



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

October 12, 2007

Mr. Jay Levine
Head of RBS Global Banking
& Markets, North America
The Royal Bank of Scotland
101 Park Avenue
New York, New York 10178

Dear Mr. Levine:

This is in response to the request by The Royal Bank of Scotland plc (“RBS”), Edinburgh, Scotland, for a temporary exemption from section 23A of the Federal Reserve Act and the Board’s Regulation W.¹ The exemption would allow RBS’s branches in New York, New York, and Greenwich, Connecticut (“Branches”), to engage in certain securities financing transactions with their affiliate, Greenwich Capital Markets, Inc. (“Affiliated Broker-Dealer”), also in Greenwich, as described below.

The Branches propose to extend credit to market participants in need of short-term liquidity to finance their holdings of certain residential and commercial mortgage loans and mortgage-backed securities, asset-backed securities, commercial paper, and other structured products (“Assets”). For operational reasons, the Branches propose to channel these transactions through the Affiliated Broker-Dealer. The transactions between the Branches and the Affiliated Broker-Dealer and the mirror transactions between the Affiliated Broker-Dealer and the unaffiliated market participants would take the form of either reverse repurchase agreements or securities borrowing transactions (collectively, “securities financing transactions” or “SFTs”). For each of the proposed SFTs, the Branches will at all times be overcollateralized; the extent of

¹ 12 U.S.C. § 371c; 12 CFR part 223.

this overcollateralization will vary depending on the type of assets offered by the unaffiliated market participants as collateral for the SFTs.

Sections 23A and 23B and Regulation W apply to transactions between a U.S. branch of a foreign bank and a U.S. affiliate engaged in securities underwriting, insurance underwriting, or merchant banking activities (an “FHC affiliate”) in the same manner and to the same extent as if the branch were a member bank.² Section 23A and Regulation W limit the aggregate amount of “covered transactions” between a U.S. branch of a foreign bank and any FHC affiliate to 10 percent of the foreign bank’s capital stock and surplus, and limit the aggregate amount of covered transactions between a U.S. branch of a foreign bank and all its FHC affiliates to 20 percent of the foreign bank’s capital stock and surplus.³ “Covered transactions” include the purchase of assets by a U.S. branch from an FHC affiliate, the extension of credit by a U.S. branch to an FHC affiliate, the issuance of a guarantee by a U.S. branch on behalf of an FHC affiliate, and certain other transactions.⁴ The statute and regulation also require a U.S. branch of a foreign bank to secure its extensions of credit to, and guarantees on behalf of, FHC affiliates with prescribed amounts of collateral.⁵

In addition, section 23A and Regulation W specifically authorize the Board to exempt transactions or relationships from the requirements of the statute and rule if the Board finds such an exemption to be in the public interest and consistent with the purposes of section 23A.⁶ The Board previously has indicated that the twin purposes of section 23A are (i) to protect against a depository institution suffering losses in transactions with affiliates; and (ii) to limit the ability of an institution to transfer to its affiliates the subsidy arising from the institution’s access to the federal safety net.⁷ The Board also has stated that it decided to apply

² 12 CFR 223.61(a).

³ 12 U.S.C. § 371c(a)(1) and 12 CFR 223.11, 223.12, and 223.61(b)(1)(ii).

⁴ 12 U.S.C. § 371c(b)(7) and 12 CFR 223.3(h).

⁵ 12 U.S.C. § 371c(c); 12 CFR 223.14 and 223.61.

⁶ 12 U.S.C. § 371c(f)(2) and 12 CFR 223.43.

⁷ 67 Federal Register 76560 (Dec. 12, 2002).

Regulation W to transactions between a U.S. branch of a foreign bank and its FHC affiliates to preserve competitive equity between U.S. banks and foreign banks.⁸

The SFTs between the Branches and the Affiliated Broker-Dealer would be covered transactions under section 23A and Regulation W. Because the Branches propose to engage in SFTs with the Affiliated Broker-Dealer in amounts that exceed the Branches' quantitative limits under the statute and rule, RBS must receive an exemption from the Board to engage in the proposed transactions.

A temporary, conditional exemption from section 23A and Regulation W for the proposed SFTs would appear to be consistent with the purposes of section 23A, in the public interest, and consistent with Board precedent. The Board recently granted substantively identical exemptions to Citigroup Inc. ("Citigroup"), JPMorgan Chase & Co. ("JPMC"), Bank of America Corporation ("BofA"), and Deutsche Bank AG ("Deutsche Bank").⁹

RBS has agreed to several conditions that will help ensure that it engages in the proposed SFTs in a safe and sound manner. RBS is well capitalized and has represented that it will limit its lending under this exemption to \$10 billion, which constitutes less than 30 percent of RBS's total regulatory capital. RBS will, as a condition of the exemption, also agree either to guarantee the obligations of the Affiliated Broker-Dealer to the Branches in connection with the proposed SFTs or to pledge to the Branches funds equal to 5 percent of the value of the Assets to help ensure that the Branches do not incur losses in connection with the SFTs. This commitment provides additional protection to the Branches in the event of the insolvency of the Affiliated-Broker Dealer.

Each of the proposed SFTs will at all times be overcollateralized, the Branches will mark to market the SFTs on a daily basis, and the SFTs will be subject to daily margin maintenance requirements. In addition, the Affiliated Broker-Dealer must execute an SFT with an unaffiliated market participant that is substantially contemporaneous with and on the same terms as the Branch's SFT

⁸ 67 Federal Register 76560, 76598 (Dec. 12, 2002).

⁹ See Board Letters dated August 20, 2007, to Carl Howard, Esq. (Citigroup); Kathleen A. Juhase, Esq. (JPMC); Patrick S. Antrim, Esq. (BofA); and September 12, 2007, to Michael L. Kadish, Esq. (Deutsche Bank).

with the Affiliated Broker-Dealer. This requirement should help ensure that each transaction with the Branches is on market terms, that the Branches do not use SFTs to finance the preexisting securities inventory of the Affiliated Broker-Dealer, and that the affiliate serves only as a conduit through which the Branches engage in SFTs with unaffiliated counterparties.

To enhance the ability of the Branches to promptly close out and liquidate SFTs with the Affiliated Broker-Dealer in the event of the affiliate's insolvency, the SFTs between the Branches and the Affiliated Broker-Dealer must be promptly collectable even in the case of bankruptcy by the Affiliated Broker-Dealer.¹⁰ Moreover, this would be a temporary exemption. The exemption would be available only for SFTs initiated during the period that the Federal Reserve System's special discount window lending facility is available. For SFTs with a term that exceeds the life of the special discount window lending facility, the Branches would be permitted under the exemption to hold these existing transactions to maturity.

Granting the exemption described above would have significant public benefits. First, the exemption would enable the Branches to provide a substantial amount of liquidity to the markets for the Assets. Because of the operational advantages to the Branches of using the Affiliated Broker-Dealer as a conduit to convey funds to market participants, the exemption would allow the Branches to provide the needed liquidity in the most rapid and cost-effective manner possible for the Branches and the market participants.

The Branches would continue to be subject to the market-terms requirement of section 23B of the Federal Reserve Act.¹¹ Section 23B requires that the SFTs between the Branches and the Affiliated Broker-Dealer be on terms that

¹⁰ This protection applies to "securities contracts" under section 555 of the Bankruptcy Code. If an SFT between a Branch and the Affiliated Broker-Dealer qualifies as a securities contract under the Bankruptcy Code, the Branch's ability to liquidate the transaction in the event of the bankruptcy of the Affiliated Broker-Dealer generally cannot be stayed, avoided, or otherwise limited by operation of any provision of the Bankruptcy Code. See, e.g., 11 U.S.C. § 555.

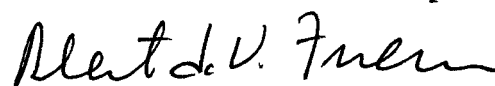
¹¹ 12 U.S.C. § 371c-1; 12 CFR part 223, subpart F.

are substantially the same, or at least as favorable to the Branches, as those prevailing at the time for comparable transactions with unaffiliated companies.¹²

For the reasons stated above, and in light of all the facts you have presented, the SFTs appear to be consistent with the purposes of section 23A and in the public interest. Accordingly, the Director of the Division of Banking Supervision and Regulation, pursuant to authority delegated by the Board, and with the concurrence of the General Counsel, hereby grants the requested exemption, subject to the indicated conditions and limits.

This determination is specifically conditioned on compliance by RBS, the Branches, and the Affiliated Broker-Dealer with all the commitments and representations they made to the Board in connection with the exemption request. These commitments and representations are deemed to be conditions imposed in writing by the Board in connection with granting the request and, as such, may be enforced in proceedings under applicable law. This determination is based on the specific facts and circumstances of the transactions described in your correspondence and this letter. Any material change in those facts and circumstances or any failure by RBS, the Branches, or the Affiliated Broker-Dealer to observe any of its commitments or representations may result in a different view or in a revocation of the exemption.

Sincerely yours,



Robert deV. Frierson
Deputy Secretary of the Board

cc: Michael Schussler, Esq.
Federal Reserve Bank of New York

¹² See 12 U.S.C. § 371c-1(a)(1).