Meeting Between Staff of the Federal Reserve Board, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and Citigroup May 23, 2016

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Summary: Staff of the Federal Reserve Board, Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation met with representatives of Citigroup's Treasury department to discuss the notice of proposed rulemaking to establish the Net Stable Funding Ratio (NSFR) in the United States. Specifically, Citigroup's representatives discussed the conceptual basis for the NSFR, the individual available stable funding and required stable funding factors that are assigned to certain assets and liabilities and how they differ from the run-off rates assigned in the Liquidity Coverage Ratio rule. In addition, Citigroup's representatives discussed the treatment of derivatives, trade date payables and receivables, and interdependent assets and liabilities in the proposed rule.

Attachment

Citi's View on Proposed U.S. Net Stable Funding Ratio (NSFR)

May 23, 2016

U.S. Proposed Net Stable Funding Ratio

- Overall, Citi supports the U.S. regulatory approach on many key elements of the Proposal, as they:
  - Appropriately measure structural liquidity risk
  - Establish a standardized framework across the industry
  - Provide the necessary complement to the short-term Liquidity Coverage Ratio (LCR)

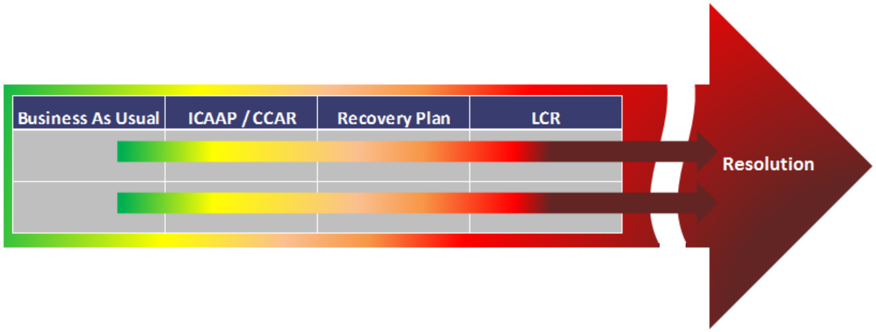
- However, certain elements of the Proposal differ from BCBS standards, and if maintained, can:
  - Create new, or widen existing, differences across jurisdictions
  - Makes comparison across internationally-active financial institutions challenging due to factors unrelated to their liquidity risk management practices and risk profiles

- As such, Citi plans to continue both bi-lateral and industry advocacy efforts to address several key elements of the Proposal, including:

  1. Stress Scenario Construct
  2. Treatment of Deposits
  3. Securities Valuation
  4. Treatment of Derivatives
  5. Trade Date Payables & Receivables
  6. Interdependent Assets and Liabilities

1. Construct of Scenario

➢ **The Proposal does not define the underlying scenario making it difficult to understand its place on the continuum of stress scenarios**



- Neither the Proposal, nor the BCBS standards, provide sufficient clarity on the market and/or firm-specific conditions under which the NSFR was calibrated

- Based on the severity of certain factors, the implied scenario appears to be more severe than the LCR scenario, which is a firm-specific crisis scenario; If so, this would challenge the presumption that NSFR was intended to be a 'going-concern' scenario
  - For instance, a 50% loss of wholesale operational deposits suggests an idiosyncratic event which would fuel clients to sever their customary working relationships; On the asset side, the assumed reduction of certain loan portfolios by up to 50% would likely cause significant franchise concerns

- While Citi does not advocate that all assumptions should be identical or less severe than LCR, its expectations is that both metrics, when considered together, should lead to reasonable comparisons and conclusions in light of their differing scenario definitions

- Internally, Citi maintains a comparable 'going-concern' stress test to ensure the maintenance of a sufficient level of structural liquidity to withstand an extended period of highly stressed market conditions
  - On Citi's internal continuum, this scenario more closely aligns with a Recovery Scenario

2. Treatment of Deposits

- **Non recognition of international deposit insurance programs, as well as partially insured domestic balances**

- The presence of deposit insurance programs clearly has some influence on depositor behavior - retail clients in particular – in both the domestic and international markets:
  - The security of deposit insurance, whether domestic or international, provides a level of protection to depositors which clearly warrants some differentiation in the determination of liquidity value
  - Outside of an idiosyncratic stress event, depositors are likely to limit the amount of funds transferred to another institution to the portion which exceeds the insurance limit; It is unlikely the transfer will include the insured portion unless the motivation for the transfer is firm specific

- **Deposit runoff is more severe than the firm-specific crisis scenario of LCR**

- Stable Domestic retail balances under the Proposal are assigned a higher runoff factor than LCR (5% vs 3%)
  - With respect to retail depositors, Citi's view is that the duration of a market event (12mths vs 1mth) would not necessarily result in a higher level of runoff; It is the severity of the scenario, and the firm specific impact of the scenario, that would determine the level of runoff

- Wholesale operational deposits are assigned a notably higher runoff rate under NSFR (50%), as compared to LCR (25%)
  - Citi does acknowledge that a longer duration scenario would provide an increased opportunity for clients to transfer operational activity to alternate providers
  - However, given existing relationships generally provide clients meaningful efficiencies/synergies, runoff of this magnitude would imply that the financial position of the covered company is significantly inferior to the alternative providers

3. Securities Valuation

- **Under the Proposal the valuation of High Quality Liquid Assets is more conservative than the shorter, more extreme LCR scenario**

- The Proposal assumes a reduced liquidity value for Level 1 assets, including unencumbered US Treasury positions
  - Level 1 assets, which are assumed to be fully liquidated in the 30-day stress, will require 10% stable funding under the existing Proposal
  - With a significantly longer liquidation period, the ability of a firm to liquidate HQLA securities, without pricing pressures, is dramatically higher, not lower

- Furthermore, given the longer duration and presumably less severe market conditions, market demand for higher quality securities would likely extend beyond those defined as HQLA under LCR market conditions

- Citi will continue to work with industry groups to ensure that the agencies receive constructive feedback which can be considered in developing the final ruleset.

4. Treatment of Derivatives

- **Citi acknowledges the inherent liquidity risks, as well as the need to maintain sufficient levels liquidity to fund existing positions and mitigate potential changes in the funding requirements**

- Citi's internal stress tests include reserves for the same derivative risks cited; However, the approaches to establish the reserve requirements are more dynamic than the binary approaches in the Proposal

- The Proposed approach is overly simplistic with inherent flaws which will result in imprecise funding requirements
  - Establishing the level of contingent funding requirements via the one-dimensional 20% charge will result in questionable outcomes; For example:
    - At inception of a position, the proposed approach would result in a zero derivative liability position, and therefore a contingent reserve of $0 for future MTM fluctuations
    - On the contrary, a 1-year old trade with a MTM loss of $100 which matures in a day, would require contingent funding of $20
  - Zero recognition of variation margin received in securities form, irrespective of quality, significantly overstates the potential market risk of the higher quality positions
    - RSF factors are calibrated to account for potential changes in market value; Unencumbered assets should be assigned the same RSF irrespective of its origin, particularly Level 1 & 2A securities

- Citi will continue to work with industry groups to ensure that the agencies receive constructive feedback which can be considered in developing the final ruleset

5. Trade Date Payables and Receivables

- **Proposal requires an RSF of 100% for the sale of financial instruments, foreign currencies or commodities which have failed to settle within the standard settlement period**
- **Conversely, the failure of a purchase is assigned a zero percent ASF factor**

- Operational issues, which are generally temporary in nature, can delay the settlement of financial transactions; however a majority of these issues are rectified and the transactions settle, as expected, with only a minimal delay
- Furthermore, in Citi's experience, there is a clear correlation between 'fail to deliver' and 'fail to receive' positions which is inconsistent with the proposed treatment
- Citi will continue to work with industry groups to ensure that the agencies receive constructive feedback which can be considered in developing the final ruleset

6. Interdependent Assets and Liabilities

- **While Citi acknowledges the underlying issues being addressed by the condition, we continue to believe that there are banking activities which meet the spirit of the rule but not necessarily letter**

- Several activities, including the TRS and Short-Sale examples cited in the Proposal, consist of a linked asset and liability which are interdependent due to fundamental risk management and balance-sheet management practices; While these positions are clearly linked, from the firm's perspective, they do not necessarily meet all of the conditions set forth by the BCBS

- As such, Citi will continue to work with industry groups to ensure that the agencies receive constructive feedback which can be considered in developing the final ruleset, including the examination of potential reforms to market convention to ascertain modifications required to eliminate the gaps and therefore eligibility

BCBS Interdependent Conditions:

(1) the interdependence of the asset and liability must be established on the basis of contractual arrangements
(2) the liability cannot fall due while the asset remains on the balance sheet
(3) the principal payment flows from the asset cannot be used for purposes other than repaying the liability
(4) the liability cannot be used to fund other assets
(5) the individual interdependent asset and liability must be clearly identifiable
(6) the maturity and principal amount of both the interdependent liability and asset must be the same
(7) the bank must be acting solely as a pass-through unit to channel the funding received from the liability into the corresponding interdependent asset
(8) the counterparties for each pair of interdependent liabilities and assets must not be the same