

## **Opening Statement of Charles Prince**

**Before the Senate Permanent Subcommittee on Investigations**

**December 11, 2002**

### **Introduction**

Thank you Mr. Chairman and members of the Committee.

My name is Chuck Prince. Since September of this year, I have been Chief Executive Officer of Citigroup's Global Corporate and Investment Bank. Before that, I was Chief Operating Officer of Citigroup, and have been with the company or its predecessors for the past 23 years. I appreciate the opportunity to appear before you to discuss these important issues and commend you on your determination to understand how and why a Fortune 10 company like Enron could unravel so quickly and to such devastating effect. The collapse of that company has been a disaster for thousands of people -- employees, investors and others -- and making sure that similar events do not happen again is a critically important objective that we share.

The last year has been a challenging one on Wall Street. Industry practices that were standard operating procedure for years have come under sharp scrutiny by Congress, regulators and investors. Many of these practices have been changed and others are in the process of changing. Although it has not always been pleasant, we believe it has been a useful and largely constructive process. For our part, we want to be at the forefront of change, setting a standard for integrity and professionalism in our industry. This has become a guiding mission for the senior management of our entire organization.

Enron and its aftermath has, indeed, been a catalyst for change in our industry more generally, and we recognize that while we have sought a leadership role, many other financial institutions are examining their own ways of doing business and making changes. And, of course, legislators and regulators have been and continue to be critical drivers of the reform process.

Part of our process of self-examination has included the recognition that we have engaged in certain activities that do not reflect the way we believe business ought to be done going forward.

Let me be clear: I believe that the Citigroup professionals involved with these transactions acted in good faith and understood these transactions to comply with the existing law and prevailing standards of the time. But let me be equally clear: good faith and legal compliance are no longer the issue as far as I'm concerned. Even assuming that these transactions were entered into in good faith and were entirely lawful, they do not reflect our standards and they would not happen now, at Citigroup. The facts that have been uncovered about Enron and other companies show us that opaque transactions like those Enron sought to take advantage of do not serve the interests of the capital markets and clearly do not serve the interests of institutions like ours, because they undermine our credibility with investors. Our credibility is our most important asset.

Recognizing the problems our industry faces, we have worked diligently to develop new practices and policies reflecting the lessons we've learned. When Sandy Weill asked me to take the helm at the GCIB three months ago, he gave me a mandate to accelerate the process of reform and change that was already underway in that

business. Before turning to the specific arena of structured finance that is the focus of this hearing, I think it would be useful for me to briefly outline the broader reforms that Citigroup has taken a leadership role to institute.

### **Citigroup's Recent Reforms**

In facing a variety of industry-related challenges, Citigroup has instituted a number of leading reforms:

- **Strong Code of Conduct** -- Citigroup's Board of Directors recently approved an updated and strengthened Code of Conduct for all employees. In addition, much earlier this year, we initiated a complete review of our compliance and governance that has already resulted in significant changes.
- **Expensing stock options** -- Citigroup was among the first of the major financial institutions to adopt the proposal to expense stock options.
- **Pension reform** -- Citigroup has taken steps so that, by year end, Citigroup's pension will be fully funded.
- **Independent research**
  - We were the first major firm to voluntarily adopt the Spitzer Principles to insulate equity research from investment banking.
  - We were the first major firm to adopt the SEC's proposal that analysts certify their research, putting the requirement into place immediately after it was proposed.
  - We were the first, and so far the only, major firm to structurally separate research from investment banking by moving it into a new independent business unit, headed by Sallie Krawcheck, former CEO of the research

firm Sanford A. Bernstein and a leading voice on analyst independence.

This structure ensures the independence of research from investment banking.

- While we continue to work with the industry and regulators on reforms designed to protect the independence of research, last month we unilaterally adopted interim policies governing the ways that research analysts may interact with investment bankers. These policies prohibit analysts from attending investment banking pitches or road shows, and include other significant limitations on the circumstances in which analysts and bankers may interact, as well as gate keeping procedures to monitor those interactions.
- Ongoing review of business practices -- We have established a new corporate-level Business Practices Committee to ensure that all business practices are consistent with industry leading standards.
- Corporate governance -- Our Board formed a new Nomination and Governance Committee chaired by Frank Thomas -- our longest serving independent board member and the former President of the Ford Foundation -- to ensure continued focus on the highest standards of corporate governance.
- Auditor consulting -- To avoid even the appearance of conflicts, Citigroup does not use its outside auditor for consulting. Our auditor only provides audit, audit-related and tax services.
- Control processes -- We have strengthened an already robust control environment by, among other things: establishing a Business Practices

Committee specifically for the GCIB and requiring that our Capital Markets Approval Committee (CMAC) periodically report to that Committee on transactions it reviews; expanding the jurisdiction of the CMAC to cover all complex transactions that raise accounting issues; requiring formalized approval of the creation of new legal vehicles, including Special Purpose Vehicles, as well as enhanced review of transactions involving the use of SPVs; and establishing a rigorous policy governing tax sensitive transactions.

### **Structured Finance -- The Transactions at Issue**

Let me turn now to the issue of structured transactions that is the focus of today's hearing and was the focus of the hearing you held, Mr. Chairman, on July 23 of this year. As I hope you will agree when I discuss the reform initiative we announced just two weeks after that hearing, at Citigroup we heard you and we took appropriate action.

First, though, let me say a few words about the specific transactions under review. While I believe our people acted in good faith, I think it is fair to say that we never anticipated -- no one ever anticipated -- that a financial intermediary would be criticized for the accuracy of the accounting treatment that a Fortune 10 company gave to its transactions with the express approval of a then-highly respected Big Five accounting firm. At the time we entered into these transactions, we never imagined -- no one ever imagined -- that Arthur Andersen wouldn't exist a year later or that a failure of ethics would have destroyed Enron, a company ranked 18th on the list of *Fortune Magazine's* Most Admired Companies for the year 2001. But we all learned something - that reliance on public accountants or a company's widely held excellent reputation has important limits, particularly in the face of corporate malfeasance.

## **Structured Finance -- Citigroup's Reform**

To say that our professionals acted in good faith and in ways they believed to be appropriate is not to say that we consider a business-as-usual approach to be an acceptable prescription going forward. On the contrary, we concluded in the days and weeks following your July 23 hearing that we needed to act, even in the absence of industry or regulatory action, and that the best way to protect both investors and our own reputation with regard to the kinds of transactions that appropriately concern this Committee was to insist on transparency. The regulators have recognized the same principle, and indeed last January recommended guidance for the disclosure of off balance sheet and related transactions. But, in the absence of any mandatory rules, we recognized that we needed to play a leadership role by requiring companies with whom we did business to make clear, straightforward disclosure of the impact of structured financings and related transactions.

Accordingly, on August 7, Citigroup announced a new transparency policy, saying, in essence, that from that day forward, Citigroup would execute material financing transactions for companies that were not going to be recorded as debt on their balance sheet if -- and only if -- the company agreed to disclose the net effect of the transaction on its financial condition. We announced this "net effect" rule for two reasons -- first, to encourage companies to account for financings in a transparent manner so that investors can adequately assess the net effect of the transaction on the financial condition of the company, and second because we simply did not wish to be a party to transactions that fail to meet a high standard of transparency. Under our net

effect rule, the transactions at issue in today's hearing would not and could not have happened at Citigroup unless Enron had made clear, detailed disclosure to investors. We simply would have refused to do these transactions without a commitment to make such disclosures.

**The Policy.** Our policy is based on a few key principles. First, it applies to any material structured or complex financing transaction of the sort this Committee has been concerned about. In determining whether the policy applies to a given transaction, the economic reality -- not just the form of the transaction -- is critical.

Second, the required disclosures include, among other things, (1) management's analysis of the net effect of the transaction on the financial condition of the company; (2) the nature and amount of the obligations; and (3) a description of events that may cause an obligation to arise, increase, or become accelerated. Examples of appropriate disclosures might include: the transaction amount, the term (including the economic features that could shorten the maturity, such as step-ups, ratings triggers, or events of default), any recourse, and the effect on assets, liabilities, net income, earnings per share, cash flow or other significant balance sheet items. The precise elements of the required disclosure will vary depending on the transaction.

Third, Citigroup will obtain the client's written commitment that disclosure of such transactions in the client's relevant public filings will fairly present the transaction's financial impact. If we do not receive this commitment, we will not do the deal.

Fourth, Citigroup will do these transactions only for clients that agree to provide the complete set of transaction documents to their chief financial officer, chief legal officer and independent auditors. If there are any oral assurances from the client in

connection with any transaction that Citigroup believes may give rise to accounting or disclosure issues, these have to be documented and then included with such transaction documents.

Fifth, key decisions, such as whether the policy requires additional disclosure in a particular transaction, are made by senior management from our Accounting Advisory, Legal and Risk Management control functions, acting together. If the senior managers of our control functions do not approve a proposed transaction then, very simply, that transaction will not go forward. Concerns about accounting or similar matters must be fully resolved and documented if a transaction is to go forward. I am committed to making sure that our new procedures are fully observed. In order to do that, we are enhancing our decision-making process so that, at every step, decisions are documented and our internal audit group can review and verify compliance with our procedures.

**Implementation.** Promptly after Citigroup announced this transparency policy, we erected what amounted to a roadblock for each structured finance and related transaction to see whether it was the kind of transaction that would not be reflected as debt on the balance sheet, and should therefore be specially disclosed to the company's investors. None of these transactions was permitted to go forward unless it was submitted to a rigorous examination process by a working group composed of top management from Financial, Legal and Risk Management control functions. This process, while initially cumbersome, served both to ensure that the policy was implemented immediately upon its enactment and to educate the business units about the details of the policy. As we move forward, we are continually adjusting and fine



tuning the process to allow for more efficient, but equally rigorous, review. We are now preparing to launch a training program that will be based on our experience so far and informed by the SEC's new proposed disclosure rules.

We recognize, of course, that our execution will not be perfect. We are feeling our way, seeing what works, discovering the challenges of applying a policy like this to an enormous range of complex transactions. Leaders, by definition, move in uncharted territory and will make some mistakes.

But I am quite encouraged by what I have seen so far -- by the seriousness and intensity with which Citigroup professionals are grappling with this new policy, from the transactional people on the front lines to the most senior managers of our company. It has already made a measurable difference in the kinds of deals we are doing or declining to do and in the nature of the disclosure clients are making.

### **SEC's Proposed Disclosure Rules**

Of course, our unilateral initiatives do not satisfy the need for a strong, independent accounting profession and for clear regulatory guidance. In this regard, we were pleased that the Sarbanes-Oxley law takes a number of important steps, such as requiring auditors to give up certain consulting duties in light of their potential to create at least the appearance of a conflict of interest, and mandating new SEC rules on the periodic reporting of off balance sheet transactions, which were just released in proposed form by the SEC last month.

We embrace the SEC's proposed rules. They are properly directed at public companies and issuers, since the legal disclosure obligation belongs to them, not to financial intermediaries. The SEC's proposed rules follow earlier guidance from the

SEC on this subject, issued last January, which Citigroup followed in disclosing off balance sheet transactions in our most recent 10-K filing. Having done so, our own disclosures are now in substantial conformance with the SEC's most recent proposals. We will, of course, fully comply with the new SEC requirements when the proposals are finalized. Greater transparency is also important to us as a lender and underwriter, since in those roles we necessarily place much reliance on financial statements.

The SEC's new proposed rules, when finalized, will supersede one objective of our net effect rule -- the one aimed at prodding companies to make better disclosure -- because that role appropriately will be played by the SEC, with the more comprehensive scope and forceful tools that a regulator commands. At the same time, the other objective of our net effect rule -- assuring that we don't walk into transactions that we would be better off avoiding -- remains fully in force. We recognize that as a financial intermediary -- even though the legal disclosure obligation is not ours -- we have an active interest in sustaining the credibility of the financial markets, the confidence of investors, and our own reputation.

### **Conclusion**

Mr. Chairman, the world has changed markedly in the past year and is continuing to change. The collapse of Enron and the turmoil that followed on Wall Street has done tremendous damage to a great many people and businesses. We recognize that we must take real steps to change our ways of doing business and get real results. We have done this and are continuing to do more. This is not a time for half measures or foot-dragging or public relations gimmicks. We at Citigroup understand our role as a

leader, embrace the mandate for change, and subscribe to the goal of effective, far-reaching reform.

We appreciate the seriousness and vigor with which you approach these issues, and look forward to working with you and your colleagues on these and other reforms.

I thank you and look forward to answering your questions.