Stefan M. Gavell
Executive Vice President and Head of
Regulatory and Industry Affairs

State Street Corporation
State Street Financial Center
One Lincoln Street
Boston, MA 02111-2900

Telephone: 617.664.8673
Facsimile: 617.664.4270
smgavell@statestreet.com

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 FDIC Deposit Insurance Assessment Framework

Dear Mr. Feldman:

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") implementing changes to the deposit insurance assessment base, as mandated by Section 331 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

Headquartered in Boston, Massachusetts, State Street specializes in providing financial services to institutional investors, including investment servicing, investment management and investment research and trading. With $20.2 trillion in assets under custody and administration, as well as $1.9 trillion in assets under management, we are one of the world's largest custody banks, operating in 25 countries and in more than 100 markets worldwide.[1] State Street is organized as a financial holding company, with operations conducted through several entities, primarily our wholly-owned bank subsidiary, State Street Bank and Trust Company.

Section 331 of the Dodd-Frank Act requires the FDIC to adopt an asset-based deposit insurance assessment framework, but also recognizes the inappropriateness of this approach for specialized custodial banks, and therefore requires the FDIC to adopt a custodial bank adjustment to ensure a FDIC premium more reflective of the risks such banks pose to the Deposit Insurance Fund ("DIF").

[1] State Street Corporation - as of September 30, 2010

Our comments today are premised on the FDIC's general conceptual approach to the custodial bank adjustment, as articulated in the NPR, which suggests providing an additional deduction from the assessment base for assets linked to the provision of custodial service. While this approach, if properly formulated, could result in deposit insurance premiums for custody banks consistent with the risks they pose to the DIF, the conditions proposed in the NPR --- particularly limiting the adjustment to assets with stated maturities of 30-days or less --- are inconsistent with the asset-liability management practices of custodial banks and diverge significantly from other regulatory standards for liquidity.

As a result, the NPR, if finalized in its current form, will result in significantly increased premiums for custody banks (up to triple current premiums), far beyond levels suggested by any reasonable estimate of the risk such banks pose to the DIF --- and falling considerably short of meeting the requirement mandated by Congress under Section 331 of the Dodd-Frank Act.

Our comments today describe:

- The purpose of the custodial bank adjustment and Congressional intent;
- The level of assessments paid by State Street, under both the current and proposed systems;
- The nature of a custodial bank's deposits, which result in the disproportionate premiums paid by such banks under both the current and proposed systems, and which necessitate the Congressionally-mandated adjustment;
- Custodial bank asset-liability management practices, which determine the types of assets suitable for investment of custodial deposits;
- Reasons why the FDIC's proposed 30-day maturity limitation is unsuitable for the custodial bank adjustment;
- Our concerns with the FDIC's proposed distinction between deposits resulting from "fiduciary" and "custody and safekeeping" accounts; and
- Our concerns with potential application of the new assessment base to Financing Corporation ("FICO") premiums.

We conclude our comments with recommended modifications to the FDIC's approach, largely focused on eliminating the proposed 30-day maturity limitation from the definition of high quality liquid assets, eligible for the custodial bank adjustment.

Purpose of the Custodial Bank Adjustment

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. Section 331 also directs the FDIC to provide a custodial bank adjustment, which Congress determined was necessary to ensure equitable treatment of such banks, which, due to their unique business model, would otherwise be assessed deposit insurance premiums at levels significantly overstating their risk to the DIF.

Congressman Luis Gutierrez (D-IL), the sponsor of the amendment which became Section 331, confirmed the purpose of the custodial bank adjustment in comments on the floor of the House of Representatives. On December 11, 2009, in reference to the addition of a custodial bank adjustment to the House legislation, Mr. Gutierrez stated:

"Chairman Frank, while I continue to strongly support the amendment that I offered during the Financial Services Committee markup changing the assessment base for FDIC deposit insurance funds payments from domestic deposits to total assets less tangible equity, it has come to my attention that the change adopted by the Committee may result in disproportionate impacts on certain types of specialized banks, including custodians and bankers' banks.

A provision you included in the manager's amendment would address this issue and require the FDIC to make appropriate adjustments to the assessment base for custodians and bankers' banks. The FDIC has advised my staff that the revised version of this provision will give the agency sufficient flexibility.

I appreciate your willingness to accept this change to address the legitimate issues raised by the specialized business models of custodians and bankers' banks."

Section 331 of the Dodd-Frank Act as eventually enacted into law, directs the FDIC to provide an adjustment for custodial banks that will result in assessments consistent with the definition of a risk-based assessment system under Section 7(b)(1) of the Federal Deposit Insurance Act ("FDI Act"). Under Section 7(b)(1), the FDIC is required to establish assessments for each insured institution based on both the probability of a DIF loss with respect to that institution and the likely amount of such a loss. The latter requirement --- that assessments reflect the likely amount of a loss --- is particularly relevant to custodial banks, due to their institutional investor client base and unique liability profile, largely consisting of operationally-linked custodial deposit accounts.

State Street's FDIC Assessments

State Street and other custody banks operate a relatively small number of large deposit accounts, many of which routinely carry balances well in excess of the FDIC's base deposit insurance coverage of $250,000[2], or otherwise fall outside of the scope of FDIC insurance coverage (such as foreign deposits). As a result, the potential losses to insured depositors, and therefore the DIF, that could result from the failure of an institution such as State Street would be very small, compared to domestic deposits, total deposits or total assets.

The current, pre-Dodd-Frank Act, assessment base, essentially domestic deposits, already results in disproportionately high FDIC premiums for State Street and other custody banks. In State Street's case, for example, we report insured deposits under the current system of just under $1 billion, or approximately 5% of our assessable domestic deposit base of just over $20 billion. This compares to, for example, a ratio of approximately 50% for a representative very large, diversified bank holding company, over 75% for a representative regional bank, and over 90% for a representative smaller institution. As a result, State Street, and other similar custodial banks, already pay FDIC premiums well beyond the risk that they present to the DIF.

[2] For purposes of this discussion, we do not reflect either previous or current temporary unlimited deposit insurance programs for transaction accounts, but base the analysis on the permanent $250K insured deposit limit. The Dodd-Frank Act creates a temporary (2-year) program providing unlimited deposit insurance for non-interest bearing transaction accounts, which will temporarily provide additional potential deposit insurance coverage to custodial banks. We note that State Street chose to opt out of the FDIC's previous similar unlimited deposit insurance program (the TAG program).

Absent a suitable custodial bank adjustment, the Dodd-Frank Act mandated change to the assessment base would further amplify the disparity between custody bank premiums and the risk posed to the DIF, contrary to the principles of the risk-based assessment system under Section 7(b)(1) of the FDI Act. Under both the existing risk-based assessment methodology, and the proposed new "scorecard" system for large or highly complex banks, State Street receives a very favorable rating, reflecting the low-risk to the DIF of its core custody business and the conservative nature of its asset-liability management. Nevertheless, on a pro-forma basis, we anticipate that under the new asset-based assessment framework, even giving effect to the FDIC's proposed custodial bank adjustment, our deposit insurance assessment will increase up to three-fold. While the FDIC has not released detailed data describing the bank-by-bank impact of the proposed assessment base change, this near tripling of State Street's assessment is considerably higher than the approximately 15% shift in overall burden to larger (over $10 billion in assets) banks publicly described by FDIC officials.

As measured against either total assets (approximately $150 billion) or total deposits (over $100 billion), the risk posed to the DIF by State Street's $1 billion in insured deposits is extremely low. We estimate that State Street's deposit insurance premium would approximate 900 basis points of insured deposits --- an extraordinarily high insurance premium by any measure, but particularly for an institution which, as confirmed by the FDIC's proposed "scorecard" methodology, presents very low risk to the DIF.

Custodial Bank Deposits

The custodial services provided to institutional investor clients by State Street and other specialized custody banks results in balance sheet liabilities largely comprised of custody deposits. These deposits originate primarily from assets held on behalf of mutual funds and other similar regulated investment funds, pension funds, corporate and public retirement plans, insurance companies, endowments and foundations. This substantial or, in the case of State Street, almost exclusive proportion of deposits from institutional clients is a distinguishing feature of custodial banks. The institutional and custodial nature of our deposit base also results in average account balances that are well in excess of the FDIC's core deposit insurance coverage. It is not unusual for individual institutional client accounts to have balances at State Street well in excess of $10 million.

Institutional clients rely upon a careful credit evaluation when selecting a custodial bank rather than reliance upon the FDIC's insurance program, which would in any case be insufficient to cover the vast majority of balances held in custodial accounts. While custodial deposits are by definition available at any time for withdrawal by the customer, the nature of the custodial relationship results in an aggregate deposit base that is quite stable over time, even during periods of general market disruption. The aggregate "stickiness" of these deposits permits in turn the asset-liability management practices followed by custodial banks.

Institutional investor clients maintain deposit balances with their custodial banks for a variety of reasons, including:

- day to day investment-related activity, such as the buying and selling of securities;
- short-term cash holdings pending reinvestment or other use;
- execution of foreign currency transactions;
- the receipt and distribution of dividends and the processing of corporate actions;
- payment of investment-related expenses; and

- liquidity to cover client subscriptions and redemptions, differences in redemption vs. securities settlement cycles and unadvised movements of cash.

These operational needs are regular and predicable and result in our institutional investor clients maintaining a reliable level of deposit balances. In addition, since the use of cash deposits is broadly linked to the operational needs of the portfolio under custody, operational efficiency encourages the maintenance of these deposits with the custodial bank rather than with another financial institution. The underlying relationship between the custodian and the institutional investor client is governed by contract, including specific provisions regarding the termination of the custodial relationship and the migration of assets to another custodial entity.

Custodial contracts incorporate specific minimum notification periods for termination, which can range anywhere from 30 days to one year. Even after such notification, the eventual transfer of assets can be quite complex and time-consuming, including the initiation of a parallel period of shadow accounting and the progressive migration of relevant financial data. Transfers of custodial relationships can take anywhere from six months to several years to complete. Most importantly, throughout this transitional period, institutional investor clients are unlikely to reduce their existing transactional balances, since these are necessary to ensure both continued investment activity and overall operational stability.

Consistent with these operational dependencies, statistical analysis demonstrates that a substantial proportion of custodial deposits reflect the characteristics of core, stable funding, with average durations of several years. In fact, the effective duration of State Street's custodial deposits has historically been more closely aligned with retail deposits than with traditional wholesale funding. The recently released "Basel III International Framework for liquidity risk measurement, standards and monitoring," ("Basel Liquidity Paper") supports this view, assuming a run-off factor in times of stress for custodial deposits resulting from operational relationships of 25%, considerably lower than the 100% rate assigned to traditional wholesale funding.

State Street's own experience during the financial crisis was that custodial deposits increased, at times substantially, when market fears surfaced, supporting the contention that custody deposits are a stable source of funding. At December 31, 2008, our custodial deposits were $110.7 billion, compared to $83.1 billion at December 31, 2007 and $88.7 billion at December 31, 2009.

Custodial Bank Asset-Liability Management

In State Street's view, the most direct and appropriate balance sheet measure of custodial bank activity is custody deposits. These custody deposits reflect the on-balance sheet impact of providing custody services, can be easily measured and reported to the FDIC for purposes of the custodial bank adjustment, and would be consistent with the requirements of Section 331 of the Dodd-Frank Act.

We understand, however, that the FDIC may prefer to develop a custodial bank adjustment based on balance sheet assets. While we believe that a custodial bank adjustment based on custody deposits would more closely align with Congressional intent, the FDIC's asset-based custodial bank adjustment is acceptable in principle, but requires modification to reflect the nature of the assets held by custody banks.

Custody banks invest funding derived from custodial deposits in a portfolio of high quality, diversified, and suitably liquid assets, appropriately matched to the liquidity requirements of the underlying business model. While the profile of a custody bank's balance sheet may differ somewhat from that of a commercial bank --- typically with larger securities portfolios and very low, if any, loan portfolios --- there is nothing unique about the assets purchased by a custodial bank, other than their funding source, namely custody deposits.

State Street and other custody banks actively manage and monitor the quality and liquidity of this asset pool, using prudent risk management practices to protect shareholders, depositors, customers, and, ultimately, the DIF. State Street's asset-liquidity management practices are closely monitored by our regulators, and are consistent with the Interagency Policy Statement on Funding and Liquidity Risk Management.[3] This includes the monitoring of our liquidity needs under both expected and stress conditions. It is noteworthy that this Policy Statement does not prescribe a maturity limit on liquid assets, and explicitly contemplates banks relying on liquidity in times of stress through the pledging of high-quality, unencumbered assets in repurchase or other similar arrangements.

<u>The FDIC's Proposed 30-day Maturity Limitation</u>

An asset-based measure of custodial activity should properly focus on the particular characteristics of assets funded by custody deposits. The FDIC's proposal to limit the custodial bank adjustment to assets with stated maturities of 30-days or less fails to meet this test, for two reasons.

First, the assumption that the custodial bank adjustment should only be available "in recognition of the bank's need to hold liquid assets to facilitate the payments and processing function associated with custody and safekeeping accounts" suggests an overly narrow focus on short-term liquidity, and does not reflect the relatively long effective duration of custody deposits, and the need to manage the asset-liability function to minimize interest rate risk.

Although custodial banks do rely extensively on high quality liquid assets to manage their liabilities, there is no compelling operational or business reason for these assets to be limited to those which are short term in nature. To the contrary, prudent liquidity and interest rate risk management requires a portfolio with assets spread over a time horizon well in excess of the proposed 30-day limit. Assuming a maturity limit of 30-days on liquid assets could hinder the ability of custody banks to align the liquidity of assets with the behavioral characteristics of their liabilities, resulting in liquidity and interest rate mismatches and hence increased risk.

Second, should the FDIC nonetheless decide that some liquidity constraint is appropriate, its proposed approach --- limited to assets with stated maturity of 30 days or less --- is overly restrictive, and inconsistent with both market practice and general regulatory liquidity measures. Since assets in the 0% and 20% risk weight categories are by definition liquid, any further liquidity condition on the custodial bank adjustment is in our view unnecessary. These assets include US Treasury and government agency securities, balances held at central banks, other cash items due from banks, repurchase transactions collateralized by government or agency securities, and asset-backed securities rated AAA and AA.

Treasury and Agency debt is considered to be liquid across all maturities with market participants able to transact in large quantities within narrow bid-ask spreads. The ability to transact in these markets across all maturities was proven even at the height of the financial crisis. Many fixed income asset classes have active repo and funding markets for securities with maturities of as

[3] March 2010

long as 30 years, providing thereby reliable sources of collateralized funding regardless of term to maturity.

The liquidity of 0% and 20% risk weighted assets is further evidenced by their acceptance as collateral by the Federal Reserve Discount Window lending program with very low haircuts, including:

- For US Treasury securities, a range from 1% for securities with durations of up to 5 years to 4% for bonds with maturities of over 10 years;
- For securities issued or guaranteed by GSEs, a range from 2% for securities with durations of up to 5 years to 5% for bonds with maturities of over 10 years;
- For Agency-backed mortgage securities, haircuts that range from 2% to 5% for pass-throughs, depending on length to maturity;
- For asset-backed securities with AAA ratings, haircuts that range from 2% for securities with durations of up to 5 years to 5% for securities with maturities between 5-10 years.

While regulatory requirements defining liquidity vary according to their intended purpose, the proposed 30-day term limit for the custodial bank adjustment is far more restrictive than those used for other regulatory purposes, which generally focus on the convertibility of an asset to cash. For example, the Basel Liquidity Paper states that "assets are to be considered …high-quality liquid assets if they can be easily and immediately converted to cash at little or no loss of value." Moreover, the Basel Liquidity Paper does not impose any explicit maturity limits in its definition of high quality liquid assets. Instead, for high quality, liquid assets deemed more likely to experience pricing declines during times of stress ("Level 2" assets), the Basel Committee suggests appropriately calibrated haircuts against current market value.

The Federal Reserve's proposed rule, issued on November 26, 2010, which defines "liquid assets" for purposes of the Volcker Rule, draws heavily from existing Securities and Exchange Commission ("SEC") and banking regulations, and focuses primarily on the existence of ready markets and the availability of pricing, rather than on maturity limitations. A measure of convertibility to cash is also consistent with the approach of the SEC in evaluating liquidity. The SEC has traditionally defined a security that is not liquid as one that **"**cannot be sold or disposed of in the ordinary course of business within seven calendar days at approximately the value ascribed to it…" (see Rule 2a-7(a) (19)). This standard, while applied more broadly, is used by the SEC in the context of money market funds which by contract are required to meet all demands for redemption within a three business day settlement cycle. Similar reasoning applies in the SEC's rules related to net capital for broker-dealers.

For the reasons described above, the proposed 30-day term limitation on assets qualifying for the custodial bank adjustment is inappropriate, inconsistent with concepts of liquidity used elsewhere in regulation, unnecessarily penalizes the custody bank business model, and fails to accurately capture the level of assets resulting from the provision of custodial services. Under the FDIC's proposal, many of the assets held by custodial banks and funded with custody deposits will not qualify for the custodial bank adjustment, resulting in significantly and disproportionately higher deposit insurance premiums, contrary to Congressional intent and the statutory requirements of Section 331.

Treatment of Fiduciary Accounts

As noted above, State Street's primary concern with the FDIC's proposed custodial bank adjustment relates to the 30-day stated maturity limitation. In addition, however, we are concerned that the proposed treatment of deposits linked to "fiduciary accounts" broadly misinterprets the nature of custodial services provided by custody banks on behalf of these accounts.

While State Street, as required by regulation, separately reports non-managed assets held by our customers in "fiduciary" and "safekeeping and custody" accounts, the custodial services provided to these accounts are generally identical. Contrary to the FDIC's description in the NPR, fiduciary services are almost always ancillary to the provision of core custody and safekeeping, and therefore represent at best a small fraction of overall income derived from these accounts. If State Street were to lose a custody or safekeeping relationship, it is almost certain that any related fiduciary services would also cease, given its clear incidental nature. In our view, eliminating from the FDIC's definition of "custody deposits" accounts where a custodial bank provides ancillary fiduciary services would, contrary to Congressional intent, unfairly increase assessments on custodial banks providing core custody services.

FICO Premiums

It is our understanding that the FDIC intends to use the revised deposit insurance assessment framework to also calculate FICO premiums paid by the banking industry. FICO premiums are assessed on banks to cover interest payments due on bonds issued between 1987 and 1989 to help recover costs associated with the savings and loan crisis. As such, they are not in any way related to the revenue obligations of the DIF, the current financial crisis or the risk profile of existing banks.

This includes custodial banks which as previously noted, already pay a disproportionate share of assessments under the deposit-based premium framework. The banking industry has fairly paid FICO premiums in accordance with the existing deposit assessment framework for in excess of 20 years. We believe that it is neither necessary nor equitable to change this approach and impose an additional financial burden on custodial banks for a savings and loan crisis that occurred 20 years ago.

Recommended Approach

Consistent with both Section 331 of the Dodd-Frank Act and Congressional intent, State Street recommends that the FDIC revise its proposed custodial bank adjustment to more accurately capture balance sheet assets linked to custodial banking activities. While we agree with the FDIC proposals to limit the adjustment to assets with risk weights of 20% or less, and to cap the adjustment based on custodial deposits, we disagree with the proposed 30-day maturity restriction. We propose instead that the FDIC adopt a custodial bank adjustment that includes cash and balances due, investment securities, federal funds sold, and securities purchased under agreements to resell with risk-weight of 20% or less, regardless of term to maturity. In practical terms, this would mean that the custodial bank adjustment would equal the sum of the balances reported by custody banks on lines 34, 35, 36 and 37 of Call Report Schedule RC-R, not to exceed the value of custody deposits.

While our proposed approach provides a reliable and easily quantifiable measure of assets linked to custodial activity, should the FDIC determine that additional conditions on the custodial bank adjustment are necessary, we strongly recommend against the use of the proposed 30-day term to maturity requirement. A requirement focused on the initial term of an asset ignores the necessity of aligning asset maturities to the effective duration of custody deposits, and is contrary to numerous other regulatory and market conventions defining liquidity. Moreover, assets in the 0% and 20% risk weight categories are by definition liquid.

Alternatively, we believe that concerns with respect to the potential illiquidity of assets during times of stress, particularly those within the 20% risk-weight category, can effectively be addressed via the adoption of appropriately calibrated haircuts, following the well-established model of the Federal Reserve Discount Window lending program. Such an approach would result in a considerably more accurate measure of assets attributable to custodial activities than the 30-day term to maturity condition as proposed.

In addition, we recommend that the FDIC clarify that the custody deposit cap includes all deposits directly linked to accounts providing custodial services, regardless of whether the bank also assumes the role of fiduciary. Finally, we recommend that the FDIC maintain the current deposit-based assessment framework for the determination of industry FICO premiums.

Once again, State Street appreciates the opportunity to comment on this proposal. Please feel free to contact Ed Novakoff at enovakoff@statetreet.com should you wish to discuss our submission in greater detail.

Sincerely,

Stefan M. Gavell