BNY MELLON

January 31, 2014

BY ELECTRONIC SUBMISSION

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket No. R-1466

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
FDIC RIN 3064-AE04

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW
Suite 3E-218
Mail Stop 9W-11
Washington, DC 20219
OCC Docket ID OCC-2013-0016

Re: ***Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring; Proposed Rule***

Ladies and Gentlemen:

The Bank of New York Mellon Corporation ("**BNY Mellon**")[1] appreciates the opportunity to comment on the proposed rulemaking, *Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring* (the "**Proposed Rule**"),[2] 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 (collectively, "**the Agencies**"). The Proposed Rule seeks to implement the Basel III liquidity coverage ratio (the "**Basel III LCR**")[3] established by the Basel Committee on Banking Supervision ("**Basel Committee**") for large, internationally active banking organizations, including BNY Mellon. Our role as a global custodian and our

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1 BNY Mellon is a global investments company dedicated to helping its clients manage and service their financial assets throughout the investment lifecycle. BNY Mellon performs investment management and investment services in 35 countries and more than 100 markets. As of September 30, 2013, BNY Mellon had $27.4 trillion in assets under custody and/or administration and $1.53 trillion in assets under management.

2 Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring; Proposed Rule, 78 Fed. Reg. 71,818 (Nov. 29, 2013).

3 Basel Committee on Banking Supervision, *Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools* (Jan. 2013).

deposit-funded business model provides us with a unique perspective on the ways in which the Proposed Rule may impact financial markets and financial participants.

BNY Mellon strongly supports the Agencies' and international efforts "to strengthen liquidity and promote a more resilient financial sector by improving the banking sector's ability to absorb shocks arising from financial and economic stress."[4] We believe the Basel Committee made significant strides in this regard by establishing an LCR that strikes the appropriate balance among historical experiences, conservative estimates of liquidity risk, actual industry practices, and compliance requirements. But the Proposed Rule deviates from the Basel III LCR in significant and unwarranted ways that distort the liquidity risk profiles of banking organizations, especially for a liability-driven custody bank such as BNY Mellon.

This letter addresses four issues that are of particular concern to BNY Mellon.[5] Part I provides background on operational services at BNY Mellon, including the complexities of moving operational deposits to another entity. Part II highlights our concerns regarding the 30-day net cash outflow calculation based on a "peak-day" assumption, and urges the Agencies to develop a methodology that addresses maturity mismatches at the international level following a quantitative analysis. Part III recommends six revisions and clarifications regarding the standards governing "operational deposits" to better align the U.S. rule with the Basel III LCR and to better capture the range of deposits that are "truly operational in nature." Part IV explains that U.S. mutual funds and their foreign equivalents did not significantly draw down committed facilities, and as such, committed facilities provided to investment companies should receive the same outflow rates as committed facilities provided to general corporates. Finally, Part V highlights the compliance complexities of the daily LCR calculation, especially when combined with "peak-day" assumptions, excess amount calculations, and additional changes in the final version of the rule, and urges the Agencies to delay compliance with the daily calculation requirement until at least January 2017 as permitted by the Basel Committee.

Part I: Operational deposits provide a stable, predictable source of funding.

BNY Mellon is one of the largest providers of global custody services, specializing in safekeeping, settlement, asset administration, and trust and banking services provided to institutional investors. BNY Mellon also holds customers' residual cash arising from these services in deposits. These deposits are solely a by-product of the operational services BNY Mellon provides. Unlike many other types of wholesale funding, operational deposits have proven to be stable and predictable over the long term. These highly stable, customer-driven cash liabilities are a central part of custody bank balance sheets and liquidity profiles.

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[4] Proposed Rule, 78 Fed. Reg. at 71,820.

[5] BNY Mellon has additional concerns regarding the Proposed Rule that are explained in industry group letters. *See* Letter from The Clearing House Association, the American Bankers Association, the Securities Industry & Financial Markets Association, the Financial Services Roundtable, the Institute of International Bankers, the International Association of Credit Portfolio Managers, and the Structured Finance Industry Group, to the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance System Re: Liquidity Coverage Ratio (Jan. 31, 2014).

As a general matter, operational deposits are unlikely to run during the sort of 30-day stress period envisioned in the LCR. At least four particular characteristics of our operational services contribute to the long-term, stable nature of operational deposits. First, it is extremely difficult to bifurcate the deposits from the services, and the operational services themselves are very difficult to transfer. Our operational services are specialized, complex, and have few substitutes; the provision of these services is not commoditized. The time and resources required by BNY Mellon and the customer to establish the service relationship significantly reduce the risk that a customer will quickly withdraw its funds or switch to another custodian. For instance, the typical on-boarding process for a BNY Mellon asset servicing relationship requires initial analysis, account set-up, asset/cash transfer, account reconciliation, training, accounting, and performance. This process usually takes more than three months to complete and requires significant investments in technology, platforms, and staff. As a result, the average asset servicing relationship for top BNY Mellon customers is longer than a decade. Even if a customer decides to transition to another custodian, the customer is unlikely to significantly reduce its deposits at BNY Mellon during the transition because cash balances are necessary to support the customer's ongoing, day-to-day operations.

Second, the underlying service relationship is subject to a legally enforceable contract. These contracts generally specify minimum notification periods of at least 30 days to terminate a contract or require the customer to incur significant transition costs. Even after termination, the customer and BNY Mellon must develop and agree to a plan to transition servicing responsibilities and assets to another custodian. Further, many contracts contain strict limits on the use and movement of customer funds. As trustee, for example, BNY Mellon holds deposits for the life of the transactions, which can extend for many years.

Third, the service relationship is often mandated by law. The Investment Company Act of 1940 requires U.S. mutual funds to ensure the proper safekeeping and segregation of fund assets.[6] U.S. mutual funds are also subject to clear rules designed to prevent theft and other instances of fraud.[7] Further, U.S. mutual funds must strike a net asset value ("**NAV**") on a daily basis; mutual funds maintain all of their assets in one place to more efficiently meet these tight daily NAV deadlines. Thus, as a matter of practice, U.S. mutual funds use a single custody bank to maintain centralized oversight and control over day-to-day investments, client subscriptions and redemptions, and other operational functions. Given these legal requirements, it is highly unlikely that a mutual fund customer will quickly move all of its operations to another custodian.

Finally, BNY Mellon has a diverse customer base that helps smooth potential funding shocks arising from a particular customer. Although idiosyncratic stress events affecting a particular fund may lead it to terminate its contract, it is difficult to imagine all fund customers terminating all of their contracts at the same time. Even if this unlikely event were to occur, it would be very operationally challenging for BNY Mellon or any other custody bank to transfer all of these customers' services, cash deposits, and other assets within 30 days. This diverse customer base further contributes to the long-term stability of operational deposits.

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[6] *See* 15 U.S.C. § 80a-17(f).

[7] *See* Investment Company Institution, 2013 Investment Company Fact Book: A Review of Trends and Activities in the U.S. Investment Company Industry Appx. A, 222 (53 ed. 2013), *available at* http://www.icifactbook.org/pdf/2013_factbook.pdf.

Quantitative evidence supports these qualitative factors. There is extensive evidence that operational deposits remain stable, even during times of economic stress. Indeed, deposit data shows that BNY Mellon's deposit base tends to be countercyclical: deposit inflows significantly increased following the Lehman Brothers crisis in 2008 and the U.S. debt ceiling debates.

Part II: Any 30-day net cash outflow methodology addressing maturity mismatches should be developed at the international, Basel Committee level using quantitative data and analysis.

The Basel III LCR requires internationally active banking organizations to maintain an amount of high quality liquid assets ("**HQLA**") that is at least 100 percent of its total net cash outflows over a 30-day period.[8] The Basel III LCR appropriately measures total net cash outflows cumulatively over a 30-day period by using "the total expected cash outflows minus total expected cash inflows in the specified stress scenario for the subsequent 30 calendar days."[9] The Proposed Rule deviates from this methodology and instead calculates the LCR denominator using the "dollar amount on the day within a 30 calendar-day stress period that has the highest amount of net cumulative cash outflows."[10] The Proposed Rule further specifies that a covered company must assume that deposits and other financial commitments without a contractual maturity date run off on the first day of the 30-day period.[11] This approach reflects "the most conservative" estimate by assuming "the earliest possible date for outflows and the latest possible date for inflows,"[12] and essentially grounds the LCR in "peak day" data.

BNY Mellon appreciates the need to "take into account potential maturity mismatches between a covered company's outflows and inflows."[13] We also understand the Agencies' concern that companies should identify a conservative maturity or transaction date for inflows and outflows[14] because they do not necessarily occur on a linear basis, particularly if an institution is under stress. But we would caution that such a measurement methodology should reflect observed, historical experiences and should not distort the liquidity profile of banking organizations. Moreover, such a significant deviation from the Basel III LCR should be made at the international level to avoid arbitrage between different regulatory regimes.

As discussed above, deposits and other commitments with indeterminate maturities, including operational deposits, have not and cannot all been drawn on the first day of a stress scenario. In our experience, customers likely will not draw down all of a committed facility in one day because the customer would suffer severe reputational damage from such a rapid draw down. Moreover, in the "flight to quality" during a crisis, customers are likely to liquidate their assets and deposit cash with their bank rather than withdraw it and place it in a more risky asset. This countercyclical behavior is especially true with respect to custody banks like BNY Mellon. To the extent customers do withdraw their funds, they would maintain at least some

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8 Basel III LCR, at ¶ 22.

9 *Id.* at ¶ 69.

10 Proposed Rule, 78 Fed. Reg. at 71,833.

11 *See id.* at 71,834.

12 *Id.*

13 *Id.* at 71,833.

14 *See id.* at 71,844.

funds at the bank to conduct day-to-day operations during the transition period, as it is extremely difficult to bifurcate cash deposits from operational services.

Further, deposits and other financial commitments cannot all run off on the first day of a stress period because the banking industry simply does not have the operational capacity to make such massive changes in one day. As discussed above, significant time and resources are required to establish and transfer a servicing relationship and the associated deposits. Specific to the custody bank context, even if one assumes that all clients were to withdraw their deposits in one day without transitioning to another custodian, banks are unlikely to have the operational capability and Automated Clearing House networks are unlikely to have the capacity to transfer all of these funds in one day.

Thus, rather than adopt "the most conservative" approach, we urge a more moderate—yet still conservative—approach that better reflects actual historic experience, operational capabilities, and international agreement. We encourage the Agencies to work with the Basel Committee to conduct a quantitative study and analysis to better understand actual outflow rates and operational capabilities during a stress scenario. This quantitative study and analysis should form the basis of any 30-day net cash outflow calculation that addresses maturity mismatches.

Part III: The final rule should better align the criteria and definitions regarding "operational deposits" with the Basel III LCR to avoid excluding a substantial amount of deposits that are "truly operational in nature."

BNY Mellon supports the Basel Committee's and the Agencies' efforts to strengthen global liquidity requirements and to improve the banking industry's ability to absorb liquidity shocks in stress scenarios. It is critical, however, that such efforts be appropriately tailored to reflect the actual liquidity risk of banking organizations. In this regard, we welcomed the Basel Committee's adoption of a 25 percent outflow rate for operational deposits to recognize that operational deposits are more stable and less likely to run than other wholesale deposits. BNY Mellon understands this 25 percent outflow rate to be a conservative estimate of the run-off behavior of operational deposits in a stress event.

The Proposed Rule assigns this conservative, 25 percent outflow rate to operational deposits, but it also deviates from the Basel III LCR in unwarranted ways that significantly narrow the scope of deposits that would qualify as operational. The Agencies reason that the proposed criteria and definitions for operational deposits are intended to be "restrictive" and capture only those deposits that are "truly operational in nature."[15] While BNY Mellon understands the need for appropriately "restrictive" criteria, we believe the proposed deviations from the Basel III LCR would, in practice, exclude a substantial amount of deposits that are "truly operational in nature." If implemented as proposed, this narrow scope of operational deposits would understate the liquidity value of core custody bank deposits.

We believe that the following revisions and clarifications to the U.S. LCR would better capture the range of deposits that are "truly operational in nature," better align with the Basel III LCR, and more accurately reflect the liquidity risk of custody bank deposits:

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[15] *Id.* at 71,841.

- Require operational services, rather than operational deposits, to be subject to a legally binding written agreement;
- Clarify that excess amounts should be calculated on an aggregate basis;
- Exclude only those deposits provided in connection with specifically defined prime brokerage services, rather than broadly exclude all deposits provided in connection with all operational services to all investment companies, non-regulated funds, and investment advisers;
- Clarify that the exclusion for deposits provided in connection with correspondent banking services is limited to the settlement of foreign currency transactions;
- Recognize instances where a bank provides operational services as an agent or administrator, and clarify that a deposit need only be necessary (rather than contractually required) to perform the operational service; and
- Include the administration of investment assets and collateral management services in the enumerated list of operational services, and recognize that such enumerated services may be performed as a trustee.

The following sections describe each of these six recommendations in greater detail.

A. Require a Written Agreement for Operational Services

The Proposed Rule establishes eight criteria for a deposit to qualify as an "operational deposit." The first criterion provides that the "*deposit* must be held pursuant to a legally binding written agreement, the termination of which is subject to a minimum 30 calendar-day notice period or significant termination costs are borne by the customer providing the deposit if a majority of the deposit balance is withdrawn from the operational deposit prior to the end of a 30 calendar-day notice period."[16]

This criterion deviates from the Basel III LCR, which specifies that the "*services*" underlying the deposit must be provided pursuant to a legally binding agreement.[17] The Basel III LCR approach better reflects actual industry practice with regards to custody and investment servicing because operational deposits are simply a by-product of the operational services provided.[18] The deposits are not held independently of the underlying operational service and are not subject to an independent contractual agreement. The provision of an operational deposit account is part of a broader suite of investment services that is governed by a servicing agreement.

Likewise, the criterion should require the customer to bear the switching costs of ending the operational service rather than the costs of withdrawing the deposit. This focus on the operational service provided, rather than the deposit balance, better reflects the true costs of

[16] *Id.* at 71,859 (proposed § __.4(b)(1)) (emphasis added).

[17] *See* Basel III LCR, at ¶ 94 (emphasis added).

[18] *See id.* at ¶¶ 93 & 95.

termination and transfer to a new custodian. A customer's deposit balance is intended to fluctuate in the normal course of business, and there are no "termination costs" associated with this ordinary activity. There are substantial costs, however, when a customer seeks to terminate the broader servicing contract and transfer those servicing relationships to another entity.[19]

To reflect these industry practices, BNY Mellon recommends that section 4(b)(1) of the U.S. LCR rule be revised to state: "*The operational services to which the deposit relates are provided pursuant to a legally binding written agreement, the termination of which is subject to a minimum 30 calendar-day notice period or significant switching costs to be borne by the customer.*"

B. Clarify that Excess Amounts Should be Calculated on an Aggregate Basis

Similar to the Basel III LCR, the Proposed Rule would disqualify any excess deposit balance from the category of operational deposits: "The [BANK] must demonstrate that the deposit is empirically linked to the operational services and that it has a methodology for identifying any excess amount, which must be excluded from the operational deposit amount."[20]

BNY Mellon generally supports this approach, and we urge the Agencies to clarify in the rule text or the preamble that this "demonstration" may be made on an aggregate—and not on a deposit-by-deposit—basis. It is standard industry practice for custody banks to assess the stability and nature of their operational deposits on an aggregate basis, such as by customer type or service category.

C. Exclude Expressly Defined Prime Brokerage Services

The Basel III LCR specifically excludes deposits arising out of correspondent banking and prime brokerage services from the category of operational deposits.[21] In implementing the exclusion for deposits associated with prime brokerage services, the Proposed Rule goes well beyond the Basel III LCR by excluding *all* deposits from *all* operational services provided to *all* investment companies, non-regulated funds, or investment advisers.[22] This sweeping approach is unnecessary and would exclude substantial amounts of deposit balances arising from ordinary operational activities wholly unrelated to prime brokerage services.

By focusing on the type of *customer* rather than the type of *service*, the Proposed Rule assumes that all "such balances, owned by hedge funds and other institutional investors, are at risk of margin and other immediate cash calls in stressed scenarios and have proven to be more volatile during stress periods."[23] The preamble further assumes that "most prime brokerage customers maintain multiple prime brokerage relationships and are able to quickly shift from one covered company to another."[24]

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19 These operational and legal costs are described in greater detail in section I.

20 Proposed Rule, 78 Fed. Reg. at 71,859 (proposed § __.4(b)(6)).

21 Basel III LCR, at ¶ 99 & n. 42. Correspondent banking services are addressed in section III.D.

22 *See* Proposed Rule, 78 Fed. Reg. at 71,859–60 (proposed §__.4(b)(7)).

23 *Id.* at 71,841–42.

24 *Id.* at 71,842.

While BNY Mellon shares the Agencies' concerns regarding the volatility of deposits associated with prime brokerage services, we believe this criterion is based on mistaken assumptions. Instead, we urge the Agencies to exclude only deposits provided in connection with prime brokerage *services* from the category of operational deposits. This approach would be more consistent with the Basel III LCR and would not improperly exclude stable deposits related to operational servicing relationships with mutual funds and their foreign equivalents. Several factors inform this view.

First, custody bank services differ from prime brokerage services in significant ways that materially affect the liquidity profile of the underlying deposit. Prime brokerage involves a package of services where the prime broker finances customer trades executed by the customer with a third party. The customer "maintains its funds and securities in an account with the prime broker," and the prime broker "clears and finances the customer trades executed by one or more registered broker-dealers . . . at the behest of the customer."[25] The prime broker may act as principal, and the prime brokerage agreement gives the prime broker the right to use the customer's assets for its own accounts.[26] Because the prime broker finances customer trades and has a right to make use of the customer's assets, the customer is exposed to and dependent on the solvency of the prime broker.

By contrast, custody banks act as agents on behalf of their customers. Under an ordinary operational services agreement, customer securities are held in a segregated account and are not on the bank's balance sheet. The customer is less exposed to the custody bank during periods of stress because the bank does not have routine access to these customer securities and does not finance customer trades. As a result, customers are unlikely to withdraw deposits held in connection with ordinary operational services. Historical experience supports this stable deposit profile. Indeed, in our experience, operational deposit balances increased during times of stress as mutual funds liquidated their positions to hold cash balances.

Consistent with our experience that the type of service rather than the type of customer drives deposit stability, the Basel Committee and other regulators have defined prime brokerage in terms of the specific services performed. The Basel III LCR defines prime brokerage as "a package of services offered to large active investors," including "clearing, settlement and custody; consolidated reporting; financing (margin, repo or synthetic); securities lending; capital introduction; and risk analytics."[27] The Securities and Exchange Commission has long characterized prime brokerage as a system in which the prime broker "clears and finances" customer trades executed by third parties.[28] The United Kingdom's Financial Conduct Authority and Prudential Regulatory Authority define "prime brokerage services" as "a package of services

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[25] Letter from Brandon Becker, Director of the Division of Market Regulation, Securities and Exchange Commission, to Jeffrey C. Bernstein, Prime Broker Committee, at 2 (Jan. 25, 1994), *available at* http://www.sec.gov/divisions/marketreg/mr-noaction/pbroker012594-out.pdf.

[26] *See* Financial Conduct Authority & Prudential Regulatory Authority Handbook, Glossary (April 2013), *available at* http://www.fshandbook.info/FS/html/handbook/.

[27] Basel III LCR, at ¶ 99 n. 42.

[28] *See* Letter from Brandon Becker, Director of the Division of Market Regulation, Securities and Exchange Commission, to Jeffrey C. Bernstein, Prime Broker Committee, at 2 (Jan. 25, 1994), *available at* http://www.sec.gov/divisions/marketreg/mr-noaction/pbroker012594-out.pdf.

provided under a prime brokerage agreement which gives a prime brokerage firm a right to use safe custody assets for its own accounts."[29]

Consistent with the Basel III LCR and observed customer behavior, the U.S. LCR should expressly define prime brokerage services and exclude deposits in connection with the provision of such services from the scope of operational deposits. To the extent the Agencies have concerns regarding a particular bank's categorization of prime brokerage services, the Agencies should address these concerns through their supervisory powers rather than through a broad rule that unfairly sweeps across all custody bank services.

BNY Mellon recommends that the final U.S. LCR rule define "prime brokerage services" to mean: "*a package of services provided by a [BANK] under a contractual arrangement whereby the [BANK], among other services, clears, settles, carries, and finances transactions entered into by a client with the [BANK] or a third-party entity (such as an executing broker), and where the [BANK] has a right to use assets provided by the client, including in connection with the extension of margin and other similar financing of the client, subject to applicable law*."

Section 4(b)(7) of the final U.S. LCR rule should then state: "*The deposit must not be provided in connection with the [BANK's] provision of prime brokerage services*."

To the extent the Agencies continue to distinguish among different types of customers, the rule should exclude only those customers that actually use prime brokerage services, namely hedge funds and other private funds. Investment companies, such as U.S. mutual funds and their foreign equivalents, should not be included in this category because they do not use prime brokerage services in their ordinary business operations. Mutual funds have little to no need for prime brokerage services because they are subject to strict limits on their ability to borrow funds.[30] By contrast, hedge funds typically are leveraged and use prime brokers to finance their investments. Mutual funds generally have lower-risk investment strategies, whereas hedge funds have higher-risk trading strategies that tend to focus on higher yields and risker alternative assets. Moreover, mutual funds are subject to clear rules governing segregation, custody, and reconciliation of fund assets, and nearly all mutual funds use a bank custodian to meet these requirements.[31] There are also unique fund governance reasons that make mutual fund deposits "sticky," including individual fund board approvals.

Under this alternative approach to exclude prime brokerage deposits, section 4(b)(7) should not include investment companies. Instead it should state: "*The deposit must not be provided in connection with the [BANK]'s provision of operational services to a non-regulated fund or to an investment adviser when managing the assets of a non-regulated fund*."

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[29] Financial Conduct Authority & Prudential Regulatory Authority Handbook, Glossary (April 2013), *available at* http://www.fshandbook.info/FS/html/handbook/.

[30] *See* 15 U.S.C. § 80a-18.

[31] *See* 15 U.S.C. § 80a-17(f); Investment Company Institution, 2013 Investment Company Fact Book: A Review of Trends and Activities in the U.S. Investment Company Industry Appx. A, 222 (53 ed. 2013), *available at* http://www.icifactbook.org/pdf/2013_factbook.pdf.

D. Clarify the Exclusion of Correspondent Banking Deposits

The Basel III LCR specifically excludes deposits arising from certain correspondent banking services from the definition of operational deposits.[32] The Basel III LCR defines correspondent banking as "arrangements under which one bank (correspondent) holds deposits owned by other banks (respondents) and provides payment and other services in order to settle foreign currency transactions (eg so-called nostro and vostro accounts used to settle transactions in a currency other than the domestic currency of the respondent bank for the provision of clearing and settlement of payments)."[33] Thus, the exclusion is limited to instances in which the correspondent bank provides services to settle foreign currency transactions and does not extend to all operational services related to correspondent banking.

The Proposed Rule, by contrast, provides that "deposits must not be for correspondent banking arrangements pursuant to which the [BANK] (as correspondent) holds deposits owned by another depository institution bank (as respondent) and the respondent temporarily places excess funds in an overnight deposit with the [BANK]."[34] This definition of correspondent banking in the Proposed Rule would cover a much broader swath of correspondent banking deposits than the Basel III LCR and would exclude ordinary custody bank deposits from the category of operational deposits. The preamble did not provide an explanation for this deviation. We therefore ask the Agencies to clarify in the rule text or the preamble that, consistent with the Basel III LCR, the exclusion for deposits related to corresponding banking services will be limited to those instances in which the correspondent bank provides services to settle foreign currency transactions.

E. Include Deposits "Necessary" to Provide Operational Services as an "Independent Third-Party Intermediary, Agent, or Administrator"

The Proposed Rule defines "operational deposit" as "unsecured wholesale funding that is required for the [BANK] to provide operational services as an independent third-party intermediary to the wholesale customer or counterparty providing the unsecured wholesale funding."[35]

This definition does not capture the various capacities in which custody banks provide operational services. In addition to providing services as an independent third-party intermediary, custody banks routinely provide operational services as agent and administrator, such as an ERISA plan administrator. An adjustment to the proposed definition of operational deposit to capture these roles would better encompass the range of services provided by custody banks.

Further, we ask the Agencies to clarify that a "required" deposit is one that is "necessary" for the bank to provide operational services, even if the deposit is not contractually required by the agreement. This clarification would better align with actual industry practice. As discussed above, the defining characteristic of an operational deposit is that it is necessary for the bank to

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32 Basel III LCR, at ¶ 99 & n. 42.

33 *Id.*

34 Proposed Rule, 78 Fed. Reg. at 71,860 (proposed § __.4(b)(8)).

35 *Id.* at 71,858 (proposed § __.3) (emphasis added).

provide operational services to the customer.[36] The deposit itself is not subject to a written agreement because it is a by-product of the service.

To better capture these ordinary custody bank deposits that are truly operational in nature, the definition of "operational deposits" should be revised to mean: "*unsecured wholesale funding that is necessary for the [BANK] to provide operational services as an independent third-party intermediary, agent, or administrator to the wholesale customer or counterparty providing the unsecured wholesale funding . . . .*"

F. Recognize Operational Services Provided in a Trustee Capacity, and Include Asset Administration and Collateral Management Services

The Proposed Rule defines "operational services" as a number of enumerated services, provided they are performed as part of "cash management, clearing, or custody services." While BNY Mellon appreciates the scope of the services listed, the proposed definition excludes several activities that are an important part of the suite of operational services provided by custody banks.

Custody banks provide an extensive range of asset administration services as a core part of their business. These administrative services include processing corporate action events and tax reclamations, receiving dividend and other investment income, and other general functions that are not specifically enumerated. The Basel III LCR expressly recognizes these administrative services within the definition of operational deposits.[37] Likewise, custody banks provide collateral management services as part of their general suite of services. This includes the safekeeping and administration of cash and non-cash collateral, the exchange of cash margin, and access to financial market infrastructures. The Basel III LCR likewise recognizes these collateral services.[38]

Additionally, custody banks provide these and other enumerated operational services as trustee, and not just as part of their custody, clearing, and cash management functions. Deposits in connection with BNY Mellon's trustee services have stable deposit profiles just like those in connection with cash management, clearing, and custody services. Corporate trust services, for example, are governed by contracts that limit the use and movements of customer funds. The bank trustee holds deposits for the life of the transactions, which can extend for years. There are also high barriers to exit for corporate trust services, including bondholder approval and a lengthy, expensive on-boarding process. Although the Basel III LCR does not expressly include operational services provided in a trustee capacity, we note that it does recognize that custodial services can "extend to asset and corporate trust servicing."[39]

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[36] *See* Basel III LCR, at ¶¶ 93 & 95.

[37] *See id.* at ¶ 102 ("A custody relationship, in this context, refers to . . . processing of assets or the facilitation of the operational and administrative elements of related activities on behalf of customers in the process of their transacting and retaining financial assets. . . . Also included are the receipt of dividends and other income, client subscriptions and redemptions.").

[38] *See id.* at ¶¶ 101–03 (noting that custodial services include "the transfer of contractual payments, the processing of collateral," and "payment and settlement services").

[39] *Id.* at ¶ 102.

To recognize these additional operational services, BNY Mellon recommends that the final U.S. LCR rule defines "operational services" to mean: "*the following services, provided they are performed as part of cash management, clearing, custody, or trustee services: . . . (12) Administration of investment assets; and (13) Collateral management services*."

Part IV: Mutual funds did not significantly draw down committed facilities, and as such, committed facilities provided to investment companies should receive the same outflow rates as committed facilities provided to non-financial companies.

The Proposed Rule would include the undrawn portion of committed credit and liquidity facilities provided by a bank to its customers that can be drawn down within 30 days of the calculation date.[40] The outflow rates for committed facilities "are meant to reflect the characteristics of each class of customers and counterparties in a stress scenario, as well as the reputational and legal risks covered companies face if they try to restructure a commitment during a crisis to avoid drawdowns by customers."[41] Commitments provided to companies that are not "financial sector companies whose securities are excluded from HQLA" would receive a 10 percent outflow rate for credit facilities and a 30 percent outflow rate for liquidity facilities.[42] Commitments provided to financial sector companies, including investment companies, non-regulated funds, pension funds, and investment advisers, would receive a 40 percent outflow rate for credit facilities and 100 percent for liquidity facilities.[43] The Agencies state that commitments to non-financial sector companies receive lower outflow rates "based on their typically longer-term funding structures and perceived higher credit quality profile in the capital markets, particularly during times of financial stress."[44]

BNY Mellon appreciates the Agencies' efforts to distinguish between different types of facilities and customers, and we support lower outflow rates for commitments provided to companies with historically low draw down rates and higher credit profiles. But we strongly believe that commitments to investment companies should be included in the lower outflow category with general corporates rather than in the higher outflow category with non-regulated funds and other financial companies.

In our experience, mutual funds and their foreign equivalents are unlikely to draw down their facilities, even in times of economic stress. In particular, we did not experience significant draws from mutual fund liquidity lines during the 2008–09 crisis.

Moreover, mutual funds have, or at least are perceived to have, higher credit quality than non-regulated funds and other private financial companies. This is due, in part, to the extensive regulations governing mutual funds. U.S. mutual funds and their foreign equivalents are subject to clear rules limiting their use of borrowed funds. U.S. mutual funds are not permitted to incur debt unless the fund maintains an asset coverage ratio of at least 300 percent,[45] and many

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40 Proposed Rule, 78 Fed. Reg. at 71,863 (proposed § __.32(e)(2)).

41 *Id.* at 71,838.

42 *See id.* at 71,862 (proposed § __.32(e)(1)(iii)).

43 *See id.* (proposed § __.32(e)(1)(v)).

44 *See id.*

45 *See* 15 U.S.C. § 80a-18.

mutual funds voluntarily go beyond these prohibitions to further restrict their ability to issue senior securities or borrow.[46] Retail Undertakings for Collective Investments in Transferable Securities ("**UCITS**") may not borrow more than 10 percent of the fund's net assets.[47] Other types of UCITS are subject to borrowing limits through the fund's investment profile.

Given these factors, the final U.S. LCR rule should assign a 10 percent outflow rate for committed credit facilities and a 30 percent outflow rate for committed liquidity facilities provided to investment companies, consistent with the proposed approach for non-financial sector companies.

Part V: The final rule should delay implementation of the daily LCR calculation until at least January 2017, as permitted by the Basel Committee, to account for the complications of developing and implementing the systems necessary to calculate the LCR.

The Basel III LCR requires internationally active banking organizations to meet 60 percent of the LCR requirement by 2015, increasing by an additional 10 percent over the next four years to meet 100 percent of the LCR requirement by 2019.[48] The Proposed Rule significantly accelerates this timeline to require covered companies to meet 80 percent of the LCR requirement by 2015, increasing by an additional 10 percent over the next two years to meet 100 percent of the LCR requirement by 2017.[49] The Proposed Rule also requires more complicated calculations than the Basel III LCR: covered companies must calculate the LCR on a daily basis at the same time on each business day,[50] and they must assume "the earliest possible date for outflows and the latest possible date for inflows."[51] Covered companies also must make related determinations, such as calculations to distinguish excess amounts from operational deposits. The Agencies state that this accelerated transition period "build[s] on the strong liquidity positions these companies have achieved since the recent financial crisis."[52]

BNY Mellon appreciates the Agencies' recognition of the strong liquidity positions across the banking industry. BNY Mellon also understands and supports the use of daily calculations. But we have significant concerns that the Proposed Rule would halve the amount of time the Basel Committee provided to comply with the LCR while introducing new, more complicated calculation methodologies. The calculation methodologies may change between now and publication of the final rule, which would further reduce the amount of time available to implement systems before the 2015 compliance date.

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[46] *See* Investment Company Institution, 2013 Investment Company Fact Book: A Review of Trends and Activities in the U.S. Investment Company Industry Appx. A, 222 (53 ed. 2013), *available at* http://www.icifactbook.org/pdf/2013_factbook.pdf.

[47] *See* European Council Directive 85/611/EEC on the Coordination of Laws, Regulations, and Administrative Provisions Relating to UCITS Art. 36 (Dec. 20, 1985).

[48] Basel III LCR, at ¶ 10.

[49] Proposed Rule, 78 Fed. Reg. at 71,865 (proposed § __.50).

[50] *Id.* at 71,860 (proposed § __.10(a)).

[51] *Id.*

[52] *Id.* at 71,846.

The daily calculation—especially when combined with peak-day assumptions, excess amount determination, and other calculations—would require banks to develop and implement extensive automated systems and controls across multiple legal entities to gather data, recalibrate data, and calculate ratios.[53] In light of the significant time and resources required to make these operational changes, we urge the Agencies to defer daily reporting until at least January 2017, as permitted by the Basel Committee.[54]

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BNY Mellon appreciates this opportunity to comment on the Agencies' critical work to strengthen liquidity requirements for U.S. banking organizations. We respectfully request that the Agencies consider our recommendations regarding the U.S. LCR to better align it with the Basel III LCR, observed historical experiences, and industry practice. BNY Mellon believes that these recommendations would better reflect the actual liquidity risk profile of custody banks while remaining appropriately conservative.

We would be happy to provide any additional information regarding the views contained in this letter. Should you have any questions, please contact me at (212) 815-4008 or scott.freidenrich@bnymellon.com, or Heather Koenig, our Global Chief Regulatory Counsel, at (212) 635-7399 or heather.koenig@bnymellon.com.

Respectfully submitted,

Scott Freidenrich
Executive Vice President
and Treasurer

[53] We note that these systems, controls, and other operational changes will need to be made in addition to existing efforts to implement the final Basel III capital rules, supplementary leverage ratio, stress testing, resolution planning, the final Volcker Rule, and the forthcoming enhanced prudential standards. The cumulative burden of all these operational changes will require significant time and resources.

[54] *See* Basel Committee on Banking Supervision, *Liquidity Coverage Ratio Disclosure Standards* ¶ 13 (Jan. 2014).