STATE STREET.

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

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

RE: Docket Number OP-1309

Policy on Payment Systems Risk – Collateralization of Daylight Overdrafts

Dear Ms. Johnson:

State Street Corporation ("State Street") appreciates the opportunity to comment on the Policy Statement issued by the Board of Governors of the Federal Reserve System ("Board") relative to changes to the rules governing daylight overdrafts within the Federal Reserve ("Fed") payment system. Headquartered in Boston, Massachusetts, State Street specializes in providing institutional investors with investment servicing, investment management and investment research and trading. With $14.9 trillion in assets under custody and $2.0 trillion in assets under management as of March 31, 2008, State Street operates in 26 countries and more than 100 markets worldwide.

State Street was among the respondents to the Board's June 21, 2006 Consultation Paper on Intra-day Liquidity Management and Payment Systems Risk Policy. As noted in our response, we agree that there is an increasing demand for intra-day credit within the Fed payment system, as well as a heavy concentration of late in the day high value payments. We also identified enhanced opportunities to make use of collateral on a voluntary basis to cover daylight overdrafts as an attractive component of a more efficient, liquid and risk sensitive payment system.

State Street is therefore broadly supportive of the Board's proposal to amend its Payment Systems Risk ("PSR") policy so as to encourage the voluntary pledging of collateral to support intra-day credit, including an increase in the fee for uncollateralized intra-day overdrafts to 50 basis points. State Street urges the Board however, to clarify certain practical matters of importance to the industry. This includes the degree of flexibility which financial institutions will have when pledging collateral to the Federal Reserve Bank ("FRB"), as well as envisioned changes to applicable collateral management capabilities. In addition, States Street emphasizes the desirability of an approach which acknowledges the increasingly global nature of the financial system, notably via the ability to use collateral on a fungible, cross-border basis.

In order to facilitate our assessment of the proposal, we have structured our comments around applicable questions posed in Section V of the Consultation Paper.

Question #1 – State Street agrees that the introduction of a zero fee for collateralized daylight overdrafts will help reduce risk within the Fed payment system. State Street also believes that this measure should help reduce the practice at certain institutions, of holding back payments in order to minimize intra-day charges. State Street notes, however, that this measure is unlikely to have any impact upon the late in the day compression of funds. This reflects the predominant impact of other factors in this process, notably the timing of same day trade instructions, the timing of the return of maturity proceeds in certain cash markets, and the late in the day calculation of money market funding.

Question #2 – State Street does not anticipate making substantial changes to its systems and procedures as a result of the Board's proposed policy change. This reflects the overall consistency of the Board's proposal with core elements of the existing PSR policy framework, notably the continued use of both net debit cap and max cap thresholds.

Question #3 – As part of normal day to day business operations, State Street makes regular use of FRB daylight credit and currently maintains sufficient collateral to take advantage of the zero fee option. In order, however, to accommodate our evolving business needs, collateralization levels may from time to time require adjustment, including on a cross-border basis. It is therefore difficult to predict the proportion of our expected average and peak overdrafts which we would seek to collateralize on a forward basis, except to note that we would not envision collateralization levels substantially below 50% of net debit cap. In addition, we would also always aim to fully collateralize our max cap threshold.

Question #4 – State Street does not anticipate that the Board's proposed PSR policy change will have any impact upon our use of intra-day credit. This reflects the nature of our liquidity management strategy, which is designed to ensure the efficient servicing of our clients' needs.

Question #5 – As with any financial institution, State Street anticipates some opportunity cost associated with the pledging of collateral to cover FRB daylight overdrafts since this approach necessarily impacts the availability of collateral for other purposes. This can, however, be partially mitigated via an approach which allows firms to make day to day, real time decisions regarding the allocation of collateral within the Fed payment system. This includes the ability to determine whether to make use of the zero fee option or alternatively, to incur the applicable uncollateralized overdraft charge.

Question #6 – Consistent with our response to Question #5, State Street believes that the Board's proposal will have some impact upon financial market activity. We do not, however, anticipate that this impact will prove substantial, especially if the Board's approach provides firms with sufficient flexibility to manage collateral on a day to day, real time basis.

Question #7 –State Street believes that the Board's proposal will increase the importance of mechanisms which facilitate the efficient management of collateral. This includes the ability to quickly adjust collateral levels in and out of core operational systems. State Street therefore recommends changes to FRB systems which would enable firms to view and adjust collateral positions on a real time basis. Key in this regard are improved on-line reporting and asset transfer capabilities. In addition, State Street recommends enhancements to FRB systems so as to enable the pledging of assets held within other large value settlement systems, notably international central securities depositories. Similarly, State Street recommends that the Board expand the range of assets available for use as collateral. This includes excess reverse repurchase collateral and highly rated non-USD asset backed securities.

Although sensitive to the operational challenges inherent in such an approach, State Street further notes the considerable value of a system which would enable firms to hold and pledge collateral on a centralized basis across key central banks. State Street therefore recommends that the Board, in consultation with other central banks, actively consider the feasibility of such an approach for potential inclusion in a further round of rulemaking.

Question #8 – This question is not applicable to State Street.

Question #9 – State Street does not anticipate any changes relative to the timing of our activity within the Fed payment system. This reflects the nature of our liquidity management strategy which is designed to ensure the efficient servicing of our clients' needs.

Question #10 – State Street does not believe that the Board's proposed PSR policy change will materially impact current practice relative to the early return of securities used in repurchase transactions. This reflects the well-established nature of existing market practice.

Question #11 – State Street believes that the market for the early return of Fed Fund loans has historically been constrained by two factors: uncertainty regarding daylight overdraft needs and the lack of a viable early return incentive. Although the Board's proposal is unlikely to have a substantial impact upon daylight overdraft uncertainty, it is likely to improve the economic basis of the early return market by creating an attractive spread between the cost of a loan and the cost of collateralized daylight overdraft. State Street therefore anticipates that the Board's proposal may have some beneficial impact upon the early return of Fed Funds, including an increase in market participation and a narrowing of applicable spreads.

Question #12 – While we anticipate making extensive use of the zero fee option, there may be instances where it is advisable for State Street to avail itself of the uncollateralized alternative. In such instances, we would anticipate the absorption of higher intra-day overdraft fees as a normal cost of doing business.

Thank you once again for the opportunity to comment on this important matter. To summarize, State Street is broadly supportive of the Board's proposal to encourage the use of collateral to manage intra-day exposure, but believes that it would be useful if clarification were provided on certain practical matters of importance to the industry. This includes the extent to which firms will be able to manage their collateral on a day to day, real time basis and the scope of envisioned changes to FRB collateral management capabilities. In addition, State Street urges the Board to expand opportunities for firms to use collateral on a fungible, cross-border basis. Finally, State Street agrees with the conclusion found in the joint Payments Risk Committee – Wholesale Customer Advisory Group comment letter that a one year implementation timeframe may be feasible, and therefore recommends that the Board work with the industry to implement its proposed policy change on an accelerated basis.

Please do not hesitate to contact me should you have any questions regarding State Street's submission.

Sincerely,

Stefan M. Gavell