



STATE STREET

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Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219
E-mail: regs.comments@occ.treas.gov
Docket ID: OCC-2010-0003

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20051
E-mail: regs.comments@federalreserve.gov
Docket Number: R-1401

Robert E. Feldman, Executive Secretary
Attn: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
E-mail: comments@fdic.gov
RIN Number: 3064-AD70

Notice of Proposed Rulemaking – Alternatives to Credit Ratings for Debt and Securitization Positions in the Market Risk Rules

Dear Sir/Madam:

State Street Corporation (“State Street”) appreciates the opportunity to comment on the Notice of Proposed Rulemaking (“NPR”) issued by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (“the agencies”), on alternatives to the use of credit ratings for debt and securitization positions in the market risk rules.

Headquartered in Boston, Massachusetts, State Street specializes in providing financial services to institutional investors, including investment servicing, investment management and investment research and trading. With \$21.8 trillion in assets under custody and administration and \$1.9 trillion in assets under management, we operate in 29 countries and in more than 100 geographic markets worldwide.¹ State Street is organized as a financial holding company and conducts operations through several entities, primarily its wholly-owned bank subsidiary, State Street Bank and Trust Company.

The NPR seeks to amend the agencies' market risk NPR, published in January 2011. Consistent with Section 939A of the Dodd-Frank Act, the NPR seeks comment on alternative methodologies for calculating specific risk-weighting factors for debt and securitization positions that do not rely on credit ratings. This includes the introduction of a new simplified supervisory formula approach ("SSFA") for securitized assets. Although specific to the market risk rules, the agencies have confirmed that they intend to use similar methodologies when revising their general risk-based capital rules, via one or more subsequent rulemakings.

As reflected in the joint comment letter submitted by the American Bankers Association, the Financial Services Roundtable, the Clearinghouse, the American Securitization Forum and the Securities Industry and Financial Markets Association ("the industry associations"), the treatment of debt and securitization positions in the risk-based capital rules is of substantial concern to the financial services industry. In this respect, we note our broad support for the conclusions drawn by the industry associations, especially on the treatment of securitized assets, and we welcome their suggestions for improving the intended framework. In addition, we would like to offer the following high-level observations.

Overview

Although we welcome the agencies' efforts to identify alternative measures of creditworthiness that do not rely on credit ratings, we are concerned that the SSFA, as proposed, lacks sufficient risk-sensitivity and is therefore likely to significantly overstate the amount of capital required to support securitized assets. With the exception of 'prudently underwritten' residential mortgages (Kg of 4%) and underlying exposures that are explicitly guaranteed by sovereign and related entities, all other categories of securitized assets are assigned a fixed Kg of 8%. Moreover, the minimum capital requirement for asset securitizations under the proposed methodology is 1.6%, or three times the current Basel II Risk-Based Approach ("RBA").

This significant increase in required risk-based capital is likely to have a number of important consequences for financial markets, including a reduction in bank willingness to hold securitized assets, a pronounced decline in relevant asset prices, broad volatility in bank mark-to-market valuations, and a substantial increase in the cost of capital for corporate and financial issuers. In turn, this will translate into higher borrowing costs for

¹ As of December 31, 2011

both consumers and businesses, with substantial negative implications for the US economy.

Given these potential outcomes, we strongly encourage the agencies to undertake a comprehensive quantitative impact study (“QIS”) of the proposed SSFA on bank asset securitization portfolios. Notwithstanding the agencies’ goal of developing a framework that produces capital requirements broadly consistent with the Basel Committee’s standardized measurement approach for specific risk, we believe that a QIS will clearly demonstrate that the SSFA is not capital neutral and is therefore likely to result in elevated levels of required risk-based capital that will, among others, place US banks at a competitive disadvantage.

State Street, in common with other custodial banks, does not engage in substantial commercial lending activities, but instead holds a sizable portfolio of diversified, high-quality assets derived from significant amounts of stable, customer deposits. These assets, including high-quality asset securitizations, are subject to rigorous, ongoing analysis for credit and liquidity quality, as well as an estimation of required economic capital. In our view, the proposed SSFA results in a disproportionate risk-based capital charge for securitized assets that would unjustly penalize this conservative business model. In order to address this concern, we recommend a series of targeted changes to the SSFA, designed to more accurately reflect underlying risk.

Definition of Kg

The proposed use of the existing general risk-based capital rules to determine Kg is highly-risk-insensitive, and fails to accommodate important differences in the credit quality of diverse securitized assets. Moreover, it may have the perverse effect of penalizing banks for holding low-risk tranches of well-performing, stable asset types when compared with riskier positions with higher returns. In order to address this limitation, we recommend the introduction of greater granularity in potential Kg inputs, reflecting both asset class and certain limited credit quality classifications. So as to ensure transparency and ease of use, this might best be accomplished on the basis of a simple, supervisory-specified look-up table, informed by market experience.

Calculation of Cumulative Loss

Although subject to some ambiguity, our understanding of the NPR is that cumulative loss for the purposes of the SSFA is intended to be calculated at the level of the underlying pool as of origination. This has the effect of broadly ignoring asset structure, including varying types of credit enhancements that support securitized assets, such as excess spread, over-collateralization, reserve or capital interest accounts, and external guarantees. By ignoring credit enhancements, the proposed SSFA is likely to generate capital requirements that are not consistent with the riskiness of the securitization position. As a result, we recommend that the calculation of cumulative loss be modified to reflect losses incurred at the level of the securitization as of origination, rather than at the level of the pool. Alternatively, we strongly recommend the introduction of a scaling

factor or other similar methodology, designed to lower cumulative loss in the presence of credit enhancements.

Calibration of the Supervisory Minimum Risk-Weighting Floors

The proposed SSFA incorporates a supervisory prescribed look-up table that assigns a limited number of specific risk-weighting factors to securitized assets on the basis of realized cumulative loss. In our view, the proposed calibration of the intended framework is onerous, including with respect to high-quality securitizations. This is particularly true when combined with our understanding of the definition of cumulative loss, since the prescribed risk-weighting factors will result in the same capital requirements for both more risky junior tranches and much less risky senior positions backed by the same collateral pool. Furthermore, higher floor values escalate very quickly in the intended framework, causing resulting capital to exhibit a pronounced cliff effect, especially in a stressed environment. This may result in unwarranted capital volatility, including in the capital planning process. As a result, we strongly recommend that the agencies consider the introduction of greater granularity in the supervisory look-up table, either by matching the current Basel II RBA or by adjusting the structure to reflect a loss-coverage multiple based approach.

Treatment of Asset Write-downs (Carrying Value)

Although currently proposed in the context of the market risk rules, we are concerned that the intended SSFA does not provide for write-downs which banks may record on securitized assets carried as non-trading assets. If unresolved, this would result in a punitive double-counting of risk-based capital. To address this limitation, we suggest that the SSFA, when proposed in the context of general risk-based capital rules, incorporate provisions allowing banks to adjust attachment and detachment points to account for write downs recorded on securitization positions.

Need for Clarification

There are certain ambiguities in the proposed methodology which in our view would benefit from additional guidance. As an example, it is not clear how to calculate K_g in the presence of a government guarantee, such as those supporting FFELP student loans. This is also true of third party guarantees or credit risk mitigants, such as mono-line or lender mortgage insurance policies. In addition, there is uncertainty as to how the SSFA will accommodate credit enhancements that may increase over the life of an asset, such as in certain revolving securitizations. Finally, guidance is also required regarding the treatment of foreign asset securitizations, where certain events, such as asset write-downs, may be subject to different treatment.

Thank you once again for the opportunity to comment on the important matters raised within this NPR. To summarize, State Street believes that the proposed SSFA framework lacks risk-sensitivity and is therefore likely to result in excessive amounts of required risk-based capital, especially for conservative business models that rely heavily on

investment assets. In order to mitigate this concern, we recommend adjustments to the definition of Kg, changes in the calculation of cumulative loss, the introduction of greater granularity in the supervisory minimum risk-weighting floors, and provisions for the treatment of asset write-downs on non-trading assets. In addition, we make note of certain areas where the intended approach may benefit from further regulatory clarification.

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

Sincerely,

A handwritten signature in black ink, appearing to read 'Stefan M. Gavell', written in a cursive style.

Stefan M. Gavell