CtW Investment Group

January 14, 2008

C. Michael Armstrong
c/o the Corporate Secretary
Citigroup Inc.
399 Park Avenue
New York, NY 10043

Dear Mr. Armstrong:

Citigroup's failure to manage mortgage-related risk cost its shareholders $126 billion in 2007, a 46% decline that wiped out nearly all of the shareholder value created over the previous four years. As a diversified financial services company, Citigroup's acute vulnerability to the mortgage meltdown has been an especially unwelcome surprise for shareholders, and tomorrow's fourth quarter earnings release is expected to contain more bad news.

With Citigroup's 2008 director election only three months away, we call on you, as a member of the Audit and Risk Management Committee of the Board of Directors (the "Audit Committee") in 2005 and 2006, to describe the actions you took during that period to understand and assess Citigroup's underlying exposure to mortgage risk across its businesses and satisfy yourself that management was taking appropriate steps to control such exposure. Absent a compelling explanation, we intend to recommend that shareholders vote against your re-election at Citigroup's 2008 annual meeting.

The crux of our concern is as follows:

1. By mid-2005 it was apparent that mortgage lenders were loosening lending standards and that an overheated U.S housing market was at risk of collapse. Despite numerous red flags, it appears that management failed to control Citigroup's substantial mortgage risk, especially relating to its investments in collateralized debt obligations (CDOs), until late-2007. By then it was too late to avoid huge losses. In fact, it appears that Citigroup substantially increased its mortgage-related exposure in 2006.

2. Audit Committee members should have recognized that the risks of such a collapse had risen dramatically by late 2005 and thus taken particular care to satisfy yourselves that management was taking steps to monitor and control Citigroup's exposure. As Mark Adelson, Head of Structured Finance Research at Nomura Securities, warned in September 2005: "Even the possibility of a [housing] bubble burst should lead [investors] to a defensive position." (*Asset Securitization Report,* September 20, 2005)

3. The board's acceptance of CEO Charles Prince's resignation last November 4th—the same day Citigroup disclosed an estimated fourth quarter write-down of up to $11 billion relating to sub-prime exposure—does not absolve Audit Committee members from your responsibility over the prior two years to review Citigroup's financial risk exposures and satisfy yourselves that its exposure to mortgage-related risk was defensible and its risk management systems robust.

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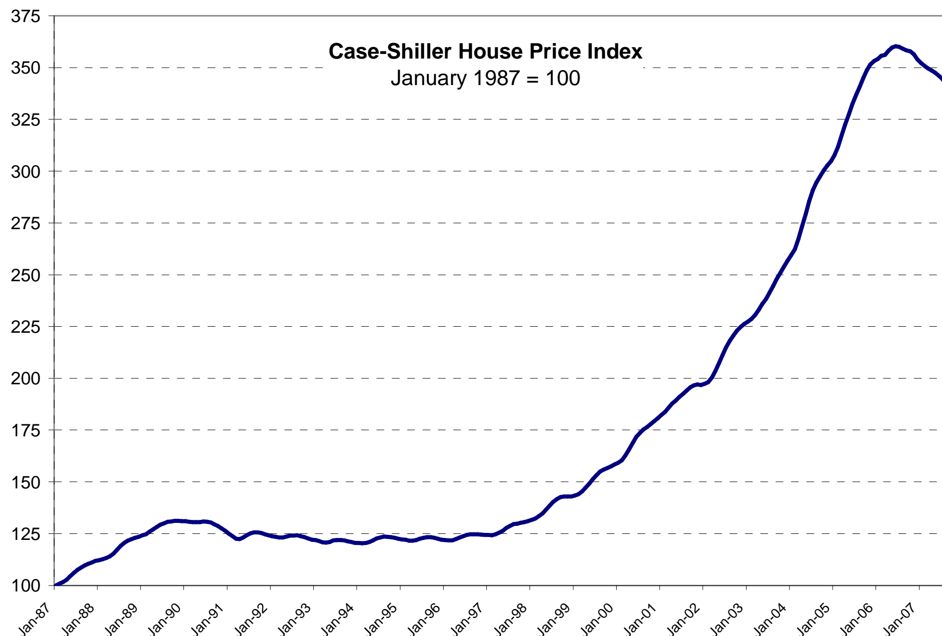
The CtW Investment Group works with pension funds sponsored by unions affiliated with Change to Win, a coalition of unions representing nearly 6 million members, to enhance long-term shareholder value through active ownership. These funds, together with public pension funds in which CtW union members participate, have about $1.4 trillion in assets and are substantial long-term Citigroup shareholders. We detail our concerns further below.

The Warning Signs Were There

By mid-2005, it was apparent that a housing bubble had developed and that the risks of a severe mortgage downturn had increased dramatically. Fueled by historically low interest rates, the creation of mortgage products targeting less credit-worthy borrowers and abundant liquidity from a booming secondary market for securitized mortgages, home prices had virtually doubled over the previous five years (see below graph).



Housing starts, which had increased every year since 2000, peaked in second quarter 2005. Mortgage interest rates began rising, with the average rate on a conventional 30-year fixed rate loan jumping from 5.6% to 6.7% between June 2005 and June 2006. Mortgage lenders were loosening their lending standards and increasingly using novel loan products. And within Citigroup's own Consumer Lending Group the percentage of second mortgages more than 90 days past due jumped to 0.13% at September 30, 2005 – and reached approximately 0.25% by the end of 2005 – up from only 0.07% at the end of September 2004.

One need have been an economist or the director of financial services firm with access to these data, however, to know that a national housing bubble had developed and could burst. One need only have read the news to see that a growing number of economists, investment professionals and public policy experts were sounding the alarm:

- On May 27, 2005, economist Paul Krugman of the *New York Times* said he saw "signs that America's housing market, like the stock market at the end of the last decade, is approaching the final, feverish stages of a speculative bubble."
- On June 9, 2005, Federal Reserve Chairman Alan Greenspan, while downplaying risk of a national housing bubble, acknowledged in testimony to the Joint Economic Committee that he saw "signs of froth in some local markets where home prices seem to have risen to unsustainable levels."
- On July 26 2005, *The Wall Street Journal* reported that "Mortgage lenders are continuing to loosen their standards, despite growing fears that relaxed lending practices could increase risks for borrowers and lenders in overheated housing markets." The article cited increases in novel loan products, including interest-only mortgages, option adjustable-rate mortgages and no documentation loans.
- By December 2005, even some CDO traders warned the bubble could burst. Jason Schechter, then head of CDO trading at Lehman Brothers, echoed other participants at the Opal Financial Group CDO Summit when he said: "What concerns me though is: is this liquidity here to stay, or are we at risk for a sizable downturn?" (*Asset Securitization Report*, December 12, 2005)

While Citigroup and many of its peers failed to heed these warnings, a number of firms did take action to reduce their mortgage risk exposure. Goldman Sachs, for example, began aggressively reducing its mortgage-backed securities exposure in late 2006, both by reducing inventory and hedging. Morningstar recently named PIMCO's Bill Gross the best fixed-income fund manager in 2007, lauding him for avoiding exposure to subprime securities and for anticipating the effect that the decline in home prices would have on the broader economy and corporate bonds.

Despite these Red Flags, Citigroup Failed to Control Its Mortgage-Related Risk

As a leading underwriter of CDOs in the U.S., the fifth largest residential originator by loan volume and the seventh largest sub-prime originator, Citigroup has substantial exposure to mortgage-related risk. Despite this concentrated exposure, it appears that Citigroup failed to take adequate steps to manage this risk in response to the warning signs of late 2005.

Citigroup did take steps to limit subprime exposure in its lending business in 2005. Specifically, its non-prime mortgage originations declined 20% in 2005 due to its decision to avoid offering teaser rate and interest–only mortgages to customers with lower credit scores. But that decision was overshadowed by Citigroup's subsequent decision to expand its Mortgage-Backed Securities Program in 2006. As a result, investments in mortgage-backed securities skyrocketed 537% to $82.4 billion during 2006.

The consequences of Citigroup's failure to limit its exposure to a possible mortgage meltdown are increasingly evident. On November 4, 2007, the company disclosed an estimated fourth quarter write-down of $8 billion to $11 billion relating to sub-prime exposure in both its lending and structuring business and its investments in CDOs. Goldman Sachs analyst William Tanona subsequently estimated that the write-down could be as much as $18.7 billion when Citigroup reports earnings tomorrow and, just two days ago, TheStreet.com reported that the writedown could reach $24 billion.

Even before the announced fourth quarter write-down, Citigroup's balance sheet was showing signs of stress. According to its third quarter 2007 10Q, the firm's Tier 1 Ratio had fallen to 7.3%, from 8.6% the prior year, and below the company's own internal target of 7.5%. In addition, its leverage ratio declined from 5.2% to 4.1% over the same period, requiring the company to obtain a waiver from regulators since it had fallen below the 5% requirement.

While the subsequent sale of $7.5 billion in convertible debt to the Abu Dhabi Investment Authority provided a desperately needed capital infusion, CIBC analyst Meredith Whitney estimates that Citigroup will need to raise an additional $30 billion to weather this crisis. That message was reinforced on December 14th when Moody's Investors Service downgraded Citigroup's long-term ratings and warned that the bank could face further downgrades.

Where was the Audit Committee?

While it is the CEO's job to manage Citigroup's overall exposure to risk, it is the responsibility of the board's Audit Committee to review the firm's major financial risk and assess the steps management has taken to control such exposure. This duty is mandated by the NYSE listing requirements and defined in the Audit Committee's charter. Moreover, while directors cannot be expected to understand every technical aspect of an underlying business, they still must acquire and maintain sufficient knowledge and understanding of the company's business to properly discharge their duty of care.

We believe that Citigroup's Committee failed in these duties as they relate to the company's exposure to mortgage-related risk in general and its investments in complex, mortgage-backed derivatives in particular. As *The New York Times* reported on December 21, 2007: "This year the leaders of some of the world's most respected financial institutions — leaders who are paid first and foremost to manage risk — have been caught either unaware or uninformed about giant risks their companies took. Their financial engineers concocted securities so complex that even the brainiacs cannot figure out what those investments are worth."

One factor may be the composition of the Audit Committee itself. As you know, three of the seven current members—George David, Andrew N. Liveris and Anne M Mulcahy—are active CEOs of S&P 500 firms. Given the tremendous time demands of their management jobs, we question whether these directors had the time to effectively monitor Citigroup's exposure to mortgage risk and fully understand its investments in complex derivates, as well as carry out the many other responsibilities of an Audit Committee director. For this very reason, many institutional investors have proxy voting policies that dictate that CEOs should restrict their service on outside boards.

Of the four remaining Audit Committee members, two were not active participants during the period in question: Judith Rodin was on leave from the Audit Committee in 2005 and most of 2006 in order to chair the Special Litigation Committee and Robert L. Ryan did not join the Audit Committee until 2007.

Citigroup Shareholders Require a Detailed Explanation

In preparation for Citigroup's 2008 director election, we believe shareholders are entitled to a detailed explanation as to what steps the Committee members took, individually and collectively, to: (1) understand Citigroup's exposure to mortgage risk through both its lending and structuring business and its investments in CDOs, SIVs and other exotic debt instruments; and (2) satisfy themselves that management was taking appropriate steps to control such exposure. Among the issues we would like Committee members to address:

- *Internal flow of information*. What information was routinely provided to you by management? How frequently was the information provided? Did you request additional information from management in response to mounting concerns with mortgage-related risk? What additional information did you request and when was it requested? Did the Committee meet regularly with the senior executives at the company with direct responsibility for measuring, analyzing and managing risk? How often did these meetings task place? Who was present at these meetings?

- *Independent assessment of information*. What independent steps did you take to evaluate the information provided by management? Third-party advisors can serve as an important tool for directors to assess the quality of information they are receiving in the boardroom. Which, if any, outside firms were used by the Committee? When were they hired and what role did they play?

- *Committee deliberations and actions*. What additional actions, if any, did the Committee require management to take to control Citigroup's significant mortgage-related exposure? We are particularly interested in deliberations and actions with respect to risk assessment, internal valuation models and hedging strategies. When did these actions occur?

We are not seeking an exhaustive set of documentation, but rather a cogent description of specific steps that you, as an incumbent director on the committee responsible for risk oversight, took to independently and pro-actively protect the interests of Citigroup shareholders from excessive exposure to mortgage risk. We have made similar requests of John M. Deutch, Ms. Mulcahy and Messrs. David and Liveris.

We look forward to a timely response so that shareholders can properly assess the suitability of your candidacy.

Sincerely,

William Patterson
Executive Director

cc: Sir Winfried Bischoff, Chairman of the Board
Alain J.P. Belda, Chair of the Nominating and Corporate Governance Committee