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Northern Trust

Legal Department

January 3, 2011

VIA E-MAIL: **Comments@FDIC.gov**

Robert E. Feldman
Executive Secretary
ATTN: Comments
FEDERAL DEPOSIT INSURANCE CORPORATION
550 17th Street, NW
Washington, DC 20429

RE: RIN 3064-AD66

Notice of Proposed Rulemaking – Implementation of the Deposit Insurance Assessment Framework

Dear Mr. Feldman:

Northern Trust Corporation ("Northern Trust") appreciates the opportunity to comment on the Notice of Proposed Rulemaking ("NPR") issued by the Federal Deposit Insurance Corporation ("FDIC") regarding changes to the deposit insurance assessment framework for insured depository institutions ("IDI"), including a new assessment base, adjustments to risk-based pricing and a revised assessment rate schedule.

Northern Trust, a financial holding company based in Chicago, Illinois, is a leading provider of investment management, asset and fund administration, banking solutions and fiduciary services for corporations, institutions and affluent individuals worldwide. Northern Trust has offices in 18 states and 16 foreign locations in North America, Europe, the Middle East and the Asia-Pacific region. As of September 30, 2010, Northern Trust had US $3.9 trillion in assets under custody, and US$657.2 billion in assets under investment management.

Northern Trust generally concurs with the comment letter submitted by the Financial Services Roundtable with respect to many of the issues raised in the NPR. However, Northern Trust, as a global custodial bank, believes it is important to comment specifically on aspects of the NPR that deal with the definition of a custodial bank and the methodology proposed to risk-adjust the assessment base for custodial banks to meet the requirements of section 331 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

Section 331 of the Dodd-Frank Act requires the FDIC to amend its regulations to define the term "assessment base" for the purposes of deposit insurance premiums to mean average total consolidated assets minus average tangible equity. In addition, section 331 directs the FDIC to provide an adjustment for custodial banks and banker's banks, consistent with the definition of a risk-based assessment system under section 7(b)(1) of the Federal Deposit Insurance Act.

Northern Trust strongly supports the required custodial bank adjustment, which is mandated by law and is intended to provide for equitable treatment of custody banks under the revised asset-based deposit insurance assessment framework. Without such an adjustment, custodial banks such as Northern Trust would have been required to pay a disproportionately large assessment to the FDIC due to the large amount of low-risk balance sheet assets derived from our global custody business. We note, in this respect, that even under the current deposit insurance assessment framework, custody banks such as Northern Trust pay a disproportionate share of total industry premiums. Unless adequate provisions are made when implementing section 331, custody banks will be even further disadvantaged, with an increase in deposit insurance premiums far in excess of the risk that they pose to the DIF and disproportionate when compared with other large IDIs. This result clearly is not consistent with Congressional intent.

Northern Trust therefore urges the implementation of an adjustment for custodial banks that helps ensure their proportionate treatment under the revised deposit insurance assessment framework. In our view, the clearest and most logical way to structure a custody bank adjustment is on the basis of liabilities, such as custodial deposits, directly linked to the custody business model. However, since section 331 places the focus on assets, we agree that it is reasonable to define the custody bank adjustment on the basis of high quality liquid assets. Although we welcome the general direction of the FDIC's approach, for the reasons set forth in this letter we believe that the proposed 30-day maturity requirement for high-quality assets, if adopted in the final rule, will continue to place a disproportionate cost on custodial banks that is inconsistent with Congressional intent and the risk profile of custodial banks.

Defining a Custodial Bank

The FDIC proposes to adopt a definition based on assets under custody of at least $50 billion or revenues from custody of more than 50% of total revenue. Except as set forth below, Northern Trust does not object to this definition, but as the FDIC acknowledges in the NPR, the definition will include many banks that are not perceived generally as "custody banks" because their respective custody businesses are relatively small in relation to their total businesses both in terms of assets and revenues. Moreover, it will be necessary for the FDIC to provide further clarity as to how "custody and safekeeping assets" and "total revenue from custody" will be measured based on objective and consistent criteria. Preferably this data would be taken from line items in the FFIEC Consolidated Report of Condition and Income ("Call Report"). Schedule RCT lines 9 and 10 appear to be the appropriate place for banks to report assets held in custody or safekeeping.

Northern Trust does not concur with the FDIC proposal to exclude fiduciary accounts from custody and safekeeping accounts on the basis that "custodial activity associated with them…is incidental to the fiduciary business and represents a small fraction of the income realized from these accounts." This issue is not material to the definition of a custodial bank, but if it is meant to carry over to the calculation of custody and safekeeping deposits on the balance sheet for calculating the assessment adjustment, the issue is very material and the reason set out in the NPR for exclusion of fiduciary accounts is not accurate. In the vast majority of cases in which an IDI is a fiduciary, the IDI also has custody of the assets. For example, an IDI may be appointed a trustee under ERISA rules for a pension trust, or may be appointed a trustee under a Delaware statutory trust (or a trust established under another applicable law), or may be appointed a trustee under an offshore collective investment trust. In each of these cases the fiduciary appointment is essentially a "directed trustee" function that is ancillary to the custody or safekeeping activity, and most of the income is generated from the custodial activity and not the fiduciary activity. It has been our experience that, when the IDI is appointed as an investment manager, income from that function exceeds income from the custody function; however, as an IDI with one of the largest fiduciary businesses in the U.S., it is not our experience that an IDI is significantly compensated specifically for acting as a fiduciary.

There does not appear to be any requirement or justification for the FDIC to exclude assets held in a custodial or safekeeping capacity from the calculation just because the IDI may also be acting in a fiduciary capacity (nor does there appear to be any reason to base the determination on percentage of income derived from the different activities). Moreover, such an exclusion, if it applies to the assessment base calculation, would result in custodial banks being unable to include a large amount of custody and safekeeping deposits just because the custody bank also acts as a fiduciary. This result would seriously diminish the benefit of the proposed adjustment for custody banks and would frustrate Congressional intent with respect to the adjustment. We therefore recommend that the FDIC permit a bank to include all deposits held in a custody or safekeeping account in its daily average value of deposits identified by the institution as being held in a custody and safekeeping account, whether or not the bank is also acting as a fiduciary.

Assessment Base Calculation for Custodial Banks

The FDIC proposal concerning the assets that may be excluded from the assessment base is linked to two criteria: (1) the daily average value of highly liquid, short-term assets, and (2) the daily average value of deposits identified as being held in a custody and safekeeping account.

Northern Trust agrees with the FDIC proposal to include only high quality liquid assets as one element of the assessment adjustment calculation. We concur that all assets with a Basel risk weighting of 20% or less should qualify as high quality liquid assets. Custodial banks typically invest deposits received from custody clients in high quality liquid assets and a Basel risk weighting of 20% or less is consistent with Northern Trust's investment practices. Northern Trust also concurs that it is reasonable to limit the exclusion to the value of deposits identified by the institution as being held in a custody and safekeeping account. We note that currently there is not a line item in the Call Report for deposits related to custody and safekeeping accounts, and that the FDIC will probably have to revise the Call Report to include an item for such deposits.

For the reasons stated above, a bank should be permitted to include deposits related to custody and safekeeping if the bank also acts as a fiduciary for the account.

Northern Trust does not believe the FDIC should impose a requirement that the assets also have a stated maturity of 30 days or less. That requirement is not consistent with the investment practices and risk profile of custodial banks with respect to custodial deposits received, it will significantly reduce the amount of assets that may be used for the assessment adjustment by custodial banks, and will frustrate Congressional intent to provide an appropriate adjustment for custodial banks. In fact, a maturity limitation will benefit primarily the very large IDIs that have much larger amounts of short term assets to support their other business activities relative to custody deposits.

As an initial matter, we note that the balance sheets of custody banks such as Northern Trust are largely funded by custodial deposits which originate from the assets of institutional collective investment funds such as mutual funds and other similar regulated investment products, corporate and public retirement plans, insurance companies, endowments and foundations. Collective investment funds are created for the purpose of managing assets on behalf of their beneficiaries and therefore maintain an active operational relationship with their custodian banks. This includes the management of day-to-day investment related activities, the maintenance of liquidity to cover certain routine administrative functions and the management of cash balances.

Although custodial deposits are not contractual, the underlying relationship between the custodian and the institutional client is governed by contract. This is unique to the custody industry and includes specific provisions regarding the termination of the relationship and the migration of assets to another custodial entity. Consistent with these operational dependencies, detailed statistical analysis demonstrates that a substantial proportion of custodial deposits reflect the characteristics of core, stable funding with material durations far in excess of 30 days. To the extent that client needs require a bank to reduce the level of deposits related to custody accounts, the high quality investments can easily be liquidated prior to their stated maturity to fund deposit repayments.

In fact, the behavior of custodial deposits has historically been more closely aligned with retail deposits than with traditional sources of wholesale funding. As such, although custody banks do rely extensively on high quality liquid assets, there is no compelling operational or business reason for these assets to be primarily short term in nature. Indeed, prudent liquidity management allows the efficient matching of assets and liabilities over a time horizon well in excess of 30 days.

Northern Trust therefore recommends that the FDIC revise its envisioned custodial bank adjustment to eliminate the 30-day maturity requirement for high quality assets. There are, in our view, several important advantages to this approach. First, we believe that it more closely aligns with Congressional intent to ensure the equitable treatment of custodial banks, by limiting the potential exponential increase in deposit insurance premiums. Indeed, without this broader definition of high quality liquid assets, custody banks will face a significant increase in deposit insurance premiums, well in excess of their risk profile and potential exposure to the DIF.

Similarly, this approach also better reflects the underlying characteristics of high quality liquid assets. According to the Basel Committee, high quality liquid assets are characterized by low credit and market risk, ease and certainty of valuation, low correlation with risky assets, accessibility via well-established trading mechanisms and eligibility as central bank collateral.[1] We strongly support this view, and note that balance sheet assets reported by banks on lines 34, 35, 36 and 37 of Call Report Schedule RC-R with a Basel risk-weight of 20% or less regardless of term to maturity, broadly meet this definition.

Third, this approach would help address a potentially troubling unintended consequence of the FDIC's envisioned approach, namely the more favorable treatment under the rule of certain very large IDI's when compared with more specialized custody banks. This reflects the size of the balance sheets of certain very large IDI's relative to the extent of their custody bank operations, as opposed to specialized custody banks with a much greater relative proportion of assets under custody. Indeed, whereas specialized custody banks will typically have ratios of assets under custody to total assets well in excess of 30, other very large IDI's that fall within the proposed definition of a custodial bank may have ratios in the single digits.

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[1] Basel Committee Consultative Document, "International Framework for Liquidity Risk Measurement, Standards and Monitoring" (December 2009)

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As such, these very large IDI's are likely to be able to fully deduct assets that meet the FDIC's fairly narrow definition of high quality liquid asset, up to the value of deposits held within custody or safekeeping account, whereas specialized custodial banks with much smaller balance sheets will only be able to benefit from a small portion of their custody related activities. By prudently adjusting the scope of its intended definition, the FDIC can in our view effectively address this inconsistency, without any material reduction in its overall revenue expectations. This stems from the impact of the accompanying deposit-based cap, which effectively precludes any IDI currently benefiting in full from the narrower definition of high quality liquid assets, from obtaining any further deposit insurance relief.

Finally, we note that our suggested approach has the advantage of being fully aligned with information currently provided to the FDIC via the existing Call Report. As such, the impact of the proposed rule on financial reporting is likely to be minimal, thereby helping to facilitate timely industry implementation.

Thank you once again for the opportunity to comment on the important matters raised within this NPR. To summarize, Northern Trust strongly supports the implementation of an adjustment to the revised deposit insurance assessment framework to ensure the equitable treatment of custodial banks. While we believe that the most effective way to structure such an adjustment is on the basis of liabilities, such as custody deposits directly linked to the custody business model, we recognize the value of an approach predicated on the exclusion of high quality liquid assets up to the amount of assets held in custody accounts. However, we oppose the proposed exclusion of custody accounts for which the custodian also has fiduciary duties and the 30-day maturity limitation for high-quality assets as being both unnecessary and contrary to the intended outcome of the section 331 assessment adjustment for custodial banks.

Please feel free to contact the undersigned should you wish to discuss our submission in greater detail.

Sincerely,

James Roselle

James Roselle
Associate General Counsel