22 March 2007

The Office of the Controller of the Currency
250 E Street, SW
Washington, DC 20219
[12 CFR Part 3; Docket No. 06-09
RIN 1557-AC91]

Robert E Feldman
Executive Secretary, FDIC
550 17th Street, NW
Washington, DC 20429
[12 CFR Part 325;
RIN 3064-AC73]

Jennifer J Johnson
Secretary, Board of Governors of the FED
20th Street and Constitution Avenue, NW
Washington, DC 20551
[12 CFR Parts 208 and 225;
Regulation H and Y; Docket No. R-1261]

Regulatory Comments
Chief Counsel's Office, OTS
1700 G Street, NW
Washington, DC 20552
[12 CFR Part 566;
RIN 1550-AB56]

Dear Sirs & Madam,

NOTICE OF PROPOSED RULE-MAKING (NPR) - BASEL II

Thank you for the opportunity to comment on your proposals for implementing the Basel Accord within the United States.

By way of background, the Royal Bank of Scotland Group (RBSG) is one of the top ten global banks. We have significant activities in North America, including Retail and Commercial Banking, Asset Finance and Capital Markets operations. The largest single business, measured by assets, is Citizens Financial Group, Inc., a Providence-based commercial bank holding company that operates over 1,600 Citizens Bank and Charter One branch offices in Connecticut, Massachusetts, New Hampshire, New Jersey, Rhode Island, Pennsylvania, Delaware, New York, Vermont, Illinois, Indiana, Michigan, and Ohio.

The majority of the Group's exposures are already covered by the EU Capital Requirements Directive (EU CRD). Citizens, with over $160 billion in assets, falls outside the "top 10" group of core banks mandated to operate the advanced approaches for credit and operational risk in 2009. However, we are planning to move the US business to Basel II during 2009. Given our

geographic spread, we are clearly interested in how the proposals will be implemented within the US and, importantly, in driving consistency in international implementation.

Whilst we support the US agencies objectives of moving forward with Basel II, we believe that elements of the NPR should be revisited before the rules are finalized. We believe that the US regulators should avoid divergence from the international standards agreed at Basel - this is important for a range of practical implementation, competitive and home-host issues. The key areas that we believe should be reconsidered are:

- Different definitions of default, capital requirements for defaulted exposures, LGD, capital floors and Pillar 3 disclosures.
- Possible changes in aggregation, should overall capital fall by 10%.
- Loss of SME exposures as a separate category and the PD/LGD approach for Equity exposures
- More conservative treatment of EAD.

Detailed responses to the various questions raised in the NPR are covered in the attached appendix. These reflect the views of the RBSG, Citizens and Greenwich Capital Markets. In addition to these comments, we have also contributed to the industry response being submitted by the Institute of International Finance (IIF). We support their conclusions which are consistent with these views.

We hope that these comments are useful to you in taking forward the implementation of the new Basel Accord in the United States. Please do not hesitate to contact either me or Bob Gormley, Chief Risk Officer, CFG, should you wish to discuss any of these points in more detail.

Yours faithfully,

David Thomas
Head of Basel II

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c.c. Bob Gormley

Appendix
March 2007

Citizens / RBS NPR Comments

QUESTION	CFG/RBS Comments
Q 1: The agencies seek comment on and empirical analysis of the appropriateness of the proposed rule's AVCs for wholesale exposures in general and for various types of wholesale exposures (for example, commercial real estate exposures).	No comment.
Q 2: The agencies seek comment on and empirical analysis of the appropriateness and risk sensitivity of the proposed rule's AVC for residential mortgage exposures – not only for long-term, fixed-rate mortgages, but also for adjustable-rate mortgages (ARMs), home equity lines of credit, and other mortgage products – and for other retail portfolios.	As default estimation is largely performed at the segment or "risk grade" level, the correlation effects are implicitly included in the estimation process. Little empirical evidence exists to support meaningful AVC's on ARMs, home equity lines of credit or portfolios which exhibit very high prepayments. We recommend that agencies consider lowering the proposed AVC values for mortgages.

QUESTION	CFG/RBS Comments
Q 3: The agencies seek comment and supporting data on the appropriateness of this limit.	There is a difference in accounting standards that govern the establishment of the ALLL in the US and their UK equivalent, provisions. In the US, Citizens follows the US guidance for establishment of reserves which contemplates a longer time horizon and progress through the credit cycle. In the UK, the calculation of reserve amounts (provision) is based on known and identifiable existing conditions in the portfolio currently, in accordance with International Accounting Standard 39 (IAS39). The result is that the ALLL reserve amount for US purposes is higher than the provision amount for UK purposes. The difference in treatment will result in US ALLL exceeding the Basel EL measure over a one-year time horizon (ECL), although we are unable to estimate the difference between the two data sets. Citizens have not, based upon its historical credit profile, experienced ALLL amounts in excess of the 1.25% limitation. However, it is generally believed to be well below the 0.06% limit. We do not believe this limitation will be a factor in determining the amount of ALLL qualifying for Tier 2 capital, and believe this limitation to be appropriate.
Q 4: The agencies seek comment on the use of a segment-based approach rather than an exposure-by-exposure approach for retail exposures.	RBS supports the use of a segment (or pooled) based approach, in line with the original Basel proposals. This approach is now reflected in our Group Risk Data Warehouse and capital calculation engine.

QUESTION	CFG/RBS Comments
Q 5: The agencies seek comment on this approach to ensuring that overall capital objectives are achieved.	Whilst we recognize that one of the original objectives of Basel 2 was to maintain capital within the system at a constant level and understand the background of the transitional floors, we believe that the changes to calibration should occur at a Basel Committee level wherever appropriate, thereby reducing international fragmentation and the associated (and well known) issues associated with home:host divergence. Any material change in calibration, as outlined in the NPR, could impact on the mutual recognition status between home and host regulators (the UK and USA in this instance) and, potentially, undermine attempts, through the AIG, to allow greater flexibility between jurisdictions on consolidation. Equally, the US authorities need to consider any capital implications around Pillar 2, before making arbitrary decisions around the calibration of Pillar 1.
Q 6: The agencies seek comment on all potential competitive aspects of this proposal and on any specific aspects of the proposal that might raise competitive concerns for any bank or group of banks.	On implementation, the US will be working on three Basel approaches – Basel 1, 1a and Basel 2 Advanced. Such a structure, like the EU, leads to different capital requirements at the product level which may give rise to competitive inequality, undermining the level playing field that firms wish to retain. The differences may benefit internationally active banks or, equally, firms that migrate to Basel 1a. With regard to potential consolidation created by these rules, we believe that the current round of consolidation is driven more by legal changes, scale, efficiency and trends towards globalization. It is too early to say whether Basel 2 will accelerate this trend.

QUESTION	CFG/RBS Comments
Q 7: The agencies request comment on whether U.S. banks subject to the advanced approaches in the proposed rule (that is, core banks and opt-in banks) should be permitted to use other credit and operational risk approaches similar to those provided under the New Accord. With respect to the credit risk capital requirement, the agencies request comment on whether banks should be provided the option of using a U.S. version of the so-called ''standardized approach'' of the New Accord and on the appropriate length of time for such an option.	At the principle level, we support any action that drives consistency in international implementation. Given this stance, which underpins our external engagement, we would support any moves by the US agencies to allow for the standardized approaches for credit (and TSA for operational risk) to be available for firms operating in the US market. Indeed, flexibility around credit risk may be beneficial as it is not always possible, given the lack of default data, to apply the AIRB requirements (data and associated use test). We would not support, however, a move to implement an amended standardized approach for credit and operational risk; this would just create confusion and extra burdens for firms, regulators and stakeholders alike. At a practical level, however, we would not be able to retain much of Citizens on the standardized approach to credit risk as, under the FSA interpretation of the EU CRD, no more than 15% of total group assets can remain on this approach. In reality, we need to implement an IRB approach in Citizens to achieve our wider objectives. As the EU elements of the Group are using TSA for operational risk initially, we might wish to consider this option as an interim step within the US, should other calculation methods be made available for this risk type.
Q 8A: The agencies seeks comment on the proposed BHC consolidated non-insurance assets threshold relative to the consolidated DI assets threshold in the ANPR. **Q 8B:** The agencies seek comment on the proposed scope of application. In particular, the agencies seek comment on the regulatory burden of a framework that requires the advanced approaches to be implemented by each subsidiary DI of a BHC or bank that uses the advanced approaches.	To be covered in the letter accompanying the response. CFG is an opt-in bank. Should the group adopt a BHC approach in the US, this status may change to mandated. This may occur before the 1/1/09 implementation date. A flexible approach would need to be adopted by the US regulators as it is unlikely that the Group could accelerate implementation of Basel 2 in the US, even with a change of regulatory status.

QUESTION	CFG/RBS Comments
Q 9: The agencies seek comment on the application of the proposed rule to DI subsidiaries of a U.S. BHC that meets the conditions in Federal Reserve SR letter 01-01 and on the principle of national treatment in this context.	We support the efforts of the US agencies to ensure all financial institutions maintain strong capital adequacy standards and agree with the principle around uniformity of treatment regarding capital adequacy standards for domestic DI's or those owned by a banks headquartered outside the US. Citizens agrees that the agencies should retain the authority to require any BHC, including a U.S. BHC owned or controlled by a foreign banking organization, to maintain capital levels above the regulatory minimums. However, we believe that the rule could be reworded to better conform the language of SR letter 01-0121. The third paragraph of SR letter 01-0121, which makes clear that the authority to require higher capital levels would only be exercised where such higher capital levels were deemed appropriate under "safety and soundness" would be helpful to ensure that this measure was not implemented in an arbitrary or discriminatory manner.
Q 10: The agencies seek comment on this approach and on how and to what extent future modifications to the general risk-based capital rules should be incorporated into the transitional floor calculations for advanced approaches banks.	We do not understand why the agencies have implemented a harsher set of transitional floors (and arrangements) than those incorporated within the Basel Accord and the EU CRD. Any changes in the rules or calibration should, ideally, be undertaken at an international level rather than be implemented on a bi-lateral basis.
Q 11: The agencies seek comment on what other information should be considered in deciding whether those overall capital goals have been achieved.	Regulators should focus on Basel 1, Basel 2 and Economic (or Internal) capital requirements, as proposed. We do not believe that firms adopting Basel 2 should also have to implement Basel 1a, as this imposes additional implementation requirements for firms, which can only divert focus away from Basel 2 implementation. Additionally, regulatory authorities should review the current requirements of the well capitalized bank regime. Without changes to the leverage ratio calculation, the behavioral benefits of Basel 2 are unlikely to be achieved.

QUESTION	CFG/RBS Comments
Q 12: The agencies seek comment on this proposed timetable for implementing the advanced approaches in the United States.	The timing of implementation is a matter for the US authorities. The three year transition period, with associated floors, may give rise to competitive advantages to EU banks (either within the EU or using a branch structure within the US), given the slightly more beneficial (and shorter) floors proposed within the CRD.
Q 13: The agencies seek comment on this aspect of the proposed rule and on any circumstances under which it would be appropriate to assign different obligor ratings to different exposures to the same obligor (for example, income-producing property lending or exposures involving transfer risk).	The NPR requires each obligor to have a consistent probability of default (PD) rating, with an LGD that reflects the estimated outcome in the event of default. With regards to our US Government entity asset/receivable financing portfolios, we believe that literal interpretation creates significant problems, because requiring the same PD rating does not reflect these circumstances: ▪ The nature of government financing results in a different structural risk profile, despite sharing the same ultimate borrower. ▪ Some transactions include the risks of Termination, Non-Renewal and Non-Appropriation while other transactions are funded with multi year authority substantially mitigating those risks. Transactions may include performance risk, creating reliance on third party contractor performance, resulting in the risk of partial off-set and abatement of the underlying government obligation. ▪ Such contracts may terminate and/or become subject to litigation, throwing the specific obligation into a non-performing status. A practice of treating all Government obligations equally under Basel 2 could result in such deals being marked as non-accrual, notwithstanding the performance of the majority of other transactions. To reflect the special nature of these facilities, we believe a special override should be provided within the Basel 2 rules for US Government and related financings. This would allow an institution with appropriate, well thoughtout and documented policies and processes to raise or lower the PD within a borrower identity to reflect such specific circumstances. We urge the agencies to reconsider this treatment, and introduce an override procedure that recognizes such anomalies.

QUESTION	CFG/RBS Comments
Q 14: The agencies seek comment on this proposed definition of default and on how well it captures substantially all of the circumstances under which a bank could experience a material credit-related economic loss on a wholesale exposure. In particular, the agencies seek comment on the appropriateness of the 5 percent credit loss threshold for exposures sold or transferred between reporting categories. The agencies also seek commenters' views on specific issues raised by applying different definitions of default in multiple national jurisdictions and on ways to minimize potential regulatory burden, including use of the definition of default in the New Accord, keeping in mind that national bank supervisory authorities must adopt default definitions that are appropriate in light of national banking practices and conditions.	The inclusion of 5% credit losses recognized in a sale or in an anticipated sale (characterized by held for or available for sale) introduces an unnecessary burden on banks in data collection and management. This requirement increases the number of defaults required. Additionally, any loan placed on non-accrual status, if sold at a loss, is captured in loss given default calculations. Such rules could severely restrict well reasoned, sound portfolio management practices since asset sales occur frequently for reasons other than disposing of problem loans. We recommend that agencies consider applying the retail exposures default definition to "retail small business loans" since this segment is managed similarly to retail portfolios. Although we broadly agree with the other changes proposed to the definition of default since they reflect the way most banks measure defaults, we are concerned that, for international institutions like ourselves, this creates significant implementation challenges given the differences in default definitions applied between jurisdictions.
Q 15: In light of the possibility of significantly increased loss rates at the subdivision level due to downturn conditions in the subdivision, the agencies seek comment on whether to require banks to determine economic downturn conditions at a more granular level than an entire wholesale or retail exposure subcategory in a national jurisdiction.	We support the idea that the banks be given the flexibility to determine downturn conditions at a more granular level than the entire wholesale or retail exposure subcategory in a national jurisdiction. We would not support a mandatory treatment.

QUESTION	CFG/RBS Comments
Q 16: The agencies seek comment on and supporting empirical analysis of (i) the proposed rule's definitions of LGD and ELGD; (ii) the proposed rule's overall approach to LGD estimation; (iii) the appropriateness of requiring a bank to produce credible and reliable internal estimates of LGD for all its wholesale and retail exposures as a precondition for using the advanced approaches; (iv) the appropriateness of requiring all banks to use a supervisory mapping function, rather than internal estimates, for estimating LGDs, due to limited data availability and lack of industry experience with incorporating economic downturn conditions in LGD estimates; (v) the appropriateness of the proposed supervisory mapping function for translating ELGD into LGD for all portfolios of exposures and possible alternative supervisory mapping functions; (vi) exposures for which no mapping function would be appropriate; and (vii) exposures for which a more lenient (that is, producing a lower LGD for a given ELGD) or more strict (that is, producing a higher LGD for a given ELGD) mapping function may be appropriate (for example, residential mortgage exposures and HVCRE exposures).	Other than for Real Estate exposures, there is no empirical evidence to support the view that loss given defaults are significantly different/higher during downturns. In general, LGD is influenced by collection efficiencies, as well as geographic, product, and customer characteristics; hence, it is preferable for banks to develop internal estimates of LGD for their wholesale and retail exposures. The historical ELGD for most senior, secured exposures is likely to be in the 20% to 25% range. The proposed mapping rule will shift 'mean ELGD' for these exposures in a downturn environment by 25% to 30% (higher). The proposed mapping function is inappropriate for many exposure types. It is not clear that a robust mapping function can be developed that would be applicable to all exposure types and institutions. We think that the proposed mapping rule is an attempt to introduce a level of precision that may not really exist for many exposure types. We recommend that the agencies consider requiring "downturn LGD's" for capital computations only for selected exposures such as residential mortgage and HVCRE. More generally, we would support a consistent approach between the US and EU markets, thereby avoiding fragmentation of approach and confusion within Pillar 3.
Q 17: The agencies seek comment on the extent to which ELGD or LGD estimates under the proposed rule would be pro-cyclical, particularly for longer-term secured exposures. The agencies also seek comment on alternative approaches to measuring ELGDs or LGDs that would address concerns regarding potential pro-cyclicality without imposing undue burden on banks.	An over emphasis on the calibration of model parameters to historical data, especially with short time series data, will create pro-cyclical results. Firms should have flexibility to use logical, forward-looking factors in the models to reflect long-run effects/behaviors, as a means of minimizing this.

QUESTION	CFG/RBS Comments
Q 18: The agencies seek comment on the feasibility of recognizing such pre-default changes in exposure in a way that is consistent with the safety and soundness objectives of this proposed rule. The agencies also seek comment on appropriate restrictions to place on any such recognition to ensure that the results are not counter to the objectives of this proposal to ensure adequate capital within a more risk-sensitive capital framework. In addition, the agencies seek comment on whether, for wholesale exposures, allowing ELGD and LGD to reflect anticipated future contractual paydowns prior to default may be inconsistent with the proposed rule's imposition of a one-year floor on M (for certain types of exposures) or may lead to some double-counting of the risk-mitigating benefits of shorter maturities for exposures not subject to this floor.	Contractually enforceable, pre-default pay downs should be eligible for recognition as part of the recovery process in the ELGD, and LGD estimates. Such recognition will be consistent with the agencies' safety and soundness objectives. Since ELGD and LGD will be calculated on the basis of adjusted net EAD, we do not believe the imposition of a one-year floor would lead to any inconsistency.We recommend that agencies should give the banks the flexibility to recognise the value in this structure.
Q 19: The agencies solicit comment on all aspects of the proposed treatment of operational loss and, in particular, on (i) the appropriateness of the proposed definition of operational loss; (ii) whether the agencies should define operational loss in terms of the effect an operational loss event has on the bank's regulatory capital or should consider a broader definition based on economic capital concepts; and (iii) how the agencies should address the potential double-counting issue for premises and other fixed assets.	Taking the first two questions in turn: (i) The proposed definitions for Operational Risk, Operational Loss and Operational Loss Events are consistent with our own interpretation. Introducing change would lead to confusion and lead to unnecessary rework. (ii) We recommend the use of the 'Replacement' cost of any Fixed Asset affected by an Operational Loss Event as this reflects the actual financial impact on a given business line. We do not have a comment on the third question posed.

QUESTION	CFG/RBS Comments
Q 20: The agencies seek comment on the appropriateness of the 24-month and 30-day time frames for addressing the merger and acquisition transition situations advanced approaches banks may face.	We would favor a more flexible approach, based on the underlying transactions. For small acquisitions, 24 months may be too generous; for larger, complex deals, too onerous. We would prefer the timeframe to be agreed through discussion between regulators and firms, based on the scale, complexity and model approach adopted by any target firm. The EU has suggested a 36 month timeframe, which seems more appropriate.
Q 21: Commenters are encouraged to provide views on the proposed adjustments to the components of the risk-based capital numerator as described below. Commenters also may provide views on numerator-related issues that they believe would be useful to the agencies' consideration of the proposed rule.	The US are taking a "less prudent" approach than that adopted in Europe (and original Basel II framework) by allowing MSR and PCCR intangibles not to be treated as a deduction to Tier 1 capital.
Q 22: The agencies seek comment on the proposed ECL approach for defaulted exposures as well as on an alternative treatment, under which ECL for a defaulted exposure would be calculated as the bank's current carrying value of the exposure multiplied by the bank's best estimate of the expected economic loss rate associated with the exposure (measured relative to the current carrying value), that would be more consistent with the proposed treatment of ECL for non-defaulted exposures. The agencies also seek comment on whether these two approaches would likely produce materially different ECL estimates for defaulted exposures. In addition, the agencies seek comment on the appropriate measure of ECL for assets held at fair value with gains and losses flowing through earnings.	The two approaches are likely to produce materially different estimates since ELGD and LGD are derived from long run historical data on fairly homogeneous pools/segments of data, whereas expected economic loss rates on defaulted exposures are likely to be estimated based on individual appraisals.

QUESTION	CFG/RBS Comments
Q 23: The Board seeks comment on this proposed treatment and in particular on how a minimum insurance regulatory capital proxy for tier 1 deduction purposes should be determined for insurance underwriting subsidiaries that are not subject to U.S. functional regulation.	No comment.
Q 24: The agencies seek comment on how to strike the appropriate balance between the enhanced risk sensitivity and marginally higher risk-based capital requirements obtained by separating HVCRE exposures from other wholesale exposures and the additional complexity the separation entails.	No comment.
Q 25: The agencies request comment and supporting evidence on the consistency of the proposed treatment with the underlying riskiness of SME portfolios. Further, the agencies request comment on any competitive issues that this aspect of the proposed rule may cause for U.S. banks.	No comment.
Q 26: The agencies request comment on the appropriate treatment of tranched exposures to a mixed pool of financial and non-financial underlying exposures. The agencies specifically are interested in the views of commenters as to whether the requirement that all or substantially all of the underlying exposures of a securitization be financial exposures should be softened to require only that some lesser portion of the underlying exposures be financial exposures.	We would welcome the use of this approach to the composition of the tranche, with the inclusion of the following: "some lesser portion of the underlying exposures being financial exposures." This is particularly relevant where a diversified portfolio is being considered – and the industry concentrations will permit an amount of financial exposures, but will enable a standard CLO type rating model to be applied. The proposed flexibility is to be applauded.

QUESTION	CFG/RBS Comments
Q 27: The agencies seek commenters' perspectives on other loss types for which the boundary between credit and operational risk should be evaluated further (for example, with respect to losses on HELOCs).	The following areas are worthy of consideration regarding the boundary between credit and operational risk: 1) **ATM/Credit/Debit card losses:** fraud losses are highly predictable given transaction volume and past historical trending. 2) **Check fraud losses:** can be predictable based upon historical experience and transaction volume. There are some frauds that are unique or one-offs from a trending perspective, but possibly the outliers could be removed when considering future losses. 3) **Overdraft (fraud) losses:** some consistency exists based upon volume of overdrafts when trended over a period of time using historical data. Outliers would need to be excluded from the calculations. 4) **Small business loan fraud:** may also lend itself to trending and predicting losses. However, firms should be responsible for ensuring that there is appropriate allocation of risks for credit and operational risk; this is not an area where additional *ex ante* guidance is required, as highlighted below (see question 28).
Q 28: The agencies generally seek comment on the proposed treatment of the boundaries between credit, operational, and market risk.	The NPR text aligns with our intended approach. However, credit risk losses that arise from an operational loss event are captured within our operational loss data for management information purposes, but are clearly flagged to avoid double counting for regulatory capital purposes.
Q 29: The agencies seek comment on this approach to tranched guarantees on retail exposures and on alternative approaches that could more appropriately reflect the risk mitigating effect of such guarantees while addressing the agencies' concerns about counterparty credit risk and correlation between the credit quality of an obligor and a guarantor.	If documented, legally enforceable guarantees exist, we believe these should be incorporated into risk weighting calculations.

QUESTION	CFG/RBS Comments
Q 30: The agencies seek comment on wholesale and retail exposure types for which banks are not able to calculate PD, ELGD, and LGD and on what an appropriate risk-based capital treatment for such exposures might be.	Firms should be allowed to define and use reference (benchmark) portfolios based on internal analysis. These portfolios could then act as proxies to which mapping rules or functions could be applied to derive or assign PD, ELGD, and LGD factors. The proxies would represent exposure pools for new products or for portfolio segments without sufficient history or products/segments which are in run-off mode). The basis for defining reference portfolios could be internal analysis or industry (external) benchmarks. ——————————
Q 31: The agencies seek comment on the appropriateness of permitting a bank to consider prepayments when estimating M and on the feasibility and advisability of using discounted (rather than undiscounted) cash flows as the basis for estimating M.	Banks should be allowed to use appropriate prepayment assumptions when estimating M, consistent with the rule permitting the use of best estimates of "future interest rates" in computing cash flows. Empirical evidence exists to demonstrate the relationship between interest rates, prepayments, and average life of the facility. Undiscounted cash flows may also be more appropriate, given their alignment with funding methodology.
Q 32: The agencies seek comment on whether the agencies should impose the following underwriting criteria as additional requirements for a Basel II bank to qualify for the statutory 50 percent risk weight for a particular mortgage loan: (i) that the bank has an IRB risk measurement and management system in place that assesses the PD and LGD of prospective residential mortgage exposures; and (ii) that the bank's IRB system generates a 50 percent risk weight for the loan under the IRB risk-based capital formulas.	Citizens have few exposures in these asset classes. We believe that the requirement can be met with relative ease.
Q 33: The agencies seek comment on all aspects of the proposed treatment of one-to-four family residential pre-sold construction loans and multifamily residential loans	No comment.

QUESTION	CFG/RBS Comments
Q 34: For purposes of determining EAD for counterparty credit risk and recognizing collateral mitigating that risk, the proposed rule allows banks to take into account only financial collateral, which, by definition, does not include debt securities that have an external rating lower than one rating category below investment grade. The agencies invite comment on the extent to which lower-rated debt securities or other securities that do not meet the definition of financial collateral are used in these transactions and on the CRM value of such securities.	If firms retain the seniority and material value exists for recovery, lower rated debt securities should be recognized as collateral in the determination of EAD for counterparty credit risk.
Q 35: The agencies recognize that criterion (iii) above may pose challenges for certain transactions that would not be eligible for certain exemptions from bankruptcy or receivership laws because the counterparty—for example, a sovereign entity or a pension fund—is not subject to such laws. The agencies seek comment on ways this criterion could be crafted to accommodate such transactions when justified on prudential grounds, while ensuring that the requirements in criterion (iii) are met for transactions that are eligible for those exemptions.	No comment.
Q 36: The agencies seek comment on the appropriateness of requiring that a bank have a perfected, first priority security interest, or the legal equivalent thereof, in the definition of financial collateral.	The definition of financial collateral is too restrictive. Banks should be allowed to include second or lower priority interests as long as material recoveries to offset the potential losses exist.

QUESTION	CFG/RBS Comments
Q 37: The agencies recognize that this is a conservative approach and seek comment on other approaches to consider in determining a given security for purposes of the collateral haircut approach.	The haircuts are currently calculated using credit spreads (for debt securities). Securities are assigned to credit spread bands for which one single haircut is calculated. The approach differs for those debt securities falling below investment grade for which haircut is calculated individually.
Q 38: The agencies seek comment on methods banks would use to ensure enforceability of single product OTC derivative netting agreements in the absence of an explicit written legal opinion requirement.	No comment.
Q 39: The agencies request comment on all aspect of the effective EPE approach to counterparty credit risk, and in particular on the appropriateness of the monotonically increasing effective EE function, the alpha constant of 1.4, and the floor on internal estimates of alpha of 1.2.	The proposed approach would present issues if applied to more advanced methods used for measuring EPE for collateralised counterparties, which capture the effects of margining. Such approaches would typically involve looking at the exposure by marking-to-market of the underlying transactions, removing the modelled collateral balance and margin period of risk. This would be undertaken at several time points in the first year. Where changes in mark-to-market are the result of market rate movements, this would present a measure which is likely to be relatively constant. However, where changes in mark to market are the result of contractual cash-flows, the measure is subject to extreme spikes. The results from such an approach are not suited to a monotonically increasing function. The concept of a floor is not helpful – this stifles research and innovation and, in extreme cases, may discourage banks from adopting the approach altogether. The need for conservatism is well understood and accepted, but it is not best reflected in a floor. Having a floor set at a level will not encourage diversification in the overall risk of a portfolio when the model indicates an alpha which is lower than the floor level.

QUESTION	CFG/RBS Comments
Q 40: The agencies request comment on the appropriateness of these criteria in determining whether the risk mitigation effects of a credit derivative should be recognized for risk-based capital purposes.	A risk based capital approach should make allowance for both collateral and credit derivatives.
Q 41: The agencies are interested in the views of commenters as to whether and how the agencies should address these and other similar situations in which multiple credit risk mitigants cover a single exposure.	We recommend that the agencies give the bank the flexibility to apply pragmatic rule based procedures or mathematical programming based approaches to optimally allocate the available credit risk mitigants (guarantees) to the underlying exposures. RBS approach uses Linear programming to optimise the allocation of one (or a pool of) mitigant(s). We would be happy to explain this in more detail should this be required.
Q 42: The agencies seek comment on this alternative approach's definition of eligible retail guarantee and treatment for eligible retail guarantees, and on whether the agencies should provide similar treatment for any other forms of wholesale credit insurance or guarantees on retail exposures, such as student loans, if the agencies adopt this approach.	We support the use of common retail mitigants which are embedded in the data to be allowed for PD, EAD and LGD, not just EAD and LGD, and for a relaxed definition of eligible as it will not be possible to identify ineligible guarantees in the retail data and isolate the impact of their exclusion in the modelling.
Q 43: The agencies seek comment on the types of non-eligible retail guarantees banks obtain and the extent to which banks obtain credit risk mitigation in the form of non-eligible retail guarantees.	The impact of the guarantee / CRM is embedded in loss history (PD, EAD or LGD). The effect of the CRM compared to other more general effects is impossible to isolate, and evidencing eligibility is problematic. This leads to potential double jeopardy; the firm is unable to evidence eligibility and so has to strip out the effects, but this is not possible as the answer is embedded within historical data. The NPR assumes, incorrectly, that clean loss data exists to model PD, EAD and LGD without the effect of mitigants.

QUESTION	CFG/RBS Comments
Q 44: The agencies seek comment on both of these alternative approaches to guarantees that cover retail exposures. The agencies also invite comment on other possible prudential treatments for such guarantees.	See comments to question 43.
Q 45: The agencies seek comment on this differential treatment of originating banks and investing banks and on alternative mechanisms that could be employed to ensure the reliability of external and inferred ratings of non-traded securitization exposures retained by originating banks.	Taking each of the points in turn: ▪ **Originating banks:** where a rating agency has been agreed for use within an internal policy as being acceptable, the rating assigned by that agency will always be used if available. If ratings are available from more than one of the agreed rating agencies, the most conservative will be used. Where both internal & external methodologies are available, the bank will use the external rating. The proposal that at least two ratings are required for originating banks may be unattainable. It should be removed. ▪ **Investing banks:** the proposed requirement for the investing bank is acceptable. ▪ **Inferred ratings:** an alternative is to have the home regulator review the inferred rating methodology to ensure the use of a conservative and consistent approach (with that used by external agencies). Periodic benchmarking exercises conducted by the home regulator demonstrate consistency across the UK market for models based ratings methodology.
Q 46: The agencies seek comment on whether they should consider other bases for inferring a rating for an unrated securitization position, such as using an applicable credit rating on outstanding long-term debt of the issuer or guarantor of the securitization exposure.	We would prefer to have other options to infer ratings for an unrated securitization position. The consideration of utilising credit ratings, such as that of the outstanding long-term debt of the issuer or that of a guarantor of the securitisation exposure, would be a welcome flexibility. The use of a guarantor's credit rating is consistent with that approach used under the IRB credit risk mitigation estimation techniques for unfunded credit risk protection, whereby the bank is permitted to substitute the obligor's PD for the guarantor's PD.

QUESTION	CFG/RBS Comments
Q 47: The agencies seek comment on the appropriateness of basing the risk-based capital requirement for a securitization exposure under the RBA on the seniority level of the exposure.	We see this as good practice, appropriate and consistent with other regulators' approaches to calculating regulatory capital under the RBA methodology.
Q 48: The agencies seek comment on how well this approach captures the most important risk factors for securitization exposures of varying degrees of seniority and granularity.	We believe this approach captures the important risk factors for securitization exposures, in so far as it is an effective means of driving out undue concentrations within the tranche and establishing an appropriate view of the granularity of the relevant tranches.
Q 49: The agencies seek comment on suggested alternative approaches for determining the N of a re-securitization.	The home regulator should drive model approval for a models-based approach for IRB status banks, with appropriate input from the wider regulatory college. If such an approach was not possible, it would be useful to have consistency with the UK rules; the FSA prescribed approach for the calculation of N in the case of a re-securitization: [BI-PRU 9.11.17 (R) - March 2006]. *"In the case of resecuritisation, the firm must look at the number of securitisation exposures in the pool and not the number of underlying exposures in the original pools from which the underlying securitisation exposures stem. If the portfolio share associated with the largest exposure, C_1, is available, the firm may compute N as $1/C_1$."*
Q 50: The agencies have not included this concept in the proposed rule but seek comment on the prevalence of eligible disruption liquidity facilities and a bank's expected use of the SFA to calculate risk-based capital requirements for such facilities.	We would support changes that drive consistency in international implementation. In this instance, these facilities are widely used in the European market. In such circumstances, the FSA ask that liquidity facilities pass an eligibility test set out in BI-PRU 9.10.10 (R). The SFA calculation and the use of the 20% CF (conversion factor) appear to be consistent with BI-PRU 9.11.25 (R) and is therefore appropriate in this case.
Q 51: The agencies seek comment on the appropriateness of these additional exemptions in the U.S. markets for revolving securitizations.	Our objective is to drive broad consistency between the US and EU rules, which is achieved as the proposed exemptions mentioned on NPR page 289, are similar to those stated under BI-PRU 9.12.8 (R).

QUESTION	CFG/RBS Comments
Q 52: The agencies solicit comment on the distinction between controlled and non-controlled early amortization provisions and on the extent to which banks use controlled early amortization provisions. The agencies also invite comment on the proposed definition of a controlled early amortization provision, including in particular the 18-month period set forth above.	We use an 18 month amortization period in outstanding revolving securitizations, in line with the NPR proposals
Q 53: The agencies seek comment on the appropriateness of the 4.5 percent excess spread trapping point and on other types and levels of early amortization triggers used in securitizations of revolving retail exposures that should be considered by the agencies.	The 4.5% is in line with the proposed FSA treatment. Where securitization requires the excess spread be trapped, this point is set by the rating agencies rather than the regulator.
Q 54: The agencies seek comment on and supporting empirical analysis of the appropriateness of a more simple alternative approach that would impose at all times a flat CCF on the entire investors' interest of a revolving securitization with a controlled early amortization provision, and on what an appropriate level of such a CCF would be (for example, 10 or 20 percent).	Our methodology is still under development so we are unable to comment on the proposals or the appropriate CCF.

QUESTION	CFG/RBS Comments
Q 55: The agencies seek comment on this definition.	The US NPR definition seems reasonable. We welcome the inclusion of point (iii) any non-U.S.-based securities exchange that is registered with, or approved by, a national securities regulatory authority, provided that there is a liquid, two-way market for the exposure (that is, there are enough bona fide offers to buy and sell so that a sales price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined promptly and a trade can be settled at such a price within five business days).
Q 56: The agencies seek comment on the approach to adjusted carrying value for the off-balance sheet component of equity exposures and on alternative approaches that may better capture the market risk of such exposures.	No comment.
Q 57: The agencies seek comment on the proposed rule's requirements for IMA qualification, including in particular the proposed rule's use of a 99.0 percent, quarterly returns standard.	No comment.
Q 58: The agencies seek comment on the operational aspects of these floor calculations.	Calculation of the floors requires a moderate resource commitment. Given materiality issues, our plans are focused on applying standard risk weights.
Q 59: The agencies seek comment on the necessity and appropriateness of the separate treatment for equity exposures to investment funds and the three approaches in the proposed rule. The agencies also seek comment on the proposed definition of an investment fund.	No comment.

QUESTION	CFG/RBS Comments
Q 60: The agencies are interested in commenters' views on other business lines or event types in which highly predictable, routine losses have been observed.	The following areas are worthy of further consideration: ▪ **Commercial/business credit card fraud:** Citizens currently treats commercial/business credit card fraud as an operational loss for capital calculation. We believe that the NPR should allow business cards to be treated the same as retail card fraud. ▪ **HELOCs:** can include both credit and operational losses depending on circumstances (e.g. if fraud exists), and that for capital purposes it may be appropriate to separate operational losses from credit losses when the classification can be clearly determined.
Q 61: The agencies seek commenters' views on all of the elements proposed to be captured through the public disclosure requirements. In particular, the agencies seek comment on the extent to which the proposed disclosures balance providing market participants with sufficient information to appropriately assess the capital strength of individual institutions, fostering comparability from bank to bank, and reducing burden on the banks that are reporting the information.	Our plans for Pillar 3 disclosures are well advanced (as required by the Basel Committee) at the Group level. Any requirements that force subsidiaries to also publish Pillar 3 disclosures are super equivalent to the Basel requirements. Equally, such additional requirements will fall disproportionately to EU firms with US subs. Given the current level of regulatory and statutory disclosure, any additional work is unlikely to improve the understanding of the market. The current wording around "for each of the last three years… since the bank entered its first floor period" is misleading. It is not possible to calculate or publish detailed Pillar 3 data for the period before parallel run, as it does not exist. It is possible to publish the capital indices, but even this will be problematic given changes in the capital definition over time. Simply, firms should be required to adopt Pillar 3 when they go live on the minimum capital requirements under Pillar 1. Any other proposal is unrealistic.
Q 62: Comments on regulatory reporting issues may be submitted in response to this NPR as well as through the regulatory reporting request for comment noted above.	It is not possible to comment without sight of the proposed Regulatory Returns.

Regulatory Reporting (page 55986)

Regulatory Reporting NPR Question (Page 55986)	RBS/Citizens Response
Q 1: The agencies seek comment from the industry concerning the feasibility of collecting certain additional information beyond that described in this proposal. The purpose of this additional information is to help identify the causes of changes in credit risk regulatory capital requirements (for example, due to changes in exposure mix or changes in the bank's assessment of risk). To facilitate such analyses, reporting banks would be required to submit additional data items that summarize current and previous risk parameters for exposures that were in wholesale and retail credit portfolios as of the previous reporting period (for example, prior quarter, prior year)—the ''lookback'' portfolio. The intent of this lookback portfolio approach would be to allow the agencies to better identify reasons for observed changes in regulatory credit risk capital requirements and allow for peer comparisons of changes from period to period. A lookback-portfolio approach would require additional data collection and processing. For example, banks would need to retain data on the internal risk rating category to which each exposure was previously assigned, and the previous EAD of each exposure. The agencies believe that this data maintenance requirement is consistent with supervisory expectations described in the NPR and proposed AIRB guidance in that banks subject to the Advanced Capital Adequacy	1. Standardizing additional disclosures should attempt to identify macro reasons for changes in the level of risk assets, for example: ▪ Purchased portfolios with differing risk characteristics. ▪ New lending practices or areas of focus (change in origination strategy) ▪ Deterioration or improvement in the credit quality of historical portfolios. 2. Citizens does not believe any format would reduce the reporting burden.

Regulatory Reporting NPR Question (Page 55986)	RBS/Citizens Response
Framework are expected to be able to evaluate and explain changes in risk parameters in order to assess their risk parameter estimation procedures. The agencies specifically seek industry comment on the following questions: 1. What aggregate summary information might banks submit that best describes or characterizes period-to-period migration across internal rating grades or retail segments? 2. If such information were required, are there particular formats or other considerations that would reduce the reporting burden for banks?	
Q 2: The agencies are considering another alternative reporting treatment with respect to the wholesale and retail portions of the above proposal (Schedules C–R). This alternative treatment would complement the lookback-portfolio approach just described but could be implemented whether or not the lookback-portfolio approach was implemented. Under this approach, banks would submit data according to each of their internal obligor rating grades or segments, rather than in the fixed bands defined in the current regulatory reporting proposal. In this case, each reporting bank could submit a different number of rows corresponding to the number of internal risk rating/segmentation categories employed by that bank for the given portfolio. The agencies specifically seek industry comment on the following question: 1. Would reporting burden be lessened if banks submitted data using internally-defined obligor	The proposal would not lessen the burden. On the contrary, Citizens believes it would increase the burden as users of this disclosure would seek consistency of presentation between bank holding companies and would seek to understand how one banking entities portfolio might fit in to a competitor's internally defined grades or segments.

Regulatory Reporting NPR Question (Page 55986)	RBS/Citizens Response
grades or segments, rather than aggregating the grades or segments in supervisory reporting bands?	
Q 3: The agencies request comment on the appropriateness of making the data items on Schedules A and B and data items 1 through 7 of the operational risk reporting schedule (Schedule V) available to the public for each reporting entity for data collected during periods subsequent to its parallel run reporting periods as currently proposed. Comments are requested on the extent to which banks are already providing these data to the public or are planning to make such data public as well as the timing of these disclosures. In addition, comments are requested on the perceived risks associated with public reporting of these data items.	Citizens do not see risk in publicly reporting these data, assuming an industry recognized standard method of calculation is agreed.
Q 4: What changes in the proposed regulatory reporting requirements for the Advanced Capital Adequacy Framework, including additional data or definitions, would better assist the agencies in reaching their stated goals? In this regard, the agencies also seek input on possible alternative ways to capture the requested information and the appropriateness of the requested data given the stated purposes of the information collections and the associated reporting burden.	No comment.