June 13, 2011

SUBMITTED ELECTRONICALLY

Department of the Treasury
Office of the Comptroller of the Currency
250 E Street, SW., Mail Stop 2-3
Washington, DC 20219
Docket No. OCC-2011-0002, RIN 1557-AD40

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attn.: Elizabeth M. Murphy, Secretary
RIN 3235-AK96
Release No. 34-64148; File No. S7-14-11

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attn: Jennifer J. Johnson, Secretary
Docket No. 2011-1411, RIN 7100-AD-70

Federal Housing Finance Agency
Fourth Floor
1700 G Street, NW
Washington, DC 20552
Attn.: Alfred M. Pollard, General Counsel
RIN 2590-AA43

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attn.: Comments, Robert E. Feldman, Executive Secretary
RIN 3064-AD74

Department of Housing and Urban Development
Regulations Division
Office of General Counsel
451 7th Street, SW, Room 10276
Washington, DC 20410-0500
RIN 2501-AD53

Re: CREDIT RISK RETENTION; PROPOSED RULE

Ladies and Gentlemen:

Citigroup Global Markets Inc. ("Citi")[1] appreciates the opportunity to respond to the request for comment by the Department of the Treasury, Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Securities and Exchange

[1] Citi is a registered broker-dealer, and together with its affiliates, is a major participant in the securitization markets. Citi is a wholly owned indirect subsidiary of Citigroup Inc. Citigroup Inc., the leading global financial services company, has approximately 200 million customer accounts and does business in more than 160 countries and jurisdictions. Through Citicorp and Citi Holdings, Citi provides consumers, corporations, governments and institutions with a broad range of financial products and services, including consumer banking and credit, corporate and investment banking, securities brokerage, transaction services, and wealth management.

Commission, the Federal Housing Finance Agency and the Department of Housing and Urban Development (collectively, the "Agencies")[2] on the Agencies' joint proposed rule to implement Section 941(b) of the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), which is codified as new Section 15G of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). We refer in this letter to the proposed rule and the accompanying supplementary information collectively as the "Proposing Release."[3]

This comment letter supplements and supports the comment letters that we expect will be submitted by the Securities Industry and Financial Markets Association, the Commercial Real Estate Finance Counsel, the Loan Syndications and Trading Association, the Financial Services Roundtable and the American Securitization Forum ("ASF", and the letters collectively, the "Industry Letters"). Citi has participated in the drafting of the Industry Letters and we concur with and support the Industry Letters.

Citi submits this comment letter to respectfully request that the Agencies issue a revised rule proposal prior to finalizing the Proposing Release, so that interested participants may have a meaningful opportunity to comment on a more developed rule proposal. In respect of this request, we highlight certain issues in regard to the Proposing Release, as set forth below.

Additional Analysis Required

Section 946 of the Dodd-Frank Act required the Chairman of the Financial Stability Oversight Council to conduct a study on the macroeconomic effects of risk retention (the "FSOC Report").[4] The FSOC Report warned that "if regulators set risk retention requirements at an inappropriate level, or design them in an inappropriate manner, the costs in terms of lost long-term output could outweigh the benefits of the regulations".[5] Also, the report produced by the Board of Governors of the Federal Reserve System (the "Federal Reserve Report")[6] recommended that the agencies responsible for implementing credit risk retention take into account eight factors "in order to help ensure that the regulations promote the purposes of the Act without unnecessarily reducing the supply of credit" including:

> the economics of asset classes and securitization structure… the potential effect of credit risk retention requirements on the capacity of smaller market participants to comply and remain active in the securitization market… the potential for other incentive alignment mechanisms to function as either an alternative or a complement to mandated credit risk retention… the interaction of credit risk retention with both accounting treatment and regulatory capital requirements… and do not provide undue incentives to move intermediation into other venues….[7]

We also reference the letters from the United States Senate Committee on Banking, Housing, and Urban Affairs which urge the Agencies to conduct rigorous cost-benefit and economic impact analyses ("Impact Study") in connection with rule making, and specifically the implementation of the risk retention rules, given the "potential harm to our already weak economy and the public from ill-conceived rules".[8] These

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[2] When we refer to "the Agencies" in this letter, we refer to the appropriate Agencies having rule-writing authority with respect to any particular aspect of the Proposing Release.
[3] Credit Risk Retention, 76 FR 24090 (April 29, 2011).
[4] Financial Stability Oversight Council, "Macroeconomic Effects of Risk Retention Requirements" (January 2011).
[5] FSOC Report, 30.
[6] Board of Governors of the Federal Reserve System, "Report to the Congress on Risk Retention" (October 2010).
[7] Federal Reserve Report, 3-4.
[8] Letter dated February 15, 2011 to The Honorable Timothy Geithner, Secretary, The Department of Treasury, et al., and letter dated May 4, 2011 to Elizabeth A. Coleman, Inspector General, Federal Reserve Board, et al.

concerns and recommendations should be fully addressed in the Proposing Release and the major elements of the Proposing Release should be supported by a rigorous Impact Study. There should be analyses regarding (i) the general efficacy of the Proposing Release, (ii) how the proposed risk retention requirements may translate into a reduced credit supply or how a likely reduction in liquidity will affect borrowers, (iii) how an extra $53 billion of unhedgeable and unsaleable credit risk per year will impact financial institutions,[9] and (iv) the impact on the United States financial services industry, which represents approximately 21% of the GDP of the United States and approximately 7% of the private sector work force.[10] In short, there should be a rigorous Impact Study on how the Proposing Release will affect the economy of the United States before the rules are finalized.

We acknowledge the discussions in Part VIII of the Proposing Release, but they do not obviate the need for a rigorous Impact Study. For example under "Regulatory Flexibility Act", the Agencies assert that small entities will not be affected by the Proposing Release by focusing solely on the technical issue of whether the covered institutions would be subject to risk retention, and the Agencies do not address the practical implications of a potential contraction in the secondary mortgage market caused by the Proposing Release and the potential reduction of these institutions' mortgage origination volumes by approximately 70%, if Fannie Mae and Freddie Mac adopt the qualifying loan criteria.[11] Also, in this regard, it seems inappropriate for the Agencies to assert that these institutions would not be affected because they "sell their loans to Fannie Mae or Freddie Mac, which retain credit risk through agency guarantees and would not be able to allocate credit risk to originators under this proposed rule,"[12] while at the same time acknowledging plans to transition away from Fannie Mae and Freddie Mac.[13]

Similarly, in Part VIII under "Commission Economic Analysis", we note that the analysis "examines the costs and benefits of alternative implementations of a risk retention requirement meeting the mandates of the Dodd–Frank Act, rather than the existence of a risk retention requirement" [emphasis added].[14] In other words, this analysis does not cover the impact of a risk retention requirement. By not completing this analysis, the Agencies do not seem to have complied with the statutory mandate to "provide for a total or partial exemption of any securitization, as may be appropriate in the public interest and for the protection of investors."[15] As specified in the FSOC Report, "Section 941 provides the Agencies with exemptive authority to make adjustments as they deem appropriate."[16] Without this fundamental analysis, there does not seem to be a reasonable basis for the Agencies' conclusion that the Proposing Release will have "no competitive effects" and can be implemented "without causing economic inefficiencies or hindering capital formation."[17]

Finally, we note that for purposes of Part VIII under "Commission: Small Business Regulatory Enforcement Fairness Act", we believe that the Proposing Release is a "major rule" under the Small

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[9] According to the Proposing Release, approximately $8.5 trillion of new asset backed securities (not including agency mortgage backed securities) were issued between 2002 and 2009, and the $53 billion figure is approximately 5% of the average annual issuance volume.
[10] Bureau of Economic Analysis, U.S. Department of Commerce, "Value Added by Industry as a Percentage of Gross Domestic Product" and "Full-Time and Part-Time Employees by Industry" (April 26, 2011).
[11] Amherst Securities Group LP, Letter to Agencies (June 2, 2011), noting that in 2009 only 30.5% of GSE loans would have qualified under the qualified residential mortgage loan criteria: "These numbers are particularly frightening, as 2009 was a year in which the GSEs produced very high quality product. For Freddie Mac, excluding HARP Refi loans, the average original LTV was 66, with a 762 average FICO score."
[12] 76 FR 24144-46.
[13] 76 FR 24111-12.
[14] 76 FR 24150.
[15] Rule 15G(c)(1)(G)(i).
[16] FSOC Report, 24.
[17] 76 FR 24151.

Business Regulatory Enforcement Fairness Act of 1996. Given that, as noted above, issuance volume averaged over $1 trillion per year between 2002 and 2009, and that the average additional risk retention would have amounted to over $53 billion per year on average, we believe that the Proposing Release is reasonably likely to have an annual effect on the economy in excess of $100 million.

Lack of Clarity in Application

We note that a central theme of discussion among industry participants is confusion over the fundamental underpinnings of the Proposing Release. One of the most serious issues is uncertainty regarding the meanings of "ABS interest", "par value", and "gross proceeds", and their application to various forms of securitization. These terms are crucial and necessary components of understanding how risk retention will be applied.[18] Without a firm understanding of these terms, industry participants must guess on how the Proposing Release will be applied, and they will not be able to accurately assess the impact of the Proposing Release.

There is also confusion regarding the overly broad application of the risk retention rules. Although the Agencies acknowledge the expectation of Congress that "the agencies be mindful of the heterogeneity of securitization markets"[19] and while the Agencies provide for master trust structures and asset backed commercial paper ("ABCP") conduits, the Proposing Release generally does not address material differences among asset classes. In particular, the Proposing Release does not account for actual performance. For example, the Federal Reserve Report notes that while both mortgage backed securities ("MBS") and commercial mortgage backed securities ("CMBS") experienced downgrades, "[i]n contrast, in all years the other ABS categories have very few or no securities rated likely to default."[20] In addition, with respect to the $554 billion of CMBS issued between 2002 and 2010 with original ratings of investment grade or higher,[21] there have been only approximately $46 million, or in percentage terms approximately 0.0082%, of principal losses realized as of June 7, 2011.[22] In other words, despite the worst economic crisis since the Great Depression, non-residential mortgage asset backed securities ("ABS") performed well without mandatory risk retention, but the Proposing Release does not recognize this fundamental difference.

Also, it's not entirely clear why the Agencies are applying risk retention to asset classes that are not true securitizations, such as ABCP or repackaging transactions (whether municipal or private issuer), or why mandatory risk retention is required of asset classes that already have "significant retention of risk by participants in the securitization process…including auto loans and leases, credit cards, and CLOs",[23] or why the Proposing Release requires risk retention from non-profit sponsors, or why qualified loan pool securitizations must be all-or-nothing as opposed to allowing pro rata risk retention, or why risk retention must be for the life of a transaction, or why the Proposing Release essentially prohibits resecuritizations, despite the vital role resecuritizations played in the recovery of the MBS market and the prevention of a "fire sale" scenario after a series of MBS credit rating downgrades.

[18] We refer to the Industry Letters for a detailed technical discussion of the issue.
[19] 76 FR 24096.
[20] Federal Reserve Report, 49.
[21] For this purpose, meaning rated "BBB" or higher by Standard & Poor's Financial Services, LLC. ("S&P").
[22] Citi Investment Research & Analysis.
[23] Federal Reserve Report, 43.

Securitization Structures

Conceptually, many securitizations are structured with senior and junior interests based on loss and default models, not only to prioritize payments to senior interests, but also to allocate losses to junior interests. The public interest is not served by requiring securitizers to hold positions that have been specifically designed to take losses. For example, all deal parties, the rating agencies, and the investors are fully aware that the lowest tranche, sometimes referred to as a "first loss" tranche, may take losses and no representation is made that such tranche is either investment grade or will receive all of its stated principal or interest.

Each investor in a particular credit tranche makes its own risk-return analysis, with the knowledge that each downward step in the securitization structure increases the likelihood of losses. As noted in the Federal Reserve Report, there are investors who are willing to take these risks,[24] but securitizers should not be required to hold such positions in disregard of their specific risk, capital or market requirements. There is not a public benefit in requiring the securitizer to share losses with an investor who has deliberately chosen a higher level of risk. On the other hand, returning to the example of a first loss tranche, it seems against public policy to force certain financial institutions, like retail banks, to hold securities that are designed from inception to be high risk, while at the same time, preventing them from protecting themselves against losses.

Also, the assumption that retaining portions of lower credit tranches will somehow encourage better loan underwriting standards or protect investors should be revisited. While the sizing of the junior and support classes will be determined by perceived asset quality, the performance of the securities issued in a securitization is correlated to the accuracy of the loss and default models, which are imposed by outside credit rating agencies, and are not within the control of the securitizer. The Agencies should reconsider whether securitizers should be required to hold junior positions, whether by vertical, horizontal or L-shaped methodologies, or whether risk retention goals can be equally served by allowing securitizers to choose any interest or tranche within the structure.

Practically, the Proposing Release does not address the nature and variety of interests in a securitization. For example, it's unclear why a deal party should be required to retain an interest in a non-economic residual or a REMIC residual interest, which is actually a tax liability. Similarly, it is unclear whether the Agencies have fully considered the implications of the Proposing Release on structuring. For example, the restrictions on resecuritizations may have a material negative impact on certain securitization structures which rely on intermediate structures, such as the use of owner trusts or special units of beneficial interest, which may not only result in multiple instances of retention within a single transaction, but also may raise the possibility that certain deal structures may no longer be viable.

Also, the Proposing Release does not acknowledge or account for existing mechanisms, in addition to credit risk retention, which also act to align incentives and create "skin in the game". For example, the Federal Reserve Report notes that overcollateralization, subordination, third-party credit enhancement, representations and warranties and conditional cash flows all serve a similar purpose.[25] We note that there are other additional forms of risk retention in transactions, such as servicing fees, credit support and liquidity facilities, guarantees, funding loss reserves, incentive or performance fees and excess spread. The Proposing Release should acknowledge and give credit for these forms of risk retention.

[24] Federal Reserve Report, 13.
[25] Federal Reserve Report, 41-43.

Premium Capture Cash Reserve Account

The Premium Capture Cash Reserve Account provision would penalize any profitable securitization by "capturing" any premium and forcing that premium to be applied as a first loss reserve for the life of the transaction. Simply speaking, this provision needs to be removed in order to prevent a material contraction in securitization activity. While there have been various discussions between members of the Agencies and industry participants discussing technical interpretive issues and potential patches to the language, the premise that profitable securitizations need to be compromised and discouraged is not supported by the Dodd-Frank Act, and is simply not supportable as a business model. Given that industry participants have a consensus view that this provision will eliminate or severely constrain large segments of the securitization market, we request that the Agencies withdraw this provision.

Qualified Loan Definitions

The general consensus among industry participants is that the qualified loan definitions need to be substantially revised. With respect to the qualified residential mortgage section, we note that securitization sponsors are joined by both representatives of the Senate and the House of Representatives, as well as community advocates and minority groups in their opposition to the proposed criteria.[26] With respect to qualified auto loans, industry participants believe that no auto securitization would have qualified under the Proposing Release's criteria.[27] With respect to qualified commercial loans, initial indications are that only a very small minority, if any, would have satisfied the criteria.[28] With respect to qualified commercial mortgage loans, based on Citi research, it appears that less than 200 out of 70,000 commercial mortgage loans that have been securitized would have satisfied the proposed criteria.[29]

Also, we note that despite both Congressional intent and the recommendations in the Federal Reserve Report, the Proposing Release does not adequately address the heterogeneity or distinguish the requirements of various asset classes. The Proposing Release only covers residential mortgage loans, commercial mortgage loans, commercial loans, and auto loans, which would have represented approximately 62-68% of new ABS issuances between 2005-2009.[30] This means that the Proposing Release does not address approximately one-third of the securitization market. In this respect, we note that the Agencies, by not providing criteria for one-third of the securitization market, have essentially created a default 5% credit risk retention threshold without examination. In explaining this position, the Proposing Release states that this portion of the market is "collateralized by assets that exhibit significant heterogeneity, or assets that by their nature exhibit relatively high credit risk."[31] With respect to the first point, we note that the Agencies were expected by Congress to address the heterogeneity of asset classes.

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[26] See Letter to Agencies from Representatives John Campbell, Brad Sherman, et al, May 31, 2011; Letter to Agencies from Senators Mary Landrieu, Kay Hagan, Johnny Isakson, et al, dated May 26, 2011; Letter to Agencies from National Urban League, dated June 1, 2011; QRM Coalition, "Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery".

[27] Statement of Tom Deutsch, Executive Director of the American Securitization Forum, Testimony before the House Financial Services Committee Subcommittee on Capital Markets and Government Sponsored Enterprises (April 2011) ("ASF Testimony"), 48-49.

[28] Only 2 of 61 loans examined would have satisfied even three of the criteria. Morgan Stanley & Co. Incorporated, "Securitized Market Insights: Risk Retention Proposal: Implications to Securitization" (April 6, 2011).

[29] Citi Investment Research & Analysis, "Securitized Products Strategy: Retention Rules Feature Much Flexibility and a Few Surprises" (April 1, 2011).

[30] There seems to be a difference between the seemingly identical tables in the Federal Reserve Report (page 28), and in the Proposing Release (76 FR 24094). According to the Proposing Release, the figure is 68%, but under the Federal Reserve Report, it is 62%.

[31] 76 FR 24130.

With respect to the second point, we do not believe there was any asset class that created as much risk to the financial system as residential mortgage loans, which are covered by the Proposing Release. If the Agencies cannot address these other asset classes, instead of simply defaulting to a 5% risk retention threshold, the Agencies should consider applying a zero risk retention threshold until the Agencies have completed their analysis.

Issue Resolution Process

The Proposing Release should be revised and re-issued for comment with an explicit process for issue resolution. Given the complexity of the Proposing Release, the required involvement of the six Agencies and potential jurisdictional overlap, and the certainty that questions and issues will arise during implementation of the Proposing Release and the evolution of Dodd-Frank Act rule-making, the Proposing Release absolutely requires a certain process for issue resolution. While the Proposing Release states that the "Agencies expect to coordinate with each other to facilitate the processing review and action on requests for such written interpretations or guidance, or additional exemptions, exceptions or adjustments"[32], this seems to be an insufficiently precise statement of process. Without specific agreement on how issues will be resolved, there is likely to be confusion, inefficiency, delay and uncertainty. For example, it's not clear how all six Agencies must "jointly approve any written interpretations, written responses to requests for no-action letters and legal opinions, or other written interpretative guidance"[33] but individual Agencies may issue "staff comment letters and informal written guidance provided to specific institutions or matters raised in a report of examination or inspection of a supervised institution."[34] Without a framework, this individual guidance process seems likely to create conflict and uncertainty.

Conclusion

The securitization markets are important to the health of the American economy. As noted by the ASF, "[s]imply put, the absence of a properly functioning securitization market, and the funding and liquidity this market has historically provided, adversely impacts consumers, businesses, financial markets and the broader economy."[35] Securitization issuance between 2002 and 2009, even excluding agency issuance, exceeded $8.5 trillion.[36] Because we believe that the Proposing Release has the potential to significantly damage the securitization market,[37] a market that has historically performed well, [38] to the extent that the

[32] 76 FR 24097.
[33] Ibid.
[34] Ibid, footnote 27.
[35] ASF Testimony, 5.
[36] 76 FR 24095.
[37] See eg, Morgan Stanley & Co. Incorporated, "Securitized Market Insights: Risk Retention Proposal: Implications to Securitization" (April 6, 2011); "if rules for risk retention in securitization transactions are implemented as proposed, they would curtail credit availability and increase the end-use cost of credit across asset classes – from mortgages to leveraged loans."
[38] Overall, the historical default rate for "BBB" rated structured finance products, with a median default rate of 0.07%, is similar to that of corporate debt, with a median default rate of 0.21%, and the median default rate for both categories that were rated "AAA", "AA" or "A" is 0 (S&P, "Default Study: Global Structured Finance Default Study–1978-2010: Credit Trends Started To Improve In 2010, But U.S. RMBS Faces Challenges" (March 28, 2011), table entitled "Global Structured Finance One-Year Default Rates, 1978-2010"; S&P, "2010 Annual U.S. Corporate Default Study and Rating Transitions" (March 30, 2011), table entitled "Descriptive Statistics On One-Year Global Default Rates" covering a period between 1981-2010). Even with respect to non-agency MBS, for issuances between 2002 and 2010 with original ratings of investment grade or higher (meaning rated "BBB" or

Agencies have not yet completed a robust Impact Study, we respectfully request that the Agencies re-propose the risk retention rules after they have done so and in light of the comments received on the Proposing Release. While we appreciate the timing constraints under the Dodd-Frank Act, given the importance of this market and the potential impact to consumers and to the overall economy, if the Agencies do not have the time or do not have the capability to assess the impact of the Proposing Release on each asset category, we urge the Agencies to use their power under the Dodd-Frank Act to exempt those categories until such time as they can fully consider and analyze the impact of risk retention, whether generally or with respect to a specific segment of the securitization market. The Agencies should carefully assess the Proposing Release and understand the implications before finalizing the rules, and notwithstanding the extension of the comment period on the Proposing Release, publish a revised rule proposal in order to give interested parties a meaningful opportunity to review and comment.

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Citi appreciates the opportunity to comment on the Proposing Release. Please feel free to contact us should you have any questions or if we may be of any assistance to you as you consider these issues.

Very truly yours,

/s/ Jeffrey A. Perlowitz
Jeffrey A. Perlowitz
Managing Director and
Co-Head of Global Securitized Markets

/s/ Myongsu Kong
Myongsu Kong
Managing Director and Counsel

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higher, and where multiple rating agencies were rating the security, where such rating was the lowest of those issued by S&P, Moody's Investors Service, Inc. or Fitch, Inc.) there have been approximately 0.26% of principal losses realized as of May 25, 2011 (Citi Markets Quantitative Analysis).