BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

June 15, 2007

Mr. John C. Gerspach
Controller and Chief Accounting Officer
Citigroup Inc.
399 Park Avenue
3rd Floor
New York, NY 10022

Dear Mr. Gerspach:

This is in response to your letter dated May 17, 2007, regarding the regulatory capital treatment of the Regulation T margin debits ("Reg. T margin loans") of the registered U.S. broker-dealer subsidiary of Citigroup Inc. ("Citigroup"), Citigroup Global Markets Inc. ("CGMI"). You ask that Citigroup be granted an exception from the Board's risk-based capital adequacy guidelines for bank holding companies (the "guidelines") (12 CFR part 225, App. A), which require a 100 percent risk weight for Reg. T margin loans. Specifically, you ask for an exception from the guidelines to permit Citigroup to assign a lower (such as 10 percent) risk weight to its Reg. T margin loans.

In the request, you contend that a lower risk weight for Citigroup's Reg. T margin loans would more closely align the regulatory capital requirement for such loans to the credit risk associated with such loans, given their high level of collateralization and Citigroup's long history of low loss rates on such loans. In support of your contention, you note that Citigroup's internal economic capital charge for credit risk on Reg. T margin loans is de minimis. You also state that a lower risk weight for Citigroup's Reg. T margin loans would be appropriate to, among other things, reduce competitive disadvantages that Citigroup (through CGMI) has relative to U.S. broker-dealers that are not consolidated subsidiaries of bank holding companies ("BHCs") and to non-U.S. banks and broker-dealers.

A margin account at a broker-dealer registered with the Securities and Exchange Commission ("SEC") is a leveraged account through which securities can be purchased, sold short, carried, or traded using a loan from the broker-dealer and a deposit of cash or securities by the customer. The amount of leverage available to a customer is limited by the Board's Regulation T (12 CFR part 220), the margin-maintenance rule of the New York Stock Exchange (NYSE Rule 431), and the lender's internal margin-maintenance requirements.[1] For example, a customer who purchases $100 of equity securities in a margin account may borrow only $50 against those securities from the broker-dealer under Regulation T. If this is the only transaction in the margin account, the loan will be 200 percent collateralized at the time of purchase because the market value of the securities is twice that of the margin loan. If, on a daily basis, the equity in the account falls below the required NYSE margin maintenance of 25 percent – that is, if the value of the collateral falls below 133 percent of the loan – the customer is required to post additional collateral (either cash or securities) to eliminate the margin deficiency. If the customer does not meet the margin call within the required time, the broker-dealer must sell sufficient securities in the account to increase the account equity to the required maintenance level. Your request also explains that Citigroup applies in most instances (and in all instances when the collateral is equities or non-investment-grade bonds) internal margin-maintenance requirements that exceed those in NYSE Rule 431.[2]

You have indicated that Citigroup's Reg. T margin loans are typically collateralized by liquid and readily marketable securities and generally can be terminated on demand at any time by Citigroup. You also have represented that Citigroup marks to market the Reg. T margin loans and associated securities collateral on a daily basis and makes daily margin-maintenance calls for any collateral deficiencies.

In addition, you have concluded that the collateral for a Reg. T margin loan generally should be available to Citigroup for prompt liquidation even in the event of the borrower's bankruptcy. The Board notes that the Ninth Circuit Court of Appeals held in 1998 that Regulation T securities collateral is exempt from the automatic stay under the U.S. Bankruptcy Code.[3] This judicial decision was reinforced by the 2005 amendments to the U.S. Bankruptcy Code. Section 901(b) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 defined the term "securities contract" – a class of transactions exempt from the automatic stay in bankruptcy – explicitly to include "margin loans." Moreover, the legislative history of the statute clarifies specifically that Congress considered Reg. T margin loans to be "margin loans" exempt from the automatic stay.[4] Therefore, if a Reg. T margin loan borrower were to file for bankruptcy, or otherwise become insolvent, Citigroup generally would be able to promptly liquidate the collateral for the loan.

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[1] If the broker-dealer is not a member of the NYSE, the margin-maintenance rule of the NASD (NASD Rule 2520) generally would apply instead. Both rules impose the same leverage limitations.

[2] Regulation T initial margin requirements and NYSE margin-maintenance requirements for debt securities and options differ from those applicable to equity securities.

[3] <u>In re Weisberg</u>, 136 F.3d 655, 659 (9th Cir. 1998).

[4] H.R. Rep. 109-31, 109th Cong., 1st Sess., p. 119 (2005).

As noted above, Reg. T margin loans held by U.S. BHCs currently are assigned to the 100 percent risk weight category under the guidelines, resulting in a risk-based capital requirement of 8 percent. In contrast, other domestic and foreign firms, including foreign banking organizations that own U.S. broker-dealers, as well as U.S. broker-dealers and consolidated supervised entities ("CSEs") regulated by the SEC, are currently required to hold either no or de minimis regulatory capital against Reg. T margin loans. You have maintained that the much higher regulatory capital requirement that U.S. BHCs incur for Reg. T margin loans places U.S. broker-dealers owned by U.S. BHCs at a disadvantage in competing for this low-risk business.

After carefully considering your request, and subject to the conditions listed below, the Board has approved an exception to the guidelines that permits Citigroup to treat Reg. T margin loans in a manner that differs from that set forth in the guidelines. Specifically, the Board will allow Citigroup to apply a 10 percent risk weight to its Reg. T margin loans. The Board has approved this exception under the reservation-of-authority provision contained in the guidelines (12 CFR part 225, App. A, § III.A). This provision permits the Board, on a case-by-case basis, to determine the appropriate risk weight for any asset or off-balance-sheet item that imposes risks on a BHC that are incommensurate with the risk weight otherwise specified in the guidelines.

To qualify for the capital treatment outlined above, Citigroup's Reg. T margin loans must meet the following conditions:

1. The securities collateral for the Reg. T margin loans is liquid and readily marketable;

2. The Reg. T margin loans and associated collateral are marked to market each business day;

3. The Reg. T margin loans are subject to initial margin requirements under Regulation T and daily margin-maintenance requirements under NYSE Rule 431; and

4. Citigroup has a reasonable basis for concluding that it would be able to liquidate the collateral for the Reg. T margin loans without undue delay, even in the case of bankruptcy or insolvency of the borrower.

The Board believes that the capital treatment approved above for Citigroup's Reg. T margin loans provides a more risk-sensitive treatment for these transactions than their treatment under the guidelines. The combination of initial margin requirements under Regulation T, ongoing margin-maintenance requirements under NYSE regulations, generally higher ongoing margin-maintenance requirements under Citigroup's internal policies, Citigroup's daily mark-to-market and margin-call policies, the high liquidity of the collateral, Citigroup's typical right to terminate the loan at any time, and Citigroup's general protection from the automatic stay in bankruptcy makes these loans a low-credit-risk product that warrants a 10 percent risk weight.

The Board also notes that lowering the risk-based capital requirement for Citigroup's Reg. T margin loans is fully consistent with the intent of the Gramm-Leach-Bliley Act of 1999 ("GLBA"), which authorized the creation of financial holding companies ("FHCs") and greatly expanded the scope of permissible activities for BHCs that meet the criteria to become FHCs. In enacting GLBA, Congress envisioned that the Board would, where appropriate, tailor its regulatory and supervisory framework, including risk-based capital standards, for FHCs that engage in a significant amount of securities-related activities.[5] Congress also expected the Board, to the extent feasible and consistent with safety and soundness considerations, to make the risk-based capital requirements for BHCs that own significant broker-dealers more consistent with the capital standards applied by the SEC to broker-dealers.[6] This exception accommodates Citigroup's broker-dealer activities in a risk-sensitive manner, helps remove an artificial and anachronistic constraint on certain of Citigroup's securities-based lending operations, and brings Citigroup's risk-based capital requirement for Reg. T margin loans more in accord with the capital requirement for such loans that the SEC imposes on broker-dealers and CSEs. Citigroup should be aware, however, that the Board may in the future impose a regulatory capital treatment for Reg. T margin loans that differs from the treatment described in this letter, depending in part on the outcome of the current efforts to implement the Basel II Capital Accord in the United States.

This determination is conditioned on Citigroup's compliance with all the commitments and representations it has made to the Board in connection with the request. These commitments and representations are deemed to be conditions imposed in writing by the Board in connection with granting the request and, as such, may be enforced in proceedings under applicable law. Further, this determination is based on the specific facts and circumstances described in the request and in your discussions with Federal Reserve staff. Any material change in those facts and circumstances or any failure by Citigroup to observe any of its commitments or representations may result in a different view or in a revocation of the regulatory capital treatment permitted under this determination.

The capital treatment set forth in this letter for Reg. T margin loans will be made available to similarly situated institutions that request and receive Board approval for such treatment.

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[5] See, e.g., H.R. Conf. Rep. 106-434, 106th Cong., 1st Sess., p. 159 (Nov. 2, 1999).

[6] Id.

If you have any questions with regard to this letter, please direct them to Norah Barger, Associate Director, at (202) 452-2402, or Juan C. Climent, Supervisory Financial Analyst, at (202) 872-7526, in the Division of Banking Supervision and Regulation; or Mark E. Van Der Weide, Senior Counsel, at (202) 452-2263, or April Snyder, Senior Attorney, at (202) 452-3099, in the Legal Division.

Sincerely yours,

Robert deV. Frierson

Robert deV. Frierson
Deputy Secretary of the Board

cc: Federal Reserve Bank of New York