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Tim Clark, Senior Associate Director
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Proposal to Strengthen Scenario Development

Dear Mr. Clark:

On behalf of Citigroup, I am pleased to comment on the policy proposal issued by the Board of Governors of the Federal Reserve System (the Board) on November 15, 2012, "Policy Statement on the Scenario Design Framework for Stress Testing" (the Proposal).

Citi has long supported the goals of the Federal Reserve's CCAR process, and shares the Board's objective of creating transparency around the approach to scenario design for stress testing. We believe that many of the concepts in the Proposal facilitate that desired transparency. We also propose that increased rigor in scenario calibration and enhanced international scenario descriptions will support meaningful forward-looking capital planning, and will enable investors and other market participants to make more informed evaluations of the strength of financial institutions, which should in turn enhance systemic stability.

Citi is an active participant in a number of industry groups and has provided input consistent with the concerns noted below.

- **Calibration of Scenarios**: We believe that the recession-based approach for developing the US severely adverse scenario can create volatility in capital requirements, making appropriate and prudent capital planning difficult to achieve.

  The relative severity of a scenario depends on its starting point, as stress losses are calculated relative to the 'base' environment. The likelihood of a given event occurring over the planning horizon is highly dependent on the current economic environment; at any point in time, it could be probable, or it could be highly unlikely. By anchoring stress scenarios to specific events, e.g., a recession must occur in the scenario, or unemployment must rise by 3 – 5 percentage points and be at least 10 percent, the resulting stress losses (and capital requirements) will vary considerably, based on the starting point. Simplistically, the requirement to have an unemployment rate of "at least 10 percent" could result in a more severe shock if the starting point is a low unemployment rate of 4 percent (i.e., a 6+ percentage point change in unemployment), compared to a starting point of an elevated unemployment rate of 9 percent (i.e., potentially only a 3 percentage point change in unemployment). Each of these scenarios would consequently require significantly more or less capital to be held by the banking system. In essence, this approach would signal false positives of the safeness of the banking system when the economy was weak (and less capital would be required) and false alarms when the economy was strong (as more capital would be required). The significantly different likelihoods associated with each of these scenarios, create very different stress losses and associated capital requirements, making it difficult for firms carry out forward-looking regulatory capital planning.

Citi would strongly encourage that the **overall** probability of a scenario occurring be consistent from year to year but the **individual** components of the scenario should have significant variability to reflect existing and emerging concerns. While we acknowledge that the Federal Reserve has raised some concerns with a "probabilistic approach", Citi believes that such an approach will create the greatest stability in the regulatory capital planning process. The "recession approach", as currently constructed, can result in wide variability in regulatory capital requirements, based on the starting point. Citi strongly believes that rigor in the calibration of the overall aggregate global scenario - coupled with full regulatory discretion to design a scenario and select movements in the individual macroeconomic variables within the scenario - would create stability in the regulatory capital planning process, and would also ensure a proactive and prudential supervisory scenario design process.

- **International Scenario Components**: While the stated intent of the stress test scenarios is to capture the material risks of covered companies, we believe the Proposal could be enhanced with more information about the international components, which are important for the stress testing of institutions with significant operations outside the US. We believe that the Board could enhance its approach to scenario design by providing greater clarification on the international scenario development process and narrative. This detail would help clarify the intent of the international scenario, and allow banks to more robustly forecast their non-US exposures where macroeconomic factors are not directly provided in the scenario. For example, this narrative could address whether the international scenarios are intended to reflect global conditions or whether they are designed to reflect idiosyncratic stresses at the country level. This would enable globally-oriented institutions to implement the scenarios in a manner that is closely aligned with supervisory intentions, thereby achieving greater consistency in the amount of capital that covered companies are required to hold.

Thank you for the opportunity to provide this feedback to you on this critical initiative to create greater transparency on scenario development. We would welcome further discussion with you on the Proposal and our concerns.

Sincerely,

Brian Leach

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Citigroup Head of Franchise Risk and Strategy