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OCC Memorandom from John Fleming to Alfred Crumlish Re Examination of Citi Risk Management Risk Management

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MEMORANDUM

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To: Alfred P. Crumlish, SNBE

From: John A Fleming, NBE

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Subject: Examination of Citigroup Risk Management (CRM)

Scope and Objectives

The primary objective of this review was to assess the overall effectiveness of the Citigroup Risk Management (CRM) structure and management from a top-level perspective. Senior risk executives were interviewed and various top-level information materials, including board reports, policies, and training resources were read and analyzed. Additionally, results of various OCC examinations were evaluated to obtain insights on the effectiveness of the risk management processes in specific areas.

Conclusions

- CRM provides satisfactory oversight of credit and market risks, subject to issues identified and recommendations made during recent examinations. CRM is independent and risk executives within CRM are knowledgeable and experienced.
- Broader risk management practices need strengthening to help prevent the recurring control failures, such as those in Japan, from impacting the company. CRM's process and mandate should be modified to incorporate the identification of issues that span businesses and the root causes of control breakdowns. Specific matters requiring attention are presented below.

Summary of Findings

Risk Management is structurally independent and its responsibilities and role has been augmented over the past two years. Citigroup's Senior Risk Officer reports directly to the CEO and provides regular updates to the Audit & Risk Management Committee of the Board. The CRM organization is generally aligned against the major businesses. The recent assimilation of Global Compliance into CRM is intended to strengthen independence and enhance its testing and monitoring capabilities. CRM includes Risk Architecture, which is responsible for corporate policy, reporting and risk systems. A new role, Risk Aggregation, is designed to capture potential concentrations across legal vehicles and product organizational structures.

CRM generally performs well with respect to credit and market risk, and has played a significant role in improvements in measurement methodologies such as operating risk and economic (risk) capital. CRM has been less effective in foreseeing issues that cross business lines or that are less quantifiable. Recommendations contained in OCC conclusion memoranda and other correspondence stress a need to address specific gaps in the control process, some of which are related to efforts to control costs. The company recently recognized a need to address cultural issues such as the broader tradeoff between risk and reward, and the role of incentive and compensation programs. Recurring issues having a significant impact on the firm indicate that risk management processes and ultimately the risk culture in Citigroup need to be improved.

In the context of the CRM organization, the nature of issues impacting the firm indicates a need for the organization to incorporate a focus beyond specific lines of businesses and adopt processes to more firmly encompass enterprise risk management. In general, a broader perspective is consistent with the recommendations of the COSO, Enterprise Risk Management Framework. In order to promote this perspective, certain specific actions should be taken. These are presented below.

Matters Requiring Attention

- Risk management in business lines, legal vehicles, countries, and regions should broaden their perspective beyond individual risk silos (e.g., credit, market and operational risk) by assessing linkages among the various risk types.

- A common set of risk definitions and types should be established.

- A corporate policy for new products and services should be adopted.

- Key risk indicators should be defined and more actively analyzed and used.

- Risk management should be formally integrated into strategic and business / budget planning.

Risk management's scope and reporting should transcend the current risk specialties, namely credit, market and operational risks, and encompass a more holistic view of business risks. CRM's reporting should focus on key issues in addition to the current summary of issues by risk type. In many cases, trends are linked and indicate larger issues which may not be apparent or fully appreciated without the broader context. This is particularly the case with respect to issues that impact the bank's reputation or longer term strategic objectives. CRM should focus on evaluating these linkages to identify and report emerging systemic issues and root causes of control failures.

The company does not have a standardized set of risk definitions. This can hinder consistent understanding and communication across businesses or corporate control functions, as well as detract from systematic analysis. In order to properly identify, measure, report, and manage risk, common risk definitions should be developed by CRM for use throughout the company. It may also be beneficial to identify individuals responsible for managing the key risks or a systemic basis.

The methodology for approving new products and services is handled within specific businesses following their own processes. There should be a standard, corporate-wide policy covering new products and services. It should include a definition of what constitutes a "new product," and establish an overall process, to include documentation and approval requirements as well as ongoing monitoring and oversight. Specific implementation of this policy may be delegated to businesses or specialized product committees, as long as these process conform to the corporate standard.

CRM should also develop and use its own key risk indicators as an alert system to signal potential changes in the risk profile. These changes can be both quantitative and qualitative, and can be tailored to specific businesses, the overall enterprise, or CRM priorities to address specific issues. Changes can emanate externally (e.g., a more aggressive regulatory regime, intense competition, etc.) as well as internally (e.g., new management, volume and earnings growth, changes in reported risk levels, budget issues, audit and regulatory exceptions, compensation etc.).

Finally, it is essential that risk management become more firmly embedded in the culture of Citigroup. Earnings and profitability growth have taken precedence over risk management and internal control. CRM should be formally integrated into the strategic and business (budget) planning process in a manner that ensures that a sufficient control infrastructure is in place prior to any significant expansion in business lines, products or risks.