



**Group Risk Management**  
280 Bishopsgate  
London EC2M 4RB  
Switchboard: 020 7672 1239  
www.rbs.com

23<sup>rd</sup> January 2007

Mr. John C. Dugan  
Comptroller of the Currency, OCC  
250 E. Street, SW  
Washington, DC 20219  
[12 CFR Part 3; Docket No. 06-10  
RIN 1557-AC99]

Ms. Sheila C. Bair  
Chairman, FDIC  
550 17<sup>th</sup> Street, NW  
Washington, DC 20429  
[12 CFR Part 325;  
RIN 3064-AD10]

Mr Ben S. Bernanke  
Chairman, FED  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, DC 20551  
[12 CFR Parts 208 and 225;  
Regulation H and Y; Docket No. R-1266]

Mr. John C. Reich  
Director, OTS  
1700 G Street, NW  
Washington, DC 20552  
[12 CFR Part 566;  
Docket No. 2006-34;  
RIN 1550-AC02]

Dear Sirs and Madam,

**NOTICE OF PROPOSED RULE-MAKING (NPR) - Risk-Based Capital Standards: Market Risk**

Thank you for the opportunity to comment on your proposals for implementing the Market Risk NPR within the United States.

Our response, that reflects the views of RBS, Citizens Financial Group and Greenwich Capital Markets, is outlined in the attached appendix. In addition, we have contributed to the response being submitted by the Institute of International Finance (IIF).

We hope that these comments are instructive in taking forward implementation of the new Market Risk NPR in the United States. If you have any questions, please do not hesitate to contact me.

Yours faithfully,

Richard Wild  
Head of Basel 2 and Group Risk Operations  
Group Risk Management, Royal Bank of Scotland Group

c.c. Bob Gormley, Citizens Financial Group  
Steve Farrall, Head of Group Market Risk  
Stuart Kessler, Head of Finance, Greenwich Capital Markets

### Market risk - General questions (page 55963 to 55969)

Question	Response
<p><b>Q 1:</b> The agencies seek comment on the thresholds for the application of the market risk capital rule and, if they should be changed, on what appropriate thresholds might be.</p>	<p>The 10% limit seems appropriate. Smaller US banks may benefit from a competitive advantage, given that these rules (and associated implementation costs) do not apply.</p>
<p><b>Q 2:</b> The agencies request comment on all aspects of the proposed definition of covered position. The agencies are particularly interested in comment on additional safeguards that the agencies might implement to prevent abuse of the hedge component of the definition of covered position and increase transparency for supervisors</p>	<p>The definition applied is consistent with that in the EU CRD. Regarding additional safeguards, the UK FSA require banks to have relevant policies and procedures to prevent market abuse.</p>
<p><b>Q 3:</b> The agencies request comment on whether there is a better approach that matches more effectively the true economic impact of these transactions.</p>	<p>The proposal aligns with current practice and is consistent with the approach adopted in the EU.</p>
<p><b>Q 4:</b> The agencies request comment on the extent and materiality of any distortion of the VaR-based measure due to the inclusion of some, but not all, offsetting transactions, and on any appropriate approaches to address this distortion in the final rule, including, subject to certain restrictions, (1) permitting a bank to include in its VaR-based measure the interest rate risk associated with certain noncovered positions that are hedged by covered positions (while remaining subject to a credit risk capital requirement for the noncovered positions) or (2) permitting a bank to include in its VaR-based measure certain internal interest rate derivatives hedging noncovered positions. The agencies also request comment on any operational considerations such approaches would entail.</p>	<p>The circumstances outlined do not apply within the RBS Group. Interest rate risk in the banking book is managed down to low residual levels under Group Treasury Structural Interest Rate Risk Exposure (SIRE) policies. Treasury transfers the net position to the trading book where it forms part of the overall trading position measured by VaR.</p>

Question	Response
<p><b>Q 5:</b> The agencies seek comment on the proposed definition of residual securitization position, and on the market maker exception and the conditions to use that exception. With respect to positions that do not qualify for the market maker exception, the agencies request comment on the treatment of those positions under the credit risk capital rules and whether such treatment could give rise to any operational or other issues.</p>	<p>The proposed treatment appears consistent with that proposed by other regulators.</p>
<p><b>Q 6:</b> The agencies seek comment on these requirements and on whether different or additional policies and procedures would be beneficial for ensuring appropriate identification of positions to which the market risk capital rule should be applied and appropriate risk management of covered positions.</p>	<p>It is entirely appropriate for a bank to maintain “dealing mandates” for each of its trading desks. However, trading strategies will change intra-day due to reaction to market movements – to fully document every trading strategy would be impracticable. Daily assessment of the banks ability to hedge individual positions and extent of liquidity at a micro strategy-by strategy level would be onerous and impractical. Our solution is to have a well implemented policy framework and suitable limits.</p>
<p><b>Q 7:</b> The agencies request comment on all aspects of prepayment risk, including the extent and materiality of prepayment risk, whether material prepayment risk specific risk, and the interplay between prepayment risk and default risk for purposes of determining the bank’s overall measure for market risk. The agencies also seek comment may warrant a further explicit requirement that banks hold capital against prepayment risk over a one-year horizon under both the internal models and standard approaches to on how an explicit capital requirement for prepayment risk could be designed.</p>	<p>We believe a one-year horizon is inappropriate, as this is out of line with risk management practices and does not reflect the active risk management of the trading book. The capital horizon over which a defined level of risk may be taken can be amended more frequently than annually.</p>

Question	Response
<p><b>Q 8:</b> The agencies request comment on the exclusion of fees, commissions, reserves, and net interest income for the trading profit or loss used for regulatory backtesting, including the appropriateness and feasibility of these exclusions, and whether additional items should also be excluded. The agencies also request comment on the role of hypothetical backtesting-- specifically, whether hypothetical backtesting is feasible as part of model validation; whether other forms of backtesting should also be used; and whether regulatory backtesting should be based on hypothetical backtesting.</p>	<p>We comment as follows:</p> <ul style="list-style-type: none"> <li>▪ <b>Net interest income (or costs):</b> should be included in regulatory backtesting profit, (it is often the offset for the theta movement in derivative MtM).</li> <li>▪ <b>Hypothetical backtesting:</b> is feasible as part of model validation, but regulatory backtesting should continue to be based on Clean P&amp;L backtesting. Hypothetical backtesting would be difficult to perform on a daily basis due to operational constraints such as time series cleaning.</li> </ul>
<p><b>Q 9:</b> The agencies request comment on the proposed timeframe for phasing out partial modelling of specific risk and on whether it would allow banks enough time to implement the proposed changes.</p>	<p>The timeframe seems reasonable; at the Group level, we are already addressing this for the FSA.</p>
<p><b>Q 10:</b> The agencies seek comment on the extent and materiality of specific risk for commodities and foreign exchange positions and on whether and how a specific risk capital requirement for those positions could be developed under both the internal models and standard approaches.</p>	<p>As long as time series exist for each commodity type and currency pair, firms can capture specific risk directly.</p>
<p><b>Q 11:</b> The agencies request comment on how a bank should adjust the incremental default risk capital requirement to adjust for the impact of liquidity, concentrations, hedging, and optionality.</p>	<p>This is still under discussion by the ISDA/IIF/LIBA working group with the appropriate regulator.</p> <p>We will continue to participate in the industry discussion. We certainly do not think these elements should be additive in the capital charge. We are unclear on what is implied by 'hedging' - we take net default delta positions (i.e. after recognizing hedging) into our own FSA IDRC calculation.</p>

Question	Response
<p><b>Q 12:</b> The agencies request comment on all aspects of the proposal to reflect in the market risk capital requirement a measure of incremental default risk. Specifically, the agencies seek comment on the feasibility of measuring incremental default risk at a one-year, 99.9 percent confidence level and the appropriateness of the assumption of a constant level of risk.</p>	<p>As per Q11, this is still under discussion.</p> <p>We think the 1 year 99.9% / constant risk level requirements are contentious. The allocation of risk in the trading book, and the determination and allocation of the appropriate level of capital to support this, can be amended with far shorter lead times than 1 year.</p>
<p><b>Q 13:</b> The agencies request comment on the extent to which banks, at present, measure incremental default risk and the prospects for development of methodologies to capture this risk fully in internal models by the proposed January 1, 2010 deadline. The agencies also request comment on the fallback methods proposed for banks unable to develop an internal model to capture incremental default risk by January 1, 2010.</p>	<p>As per Q11, this is still under discussion.</p>
<p><b>Q 14:</b> The agencies seek comment on all aspects of the proposed public disclosure requirements.</p>	<p>Pillar 3 applies at the Group level. We will be conforming to the requirements outlined by the FSA in BIPRU Section 11 and ensuring that we meet the needs of market analysts who will be key users of the information produced.</p>
<p>(a) Whether the proposed collections of information are necessary for the proper performance of the agencies' functions, including whether the information has practical utility;</p>	
<p>(b) The accuracy of the agencies' estimates of the burden of the proposed information collections, including the validity of the methodology and assumptions used;</p>	
<p>(c) Ways to enhance the quality, utility, and clarity of the information to be collected;</p>	
<p>(d) Ways to minimize the burden of information collections on respondents, including through the use of automated collection techniques or other forms of information technology; and</p>	

Question	Response
(e) Estimates of capital or start up costs and costs of operation, maintenance, and purchase of services to provide information.	