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VIA EMAIL TO REGS.COMMENTS@FEDERALRESERVE.GOV

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attention: Robert deV. Frierson, Secretary

Re: Regulation YY: Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies; Docket No. 1438; RIN 7100-AD-86

Ladies and Gentlemen:

The Royal Bank of Scotland plc ("**RBS**") is pleased to submit this comment to the notice of proposed rulemaking (the "**NPR**") issued by the Board of Governors of the Federal Reserve System (the "**Federal Reserve**") to implement the enhanced prudential standards and early remediation provisions of sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank Act**") by adding new Subparts K through R to Regulation YY that would be applicable only to foreign banking organizations ("**FBOs**") and foreign nonbank financial companies.[1] RBS and its parent, The Royal Bank of Scotland Group plc, and its subsidiary RBS Citizens Financial Group Inc., are financial holding companies that are registered bank holding companies as a result of their ownership of two wholly owned FDIC-insured depository institutions, RBS Citizens Bank, N.A., and Citizens Bank of Pennsylvania.

I. Executive Summary

RBS commends the Federal Reserve for so thoroughly articulating in the NPR, and in Governor Tarullo's November 28, 2012 speech presaging its publication,[2] the policy concerns motivating the proposal. RBS understands the Federal Reserve's concerns leading to publication of the NPR: changes of the U.S. operations of some FBOs leading to a current profile of providing funding on a net basis to non-U.S. operations and increasing concentration,

[1] 77 Fed. Reg. 76,628 (Dec. 28, 2012).

[2] Regulation of Foreign Banking Organizations, Speech by Governor Daniel K. Tarullo (Nov. 28, 2012), available at http://www.federalreserve.gov/newsevents/speech/tarullo20121128a.htm.

interconnection and complexity; increasing reliance on short-term wholesale U.S. dollar liabilities creating financial stability risks; and prudential supervision initiatives undertaken by other jurisdictions that the Federal Reserve views as calling into question the availability of capital and liquidity to support U.S. operations at the moment of a crisis.

However, RBS shares the concerns of internationally active banks and international financial trade groups that the NPR:

- Represents a departure from the U.S. principle of national treatment by imposing restrictions that create competitive disadvantages to U.S. operations of FBOs;
- Evidences an apparent retreat from efforts to achieve coordination and consistency in prudential supervision and resolution among international regulators;
- Has the potential to aggravate cross-border systemic risk by ring-fencing capital and liquidity in a way that inhibits deployment when and where it is needed most. In effect, this will require more capital and liquidity from FBOs individually and collectively to compensate for lack of mobility; and,
- Prescribes governance, management and compliance frameworks that will require redundant structures to satisfy both U.S. and home country regulators. This will result in increased costs and other adverse effects that outweigh any enhancements to safety and soundness or resolvability.

RBS concurs with the more comprehensive comments filed by trade associations, such as The Institute for International Banking ("**IIB**"); The Clearing House Association L.L.C.; The Institute for International Finance; the Global Financial Markets Association; and the Securities Industry and Financial Markets Association (together, the "**Associations**"), that the Federal Reserve has not appropriately balanced all of these competing policy considerations. This comment letter is limited to issues of particular interest to RBS by urging the Federal Reserve to make the following changes to the NPR:

1. In the Single Counterparty Credit Limits ("**SCCL**") provisions (Subpart N of the proposed rule), exempt exposures to at least high-quality sovereigns from the definitions of "exposure", and eliminate provisions that unnecessarily reduce the ability of FBOs to fairly compete with U.S. banking organizations;
2. Extend beyond July 1, 2015, the date by which the requirements of the rule become effective;
3. Revise proposed section 252.212 to treat a fully consolidated bank holding company subsidiary of an "Intermediate Holding Company" ("**IHC**") as a "depository institution" for purposes of allowing an IHC to include in common equity tier 1 minority interest any minority interest arising from the issuance of common shares by the subsidiary bank holding company.
4. Revise proposed Subpart K to expand the categories of U.S. "subsidiaries" that may be held outside of the IHC; and,
5. Revise the Early Remediation Framework in proposed Subpart R to eliminate the risk that executive officers and directors could be held responsible for early remediation triggering events that are beyond their control.

II. Detailed Comments

A. Single Counterparty Credit Limits

Proposed Subpart N, like proposed Subpart D of Regulation YY issued for comment in December 2011 (the "2011 Proposal"), would require any banking organization covered by the SCCL rules (a "**SCCL covered institution**") to apply the SCCL to all sovereign government exposures (other than exposures of the SCCL covered institution's home country) and to aggregate exposures to a sovereign government with exposures to any commercial enterprises controlled by that sovereign.

RBS repeats the point made in its April 30, 2012 comment letter to the 2011 Proposal that the SCCL rule should exempt exposures to high-quality non-U.S. sovereign obligations. The European Commission's large exposure regime, which is implemented by member countries, excludes from the applicable credit limit exposures to sovereigns with a 0% risk-weight and certain central counterparties.[3] RBS agrees with the Associations' observation that exempting exposure to the U.S. Government, but not to non-U.S. sovereigns with similar levels of liquidity and creditworthiness, is unfair; and that by discouraging SCCL covered institutions from investing in, or accepting as collateral, non-U.S. sovereign obligations, will distort the market for non-U.S. sovereign obligations and reduce liquidity for these obligations; and with the recommendation that the following exposures be exempt:

- sovereign debt securities that are assigned a specific risk-weighting factor of 1.6 or less (equivalent to a risk-weighting of 20% or less under the U.S. banking agencies' Basel I-based capital rules) under the market-risk rules; and
- obligations of the government of a country that is a full member of the Organization for Economic Cooperation and Development or that has concluded special lending arrangements with the International Monetary Fund.

Section 252.242(d) of this NPR, like section 252.92(k) in the 2011 Proposal, would define "counterparty" for purposes of the SCCL rules to include a foreign sovereign entity and all of its "instrumentalities." The NPR includes following Question 38:

> **<u>Question 38</u>**: . . . Should exposures to a company controlled by a foreign sovereign entity be included in the exposure to that foreign sovereign entity?[4]

This is the same inquiry as Question 25 in the 2011 Proposal. The Federal Reserve should not treat a company controlled by a foreign sovereign entity as an instrumentality of the foreign sovereign government or otherwise require that a SCCL covered institution's exposures to such a

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[3] *See*, Letter of April 27, 2012, from The Clearing House Association L.L.C., the American Bankers Association, the Financial Services Forum, The Financial Services Roundtable, and the Securities Industry and Financial Markets Association to the 2011 Proposal, Annex C, p. C-3, available at: http://www.federalreserve.gov/SECRS/2012/May/20120501/R-1438/R-1438_042712_107270_542775340448_1.pdf.

[4] 77 Fed. Reg. at 615.

company be aggregated with those to the sovereign. Doing so will create at least the following five adverse consequences without compensating benefit:

- Reduce the ability of a FBO that is controlled by a foreign sovereign entity, its subsidiary IHC, and any subsidiary bank holding company and insured depository institution ("**IDI**"), to obtain funding from and transact as a counterparty with SCCL covered institutions subject to the SCCL;
- Undermine the ability of a FBO that is controlled by a foreign sovereign entity, its subsidiary IHC, and any subsidiary bank holding company to conduct the liquidity stress testing and contingency funding planning required by sections 252.226, 252.56 and 252.58 of Reg. YY as currently proposed;
- Interfere with the liquidity of the sovereign's debt securities because every dollar (or other currency unit) of exposure to the FBO and its subsidiaries would reduce the ability of the SCCL covered institution to hold the sovereign's debt (including posting reserves with the sovereign's central bank) – and possibly to accept it as collateral for third parties' obligations;
- Restrict the SCCL covered institution's ability to conduct operations in the jurisdiction of a sovereign that controls a FBO to which the SCCL covered institution has credit exposure, because every dollar (or other currency unit) of exposure to the FBO and its subsidiaries would reduce the ability of the banking organization to hold required deposits with the central bank or hold debt of the sovereign of that jurisdiction; and
- Impede the ability of a foreign sovereign to conduct an orderly resolution of a large internationally active FBO because any institution controlled by the foreign sovereign would immediately be restricted under the SCCL from conducting transactions with SCCL covered institutions.

In addition to the foregoing points relevant to the impact of the SCCL on a FBO when it is the counterparty to a SCCL covered institution, RBS makes the following additional point in response to new provisions in the NPR that apply to a FBO when it is the SCCL covered institution. As proposed, section 252.244(e) and (f) would permit the U.S. branches and subsidiaries of a FBO that is a covered institution to use eligible guarantees from an eligible protection provider to reduce its aggregate credit exposure on credit transactions with a covered institution. The definition of "eligible protection provider" in proposed section 252.40 includes any sovereign entity, bank holding company, and foreign banking organization "other than the foreign banking organization or an affiliate thereof." In addition to the argument made by the IIB that the U.S. operations of a FBO should be allowed to rely on a guarantee from its head office or an affiliate to reduce its SCCL exposure to a customer, RBS does not believe there is justification to prevent a FBO from using a guarantee from its home country sovereign to reduce its credit exposure to a SCCL covered institution. Such a restriction on the utility of home sovereign guarantees could put a FBO controlled by a sovereign entity at a significant competitive disadvantage with other U.S. and non-U.S. institutions in providing trade finance services.

Section 252.45(c) proposes that if either a FBO's IHC subsidiary or its combined U.S. operations is not in compliance with the SCCL rule with respect to a counterparty (where the FBO is the SCCL covered institution), neither the IHC (and its subsidiaries) nor the U.S.

branches could engage in any additional credit transaction with that counterparty unless the Federal Reserve determines that the additional transactions are necessary or appropriate to preserve the safety and soundness of the FBO or U.S. financial stability. RBS believes this "cross-trigger" feature is unfair and, in fact, is likely to be contrary to the interests of subsidiary IDIs whose interests the Federal Reserve should be protecting. The IDIs are subject to their own lending limits under state and federal law, as well as to the SCCL rule applied to any IHC of which they are subsidiaries. An IDI's primary regulator expects and insists that an IDI be managed independently of its affiliates. Denying an IDI the ability to take an opportunity for revenue-generating activity consistent with its own risk tolerance because of a SCCL rule violation by an affiliated U.S. branch of its parent FBO would be contrary to the interests of the IDI and its federal and state regulators.

B. Extend Implementation Dates

RBS believes that an effective implementation date of July 1, 2015, is too soon for a FBO to develop the systems and processes needed to implement the requirements of the proposal, in light of the potential business and structural changes necessary to organize and begin operating for the first time as a single U.S. domestic business, especially for a financial service entity not previously organized to operate in this way.

Assuming final rules are issued late 2013, the proposed implementation provisions would effectively require FBOs to fully comply with risk management-related requirements within an 18-month time period to meet the proposed July 1, 2015 date (e.g., risk-based capital, liquidity, risk management, single counterparty credit limits). Comprehensive Capital Analysis and Review ("**CCAR**") and stress testing would be fully required very shortly thereafter for the autumn 2015 CCAR cycle.

The proposed rules do not leave sufficient time for a FBO to reorganize its U.S. operations *in the manner necessary to comply with the proposed IHC requirements while preserving its* global business strategy. The short timeframes provided in the proposed rule will be further reduced by the need to build out significant new systems that will be required for the newly restructured U.S. subsidiary operations to comply with CCAR, and that, by necessity, can be done only after essential questions prompted by the proposed rules regarding the structure and operations of the FBO's U.S. operations have been clarified. Forcing FBOs to undertake the build-out of systems and infrastructure required for stress testing without adequate time to fully analyze the far-reaching strategic and structural implications of the proposed rules would be quite likely to produce suboptimal long-term outcomes on all fronts. Further, building such major risk management systems to make all IHCs compliant by July 1, 2015, will require the simultaneous procurement of scarce resources by multiple enterprises to develop and implement the requisite new processes, models and technology, making it that much more difficult for any one of the FBOs to achieve timely compliance with all requirements applicable to an IHC.

In addition to CCAR implementation, RBS also believes that it is not practical to require a new IHC to remediate immediately upon its formation any shortfall in liquidity or capital under the liquidity buffer and capital requirements. A requirement for such immediate compliance would be particularly burdensome if there were to be a need to raise liquidity from third-party sources to close any liquidity buffer shortfall, as there would be insufficient time to identify and exploit new funding sources given the need to obtain agency ratings, formulate a consolidated funding strategy, and test the market for the first time.

RBS respectfully suggests that any final FBO enhanced prudential standards provide a phase-in for capital and liquidity requirements, particularly in cases where the requirements are likely to be dependent on the legal form of the IHC, the reorganization of business activities, and the potential need to obtain agency ratings and / or provide for external issuance. For example, even if notwithstanding industry concerns reflected in the Associations' comments, the liquidity and capital buffer requirements are adopted as proposed, they could be phased in over time, much as the Federal Reserve has proposed to transition in minimum common equity tier 1 and tier 1 capital ratios and capital conservation and countercyclical capital buffers in Subpart G of proposed rules to implement the Basel III Accord.[5] CCAR could be phased in to first apply in the year following IHC formation, rather than in the same year. In this way, an IHC would be provided some time to mature its consolidated business activities; to demonstrate to the marketplace the ability to operate as a single consolidated business. Such phased-in implementation would also lessen the crowded and chaotic rush to market that would undoubtedly unfold if multiple firms are forced to raise capital or liquidity in the markets in a short time window.

C. Revise Proposed Section 252.212 to Accommodate Issuances of Equity and Debt by a Bank Holding Company Subsidiary of an IHC.

The NPR acknowledges that some FBOs already own a U.S. bank holding company. Section 252.201 of the proposed rule requires any FBO meeting the $50 billion asset threshold to establish an IHC regardless of whether or not the FBO has or does not have a U.S. bank holding company.[6] As a threshold matter, we note that some FBOs may have an existing entity that fulfills or could be made to fulfill the Subpart K criteria for an IHC, and we see no reason why such an existing company could not be used as the IHC. We recommend, therefore, that the words "establish a U.S. intermediate holding company" be changed to "establish or designate a company to be a U.S. intermediate holding company." Such language appears in proposed sections 252.201(a)(1) and (3), section 252.201(b) (change "form" to "form or designate"), section 252.202(a) and (b), and section 252.203(b).

It is likely that many IHCs would need to issue equity securities and/or debt in order to meet the capital and liquidity buffer requirements when the rules become effective. A FBO may decide that it is more efficient for the IHC to issue such equity or debt directly to third parties, or it may turn out to be more efficient to use an existing subsidiary U.S. bank holding company (which may already have issued equity or debt to third parties) to issue such equity or debt.

[5] Joint Notice of Proposed Rulemaking, Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action, 77 Fed. Reg. 52792 (Aug. 30, 2012).

[6] See Section 252.212(a) of the proposed rule: "A U.S. intermediate holding company, regardless of whether it controls a bank, must calculate and meet all applicable capital adequacy standards . . . in the same manner and to the same extent as a bank holding company in accordance with any capital adequacy standards established by the Board for bank holding companies."

Section 252.201 of the proposed rule would effectively subject an IHC to all of the risk-based capital and leverage rules applicable to bank holding companies. This would include, when they become final, the capital adequacy rules proposed in 2012 to implement the Basel III Accord. Section 21 of those proposed capital adequacy rules would impose restrictions on the extent to which minority interests held by third parties in subsidiaries of a banking organization may be counted as capital of the banking organization.[7] Minority interests would be able to be counted as common equity tier 1 capital of the banking organization only if the minority interest was issued by a depository institution subsidiary of the banking organization. At a minimum, Section 252.212 should be amended (at least after such time as the proposed capital requirements are finalized) to explicitly permit an IHC to be able to count as common equity tier 1 capital minority interests issued by a depository institution holding company to the same extent as it would be able to do if the equity had been issued by an IDI subsidiary of the IHC. The same reasoning that justifies better treatment for equity issued by an IDI also applies to equity issued by a depository institution holding company; both types of institutions would be subject to the same capital rules and stress testing requirements. Moreover, because even a FBO that already owns a U.S. depository holding company will be required to form or designate an entity to be an IHC, the IHC should not be limited in its ability to count as any category of capital any equity or debt already issued to third parties by a U.S. depository institution holding company that exists at the date the NPR is finalized if the FBO moves that depository institution holding company under an IHC to comply with Subpart K.

Given that the IHC is an arbitrary business construct imposed upon FBOs, rather than a planned and demonstrably viable stand-alone commercial enterprise, market receptivity for equity and debt issuance by IHCs is uncertain. This is particularly true, given that the market may be crowded by several FBOs seeking to raise capital and liquidity for their U.S. operations in the short window that will surround IHC formation, all of which will need to comply with the capital and liquidity buffer requirements. Therefore, to facilitate ease of raising any necessary capital and long-term funding to meet the IHC capital and liquidity buffer requirements, RBS urges the Federal Reserve to consider amending section 252.212 to permit an IHC to fully recognize any minority interest in capital instruments issued by their subsidiary depository institutions or depository institution holding companies as long as over any rolling eight-quarter period, the percentage of the amount of the capital component (e.g., common equity tier 1, tier 1) sought to be recognized by the IHC represented by the subsidiary does not exceed the percentage of the IHC's consolidated assets that is attributable to that subsidiary. In other words, if an IHC owns an IDI, and that IDI's common equity tier 1 capital represents 10% of the IHC's tier 1 capital, the IHC should be permitted to count as common equity tier 1 capital all minority interests in the IDI's common equity tier 1 capital to the extent that the IDI's assets comprise 10% or more of the consolidated assets of the IHC. The test would have to be measured over a rolling period to prevent capital from "winking in and out" of the IHC.

RBS believes it would be appropriate to permit minority interests in IDI and depository institution holding company subsidiaries of an IHC to count as capital of the IHC in the manner described above because that would be consistent with (i) the fact that the primary focus of the

[7] 77 Fed. Reg. 52792.

Bank Holding Company Act is the provision of resources to subsidiary IDIs, and (ii) the Basel III Accord, which permits a bank to count as capital minority interests (which represent genuine third party common equity contributions) in any institution that is subject to the same minimum prudential standards and level of supervision as a bank.[8] In the 2012 Capital Adequacy Proposal, the U.S. bank regulatory agencies expressed a concern that minority interests held in a subsidiary would not always be available to absorb losses at the consolidated level.[9] Given that a bank holding company is expected to serve as a source of strength to its U.S. IDIs, and is subject to the same stress testing and even more rigorous capital planning requirements than the IDIs, RBS believes this approach would be consistent with the Basel III Accord and the overall IHC framework.

D. Amend Section 252.201(b) to Allow a FBO to Continue to Own Additional Subsidiaries Outside of the IHC.

RBS recognizes that the requirement that FBOs form intermediate holding companies to hold all of their U.S. subsidiaries raises enormous questions of competitive equality, financial and compliance burden, and coordination of international supervisory and orderly resolution efforts. The lack of attention devoted in this comment letter to those large issues should not be taken as RBS's agreement with the IHC approach; rather, RBS is deferring to the comments of the Associations and is focusing on certain technical aspects of the IHC proposal that it believes should be revised if the Federal Reserve determines, notwithstanding the objections of the international banking community, to proceed with the IHC approach.

Of particular concern to RBS is the definition of "subsidiary" in the requirement that all of a FBO's U.S. subsidiaries other than those held pursuant to section 2(h)(2) of the Bank Holding Company Act, be controlled by the FBO's IHC. The proposal applies the definition of "subsidiary" in the Bank Holding Company Act, and, in particular, section 225.2(o) of Regulation Y. This brings in companies in which the FBO, directly or indirectly, holds 25% or more of a class of voting securities, or over which the FBO has a controlling influence, even if the FBO has no actual control. This is not only unfair, but impractical.

If a FBO owns less than a majority of the voting shares and has no actual control of a non-U.S. company (e.g., another foreign bank), and that foreign bank were to control a U.S. subsidiary, then the FBO would be required to put the U.S. subsidiary into its IHC – but would have no practical way of doing so. Moving the investment in the foreign bank into the IHC would create insurmountable problems, as any exemption under section 2(h)(2) of the BHC Act would be lost for companies controlled by the foreign bank, and there would be very adverse tax consequences. Moreover, applying the controlling influence test to non-U.S. companies is also unfair – the complexities of the Federal Reserve's controlling influence guidance are particularly difficult to apply to investments in non-U.S. companies, where the forms of corporate governance and customs and practices regarding shareholder rights are very different from those

[8] Basel Committee on Banking Supervision, *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems*, ¶ 62, nn. 23-24, pp. 19-20 (Dec. 2010, *rev.* June 2011), available at http://www.bis.org/publ/bcbs189.pdf

[9] 77 Fed. Reg. at 52815-816.

in the U.S. Accordingly, only interests in subsidiaries financially consolidated by the FBO should be required to be held by the IHC. We note that for purposes of the U.S. Basel II advanced approaches in Appendix G to Regulation Y, "control" is defined as ownership, control or power to vote 25% or more of a class of voting securities, or financial consolidation.[10] This same definition would be retained in Section 2 of the capital adequacy rules proposed in 2012 to implement Basel III.[11] The Federal Reserve has the statutory flexibility to adopt a rule that only financially consolidated entities should be treated as "subsidiaries" for purposes of proposed Subpart K because the NPR is proposed pursuant to section 165 of the Dodd-Frank Act, not the Bank Holding Company Act; therefore, the Federal Reserve is not required to incorporate the definitions of control in section 2 of the Bank Holding Company Act. The activities of a subsidiary as defined in the Bank Holding Company Act would continue to be subject to the activity restrictions of that Act regardless of where within the FBO organization the subsidiary is held, so allowing a nonconsolidated subsidiary to be held outside the IHC would not frustrate the purposes of the Bank Holding Company Act.

In addition, RBS believes that each of the following categories of subsidiaries should not be required to be held in the IHC:

- Subsidiaries of U.S. branches;
- Conduits and other entities used solely for funding the FBO's U.S. or global operations;
- Investments held in satisfaction of debt previously contracted in good faith ("**dpc assets**");
- Investments made before the IHC rules are adopted in any company with assets of less than $10 billion.

Federal and state banking laws generally prohibit a subsidiary of a federally or state chartered branch from engaging in any activity that is not permitted to the branch. These are the direct analog of operating subsidiaries that U.S. banks are permitted to own. There are tax, operational, and non-regulatory legal reasons that make it advantageous for a FBO to choose to house activities in an incorporated division of its U.S. branch rather than in the branch itself, and the activities of such an operating subsidiary are frequently such that significant benefits would be lost – without any meaningful supervisory benefit – if the subsidiary had to be moved to an IHC. Similarly, conduits and other entities used solely for funding the FBO's U.S. operations may lose their functionality if moved to an IHC, with perverse implications in the context of a proposal intended in large part to enhance liquidity management by FBOs in the U.S.

Certain conduits and other entities used to fund FBOs' U.S. operations would lose their utility if moved to an IHC. For example, it is a common structure for a FBO to maintain one or more U.S. subsidiaries in connection with trust preferred arrangements that provide capital to the FBO. In a typical trust preferred structure, the U.S. subsidiary holds perpetual preferred capital instruments issued by the FBO and deposits the preferred instruments into funding trusts, which in turn issue paper to the market. The instruments issued by the funding trusts pay yields that

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[10] 12 C.F.R. 225 App. G, § 2.

[11] 77 Fed. Reg. at 52848.

mirror those of the preferred instruments issued by the FBO, which fully guarantees the instruments, and all recourse is to the FBO. The funding trusts' only source of cash to pay the coupon to investors is from the payments made by the FBO on the preferred instruments it issued to the funding trusts. Moving the subsidiary that holds the perpetual preferred instruments to the IHC would interfere with effectiveness of these trust preferred arrangements, but would not further any substantial supervisory objective of the Federal Reserve.

The Federal Reserve should permit dpc assets to remain in the business unit that effected the transaction that led to taking the dpc asset, or in an entity that manages dpc assets on a global or regional basis that may be outside an IHC. There is no visible benefit to requiring dpc assets to be moved to an IHC, and ample precedent for treating dpc assets differently than other assets held by banking organizations. Bank holding companies and insured depository institutions are permitted to hold dpc assets because the importance of an orderly disposition of such assets to controlling loss exposure outweighs restrictions on banking organizations engaging in commercial activities.

In addition, the Federal Reserve should not require a FBO to move to an IHC investments made prior to adoption of the NPR with no expectation of a requirement that they be held in a U.S. subsidiary. This requirement may trigger tax and other consequences far worse than they would have been had the investment been placed under a U.S. holding company at the outset. We are cognizant that there are certain existing subsidiaries that the Federal Reserve seeks to have moved to an IHC for defined policy reasons, but believe that it is unnecessarily burdensome to require the movement of investments -- already subject to the activity restrictions of the Bank Holding Company Act – that have no material impact on the FBO or the U.S. financial system. Therefore, RBS proposes that the Federal Reserve provide grandfather rights to allow a FBO to hold outside an IHC any investment in any company with total consolidated assets of less than $10 billion.[12]

E. Amend Section 252.284(c)(5) to Eliminate Automatic Sanctions

Section 252.284(c)(5) would, if adopted as proposed, prohibit a FBO that becomes subject to "level 3 remediation" from increasing the compensation of, or paying any bonus to, an executive officer whose primary responsibility pertains to any part of the combined U.S. operations, or any member of the board of directors of the IHC. RBS is concerned that any provision that makes a compensation freeze automatic upon the occurrence of certain events will make it difficult for a FBO to attract and maintain quality officers and directors, particularly at a time of distress when it would be most crucial to have access to the best possible managerial talent. This provision is particularly problematic in that such a freeze on compensation could be triggered by events completely outside of the control of the affected officer or director. For example, compensation of an IHC officer or director could be triggered by: (i) failure of the FBO at a consolidated level to meet applicable capital thresholds (section 252.282(a)(3)); or (ii) substantial noncompliance of the FBO's U.S. branches with the enhanced liquidity risk

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12 Sections 163(b) and 604(e) of the Dodd-Frank Act require notice of acquisitions of shares of nonbank companies only if they have total consolidated assets exceeding $10 billion, suggesting that Congress recognized that holdings of companies with lesser assets do not raise systemic risk issues.

management requirements under Subpart M of the proposed rule (section 252.282(d)(3)). Similarly, compensation of an officer of a U.S. branch could be automatically frozen based on a triggering event at the IHC over which the officer had no control or responsibility.

Section 252.284(c)(6) would permit the Federal Reserve to require the IHC to replace any or all of the IHC's directors, or terminate any executive officer whose primary responsibility pertains to any part of the FBO's combined U.S. operations. Such action would be taken after notice and opportunity for hearing, and, presumably, only if the Federal Reserve were to determine that the directors or officers to be removed were in some way responsible for the level 3 triggering event. RBS believes that freezes in compensation should be administered similarly; i.e., effected only after notice and opportunity for hearing and a finding that the affected officer or director was in some way responsible for the triggering event.

Adoption of Subpart R in its currently proposed form would make it difficult for a FBO to attract and retain qualified directors and executive officers of the IHC because they could have their compensation or continued employment adversely impacted by capital or liquidity events elsewhere in the operations of the FBO over which they have no influence. If the Federal Reserve nevertheless adopts automatic compensation restrictions on officers and directors within the combined U.S. operations of a FBO that experiences a level 3 triggering event, it should limit the automatic implementation of such a freeze to officers or directors of the component of the combined U.S. operations at which the triggering event occurs, and, in any event, not for triggering events occurring at the consolidated parent level.

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RBS appreciates the opportunity to provide comments on the NPR. We hope that the Federal Reserve 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,

The Royal Bank of Scotland plc

By: Ellen Alemany

Ellen Alemany
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RBS Citizens Financial Group
And Head of RBS Americas