



June 3, 2016

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

RE: Docket Number R-1534 and RIN Number 7100-AE 48

Via e-mail: regs.comments@federalreserve.gov

Notice of Proposed Rulemaking – Single-Counterparty Credit Limits for Large Banking Organizations

Dear Sir/ Madam:

State Street Corporation (“State Street”), the Bank of New York Mellon Corporation (“BNY Mellon”) and the Northern Trust Corporation (“Northern Trust”) (collectively the “Custody Banks”) appreciate the opportunity to comment on the Notice of Proposed Rulemaking (“proposed rule”) issued by the Board of Governors of the Federal Reserve System (“FRB”) regarding the implementation of Section 165(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) which mandates the establishment of single counterparty credit limits (“SCCL”) for certain domestic and foreign bank holding companies (“BHC”) operating in the United States (“US”).

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 \$26.8 trillion in assets under custody and administration and \$2.3 trillion in assets under management as of March 31, 2016, State Street operates in more than 100 geographic markets worldwide.

BNY Mellon is a global investments company that provides investment management and investment services to help institutions and individuals invest, conduct business, and transact in markets globally. BNY Mellon operates in over 100 markets, with \$29.1 trillion assets under custody and/or administration and \$1.6 trillion assets under management as of March 31, 2016.

Northern Trust is a leading provider of wealth management, asset servicing, asset management and banking to corporations, institutions, affluent families and individuals. As of March 31, 2016, Northern Trust had assets under custody of \$6.2 trillion, and assets under management of \$900 billion.

The Custody Banks have been active participants in the policy debate regarding the appropriate design of credit exposure limits, providing comments in April 2012 on the FRB's proposed SCCL rule and comments in June 2013 on the Basel Committee's proposed large exposure regime, emphasizing the potential unintended impact of these measures on the custody bank business model. We appreciate the opportunity to offer insight on the proposed rule's impact on the Custody Banks and recommend a series of adjustments to the proposed SCCL Framework to avoid unwarranted disruptions to financial markets and our highly-valued business model.

Treatment of Securities Financing Transactions

The FRB proposes to require covered companies to measure their securities financing transaction ("SFT") exposures, including exposures to agency-indemnified SFTs, using the highly risk insensitive haircut-based 'comprehensive approach' as prescribed in the US implementation of the Basel III framework.¹ In doing so, the FRB appears to disregard the Basel Committee's work on a revised standardized methodology for SFTs, which is designed to address flaws in the comprehensive approach, while respecting the key policy objectives of a simple, stable, conservative and transparent view of credit risk. Furthermore this contrasts with the treatment of over-the-counter ("OTC") derivatives transactions, where the FRB acknowledges the development by the Basel Committee of the standardized approach for counterparty credit risk ("SA-CCR") and permits, as an interim measure, 'covered companies' to calculate their derivatives exposures 'using any methodologies that the covered company is permitted to use under the (FRB's) risk-based capital rules', including approved internal models.² The Custody Banks strongly oppose this divergent approach in the treatment of SFT and OTC derivatives transactions, especially given its potential to incentive the movement of financial activity away from the SFT market in favor of derivative-based synthetics. As the Custody Banks have previously expressed, securities lending plays an essential role in the provision of market liquidity and the timely settlement of securities transactions, while also providing incremental returns to institutional investors used to enhance performance and offset administrative and other portfolio costs.

We therefore strongly recommend that the FRB implement an approach for the measurement of SFT exposures in the SCCL Framework which mirrors the intended approach for the

¹ 'Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule', Office of the Comptroller of the Currency and Board of Governors of the Federal Reserve System, Federal Register, Volume 78, No. 198 (October 11, 2013).

² FRB Notice of Proposed Rulemaking, page 34.

measurement of exposures to OTC derivatives transactions and which ensures alignment with the emerging standardized methodology for risk-based capital. Under this approach, a 'covered company' would be permitted to calculate its gross credit exposure using any of the methodologies permitted under the Board's risk-based capital rules, until such time as the FRB considers the benefits of incorporating the revised 'comprehensive approach' proposed by the Basel Committee within the risk-based capital framework. As previously noted, by aligning these two approaches, the FRB will help avoid any prospect of broad-based regulatory arbitrage, which may ensue due to the use of vastly different methodologies for the measurement of exposures to SFTs and OTC derivatives transactions. There is already evidence of a shift in the market towards the broader use of derivatives-based synthetics and we believe that this trend will accelerate if the SCCL is finalized as intended, leading to further concentration of credit risk in the already substantially over-sized OTC derivatives market.

Definition of a Controlled Subsidiary and the Treatment of Sponsored Funds

Under the proposed rule, the credit exposure limits foreseen in the SCCL framework apply to a 'covered company' on a consolidated basis. This is defined by the FRB to extend beyond financial consolidation to also include subsidiaries which are directly or indirectly controlled by the 'covered company', using the control standard found in Section 2(a) of the Bank Holding Company Act. In addition, the FRB seeks comment on an alternative approach where the definition of a subsidiary would be based on the control test specified in the proposed rule for determining entities which must be aggregated to a 'counterparty'.³ The Custody Banks strongly support this alternative approach. This reflects our concern that the control standard in Section 2(a) of the Bank Holding Company Act is unduly complex and may unwittingly capture certain sponsored funds, such as European Union Undertakings for Collective Investments in Transferable Securities ("UCITS") and bank common and collective investment funds, which are legally distinct from the 'covered company' and where there is no evidence of any material control or economic interdependence.

Additionally, in the preamble to the proposed rule, the FRB seeks comment on whether the definition of a subsidiary should be expanded to include "any investment fund or vehicle advised or sponsored by a covered company".⁴ We believe that the current approach in the proposed rule already properly reflects the legal nature of the relationship that exists between a 'covered company' and its sponsored or advised funds, and thus do not support this expansion of the definition of "subsidiary".

Look-Through Requirement for Exposures to Investment Funds

Similar to the Basel Committee's large exposure framework, the FRB proposes the implementation of a 'look-through' requirement designed to capture indirect exposures that a 'covered company' may have to the issuer of assets held within an investment fund structure.

³ FRB Notice of Proposed Rulemaking, page 14.

⁴ FRB Notice of Proposed Rulemaking, page 14

In this respect, the Custody Banks request clarification that, consistent with the Basel Committee's large exposure regime, the requirement to 'look-through' to the issuer of assets held in an investment fund structure (*i.e.* a securitization fund, investment fund or other special purpose vehicle) only applies in cases where the 'covered company' invests in such a fund. If the FRB determines after consideration and finalization of the SCCL rule that the 'look-through' requirement is meant to apply more generally to all credit exposures to an investment fund structure, we strongly recommend the introduction of an exemption for exposures to an investment fund client that results from the provision of traditional custody services, including payment, settlement and asset administration services. These custody-related credit exposures are incidental to the provision of a fee-based financial service and since they are not designed to generate yield from credit risk assets, are offered in a manner which limits the scope of any potential risks to the 'covered company'. We therefore believe they should not be captured under this requirement.

Exposures Relating to the Provision of Traditional Custody Services

In an attempt to minimize the impact of the rule on the payment and settlement of transactions, the FRB proposes to exempt from the SCCL framework the intra-day credit exposures of a 'covered company' to a 'counterparty'. The Custody Banks support this exemption but believe that, unless it's expanded, the current framework could have profoundly negative implications for the ability of 'covered companies' to support normal course payment, clearing and settlement activities. Given the transactional nature of custody-related exposures, custody banks must have the ability to incur transactional exposures to a given counterparty when the applicable credit exposure limit is exceeded in order to ensure the continued seamless operation of payment, clearing and settlement systems. We therefore recommend that the FRB incorporate in the final rule, an exemption for short-dated exposures arising from the provision of traditional custody services that is consistent with the exemption contained in the EU large exposure regime, which recognizes the importance of transactional activities in financial markets, and thus makes provisions to accommodate temporary extension of credit related to day-to-day transactional activities.⁵

Alternatively, the FRB may wish to consider the implementation of a 'cure period' for short-dated exposures arising from the provision of traditional custody services. This 'cure period' could be based on the longest timeframe specified in the EU large exposure regime, or five business days, provided that the 'covered company' is permitted to execute additional transactions on behalf of its institutional investor clients during the 'cure period' if necessary to support normal course payment, clearing and settlement activities.⁶

⁵ 'EU Regulation No. 575/2013 of the European Parliament and the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms and Amending Regulation EU No. 648/2012', CRR Article 390(6).

⁶ The Basel Committee's large exposure framework recommends a similar approach, albeit under "stressed circumstances," providing that a national regulator may have to accept a "breach of an interbank limit *ex post*, in order to help ensure stability in the interbank market."

Conclusion

Once again, the Custody Banks appreciate the opportunity to comment on the FRB's proposed rule. While we strongly support the risk mitigation benefits of Section 165(e) of the Dodd-Frank Act, we continue to have concerns relative to the impact of the rule on the custody bank business model, and our ability to continue to provide seamless services to our clients. We believe that the adjustments recommended above, particularly regarding the treatment of SFTs, will help prevent unwarranted disruptions to our stable and highly-valued business model.

Should you have any questions or need any additional information, please contact:

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Respectfully submitted,



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