BANCO DE MEXICO

GOBERNADOR

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February 14, 2012

Ben Bernanke
Chairman of the Federal Reserve
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551
The United States of America

Dear Chairman Bernanke:

I am writing to express my concern about the negative effects that the proposed implementation of the Volcker Rule (hereinafter called "proposed Rule") would have on Mexican financial entities and markets, as well as on the Mexican government's finances, without any corresponding benefit to U.S. financial stability or the safety and soundness of U.S. banks.

The proposed Rule would not only hinder the ability of U.S. banks to participate in non-U.S. sovereign bond markets, but also curtail the activities of banks incorporated in other jurisdictions. The latter would potentially have a significant adverse impact on world sovereign debt and other financial markets, particularly in emerging market economies with a large foreign bank presence.

Given its application to both U.S. banks and international banks with U.S. operations, the proposed Rule would apply to the Mexican banking system almost to the same extent as in the United States. The subsidiaries of U.S. and of international banks with U.S. operations manage more than 70% of Mexican banking assets. The rest of Mexican banks have diverse U.S. operations.

The inter-linkages between our two financial systems and economies, as well as the high degree of participation of U.S. banks and other international banks in the Mexican economy, means that the proposed regulation, as it is drafted, would significantly interfere with the activities of banks incorporated under Mexican laws and regulations and affect the current functioning of Mexico's financial system. It would also increase the financing costs of the Mexican government, hindering its ability to manage its budget and hedge its financial risks. Finally, the proposed Rule would undermine the soundness of the subsidiaries of U.S. banks as it would significantly weaken their role as financial intermediaries in foreign countries and hamper their ability to compete with non-U.S. banks.

The proposed regulation does not recognize that in emerging market economies banks play a central role in preserving liquid and efficient financial markets by taking risk positions and holding inventories. Given that U.S. banks and their Mexican affiliates are important providers of liquidity, restraining their activities would create significant disruptions in Mexican financial markets. The proposed regulation would effectively decrease the risk positions that U.S. banks and other subsidiaries of foreign banks operating in Mexico, including one of the largest banks, would be willing to take in derivatives, foreign-exchange forwards, and Mexican sovereign and corporate debt. This would reduce liquidity in secondary markets significantly and in turn cause greater volatility. Diminished liquidity would limit the ability of mutual funds and other institutional investors to efficiently manage their investments and risks. It would also increase funding costs for corporate issuers and trigger decreases in the value of existing financial instruments held by pension funds, institutions and customers. The proposed Rule would also make it more difficult and costlier for the Mexican government to issue and distribute its debt. Finally, it would affect Banco de Mexico's ability to conduct open market operations as part of their implementation of monetary policy.

The proposed Rule also restricts transactions in short-term foreign exchange swaps. These operations are widely used by banks not only as a source of funding in U.S. dollars, but also to manage their foreign exchange risks. The proposed Rule would inhibit the provision of liquidity in U.S. dollars by U.S. banks and their subsidiaries to their counterparties. The latter would squeeze dollar funding and induce banks to deleverage from U.S.-dollar-denominated assets. Short-term foreign-exchange swaps should be exempted from the restrictions.

Although the proposed regulation exempts from the prohibitions transactions conducted and executed "solely outside of the United States" by non-U.S. banks, the retreat by U.S.

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banks and their Mexican subsidiaries from active trading in Mexican financial markets would cause much harm given their size and the magnitude and scope of their activities in Mexico.

U.S. banks and their Mexican subsidiaries are also important counterparties of non-U.S. banks in transactions conducted in Mexican financial markets. While some transactions would be permissible under exemptions such as market-making and risk mitigating, it is not clear how these operations can in practice be differentiated from proprietary trades. Also, reliance on those exemptions requires complex compliance obligations.

Under the proposed Rule, any trading that involves U.S. infrastructure would not qualify for the Non-U.S. Trading and Fund Provision's exceptions and thus be subject to the Volcker Rule. The Rule would push the execution of international trades away from the United States. The latter would complicate the implementation of Title VII of the Dodd-Frank Act and the international efforts being made under the aegis of the G20 to move some OTC derivative operations to recognized central clearing facilities. OTC derivative trades between a Mexican bank and a Mexican subsidiary of a U.S. bank would have to be executed in a central counterparty established outside the United States but recognized by U.S. authorities in order to qualify for the "solely outside of the United States" exemption.

The proposed Rule exempts from the prohibition trades in U.S. government securities. It would be appropriate to review whether the North American Free Trade Agreement ("NAFTA") requires the United States to give comparable treatment to Mexican government debt: "The required assurance of equal competitive opportunities by a NAFTA party must not put at a disadvantage financial institutions and cross-border financial services providers of another Party in their ability to provide financial services as compared with the ability of the Party's own financial institutions and financial services providers to provide such services, in like circumstances." There is an exception in NAFTA that permits a Party to adopt reasonable prudential measures for reasons of safety and soundness, and for the maintenance of the integrity and stability of a Party's financial system. We do not believe, however, that financial institutions trading in Mexican government debt could represent a threat to the safety and soundness or the integrity of the U.S. financial system. To the contrary, placing constraints on trading Mexican government debt could present

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risks to Mexico's financial system and would be inconsistent with promoting the safety and soundness of financial institutions operating in Mexico (including U.S. bank subsidiaries).

Finally, the proposed Rule would significantly increase the costs of end users' activities in the commodities markets, including those with the sole purpose of hedging commercial activities. One such example is Mexico´s Oil Hedging Program. A commodity hedge program of the size and characteristics of Mexico's requires swap dealers to take significant commodity risks for extended periods of time in order to provide liquidity to markets. This derives from the particular characteristics of commodity markets which are generally less well diversified than equity or bond markets and thus require swap dealers to warehouse risks for longer terms. Unlike most equity or bond markets where risks are concentrated in or highly correlated to reasonably liquid, standardized benchmarks, commodity markets have a wide variety of underlying assets that may be less liquid and more difficult to trade, potentially adding significant basis risk to the exchange-traded benchmarks. Often, those risks have to be taken by the swap dealers. Finally, non-end-user activity tends to be concentrated in the "spot" contracts, while most end-users such as Mexico manage their risks by using forward contracts. Swap dealers are also used to bridge that gap.

While the Volcker Rule recognizes the importance of swap dealers in providing end-user liquidity, many elements of the proposed rule are vague enough to be subject to a wide degree of interpretation. A misapplication of a metric-based approach may mistakenly categorize the risks taken by swap dealers as proprietary trading and result in forcing the swap dealer to cease the activity. Any change in the hedging strategies by swap dealers will result in increased costs for Mexico and other end-users.

Banco de Mexico fully supports the efforts by the United States to strengthen its prudential regulation and the resilience of its financial system. However, the global nature of financial markets and the cross-border reach of international banks and other financial intermediaries highlight the importance of coordinating the reforms to strengthen the financial system internationally. Mexico is an active participant in and a strong supporter of such efforts, and it has expressed its commitment to promoting swift implementation of international reform agreements during its G20 Presidency. Banco de Mexico also supports individual countries' efforts to implement additional reforms designed to strengthen their

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domestic banking systems. It is important, however, that these additional reforms are not applied in a manner that leads to unjustified and inappropriate extraterritorial consequences.

Attached please find our formal comments on the joint notice of proposed rulemaking implementing section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act submitted by Banco de Mexico to the U.S. authorities and an additional document that could be of your interest.

Yours very truly,

Agustin Guillermo Carstens Carstens
Governor

CC. William C. Dudley, President and Chief Executive Officer, Federal Reserve Bank of New York.
Richard W. Fisher, President and Chief Executive Officer, Federal Reserve Bank of Dallas.

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February 8, 2012

MEMORANDUM

To: Grupo Financiero Banamex S.A. de C.V.

RE: Impact of the Volcker Rule on Banamex

This memorandum provides an initial assessment of the impact of Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, commonly known as the "Volcker Rule," on Citigroup's operations in Mexico and the Mexican financial markets. Citi's Mexican operations are conducted through Grupo Financiero Banamex S.A. de C.V. ("Grupo Banamex") and, to a lesser extent, Citibank, N.A.'s branches in New York.

As set out below, there are important issues still to be resolved relating to the impact on the operations of major U.S.-based international banking institutions and on financial markets in general, particularly in growth regions such as Mexico, if the Volcker Rule were to be implemented under the regulations recently proposed by the U.S. financial regulators (the "Proposal"). In particular, there are possible adverse effects of the Proposal on Grupo Banamex, Mexican consumers and businesses, the Mexican government and the Mexican economy given the relevance of Grupo Banamex. The Proposal would limit the ability of financial institutions to make efficient and liquid markets by reducing their ability to take principal positions in market making and related services for customers. The resulting reduction in liquidity could have a broad impact on financial markets, particularly markets for sovereign and corporate debt. Implementation of the Proposal could also lead to increased funding costs for issuers and a decline in value of existing financial instruments held by funds, institutions, corporations and consumers.

This memorandum has four parts. In Part I, the memorandum briefly summarizes the two main prohibitions of the Volcker Rule as they would be implemented under the Proposal. In Parts II and III, the various businesses of Grupo Banamex and Citi in Mexico are described, and then the restrictions, costs and compliance requirements that the Proposal appears to impose on them are discussed. In Part IV, the memorandum describes some of the potential broader effects of the Proposal on markets generally and the Mexican market in particular.

I. Overview of the Volcker Rule

A. Status of the Rule

The U.S. regulatory agencies responsible for implementing the Volcker Rule are: the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission and the Commodity Futures Trading Commission (the "Agencies"). The Agencies have issued the Proposal to implement the Volcker Rule, and have requested comment from the industry, the public and any other interested parties. The principal comment deadline is Monday, February 13, 2012; comments have begun to be submitted, and are publicly available.

The discussion below is based on the draft Proposal as if it were applied to affected institutions without change. The Proposal, however, is expected to be revised by the Agencies based on comments received during the comment period. The timing for publication of final regulations is not yet known.

B. General Application of the Volcker Rule to Citigroup

Citigroup is a financial holding company under the laws of the United States. A financial holding company is a company that owns or controls a U.S. depository institution and has additional powers to conduct businesses in separate holding company subsidiaries that are not themselves depository institutions.

The Volcker Rule by its own terms applies to U.S. insured depository institutions, and to any holding company, affiliate or subsidiary of a U.S. insured depository institution anywhere in the world. Accordingly, restrictions in the Volcker Rule apply to Citigroup's operations worldwide, including the operations of Grupo Banamex.

C. The Main Prohibitions of the Volcker Rule

The Volcker Rule has two main prohibitions. First, the Volcker Rule prohibits engaging in "proprietary trading" by U.S. depository institutions and their affiliates worldwide. Second, the Volcker Rule prohibits these entities from "sponsoring," or acquiring or retaining any ownership interest in, a hedge fund or private equity fund. Each of these prohibitions is subject to certain exceptions.

1. The Proprietary Trading Prohibition

The Volcker Rule defines proprietary trading as the purchase as principal of certain financial instruments for the purpose of selling in the near term or otherwise with the intent to resell in order to profit from short-term price movements. Further defining this key term in the regulations is a considerable challenge.

Generally, the Proposal would require that entities subject to the Volcker Rule identify all trading operations where they engage as principal in the purchase or sale of securities, derivatives, futures, or options on any of those financial instruments. These covered trading operations generally include those operations where there is short-term trading intent, and generally would not include purchases and sales for investment purposes, although the distinction between trading and investment is not fully clear in the Proposal.

Under the Proposal, all trading operations would be subject to the ban on proprietary trading, unless an activity had been designated as permissible or as an exception to the ban. Permitted activities would include, among others, engaging in underwriting and market-making-related activities, risk-mitigating hedging, trading in U.S. federal government and certain U.S. state and municipal government securities, and certain limited trading on behalf of customers.

Each category of permitted activity would be subject to an extensive compliance regime that requires policies, procedures, trader mandates, training, independent testing and overall monitoring in an effort to prevent any prohibited proprietary trading. The permitted trading activities also would be subject to the maintenance and reporting of extensive quantitative metrics that the Agencies would review to assess the possibility of proprietary trading occurring within a permitted activity.

The Proposal exempts the purchase and sale of loans, spot foreign exchange and physical commodities from the general prohibition, although derivatives on these asset classes would be subject to restrictions in the Proposal. The Agencies have also excluded repurchase and reverse repurchase agreements and securities borrowing and lending transactions.

As discussed further below, many industry participants are concerned that the scope of trading operations covered by the Proposal is so broad that it would have a significant impact on how an institution like Citi could continue to fulfill its role as a financial intermediary. Furthermore, the extensive compliance and metric-reporting burden on otherwise permissible activities could, in practice, contribute to limiting the range of certain permissible activities in which a financial institution would engage.

2. The "Hedge Fund or Private Equity Fund" Prohibition

The Volcker Rule prohibits U.S. depository institutions and their affiliates world-wide from acquiring or retaining any ownership interest in, or sponsoring, "covered funds," subject to certain exemptions. The Proposal appears to apply not just to traditional private equity and hedge funds, but to many other investment vehicles as well. There are important questions under the Proposal about the prohibition's application to foreign funds, as well as to securitization or pooling vehicles.

The main exception to the prohibition permits a banking entity to "organize and offer" (including sponsor) a covered fund in connection with asset management services and to make and hold certain limited (less than 3% of total fund interests) investments in that fund. Although this exception is intended to permit banking entities to engage in traditional asset management activities, it is limited in scope. The Proposal would also prohibit a banking entity from entering into lending or certain other transactions with covered funds that it sponsors or advises. Making markets in the ownership interests of any covered fund is also called into question because of the prohibition on acquiring interests in such funds.

The compliance requirements that would apply to permissible covered funds activities and investments are extensive, though more limited in scope than those applicable to the activities permitted under the proprietary trading ban, and the extensive metrics requirements would not be applicable. Banking entities would have to comply with certain policies and procedures, internal controls, and reporting and recordkeeping requirements. The internal controls must be designed to monitor a banking entity's investments in covered funds, its relationships with covered funds, and the effectiveness of its compliance program.

3. Timing Issues

Pursuant to the statute, the Volcker Rule is to become effective in July 2012, but provides for a subsequent two-year "conformance" period. Nevertheless, the Agencies have indicated that compliance programs should be in place as early as July 2012, and activities should be conformed to the Proposal "as soon as practicable" during the conformance period. Given the many issues that are being raised by both the industry and other observers and the uncertainty as to the extent the Agencies will revise the Proposal, commenters have suggested to the Agencies that the timetable for effectiveness be pushed back.

II. Citigroup's Operations in Mexico

Grupo Banamex, Citigroup's principal Mexican holding company subsidiary, has extensive operations in Mexico, including Banco Nacionál de México ("Banamex"), one of Mexico's largest banks. Grupo Banamex provides financial services in Mexico and internationally, offering consumer deposit and lending services, debit and credit cards, and commercial banking and financing. It also provides significant wealth management, private banking, investment, and fiduciary services, as well as life, damage, accident and health insurance products. The company also acts as an intermediary in all forms of securities and financial transactions, including market-making and underwriting in a wide range of securities. Grupo Banamex's client base includes individuals, small and medium-size companies, the Mexican federal government and state governments and related agencies and corporate and institutional customers.

In addition to Banamex, Grupo Banamex's principal subsidiaries include Afore Banamex (retirement services fund management services), Impulsora de Fondos Banamex (asset management services), Seguros Banamex (insurance products) and Accival-Acciónes y Valores Banamex (broker-dealer activities). With regard to securities services, almost 14% of the daily trading volume in the Mexican financial markets is traded through Banamex. Accival is the top brokerage house in the country, and Afore Banamex and Impulsora de Fondos Banamex are the largest retirement services fund manager and the largest mutual fund manager in Mexico, respectively.

Grupo Banamex, through its subsidiaries, is a significant owner and dealer in Mexican sovereign debt. Through its asset management and fund administration businesses, Grupo Banamex also manages significant amounts of Mexican sovereign investments for clients.

Citibank, N.A. also conducts activities in Mexico through its branches in New York.

III. Potential Effects of the Proposal on Citigroup's Mexican Operations

The drawing of lines between prohibited activities and permitted activities under the general terms of the Volcker Rule has presented the Agencies with a difficult task. Generally, the industry and recent commenters (including non-U.S. regulators and governments) have been concerned that the permitted activities have been drawn too narrowly while the prohibited activities have been defined too broadly. This could result in significant negative effects, not only on the operations of any one institution, but on the role of financial intermediaries and on the markets themselves. If finalized as is, the Proposal could have a significant impact on the conduct of many of Citi's current operations in Mexico. The possible impacts on different business lines in Mexico are discussed below.

Pure Proprietary Trading. By the terms of the Volcker Rule in the statute, any proprietary trading by Grupo Banamex – that is, trading solely for Grupo Banamex's own account, and where profits are primarily from short-term price movements – would have to be terminated.

Underwriting and Market-Making. Grupo Banamex's businesses engage in securities underwriting and market-making in securities, derivatives and futures. Although these business lines are specifically permitted under the Proposal, the Proposal's limitations on these activities could reduce Grupo Banamex's underwriting and market-making capabilities, impose significant compliance costs and impair Grupo Banamex's ability to serve customer needs in Mexico.

The Proposal contains several criteria for determining whether market-making or underwriting activities might involve impermissible proprietary trading. The Agencies have proposed that indicia of prohibited proprietary trading would include the holding of inventory and the potential for revenues arising from the increase in price from holding inventory. The Proposal would require the trading operation to focus on deriving profits primarily from fees, commissions and bid-ask spreads. This approach seems not to recognize that, in many markets, including in Mexico, dealers must take principal positions in order to maintain efficient and liquid markets. This is particularly the case in less liquid markets, where maintaining inventory and the possibility of generating revenues from price appreciation are a necessary part of a market-maker's or underwriter's overall business strategy, which must include standing ready to meet its customers' needs. Under the Proposal, therefore, Grupo Banamex could be constrained in its ability to engage in certain market-making and underwriting activities.

In addition, the Proposal would require instituting specific and extensive policies and procedures, as well as developing systems to produce and report frequently a set of various metrics. The proposed metrics are quite extensive for market-making activities (17 parameters), although less so for underwriting (five parameters). Many of these metrics currently are not produced by financial institutions, and would require the build-out of systems to comply.

Moreover, the Proposal is unclear as to whether Grupo Banamex entities would be restricted from undertaking any market-making or underwriting activities in securities issued by funds that any affiliate advises, if such funds were deemed to be "covered funds" under the covered fund investment prohibition described below.

Further, trades undertaken in a fiduciary capacity—where the position is beneficially owned by the customer—would not be covered by the proprietary trading ban, but would be subject to compliance policies designed to ensure that the trading remains in a fiduciary capacity. Broker and agency trades where Grupo Banamex entities do not act as principal would not be affected, although riskless principal trades would be subject to a compliance program to ensure that the riskless principal trading did not become prohibited proprietary trading.

Insurance Business. Under the Proposal, Grupo Banamex's regulated insurance company affiliates would be permitted to engage in proprietary trading under two exemptions: (1) for their "general accounts", and (2) for the separate accounts of policy holders. However, the Agencies would have the authority, in certain circumstances, to disqualify a foreign insurance company from this exemption. It is unclear to us at this point how the concepts of general and separate accounts might be applicable to foreign insurance companies. It does appear, however, that the Proposal would prohibit Grupo Banamex from investing in covered funds through its insurance company affiliates.

Hedging Activities. In accordance with safe and sound operations of financial institutions, Grupo Banamex hedges risks present in its various business lines. To the extent that hedges use securities, derivatives, futures, or options on any of those instruments, and to the extent hedges are required to be in trading accounts rather than the banking book, hedging activity would be required to fit within the Proposal's definition of "risk-mitigating" hedging activity to avoid the ban on proprietary trading. The Proposal would require a reasonable degree of correlation of the hedge, with consistent monitoring to ensure that correlation with the hedged risk continues over time. The Proposal also would require that hedges not introduce significant additional risks to the institution, even if the institution in fact mitigates the risk of the hedged position.

Generally, any hedging activity would be subject to a new and extensive compliance regime. Although hedging generally would require fewer metrics reports than market-making, any hedging within the market-making book would be subject to all of the metrics required for market-making. The net effect of the narrow exemption for hedging, when combined with the Proposal's many restrictions, could be to impair, or at least raise the cost of, Grupo Banamex's ability to effectively hedge its risks.

Local Asset-Liability Management. The Proposal would provide an exemption for principal positions maintained in accordance with a well-defined "liquidity management" program. The program could use only highly liquid instruments that are specifically authorized by appropriate internal policies and procedures. The Proposal does not provide an exemption for the full range of "asset-liability" management activities in which financial institutions traditionally engage. The activities that Grupo Banamex and other Citi businesses conduct in Mexico include more than liquidity management, and are targeted to managing tenor, rate, foreign exchange, and other liability and asset mismatches. Internal treasury and asset-liability management functions not covered by the narrow liquidity management exception would then be required to seek other exemptions from the proprietary trading ban for the positions that they hold, even if it would mean applying the required full compliance program and metrics reporting to these traditional banking activities.

Furthermore, as described in more detail below, non-U.S. sovereign securities, including the significant amounts of Mexican government bonds that are used for asset-liability management in Mexico, would not be exempt instruments. This means that Grupo Banamex might have to treat positions it holds in Mexican government bonds for asset-liability purposes as if they were proprietary trading positions, unless the positions otherwise qualify for exceptions under the Proposal as noted above. This is an important concern not only in relation to Grupo Banamex, but because the adverse impact this may have in the global financial markets. For global banks such as Citi, local currency deposits are typically placed in local currency loans and securities, especially local government bonds.

Fund Operations. Grupo Banamex, through its subsidiaries Afore Banamex and Impulsora de Fondos Banamex, provides retirement and mutual fund management services. Fund managers in Mexico are in some cases required by law to hold some amount of equity in the funds they manage.

The restrictions on sponsoring, or investing in, private equity or hedge funds are not intended to apply to mutual funds or similar broadly distributed public funds. However, as noted above, there is ambiguity as to the range of funds that may be "covered" and therefore subject to the prohibition.

Grupo Banamex should be able to continue pure advisory activities for all funds, although it may be subject to restrictions on transactions with funds it advises if the fund were a covered fund.

If a fund were deemed to be a covered fund, then Grupo Banamex's ability to organize, offer or sponsor the fund would be required to meet certain parameters to be permissible. If those parameters are met, investments by Grupo Banamex in any fund it organizes, offers and sponsors would still be limited to 3% of the fund's ownership interests (subject to permission to seed the fund in the first year) as well as a separate aggregate limit on all permitted fund interests. Investments in any third party fund deemed a "covered fund" would be prohibited.

The Proposal, if adopted as proposed, might lead U.S.-based financial institutions like Citi to curtail certain fund management businesses, and to divest interests in funds they currently hold. Because of the uncertainty about the breadth of the definition of "covered fund," the divestiture requirement could extend to assets that might not normally be considered to be "funds," such as securitizations or pooled vehicles.

Cross-Border Activity. Citi's U.S. operations often engage in cross-border activity into Mexico with Mexican clients, including the Mexican government. Though not related to the Volcker Rule, to the extent this activity includes swap and derivatives activities, U.S. regulatory reform initiatives will significantly regulate the swaps markets and dealers in swaps. In particular, Title VII of the Dodd-Frank Act requires clearing swaps through central counterparties and trading swaps on exchanges, collection of margin from customers, reporting of trades to swap data repositories and adherence to business conduct rules that will impact the way swap and derivative dealers engage with customers. In addition, Citibank, N.A. will be subject to Section 716 of the Dodd-Frank Act which will require it to curtail equity, commodity and certain credit derivatives in mid-2013, thus forcing Citi to engage customers through swap dealer entities other than its lead bank.

IV. Potential Effects of the Proposal in Mexico

A. Impact Beyond U.S. Institutions

The Proposal applies to all of Citi's operations globally. The same is true for other U.S. banking institutions and their branches and subsidiaries in Mexico. Non-U.S. institutions are likely to be able to conduct a broader range of fund and trading activities in Mexico, but only if they can meet the test that such activities be conducted "solely outside the United States." The Proposal has crafted that test relatively narrowly, however, and, to the extent that they cannot meet the requirements of such test, many important institutions that operate in Mexico will be subject to the same restrictions and compliance burdens described for Grupo Banamex's operations. For example, a foreign bank may not use the "solely outside the United States" exception to the proprietary trading ban if it were to transact business with U.S. persons. The Proposal would treat foreign branches, including the Mexican branches, of U.S. banks as U.S. persons, even if the transaction occurred wholly outside the United States. Given the choice between looking to other market participants and trading with a branch of a U.S. institution, foreign banks would be strongly incentivized to avoid dealings with these branches.

To highlight the Proposal's reach into the Mexican financial system, most of the banks that have leading roles in Mexico are subsidiaries of either U.S. banking institutions (which would be fully subject to the Proposal) such as Goldman Sachs, Morgan Stanley, JP Morgan Chase, Bank of America, or foreign banks with U.S. operations, such as BBVA, Santander, HSBC, Deutsche Bank, Credit Suisse and Scotiabank (only those operations that are solely outside the U.S. would not be subject to the Proposal). To the extent that such non-U.S. banks operating in Mexico structure their operations to meet the Proposal's requirements for funds and trading "solely outside the United States," Banamex could be at a serious competitive disadvantage, especially since other locally owned banks may not be subject to such restrictions.

B. Market Liquidity, Particularly for Mexican Sovereign Debt

In defining the permitted market-making and underwriting activities, the Proposal applies restrictions and presumptions that would make it difficult for financial institutions to continue to engage in those activities as currently conducted. In particular, the Proposal treats the maintenance of inventory by a market-maker or underwriter, and the possibility of revenues from price appreciation of inventory (rather than from commissions or a bid-ask spread), as indicia of prohibited proprietary trading. In order to avoid a regulatory violation, institutions are likely, if the Proposal is adopted as proposed, to avoid trades of a size or duration that cannot be hedged or otherwise sold quickly. This would be especially true in less liquid markets such as those for emerging market and corporate debt. There is concern that compliance with the Proposal as currently drafted could reduce liquidity in markets generally, particularly because so many major international financial institutions would be subject to these requirements. Liquidity constraints, of course, could lead to a decrease in the value of securities owned by institutions, investors and consumers. Another likely result could be increased funding costs for consumers, corporations and governmental entities in the capital markets. Even a small basis point increase in the cost of funding in the Mexican market could significantly increase funding costs for Mexican companies and governments. Furthermore, pension funds and other regulated investors might be discouraged from investing in portions of the Mexican market due to decreased liquidity.

The Volcker Rule contains an exemption from the proprietary trading ban for U.S. government securities, but does not exempt the securities of any other sovereign. It has been publicly reported that Canada, Japan and the United Kingdom have weighed in with their concerns about the negative impact the Proposal could have on the liquidity of their financial markets, in particular their sovereign debt markets.

As is the case in the United States, sovereign securities are often the preferred choice of local institutions and counterparties for the posting of collateral because of their current quality and liquidity. Also, institutions frequently manage interest rate and foreign exchange risks with transactions in sovereign bonds, particularly in their local operations. Local sovereign securities typically are also used for liquidity and asset-liability management in local operations. Institutional investors, such as mutual, retirement and other investment funds, as well as insurance companies, are large holders of non-U.S. sovereign debt that may decrease in value because of impaired liquidity. Thus, there is concern that decreased liquidity in foreign sovereign securities could impair the ability of all financial institutions to deal with customers and to manage risk.

Because the Proposal does not exempt Mexican and other non-U.S. government securities (and derivatives referencing these securities), there could be particular burdens placed on international banks that rely on non-U.S.-dollar-denominated (e.g., peso-denominated) debt securities to manage the liquidity and funding risks arising from their Mexican operations, and that this could have significant negative effects on liquidity in the Mexican sovereign debt market. The financial services industry is in agreement that this could not only increase bid-ask spreads and transaction costs for those instruments, but also increase financing costs for the Mexican public sector.

Furthermore, given that a significant portion of the outstanding debt in the Mexican market is comprised of Mexican government debt, and that foreign investors (which include large U.S. companies and global companies with operations in the U.S.) hold significant positions in Mexican sovereign debt, the Volcker Rule could have a significant adverse impact on the Mexican market.

C. Foreign Exchange Markets

The Agencies determined that the Volcker Rule is not applicable to spot foreign exchange transactions. However, the Proposal would subject foreign exchange swaps and forwards to the proprietary trading ban. Were this to lead to decreased market liquidity for swaps and forwards this also could negatively affect the spot market. Although foreign exchange is currently a highly liquid market, global banking organizations might be reluctant to take on the timing issues that occur as markets open and close around the globe for fear of regulatory scrutiny under the Proposal. Any negative effects on liquidity and foreign exchange risk management could directly impair this core banking function.

V. Citigroup's Advocacy Efforts

The discussion above has assumed the application of the Proposal as drafted by the Agencies. The Agencies will be accepting comments on the Proposal and the hope is that the Proposal will be significantly revised to avoid the consequences highlighted in this memorandum. Of course, there is no assurance that will be the case.

Given the relevance that Grupo Banamex has in both the Mexican economy and Citigroup's overall global strategy, there is special concern about the potential impact of the Proposal on financial markets and Citi's operations in Mexico, as conducted primarily through Grupo Banamex. In meetings with the Agencies, Citi has expressed that it stands firmly behind the Volcker Rule's core principles of re-focusing trading businesses on the needs of customers while reducing potential risk to financial institutions and the financial system, but it believes there is a high likelihood that the Proposal will lead to serious unintended consequences. Citi has also heard from many clients, business trade associations, and U.S. and non-U.S. government officials who share these concerns.

The public comment period on the Proposal ends February 13, 2012 (though for one of the Agencies the comment period expires about a month later). Citi has submitted, and will be submitting, comment letters to the Agencies that address the Proposal's impact on market-making, sovereign debt markets, and other matters. Citi is also working closely with various financial services industry groups to submit comment letters on other aspects of the Proposal, including its overall compliance framework and its application to asset-liability management activities and local markets.