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Ms. Diane Farrell
Deputy Under Secretary for International Trade
International Trade Administration
Department of Commerce
1401 Constitution Avenue, NW
Washington, DC 20230
Docket ID #: ITA 2022-0003

E-mail: digitalassets@trade.gov

Request for Comment – Developing a Framework on Competitiveness of Digital Assets

Dear Ms. Farrell:

State Street Corporation (“State Street”) welcomes the opportunity to respond to the request for comment (“RFC”) issued by the Department of Commerce regarding the development of a framework to enhance the economic competitiveness of the United States (“US”) in the area of digital asset technology. The RFC reflects the mandate of Section 8(b)(iii) of Executive Order 14067 (“Executive Order”) on ‘Ensuring Responsible Development of Digital Assets’, which outlines the policy objectives of the administration with respect to digital assets, including: (i) the protection of consumers, investors and businesses; (ii) the mitigation of potential systemic financial risk; (iii) the mitigation of potential illicit finance and related national security risks; and (iv) the development of technological advancements that promote responsible innovation.¹ We strongly support the goals of the Executive Order, which we believe are best supported by a ‘whole of government’ approach that promotes the development of comprehensive regulatory framework for digital assets that both recognizes the essential role played by banks in promoting responsible innovation and which addresses existing risks in the ecosystem through the application of the core principle of ‘same activity, same risk, same regulation.’

¹ Executive Order 87 FR 14143, March 14, 2022.

Headquartered in Boston, Massachusetts, State Street is a global custody bank which specializes in the provision of financial services for institutional investor clients. This includes investment servicing, investment management, data and analytics, and investment research and trading. With \$41.72 trillion in assets under custody and administration and \$4.02 trillion in assets under management, State Street operates in more than 100 geographic markets globally.² State Street is organized as a US bank holding company, with operations conducted through several entities, primarily its wholly-owned Massachusetts state chartered insured depository institution subsidiary, State Street Bank and Trust Company. The State Street organization includes State Street Digital, which was established to address the ongoing digital transformation of the financial system and the development of solutions to support our clients' evolving needs across the entire investment life cycle.

The digital transformation of the financial system driven by emerging technologies such as tokenization, blockchain and artificial intelligence, is real and will result over time in greater access to new investment solutions and improvements in the efficiency of the financial markets with important benefits for long-term institutional investors such as pension plans and mutual funds that support the accumulation of retirement savings and other sources of personal wealth. We greatly welcome, in this respect, the 'whole of government' approach to the development of policy for digital assets envisioned by the administration in the Executive Order, which we believe will best support the emergence of thoughtful outcomes for the financial services industry that fosters responsible innovation, promotes US competitiveness and reinforces the leadership of the US in the global financial system.

We appreciate the opportunity to offer our thoughts on several of the matters raised by the Department of Commerce in the RFC as they relate to the financial services industry. As such, the observations found below are primarily responsive to questions 3, 7 and 17 of the RFC.³

Need for a Robust and Coordinated Regulatory Framework

In order to achieve the policy objectives articulated by the administration, we believe that a key area of focus must be the development of a coherent regulatory framework that appropriately defines key terms, principles and expectations; fairly allocates responsibilities across varying regulators; reduces unnecessary duplication and overlap; and ensures the proper assessment and management of risk. Furthermore, we believe that regulatory policy should focus not on

² As of March 31, 2022. Assets under management includes approximately \$73 billion of assets with respect to SPDR® products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

³ Question 3: 'How does the current US regulatory landscape affect US digital asset businesses globally? Are there regulatory shifts that could support greater global competitiveness of the US digital asset businesses?'; Question 7: 'What impact, if any, will global deployment of CDCDs have on the US digital asset sector? To what extent would the design of a US CBDC impact the sector?'; Question 17: 'To what extent will interoperability between different digital asset networks be important to the future? What risk does a lack of interoperability pose?'

barriers to the involvement of the banking sector in the development of the digital asset ecosystem, but rather on defining the parameters for how the industry can help support, through its expertise, value added innovations that drive greater efficiencies, reduce risk and enhance overall system-wide resilience.

The leadership role played by US firms today in the provision of financial services, including in the global custody industry, is underpinned by the strength of our regulatory framework. For instance, the manner in which US custody banks organize and operate their safekeeping and asset administration services today, is heavily influenced by Section 17(f) of the Investment Company Act of 1940, which is viewed as the ‘gold standard’ for custody, and which requires mutual funds to maintain their securities and similar investments with entities under conditions designed to maintain the safety of fund assets. Similarly, the services offered by custody banks are also influenced by Rule 206(4)-2 of the Investment Advisors Act (*i.e.* the ‘custody rule’) which requires investment advisors that have custody of client assets to use a ‘qualified custodian’, such as a banking organization, to maintain those assets.

We believe that a similar leadership role should be exercised by policymakers in their approach to the regulation of digital assets, where custody banks, such as State Street, are uniquely well-placed to offer solutions that both enhance investor protection and reduce risk. While US financial institutions clearly do not lack the ability to innovate, the existing regulatory framework for digital assets creates too much uncertainty to support responsible innovation and therefore limits the ability of US firms to effectively compete. We eagerly await, in this respect, the results of the ongoing joint banking agency ‘crypto-asset’ sprint which is intended to provide coordinated and timely clarification regarding the scope of permissible activities for banking organizations and expectations for the appropriate management of risk.⁴ This includes guidance regarding crypto-asset safekeeping and the provision of ancillary custody services.

The implications of Staff Accounting Bulletin 121 (“SAB 121”) recently issued by staff of the Office of the Chief Accountant (“OCA”) of the Securities and Exchange Commission (“SEC”) relative to the treatment of safeguarded crypto-assets is a revealing, ‘real world’ example of the highly negative outcomes that can result from an inadequately defined and poorly coordinated regulatory process. SAB 121, which was issued on March 31, 2022 requires (i) any entity that safeguards crypto-assets, including banking organizations, to present a liability (and recognize a corresponding asset) on its balance sheet equal to the fair value of the safeguarded crypto-assets, and (ii) to make certain disclosures in its financial statements regarding those assets. While we are broadly supportive of the enhanced disclosure mandate, the obligation to place safeguarded crypto-assets on balance sheet is completely at odds with the existing accounting treatment of custodied assets. The OCA’s release was issued without substantive consultation, and reflects general concerns raised by SEC staff related to legal, regulatory and

⁴ ‘Joint Statement on Crypto-Asset Policy Sprint Initiative and Next Steps’, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency (November 23, 2021).

technology risk in digital assets and the implications of those risks for investor protection. In issuing SAB 121, the SEC made no attempt to recognize any differences which exist in industry business models, notably those which distinguish regulated banking organizations from non-banking entities that currently dominate the crypto-asset market.

As a practical matter, SAB 121 therefore ignores the robust and well-developed regulatory framework that applies to banking organizations in the US and the way in which this framework comprehensively addresses the concerns raised by the SEC in a manner that makes the on balance sheet treatment of safeguarded crypto-assets highly inappropriate. This outcome, which presents major obstacles to the participation of banking organizations in the development of the digital asset ecosystem, due to the impact of additional on balance sheet assets for required amounts of regulatory capital, could have been avoided had a greater emphasis been placed by SEC staff on proper communication and coordination among the agencies. In the interim, and unless SAB 121 is significantly revised, US banking organizations are effectively prevented from offering safekeeping and other related financial services for digital assets, undermining in the process the development of solutions that promote responsible financial innovation, reduce system-wide risk and help enhance US competitiveness.

Regulation of Non-Bank Entities

Beyond the current treatment of banking organizations, US policy for digital assets is also impaired by the fractured and inconsistent manner in which the activities of non-bank entities in this space are regulated and supervised. While this situation results from many complex legal, structural and operational considerations, the practical outcome is an approach to the regulation of crypto-asset activities today that is suboptimal, with insufficient regard for investor protection, financial stability and the proper management of risk. This also includes highly inconsistent standards for core functions, such as the protection of client data, operational resilience and cybersecurity controls. One clear manifestation of this outcome are the repeated instances in which digital assets have recently been misappropriated from thinly regulated platform entities offering trading, safekeeping, lending and other services without the controls that apply to banking entities.

In order to overcome these limitations, we believe that the administration should work in close coordination with the agencies to appropriately define and consistently apply a robust set of regulatory standards for all non-bank entities operating in the digital ecosystem based on the core principle of 'same activity, same risk, same regulation.' For instance and from our perspective as a custody bank, this would include the requirement for all providers of safekeeping services to (i) functionally separate trading and custody activities, (ii) deploy robust risk management systems, processes and controls to ensure the segregation of client assets at all times from the providers own assets, and (iii) exercise proper control over the private keys underlying the crypto-asset to ensure that there is no single point of failure. Furthermore, non-bank providers of safekeeping services should be subject to appropriate capital and liquidity

requirements, operational resilience obligations, business continuity mandates and the implementation of robust data privacy and cybersecurity controls. Finally, non-bank providers of safekeeping services for crypto-assets should be subject to ongoing supervisory oversight and review.

Role of Banking Organizations

In order to help achieve the administration's stated policy objectives for digital assets, we believe that regulators should actively seek to promote the participation of banking organizations in the nascent digital asset ecosystem. This reflects the strong track record of the industry in the development of responsible innovation that both supports evolving client needs and the appropriate management of risk. For instance, custody banks have historically adapted their systems and controls to address new technologies, and have successfully provided safekeeping solutions to account for evolving practices, from the use of paper certificates held in vaults, to book entry records in computer databases, to tokenized assets held in distributed ledger systems and other similar applications.

Banking organizations are subject to comprehensive safety and soundness expectations, robust prudential mandates, detailed investor protection standards and ongoing supervision and examination processes. This includes the careful evaluation and management of technology risk, covering the full lifecycle of development, from the product stage, to implementation within the existing risk control framework, to the ongoing monitoring and review of outcomes. Furthermore, banking organizations must meet prescriptive expectations for operational resilience and are required to deploy robust anti-money laundering and financial crimes control infrastructure. Thus, the existing regulatory framework for banking organizations places risk-management at the forefront of the entity's business activities and the integration of the digital asset ecosystem within this framework will help ensure that digital asset innovation is held to the same high standards. In contrast, any approach that substantially limits banking industry participation in the digital asset ecosystem will force the concentration of activities within non-bank providers least equipped to manage the resulting risk.

CBDCs and Digital Assets

The implications of a central bank digital currency ("CBDC") for the US financial system are vast and complex, and include the potential disruption of existing bank funding models, the disintermediation of key components of the short-term funding markets and the potential for greater susceptibility of the banking system to financial stability risk. On the other hand, there are a number of processes in the wholesale financial market where the need for greater efficiencies are clear and where the development of a CBDC has the potential to materially improve outcomes. This includes, for instance, a reduction in the settlement cycle for securities transactions, the reengineering of various asset administration functions, such as the processing of corporate action events and income payments, the tokenization of asset-backed

instruments and related payment entitlement flows, and the streamlined management of collateral.

As such, we recommend that the administration prioritize efforts to develop a CBDC for use in the wholesale financial markets, and more specifically the development of solutions to support transactions in the interbank payment system (both domestic and cross-border). Approaching the development of a CBDC solution in this manner has a number of advantages. First, it would allow further time for policymakers to consider the implications for the US economy and the financial system of a broader approach based on the deployment of a retail-focused CBDC. Second, this approach would be far less disruptive to the financial system, limiting the potential for a sustained decline in credit intermediation by banks and the possibility of destabilizing runs caused by sudden outflows of deposits, particularly in periods of acute market stress. Third, this approach would offer policymakers the opportunity to study and test various design features in a 'sand box' type environment with stakeholders that have considerable experience in managing complex processes before assessing a CBDC solution with broader applicability. Finally, this approach is likely to prove helpful in preserving the role of the US dollar in global payments and as a reserve currency even outside of a broader retail-focused solution.

Interoperability

In order to help achieve the full benefits of digital asset innovation, we believe that policymakers should focus on solutions for the deployment of CBDCs and other technological innovations that support interoperability and that can operate alongside existing legacy systems. Interoperability should be considered across all relevant operational, technical and transactional value chain stacks, as well as at various stages in the development process, from initial design, to launch to full deployment within the existing ecosystem. Interoperability provides users the ability to interact on different distributed ledger systems by moving and exchanging relevant data. Thus, interoperability plays a critical role in the adoption of digital assets by providing the industry with the necessary technical 'bridge' to interact with other participants on different blockchains in an efficient and trust-enabled manner. Furthermore, interoperability is also a core building block for Web3.0, where each participant in a peer-network will have the equal opportunity to contribute to the development and deployment of the network and web experience. This includes the opportunity to devise and adopt new data interchange, technical and security frameworks and standards that can help address operational uncertainty and facilitate the deployment of new protocols to better manage risks.

Thank you once again for the opportunity to comment on the various matters raised in the RFC. To summarize, State Street welcomes the 'whole of government' approach adopted by the administration for the implementation of policy relative to digital assets, including with respect to the financial services industry. We believe that policymakers should prioritize the development of a comprehensive regulatory framework that appropriately addresses relevant risks, while also recognizing the important role that the banking industry can play in helping to

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promote responsible innovation. Furthermore, we believe that all market participants in the crypto-asset ecosystem should be subject to appropriate regulatory oversight based on the core principle of 'same activity, same risk, same regulation.' Finally, we believe that there is an important role for CBDCs to play in the development of innovative solutions in the wholesale financial markets, where we recommend that policymakers prioritize their initial development efforts, and carefully consider ways to promote the interoperability of core systems and processes, while managing risks.

Please feel free to contact me at jjbarry@statestreet.com should you wish to discuss the contents of this submission in greater detail.

Sincerely,

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

Joseph J. Barry