Northern Trust Corporation
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Michael O'Grady
President and Chief Executive Officer

January 22, 2019

Via Electronic Mail

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551
Docket No. R–1627; RIN 7100–AF20
Docket No. R–1628; RIN 7100–AF21

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street, SW
Suite 3E-218
Washington, D.C. 20219
Docket ID OCC–2018–0037

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
RIN 3064–AE96

Re: Comment Letter on the Notices of Proposed Rulemaking Regarding Prudential Standards for Large Bank Holding Companies and Savings and Loan Holding Companies and Applicability Thresholds for Regulatory Capital and Liquidity Requirements

Ladies and Gentlemen:

Northern Trust Corporation ("**Northern Trust**" or the "**firm**") welcomes the opportunity to comment on the notices of proposed rulemaking (the "**Tailoring Proposals**") issued by the Board of Directors of the Federal Reserve System (the "**Federal Reserve**"), the Office of the Comptroller of the Currency (the "**OCC**") and the Federal Deposit Insurance Corporation (the "**FDIC**" and, together with the Federal Reserve and OCC, the "**Agencies**") that would tailor the applicability thresholds for the Federal Reserve's enhanced prudential standards ("**EPS**") and the

Agencies' capital and liquidity rules to firms,[1] pursuant to section 401 of the Economic Growth, Regulatory Relief, and Consumer Protection Act ("**EGRRCPA**").[2] Northern Trust appreciates the Agencies' efforts to tailor regulatory requirements to firms' business models through a framework that is intended to be simple, transparent, efficient and predictable. In certain respects, the Tailoring Proposals' categorization framework for determining the applicability of EPS and capital and liquidity requirements would be a positive step towards such a framework.

Northern Trust has a number of concerns, however, with the Tailoring Proposals. The firm believes that the Tailoring Proposal should go further in tailoring regulatory requirements to a firm's business model, as summarized below and described in the following sections of this letter:

- The final rules implementing the Tailoring Proposals (the "**Final Tailoring Rules**") should determine which firms are subject to which category of requirements through a weighted averaging of multiple risk-based indicators rather than allowing a single risk-based indicator to determine a firm's category, such as Northern Trust being subject to the most restrictive Category II requirements solely because of the firm's cross-jurisdictional activity (Section II.A).[3]

- Regardless of whether the Final Tailoring Rules adopt such a weighted, multi-factor categorization methodology, (i) the rules should adjust the calculation of a firm's cross-jurisdictional activity to limit the measure to cross-jurisdictional claims only or (ii) if cross-jurisdictional claims are included in a firm's measure of cross-jurisdictional activity, the cross-jurisdictional activity threshold should be set at a significantly higher level than $75 billion. At a minimum, the Final Tailoring Rules should allow cross-jurisdictional claims consisting of central bank deposits and other high-quality liquid assets ("**HQLAs**") to be netted against cross-jurisdictional liabilities in the same jurisdiction when calculating cross-jurisdictional activity, thus focusing this risk-based indicator on the activities that actually give rise to the risks it is designed to capture. As proposed, the calibration of the cross-jurisdictional activity indicator would over count firms' non-U.S. activities generally, and in a manner that particularly affects custody banks such as Northern Trust (Section II.B).

- Category II firms should not be required to calculate their risk-based capital ratios under the advanced approaches (the "**advanced approaches capital requirements**") and should be allowed to opt out of reflecting accumulated other comprehensive income ("**AOCI**") in

[1] Federal Reserve, Prudential Standards for Large Bank Holding Companies and Savings and Loan Holding Companies, 83 Fed. Reg. 61,408 (Nov. 29, 2018) (the "**Federal Reserve Tailoring Proposal**"); Federal Reserve, OCC, FDIC, Proposed Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements, 83 Fed. Reg. 66,024 (Dec. 21, 2018) (the "**Joint Tailoring Proposal**").

[2] Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub.L. 115–174, § 401 (2018) ("**EGRRCPA**").

[3] *See* Federal Reserve Tailoring Proposal at 61,412; Joint Tailoring Proposal at 66,028 (describing the proposed category thresholds).

the firm's regulatory capital ratios, as these capital requirements do not address the liquidity risks that the cross-jurisdictional assets indicator is designed to measure (Section II.C).

- Category II and Category III custody banks should be eligible for reduced Liquidity Coverage Ratio ("**LCR**") and Net Stable Funding Ratio ("**NSFR**") requirements to reflect the large amount of client deposits, a substantial percentage of which are operational deposits for purposes of the Agencies' LCR rules,[4] which are largely stable and are part of their custody banking business model (Section II.D).

- Category II and Category III custody banks should not be required to submit daily FR 2052a reports (Section II.E).

- The Agencies should specifically allow Category II and Category III custody banks a one-day grace period to cure any breach of single-counterparty credit limit ("**SCCL**") requirements to the extent any such breach relates to overnight deposits or extensions of credit custody banks typically place with sub-custodians or make to clients in connection with securities settlement activities (Section II.F).

- The Agencies' future tailoring proposals and supervisory and regulatory expectations should maintain a clear distinction between the requirements applicable to Category I firms (i.e., global systemically important banks ("**GSIBs**")) and Category II firms, which by definition are not GSIBs (Section II.G).

- The Agencies should remove any legacy reference to a $10 trillion assets under custody threshold from their regulations (Section II.H).

I. Overview of Northern Trust

Northern Trust is a leading custody bank with approximately $132 billion in total consolidated assets as of September 30, 2018.[5] Northern trust has two core business lines: custody and wealth management. Each of these businesses is in and of itself relatively simple and presents relatively low credit risk. Each business generates revenues that consist primarily of stable, fee-based income for the provision of services, supplemented by net interest income derived from the reinvestment of client cash deposits in diversified and liquid investment portfolios. Each business funds itself primarily from client deposits rather than other forms of wholesale funding or significant interbank borrowings. The asset side of Northern Trust's balance sheet consists primarily of HQLAs, mainly fixed-income securities, including government, agency and asset-backed securities. Northern Trust operates primarily through one U.S. subsidiary bank (the "**Bank**") and expects that, for the foreseeable future, the Bank will continue to be the major source

[4] *See* 12 C.F.R. §§ 249.3 (Federal Reserve), 50.3 (OCC), 329.3 (FDIC) (defining "operational deposit").

[5] Unless otherwise indicated, all figures are as of September 30, 2018.

of Northern Trust's consolidated assets, revenues, and net income. The liabilities side of Northern Trust's balance sheet is heavily weighted toward client deposits, which represent approximately 86 percent of the firm's total consolidated liabilities.

Northern Trust's Custody Business

Custody banking is a stable and relatively simple line of business.[6] Custody services consist of holding and servicing assets, primarily securities, as agent for the beneficial owners of the securities. As custodian, Northern Trust provides safekeeping, recordkeeping, reconciliation and monitoring services relating to clients' assets. In this capacity Northern Trust acts as agent for, and on the instructions of, its clients, and does not exercise any discretion over the use or reuse of client assets and does not use them for any proprietary purposes.

Client securities are recorded and held in securities accounts. These securities are beneficially owned by Northern Trust's clients, or else clients of Northern Trust's clients, not by Northern Trust, and are segregated from Northern Trust's own assets. Northern Trust bears no market or credit risk in respect of its clients' securities. As a result, securities held in client securities accounts are not reflected on Northern Trust's balance sheet. A custody bank such as Northern Trust provides post-trade, securities settlement services by facilitating the delivery or receipt of sold or purchased securities and any related cash consideration at the direction of its clients. In settling securities transactions, Northern Trust may simply record credits and debits to securities and cash accounts on its books (if both the purchaser and seller of securities have accounts with Northern Trust) or else will transmit purchase or sale settlement instructions to its sub-custodians or securities settlement systems in the relevant jurisdictions in which the securities are physically held (if the securities are represented by global or individual certificates) or are recorded on an electronic register (if they are in dematerialized form). Northern Trust thus facilitates transactions in client securities, but does not make markets in or underwrite the issuance of the securities.

Clients with securities held under custody at a custody bank such as Northern Trust also need access to a cash account in order to hold cash used to purchase securities, receive cash from the sale of securities and from dividends and interest payments, and hold cash used for or resulting from various corporate actions by issuers of securities (such as repurchases, exchanges, mergers or spin-offs), and for subscriptions and redemptions of, for example, mutual fund shares. Client cash is held on deposit in a cash account with Northern Trust and represents a liability of Northern Trust to the client for the amount of the deposit, and thus – unlike the client's securities held in custody – is reflected on Northern Trust's balance sheet. Whereas a custody client does not have credit exposure to Northern Trust for its securities held in custody, it does have a credit exposure to Northern Trust for the amount of its cash on deposit.[7]

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[6] For additional information on the operations and business model of custody banks, see generally The Clearing House, The Custody Services of Banks (July 2016), available at https://www.theclearinghouse.org/-/media/tch/documents/research/articles/2016/07/20160728_tch_white_paper_the_custody_services_of_banks.pdf.

[7] A portion of a client's cash deposit with Northern Trust may be insured by the Federal Deposit Insurance Corporation ("**FDIC**") or under an equivalent non-U.S. deposit guarantee scheme.

A custody bank's balance sheet is driven primarily by its client cash deposits, which in turn are driven by clients' investment and transactional activity, and a custody bank such as Northern Trust has little or no direct means of control over such client activities. As a result, Northern Trust's custody-related cash balances can fluctuate even on a relatively short-term basis, and in times of market unrest or crisis can actually expand as custody clients may liquidate holdings of securities in favor of cash and leave more cash on deposit. However, because client cash deposits are generally held in connection with broader relationships with the firm, including the security accounts discussed above and ancillary record keeping and accounting service relationships, all of which are governed by custody agreements and other relationship documentation that include provisions limiting the ability of a client to terminate immediately its custody relationship with the firm, a substantial percentage of Northern Trust's cash deposits qualify as operational deposits under the Agencies' LCR rules.[8] Consistent with these provisions, Northern Trust has developed detailed statistical analysis demonstrating that a substantial proportion of custodial deposits reflect the characteristics of core, stable funding with material durations far in excess of 30 days.

The asset side of a custody bank's balance sheet generally reflects the volume of its clients' investment and transaction activities. This is one of the primary reasons Northern Trust has never favored the idea of tying EPS solely or even primarily to asset size: for a custody bank, asset size is effectively a derivative of its agency custody activities, which reflect client activity. Imposing requirements based solely or primarily on asset size means that a custody bank may find itself subject to an additional level of regulatory constraints and burdens solely as a result of providing agency custody activities that are necessary for investors such as U.S. pension funds, mutual funds, index funds, exchange traded funds and the like to access securities markets around the world in line with market growth.

The asset side of Northern Trust's custody business balance sheet consists primarily of securities that are HQLAs and cash on deposit with the Federal Reserve and other national central banks, including any such deposits required as reserves against client deposits. The firm's securities portfolios are generally held for investment purposes, to secure extensions of credit from financial market utilities ("**FMUs**") and sub-custodians related to Northern Trust's securities settlement activities on behalf of its clients, and to enable Northern Trust to meet any outflows of liquidity resulting from a reduction in client activity and thus client cash deposits.

In the course of facilitating the settlement of clients' securities transactions or the timing of availability of cash receipts arising from redemptions, dividends or interest payments, a custody bank such as Northern Trust may also extend short-term credit (which in most cases is limited to intraday or overnight credit) to a client when the amount in the client's cash account is not sufficient to fund the client's transactions. In the case of Northern Trust, these custody-related short-term loans represent a significant percentage of the firm's total custody-related loans, which typically are supported by cash or securities held in client accounts at Northern Trust. The firm's

[8] These agreements may include provisions that generally would require notice before terminating the custody relationship. In addition, moving securities portfolios from one custodian to another is a process that typically occurs over a period of months rather than days or weeks.

custody business balance sheet, unlike the balance sheets of most commercial banks, does not reflect significant maturity transformation activities, i.e., the making of long-dated loans or investments funded primarily by demand deposits, and thus does not present a significant duration or liquidity mismatch. As a result, from a liquidity perspective, Northern Trust's custody business relies primarily on custody-related client cash deposits and does not rely on material amounts of short-term wholesale funding.

Northern Trust's custody business is international in scale, as it allows U.S. clients access to securities issued and traded in markets outside the United States and non-U.S. clients access to securities issued and traded in the United States. Northern Trust has operations in 23 countries. However, its cross-jurisdictional claims and cross-jurisdictional liabilities are concentrated primarily in four jurisdictions outside the United States, namely, the United Kingdom, Luxembourg, the Cayman Islands and Australia: 84% of the firm's cross-jurisdictional claims and 92% of the firm's cross-jurisdictional liabilities are concentrated in these four jurisdictions.

Northern Trust's Wealth Management Business

Northern Trust's wealth management business focuses on high-net-worth individuals and families, business owners, executives, professionals, retirees, and established privately-held businesses in its target markets. The business also includes the Global Family and Private Investments Offices group, which provides customized services to meet the financial needs of individuals and family offices with assets typically exceeding $200 million. In supporting these targeted segments, wealth management provides trust, investment management, custody, and philanthropic services; financial consulting; guardianship and estate administration; family business consulting; family financial education; brokerage services; and private and commercial banking. Northern Trust's wealth management business has assets under custody/administration of $676 billion, assets under custody of $666 billion, and assets under management of $296 billion, respectively. Northern Trust's wealth management services are delivered by multidisciplinary teams located primarily in the United States through a network of over 60 domestic offices in 18 U.S. states and Washington, D.C. The wealth management business also has three international offices in London, Guernsey, and Abu Dhabi.

Northern Trust's wealth management business is relatively straightforward. The vast majority of wealth management's revenue is generated in the United States from trust fees and net interest income, with approximately 63% from trust fees and approximately 33% from net interest income. A limited amount of wealth management revenue is generated from ancillary services provided to wealth management clients, including foreign exchange and brokerage services among other ancillary services. Like the client assets held by Northern Trust's custody business, wealth management client assets are beneficially owned by the clients and thus are not reflected on Northern Trust's balance sheet.

The wealth management business is funded primarily by stable deposits from individuals and family investment vehicles such as trusts. The asset side of the wealth management business consists of high quality relationship-based loans, including loans secured by cash or marketable securities, residential real estate loans primarily made as an accommodation to clients and

commercial real estate loans extended primarily to investors well known to Northern Trust. All residential real estate loans are underwritten utilizing Northern Trust's credit policies, which do not support the origination of loan types generally considered to be of high risk in nature, such as option ARM loans, subprime loans, loans with initial "teaser" rates, and loans with excessively high loan-to-value ratios. Residential real estate loans consist of traditional first lien mortgages and equity credit lines that generally require a loan-to-collateral value of no more than 65% to 80% at inception. The commercial real estate portfolio consists of commercial mortgages and construction, acquisition and development loans to high quality borrowers. Underwriting standards generally reflect conservative loan-to-value ratios and debt service coverage requirements. Recourse to owners through guarantees also is commonly required in commercial real estate loans made to wealth management clients.

Ancillary Custody- and Wealth Management-Related Services

In connection with its custody and wealth management businesses, Northern Trust offers various ancillary asset servicing options to its clients, including foreign exchange services and agency securities lending services. Because clients need to settle securities transactions in multiple currencies, Northern Trust offers a variety of FX products and services, including FX spot and forward transactions and FX derivatives to help clients manage their FX risk.

Northern Trust also offers agency securities lending services in response to client demand to enhance their yield on securities they hold in custody with Northern Trust. In agency securities lending transactions, Northern Trust generally acts as agent for the securities lender. Securities lending transactions are secured transactions in which borrowers collateralize their obligations to the lenders to return the loaned securities with cash or other securities, often government and agency securities. In its role as agent, Northern Trust effects the loan of securities against collateral, monitors the value of the collateral over the life of the transaction and verifies that, to the extent necessary, additional collateral is posted or excess collateral is released. Northern Trust also agrees to indemnify securities lenders in the event that borrowers do not return the loaned securities, with its principal credit exposure being limited to any shortfall in the value of the collateral posted by the borrower compared to the value of the loaned securities.

The combination of Northern Trust's two core business lines results in an aggregate business model that is relatively simple and low risk, with no material trading or investment banking activities. It is a business model that generates stable fee income, even during times of economic stress. In periods of macroeconomic stress, custody banks typically see an inflow of client deposits, reflecting the fact that custody banks are viewed by clients as "safe havens." During the financial crisis, for example, Northern Trust experienced only one quarter of net losses, and did not have any aggregate net losses for any calendar year.

As described in more detail in the following sections of this letter, Northern Trust is concerned that the Tailoring Proposals are not sufficiently tailored to the relatively low level of risk associated with the firm's business model. Among other things, the calibration and use of the cross-jurisdictional activity risk-based indicator under the Tailoring Proposals would over count

firms' non-U.S. activities generally, and in a manner that particularly affects custody banks such as Northern Trust.

II. Northern Trust's Comments on the Tailoring Proposals

Northern Trust strongly supports the Agencies' goal of tailoring regulatory requirements, including those for enhanced prudential standards under Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**"),[9] the Federal Reserve's Regulation YY[10] and the Agencies' Basel III capital and liquidity rules,[11] to firms' unique business models. In particular, as a bank with approximately $132 billion in total consolidated assets that operates two relatively simple business lines, custody and wealth management, and is far from being systemically important under any existing systemic importance metric or as compared to other depository institution holding companies,[12] Northern Trust believes that any tailoring of applicable regulatory requirements should take into account the specific characteristics of the custody bank business model, which is unique and different from the business model of a universal commercial bank or a bank with significant capital markets activities such as securities underwriting, dealing and market-making. Northern Trust is not a GSIB, has a balance sheet that is smaller than many U.S. regional commercial banks, and is heavily engaged in custody activities that, as discussed above, consist in large part of acting as agent for clients in effecting securities settlement, securities lending and FX transactions.

Yet, under the Agencies' Tailoring Proposals, Northern Trust would be uniquely placed in the *highest* category of enhanced prudential standards and capital and liquidity requirements applicable to non-GSIB banking organizations, indeed in a category that would normally require total consolidated assets of $700 billion – *i.e.*, 5.3 times the size of Northern Trust's balance sheet. This would occur solely because Northern Trust would exceed the $75 billion threshold for *one* (and only one) of the four specific risk indicators for banking organizations that exceed the minimum asset threshold of $100 billion for applicability of any of the Federal Reserve's enhanced prudential standards other than the risk committee requirement – an amount that is already $150 billion in total consolidated assets *lower* than EGRRCPA's threshold of $250 billion for general applicability of enhanced prudential standards.[13] As a result, while EGRRCPA clearly

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[9] 12 U.S.C. § 5365.

[10] 12 C.F.R. pt. 252.

[11] 12 C.F.R. pts. 217, 249 (Federal Reserve), 3, 50 (OCC) and 324, 329 (FDIC); *see also* Net Stable Funding Ratio: Liquidity Risk Management Standards and Disclosure Requirements, 81 Fed. Reg., 35,124 (June 1, 2016); Joint Tailoring Proposal at 66,046–47, 66,053, 66,057–58 (proposing the net stable funding ratio).

[12] Northern Trust's GSIB method 1 score, based on the data provided in the firm's FR Y-15 as of September 30, 2018, is *less than half* of the threshold method 1 score of 130 that would cause a firm to be designated as a GSIB under Federal Reserve rules. 12 C.F.R. § 217.402. As of September 30, 2018, Northern Trust also ranked only 29th in the National Information Center's list of U.S. depository institution holding companies with total consolidated assets above $10 billion. National Information Center, Holding Companies with Assets Greater Than $10 Billion, https://www.ffiec.gov/nicpubweb/nicweb/HCSGreaterThan10B.aspx.

[13] *See* EGRRCPA § 401(a).

reflects Congressional intent to apply the full panoply of enhanced prudential standards only starting at an asset threshold that is approximately twice as large as Northern Trust's and merely authorizes the Federal Reserve to apply enhanced prudential standards in a tailored fashion to banking organizations with total assets between $100 billion and $250 billion, the Agencies' Tailoring Proposals would actually apply the full panoply of non-GSIB requirements solely to Northern Trust.

Northern Trust respectfully submits that this is not the result that Congress intended in enacting EGRRCPA. On the contrary: given that EGRRCPA requires the Agencies to tailor their regulations only for firms with *less than* $250 billion in total consolidated assets, we believe that a banking organization such as Northern Trust with between $100 billion and $250 billion in total consolidated assets should be subject to a less stringent regulatory framework than banking organizations with $250 billion or more in total consolidated assets, not the other way around.[14]

The sections that follow outline the primary changes Northern Trust believes should be made to the Tailoring Proposals to reflect Congressional intent and to actually tailor the applicable enhanced prudential standards in ways that would properly take into account Northern Trust's risk profile and business model.

A. The Final Tailoring Rules should adopt a weighted, multi-factor methodology for categorizing firms.

The fundamental flaw with the Tailoring Proposals is that all it takes for a banking organization with $100 billion or more in total consolidated assets to be placed in a higher category of applicable enhanced prudential standards and capital and liquidity requirements is to exceed a $75 billion threshold for any one of four specific risk indicators: cross-jurisdictional activity, weighted short-term wholesale funding ("**STWF**"), nonbank assets, or off-balance sheet exposure. This effect is amplified with respect to Category II firms that have less than $700 billion in assets, as the Tailoring Proposals would establish a single non-asset size indicator – cross-jurisdictional activity – to distinguish Category II firms from other firms subject to the Tailoring Proposals. Consequently, even if a banking organization has a relatively low risk profile and is well below the $75 billion threshold for three risk indicators, it would be placed in a higher category than the category that applies generally to banking organizations that have between $100 billion and $250 billion of total consolidated assets, solely because it crosses the threshold for one risk indicator. Northern Trust believes that such an approach, which effectively gives primacy to one or at most two factors, is inconsistent with EGRRCPA, which affirmatively requires a *multi-factor*

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[14] Northern Trust also notes that there are at least two more proposed rulemakings to come that may yet apply additional requirements to Northern Trust: a proposal to amend the Federal Reserve's capital planning requirements, which currently apply in full to Northern Trust, but solely because Northern Trust has more than $100 billion in total consolidated assets, and a proposal to amend the Federal Reserve and Federal Deposit Insurance Corporation's joint resolution planning rules. *See* Federal Reserve Tailoring Proposal at 61,410; *see also* Federal Reserve, Statement Regarding the Impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) at 6 (July 6, 2018), available at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706b1.pdf (exempting firms with less than $100 billion in assets from capital planning requirements).

approach.[15] As a result, and as the Agencies seem to recognize in proposing an alternative categorization methodology in the Tailoring Proposals based on the GSIB methodology,[16] Northern Trust believes the Agencies should adopt a categorization methodology that weights and averages multiple risk-based indicators applicable to firms.

The proposed categorization methodology in the Tailoring Proposals seems to be a half-step towards tailoring, as it establishes five risk-based indicators – size, cross-jurisdictional activity, weighted STWF, nonbank assets and off-balance sheet exposure – but would allow just one of these indicators to determine the category applicable to a firm.[17] While Northern Trust appreciates the transition from the current size-based approach – under which a firm's size alone would determine whether it is subject to most EPS and many capital and liquidity requirements – to the proposed approach that considers four additional factors, allowing any one of these factors to determine a firm's category oversimplifies the impact of specific risks associated with a firm's business model. A more tailored and risk-sensitive approach would involve categorizing firms based on a weighted average of all relevant risk factors applicable to a firm, as many firms' business models may involve slightly higher risks in one dimension but lower risks in other dimensions. A weighted, multi-factor categorization methodology would reflect the true picture of a firm's risks without giving any one indicator a determining effect on the regulatory requirements applicable to a firm.

The proposed approach in the Tailoring Proposals is also flawed in that it fails to index the threshold applicable for each risk-based indictor for inflation, or general growth of the banking sector in line with economic growth, or to reflect the amount of a specific firm's indicator as measured against the total amount of the indicator throughout the financial system. Establishing absolute indicator thresholds risks causing "category creep," where all firms would tend to move from Category IV to III to II along with economic growth or inflation. In addition, while adopting the same $75 billion threshold for each of the cross-jurisdictional activity, weighted STWF, nonbank assets and off-balance sheet is a simple approach, in that the threshold number is the same for each indicator, it does not reflect the fact that total system-wide amounts of each indicator may be different. For example, system-wide nonbank assets may be different and may grow at different rates and in different distributions than system-wide cross-jurisdictional activity.

Accordingly, Northern Trust requests that a firm's category under the Final Tailoring Rules be determined based on a weighted average of multiple risk-based factors, which is adjusted for

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[15] Section 401 of EGRRCPA added a new subparagraph (C) to Section 165(a)(2) of the Dodd-Frank Act that requires that if the Federal Reserve determine to impose enhanced prudential standards on a firm with $100 billion or more in total consolidated assets, such as Northern Trust, then it *must* take into consideration the firm's "capital structure, riskiness, complexity, financial activities (including financial activities of subsidiaries), size, *and* any other risk-related factors that the [Federal Reserve] deems appropriate." EGRRCPA § 401(a)(1)(B)(iii) (emphasis added).

[16] *See* Federal Reserve Tailoring Proposal at 61,415–17; Joint Tailoring Proposal at 66,032–33.

[17] Aside from being a Category I firm – based on a firm's GSIB method 1 score, which is itself determined by 12 separate risk-based indicators – a Category IV firm could become a Category II firm based on its size or cross-jurisdictional activity alone or could become a Category III firm based on its size, weighted STWF, nonbank assets or off-balance sheet exposure alone.

banking sector growth or inflation or is measured as a weighted percentage of system-wide risks. The firm suggests that the Agencies develop a new weighted scoring system that averages each of the four non-asset size indicators (cross-jurisdictional activity, weighted STWF, nonbank assets and off-balance sheet exposures) to produce an "**average risk-based indicator amount**" for each firm, which would be measured against the proposed $75 billion threshold, as automatically adjusted to reflect banking sector growth. For example, a firm with $25 billion of each of cross-jurisdictional activity, weighted STWF and nonbank assets and $115 billion of off-balance sheet exposures would have an average risk-based indicator amount of $47.5 billion, which is below the $75 billion threshold and reflects the fact that, although one of the firm's risk-based indicators is elevated, the other relatively low indicator measures show that the firm faces a low level of risk in total. If that same firm's cross-jurisdictional activity, weighted STWF and nonbank assets were each higher, – e.g., at $65 billion each – then the firm's average risk-based indicator amount would be $77.5 billion, which would be above the $75 billion threshold. In that case, the increased level of risk represented by the firm's cross-jurisdictional activity, weighted STWF and nonbank assets would appropriately push the firm above the $75 billion threshold *even though* none of these three risk-based indicator amounts was itself above the $75 billion threshold. In other words, the average risk-based indicator amount would appropriately balance the risks presented by one of a firm's risk-based indicator measures being elevated against the risks (or lack of risk) presented by the firm's other, non-elevated risk-based indicator measures.

This approach would reduce the risk that any one factor would play an outsized role in determining the level of regulation to which a firm is subject, which is particularly relevant for identifying the firms that would be subject to heightened Category II standards. The Final Tailoring Rules should maintain the asset size-based thresholds in the Tailoring Proposal – i.e., any firm with $250 billion or more in total consolidated assets becomes a Category III firm and any firm with $700 billion or more in total consolidated assets becomes a Category II firm – because asset size still features prominently in the underlying statutory framework even after EGRRCPA. However, EGRRCPA also stands for the proposition that a firm's regulatory requirements should be based on a holistic view of the risks the firm is exposed to, based on its activities and structure. Northern Trust's proposed approach based on a firm's average risk-based indicator amount is more consistent with EGRRCPA than basing a firm's categorization solely on asset size and one of the four non-asset size indicators, as the Tailoring Proposals would do.

Northern Trust's proposed average risk-based indicator amount approach would also be more prudent than adopting a categorization framework based on either a firm's method 1 or method 2 GSIB score, as Northern Trust understands from other industry comment letters that the GSIB method 1 and method 2 scoring methodologies may warrant re-calibration. If the GSIB methodologies are going to be substantially revised in the future, it would not make sense to incorporate these methodologies into a categorization framework at this time – particularly when the Agencies have already identified four non-asset size risk-based indicators that identify risks a firm may be subject to across a number of dimensions. If the Agencies were to adopt a categorization methodology based on one of the GSIB scores, however, Northern Trust suggests that the Agencies use the method 1 score, as the method 1 scoring framework at least is consistent with international standards established by the Basel Committee on Banking Supervision ("**BCBS**").

If the Agencies do not adopt Northern Trust's proposed approach based on a firm's average risk-based indicator amount and do not adopt the alternative GSIB method 1 approach, at a minimum, Northern Trust requests that the Agencies adjust the scope of rules applicable to each category of firm to align more closely with the specific risks associated with the factors that caused the firm to fall into that category. For example, the Joint Tailoring Proposal would subject Category III firms that have less than $75 billion of weighted STWF to a lower calibration of the LCR and proposed NSFR. This approach is sensible because, as the Agencies explained, such firms have less reliance on STWF, which could lead to liquidity risk.[18] As explained in more detail in Section II.C below, however, Northern Trust does not believe that the capital requirements that would apply to Category II firms are appropriately tailored to the ring-fencing risks that the Agencies explained are associated with cross-jurisdictional activity as a risk indicator.[19]

B. The cross-jurisdictional activity indicator should be recalibrated to reflect more accurately the risks this indicator is designed to capture.

Under the Tailoring Proposals, Northern Trust would be a Category II firm because it has more than $75 billion of cross-jurisdictional activity, as that term is defined under the proposals. Northern Trust understands that cross-jurisdictional activity could in theory be a useful metric to determine certain risks to which an internationally active firm is subject – specifically, the risks of ring-fencing of the firm's liquidity resources in non-U.S. jurisdictions and asset fire sales to address liquidity needs across multiple jurisdictions.[20] Northern Trust has significant concerns, however, that the proposed cross-jurisdictional activity metric is not appropriately calibrated actually to reflect such risks.

The Bank Policy Institute ("**BPI**") is submitting a separate comment letter with respect to the Tailoring Proposals, which (together with a supplemental research paper) shows that the measure of a firm's cross-jurisdictional liabilities is not a meaningful indicator of a firm's systemic risk when a firm's cross-jurisdictional claims are already measured. Northern Trust believes it generally would be "double counting" to include both a measure of non-U.S. assets (cross-jurisdictional claims) and a measure of non-U.S. liabilities (cross-jurisdictional liabilities) to determine a firm's cross-jurisdictional activity. As described in Section I, Northern Trust has custody operations in non-U.S. jurisdictions, which generate cash account deposits, which are held in large part as central bank deposits and other HQLAs in the same jurisdiction in which the deposits are held. Where a non-U.S. liability creates a non-U.S. claim, it does not truly reflect a firm's business operations or risks to count both in the firm's measure of cross-jurisdictional activity. The current definition of an internationally active firm – codified in the requirement for such firms to calculate their risk-based capital requirements under the advanced approaches – reflects this fact and looks only to the asset side of a firm's balance sheet, establishing a threshold

[18] Joint Tailoring Proposal at 66,036.

[19] *See* Federal Reserve Tailoring Proposal at 61,418; Joint Tailoring Proposal at 66,034.

[20] *See* Federal Reserve Tailoring Proposal at 61,418; Joint Tailoring Proposal at 66,034.

based on a firm's on-balance sheet foreign exposures.[21] Accordingly, Northern Trust strongly supports BPI's request that (1) if the threshold for cross-jurisdictional activity is maintained at $75 billion, the measure of cross-jurisdictional activity should be redefined to include only cross-jurisdictional claims but not cross-jurisdictional liabilities or (2) if cross-jurisdictional liabilities are still incorporated in a firm's measure of cross-jurisdictional activity in the Final Tailoring Rules, the threshold for cross-jurisdictional activity should be set at a significantly higher level than proposed, given both industry levels of cross-jurisdictional claims and the amount of cross-jurisdictional claims that would actually give rise to the risks this measure is designed to capture.

More fundamentally, not all cross-jurisdictional activity (whether claims- or liabilities-based activity) is similarly risky. The Final Tailoring Rules should adopt a measure of cross-jurisdictional activity that is tailored to reflect the actual risks associated with the underlying activity. Where certain cross-jurisdictional activity does not give rise to the ring fencing and liquidity risks the Agencies noted in the preambles to the Tailoring Proposals, such activity should be excluded from the measure of a firm's cross-jurisdictional activity, even if that measure includes both cross-jurisdictional claims and liabilities.

For instance, an internationally active custody bank by its nature must have deposits in a number of jurisdictions across the world, but these deposits and the assets they fund are inherently less risky than the cross-jurisdictional activity of other banking businesses. A custody bank's loans are generally of a much shorter term and higher quality – e.g., overnight credit to facilitate the settlement of a securities transaction that are fully collateralized by the securities in clients' securities accounts – than the long-term (secured or unsecured) loans a traditional bank may provide in a non-U.S. jurisdiction. These high-quality, short-term loans are generally a small portion of a custody bank's cross-jurisdictional activity, however, as a custody bank's balance sheet growth is typically driven by clients' decisions to make additional cash account deposits. Such cash account deposits are typically operational deposits that a client uses to fund its ongoing securities transactions. Not only would these deposits not be expected to be withdrawn in broad financial stress, but Northern Trust's experience during the financial crisis of 2007 to 2008 indicates that cash account deposits typically *rise* during periods of macroeconomic stress. Moreover, typically a material amount of custody-related cash deposits in a particular jurisdiction in which Northern Trust operates fund central bank deposits or other HQLAs held in the same jurisdiction.

Double counting non-U.S. assets and liabilities is particularly unwarranted in these cases – where a local liability funds a local liquid asset – as this cross-jurisdictional activity does not give rise to the risks the Agencies describe the cross-jurisdictional activity metric as being designed to capture. To the extent that a local liability funds a local liquid asset, a local regulator would have

[21] 12 C.F.R. §§ 217.100(b) (Federal Reserve), 3.100(b) (OCC), 324.100(b) (FDIC). Of course, this threshold is currently set at a value, $10 billion, that has remained fixed and unchanged since at least October 2013 and does not reflect the regulatory tailoring and rebalancing mandated under Section 401 of EGRRCPA and proposed in the Agencies' Tailoring Proposals. Any cross-jurisdictional activity threshold based on cross-jurisdictional claims or on-balance sheet foreign exposures should be significantly raised to reflect the statutorily required tailoring and rebalancing.

no greater incentive to ring-fence the liquidity in a branch of subsidiary of a U.S. firm – especially if the local asset is a central bank deposit or other HQLA. But even if a local regulator did ring-fence the legal entity, it would be able to use its own HQLAs to fund local liquidity needs, in which case there is no additional risk of asset fire sales associated with these assets and no impact on funding flows between that legal entity and the rest of the firm.

Consequently, even if the Agencies were to retain both cross-jurisdictional claims and cross-jurisdictional liabilities as part of the cross-jurisdictional activity indicator, Northern Trust requests that firms be allowed to subtract from their measure of cross-jurisdictional claims and cross-jurisdictional liabilities the amount of any central bank deposits or other HQLAs in any one jurisdiction that correspond to third-party liabilities in the same jurisdiction. For example, assume that a firm has a subsidiary in a country outside the United States with the flowing cross-jurisdictional claims and liabilities:

Assets		Liabilities	
Deposits with local central bank	$5bn	Customer deposits	$30bn
Local sovereign debt/agency securities	$10bn		
Due from U.S. Parent	$15bn		
Total	**$30bn**	**Total**	**$30bn**

Northern Trust believes that the firm should be able to offset the $15 billion of local central bank deposits and local sovereign debt and agency securities against $15 billion of its customer deposits in that jurisdiction, on the basis that even if the local regulator ring-fenced this subsidiary, it would have $15 billion of its own HQLAs to offset any outflow of up to $15 billion of liabilities. In other words, the subsidiary would not need to rely on a cross-border flow of liquidity to offset up to $15 billion of liabilities. As a result, the firm would deduct $15 billion from both its cross-jurisdictional claims and $15 billion from its cross-jurisdictional liabilities, leaving the subsidiary with the following cross-jurisdictional claims and liabilities:

Assets		Liabilities	
Due from U.S. Parent	$15bn	Customer deposits	$15bn
Total	**$15bn**	**Total**	**$15bn**

Instead of showing cross-jurisdictional claims and liabilities of $60 billion in that jurisdiction, the firm would show cross-jurisdictional claims and liabilities of $30 billion because only these claims and liabilities would be put at any risk of interruption of liquidity flows as a result of ring-fencing. This approach would minimize the effect of any double counting inherent in the proposed cross-jurisdictional activity metric while also reflecting the fact than many claims and liabilities proposed to be included in this metric do not in fact give rise to the ring-fencing or asset fire sale risks that the Agencies used to justify the weight placed on the cross-jurisdictional activity metric under the Tailoring Proposals.[22]

The firm acknowledges that where a non-U.S. liability creates liquidity that is sent to other jurisdictions within a firm – thereby funding an internal receivable on the local non-U.S. balance sheet – this arrangement would give risk to potential ring-fencing and asset fire sale risks. A local regulator in Jurisdiction A where a non-U.S. entity owes liquidity back to another non-U.S. entity in Jurisdiction B under an internal receivable could be incentivized to ring-fence the firm's operations to prevent the firm from sending liquidity out of Jurisdiction A in satisfaction of the receivable held by the entity in Jurisdiction B. In addition, if the entity in Jurisdiction A has to sell assets to generate the liquidity necessary to settle the receivable of the entity in Jurisdiction B, the entity in Jurisdiction A could be required to sell these assets at a loss if it were experiencing stress when it had to repay the receivable. However, these concerns are not present where a liability in a jurisdiction represents custody bank deposits that fund central bank deposits and other HQLAs within that jurisdiction.

Custody banks, specifically, should be able to exclude central bank deposits held in the same jurisdiction as liabilities in light of EGRRCPA. Section 402 of EGRRCPA requires the Agencies to allow custody banks to exclude from their measure of total leverage exposure, the denominator under the supplementary leverage ratio ("**SLR**"), the firm's central bank deposits up to the value of deposits of the custodial bank that are linked to fiduciary or custodial and safekeeping accounts.[23] This requirement reflects the fact that a custody bank often holds a large amount of low-risk assets associated with clients' cash account deposits, which can have uniquely negative regulatory consequences for the bank. In the context of the SLR, these additional central bank deposits increase the firm's total leverage exposure, lowering the firm's actual SLR closer to the minimum requirements. Here, these central bank deposits expose custody banks to a higher risk of being categorized as a Category II firm. EGRRCPA reflects Congress's belief that custody banks should not be subject to uniquely burdensome regulatory requirements just because of the additional low-risk assets these firms hold on their balance sheets, and the Agencies should reflect

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[22] Where a firm has cross-jurisdictional claims and liabilities in a jurisdiction that has implemented the Financial Stability Board's ("**FSB's**") Key Attributes of Effective Resolution Regimes for Financial Institutions, *see* FSB, Key Attributes of Effective Resolution Regimes for Financial Institutions (Oct. 15, 2014), available at http://www.fsb.org/wp-content/uploads/r_141015.pdf, the risk of ring-fencing in the jurisdiction is especially low. Cross-jurisdictional claims and liabilities in these jurisdictions present an even stronger rationale for being subtracted from a firm's cross-jurisdictional activity.

[23] EGRRCPA § 402.

this same approach in the Final Tailoring Rules by allowing custody banks to exclude central bank deposits and associated liabilities from their measure of cross-jurisdictional activity.

C. Category II firms should not be subject to heightened capital requirements as compared to Category III firms.

As noted in Section II.A above, Northern Trust believes that at a minimum the Final Tailoring Rules should closely tailor the requirements applicable to firms in a given category to the specific risks that the metrics that caused firms to fall into that category were designed to capture. To that end, Northern Trust does not believe that Category II firms, which may become Category II firms *solely* because of their cross-jurisdictional activity, should be subject to heightened capital requirements because these requirements do not address the risks that the cross-jurisdictional activity metric is designed to identify.

The Tailoring Proposals explain that Category II firms would be subject to the advanced approaches capital requirements and would not be allowed to opt out of reflecting AOCI in the firm's regulatory capital ratios because these firms' cross-jurisdictional activities give rise to the risks of ring-fencing of the firm's liquidity resources in non-U.S. jurisdictions and asset fire sales to address liquidity needs across multiple jurisdictions.[24] Both of these risks, however, are primarily *liquidity* risks rather than credit risks or other forms of capital risk. Northern Trust understands that a firm's cross-jurisdictional activity could be a grounds for subjecting the firm to heightened liquidity requirements – including LCR, NSFR, internal liquidity stress testing and liquidity risk management requirements. The advanced approaches capital requirements and the reflection of AOCI in regulatory capital ratios do not address these liquidity and associated ring-fencing risks. Even if a non-U.S. branch or subsidiary were to be ring-fenced, the U.S. parent company would be required to continue to include the ring-fenced entity (including its risk-weighted assets and capital) in its consolidated risk-based and leverage capital calculations, in which case the ring-fencing would have no effect on the firm's risk-based capital ratios.

Moreover, the advanced approaches are not now and likely would not become Northern Trust's binding capital constraints, even in a period of macroeconomic stress. In business-as-usual conditions, the greater risk sensitivity of the advanced approaches capital calculations leads each of Northern Trust's advanced approaches risk-based capital ratios to be higher, and therefore less binding, than the equivalent risk-based capital ratio under the standardized approach. Given the high percentage of the firm's assets that qualify as HQLAs, as described in Section I above, and given that the risk weights associated with HQLAs would not be expected to significantly increase even in a period of macroeconomic stress, Northern Trust does not expect that its advanced approaches risk-based capital ratios would be materially lower than its standardized risk-based capital ratios. Furthermore, once the Federal Reserve's stress capital buffer requirements proposed rule[25] is finalized, firms' binding point-in-time risk-based capital requirement will be the firm's

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[24] *See* Federal Reserve Tailoring Proposal at 61,418; Joint Tailoring Proposal at 66,034.

[25] Federal Reserve, Amendments to the Regulatory Capital, Capital Plan, and Stress Test Rules, 83 Fed. Reg. 18,160 (Apr. 25, 2018).

common equity tier 1 ("**CET 1**") ratio, assuming the stress capital buffer is finalized, and the stress capital buffer would only be calculated in accordance with the standardized approach. The only circumstance in which a firm's advanced approaches risk-based capital ratios would become binding, therefore, would be if the difference between the firm's advanced approaches and standardized approach risk-based CET 1 ratios is greater than the firm's stress capital buffer, which is a remote possibility, even in a period of macroeconomic stress.

To be clear, Northern Trust is not suggesting that it should no longer be treated as an "advanced approaches banking organization" more generally, as that term (or its variants) is currently used in the Agencies' regulations.[26] Northern Trust acknowledges that it would still be subject, for example, to the SLR and the countercyclical capital buffer ("**CCyB**"), if deployed. In that sense, Northern Trust would continue to be an "advanced approaches banking organization." The firm is requesting only that it be exempted from the requirement to calculate its risk-weighted assets and risk-based capital ratios under the advanced approaches and the requirement to reflect AOCI (at least with respect to HQLAs, as described below) in its regulatory capital.

Removing the requirement that Northern Trust calculate its risk-based assets under the advanced approaches would also be consistent with a broader recognition, both on the part of the Trump Administration and the Agencies, of the limited benefit of continuing to have two different approaches to calculating RWAs. The U.S. Treasury Department, in its June 2017 report entitled "A Financial System That Creates Economic Opportunities – Banks and Credit Unions," specifically recommends simplifying the capital regime applicable to banks over time by "keeping the standardized approach . . . for calculating risk-weighted assets, but reducing reliance upon the advanced approaches for calculating firms' overall risk-based capital requirements."[27] This recommendation echoes the views expressed previously by former Federal Reserve Governor Daniel K. Tarullo, who in a May 2014 speech concluded that "I believe we should consider discarding the IRB [internal ratings based – another term for the advanced approaches] approach to risk-weighted capital requirements. . . . [T]he IRB approach has little useful role to play."[28] More recently, in a January 2018 speech, Federal Reserve Vice Chairman for Supervision Randal K. Quarles, noted that "[c]onfusion that results from overly complex regulation does not advance

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[26] *See, e.g.*, 12 C.F.R. 217.10(c)(4) (Federal Reserve), 3.10(c)(4) (OCC), 324.10(c)(4) (FDIC) (applying the SLR to "advanced approaches Board-regulated institutions", "advanced approaches national banks or Federal savings associations" and "advanced approaches FDIC-supervised institutions," respectively).

[27] U.S. Department of the Treasury, A Financial System That Creates Economic Opportunities – Banks and Credit Unions 53 (June 2017) ("**Treasury Report**"). Elsewhere, the Treasury Report implicitly takes aim at the requirement for advanced approaches banks to calculate their risk-based capital ratios using both the standardized approach and the advanced approaches by recommending that "U.S. regulators should also rationalize and improve the risk-based capital regime over time through, for example, reducing redundant calculation approaches . . . ." Treasury Report at 13.

[28] Daniel K. Tarullo, Rethinking the Aims of Prudential Regulation, Speech at the Federal Reserve Bank of Chicago Bank Structure Conference (May 8, 2014).

the goal of a safe system" and listed as one "candidate for simplification" the elimination of the advanced approaches risk-based capital requirements.[29]

In the alternative, if the Agencies maintain the advanced approaches capital requirements and the requirement to reflect AOCI in regulatory capital ratios for Category II firms, the Final Tailoring Rules should further tailor these requirements. With respect to the advanced approaches capital requirements, the Agencies note in the Joint Tailoring Proposal that imposing these requirements on internationally active firms would be consistent with relevant BCBS requirements. However, the BCBS approach to advanced approaches capital requirements allows firms to opt voluntarily into the advanced approaches capital requirements, but would not make these requirements mandatory.

With respect to the requirement to reflect AOCI in a firm's regulatory capital, the Final Tailoring Rules should allow Category II firms to deduct from regulatory capital any unrealized gains and losses on any securities that qualify as HQLAs for purposes of the LCR. As noted above, Northern Trust acknowledges that it would be consistent to subject firms with higher amounts of cross-jurisdictional activity to heightened liquidity requirements and that such requirements could include the LCR, which requires firms to hold minimum amounts of HQLAs. Category II firms required to hold additional HQLAs should not, however, be subjected to greater fluctuations in their regulatory capital ratios associated with reflecting AOCI associated with unrealized gains and losses on HQLA securities – especially because the AOCI requirements do not address the ring-fencing or asset fire sale risks the cross-jurisdictional activity metric is designed to capture.

D. Custody banks should be eligible for reduced LCR and NSFR requirements to reflect the large amount of client deposits a custody bank must hold as part of its business model.

As described in more detail in Section I above, Northern Trust's business lines engage in limited trading activity or other activities that would require substantial amounts of liquidity. The firm's custody banking business generates a large number of cash account deposits on behalf of the firm's custody clients. These are operational deposits that are inherent to the custody banking business model and facilitate the orderly operation of securities markets by providing available funding to settle clients' securities transactions, which allows those clients to meet their investment objectives. As part of this service, Northern Trust provides ancillary operational services for its customers, such as record keeping and accounting services. Moving the entire custody banking client relationship in a period of stress, for example, would therefore be a lengthy process, which in turn minimizes the liquidity risk of the firm's custody banking activities.

The LCR imposes heightened liquidity requirements on firms that maintain deposits as opposed to funding themselves through equity or other regulatory capital or long-dated instruments. A firm's LCR requirements are based on the firm's net cash outflows as calculated under the rule, and

[29] Randal K. Quarles, Early Observations on Improving the Effectiveness of Post-Crisis Regulation, Speech at the Am. Bar Ass'n Banking Law Comm. Annual Meeting 3, 7–8 (Jan. 19, 2018).

deposits (and especially non-retail deposits such as the majority of a custody bank's cash account deposits) increase a firm's net cash outflows, which in turn increases the requirement for the firm to maintain HQLAs. This requirement harms a custody bank's ability to provide loans to clients through its custody banking and other business lines. To the extent that a firm is required to maintain HQLAs on its balance sheet, these assets may – especially in light of the fact that they count, on a non-risk weighted basis, as part of total leverage exposure, the denominator of the SLR – have the effect of crowding out lending to clients, an activity which, in the case of a custody bank, facilitates the orderly operation of the securities market. It would be more productive for the economy and beneficial to clients if custody banks could maintain or increase their ability to extend such credit.

To reflect the inherent deposit-driven nature of a custody bank's balance sheet, Northern Trust requests that any Category II or Category III custody bank[30] be subject to a maximum reduced LCR requirement equal to a specific percentage between (1) the full LCR requirement applicable to Category I GSIBs and (2) the reduced LCR requirement of between 70% and 85% that, as proposed, would apply to a Category III firm with weighted STWF of less than $75 billion – e.g., a 90% LCR requirement.[31] Of course, a Category I custody bank would still be subject to the full LCR, while a Category III custody bank with less than $75 billion of weighted STWF would still be eligible for the reduced LCR requirement of between 70% and 85%.

Imposing a reduced LCR requirement on custody banks would not materially increase the liquidity risk associated with custody banks' balance sheets, as these firms would still be subject to monthly internal liquidity stress testing requirements, liquidity monitoring reporting on Form FR 2052a, and a number of liquidity risk management requirements. As argued in more detail in Section II.B above, such regulatory relief for custody banks would also reflect Section 402 of EGRRCPA, which required the Agencies to tailor the SLR for custody banks in light of the unique nature of the custody banking business model.

For similar reasons as discussed above with respect to the LCR, Category II and Category III custody banks should also be subject to a maximum reduced NSFR requirement (when finalized) equal to a specific percentage between the full NSFR requirement that would apply to Category I GSIBs and the reduced NSFR requirement of between 70% and 85% that would apply to a Category III firm with weighted STWF of less than $75 billion. The NSFR would require firms to maintain a stable funding profile in relation to their assets and off-balance sheet exposures. The rule would assign a factor to each of a firm's funding sources reflecting the relative stability of that funding source when determining whether the firm's funding profile is sufficiently stable in

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[30] The Final Tailoring Rules could apply any exemption or tailoring eligible to "custody banks" as that term is used in this letter, including in this Section II.D and the following Section II.F, to any "custodial bank" as that term is defined in Section 402 of EGRRCPA and any regulations issued by the Agencies to implement this section. *See* EGRRCPA § 402(a) (defining "custodial bank" to mean "any depository institution holding company predominantly engaged in custody, safekeeping, and asset servicing activities, including any insured depository institution subsidiary of such a holding company").

[31] Alternatively, Northern Trust supports the suggestion in BPI's comment letter that the Agencies adjust the calculation custody banks' net cash outflow amount to arrive at an equivalently reduced LCR requirement.

light of its assets and off-balance sheet exposures. In this calculation, deposits, and especially non-retail, non-operational deposits, would receive a lower stability factor than other funding sources, including, for example, regulatory capital issued by the firm and even long-term unsecured wholesale funding. Therefore, to the extent that a firm's business generates deposits – including the operational deposits and non-retail deposits that constitute a significant portion of a custody bank's funding profile – the firm's funding profile would be considered to be less stable under the proposed NSFR. Category II and Category III custody banks, accordingly, should be subject to a maximum reduced NSFR requirement (equivalent in percentage terms to the maximum reduced LCR requirement proposed above) to reflect the inherent deposit-driven nature of the custody banking business.

E. Category II and Category III custody banks should not be required to submit daily FR 2052a reports.

Northern Trust has taken substantial steps to enhance its liquidity monitoring, controls and reporting capabilities and has the capability to produce FR 2052a reports as required under current regulation. However, Northern Trust believes that Category II and Category III custody banks should not be subject to the additional burden of daily FR 2052a reporting on a more granular basis, as it is difficult to see what regulatory purpose would be served by this requirement. First, because all Category II and Category III firms would, under the Tailoring Proposals, be required to calculate the LCR daily, each firm's primary regulator would already have access to a daily snapshot of the firm's liquidity position. Second, because of the relative simplicity of custody banks' funding sources (primarily client cash deposits) and their stability (particularly to the extent they are operational deposits) during periods of macroeconomic stress, daily reporting likely would not show material variations in any event.

As described previously, Northern Trust is not a GSIB, and has a balance sheet that is smaller than many U.S. regional commercial banks. Furthermore, Northern Trust's balance sheet displays significantly less risk than comparably sized non-custody banks, since a majority of Norther Trust's assets are composed of HQLAs, of which a majority are categorized as Level 1 HQLAs, which would experience only a minimal decline in value in the event of financial stress.

A substantial portion of Northern Trust's remaining assets consist of short-term loans, including overdrafts, which are extended to clients in order to facilitate securities settlement, and cash deposits with sub-custodian banks. Northern Trust's custody business balance sheet, unlike the balance sheets of most commercial banks, does not reflect significant maturity transformation activities, i.e., the making of long-dated loans or investments funded primarily by demand deposits, and thus does not present a significant duration or liquidity mismatch. As a result, from a liquidity perspective, Northern Trust's custody business relies primarily on custody-related client cash deposits and does not rely on material amounts of short-term wholesale funding. Northern Trust's experience during the financial crisis of 2007 to 2008 suggests that custody banks' cash account deposit balances not only do not decrease but typically *rise* during periods of macroeconomic stress.

The resilience of Northern Trust's balance sheet under financial stress, together with the lack of reliance on short-term wholesale funding and the predictable liquidity needs of Northern Trust's two primary business lines, demonstrates that the burdens that would be imposed by requiring daily FR 2052a reporting outweigh any benefits of such daily reporting. Northern Trust's balance sheet is not generally susceptible to unpredictable and rapid liquidity movements, meaning that daily FR 2052a reporting would be of marginal usefulness to the Federal Reserve while imposing a material additional burden on Northern Trust.

F. Custody banks should be eligible for a one-day grace period to cure any breach of the firm's SCCL requirements in light of overnight credit custody banks typically extend to clients and sub-custodians to facilitate the smooth orderly operation of the markets.

As a custody bank, Northern Trust typically extends overnight credit to custody clients when the firm settles securities transactions on behalf of a client when the client's cash account balance is insufficient to pay for settlement. In addition, depending on a client's securities settlement activities in various securities markets globally, clients may temporarily have larger than usual cash deposits with Northern Trust (for example, because a securities purchase transaction failed to settle in a local market, thus leaving the client with unused cash in the local settlement currency), with the result that Northern Trust may need to sweep or maintain larger than usual overnight cash deposits with its sub-custodians in those markets. Each such overnight cash deposit represents a credit exposure of Northern Trust to the sub-custodian, which counts against Northern Trust's SCCL limit to that institution.

Extending both of these forms of overnight credit exposure facilitates the orderly operation of the capital markets because, without the extension of this credit, Northern Trust could be required to (i) halt securities transactions in the event of a temporary mismatch between clients' outstanding securities purchase and sale orders that have been processed by counterparties or other securities intermediaries on a particular day (i.e., more securities purchases, which require cash, as processed before securities sales, which generate cash) or (ii) prevent clients from making additional cash deposits to fund securities transactions (or force clients to withdraw certain cash deposits in the event that a client's securities transaction fails and leaves the client with an unexpectedly high cash account balance) as a means of reducing the amount of cash deposits that need to be swept or maintained overnight with a sub-custodian – in either case only because Northern Trust has reached its SCCL limit with respect to the client or sub-custodian.

The final SCCL rule already reflects the unpredictable nature of *intraday* credit that a custody bank (or other institution) may extend to clients or sub-custodians, as well as the crucial role such credit plays to the markets, by exempting intraday credit exposures from the rule's requirements.[32] This exemption does not, however, reflect the similar unpredictability and systemic importance of overnight credit exposures custody banks have to clients or sub-custodians to facilitate the settlement of securities transactions.

[32] 12 C.F.R. § 252.77(a)(2).

Accordingly, Northern Trust requests that, as a custody bank, it should be subject to a tailored version of the SCCL that provides a one-day grace period to cure any breach of the applicable credit limits. Such a grace period would not meaningfully limit the effect of the SCCL rule on any custody bank, as a custody bank could not maintain any ongoing credit exposure in excess of the limits established under the rule. The grace period would, however, allow Northern Trust to continue to extend overnight credit to clients or have overnight credit exposures to sub-custodians in a manner that allows for the uninterrupted operation of the capital markets. Where a client draws on such overnight credit, Northern Trust requires the client to make additional deposits to its cash account or liquidate assets in its securities account in order to repay the overnight extension of credit the following day. Northern Trust's experience indicates that this could be done within the one-day grace period.

G. Any future tailoring proposals, and the Agencies' supervisory and regulatory expectations, should maintain a clear distinction between requirements applicable to Category I U.S. GSIBs and Category II firms.

The Tailoring Proposals include reference to future proposed rules by the Agencies that would tailor firms' capital planning and resolution planning requirements in light of the Tailoring Proposals.[33] Northern Trust requests the opportunity to comment on each of these futures proposals *before* any Final Tailoring Rules are issued, especially considering that Northern Trust would be the only Category II firm and would not receive substantial relief under the Tailoring Proposals as proposed. The firm believes that it would be unfair and would not provide a meaningful opportunity to comment on these future proposals if the Agencies were to finalize the Tailoring Proposals that would categorize Northern Trust as a Category II firm without giving Northern Trust the ability to understand and comment on the extent to which this categorization would subject the firm to any additional or different capital planning and resolution planning requirements.

Regardless of when the Final Tailoring Rules are issued, Northern Trust believes that these proposals – and any supervisory or regulatory expectations under these or other tailoring proposed rules – should maintain the clear division between the regulatory requirements applicable to Category I GSIBs and Category II firms. Given the heightened risks associated with GSIBs, as reflected in these firms' higher GSIB method 1 scores, Northern Trust believes that it would not be appropriate for Category II firms – and especially not a firm with a relatively simple custody bank business model such as Northern Trust – to be subject to quantitatively or qualitatively similar capital planning, resolution planning or other regulatory requirements, guidance, or supervisory or regulatory expectations as a GSIB. Such a result would truly stand on its head the Congressional mandate in EGRRCPA to apply a more tailored and less restrictive regulatory framework to banking organizations with total consolidated assets between $100 billion and $250 billion.

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[33] *See* Federal Reserve Tailoring Proposal at 61,410.

H. The Agencies should remove any legacy reference to a $10 trillion assets under custody threshold.

Prior to the finalization of the GSIB surcharge methodology, the Agencies' rules identified GSIBs as firms that had $700 billion or more in total consolidated assets or $10 trillion or more in assets under custody ("**AUC**"). These thresholds were included in a number of the Agencies' rules and requirements, including certain reporting requirements. In light of the Federal Reserve's proposal to eliminate the $10 trillion AUC threshold as a requirement for the filing of daily liquidity monitoring reports on Form FR 2052,[34] Northern Trust assumes that the Agencies intend to remove any reference to these legacy thresholds from their regulations, especially in light of the proposed new categorization framework. Accordingly, Northern Trust requests that the OCC and FDIC amend their prompt corrective action rules relating to the enhanced SLR requirements for depository institution subsidiaries of GSIBs to replace any reference to institutions that are subsidiaries of a bank holding company that satisfies the $10 trillion AUC threshold with a reference to institutions that are subsidiaries of a Category I firm.[35]

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Northern Trust appreciates the opportunity to comment on this important topic and welcomes the opportunity to discuss the Tailoring Proposals with the Agencies. Please feel free to contact Susan C. Levy, General Counsel, at 312-557-9270, or S. Biff Bowman, Chief Financial Officer, at 312-444-5421, if you have any questions regarding this comment letter.

Sincerely,

Michael O'Grady

President and Chief Executive Officer
Northern Trust Corporation

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[34] Federal Reserve Tailoring Proposal at 61,418 n.78.

[35] *See* 12 C.F.R. §§ 6.4(c)(1)(iv)(B) (OCC), 324.403(b)(1)(vi) (FDIC).