



Joseph J. Barry

Senior Vice President and Global Head of Regulatory,
Industry and Government Affairs

T +617-664-1254
jjbarry@statestreet.com

State Street Corporation
One Congress Street
Boston, MA 02114-2016
statestreet.com

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James P. Sheesley, Assistant Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attention: Comments- RIN 3064-ZA42

E-Mail: comments@fdic.gov

Request for Information – Deposit Data

Dear Mr. Sheesley:

State Street Corporation ("State Street") welcomes the opportunity to comment on the request for information ("RFI") issued by the Federal Deposit Insurance Corporation ("FDIC") on the potential collection of additional data on the deposit liabilities of banks not currently included in the Federal Financial Institutions Examination Council's ("FFIEC") Consolidated Reports of Condition and Income ("Call Report"), including in particular for uninsured deposits. This additional data is intended to improve the FDIC's understanding of the 'characteristics that affect the stability and franchise value of different types of deposits', and the extent to which 'certain types of deposits may behave differently from each other, particularly during periods of economic or financial stress.'¹ State Street strongly believes that the liquidity framework for banks and related considerations regarding the deposit insurance system, must appropriately recognize key

¹ FDIC Request for Information, pages 1 and 3.

differences in the risk characteristics of various categories of deposits, including in particular operational deposits, a well-recognized and stable source of funding for banks, such as State Street, that specialize in the provision of custody and other financial services to institutional clients. As such, we support the incorporation of data on total operational deposits in the FFIEC Call Report for large banks subject to the banking agencies' quantitative liquidity standards based on the ruleset for operational deposits in the Liquidity Coverage Ratio ("LCR") framework and the requirements of the Federal Reserve Board's ("Fed") LCR Public Disclosure Rule.²

Headquartered in Boston, Massachusetts, State Street is a global custody bank which specializes in the provision of financial services to institutional investor clients, such as asset owners, asset managers, insurance companies and official sector institutions. This includes investment servicing, investment management, data and analytics, and investment research and trading. With \$46.8 trillion in assets under custody and administration and \$4.7 trillion in assets under management, State Street offers its clients the ability to hold assets and transact in more than 100 geographic markets globally.³ State Street is organized as a United States ("US") bank holding company ("BHC"), with operations conducted through several entities, primarily its wholly-owned Massachusetts state-chartered insured depository institution subsidiary, State Street Bank and Trust Company. As a US BHC, we are subject to consolidated supervision by the Federal Reserve System.

As emphasized in the RFI, the regional bank failures of March 2023 has prompted the FDIC and other banking agencies to reexamine the role of uninsured deposits in bank funding models and to consider ways to improve the ability to monitor potential systemic risk. At the same time, the FDIC acknowledges in the RFI that 'different types of uninsured deposits may not necessarily behave in the same way,' and in Question 1(c), it requests feedback on how 'banks measure or evaluate the stability of their operational and non-operational deposits.'⁴ Similarly, in his statement at the FDIC board meeting on July 30, 2024 in support of the RFI, Acting Comptroller of the Currency Michael Hsu emphasized his interest in comments 'that can (help) differentiate between operational and

² 'Liquidity Coverage Ratio: Liquidity Risk Measurement Standards', Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Register (October 10, 2014), and 'Liquidity Coverage Ratio: Public Disclosure Requirements', Board of Governors of the Federal Reserve System, Federal Register (December 27, 2016).

³ As of September 30, 2024.

⁴ FDIC Request for Information, page 14.

non-operational deposits consistently, transparently and credibly', across varying bank business models.⁵

There are two quantitative liquidity standards which today apply to large US banks: (i) the LCR, which is intended to assess a bank's ability to withstand a short-term period of stress over a 30-day horizon, and (ii) the Net Stable Funding Ratio ("NSFR"), which is intended to serve as a long-term measure of structural liquidity over a one year horizon.⁶ Under the LCR and NSFR, operational deposits are defined as deposits that result from the provision of three categories of financial services: cash management, clearing or custody.⁷

Informed by our role as a global custody bank, we offer below an overview of operational deposits in the context of the custody bank business model and the factors which drive their stability as a source of structural funding, even in periods of financial market stress. This includes an explanation of the detailed regulatory requirements which deposit liabilities must meet in order to qualify for treatment as operational deposits, adherence to which can be assessed through the supervisory process.

The Custody Bank Business Model

Custody banks specialize in the provision of financial services to institutional investor clients, such as pension funds, mutual funds, insurance companies and official sector institutions. As such, the custody bank balance sheet is constructed differently than other banks with extensive commercial and investment banking operations. The custody bank balance sheet is liability driven and expands not through asset growth, but instead through the provision of financial services that result in the accumulation of large amounts of stable deposit funding. In other words, custody bank deposits are driven by the services offered to clients, rather than by the custody bank's financing decisions.

⁵ 'Statement at the FDIC Board Meeting: NPR on Brokered Deposits and RFI on Deposits', Acting Comptroller of the Currency Michael Hsu (July 30, 2024).

⁶ LCR Final Rule (October 10, 2014), and 'Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements', Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Register (February 11, 2021).

⁷ LCR Final Rule (October 10, 2014).

The importance of financial services to the custody bank business model can be seen in the large amount of revenue that custody banks derive from fee-related activities. For instance, as of Q3 2024 fee revenue comprised 80% of State Street's total revenue, a ratio that is typical for specialized, stand-alone custody banks.⁸ In certain cases, the use of a bank custodian by institutional investors is a function of the prevailing regulatory regime, such as the requirements which apply to regulated investment funds in the US and the European Union. In other cases, the use of a bank custodian reflects well-established client preference to hold and administer investment portfolios with entities that are subject to prudential requirements and oversight.

The services offered by custody banks are undertaken on the basis of legally binding written agreements with minimum notification periods of 60 or more days, and center on the safekeeping and administration of client investment assets, core activities that help facilitate the seamless day-to-day operation of the financial markets and that require access to deposit accounts to support the related movement cash. This includes cash resulting from: (i) the purchase or sale of investment securities, (ii) the processing of income payments, corporate action events and tax reclamation, (iii) the movement of collateral in support of investment activities and (iv) the processing of client subscriptions and redemptions. Making it possible for long-term institutional investors to hold cash on deposit and to direct the movement of cash in and out of their accounts is therefore a central, defining feature of the custody bank business model.

Since custody banks maintain the primary operating accounts of their institutional investor clients, they are the recipients of substantial day-to-day transactional deposit flows. They also hold deposit balances associated with the prudent management of investment assets, established by their clients to address anticipated and unanticipated funding needs stemming from various operational considerations. This includes failed securities transactions, the non-receipt of payments, and timing differences in the movement of cash, and will vary according to the investment mandate and profile of the investment fund. For example, pension plans will typically raise and hold additional amounts of cash as they approach pre-determined dates for the payment of income to beneficiaries. Similarly, emerging market portfolios will generally leave greater amounts of cash on deposit in order to account for differences in local settlement cycles and the need to enter into foreign currency transactions in and out of the investment fund's base currency.

⁸ As of September 30, 2024.

Custody deposits are therefore directly linked to the safekeeping and asset administration services offered by custody banks and represent a stable, 'sticky' source of funding that cannot be withdrawn by the client without the risk of disruption to core operational processes, even in periods of financial market stress. For example, insufficient client deposit balances could disrupt the timely settlement of securities transactions in markets globally, the movement of cash through the Fedwire® Funds Service and other similar large value payment systems, and the provision of initial and variation margin in support of over-the-counter derivatives transactions. Furthermore, insufficient funding could disrupt the processing of client redemptions by mutual funds and pension plans, preventing the timely payment of retirement income and other sources of personal savings to retail investors.

While institutional investors do have the ability to change custody providers, and may be incentivized to do so in response to idiosyncratic stress, their ability to quickly withdraw investment assets is limited by contractual terms in asset servicing agreements, which as previously noted, routinely include notification periods of 60 or more days. These agreements cover a series of investment funds, each with a separate legal identity that prevent the commingling of assets. Even after notification of termination, there are a number of operational considerations that must be addressed prior to the actual transfer of assets. This includes the establishment of client profiles on the new custodian's custody and accounting systems, the migration of accounting and other financial data to the new provider, the initiation of a parallel period of shadow accounting, the opening of new accounts and the processing of revised settlement instructions for each of the global markets in which the client transacts. It is therefore not uncommon to have transitional periods in the custody industry that extend for six or more months, with the prospect of even lengthier timeframes should multiple clients seek to leave a custodian at the same time.

Most importantly, clients are unable to materially reduce their core deposit balances during the transition period since these deposits are necessary to support ongoing day-to-day transactional activities in support of each fund's investment objectives. While certain large institutional clients may have a business relationship with several custody banks, this does not extend to individual investment funds, but rather to the use of different providers for different lines of business or asset classes due to the particular expertise of the custodian and/ or pricing considerations. It is worth emphasizing, in this respect, that in many cases the use of a single custody provider is a function of legal and/or regulatory considerations. This is true, most notably, for mutual funds and

other similar regulated funds outside of the US, where the role and responsibilities of the custodian are carefully defined by regulation. More broadly, the use of a single custody provider also reflects a number of practical considerations, such as legal restrictions on the pooling or commingling of investment fund assets, the desire to maintain centralized oversight and control of investment activities, and the need to limit expenses that may negatively impact investment fund performance.

Regulatory Requirements for Operational Deposits

Unlike other categories of deposit liabilities, operational deposits are explicitly defined in the liquidity standards which apply to large US banks. Furthermore, operational deposits must meet a series of stringent qualification requirements contained in regulation and therefore subject to supervisory review. First, the operational services offered (i.e. cash management, clearing or custody) must be provided by the bank pursuant to a legally binding written agreement, subject to a minimum termination period of 30 days or significant 'contractual termination costs or switching costs'. Second, the deposit must be held in an account which is specifically designated as an operational account, and the client must hold the deposit with the bank for the 'primary purpose of obtaining the operational services provided by the bank'. Third, the deposit account must not be designed to create an economic incentive for the client to maintain excess amounts on deposit with the bank through 'increased revenue, a reduction in fees, or other offered incentives'. More broadly, the bank must demonstrate to the relevant supervisory authority that the 'deposit is 'empirically linked to the operational services provided', and must also have in place a methodology to identify and exclude 'any excess amounts.'⁹

In addition, US liquidity standards specify that deposit balances cannot result from the provision of certain types of less stable services, such as prime brokerage or correspondent banking, or from deposits resulting from the provision of services (including cash management, clearing or custody) offered to a 'non-regulated fund'. As an added layer of conservatism, US liquidity standards impose haircuts that limit the amount of deposits that otherwise meet the prescribed standards for operational deposits from counting as stable funding. This is intended to approximate expected outflow rates over the relevant timeframe in each metric. Specifically, the LCR imposes a run-off

⁹ LCR Final Rule (October 10, 2014).

rate of 25% to account for the impact of acute short-term stress, while the NSFR imposes a run-off rate of 50% to account for potential changes in structural liquidity over a one-year horizon. As a supervisory matter, large US banks are subject to detailed liquidity risk management requirements resulting from the implementation of Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank Act"). This includes the regular stress-testing of internal cash flow projections ("liquidity stress testing", or "LST"), using a series of scenarios tailored to reflect each banking entity's business activities, on-and-off balance sheet exposures and risk profile. In the case of the largest US banks, LST assumptions are a key focus in the Fed's Liquidity Program, a horizontal exercise designed to assess the liquidity position of those firms most likely to present systemic risk to the financial system.

There are a minimum of three stress scenarios prescribed by Section 165 of the Dodd-Frank Act (a market-wide stress event, an idiosyncratic stress event, and a combined idiosyncratic and market-wide stress event), which must capture at least four time horizons (overnight, 30-days, 90-days and one year) and must be sufficiently dynamic to address a variety of changes in a banking entity's internal and external circumstances. This includes the impact of market disruptions and the actions of other major market participants. Furthermore, banking entities must establish appropriate oversight of their LST, notably an independent validation function and information systems capable of collecting, sorting and aggregating the resulting data for use in the management of liquidity risk.

In order to facilitate the ongoing monitoring of their liquidity risk, large banks are required to submit to the Fed on a daily basis the FR 2052a Complex Institution Liquidity Monitoring Report ("FR 2052a"), which collects information on various assets, liabilities, funding sources and contingent liabilities, both on a consolidated basis and by material entity subsidiary. Information in the FR 2052a features prominently in the conduct of various horizontal examinations by the Fed and comprises sections covering funding classifications by product, counterparty, and purpose, segmented by maturity date. This encompasses detailed information on deposit outflows across various types of deposit accounts, including operational and non-operational account balances, providing timely, ongoing information on firm-specific funding and liquidity risk.

In effect then, the banking agencies have implemented a framework for the validation of operational deposit balances at large US banks that is extremely robust and when combined with the stringent qualification requirements in the LCR and NSFR, ensures the presence of a stable and

proven source of structural funding that is wholly distinct from uninsured deposits generally. The stability of operational deposits extends to periods of financial market stress, where custody banks tend to see substantial deposit inflows, as clients seek to de-risk or otherwise re-position their investment portfolios.

This increase in deposit inflows is predictable, with spikes in client deposit balances observed at the height of the 2008 financial crisis, the US debt ceiling crisis of late 2011 and the onset of the COVID-19 pandemic in March 2020.¹⁰ As a practical matter, custody banks manage these additional deposit inflows in the safest way possible through the placement of excess cash with the Fed and other national central banks. In this way, custody banks are able to support their institutional client's cash-related needs in a safe and secure manner without introducing additional risk to the custody bank, to the client or to the financial system as a whole.

Policy Recommendations

The primary policy objective of the RFI is to enhance the FDIC's understanding of potential differences in the characteristics, behavior and stability of varying types of deposit liabilities, notably for uninsured deposits, which contributed to the insolvencies of several regional banks in March 2023. In order to achieve this goal, we believe that it is essential for the FDIC to recognize that not all uninsured deposit liabilities are the same, and in particular to account for the unique profile of operational deposits, a well-defined and proven source of structural funding for banks, such as State Street, that specialize in the provision of custody and other financial services to institutional clients.

As such, we support revisions to the FFIEC Call Report for large banks subject to quantitative liquidity standards to require the reporting of total amounts of operational deposits based on the ruleset for such deposits in the LCR framework and the requirements of the Fed LCR Disclosure Rule. The goal of such a requirement should not be the creation of a duplicate regulatory framework for the validation of operational deposits, but instead to improve transparency of a key source of structural funding that is not otherwise captured through the binary distinction often drawn between insured and uninsured deposits. This can be seen, for instance, in the design of

¹⁰ Deposit balances at State Street during the regional bank insolvencies of March 2023 were essentially flat. This is consistent with our institutional investor client base and the lack of overlap with the commercial and private wealth deposits held by Silicon Valley Bank, Signature Bank and First Republic Bank.

the FDIC special assessment to recover the costs arising from the use of the systemic risk exception for the protection of uninsured depositors at Silicon Valley Bank and Signature Bank, where despite comprehensive industry feedback, assessments were allocated solely on the basis of total uninsured deposits (subject to a \$5 billion deduction) without regard for operational deposits and other more stable sources of industry funding.¹¹

Consistent with our view of the appropriate scope of Call Report disclosure, we do not support the collection of the additional data on deposit concentration specified in Question 5(b) of the RFI since this information extends beyond the scope of the Fed LCR Disclosure Rule and intrudes into matters best addressed through the supervisory process.¹² Furthermore, this information also touches on highly sensitive business model dependent data with the strong potential for misunderstanding by the market without the benefit of appropriate context. Finally, concentration related considerations for large banks with respect to single counterparties are already reported and addressed through the Fed's Single Counterparty Credit Exposure Limit framework and its attendant requirements.¹³

Despite the well-established role of operational deposits in the liquidity framework for large banks, we are aware that concerns have been raised by certain policymakers regard potential variability in individual banks' approaches to the assessment of their operational deposit amounts. We believe that these concerns can be addressed through the development of a set of standards, both quantitative and qualitative in nature, designed to enhance consistency in the assessment process. This would include common approaches to key design elements, such as the measurement of transactional activities, seasoning and look back periods, the identification of outlier balances and the calibration of the economic incentive test. As part of this effort, we recommend that the banking agencies conduct a quantitative information study to validate appropriate design considerations and calibration.

¹¹ "Final Rule on Special Assessment Pursuant to Systemic Risk Determination", Federal Deposit Insurance Corporation, Federal Register (November 29, 2023).

¹² LCR Final Rule (October 10, 2014).

¹³ "Single-Counterparty Credit Limits for Bank Holding Companies and Foreign Banking Organizations", Board of Governors of the Federal Reserve System, Federal Register (August 6, 2018).

Conclusion

Thank you once again for the opportunity to offer our views on the important issues raised in the RFI. To summarize, we recognize the value of a liquidity framework that appropriately reflects differences in the risk characteristics of various categories of deposits, including in particular operational deposits, which are central to the business model of banks, such as State Street, that specialize in the provision of custody and other financial services to institutional clients. We therefore support revisions to the FFIEC Call Report for large banks subject to quantitative liquidity standards to require the reporting of total amounts of operational deposits based on the ruleset for such deposits in the LCR framework and the requirements of the Fed LCR Disclosure Rule. We do not, however, support the collection of additional data on matters, such as depositor concentration by account size, deposit type or industry that extend beyond the requirements of the Fed LCR Disclosure Rule and that would unnecessarily intrude on the supervisory process.

Please feel free to contact me at jjbarry@statestreet.com or 617-664-1254 should you wish to discuss our submission in greater detail. We welcome the opportunity to further engage with the FDIC on these matters 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
Senior Vice President and Global Head of Regulatory
Industry and Government Affairs