



State Street Corporation

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Ann E. Misback, Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, DC 20551

E-mail: [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)  
Docket Number: R-1723  
RIN: 7100 AF94

**Advance Notice of Proposed Rulemaking: Modernizing the Community Reinvestment Act**

Dear Ms. Misback:

State Street Corporation (“State Street”) welcomes the opportunity to comment on the advance notice of proposed rulemaking (“proposed rule”) issued by the Board of Governors of the Federal Reserve System (“Board”) regarding various approaches to modernizing the regulatory and supervisory framework for the Community Reinvestment Act (“CRA”). The proposed rule aims, among other things, to more effectively meet the needs of low and moderate income (“LMI”) communities in the United States (“US”) and address historical inequities in credit access; account for changes in the structure of the banking industry over the past several decades, notably the growth of mobile and internet delivery channels; and increase the clarity, consistency and transparency of the CRA evaluation framework. In describing potential changes to the CRA framework, the Board strongly emphasizes the importance of tailoring to account for differences in bank size and business model. We broadly support the Board’s efforts and core recommendations, including the maintenance of the specialized wholesale designation for those banks, such as State Street, that are ‘not in the business of extending home mortgages, small business, small farm, or consumer loans to retail customers’.<sup>1</sup>

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<sup>1</sup> ‘Community Reinvestment Act – Community Development Test for Wholesale and Limited Purpose Designations’, Federal Reserve System (October 7, 2019).

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 \$38.8 trillion in assets under custody and administration and \$3.5 trillion in assets under management, State Street operates in more than 100 geographic markets globally.<sup>2</sup> 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 (“SSBT”). Our primary prudential regulators, including for purposes of the CRA, are the Massachusetts Division of Banks and the US Federal Reserve System.

## **THE CUSTODY BANK BUSINESS MODEL**

Custody banks, such as State Street, employ a highly specialized business model focused on supporting the financial services needs of institutional investor clients, such as asset owners, asset managers and official sector institutions. These clients contract with custody banks to ensure the proper safekeeping of their investment assets, as well as the provision of a broad range of related financial services. This includes access to the global settlement infrastructure in order 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. As an example, in Q4 2020, fee revenue comprised 83% of State Street’s total revenue.

Custody banks, such as State Street, do not engage in the business of retail, commercial or investment banking. They do not accept direct deposits from retail clients, they make relatively few if any retail loans, and they do not engage in loan securitization or other wholesale lending activities. Furthermore, custody banks have balance sheets which are constructed differently than other banks with extensive lending operations. Specifically, 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 stable deposits. These deposits, rather than various sources of wholesale funding, provide the largest part of the custody banks’ liabilities. As such, custody banks do not rely on an extensive network of branches, or various sources of wholesale funding, to manage their balance sheets and their day-to-day business activities.

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<sup>2</sup> As of December 31, 2020.

## **CRA WHOLESALE BANK DESIGNATION**

In keeping with their specialized business model, custody banks generally rely on the wholesale bank designation to shape their CRA programs, and each such custody bank is robustly evaluated using the Community Development Test, which addresses the scope and quality of a bank's qualified investments (including donations to non-profit entities), community development services, and in some cases community development lending. SSBT has been designated as a CRA wholesale bank since May 8, 1996, and under this designation we've maintained a comprehensive and high-quality CRA program that is deeply responsive to the needs of our local communities.

This program includes substantial investments in affordable housing initiatives, Small Business Investment Company programs, and qualified mortgage-backed securities ("MBS") supporting LMI borrowers. This program also includes extensive community outreach, including the sponsorship, via the State Street Foundation, of local education and workforce development initiatives, such as the Boston Workforce Investment Network (Boston WINs) which seeks to prepare disadvantaged Boston youth for college and career success through grants, internships and employment opportunities. Under our Executive Community Leadership Program, approximately three quarters of State Street's Executive Vice Presidents serve on the boards of non-profit organizations by providing their financial and professional expertise. We have achieved nine consecutive CRA ratings of 'outstanding' dating back to 2003, supported during the last examination period by \$1.35 billion in financial commitments.<sup>3</sup> As such, we take considerable pride in our CRA efforts and believe that the existing wholesale bank designation provides an appropriate basis for ensuring our long-term commitment to the LMI communities in which we operate in a manner that is responsive to, and draws strength from, the unique characteristics of our custody bank business model.

## **POLICY CONSIDERATIONS FOR WHOLESALE BANKS**

### **CRA Evaluation Framework**

The Board proposes the development of a revised CRA evaluation framework comprised of two tests: a Retail Test and a Community Development Test, each of which is further divided into two subtests. The Board emphasizes in the proposed rule that there are several advantages to the use of multiple tests. This includes ensuring that each type of activity is appropriately considered in the industry's overall planning efforts and also the flexibility it provides to the Board to tailor 'which tests and subtests apply to banks based on asset size and other factors'.

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<sup>3</sup> As of last CRA evaluation date. For more information, please see 'Public Disclosure: Community Reinvestment Act Performance Evaluation – State Street Bank and Trust Company' Massachusetts Division of Banks (August 12, 2019).

In the case of the Community Development Test, the Board proposes the use of a Financing Subtest which is intended to assess the scope of a bank's financial commitment to CRA eligible activities within and outside of its assessment area(s), and a Services Subtest which is designed to evaluate a bank's broader support for, and engagement with, the communities in which it operates.<sup>4</sup> Furthermore, the Board proposes to assess the CRA performance of wholesale and limited purpose banks using only the Community Development Test. We strongly support this approach which recognizes the broad diversity of business models among US banks and the important ways in which these banks support the development needs of the LMI communities in which they operate. This includes custody banks, such as State Street, which have no retail clients or retail lending product lines, and which instead focus on the provision of specialized financial services to institutional investor clients.

### **Community Development Financing Metric**

In order to improve the transparency of the CRA evaluation framework, the Board indicates that it is actively considering the implementation of a quantitative measure of Community Development Financing. Concurrently, it also affirms that the revised CRA evaluation framework should continue to 'incorporate performance context and other qualitative factors', including as a means of helping to identify unique community development needs and as a means of informing the Board's assessment of the responsiveness of a bank's CRA financing activities. We welcome this approach which we believe appropriately recognizes the balance between quantitative and qualitative considerations in the design of high-value Community Development Financing activities, while also providing greater certainty to banks in their CRA planning efforts.

In the case of large retail banks, the Board envisions the use of a Community Development Financing metric that compares the ratio of a firm's CRA lending and investment activities to its deposits. At the same time, the Board recognizes that a deposit-based metric would not be appropriate for wholesale and limited purpose banks given their differing business models and financial activities, and therefore seeks input on the development of an alternative measure of CRA capacity using an asset-based metric.

We strongly agree with the Board's view that a deposit-based measure of Community Development Financing activity is inappropriate for specialized wholesale banks, such as State Street, and in fact could result in widely disproportionate outcomes. As an example, the definition of 'retail domestic deposits' envisioned by the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation in their December 2019 rulemaking (that would initially have applied to wholesale banks), specifically 'total domestic deposits of

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<sup>4</sup> The Board requests comment in Question 42 of the proposed rule on whether to combine community development loans and qualifying investments in the Community Development Financing subtest. We support this approach.

individuals, partnerships and corporations’, would have implied a State Street retail domestic deposit base of \$116.34 billion (as of Q4 2019), even though State Street has no retail clients and does not accept direct retail deposits.<sup>5</sup> This reflects the fact that under existing US prudential standards, the term ‘corporation, or ‘corporate’ encompasses investment funds, such as US mutual funds and public and private pension plans, which are central to the custody bank business model.

While we broadly support the Board’s efforts to consider an alternative measure of CRA capacity for wholesale and limited purpose banks, we are concerned that it may be difficult to define a single asset-based metric that is sufficiently responsive to substantive differences in industry business models. As such, it may be advisable for the Board to defer a decision on the appropriate quantitative metric for wholesale and limited purpose banks until it is able to conduct a more fulsome review of impacted business models, including the relationship between a bank’s financial activities and the composition of its balance sheet.

Still, to the extent that the Board wishes to promptly define an asset-based alternative for such banks, we strongly recommend the use of a metric based on a firm’s ‘CRA-related assets’, rather than on the basis of ‘total assets’ generally. This would, in our view, permit a more granular assessment of the types of assets held by banks, their specific relationship to the bank’s underlying business model and the extent to which these assets relate to the CRA and its mandate to support the credit needs of the local communities, particularly LMI communities, in which a bank operates. More substantively, we recommend that ‘CRA-related assets’ be defined by the Board as total investment assets held by the bank (minus central bank placements, short-term US Treasury securities and other short-term sovereign debt (“central bank placements and short-term government debt”)), plus total lending activities of the bank (minus custody-related client overdrafts).

## **Exclusion of Central Bank Placements and Short-Term Government Debt**

There are two primary reasons why we believe that it would be appropriate for the Board to exclude central bank placements and short-term government debt from ‘CRA related assets’ for purposes of assessing the Community Development Financing activities of wholesale and limited purpose banks. First, these assets are primarily held by specialized wholesale-designated banks, such as State Street, not for investment purposes, but rather to accommodate the structural characteristics of their customer liabilities. As noted in our introductory comments, the custody bank balance sheet is liability driven and is primarily comprised of deposits that result from the provision of financial services to institutional investor clients. This includes surge deposits in times of financial market stress as clients seek to ‘de-risk’ their investment portfolios and build reserves to meet heightened client redemption activity. In order to prudently manage these deposit obligations, custody banks rely extensively

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<sup>5</sup> ‘Notice of Proposed Rulemaking: Community Reinvestment Act Regulations’, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation’, Federal Register Volume 85, Number 6 (January 9, 2020).

on central bank placements as a safe store of value. Importantly, these placements can vary substantially, including as a result of changes in monetary policy outside of the control of the custody bank. For instance, as of year-end 2019, just prior to the start of the COVID-19 pandemic, State Street held \$29.4 billion in Federal Reserve placements. By year-end 2020, this amount had grown as a result of Federal Reserve quantitative easing to \$55.8 billion.<sup>6</sup>

Similarly, central bank placements and short-term government debt are also held by large wholesale-designated banks, such as State Street, to meet regulatory requirements for liquid assets. This includes the Liquidity Coverage Ratio, a short-term measure of liquidity over a 30-day period of stress, and the Net Stable Funding Ratio, a longer-term structural measure of liquidity over a one-year horizon.<sup>7</sup> In effect then, central bank placements and short-term government debt serve a structural and regulatory purpose for wholesale-designated custody banks, such as State Street, that are driven by business model considerations wholly unrelated to the CRA.

Second and closely related to the above, central bank placements and short-term government debt represent obligations of sovereign counterparties issues for various national purposes, including the funding of government spending and the conduct of monetary policy, which are unconnected to the relationship that banks have with the local communities, particularly LMI communities, in which they operate. As such, their inclusion within the CRA metric for wholesale designated banks, such as state Street, would be broadly misplaced, drawing a connection to financial activities that have no bearing on, or nexus to, the development of high quality, innovative and responsive CRA programs aimed at addressing the financial needs of underserved communities.

### **Exclusion of Custody-Related Client Overdrafts**

While we acknowledge the potential additional complexity that may result from this approach, we also believe that it is appropriate to exclude custody-related client overdrafts from the Community Development Financing metric for wholesale and limited purpose banks. This is intended to address the particular role that specialized wholesale designated banks, such as State Street, play in facilitating payment, clearing and settlement activities on behalf of their clients, a function that at times results in short-term extensions of credit to ensure the timely settlement of transactions, generally on an overnight basis. For instance, a custody bank will in the normal course of business, look to settle the purchase of securities on behalf of a client on settlement date even if the funds intended to be used for that purpose are temporarily unavailable due to an error in the client's cash forecasting, or due to a mismatch in the settlement of an offsetting sell transaction. Similarly, a custody bank will generally not delay the

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<sup>6</sup> There is a strong correlation between the flow of excess deposits onto the balance sheet of custody banks and the size of the Federal Reserve's balance sheet, which has recently grown to \$3.2 trillion.

<sup>7</sup>The LCR applies in full to banks with \$250 billion or more in total assets, or \$10 billion or more in foreign exposures. The NSFR applies in full to Category I and Category II banks under the Federal Reserve's October 2019 tailoring rule, as well as Category III banks with more than \$75 billion in weighted short-term wholesale funding.

settlement of a securities transaction in a client account due to a temporary delay in the receipt of inbound funds that result from erroneous or incomplete wire instructions.

While these overdrafts play an essential role in facilitating the day-to-day operation of the financial markets, they are not intended to serve as an extension of credit from which to generate material net interest income. Furthermore, these overdrafts have no appreciable link to the CRA and the communities, particularly LMI communities, in which a bank operates. As such, their inclusion in the definition of 'CRA-eligible assets' would be at odds with the core functions of a custody bank and would likely result in an inflated metric that would distract from, rather than contribute to, the development of highly responsive CRA programs.

Alternatively, the Board may wish to consider an approach involving the establishment of a formal process within the CRA framework that would permit specialized banks, such as State Street, to request the additional carve out of specific types of financial activities from 'CRA-eligible assets' to address substantive business model considerations.

## **Qualifying Community Development Activities**

The Board explores in the proposed rule various ways to clarify and update qualifying Community Development Activities for purposes of the Community Development Test. We welcome this effort and would like to use this opportunity to emphasize several matters of particular importance to wholesale designated banks, such as State Street.

As an initial matter, we strongly support the emphasis which the Board places on affordable housing activities in the further strengthening of the CRA framework. This includes the observation in the introduction of the proposed rule that CRA-motivated capital is of 'critical importance' as a 'source of funding for affordable housing around the country and (the promotion of) homeownership among LMI populations', and as such, the CRA framework should 'ensure strong incentives for banks to provide community development loans and investments for the creation and preservation of affordable housing.'<sup>8</sup> We note, in this respect, the particularly important role which low-income housing tax credits ("LIHTC") play in enabling wholesale designated banks, such as State Street, to support the affordable housing needs of large numbers of LMI neighborhoods across the US, and therefore the imperative of ensuring that these activities are not artificially limited by rule to a firm's particular geographic assessment area(s).

The Board notes in Section VIII A(1)(f) of the proposed rule that it is contemplating the appropriate CRA treatment of MBS comprised of loans that finance various affordable housing initiatives, such as subsidized multi-family rental housing, loans for mixed-income housing that includes affordable housing units, or loans to LMI borrowers. Under the existing CRA framework, banks are eligible for CRA credit when they purchase qualifying MBS. We strongly urge the Board to maintain this approach, in particular for qualifying MBS that are held by

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<sup>8</sup> Proposed Rule, page 117.

banks in the investment portfolio rather than sold into the secondary market. This reflects several considerations. First and consistent with the Board's emphasis on tailoring CRA requirements to reflect differences in bank size and business model, we believe that it is essential to maintain parity in the CRA treatment afforded to both originating and investing banks. This includes custody banks, such as State Street, that do not originate or securitize loans and instead seek to monetize their balance sheets through the purchase of diversified portfolios of investment assets. Second, we believe that the Board and other banking agencies should not overlook the fundamental importance of secondary market activity in meeting at scale the credit needs of LMI communities in the US, and as such, should seek to preserve parity in the CRA credit provided to both primary and secondary market activities. We note, in this respect, the often-overlooked point that there is no difference in the CRA benefit of financial activities to LMI communities derived from either primary or secondary market activity.

The Board expresses a strong interest throughout the proposed rule in developing ways to incentivize certain types of Community Development Activities. This includes, among other things, the identification of designated areas of need, the use of Board specified 'impact scores' and the designation of certain activities as factors in determining whether a bank can qualify for an 'outstanding' CRA rating. While we recognize the impetus behind these initiatives, we would urge the Board to carefully consider whether, at least in certain cases, it might be more appropriate for the market to define the incentive structure for CRA activities. This includes, for example, the identification of areas of need.

Furthermore, we believe that the Board must be careful not to establish granular requirements for banks to achieve an 'outstanding' CRA rating tied to certain specific types of Community Development Activities that may not be consistent with the bank's particular business model and financial expertise. For instance, while we recognize the crucial importance of support for minority depository institutions and community development financial institutions in meeting the industry's CRA obligations, we do not believe that it would be appropriate to make the achievement of an 'outstanding' CRA rating by wholesale designated banks contingent on such support given our lack, as a custody bank, of commercial and retail bank expertise.

## **CONCLUSION**

Thank you again for the opportunity to comment on the important matters raised within the proposed rule. To summarize, State Street strongly supports the Board's emphasis on the development of a revised CRA framework that accommodates differences in bank size and business model. This includes the maintenance of the wholesale bank designation for specialized banks, such as State Street, that are not involved in the business of retail banking. We acknowledge the value of a quantitative measure of Community Development Financing and agree that a deposit-based metric is inappropriate for the assessment of wholesale and limited purpose banks. While we believe that it may be difficult for the Board to identify a single asset-based metric that appropriately accounts for broad differences in underlying business models, to the extent that it wishes to do so, we recommend a metric based on 'CRA-



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eligible assets', defined as total investment assets held by the bank (minus central bank placements and short-dated government debt), plus total lending activities of the bank (minus custody-related client overdrafts).

We welcome the Board's efforts to clarify and update qualifying Community Development Activities for purposes of the Community Development Test. We strongly support, in this respect, the Board's emphasis on affordable housing initiatives, such as LIHTC investments, that enable wholesale designated banks to support the affordable housing needs of large numbers of LMI neighborhoods nationally, and urge that these activities not be artificially restricted to a firm's narrow geographic assessment area(s). We urge the Board to maintain existing CRA credit for qualifying MBS, as well as the equal treatment of primary and secondary market activity involving CRA eligible assets. While we acknowledge the Board's interest in creating regulatory incentives for certain types of Community Development Activities, we urge the Board to also consider the benefits of market-based incentives in driving appropriate outcomes. Finally, we recommend against the introduction of prescriptive and narrowly defined criteria for the achievement of an 'outstanding' CRA rating, especially in the case of criteria that are business model dependent.

Please feel free to contact me at [jjbarry@statestreet.com](mailto: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