

Environmental and Social Risk Management

In 2003 Citi Markets & Banking (CMB) developed the Environmental and Social Risk Management (ESRM) Policy to help address environmental and social issues from both a credit risk perspective and a reputation and franchise risk perspective. Our market-leading ESRM Policy helps guide thousands of bankers on complex and challenging transactions. It provides a general framework that refers to the Equator Principles, the International Finance Corporation (IFC) Performance Standards and the IFC Environmental, Health and Safety (EHS) Guidelines for further guidance. The IFC EHS Guidelines include both General EHS Guidelines (which, in addition to environmental issues, cover worker and community health and safety) and 63 sector-specific EHS Guidelines. Citi's ESRM Policy applies to all transactions globally with known use of proceeds that meet threshold limits. In addition, corporate loans or hybrid transactions in emerging markets must adhere to the IFC standards and guidelines.

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ESRM policy update

Since 2004 we have refined the Policy several times. In January 2008* we added a section on *Areas of High Caution and Special Focus: Critical Habitat and Areas of High Conservation Value, Areas of Significant Cultural and Heritage Value, Indigenous Peoples and Large-scale Resettlement*. This update also incorporated specific climate risk assessment steps into the review process for U.S.-based thermal power projects. Our Policy continues to prohibit activities or transactions that involve significant conversion or degradation of critical habitat or utilize forced labor or harmful child labor.

* Development of this section took place in 2007.

The Equator Principles

Citi was one of the founding members of the Equator Principles in 2003 and continues to be a leader in the Equator Principles network today, with Citi's ESRM Director currently serving on the Equator Principles Steering Committee. Citi played an integral leadership role in updating the Equator Principles in 2006. For more information, please see the webpage. [www](#)

The ESRM Unit supports the business teams by

- advising on and reviewing transactions covered by the ESRM Policy, as well as monitoring these transactions over time;
- providing training on the Policy to relevant Citi employees;
- acting as the primary point of contact between stakeholder groups and Citi for issues related to the Equator Principles;
- working with other Equator Principle Financial Institutions to develop Equator Principles best practices; and
- revising the Policy as necessary.

In addition to the ESRM core management and team members in New York, Citi has appointed regional ESRM Champions. These Champions are high-level senior credit officers located in different countries around the world. They enable Citi to provide timely advice, oversight and guidance related to ESRM Policy application, informed by local knowledge about their specific geographical region and business lines. Additionally, certain senior credit officers have been appointed as ESRM Approvers with review and approval responsibilities for Category A transactions.

Our ESRM Policy covers a broad range of product types in addition to project finance transactions subject to the Equator Principles. In 2008, we broadened the kinds of transactions covered under the policy to include Acquisition Finance.

Transaction / Product Type	Required Threshold Amount
Transactions subject to the Equator Principles and Citi ESRM Policy	
Project Finance Transactions and Project Finance Advisories	Project capital costs above \$10 million
Other Transactions Subject to Citi ESRM Policy	
Project Finance: Existing Projects and Refinancings	Project capital costs above \$10 million
Corporate and Government Loans	Total facility amount above \$50 million
Official and Export Agency Loans	Total facility amount above \$50 million
Acquisition Finance	Total facility amount above \$50 million
Debt Securities Placements or Underwritings (Bonds)	Underwriter or arranger of debt securities placements or underwritings in excess of \$50 million
Equity Investment or Equity Underwriting Transactions	Citi equity investment in excess of \$5 million Underwriter, arranger, or placement agent for the selling of equity securities in excess of \$50 million
LCs, Bid Bonds and Performance Bonds	Relevant instruments in excess of \$50 million

Ensuring compliance

CMB’s independent Audit Risk and Review (ARR) group conducts periodic compliance audits so that Citi business units are appropriately applying relevant CMB Policies in transactions. In consultation with the ESRM Unit, ARR reviews whether affected business units have complied with internal ESRM Policy requirements under covered product credit programs.


ESRM Unit: The ESRM Unit serves as a technical resource and counsel for CMB on a wide variety of environmental and social risk issues.	Portfolio Banker: Continues ESRM monitoring over life of loan, in consultation with ESRM Director, as needed.
	ESRM Approvers: Senior credit officers are appointed ESRM Approvers by CMB’s Chief Risk Officer. The ESRM Approvers have review and approval responsibilities for transactions with sensitive environmental and social risks.
	Transactor: Screens transactions and complies with approval, analysis, documentation, and process requirements.

ESRM Policy implementation is a shared responsibility across Citi, including Bankers, Independent Risk Managers and the ESRM Unit. Please visit our website at www.citi.com/esrm for a detailed description of a typical project finance review, approval and monitoring cycle.


Transactions Receiving ESRM Review (By Product Type)

Transactions	2007 Total (Category A, B, C, & N/A*)	2007 Category A	2006 Total (Category A, B, C, & N/A)	2006 Category A
Project Finance (subject to the Equator Principles)	64	17	86	20
Project Finance Advisories (subject to the Equator Principles)	14	9	39	17
Corporate and Government Loans	217	30	208	26
Debt and Equity Underwriting	45	17	29	6
Other (i.e., Acquisition Finance, Letters of Credit, Refinancings)	160	12	76	1
Total	500	85	438	70


*N/A applies to transactions that were reviewed by the ESRM Unit, but were not formally subject to the ESRM Policy (i.e., non-covered product type or did not meet Policy threshold).

United States and Canada



Total ESRM Reviewed	2007	2006
Transactions:	66	59
Category A:	5	4

Latin America and the Caribbean


Total ESRM Reviewed	2007	2006
Transactions:	129	116
Category A:	18	17

Europe, Middle East and Africa


Total ESRM Reviewed	2007	2006
Transactions:	160	163
Category A:	24	23

Asia Pacific


Total ESRM Reviewed	2007	2006
Transactions:	145	100
Category A:	38	26

ESRM transaction review

Citi tracks all transactions reviewed by the ESRM Unit, along with the ongoing advice that is provided, in a master database. Transactions are added into the database at the marketing stage, regardless of whether Citi ultimately proceeds with the transaction.

Transactions are classified into three environmental and social risk categories as defined under the ESRM Policy:

- **Category A** — Use of proceeds is expected to have significant adverse social and/or environmental impacts that are diverse, irreversible, or unprecedented.
- **Category B** — Use of proceeds is expected to have limited adverse social and/or environmental impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures.
- **Category C** — Use of proceeds is expected to have minimal or no adverse impacts.

When an ESRM-covered transaction is deemed Category A, an ESRM Approver (designated senior credit officer) must review and approve the transaction, in consultation with the ESRM Director.

PROJECT FINANCE

The Equator Principles apply to project finance transactions in all industry sectors globally. In 2007, 64 project finance transactions were subject to the Equator Principles and received ESRM review and advice. Citi funded 9 project finance transactions in 2007, some of which were initiated and reviewed in previous years. Project finance transactions may not reach the funding stage for a number of reasons not related to ESRM review, including financial or credit challenges, lost bids and decisions by project sponsors to use a different financing structure. Citi was also awarded six project finance advisories in 2007— which are now a covered product type under the 2006 revision to the Equator Principles.

CASE STUDIES

Helping clients manage risk

In 2007 Citi added significant value to a large-scale aluminum complex in the Middle East and Africa region by helping to define and structure compliance with the Equator Principles. Following Citi’s counsel, the client prepared a full Environmental and Social Impact Assessment and Environmental and Social Management Plan. The Management Plan enhanced the project in numerous ways, including identification of concrete steps to improve air quality impacts, waste management, and health and safety practices, as well as the creation of public consultation sessions to assess community concerns.

Advising an infrastructure fund

Citi partnered with a leading financial services company to launch a \$1 billion infrastructure fund in an important emerging market. The fund will invest in a diversified portfolio of project equity investments in the infrastructure sector. Since specific investments were not yet identified, Citi’s ESRM team reviewed the fund’s investment policy and advised the transaction team how to integrate environmental and social risks into the fund’s risk management processes.

Evaluating risks in a challenging transaction

In early 2007 Citi was in discussions with a mining company to arrange equity financing for significant expansion of an existing mine. Citi determined that it was a Category A transaction due to significant, challenging legacy social and environmental issues and because the transaction would require the involuntary resettlement of numerous households and negatively impact cultural property. In accordance with our ESRM Policy and under the advice of the ESRM Unit, the sponsoring business unit engaged an independent consultant to review the transaction’s Environmental Impact Assessment documentation. Citi declined to participate in the transaction as the findings indicated that the project would not be able to achieve compliance with the IFC Performance Standards.

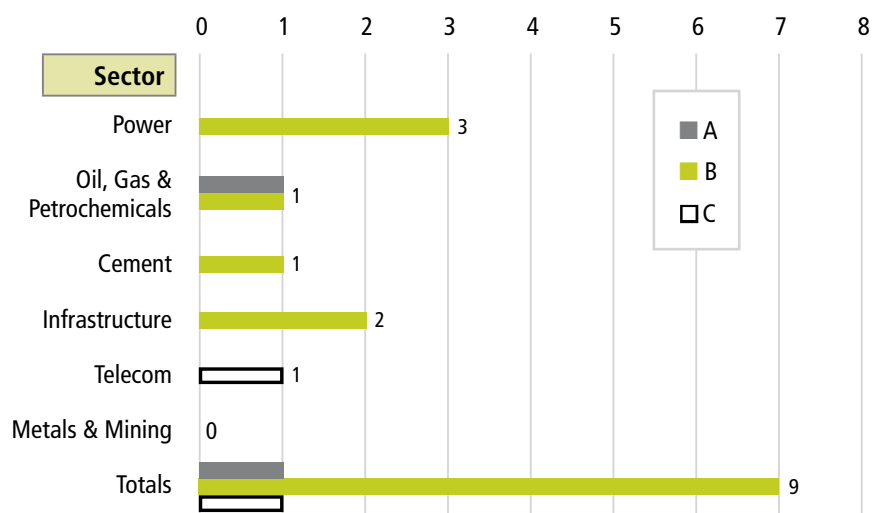
2007 Project Finance Transactions Subject to the Equator Principles

ESRM Category	Project Finance Transactions Reviewed at Marketing Stage	Project Finance Transactions Funded (with Combined Total Project Capital Costs)		Mandated Project Finance Advisories
A	17	1	\$3.5 billion	3
B	45	7	\$10.3 billion	3
C	2	1	\$5.7 billion	0
Total	64	9**	\$19.5 billion	6

Citi confirmed that all project finance transactions subject to the Equator Principles in 2007 and 2006 met all key process requirements for all Category A projects, including conducting and publishing an environmental assessment, organizing a public consultation/review of the project, preparing and covenanting an environmental management or action plan and having the project reviewed by an independent expert.

****NOTE**** Projects fail to reach the funding stage for a number of reasons beyond that of a negative ESRM review, including financial or credit challenges, lost bids and decisions by project sponsors to use a different financing structure.

2007 Funded Project Finance Transactions by Sector and Category



Training, communication and awareness-raising

Citi's size, geographically dispersed locations and growth through mergers and acquisitions demands a concentrated effort to raise awareness about our internal environmental policies and programs and to achieve robust application of our standards. In 2007, 910 Citi bankers, relationship managers, industry specialists and risk managers worldwide completed training programs on our ESRM Policy, a marked increase from the 556 Citi participants trained in 2006. These training sessions are composed of a combination of lecture, video, case studies and interactive group exercises that simulate application of the ESRM Policy during credit review and also emphasize the IFC Performance Standards and EHS Guidelines as integral components of the policy.

In partnership with Sustainable Finance Ltd, Citi's ESRM Unit finalized and disseminated a web-based training program that is available to Citi employees globally. This innovative e-learning instrument uses flash animation and interactive decision tools to allow bankers to role play the ESRM credit review process on real case studies. The web module will allow for greater ESRM training coverage, leading to more consistent application of the ESRM policy across business lines and products.

Sustainable forestry: putting policy into action

To avoid financing companies that violate local or national laws regarding illegal logging, we have incorporated a Sustainable Forestry Policy into our ESRM Policy requirements. We apply the Sustainable Forestry Policy to clients that are directly involved in logging or primary processing of timber. In addition to satisfying all ESRM Policy requirements, forestry clients operating in countries with a high

"Citi's Sustainable Forestry Policy addresses critical issues related to lending practices in the forestry sector—illegal logging, deforestation and relations with indigenous communities. These are challenging concerns confronting Citi relationship managers and bankers. Rainforest Alliance and Citi's ESRM Unit worked together to create a training program that provided the context and background needed to make such concerns more relevant to the Bankers' everyday transactions."

Jeffrey Hayward

SmartWood, Rainforest Alliance

rate of illegal logging must achieve independent certification, including confirmation of compliance with all applicable laws and regulations within an agreed timeframe (e.g., 3-5 years). Furthermore, the bankers managing the relationship must conduct a Forest Products Obligor Risk Assessment during the clients' annual review process. The full policy is available on our website. [www](#)

To increase understanding about forestry sector issues and train bankers on the Sustainable Forestry Policy, the ESRM Unit partnered with Rainforest Alliance, an internationally recognized forest certification organization, to develop and deliver two day-long Forestry and Finance Workshops in Kuala Lumpur, Malaysia, and New York City.





Citi addresses the financing of U.S.-based coal-fired power plants

In 2007 a number of stakeholder groups engaged with Citi through campaigns, dialogues and one shareholder resolution on the issue of climate and Citi's work with clients in greenhouse gas-intensive sectors. In some of these cases, the advocates requested that Citi cease all financing related to coal-fired power generation.

As documented throughout this report, Citi is deeply concerned about the impacts of climate change and has taken a leadership role in developing the recently launched Carbon Principles. We respect stakeholders' commitment to the issue of global warming. We do not, however, agree that ending all financing for coal-fired power plants is the most effective way for Citi to address climate change, especially as coal currently supplies more than 50% of all electricity in the United States. We believe it is better to continue engaging with clients, regulators, environmental groups and other stakeholders to develop and advance responsible market-based solutions to climate change, and we will continue to do so while respectfully engaging with all stakeholders around this issue.

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