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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

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Consultative Document – Principles for Operational Resilience

Dear Sir/ Madam:

State Street Corporation (“State Street”) welcomes the opportunity to comment on the consultative document issued by the Basel Committee on Banking Supervision (“Basel Committee”) regarding principles for operational resilience. These principles are intended to strengthen the ability of internationally active banks to withstand, adapt to and recover from failure events that could disrupt their ability to maintain critical operations on behalf of their clients and the financial system as a whole. This consultative document follows a series of consultations issued by regulators in the United Kingdom (“UK”) in late-2019 on building operational resilience in the UK financial sector, and more recently, joint guidance from the United States (“US”) federal banking agencies on Sound Practices to Strengthen Operational Resilience for the largest US banks.¹ These documents reflect an active debate among regulators globally about how best to define and organize the identification, assessment and management of operational disruptions and their effects. We appreciate and support, in this respect, the principles laid out by the Basel Committee which we believe provide an

¹ ‘Operational Resilience: Impact Tolerances for Important Business Services’, Prudential Regulation Authority CP29/19 (December 2019); ‘Building Operational Resilience: Impact Tolerances for Important Businesses and Feedback to DP18/04’, Financial Conduct Authority CP 19/32 (December 2019); ‘Consultation Papers: Operational Resilience for FMI’s’, Bank of England, Prudential Regulation Authority, Financial Conduct Authority (December 2019). The US federal agencies that issued the document on ‘Sound Practices to Strengthen Operational Resilience’ are the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation.

appropriate and sufficiently flexible basis for banks to develop and implement a robust, coherent and responsive operational resilience framework in a manner that aligns with their existing operational risk management processes and their business models.

Headquartered in Boston, Massachusetts, State Street is a global custody bank which specializes in the provision of financial services to institutional investor clients. This includes investment servicing, investment management, data and analytics, and investment research and trading. With \$36.6 trillion in assets under custody and administration and \$3.1 trillion in assets under management, State Street operates in more than 100 geographic markets.² State Street is organized as a US bank holding company, with operations conducted through several entities, primarily its wholly-owned state-chartered insured depository institution subsidiary, State Street Bank and Trust Company. While our primary prudential regulators are the Massachusetts Division of Banks and the US Federal Reserve System, we are subject to oversight by numerous regulators in the jurisdictions in which we operate, including for purposes of operational resilience. Our perspective in respect of the Basel Committee's consultative document is broadly informed by our status as one of the world's largest providers of custody services to institutional investor clients.

The Custody Bank Business Model

Custody banks, such as State Street, employ a highly-specialized business model focused on the provision of financial services to institutional investor clients. These clients, which include asset owners, asset managers and official sector institutions, contract with custody banks to ensure the proper safekeeping of their investment assets, as well as the provision of a broad range of closely-related financial services. This includes access to the global settlement infrastructure to complete the purchase or sale of investment securities; various asset administration 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 used to facilitate day-to-day transactional activities. The importance of financial services to the custody bank business model can be seen in the large amount of revenue derived from fee-related activities. For instance, in Q3 2020, fee revenue comprised 83% of State Street's total revenue.

Similarly, custody banks, such as State Street, have balance sheets which are constructed differently than most banks. Indeed, the custody bank balance sheet is liability driven and expands not through asset growth, but through the organic development of client servicing relationships that, over time, translate into increased volumes of highly stable deposits. These deposits, rather than various sources of wholesale funding, provide the largest part of the custody banks' liabilities. Importantly, custody banks acquire deposit liabilities as a direct result of the financial services they provide to clients. In other words, the cash deposits that come on

² As of September 30, 2020.

to the custody bank balance sheet are driven by customer demand, not by the custody banks' financing decisions.

Regulated financial institutions that rely on State Street for safekeeping and asset administration services often view us as a critical service provider. Similarly, as a custody bank, we rely heavily on third-party entities throughout the financial system for the provision of key operational capabilities in the various markets where we hold client assets. As such, our view of operational resiliency is broadly informed by our position as an intermediary within the global chain for the end-to-end provision of financial services to institutional investors, as well as our role as both a critical service provider to other financial entities and as a recipient of critical services from our own key third-party vendor relationships. We therefore appreciate the opportunity to offer our views on the Basel Committee's consultative document, based on our role as a custodial entity, a role that is widely understood by the market and by the regulatory community as providing important benefits for the safety of client assets and the stability of the financial system.

General Observations

The Basel Committee emphasizes in the consultative document its intention to promote a pragmatic and flexible approach to operational resilience, building on existing guidance and principles for the management of operational risk. This includes principles for corporate governance, the risk management environment, information and communication technology ("ICT"), outsourcing, and business continuity planning ("BCP"), as outlined in its document on Principles for the Sound Management of Operational Risk, which is currently subject to a separate consultation on proposed revisions designed to further strengthen the overall operational risk management framework for banks.³ We strongly support this practical approach to operational resilience, which we believe effectively draws out the key elements of a well-designed framework informed by a firm's existing operational risk management processes, while also accommodating important differences in industry business models.

Indeed, the use of a principles-based approach to operational resilience will, in our view, permit firms to develop solutions that most effectively reflect their particular role within the financial system, leveraging in the process, existing compliance structures, processes and practices. This includes the ability to pivot from existing operational risk management functionality by placing a resiliency lens on a firm's assessment of its critical functions and services. While a principles-based approach will invariably lead to certain differences in the solutions adopted by individual banks, we view this as a welcome development that should lead to better operational resiliency outcomes for both firms and regulators alike.

³ 'Consultative Document: Revisions to the Principles for the Sound Management of Operational Risk', Basel Committee on Banking Supervision (August 2020).

We note and appreciate the emphasis which the Basel Committee places in the consultative document on the alignment of a firm's operational resilience framework with the structure, organizational mapping and taxonomy developed for purposes of recovery and resolution planning ("RRP"). Similarly, we also welcome the Basel Committee's direction that firms should ensure that their operational resilience framework is appropriately harmonized with BCP for the delivery of critical operations, including key dependencies on critical third-party and internal service providers. Importantly, the Basel Committee emphasizes that the term 'critical operations' encompasses 'critical functions' as defined by the Financial Stability Board, expanded to include other services that would be materially disruptive to the bank's continued operations and role within the financial system. By recognizing the inter-relationship that exists between operational resilience planning and other core aspects of a bank's operational risk-management framework, we believe that banks will be incentivized to create robust 'fit for purpose' solutions that effectively support the goal of enhanced resiliency.

In order to support these efforts, we believe that the Basel Committee should pay particular attention to the development of a common taxonomy for operational resilience, drawing to the greatest extent possible on existing RRP terminology. Indeed, while we acknowledge that there are both conceptual and practical differences inherent in each of these mandates, we believe that the emphasis of regulators globally should be on the use of a common approach where possible, accommodating differences where necessary, in order to avoid the emergence of a 'siloed' approach to the overall management of operational risk that would undermine rather than promote effective outcomes.

More broadly, we support the emphasis which the Basel Committee places on the role of operational resilience in ensuring financial stability, which we believe is the appropriate primary basis for assessing the criticality of the custody bank business model. This reflects the particular role that custody banks, such as State Street, play as intermediary between institutional investors and the global financial markets, including in the provision of payment, clearing and settlement services.

Global Harmonization

The Basel Committee notes in the introductory section of the consultative document that there are a number of jurisdictions that are actively considering how best to enhance the operational resilience of their financial sectors, emphasizing in turn that operational resiliency outcomes can best be achieved through further international engagement and collaboration. We strongly endorse this approach and urge regulators globally to work towards broad alignment in their respective approaches to operational resilience. The necessity for global consistency is particularly important to custody banks given the scope and breadth of their cross-border operations in support of their clients' investment activities. Indeed, having to address disparate operational resiliency requirements for the same critical services in multiple jurisdictions would invariably heighten operation complexity and therefore undermine rather than support the

ability of custody banks to offer their clients access to highly integrated financial services at scale across global markets.

As such, we strongly urge the Basel Committee to continue its efforts to promote international engagement, and also recommend that it encourage each of its member jurisdictions to carefully consider how its intended approach to operational resilience aligns with the Basel Committee framework, and whether certain adjustments would help ensure better global harmonization.

Achieving Sound Operational Resilience

Based on our experience, we believe that a sound operational resilience framework is comprised of the following key inputs:

- The identification of a firm's critical business services, in a manner that leverages existing BCP and RRP processes;
- The mapping of the chain of activities underlying those services to identify key dependencies, both internal and external;
- The establishment of tolerance parameters for critical business services within which to operate, as a complement to other internal recovery metrics, such as 'recovery time' and 'recovery point' objectives;
- The establishment of management information ("MI") processes to measure and assess the firm's ability to work within the specified tolerance parameters, including the identification of key vulnerabilities;
- The implementation of enhanced scenario testing, using severe but plausible scenarios; this includes the use in scenario testing of the concept of assumed failure;
- The layering of operational resilience processes into a firm's existing governance structure, including risk escalation procedures and actions to be taken to address and learn from disruptions;
- The implementation of a robust communication strategy with key stakeholders, both internal and external, closely aligned with existing BCP and crisis management processes.

In our view, the principles set forth by the Basel Committee effectively encompass these inputs, thereby encouraging internationally active banks to develop strategies for operational resilience that lead to the right outcomes based on each bank's business model and the particular role that it plays within the financial system. We reiterate, in this respect, that the ability to use existing processes developed as part of a firm's overall operational risk management framework will be key to ensuring responsive, actionable and proportionate outcomes. This includes MI, scenario development and testing, and communication processes leveraged to support a resiliency view of a firm's operations.

Similarly, we believe that the ability of a firm to deploy a risk-based approach to the development of its testing program for operational resilience, including the types of tests used based on individual scenarios, will help firms refine and improve their processes over time, in a manner that will lead to more meaningful and useable outcomes. Finally, we believe that the ability of banks to effectively manage their third-party dependencies, notably those involving large, integrated ICT platform providers, would be greatly enhanced if the Basel Committee were to develop guidelines specifying its expectations for the management of the resulting operational risk, including access to third-party premises and systems, key controls and testing obligations, and the deployment of appropriate BCP procedures.

Lessons Learned from COVID-19

As a threshold matter, we believe that internationally active banks have demonstrated strong levels of resiliency throughout the COVID-19 crisis, supported by a combination of heightened prudential standards in the wake of the financial crisis and extensive upgrades to internal operational risk management systems, processes and controls. As a custody bank, we note in particular, our success in supporting very high levels of client transactions and inquiries, the effective use of exposure limits, incident management and escalation protocols, the ability to swiftly reassign and distribute work across our global footprint, and the effective management of both personal client data and confidential information controls.

From a lessons learned perspective, we would emphasize in particular the need for ongoing vigilance in the assessment of potential vulnerabilities, recognition that temporary work solutions and process exceptions may become quasi-permanent, the importance of close and continuous dialogue with the regulatory community, and the need to consider in ITC planning the long-term resiliency of our staff. Finally, we believe that the COVID-19 crisis has demonstrated the need for the industry and regulatory community to work collaboratively towards a more digital environment for required regulatory filings and the elimination of residual manual requirements in various asset administrative functions, such as the use of physicals documents and wet signatures, which are unsustainable in a prolonged work-from-home environment and yet can readily be replaced with safe, scalable and secure electronic alternatives.

Conclusion

Thank you once again for the opportunity to comment on the important matters raised within the consultative document. To summarize, State Street appreciates and supports the Basel Committee's use of a principles-based approach to the development of a firm's operational resilience framework, informed and appropriately aligned with its existing RRP and BCP processes. This includes the use, to the extent possible, of a common taxonomy for operational resilience globally, informed by existing terminology for RRP. We strongly endorse international harmonization in the design of operational resilience frameworks by national jurisdictions, and

urge the Basel Committee as the global standard setter for banks, to encourage member jurisdictions to consider the steps that each may take to improve global alignment.

We believe that the principles set forth by the Basel Committee broadly incorporate the key elements of an effective operational resilience framework and recommend that firms be encouraged to use their existing operational risk management processes and controls to structure their efforts. We believe that the COVID-19 crisis demonstrates the need for the ongoing monitoring and assessment of potential vulnerabilities by internationally active banks, as well as the need for close and continuous dialogue between the industry and the regulatory community. We also view the COVID-19 crisis as an opportunity for the industry and regulatory community to together revisit required regulatory filings and existing manual processes that can readily be replaced with more stable and efficient electronic solutions. Furthermore, we believe that the ability to rely on an impact-based approach for key parameters of the operational resilience framework, such as scenario development and testing, will help produce over time, more meaningful and useable outcomes, in a manner that reflects the evolving nature of operational resilience threats and practices. Finally, we recommend the development by the Basel Committee of guidelines setting out expectations for the management of operational resilience in third-party arrangements, notably for critical ITC platforms and systems.

Please feel free to contact me at jjbarry@statestreet.com should you wish to discuss the contents of this submission in greater detail. We welcome the opportunity to further engage with the Basel Committee on this topic and we stand ready to provide whatever assistance may be appropriate.

Sincerely,

A handwritten signature in black ink, appearing to read "JJ Barry", with a stylized flourish at the end.

Joseph J. Barry