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Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218
Washington, DC 20219
E-mail: regs.comments@occ.treas.gov
Docket ID OCC-2018-0002
RIN: 1557-AE35

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
E-mail: regs.comments@federalreserve.gov
Docket Number: R-1604
RIN: 7100 AF-03

Joint Notice of Proposed Rulemaking - Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standard for United States ("US") Global Systemically Important Bank Holding Companies ("G-SIB") and Certain of their Subsidiary Insured Depository Institutions; Total Loss-Absorbing Capacity Requirements for US G-SIBs

Dear Sir/ Madam:

State Street Corporation ("State Street") welcomes the opportunity to comment on the joint notice of proposed rulemaking ("proposed rule") issued by the Board of Governors of the Federal Reserve System ("FRB") and the Office of the Comptroller of the Currency ("OCC") (collectively the "agencies"), regarding modifications to the enhanced supplementary leverage ratio ("eSLR") requirement for United States ("US") global systemically important banks ("G-SIB"), as well as conforming changes to the leverage ratio buffer requirements in the FRB's total loss absorbing capacity ("TLAC") and long-term debt ("LTD") framework. Generally speaking, the proposed rule would replace the existing series of uniform leverage ratio buffer requirements which apply to US G-SIBs and their insured depository institution ("IDI") subsidiaries, with a tailored series of buffers calibrated at ½ of each G-SIB's applicable risk-based capital surcharge. We welcome and strongly support the agencies' proposed rule which broadly addresses the disproportionate impact of leverage-based measures of capital in the prudential framework for US G-SIBs.

Headquartered in Boston, Massachusetts, State Street specializes in the provision of financial services to institutional investor clients. This includes investment servicing, investment management, data and analytics, and investment research and trading. With $33.28 trillion in assets under custody and administration and $2.73 trillion in assets under management, State Street operates in 30 countries and in more than 100 geographic markets.[1] State Street is organized as a US bank holding company ("BHC"), with operations conducted through several entities, primarily its wholly-owned IDI subsidiary, State Street Bank and Trust Company. As of March 31, 2018, our fully-phased in Basel III advanced approach common equity Tier 1 ("CET1") ratio was 12.1% and our fully-phased in Basel III standardized approach CET1 ratio was 10.8%. Also as of March 31, 2018, our SLR totaled 6.0% at the level of the BHC and 6.5% at the level of the IDI.

THE CUSTODY BANK BUSINESS MODEL

Our perspective in respect of the proposed rule is broadly informed by our status as one of the world's largest providers of custody services to institutional investors, and concurrently our status as one of only two stand-alone custody banks which have been designated as a G-SIB. Custody banks, such as State Street, employ a highly specialized business model focused on the provision of operational services to their clients, rather than the generation of yield from credit risk assets. These clients, which include asset owners, asset managers, official institutions and insurance companies, contract with custody banks to ensure the proper safekeeping of their investment assets, as well as the provision of a broad range of related financial services. These services include access to the global settlement infrastructure in order to complete the purchase or sale of investment securities; various asset administration functions, such as the processing of income and other interest payments, corporate action events, tax reclamations and client subscriptions and redemptions; and the provision of banking services, notably access to deposit accounts used to facilitate day-to-day transactional activities. The importance of financial services to the custody bank business model can be seen in the large amount of revenue derived from fee-related activities. As an example, in Q1 2018, fee revenue comprised 78.3% of our total revenue.

Similarly, custody banks have balance sheets which are constructed differently than most banks with extensive commercial and investment banking operations. Indeed, the custody bank balance sheet is liability driven and expands not through asset growth, but through the organic

[1] As of March 31, 2018.

development of client servicing relationships that, over time, translate into increased volumes of highly stable deposits. These deposits, rather than various sources of wholesale funding, provide the largest part of the custody banks' liabilities. As such, stand-alone custody banks do not rely extensively on various sources of debt (both short-term and long-term) to manage their balance sheets or their day-to-day business activities. For example, on average, client deposits made up approximately 73% of State Street's total balance sheet liabilities in Q1 2018. Importantly, custody banks acquire deposit liabilities as a direct result of the financial services they provide. In other words, the cash deposits that come on to the custody bank balance sheet are driven by customer demand, not by the custody banks' financing decisions.

We appreciate the opportunity to offer insight relative to the implications of the proposed rule on our role as a custodial entity, a role that is widely understood by the market and by the supervisory community as providing important benefits for the safety of client assets and the stability of the financial system.

RECALIBRATION OF THE ENHANCED SUPPLEMENTARY LEVERAGE RATIO

The agencies proposed rule would replace the existing 5% eSLR requirement for G-SIB BHC's with a variable eSLR requirement, calibrated as the sum of the 3% minimum SLR requirement for advanced approaches banks, plus ½ of each G-SIB's risk-based capital surcharge. Similarly, the proposed rule would replace the existing 6% eSLR requirement for G-SIB IDI subsidiaries under the supervision of the FRB and OCC, with a variable requirement calculated in the same manner as for the BHC. From a State Street perspective, the proposed rule would therefore result in a new and uniform minimum BHC and IDI subsidiary eSLR requirement of 3.75%.

Key policy considerations

Broadly speaking, we believe that leverage-based measures of capital, such as the eSLR, should reflect three interrelated policy considerations. First, given the global nature of the financial system and the dispersion of large, internationally-active banks across national jurisdictions, we believe that every effort should be made to implement regulatory capital requirements on a globally consistent basis. This is designed to achieve a level-playing field among banks and avoid the emergence of competitive disparities that could lead to the migration of financial activities to entities not subject to the same prudential requirements.

Second, we believe that it is essential for leverage-based measures of capital to serve as a complement to risk-based capital, rather than as a *de facto* binding constraint, as is currently the case for State Street. This is designed to avoid a capital framework that discourages banks from supporting high-volume, low-risk, low-return client-driven financial activities which are central to the operation of the financial system. From our perspective as a custody bank, this includes the ability to manage the day-to-day payment, clearing and settlement activities of our clients, as well as the client's ability to hold cash on deposit, and to freely direct the movement of such cash. Third, we believe that prudential regulation should appropriately recognize the differences which exist in industry business models, along with the implications of these differences for the presence and management of potential systemic risk. This includes the eight US G-SIBs, which despite their common label, are not uniform in terms of size and scope, and which do not engage in identical lines of business. We believe that the agencies proposed rule effectively incorporates each of these policy considerations.

In December 2017, the Basel Committee on Banking Supervision ("Basel Committee") released a final version of the Basel III capital framework which includes, among other, a uniform leverage ratio surcharge for all G-SIBs, regardless of national jurisdiction, calibrated at ½ of the G-SIB's risk-based capital surcharge.[2] While the US has adopted a super-equivalent G-SIB risk-based capital surcharge which uses two discrete methodologies and an expanded range of capital outcomes (*i.e.* a surcharge of between 1% and 4.5% of CET1 capital), the recalibration of the minimum eSLR requirement foreseen in the proposed rule is directionally consistent with the Basel Committee's approach.[3]

As such, it substantially reduces the existing disparity in the leverage ratio requirement for US G-SIBs relative to their global peers, particularly for the stand-alone custody banks which conduct virtually all of their financial activities within their IDI subsidiaries. Nevertheless, we would encourage the agencies to take the next logical step in the promotion of a globally consistent approach by also considering the elimination of the 'gold-plated' Method 2 G-SIB assessment methodology. Under this alternative approach, each US G-SIB's eSLR buffer would be determined on the basis of the Method 1 G-SIB assessment methodology, using the 1% to 2.5% CET1 range foreseen by the Basel Committee. In the specific case of State Street, this would result in a uniform BHC and IDI subsidiary eSLR requirement of 3.5%.

The joint FRB, OCC and Federal Deposit Insurance Corporation ("FDIC") notice of proposed rulemaking which introduced the eSLR requirement for US G-SIB's in July 2013, was issued without evidence of any pre-rulemaking quantitative impact assessment or other empirical foundation.[4] Furthermore, there was no indication in the proposed rule of any particular effort to assess the impact of the intended calibration of the requirements on the ability of the G-SIBs to support economic activity and the provision of essential client-facing financial services. Predictably, the result was an approach in which the eSLR emerged as the binding capital constraint for most US G-SIBs, rather than serving as a complement to risk-based capital. This was especially true for business models, such as custody banking, which requires access to deposit accounts and other banking functions housed within IDI subsidiaries. Indeed, the

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[2] 'Global Systemically Important Banks – Updated Assessment Methodology and the Higher Loss-Absorbency Requirement', Basel Committee on Banking Supervision (July 2013).

[3] FRB regulations require US G-SIBs to calculate their risk-based capital surcharge using two discrete methodologies; Method 1 which replicates the five-indicator based international standard adopted by the Basel Committee, and Method 2 which incorporates a quantitative measure of short-term wholesale funding. State Street is currently assigned a 1% risk-based capital surcharge under Method 1 and 1.5% under Method 2.

[4] 'Joint Notice of Proposed Rulemaking: Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and their Subsidiary Insured Depository Institutions', Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation (July 2, 2013).

adoption of an eSLR approach with a bifurcated standard for the BHC (5%) and the IDI subsidiary (6%) had the perverse effect of penalizing firms, such as State Street, which are unable to make broad use of the BHC to conduct their financial activities. As such, we welcome the agencies' acknowledgment in this round of rulemaking that the current eSLR framework may create 'disincentives for firms…to provide certain banking functions, such as....the taking of custody deposits', and strongly support the use of a eSLR surcharge at both the BHC and the IDI subsidiary calibrated at ½ of each G-SIB's risk-based capital surcharge.[5]

While Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act provides the FRB with the authority to develop enhanced prudential standards for BHC's 'on an individual basis….taking into consideration (a company's) capital structure, riskiness, complexity, financial activities (and) size', the FRB, OCC and FDIC have implemented leverage-based measures of capital for G-SIBs that do not take into consideration individual business models or risk profiles.[6] This has resulted in a series of 'one size fits all' mandates with important unintended consequences for the provision of value-added financial products and services. In the case of the custody banks, this includes pressing constraints on their ability to accept client deposit inflows and serve as a safe store of value for client cash, notably in periods of financial market uncertainty.

As previously described, stand-alone custody banks, such as State Street, employ a highly specialized business model focused on the provision of safekeeping and asset administration services to institutional investor clients. This requires access to deposit accounts and cash management services offered as a normal part of the custody function. As such, stand-alone custody banks, such as State Street, have large volumes of client deposit inflows and will often end up with 'excess' amounts of cash on their balance sheet; that is more cash than what the client requires to address their immediate operational needs. While institutional investors will typically invest cash in order to maximize returns, there are occasions where they will leave cash on deposit with their custodian bank beyond what is needed to support normal course transactional activities. This is especially true in periods of financial market stress, when institutional investors may seek to adjust their risk exposures or otherwise take steps to preserve the value of their assets.

Because the amount of excess cash that institutional investors will hold at any given time is unpredictable, custody banks such as State Street, manage these deposit inflows through placements with national central banks, notably the FRB. This highly conservative asset-liability management strategy enables custody banks to support their client's cash-related needs in a safe and secure manner, without introducing greater risk to the bank, the client or the broader financial system. This practice is consistent with the custody banks' objective of providing highly

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[5] 'Joint Notice of Proposed Rulemaking: Regulatory Capital Rules and Total Loss-Absorbing Capacity Requirements of US G-SIBs', Board of Governors of the Federal Reserve System and Office of the Comptroller of the Currency (April 2018).

[6] 'Section 165: Enhanced Supervision and Prudential Standards for Non-Bank Financial Companies Supervised by the Board of Governors and Certain Bank Holding Companies', Dodd Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203 (July 21, 2010).

liquid, low-risk banking services which help smooth the day-to-day operations of the financial markets.

As currently designed, the eSLR does not recognize the unique role played by the custody banks in the financial system, or the particular risk characteristics of central bank placements used by custody banks to manage their deposit funded balance sheets. Importantly, it is precisely in times of financial market uncertainty that the custody banks are most needed to play their stabilizing role in the financial system by freely accepting inflows of excess client cash, and yet are most at risk of breaching leverage-based metrics, such as the eSLR. In our view, this unique position should be supported by the FRB, OCC and FDIC through carefully designed policy measures. By proposing to replace the existing bifurcated eSLR requirement for US G-SIB BHCs and their IDI subsidiaries, with a tiered leverage ratio construct calibrated at ½ of each G-SIB's risk-based capital surcharge, the agencies have taken an essential step in addressing our concerns, which we strongly endorse.

Exclusion of central bank reserves

The agencies make note in Question 5 of the proposed rule that there may be 'alternative approaches to address the relative bindingness of leverage requirements to risk-based capital requirements for certain firms', and asks for views on the 'benefits and drawbacks of excluding central bank reserves from the denominator of the SLR.'[7] As emphasized by FRB Vice Chairman for Supervision Randy Quarles in his recent testimony before the House Financial Services Committee, the exclusion of central bank placements from the denominator of the SLR is intended to address the same fundamental problem as the proposed recalibration of the eSLR; namely the use of minimum leverage ratio requirements in the US prudential framework which serve as the *de facto* binding constraint rather than as a complement to risk-based capital.[8]

There are, in our view, a number of benefits to an approach involving the exclusion of central bank placements from the SLR denominator. This includes legislative certainty for the stand-alone custody banks, and a framework that is better adapted to the unique role played by custody banks as a safe haven for client cash, especially in periods of financial market uncertainty. As such, our preferred solution involves an approach which combines recalibration of the eSLR as proposed by the agencies, with the targeted exclusion of central bank placements from the SLR denominator in periods of heightened client deposit activity. Furthermore, the agencies may also wish to consider the impact of the Tier 1 leverage ratio on the ability of the stand-alone custody banks to absorb sharp spikes in client deposit activity, as observed during the financial crisis, and therefore the benefit of additional, targeted Tier 1 leverage ratio relief in certain well-defined circumstances. Nevertheless, we welcome the

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[7] 'Joint Notice of Proposed Rulemaking: Regulatory Capital Rules and Total Loss-Absorbing Capacity Requirements of US G-SIBs', Board of Governors of the Federal Reserve System and Office of the Comptroller of the Currency (April 2018).
[8] Economic Growth, Regulatory Relief and Consumer Protection Act (S2155), 115th Congress (2017-2018); a bill introduced by Senator Mike Crapo (R-ID).

agencies proposed recalibration of the eSLR and agree that it will provide the custody banks with essential and long overdue relief.

Structure of the IDI SLR requirement

As designed, the agencies proposed rule would establish a variable 'well-capitalized' threshold for the IDI subsidiaries of US G-SIBs using a buffer added on top of the 3% 'adequately capitalized' threshold for advanced approaches banks, equal to ½ of the firm's risk-based capital surcharge. As an example, State Street's 'well-capitalized' IDI requirement would equal 3.75% (i.e. 3% + .75%).[9] Nevertheless, the agencies seek comment on an alternative approach that would replace the 'well-capitalized' construct with a capital buffer requirement for IDI subsidiaries that would operate in the same manner as the capital buffer requirement for the BHC. Under this approach, all G-SIBs would have to meet the base 'adequately capitalized' threshold of 3%. This would then be paired with a firm-specific leverage ratio buffer that would sit on top of the 3% minimum, which if breached would trigger progressively more stringent limitations on the distribution of capital and the payment of certain discretionary bonuses.

Given the role of the prompt corrective action framework in setting certain regulatory mandates and requirements, we believe that it would be suboptimal to have a 'well-capitalized' threshold for IDI subsidiaries that would vary from firm-to-firm, and that could change from year-to-year depending upon the financial circumstances and activities of a particular firm. As such, we recommend that agencies adopt their alternative approach involving the use of a uniform 'adequately capitalized' threshold of 3% for the IDI subsidiaries of all advanced approach banks, coupled with a capital buffer requirement for each IDI subsidiary equal to ½ of the G-SIB's applicable risk-based capital surcharge.

TOTAL LOSS ABSORBING CAPACITY STANDARDS

In order to promote greater coherence in the prudential framework for US G-SIBs, the agencies' proposed rule also includes conforming changes to the leverage ratio requirements in the TLAC/LTD framework. Specifically, the proposed rule would replace the existing 2% TLAC leverage ratio buffer, which sits on top of a base TLAC leverage ratio requirement of 7.5%, with a variable buffer set at ½ of each G-SIB's risk-based capital surcharge. Furthermore, the proposed rule would replace the 4.5% LTD leverage ratio requirement with a LTD leverage ratio requirement of between 3% and 4.75%, calculated in the same manner as the TLAC leverage ratio buffer. In the case of State Street, this would result in a minimum TLAC leverage ratio requirement of 8.25% and a minimum LTD leverage ratio requirement of 3.25%.

As emphasized in our February 2016 response to the FRB's notice of proposed rulemaking implementing the TLAC/ LTD framework for US G-SIBs, we have pressing concerns regarding the

[9] State Street's 'well-capitalized' requirement would equal 3.5% using the FRB's Method 1 G-SIB risk-based capital surcharge.

design and calibration of the TLAC/ LTD construct, which we believe does not sufficiently account for the particular characteristics and risk profile of individual G-SIBs.[10] This includes the G-SIB custody banks, which focus on the provision of essential payment, clearing and settlement services to their clients; have conservatively managed balance sheets; make broad use of central bank placements to manage their risk; and serve as a safe haven for client cash, notably in periods of financial market stress. As such, we strongly support the revisions proposed by the agencies to the TLAC/LTD framework, which represent an important step forward in addressing many of our concerns. Still, we believe that there is room for the agencies to consider further revisions to the TLAC/ LTD framework, designed to ensure greater consistency in the ruleset for internationally-active banks, reinforce the alignment of leverage capital as a complement to risk-based capital, and achieve greater simplification in the US prudential framework. Specifically, we urge the agencies to consider three additional changes.

First and consistent with our comments in regards to the proposed calibration of the eSLR requirement, we believe that the agencies should eliminate the use of the G-SIB Method 2 construct in all relevant portions of the TLAC/LTD framework. Second, rather than relying on a base TLAC leverage ratio requirement of 7.5%, we urge to agencies to make use of the internationally agreed upon Financial Stability Board ("FSB") standard of 6.75%.[11] Under this approach, the TLAC leverage ratio requirement for US G-SIBs would total 6.75% plus a firm-specific leverage ratio buffer equal to ½ of that firm's Method 1 risk-based capital surcharge. For example, this would result in a minimum TLAC leverage ratio requirement of 7.25% (*i.e.* 6.75% + .50%). Alternatively, since the TLAC requirement is intended to ensure that a G-SIB can be recapitalized in the event of insolvency by replenishing its going concern capital, we recommend adoption of a 'capital refill' approach involving a uniform TLAC leverage ratio requirement equal to twice the 3% minimum SLR requirement, minus the FRB's balance sheet depletion allowance of .5%. This would result in a minimum TLAC leverage ratio requirement for all US G-SIBS of 5.5% (i.e. 3% + 3% - .5%).

Third, since there is no similar requirement in the internationally agreed upon FSB standard, and given the presence of both a minimum TLAC leverage ratio requirement and a LTD risk-weighted requirement, we recommend that the agencies abandon the use of a leverage metric for LTD, regardless of calibration. Alternatively, if the agencies wish to maintain a dual approach to leverage ratio requirements in the TLAC/LTD framework, they should consider the adoption of a uniform leverage ratio requirement of 2.5%, which equates to the minimum 3% SLR requirement for advanced approaches banks, minus the FRB's balance sheet depletion allowance of .5%.

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[10] 'Notice of Proposed Rulemaking – Total Loss Absorbing Capacity, Long-Term Debt and Clean Holding Company Requirements for Systemically Important US Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations; Regulatory Capital Deduction for investments in Certain Unsecured Debt of Systemically Important US Bank Holding Companies', Board of Governors of the Federal Reserve System (December 2016), State Street Corporation Comment Letter (February 19, 2016).

[11] The Financial Stability Board prescribed a minimum TLAC leverage ratio requirement of 6% as of January 2019, rising to 6.75% as of January 2022.

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CONCLUSION

Thank you once again for the opportunity to comment on the important matters raised within this consultation. To summarize, we welcome and support the agencies' efforts to recalibrate the eSLR requirement for US G-SIBs and their IDI subsidiaries in order to achieve greater consistency in the treatment of large, internationally-active banks across national jurisdictions, improve the balance between leverage-based and risk-based measures of capital, and better recognize differences in industry business models. This includes the decision to make use of a firm-specific leverage ratio buffer calibrated at ½ of each G-SIB's applicable risk-based capital surcharge. This also includes the decision to eliminate the punitive and wholly unnecessary difference which exists in the minimum eSLR requirement for the BHC and their IDI subsidiaries.

In order to further enhance international consistency, we would urge the agencies to also consider eliminating the US-specific Method 2 G-SIB assessment surcharge, so that the eSLR buffer would be calibrated solely on the basis of the Method 1 approach prescribed by the Basel Committee. Furthermore, we support the agencies' alternative approach to the IDI leverage ratio requirement, involving a firm-specific capital buffer above the 3% 'adequately capitalized' threshold for advanced approaches banks, rather than the implementation of a variable 'well-capitalized' threshold tied to each G-SIB's risk-based capital surcharge.

We strongly support the agencies' decision to make conforming changes to the TLAC/LTD framework, and agree that these changes address many of the existing framework's most pressing limitations. Nevertheless, there is room for the agencies to consider additional adjustments in order to improve international consistency, reduce unnecessary complexity and better calibrate leverage-based measures of capital as a complement to risk-based capital. This includes the elimination of the G-SIB Method 2 construct in the TLAC/LTD framework and the use of the base TLAC leverage ratio requirement of 6.75% prescribed by the FSB, or alternatively calibration of the TLAC leverage ratio requirement using the 'capital refill' approach. This also includes the elimination of the LTD leverage ratio requirement, which does not exist in the FSB standard, or alternatively, its recalibration for all G-SIBs to 2.5%.

Please feel free to contact me at smgavell@statestreet.com should you wish to discuss State Street's submission in greater detail.

Sincerely,

Stefan M. Gavell