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Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
E-mail: comments@fdic.gov
RIN Number: 3064-AE16

Notice of Proposed Rulemaking – Revisions to the FDIC Deposit Insurance Assessment System

Dear Sir/Madam:

State Street Corporation ("State Street") appreciates the opportunity to comment on the Notice of Proposed Rulemaking ("NPR") issued by the Federal Deposit Insurance Corporation ("FDIC"), revising the deposit insurance assessment system for United States ("US") insured depository institutions ("IDI"). The NPR proposes three broad changes to the existing system: (i) revisions to prescribed capital ratios and ratio thresholds to conform to the prompt corrective action standards foreseen in the final Basel III risk-based capital rules; (ii) changes in the methodology for calculating the custody bank adjustment; and (iii) the measurement of counterparty exposure to derivatives transactions and securities financing transactions ("SFT") by certain highly complex institutions, using the Basel III Standardized Approach.

Headquartered in Boston, Massachusetts, State Street specializes in providing institutional investors with investment servicing, investment management and investment research and trading. With $28.4 trillion in assets under custody and administration and $2.5 trillion in assets under management, State Street operates in 29 countries and in more than 100 geographic markets. State Street is organized as a US bank holding company ("BHC"), with operations conducted through several entities, primarily its wholly-owned bank subsidiary, State Street Bank and Trust Company. State Street has among the highest capital levels in the industry, with a Basel III Advanced Approach Tier 1 common ratio of 12.8% and a *pro forma* Basel III Standardized Approach Tier 1 common ratio of 11.3%. Our US Tier 1 Leverage ratio is 6.9%,

while our *pro forma* Basel III Supplementary Leverage Ratio ("SLR") equals 6.1% at the level of the BHC and 5.8% at the level of the IDI.[1]

Our perspective in respect of the NPR is largely informed by our status as one of the world's largest providers of custody services to institutional investor clients. These clients include asset owners, asset managers and official institutions, and encompass US mutual funds and other similar foreign equivalents; corporate and public retirement plans; sovereign wealth funds; central banks, alternative investment funds, insurance company general and separate accounts; charitable foundations and endowments. Institutional investor clients contract with custody banks, such as State Street, to ensure the proper safekeeping of their investment assets, as well as the provision of a broad range of associated financial services. This includes access to the global settlement infrastructure in order to complete the purchase or sale of investment securities. This also includes various asset servicing and cash management functions, such as the processing of income and other interest payments, tax reclamations, foreign currency transactions, the facilitation of client subscriptions and redemptions and other day-to-day transactional matters.

Consistent with the profile of our institutional investor client base, State Street operates a relatively small number of demand deposit accounts, many of which routinely carry balances well in excess of the FDIC's deposit insurance limit of $250,000 per depositor, or otherwise fall outside of the scope of FDIC insurance coverage (e.g. foreign deposits). Indeed, it is not uncommon for individual institutional investor clients to have balances at State Street well in excess of $10 million. In practical terms, this means that the risk that State Street presents to the FDIC deposit insurance fund ("DIF") in the event of insolvency is extremely low. As an example, as of June 30, 2014, only 0.8% of our total domestic deposit base of $104.7 billion represented insured deposits. This compares with 51.4% of total domestic deposits for all US IDIs and 41.7% for the 37 IDIs with more than $50 billion in total assessable assets.

In view of our specialized business model, custody banks have historically faced disproportionately elevated deposit insurance premiums. It was in response to this concern that the US Congress chose to introduce in Section 331 of the Dodd Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), a custody bank adjustment, designed to mitigate further increases in insurance premiums that would otherwise result from the shift to an asset vs. deposit-based assessment system. More specifically, Section 331 directs the FDIC to provide an adjustment for custodial banks that 'is necessary to establish assessments consistent with the definition of Section 7(b) (1) of the Federal Deposit Insurance Act'. Section 7(b)(1) requires, in turn, the establishment of assessments for each IDI based upon both the probability of a loss to the DIF resulting from that IDI and the likely amount of any such loss. It is the latter requirement that is particularly relevant in the design of the custody bank adjustment, due to the very limited risk of loss that custodial banks present to the DIF. As such, State Street has and continues to support a well-calibrated custody bank adjustment as a

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[1] As of June 30, 2014.

means of ensuring the fair and equitable treatment of specialized custody banks in the apportionment of deposit insurance premiums.

While we acknowledge the importance of conforming FDIC regulation to the revised US Basel III risk-based capital rules, we note that these rules are complex and that they incorporate various standards and thresholds which can impact banking institutions and industry business models in very different ways and which greatly complicate the assessment of changes in prudential regulation. This includes the requirement of Section 171 of the Dodd-Frank Act, also known as the 'Collins Amendment', which mandates the calculation of risk-weighted assets by advanced approach banks using both the standardized and advanced approaches. This also includes the SLR, which establishes a minimum total leverage ratio requirement for advanced approach banks of 3% of Tier 1 Capital, and in the case of the eight US banking organizations designated as global systemically important ("G-SIB"), an enhanced minimum standard ("eSLR") of 5% of Tier 1 Capital at the BHC and 6% at the level of the IDI. Furthermore, US risk-based capital rules are subject to various transition schedules and implementation dates, stretching over a period of three years to January 1, 2018.

As such, we have important reservations regarding changes proposed by the FDIC relative to the calculation of the custody bank adjustment, due to its potential to substantially alter the calibration of existing deposit insurance premiums for custody banks. This is especially true since custody banks do not represent any greater risk to the DIF than when the custody bank adjustment was first implemented in February 2011. In addition, we would like to offer comment on the use of the Basel III standardized approach for the measurement of counterparty exposure to SFT, given its significant implications for banks acting as agent lenders on behalf of their clients. Indeed, we believe that it would be deeply incongruous if the various changes foreseen by the FDIC in its NPR were to result in a material increase in deposit insurance premiums for categories of IDIs, such as specialized custody banks, that represent limited risk to the DIF.

We have participated in the development of the responses submitted by various financial services trade groups, notably the letter from the American Bankers Association, and we generally support the observations and recommendations made therein. Our intention with this letter is to highlight issues of particular concern to State Street resulting from our custody bank business model.

THE CUSTODY BANK ADJUSTMENT

Treatment of Securitized Assets

The FDIC proposes to substantially revise the prevailing custodial bank adjustment by pre-emptively excluding from the assessment base deduction, any asset that represents a securitization exposure. This is based on the general observation that 'these assets are not liquid' and therefore do not reflect a custodial bank's 'need to hold low-risk, liquid assets to

facilitate the payments and processing function associated with its custody and safekeeping accounts'.[2]

We strongly disagree with this approach, which we believe fails to recognize the credit and liquidity value of high-quality securitizations, as well as the asset-liability management practices of custody banks. Simple securitizations are well-established investment structures that facilitate access to consumer and commercial financing, as well as the diversification and management of risk. They represent pooled investment vehicles, backed by various financial assets, such as residential mortgages, credit cards, auto loans, government guaranteed and private student loans and commercial mortgages. Simple securitizations therefore benefit from stable and predictable cash flows, and are fully secured by the underlying loan receivables.

Unlike other highly-rated assets, such as investment grade corporate bonds, simple securitizations benefit from a series of credit enhancements designed to mitigate risk. This includes the use of a 'tranche' structure, characterized by a senior class of securities and one or more subordinated classes that functions as a protective layer, assuming the first loss position in the event of a default on the underlying loan receivables. Securitizations are typically structured with credit enhancements sized to prevent senior bond holders from realizing losses under a scenario that would generate exposures of between three to five times base-case loss assumptions. Senior bond holders are therefore protected from loss in securitizations, unless the loss exceeds the full amount of the subordinated tranches.

Moreover, there are often additional credit protections built into various securitization structures which further insulate senior bond holders from losses. This includes reserve accounts and the collection of interest payments beyond what is immediately due to the bond holders. Similarly, Federal Family Education Loan Program ("FFELP") student loans, which are the dominant securitization structure in the US student loan market, are issued with a US government guarantee covering 97% to 98% of the underlying obligations. Hence, in a scenario in which 100% of the underlying borrowers default on their student loans, FFELP securitizations might not experience even a single dollar of loss.

High-quality securitizations therefore have low and predictable risk-weights. As an example, a representative sample of the senior tranches of securitizations held by State Street encompassing residential mortgage-backed securities ("RMBS"), credit card asset-backed securities ("ABS"), auto loan ABS, FFELP and private student loan ABS and commercial mortgage-backed securities ("CMBS"), generate average risk weight charges under the Simplified Supervisory Formula Approach ("SSFA") of between 20.0% and 23.5%.[3] To the extent that it would be helpful, we are happy to provide the FDIC with a more granular view of this data on a confidential basis.

[2] Federal Deposit Insurance Corporation, Notice of Proposed Rulemaking – Deposit Insurance Assessments, Federal Register Volume 79, Number 141, page 42702.
[3] As of June 30, 2014.

Furthermore, there is growing recognition among supervisory authorities of the importance of high-quality securitizations in the development of robust sources of market-based funding, in support the real economy. As an example, Comptroller of the Currency Thomas Curry noted in a recent speech that 'Securitization markets are an important source of credit to US households, businesses and state and local governments. When properly structured, securitization provides economic benefits that lower the cost of credit'.[4] Similarly, in an April 2014 paper, the Bank of England ("BoE") and the European Central Bank ("ECB") comment that 'Securitizations, if appropriately structured and regulated, can complement other long-term wholesale funding sources for the real economy, including for small and medium-sized enterprises… A particular focus (of the BoE and ECB) is the promotion of simple structures and well identified and transparent underlying asset pools with predictable performance (so-called 'high-quality' securitization), while…impeding the resurgence of the more complex and opaque structures that contributed to the financial crisis'.[5]

Beyond their stable credit profile, high-quality securitizations also benefit from strong liquidity and broad acceptance among institutional investors. This includes banks, insurance companies, broker-dealers, pension funds, regulated mutual funds and alternative investment funds. According to industry data, there are nearly $2 trillion in outstanding ABS and CMBS.[6] This is roughly half the size of the US agency mortgage-backed securities market ("MBS") which, other than a handful of sovereign debt markets, is the most liquid fixed income market in the world. Securitized products, including ABS and CMBS, comprise nearly one-third of the Barclays Aggregate Bond Index by market value, thereby ensuring broad investor participation.

The below table offers information on market size, as well as recent and anticipated issuance for various classes of ABS and CMBS:

Sector	Market Size (Outstanding)	New Issuance 2013	Exp. New Issuance 2014
Auto ABS	$170 billion	$88 billion	$95 billion
Credit Card ABS	$130 billon	$36 billion	$45 billion
Student Loan ABS (FFELP and Private)	$225 billion	$18 billion	$16 billion
CMBS (Multi-Borrower)	$500 billion	$55 billion	$60 billion

In addition, securitizations benefit from robust secondary market liquidity. As an example, average daily trading volumes in the first quarter of 2014 totaled $780 million for auto ABS,

[4] Testimony of Thomas J. Curry, Comptroller of the Currency Before the Committee of Banking Housing and Urban Affairs, United States Senate (February 14, 2013).
[5] 'The Impaired EU Securitization Market: Causes, Roadblocks and How to Deal With Them', Bank of England and the European Central Bank (April 11, 2014).
[6] Financial Industry Regulatory Authority, Trade Reporting and Compliance Engine (TRACE), Q1 2014.

$445 million for credit card ABS, $325 million for private and FFELP student loan ABS and $1.85 billion for CMBS.[7] Moreover, transaction costs in a normal trading environment are modest, with bid-ask spreads ranging from 2 bps to 5 bps. As a result, most high-quality securitizations can be monetized in the private market, either via secured funding or via outright sale, and therefore represent a stable source of structural liquidity. In addition, most high-quality securitizations are eligible collateral in US and other central bank operations, and can therefore be monetized in normal course discount window transactions.

Custody deposits are the primary building block of the custody bank balance sheet, representing the residual operational cash of institutional investor clients resulting from the provision of safekeeping and asset administration services. Custody banks, such as State Street, invest funding derived from custody deposits in a well-diversified portfolio of high-quality and suitably liquid assets, including securitized assets, appropriately matched to the liquidity requirements of their business profile. State Street actively monitors and manages the credit quality and structural liquidity of these investments, using prudent and proven risk management practices. These are closely monitored by our banking regulators and are governed by, among others, Enhanced Prudential Standards SR 10-6, the Interagency Policy Statement on Funding and Liquidity Risk Management.[8] This also includes the assessment of our liquidity needs under both expected and stressed conditions.

As a result, we believe that it is entirely reasonable and appropriate for custody banks, such as State Street, to invest in high-quality securitized assets as an integral part of the safekeeping and asset administration services offered to our institutional investor clients. We therefore strongly recommend that the FDIC adjust its approach by permitting the continued inclusion of securitized assets within the scope of the custody bank adjustment.

Revised Methodology for Securitized Assets

In addition to the disqualification of securitized assets, the FDIC proposes to amend the custody bank adjustment by requiring the use of the Basel III standardized approach when determining in scope assets. We are concerned that even if securitized assets are restored within the custody bank adjustment, moving from the more simplified Basel I approach to the more granular methodology prescribed in the Basel III framework presents important practical challenges that require the use of a revised methodology for determining the assessment base deduction. This is largely a function of the requirements developed by the federal banking agencies to address Section 939A of the Dodd-Frank Act, which prevents the use of or reliance on, credit ratings in US regulation.

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[7] Financial Industry Regulatory Authority, Trade Reporting and Compliance Engine (TRACE), Q1 2014.

[8] Interagency Policy Statement on Funding and Liquidity Risk Management; Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve, Federal Deposit Insurance Corporation, Office of Thrift Supervision and National Credit Union Administration (March 17, 2010).

In the case of securitized assets, this is reflected in the mandatory use of either the gross up approach, or more commonly the SSFA, for determining each asset's individual risk weight. The SSFA is a mathematical equation that requires the use of various data inputs, such as Kg, or the capital charge that the institution would incur if it directly held the underlying assets in the securitization exposure, parameter W, or the value of the underlying securitized assets severely delinquent or in default, attachment point A, or the point in the capital structure where the specific tranche begins to absorb losses, detachment point D, or the point in the capital structure where the specific tranche faces a total loss, and finally parameter P which equals 0.5 for securitization exposures and 1.5 for re-securitization exposures. This approach results in a highly granular assessment of risk, generally calculated to the first decimal point (e.g. 20.5%). Moreover, under the US Basel III standardized approach, securitized assets are subject to a risk-weight floor of 20%.

Hence, while we understand the reasons for the FDIC's decision to adjust its deposit insurance assessment system to reflect the Basel III risk-based capital framework, we believe that the adoption of this more granular standard requires a corresponding adjustment to the design of the custody bank adjustment. As currently constituted, the custody bank adjustment categorizes eligible assets into one of two risk-weight buckets: 0% or 20%. Assets in the 0% bucket can be fully deducted from a custody bank's assessment base, whereas assets in the 20% bucket benefit from a 50% deduction. The custody bank adjustment is capped for eligible institutions by total deposits held in a fiduciary or custodial and safekeeping account. In our view, this approach is insufficient to accommodate the far greater granularity in the US Basel III standardized approach, including for securitized assets.

We therefore recommend that the FDIC consider the introduction of a revised methodology based upon a uniform conversion factor applied to eligible assets. As previously noted, under the current methodology, the 20% risk-weight bucket is assigned an assessment base deduction of 50%, or 2.5x the underlying risk-weight. We recommend that the 2.5 factor be used as the basis for the uniform conversion factor. For instance, a high-quality securitization with a Basel III risk-weight of 22.5% would be assigned an assessment base deduction equal to 43.75%, or 100% minus the product of 22.5 and 2.5. Similarly, a Basel III 30% risk-weighted asset would be assigned an assessment base deduction equal to 25%, or 100% minus the product of 30 and 2.5. Under this approach, the maximum eligible risk weight for assets included in the custody bank adjustment would be 40%, since the product of 40 and 2.5 results in an assessment base deduction of 0%.

This approach can also be used to more accurately reflect the impact of a custody bank's exposure to a qualified central counterparty ("QCCP") or central counterparty ("CCP"), including the posting of initial margin. Indeed, while we welcome and support the decision to incorporate exposures to a QCCP/CCP in the custody bank adjustment, we believe that the use of a 50% assessment base deduction is far too conservative for exposures with risk-weights of either 2% or 4%, thereby failing to create appropriate incentives for the clearing of various financial instruments. In comparison, using our recommended methodology, the exposure of a custody bank to a QCCP would result in an assessment base deduction equal to 95%, or 100% minus the

product of 2 and 2.5. Similarly, exposures to a CCP would result in an assessment base deduction equal to 90%, or 100% minus the product of 4 x 2.5.

There are, in our view, several important advantages to our recommended approach. First, the use of a uniform conversion factor for assets with risk weights from 0% to 40%, results in a far more granular and incremental measure of risk, thereby avoiding the pronounced cliff effect inherent in an approach with only two risk weighted buckets. Second, the use of a uniform conversion factor enables the more equitable assessment of the relative quality of assets held by custody banks as part of a prudently managed and well-diversified investment portfolio. Finally, this approach is likely to further incentivize investments in higher quality assets, without artificially limiting access to the entire spectrum of securitization exposures. We therefore strongly encourage its adoption as part of the reform of the FDIC's deposit insurance assessment system.

Although somewhat less optimal, an alternative approach that the FDIC may wish to consider involves the introduction of a broader range of standardized risk weight buckets, designed to better reflect the granularity of risk weights produced by the SSFA. As an example, one might envision a custody bank adjustment with four rather than two risk-weight buckets, capped at a maximum Basel III risk weight of 50%. These would, in turn, be tied to assessment base deductions ranging from 100% to 25% of total eligible assets.

Revised Methodology without Securitized Assets

Notwithstanding our above recommendation, if the FDIC determines that it is appropriate to fully exclude securitized assets from the scope of the custody bank adjustment, we believe that it is essential for the FDIC to also adjust the existing assessment base deduction for assets in the 20% risk weight bucket. The FDIC justifies the elimination of securitized assets from the scope of the custody bank adjustment due to concerns that such assets are insufficiently liquid. While the use of a 50% deduction for 20% risk-weighted assets may be appropriate based upon the original design of the custody bank adjustment, this would no longer be the case if the framework is revised to exclude securitized assets. Indeed, absent securitized assets, the 20% risk weight bucket would be limited under the Basel III standardized approach to agency MBS, high-quality general obligation municipal bonds and various forms of bank placements, such as collateralized repurchase agreements and covered bonds. Each of these asset types has strong credit risk profiles and robust structural liquidity that warrant more favorable treatment under a revised custody bank adjustment.

In our view, it would be reasonable for the FDIC to adjust the assessment base deduction for 20% risk-weighted assets from 50% to 85%.This treatment is consistent with the core assumptions contained in the global liquidity framework adopted by the Basel Committee on Banking Supervision, which is designed to promote greater stability in bank funding profiles and the more effective management of liquidity risk, by incentivizing banks to hold various

categories of highly liquid assets.[9] This approach would also ensure the more proportional treatment of low-risk exposures to both QCCPs and CCPs. Under this approach, the FDIC's assessment base deduction would be designed as follows:

Risk Weight Bucket	Assessment Base Deduction
0%	100%
< 0% but not more than 20%	85%

MEASUREMENT OF EXPOSURE TO SFT

The FDIC proposes to require large banks meeting the definition of a highly complex institution, to calculate their counterparty exposure for both derivatives transactions and SFT, using the Basel III standardized approach for purposes of two financial measures in the risk-based assessment scorecard. The first is Top 20 Counterparty Exposures vs. Tier 1 Capital and Reserves. The second is Largest Counterparty Exposure vs. Tier 1 Capital and Reserves. According to the FDIC, this is designed to ensure consistency in the measurement of exposures to derivatives transactions and SFT among institutions that may or may not make use of internal models in the measurement of counterparty exposure.

While we acknowledge the value of consistency in various measures of regulatory capital, we have serious reservations regarding the proposed use of the Basel III standardized approach at this time. Notwithstanding the finalization of the US Basel III risk-based capital framework in October 2013, there is broad agreement among global regulators that existing standardized approaches for derivatives transactions and SFT are insufficiently risk sensitive. As an example, the Basel III standardized approach for SFT produces risk exposures for our top 20 counterparties that is more than three times the amount resulting from the prevailing Basel I standard. This reflects substantial limitations in the Basel III haircut-based methodology that results in the dramatic overstatement of credit risk. These limitations include insufficient granularity in volatility factors that do not consider loan tenor, the use of a 10-day liquidation period rather than the regulatory standard of 5 days, the lack of recognition for the correlation between securities placed on loan and securities received as collateral, and insufficient recognition of the risk-mitigating benefit of netting underpinned by a legally enforceable written agreement.

In response to these limitations, active efforts are underway among global regulators to develop appropriate non-model based alternatives. In the case of SFT, this is reflected in the Basel Committee's April 2014 document on the large exposure regime, where it states that 'The Committee is undertaking a review of the standardized approach for credit risk, which includes a review of the Comprehensive Approach used for the measurement of SFT exposures….The Committee's expectation is that the review of the standardized approach will have been completed in advance of the implementation deadline (for the large exposure regime)…but in

[9] Under the US LCR, Level 2A assets are assigned a liquidity value of 85%.

the event of a delay, banks would be allowed to use the (Basel I) method….for calculating their risk-based capital requirements against SFT'.[10] In view of this broad uncertainty, we believe that it would be inappropriate for the FDIC to adopt the Basel III standardized approach for the measurement of exposures to SFT, until completion of efforts to develop and introduce within US regulation an alternative non-models approach. In the interim, we suggest that highly complex institutions be permitted to continue making use of the methodologies prescribed in the prevailing Basel I framework.

The FDIC requests views in its NPR on an alternative approach that would require highly complex institutions to use 'total leverage exposure', as defined in the now final rule on the SLR, when calculating Top 20 Counterparty Exposures vs. Tier 1 Capital and Reserves and Largest Counterparty Exposure vs. Tier 1 Capital and Reserves.[11] We believe that this alternative approach has significant merit. This reflects considerable improvements in the risk sensitivity of the SLR denominator in the final rule, including the ability to net SFT undertaken on a principal basis subject to certain specified conditions, clarification regarding the measurement of exposures to SFT when a banking institution is acting as agent and offers an indemnity or other similar guarantee, and the use of standardized credit conversion factors for exposures to unfunded commitments. This also reflects the reality that highly complex institutions will be required to begin reporting the SLR as of the first quarter of 2015. As such, we urge the FDIC to adopt 'total leverage exposure' for the measurement of counterparty exposure to SFT as an alternative to the Basel III standardized approach, should it conclude that it's not feasible to await finalization of a revised Basel III non-models methodology.

CONCLUSION

Thank you once again for the opportunity to comment on the several matters raised within the NPR. To summarize, we strongly oppose the proposal to pre-emptively exclude securitized assets from the scope of the custody bank adjustment, since this fails to recognize the credit and liquidity value of high-quality securitizations, as well as the asset-liability management practices of custody banks. Furthermore, we recommend the introduction of a more granular methodology for determining the assessment base deduction for custody banks under the Basel III standardized approach, involving the use of a uniform conversion factor for assets, including securitized assets, with risk weights between 0% and 40%.

Still, if the FDIC decides to proceed with the disqualification of securitized assets from the scope of the custody bank adjustment, we urge that it simultaneously increase the assessment base deduction for 20% risk weighted assets (along with exposures to QCCPs/ CCPs) to 85%, in a manner consistent with the Basel Committee's liquidity framework. Finally, we urge the FDIC to

[10] 'Supervisory Framework for Measuring and Controlling Large Exposures', Basel Committee on Banking Supervision (April 2014).

[11] 'Regulatory Capital Rules: Regulatory Capital, Revisions to the Supplementary Leverage Ratio', Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve and the Federal Deposit Insurance Corporation, Final Rule (September 3, 2014).

postpone the introduction of the Basel III standardized approach for the measurement of counterparty exposure to SFT until completion of ongoing work on a revised non-model methodology, or alternatively the use of 'total leverage exposure' as defined for purposes of the SLR.

Please feel free to contact me at smgavell@statestreet.com should you wish to discuss State Street's submission in further detail. We believe that it is essential for the FDIC to carefully consider the implications of its proposed rulemaking on custody banks, and we welcome the opportunity for further engagement relative to our concerns and recommendations.

Sincerely,

Stefan M. Gavell