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### FRB Memo from Division of Banking Supervision and Regulation to Governor Bies Re Upgrade of Citigroups Risk Management Rating

Federal Reserve System: Board of Governors

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## BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF BANKING SUPERVISION AND REGULATION

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**Date:** February 17, 2006  
**To:** Governor Bies  
**From:** Division of Banking Supervision and Regulation<sup>1</sup>  
**Subject:** Upgrade of Citigroup's "Risk Management" Rating

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**For Information Only**

As you will recall, the Federal Reserve downgraded Citigroup's "Risk Management" rating from "Satisfactory" to "Fair" in the first quarter of 2005, primarily in response to widespread weaknesses in the company's compliance risk management processes and increasing concerns regarding demonstrated weaknesses in the company's ability to comply with all laws and regulations. During the same time period the Board approved Citigroup's acquisition of a small bank holding company in Texas, but directed Citigroup management, in the public Board Order, to devote its attention to implementing planned improvements to its control and compliance infrastructure prior to undertaking significant expansionary activity.

Federal Reserve Bank of New York and Board staff have worked closely with Citigroup over the past year to determine if proposed transactions might inappropriately divert management attention and resources from improving the control infrastructure. While Citigroup has been allowed to proceed with a number of transactions, staff advised the company that consistent with the Board's public Order, certain other proposed transactions would not be appropriate during this period.

Reserve Bank staff are currently in the process of completing their annual "roll-up" examination, or reassessment of Citigroup, and reevaluating the assigned supervisory ratings. The examiners have concluded that the company has made substantial improvements in the key areas of identified weakness and that the risk management rating should be upgraded from "Fair" to "Satisfactory." This assessment is based upon both close communication with Citigroup senior management and the Reserve Bank's on-site supervisory reviews. Examiners continue to rate Citigroup's financial condition as "Strong" (1) and the company's overall composite rating will continue to be rated "Satisfactory" (2). Both the President and the EVP for Supervision at the New York Reserve Bank concur with the examiners' recommendations.

Citigroup had begun to develop and implement significant corrective action prior to the Board's order in March of 2005; however, significant weaknesses had not been adequately addressed at that time. Through the course of continuous monitoring and targeted examination activities, Reserve Bank and Board staff now believe that the company has made, and is continuing to make, significant improvements in its compliance and control infrastructure. The company has restructured the global compliance function to be independent of the business lines, established a Chief Compliance officer that sits on the company's management committee,

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<sup>1</sup> Messrs. Spillenkothen, Hoffman, Miles and Sheerin, and Ms. Bailey.

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revised compliance policies and procedures, and substantially increased the budget for compliance and internal audit staff and compliance technology. Among other things, the company has also improved the governance of international operations, strengthened internal audit processes, and completed improvements necessary to bring the company into substantial compliance with two existing Federal Reserve enforcement actions related to the execution of highly structured transactions and controls over the nonbank consumer finance lending business. Importantly, examiners believe that Citigroup's board and senior management are committed to, and have made substantial, measurable progress in communicating and establishing a stronger and healthier corporate culture. Over the last year Board staff have also met with senior management and certain Citigroup board members, and share the view that the organization is committed to successfully addressing the supervisory issues.

Notwithstanding the company's progress over the past one to two years, Board and Reserve Bank staff recognize that many aspects of the company's compliance risk management processes are new and that it will take time to fully demonstrate their effectiveness. Seasoning of these controls, and the completion of other improvements that are planned to be implemented during 2006, is necessary before the corporate compliance function can be considered fully satisfactory. Recent reviews of the corporate compliance function by the OCC and Citigroup's internal audit function agree with the Federal Reserve's assessment that the function is not yet satisfactory, but that the organization has made, and is continuing to make substantial progress against a well defined project plan which is expected to result in a fully satisfactory function. The substantial progress to date, the positive trend identified by examiners, and the strengths of the many other aspects of the risk management function justify the upgrade of risk management from a 3 to a 2.

When considering the substantial improvements mentioned earlier, in combination with the satisfactory assessment of other key risk management functions, the Federal Reserve and the OCC examiners who supervise the national bank subsidiaries have concluded that the company is satisfactorily controlled and managed. Although the OCC never downgraded either the management component or the composite assessment of the CAMELS rating, OCC examiners concur with the Federal Reserve that the organization has made substantial progress in strengthening its internal control structure during the past year. As noted, Board staff have discussed this rating upgrade with both the head of supervision and the president in New York, who both support the rating upgrade.

The Reserve Bank plans to inform Citigroup of the revised supervisory assessment next week, emphasizing a strong expectation that Citigroup continue to implement the remaining aspects of the company's plans to further improve its compliance risk management program, and that examiners will be closely monitoring progress. As a satisfactorily managed bank holding company, Citigroup will again be free to pursue expansionary activity in the normal course of business.

cc: Vice Chairman Ferguson  
Governor Olson  
Governor Kohn