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Bilangan Kami : JP2/FB/17/RPT

SULIT

SERAHAN TANGAN

30 Disember 2010

[redacted]
Pengerusi
[redacted]
Menara [redacted]
165, Jalan Ampang
50450 Kuala Lumpur

Tuan,

2010 Supervisory Letter

We have completed our supervisory assessment on [redacted] for the year 2010 as required under Seksyen 69, Akta Bank dan Institusi-institusi Kewangan 1989. The supervisory assessment was performed in relation to the safety and soundness of [redacted] its ability to honour commitments when due and compliance with the applicable acts and guidelines.

2. Our supervisory regime is an on-going supervisory review comprising continuous analysis, monitoring, and on-site reviews of your institution. However, our reviews do not constitute a financial audit and in this regard, we rely on the opinion of the external auditors to ascertain the fairness of the financial statements disclosed by your institution.

Scope of Supervisory Review

3. The scope of our supervisory review covers Residential Mortgage, Credit Card, Corporate Banking, Treasury and Asset and Liability Management activities which are considered as significant activities of [redacted] It also includes assessment on the earnings performance, capital adequacy and the effectiveness of Citibank's operational management and risk management control functions in mitigating the inherent risks of Citibank's significant activities. The review of [redacted] risk management control functions includes assessment on the effectiveness of Board of Directors (Board), senior management, risk management, compliance and internal audit functions.

Composite Risk Rating

4. Bank Negara Malaysia assigns a Composite Risk Rating to each licensed financial institution based on the results of the supervisory assesment conducted during the year. The Composite Risk Rating represents Bank Negara Malaysia's assessment of the safety and soundness of a financial institution and is determined in a manner consistent with the Risk-based Supervisory Framework. The rating may be adjusted at any stage of the supervisory process based on changes in business or economic conditions or new supervisory findings and observations.

5. There are four possible rating categories for an institution's Composite Risk, i.e. Low, Moderate, Above Average and High. The assessment criteria containing these ratings is provided in **Appendix 1**.

6. As disclosed to [redacted] Chief Executive Officer (CEO) on 14 December 2010, the current Composite Risk Rating for Citibank is **'Low'.** The direction of risk is 'Increasing' due to the potential impact on the bank's consumer and treasury portfolio arising from the heightened risk outlook surrounding the consumer segment and market volatility.

7. With regard to the Islamic banking windows (IBW) operations, we have assigned the Composite Risk Rating of '**Low**' with 'Increasing' risk of direction. This is in view of the operation's increased reliance on its treasury activities which are highly volatile to market uncertainties and the heightened risk outlook surrounding the consumer segment.

8. Based on our supervisory assessment, there were several issues of supervisory concerns that may affect the bank's overall performance and operations. In this regard, the bank is required to take immediate and effective measures to address the following areas :

8.1 Ineffective Implementation of Continuity of Business (CoB) Plan

There was a prolonged delay of 10 hours during the CoB activation in September 2010 due to the bank's upgrading of its inward check clearing system which triggered for manual intervention. The bank experienced similar delay on 3 February 2010 due to the unsuccessful activation of CoB, impelled by the failure of its RENTAS settlement system. The recurrence of such incidence reflected the shortcomings in the bank's risk management in managing its operational risk.

It is imperative that the bank implements proper measures to ensure the effectiveness of its CoB plan during system downtime. Amongst others, [redacted] is required to continuously perform periodic reviews on its system's capacity in order to ensure the sustainability of all critical systems in supporting the bank's operations under BAU and unexpected crisis or circumstances. Changes and upgrading of all core systems must be undertaken in a controlled environment and supported by robust policy, procedures and internal controls.

8.2 Improper Treatment on Reclassification of Restructured and Rescheduled (R&R) Loans

The bank's current practice allows R&R loans to be reclassified as non-impaired upon rescheduling or restructuring of loans. The bank's R&R loans as at 30 September 2010 stood at RM1.8b, of which, RM99.2m or 5.6% turned impaired after being restructured or rescheduled. The impairment level for rehabiliated loans increased by RM3.4m or 3.6% as compared with RM95.7m or 5.8% recorded in 2009.

In ensuring consistency and in line with prudent practices, the bank is required to determine the 'observation period' to ascertain the capabilities and capacity of borrowers in meeting with the new repayment terms before reclassification of accounts as non-impaired. The determination of 'observation period' and its implementation must be adequately supported by a sound policy approved by the Board.

8.3 Role of Nomination Committee to Improve the Effectiveness of Board Oversight Function

Citibank's Board comprised 7 members, with 3 independent directors that comply with the requirement as stipulated by BNM/GP1. However in view of the changing regulatory requirements, financial landscape and global outlook as well as expansion in the bank's business and operations, there is a need for the NC to re-assess the effectiveness of the Board's composition and required skill mix. The Board relies on the banking expertise from [redacted] executives as none of the independent and non-executive directors have commercial banking or risk management experiences. There is a need to ensure a balanced Board's composition between the independent and non-independent directors with the right skill mix and expertise to ensure adequate check and balance as well as effective Board oversight function.

8.4 Inadequacies in Islamic Banking Window (IBW) Operations

8.4.1 In view of the resignation of the Compliance and Control Officer for the IBW operations in October 2010, it is imperative for the bank to identify the successor immediately, to ensure that the IBW operations remain efficient and in conformity with Shariah requirements. The vacancy will pose greater operational and Shariah risks and affects the bank's implementation of Shariah Governance Framework issued by BNM.

8.4.2 The IBW operations recorded a marginal business growth of 11.9% in 2010 albeit its financing assets contracted by 3.1% or RM16.3m. The Islamic business remains concentrated in treasury activities since its incorporation and its contribution to MIFC's agenda is relatively marginal as compared with its peers. In this regard, there is a need for the bank to re-assess the strategic direction of its IBW operations to ascertain the business viability and strategic focus moving forward.

9. [redacted] risk management control functions are expected to be continuously robust in identifying emerging risks and to undertake pre-emptive interventions in mitigating the risks at the early stage. Based on our supervisory review, there were several potential risk areas which require closer monitoring and greater oversight by [redacted] Board and senior management.

9.1 Potential Risk Emanating from Consumer Banking Portfolio

9.1.1 The bank has recorded a contraction in its overall mortgage portfolio by RM0.6b or 6.3%, from RM10.5b as at 31 December 2009 to RM9.8b as at 30 September 2010. However, the 30 day-past-due (dpd) has increased to 5.43% or RM534.5m (Dec'09: 4.4% or RM465.0m). In addition, there were signs of heightened risk profile of the mortgage portfolio as reflected by a moderate upward trend in the R&R loans from RM958.1m (Dec'09) to RM1,043.5m (Sept'10). The bank has also relaxed its underwritting standards since second half of 2009, where its Loan to Value (LTV) was increased from its previous capping of 80% to a maximum of 89% on a selective basis.

9.1.2 On the contrary, credit card portfolio recorded a significant growth in 2010 of 16.3% as compared with 2.2% growth in December 2009. The loans under 30dpd and 90dpd have increased to RM338.0m (Dec'09: RM334.0m) and RM93.0m (Dec'09: RM90.0m) respectively. The bank's R&R loans have also increased significantly by 8.4% or RM53.9m from December 2009 coupled with higher 30dpd (Sept'10:11.1% ; Dec'09: 9.8%) and 90dpd (Sept'10: 2.3% ; Dec'09: 1.9%).

The increasing trends in loan delinquencies and rehabilitation of consumer loans are expected to continue in the near future, mainly driven by the global economic challenges and rising interest rate environment which may affect the repayment capacity of the borrowers.

In this regard, the bank should put in place active portfolio management to enable timely interventions in containing emerging risks at the early stage. The bank is also expected to ensure the relaxation in its underwriting standards will not compromise the overall quality of its mortgage portfolio.

9.2 Increasing Risk from Foreign Exchange (FX) Activities

The bank's USD Net Open Position has been trending upward since May 2010 with its exposure culminating at 25% of capital base (USD292.0m) in September 2010. Given the increasing volatility and heightened uncertainties in the FX market, the risks emanating from its FX positions may pose a significant threat to the bank's earnings, if not well mitigated. The bank is expected to ensure that its FX risk-taking activities are within its risk tolerance levels and subject to increased oversight by the Board and senior management. In addition, measures must be in place to ensure that the bank does not facilitate any speculative trading of Ringgit by its customers. The bank is required to verify that all customers' FX transactions are adequately supported by genuine underlying trade transactions and such verifications are undertaken on a continous basis.

Confidentiality of Supervisory Information

10. This letter has been prepared for regulatory purposes only and its contents should be treated as confidential and should not be used for any other purposes. The contents also should not be disclosed to any party other than your members of the Board, management team, relevant employees and external auditors.

Concluding Remarks

11. The issues highlighted during our supervisory reviews should be tabled at your next Board of Directors' meeting. Please revert to us with confirmation by **10 February 2011** that the contents of this supervisory letter has been reviewed and considered by your Board. Please also provide details of the actions taken or planned with their respective timelines by **10 February 2011.**

12. Should you have any query relating to the content of this letter, please do not hesitate to contact [redacted].

13. We would like to take this opportunity to thank the management and staff of [redacted] for the co-operation and assistance extended to our supervisors throughout the supervision period.

Sekian,harap maklum.

Yang Benar,

s.k.: Pengerusi, JawatanKuasa Audit, [redacted]
Ketua Pegawai Eksekutif [redacted]
Ketua Pegawai Eksekutif, [redacted]