RBS Citizens
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Office of the Comptroller of the Currency 400 Seventh Street, SW, Ste. 3E-218 Mail Stop 9W-11 Washington, D.C. 20219 **Docket ID OCC-2013-0016** **RIN 1557 AD 74** Via email to regs.comments@occ.treas.gov	Board of Governors of the Federal Reserve System 20th Street and Constitution Avenue, NW Washington, DC 20551 Attention: Robert deV. Frierson, Secretary **Docket No. R-1466** **RIN 7100-AE03** Via email to regs.comments@federalreserve.gov
Federal Deposit Insurance Corporation 550 17th Street, NW Washington, DC 20429 Attention: Robert E. Feldman, Executive Secretary **RIN 3064-AE04** Via email to comments@FDIC.gov	

Re: **Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards and Monitoring**

Ladies and Gentlemen:

RBS Citizens Financial Group Inc., Providence RI ("**RBS Citizens**"), a bank holding company by virtue of its ownership of subsidiary insured depository institutions ("**IDIs**"), RBS Citizens, National Association, Providence, Rhode Island, and Citizens Bank of Pennsylvania, Philadelphia, Pennsylvania (together, the "**Citizens Banks**"), is pleased to submit this comment to the notice of proposed rulemaking (the "**NPR**") issued by the Office of the Comptroller of the Currency (the "**OCC**"), the Federal Deposit Insurance Corporation (the "**FDIC**"), and the Board of Governors of the Federal Reserve System (the "**Federal Reserve**", and together with the OCC and FDIC, the "**Agencies**") entitled *Liquidity Coverage*

Ratio: Liquidity Risk Measurement, Standards, and Monitoring, published at 78 Fed. Reg. 71818 (Nov. 29, 2013). Although RBS Citizens is a wholly owned subsidiary of The Royal Bank of Scotland Group plc and The Royal Bank of Scotland plc, it is submitting this comment letter because it and its subsidiary IDIs would be directly subject to the Liquidity Coverage Ratio ("**LCR**") if the NPR is finalized in its current form. The NPR would implement the international liquidity standards ("**Basel LCR**") published by the Basel Committee on Banking Supervision ("**Basel Committee**").

RBS Citizens supports the extensive comments submitted by The Clearing House Association L.L.C., the American Bankers Association, the Securities Industry & Financial Markets Association, the Financial Services Roundtable, the Institute of International Bankers, and the Structured Finance Industry Group (together, the "**Associations**"). It submits this comment letter to highlight issues of particular importance to RBS Citizens relating to the NPR.

I. Executive Summary

RBS Citizens notes the Associations' comments highlighting specific requirements of the NPR relative to the Basel LCR, and focuses on the following adverse impacts resulting from those requirements that go beyond those in the Basel LCR:

1. The proposed implementation schedule is particularly troublesome, given the NPR's explicit and imputed stressed outflow rates across all liability and contingent asset categories; the significant valuation implications for associated products and services among different client segments (i.e., retail, commercial, and other non-retail); and the required daily reporting frequency.
2. The proposed treatment of GSE securities as level 2A HQLAs with a 40% cap creates a critical negative externality that may have adverse pro-cyclical impacts in the very times of financial stress that the NPR is intended to ameliorate.
3. The secured-funding 'unwind provision' creates a critical disincentive for banks to accept municipal deposits. Together with the proposed exclusion of municipal securities from HQLA classification, this treatment is disproportionately unfavorable to both banks and their client municipalities.
4. The proposed definition of operational deposits is too narrow, and penalizes a significant amount of otherwise stable deposits currently within the banking system.

II. The Implementation Schedule Is Too Aggressive

Although on its face the effective date of the LCR rule -- January 1, 2015 -- appears consistent with the Basel III LCR, the requirement that banking entities, even those subject to the modified LCR instead of the full LCR, calculate the ratio on a daily basis rather than on a monthly basis as required in the Basel III LCR, makes the task of conforming to the proposed LCR substantially more burdensome than compliance with the Basel III LCR. The transition provisions -- meeting a ratio of 80% in 2015 and 90%

in 2016, with the 100% requirement not effective until January 1, 2017 -- do not recognize the requirements and costs associated with building the infrastructure needed to calculate the ratio on a daily basis. At a minimum, any banking organization not subject to the existing daily liquidity reporting requirements under FR 2052 (more specifically institutions currently required to complete the monthly FR 2052b) should be given until 2017 to comply with daily calculation of the LCR. More importantly, these institutions, including regional banking institutions, should be permitted to calculate the ratio on a monthly basis consistent with the Basel III LCR. Generally, regional banks are not subject to daily reporting on the FR 2052b precisely because they rely on deposits for funding and have relatively simple and homogeneous balance sheets and liquidity profiles, in contrast to the complex balance sheets and funding arrangements more commonly associated with G-SIBs. RBS Citizens continues to monitor, report, and manage to a host of daily liquidity metrics at the legal entity level.

We respectfully request that the Agencies consider that the implementation of the LCR requirements would be happening simultaneously with implementation of other important but resource-intensive regulatory requirements, such as the U.S. Basel III capital requirements, the Volcker Rule, the Dodd-Frank Act Title I enhanced prudential supervision requirements, the Qualified Mortgage rules, and CFTC and SEC rules under Title VII of the Dodd-Frank Act. These initiatives all require additional changes to the infrastructure of banking organizations, and the Agencies should be cautious about unnecessarily accelerating implementation of an LCR rule that includes a reporting frequency that was neither contemplated in the Basel III LCR nor anticipated by regional banks. We are particularly concerned with the cumulative, and as yet unknown, impact of the LCR and the additional regulatory changes being implemented, on institutions, practices, customers, products, and markets.

III. GSE Securities Should Be Treated as Level 1 HQLAs

The agencies acknowledged that securities issued and guaranteed by U.S. GSEs consistently trade in very large volumes and generally have been highly liquid, including during times of stress. 78 Fed. Reg. at 71827. The OCC, in its Unfunded Mandates Reform Act of 1995 Determination, acknowledged that the NPR presents potential problems from liquidity hoarding, especially during a crisis. 78 Fed. Reg. at 71855. The Agencies nevertheless propose to treat GSE securities as level 2A HQLAs with a 40% cap. RBS Citizens believes that the unintended consequence of this, together with the unwind required for secured funding transactions that punishes holding anything other than securities issued by or backed by the full faith and credit of the U.S. government, will be a significant shift in demand from GSE to GNMA securities. Aside from potentially distorting mortgage financing markets, forcing banking organizations into a concentration of a single issuer's securities exacerbates, rather than mitigates, systemic risk. In future stress scenarios, risk correlations resulting from more homogenous and concentrated securities holdings may result in increased liquidity stresses and contagion that may cause the very systemic trauma the Agencies seek to address through the NPR. Further, under the NPR, funding with Level 1 HQLAs is an LCR-neutral action (total Level 1 HQLAs are unchanged since cash increases but Level 1 HQLAs similarly decline); in contrast, the LCR is improved by term funding secured with assets that are not HQLAs, and by Level 2A/2B HQLAs that exceed the HQLA eligibility cap. As a result, there may be hoarding of Level 1 securities, with the gap filled in the secured-funding markets through obligations that are not HQLAs.

To partially mitigate these impacts and ease the LCR constraints on affected institutions, the NPR should recognize securities issued by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation as Level 1 HQLAs, particularly while those GSEs are in conservatorship overseen by the Federal Housing Finance Agency. Even beyond that time, the Agencies should consider designating GSE securities as Level 1 HQLAs, in order to minimize potential impacts on institutions, the mortgage industry, and the markets, given the unique role of these instruments in U.S. banks' management of liquidity and the performance of these obligations during the 2008 crisis. Finally, as an alternative solution, GSEs above the 40% cap could be recognized, but at lower valuation levels (higher haircuts to market value). These actions are consistent with the recommendations of the study by van den End and Kruidhof (2013) to which the OCC refers in its Unfunded Mandates Reform Act of 1995 Determination. *Id.* That study suggested widening the LCR buffer definition to include more assets as one suggested policy response to severe liquidity shocks. We believe these alternatives also address the issue of single-issuer concentrations across bank securities portfolios.

IV. The Secured-Funding Unwind Provision Should Not Apply to Secured Municipal Deposits

As currently drafted, the NPR creates a significant disincentive for banks to hold collateralized municipal deposits. While the stated intent of the 'unwind provision' is to prevent HQLA manipulation, it unnecessarily penalizes regional banks like RBS Citizens that simply utilize unencumbered portfolio securities to collateralize these deposits. Additionally, because secured-funding transactions are already assigned outflow rates at maturity based on the quality and liquidity of the underlying pledged assets (Section 32 (i) and (j) of the proposed rule), the impact of the unwind requirement on the HQLA numerator of the LCR is excessively punitive. The following example demonstrates and quantifies the potential punitive impact of the proposed rule on municipal deposits.

Example of Punitive Impact of the Unwind Provision

I. Scenario: Bank has $11 billion in non-maturity, municipal deposits, collateralized by $12 billion in Level 2A HQLAs	
Unencumbered Level 1 Assets	15,000
Unencumbered Level 2A Assets	15,294
Unencumbered Level 2B Assets	0
1. Beginning LCR balances:	
a. Level 1 Liquid Asset Amount	15,000
b1. Level 2A Liquid Asset Amount, before 40% cap (15,294 * .85)	13,000
b2. Level 2A Liquid Asset Amount, after 40% cap [(2/3)*Level 1 Assets = (2/3) * 15,000] =	10,000
c. Level 2B Liquid Asset Amount	0
2. Beginning HQLA Numerator (= Level 1 HQLAs + Allowable Level 2A HQLAs) or	
[Level 1 HQLAs + ((2/3) * Level 1 HQLAs)] = [15,000 + ((2/3) * 15,000)] = [15,000 + 10,000] =	**25,000**

II. Secured-funding transaction must be unwound	
3. Initial transaction-unwind impacts:	
a. Adjusted Level 1 Liquid Asset Amount	
= [(Level 1 Liquid Asset Amount - Secured-funding balance) = (15,000 - 11,000)] =	4,000
b. Adjusted Level 2A Liquid Asset Amount	
= [(Level 2A Liquid Asset Amount + LCR value of returned Level 2A HQLAs) = (13,000 + (12,000 * .85))] =	23,200
c. Adjusted Level 2B Liquid Asset Amount	
= [(Level 2B Liquid Asset Amount = (0 * .50)] =	0

III. Unadjusted Excess HQLA Amount	
a. Level 2A Cap Excess Amount:	
= Max [Level 2A Liquid Asset Amount - (2/3) * Level 1 Liquid Asset Amount, 0]	
= Max[13,000 - (2/3) * 15,000, 0] =	3,000
b. Level 2B Cap Excess Amount:	
= Max[Level 2B Liquid Asset Amount - Level 2A Cap Excess Amount - .1765 * (Level 1 Liquid Asset Amount + Level 2A Liquid Asset Amount), 0]	
= Max[(0 * .50) - 3,000 - (.1765 * (15,000 + 13,000)), 0] =	0
c. Unadjusted Excess HQLA Amount:	
= [Level 2A Cap Excess Amount + Level 2B Cap Excess Amount] = [3,000 + 0] =	**3,000**

IV. Adjusted Excess HQLA Amount	
a. Adjusted Level 2A Cap Excess Amount:	
= Max[Adjusted Level 2A Liquid Asset Amount + Adjusted Level 2B Liquid Asset Amount - (2/3) * Adjusted Level 1 Liquid Asset Amount), 0]	
= Max[23,200 + 0 - ((2/3) * 4,000)] =	20,533
b. Adjusted Level 2B Cap Excess Amount:	
= Max[Adjusted Level 2B Liquid Asset Amount - Adjusted Level 2A Cap Excess Amount - (.1765 * (Adjusted Level 1 Liquid Asset Amount + Adjusted Level 2A Liquid Asset Amount)), 0]	
= Max[0 - 20,533 - (.1765 * (4,000 + 23,200)), 0] =	0
c. Adjusted Excess HQLA Amount:	
= [Adjusted Level 2A Cap Excess Amount + Adjusted Level 2B Cap Excess Amount] = [20,533 + 0] =	**20,533**
V. Calculation of the HQLA Amount	
a. HQLA Amount:	
HQLA Amount = [Level 1 Liquid Asset Amount + Level 2A Liquid Asset Amount + Level 2B Liquid Asset Amount - Max[Unadjusted Excess HQLA Amount, Adjusted HQLA Excess Amount]	
= [15,000 + 13,000 + 0 - Max (3,000, 20,533)] =	**7,467**

If, as suggested by the foregoing example, accepting deposits from municipalities and other public sector entities in fact lowers a banking organization's LCR, insured depository institutions ("**IDIs**") may well be unwilling to accept such deposits. These actions would have a profound adverse impact on public sector entities as well as on the IDIs that have been forced to forego this historically stable source of liquidity. Although the unwind provision would seem to be consistent with the Basel LCR, the common state law requirement that such deposits be collateralized constitutes a clear "country specific circumstance" justifies deviation from the Basel LCR.

V. The Definition of "Operational Deposits" Is Too Narrow

RBS Citizens believes that the definition of "operational deposits" is so narrow that the liability category will not provide the relief intended in the NPR. RBS Citizens agrees with the comments of the Associations that paragraphs (b)(1) and (8) of Section 4 of the NPR should be revised in the manner suggested by the Associations, and that paragraphs (b)(2) and (b)(4) should be deleted, so that the definition of "operational deposit" is defined principally by the "excess amount" provisions of paragraph (b)(6). Failure to accept these comments will result in banks devaluing commercial -- indeed all non-retail -- deposits, likely leading such deposits to migrate to money-market funds or elsewhere in the shadow banking system. This would increase, not mitigate, systemic risk, particularly in times of economic stress.

VI. Conclusion

Although RBS Citizens supports the regulators' efforts to continue to identify and formalize best practices in the liquidity management space and further improve the resilience of both individual banks and the broader financial system against idiosyncratic and systemic liquidity shocks, the requirements of the NPR, as currently proposed, would reduce incentives to maintain diversified liquid asset portfolios and funding sources. The result will be the loss of diversification in banking organizations' sources of funding, as organizations increasingly eschew municipal and other public deposits, GSE securities (in favor of GNMA securities), and non-retail deposits, in favor of assets and funding sources that qualify for more favorable LCR treatment. These results will not only create a potentially unsafe concentration in a narrow band of assets and funding sources, but it also threatens to distort asset markets -- for example, by giving GNMA a dramatic competitive edge over other sources of mortgage funding.

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RBS Citizens appreciates the opportunity to provide comments on the NPR. We hope that the Agencies will make appropriate revisions to the proposed rules and avoid adverse consequences to regulated FBOs and the U.S. and global financial systems that could outweigh the benefits of the proposed rules.

Respectfully submitted,

RBS Citizens Financial Group Inc.

By:____________________
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