number of significant improvements, including the use of sophisticated projections concerning prepayment, default rates and loss severity. Its loss projections are as (or more) severe than those generated by published models of other firms and rating agencies. During this year-end process, the Company revisited whether it might be appropriate to employ a collateral-based valuation approach. That approach was rejected, for the reasons outlined above.

Notably, when the Company compared the results of the Default model with the results obtained using a collateral-based valuation model, the fourth-quarter marks were merging—a fact referenced in your Letter. It is worth noting in this regard that on March 13, 2008, Standard & Poor's stated that "[b]ased on available information, we believe that the largest players [specifically including Citi] can be seen as having undertaken a rigorous valuation methodology to come up with conservative valuations" for super-senior positions. (*See* exhibit 17; *see also* exhibit 68 (Standard & Poor's, Subprime Write-Downs Could Reach $285 Billion, But Are Likely Past the Halfway Mark (Mar. 13, 2008)).) The Company regards the valuation of its super-senior positions as a dynamic and iterative process, and is continuing to draw upon all available expertise to formulate the best possible valuation methodology, going forward.

2. ***Product Control does not have sufficient staff or quantitative resources to evaluate the various components of the valuation model. [Product Control] is set up for checking marks directly against market observables, and has not adapted to situations where there are no direct quotes. . . . In addition to being disjointed from the business, control groups were inadequately engaged with each other at a time when they should have been active partners.*** (Letter at 6.)

While we continue to seek to improve our product-control function and other control groups, we believe the OCC's criticism is unfair.

First, as the OCC is aware, on May 22, 2006, the Fed issued findings commending "Citigroup's valuation and measurement practices with respect to complex and illiquid exposures. . . ." (*See* exhibit 69 at 1 (Letter from Federal Reserve Bank of New York to Paul Smith (May 22, 2006)).) Among other conclusions, the Fed determined that the Company "exhibited a high degree of discipline with respect to valuation." (*Id.*) The Fed also concluded that Citi's practices exceeded those of other firms in terms of its processes "to identify and monitor exposures that are difficult to price verify using third-party data." (*Id.*) The Fed also noted that Citi's "processes seek to quantify and control the associated valuation risk by classifying exposures according to level of risk, stress testing them, setting limits and escalating exceptions to the Risk Committee." (*Id.*) With respect to VaR, the Fed concluded that Citi has a "well-disciplined process[] to ensure the timeliness and completeness of exposure and historical data. . . . [The Company] relied less on proxies (e.g., indices) for cash instruments; utilized data that was more closely reflective of security-specific attributes; and updated historical time series more frequently." (*Id.* at 2.)

In the period since the Fed issued its favorable findings, the Company has enhanced its product-control function. Among other things, it is a priority at Citi to staff Product Control with experienced individuals. To that end, Citi has maintained a staff of three to five PhDs in this group, which we believe represents one of the largest such staffs maintained among our peers. The Company continues to seek similarly highly qualified candidates. As the Fed noted, Citi's product control staff "is well-informed of the direction of prospective fair value pronouncements and [is] well-positioned to implement standards when they are finalized." (*Id.* at 1.)

In addition, since late 2006, product control managers have met on a weekly basis with their counterparts in risk to review the prior week's P&L in each business, new transactions, market developments, business issues and business-risk measurements, among many other issues. These weekly meetings provide an open forum for both product control and risk to discuss any issues that may be of concern.

Second, the Company's Model Control Policy for the Corporate and Investment Bank sets forth the roles and responsibilities of the various personnel involved in the model-validation process. (*See* exhibit 70 (The Model Control Policy for the Corporate and Investment Bank and Emerging Markets – Consumer (Jan. 2006)).) That policy states that independent pricing groups and the financial division shall "[p]erform independent verification of observable inputs, as described in the CIB Price Verification Policy" and, "[a]s requested, assist in the prioritization of Model Validations and the determination of Assumption Review frequency." (*Id.* at 12.) With respect to the models used by the Company to arrive at its third and fourth-quarter marks, Product Control fulfilled its obligations under this policy.

One of Product Control's principal responsibilities is to classify the Company's inventory as Level 1, 2 or 3, pursuant to the mandates of FAS 157, and to perform price verifications with respect to that inventory. Product Control is not charged with verifying prices on Level 3 inventory in the same way that it is with respect to Level 1 and 2 inventory. Level 3 inventory is unverified, and Product Control's role with respect to it is limited to "[r]eview[ing] for reasonableness the methodologies used in marking inventory that is classified as unverified." (*See* exhibit 71 at 15 (Capital Markets and Banking ("CMB") Pricing and Price Verification Standards and Procedures).) There was an unprecedented rise in the Company's unverified inventory during the third quarter: as a result of the tremendous shifts in the market, including the seizing up of credit markets and the resulting sudden lack of liquidity, unverified inventory in Citi's Markets and Banking business increased 97 percent, or by $66.5 billion, between June 30, 2007 and October 15, 2007. As the Letter acknowledges, market events placed tremendous pressure on the business to develop a new valuation methodology on extremely short notice.

Despite these challenges, Product Control appropriately overcame the absence of "direct quotes" in the third and fourth quarters of 2007. The process employed was vigorous and thorough, and ultimately Product Control determined, consistent with its mandate, that the marks used in both the third and fourth quarters were reasonable.

* * * * *

We hope that this response has fully addressed the issues identified in your Letter. We understand and appreciate your recommendations, and will promptly address those matters that we have not already resolved. At the same time, we believe, respectfully, that the Letter's criticisms and conclusions regarding independent risk management, and the roles played by the Board and the Audit Committee, are not justified. We hope that you will receive our observations with an open mind and take them into consideration in determining how most appropriately to proceed.

We look forward to continuing to work closely and collaboratively with you on these issues, as we continue to manage our risks in this challenging market environment.[8]

Respectfully submitted,

Brian Leach

Michael Helfer

cc: Office of the Comptroller of the Currency (w/o exhibits)
Disclosure (FOIA) Office
Washington, D.C. 20219
Attn: Frank Vance

[8] We respectfully request, pursuant to 31 C.F.R. § 1.6, Appendix J thereto, and 5 U.S.C. § 552b, that confidential treatment be accorded this letter, the accompanying exhibits, and the confidential and privileged business, commercial, and financial information they contain, as well as any transcripts, notes, memoranda, or other records created by, or at the direction of, the OCC, its officers or staff that reflect or relate to this confidential information. We also respectfully request that you promptly inform us of any request under the Freedom of Information Act seeking access to any of the information enclosed herewith, to permit us to substantiate the grounds for confidential treatment.