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Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
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Via e-mail: fsb@bis.org

Consultative Document – Adequacy of Loss-Absorbing Capacity for Global Systemically Important Banks in Resolution

Dear Sir/ Madam:

State Street Corporation ("State Street") welcomes the opportunity to comment on the Consultative Document ("Consultation") issued by the Financial Stability Board ("FSB") regarding measures to enhance the loss-absorbing capacity of global systemically important banks ("G-SIB") in resolution. This centers on a proposed total loss absorbing capacity ("TLAC") standard, comprised of regulatory capital instruments and eligible long-term debt, designed to ensure the orderly resolution of a G-SIB in the event of insolvency, without recourse to taxpayer funding and with minimal disruption to financial markets. We strongly support the FSB's policy efforts, and believe that the proposed TLAC standard represents a crucial step forward in the development of a coherent framework for the resolution of the largest, most interconnected and most internationally active firms, in a manner that heightens confidence in the stability and integrity of the global financial system.

Headquartered in Boston, Massachusetts, State Street specializes in providing institutional investors with investment servicing, investment management and investment research and trading. With $28.5 trillion in assets under custody and administration and $2.4 trillion in assets under management, State Street operates in 29 countries and in more than 100 geographic markets. State Street is organized as a United States ("US") bank holding company, with operations conducted through several entities, primarily its wholly-owned bank subsidiary, State Street Bank and Trust Company. We have among the highest capital levels in the industry, with a Basel III Advanced Approach common equity tier 1 ratio of

12.8%, a *pro forma* Basel III Standardized Approach common equity tier 1 ratio of 10.9% and a *pro forma* supplementary leverage ratio of 5.7%.[1]

Our perspective in respect of the Consultation is broadly 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 their non-US 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; various asset servicing functions, such as the processing of income and other interest payments, corporate action events, tax reclamations and client subscriptions and redemptions; and the provision of banking services, notably access to deposit accounts in order to facilitate day-to-day transactional activities.

We have participated in the development of a number of responses prepared by various financial services trade groups, notably the joint submission from The Clearing House Association, the Securities Industry and Financial Markets Association, the American Bankers Association and the Financial Services Roundtable, and we generally support the observations and recommendations made therein. Our intention with this letter is to offer additional feedback based on our role as a custodial entity, a role that is widely understood by the market and by the supervisory community as providing important benefits for the safety of client assets and the stability of the financial system.

INTRODUCTORY COMMENTS

State Street recognizes the imperative of ensuring the resolvability of all financial institutions and we support the proposed TLAC standard as a means of enhancing a G-SIB's recovery and resolution planning. We also support enhanced transparency in the composition of a firm's TLAC as a means of improving the market's understanding of each G-SIB's loss absorbing capacity, as well as the order in which losses would be absorbed in the event of insolvency. Nevertheless, we believe that the proposed TLAC standard could be improved to make it more risk-sensitive and to better reflect the risk posed by certain industry business models, notably deposit funded institutions, such as global custody banks. We therefore recommend certain adjustments to the intended TLAC standard, designed to mitigate potentially disruptive structural complexity, unwarranted changes to existing business models and the possible emergence of inconsistencies in national implementation.

CUSTODY BANK G-SIBs

Notwithstanding their common label, G-SIBs are not uniform in terms of size and scope, running the spectrum from mega-banks with total assets of almost $3.2 trillion, to State Street with total assets of $275 billion. Indeed, State Street is the smallest of the G-SIBs, with total assets representing

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[1] As of September 30, 2014.

substantially less than 1% of the total aggregate assets of all designated G-SIBs.[2] Also, while most G-SIBs are universal banks with extensive retail, commercial, investment banking and capital markets operations, the list of G-SIBs includes two stand-alone custody banks which operate with a very different business model.

Global custody banks, such as State Street, are uniquely focused on serving the investment needs of their institutional investor clients. As described above, this centers on the provision of safekeeping and asset administration services to large and diversified portfolios of investment assets. In keeping with their function, custody banks maintain the primary deposit accounts of their institutional investor clients used in the day-to-day management of assets. Moreover, custody banks also hold residual cash on behalf of their clients, which is a normal byproduct of the investment allocation process and which varies according to the client's investment mandate and view of financial markets. As a result, custody banks tend to experience significant 'flight to cash' during periods of financial market uncertainty as institutional investors seek to adjust their risk exposures or otherwise rebalance their investment allocation. This can, in turn, lead to large client deposit inflows and therefore considerable volatility in balance sheet assets.

As an example, in the days following the Lehman Brothers insolvency in September 2008, State Street experienced a rapid increase in client deposits of $53.8 billion, or 36% of our total client deposit base. Similarly, during the US debt ceiling crisis of late-2011, client deposits surged by $27.9 billion, representing an additional 18% increase in our deposit balances from levels already impacted by general financial market stress. More recently, State Street has experienced over the past several years, elevated levels of client deposit inflows as a result of quantitative easing and macro-economic uncertainty in both the US and Europe. In keeping with their short-term, transitory nature, State Street has sought to manage these and other similar excess deposit inflows via the placement of cash with national central banks, particularly the US Federal Reserve System.

Global custody banks, such as State Street, have balance sheets that are constructed differently than the universal bank G-SIBs. Custody bank balance sheets are built around client deposits derived from the provision of safekeeping and asset administration services. These deposits represent a stable source of funding whose value is monetized by custody banks via the purchase of large and well-diversified portfolios of high-quality investment securities. The stability of these deposits is recognized by the Basel Committee on Banking Supervision ("Basel Committee") which assigns deposits generated by 'clearing, custody and cash management activities' (other than excess deposits) a more favorable draw-down rate of 25% for purposes of the Liquidity Coverage Ratio, due to the need for clients to 'leave (such) deposits with a bank in order to facilitate their access to and ability to use payment and settlement systems, and otherwise make payments'.[3] Unlike many other G-SIBs, custody banks do not need to rely extensively on sources of short and/or long-term debt to manage their balance sheets or business activities, but instead have access to significant levels of funding via their customer deposit base.

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[2] SNL Financial LC, September 30, 2014.

[3] 'Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools', Basel Committee on Banking Supervision (January 2013), paragraph 93.

EXTERNAL TLAC

The FSB foresees the introduction of an external TLAC standard for each resolution entity within a G-SIB, incorporating a minimum Pillar 1 requirement and a possible Pillar 2 add-on to address entity-specific considerations. The minimum Pillar 1 requirement is defined, in turn, on the basis of a firm's total risk-weighted assets ("RWA"), along with a leverage floor set at not less than two times the relevant 'tier 1 leverage ratio requirement'. We are concerned that the use of a leverage floor in the TLAC standard will disproportionately impact firms with more conservative balance sheets, such as custody banks, while also disadvantaging core features of our custody business model. This includes the facilitation of high-volume, low-risk, low-return financial activities through client deposit accounts, along with broad reliance on essentially riskless assets to manage deposit volatility. Indeed, we believe that it would be highly incongruous if custody bank G-SIBs were forced to raise additional TLAC in order to accommodate an otherwise temporary increase in client deposit inflows associated with a 'flight to cash' event, when such excess deposits are generally managed via the placement of cash with a national central bank.

We therefore recommend the removal of the leverage floor in the final TLAC standard, or alternatively confirmation that the reference to a leverage requirement of at least twice the relevant 'Tier 1 leverage ratio', specifically means a threshold set at two times the Basel III leverage ratio, or 6%. Furthermore, we urge clarification by the FSB that jurisdiction specific leverage buffers, if any, should be added on top of the minimum 6% ratio, rather than also being subject to a doubling of the quantum of required capital. This is consistent with the design of the RWA component of the TLAC standard, in which capital buffers, such as the capital conservation buffer and the G-SIB capital surcharge, apply on top of each firm's TLAC and therefore do not require additional incremental issuance.

More generally, we welcome the FSB's statement that 'items that count towards satisfying minimum regulatory capital requirements may also count towards satisfying the minimum TLAC requirement'. Also, while we recognize the need for some level of debt to facilitate the orderly resolution of an insolvent G-SIB, we believe that each firm should have the flexibility to comply with the TLAC standard in a manner consistent with its business model and risk profile. This includes deposit funded institutions, such as custody banks, which generally do not need to issue large amounts of debt to manage their balance sheets or business activities, and which do not have substantial amounts of wholesale liabilities that can be converted into TLAC eligible instruments. We therefore do not support the inclusion of a specific 'one –size fits all' measure for minimum amounts of eligible debt and recommend instead clarification that the long term debt component of TLAC should be determined by each G-SIB as part of its recovery and resolution planning, in conjunction with its home supervisory authority.

INTERNAL TLAC

In order to improve the confidence of host supervisory authorities that a G-SIB can be resolved in an orderly manner, the FSB contemplates the introduction of an additional internal TLAC standard, designed to ensure the appropriate pre-positioning of loss-absorbing capacity in a host jurisdiction. This requirement is meant to apply to 'material subsidiaries' as defined in the TLAC term sheet, along with any other subsidiary entity at the entire discretion of the host authority. While we appreciate the need for confidence building measures among home and host supervisory authorities, we have certain concerns regarding the structure of the internal TLAC standard as proposed by the FSB.

First, we believe that there is ambiguity surrounding the process for determining a firm's resolution entity or entities. In particular, we have reservations regarding the statement found in Paragraph 20 of the TLAC term sheet that the proposed resolution framework does 'not limit a host authority's legal power to impose external or internal TLAC requirements on a material or non-material subsidiary'. This reflects our strongly held view that the unilateral imposition of an external TLAC requirement by a host supervisory authority has the potential to be broadly disruptive to the design of a coherent, firm-specific recovery and resolution strategy. As such, we urge clarification by the FSB that it is the home supervisory authority's responsibility to oversee the development and implementation of a firm-wide resolution strategy. This includes authority to designate one or more resolution entity, whether independently or in conjunction with relevant host authorities.

Second, we are concerned that too much discretion is provided to host authorities to determine entities that could be required to meet the internal TLAC requirement. This includes the definition of a 'material subsidiary', which is solely based on the size of the entity relative to the consolidated G-SIB, without any consideration for the relevance of that activity in the local market. This also includes the broad discretion afforded to host supervisory authorities to impose internal TLAC on a non-material subsidiary. We therefore recommend that the FSB adjust the current definition of a 'material subsidiary', by adding an additional requirement based upon the significance of that entity in the local market. More specifically, we suggest that the internal TLAC requirement should only apply to subsidiary entities that represent 5% or more of a G-SIB's total RWA, total revenue or total leverage exposure, and which have been formally designated in the local jurisdiction as systemically important. This includes designation on the basis of the Basel Committee's framework for domestic systemically important banks.[4]

Furthermore, we urge the FSB to clarify that the minimum eligible long-term debt requirement for external TLAC is not intended to apply to internal TLAC, which can instead be met with any instrument eligible for inclusion in minimum regulatory capital, or at the mutual discretion of the home and host supervisory authorities, a collateralized guarantee subject to the conditions specified in Paragraph 23 of the TLAC term sheet. In our view, unless there is a consistent, cooperative and thoughtful approach among supervisory authorities to the designation of resolution entities, material subsidiaries and non-material subsidiaries, as well as the design and composition of internal TLAC, there is the strong potential that the TLAC standard could be used to create exactly the type of ring fencing and internal capital brittleness that the FSB is seeking to prevent.

CONCLUSION

Thank you once again for the opportunity to comment on the important matters raised within this Consultation. To summarize, State Street recognizes the importance of the TLAC standard in promoting effective recovery and resolution planning, and we strongly support its use as a complement to risk-based capital requirements for G-SIBs. Nevertheless, we believe that there is room to improve the intended TLAC standard in order to make it more risk-sensitive and to better reflect certain industry business models, notably deposit funded institutions, such as global custody banks.

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[4] 'A Framework for Dealing with Domestically Important Banks', Basel Committee for Banking Supervision (October 2012).

We therefore urge the removal of the leverage ratio floor in the final TLAC standard, or alternatively its replacement with a specific threshold set at two times the Basel III leverage ratio, or 6%. Similarly, we suggest clarification that national leverage buffers, if any, should apply on top of the minimum 6% leverage ratio rather than being included within the quantum of twice the capital required to meet the relevant 'Tier 1 leverage ratio'. Furthermore, we recommend the elimination of a specific reference to minimum amounts of TLAC eligible debt, in favor of clarification that the long-term debt requirement should be determined by each G-SIB as part of its recovery and resolution planning, in conjunction with its home supervisory authority.

We urge, in turn, confirmation by the FSB that the home supervisory authority is responsible for the development and implementation of a firm's recovery and resolution strategy, including the designation of one or more resolution entity that would be subject to the external TLAC standard. In addition, we recommend an adjustment to the intended definition of a 'material subsidiary' for purposes of internal TLAC, by adding a parallel standard based upon an entity's designation in the local market as systemically important. Finally, we urge clarification that the minimum long-term debt requirement in the external TLAC standard does not apply to internal TLAC.

Please feel free to contact me at smgavell@statestreet.com should you wish to discuss State Street's submission in further detail.

Sincerely,

Stefan M. Gavell