State Street Corporation

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Board of Governors of the Federal Reserve System
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Discussion Paper – Money and Payments: the US Dollar in the Age of Digital Transformation

Dear Sir/Madam:

State Street Corporation ("State Street") welcomes the opportunity to comment on the discussion paper issued by the Board of Governors of the Federal Reserve System ("Board") regarding the potential implementation of a United States ("US") central bank digital currency ("CBDC"). This includes an assessment by the Board of key policy and design considerations for a CBDC 'that is a digital liability of the Federal Reserve System….widely available to the general public' and the implications of these considerations for the structure and stability of the financial system. While we recognize the considerable interest which exists relative to the potential development of such a retail-focused CBDC, we believe that essential decisions regarding design features, commercial model and operational structure are likely to benefit from initial work by the Board and other stakeholders on the development of narrower CBDC solutions for the wholesale market.

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.[1] State Street is organized as a US bank holding company, with operations conducted through several entities, primarily its wholly-owned Massachusetts state chartered insured

[1] As of March 31, 2022.

depository institution subsidiary, State Street Bank and Trust Company. Our primary prudential regulators are therefore the Massachusetts Division of Banks and the US Federal Reserve System.

We appreciate the opportunity to comment on the Board's discussion paper. The implications of a 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, such as money market funds and commercial paper, and the potential for greater susceptibility of the system to financial stability risk. We therefore welcome the deliberative manner in which the Board has chosen to proceed with its assessment of policy considerations for a CBDC and their related benefits, costs and risks.

The digital transformation of the US financial system, driven by emerging technologies such as tokenization, blockchain and artificial intelligence, is real and will result over time in material improvements to market efficiencies, with important benefits for long-term investors. However, in order to fully achieve these outcomes, we believe that the digital transformation must be supported by new and robust payment functionality, capable of facilitating the real-time movement of cash. Furthermore, it is also crucial for this new functionality to be offered in a way that preserves commercial parity among banks, as is the case today for the Fedwire Funds Service system.

In Footnote 14 of the discussion paper, the Board notes that while its analysis is focused on the issues raised by a retail CBDC, a 'narrower focused CBDC could also be developed, such as one designed primarily for large value institutional payments and not widely available to the public'.[2] It then notes its interest in receiving comments from stakeholders on the potential uses of a more narrowly defined CBDC. In our view, efforts to thoroughly assess the benefits, costs and risks of a potential retail CBDC, and the ability to make informed decisions regarding key design features and operational structures, are likely to benefit from initial work by the Board on the development of narrower CBDC solutions for the wholesale market. In particular, we believe that the Board should prioritize efforts to develop a CBDC solution for the interbank payment system (both domestic and cross-border), an initiative which can then be deployed over time to achieve greater efficiencies in various high-volume processes in the wholesale markets, such as trade settlement and the management of collateral.

This approach has a number of advantages. First, it would enable the Board to focus its initial attention on existing wholesale market processes where the need for greater efficiencies is already well-established and understood by industry participants. Second, this approach would offer the Board the opportunity to study and test various design features in a 'sand box' type environment with stakeholders that have considerable experience in managing complex system-wide change before assessing solutions with broader applicability. Third, our proposed use case is achievable in the near-to-medium term, and is therefore likely, once complete, to

[2] Consultation Paper, page 13.

create positive momentum for further innovation focused on addressing clear instances of market inefficiency. This includes, for instance, further progress in reducing 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. Finally, this approach would help minimize disruptive changes to the financial system that may result from the implementation of a broad-based retail CBDC and the potential for these changes to heighten systemic risk. This includes, in particular, the greater vulnerability of the banking system to sudden deposit outflows, particularly in periods of acute market stress, as customers seek to hold funds as a direct liability of the Federal Reserve System regardless of pricing or other normal course considerations.

In order to help realize the practical benefits of a wholesale CBDC, we encourage the Board to work collaboratively with the private sector on discrete initiatives, supported by careful planning, ongoing dialogue and an active commitment to the full and comprehensive management of risk. This includes additional efforts to understand the potential benefits of bank-issued stable-coins in preserving the role of the US dollar in global payments and as a reserve currency. Furthermore, we recommend the use of well-defined test pilots, supported by clear and transparent systems specifications and comprehensive industry wide-testing. Finally, we also recommend clear governance standards for new wholesale payments functionality and the coordination of the Board's work with other national or regional central banks to help encourage the emergence of consistent and broadly interoperable solutions.

CONCLUSION

Thank you once again for the opportunity to comment on the policy considerations raised by the potential implementation of a US CBDC. To summarize, State Street believes that efforts to understand and deploy the transformative implications of a US CBDC are best supported by initial work on narrower focused CBDC solutions designed to address existing inefficiencies in the wholesale market. In particular, we recommend that the Board prioritize efforts to develop and implement CBDC functionality for the inter-bank payment system, both domestic and cross-border, which can then be leveraged over time to address other promising use cases.

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

Sincerely,

Joseph J. Barry