Write to Rubin? – Pressure on Underwriting Standards at Citigroup

A Case Study in Financial Control within a Global Financial Conglomerate

Stephen V. Arbogast, Executive Professor
C.T. Bauer College of Business, University of Houston

Abstract

The case probes a number of resistance dilemmas faced by individuals operating within corrupted cultures during the Financial Crisis. Richard Bowen, aware that fraud practiced within CitiMortgage is exposing the bank to millions in liability, is considering a 'Hail Mary' pass. He has drafted an e-mail to Chairman Robert Rubin disclosing that Citi has been selling mortgage securities based on false representations. Should he actually send it? Will it finally result in corrections which should have taken place months ago, will it just be ignored, or will it result in terminating Bowen's career?

The case contemplates the dilemmas of administering sound financial control at institutions grown by turns oversized, bureaucratic, and sporting an 'eat what you kill' culture. Few institutions combined these traits as intensively as did Citigroup. Upon the merger of Citicorp and Primerica, it became the largest global bank by assets. Its scale was staggering, with 16,000 offices in 140 countries populated by over three hundred thousand employees. Senior management was very distant from Citi's various 'shop floors.' Financial control also was affected. A case attachment depicts Citi's almost byzantine financial control structure, which system did not prevent Citi from racking up an impressive list of scandals and settlements.

Citi's organization and culture presented Bowen with several difficulties. Management at the mortgage business units was thoroughly imbued with a "get it done, don't bother me with the details" mindset. To operate in this way, Citi's control systems had to be neutralized. At Bowen's level this meant that fraud warnings issued by his boss resulted in that individual's sudden departure. It further meant line management ordering Bowen's mortgage underwriters to ignore their own findings and misrepresent their reports. Internal Audit, though feared, was distant and uninvolved. Bowen's warning memos to operating managers were ignored.

Bowen thus perceives his dilemma as one of finding a place within Citi's vast structure where his warnings can gain traction. His plan is to appeal over the heads of all the layers. He heard that Robert Rubin had a good controls reputation at Goldman Sachs. As a former Treasury Secretary, Rubin presumably is not concerned with climbing any corporate ladder, but should want to protect his distinguished reputation. Directly appealing to Rubin might work.

Bowen knows, however, that leaping over many management layers usually does not go unpunished. Moreover, the moment is not propitious. Citigroup is in crisis. Indeed, CEO Charles Prince is tottering and may step aside any day. In such a climate, will Bowen's warnings get the attention he hopes for? The case asks students to look again at Citi's organization, consider the risks of 'writing to Rubin,' and then decide if more effective options exist to reverse Citi's selling of subprime securities based on false representations.

Write to Rubin? – Pressure on Underwriting Standards at Citigroup

A Case Study in Financial Control within a Global Financial Conglomerate

Stephen V. Arbogast, Executive Professor
C.T. Bauer College of Business, University of Houston

"As long as the music is playing, you've got to get up and dance." 1
Charles O. Prince III, CEO Citigroup

Richard Bowen had had just about enough. Since 2005 Bowen had been Business Chief Underwriter for Correspondent Lending at Citigroup's Consumer Lending Group (CLG). In this capacity he was responsible for supervising hundreds of underwriters. These professionals examined billions of dollars in mortgages purchased by Citibank from originators and brokers. Their primary job was to ensure that the mortgages purchased were in compliance with Citi's rigorous credit standards. Since moving into this position, Bowen had watched Citi's adherence to these standards steadily erode. By allowing this to happen, Bowen was convinced that Citi was exposing itself to tens of billions of dollars in losses.

These concerns was not theoretical. They didn't involve some disaster scenario unfolding in the far off future. Rather the exposures involved assurances, "representations and warranties" in Wall Street parlance, that Citi was disclosing to investors. Citi was repackaging many of the purchased mortgages into securities. When it sold these securities, it warranted that the underlying mortgages adhered to Citigroup's underwriting standards. If, in fact, the loans did not comply and later ran into trouble, investors could "put" their securities back to Citi. If/when they were put back, they'd likely be worth only a fraction of their original "par" value.

Bowen had documented for his bosses that Citi's underwriting standards were being systematically violated. He also advised them that deliquencies were mounting in the subprime mortgage market. It was now November 2007. The Rating Agencies had recently downgraded many subprime mortgage securities and CDOs. Citigroup itself was shuddering under the impacts of the mortgage market's unraveling. A major reackoning might be closer than anyone suspected.

Citi's underwriting practices had decayed despite Bowen's efforts to stop the slide. Since mid-2006 he had issued warnings in all directions. Bowen had convinced his boss, the Chief Underwriter for Retail Lending (REL), that the risks were serious. Together they contacted multiple members of REL management as well as the Chief Risk Officer for the Consumer Lending Group (CLG). Their messages advised that over 70% of some purchased mortgage pools had defective credit files. Bowen's boss had warned that "there will be serious long term consequences for failing to take action." 2 In response, all of his duties were assigned to other executives. Bowen's boss then retired early in 2007. 3

After continuing to issue unheeded warnings throughout 2007, Bowen began to wonder how to get his organization's attention. Citigroup is a huge and complex organization. Power and authority do not always follow the organization chart. Bowen observed, for example, that mortgage "turned down" decisions were being reversed by the Chief Wall Street Risk Officer. On what basis did a"securities" risk officer reverse underwriting decisions on residential mortgages? Had someone higher in the organization encouraged him to do so? Bowen didn't know. The action had ocvcured well away from him and much higher up.

Recent events intensified matters. Two hedge funds that invested in subprime securities had recently gone bust. Next had come the raft of ratings downgrades. 4 With a crisis seemingly on the doorstep, Bowen decided the time for routine warnings had passed. He had drafted an e-mail to Citi Chairman Robert Rubin. The note (See Attachment 1) laid out Citi's legal exposures, giving essential details.

Rubin, the former U.S. Treasury Secretary, was a legendary figure. During his time at Goldman Sachs, Rubin had earned a reputation for risk management and supporting sound controls. Now that the e-mail was drafted however, Bowen was having second thoughts. Going to the firm's Chairman in writing was a bit of a "Hail Mary" pass. Perhaps Rubin would get interested and intervene. Perhaps he would decide other matters were more important and hand Bowen's note to some subordinate for "handling."

Bowen wondered whether he had fully explored all the internal Citi channels for action. Before hitting the "send" button on the Rubin note, he would review his options one last time. Perhaps he could find, within Citi's byzantine structure, some route that would direct his warnings to someone who would act.

<u>National City Bank becomes a Giant Financial Conglomerate</u>

Part of Bowen's problem concerned the organization that Citi had become. By 2007 Citi was so huge and complicated that it was hard for business unit executives to get clear messages up to top management. Similarly, top managers often had only a vague understanding of what was happening down at the level where mortgages were bought, securities packaged and bonds sold. Citi had grown far and wide beyond its original banking roots.

Founded in 1812 as City Bank of New York, Citi started as a lender to New York's commercial interests. For most of the 19th century, it focused its activities on the burgeoning industrial companies headquartered in and around the City. It also had an active international trade finance business. As the 19th century closed, the bank, now called The National City Bank of New York, began opening branches in countries that were major U.S. trading partners. 5

During the first half of the 20th Century, National City acquired foreign operations to create one of the world's largest international banking networks. This expansion gave it a hard to duplicate ability to service American multinationals at home and abroad. National City also became a leader in financial innovation. Citi introduced certificates of deposit to attract funding and credit cards to service retail and business accounts. The bank also became a leading player in London's growing Eurodollar market. 6

The 1970's inaugurated a period of rapid change for Citibank. On one hand, the bank's international position was unparalleled. Citibank led the way in recycling Petrodollars into loans to consuming state governments and helped develop the Eurobond and Yen capital markets. On the downside, Citibank saw many of its historic industrial clients move away from relying on bank borrowing. Increasingly these "name credits" turned to investment banks to help them sell bonds in the capital markets.

Facing a fundamental threat to its core business, Citibank decided to invade investment bankings' turf. This effort, which unfolded over decades, was crafted by the bank's aggressive CEO Walter Wriston. For starters, Citibank formed a holding company called Citicorp. This organization would own many subsidiaries, one of which was the historic Citibank. Citicorp launched numerous subsidiaries that bit into the edges of investment banking's domain. The first of these involved leasing and the issuance of asset-backed securities. Others would follow.

At the same time Citicorp launched a powerful lobbying effort aimed at overturning the Glass-Steagall Act (GSA). This depression-era law prohibited institutions that took retail customer deposits from engaging in investment banking or the selling of insurance. Citi's ultimate ambition was to operate like the European "Universal Banks." Institutions like Barclays and Union Bank of Switzerland (UBS) faced no such prohibitations on permissable lines of business. For Citi to duplicate their approach, Glass-Steagall would have to be repealed.

Under Wriston and his successor, John Reed, Citicorp relentlessly expanded the breadth of its financial services. Some of this involved innovation. Reed helped lead commercial banks into electronic banking. Citi pioneered ATM services and systems which enabled retail customers to consolidate various financial activitiess under the bank's umbrella. Acquisitions also played a part. Citi swallowed up regional banks and mortgage lenders. In the process, Citi evolved from a New York bank into a continent-wide U.S. bank serving both retail and business customers. Using the Citicorp holding company, Citi also built a network of subsidiaries conducting investment banking business outside the U.S. Citi was now one step away from crossing the "GSA Line." That line would soon be crossed.

The events which led to the crossing were not straightforward. Citicorp itself fell victim to the banking consolidation process it had helped foster. Sandy Weill, the former Shearson Lehman CEO, had his eyes on Citi. A master deal maker, Weill had taken an obscure financial firm, Primerica, and used it to capture the Travellers and Aetna insurance firms, plus Smith Barney and Salomon Brothers. In 1998, Weill proposed that Primerica and Citicorp merge.

Weill's proposal was clearly illegal under the provisions of Glass-Steagall. However, the law permitted Citicorp up to five years to divest prohibited operations. Weill was confident Citi would not need to do so. Shortly after the announcement, Weill publicly stated that Citicorp had undertaken the merger with the expectation that GSA would soon be abolished. He was right. The following year Congress passed the Gramm-Leach-Bliley Act eliminating the prohibition on cross ownership among commercial and investment banks and insurance.

Citicorp and Primerica completed their merger with Weill and Reed emerging as co-CEOs. That unlikely power sharing arrangement did not last. Weill emerged as the sole CEO with Reed forced out. The implications of handing Citicorp's keys to this compulsive dealmaker would soon become apparent.

Weill's new entity, now dubbed Citigroup, was a financial goliath. Citi became the largest bank in the world with $700 billion in assets. It operated 16,000 offices worldwide in 140 countries. Global employment totaled 357,000. 7 Weill combined Salomon Brothers and Smith Barney (SB) with Citi's investment banking operation, creating a strong presence in underwriting, trading and retail brokerage. In Travelers, Citigroup possessed a prominent, full service insurance firm. The stage was now set to test whether financial "supermarkets" were the wave of the future. In Weill's vision, Citibank would also sell insurance and promote the use of SB's investment banking services. The bank would also provide financial products, e.g. swaps, options and mortgage products, for SB to securitize, market and trade.

With Citi's now impressive scale and diversity came three major challenges. The first involved blending radically different business cultures. SB and Salomon were historic competitors. Both tended to look down on commercial banking and insurance as financial backwaters. Investment bankers typically enjoyed pay scales which were the stuff of dreams for branch managers and insurance salesmen.

Just as challenging was the task of integrating and managing the merged companies. The new Citigroup was an organizational beast. Weill's financial supermarket contained aisle after aisle of product lines. These often had substantial sub-product lines underneath them. To take one example, in mortgages Citi had a sub-business line that originated loans through the branch networks. It had another which bought mortgages from brokers. It had a third which bought pools of mortgages from Wall Street firms. All of these units had separate managements. Frequently they provided mortgage products to the investment bank for securitization and marketing. Yet another unit traded mortgage bonds in the secondary market. All of these operations were focused on the United States. Parallel activities were carried out in London and other major financial centers. Specific activities, like originating mortgages, were carried out in many of Citi's overseas branches. Attachment 2 provides a rough schematic of Citigroup's organization post-merger. Attachment 3 provides a more detailed organizational breakdown for the U.S. mortgage business, within which Richard Bowen operated.

Citi's unique franchise and offerings allowed it to post impressive results in most post-merger years. Attachment 4 provides an overview of financial results and stock price performance for the years 2001-05. Weill retired in 2006 believing his vision for Citi had been realized. His hand-picked successor, Charles Prince, would discover otherwise.

Hidden in the organizational complexity bequeathed by Weill was a third challenge: financial control and risk management. Citibank already had a checkered history in this area. The bank was almost brought to its knees by the Latin American debt crisis in the 1980's. Convinced that "countries didn't go bankrupt," Citi had led the way in recycling petrodollars into "Balance of Payments" loans to oil-importing nations like Brazil. Countries may not declare bankruptcy, but they proved equally capable of not paying their bills, and Citi took huge losses. The bank's stock price fell below $2/share in 1991. Management promised to revamp internal risk management. Subsequent annual reports devoted whole sections to touting the bank's new, improved risk management systems.

Unfortunately, Citi's complexity kept outpacing its risk management reforms. Sudden entrances into investment banking and brokerage didn't fit neatly into the frameworks designed to guard against risky bank loans. Citigroup's ever increasing size and diversity presented other problems. Were there enough financial control resources to respond to the new entity's scale? Could a "go-go" bank afford that much overhead in its historic commodity product lines, e.g. branch banking, mortgage origination? Did Mexico's unique financial control environment require more or less risk management attention? The questions posed by Weill's creation were new and many.

Foremost among them was this problem – how would Citigroup's financial control culture deal with the inherent "conflict-of-interest" potential embedded within Weill's supermarket vision? To give one example, if Citi's investment bankers wanted to bring a new company to market via-IPO, but the firm's brokerage research arm thought the new shares overpriced, what role did sound control practices play in refereeing this conflict? To say it differently, would accurate reporting and fiduciary responsibilities shape the broker's research report or the marketing needs of the investment bank?

The controls difficulties posed by Citi's ever expanding complexity were not easily solved. As a result, Citi found itself dealing with one embarrassing scandal after another. Some were SEC complaints and resulted in settlements. Others were shareholder suits. Many times they were expensive. Citigroup would pay out almost $5 billion to extract itself from complaints and lawsuits associated with its lending to Enron and WorldCom. Attachment 5 provides a sequential summary of Citi's complaints and settlements from 2001-2007.

This checkered history resulted in a bifurcated controls structure within Citigroup. As a residue of past scandals, Citi had an elaborate formal controls system. There were extensive controls, comprehensive procedures, and an elaborate system of risk officers and audits. The density of this system tended to reflect past problems. On the other hand, senior management was not fully invested in creating a sound controls environment. A deal making rather than an operating culture dominated at the top. Weill's personality reinforced a culture that thrived on pressure to produce quick results. Moreover, there were now many layers of management between Weill, Prince, and CFO Gary Crittenden's 399 Park Avenue offices, and the Citigroup operations out dealing with customers.

For Dick Bowen, Citigroup's organizational complexity explained both his problem and his difficulty in solving it. Increasingly, the investment bank's management seemed capable of overriding the CLG's risk management systems. How had this happened? Moreover, to whom could Bowen turn in his effort to alert senior management about the potential for another set of multi-billion dollar losses? Bowen decided to revisit how Citi's mortgage activities had become intertwined with investment banking, and to review whether there was a "controls channel" available to get his concerns up to top management. If there was not, writing to Bob Rubin might be the only available option.

<u>Growth and Controls within Citigroup's Mortgage Operations</u>

As America's housing boom took off, Citigroup set aggressive targets for mortgage lending and security underwriting. In 2001 it ranked 13th in mortgage origination. Thereafter all Citi mortgage units received quarterly updates on market share progress. By 3rd quarter 2006, Citi had risen to #3.

Like the bank, Citi's mortgage controls were complex. Bowen's direct responsibilities were a case in point. Bowen's area, Correspondent Flow, was one of four mortgage acquisitions channels reporting into Real Estate Lending. Each had a Chief Underwriter, as did REL. Above the REL Underwriter was a Chief Risk Officer for the CLG. Separate from this structure were two other control units, Business Risk and Control (BRC) and Internal Audit. 8 These units had their own reporting lines to higher management. Attachment 6 depicts this structure and its relationship to Citi's mortgage business units.

In early 2006 Bowen became Business Chief Underwriter for correspondent lending within the CLG. This business line did not originate or underwrite residential mortgages. Rather, it purchased mortgages from third-party originators and brokers. Correspondent lending was huge however; it annually purchased $90 billion in mortgages and mortgage packages from 1600 correspondents. Some $50 billion of these was repackaged into securities sold to investors like Fannie Mae and Freddie Mac. Some of the remainder was sold to Ginnie Mae after Citi had obtained necessary FHA/VA insurance coverage. A third activity involved pools of mortgages purchased from other Wall Street firms. Bowen was placed in charge of 220 underwriters for all of these activities. 9

Mortgage underwriting involves vouching for the credit quality of the loan. The mortgage underwriter's job is to assure that essential credit practices are followed. This includes assuring that the borrower has a job, that the stated income is correct, and that there is no history of prior defaults or bankruptcies. Citi did not actually do this work for the mortgages it purchased from correspondents. Instead, those institutions "represented" that they had followed Citi credit standards in making the loan. When, in turn, Citi repackaged the loans and sold mortgage securities to investors, it would represent that Citi credit policies had been followed on the underlying mortgages.

Bowen's group sampled the purchased mortgages to assure compliance with Citi's credit policies. This was necessary because of the representations Citi made to the ultimate investors. Often the investors were Fannie Mae and Freddie Mac. If mortgage securities sold by Citi ever defaulted and the investors could show that Citi's representations were false, Citi could be liable for damages. In a severe case Citi might be forced to repurchase the defaulted securities at par. Given the volume of mortgage securities Citi was underwriting, the potential liabilities for false representations were huge. 10

When Bowen's underwriting group reviewed credit files for the mortgages they sampled, they checked for credit policy compliance and for documentary completeness, e.g. did the file contain proof of income? The underwriters then rendered a verdict on each file sampled: 1) agree; 2) disagree; or 3) agree, contingent. The latter meant that the file was missing key documents and approval was contingent on the originator supplying them. 11

Shortly after taking his new assignment, Bowen discovered a number of controls weaknesses. For starters, his underwriters' results, submitted monthly to a Third Party Origination Committee (TPO), were required by the TPC to demonstrate a 95% "Agree" verdict. Bowen considered this mandate to be fundamentally at odds with properly evaluating the mortgages. He then learned that his group was meeting this mandate by reporting all "Agree, Contingent" files as part of "Agree." The "Agree, Contingent" finding was actually the case for 55-60% of all sample files. 12

To Bowen, this reporting practice would either mislead the TPO, eviscerate quality control, or both. Most importantly, Bowen discovered that the practice exposed Citi to major investor liability. Should the originator/brokers fail to produce the missing documents, Citi's investor representations could be shown to be false. Billions in bonds could come pouring back. Bowen also discovered that the same documentary problems could invalidate the FHA/VA insurance Citi wrapped around its sales to Ginnie Mae. Finally, he found that the Chief Wall Street Risk Officer had started overrulling his underwriters' "turn down" verdicts. For example, in 3rd quarter 2006, this Risk Officer reversed 260 out of 716 "turn down" decisions on one $300 million purchased mortgage pool. 13

Beginning in June 2006, Bowen began to warn management and various risk officers that Citi was accruing large potential liabilities. His warnings went unheeded. Citi kept increasing the volumes of mortgages purchased and repackaged. By mid-2007 the percentage of defective new mortgage files covered by Citi's representations had risen to 80% 14

Since routine warnings had failed to alter Citi's risky practices, Bowen began to review his options for getting management to take his warnings seriously.

Bowen considers his Next Step – Write to Rubin?

As Bowen fingered his draft e-mail to Rubin, he reflected that senior management was now under great pressure. Third quarter 2007 financial results had been released. These results were sharply negative relative to the 2nd quarter. The news contained in the earnings statement was so negative that Citi had taken an unusual step, issuing a "Warning" press release on October 1. Among other disclosures, that document included the following:

"Citigroup Inc. announced today that dislocations in the mortgage-backed securities and credit markets, and deterioration in the consumer credit environment are expected to have an adverse impact on third quarter financial results. Citi currently estimates that it will report a decline in net income in the range of 60% from the prior-year quarter, subject to finalizing third quarter results…

The following accounts for a significant portion of the expected decline in third quarter results:

Losses of approximately $1.3 billion pre-tax, net of hedges, on the value of sub-prime mortgage-backed securities warehoused for future collateralized debt obligation ("CDO") securitizations, CDO positions, and leveraged loans warehoused for future collateralized loan obligation ("CLO") securitizations…

Global Consumer

- *An increase in credit costs of approximately $2.6 billion pre-tax versus the prior-year quarter due to continued deterioration in the credit environment, organic portfolio growth, and acquisitions. Approximately one-fourth of the increase in credit costs was due to higher net credit losses and approximately three-fourths was due to higher charges to increase loan loss reserves…" 15*

The actual earnings release, issued on October 15, confirmed a 60% earnings decline versus the prior quarter. This earnings report was immediately followed by widespread press articles speculating on further losses embedded within Citi's far-flung operations. Citi Securities and various banking activities were cited as areas of special concern.

Capping the uncertainty, reports surfaced that a Citigroup Board meeting had been scheduled for Sunday, November 4, where it was widely speculated that CEO Charles Prince III would resign.

Bowen thought that these dramatic events altered the context in which his warnings might be considered. Senior management was now sorely distracted. Indeed, their ongoing employment might be at risk. Could they handle having another hand grenade of an issue dropped on their destk? On the other hand, Bowen's earlier warnings now seemed prescient. That should lend credibility to his effort to get the Executive Committee's attention. Citigroup was likely to have to change course. Perhaps as part of this shakeup, senior managers might reconsider, and even welcome, Bowen'ss bringing potential liabilities to their attention.

Before sending his note to Rubin however, Bowen considered whether these new events might reopen more normal channels for his concerns. Reviewing his options, Bowen identified various routes for renewing his case:

- ***Bowen could renew the discussion with the CLG Chief Risk Officer***, arguing that the subprime mortgage securitization business was shutting down and that attention should now shift to reducing Citi's exposures of all sorts – that would include these exposures related to Citi's credit policies and representations
- ***Bowen could take his case to the BRC***, and through them ***to Audit***. Possibly in the new environment Audit might investigate. This could lead to independent confirmation of Bowen's concerns. Audit also had a direct reporting line to Citi's Board Audit Committee. A concerned

Audit could get the issue to the top of Citigroup without Bowen having to send a message outside of channels.

- ***Bowen could also approach Citigroup's Law department***. The exposures he had discovered were of a legal nature. If they resulted in actual liability, Law would end up fighting the suits and settling the claims. There also were disclosure issues, especially since the potential liabilities were material under securities laws. A concerned Law function could buttress Bowen's findings with opinions from outside counsel that would be hard for management to disregard.

There was one other option that crossed Bowen's mind. He could quietly pass the information to one of the financial journalists who recently had been writing about Citi's hidden exposures. This course had several downsides. It could intensify pressure on Citi at a delicate time. It had a flavor of disloyalty about it – after all, Bowen would be abandoning working within the Citi management structure.

On the other hand, Citi's management had yet to show a willingness to face up to unpleasant news. Bowen's warnings had been stoutly ignored for over a year. There was also the risk that senior management would "shoot the messenger" who brought unwelcome timings forward at such a difficult time. Quiet outside disclosure might be the only way to actually get his concerns taken seriously and still hold onto his career.

Reviewing his options, Dick Bowen realized he had arrived at a pivotal crossroads in his Citigroup career. Whatever he did was liable to affect the bank in a major way. He also might be betting his career on the outcome. On the other hand, what was the point of being an underwriter if that meant staying silent in the face of obvious credit policy breaches?

Bowen held off from hitting the send key for his e-mail, and decided to go through the alternatives one more time.

Attachment 1

DRAFT

Bowen Email to Mr. Robert Rubin

Bowen, Dick [GCG-REO]

From: Bowen, Dick [GCG-REO]

Sent: Saturday, November 03, 2007 4:47 PM

To: Rubin, Robert E [CCC}: Bushnell, David C [CCC}; Crittenden, Gary [CCC]; Howard, Bonnie [CCC]

Cc: Bowen, Dick [GCG-REO]

Subject: URGENT – READ IMMEDIATELY – FINANCIAL ISSUES

TO: Robert, Rubin – Chairman of Executive Committee
David Bushnell, Senior Risk Officer
Gary Crittenden, Chief Financial Officer
Bonnie Howard, Chief Auditor

Gentlemen:
I am currently (since early 2006) the Business Chief Underwriter for the Real Estate Lending Correspondent channel, which is within the Consumer Lending Group. From 2002 to 2006 I was SVP and Chief Underwriter for the Correspondent and Acquisitions channel within Citifinancial Mortgage. I am also licensed as a Certified Public Accountant in the State of Texas.

The reason for this urgent email concerns breakdowns of internal controls and resulting significant but possibly unrecognized financial losses existing within our organization.

Since mid-2006, I have continually identified these breakdowns in processes and internal controls. The REL Chief Underwriter (my 2006 manager) and I have widely communicated these breakdowns, with possible ramifications, in weekly reports emails, and discussions (which included the CLG Chief Risk Officer). There have also been two special investigations by CLG Business Risk and Control (the first initiated by me), with the findings confirming these breakdowns.

However, to my knowledge, these breakdowns have not been communicated to or recognized by either Audit or Finance.

I have been agonizing for some time over these issues, and in all good conscience feel I must now communicate these concerns outside of the Consumer Lending Group. I sincerely regret the delay.

CONCERN #1 – CORRESPONDENT FUNDINGS THOUGH DELEGATED AUTHORITY

- We currently purchase from mortgage companies and sell to third party investors approximately $50 billion annually ($42 billion YTD 2007) of mortgage loans which have not been underwritten by us but which we rep and warrant to the investors (primarily Fannie/Freddie) that these files are complete and have been underwritten to our policy criteria.

- Our internal Quality Assurance function, which underwrites a small sample of these files post-purchase, has reflected since 2006 (when this function started reporting to me) that 40-60% of these files are either outside of policy criteria or have documentation missing from the files. QA for recent months indicate 80% of the files fall into this category.
- If any of the mortgages in this category default, the investor may require that Citi repurchase the defaulted files based upon our reps and warrants. Under seller reps and warrants Citi may then force the selling mortgage company to repurchase the files, if the seller mortgage company remains financially viable at that time.(As one example QA results indicate that Citi may be responsible for in excess of 50% of the losses associated with files purchased from the failed Aegis Mortgage - $2.5 billion purchased since Jan'06).
- A CLG BRC investigation, requested by me, confirmed the breakdowns associated with the QA process and the fact that the QA findings were significantly out of compliance with QA Risk Policy. The Chief Underwriter responsible for this function was terminated and a new QA Risk Policy was approved in 2006.

  Attachment 1 a)

We continue to be significantly out of compliance with the new QA Risk Policy.

- I do not believe that our company has recognized the material financial losses inevitably associated with the above Citi liability.

CONCERN #2 – CORRESPONDENT FUNDINGS THROUGH WALL STREET BULK PURCHASES

- During 2006-07 there were pools of mortgage loans aggregating $10 billion which were purchased from large mortgage companies with significant numbers of files identified as "exceptions" (higher risk and substantially outside of our credit policy criteria). These exceptions were approved by the Wall Street Channel Chief Risk Officer, many times over underwriting objections and with the files having been turned down by underwriting. These pools involved files aggregated and originated by Merrill Lynch, Residential Funding Corp, New Century, First NLC and others.
- The purchase decisions on many of these pools were approved even though execution rates and other criteria established by the CLG Bulk Acquisition Policy were not met.
- Because of the initial high losses associated with any of these pools, CLG BRC investigated and reviewed correspondence which documented underwriting objections to purchasing identified pools.
- BRC conducted an investigation of one Merrill Lynch pool, identifying generic breakdowns of process required by policy and recommended needed changes.
- Changes were made in the bulk purchase process, but I do not know if the expected material financial losses from these pools have been recognized.

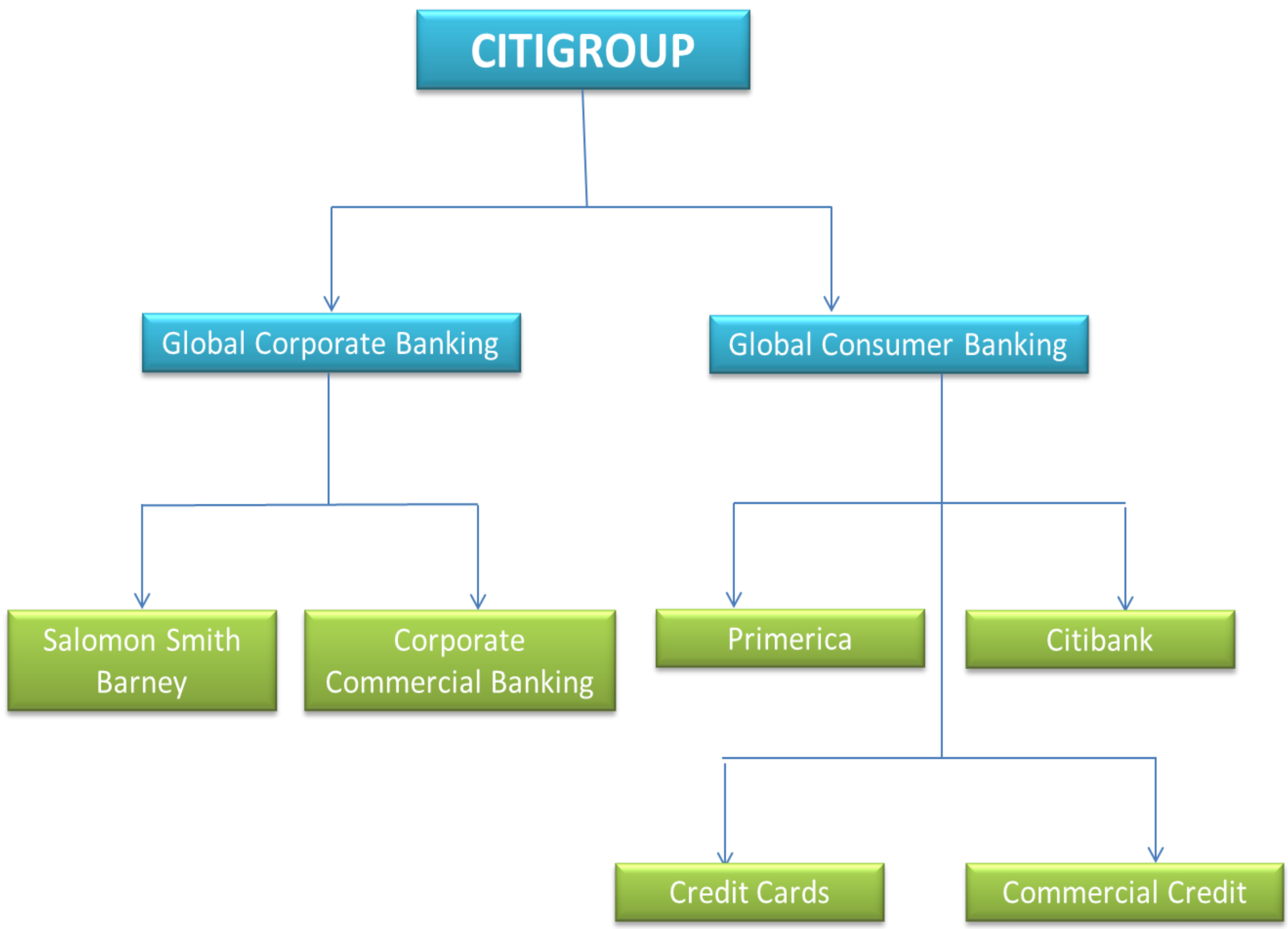
I know that this will prompt an investigation of the above circumstances which will hopefully be conducted by officers of the company outside of the Consumer Lending Group, and I pledge my full cooperation.

As a professional, as well as a shareholder of this company, I am deeply distressed with having to report the above.

I will be in the office Monday, and can be available by cell phone, if needed, this weekend.

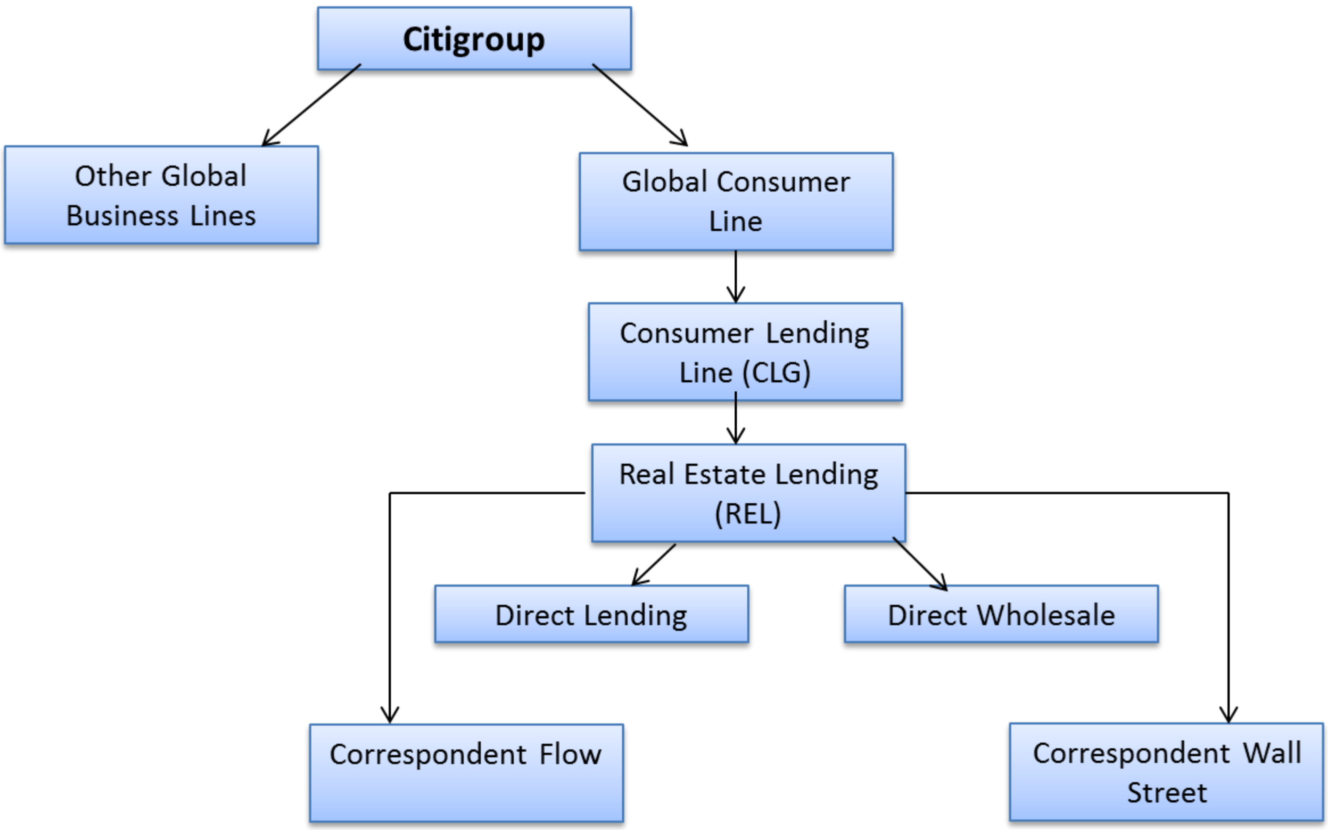
Dick Bowen
469-220-1151 office
214-497-xxxx   cell

Attachment 2



Attachment 3

Citigroup Mortgage Business: Organizational Structure



Attachment 4

Citigroup Financial Results: 2001-2005

In Millions of the trading currency, except per share items.					
Key Financials[1]					
For the Fiscal Period Ending	**Dec 2001**	**Dec 2002**	**Dec 2003**	**Dec 2004**	**Dec 2005**
Total Revenue	$60,567.00	$62,472.00	$63,548.00	$73,402.00	$75,713.00
Growth Over Prior Year	*4.0%*	*3.1%*	*1.7%*	*15.5%*	*3.1%*
Net Income	$14,126.00	$15,276.00	$17,853.00	$17,046.00	$24,589.00
Margin %	*23.3%*	*24.5%*	*28.1%*	*23.2%*	*32.5%*
Total Assets	$1,051,450.00	$1,097,590.00	$1,264,032.00	$1,484,101.00	$1,494,037.00
Growth Over Prior Year	*16.5%*	*4.4%*	*15.2%*	*17.4%*	*0.7%*
Total Debt	$316,083.00	$341,552.00	$402,287.00	$467,835.00	$479,462.00
Total Equity	$735,367.00	$756,038.00	$861,745.00	$1,016,266.00	$1,014,575.00
Total Debt to Capital	30.1%	31.1%	31.8%	31.5%	32.1%
Stock Price	$50.48	$35.19	$48.54	$48.18	$48.53
Diluted EPS Excl. Extra Items[3]	**25.5**	**25.9**	**32.7**	**30.7**	**38.2**
Growth Over Prior Year	*7.6%*	*1.6%*	*26.3%*	*(6.1%)*	*24.4%*

Attachment 5

Citicorp/Citigroup Complaints & Settlements, 2001-2007

Citibank, State Bank of India agree to cease alleged securities law violations

Associated Press Archive - November 19, 2001

Federal regulators have alleged that U.S. giant Citibank and India's largest commercial bank violated securities laws in 1998 by selling $532 million of Indian bonds in the United States without registering them. The action Monday by the Securities and Exchange Commission came less than a week after the Federal Reserve and other U.S. banking regulators fined the government-owned State Bank of India $7.5 million for allegedly unsafe banking practices

Source: http://nl.newsbank.com/nl-search/we/Archives?p_product=NewsLibrary&p_multi=APAB&d_place=APAB&p_theme=newslibrary2&p_action=search&p_maxdocs=200&p_topdoc=1&p_text_direct-0=0F8926BCD2DF97EA&p_field_direct-0=document_id&p_perpage=10&p_sort=YMD_date:D&s_trackval=GooglePM

Victims of alleged predatory lending practices may receive partial refunds under a $240 million settlement announced Thursday.

Article ID: 871791
Date: September 20, 2002
Publication: Oakland Tribune, The (CA)

In what would be the largest consumer protection settlement ever, Citigroup Inc., parent company of CitiCorp Inc., Citibank and CitiFinancial Credit Co., agreed to pay $215 million to resolve a nine-count Federal Trade Commission complaint accusing Associates First Capital Corp., a firm Citigroup acquired in November 2000, of bilking consumers with unfair lending

Source: http://nl.newsbank.com/nl-search/we/Archives?p_product=OKTB&p_theme=oktb&p_action=search&p_maxdocs=200&p_topdoc=1&p_text_direct-0=0F993677EF71194C&p_field_direct-0=document_id&p_perpage=10&p_sort=YMD_date:D&s_trackval=GooglePM

SEC Settles Enforcement Proceedings against J.P. Morgan Chase and Citigroup

FOR IMMEDIATE RELEASE
2003-87

As to Citigroup, the Commission instituted an administrative proceeding and issued an order making findings and imposing sanctions. Without admitting or denying the Commission's findings, Citigroup consented to the issuance of the Commission's Order whereby Citigroup (i) was ordered to cease and desist from committing or causing any violation of the antifraud provisions of the federal securities laws, and (ii) agreed to pay $120 million as disgorgement, interest, and penalty. Of that amount, $101 million pertains to Citigroup's Enron-related conduct and $19 million pertains to the Dynegy conduct.

Source: http://www.sec.gov/news/press/2003-87.htm

Citigroup Settles WorldCom Case

The bank agrees to pay $2.65 billion to bond and stock buyers hurt in the telecom company's accounting fraud.

May 11, 2004|From Associated Press

In one of the largest securities-fraud settlements ever, banking giant Citigroup Inc. will pay $2.65 billion to settle a lawsuit brought by WorldCom investors who lost billions when the company filed for bankruptcy protection in an accounting scandal. The deal announced Monday was the first of what could be several large WorldCom settlements. New York State Comptroller Alan G. Hevesi, who is leading the class-action case, said he was pursuing similar deals with 17 other banks that could result in $2.8 billion more for WorldCom investors.

Source: http://articles.latimes.com/2004/may/11/business/fi-citi11

Global Crossing Investors Settle With Citigroup

By REUTERS

Published: March 3, 2005

Citigroup said yesterday that it would pay $75 million to settle a lawsuit from investors over its role in the collapse of the telecommunications company Global Crossing. Citigroup, which had been one of Global Crossing's bankers, was accused in the three-year-old class-action suit of issuing exaggerated research reports and failing to disclose conflicts of interest. It said the settlement, equivalent to $46 million after taxes, covered those who invested in Global Crossing and an affiliate, Asia Global Crossing, from Feb. 1, 1999, to Dec. 8, 2003.

Source: http://www.nytimes.com/2005/03/03/business/03citigroup.html

Citigroup to Pay $208 Million to Settle Charges Arising from Creation of Affiliated Transfer Agent to Serve Its Proprietary Mutual Funds

FOR IMMEDIATE RELEASE
2005-80

Washington, D.C., May 31, 2005 — The Securities and Exchange Commission announced settled fraud charges against two subsidiaries of Citigroup, Inc. relating to the creation and operation of an affiliated transfer agent that has served the Smith Barney family of mutual funds since 1999. The two subsidiaries named as respondents in the action are Citigroup Global Markets, Inc. and Smith Barney Fund Management LLC, the investment adviser to the mutual funds.

Source: http://www.sec.gov/news/press/2005-80.htm

Citigroup to Settle With Enron Investors

By Carrie Johnson
Washington Post Staff Writer
Saturday, June 11, 2005

Citigroup Inc. yesterday agreed to pay $2 billion to settle a class-action lawsuit filed by investors who argue the world's largest bank helped a faltering Enron Corp. disguise billions of dollars in debt. The settlement is among the largest ever -- following closely behind a $2.65 billion payment Citigroup made last year to wipe away a lawsuit involving its underwriting work for WorldCom Inc.

Source: http://www.washingtonpost.com/wp-dyn/content/article/2005/06/10/AR2005061000532.html

SEC Finalizes ARS Settlements With Citigroup And UBS, Providing Nearly $30 Billion in Liquidity to Investors

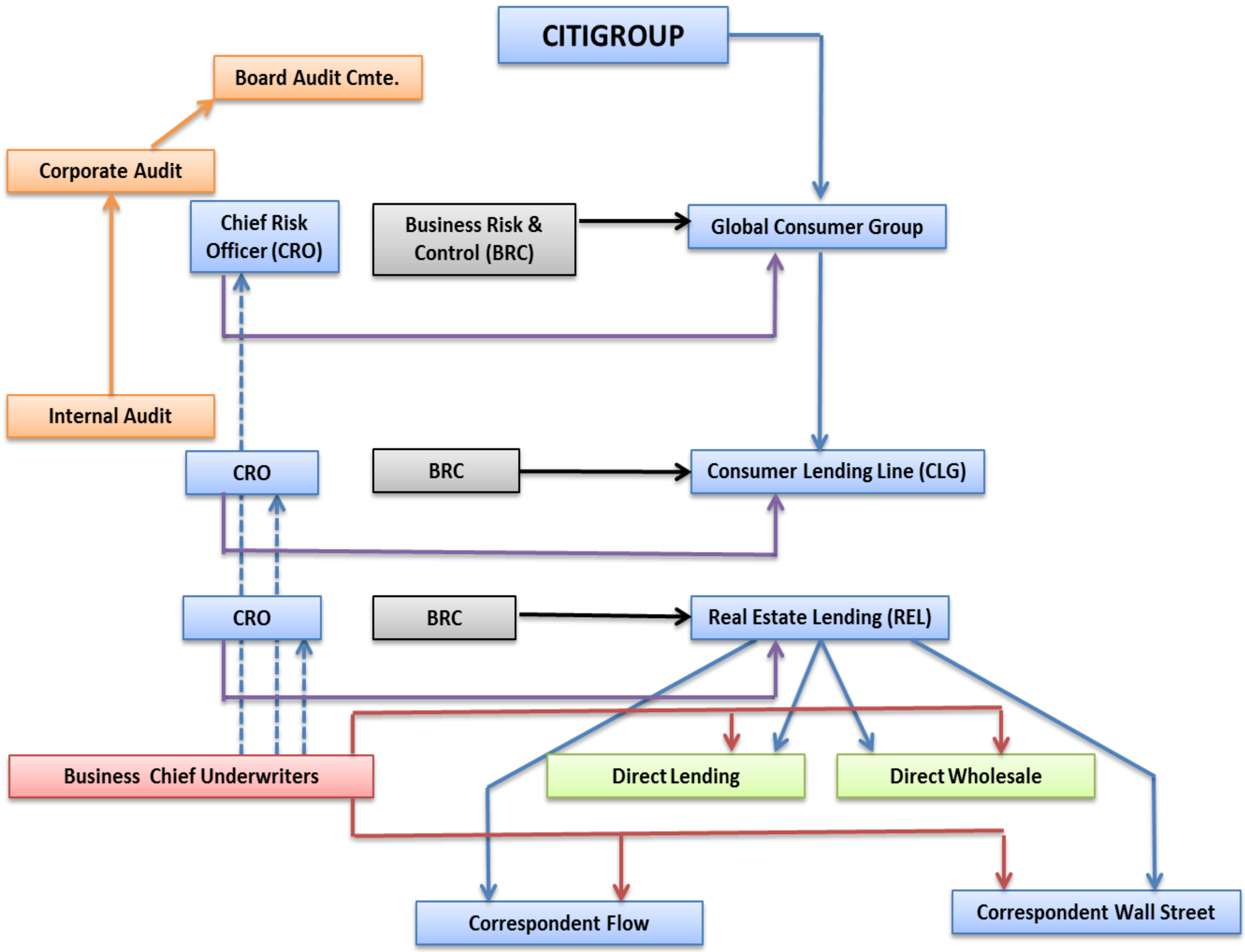
FOR IMMEDIATE RELEASE
2008-290

Washington, D.C., Dec. 11, 2008 — The Securities and Exchange Commission today finalized settlements with Citigroup Global Markets, Inc. (Citi) and UBS Securities LLC and UBS Financial Services, Inc. (UBS) that will provide nearly $30 billion to tens of thousands of customers who invested in auction rate securities before the market for those securities froze in February.

Source: http://www.sec.gov/news/press/2008/2008-290.htm

Attachment 6

Citigroup Mortgage Business: Organizational + Controls Structure



Author's Note

This case focuses on Richard Bowen's discovery of huge potential liabilities within CitiMortgage and takes up his challenge to find a viable path to get appropriate management attention. The essence of the challenge for students is to identify the best internal challenge for bringing forward Bowen's findings.

In confronting this challenge, students must also face a larger question – was Citigroup even manageable at the time Bowen sought management's attention? In Citigroup we find the chief protagonist that sought the demise of Glass-Steagall. This case seeks to offer a close up of what that demise ushered in. By 2007, Citi is every bit the financial supermarket that Sandy Weill sought to create. Its internal structure was so complex it defeats straightforward attempts to reduce it to manageable charts. Citigroup's financial control structure was no less complex. The case then poses the question – did this complexity and the culture of deal making that spawned it make it ungovernable? If so, did this lack of governance also mean that risk management and controls were likely to be inadequate?

To frame this question, the case provides considerable background on Citi's growth, business strategy, and its crusade to overturn Glass-Steagall. There is much circumstantial evidence to support the view that Citi became almost ungovernable. For starters there is the sheer breadth and scale of the enterprise, a complexity so vast it can only be hinted at in the chart found in Attachment 2. More telling is the multiplicity of layers found in Attachment 3's schematic of Citi's mortgage business. When one realizes that this chart was essentially replicated in several foreign countries, and that the mortgage business was one of several business lines inside real estate lending, which was one line among several in consumer lending, which was one geographic business among many inside the global consumer business, which then competed for attention with all of Citigroup's other global businesses, one begins to sense how difficult it must have been for CEO Prince, Chairman Rubin and CFO Crittenden to keep their fingers on the pulse of action at the grassroots.

Citi's organizational complexity was also replicated in its controls structure, charted for the mortgage business in Attachment 6. Intuitively, one can sense the difficulties with this structure. Lines of authority are so complex that it is difficult to determine who is in charge, and even more difficult for this diffuse structure to summon the will to face difficult issues. Independence is also in question. Controls officials always seem in the grasp of business managements that are more concerned with responding to "produce now" orders than to sustaining sound controls. Almost certainly, Citigroup's management would disagree with this assessment. They in turn must answer for Citi's record of serial controls breeches and violations of the law, only a part of which is documented in Attachment 5.

The somewhat cynical interpretation of this record is that Citi came to view lawsuits and settlements as just a "cost of doing business." I don't believe this interpretation to be correct. No public company management sets out to embed in its business model practices that will result in paying out almost $5 billion just to settle the Enron and WorldCom disputes. The alternative view is that Citicorp was already enormous, and then Sandy Weill made it positively gargantuan. Citi's management never cracked the code on how to reconcile Weill's go-go approach with providing risk management and controls to such an unprecedented enterprise.

This is the context which Richard Bowen confronted, and which students of this case, in turn, must consider. Bowen's challenge before he hit the key sending his e-mail was to review whether there was a viable internal channel left to use. Sending an e-mail from down in the ranks to the Chairman is always a "Hail Mary" pass. Doing so as a financial tsunami approached Citi's shores was even more of one. Was it truly a time for desperate measures, or was there a better way forward still available?

This case is based primarily upon Richard Bowen's testimony before the Financial Crisis Inquiry Commission, supplemented by discussions with Mr. Bowen. The author also reviewed various articles and Mr. Bowen's interview with **CBS' 60 Minutes**. Public information is somewhat limited because Bowen did not file a lawsuit against Citi. His testimony before the Commission was also redacted. The essence of the story, however, gains credibility from subsequent revelations in the lawsuit filed by Sherry A. Hunt (see Case 11, below). Ms. Hunt worked for Bowen. She successfully sued Citi under the False Claims Act, which suit contains many collaborating details about weak controls practices within CitiMortgage. The case was settled by Citi for almost $160 million, without Citi ever contesting Ms. Hunt's claims in open court.

Although Citi's top management has changed, the organization and business model remains largely unchanged from that which produced the record charted in this case – and a $45 billion government bailout. It remains to be seen whether Vikram Pandit's team will be any more successful at governing the enterprise with sound controls.

Notes

1. http://www.commentarymagazine.com/article/the-case-for-optimism/
2. Financial Crisis Inquiry Commission, Hearing on Subprime Lending and Securitization and Government Sponsored Enterprises, ***Testimony of Richard M. Bowen III**,* April 10, 2010, pg. 8
3. Ibid., pg. 8
4. McLean, Bethany and Nocera, Joe, ***All the Devils are Here,*** Portfolio/Penguin, New York, 2010, pp. 298-299
5. *en.wikipedia.org/wiki/**Citigroup,*** History, Citicorp.
6. Ibid.
7. Ibid.,, Introduction, and Citicorp and Travelers Merge
8. Financial Crisis Inquiry Commission, op. cit., pp. 3-4
9. Ibid., pg. 1
10. Ibid., pg. 1
11. Ibid., pg. 5
12. Ibid., pg. 6
13. Ibid., pg. 9
14. Ibid., pg. 6
15. ***Citi Expects Substantial Decline in Quarter Net Income;*** *www.**citi**.com/**citi**/press/**2007**/071001a.htm*, Oct 1, 2007