APPENDIX E: OCC SUPERVISION OF CITIBANK, N.A.

I. OCC's Supervision of Large National Banks

The foundation of the OCC's supervision of the largest national banks is our continuous, on-site presence of examiners at each of our 15 largest banking companies. Citibank is one of the banks in our Large Bank Program. These 15 banking companies account for approximately 89 percent of the assets held in all of the national banks under our supervision. The resident examiner teams are supplemented by subject matter experts in our Policy Division, as well as Ph.D. economists from our Risk Analysis Division trained in quantitative finance. Since 2005, the resident examiner team at Citibank averaged approximately 50 resident examiners, supplemented by the subject matter experts and economists mentioned above, and additional examiners as needed on specific targeted examinations.

Our Large Bank Program is organized with a national perspective. It is highly centralized and headquartered in Washington, and structured to promote consistency and coordination across institutions. The onsite teams at each or our 15 largest banks are led by an Examiner-In-Charge ("EIC"), who reports directly to one of the Deputy Comptrollers in our Large Bank Supervision Office in Washington, DC. This enables the OCC to maintain an on-going program of risk assessment, monitoring, and communication with bank management and directors.

Resident examiners apply risk-based supervision to a broad array of risks, including credit, liquidity, market, compliance, and operational risks. Supervisory activities are based on supervisory strategies that are developed for each institution that are risk-based and focused on the more complex banking activities. Although each strategy is tailored to the risk profile of the individual institution, our strategy development process is governed by supervisory objectives set forth annually in the OCC's Bank Supervision Operating Plan. Through this operating plan, the OCC identifies key risks and issues that cut across the industry and promotes consistency in areas of concerns.

With the operating plan as a guide, EICs develop detailed strategies that will direct supervisory activities and resources for the coming year. Each strategy is reviewed and approved by the appropriate Large Bank Deputy Comptroller. Our risk-based supervision is flexible, allowing strategies to be revised, as needed, to reflect the changing risk profile of the supervised institutions.

Our risk-based supervision seeks to identify the most significant risks and then to determine whether a bank has systems and controls appropriate to identify, measure, monitor, and control those risks affecting the institution. We assess the integrity and effectiveness of risk management systems, with appropriate validation through testing.

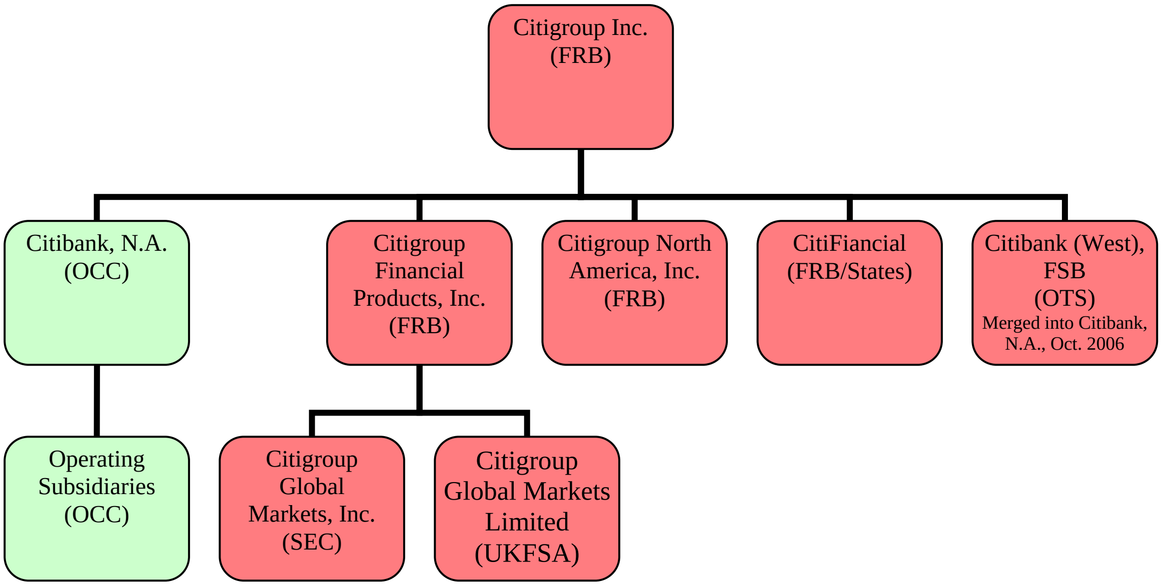
Our supervisory process involves a combination of ongoing monitoring and targeted examinations. Our ongoing supervision allows us to review management reports, discuss business and risk issues, and maintain an understanding of the bank's risk profile. The purpose of our targeted examinations is to validate that risk management systems and processes are functioning as expected and do not present significant supervisory concerns. Our supervisory conclusions are communicated directly to bank senior management. When we identify concerns, we "drill down" to test additional transactions. These concerns are then highlighted for management and the Board as "Matters Requiring Attention" ("MRAs") in supervisory communications. If these concerns are not appropriately addressed within a reasonable period, we have a variety of regulatory and enforcement tools with which to respond, ranging from informal supervisory actions directing corrective measures, to formal enforcement actions, to referrals to other regulators or law enforcement.

It is not uncommon to find weaknesses in structure, organization, or management information, which we address through MRAs and other supervisory processes described above. But more significantly at some of our institutions, what appeared to be an appropriate governance structure was made less effective by a weak corporate culture, which discouraged credible challenge from risk managers and did not hold lines of business accountable for inappropriate actions. Corporate culture issues can be difficult to assess during benign economic times. But when the market disruption began to occur in mid-2007, we began to document examples where risk management did not appropriately constrain certain business activities, at least in part due to its relative lack of stature.

As previously noted, we have a staff of experts who provide on-going technical assistance to our on-site examination teams. Our Risk Analysis Division includes 40 Ph.D. economists and mathematicians who have strong backgrounds in statistical analysis and risk modeling. These individuals frequently participate in our examinations to help evaluate the integrity and empirical soundness of banks' risk models and the assumptions underlying those models. Our policy experts help keep abreast of emerging trends and issues within the industry and the supervisory community. Staffs from our Credit and Market Risk, Operational Risk, and Capital Policy units have been key participants and contributors to the ongoing work of the Senior Supervisors Group, Financial Stability Forum, President's Working Group, and Basel Committee on Bank Supervision.

II. Citigroup/Citibank Organization

Citigroup is one of the largest financial institutions in the world. It has operations in approximately 100 countries and provides a full set of financial products. Its major business segments are commercial banking, consumer financial services, and broker-dealer and investment banking activities. These businesses are conducted through a variety of legal entities, including national banks and their subsidiaries, which are subject to regulation and supervision by the OCC, and non-bank subsidiaries of the holding company that are affiliates but not subsidiaries of Citibank ("holding company affiliates"), which are subject to regulation by other federal and state regulators. The key entities referred to in the discussion below, and their relevant regulators, are depicted in the simplified chart below, with the green boxes depicting the entities subject to OCC supervision.



A. Citibank, N.A.

Citibank, N.A., is the largest single legal entity in Citigroup, although it represented less than half of Citigroup's assets for the five years prior to the financial crisis. In 2002, Citibank constituted 43.1 percent of Citigroup assets. In 2006, it constituted 49.5 percent of the group total. Throughout this time, Citibank, N.A. functioned primarily as a corporate bank in the United States and abroad, with retail operations mainly in New York State and internationally. A major legal vehicle restructuring occurred in late 2006 that brought most domestic retail activities into Citibank, N.A. and OCC supervised subsidiaries of the bank. At year-end 2009, the bank constituted 62 percent of Citigroup. Citigroup also uses separate national banks to conduct its credit card lending. Citibank, N.A., its operating subsidiaries, and the other national banks and their subsidiaries are supervised by the OCC.

B. Key Non-bank Entities Owned by Citigroup

Citigroup conducts a substantial amount of its business in holding company affiliates. These holding company affiliates are subject to regulation by the Federal Reserve, the states, and in some cases, other regulators such as the Securities and Exchange Commission. Holding company affiliates are not regulated by the OCC. For the purposes of the Commission's inquiry, several key holding company affiliates are as follows:

- Citigroup Global Markets, Inc. ("CGMI"), a holding company affiliate of the bank, is a U.S. broker-dealer subject to supervision primarily by the Securities and Exchange Commission ("SEC"), but also by the Federal Reserve. CGMI conducted the cash collateralized debt obligation ("CDO") structuring business for the group and was the main warehouse for the CDO structuring business.
- Citigroup Financial Products, Inc. ("CFPI"), a holding company affiliate, was used as a warehouse for the CDO structuring business. It is supervised by the Federal Reserve.

- CitiFinancial is a non-bank holding company affiliate used for subprime lending and consumer finance activities and is supervised by the Federal Reserve and the states.
- Citigroup North America, Inc. ("CNAI") is a non-bank holding company affiliate used for booking and assigning capital for certain leveraged loans and bridge loans. CNAI is also supervised by the Federal Reserve.

C. Legal Vehicle Simplification Project

Citigroup completed a major legal vehicle simplification project in October 2006. Citigroup management recognized the need to streamline its activities and improve oversight and control. It wanted to concentrate its business activities in three main legal vehicles: an investment bank, a commercial bank, and a credit card bank. This project also diversified Citibank's domestic activities.

The simplification project reduced the number of insured depository institutions from twelve to five, and consolidated approximately $200 billion of assets into Citibank, N.A. Approximately 10 percent of these assets were subprime mortgages that had been originated outside of the national bank (either through the CitiFinancial or Citibank (West), FSB).

After the consolidation, the OCC discovered that management was not consistently applying the Interagency Policy Statement on Loan Loss Reserves at its former thrift and finance company entities. The OCC directed bank management to improve processes and augment reserves. In addition, the quality of mortgages was substantially worse than expected. At the time of the conversion, the 2005 and most of the 2006 mortgage vintages had already been completed, and the 2007 production was gearing up. As with other mortgage lenders, these three years turned out to be problematic. Citibank subsequently incurred substantial credit losses and increased loan loss provisions from this mortgage lending business.

D. Current Operating Structure

Citigroup currently operates, for management reporting purposes, via two primary business segments which span multiple legal entities: Citicorp and Citi Holdings. Citicorp (core business) includes the Institutional Clients Group (securities & banking and transaction services) and Regional Consumer Banking (traditional banking services). Citi Holdings (noncore business) include Brokerage and Asset Management, Local Consumer Lending (residential mortgages, private-label cards, student and auto loans, Primerica Financial Services), and a special asset pool (securities, wholesale and consumer credits, leverage loans, SIV assets). Management plans to reduce the assets in Citi Holdings over time through asset and business sales and amortizations.

III. Citibank's Financial Condition

Citibank, N.A., the largest national bank owned by the holding company, Citigroup, had substantial financial strength as it entered the crisis. Citigroup management had committed to the OCC to maintain Citibank's capital at a range significantly above minimum "well capitalized" levels of 6 percent Tier 1 risk-based capital, 10 percent total risk-based capital, and

5 percent leverage capital. In fact, for many years, Citibank's Tier 1 capital was above 8 percent and its total risk-based capital was above 12 percent. Citibank would dividend capital in excess of this range for Citigroup's strategic use. At year end 2006, Citibank had total equity capital of $72 billion, Tier 1 capital of 8.3 percent, and Total capital of 12.4 percent, which was consistent with this agreement. Nevertheless, the bank's Tier 1 leverage capital ratio had been declining, and the OCC downgraded its capital rating at that time to reflect this trend. Around this time, Citibank was assigned a "Aaa" rating from Moody's.

As shown in the chart below, Citibank, N.A., and its sister national bank (a credit card specialty bank), reported net income of $13.1 billion in 2006. As the financial crisis began to unfold, the national banks reported a positive, though decreased, net income in 2007 of $5.1 billion, compared with a loss of $1.5 billion in Citigroup, excluding the national banks. In 2008, the national banks reported a loss of $6.3 billion, compared with losses of approximately $21.4 billion in Citigroup, again excluding the national banks. For 2009, the national banks reported a loss of $3.0 billion. In both 2008 and 2009, OCC examiners required management to downstream capital to strengthen the bank.

Net Income $B	2006	2007	2008	2009
National Banks	$13.1	$5.1	- $6.3	-$3.0
Non-Banks	$8.5	-$1.5	-$21.4	$1.4

Prior to the crisis, Citigroup management faced ongoing shareholder criticism for lackluster stock performance. Management attempted to improve income by making the strategic decisions to expand the cash CDO structuring business, synthetic CDO business, and syndicated (including) leveraged lending activities. These activities crossed multiple products, legal vehicles, and geographies. The cash CDO business was run from the CGMI, the U.S. broker-dealer, which also served as the main warehouse for the CDO structuring business; a CDO warehouse also was run from CFPI; the synthetic CDO business was managed in London, at both the national bank branch and a London-based holding company affiliate, Citigroup Global Markets Limited ("CGML"); and the loan syndication and bridge loan business was booked primarily through the non-bank holding company affiliate, CNAI. The complexity of the exposures and processes made it difficult to have a complete picture of the risks. These businesses became the sources of most of the bank's subprime and leveraged lending exposures and its subsequent losses.

IV. Citigroup's Subprime Exposure

Leading up to the crisis, Citigroup's exposure to subprime credit risk took various forms. One was from the direct origination of subprime loans that were held on the company's books. These were predominantly originated by entities other than OCC-supervised national banks or national bank subsidiaries.

A second form was from the structuring and ownership of securities backed by subprime loans. Most, but not all, of this structuring business was conducted by holding company affiliates of Citibank that were not supervised by the OCC. However, Citibank, N.A. came to own and otherwise be exposed to significant risks from those securities, which resulted in significant losses during the crisis.

A Subprime Loan Origination

Subprime mortgages were originated by CitiFinancial, a holding company affiliate, and to a lesser degree by CitiMortgage, while it was an OTS-regulated subsidiary of Citibank (West), FSB. As a result of the Legal Simplification Project described above in subsection II.C., subprime mortgages originated by CitiFinancial and Citibank (West), FSB, were transferred to Citibank, N.A. After the consolidation, Citibank continued to originate and hold on its books a limited volume of subprime mortgages in 2007, but these mortgages became subject to the new interagency guidance on subprime lending adopted that year, as well as OCC lending standards. As with many of the mortgages on Citibank's books, both prime and nonprime, originated during 2005 – 2007, the bank has taken significant losses on these subprime loans.

B. Exposure to Securities backed by Subprime Loans

A significant exposure of Citibank, N.A. to securities backed by pools of subprime loans came from collateralized debt obligations, or CDOs. In particular, Citibank was exposed to the highest or "safest" tranches of these subprime CDOs, sometimes referred to as "super senior" tranches that were rated "triple A" by the credit rating agencies. The bank had two sources of super senior exposure: liquidity puts issued to support Citigroup's Cash CDO Business in the U.S., and synthetically produced CDO exposure through its London branch office.

1. Liquidity Puts and Cash CDO Exposures

In late 2004, Citigroup management made the strategic decision to expand the CDO structuring and warehousing business. It is our understanding that this business purchased mortgages, including subprime mortgages, from third parties (not from the national bank or its subsidiaries) and packaged them into residential mortgage-backed securities ("RMBS"). These RMBS, along with other RMBS purchased from third parties, were then packaged into cash CDOs. Each cash CDO was sold to investors through an off-balance sheet, special purpose vehicle or SPV. The CDO SPV issued equity and classes of debt, with short-term commercial paper constituting the most senior class of debt. In essence, the first cash flows of the CDO/SPV were dedicated to the commercial paper investors, and because of the credit support provided in lower tiers of the funding structure, the commercial paper investors had very limited or "super senior" credit exposure to losses generated by the loans underlying the CDO.

This CDO structuring business, and the associated pipeline and warehouse activities, was not conducted by the national bank. Instead, it was conducted by the Cash CDO Desk of CGMI, the U.S. broker-dealer holding company affiliate of the bank, as well as by CFPI, a CDO warehousing affiliate. However, the national bank became exposed to the CDO SPV by issuing "liquidity puts" that guaranteed funding to the SPV in the event that short-term commercial paper investors became unwilling, presumably in a liquidity crisis, to roll over their funding. Such puts, which helped obtain high credit ratings for the commercial paper, were similar in nature to the kind of liquidity support that the bank typically provided to other funding vehicles, such as multi-seller conduits, that issued commercial paper. By providing this support, the bank was essentially assuming, in the event of a prolonged and critical liquidity problem, the "super senior" credit exposure that had been held by the commercial paper investors. The deals supported by these puts were all managed by external investment managers. This did not serve to reduce franchise risk.

The OCC is restricted in its ability to examine broker-dealer or other holding company affiliates. As a result, examiners did not possess direct knowledge of the nature or quality of the loans that backed the cash CDOs. However, because of the high credit ratings of the exposure, and the fact that the liquidity support was similar in nature to other kinds of low risk support provided to other funding conduits, the risk of these liquidity puts was viewed as low. Indeed, Citigroup management considered the possibility of losses from liquidity puts to be extremely remote based on a variety of factors, including that the bank would only be legally required to fund in a short-term market liquidity event; that the puts only covered the super senior exposures of the CDO, and could not be exercised in the event of credit problems rather than liquidity problems; and that super senior positions were above the highest AAA ratings provided by the rating agencies , and the commercial paper rating was the highest as well. These ratings indicated that the exposure was extremely well protected by the other, subordinate classes in the CDO.

Moreover, when the liquidity puts were first provided to CDOs, nearly seven years ago, only high quality asset-backed securities ("ABS") and mortgage product was included in these structures, and they performed well. However, during the middle years of this past decade, the business and the industry began introducing riskier subprime collateral into the CDOs. While the credit ratings for the super senior exposures remained high, the use of this riskier collateral was a significant change. As the OCC was not able to examine the structuring and warehousing elements of this business, we are not able to comment on the risk assessments and controls over this change.

When the liquidity crisis occurred, Citibank, as the result of the liquidity puts, assumed the credit risk of super senior exposures to subprime RMBS CDOs totaling $25 billion. This exposure generated significant mark-to-market losses to the bank, although the obligations remain current and the ultimate credit loss is not yet known.

2. Synthetic CDOs

Citibank's London branch and CGML, its London-based operating subsidiary also supervised by the OCC, created synthetic CDO exposures through its ABS correlation desk in London. These exposures were ramped up in 2006 and early 2007, reportedly following the capping of the limit on the New York Cash CDO business. The bank's activities were reviewed by the OCC during an examination of the EMEA (Europe, Middle East, and Africa) Structured Credit Business in the first quarter of 2007. Exposure to subprime credit was created synthetically using credit derivatives on either the underlying ABS securities or relevant indices. When the structured deals were packaged, equity and mezzanine tranches were sold to Citigroup clients, and unlike the NY CDO desk that distributed the super senior positions, the London trading desk retained the super senior position. Super senior exposure is the most protected level in a CDO structure, with all subordinate classes expected to absorb any expected or stressed losses anticipated in the deal. As such, these super senior pieces were either rated or sat above the AAA by rating agencies who routinely provided ratings to these structures. Our understanding is that for a synthetically created CDO, a total return swap can be used to transfer the economic exposure from the synthetically created pool of credit risk exposure (ABS and/or RMBS) into the associated special purpose entity. The special purpose entity would then create the tranched securities to be sold to investors. An estimate of $6 billion of super senior notional exposure was created in the bank; and additional exposures were also created and booked in CGML, the non-bank entity in London that was a subsidiary of the bank. The amounts of exposure reported in late 2007 were significantly greater than what we observed on risk reports earlier in the year.

V. Impact on Citibank of Syndicated and Leveraged Lending Conducted in Holding Company Affiliates

Citigroup also committed itself to the syndicated and leverage lending markets. Group management felt that as a major financial institution, it was important for it to participate in a large percentage of the syndicated market. In 2006, bank management increased its loan syndication pipeline limit 40 percent (from $35B to $50B), and then doubled it to $100B six months later in 2007. Management expected to participate in all large, significant sponsor-backed transactions, and it joined in more than ten material transactions simultaneously in 2007.

Citigroup used CNAI, the non-bank, holding company affiliate supervised by the Federal Reserve Bank of New York, as the primary vehicle for managing the syndication process. Approximately 80 percent of leveraged syndications and bridge loans were booked in CNAI, and the remaining 20 percent booked directly in the bank. When the syndication markets closed down in mid-2007, CNAI did not have the capital or liquidity to support the huge pipeline. Citigroup management then decided to use Citibank's balance sheet to book these high-risk and ultimately costly deals. The assets came on balance sheet, and ultimately some had to be substantially written down.

VI. OCC Regulatory Focus

A. Overview

The OCC identified a number of risk management issues over the years that we treated as "Matters Requiring Attention" in Supervisory Letters to bank management. Some of the issues involved consolidated risk reporting, risk measurement, model validations, and credible challenge by independent risk management. We brought forward certain issues to our Reports of Examination that were presented to the bank's audit committee. We also had enforcement actions specific to identified issues. Management was responsive to each individual issue, and personnel actions and organizational changes periodically occurred as a result of our letters.

One regulatory focus during these years was on the massive expansion of the complexity and volume of credit derivatives instruments. These risks centered on a problematic operational risk profile, and control over highly complex products and risk exposures via complex modeling.

In 2005, we were highly critical of management and risk management oversight of the areas that were considered higher risk. In this case, management responded to our criticisms by curtailing trading activities and changing management within the business. As such, our supervision was trying to ensure that the growth in a complex business was prudent and commensurate with infrastructure.

The company's Capital Markets Approval Committee process had looked at and approved liquidity puts and management's desire to book synthetic exposures in the bank. However, nowhere did these documents discuss the deterioration in collateral supporting these "highly rated" ABS securities or indices. Market events, and the substantial deterioration in the quality of underlying mortgage collateral, placed a significant burden on vehicles that were intended to work under usual and expected stressed situations. That said, participants in this business, and with this collateral, should have anticipated the potential for this market event, and risk management should have been aware of the asset quality deterioration that effectively went unheeded.

In early 2007, we examined the activities of the London branch and its ABS correlation desk. During this examination, we noted that the desk had switched emphasis to structured deals, and that synthetic exposures had been created at both the branch and the local non-bank entity, CGML. We determined that risk was high, and required additional work on the expansion of risk in synthetic exposures in concert with market events unfolding. By this time, the bank's exposure was already considerable. Just prior to issuing our supervisory letter, the bank changed desk management to an individual with whom we were comfortable.

During the summer of 2007, as events were unfolding related to subprime mortgages, we were informed of the critical nature of this exposure by Citigroup's Treasury upon the funding of the liquidity puts in August 2007. We and examiners from other agencies then began additional research on the liquidity puts and the potential exposures. We found that the assets under the liquidity puts had older vintages than the production the markets had seen in the most recent run-up of subprime loans in 2006 and 2007. This was due to the longer existence of those structures and the fact that replenishment of those structures was reportedly mostly subprime, where initial RMBS were of higher quality.

We were also informed that Commercial and Investment Bank management sought to acquire its own subprime mortgage origination source after confirming that Citibank would not be a source of subprime mortgage paper. This led management to pursue the purchase of a subprime originator Argent. While the Commercial and Investment Bank management's decision to bring in house a subprime originator was faulty, Argent did not include any loans, and no additional loans were generated by the entity due to the fact that the market had significantly deteriorated by that time.

We performed a comprehensive examination in the fourth quarter of 2007 to determine the nature of the problem and whether the company was properly valuing these CDO instruments. The findings of this exam are in the materials that have been provided to the commission.

B. Administrative Actions

During the five year period prior to the crisis, Citibank was subject to both formal and informal regulatory actions. Formal action came in 2003 when the OCC put Citibank under a Formal Agreement for activities related to Enron, WorldCom, and others. The bank was using Complex Structured Financial Products to provide funding to these companies without having the transactions appear on the client's financial statements. The formal agreement ("FA") required the bank to implement enhanced oversight and controls over all complex structured finance transactions. Most of the requirements of the FA were later codified in an interagency policy statement on Complex Structured Financial Products issued to the industry. The bank achieved compliance with the FA in late 2006.

Informal actions were imposed to address legal, compliance, and control issues that became evident in a number of high-profile events. These included deficiencies in Citibank's Japan Private Bank, a trading incident in London, and a number of other non-public events. The bank embarked on a "Five Point Plan for Improvement" in 2005 to strengthen culture and control. The five point plan was supplemented by an extensive corrective action plan to address legal, compliance, and control issues. Extensive work was performed to improve processes and controls, and the bank achieved substantial compliance with this plan in early 2007.

The OCC's administrative actions did not directly apply to the syndicated lending and CDO businesses. The FA dealt with client specific transactions. Informal actions covered legal, compliance, and internal control issues. Neither dealt with specific businesses, and as such, they did not constrain the group's expansion into syndicated lending and CDO warehousing. In fact, the bank began increasing syndicated loan limits while the FA was still in place. Moreover, both businesses were mostly conducted in legal vehicles outside of the OCC's supervisory control. Syndicated lending was managed mostly through the non-bank holding company affiliate CNAI, and CDO structuring and warehousing was done in the broker-dealer and CFPI, both of which were holding company affiliates.