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Manager, Dissemination Branch
Information Management and Services Division
Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552

ATTN: Docket No. 2001-14

Dear Sirs and Madams:

Citigroup, a financial services holding company and the parent of two federal savings banks, appreciates the opportunity to comment on the proposal of the Office of Thrift Supervision ("OTS") to amend its capital regulations. 66 Fed. Reg. 15049 (March 15, 2001). Our comments relate solely to the OTS proposal on one-to four family residential mortgage loans.

Citigroup is pleased that the OTS proposes to align more closely its capital rules to the rules of other bank regulators and permit first mortgage loans with LTV ratios below 90% to qualify for the 50% risk weight. The current OTS regulations on this issue represent one of the few instances involving residential mortgage lending where savings associations are at a significant disadvantage compared to other depository institutions. Citigroup believes that the proposed change is appropriate.

As the proposal notes, savings associations need regulatory clarity in these rules because of their greater concentration in home mortgage lending. However, the Riegle Community Development and Regulatory Improvement Act of 1994 also generally requires that the capital rules and guidance of the banking regulators be uniform. Therefore we suggest that the OTS capital regulations should incorporate the Interagency Guidelines for Real Estate Lending ("Interagency Lending Guidelines") in the same manner as the regulations of the other banking regulators, but provide clarifications on the issues which are not fully described in the Interagency Lending Guidelines and identification of any substantive differences.

The following are our comments on specific questions asked in the proposal.

- *LTV of Precisely 90%*

The proposal asks whether an LTV of precisely 90% should qualify for the 50% risk weight. There is obviously no significant difference in risk for a loan with an LTV of precisely 90% than for a loan whose principal balance has been reduced by a few dollars so that its LTV is slightly less than 90%. However, permitting a loan with an LTV of precisely 90% to qualify for the lower risk weight provides significant benefits. Communicating an LTV limit of 90% is much simpler than communicating a limit of less than 90%, and this simplification will make it easier for a savings association to train employees, program systems and explain its LTV limits to customers. Permitting a loan with an LTV of precisely 90% to receive the lower risk weight would be a prudent and beneficial change.

- *Explicit LTV Standard*

The Interagency Lending Guidelines are reasonably clear that an LTV of less than 90% would normally qualify for a 50% risk weight. However, clarifications on the questions raised in the proposal about changes in the loan's LTV due to appreciation, depreciation, negative amortization, and paying down the loan balance would be helpful. We have commented on these items below under the captions "Reevaluation of Property Value" and "Loan Amortization."

- *Standards other than LTV Ratio/Holding First and Junior Liens on Same Property*

The proposal asks whether a standard other than the LTV ratio should be used to determine whether a mortgage should be accorded a 50% risk weight. Under both the current and proposed OTS regulations, if a savings association holds first and junior lien loans on the same residential property, both loans will be risk weighted at a 100% if the CLTV exceeds the specified limit (80% currently, less than 90% under the proposal). We believe that this requirement should be restricted to instances where the savings association makes the first and junior lien loans simultaneously. Under the current rule, if a savings association holds a customer's first mortgage and that customer subsequently applies for a junior lien loan on the same property where the CLTV would be 90% or more, the savings association must either decline the customer's application, sell the first mortgage loan, or increase the risk weight on the first mortgage loan to 100%. The customer's two loans present no greater risks than similar first and junior lien loans underwritten to the same standards on different properties, and the savings association should not be penalized with more onerous capital requirements on the first loan simply because of the junior loan.

- *Credit Enhancements*

Another area where savings associations are treated less favorably than lenders subject to the regulations of the other banking regulators concerns the types of credit enhancements that will permit a loan to have a risk weight of 50% when its LTV is 90% or more.

Mortgage Insurance

The proposal would continue to require that only mortgage insurance from an insurer approved by Fannie Mae or Freddie Mac would qualify as an appropriate credit enhancement. The Interagency Lending Guidelines do not limit mortgage insurance to insurers approved by Fannie Mae or Freddie Mac, and neither should the OTS regulations.

Readily Marketable Collateral

The Interagency Lending Guidelines provide that "readily marketable collateral" is an appropriate credit enhancement. The requirements contained in the Interagency Lending Guideline's definition of readily marketable collateral adequately address safety and soundness issues by limiting the types of property qualifying as readily marketable collateral, requiring a perfected security interest, and requiring an appropriate discount from market value in determining its value as collateral. The OTS regulations should similarly explicitly permit readily marketable collateral as an appropriate credit enhancement. In addition, the OTS should consider whether any further regulation is necessary to conform to the principles of the Federal Reserve Board's proposed Regulation W, permitting broader use of affiliates' securities as collateral.

Other Acceptable Collateral

The proposal also asks whether other types of credit enhancements, such as irrevocable standby letters of credit, should be acceptable. The Interagency Lending Guidelines provide a definition of "other acceptable collateral" which includes irrevocable standby letters of credit, but is not clear on how other acceptable collateral affects capital requirements. It would appear that if other collateral is "acceptable" it should be considered along with the value of the real property when calculating the loan's LTV (thereby potentially lowering the loans LTV below 90%). However, the Interagency Lending Guidelines discussion of "appropriate" credit enhancements includes readily marketable collateral but does not mention other acceptable collateral. We suggest that the OTS regulation make it clear that other acceptable collateral should be included when calculating a loan's LTV.

- *Reevaluation of Property Value*

The proposal asks whether savings associations should be permitted to reevaluate the property's value in an appreciating market, or be required to reevaluate the property's value in a depreciating market. We suggest that savings associations be permitted but not required to reevaluate the property's value during the term of the loan. Requiring savings associations to reevaluate property values would result in considerable costs and complexity.

- *Loan Amortization*

We support the proposal's clarification that a loan which is not a qualifying mortgage loan at the time of origination because of the loan's LTV may become a qualifying mortgage loan when it is subsequently paid down to the appropriate LTV level.

The proposal asks how loans that are originated at an LTV below 90% should be treated if they allow for negative amortization that could cause the LTV to increase above 90%. The proposal also asks whether distinctions should be made between loans whose scheduled payments are designed to cause negative amortization and loans which may or may not have negative amortization depending upon future events, such as interest rate changes. We agree that the capital regulations should consider how the amortization of the loan affects the LTV over the entire loan term. We suggest that the risk weight at origination should be based upon the LTV at origination, but if the LTV increases above 90% due to negative amortization the risk weight should increase to 100% unless the lender shows that the actual LTV remains below 90% due to appreciation in the value of the property confirmed by an appropriate appraisal or other property valuation. This rule would ensure that loans in programs that have scheduled negative amortization would be appropriately risk weighted when their respective LTVs reach 90%, while not requiring the higher risk weight on loan programs merely because there is a possibility that the LTV could exceed 90%. However, if the LTV reaches 90% as the result of default by the borrower, any increase in the capital requirements should be governed exclusively by the rules relating to classified loans.

Thank you for your attention to our comments. If you would like to discuss these issues further, please contact Edward Handelman at (212) 559-3677 or Douglas Webb at (716) 248-7690.

Very truly yours,

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CVH/kj