Extraordinary Financial Assistance Provided to Citigroup, Inc.

Special Inspector General for the Troubled Asset Relief Program

SIGTARP 11-002

January 13, 2011

OFFICE OF THE SPECIAL INSPECTOR GENERAL
FOR THE TROUBLED ASSET RELIEF PROGRAM
1801 L STREET, NW
WASHINGTON, D.C. 20220

January 13, 2011

MEMORANDUM FOR: The Honorable Timothy F. Geithner, Secretary of the Treasury

The Honorable John Walsh, Acting Comptroller of the Currency

The Honorable Sheila C. Bair, Chairman, Board of Directors of the Federal Deposit Insurance Corporation

The Honorable Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System

FROM: Neil M. Barofsky – Special Inspector General for the Troubled Asset Relief Program

SUBJECT: Extraordinary Financial Assistance Provided to Citigroup, Inc. (SIGTARP-11-002)

We are providing this audit report for your information and use. It discusses the basis for the decision to provide Citigroup, Inc. ("Citigroup") with additional Government assistance under the Targeted Investment Program ("TIP") and Asset Guarantee Program ("AGP"); how the AGP asset pool was determined; and the basis for the decision to permit Citigroup to terminate the AGP and repay its TIP capital infusion. The Office of the Special Inspector General for the Troubled Asset Relief Program conducted this audit under the authority of Public Law 110-343, as amended, which also incorporates the duties and responsibilities of inspectors general of the Inspector General Act of 1978, as amended.

The Department of the Treasury and the Federal Deposit Insurance Corporation provided us formal written comments to the draft of this report. The comments are addressed in the report, where applicable, and copies of the agencies' responses to the audit are included in the Management Comments section of this report, in Appendix L.

We appreciate the courtesies extended to our staff. For additional information on this report, please contact Mr. Kurt Hyde (kurt.hyde@do.treas.gov / 202-622-4633), or Mr. Clayton Boyce (clayton.boyce@do.treas.gov / 202-622-9257).

SIGTARP

Office of the Special Inspector General for the Troubled Asset Relief Program

Summary of Report: SIGTARP-11-002

Why SIGTARP Did This Study

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 ("EESA") created the Troubled Asset Relief Program ("TARP") and provided the Secretary of the Treasury with the authority and facilities to restore liquidity and stability to the U.S. financial system. Section 102 of EESA required that if the Treasury Secretary established an asset purchase program, a program must also be established to guarantee troubled assets.

At the time of enactment of EESA, Citigroup, Inc. ("Citigroup") was one of the largest financial institutions in the world. On October 28, 2008, the Department of the Treasury ("Treasury") announced Citigroup and eight other financial institutions as the first recipients of TARP funds through the Capital Purchase Program ("CPP"), which was intended, in part, to "encourage U.S. financial institutions to build capital to increase the flow of financing to U.S. business and consumers and to support the U.S. economy." This program provided Citigroup $25 billion – the maximum amount that Treasury said it would invest in any one institution under CPP.

However, Citigroup suffered significant instability shortly after receiving the initial $25 billion TARP investment. On November 23, 2008, Treasury, the Federal Reserve Board ("FRB"), and the Federal Deposit Insurance Corporation ("FDIC") announced a package of transactions intended to reduce the risk of Citigroup failing and dragging down the rest of the financial system with it. As part of the package, the Government said that it would provide guarantees in connection with a Citigroup asset pool of up to $306 billion (that number was later adjusted to $301 billion). The announcement also promised Citigroup an additional $20 billion in TARP funds in return for additional shares of preferred stock and warrants. On January 2, 2009, Treasury gave titles to these already announced assistance transactions: the asset pool was named the Asset Guarantee Program ("AGP") and the additional capital assistance was named the Targeted Investment Program ("TIP").

As part of SIGTARP's continuing oversight of TARP, and to respond to a request from former Congressman Alan Grayson, SIGTARP performed a review of the U.S. Government's decision to provide additional funding and asset guarantees to Citigroup. SIGTARP's reporting objectives for this audit were to determine: (1) the basis for the decision to provide Citigroup with additional Government assistance; (2) how the asset guarantee pool was determined; and (3) the basis for the decision to permit Citigroup to terminate its AGP agreement and repay TIP.

January 13, 2011

Extraordinary Financial Assistance Provided to Citigroup, Inc.

What SIGTARP Found

In November 2008, worried that Citigroup would fail absent a strong statement of support from the U.S. Government, and that such failure could cause catastrophic damage to the economy, federal officials decided to rescue one of the largest financial institutions in the world. Late on November 23, 2008, following a frantic few days dubbed "Citi Weekend," Citigroup agreed to a Government proposal that would provide Citigroup asset guarantees and a $20 billion capital infusion in exchange for preferred shares of Citigroup stock. The essential purpose of the deal, as then-Treasury Secretary Henry Paulson and then-Federal Reserve Bank of New York President Timothy F. Geithner later confirmed to SIGTARP, was to assure the world that the Government was not going to let Citigroup fail.

SIGTARP found that the Government constructed a plan that not only achieved the primary goal of restoring market confidence in Citigroup, but also carefully controlled the risk of Government loss on the asset guarantee. The Government summarily rejected Citigroup's initial proposal and made a take-it-or-leave-it offer that Citigroup only reluctantly accepted, against the advice of Citigroup insiders who considered the Government's terms too expensive in light of the assistance provided. In the end, Citigroup accepted the deal chiefly because of its expected impact on the market's perception of Citigroup's viability.

After the deal was announced, that impact was immediate: Citigroup's stock price stabilized, its access to credit improved, and the cost of insuring its debt declined. And while the transactions hardly solved all of Citigroup's problems – just months later the Government was compelled to significantly restructure its ownership interest in a manner that left it as Citigroup's single largest common stockholder – the Government incurred no losses, and even profited on its overall investment in Citigroup by more than $12 billion.

Nevertheless, two aspects of the Citigroup rescue bear noting.

First, the conclusion of the various Government actors that Citigroup had to be saved was strikingly ad hoc. While there was consensus that Citigroup was too systemically significant to be allowed to fail, that consensus appeared to be based as much on gut instinct and fear of the unknown as on objective criteria. Given the urgent nature of the crisis surrounding Citigroup, the ad hoc character of the systemic risk determination is not surprising, and SIGTARP found no evidence that the determination was incorrect.

Nevertheless, the absence of objective criteria for reaching such a conclusion raised concerns about whether systemic risk determinations were being made fairly and with consistent criteria. Such concerns could be addressed at least in part by the development, in advance of the next crisis, of clear, objective criteria and a detailed road map as to how those criteria should be applied. Treasury Secretary Timothy F. Geithner told SIGTARP that he believed creating effective, purely objective criteria for evaluating systemic risk is not possible, saying "it depends too much on the state of the world at the time. You won't be able to make a judgment about what's systemic and what's not until you know the nature of the shock" the economy is undergoing. He also said that whatever objective criteria were developed in advance, markets and institutions would adjust and "migrate around them."

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") charged the Financial Stability Oversight Council ("FSOC") with responsibility for developing the specific criteria and analytical framework for assessing systemic significance. That process is under way.

Treasury provided an official written response to this audit report in a letter dated January 12, 2011, which is reproduced in full in Appendix L. Treasury's response broadly concurred with the report. FDIC provided an official written response to this audit report in a letter dated January 12, 2011. FDIC's letter offers four "clarifications" to the report. While SIGTARP has not incorporated FDIC's suggested changes, the letter is reproduced in full in Appendix L. FRB stated that it intends to provide an official written response in the near future, a copy of which, if available, will be included in SIGTARP's upcoming Quarterly Report and will be added to the online version of this audit report. OCC stated that it would not be providing a formal response.

SIGTARP remains convinced that even if some aspects of systemic significance are necessarily subjective and dependent on the nature of the crisis at the time, an emphasis on the development of clear, objective criteria in advance of the next crisis would significantly aid decision makers burdened by enormous responsibility, extreme time pressure, and uncertain information. It is also imperative that FSOC not simply accept the adaptability of Wall Street firms to work around regulation, but instead maintain the flexibility to respond in kind.

Second, the Government's actions with respect to Citigroup undoubtedly contributed to the increased moral hazard that has been a direct byproduct of TARP. While the year-plus of Government dependence left Citigroup a stronger institution than it had been, it remained, and arguably still remains, an institution that is too big, too interconnected, and too essential to the global financial system to be allowed to fail. When the Government assured the world in 2008 that it would not let Citigroup fail, it did more than reassure troubled markets – it encouraged high-risk behavior by insulating risk takers from the consequences of failure.

Unless and until institutions like Citigroup can be left to suffer the full consequences of their own folly, the prospect of more bailouts will potentially fuel more bad behavior with potentially disastrous results. Notwithstanding the passage of the Dodd-Frank Act, which does give FDIC new resolution authority for financial companies deemed systemically significant, the market still gives the largest financial institutions an advantage over their smaller counterparts by enabling them to raise funds more cheaply, and enjoy enhanced credit ratings based on the assumption that the Government remains as a backstop. And because of the prospect of another Government bailout, executives at such institutions might be motivated to take greater risks than they otherwise would.

The Dodd-Frank Act was intended in part to address the problem of institutions that are "too big to fail." Whether it will successfully address the moral hazard effects of TARP remains to be seen, and there is much important work left to be done. As Secretary Geithner told SIGTARP, while the Dodd-Frank Act gives the Government "better tools," and reduced the risk of failures, "[i]n the future we may have to do exceptional things again" if the shock to the financial system is sufficiently large. Secretary Geithner's candor about the prospect of having to "do exceptional things again" in such an unknowable future crisis is commendable. At the same time, it underscores a TARP legacy, the moral hazard associated with the continued existence of institutions that remain "too big to fail." It also serves as a reminder that the ultimate cost of bailing out Citigroup and the other "too big to fail" institutions will remain unknown until the next financial crisis occurs.

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Introduction

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 ("EESA") was signed into law. It provided the Secretary of the Treasury with the authority and facilities to restore liquidity and stability to the U.S. financial system, and included up to $700 billion under the Troubled Asset Relief Program ("TARP"). Section 101 of EESA authorized the Treasury Secretary to purchase troubled assets from any financial institution under terms, policies, procedures, and conditions determined by the Secretary. Section 102 of EESA required that if the Treasury Secretary established an asset purchase program, a program must also be established to guarantee troubled assets.

At the time of the enactment of EESA, Citigroup, Inc. ("Citigroup") was one of the largest financial institutions in the world. Specifically, as detailed by the Federal Reserve Board ("FRB"):[1]

- As of September 30, 2008, Citigroup, including its insured depository institution subsidiaries, was the second-largest banking organization in the United States and had total consolidated assets of slightly more than $2 trillion. Citigroup's lead subsidiary bank, Citibank, N.A. ("Citibank"), had total consolidated assets of approximately $1.2 trillion, making it the third-largest U.S. depository institution as measured by total assets. Citigroup held more than $794 billion of deposits at the end of the third quarter of 2008, making it one of the largest deposit holders in the world. Of that amount, domestic deposits totaled more than $277 billion, of which $175.4 billion was not insured by the Federal Deposit Insurance Corporation ("FDIC"). Citigroup's uninsured domestic deposits exceeded the uninsured deposits at all but two other U.S.-insured depository institutions. Citigroup held a large amount of foreign deposits and performed consumer banking across the globe in more than 100 countries.[2]

- Citigroup was a major supplier of credit in the United States and abroad. At the time, it was the largest consumer finance lender in the world, the third-largest mortgage servicer, the fourth-largest student lender, and the world's largest credit card lender.[3] Citigroup had more than $785 billion of loans outstanding at the end of the third quarter of 2008, with nearly $450 billion of them at its U.S. offices. Its domestic loans included more than $225 billion of residential real estate loans, almost $100 billion of consumer loans, more than $50 billion of commercial and industrial loans, and more than $10 billion of commercial real estate loans. FRB also stated that Citigroup was a major securitizer of credit and had an interest in $1.2 trillion in special purpose vehicles[4] ("SPVs"), of which $718 billion was related to consumer credit.

[1] FRB documented Citigroup's size and systemic significance in a letter from FRB Chairman Ben Bernanke to then-Treasury Secretary Henry Paulson, dated December 2, 2008, in which Chairman Bernanke recommended Secretary Paulson invoke a systemic risk exception for Citigroup, which would permit the extraordinary assistance to Citigroup detailed in this report, and in an FRB memo dated December 3, 2008, and titled, "Considerations Regarding Invoking the Systemic Risk Exception for Citibank, N.A."

[2] According to Citigroup officials, more than 74% of Citigroup's 2008 total net revenue was derived from foreign assets.

[3] Figures as of November 2008.

[4] A special purpose vehicle is an off-balance-sheet legal entity that holds the transferred assets presumptively beyond the reach of the entities providing the assets, and is legally isolated.

- Citigroup had significant amounts of commercial paper and long-term senior and subordinated debt outstanding, and was a major participant in numerous domestic and international payment, clearing, and central counterparty arrangements.

- Citigroup provided a wide range of investment banking, capital markets, asset management, and retail brokerage services through its subsidiary Citigroup Global Capital Markets, Inc. Citigroup's brokerage arm, Smith Barney, was one of the largest in the United States by the end of the third quarter of 2008, with $1.55 trillion in client assets in 9.2 million accounts.

- Citigroup was also a major player in a wide range of derivatives markets, both as a counterparty to over-the-counter trades and as a broker and clearing firm for trades on exchanges. At the end of the third quarter of 2008, the notional principal value of its derivatives positions was more than $35 trillion, the bulk of which was held by its Citibank, N.A., subsidiary.

- Citigroup also operated its Global Transaction Services ("GTS") unit, a wholly owned subsidiary that had a presence in more than 100 countries and handled more than $3 trillion in transactions around the world each day for hundreds of corporations and dozens of governments and agencies, including the Federal Reserve. It is still the world's largest provider of foreign currency exchange services and holds large deposits for several Fortune 500 companies.

On October 28, 2008, Citigroup and eight other financial institutions became the first recipients of TARP funds through the Capital Purchase Program ("CPP"),[5] which was intended, in part, to "encourage U.S. financial institutions to build capital to increase the flow of financing to U.S. business and consumers and to support the U.S. economy." This program provided Citigroup $25 billion – the maximum amount that Treasury said it would invest in any one institution under CPP.[6] This would not be the last time that Citigroup benefited from TARP funds.

Government officials told the Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") that the financial health of the first nine institutions selected to receive CPP funds was not a primary factor in the institutions' selection, though Government officials made several references to the health of the nine institutions at the time. On October 14, 2008, for example, then-Treasury Secretary Henry Paulson stated that the nine "are healthy institutions, and they have taken this step for the good of the U.S. economy. As these healthy institutions increase their capital base, they will be able to increase their funding to U.S. consumers and businesses." A joint statement released by Secretary Paulson, FRB Chairman Ben Bernanke, and FDIC Chairman Sheila Bair on October 14, 2008, similarly stated that "these healthy institutions are taking these steps to strengthen their own positions and to enhance the overall performance of the U.S. economy."

However, Citigroup's health would soon come into question. Indeed, Citigroup suffered significant instability shortly after receiving the initial $25 billion TARP investment. Citigroup would lose

[5] Bank of America and Merrill Lynch were in the process of merging when CPP was announced. Through CPP, $15 billion was immediately invested in Bank of America and $10 billion was pledged to Merrill Lynch, with the agreement that Bank of America would receive those funds on consummation of the merger. The merger received regulatory approval on November 26, 2008, and was completed on January 1, 2009.

[6] JPMorgan Chase & Co., Bank of America Corporation, and Wells Fargo & Company each also received the maximum of $25 billion in CPP.

$27.68 billion in 2008, and by November 19, 2008, its stock price had dropped precipitously. In the view of Secretary Paulson, the company was teetering on the brink of failure. The company's survival was in doubt, and the Government, through TARP and other means, stepped in to save one of the world's largest financial institutions. On November 23, 2008, Treasury, FRB, and FDIC announced a package of transactions intended to reduce the risk of Citigroup failing and, in turn, dragging down the financial system with it (see Appendix D). As part of the announced package, the Government said that it would provide guarantees in connection with a Citigroup asset pool of up to $306 billion.[7] Treasury, in a report to Congress, said that extending the asset guarantee, which was not executed until January 15, 2009, was "part of a broader effort to support Citigroup as the company executes its restructuring plans." The announcement also promised Citigroup an additional $20 billion in TARP funds (considered exceptional financial assistance by Treasury) in return for additional shares of preferred stock and warrants, a transaction that closed on December 31, 2008. On January 2, 2009, Treasury announced the titles of these previously disclosed assistance transactions: the asset pool protection was named the Asset Guarantee Program ("AGP") and the additional capital assistance was named the Targeted Investment Program ("TIP").

Over the following year, the economy and Citigroup's outlook improved. The financial system stabilized, the flow of private capital returned for many of the largest institutions, and Citigroup's capital structure was significantly improved through capital exchanges that occurred on July 23, 2009, and July 30, 2009. In these exchanges, preferred shares, including Treasury's initial $25 billion CPP investment, were converted into common stock, which was more favorable to Citigroup's balance sheet.[8]

In December 2009, less than 12 months after providing the additional assistance, Federal regulators approved Citigroup's exit from TIP and AGP. Among other things, Citigroup's exit from TIP meant that it was no longer subject to TARP's exceptional financial assistance requirements, which had imposed upon Citigroup enhanced executive compensation review and approval. However, Citigroup told SIGTARP it voluntarily abided by those restrictions through 2009. As of December 10, 2010, Treasury had sold all 7.7 billion shares of common stock in Citigroup that it received as a result of the CPP exchange. As part of SIGTARP's continuing oversight of TARP, and to respond to a request from then-Congressman Alan Grayson, SIGTARP performed a review of the U.S. Government's decision to provide additional funding and asset guarantees to Citigroup. The report's objectives are to determine:

- the basis for the decision to provide Citigroup with additional Government assistance;
- how the asset guarantee pool was determined; and
- the basis for the decision to permit Citigroup to terminate its AGP agreement and repay its TIP capital infusion.

For a discussion of the audit scope and methodology, and a summary of prior coverage, see Appendix A. For additional information and comments from responding agencies, see other appendices.

[7] Treasury's press release dated November 23, 2008, stated $306 billion; however, that number was adjusted to $301 billion when the final Master Agreement was signed on January 15, 2009.

[8] For more information on these exchanges, see SIGTARP's Quarterly Report to Congress, October 21, 2009, pages 68-69.

Background

By the end of September 2008, financial markets as a whole had suffered a loss in investor confidence. During that month, a succession of major U.S. financial institutions either collapsed or approached the brink of failure, and for some the Government stepped in to provide Federal assistance. The critical events included:

- September 7 – The Federal Housing Finance Agency ("FHFA"), which had been created two months earlier, placed under conservatorship two of the Government-sponsored enterprises, the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"). Both are key participants in the secondary mortgage market.[9]

- September 15 – Lehman Brothers, Inc. ("Lehman") filed for bankruptcy. To many market observers, the failure of Lehman was particularly detrimental to market confidence because it demonstrated that the Government might not be willing to rescue large financial institutions.

- September 15 – Bank of America announced plans to purchase Merrill Lynch – at that time the nation's sixth-largest financial institution.

- September 16 – With the approval of FRB and with the support of Treasury, Federal Reserve Bank of New York ("FRBNY") provided an $85 billion credit facility to insurance conglomerate American International Group ("AIG") to prevent its failure. FRBNY acquired an approximately 80% equity interest in the company as consideration for extending the credit facility. Government officials believed that an AIG failure would pose considerable risk to the global financial system and would have significantly intensified an already severe financial crisis.[10]

- September 21 – The large investment banking firms Goldman Sachs Group, Inc. ("Goldman Sachs") and Morgan Stanley converted to bank holding companies. The conversions allowed them greater access to more stable sources of funding from retail deposits and made them eligible for Government assistance to which they otherwise would not have been entitled.

- September 25 – Washington Mutual, Inc. was closed by the Office of Thrift Supervision ("OTS") and FDIC was named receiver in what was the largest depository institution failure in U.S. history.

- September 29 – Citigroup issued a press release relating to its announced agreement in principle to acquire the banking operations of Wachovia Corporation ("Wachovia") in an FDIC-assisted transaction. Four days later, on October 3, 2008, Wells Fargo & Company ("Wells Fargo") announced that it would purchase Wachovia without FDIC assistance. On October 9, 2008, Citigroup announced that it had ended its negotiation with Wells Fargo on the Wachovia transaction. Former Comptroller of the Currency John Dugan told SIGTARP that he believed that the failure of the Citigroup-Wachovia deal and the perceived FDIC role in shifting the purchase from Citigroup to

[9] In the secondary mortgage market, mortgage loans and servicing rights are bought and sold between mortgage originators, mortgage aggregators (including the housing-related Government-sponsored enterprises), and investors.

[10] For a more complete discussion of the decision to rescue AIG, see SIGTARP's audit report on "Factors Affecting Efforts to Limit Payments to AIG Counterparties," SIGTARP-10-003, November 17, 2009.

Wells Fargo contributed to negative market perceptions of Citigroup. According to an Office of the Comptroller of the Currency ("OCC") examiner, it appeared to the market that something was structurally wrong with Citigroup and that FDIC did not believe that the company was strong enough to merge with Wachovia.[11]

- September 29 – The U.S. House of Representatives voted down H.R. 3997, the original version of the legislation that later created TARP and that would have authorized Treasury to assist banks by purchasing, managing, and selling troubled mortgage-related assets. That same day, the Dow Jones Industrial Average suffered its largest one-day point loss in history, dropping 777.68 points.

These events, among others, devastated investor confidence in the nation's financial system and set the stage for the ensuing TARP. In addition, in response to the continuing and growing economic crisis, the U.S. and other governments sought to implement even more aggressive plans to address the stresses on financial institutions in their countries and the turmoil in the global financial markets. The governments of the United Kingdom, Germany, France, Canada, Ireland, and Sweden either provided liquidity and capital injections to their institutions or banned short selling of stocks of several financial institutions.

Although Congress rejected Treasury's initial proposal to assist banks, Congress enacted EESA on October 3, 2008. The first wave of TARP financial assistance was announced on October 14, 2008, in the form of CPP investments. Treasury announced that it created CPP to provide funds to "stabilize and strengthen the U.S. financial system by increasing the capital base of an array of healthy, viable institutions, enabling them [to] lend to consumers and businesses." Secretary Paulson stated in a press release that the intent of the program "is to increase confidence in our banks and increase the confidence of our banks, so that they will deploy, not horde [sic], their capital. And we expect them to do so, as increased confidence will lead to increased lending. This increased lending will benefit the U.S. economy and the American people." One of the first uses of TARP funds was to pledge a total of $125 billion of capital to nine major financial institutions as part of CPP, which was originally approved to provide up to a total of $250 billion of TARP funds to institutions deemed to be "Qualifying Financial Institutions."[12]

According to Treasury, the nine financial institutions identified to receive the initial $125 billion investment were selected for their perceived importance to the greater financial system. Citigroup received $25 billion in that initial capital commitment. This was loosely based on a formula, determined by Treasury, that institutions receive 1% to 3% of their risk-weighted assets,[13] to a maximum of $25 billion. Citigroup, as of September 30, 2008, held almost $1.18 trillion of risk-weighted assets, and received the maximum investment of $25 billion in return for preferred stock.[14] Despite the initial assistance from Treasury, disruptions in the financial markets and losses in the financial industry continued, and the nine institutions

[11] In commenting on a draft of this report, FDIC disputed this characterization, noting that it "*publicly stated at that time it would stand by the Citigroup offer even after the Wells Fargo offer emerged*."

[12] Qualifying Financial Institutions were private and public U.S.-controlled banks, savings associations, bank holding companies, and certain savings and loan holding companies that were deemed "healthy and viable."

[13] Risk-weighting of assets is the classification of assets according to the risk of loss from investment in the asset. A bank's assets are weighted according to credit risk, and some assets, such as debentures, are assigned a higher risk than others, such as cash or Government bonds. This sort of asset calculation is used by regulators to determine the capital requirements for financial institutions.

[14] Preferred equity ownership usually pays a fixed dividend prior to distributions for common stock owners but only after payments due to holders of debt and depositors. It typically confers no voting rights. Preferred stock also has priority over common stock in the distribution of assets when a bankrupt company is liquidated.

that initially received CPP funds collectively lost $40.9 billion in the fourth quarter of 2008 alone.[15] Then-FRBNY President Timothy F. Geithner told SIGTARP that even though the CPP investments helped slow the momentum of the financial panic, there was still tremendous stress on the system. He stated, "It was clear in late October and early November that we would have to escalate the commitment to large institutions that needed additional assistance."

In a matter of weeks, two of the nine institutions (Citigroup and Bank of America) needed additional support. On November 23, 2008, the Federal Government announced that it would provide Citigroup with further assistance, including an asset guarantee and an additional $20 billion of TARP funds in the form of a preferred equity capital injection. Together with CPP, the $20 billion brought the total TARP capital that Treasury announced or awarded to Citigroup in little more than a month to $45 billion. Citigroup received the additional $20 billion on December 31, 2008.[16] Two days later, on January 2, 2009, the Federal Government announced that the funding had been provided under the newly titled Targeted Investment Program ("TIP").[17]

Treasury described the new investment program as intended to stabilize the financial system by making investments in institutions it deemed critical to the system's functioning. The only institutions to receive funds under TIP were Citigroup and Bank of America. The stated goal of this program was to invest funds, on a case-by-case basis, "to strengthen the economy and protect American jobs, savings, and retirement security" where "the loss of confidence in a financial institution could result in significant market disruptions that threaten the financial strength of similarly situated financial institutions."[18] TIP allowed Treasury to make targeted investments in financial institutions beyond those under CPP if it believed a loss of confidence would threaten other similar institutions, the broader financial markets, or the economy as a whole. Treasury announced the following five determining factors for deciding whether to make future investments under this program:

1. the extent to which destabilization of an institution could have threatened the viability of its creditors and counterparties, whether directly or indirectly;

2. the extent to which an institution was at risk of a loss of investor confidence and the degree to which that stress was caused by a distressed or illiquid portfolio of assets;

[15] The profit or <loss> for each of the nine institutions in the fourth quarter of 2008 was: Bank of America Corporation, <$1,789,013,000>; The Bank of New York Mellon Corporation, $61,000,000; Citigroup, Inc., <$17,263,000,000>; Goldman Sachs Group, Inc., <$2,006,000,000>; JPMorgan Chase & Co., $702,000,000; Morgan Stanley, <$2,295,000,000>; State Street Corporation, $256,747,000; Wells Fargo & Company, <$2,734,000,000>; Merrill Lynch & Co., Inc., <$15,844,000,000>.

[16] After consultation with Chairman Bernanke, Secretary Paulson signed a determination on December 30, 2008, stating that shares of preferred stock and warrants issued by Citigroup are financial instruments the purchase of which is necessary to promote financial stability, and, as such, are "troubled assets," eligible to be purchased under TARP. The Secretary's determination was transmitted to the appropriate committees of Congress that same day in accordance with Section 3(9) (B) of EESA.

[17] A senior Treasury official told SIGTARP that Treasury could have made the $20 billion TIP investment under the existing Systemically Significant Failing Institution program, which had been announced in November 2008 in connection with its assistance of AIG, but Treasury did not do so, in part because it did not want to identify Citigroup as a "failing institution."

[18] Treasury, Guidelines for Targeted Investment Program, updated 11/20/2009, http://www.financialstability.gov/roadtostability/tipguidelines.html, accessed 11/3/2010.

3. the number and size of financial institutions that were similarly situated, or that would likely have been affected by destabilization of the institution being considered for the program;

4. whether the institution was sufficiently important to the nation's financial and economic system such that a loss of confidence in the firm's financial position could potentially have caused major disruptions to credit markets or payment and settlement systems, destabilized asset prices, significantly increased uncertainty, or led to similar losses of confidence or financial market stability that materially could have weakened overall economic performance; and

5. the extent to which the institution had access to alternative sources of capital and liquidity, whether from the private sector or from other sources of Government funds.

At the same time that Citigroup announced the additional $20 billion preferred stock investment by Treasury, Citigroup announced a third transaction with the Government, which, according to Citigroup officials, was patterned conceptually on a plan that was developed, in conjunction with regulators, when Citigroup agreed to purchase Wachovia's banking operations. Treasury, FDIC, and FRBNY agreed to guarantee a portion of potential losses on a designated pool of Citigroup assets valued initially at approximately $306 billion through a program that Treasury would later name AGP.[19] The asset pool was also referred to as a "ring-fence." AGP provided certain loss protections "for assets held by systemically significant financial institutions that face a high risk of losing market confidence due in large part to a portfolio of distressed or illiquid assets."[20] Treasury and FDIC received $7.059 billion in preferred stock from Citigroup in exchange for the guarantee.[21] Of this, Treasury received $4.034 billion and FDIC received $3.025 billion.

Although Citigroup was the only institution to receive an asset guarantee through AGP,[22] Treasury announced five factors it may consider, among other things, in determining whether to use the program for an institution. The factors for AGP were the same as those listed above for TIP.

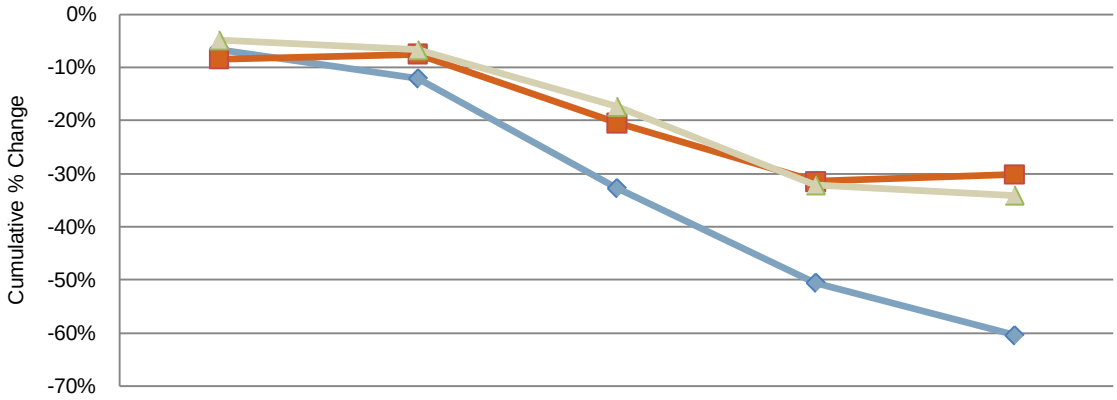
[19] Pursuant to Section 102 of EESA, Treasury issued a written report to Congress on December 31, 2008, in connection with the insurance program (*i.e.*, AGP) established under Section 102 (a).
[20] Treasury, Section 102 Report, December 31, 2008, http://www.treas.gov/press/releases/reports/0010208%20sect%20102.pdf, accessed August 10, 2010.
[21] Treasury also received warrants to purchase common stock from Citigroup as part of CPP, AGP, and TIP transactions.
[22] While Treasury announced an AGP transaction for Bank of America, the transaction was not completed.

Stock Price Declines and Increases in CDS Spreads Trigger a Potential Run

This section presents a description of the market events that led to the decision to provide Citigroup with extraordinary Government assistance.

Even after Citigroup received $25 billion in CPP funds, its stock price dropped steadily and dramatically in the first three weeks of November 2008, and FRBNY's General Counsel told SIGTARP that the market still perceived Citigroup as an institution "less strong than others." Robert Rubin, a former Citigroup Director and Senior Counsel, told SIGTARP that on the evening of November 18, 2008, he called Treasury Secretary Paulson to tell him short sellers were attacking the bank, and that the Securities and Exchange Commission ("SEC") should reimpose the uptick rule on short selling.[23] Citigroup's share price fell from around $13.99 at the market's close on November 3, 2008, to $3.05 per share on November 21, 2008, before closing that day at $3.77. In the week leading up to the decision to extend Citigroup extraordinary assistance, Citigroup's stock decreased far more than that of its peers, losing over half its value (see Figure 1 for Citigroup's stock price from November 17-21, 2008).

FIGURE 1
CITIGROUP AND PEERS CUMULATIVE STOCK PRICE FOR THE WEEK OF NOVEMBER 17, 2008



	17-Nov-08	18-Nov-08	19-Nov-08	20-Nov-08	21-Nov-08
Citigroup	-7%	-12%	-33%	-51%	-60%
Bank of America	-8%	-7%	-20%	-31%	-30%
JPMorgan Chase	-5%	-7%	-17%	-32%	-34%

Note: The cumulative change is from Friday, November 14, 2008, and is based on closing prices.
Source: SIGTARP analysis of Bloomberg data.

Referring to the drop in Citigroup's stock price, Citigroup Vice Chairman Ned Kelly told SIGTARP "it wasn't entirely clear why we had a problem. It appeared to be market psychology without any regard to

[23] The uptick rule was mandated by the Securities Exchange Act of 1934 as Rule 10a-1 and was implemented in 1938. The rule required that a short sale transaction be entered only at a price that is higher than the price of the previous trade. A short sale occurs when an investor enters into an agreement to sell a stock at a current price and at a later time buy that amount of stock at what the investor hopes will be a lower price. The uptick rule prevents short sellers from adding to the downward momentum when the price of an asset is already declining. The SEC revoked the uptick rule in September 2007.

fundamentals." He said he believed that Citigroup's underlying financials had not changed. FRB Chairman Bernanke told SIGTARP that Citigroup's biggest problems were credit and confidence, and an FRBNY official told SIGTARP that FRBNY had observed this same type of activity preceding the failure of Lehman. He told SIGTARP that "banking is a game of confidence…and we saw the behavior and the lack of confidence, …[which] was alarming."

Citigroup Chief Executive Officer ("CEO") Vikram Pandit testified before the Congressional Oversight Panel on March 4, 2010, that he believed Citigroup was a "healthy financial institution" both on October 1, 2008, and on November 21, 2008. Mr. Pandit testified that Citigroup's problems were "not about the capital we had, not about the funding we had at that time, but with the stock price where it was."

In an interview with SIGTARP, Mr. Pandit reiterated his view that Citigroup was "financially healthy" on November 21, 2008, and clarified that he meant that Citigroup was comfortable with its capital, liquidity, reserves, and portfolio asset values. He stated that the financial health of the company was not the issue, but that the market had seen significant stock price declines with Lehman, Merrill Lynch, and AIG immediately prior to the financial distress of these companies, and now the same thing was happening at Citigroup. Mr. Pandit indicated that, in a market that is not completely rational, when the stock price declines to a certain level, the perception of the stock price can create a reality.

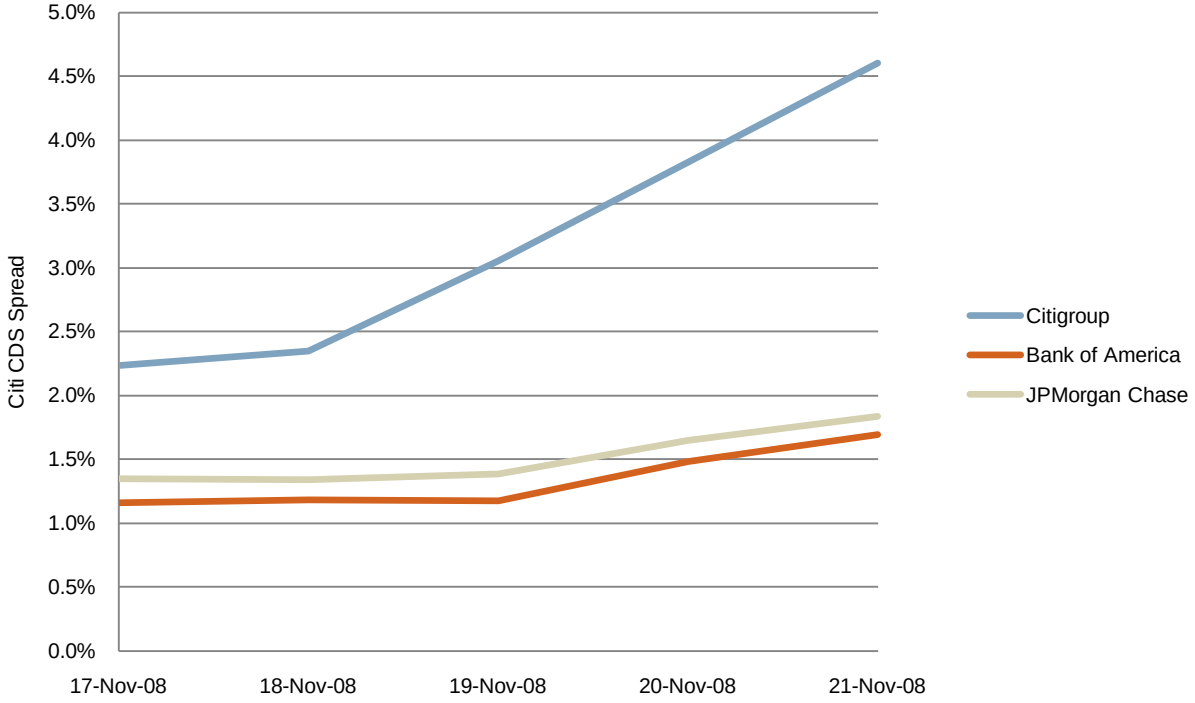
During this time, market participants also began to question Citigroup's ability to honor its commitments. A strong indicator that the market had lost confidence in Citigroup was that those who owned Citigroup debt (*i.e.*, its bonds) were finding it increasingly expensive to hedge that debt. The price for a credit default swap ("CDS"), which essentially provides insurance against default, was increasing dramatically. In other words, the market was increasingly concerned that Citigroup would not be able to make good on its debts. Regulators frequently cited the expansion of Citigroup's CDS spreads as one of the most telling indicators of the market's perception of Citigroup during the period leading up to the implementation of AGP and TIP.

Figure 2 illustrates that from November 17, 2008, through November 21, 2008, the company's CDS spreads more than doubled. The CDS spreads of Bank of America and JPMorgan Chase, meanwhile, had been about half those of Citigroup and increased far less significantly during that week.

Credit Default Swaps and CDS Spreads

A credit default swap ("CDS") is an insurance-like contract in which the seller receives a series of payments from the buyer in return for agreeing to make a payment to the buyer if a particular credit event outlined in the contract occurs – for example, if a bond or loan goes into default. A CDS spread is stated as a percentage of par value that the insurance buyer is willing to pay the insurance seller in exchange for the insurance for a specific period. For the purposes of this report, CDS spreads are stated as annualized quarterly payments. The higher the CDS spread, the more expensive it is to buy protection against default, reflecting that the market sees that the institution standing behind the bond is more likely to default on its obligations. In other words, the greater the spread, the less creditworthy the institution is regarded by the market.

FIGURE 2
CREDIT DEFAULT SWAP SPREADS



Source: SIGTARP analysis of company data.

Both the stock price and Citigroup's credit default swap spread changed unfavorably, as depicted in Figure 3 below.

A Run on Citigroup Becomes a Possibility

Secretary Paulson, FRB, and OCC expressed concern at the time that depositors might start a run[24] on Citigroup, and that as a result, the bank would suffer a severe liquidity crisis (not have enough cash on hand) and not be able to meet its obligations as they became due. On Friday, November 21, 2008, these concerns were substantiated by significant corporate withdrawals (*i.e.*, a run), primarily in the U.S. and secondarily in Europe. An OCC official stated that OCC received indications that problems related to deposit outflows were also beginning to emerge for Citigroup in Asia's Monday morning trading hours (the evening of Sunday, November 23, 2008, Eastern Standard Time ("EST")) until the Government announced its support of Citigroup.

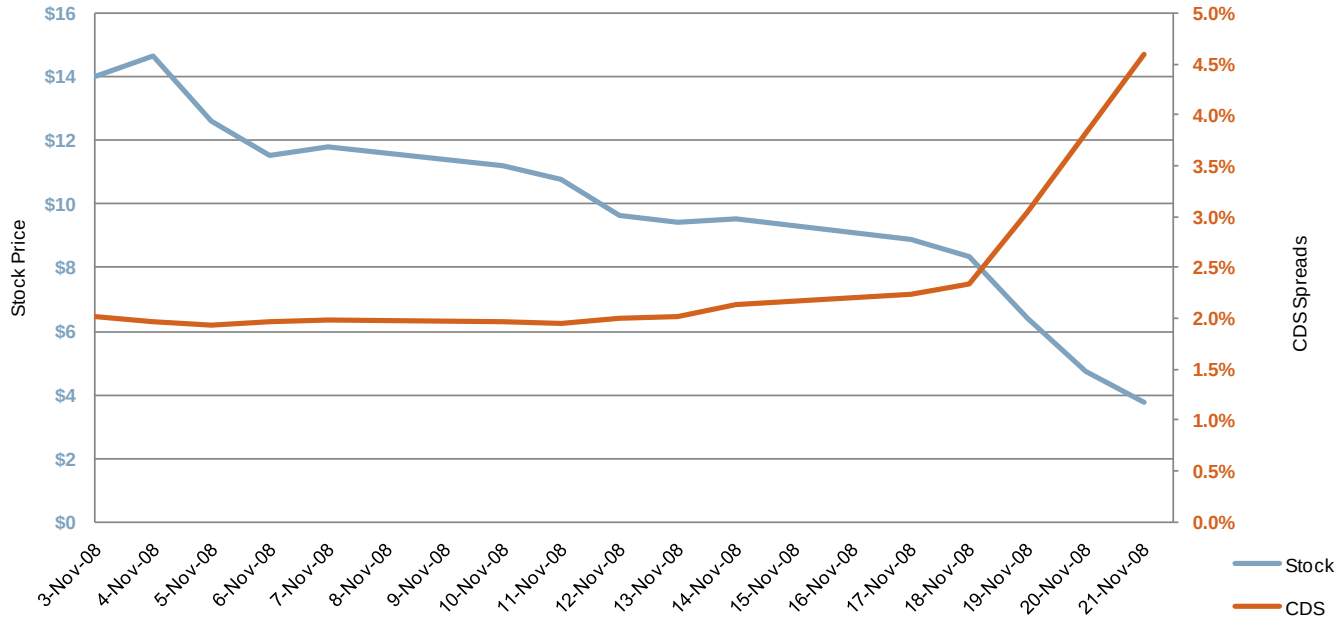
Citigroup CEO Pandit acknowledged that the unfavorable stock price movements could have been a cause of the significant deposit outflows occurring on November 21, 2008. Over the course of just one night (November 20-21, 2008), Citigroup's balance of available funds in its GTS unit shrank by $13.8 billion, from $288.0 billion to $274.2 billion. If Citigroup's deposit outflows continued and Citigroup was not able

[24] A run occurs when large numbers of depositors suddenly demand to withdraw their deposits from a bank. This may be caused by a decline in depositor confidence or fear that the bank will be closed by the chartering agency. Banks keep only a small fraction of their deposits in cash reserves, and thus, large numbers of withdrawals in short periods of time can cause even a healthy bank to have a severe liquidity crisis that could cause the bank to be unable to meet its obligations and fail.

to access additional liquidity, FRBNY and OCC officials questioned whether Citigroup could make it through the following week.

FIGURE 3

CITIGROUP CDS SPREAD VS. STOCK PRICE



Source: SIGTARP analysis of company data.

Counterparties Pull Back from Citigroup

By mid-November 2008, Citigroup had started receiving calls from investors, counterparties, fund managers, and other professional investors inquiring about the viability of the institution, and asking for more and better collateral on Citigroup debts that the investors held. The OCC Deputy Comptroller for Large Bank Supervision told SIGTARP that "numerous counterparties called with concerns about counterparty risk." FRBNY President Geithner told SIGTARP that he observed the stock price declining and funding becoming shorter term and more expensive on a daily basis.

According to an FRBNY official, by November 21, 2008, counterparties began to "pull back from Citigroup" because of its perceived decline in creditworthiness. This meant, as he described it, that Citigroup's counterparties were increasingly unwilling to engage in financial transactions with Citigroup or to provide it with credit. These included federal funds[25] market counterparties (other depository institutions that would normally extend Citigroup credit in overnight borrowing) and, even more troubling, secured financing[26] counterparties. The FRBNY official described short-term funding through secured financing as a "good liquidity barometer." Liquidity is the degree to which an asset can be easily converted to cash.

[25] Federal funds are unsecured loans (loans without collateral) of reserve balances at Federal Reserve Banks between depository institutions. The most common duration or term for a federal funds transaction is overnight, although longer-term deals are arranged.

[26] Under a short-term secured financing arrangement, lenders receive an asset as collateral in exchange for a loan. They hold the collateral for the period of time that the loan is outstanding (*e.g.*, one week), and then return the collateral once the loan is

An FRBNY official told SIGTARP that it was "a bad sign" when lenders started to differentiate Citigroup's collateral from its peers or declined short-term funding for Citigroup. Another FRBNY official stated that it was clear the market was singling out Citigroup, as its peers were not experiencing the same problems. Citigroup was also having difficulty issuing commercial paper. A former Citigroup Treasurer told SIGTARP that it became hard for Citigroup to finance commercial paper for any length of time beyond overnight but stated that it was not an important avenue of liquidity. FRBNY officials told SIGTARP that commercial paper purchasers such as mutual funds lost confidence in Citigroup's ability to repay, which forced Citigroup to issue debt with shorter maturities.

repaid. In the event the borrower defaults on the loan, the lender retains the collateral, which is typically comparable in value to the loan extended.

Citigroup Declared a 'Systemic Risk'

This section describes the conclusions of the relevant Government entities that a failure of Citigroup would constitute a systemic risk to the national and global economy and that Citigroup therefore needed additional Government assistance.

Saving Citigroup at All Costs

An FRBNY official told SIGTARP that a consensus of Federal Government parties held that it was necessary to "save Citigroup at all costs" in order to stabilize the nation's financial system. OCC,[27] Treasury, FRB, and FDIC took active roles and ultimately concluded that, without additional assistance, Citigroup could collapse, resulting in systemic effects throughout the financial markets and the economy as a whole. Citigroup CEO Pandit stated he did not know what the systemic effects of a Citigroup failure would be, and, essentially, that no one wanted to find out. CEO Pandit told SIGTARP, "We saw what happened with Lehman, and we're a lot bigger than Lehman."

Systemic Risk Determination Process

By law, FDIC could not participate in the Government's assistance package for Citigroup, which would constitute "open bank assistance,"[28] without a waiver from the Secretary of the Treasury in the form of a Systemic Risk Determination.[29] In order to make this determination, which includes the conclusion that FDIC's normal resolution process "would have serious adverse effects on economic conditions or financial stability,"[30] the Secretary of the Treasury must first receive recommendations from the Board of Directors of FDIC[31] and the Board of Governors of the Federal Reserve System, and consult with the President of the United States.

FRB Assesses Citigroup's Systemic Risk

On the morning of Thursday, November 20, 2008, Secretary Paulson and FRBNY President Geithner held a conference call with FRB Chairman Bernanke, FDIC Chairman Bair, and Comptroller Dugan to discuss Citigroup. Chairman Bernanke told SIGTARP they discussed Citigroup's condition and the "too big to fail" issue. During the call, FRBNY President Geithner told the other principals, "We've told the world we're not going to let any of our major institutions fail. We are going to have to make it really clear we're standing behind Citigroup." According to Chairman Bernanke, it was "not even a close call to assist them."

Chairman Bernanke told SIGTARP that a Citigroup failure "would have been Lehman times two or three in terms of the financial sector and the economy." "This was a view strongly held" at the time, he said. Citigroup was perceived as being interdependent and interconnected with a broad array of different financial institutions both in the U.S. and internationally, and in FRB's view, Citigroup's failure would have implications that reached beyond the bank itself, including serious adverse effects on domestic and

[27] OCC, as one of Citigroup's primary regulators, played an extensive role throughout Citi Weekend in providing material data and analysis about Citibank to FDIC and FRB.

[28] In an open bank assistance agreement, FDIC provides financial assistance to an operating insured bank or thrift determined to be in danger of closing.

[29] 12 U.S. Code, section 1823(c)(4); 12 C.F.R. 360.1. The only exception to the "least-cost resolution" requirement is when it is determined that a systemic risk to the financial system exists. 12 U.S. Code, section 1821(c)(4)(G).

[30] 12 U.S. Code, section 1823(c)(4)(G)(i)(I).

[31] The Board of Directors of the FDIC includes the FDIC Chairman, FDIC Vice Chairman, FDIC Director, Comptroller of the Currency, and the Director of the Office of Thrift Supervision.

international economic conditions and financial stability. Specifically, FRB regulators believed that a Citigroup failure would have destabilized the global financial system by seriously impairing already disrupted credit markets, including short-term interbank lending, counterparty relationships in qualified financial contract[32] markets, bank and senior subordinated debt markets, and derivatives.

Given the significance of Citigroup's GTS unit,[33] the collapse of Citigroup would have had devastating effects on the broader economy. Chairman Bernanke told SIGTARP that he believed that a Citigroup failure had the potential to block access to ATMs and halt the issuing of paychecks by many companies and governments. An FDIC official separately said that adverse effects on money market liquidity could be expected on a global basis.

According to FRB's memorandum assessing the company's systemic risk, Citigroup also was a major player in a wide range of derivatives markets, both as a counterparty to over-the-counter trades, and as a broker and clearing firm for trades on exchanges. At the end of the third quarter, the notional principal value of its derivatives positions was more than $35 trillion, the bulk of which was held by its Citibank, N.A., subsidiary. A failure of Citigroup would have left many of its derivatives counterparties scrambling to replace contracts that they had with Citigroup. Citigroup's derivatives positions were fairly well balanced, so in more normal conditions counterparties might be able to replace Citigroup's derivatives contracts relatively easily, according to the FRB memo. However, given concerns about counterparty credit risk and strains in some derivatives markets at the time, those contracts might have proven difficult to replace.

On November 23, 2008, the Board of Governors of the Federal Reserve voted unanimously to recommend to the Secretary of the Treasury that a potential Citigroup failure posed a systemic risk.

FDIC Assesses Citigroup's Systemic Risk

On Sunday, November 23, 2008, FDIC's Board of Directors met to consider whether or not to recommend that Treasury invoke the systemic risk exception and allow FDIC to participate in open bank assistance. During this meeting, FDIC staff recommended that the Board find that the failure of Citigroup and its insured affiliate banks and thrifts would have serious adverse effects on domestic and international economic conditions and financial stability.

Based largely on information from Citigroup's primary regulators, FRB and OCC, FDIC's Board of Directors and FDIC staff discussed how Citigroup's failure would seriously and negatively affect already disrupted credit markets, including short-term interbank lending, counterparty relationships, qualified financial contracts markets, and bank and senior subordinated debt markets, and would further disrupt the related markets in derivatives and other products. In addition, they noted in the meeting that Citigroup's failure would have serious consequences for the functioning of the global payment system. Chairman Bair told SIGTARP, "We were told by the New York Fed that problems would occur in the global markets if Citi were to fail. We didn't have our own information to verify this statement, so I didn't want to dispute that with them." During this meeting several concerns were highlighted by FDIC Board members and staff:

[32] A qualified financial contract is a type of financial agreement that includes, but is not limited to, securities contracts, forward contracts, repurchase agreements, and swap agreements.

[33] The GTS unit offers integrated cash management, trade, and securities and fund services to multinational corporations, financial institutions, and public sector organizations spanning more than 100 countries and 65,000 clients.

- "It's obviously a systemic risk situation. I don't have any question about that," said Office of Thrift Supervision Director John Reich.
- "The risk profile of Citibank[34] is increasing rapidly due to the market's lack of confidence in the company and the substantially weakened liquidity position. Without substantial Government intervention that results in a positive market perception on Monday morning, OCC and Citigroup project that Citibank will be unable to pay obligations or meet expected deposit outflows next week," an FDIC official said.
- "We were on the verge of having to close this institution because it can't meet its liquidity Monday morning," Chairman Bair said. "They have $500 billion in foreign deposits that nobody can guarantee."
- "The issue now is the potential for a large worldwide bank run, and that's what has got to be brought under control," one participant[35] said.

At the end of the November 23, 2008, meeting, the FDIC Board unanimously voted to recommend that Treasury invoke the systemic risk exception for Citigroup, thereby authorizing FDIC's participation in open bank assistance to the firm in the form of a ring-fence of assets later to be titled the Asset Guarantee Program. While the vote was unanimous, OTS Director Reich, an FDIC Board member, expressed the concern that there had been "some selective creativity exercised in the determination of what is systemic and what's not," and that there "has been a high degree of pressure exerted in certain situations, and not in others, and I'm concerned about parity." In terms of Citigroup, an FDIC official told SIGTARP that the FDIC directors and other Government entities "made a judgment call." With both recommendations in hand, Secretary Paulson was then able to move forward with the process to invoke the systemic risk exception for Citigroup.

Treasury Determines Citigroup Is a Systemic Risk

On November 21, 2008, Secretary Paulson said, "If Citi isn't systemic, I don't know what is." Secretary Paulson consulted with President Bush about making an emergency Systemic Risk Determination for five Citigroup subsidiary banks, which then authorized FDIC to take appropriate action under the systemic risk exception.

An undated action memorandum for the Secretary discussed Treasury's reasons for supporting the Systemic Risk Determination. According to the memorandum, Citigroup's failure would threaten the viability of creditors and counterparties exposed to the institution, impair the liquidity of even well-capitalized institutions, dislocate the credit markets, and undermine business and household confidence in the broader economy.

Secretary Paulson ratified the actions he took on November 23, 2008, in a written determination he executed on January 15, 2009.[36] That determination states that FDIC and FRB both recommended that the Secretary

[34] Citibank, also known as Citibank, N.A., is the largest of Citigroup's five insured entities.
[35] The record of this meeting failed to identify which meeting participant made this statement.
[36] Treasury submitted written notice to Congress, pursuant to Section 13(c)(4)(G) of the Federal Deposit Insurance Corporation Improvement Act of 1991, on December 7, 2009, stating the Systemic Risk Determination, the least-cost resolution exemption, and therefore the AGP, would be available to Citigroup. In the same written notice, Treasury explained its delay in notifying Congress: "In reviewing the Department of the Treasury's records, we have not been able to ascertain whether you received the formal notice of this determination as required by Section 13(c)(4)(G). As such, we are providing to you notice of the determination and have attached a copy of the written determination made by Secretary Paulson."

make an emergency Systemic Risk Determination, states that the Secretary has consulted with the President about such a determination, and concludes that the Secretary has made such a determination. The determination also states that FDIC's least-cost resolution requirements with respect to Citigroup would have had serious effects on economic conditions and financial stability, and FDIC's taking of other action under the emergency systemic risk exception (*i.e.*, AGP) would avoid or mitigate such effects.

Citigroup's Proposal and the Federal Regulators' Response During Citi Weekend

This section presents the discussions that led to the form of the Federal Government's additional assistance to Citigroup.

On Friday, November 21, 2008, FRBNY officials held a conference call with Citigroup officials. During this conversation, FRBNY officials said, it became clear that the risk profile[37] of Citigroup was increasing rapidly, and liquidity pressures had reached crisis proportions. Based on this judgment – and its view of the systemic risk that Citigroup presented to the economy – FRBNY requested that Citigroup submit a proposal for additional Government assistance, without specifying the details of what Citigroup should include in the proposal. Citigroup agreed to draft a proposal. Federal officials would later label the weekend of this crisis – November 21-23, 2008 – as "Citi Weekend."

At 3:36 a.m. on Saturday, November 22, 2008, Citigroup provided FRBNY with a proposal for additional Government assistance.[38] Citigroup CEO Pandit told SIGTARP that this proposal was based on a plan developed with regulators for Citigroup's unsuccessful attempt to purchase Wachovia. Citigroup's original proposal did not seek a capital injection but instead included the request that the Government guarantee 100% of the total value of $306 billion in a pool of specified troubled assets. In exchange for this guarantee, Citigroup would issue the Government $20 billion in preferred stock. This stock would pay a 5% annual dividend and could be repaid or converted into common stock, at Citigroup's preference, in five years. Citigroup CEO Pandit described the $20 billion in preferred stock as "paying for expected losses. The first loss would have resulted in a loss for the Government. There was an expected loss for it." The proposal did not list specific assets, but listed general asset classes that Citigroup's Chief Risk Officer for Real Estate/Mortgages told SIGTARP were causing investors the most concern. Included were assets such as residential mortgage-backed securities ("RMBS"),[39] commercial mortgage-backed securities ("CMBS"),[40] consumer mortgages, commercial real estate, collateralized debt obligations ("CDOs"), [41] and troubled corporate loans. Among the different asset classes, Citigroup included assets with "tail risk" – assets that had a low probability of losses, but for which any losses would be severe or complete. Citigroup selected these assets, which the "public most feared," to make up the majority of its proposed asset pool.[42]

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[37] An FDIC official clarified that "risk profile" referred to Citigroup's liquidity risk. In the market, the lack of confidence in Citigroup was stressing its liquidity – there was a run on Citigroup's foreign deposits, and counterparties had stopped providing the institution with wholesale funding.

[38] Citigroup, in an email sent to FRBNY at 11:14 p.m. on Saturday, November 22, 2008, also requested that FRBNY double the financing capacities of its subsidiaries under the Commercial Paper Funding Facility ("CPFF"), a program that helped institutions obtain short-term financing. This request was denied.

[39] An RMBS is a financial instrument backed by a pool of residential real estate mortgages.

[40] A CMBS is a financial instrument backed by a pool of commercial real estate mortgages.

[41] A collateralized debt obligation is a financial instrument that entitles the purchaser to some portion of the cash flows from a portfolio (or group) of assets, which may include bonds, loans, mortgage-backed securities, or even other CDOs.

[42] Citigroup's proposal consisted of three pages. The first page, with the heading "Structure / Term Sheet," is included in Appendix I. The second page, with the heading "Financial Impact," described Citigroup's assessment of the impact of its proposal on its capital ratio and pro forma profit-and-loss statement. The third page, with the heading "Ring-Fenced Assets and Expected Losses," listed the asset class categories and detailed their dollar amounts, reserves, and expected losses. Citigroup objected to SIGTARP's inclusion of the Financial Impact page and the Ring-Fenced Assets and Expected Losses page in this report, contending that the estimates of pro forma financial impacts, without underlying information about the relevant assumptions upon which they were based, could mislead readers, and that Citigroup's method of calculating its pro forma

FRBNY officials forwarded Citigroup's proposal to Federal regulators (the Board of Governors of the Federal Reserve System, FDIC, OCC, and Treasury) for review in advance of a meeting scheduled for the afternoon of Saturday, November 22, 2008. At about noon that day, Federal regulators met with Citigroup senior management, who described key details of Citigroup's proposal. The terms would change considerably before a deal was ultimately finalized.

On the afternoon of November 22, 2008, a series of conference calls took place among representatives of the Federal agencies involved in the decision regarding the manner and method of saving Citigroup. According to FRBNY President Geithner, "It was almost a continuous conversation with the principals on all sorts of ideas on how to do it. We were guided by two objectives: One, we needed a definitive strategy that would work, and, two, we had to do it in a way that would be most economical and fair for the U.S. Government and protect its interests." In addition to Citigroup's proposal, they discussed several other ideas to address the lack of market confidence in Citigroup, including:

- ***Creating a conservatorship similar to those for Fannie Mae and Freddie Mac***[43] – This approach was rejected because the Government did not want the market to perceive that the Government had nationalized[44] Citigroup, an FRB official told SIGTARP.
- ***Creating a Special Purpose Vehicle ("SPV") to purchase troubled assets from Citigroup with Government funds*** – A special purpose vehicle is an off-balance-sheet legal entity, a corporation to hold transferred assets that are theoretically beyond the reach of the entities providing the assets. According to participants, this approach was rejected because the Government preferred a solution that was quick, scalable, and replicable with other institutions. Pricing the highly illiquid assets was very difficult and time-consuming; in fact, Treasury had announced on November 12, 2008, that it would not use the remaining TARP funds to make purchases of illiquid mortgage assets, in part due to the difficulty in solving the pricing issue. In light of this, the SPV option was rejected.
- ***Creating a public-private investment fund to buy troubled or toxic assets from the bank*** – This would move the assets off the bank's balance sheet. According to participants, this approach was rejected because it was very difficult to price the assets on the balance sheet of Citigroup absent a reliable secondary market for them.
- ***Additional capital injection*** – This approach was described by an FRBNY official as "throwing cash at it." The consensus among Government officials was that sufficient funds were not available under TARP at that time to fully address Citigroup's problems, and that a lesser amount would not be sufficient, as evidenced by its need for assistance after the initial $25 billion CPP fund infusion. It was determined that some injection was necessary, and Citigroup did receive an additional $20 billion in TARP funds.

financials and loss projections, which might be reverse-engineered from the Financial Impact page and the Ring-Fenced Assets and Expected Losses page, is proprietary information. SIGTARP, without endorsing Citigroup's claims, has decided not to include the Financial Impact page or the Ring-Fenced Assets and Expected Losses page of the Citigroup proposal in this report.

[43] As conservator of Fannie Mae and Freddie Mac, Treasury provides support to these institutions for an indefinite period of time while the newly created Federal Housing Finance Agency closely oversees the operations of the companies.

[44] Nationalization is the act of taking private assets into public ownership by a national government or state.

Government Response

The Government's representatives ultimately decided that a further cash infusion and some form of guarantee for a defined pool of assets would best address threats to Citigroup's viability. An FRBNY official noted that Citigroup's idea of a guarantee would keep the asset portfolio on Citigroup's books but the assets would be identified and the Government would monitor them. In addition, the asset pool option would cost the Government far less money than purchasing the assets outright. The Government also felt that this approach could be replicated for other institutions that came under similar pressures.

Over the weekend of November 22-23, 2008, representatives of the Federal agencies negotiated terms for Citigroup that were acceptable to all Government parties. An FRBNY official told SIGTARP that the Government sought to calm the global markets with decisive action before markets opened in Asia when the weekend was over. As the weekend drew to a close, the Government offered Citigroup a package that included a Government guarantee of distressed assets and additional capital assistance.

Government Guarantee of Distressed Assets

In response to Citigroup's proposals, the Government ultimately agreed to guarantee possible losses to a ring-fence or pool of assets of roughly $300 billion – but only if Citigroup would be responsible for the first $37 billion of losses, which was approximately what the Government "pegged" as the expected loss for the ring-fence and is described below. According to OCC officials, this assistance was intended both to strengthen Citigroup and to help prevent a further decline in confidence in the market from spreading throughout the financial system and the global economy. In the action memorandum that described Citigroup as a systemic risk, Treasury staff noted the concern for protecting FDIC's insurance fund: "Providing guarantees for the asset pool as described for these insured institutions and their holding company is an appropriate mitigation tool as it will facilitate lending and will help stabilize this bank organization and also be beneficial to the Nation's financial stability, protect the Fund from unnecessary losses, and therefore be beneficial to the taxpayers."

Over the course of the weekend, Government officials obtained details regarding the proposed assets in the $306 billion pool. Citigroup had estimated that the pool had embedded credit losses[45] of approximately $29 billion over the 10-year life of the agreement. Using financial modeling techniques and bank examiner estimates, on-site interagency Government staff analyzed information on the proposed asset pool and developed an initial regulatory estimate of embedded credit losses of $38 billion. This estimate was further refined, resulting in an estimated loss position in the portfolio of somewhere between $34.6 billion in a moderately adverse scenario and $43.9 billion in a severely adverse scenario. Based upon these two adverse loss projection scenarios, the Government pegged the expected loss for the ring-fence at $37 billion.

FDIC maintained that Citigroup should take a first loss position equal to 110% of the initial regulatory estimate of embedded credit losses, or $42 billion, before the agency would start to cover losses. This point was taken into consideration as the Government parties discussed the structure and order of the Government loss positions. FDIC told SIGTARP that it found Citigroup's ultimate first loss position of $37 billion acceptable because Treasury was willing to take a $5 billion second loss position through TARP. FDIC would not cover losses until 110% of the initial regulatory loss estimate, or $42 billion, was reached.

[45] Embedded credit loss is defined by FDIC as the total amount of future credit losses a pool of assets will incur, including losses covered by any associated loan loss reserves as well as losses in excess of reserves.

By January 15, 2009, after further analysis, asset substitutions, and exclusions, Citigroup's first loss position was increased to $39.5 billion. This loss position reflected $1.5 billion in additional reserves associated with the assets substituted into the pool and $1 billion as consideration for the removal of hedges from the pool.

The Government ultimately would set Citigroup's first loss position at $39.5 billion,[46] which was more than the expected losses. The Government acted to further protect taxpayer interests by requiring Citigroup to absorb 10% of any losses in excess of $39.5 billion, with the Government assuming liability for the remaining 90% of any losses. The responsibility for reimbursing that 90% would be divided among Treasury, FDIC, and FRBNY (see Table 1). Treasury would use TARP funds to guarantee the second loss position by absorbing 90% of the next $5.6 billion, or $5 billion, of losses exceeding the initial $39.5 billion. Citigroup would absorb the remaining $0.6 billion of those losses, resulting in a maximum TARP payout of $5 billion. For the third loss position of $11.1 billion, FDIC would absorb 90% of losses, or up to $10.0 billion, with Citigroup covering the remaining $1.1 billion.

If these losses were realized, the remaining assets in the covered pool would serve as collateral for an FRBNY loan to cover the additional losses and that would be issued to Citigroup at 90% of the collateral's value. The FRBNY loan was non-recourse, meaning that if Citigroup's losses were such that the remaining value of the asset pool became insufficient to cover the FRBNY loan, Citigroup would not have been obligated to repay FRBNY the full balance of the loan. Instead, FRBNY would have received ownership of the impaired assets. FRB Chairman Bernanke told SIGTARP that when he agreed to the transaction, he did not expect FRB would ever have to pay for any losses because of the structure of the first, second, and third loss positions.

TABLE 1

U.S. GOVERNMENT GUARANTEES AND LOSS PROTECTIONS TO CITIGROUP

($ Billions)

	Loss 1	Loss 2	Loss 3	Non-recourse Loan	Total
Citigroup	$39.5	$0.6	$1.1	$24.5	$65.7
Treasury (TARP)	--	$5.0	--	--	$5.0
FDIC	--	--	$10.0	--	$10.0
FRBNY	--	--	--	$220.4	$220.4
Total	$39.5	$5.6	$11.1	$244.8	$301.0

Note: Numbers affected by rounding. According to the Federal Reserve, Citigroup's loss position is "exclusive of reserves."
Sources: Citigroup Master Agreement, 1/15/2009; Federal Reserve, 1/29/2009.

The Government's representatives also calculated "premiums" to be paid by Citigroup to Treasury and FDIC for their guarantees of the asset pool. While the "expected loss" was $37 billion, there remained a chance that the loss would be higher and thus required the Government to make good on its guarantee. Using financial models and actuarial analyses, the Government determined that Citigroup should issue $7.059 billion in perpetual preferred shares, paying 8% annual dividends, as a premium to be divided

[46] Indeed, as discussed more fully below, the final agreement allowed the Government to increase this deductible amount at the time of finalization if expected losses on the portfolio exceeded $39.5 billion.

between Treasury and FDIC[47] for the guarantee. Based on their relative loss positions and the size of their guarantee, Treasury would receive $4.034 billion in shares, while FDIC would receive $3.025 billion. In addition, Treasury would receive warrants to purchase 66,531,728 shares of common stock at a price of $10.61 per share.

Additional Capital Injection

Having decided that an additional capital investment in Citigroup was necessary, Government representatives discussed the amount of capital to inject into the firm, as well as the form the capital would take. While the capital injection could not directly affect Citigroup's liquidity in the short term, because the capital would not be transferred until December, the announcement of a planned capital injection and other assistance would reassure counterparties that the Government would not let Citigroup fail. With such assurances, Citigroup's counterparties could be expected to relax the terms of loans to Citigroup and make more funds available to Citigroup in the short term. On Saturday evening, November 22, 2008, FRB Chairman Bernanke and Secretary Paulson discussed the merits of structuring the capital as a common or preferred equity investment.

Initially, Chairman Bernanke raised the idea of a common equity investment. However, Secretary Paulson supported preferred equity, arguing that injecting preferred equity into Citigroup would not dilute common shareholder equity or carry the political implications surrounding a major Government ownership stake in Citigroup. A senior FRB official also believed at that time, he told SIGTARP, that nonconvertible preferred shares (preferred shares that could not be converted into common shares) would deter complaints of bank nationalization, which could have undermined confidence rather than restored it. Preferred equity, which is senior to common equity in the event of liquidation, also theoretically had a greater likelihood of repayment than common equity, thus affording the taxpayers some additional protection, and earned an obligation from Citigroup to make quarterly dividend payments.

Citigroup Vice Chairman Kelly told SIGTARP that Citigroup was not involved in any discussions about the $20 billion of additional TARP capital to be invested by Treasury. CEO Pandit told SIGTARP that the capital infusion was not requested by Citigroup, but that it was suggested by "Washington" at the tail end of Citi Weekend. Infusing capital into Citigroup, an FRB official said, "was a clever way for the government parties to provide more protection and be more protected themselves." Put another way, injecting TARP capital into Citigroup would provide an increased reserve cushion to allow for losses or the guaranteed assets to be absorbed by Citigroup, and, potentially, by TARP. Furthermore, the potential loss of an additional $20 billion in TARP funds was viewed as far less than the cost to the financial system of a Citigroup failure.

Secretary Paulson told SIGTARP that he made the final decision as to the form and amount of the capital injection – $20 billion of preferred capital that required an 8% annual dividend, payable quarterly. Secretary Paulson stated that he did not perform any analysis specific to Citigroup in arriving at the $20 billion figure. Rather, he took into consideration the limited amount of TARP funds still available, as well as the prospect that another bank could soon need assistance. SIGTARP found no written

[47] FDIC's Associate Director of the Large Institutions Group noted that if the guarantee were worth more than the compensation for the guarantee when FDIC first booked the transaction, then FDIC would have to make a special assessment of the industry to recoup the cost. FDIC wanted to avoid this action because the nation's banks were already under severe financial stress. FDIC told SIGTARP that a special assessment would also be made if the ultimate cost of the guarantee exceeded the compensation.

documentation of the decision-making process behind the $20 billion capital injection. FRBNY President Geithner also told SIGTARP he did not recall exactly how the Government arrived at the $20 billion figure, but it came through a mix of FRBNY and Treasury discussions. He stated "there's no perfect science to this thing…You need to balance risk versus what the firm needs, but it was Treasury's money." As part of the program that would later become known as TIP, Treasury would provide $20 billion in capital to Citigroup on December 31, 2008, and in return receive $20 billion in preferred stock and warrants to purchase common stock.

Citigroup Receives the Government's Term Sheet

On the afternoon of November 23, 2008, Government representatives returned a term sheet (see Appendix J) to Citigroup that reflected the asset guarantee and additional capital assistance described above. It differed substantially from the original Citigroup proposal. Citigroup executives were concerned that the Government's terms were very expensive in light of the amount of assistance provided, and Vice Chairman Kelly noted that "many people" in Citigroup's management recommended against accepting the proposal. Nevertheless, Citigroup ultimately agreed to the terms late Sunday night. According to Vice Chairman Kelly, Citigroup accepted the deal because it provided substantial capital relief by reducing the company's total risk-weighted assets and strengthening the company's key capital ratios. Kelly further emphasized that the deal would dramatically improve the market's perception of Citigroup's viability.

Citigroup CEO Pandit also told SIGTARP that, in his view, the purpose of the Government assistance was to help restore market confidence in Citigroup. On Sunday, November 23, 2008, at 11 p.m., Treasury released a joint statement with the Federal Reserve and FDIC describing the package of guarantees and capital (see Appendix D for the complete text of the statement). See Figure 4 below for a depiction of what Citigroup proposed to the Government early on the morning of Saturday, November 22, 2008, compared to what the Government's term sheet proposed when provided to Citigroup on Sunday, November 23, 2008.

An FRBNY official noted that the timing for an agreement was crucial, as Citigroup had to announce that the Government was guaranteeing the tail risk, or unknown losses, of the assets before the markets opened in Asia between 7 p.m. and 8 p.m. EST. According to the official, the term sheet worked by "convincing the skittish market that the Federal Government was taking the risk, even though the risk really remained with Citigroup," because the Citigroup loss position was greater than anticipated losses. While the parties failed to meet that deadline, the announcement was made within hours of the opening of the Asian markets.

On November 24, 2008, the first trading day after the Government announcement, several market indicators reversed their adverse trends from the previous week. For example, Citigroup's stock price increased from $3.77 to $5.95 a share, temporarily reversing the stock's downward trend. At the same time, Citigroup's credit default swap spread, or the price of insuring its debt, declined from 4.6% to 3.6%.

Continuing Concerns About Citigroup

Not all Government participants were convinced that the Government's proposed plan would be sufficient. "I don't think this [additional assistance] is going to fix Citi. And unless you figure out a way to stabilize the situation, we are going to be back in here writing more checks," FDIC Chairman Bair noted during the FDIC Board systemic risk discussions about Citigroup on November 23, 2008. "We all need to be realistic about some of the underlying problems at this institution. It's not just because the market is having problems; this institution has some problems very specific to itself…We all need to work together on how we need to fix that."

Citigroup's problems had been well documented by its regulators prior to Citi Weekend. A Memorandum of Understanding ("MOU") with Citigroup, written by FRBNY and dated May 27, 2008, required Citigroup to create a risk management plan. This required Citigroup to, among other things, "strengthen risk monitoring practices and management information systems that identify and measure on- and off-balance-sheet risk exposures to ensure accurate, timely, and frequent reporting of information to the board of directors and senior management…." This was to include, but not be limited to, "risk exposures of the business lines; aggregation of risks on a consolidated basis across all business lines and activities; reports on deviations from established risk limits and risk management objectives; reports on new and emerging risks; and reports to identify adverse trends." Also, OCC had, and continues to have, a comprehensive MOU (signed June 10, 2008) with Citibank including required upgrades to risk management. Even several months after Citi Weekend, regulators continued to express concern about Citigroup. In an email to Citigroup's regulators on February 22, 2009, Chairman Bair emphasized FDIC's view that Citigroup required "greater senior management bank experience" and the need for management changes "at the top of the house."

FIGURE 4
CITIGROUP'S PROPOSAL VS. GOVERNMENT'S TERM SHEET

Citigroup Proposal (November 22, 2008)

Non-Cash	Cash
• $306 Billion Asset Pool Guarantee. • Government to accept 100% of losses on asset pool. • Government to receive compensation for the guarantee in the form of $20 billion in preferred shares with a 5% dividend, redeemable at Citigroup's option in five years as cash or common stock.	No Capital Infusion

Government Term Sheet (November 23, 2008)

Non-Cash	Cash
• $306 Billion Asset Pool Guarantee. • Citigroup to accept the first loss position with a deductible of $29 billion plus existing reserves, for a total of $37 billion. Losses in excess of Citigroup's deductible shared by the Government (90%) and Citigroup (10%). Treasury to accept the second loss position up to $5 billion. FDIC to accept the third loss position up to $10 billion. FRBNY to provide a non-recourse loan equal to the 90% of the value of the remaining assets in the pool at the Overnight Index Swap Rate plus 300 basis points after the first $56 billion in losses. • Government to receive a premium of $7 billion in preferred shares with an 8% dividend.	$20 Billion Capital Infusion (in the form of preferred stock with an 8% dividend)

Source: Citigroup email to FRB.

Changes to the Guaranteed Portfolio and Conversion of the Government's Preferred Stock

This section discusses how the Government's asset criteria affected the composition of Citigroup's asset pool. The timeframe for finalizing the asset pool was governed by the Asset Guarantee Program's Master Agreement, which was signed on January 15, 2009. This section also discusses Treasury's decision to modify its original agreement and allow Citigroup to convert the preferred stock Treasury received from Citigroup into a combination of common stock and trust preferred securities.

After the Government and Citigroup announced their preliminary agreement on the framework of the $306 billion asset pool guarantee on November 23, 2008, the parties still needed to negotiate and sign a Master Agreement and agree upon the assets covered by the guarantee. Citigroup analyzed the asset pool that it had proposed over Citi Weekend and set its value at $307.2 billion. In subsequent discussions, the Government defined a set of criteria, which it called "filters," that qualified individual assets for the guaranteed portfolio. Application of these criteria, along with accounting adjustments, led to approximately $100 billion in changes from the originally proposed asset portfolio.

From November 24, 2008, through December 6, 2008, the Government agencies discussed with each other the unique concerns that they had, including the intent, previously discussed with Citigroup, to exclude foreign assets from the pool, and determined a collective strategy for concluding a Master Agreement with Citigroup. An FRBNY official noted that during the initial meeting in person with Citigroup officials on December 6, 2008, the Government instructed Citigroup to await documentation of the specific terms of the agreement, and noted that the Government would allow little if any negotiation of the terms.

On December 23, 2008, the Government's representatives provided Citigroup with a draft of the asset pool agreement. According to Citigroup, although it had already started discussing asset criteria with the Government, this was the first time Citigroup received any written guidance on the types of assets eligible for the guaranteed pool. The asset criteria in the draft agreement specified that:

1. each asset be owned by a Citigroup affiliate and have been included on its balance sheet as of the beginning of Citi Weekend (November 21, 2008);

2. no foreign assets could be included;

3. no equity securities (such as shares of stock in other entities) or derivatives of such equity securities could be included;

4. all assets in the pool were to have been issued or originated before March 14, 2008; and

5. Citigroup and its affiliates could not be the obligor[48] of any assets.

Later, a sixth criterion was added: "The assets were not to be guaranteed by any Governmental authority pursuant to another agreement." Based on these criteria, Citigroup performed an iterative asset-swapping

[48] An obligor is the person or entity who owes an obligation to another, as one who must pay a promissory note.

process that occurred mostly before the execution of the definitive agreement on January 15, 2009.[49] During this process, with the review and approval of the Government, Citigroup removed assets that had originally been designated for the pool and replaced them with other assets. Driven by the criteria (as well as by what Citigroup excluded for other reasons[50] and accounting adjustments), these substantial changes to the composition of the pool reduced the value of the pool from $307.2 billion[51] to $300.79 billion (see Table 2 below). The majority of the approximately $102.16 billion of asset reductions from the original Citigroup-proposed asset pool were assets considered ineligible per the Government's criteria. These assets were replaced with $95.75 billion of new assets. During this screening and replacement, the Government initiated a due diligence review[52] to gain comfort with Citigroup's processes and hired PricewaterhouseCoopers LLP ("PwC") and BlackRock for that purpose.

TABLE 2

CHANGES TO ASSET POOL BETWEEN 11/21/2008 AND 1/15/2009
($ BILLIONS)

Citigroup Initial Proposal	Asset Pool Reductions	Assets Added to Pool	1/15/2009 Pool
$307.20	$(102.16)	$95.75	$300.79

Source: Citigroup.

After January 15, 2009, according to data provided by Citigroup officials, accounting adjustments of replacement asset balances further reduced the pool balance by a net $1.2 billion, and confirmation process adjustments increased the pool balance by a net $1.35 billion. FRBNY also stated that the Government objected to, and Citigroup removed, $2.26 billion of assets that failed the Government's asset criteria. Citigroup replaced these with $2.26 billion of new assets. In addition, FRBNY told SIGTARP that Citigroup was permitted to remove an additional net $200 million of assets from the pool because their inclusion would have been overly burdensome from an operational perspective. While the Government permitted these removals, it considered them to be voluntary (*i.e.*, excluded for reasons other than failing the eligible asset criteria) and, therefore, ineligible for replacement. On November 17, 2009, almost one year after Citi Weekend, and just 36 days before AGP was terminated, the asset pool was finalized at $300.75 billion.[53]

[49] On January 15, 2009, after consulting with Chairman Bernanke, Secretary Paulson signed a determination, in connection with Section 3(9)(B) of EESA, which allowed non-mortgage-related Citigroup assets to be eligible for inclusion into the AGP.

[50] FRBNY explained to SIGTARP that an overwhelming majority of the excluded assets were excluded because they did not meet one of the asset criteria (*e.g.*, the date criterion). A small group of CDOs was excluded because Citigroup viewed them as problematic and believed it did not make business sense to include them because they had been marked down already. The Government did not allow Citigroup to replace that group of excluded CDOs with other assets.

[51] According to the terms of the January 15, 2009, Master Agreement, the size of the asset pool was limited to $301 billion.

[52] FRBNY signed contracts with the accounting firm PricewaterhouseCoopers ("PwC"), effective December 1, 2008, and the asset management firm BlackRock, effective December 14, 2008, to perform due diligence procedures on the assets comprising the asset pool in accordance with the terms of the Master Agreement. PwC was primarily responsible for examining Citigroup's valuation processes and testing assets in the ring-fence for compliance with the Government's asset criteria. BlackRock performed loss projections on assets in the pool under a variety of different economic scenarios to determine whether Citigroup's $39.5 billion deductible (*i.e.*, first loss position) was adequate. The size of the asset pool and time constraints required extending the review process beyond the date on which the Master Agreement was executed.

[53] When SIGTARP proposed to publish the final, asset-level, list of assets in the pool, Citigroup objected on the ground that doing so would negatively affect its ability to sell those assets. Without conceding that Citigroup's concerns are well-founded, SIGTARP, in an abundance of caution, has decided to honor Citigroup's request.

Two criteria were responsible for the majority of asset removals:

- **Foreign asset criterion** – A Federal Reserve official noted that the Government's representatives worried about the prospect of political fallout from using public funds to support foreign obligors.[54] Furthermore, the Federal Reserve expressed concern about the possible difficulties it could face as a creditor in perfecting[55] its interests in foreign collateral.[56]
- **Origination date criterion** – The Government excluded all assets originated after March 14, 2008, as required by Section 102 of EESA.

One OCC examiner told SIGTARP that Citigroup did not have sufficient information from its computer systems about all the assets, and did not have the capacity to readily aggregate global data. As a result, Citigroup was not able to provide regulators with effective information about all of the assets during the initial review over Citi Weekend. Nor was it subsequently able to determine whether some of the originally proposed assets met the asset criteria. Similarly, PwC told SIGTARP it faced problems testing the asset pool, particularly in extracting data from Citigroup's many different computer systems across several different entities. However, almost one year after Citi Weekend, on November 17, 2009, the Government was finally confident that the assets that did not meet its criteria had been excluded from the pool.

Citigroup's Rationale for Including Specific Assets

According to Citigroup officials, Citigroup's originally proposed asset guarantee pool mainly included categories of assets that had been the center of negative public and media attention. Generally, the market was concerned about CDOs, consumer mortgages, commercial real estate, and auto loans. Large portfolios of loans and securities in these categories therefore made up the majority of the asset pool that Citigroup originally submitted over Citi Weekend. Within the originally submitted ring-fence pool, Citigroup generally included entire portfolios of loans and securities, seeking to avoid the perception that Citigroup was selecting individual bad loans and securities for the pool.[57] Table 3 below details the asset class composition of the originally proposed portfolio and how it had changed by the time the portfolio was finalized.

In response to the Government-imposed asset criteria and other accounting adjustments, by the time the asset pool was finalized, Citigroup had removed from the asset pool proposed over Citi Weekend all $12.17 billion of the proposed CDOs. Citigroup also reduced proposed commercial real estate by $17.44 billion,[58] and reduced proposed loans to auto companies by $24.28 billion.[59] Citigroup also removed $17.09 billion of originally submitted consumer mortgages and replaced them with an additional $39.21 billion in other consumer mortgages. Ultimately, when the asset pool was finalized at $300.75 billion in November 2009, approximately $100 billion in changes from the initially proposed assets had been made. In response to the asset exclusions, Citigroup substituted $98 billion of assets into the pool,

[54] EESA did not prohibit purchasing or protecting foreign assets.
[55] Security interest in an asset (mortgaged as collateral) protected from claims by other parties.
[56] Exceptions were listed in the Master Agreement's definition of "Foreign Assets."
[57] One FRBNY official told SIGTARP the Government did not require that Citigroup submit entire portfolios of loans and securities for the asset pool.
[58] The Government criteria and accounting adjustments removed $18.14 billion of the originally submitted commercial real estate, which Citigroup replaced with an additional $0.70 billion in other commercial real estate, for a net decrease of $17.44 billion.
[59] The Government criteria and accounting adjustments removed $24.38 billion of the originally submitted loans to auto companies, which Citigroup replaced with an additional $0.10 billion in other loans to auto companies, for a net decrease of $24.28 billion.

drawing the substitutions largely from asset classes perceived to be less risky. For example, Citigroup's replacement assets included $39.21 billion of generally higher quality prime-consumer mortgages and $20.69 billion of commercial loans, an asset class that had not been initially proposed.

TABLE 3

RING-FENCE PORTFOLIO ASSET EXCLUSIONS AND SUBSTITUTIONS ($ BILLIONS)

Pool Category	Original November 2008 Pool	January 15, 2009 Pool	Final November 2009 Pool	Net Changes and Adjustments
Consumer Loans and Lending Commitments				
Consumer Home Mortgage Loans	$153.00	$176.49	$175.12	$22.12
Retail Auto Loans	$19.70	$16.15	$14.98	$(4.72)
Commercial Lending[a]	$0	$23.08	$20.69	$20.69
Consumer Lending	$0	$3.35	$2.75	$2.75
Total Consumer	$172.70	$219.07	$213.53	$40.83
Corporate Securities, Loans, and Lending Commitments				
Alt-A RMBS and Loans for Securitization[b]	$14.33	$11.69	$11.66	$(2.67)
CDOs	$12.17	$0	$0	$(12.17)
Commercial Real Estate	$36.95	$19.91	$19.51	$(17.44)
Financing to Auto Companies	$29.08	$5.73	$4.80	$(24.28)
Private Equity	$0.49	$0	$0	$(0.49)
Monoline Insurance Company Derivatives[c]	$4.45	$0	$0	$(4.45)
Structured Investment Vehicles[d]	$8.58	$6.35	$6.08	$(2.50)
Prime and Subprime RMBS, Highly Leveraged Finance, and Other	$28.45	$38.04	$45.16	$16.71
Total Corporate	$134.50	$81.72	$87.22	$(47.28)
Total Ring-Fence[e]	$307.20	$300.79	$300.75	$(6.45)

Note: Totals may not agree due to rounding.
[a] Within Citigroup's consumer banking category are loans to small and midsize companies.
[b] Loans underlying Alt-A mortgage-backed securities typically are made to borrowers with less than full documentation, lower credit scores or higher loan-to-values or borrowers that fail to meet lenders' other underwriting criteria.
[c] Derivatives receivables from monoline insurance companies hedging Citigroup's exposure to CDOs. Consistent with the no equities or derivatives criterion, the final ring-fence did not include monolines.
[d] A Structured Investment Vehicle ("SIV") is a finance company that attempts to profit from credit spreads between long-term assets, such as asset-backed securities, and short-term liabilities, such as commercial paper.
[e] The ring-fence contained $16.4 billion of RMBS in the originally proposed pool and contained $20.6 billion in the final pool.
Source: SIGTARP analysis of data provided by Citigroup in November 2009.

According to a Citigroup official, substituting higher-quality assets for some of the lower-quality assets in the pool reduced the expected loss of the guaranteed asset pool, by its internal calculations, using November 2008 assumptions, from approximately $29 billion to $19.6 billion. Although the premium that Citigroup was paying for the guarantee did not change, from Citigroup's perspective, the probability that losses from the pool would exceed Citigroup's $39.5 billion deductible was substantially reduced, as was the probability that the Government would pay Citigroup for its losses. One Citigroup official elaborated: "We were getting less from the Government for the same pay." However, "we proceeded because we were stuck with the deal."

Confirmation Process Finalizes the Asset Pool

FRBNY told SIGTARP that while there was no statutory or regulatory deadline for completing the Master Agreement, Citigroup wanted to complete it before its earnings were released in January 2009. A Master Agreement was signed on January 15, 2009, but according to FRBNY it was not feasible to finalize the assets in the pool and complete a thorough due diligence review of the assets by then. The Federal agencies involved expressed concerns over whether they could set the loss positions and pricing appropriately, or execute final documentation without a conclusive listing of assets in the guaranteed portfolio.

In response to these concerns, the Master Agreement was structured in a way that did not specify the precise value or composition of the guaranteed asset pool. Rather, it set a post-signing process for negotiating and finalizing those details, called the confirmation process. More than 10 months passed between the signing of the Master Agreement on January 15, 2009, and finalization of the asset pool on November 17, 2009. The Master Agreement governed the confirmation process, and according to its terms, the composition of the asset pool was subject to final confirmation by the Government. The Master Agreement included the following terms as to timing:

- After signing the Master Agreement on January 15, 2009, Citigroup had until April 15, 2009, to provide an asset list to the Government agencies for approval.
- The Government had 120 days, from April 15, 2009, until August 13, 2009, to complete its review of the asset pool.
- From that point, Citigroup had 30 days, until September 12, 2009, to review the assets that the Government objected to and notify the Government of any disagreements. Citigroup and the Government had another 30 days, until October 12, 2009, to discuss and resolve the disagreed upon assets.
- Citigroup had another 30 days to add assets to the guaranteed asset pool to offset asset decreases from Government objections or an aggregate change in the asset pool's value.

The parties met all but the final deadline:

- On April 15, 2009, Citigroup delivered a list of $300.95 billion in assets.
- On August 13, 2009, the Government provided Citigroup with a listing of roughly $2 billion of assets that it said did not meet the asset criteria.
- On October 9, 2009, Citigroup delivered a final listing of assets to the Government.
- On November 17, 2009, the Government finalized the composition of the guaranteed portfolio.

According to Government officials, the Master Agreement provided 10 months for the asset confirmation process because considerable time was required to verify individual assets' terms on the almost $301 billion ring-fence asset pool, compare them against the specified asset criteria, and perform the necessary due diligence.

FRBNY contracted with PwC and BlackRock to perform asset eligibility testing and valuation procedures on the asset pool. PwC was responsible for testing the assets in the ring-fence for compliance with the Government's asset criteria, and BlackRock performed loss projections on assets in the ring-fence under a variety of different economic scenarios to determine whether Citigroup's $39.5 billion deductible (*i.e.*, first loss position) was adequate. PwC and BlackRock performed most of this due diligence during the confirmation process between December 2008 and April 2009.

PwC's first objective was to understand the asset valuation control environment at Citigroup. PwC officials stated that they tested whether "the assets existed, jibed with records, and reported losses accurately," and that PwC ultimately determined that Citigroup's valuation process was reasonable. The second objective of PwC's engagement examined the governance practices Citigroup was to employ with the guaranteed assets. Governance, PwC officials told SIGTARP, meant the "policies, procedures, and people" that controlled the assets in the ring-fence, as well as various monthly and quarterly reporting requirements. PwC's third objective was to test the majority of proposed assets against eligibility criteria (*e.g.*, foreign asset exclusions and origination date requirements). This testing took place between January 16, 2009, and April 15, 2009, after the vast majority of asset substitutions had occurred. PwC reported that during this stage of the review, it did not encounter any material instances where Citigroup's assets conflicted with the asset criteria.[60]

FRBNY engaged BlackRock to project the possible losses for the finalized asset pool, estimating both the expected losses (called the base scenario) and a more severe loss level that was less likely to occur (called the stress scenario). An FRBNY official told SIGTARP that the first loss projection agreement with BlackRock covered all work through the finalization of the asset pool on November 17, 2009. An amendment to the first agreement was subsequently negotiated in order to cover ongoing loss projections, made on a quarterly basis, after the finalization of the asset pool.[61]

On March 5, 2009, BlackRock reported loss projections of $32.7 billion under a base scenario and $50.8 billion under a stress scenario based on the asset pool delivered as of January 15, 2009.[62] An FRBNY official told SIGTARP that FRBNY felt comfortable with Citigroup's $39.5 billion deductible based on these projected losses, which suggested that even under a stress scenario, while Treasury and FDIC would be exposed to losses, FRBNY would not. After this report, BlackRock continued to work on loss projections for the final asset pool. The FRBNY official stated that if the Government saw that "things had changed," based on BlackRock's final pool loss projections, the Master Agreement allowed the Government one immediate opportunity to either increase Citigroup's deductible to more than $39.5 billion, change the assets in the pool to get a pool with loss projections that support a $39.5 billion deductible, or increase the compensation Treasury and FDIC received in exchange for their loss positions. According to the official, the asset guarantee was terminated before BlackRock completed its loss projection on the finalized asset pool, and FRBNY informed BlackRock to discontinue its loss projection process on December 14, 2009, and formally terminated its contract on December 23, 2009.

Citigroup and Treasury Agree to Exchange Preferred Securities for Common and Trust Preferred Securities

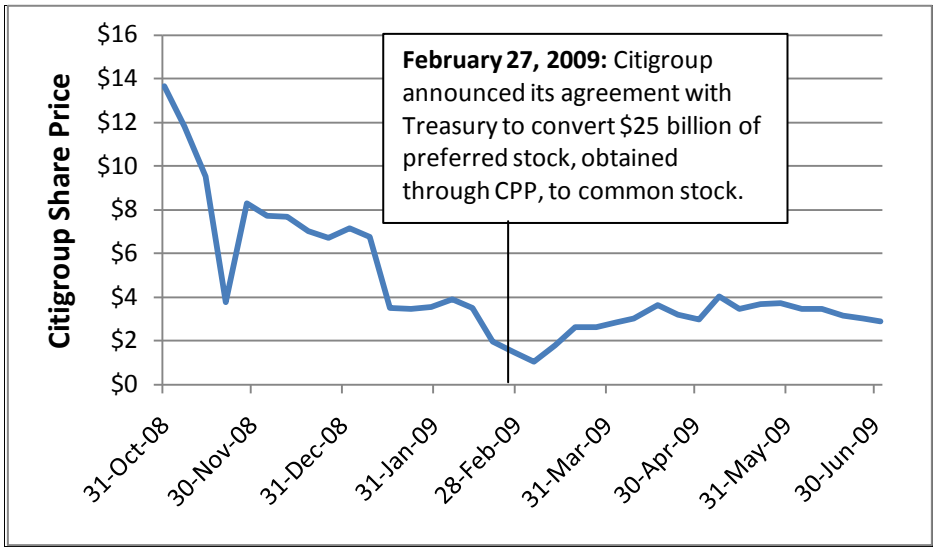
Even after the Government invested an additional $20 billion of preferred equity on December 31, 2008, under what became known as TIP, Citigroup's stock price continued to decline (see Figure 5), and fell below a dollar per share in March 2009. According to OCC examiners, the market viewed the $45 billion of TARP preferred equity as the equivalent of debt and wanted Citigroup to be infused with common equity.

[60] Treasury also performed some independent verification on the final asset pool separate from PwC. Treasury's additional review compared the changes from the April 15, 2009, ring-fence asset pool listing to the final asset pool listing, and substantiated the information received from PwC.

[61] The quarterly loss projection engagement was rendered moot when the Citigroup portfolio guarantee agreement was terminated December 23, 2009.

[62] During Citi Weekend, on-site interagency staff estimated embedded credit losses of the asset pool to be $38 billion.

FIGURE 5
CITIGROUP STOCK PRICE (OCTOBER 31, 2008 – JUNE 30, 2009)



Note: Citigroup's stock price bottomed out on March 5, 2009, at $0.97 per share.
Source: SIGTARP analysis of Citigroup data.

Citigroup and Treasury each announced on February 27, 2009, that to bolster Citigroup's Tangible Common Equity ("TCE")[63] without additional monetary assistance, Treasury had agreed to exchange up to $25 billion of preferred stock obtained under CPP for common stock at $3.25 per share.

The agreement was entered into on June 9, 2009, and the exchange took place on July 23, 2009, and July 30, 2009, with Treasury receiving $25 billion of Citigroup common stock equivalent. This common stock equivalent converted to 7,692,307,692 shares of common stock. After the exchange was completed, Treasury was the largest single shareholder of Citigroup, holding approximately 33.6% of Citigroup common stock. A more detailed description of the decision-making process that led to the conversion of the preferred shares of stock that Treasury received through CPP to common equity will be included in SIGTARP's upcoming audit on the CPP exit process.

In addition to the exchange of $25 billion of its preferred shares obtained under CPP, on July 30, 2009, Treasury also exchanged its preferred stock investment in Citigroup acquired under TIP and AGP for new trust preferred securities,[64] which strengthened some of Citigroup's key capital ratios. According to Treasury, the new securities had "greater structural seniority" than the existing preferred stock; for example, they had a more senior claim in bankruptcy and Treasury would continue to collect its dividend. They paid an annual coupon rate of 8% and were scheduled to mature in 2039.

After the exchanges, Treasury's holdings of Citigroup securities consisted of the following:

[63] TCE, as defined by Citigroup, represents common equity minus goodwill and intangible assets, other than Mortgage Servicing Rights, net of related deferred taxes. Other companies may calculate TCE differently.
[64] A trust preferred security is a security that has both equity and debt characteristics, created by establishing a trust and issuing debt to it.

- **Capital Purchase Program Investment:** The preferred shares worth $25 billion (25,000 preferred shares at $1 million per share) obtained through CPP were converted into $25 billion in Citigroup common shares (approximately 7.7 billion common shares at $3.25 per share); Treasury also still held the original warrants it had received under CPP to purchase 210,084,034 common shares at a strike price of $17.85 per share.

- **Targeted Investment Program:** The Citigroup preferred shares worth $20 billion obtained through TIP were converted into $20 billion of Citigroup trust preferred securities; Treasury also still held the original warrants it had received under TIP to purchase 188,501,414 common shares at a strike price of $10.61 per share.

- **Asset Guarantee Program Investment:** The Citigroup preferred shares worth $4.03 billion obtained through AGP were converted into trust preferred securities; Treasury also still held the original warrant it had received under AGP to purchase 66,531,728 common shares at a strike price of $10.61 per share.[65]

[65] FDIC's $3.025 billion in preferred shares were similarly converted to trust preferred securities.

Citigroup's Request to Leave TIP and AGP

This section presents the events between September 11, 2009, and December 31, 2009, and the basis for the Government's decision to allow Citigroup to repay TIP and terminate AGP.

The conditions of Citigroup's TIP repayment were governed, in part, by the American Recovery and Reinvestment Act of 2009, which provides that once an institution notified Treasury that it wanted to repay its TARP investment, Treasury had to permit repayment, after consulting the appropriate federal banking agency. According to Treasury guidance, financial institutions seeking to repay TARP are subject to the existing supervisory procedures for approving redemption requests for capital instruments. When assessing a redemption request, bank regulators consider the institution's soundness, capital adequacy, and ability to lend. Regulators also confirm that the institution has a comprehensive internal capital assessment process. Only after regulators are convinced that a TARP recipient is ready to redeem outstanding preferred stock will they permit a bank to do so.

FRBNY is the supervisor of Citigroup and had the responsibility to review Citigroup's repayment proposal, while FRB had final approval authority. The primary method that FRBNY ultimately used to determine Citigroup's condition was a stress test akin to one performed in the Supervisory Capital Assessment Program ("SCAP") in March 2009 and April 2009 (see box). FRB also obtained recommendations from other regulatory agencies, such as FDIC and OCC, on whether to approve or reject Citigroup's request to redeem its Treasury capital. On September 11, 2009, Citigroup CEO Pandit met with FRBNY President William Dudley and other officials to discuss repayment of the TIP investment. The purpose of the meeting was for Citigroup to present its financial condition, including the results of an internal Citigroup stress test. While Citigroup's presentation offered material information about its financial condition, FRB concluded that the information was not of sufficient depth to determine whether or not Citigroup was in a condition to repay TIP and terminate AGP. Following this meeting – and largely because of it – FRB took steps to perform a second stress test, carried out largely by FRBNY, with the intent of completing it by late November 2009 in time for Citigroup to be able to execute in mid-December the capital raise that would be needed to repay the TIP investment and terminate AGP.

Following Citigroup's September 11 meeting, FRB told Citigroup to wait until the agency had issued additional guidance to all bank holding companies, including Citigroup, which had participated in the original SCAP stress tests and were still in the TARP program. On October 20, 2009, and October 23, 2009, Secretary Geithner met with FRB Chairman Bernanke, FDIC Chairman Bair, OCC Comptroller

Supervisory Capital Assessment Program

In early 2009, Treasury and the Federal Reserve announced that the Government would test the economic health of Citigroup and 18 other bank holding companies to judge whether they had enough capital to withstand losses while continuing lending, even in a worsening economy. SCAP "stress tests" used two macroeconomic scenarios: one in which the crisis continued as most economists were projecting at that time, and one in which the crisis worsened beyond most projections.

According to FRBNY officials, AGP guarantees had little effect on how Citigroup fared in the tests. The tests estimated that under the more adverse scenario, Citigroup would require an additional $5.5 billion in common equity. Citigroup ultimately met the $5.5 billion additional capital condition in a pre-existing capital exchange program, which was executed in July 2009.

Dugan, FRBNY President Dudley, and other representatives of the federal financial regulatory agencies and discussed guidance on the terms of repayment for the SCAP institutions remaining in TARP, as well as the financial conditions of those institutions.

On November 3, 2009, FRB issued additional guidance[66] that detailed the steps a recipient had to take to repay its TARP assistance. The guidance included maintaining sufficient capital levels after repaying Treasury and demonstrating the ability to access long-term debt markets without the use of FDIC's Temporary Liquidity Guarantee Program ("TLGP").[67] The guidance also stipulated that recipients could expedite their repayments by agreeing to raise at least $1 of new common equity for every $2 of Treasury capital redeemed. On November 5, 2009, an FRBNY official met with Citigroup CEO Pandit and Citigroup's Chief Financial Officer. During this meeting, the FRBNY official informed Citigroup management that Citigroup would have to repay its TIP capital with a larger proportion of newly raised common equity than other SCAP bank holding companies.

On November 9, 2009, FRBNY and others from the Federal Reserve System began performing a repayment stress test on Citigroup to determine the strength of its financial condition. FRB would ultimately use the results of this stress test to decide whether to accept or reject the proposals later made by Citigroup to exit TIP and AGP. The repayment stress test used the format and process of the original SCAP stress test, but several data inputs were updated. For example, the original SCAP stress test used Citigroup financial data as of December 31, 2008, while the repayment stress test used financial data as of September 30, 2009. The worst-case unemployment rate used in the stress test was increased from 10.4% to 11.1% to reflect an increase in the actual unemployment rate from 8.9% in April 2009 to 10% in November 2009. While actual housing prices had risen during that period, the worst-case forecast for housing prices in the repayment stress test was maintained at the same level used in the SCAP stress test.

Factors Leading to Citigroup's Proposal for TARP Redemption

Several motivations have been suggested for Citigroup's decision to repay its TIP funds when it did. Some of these factors, such as restrictions on executive compensation, had been present since the inception of TIP. An FDIC official told SIGTARP that FDIC believed that executive compensation restrictions were one reason why Citigroup wanted to exit TIP. If Citigroup repaid the $20 billion TIP injection, Citigroup would no longer be under the restrictions on its executive compensation for companies under "exceptional

[66] In a draft of this report, SIGTARP included as appendices copies of Citigroup's final proposal to FRB, FRB's response to Citigroup repayment proposal, and the additional guidance issued to SCAP participants on November 23, 2009, on exiting TARP. In commenting on that draft, the FRB strenuously objected to our inclusion of these documents as violative of the bank supervision privilege and stated that including them, among other things, would create a "loss of trust" in FRB by supervised entities. While SIGTARP respectfully disagrees with FRB's prediction of harm and believes that exclusion of the documents unnecessarily inhibits transparency, in deference to FRB, SIGTARP has removed these documents from the report.

[67] The Temporary Liquidity Guarantee Program ("TLGP") was established in October 2008 to address "disruptions in the credit market, particularly the interbank lending market, which reduced banks' liquidity and impaired their ability to lend. The goal of the TLGP is to decrease the cost of bank funding so that bank lending to consumers and businesses will normalize." The program does not rely on the taxpayer or the deposit insurance fund, but is entirely funded by industry fees. Participating institutions may issue debt under TLGP's Debt Guarantee Program, which provided an FDIC guarantee of newly issued senior unsecured debt of participating insured depository institutions and other eligible entities. New guarantees were issued until October 31, 2009, with the debt being guaranteed until "the earliest of the opt-out date, the maturity of the debt, the mandatory conversion date for mandatory convertible debt, or December 31, 2012."

assistance," including restrictions set by the Special Master for TARP Executive Compensation.[68] An OCC official said that Citigroup's risk of losing key employees to other banks because of the restrictions was "very real."

Citigroup management also cited executive compensation as a motivating factor. CEO Pandit told SIGTARP that "keeping the team together…was a big deal for management." He also told SIGTARP that some employees in the top tiers of the firm left Citigroup and he acknowledged that executive compensation restrictions might have been a contributing factor. Citigroup Vice Chairman Kelly told SIGTARP that executive compensation was a barrier to hiring and retaining qualified managers and well-known traders "in a narrow sense." But he also told SIGTARP that improving lower-level employee morale was another motivation to pay back TIP and terminate AGP. The assistance had led Citigroup employees to ask what participation in TARP meant for the company's survival, Kelly said.

A new motivating force arose when Citigroup's peers remaining in TARP began the process of exiting the program. On Wednesday, December 2, 2009, Bank of America announced that it would redeem its TARP capital ($25 billion in CPP and $20 billion in TIP) that same month. According to FDIC officials, Bank of America's action was the catalyst for Citigroup to submit its own formal redemption proposal to FRBNY. OCC officials told SIGTARP that Citigroup's pressure to repay was "originating unquestionably from the marketplace" and from Bank of America's plan to repay its TARP funds. OCC noted that if Citigroup did not repay its TIP funds soon after Bank of America successfully repaid its TARP funds, then Citigroup might have suffered from the perception that it was a weaker institution.

Citigroup Vice Chairman Kelly told SIGTARP that Citigroup would have had a "huge competitive disadvantage" as the "only remaining large commercial bank" that had not repaid TARP. CEO Pandit told SIGTARP that "having $45 billion from the government had no positive impact on Citigroup's image," and "repaying the $20 billion, getting out of the guarantee, and Special Master, signaled that this bank has a very strong future."

Stress Test Results and Resulting Repayment Proposal

On Thursday, December 3, 2009, just one day after Bank of America announced it would redeem its TARP capital, FRBNY officials presented the results of the recently completed repayment stress test at Citigroup's executive offices to Citigroup's Chief Risk Officer and Chief Financial Officer. Citigroup was then able to take into account the results of the stress test when planning its proposal to exit TIP and AGP. According to documents obtained by SIGTARP from FRBNY, the stress test required Citigroup to maintain a Tier 1 Capital ratio of 6.0% and a Tier 1 Common ratio of 4.0% in a forecasted adverse environment. If the stress test indicated Citigroup could not maintain these ratios, then an additional capital buffer would be needed. According to FRB, Citigroup would maintain a Tier 1 Capital ratio of 6.6% and a Tier 1 Common ratio of 4.6% if the following occurred:

- Citigroup raised $21.4 billion through the issuance of common stock;
- All $20 billion TIP trust preferred securities were repaid; and
- The ring-fence agreement was canceled.

[68] Under the Interim Final Rule on TARP Standards for Compensation and Corporate Governance, Treasury created a new Office of the Special Master for TARP Executive Compensation ("Special Master"), responsible for the review and analysis of executive compensation at TARP recipient companies.

According to FRBNY, a dialogue between FRBNY and Citigroup occurred following the December 3, 2009, meeting. The two parties discussed the amount of common equity that Citigroup would be able to raise in the market environment at that time. On December 9, 2009, an FRBNY official requested written documentation from Citigroup detailing its repayment proposal. Late that day, Citigroup sent FRBNY a repayment proposal. This was the first repayment proposal following the November 2009 stress test. The proposal, and all subsequent proposals, requested to fully repay all $20 billion in Citigroup TIP trust preferred securities and to terminate Citigroup's involvement in AGP. Citigroup proposed raising capital through:

- $15 billion in common stock,
- $2.25 billion in a common stock overallotment option,[69]
- $2.5 billion in tangible equity units,[70] of which $2 billion would count as common, and
- $1 billion in employee stock options.

The cumulative common capital to be raised was estimated to be up to $20.25 billion. The proposal had a pro forma financial summary that depicted the expected impact of the repayment. The proposal stated that the portion of the $7 billion in AGP trust preferred securities that would be surrendered by the Government as a result of early termination of the guarantee would be "determined by good faith negotiations at a later date." FRBNY responded by informing Citigroup that the capital raise detailed in the proposal did not contain enough common equity.

On Thursday, December 10, 2009 – one day after Citigroup submitted the previous proposal to FRBNY – Citigroup submitted a second similar, but more conservative, proposal. The types of capital that Citigroup hoped to raise were identical, but the amounts were increased to:

- $17 billion in common stock,
- $2.55 billion in a common stock overallotment option,
- $3.5 billion in tangible equity units, of which $2.8 billion would count as common, and
- $1.7 billion in employee stock options.

The cumulative common capital raise was estimated to be up to $24.05 billion. Citigroup also reiterated its suggestion that the portion of AGP trust preferred securities to be surrendered would be negotiated at a later date. An FRBNY official told SIGTARP that at the time FRBNY considered the amount of capital to be adequate but was concerned that Citigroup might not be able to fill its overallotment option, which was dependent on future market demand. In light of this concern, FRBNY informed Citigroup that the next repayment proposal should include a clause stipulating actions that Citigroup would need to take in the event the overallotment was not sufficiently filled.

[69] An overallotment option, called a "green shoe," would allow Citigroup's underwriters to sell more common stock if the initial amount is sold out. In this case, the overallotment option allows the underwriters to sell up to 15% more than the base allotment of $15 billion, for an overallotment of $2.25 billion.

[70] The tangible equity units consisted of a stock purchase contract and a junior subordinated amortizing note. The stock purchase contract has a settlement date of December 15, 2012, and will settle for between 25.3968 and 31.7460 shares of Citigroup common stock. The amortizing notes will pay holders equal quarterly installments of $1.875 per amortizing note, totaling a 7.5% cash payment per year for each $100 of tangible equity units. The final payment is scheduled for December 15, 2012.

On Sunday, December 13, 2009, Citigroup submitted its final proposal to FRBNY. The proposed types and amounts of the capital raise in this proposal matched the December 10 proposal. Unlike previous proposals, the December 13 proposal included capital raise conditions and the amount of AGP trust preferred securities to be surrendered. Citigroup's proposal included an acknowledgment that "…if the offering of common stock and tangible equity units do not generate at least $21.3 billion of additional equity capital, the regulators would expect Citigroup to issue additional trust preferred securities in a ratio of $2 for every $1 the equity raised falls short of $21.3 billion, subject to a minimum equity raise of $19.8 billion, up to a maximum of $3.0 billion of trust preferred securities during the first quarter of 2010." Citigroup would have to fill at least $1.5 billion of the overallotment option in order to satisfy the $21.3 billion requirement. As described below, Citigroup was not able to fill the overallotment option and ultimately would raise trust preferred securities in the first quarter of 2010 to meet the capital raise requirements.

The December 13 proposal also included a provision for the Government to surrender $1.8 billion of AGP trust preferred securities in exchange for early termination of AGP, which resulted from separate negotiations with Treasury. Treasury told SIGTARP that initially Citigroup proposed a "straight-line method" by which the Government would surrender a percentage of the AGP trust preferred securities commensurate with the percentage of the original 10-year term remaining at the date of termination – roughly 90%, or $6.2 billion. Treasury considered Citigroup's "straight-line proposal" to be "entirely unacceptable."

Instead, the Government took the position that the overwhelming majority of the value of the AGP was in the first few weeks of its existence, when the guarantee helped Citigroup avoid collapse, and that therefore, only a small portion of the AGP trust preferred securities should be surrendered. Treasury also told SIGTARP that it would agree to the terms only if the transaction enhanced the value of its TARP portfolio. According to Treasury, the terms accomplished this by removing the full liability of Treasury's $5 billion loss position in the ring-fence while surrendering less than half of the corresponding $4 billion in AGP trust preferred securities. Ultimately, the Government and Citigroup came to agree that the Government would surrender $1.8 billion of the AGP trust preferred securities. Treasury surrendered $1.8 billion out of its $4 billion allocation and may also receive $800 million from FDIC upon Citigroup's exit from TLGP, described below.

The Government kept the other $5.3 billion in Citigroup trust preferred securities as payment for its guarantee of the asset pool for one year. According to the final Citigroup repayment proposal submitted to FRBNY on December 13, 2009, Citigroup expected a $1.1 billion capital benefit to result from the $1.8 billion in AGP trust preferred securities that the Government surrendered. With this $1.1 billion benefit added to the expected capital raise of $24.05 billion, Citigroup expected its proposal would generate up to $25.15 billion in capital to replace the TIP capital. FRBNY and FRB staff analyzed Citigroup's final proposal and submitted their analysis to FRB's Governors.

On Monday, December 14, 2009 – one day after Citigroup submitted its final proposal – FRB sent Citigroup a letter indicating FRB approved Citigroup's final request to repay the TIP capital and terminate AGP. The letter also detailed the conditions Citigroup would need to meet to exit the two programs. On the same day, a Citigroup press release announced the approval of its repayment of TIP and termination of its involvement in AGP – just 27 days after the finalization of the asset pool.

On Wednesday, December 16, 2009 – two days after receiving approval for repayment – Citigroup priced its offering and announced the details of the corresponding capital raise, which Citigroup began executing that same day (see Appendix G). The press release said that Citigroup planned to issue 5.4 billion common shares priced at $3.15 per share, and generate proceeds of about $17 billion. Citigroup also announced the offering of 35 million tangible equity units, priced at $100 per unit. The tangible equity unit offering was to generate total net proceeds of $3.5 billion (approximately $2.8 billion of which would count as equity capital). The combined issuance satisfied the minimum initial $19.8 billion capital issuance requirement. The press release also noted that Treasury agreed not to sell any of its 7.7 billion shares of common stock for the following 90 days. "The combined offering of common stock and tangible equity units is the largest public equity offering in U.S. capital market history," Citigroup said.

On December 23, 2009, Citigroup, Treasury, FDIC, and FRBNY all signed the Termination Agreement for Citigroup's participation in AGP. That same day, Treasury and Citigroup also signed an agreement for the repayment of TIP. The Termination Agreement states: "On December 22, 2009, Citigroup completed an offering of common stock and mandatory convertible preferred stock as contemplated by the Federal Reserve Conditional Approval."

However, Citigroup did not meet the $1.5 billion overallotment option necessary to satisfy the total $21.3 billion additional equity capital requirement. Instead, Citigroup raised only $0.6 billion from the overallotment, resulting in a $0.9 billion capital shortfall and a need to raise at least $1.8 billion in additional trust preferred securities during the first quarter of 2010. Citigroup was required to raise $2 of trust preferred securities for every $1 it fell short. In March 2010, Citigroup raised $2.3 billion in trust preferred securities thereby satisfying the capital raise requirement.

TARP's Remaining Citigroup Investment

On March 16, 2010, Treasury's agreement not to sell its Citigroup common stock for 90 days expired and Treasury announced that it would sell the Citigroup common stock it held as a result of its CPP investment. Treasury had agreed not to sell Citigroup stock during those 90 days to facilitate an equity offering initiated by Citigroup on December 16, 2009, which enabled Citigroup to raise funds and exit TIP. In exchange for the 90-day lock-up period, Citigroup agreed to pay all costs associated with the sale of any securities issued to Treasury by Citigroup or any of its subsidiaries. Treasury hired Morgan Stanley as its capital markets advisor in connection with its disposition of its Citigroup common stock. On March 29, 2010, Treasury stated that, under a prearranged written trading plan, it would sell its Citigroup common shares in an "orderly and measured" fashion over the course of 2010, subject to market conditions. See Table 4 below for a list of Treasury's disposition of its entire stake of Citigroup common stock.

TABLE 4

CPP CITIGROUP COMMON STOCK DISPOSITION, AS OF 12/10/2010

Date	Number of Shares (Millions)	Average Share Price (Dollars)[c]	Gross Proceeds ($ Millions)
4/26/2010 to 5/26/2010	1,500	$4.12	$6,182.5
5/26/2010 to 6/30/2010	1,109	3.90	4,322.7
7/23/2010 to 7/31/2010 [a]	226	4.12	934.0
8/1/2010 to 8/31/2010 [a]	680	3.85	2,615.0
9/1/2010 to 9/30/2010 [a]	594	3.91	2,314.5
10/19/2010 to 12/6/2010	1,166	4.26	4,967.9
12/6/2010 to 12/10/2010	2,417	4.35	10,515.7
Total [b]	7,692	$4.14	$31,852.3

Notes: Numbers may not total due to rounding.
[a] Treasury reported in the Monthly 105(a) Report individual figures for July and August for the number of shares, average share price, and gross proceeds. The 105(a) Report did not report individual figures for September, which are calculated above by adding number of shares and gross proceeds from July and August and subtracting those figures from total number of shares and gross proceeds sold from 7/23/2010 to 9/30/2010 as reported in the September 105(a) Report. Average share price for September was calculated by dividing September gross proceeds by the number of shares.
[b] Total amounts appear for Number of Shares and Gross Proceeds. Average Share Price is an average for sales between 4/26/2010 to 12/6/2010.
[c] Average price for all sales of Citigroup common stock made by Treasury over the course of the corresponding period.
Sources: Treasury, response to SIGTARP data call, 10/21/2010; Treasury, *Transactions Report*, 9/30/2010; Treasury, "Troubled Assets Relief Program (TARP), Monthly 105(a) Report," 8/2010, Treasury, *Transactions Report*, 12/8/2010 www.financialstability.gov/docs/105CongressionalReports/August%202010%20105(a)%20Report_final_9%2010%2010.pdf, accessed 9/29/2010; Treasury, "Troubled Assets Relief Program (TARP), Monthly 105(a) Report," 7/2010, www.financialstability.gov/docs/105CongressionalReports/July%202010%20105(a)%20Report_Final.pdf, accessed 9/29/2010; Treasury, 105(a) Report, 9/30/2010; http://financialstability.gov/docs/transaction-reports/12-8-10%20Transactions%20Report%20as%20of%2012-6-10.pdf, accessed 12/9/2010, Treasury, 105(a) Report, 12/6/2010.

On September 29, 2010, Treasury entered into an agreement[71] with Citigroup to exchange the entire $2.234 billion in Citigroup trust preferred securities that it held under AGP for new trust preferred securities. Because the interest rate necessary to receive par value was below the interest rate paid by Citigroup to Treasury, Citigroup increased the principal amount of the securities sold by Treasury an additional $12 million and thereby enabling Treasury to receive total gross proceeds of $2.246 billion from the sale of the Citigroup trust preferred securities, which occurred on September 30, 2010. This sale did not include the $800 million in AGP trust preferred securities held by FDIC for Treasury's benefit. FDIC is required to turn over those securities to Treasury unless it incurs losses on Citigroup debt that was guaranteed by FDIC under the TLGP. The sale also did not include the warrants for Citigroup's common stock that were issued as part of Citigroup's participation in AGP and other Treasury programs. Any proceeds from the ultimate sale of those securities will represent additional gains to the taxpayer.

[71] As part of its agreement to facilitate the sale of Treasury's trust preferred securities, Citigroup agreed to either increase the interest rate on the new trust preferred securities so that Treasury would receive par value for the sale or increase the aggregate principal amount of the securities to conform to what otherwise would be considered a premium to par, if the interest rate necessary to sell at par value was below the interest rate paid by Citigroup to Treasury prior to the sale.

TABLE 5

TREASURY'S CITIGROUP HOLDINGS AS OF DECEMBER 10, 2010

TARP Program	Number of Shares of Common Stock	Common Stock Warrants for Number of Shares (Millions)	Trust Preferred Securities (at Par Value)
CPP	-	210.1[a]	-
AGP	-	66.5	-
TIP	-	188.5	- [b]

Note: Numbers affected by rounding.
[a] On 6/9/2009, Treasury entered into an agreement with Citigroup to exchange up to $25 billion of Treasury's CPP investment in Fixed Rate Cumulative Perpetual Preferred Stock, Series H (CPP Shares) "dollar for dollar" in Citigroup's Private and Public Exchange Offerings. On 7/23/2009 and 7/30/2009, Treasury exchanged a total of $25 billion of the CPP shares for Series M Common Stock Equivalent ("Series M") and a warrant to purchase shares of Series M. On 9/11/2009, Series M automatically converted to 7,692,307,692 shares of common stock and the associated warrant terminated on receipt of certain shareholder approvals.
[b] Treasury is also entitled to receive up to $800 million in TruPS® held by FDIC that FDIC is required to turn over to Treasury unless it incurs any losses on debt of Citigroup guaranteed by FDIC under the Temporary Liquidity Guarantee Program.
Source: SIGTARP analysis of data.

According to Treasury, it has realized a profit of approximately $12 billion[72] over the course of Citigroup's participation in AGP, TIP, and CPP.

[72] According to Treasury's most recent transactions report and dividends and interest report (http://www.financialstability.gov/latest/reportsanddocs.html), the total amount of cash inflows Treasury has realized to date in excess of its cash outflows is $12.04 billion. Treasury is also scheduled to receive $800 million in trust preferred securities from FDIC after it extinguishes the TLGP (reduced by any losses in the program in connection with Citigroup's participation) and additional proceeds from selling its Citigroup warrants. The $12.04 billion includes $6.85 billion in CPP gains; $2.25 billion in AGP proceeds; and $2.94 billion in dividends.

Conclusions

In November 2008, Citigroup teetered on the brink of failure. Even though it had received $25 billion from TARP's Capital Purchase Program just weeks earlier, it was the subject of a global run on its deposits, its stock was in a nosedive as short sellers sought to profit on the market's perception of its deteriorating condition, and the cost of insuring its debt in the credit default swap market was increasing at an alarming pace compared to its peers. Worried that Citigroup would fail absent a strong statement of support from the U.S. Government, and that such failure could cause catastrophic damage to the economy, then-Treasury Secretary Henry Paulson and then-FRBNY President Timothy Geithner held a series of discussions with FRB Chairman Ben Bernanke, FDIC Chairman Sheila Bair, and then-Comptroller of the Currency John Dugan to discuss bailing out Citigroup. The underlying premise of these discussions was that Citigroup was too systemically significant to be permitted to collapse. According to Chairman Bernanke, it was "not even a close call to assist them."

By late on November 23, 2008, following a frantic few days dubbed by its participants as "Citi Weekend," Citigroup had agreed to a Government proposal that would provide Citigroup a package that included asset guarantees and a $20 billion capital infusion in exchange for preferred shares of Citigroup stock. The essential purpose of the deal, as Secretary Paulson and FRBNY President Geithner later confirmed to SIGTARP, was to assure the world that the Government would not let Citigroup fail. After the deal was announced, the impact on the market's perception of Citigroup was immediate: its stock price stabilized, its access to credit improved, and the cost of insuring its debt declined. Citigroup had been saved, at least for the time being. Just over a year later, Citigroup terminated the guarantee program and repaid the $20 billion of Government-supplied capital.

SIGTARP found that the Government constructed a plan that not only achieved the primary goal of restoring market confidence in Citigroup, but also carefully controlled the overall risk of Government loss on the asset guarantee. Citigroup's initial proposal, which would have had the Government guarantee 100% of $306 billion of troubled assets in return for $20 billion in preferred stock, was summarily rejected. Instead, the Government made a take-it-or-leave-it proposal that required Citigroup to absorb the first $37 billion[73] in losses in the asset pool as well as 10% of any losses in excess of that amount in return for approximately $7 billion in Citigroup preferred stock. The Government's risk of loss, in other words, was dramatically less than it would have been under the Citigroup proposal. Indeed, based on various loss projections, the relevant Government actors – Treasury, FDIC, and FRBNY – believed that Citigroup's initial loss position would render any Government loss unlikely. In the end, Citigroup absorbed all of the losses among the guaranteed assets, which totaled $10.2 billion at the time of the termination of the asset guarantee, far less than Citigroup's "deductible."

As one FRBNY official explained to SIGTARP, the deal was structured to "convinc[e] the skittish market that the Federal Government was taking the risk, even though the risk really remained with Citigroup," because the Citigroup loss position ultimately exceeded anticipated losses. In addition to the asset guarantee, the Government also insisted on a $20 billion capital injection in return for preferred stock, even though Citigroup did not request such an injection. Here, too, the focus was on sending a message to reassure the markets – the Government would not let Citigroup fail.

[73] This was later raised to $39.5 billion.

That the Government drove a particularly hard bargain on behalf of taxpayers was reflected in the reaction of many within Citigroup. Citigroup executives were concerned that the Government's terms were too expensive in light of the assistance provided, and some Citigroup insiders recommended against accepting the proposal. In the end, however, Citigroup accepted the deal, chiefly because of its expected impact on the market's perception of Citigroup's viability.

While the parties announced their preliminary agreement on the framework of the asset pool guarantee on November 23, 2008, they did not finalize the list of assets covered by the guarantee until almost one year later. The eventual selection of assets for inclusion in the pool was driven largely by Government-imposed criteria, the application of which, along with accounting adjustments, led to approximately $100 billion in changes from the assets originally proposed by Citigroup. These changes had the effect of reducing the expected loss of the guaranteed asset pool, according to Citigroup's internal calculations, by over $9 billion. As a result, the likelihood that the Government would have to cover losses on the guarantee was reduced even further. As one Citigroup official explained, "We were getting less from the Government for the same pay, [but] we proceeded because we were stuck with the deal."

From the perspective of minimizing taxpayer risk on the asset guarantee transaction itself, the deal with Citigroup looks even better with hindsight. Citigroup did not fail, and the global economy avoided the catastrophic financial collapse that many feared would flow from a Citigroup failure. And while the transactions hardly solved all of Citigroup's problems – just months later the Government was compelled to significantly restructure its ownership interest in a manner that left Treasury as Citigroup's single largest common stockholder – the Government incurred no losses, and even profited on its overall investment in Citigroup by more than $12 billion. Nevertheless, two aspects of the Citigroup rescue bear noting.

First, the conclusion of the various Government actors that Citigroup had to be saved was strikingly ad hoc. While there was consensus that Citigroup was too systemically significant to be allowed to fail, that consensus appeared to be based as much on gut instinct and fear of the unknown as on objective criteria. As Secretary Paulson stated on one of the Citi Weekend conference calls, "If Citi isn't systemic, I don't know what is." FDIC Chairman Bair told SIGTARP that "we were told by the New York Fed that problems would occur in the global markets if Citi were to fail. We didn't have our own information to verify this statement, so I didn't want to dispute that with them." Another FDIC official told SIGTARP that in terms of Citigroup's systemic significance, the FDIC directors and other Government entities "made a judgment call." Citigroup CEO Vikram Pandit summed up the feeling at the time when he told SIGTARP that no one knew what the systemic effects of a Citigroup failure would be, and that no one wanted to find out.

Given the urgent nature of the crisis surrounding Citigroup, the ad hoc character of the systemic risk determination is not surprising, and SIGTARP found no evidence that the determination was incorrect. Nevertheless, the absence of objective criteria for reaching such a conclusion raised concerns. Then-Director of the Office of Thrift Supervision John Reich, at FDIC's Board meeting on November 23, 2008, in which FDIC made its determination to proceed with the Citigroup transactions, observed that there had been "some selective creativity exercised in the determination of what is systemic and what's not," and that there "has been a high degree of pressure exerted in certain situations, and not in others, and I'm concerned about parity." Concerns about "selective creativity" and "parity" could be addressed at least in part by the development, in advance of the next crisis, of clear, objective criteria and a detailed road map as to how those criteria should be applied.

Secretary Geithner told SIGTARP that he believed creating effective, purely objective criteria for evaluating systemic risk is not possible: "What size and mix of business do you classify as systemic?…It depends too much on the state of the world at the time. You won't be able to make a judgment about what's systemic and what's not until you know the nature of the shock" the economy is undergoing. Secretary Geithner also suggested that whatever objective criteria were developed in advance, markets and institutions would adjust and "migrate around them." If the Secretary is correct, then systemic risk judgments in future crises will again be subject to concerns about consistency and fairness, not to mention accuracy. The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") created the Financial Stability Oversight Council ("FSOC") and charged it with responsibility for developing the specific criteria and analytical framework for assessing systemic significance. That process is under way, with FSOC having invited public comment on those issues. SIGTARP remains convinced that even if some aspects of systemic significance are necessarily subjective and dependent on the nature of the crisis at the time, an emphasis on the development of clear, objective criteria in advance of the next crisis would significantly aid decision makers likely to be burdened by enormous responsibility, extreme time pressure, and uncertain information. Moreover, FSOC must be transparent about how it will apply both objective and subjective criteria to a failing institution, and must seek to gauge the market and adjust the criteria in the event that firms do indeed seek to "migrate around them." Without minimizing the legitimate concerns raised by Secretary Geithner, it is imperative that FSOC not simply accept the adaptability of Wall Street firms to work around regulation, but instead maintain the flexibility to respond in kind.

Second, the Government's actions with respect to Citigroup undoubtedly contributed to the increased moral hazard that has been a direct byproduct of TARP. While the year-plus of Government dependence left Citigroup a stronger institution than it had been, it remained, and arguably still remains, an institution that is too big, too interconnected, and too essential to the global financial system to be allowed to fail. Indeed, a senior FRBNY official told SIGTARP in January 2010 (before the passage of the Dodd-Frank Act), that Citigroup was then still "too big to fail," and that if history repeated itself there is "no question we would do it again...[with] a similar or different program." Citigroup's creditors and counterparties were left largely unscathed by its need for repeated assistance from taxpayers, and the concern voiced by Chairman Bair on February 22, 2009, for the need for management changes "at the top of the house" at Citigroup, arguably was not fully addressed. While there have been notable changes at the board level and some changes in management, some of those in Citigroup's senior management who came to the Government seeking assistance in 2008 remain in place.

When the Government assured the world in 2008 that it would use TARP to prevent the failure of any major financial institution, and then demonstrated its resolve by standing behind Citigroup, it did more than reassure troubled markets – it encouraged high-risk behavior by insulating the risk takers from the consequences of failure. Unless and until institutions like Citigroup are either broken up so that they are no longer a threat to the financial system, or a structure is put in place to assure that they will be left to suffer the full consequences of their own folly, the prospect of more bailouts will potentially fuel more bad behavior with potentially disastrous results. Notwithstanding the passage of the Dodd-Frank Act, which does give FDIC new resolution authority for financial companies deemed systemically significant, the market still gives the largest financial institutions an advantage over their smaller counterparts. They are able to raise funds more cheaply, and enjoy enhanced credit ratings based on the assumption that the Government remains as a backstop. Specifically, creditors who believe that the Government will not allow such institutions to fail may under price their extensions of credit, giving those institutions access to capital at a price that does not fully account for the risk created by their behavior. Cheaper credit is effectively a

subsidy, which translates into greater profits, giving the largest financial institutions an unearned advantage over their smaller competitors. And because of the prospect of another Government bailout, executives at such institutions might be motivated to take greater risks than they otherwise would, shooting for a big payoff but with reason to hope that if things went wrong they might still be able to keep their jobs.

The moral hazard effects of TARP in general and the bailouts of Citigroup in particular may eventually be ameliorated by full implementation of the provisions of the Dodd-Frank Act, which was intended in part to address the problem of institutions that are "too big to fail." Whether it will do so successfully remains to be seen, with important work by FDIC, FSOC, and a host of other regulators far from complete. Even after those bodies develop and implement new rules and regulations authorized by the Dodd-Frank Act, which would prohibit some of the benefits received by Citigroup under TARP, taxpayers likely won't know about the extent of their continuing exposure until the next crisis. As Secretary Geithner told SIGTARP in December 2010, with the Dodd-Frank Act, the "probability of failure is reduced because the banks hold more capital. The size of the shock that hit our financial system was larger than what caused the Great Depression. In the future we may have to do exceptional things again if we face a shock that large. You just don't know what's systemic and what's not until you know the nature of the shock. It depends on the state of the world – how deep the recession is. We have better tools now, thanks to Dodd-Frank. But you have to know the nature of the shock."

Secretary Geithner's candor about the difficulty of determining "what's systemic and what's not until you know the nature of the shock," and the prospect of having to "do exceptional things again" in such an unknowable future crisis is commendable. At the same time, it underscores a TARP legacy, the moral hazard associated with the continued existence of institutions that remain "too big to fail." It also serves as a reminder that the ultimate cost of bailing out Citigroup and the other "too big to fail" institutions will remain unknown until the next financial crisis occurs.

Management Comments and Audit Response

Treasury provided an official written response to this audit report in a letter dated January 12, 2011, which is reproduced in full in Appendix L. Treasury's response broadly concurred with the report. FDIC provided an official written response to this audit report in a letter dated January 12, 2011. FDIC's letter offers four "clarifications" to the report. While SIGTARP has not incorporated FDIC's suggested changes, the letter is reproduced in full in Appendix L. FRB stated that it intends to provide an official written response in the near future, a copy of which, if available, will be included in SIGTARP's upcoming Quarterly Report and will be added to the online version of this audit report. OCC stated that it would not be providing a formal response.

Appendix A – Scope and Methodology

We performed this audit under the authority of Public Law 110-343, as amended, which also incorporates the duties and responsibilities of inspectors general under the Inspector General Act of 1978, as amended. We initiated this audit at the request of former Congressman Alan Grayson. The audit's specific objectives[74] were to determine the basis on which the Government's decision was made to provide Citigroup with additional assistance, how the $301 billion asset pool was determined, and the basis for the decision to allow Citigroup to terminate the AGP and repay its TIP capital infusion. We performed work at Treasury's Office of Financial Stability, FRB, FDIC, and OCC in Washington, D.C. We also performed field interviews at Citigroup, FRBNY, and OCC in New York City. The scope of this audit covered documents, records, and official testimony pertaining to Citigroup's involvement in Treasury's TIP and AGP.

To determine the basis on which the Government's decision to provide Citigroup with additional assistance was made, we interviewed Treasury, FRB, FRBNY, FDIC, OCC, and Citigroup senior officials. Among those interviewed were the former Secretary of the Treasury Henry Paulson, the former Interim Assistant Secretary of the Treasury for Financial Stability Neel Kashkari, the Chairman of the Board of Governors of the Federal Reserve System Ben Bernanke, FDIC Chairman Sheila Bair, Comptroller of the Currency John Dugan, and Citigroup CEO Vikram Pandit. We also reviewed available Treasury, FRBNY, FDIC, OCC, and Citigroup documentation – including analyses, reports, memos, meeting minutes, documents, emails, press releases – pertaining to the creation of the AGP and TIP. In addition, we reviewed Sections 101 and 102 of EESA and the American Recovery and Reinvestment Act of 2009 to obtain an understanding of the legal authority given to Treasury with regard to TIP and AGP.

To establish how the $301 billion asset pool was determined, we interviewed Treasury, FRBNY, and Citigroup officials – which included former Secretary Paulson, FRBNY Chief Counsel Tom Baxter, Citigroup Vice Chairman Kelly, and Citigroup Chief Risk Officer Brian Leach – and reviewed their email exchanges to determine their roles in creating the asset pool. We also held interviews with key decision makers from FRB, FDIC, and Treasury regarding asset pool policy decisions. We also interviewed PwC and BlackRock officials. In addition, we obtained analyses and reports BlackRock prepared in conjunction with the due diligence and valuation procedures they performed on the asset pool. We also utilized several SEC filings and FRB reporting forms. We also obtained documentation including, but not limited to emails, spreadsheets, and Word documents from Treasury, Citigroup, and FRBNY that were used to determine how and why assets were selected.

[74] The objectives for this audit were updated in January 2010 to reflect the repayment of TIP and the termination of AGP, as well as to remove the risk management and internal controls objective (*i.e.*, objective 3). Objective 3 was addressed in SIGTARP's report titled "Treasury's Monitoring of Compliance with TARP Requirements by Companies Receiving Exceptional Assistance" issued June 29, 2010. The original objectives were to determine the following: (1) the basis on which the decision was made to provide asset guarantees to Citigroup, and the process for selecting the loans and securities to be guaranteed; (2) what were the characteristics of the assets deemed to be eligible to be "ring-fenced", *i.e.*, covered under the program, how do they compare with other such assets on Citigroup's books, and what risk assessment measures were considered in their acquisition; (3) are effective risk management and internal controls and related oversight processes and procedures in place to mitigate risks to the Government under this guarantee program with Citigroup; and (4) what safeguards exist to protect the taxpayer's interests in the Government's investment in the asset guarantees provided to Citigroup, and the extent of losses to date.

In addition, we reviewed the policies and procedures within the Citigroup AGP Master Agreement that Treasury, FRB, FDIC, and Citigroup agreed to follow. To determine the basis for the decision to allow Citigroup to terminate the AGP and repay its TIP capital infusion, we conducted interviews with Treasury and Citigroup officials – including Citigroup CFO John Gerspach, Vice Chairman Kelly, and Chief Counsel Michael Helfer – as well as FRBNY and OCC bank examiners. We also reviewed the results of the SCAP stress test and the stress test that FRBNY performed on Citigroup in November 2009, as well as the related documentation pertaining to the conditions under which Citigroup would be able to pay back TIP and terminate AGP. These documents included, among other things, FRBNY memos, policies, analysis, and correspondence with Citigroup.

This audit was performed in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We conducted our review from August 2009 to January 2011. We believe that the evidence obtained during this period of review provides a reasonable basis for our findings and conclusions based on audit objectives.

Limitations on Data

Some of the individuals involved in the decision to provide Citigroup with additional assistance were no longer at Treasury at the time of SIGTARP's review. As a result, SIGTARP was unable to obtain key details from Treasury behind the decision-making process to provide Citigroup with additional assistance. In addition, we relied on the judgment of the staff of Treasury, FRB, FRBNY, FDIC, OCC, and Citigroup to provide us with complete information for us to perform our review. Other data may exist that we did not have the opportunity to review.

Use of Computer-processed Data

To perform this audit, we used ring-fence data aggregated by Citigroup's Management Information Systems. To assess the extent to which these systems generate reliable outputs, we interviewed officials of PwC, the independent firm contracted by FRBNY to validate the ring-fence assets proposed by Citigroup. We reviewed the validation report that Citigroup submitted to FRBNY and found nothing material that would impede the use of Citigroup's ring-fence data on the basis of reliability.

Internal Controls

As part of our audit, we examined the Government's rationale and criteria into the decision to provide Citigroup with additional assistance. We also examined the internal controls that the Government agencies used to validate the estimates of ring-fence losses, as well as the controls over assets that were included in the ring-fence. SIGTARP interviewed officials of BlackRock and PwC, the outside consultants that the Government agencies brought in during the AGP creation and monitoring process.

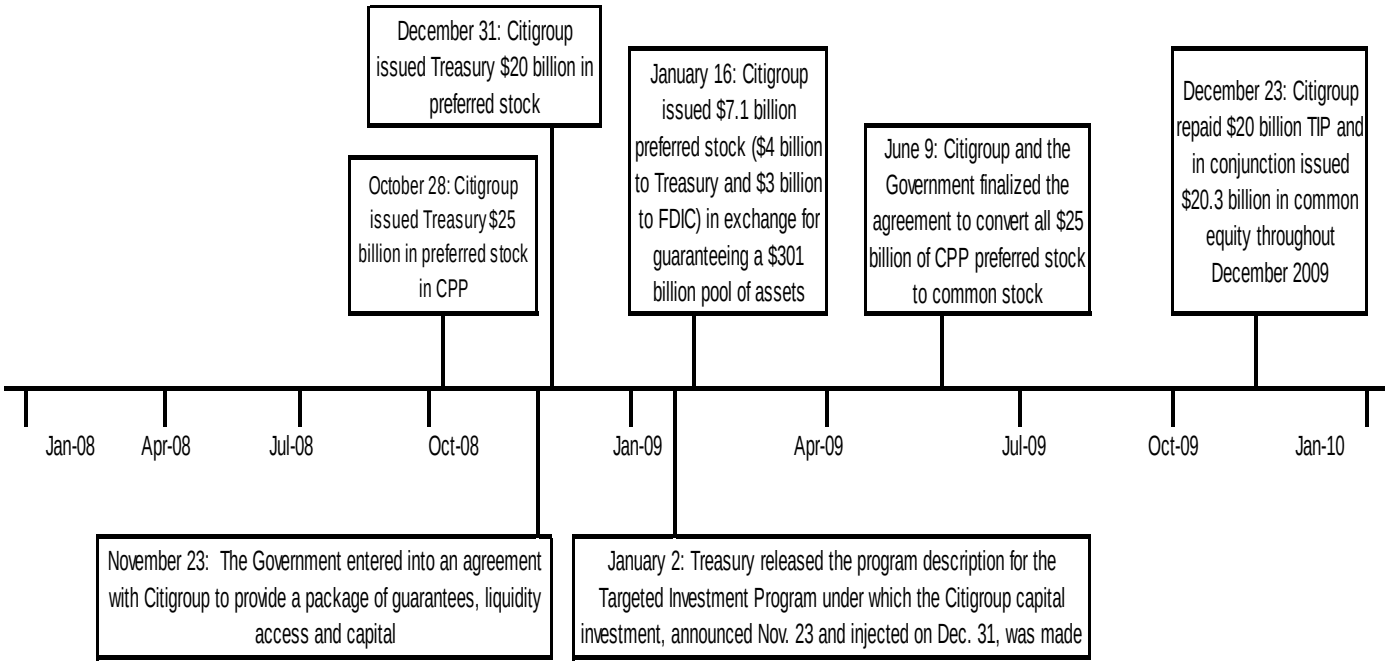
Prior Coverage

Congressional Oversight Panel, "NOVEMBER OVERSIGHT REPORT: Guarantees and Contingent Payments in TARP and Related Programs," November 6, 2009.

Government Accountability Office, "FINANCIAL AUDIT: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Year 2009 Financial Statements," December 9, 2009.

Government Accountability Office, “TROUBLED ASSET RELIEF PROGRAM: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency,” December 2, 2008.

Appendix B − Citigroup TARP Capital Changes



Source: SIGTARP analysis.

Appendix C − Governance and Asset Management Guidelines

Master Agreement
Governance and Asset Management Guidelines (Exhibit B)
Report/Document Delivery Requirements

Frequency	Report/Document (Exhibit B Reference)	Delivered to:		
		Senior Oversight Committee ("SOC")	Citigroup Audit and Risk Management Committee	US Federal Parties
Monthly	Monthly Report - detailing performance of the assets and compliance with the Agreement (Section 3.6(a))	X		X
Monthly	Excerpts of Monthly Report (Section 3.6(a))		X	
Quarterly	Quarterly Certificate – setting forth the calculations of Losses and related items and residential mortgage loan servicing file (Section 3.3)			X
Quarterly	SOC Report to Audit Committee - report on the status of the Covered Assets and compliance with the Agreement (Section 3.7)		X	X
Quarterly	ARR Quarterly Compliance Report to Audit Committee (Section 4.2(b)(ii))		X	X
Annually	Independent Auditor's Attestation of Compliance with Material Requirements (Section 4.2(c))			X
Annually	Internal Audit on Compliance with Provisions of Agreement (Section 4.2(e))			X
Annually	Covered Asset CEO Certification of Compliance with Agreement (Section 4.2(f))			X
Annually	SOC Certification of Compliance with Agreement (Section 4.2(f))			X
Annually	Independent Auditor's Review of Computations under the Agreement (Section 4.2(d))			X
Ongoing	Reports and Records of SOC (Section 1.10)			X
Ongoing	Reports, Records and Minutes of Audit Committee and Board Relating to Agreement (Section 1.10))			X
Ongoing	Schedule and Preliminary Agenda for SOC Meetings (Section 2.1(a))			X
Ongoing	ARR Audit Reports Created Pursuant to the Agreement (Section 4.2(b)(iv))	X		X

11/01/2009

Source: Citigroup.

Appendix D − Joint Statement by Treasury, Federal Reserve and FDIC on Citigroup

November 23, 2008

Washington, DC – The U.S. government is committed to supporting financial market stability, which is a prerequisite to restoring vigorous economic growth. In support of this commitment, the U.S. government on Sunday entered into an agreement with Citigroup to provide a package of guarantees, liquidity access and capital.

As part of the agreement, Treasury and the Federal Deposit Insurance Corporation will provide protection against the possibility of unusually large losses on an asset pool of approximately $306 billion of loans and securities backed by residential and commercial real estate and other such assets, which will remain on Citigroup's balance sheet. As a fee for this arrangement, Citigroup will issue preferred shares to the Treasury and FDIC. In addition and if necessary, the Federal Reserve stands ready to backstop residual risk in the asset pool through a non-recourse loan.

In addition, Treasury will invest $20 billion in Citigroup from the Troubled Asset Relief Program in exchange for preferred stock with an 8% dividend to the Treasury. Citigroup will comply with enhanced executive compensation restrictions and implement the FDIC's mortgage modification program.

With these transactions, the U.S. government is taking the actions necessary to strengthen the financial system and protect U.S. taxpayers and the U.S. economy.

We will continue to use all of our resources to preserve the strength of our banking institutions and promote the process of repair and recovery and to manage risks. The following principles guide our efforts:

- We will work to support a healthy resumption of credit flows to households and businesses.
- We will exercise prudent stewardship of taxpayer resources.
- We will carefully circumscribe the involvement of government in the financial sector.
- We will bolster the efforts of financial institutions to attract private capital.

Source: Office of Financial Stability.

Appendix E – Glossary

Asset Filters – The Government-defined set of criteria that qualified individual assets for the guaranteed portfolio.

Asset Guarantee Program ("AGP") – Established under section 102 of EESA, allows the Department of the Treasury to assume a loss position with specified attachment and detachment points on certain assets held by the qualifying financial institution. The set of insured assets are selected by Treasury and its agents in consultation with the financial institution receiving the guarantee.

Bank Failure – A bank failure is the closing of a bank by a federal or state banking regulatory agency. Typically, a bank is closed when it becomes critically undercapitalized or is unable to meet its obligations to depositors and others.

Bank Holding Company – A company that controls a bank. Typically, a company controls a bank through the ownership of 25% or more of its voting securities. The Federal Reserve defines a bank holding company as any company that directly or indirectly owns, controls, or has the power to vote 25% or more of any class of the voting shares of a bank; controls in any manner the election of a majority of the directors or trustees of a bank; or is found to exercise a controlling influence over the management or policies of a bank.

Collateral – An asset pledged by a borrower to a lender until a loan is repaid.

Collateralized Debt Obligation – A financial instrument that entitles the purchaser to some portion of the cash flows from a portfolio of assets, which may include bonds, loans, mortgage-backed securities, or other CDOs.

Commercial Paper – Commercial paper is a short-term unsecured promissory note sold by corporations and foreign governments to meet debt obligations such as payroll. For many large, creditworthy issuers, commercial paper is a low-cost alternative to bank loans.

Common Stock – Equity ownership entitling an individual to share in corporate earnings and voting rights.

Conservatorship – In the case of Fannie Mae and Freddie Mac, conservatorship involved FHFA taking control of the companies as authorized by the Housing and Economic Recovery Act of 2008. The powers of the board of directors, officers, and shareholders are transferred to FHFA. In a receivership, shareholders are permanently terminated, whereas in a conservatorship, shareholder rights are temporarily assumed by the controlling entity.

Counterparty – The other party that participates in a financial transaction. Every transaction must have a counterparty. More specifically, every buyer of an asset must be matched with a seller that is willing to sell and vice versa.

Coupon Rate – Interest rate to be paid as a percentage of the face value of the security. For example, if a $100 security has an 8% coupon, the owner of the security will receive $8 annually for the life of the security.

Credit Default Swap – A contract where the seller receives a series of payments from the buyer in return for agreeing to make a payment to the buyer when a particular credit event outlined in the contract occurs (for example, if the credit rating on a particular bond or loan is downgraded or goes into default). It is commonly referred to as an insurance-like product where the seller is providing the buyer protection against the failure of a bond. The buyer, however, does not need to own the asset covered by the contract, which means it can serve essentially as a "bet" against the underlying bond.

Credit Default Swap Spread – A CDS is an insurance-like contract in which the seller receives a series of payments from the buyer in return for agreeing to make a payment to the buyer if a particular credit event outlined in the contract occurs – for example, if a bond or loan goes into default. A CDS spread is stated as a percentage of par value that the insurance buyer is willing to pay the insurance seller in exchange for the insurance for a specific time period. For the purposes of this report, CDS spreads are stated as annualized quarterly payments. The higher the CDS spread, the more expensive it is to buy protection against default, reflecting that the market sees that the institution standing behind the bond is more likely to default on its obligations. In other words, the greater the spread, the less creditworthy the institution is regarded by the market.

Deposit Run – When large numbers of depositors suddenly demand to withdraw their deposits from a bank. This may be caused by a decline in depositor confidence or fear that the bank will be closed by the chartering agency. Banks keep only a small fraction of their deposits in cash reserves, and thus, large numbers of withdrawals in short periods of time can cause even a healthy bank to have a severe liquidity crisis that could cause the bank to be unable to meet its obligations and fail.

Dilution – A reduction in earnings per share of common stock that occurs through the issuance of additional shares or the conversion of convertible securities.

Discount Rate – The discount rate is the interest rate charged to commercial banks and other depository institutions on loans they receive from their regional Federal Reserve Bank's lending facility – also called the discount window. The Federal Reserve Banks offer three discount window programs to depository institutions: primary credit, secondary credit, and seasonal credit, each with its own interest rate. All discount window loans are fully secured.

Due Diligence – The appropriate level of attention or care a reasonable person should take before entering into an agreement or a transaction with another party. In finance, often refers to the process of conducting an audit or review of documents/information prior to initiating a transaction.

FDIC Deposit Insurance – FDIC protects depositors' funds in the event of the financial failure of their bank or savings institution. FDIC deposit insurance covers the balance of each depositor's account, dollar for dollar, up to the insurance limit, including principal and any accrued interest through the date of the insured bank's closing. The standard insurance amount currently is up to at least $250,000 per depositor, per insured bank.

FDIC Deposit Insurance Fund – FDIC's deposit insurance fund consists of premiums already paid by insured banks and interest earnings on its investment portfolio of U.S. Treasury securities. No federal or state tax revenues are involved.

Federal Funds – Funds deposited by commercial banks at the Federal Reserve banks, thereby enabling banks temporarily falling short of reserve requirements to borrow funds from banks with excess reserves.

Liquidity – The ability to easily convert an asset to cash, without any significant loss in value or transaction cost.

Mandatorily Convertible Preferred Stock – Preferred shares that can be converted to common stock at the issuer's discretion if specific criteria are met by a certain date.

Memorandum of Understanding – A written but non-contractual agreement between two or more agencies or other parties to take a certain course of action.

Moral Hazard – A term used in economics and insurance to describe the lack of incentive individuals have to guard against a risk when they are protected against that risk (for example, through an insurance policy). In the context of TARP, it refers to the danger that private-sector executives/investors/lenders may behave more recklessly, believing that the Government has insulated them from the risks of their actions.

Nationalization – Nationalization is the acquisition and control of privately owned business by government.

Non-recourse Loan – A secured loan whereby the borrower is relieved of the obligation to repay the loan upon the surrender of the collateral.

Open Bank Assistance – In an open bank assistance agreement, FDIC provides financial assistance to an operating insured bank or thrift determined to be in danger of closing. FDIC can make loans to, purchase the assets of, or place deposits in the troubled bank. Where possible, assisted institutions are expected to repay the assistance loans.

Preferred Stock – Equity ownership that usually pays a fixed dividend prior to distributions for common stock owners but only after payments due to holders of debt and depositors. It typically confers no voting rights. Preferred stock also has priority over common stock in the distribution of assets when a bankrupt company is liquidated.

Regulation – The supervision of financial markets and institutions.

Resolution – The term "resolution" throughout this report means a disposition plan for a failed or failing institution. It is designed to (1) protect insured depositors, and (2) minimize the costs to the relevant insurance fund that are expected from covering insured deposits and disposing of the institution's assets. Resolution methods include purchase and assumption transactions, insured deposit transfer transactions, and straight deposit payoffs. A resolution can also refer to an open bank assistance plan provided to an institution to help prevent it from failing.

Ring Fencing – Segregating assets from the rest of a financial institution, often so that the assets' problems can be addressed in isolation.

Secured Financing – Debt backed or secured by collateral to reduce the risk associated with lending.

Solvency – A company's ability to pay its debts with available cash.

Special Purpose Vehicle – An off-balance-sheet legal entity that holds the transferred assets presumptively beyond the reach of the entities providing the assets (*i.e.*, legally isolated).

Sub Prime – Refers to borrowers who do not qualify for prime interest rates because they exhibit one or more of the following characteristics: weakened credit histories typically characterized by payment delinquencies, previous charge-offs, judgments, or bankruptcies; low credit scores; high debt-burden ratios; or high loan-to-value ratios.

Systemic Risk – A risk that impacts the entire financial system and real economy, through cascading, contagion, and chain-reaction effects.

Systemically Significant – A financial institution whose failure would impose significant losses on creditors and counterparties, call into question the financial strength of other similarly situated financial institutions, disrupt financial markets, raise borrowing costs for households and businesses, and reduce household wealth.

Tail Risk – A form of portfolio risk that arises when the possibility that an investment will move more than three standard deviations from the mean is greater than what is shown by a normal distribution. In terms of the Citigroup ring-fence, tail risk referred to a low-probability loss scenario where losses would be severe or complete.

Tangible Common Equity – TCE, as defined by Citigroup, represents Common equity less Goodwill and Intangible assets (other than Mortgage Servicing Rights (MSRs)) net of the related net deferred taxes. Other companies may calculate TCE in a manner different from that of Citigroup.

Tier 1 Capital – Consists primarily of common equity (including retained earnings), limited types and amounts of preferred equity, certain minority interests, and limited types and amounts of trust preferred securities. T1 does not include goodwill and certain other intangibles. Certain other assets are also excluded from T1. It can be described as a measure of the bank's ability to sustain future losses and still meet depositors' demands.

Total Risk-Weighted Assets – A bank's total assets after adjusting the value of each asset based on the risk associated with that asset.

Trust Preferred Securities – Securities that have both equity and debt characteristics, created by establishing a trust and issuing debt to it.

Warrant – The right, but not the obligation, to purchase a certain number of shares of common stock at a fixed price.

Appendix F − Definitions of Acronyms

Acronym	Definition
AGP	Asset Guarantee Program
AIG	American International Group
BHC	Bank Holding Company
CDS	Credit Default Swap
CMBS	Commercial Mortgage-Backed Security
CPP	Capital Purchase Program
EESA	Emergency Economic Stabilization Act
FAS	Financial Accounting Standards
FDIC	Federal Deposit Insurance Corporation
FHFA	Federal Housing Finance Agency
FRB	Federal Reserve Board
FRBNY	Federal Reserve Bank of New York
FSOC	Financial Stability Oversight Council
GTS	Global Transaction Services
MIS	Management Information Systems
MOU	Memorandum of Understanding
OCC	Office of the Comptroller of the Currency
PwC	PricewaterhouseCoopers
RMBS	Residential Mortgage-Backed Security
SCAP	Supervisory Capital Assessment Program
SIGTARP	Special Inspector General for the Troubled Asset Relief Program
SPV	Special Purpose Vehicle
TARP	Troubled Asset Relief Program
TCE	Tangible Common Equity
TIP	Targeted Investment Program
TLGP	Temporary Liquidity Guarantee Program

Appendix G − Capital Raise Press Release

For Immediate Release
Citigroup Inc. (NYSE: C) December 16, 2009

Citi Prices $17 Billion Common Stock Offering and $3.5 Billion of Tangible Equity Units

Prices Largest U.S. Public Equity Offering in History

Citi to Repay $20 Billion of TARP Trust Preferred Securities, Terminate Loss-Sharing Agreement

U.S. Treasury Extends Lock-Up to 90 Days

NEW YORK – Citi today announced the pricing of 5.4 billion common shares and 35 million tangible equity units as part of its agreement with the U.S. government and its regulators to repay U.S. taxpayers for the $20 billion the government holds in TARP trust preferred securities and to terminate the loss-sharing agreement with the government. The common stock priced at $3.15 per share, generating net proceeds of approximately $17 billion. The tangible equity units priced at $100 each, generating net proceeds of approximately $3.5 billion (about $2.8 billion counted as equity.) The combined offering of common stock and tangible equity units is the largest public equity offering in U.S. capital markets history.
Upon completion of the offerings and the repayment of the $20 billion of the TARP trust preferred securities and the termination of the loss-sharing agreement, Citi will no longer be deemed to be a recipient of "exceptional financial assistance" under TARP.

The U.S. Treasury (UST) announced it would extend its lock-up period on the sale of its 7.7 billion share common equity stake to 90 days from 45 days after the completion of this offering. The UST decided not to sell any of its shares in connection with Citi's sale of common stock and tangible equity units.
The tangible equity units are comprised of a prepaid stock purchase contract and a junior subordinated amortizing note. Each stock purchase contract has a settlement date of December 15, 2012 and will settle for between 25.3968 and 31.7460 shares of Citi common stock, subject to adjustment as described in the final prospectus relating to the offering. The amortizing notes will pay holders equal quarterly installments of $1.875 per amortizing note, which in the aggregate will be equivalent to a 7.50% cash payment per year with respect to each $100 stated amount of tangible equity units and has a scheduled final installment payment date of December 15, 2012. Citigroup has the right to defer installment payments on the amortizing notes at any time and from time to time but not beyond December 15, 2015.

After giving effect to the issuance of the $17 billion in common stock, $3.5 billion of tangible equity units and $1.7 billion of stock compensation previously announced by Citi, as well as the repayment of $20 billion of the TARP trust preferred securities and the termination of the loss-sharing agreement, Citi's pro forma Tier 1 capital ratio at the end of the third quarter of 2009 would have been 11.0%, compared with 12.8%. The company's pro forma Tier 1 common ratio at the end of the third quarter would have been 9.0%, compared with 9.1%.

Citigroup Global Markets Inc. is serving as sole book-running manager of these offerings. Citi has granted the underwriters for the common stock offerings an overallotment option to purchase up to 809.5 million additional shares of common stock.

Appendix H – Citigroup Entities

CITIGROUP'S SIGNIFICANT LEGAL ENTITIES OF SEPTEMBER 30, 2008

Entity	Entity Type	Total Assets (millions)	% of Total Consolidated Assets
Citigroup Inc.	FHC	$2,050,131	100%
Citibank NA	Lead Bank	$1,207,007	58.9%
Citibank Overseas Investment Corp. (COIC)	Edge Corp.	496,768	24.2% (Consolidated) 41.2% (Bank)
Citibank (South Dakota) NA	Credit card issuing bank	77,738	3.8%
Citicorp Tr Bk FSB	FSB	15,599	0.8%
Citigroup Global Markets Holdings Inc.	Holding Company for Broker/Dealer subs	118,947	5.8%
Citigroup Global Markets Inc.	US Broker Dealer	333,445*	16.3%
Citigroup Global Markets Limited	UK Broker Dealer	190,774*	9.3%
Citigroup Funding Inc.	Funding Subsidiary (All guaranteed by Citigroup Inc.)	120,622*	5.9%
Associates First Capital Corp. (Associates)	Parent of CCC Funding including Canadian Commercial Paper (All guaranteed by Citigroup Inc.)	75,343*	3.7%
CitiFinancial Credit Company (CCC)	Consumer Finance Company All funding guaranteed by Citigroup Inc.	59,887*	2.9%
Citigroup Mexico Holdings LLC	Holding Company for Mexico	24,861*	1.2%
Banco Nacional De Mexico Sa	Mexican Bank subsidiary	87,205*	4.3%

* Total assets for these entities are as of 6/30/2008. Total assets for remaining entities are as of 9/30/2008.
Note: Numbers affected by rounding.
Source: Federal Reserve Board of Governors.

Appendix I – Citigroup Initial Proposal (November 22, 2008)

Structure / Term Sheet

- **Ring Fence $306B of Citi assets**
  - $205B Accrual
  - $101B MTM
- Government back stop all losses on US accrual book (net of existing LLR) for life of loan, and all credit losses in excess of those incorporated in the valuation of the MTM portfolio
  - Credit losses include charge-offs, losses, recoveries and reimbursable expenses
  - Quarterly settlements based on separate tracking of losses
- New preferred of $20B face value, 5% coupon, redeemable after 5 years in cash or common at Citi's option
- Capital forbearance on all ring fenced assets; preferred instruments to count towards Tier 1 and other regulatory ratios (leverage)
- To avoid MTM volatility on CDOs (par value of $24B), a separate guarantee on any cash flows below current value of $12B, to be settled up at maturity
- 4 year phase-in on risk weighting on assets brought back on Citi's balance sheet as a result of proposed accounting rule change (FAS 140 / FIN 46R)
- Foreign based collateral to be accepted at the Fed window

Positives

- Eliminates Citi's tail risk; removes substantial uncertainty on the balance sheet
  - Improves P&L and tangible equity
- Ability to move MTM to Held to Maturity without impairment risk
  - Reduced earnings volatility on MTM assets
  - Ability to accrete discount to par over the remaining life of the assets
- Improved Capital and Leverage Ratios
  - Preferred counted towards Tier 1 and regulatory ratios
  - Ring fenced assets get capital forbearance

Negatives

- Amortization of cost of Government back stop through P&L
- Dividends on and discount of preferred reduces EPS to common and retained earnings

Appendix J – Government's Term Sheet (November 23, 2008)

November 23, 2008

Summary of Terms

Eligible Asset Guarantee

Eligible Assets:	Asset pool consisting of loans and securities backed by residential real estate and commercial real estate, and their associated hedges, as agreed, and other such assets as the U.S. Government (USG) has agreed to guarantee. Each specific asset must be identified on signing of guarantee agreement. Assets will remain on the books of institution but will be appropriately "ring-fenced."
Size:	Up to $306 bn in assets to be guaranteed (based on valuation agreed upon between institution and USG).
Term of Guarantee:	FDIC standard loss-sharing protocol: Guarantee is in place for 10 years for residential assets, 5 years for non-residential assets.
Deductible:	Institution absorbs all losses in portfolio up to $29 bn (in addition to existing reserves) Any losses in portfolio in excess of that amount are shared USG (90%) and institution (10%). USG share will be allocated as follows: UST (via TARP) second loss up to $5 bn; FDIC takes the third loss up to $10 bn;
Financing:	Federal Reserve funds remaining pool of assets with a non-recourse loan, subject to the institution's 10% loss sharing, at a floating rate of OIS plus 300bp. Interest payments are with recourse to the institution.
Fee for Guarantee - Preferred Stock:	Institution will issue $7 bn of preferred stock with an 8% dividend rate (under terms described below). $4 bn of preferred will be issued to UST. $3 bn will be issued to the FDIC.
Management of Assets:	USG will provide institution with a template to manage guaranteed assets This template will include the use of mortgage modification procedures adopted by the FDIC, unless otherwise agreed.
Risk Weighting:	Institution will retain the income stream from the guaranteed assets. Risk weighting for assets will be 20%.

November 23, 2008

Dividends:	Institution is prohibited from paying common stock dividends, in excess of $.01 per share per quarter, for 3 years without UST/FDIC/FRB consent. A factor taken into account for consideration of the USG's consent is the ability to complete a common stock offering of appropriate size.
Executive Compensation:	An executive compensation plan, including bonuses, that rewards long-term performance and profitability, with appropriate limitations, must be submitted to, and approved by, the USG
Corporate Governance:	Other matters as specified

November 23, 2008

Preferred Securities

Issuer:	Citigroup ("Citi")
Initial Holder:	United States Department of the Treasury ("UST").
Size:	$20 billion
Security:	Preferred, liquidation preference $1,000 per share. (Depending upon the available authorized preferred shares, the UST may agree to purchase preferred with a higher liquidation preference per share, in which case the UST may require Citi to appoint a depositary to hold the Preferred and issue depositary receipts.)
Ranking:	Same terms as preferred issued in CPP.
Term:	Perpetual life.
Dividend:	The Preferred will pay cumulative dividends at a rate of 8% per annum. Dividends will be payable quarterly in arrears on February 15, May 15, August 15 and November 15 of each year.
Redemption:	In stock or cash, as mutually agreed between UST and Citi. Otherwise, redemption terms of CPP preferred terms apply.
Restrictions on Dividends:	Institution is prohibited from paying common stock dividends, in excess of $.01 per share per quarter, for 3 years without UST consent. A factor taken into account for consideration of the UST's consent is the ability to complete a common stock offering of appropriate size.
Repurchases:	Same terms as preferred issued in CPP.
Voting rights:	The Preferred shall be non-voting, other than class voting rights on (i) any authorization or issuance of shares ranking senior to the Preferred, (ii) any amendment to the rights of Preferred, or (iii) any merger, exchange or similar transaction which would adversely affect the rights of the Preferred. If dividends on the Preferred are not paid in full for six dividend periods, whether or not consecutive, the Preferred will have the right to elect 2 directors. The right to elect directors will end when full dividends have been paid for (i) all prior dividend periods in the case of cumulative Preferred or (ii) four consecutive dividend periods in the case of non-cumulative Preferred.

November 23, 2008

Transferability: The Preferred will not be subject to any contractual restrictions on transfer.

Executive Compensation: An executive compensation plan, including bonuses, that rewards long-term performance and profitability, with appropriate limitations, must be submitted to, and approved by, the USG.

Summary of Warrant Terms

Warrant: Institution will issue a warrant to UST for an aggregate exercise value of 10% of the total preferred issued to USG (in both transactions) ($2.7 bn).

Exercise Price: The strike price will be equal to $10.61 per share (the 20 day trailing average ending on November 21, 2008). The warrants issued to UST are not subject to reduction based on additional offerings.

Term: Ten years, immediately exercisable, in whole or in part.

DEPARTMENT OF THE TREASURY

_____

FEDERAL RESERVE BOARD

_____

CITIGROUP INC.

_____

FEDERAL DEPOSIT INSURANCE CORP.

_____

Appendix K – Audit Team Members

This report was prepared and the review was conducted under the direction of Kurt Hyde, Deputy Inspector General of Audits and Evaluations, and Clayton Boyce, Acting Assistant Deputy Inspector General of Audits and Evaluations, Office of the Special Inspector General for the Troubled Asset Relief Program.

The staff members who conducted the audit and contributed to the report include: Eric Potocek, John Gallagher, Natalie Lentz, and Scott Harmon.

Appendix L – Management Comments from Treasury, FDIC

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

January 12, 2011

Neil M. Barofsky
Special Inspector General
for the Troubled Asset Relief Program
United States Department of the Treasury
1500 Pennsylvania Ave., N.W.
Washington, D.C. 20220

Re: Response to SIGTARP Audit on Financial Assistance Provided to Citigroup

Dear Mr. Barofsky:

Thank you for providing the Department of the Treasury (Treasury) the opportunity to review your draft audit report regarding additional financial assistance to Citigroup, Inc. (Citigroup) in late 2008 and early 2009. Treasury appreciates the Special Inspector General's (SIGTARP's) review of the actions taken by Treasury, the Federal Reserve Board (Federal Reserve), and the Federal Deposit Insurance Corporation (FDIC) two years ago to assist Citigroup as a part of the broader effort to stabilize the financial system. This letter provides Treasury's official response to the SIGTARP audit report. Treasury has previously provided to SIGTARP staff certain factual corrections.

We appreciate the audit report's conclusion that the government assistance provided to Citigroup was carefully designed and that it achieved its primary goal of restoring market confidence. As the report notes, these actions were taken at a time of unprecedented market turmoil and panic, when there were substantial risks of catastrophic damage to our financial system and economy. SIGTARP's audit report provides a useful record that documents the seriousness of the situation and how critical these actions were in helping to restore liquidity and stability to the U.S. financial system.

We also appreciate the audit report's conclusion that the government drove a "hard bargain" with Citigroup on behalf of taxpayers. The report documents how the assistance was structured in order to limit risk to the taxpayer and describes in particular how the government rejected the terms proposed by Citigroup. The Targeted Investment Program investments provided for annual dividends of eight percent and imposed onerous terms on the company, including restrictions on executive compensation, dividends, and corporate expenses. With the Asset Guarantee Program, as you observe, "the Government summarily rejected Citigroup's initial proposal and made a take-it-or-leave it offer that Citigroup only reluctantly accepted, against the advice of Citigroup insiders who considered the Government's terms too expensive in light of the assistance provided." In the end, the government incurred no losses under the Asset Guarantee Program, and made a positive return on the premium Citigroup paid for this insurance.

SIGTARP's conclusion that the assistance was well designed is supported by the final accounting of the government's assistance to Citigroup. In 2008 and 2009, Treasury invested a total of $45 billion in Citigroup. At the time, many doubted whether Citigroup would survive and whether the government would ever be repaid. With the sale of its last common shares in December 2010, Treasury not only recovered all of the $45 billion it invested, it also made approximately $12 billion in profits, consisting of dividends, interest, and gain on the sale of Citigroup common stock and other securities.

We also appreciate the audit report's discussion of the broader implications of this assistance for the future, including your concerns regarding the potential that assistance of this type could contribute to "moral hazard" and your commentary regarding determinations of "systemic significance." It is important to remember that the actions taken to combat the financial crisis, including the assistance to Citigroup, were necessary, in part, due to the lack of tools available to resolve bank holding companies in an orderly manner. The government did not then have the ability to break apart or wind down a systemically important, failing financial firm; bankruptcy was the only option.

It was in part for these reasons, that, beginning in 2009, the Obama Administration and Treasury worked to develop and pass a comprehensive financial reform law. The Dodd-Frank Wall Street Reform and Consumer Protection Act provides the federal government with important tools that it did not have in the fall of 2008 which will be critical in addressing future crises. These include the authority to shut down and break apart large non-depository financial companies whose imminent failure would have serious, adverse effects on financial stability. The legislation also gives the government the ability to collect data and analyze risk in the entire financial system, beyond individual firms and markets, and to identify and curb reckless risk-taking. The reform legislation will help reduce the potential for moral hazard by providing the government with the authority to set more stringent capital, liquidity and leverage requirements, as well as the ability to wind down firms whose failure would have serious adverse effects on financial stability through an orderly liquidation process. As part of the liquidation process, the government must replace culpable management and ensure that shareholders and unsecured creditors bear the losses.

We appreciate the opportunity to respond to your draft audit report. We look forward to continuing to work with you and your team as we move forward.

Sincerely,

Timothy G. Massad /CAW

Timothy G. Massad
Acting Assistant Secretary for Financial Stability

FDIC
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990 General Counsel

January 12, 2011

Neil M. Barofsky
Special Inspector General
Troubled Asset Relief Program
1801 L Street, NW
Washington, D.C. 20220

Re: Comments on Report on Extraordinary Assistance Provided to Citigroup, Inc., by the Special Inspector General for the Troubled Asset Relief Program

Dear Mr. Barofsky:

We thank you for the opportunity to provide comments and suggest clarifications to the draft report on the Extraordinary Assistance Provided to Citigroup, Inc., by the Special Inspector General for the Troubled Asset Relief Program. As I noted in my prior response, we appreciate the difficult task you and your colleagues have and understand your time constraints. While we certainly would have liked more time to respond given Chairman Bair's recent travel schedule, we are providing this response consistent with your request. We also appreciate your cooperative approach to ensuring that the report accurately reflects the relevant facts and circumstances. As you know, the FDIC has strongly supported the mission and tasks that your office has undertaken and appreciates the important role you and your staff have played in protecting the public interest.

The report provides a thorough overview of the events surrounding the assistance provided to Citigroup and clearly reflects your staff's careful development of the facts. We appreciate your responsive clarifications following our prior comments, and hope that the discrete issues we identify below will help ensure further clarification of the report.

First, as we had noted previously, we are concerned that the reported comment by former Comptroller John Dugan, on pages 4 to 5, conveys an inaccurate picture of the events at that time. We appreciate your notation in the footnote that we disagree with his opinion, but would ask for a further clarification. While former Comptroller Dugan is entitled to his view, it is an ex poste comment that was not conveyed at the time. We would suggest deletion of this statement since it does not reflect accurately what the FDIC did or was prepared to do.

If you decline to delete the statement by former Comptroller Dugan, we would suggest that you balance his speculation with our contrary view that "FDIC officials disputed this statement as there was no evidence at the time that the change in the transaction reduced confidence in Citigroup and the FDIC stated publicly at that time that it stood behind the original Citigroup acquisition." In addition, appended to this letter is the statement by the FDIC on October 3, 2008 – contemporaneous with events – that demonstrates the FDIC's public statement that it would stand behind the original, proposed acquisition of Wachovia by Citigroup. It may be found on

Letter to Neil M. Barofsky
Special Inspector General
Troubled Asset Relief Program

the FDIC website at http://fdic.gov/news/news/press/2008/pr08090.html. This press release states, in relevant part, "[t]he FDIC stands behind its previously announced agreement with Citigroup." This statement is on our website, and we request at a minimum that the reference in footnote 11, page 5, be replaced with the exact language we used at the time.

Second, on pages 13 and 16 there are two references to the use of the "FDIC's normal resolution process" as potentially creating serious adverse effects on economic conditions or financial stability as grounds for application of the systemic risk determination. More accurately, it was application of the FDIC's resolution process under the statutory least costly standard in 12 U.S.C. § 1823(c)(4) that could have created this issue. As a result, we would recommend that you rephrase the description as "FDIC's resolution process under the statutory least costly standard" in those two references. A footnote cite to the statutory provision, 12 U.S.C. § 1823(c)(4), would then be appropriate.

Third, we suggest deletion of the last sentence of the last full paragraph on page 19 because it implies there was a revision or reduction in our estimate of the losses. However, the FDIC did not refine its estimate. In fact, the FDIC expected $38 billion in losses and wanted its coverage to start at 110% of estimated losses, which would put the number where the FDIC's coverage would kick in at $42 billion. However, Treasury's agreement to assume losses in the amount of $5 billion before the FDIC brought the number to be borne by Citigroup to $37 billion. As a result, it would be clearer to delete the last sentence of the last full paragraph on page 19 to avoid confusing this point.

Finally, we would suggest moving the current footnote 47 to page 19 and placing the reference at the end of the sentence reading: "FDIC told SIGTARP that it found Citigroup's ultimate first loss position of $37 billion acceptable because Treasury was willing to take a $5 billion second loss position through TARP." We would also suggest a minor edit to that footnote to have it read as follows: "FDIC noted that the systemic risk exception statute requires the FDIC to recover any loss to the insurance fund arising from the guarantee through a special assessment against members of the insurance fund. FDIC wanted to avoid this action because the nations' banks were already under severe financial stress." We believe that is a more accurate statement given the provisions of 12 U.S.C. § 1823(c)(4)(G)(ii).

Again, we thank you for the opportunity to comment on this report. Should you wish to discuss this letter or any of the FDIC staff's comments further, please do not hesitate to contact John Thomas at (202) 898-7417 or me at (202) 898-8950.

Sincerely,

Michael H. Krimminger
Acting General Counsel

Attachment

Press Releases

FDIC Chairman Sheila Bair Comments on Agreement to Merge by Wells Fargo and Wachovia

FOR IMMEDIATE RELEASE
October 3, 2008

Media Contact:
Andrew Gray
202-898-7192 or angray@fdic.gov

"Since the close of our bidding process, Wells has apparently re-assessed its position and come forth with this new offer that does not require FDIC assistance. It should be emphasized that both the Citigroup proposal as well as the new Wells proposal would stand behind all creditors including depositors, insured and uninsured. Under either proposal, all banking customers of the merged institutions would be fully covered with no disruptions in service.

"The FDIC stands behind its previously announced agreement with Citigroup. The FDIC will be reviewing all proposals and working with the primary regulators of all three institutions to pursue a resolution that serves the public interest."

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Congress created the Federal Deposit Insurance Corporation in 1933 to restore public confidence in the nation's banking system. The FDIC insures deposits at the nation's 8,451 banks and savings associations and it promotes the safety and soundness of these institutions by identifying, monitoring and addressing risks to which they are exposed. The FDIC receives no federal tax dollars – insured financial institutions fund its operations.

FDIC press releases and other information are available on the Internet at www.fdic.gov, by subscription electronically (go to www.fdic.gov/about/subscriptions/index.html) and may also be obtained through the FDIC's Public Information Center (877-275-3342 or 703-562-2200). **PR-90-2008**

Last Updated 10/3/2008 communications@fdic.gov

SIGTARP Hotline

If you are aware of fraud, waste, abuse, mismanagement, or misrepresentations associated with the Troubled Asset Relief Program, please contact the SIGTARP Hotline.

By Online Form: www.SIGTARP.gov

By Phone: Call toll free: (877) SIG-2009

By Fax: (202) 622-4559

By Mail: **Hotline: Office of the Special Inspector General for the Troubled Asset Relief Program**
1801 L Street., NW, 4th Floor
Washington, D.C. 20220

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If you have any inquiries, please contact our Press Office:

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Legislative Affairs

For Congressional inquiries, please contact our Legislative Affairs Office:

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