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April 15,2004

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Stteet and Constitution Avenue, NW
Washington, D.C. 20551

Re: Docket No, OP-1182
Policy Statement on Payments System Risk

Dear Ms, Johnson:

We appreciate this opportunity to comment on the notice by the Board of Governors (the Board) of intended changes to the Board's Policy Statement on Payments Systems Risk (PSR Policy). These modifications would revise the Board's PSR Policy to specify that the Reserve Bank will release interest and redemption payments on the Pedwire-eligible securities issues by Government Sponsored Enterprises (GSEs) or international organizations only when the issuer's Federal Reserve account contains funds to cover the amount of the interest and redemption payments to be made as well as provide for the uniform treatment of applying a penalty fee to daylight overdrafts due to general corporate account activity for the same institutions.

Sate Street Corporation (NYSE: STT - News) is the world's leading specialist in providing sophisticated global investors with investment servicing and investment management. With $9.4 trillion in assets under custody and $1.2trillion in assets under management (as of March 31, 2004), State Street is headquartered in Boston, Massachusetts and operates in 24 countries and over 100 markets worldwide.

State Street has historically supported the overall goals of the Board's PSR Policy, and understands the Board's interest in adopting changes to the Policy to both manage risk and to more closely align the treatment of GSEs and international organizations with practices for private issuing and paying agents. We believe that the market will adjust to these changes over time; however, we advocate that such changes should come about gradually so as not to be disruptive to the market and to minimize the possibility of increased systemic risk resulting from an abrupt change in intraday liquidity availability.

Background

From discussions with Board staff, we understand that the amount of intraday liquidity utilized by the GSEs to fund the payments in question averages approximately $18 billion, peaking at $145 billion. While there is no definitive information relative to the disbursement of these funds, we believe that a significant portion is concentrated among a relatively small number of institutions that are active in the clearing business. Given that there are approximately $12 billion in total reserve balances in the Federal Reserve Banks[1] it would seem clear that the receipt of the GSE principle and interest and redemption proceeds early in the business day facilitates the ability to make time sensitive payments and helps to ensure the smooth flow of transaction activity throughout the business day by providing sufficient intraday liquidity at a time when it is most needed. We anticipate that the elimination of this early morning liquidity could create pressure on some institutions' reserve balances resulting in either increased debit cap usage or a shift in the flow of payments to much later in the day.

In reviewing the current processing environment relative to the payments in question, we note that the Federal Reserve Bank provides a payment file to the receiving institutions which contains all US Treasury and GSE payments due that day. It is our understanding that common practice among many of the recipient institutions is to apply these files at or around 9:15 so that the client accounts reflect the proceeds which can then be used to fund payments and other intraday activity. It is contemplated that technology and operational processing changes will be required to accommodate the proposed changes, and these change may include but not be limited to changes in the file structure so as to eliminate the GSE activity and the addition of a new product subcode may be required in order to post these payments later in the day when funding occurs, These changes may potentially have considerable impact on the various downstream systems and processes that currently utilize the information from the existing file. The Board will need to factor in sufficient lead-time to implement the required system changes both within the Federal Reserve System and the affected institutions from a development perspective, a testing perspective, and an implementation perspective.

Additionally, from an industry perspective, it may be necessary to evaluate whether these changes could have an impact on existing posting practices for maturities and interest payments. We understand that client contractual terms and practices, which have been established based upon existing industry standards, may be impacted as a result of the proposed changes.

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[1] H.3. Report, Table 2, "Aggregate Reserves Of Depository Institutions and the Monetary Base." available here: http://www.federalreserve.gov/releases/h3/Current/

Phased-in Approach

Given the impact that this change will have on the industry and given the substantive system changes we envision will be required to support this change, we would advocate for a phased in approach beginning in July 2006.

A phased-in approach has several benefits but must be balanced with whatever system changes are required for the long-term solution. First, a gradual implementation of the proposed changes would allow markets to absorb and replace the liquidity now offered by the current PSR Policy. Second, phased-in implementation would allow issuers to identify and gradually access any necessary alternative sources of finding. Overall, a phased-in approach would accomplish the Board's goals in modifying its PSR Policy with the minimum possible market, systems, and liquidity disruptions, and the lowest systemic risk.

One suggestion for the phased approach would be for the Federal Reserve to utilize product codes in its determination. These product codes could be by issuer and/or security type. This would provide participants in these markets the opportunity to adjust to intraday liquidity changes. It would also allow sufficient time to ensure that my system modifications required can be programmed and sufficiently tested in time to meet the planned 2006 date. Additionally, it would allow time for the Board to determine the impact of the withdrawal of intraday credit as each new product type is introduced and funding is provided by the GSEs.

There has also been some discussion regarding the potential for shifting the posting of principal/interest/redemption payments on a gradual basis so that what currently gets posted today at 9:15 might be posted in the future at 10:15, 11:15 and so on thereby providing a safety net. While we believe from an intraday cash availability perspective, this has merit; it is not clear how feasible this is from a system perspective since we would envision some development required here which may be short-lived.

Industry Consultation

Regardless of the transition approach selected by the Board, the proposed change to the Board's PSR Policy will require considerable system and other changes by issuers, depository institutions, and the Federal Reserve. As discussed above, one potential change would be the ability to apply funded payments on a real time basis, including any downstream systems.

Therefore, we would support the formation of a Task Force preferably under the auspices of the Federal Reserve in order to promote cooperation and transparency to address the implementation of the resulting changes. The participants of such Task Force should be comprised of relevant market participants and work together to develop a conversion plan and an implementation schedule that would address the concerns of all parties involved as well as the various system and operational changes.

Cutoff Hour

State Street is supportive of the establishment of a cutoff hour for funding of the GSE and international organizations accounts similar to what is in place for other issuing and paying agents, such as DTCC which requires that accounts be funded by 2:30 p.m. This would facilitate an orderly end-of-day process and would allow the issuers to make whatever additional credit arrangements might be required in the event of funding gaps. An earlier cutoff time may also minimize the intraday liquidity pressure for recipients of these payments. For this reason we would also support the granting of extensions to the cutoff time, even if they resulted in a later closing time on Fedwire, in the event of significant market disruptions (such as those that occurred during the week of September 11, 2001. The importance of achieving an orderly close and settlement ofow reserve account is a high priority for us.

Ordering of GSE payments

The Policy Statement also indicates that the Federal Reserve will. apply the penalty fee for daylight overdrafts to account holders that do not have regular access to the discount window to the overdrafts incurred by the GSEs for their general corporate payment activity. While we are supportive of the Federal Reserve's desire to treat all account holders uniformly, State Street is conceraed that this change may result in the issuers prioritizing the funding of their general corporate payments to avoid daylight overdraft charges, further delaying their ability to release principle and interest payments, We believe that the establishment of a cutoff hour discussed above would encourage the issuers to address the redemption funding process first and utilize the remainder of the processing day to complete its general corporate payment activity,

We appreciate the opportunity to comment on this proposal.

Very truly yours,
Kathleen K Voigt

Kathleen K. Voigt
Vice President, Funds Flow