



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

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

November 26, 2008

Arthur S. Long, Esq.
Davis Polk & Wardwell
450 Lexington Avenue
New York, NY 10017

Dear Mr. Long:

This is in response to your letter dated November 7, 2008, and the application under section 3 of the Bank Holding Company Act ("BHC Act") by UK Financial Investments Limited ("UKFI"), a company organized under the laws of the United Kingdom, for approval to acquire an indirect controlling interest in the U.S. bank subsidiaries of The Royal Bank of Scotland Group plc ("RBSG"), Edinburgh, Scotland. UKFI is wholly owned by the U.K. government and was formed to manage the government's shareholdings in U.K. banking organizations that subscribe to the government's recapitalization fund.¹ Her Majesty's Treasury ("HMT") will be underwriting a placing and open offer by RBSG and might as a result acquire a significant shareholding in RBSG. Because existing RBSG shareholders may acquire ordinary shares in this offering, HMT could acquire as little as 10 percent or as much as 58.1 percent of the ordinary shares of RBSG. UKFI will manage the shares of RBSG held by HMT and will, therefore, have control over the U.K. government's shares within the meaning of the BHC Act. The Board understands the offer of ordinary shares of RBSG is anticipated to close on December 1, 2008.

RBSG operates in the United States through direct offices of two subsidiary foreign banks, The Royal Bank of Scotland plc ("RBS"), Edinburgh, and ABN AMRO Bank N.V. ("ABN AMRO"), Amsterdam, Netherlands. RBS

¹ UKFI will manage the U.K. government's investments in RBSG, Lloyds TSB Group plc, Northern Rock plc, and Bradford & Bingley plc.

maintains branches in New York, New York, and Greenwich, Connecticut, and representative offices in Houston, Texas, and Los Angeles, California. ABN AMRO operates branches in New York, New York, and Chicago, Illinois. RBSG also controls Citizens Financial Group, Inc., Providence, Rhode Island, and its subsidiary banks, RBS Citizens, National Association ("RBS Citizens"), Providence, Rhode Island, and Citizens Bank of Pennsylvania, Philadelphia, Pennsylvania. In addition, RBSG operates nonbanking companies in the United States. RBSG is a financial holding company for purposes of the BHC Act and is a qualifying foreign banking organization under Regulation K.²

Approval under Section 3

UKFI has requested the Board's approval under section 3 of the BHC Act³ to become a bank holding company in connection with its acquisition of control of up to 58.1 percent of the shares of RBSG. Section 3 of the BHC Act requires the Board to consider the competitive effects of the proposal in the relevant banking markets, the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal, and certain other supervisory factors. In addition, the Board must consider the convenience and needs of the community to be served by the transaction and the records of performance under the Community Reinvestment Act ("CRA") of the relevant insured depository institutions. Section 3 of the BHC Act also provides that the Board may not approve an application involving a foreign bank unless the bank is subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in the bank's home country.

The Board has carefully considered these factors in light of all the facts of record, including confidential supervisory and examination information regarding RBSG, publicly reported and other financial information, and information provided by RBSG. The competitive effects of the proposal are consistent with approval. With respect to the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal, RBSG's subsidiary U.S. banks currently are well capitalized and would remain so on consummation of this proposal. In addition, the Board has determined that considerations relating to the convenience and needs factor and the CRA performance records of RBSG's subsidiary U.S. banks are consistent with approval. With respect to the supervision of RBS, the Board previously has

² 12 CFR 211.23(a).

³ 12 U.S.C. § 1842.

determined that RBS is subject to comprehensive supervision on a consolidated basis by its home country supervisor, the Financial Services Authority ("FSA").⁴ There has been no material change in the manner in which RBS is supervised by the FSA. Based on all the facts of record, the Board has concluded that RBS continues to be subject to comprehensive supervision on a consolidated basis by its home country supervisors.⁵

In light of the unusual and exigent circumstances affecting the financial markets in the United Kingdom, and all other facts and circumstances, the Board has determined that emergency conditions exist that justify expeditious action on this proposal in accordance with the provisions of the BHC Act and the Board's regulations.⁶ The Board has provided notice to the primary federal and state supervisors of RBSG's U.S. bank subsidiaries and to the Department of Justice. Those agencies have indicated that they have no objection to the Board's approval of the proposal. Because this transaction represents the recapitalization of a foreign bank holding company by a foreign government, the Board has waived public notice of the proposal.⁷

The Board, having considered the relevant statutory factors, has approved UKFI's acquisition of a controlling interest of up to 58.1 percent of the voting shares of RBSG pursuant to section 3(a)(1) of the BHC Act. The acquisition may not be consummated before the fifth calendar day, or later than three months, after the date of this letter, unless such period is extended for good cause by the Board or by the appropriate Federal Reserve Bank, acting pursuant to delegated authority.⁸

⁴ The Royal Bank of Scotland plc, 93 Federal Reserve Bulletin C104 (2007); The Royal Bank of Scotland Group plc., 89 Federal Reserve Bulletin 386 (2003).

⁵ The Board has received adequate assurances of access to information from RBSG and RBS in connection with prior applications. The Royal Bank of Scotland plc, 93 Federal Reserve Bulletin C104 (2007); The Royal Bank of Scotland Group plc., 89 Federal Reserve Bulletin 386 (2003). In the Board's view, such assurances are sufficient for purposes of this approval.

⁶ 12 CFR 225.16(g)(2).

⁷ 12 CFR 225.16(b)(3), 225.16(g)(2), and 262.3(l).

⁸ 12 U.S.C. § 1849.

Financial Holding Company Election

UKFI also has filed an election to become a financial holding company pursuant to sections 4(k) and (l) of the BHC Act and sections 225.82 and 225.91 of the Board's Regulation Y⁹ on UKFI's acquisition of RBSG. In reliance on RBSG's status as a financial holding company, UKFI has certified that RBS and ABN AMRO are well capitalized as defined in section 225.90(b)(1)(i) and (ii) and well managed as defined in section 225.90(c).¹⁰ UKFI has also certified that the U.S. depository institution subsidiaries of RBSG, RBS Citizens and Citizens Bank of Pennsylvania, meet the well-capitalized standard of section 225.2(r)(2) and the well-managed standard of section 225.2(s) of Regulation Y.¹¹ The Board has previously found both RBS and ABN AMRO to be subject to comprehensive consolidated supervision.¹² Based on all the facts of record, the Board has determined that the election by UKFI to become a financial holding company will become effective on consummation of the proposal if, on that date, RBSG continues to meet the requirements for financial holding company status.

Exemptions under Section 4(c)(9)

The Board previously has considered the issues that arise when a foreign government-owned company seeks to conduct banking operations indirectly in the United States through foreign bank subsidiaries or by acquiring U.S. banks.¹³ In a 1988 case involving a corporation wholly owned by the Italian government, the Board determined that, as a legal matter, foreign governments were not themselves "companies" for purposes of the BHC Act, and so not covered by the act. However, the Board found that the government-owned corporation used by the Italian government to hold its interest in an Italian bank was structured

⁹ 12 U.S.C. §§ 1843(k) and (l); 12 CFR 225.82 and 225.91.

¹⁰ 12 CFR 225.90(b)(1)(i)-(ii) and 225.90(c).

¹¹ 12 CFR 225.2(r)(2) and (s).

¹² With respect to supervision of RBS, see note 6. With respect to supervision of ABN AMRO, see MeesPierson N.V., 80 Federal Reserve Bulletin 662 (1994).

¹³ See 68 Federal Reserve Bulletin 423, 425 (1982).

as a corporate vehicle and was, therefore, a company under the BHC Act.¹⁴ In considering the status of foreign government-owned companies under the BHC Act, the Board has stated that broad public policy issues are raised by applying the restrictions of the BHC Act to such companies. In the 1988 Board letter discussed above, the Board noted that the Congress had been mindful of those concerns and had provided the Board with broad authority to exempt foreign companies from the nonbanking restrictions of the BHC Act where the act has the effect of extending the impact of the U.S. regulatory framework to economic transactions and relationships that take place entirely outside the United States. The Board stated it was particularly appropriate to exercise the express authority of section 4(c)(9) of the BHC Act in the case of foreign government-owned companies to ameliorate restrictions of the act in the public interest.

Section 4(c)(9) of the BHC Act provides that the Board may exempt from the restrictions of the act:

shares held or activities conducted by any company organized under the laws of a foreign country the greater part of whose business is conducted outside the United States, if the Board by regulation or order determines that, under the circumstances and subject to the conditions set forth in the regulation or order, the exemption would not be substantially at variance with the purposes of [the act] and would be in the public interest.¹⁵

The Board has considered the situation of UKFI and its proposed acquisition of control of RBSG in the context of this background and has determined that it would be in the public interest and not substantially at variance with the purposes of the act to grant to UKFI exemptions from the nonbanking restrictions of the BHC Act under the authority of section 4(c)(9).

Under the exemptions, and subject to the conditions described below, the BHC Act would not apply to investments made by UKFI or any company (including a foreign bank) controlled by UKFI in any company, including a U.S. company or a foreign company with U.S. operations, other than a U.S. depository institution. However, any foreign bank subsidiary of

¹⁴ See Board letter to Patricia Skigen, Esq., dated August 19, 1988. The Board confirmed this approach in a recent case. See Board letter to H. Rodgin Cohen, Esq., dated August 5, 2008.

¹⁵ 12 U.S.C. § 1843(c)(9).

UKFI that now or in the future operates a branch, agency, commercial lending company, or bank subsidiary in the United States would remain fully subject to the Board's Regulations K and Y with respect to its activities and investments and would be treated the same as any other foreign banking organization.

These exemptions are conditioned on compliance with limitations designed to minimize the potential for conflicts of interest, concentration of resources, and unsound banking practices, as well as to mitigate any potential competitive advantage that may accrue to UKFI and its subsidiaries from the exemptions.

First, all transactions by a U.S. branch or agency of any foreign bank subsidiary of UKFI with a company in which UKFI has made a controlling investment (a "controlled company") would be limited. Transactions by the U.S. branch or agency with a single controlled company are limited to 10 percent of the branch's or agency's lending base, as described below, and transactions with all controlled companies in the aggregate are limited to 20 percent of the branch's or agency's lending base,¹⁶ and all such transactions must be fully collateralized. Any transaction between the U.S. branch or agency and a controlled company must be on market terms. The U.S. branches and agencies of foreign bank subsidiaries of UKFI may not cross-market goods and services in the United States with such controlled companies.

Second, UKFI must continue to conduct a majority of its business outside the United States, consistent with the requirement of section 4(c)(9).

Third, consistent with the requirements of the BHC Act and the Federal Reserve Act, UKFI and any company, including any foreign bank, that is controlled by UKFI are required to obtain prior Board approval to make a direct or indirect investment in 5 percent or more of the voting shares of a bank holding company or U.S. bank,¹⁷ or to make a controlling investment in a corporation organized under section 25A of the Federal Reserve Act (an Edge corporation).¹⁸

¹⁶ For purposes of this condition, the "lending base" of a U.S. branch or agency shall be equal to 5 percent of the branch's or agency's third-party assets. "Third-party assets" means the amount of total claims on nonrelated entities as reported on the report of condition filed by the branch or agency (FFIEC 002).

¹⁷ 12 U.S.C. § 1842(a).

¹⁸ 12 U.S.C. § 611, 619.

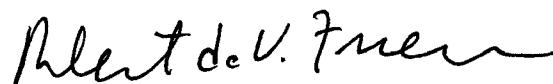
In addition, prior Board approval is required for the acquisition of a controlling interest in a U.S. insured depository institution.

The Board also has determined to exempt UKFI from the regular reporting, filing, and capital requirements of the BHC Act and the Board's regulations. With respect to reporting, UKFI, or RBSG acting on behalf of UKFI, must inform the Board of any acquisition of more than 25 percent of the shares of any company that engages in activities in the United States. UKFI is not required to report separately an investment that is made by a subsidiary foreign bank that is subject to the BHC Act when such investment is reported by that bank to the Board as part of the bank's regular reporting requirements. In addition, UKFI should monitor investments made by its controlled companies, including in this case, its foreign bank subsidiaries, in order to determine whether, in the aggregate, such investments might trigger an application threshold with respect to a U.S. depository institution or cause UKFI to be considered to control a company that owns a U.S. depository institution.

Based on all the facts of record, the Board has determined that the exemptions granted to UKFI would be in the public interest and not substantially at variance with the purposes of the BHC Act. Should there be a material change in the facts, the Board may review its determination.

The Board's decisions under sections 3 and 4(c)(9) of the BHC Act are specifically conditioned on compliance with the conditions imposed in this letter. For purposes of these actions, the conditions contained herein are deemed to be imposed by the Board in connection with its findings and decisions and, as such, may be enforced in proceedings under applicable law.

Very truly yours,

A handwritten signature in black ink, appearing to read "Robert deV. Frierson". The signature is fluid and cursive, written in a professional style.

Robert deV. Frierson
Deputy Secretary of the Board

cc: Federal Reserve Bank of Boston