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Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Notice of Proposed Rulemaking Implementing Sections 165 and 166 of the Dodd-Frank Act -- Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies: Federal Reserve Docket No. 1438 and RIN 7100-AD-86

Ladies and Gentlemen:

Citigroup Inc. would like to take this opportunity to comment on the notice of proposed rulemaking implementing Sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). Citi actively participated in the drafting of (i) the joint comment letter being submitted by The Clearing House, the American Bankers Association ("ABA"), The Financial Services Roundtable, and the Securities Industry and Financial Markets Association ("Joint Industry Letter"), (ii) the comment letter being submitted by the ABA Securities Association ("ABASA Letter"), and (iii) the comment letter being submitted by the Risk Management Association ("RMA Letter"), and has engaged directly with staff from the Board of Governors of the Federal Reserve System ("Federal Reserve Board") on several aspects of the proposed rule.

Citi supports the Joint Industry Letter, ABASA Letter and RMA Letter, and will not repeat in this letter the technical points raised therein. But there are several critical concerns that we want to emphasize with respect to the single counterparty credit limits ("Proposed Counterparty Credit Limits").

We believe that the core objectives of the Proposed Counterparty Credit Limits are to limit the interconnectedness among large financial companies and limit concentrations of risk within large financial companies. We support these core objectives, but believe that the Proposed Counterparty Credit Limits greatly overstate credit exposures, particularly with respect to counterparty exposure arising from derivatives. This overstatement will require financial institutions to substantially reduce credit activities with large corporations, central counterparties (“CCPs”), other financial institutions and non-U.S. sovereigns, in order to remain within the defined limits. As a result, major U.S. banking firms will be faced with the unappealing choices of lending less, hedging less, or hedging with less sophisticated and less well-capitalized counterparties. We believe that all of these alternatives would have significant detrimental impacts on financial markets and their participants.

We recommend that the Federal Reserve Board recalibrate the Proposed Counterparty Credit Limits in light of three primary concerns, described below, as well as those raised in the Joint Industry Letter, ABASA Letter and RMA Letter.

- 1. The Proposed Counterparty Credit Limits greatly overstate credit exposures, particularly with respect to counterparty exposure arising from derivatives, as a result of the Current Exposure Methodology (“CEM”) as well as the mandatory notional shifting of credit default swaps. The overstatement of the credit exposure will require financial institutions to substantially reduce lending to customers, reduce market-making activities in derivative instruments on behalf of customers, and either purchase less credit protection, or purchase credit protection from smaller, less well-capitalized institutions or from “shadow banking” firms.**

The Proposed Counterparty Credit Limits, by relying on the CEM approach to measure counterparty exposure arising from derivative contracts, ignore advanced risk measurement methodologies that were developed over the past several decades with quantitative experts and U.S. and international regulators. The key deficiency of CEM is that by its nature it is unable to fully take into account the effect of legally enforceable netting and margin agreements on potential future exposures, thereby substantially overstating the net credit exposure between counterparties. Citi believes that firms should be permitted to use advanced risk measurement methodologies, as an alternative to CEM, with appropriate supervisory oversight, including validation and back-testing. To answer concerns that these advanced methodologies may be inconsistently calibrated among firms, key inputs and assumptions (such as confidence levels) can be set by regulators.

Of equal concern is the requirement to shift the notional exposure on all purchased credit default swaps away from the reference entity and to the counterparty (the protection provider) when the firm has any long credit exposure to the reference entity, whether arising from loans, debt securities or derivative transactions. Such a requirement is of concern for two reasons. First, it implicitly assumes that all reference entities default, and that all protection providers also default simultaneously – clearly a scenario beyond the boundaries of “tail events” and not appropriate for what is intended to be a business-as-usual operating limit. Second, it treats all purchased credit default swaps as “linked” to other reference entity exposures, when for most large firms, the majority of credit default swaps are bought and sold as part of customer market-making activity in trading portfolios (the “public” side), and with no permitted linkage to banking book exposures

on the “private” side. Creating such an artificial linkage will mean that a decision to extend credit to a corporate customer in the banking book may be precluded if the trading book has already purchased credit default swaps on that corporate name from a given counterparty where such counterparty is near its maximum counterparty limit. (In other words, the new loan in the banking book to a corporate name would trigger a requirement to shift the notional of the credit default swap to the protection provider, thereby increasing exposure to the protection provider.)

We believe a more appropriate approach would be to permit a banking firm to choose whether to shift net credit exposure away from the reference entity, and to the counterparty, based on the underlying intent of the purchased credit default swap. Shifting may be appropriate for a credit default swap purchased explicitly as a hedge against a loan in the banking book, but it would not be for a credit default swap purchased as part of market-making activity.

2. **The Proposed Counterparty Credit Limits run counter to regulatory efforts to have much of the derivatives market cleared with CCPs. As drafted, major U.S. banking firms would have already breached, or be close to breaching, their Proposed Counterparty Credit Limits to certain key CCPs. As such, the Proposed Counterparty Credit Limits would serve to discourage and reduce centralized clearing of derivatives – running counter to many of the Dodd-Frank Act reforms that seek to increase use of CCPs in order to increase transparency in markets and reduce systemic risk.**

Citi believes that a better approach would be to have the Proposed Counterparty Credit Limits exempt credit exposures to a “qualifying central counterparty” where the Federal Reserve Board has concluded the CCP is in sound financial condition and is subject to effective oversight by a national supervisory authority. We support a global regulatory approach towards CCPs that includes strict capital, liquidity, risk management, resolution and supervision standards.

- 3. The Proposed Counterparty Credit Limits require that all non-U.S. sovereign debt (including securities posted as collateral) be counted against counterparty limits, even if the sovereign debt securities are issued by highly rated sovereigns. Such limits are inappropriate for the highest quality sovereign debt, which is widely accepted as collateral for various derivative transactions, likely will meet the margin requirements for over-the-counter derivatives, and is also considered to be “liquid” under Basel III. If U.S. banking firms must curtail their acceptance of such sovereign debt securities as collateral, this discourages international trade flows and makes it more expensive for non-U.S. sovereigns to access capital market funding.**

Citi believes it would be more appropriate to introduce a “tiered” limit structure for non-U.S. sovereign exposures, creating more expansive limits for those high quality sovereigns, as determined by objective external standards.

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In light of these concerns, and those expressed by the industry, Citi recommends that the Federal Reserve reconsider its Proposed Counterparty Credit Limits. Recalibration of certain components of the proposal will result in more meaningful measures of exposure between firms.

Such exposure could then be monitored and managed within limits and reduce systemic risk, without causing significant disruptions in the access of credit to all market participants. We strongly encourage a broad quantitative impact study of the potential impact of any proposed approach to this important initiative.

Regards,

/s/ Brian Leach
Brian Leach
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cc:

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