

January 31, 2008

### VIA ELECTRONIC MAIL

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17<sup>th</sup> Street, N.W.
Washington, DC 20429
Comments@FDIC.gov

Attn: Comments

Re: RIN 3064-AD21: Part 363 - Independent Audits And Reporting

Requirements

Dear Mr. Feldman:

Citigroup Inc. ("Citigroup"), on behalf of itself and its insured depository institutions, appreciates the opportunity to comment on the proposal of the Federal Deposit Insurance Corporation ("FDIC") to amend the provisions of Part 363 (12 C.F.R. Part 363) of the FDIC's regulations implementing section 36 of the Federal Deposit Insurance Act. 72 Fed. Reg. 62310 (November 21, 2007). It is clear that the FDIC has devoted considerable efforts to developing a thoughtful proposal and we agree with most of its provisions. However, we have the following specific comments.

I. The requirement for compliance with Part 363 at the holding company level should not be dependent on the aggregate size of the subsidiary insured depository institutions relative to the holding company.

The FDIC specifically has asked for comment on the appropriateness of an asset threshold to enable an institution to comply with Part 363 at the holding company level, whether at the parent level or that of an intermediate holding company. The FDIC has proposed a standard that would require that the total assets of the holding company's insured depository institution subsidiaries comprise 75% or more of the holding company's consolidated assets. For the reasons stated below, Citigroup recommends that the FDIC not adopt an asset test.

Currently, the insured depository institutions of a holding company that are subject to Part 363 may use the holding company consolidated financial statements to satisfy the

audited financial statements requirement of Part 363. In addition, subject to certain conditions, to the extent that the holding company has services and functions comparable to those required of the insured depository institutions under Part 363, the other requirements of Part 363 also can be satisfied by the holding company. This holding company process has been available regardless of the proportion of the consolidated assets of the holding company that the assets of its insured depository institutions represent.

Citigroup has consistently relied on the holding company process in complying with Part 363. The ability to use such consolidated process has been a significant factor in the design of our holding company structure and corporate governance, as well as our risk management and internal control processes. Citigroup undertook significant changes to its legal vehicle structure in 2005 and 2006, resulting in the elimination of several intermediate holding companies and the consolidation and reorganization of its insured depository institutions, and opted not to create an intermediate bank holding company for all of its banks. The various insured depository institutions do not have separate audit committees of their respective boards; the Citigroup Audit and Risk Management Committee serves that function. Risk management and internal control processes, including those relating to financial reporting and measuring the effectiveness of such controls, have been designed on a corporate-wide basis consistent with the requirements of Part 363 and the Sarbanes-Oxley Act ("SOX").

# Financial Reporting.

Citigroup believes that its regulatory and financial reporting process, which includes the results of its insured depository institution subsidiaries in Citigroup's audited consolidated financial statements, provides a great amount of transparency to regulators and the public. The control environment at the insured depository institutions is consistent with the control environment throughout the entire Citigroup organization, and it satisfies the requirements of Part 363 and SOX. Such internal controls are consistently applied to all insured depository institutions regardless of size.

The regulatory and financial reporting process entails the whole operation (end-to-end) and concludes with reporting to Citigroup's Audit and Risk Management Committee any significant deficiencies, unique control exceptions or known important risks. The financial position and results of operations of each insured depository institution are already reported to the appropriate banking regulators by means of the applicable regulatory reports. Both the internal control environment and the regulatory reporting process are reviewed by the company's independent public accountant during the annual audit, the quarterly (10-Q) and annual (10-K) review of financial statements, and other statutory reviews it conducts.

Currently each bank files a quarterly report (Call Report or Thrift Financial Report, as appropriate (each a "Regulatory Report")) with its primary federal regulator that includes a balance sheet and income statement with supporting schedules. The Chief Financial

Officer of each of the banking institutions attests that the balance sheet and income statement, along with the supporting schedules, have been prepared in conformance with the instructions issued by the relevant regulatory authority and are true to the best of such Chief Financial Officer's knowledge and belief (the "Attestation"). In addition, the Regulatory Report is signed by three directors of the filing institution.

The instructions issued by the regulatory agencies require that the primary financial statements and supporting schedules be prepared in accordance with Generally Accepted Accounting Principles adopted in the United States ("U.S. GAAP"). Although the financial statements of a particular banking organization are not subject to a separate independent audit, adjusting entries that are proposed by the independent public accountant in its examination of the holding company are often pushed down to the individual subsidiary institution when the Regulatory Report is prepared and are included in the appropriate Regulatory Report so that there is consistency in reporting with the holding company. As a result, except for the reporting classification of some individual line items, the primary financial statements included in the Regulatory Reports are essentially the same as those that would be presented in an audited financial statement. Hence, the financial position and results of operations of a depository institution can be determined by analyzing the information contained in its Regulatory Reports.

The supporting schedules included in a Regulatory Report provide detail for bank regulators, including the FDIC, and the public to analyze the components of a banking institution's financial statements. The schedules provide a break down of the major asset and liability categories. For example, Schedule RC-C, "Loans and Lease Financing Receivables", breaks down loans into the major exposure categories. Schedule RC-N, "Past Due and Nonaccrual Loans, Leases and Other Assets", and Schedule RI-B, "Charge-offs and Recoveries on Loans and Leases and Changes in Allowance for Loan and Lease Losses" present payment status and charge-off and recovery detail, respectively, by similar major exposure category. The information included in these schedules is held to the same level of scrutiny and internal control processes as the financial statements of the reporting banking institution. In fact, the Attestation signed by the Chief Financial Officer holds the Regulatory Report to a higher standard than financial statements prepared under U.S. GAAP.

As discussed more fully below, Citigroup has implemented a series of Internal Controls Over Regulatory Reporting ("ICORR") as part of its control structure to ensure that the company's regulatory reporting requirements are achieved in a manner that is free from any material misstatement. Imposing the costly burden of requiring an independent audit of the financial statements of each reporting insured depository institution (or of a mid-tier holding company) would not proportionally increase the level of accuracy of the financial statements and supporting schedules included in the Regulatory Reports. It will certainly result in unnecessary costs related to additional audit procedures and will duplicate financial information that otherwise is already reported.

## Internal Control Process.

As mentioned above, the financial position and results of operations of the insured depository institutions are closely monitored and reported in accordance with applicable requirements. Citigroup has very robust processes for compliance with Sections 302 and 404 of SOX and Part 363. Such processes relate to, among other things, (i) management's assessment of internal controls over financial reporting; (ii) early detection of control issues through the Risk and Control Self-Assessment ("RCSA") process, which includes management's assessment of all important risks and controls (the RCSA process is reviewed for effectiveness by Citigroup's internal audit function ("Audit and Risk Review") as part of their regular audits); (iii) centralized monitoring of the internal controls over regulatory reporting; (iv) periodic reporting of financial position and significant control deficiencies and business risks to the Citigroup Audit and Risk Management Committee; and (v) independent public accountant statutory audits and reviews. It is through these processes and the comprehensive reporting in Citigroup's audited financial statements and related footnote disclosures that there is significant transparency to regulators and the public.

Three of the internal control processes are detailed below.

<u>SOX</u>. The Citigroup SOX scope is a multi-step approach that begins with scoping done at the bank holding company level. After the selection of all significant accounts, the business units perform an additional scoping exercise to ensure that significant and critical accounts are covered. The significant accounts are mapped to the important risks and then to the key controls. There is quarterly testing of key controls. Deficiencies are evaluated and issues of significance are reported to senior management and the Citigroup Audit and Risk Management Committee.

<u>RCSA</u>. The RCSA process is a company-wide undertaking used to document, evaluate and test important risks and key controls in the internal control environment. It serves as an early warning detection system that identifies control weaknesses.

Individual RCSA entities are first identified and then RCSA processes are developed specifically for each entity. An effective RCSA process consists of an annual evaluation of the entity's RCSA internal control environment and a quarterly testing process that verifies that key controls are adequate. RCSA entity management must identify important operational risks and key controls that mitigate the important risks identified. The RCSA entity then assesses key control testing results and assigns ratings to the control, the important risk, and the overall RCSA entity.

The RCSA policy requires that corrective action plans be developed to remediate control deficiencies in a reasonable time. All businesses must comply with the RCSA policy and business unit CFOs attest quarterly to successfully complying with the policy or must disclose where they failed to comply. Audit and Risk Review monitors the RCSA process through separate audit procedures and assigns a rating on RCSA

effectiveness. A "Not Fully Effective" RCSA rating must be reported to senior management and business unit management must remediate the deficiency on a timely basis.

<u>ICORR</u>. ICORR is intended to assist management in its effort to ensure the adequacy of internal controls over regulatory reporting so that Regulatory Reports are free from material misstatements. The scope process for ICORR is similar to the SOX scope process.

The objectives for Citigroup's management assessment of ICORR are as follows. First, to report, in all material respects, on ICORR exceptions and to determine if there are any significant deficiencies or material weaknesses resulting from those exceptions. Known material exceptions are communicated to business sector management and Audit and Risk Review on a timely basis. Second, to remediate known exceptions within a reasonable period of time and, where needed, establish mitigating controls until remediation is complete and test the interim controls for effectiveness. And third, to obtain reasonable assurance that no material weaknesses exist as of the date of the assessment period.

# Additional Anticipated Costs.

For Citigroup, the incremental cost of complying with Part 363 other than at the Citigroup level will be significant. Just for the additional external audit fees, the incremental cost in the first year could be as high as approximately \$10 million, with a somewhat lower recurring yearly cost. In addition, there will be management and financial costs related to restructuring the organization, developing new internal processes and functions, constituting additional audit committees, and preparing additional financial statements and related notes. In our view, the additional effort and cost will far exceed any benefit to be derived from additional audited financial statements and related processes, and will not meaningfully enhance the early identification of needed improvements in financial management at our insured institutions.

#### Conclusion.

For the reasons discussed above, Citigroup does not believe that the imposition of an asset threshold in Part 363 is warranted. We respectfully urge the FDIC not to adopt this proposed change. If the FDIC ultimately were to adopt an asset percentage threshold for insured depository institutions to comply with Part 363 at their holding company level, Citigroup requests that institutions that currently avail themselves of the holding company process be given sufficient time to come into compliance with the new requirement. As mentioned above, such institutions, including Citigroup, will have to, among other things, decide how best to restructure themselves, negotiate with their independent public accountants for additional audit services, restructure one or more boards of directors and recruit the requisite individuals to one or more new audit

committees. For this reason, we respectfully request that affected institutions have until the end of their first full fiscal year after the FDIC promulgates the final rule to effect these changes. So, for example, an institution with a calendar fiscal year would have through the end of 2009 to make the necessary changes, assuming the FDIC promulgates the final rule later this year.

II. <u>Instances of noncompliance with the laws and regulations designated in Part 363 should not be publicly disclosed</u>.

The FDIC also specifically requested comment on whether the disclosure of instances of non-compliance with the Part 363 designated laws and regulations should be made available for public inspection or the FDIC should designate such disclosure as privileged and confidential and not available to the public.

First of all, management's certification of compliance with the Part 363 designated laws and regulations should have a materiality standard. For example, it is not difficult to imagine that a minor infraction could have occurred during the period covered by the Part 363 report and that such infraction was then promptly remedied. In this situation, there is no benefit to be gained by the depository institution having to identify a mistake that was subsequently rectified.

Second, the rule should not require the public disclosure of instances of noncompliance. For example, there could be a technical violation of Regulation O that would be a reportable violation, but that has little effect on the safety and soundness of the institution. The regulatory examination process is a better vehicle for any compliance failure to be addressed by the primary regulator. In such case, there would be no public evidence of the noncompliance, unless it were of a magnitude that results in the regulator imposing a sanction that is publicly disclosed, such as through an enforcement action. On balance, there is no discernible benefit to be gained by the public disclosure of each and every instance of a compliance breach.

Thank you for considering our comments.

Very truly yours,

William J. Gonska Deputy Controller Citigroup Inc.

WJG/sp