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Office of the Chief Counsel
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Washington, DC 20219
eRulemaking Portal: www.regulations/gov
Docket ID: OCC–2023-0008

Anne E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
E-Mail: regs.comments@federalreserve.gov
Docket Number: R-1813; RIN 7100-AG64

James P. Sheesley, Assistant Executive Secretary
Attention: Comments/ Legal OES
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
E-mail: comments@fdic.gov
RIN: 3064-AF29

Joint Notice of Proposed Rulemaking – Regulatory Capital Rule for Large Banking Organizations and Banking Organizations with Significant Trading Activity

Dear Sir/ Madam:

State Street Corporation ("State Street")[1] welcomes the opportunity to comment on the joint Notice of Proposed Rulemaking ("proposed rule") issued by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System ("Fed") and the Federal Deposit Insurance Corporation ("FDIC") (collectively the "banking agencies"), to substantially revise the capital requirements which apply to large United States ("US") banking institutions, primarily through the adoption of the final elements of the Basel III framework ("Basel III Review") issued by the Basel Committee on Banking Supervision ("Basel Committee") in December 2017.[2]

State Street has significant concerns with the proposed rule and its implications for our custody bank business model. The proposed rule is broad in scope, addressing all major components of the risk-based capital framework, including credit, market, operational and credit valuation adjustment risks. Furthermore, due to various policy choices and considerations, notably multiple deviations from the standards foreseen in the Basel III Review, the proposed rule is expected to result in a dramatic increase in capital for the US banking industry, with profoundly negative potential implications for end-users and overall economic growth. The proposed rule suffers, in this respect, from a number of limitations which are addressed at considerable length in various trade association comment letters. This includes, among other matters:

- The incorporation of a risk-insensitive listing requirement in the framework for investment grade corporate exposures, which unfairly penalizes extensions of credit to mutual funds, pension plans and other highly regulated entities;

[1]Headquartered in Boston, Massachusetts, State Street is a global custody bank which specializes in the provision of financial services for 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 $40.0 trillion in assets under custody and administration and $3.7 trillion in assets under management as of September 30, 2023, State Street offers its clients the ability to hold assets and transact in more than 100 geographic markets globally. State Street is organized as a US bank holding company ("BHC"), with operations conducted through several entities, primarily its wholly-owned 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.
[2]"Basel III: Finalizing Post-Crisis Reforms', Basel Committee on Banking Supervision, December 2017.

- The decision to omit, without explanation, the reduced risk-weights for intra-bank exposures of less than three months duration;
- The differentiated treatment of net-interest income and fee-related income in the business indicator ("BI") component of the standardized methodology ("SMA") for operational risk, including the inability to net fee-related expenses against fee-related income;
- The omission of renewable energy investments as a category of nationally legislated programs eligible for the use of an equity risk-weight of 100%;
- The requirement to calculate bank exposures to asset management-related seed investments using the market risk framework notwithstanding the lack of trading intent;
- The potential quadrupling of the capital charge for bank equity investments in financial market infrastructure ("FMI") used to support normal course payment, clearing and settlement activities;
- The use of a narrow definition of 'unconditionally cancellable commitments' subject to a reduced credit conversion factor of 10% that omits credit lines subject to automatic cancellation due to a deterioration in borrower creditworthiness;
- The failure to address the pronounced overlap of operational and market risk capital resulting from the combined effect of the proposed rule and Fed stress testing mandates; and
- The impact that the elimination of internal models has on the single counterparty credit limit ("SCCL") exposure framework, specifically as applied to repo style transactions, and the resulting need for an appropriate transition period.

Our comment letter focuses on what we believe to be the three most significant issues in the proposed rule for our custody bank business model: (i) the inability of banking institutions to apply the lower risk weight for investment grade corporate exposures to highly regulated entities, such as mutual funds and pension plans, (ii) the unequal treatment of fee-related income vs. net interest income in the BI component of the SMA for operational risk, and (iii) the obligation, notwithstanding the lack of any trading intent, to use the revised market risk framework to calculate risk-weighted assets for asset management-related seed investments in funds. These matters, which are addressed in further detail below can, in our view, be addressed through targeted changes to the proposed rule that do not undermine the banking agencies' core policy goals or materially depart from the standards prescribed by the Basel Committee in the Basel III Review.

INVESTMENT GRADE CORPORATE EXPOSURES

Drawing from the standards found in the Basel III Review, the banking agencies propose the adoption of a revised standardized methodology for corporate exposures that includes a reduced risk-weight of 65% for those exposures which are identified as investment grade. In order to rely on the investment grade designation, a banking institution must determine, as is true today under the capital rule, that the entity 'has adequate capacity to meet (its) financial commitments for the projected life of the asset or exposure', and that the 'risk of its default is low and the full and timely repayment of principal and interest is expected'.[3] In addition, the corporate entity must have 'a publicly traded security outstanding' on a recognized exchange, or must be controlled by a company that has a public listing ("listing requirement").[4] The banking agencies cite several reasons for the incorporation of the listing requirement in the standardized framework for credit risk. This includes the desire for a 'simple, objective criterion that would provide a degree of consistency' in the application of the investment grade standard, and the belief that the listing requirement ensures that the exposure is subject to 'enhanced transparency and market discipline' as a result of being publicly listed.'[5]

While we welcome the introduction of greater granularity in the standardized calculation methodology for corporate exposures, we strongly oppose the listing requirement which does not, in fact, serve as a useful measure of credit risk, does not fully define the universe of corporate entities which are subject to robust transparency requirements, and which unfairly and disproportionately impacts the custody bank business model. The listing requirement disqualifies for favorable treatment the primary client base of custody banks, high-quality investment funds, such as mutual funds and employee pension plans, which although subject to robust regulatory mandates and detailed public disclosure obligations, do not as a normal part of their function, list securities on an exchange.

Listing Requirement and Credit Risk

While the set of qualitative standards prescribed by the banking agencies for investment grade corporate exposures is robust and directly applies to the creditworthiness of the corporate entity,

[3] Proposed Rule, Page 70, Footnote 57.

[4] Proposed Rule, Page 112.

[5] Proposed Rule, Page 113.

the listing requirement is an entirely novel mandate without precedent in the assessment of risk-based capital. Moreover, the ability to list a security on an exchange does not require the corporate entity to meet any particular credit quality standard or threshold, and is therefore unrelated to the entity's creditworthiness. For instance, there are numerous fixed income instruments with below investment grade ratings that are listed on an exchange solely for the purpose of satisfying investor eligibility requirements, irrespective of the issuer's creditworthiness. Similarly, the listing standards and related disclosure requirements which apply to securities exchanges globally vary substantially. The proposed rule assumes that a securities listing equates with high standards of disclosure, which is not universally true, while ignoring the significant disclosure obligations which apply to issuers registered under the Investment Company Act of 1940 ("'40 Act"), Undertakings for Collective Investment in Transferable Securities ("UCITS") and other similar regulated investment fund structures. The listing requirement is therefore unnecessary to ensure that banking institutions properly understand and manage the credit risk of their corporate exposures.

Similarly, the listing requirement can produce highly inconsistent outcomes. For instance, while an exchange-traded fund ("ETF") that tracks the S&P 500 would be eligible for treatment as an investment grade corporate exposure, this would not be true of a traditional mutual fund with the exact same investment mandate. As such, the costs of providing credit to support the safekeeping and asset administration activities of a traditional mutual fund would be higher under the proposed rule than those of a comparable ETF without regard to any difference in underlying credit risk.

Transparency and Public Disclosure

Corporate entities that list on a US exchange are required to file with the Securities and Exchange Commission ("SEC"), and to regularly disclose to the public, information on their business and financial condition. This includes annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K. Listed corporate entities are also required to promptly disclose to the public any material information relevant to their business or financial condition.

As entities subject to registration under the '40 Act, mutual funds are also required to meet extensive transparency and public disclosure mandates. This includes the filing with the SEC of annual and semi-annual reports on Forms N-CEN and N-CSR, the reporting of monthly portfolio information on Form N-PORT and the filing of current reports on financial conditions using Form N-

RN and Form N-LIQUID. In addition, mutual funds are subject to daily asset valuation requirements and the related public reporting of their net asset value ("NAV"). As such, the transparency requirements which apply to mutual funds are robust and do not materially differ from the requirements which apply to a listed corporate entity.

This is also true of employee pension plans which are subject to regulation by the Department of Labor ("DOL"), including the disclosure of information regarding the operation of the plan and its financial condition. Employee pension plans must, as an initial matter, provide all plan participants with a Summary Plan Description ("SPD") which describes key features of the plan and its operations, and the related benefits, rights and obligations of each participant under the plan. Furthermore, any material changes to a plan or to the information contained in the SPD must be disclosed to plan participants using the Summary of Material Modification report. More broadly, employee pension plans are required to file with the DOL an annual financial statement (Form 5500), which incorporates plan information, financial statements, an actuarial statement and the opinion of an accountant, and must also distribute to plan participants an accompanying Summary Annual Report providing key details of the Form 5500 filing in narrative form.

In effect then, mutual funds and employee pension plans are subject to transparency and disclosure obligations which are at least as rigorous as those which apply to corporate entities that are listed on a securities exchange and should not on that basis be excluded by the banking agencies from categorization as investment grade exposures.

High Quality Investment Funds

Custody banks operate a highly specialized business model that is focused on serving the needs of institutional investor clients. This includes mutual funds and employee pension plans, highly regulated entities that value our ability to offer safekeeping and asset administration services globally at scale. The core function of a custody bank is to safeguard client assets in the various markets where the client may wish to invest. These assets, which are fully segregated from the custody bank's own assets, are held in one or more securities accounts specifically designated for that purpose. In turn, each securities account is linked to a deposit account used to facilitate activities that directly result from investment assets. This includes the purchase or sale of investment securities, the receipt of income and dividend payments, the receipt of proceeds from

maturing assets, the processing of corporate action events, tax reclamations and the payment of fees and expenses.

Essentially, custody banks provide their institutional investor clients with ‘checking accounts’ used to support day-to-day transactional activities that result from investments in one or more portfolios of assets. In order to facilitate the orderly function of these activities, custody banks provide their clients with various services, including short-term extensions of credit that help smooth and improve the predictability of day-to-day cash outflows. It is these extensions of credit which are directly impacted by the narrow manner in which the banking agencies are proposing to apply the investment grade framework for corporate exposures.

Mutual funds are a well-established feature of the US financial system, offering investors cost-effective access to pools of assets used to accumulate retirement savings and other sources of long-term wealth. While certain categories of mutual funds, such as ETFs, are listed on an exchange, primarily as a means of providing investors with access to pools of assets on an intra-day basis, traditional mutual funds do not issue debt or raise equity as a function of their structure and therefore have no objective reason to seek a listing. As previously noted, mutual funds are subject to registration with the SEC and are governed by specific legal statute and accompanying regulation that define how they are structured, how they can invest and how they must operate. This includes detailed asset quality, asset coverage and asset diversification mandates. It is particularly important to note the strict limits on leverage which apply to issuers registered under the ’40 Act, UCITS and other similar highly regulated investment fund structures. As an added layer of protection, mutual funds are generally managed by asset managers which are themselves subject to SEC oversight, including the obligation to act in the investor’s best interest and to manage the fund in accordance with its investment mandate.

Employee pension plans play a central role in facilitating the accumulation of wealth by every day Americans used to provide for their livelihood in retirement. Pension plans therefore serve an essential societal function, mitigating potential economic insecurity in old age and ensuring the long-term participation of retirees in the US economy. Employee pension plans are subject to detailed legal and regulatory requirements, designed to ensure the prudent management of assets on behalf of plan participants. This includes, in the case of ERISA plans, the imposition of a fiduciary standard on any entity or person responsible for the management of the plan and its assets, including plan administration and the provision of investment advice. These standards

require fiduciaries to: (i) act solely in the interest of the plan's participants and its beneficiaries; (ii) act with due care, skill, prudence and diligence; (ii) diversify plan assets so as to minimize the risk of large losses, and (iv) act in accordance with the documents and instruments governing the plan.

Employee pension plans must also meet strict funding requirements. In the case of ERISA plans, this includes: (i) minimum yearly contributions based on the value of the benefits earned by participants in the plan year, (ii) installment payments resulting from plan underfunding in previous years, and (ii) installment payments relating to waivers due to temporary hardships. Consistent with their mandate and financial purpose, employee pension plans do not issue debt or seek to raise equity. As with mutual funds, employee pension plans therefore have no objective reason to seek a listing on a securities exchange as would be required by the banking agencies under the proposed rule.

Mutual funds and employee pension plans have limited and predictable credit needs, which are supported by custody banks as a normal part of the services which they provide. This includes:

- Access to liquidity, including the provision of discretionary overdraft protection, to address settlement delays or the non-receipt of funds, generally on an overnight basis;
- Short-dated loans in order to accommodate various liquidity needs, such as the processing of redemptions ahead of the receipt of funds from the sale of investment assets, and the timely payment of management fees and other expenses; and
- Execution of foreign exchange transactions related to assets held by the investment fund, resulting from, among other things, the purchase or sale of foreign assets and the conversion of foreign income payments into base currency.

Extension of credit to mutual funds and employee pension plans are low risk and are supported by features that limit both tenor and usage. In addition, extensions of credit are also frequently backed by the mutual fund or employee pension plan's assets, or are otherwise subject to de facto collateralization via a lien or other similar legal agreement.

Internal Credit Risk Management

State Street is a leading provider of safekeeping and asset administration services to regulated investment funds globally, including mutual funds and employee pension plans. We maintain, in

this respect, a robust credit risk management framework to appropriately assess, manage and control the underlying risk. This includes an initial entity-specific risk assessment, the periodic calculation of applicable probability of default ("PD") ratings, risk alert monitoring based on a combination of exposures and daily NAV reporting, regular stress testing, and in certain cases the automated setting of credit limits based on changes in the investment fund's value. Our approach to investment grade ratings is supported by strong governance over approved PD rating models. This includes the annual review of model factor inputs and PD outputs to identify anomalies or changing market dynamics that might impact the ratings approach.

As such, State Street has never experienced a loss on an extension of credit to a mutual fund or employee pension plan, nor are we aware of any industry experience of a credit loss with these types of portfolios. Our zero-default history substantiates the quality of our investment grade PD results, which is further evidenced by minimum ratings migration within the investment grade band over a multi-year sample. Peer banks have a consistent view of the investment grade risk profile of our mutual fund and employee pension plan counterparties. This is evidenced by Credit Benchmark Industry Peer rating data, where 91% of our investment fund ratings fall within a +/- 1 ratings band and 99% falling within +/- 2 rating bands relative to our own ratings.[6] The Credit Benchmark slide enclosed in Appendix A of our comment letter provides, in our view, valuable insight that helps validate the scope of the data that the industry has on the credit risk profile of mutual funds and employee pension plans, and their consistently high quality relative to other types of investment funds.

In effect then, the incorporation of the listing requirement in the proposed standardized methodology for corporate exposures, as envisioned by the banking agencies, creates an artificial barrier that prevents the use of the investment grade designation for various highly regulated entities, such as mutual funds and employee pension plans, that would otherwise objectively meet the criteria for designation as investment grade. We strongly recommend that the banking agencies take the steps necessary to correct this outcome.

[6] Credit Benchmark provides Credit Consensus Ratings and Analytics calculated based on contributed risk views from 40+ leading global financial institutions, almost half of which are GSIBs. These institutions are domiciled in the US, Continental Europe, Switzerland, the UK, Japan, Canada, Australia and South Africa. The contributions are anonymized, aggregated and published in the form of Credit Consensus Ratings and Credit Indices.

If implemented without change, the standardized calculation methodology for corporate exposures in the proposed rule will have a number of adverse consequences, specifically:

- The US capital framework would be less risk-sensitive than in other major jurisdictions and would make arbitrary decisions based on factors unrelated to credit risk;
- Banks in the US would be placed at a further competitive disadvantage relative to banks in jurisdictions that permit the use of credit ratings for determining exposures to corporate entities;
- Banks in the US would be incentivized to favor the provision of credit to traditional corporate exposures vs. regulated investment funds in a manner that contradicts SEC efforts to reduce liquidity risk in the financial markets; and
- End-investor returns in mutual funds and employee pension plans would be reduced based on a factor unrelated to differences in credit risk.

Policy Recommendation

In Question 39 of the proposed rule, the banking agencies request feedback on whether to apply a lower risk weight to exposures to entities that are not publicly traded but are 'highly regulated'.[7] This includes, among other entities, mutual funds and employee pension plans. We strongly support this approach and believe that this can best be accomplished by clarifying the requirements in the proposed rule for designation as an investment grade corporate exposure. More specifically, we recommend that the banking agencies incorporate in the credit risk framework for corporate exposures the following clarification:

'For a corporate exposure that does not have a securities outstanding on a public exchange, a banking organization may apply the lower risk weight for investment grade securities provided that the entity is subject to regulatory or legal requirements regarding public disclosures that are significantly equivalent to the public disclosures that would otherwise be required for a publicly-traded company.

For example, corporates, such as mutual funds registered under the Investment Company Act of 1940, employee pension funds subject to ERISA reporting requirements, and other such highly

[7] Proposed Rule, Page 113.

regulated entities (including foreign equivalents) would meet the public disclosure requirement and could be assigned a 65% risk weight, provided the exposure otherwise meets the definition of investment grade.'

Clarification of the requirements in this way would, in our view, better accommodate the range of high-quality corporate entities that should objectively be categorized as investment grade, while ensuring broad consistency with the general, limiting intent of the listing requirement. In order to mitigate possible misuse of this approach, the banking agencies could also specify in any final rule that non-regulated investment funds are explicitly excluded from designation as investment grade exposures. There is precedent for such an approach in other regulations adopted by the banking agencies, including the Liquidity Coverage Ratio final rule, which affirms that deposits from non-regulated funds, defined as 'any hedge fund or private equity fund whose investment adviser is required to file SEC Form PF' is ineligible for categorization as operational deposits.[8]

Alternatively, the banking agencies could adopt a broader set of qualification standards for investment grade corporate exposures to account for highly regulated investment funds, such as mutual fund and employee pension plans. This alternative approach is consistent with the emphasis in Question 38 of the proposed rule on potential alternative criteria for identifying corporate exposures that would warrant the application of a reduced risk weight.[9] We would propose, in this respect, the following additional criteria:

- *Investment funds that are registered with the SEC under the Investment Company Act of 1940, or a foreign equivalent;*
- *An employee benefit plan (as defined in paragraphs (3) and (32) of section 3 of ERISA) or a government plan (as defined in paragraph (32) of section 3 of ERISA) that complies with the tax deferral qualification requirements in the IRC, or any similar employee benefit plan established under foreign law.*

The banking agencies request feedback in Questions 38 and 39 of the proposed rule on the suitability of an approach involving the application of a reduced risk weight of between 65% and

[8] 'Liquidity Coverage Ratio: Liquidity Risk Measurement Standards', Board of Governors of the Federal Reserve, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation, Federal Register, Volume 79, Number 197 (October 10, 2014).

[9] Proposed Rule, Page 113.

100% for corporate exposures that do not meet the listing requirement but are otherwise highly regulated. While we are not in principle opposed to such an approach, we are concerned that the adoption of a new risk weight for highly regulated corporate entities would not be consistent with the banking agencies' emphasis on the implementation of a capital framework that is broadly aligned with the standards prescribed in the Basel III Review. We therefore do not believe that the banking agencies should pursue such an approach at this time, even if there is considerable merit in further consideration of this matter with other member jurisdictions of the Basel Committee.

FEE RELATED INCOME AND THE SMA FOR OPERATIONAL RISK

The banking agencies helpfully propose to eliminate the use of internal models for the calculation of operational risk capital in favor of a new standardized approach, the SMA for operational risk, that combines a financial statement-based measure of size (the "business indicator" or "BI") with a banking organization's operational loss history over a ten-year horizon (the "internal loss multiplier"). A banking organization's total operational risk capital would be assessed, under this approach, by multiplying a firm's BI score with its internal loss multiplier. In a departure from the Basel Committee, the banking agencies propose to floor the internal loss multiplier at one, thereby effectively precluding banks from benefiting from a narrow loss history relative to industry peers.

The BI metric is comprised of three separate income streams: (i) interest income, (ii) fee income, and (iii) financial (profit and loss) income. As currently designed, the ability to net expenses in the BI is limited to interest income and financial income. Moreover, the interest income component of the BI metric also benefits from a cap equal to 2.25% of a banking institutions' total interest earning assets. In the aggregate, therefore, this results in an approach that drives outsized operational risk capital charges for banking institutions that focus on the provision of financial services when compared to banking institutions that focus on the generation of interest income. This includes the punitive treatment of the custody bank business model, which as previously noted, is uniquely focused on serving the investment-related needs of institutional investor clients. To provide context, we note that as of Q3 2023 fee revenue comprised 78% of State Street's total revenue, a ratio that is typical for specialized, stand-alone custody banks. More broadly, we also note that the US banking industry generates a larger proportion of fee income relative to net interest income than banks in other national jurisdictions.

We therefore believe that the banking agencies must actively consider adjustments to the SMA for operational risk to help address the disproportionate treatment of banking institutions with specialized business models focused on the provision of fee-related services. We strongly welcome, in this respect, Question 74 of the proposed rule which requests feedback on whether the banking agencies should consider adjustments or limits to the calculation of fee income for specific business lines, including custody.[10]

In order to address the current disproportionate treatment of fee income relative to net interest income, we believe that the banking agencies should, as an initial matter, permit custody banks to net expenses that relate to the provision of various settlement, safekeeping and asset administration services. This includes, for instance, fees incurred for membership in or access to central securities depositories and other FMI, fees related to the operation of correspondent and sub-custodian banks globally, transaction processing fees, including fees incurred to transmit trade instructions using SWIFT and other messaging systems, market participation fees (e.g. Hong Kong scrips fees) and market data feeds required to support corporate actions, income processing, tax reclamations and other similar asset administration services.

In addition, we believe that it is necessary for the banking agencies to adopt a cap on fee income in the BI metric along the lines of what is already in place for interest income. The Bank Policy Institute ("BPI"), of which we are a member, estimates that the existing cap on interest income reduces the aggregate operational risk charge for banking institutions (using pre-COVID balance sheet data) by approximately 9%. In order to achieve a similar reduction in operational risk capital for fee-related income, BPI estimates the need for a cap equal to 40% of a banking institution's total fee-income. We strongly support this approach as the simplest and clearest way to ensure the equitable treatment of banking institutions that specialize in the provision of fee-related services relative to banks with more traditional interest-income focused business models.

The Basel Committee recognized the inherent miscalibration of fee income in the SMA for operational risk in 2016 when consulting on its design and calibration, and in response, it proposed an approach whereby banking institutions for which the share of fee income is greater than 50% of the BI metric would only be required to include 10% of fee income in excess of the 50% threshold.[11]

[10] Proposed Rule, Page 217.

[11] 'Consultative Document: Standardized Measurement Approach for Operational Risk, Basel Committee on Banking Supervision (March 2016), Paragraph 20, Page 8.

While we do not believe that this approach is as effective in addressing the over-calibration of fee income in the SMA for operational risk when compared to the 40% cap identified by BPI, this approach does have the advantage of being a solution that is familiar to the Basel Committee and its members. We therefore recommend, as an alternative, that the banking agencies consider the adoption of the 2016 Basel Committee cap for fee income. We note, in this respect, that this approach is responsive to FDIC Director Johnathan McKernan's observation that by dropping the proposed 2016 BI fee income cap without public explanation, the Basel Committee effectively allowed the adoption of an 'approach that its own authors have (acknowledged) does not work.'[12]

ASSET MANAGEMENT-RELATED SEED INVESTMENTS

The banking agencies propose, without any supporting analysis, to require large banking institutions to apply the revised market risk framework to calculate their risk-weighted assets for equity investments in funds, including seed investments made in support of client-facing asset management activities. This requirement departs from the existing US capital framework, where banks are permitted, subject to supervisory approval, to measure their risk-weighted assets for equity investments in funds using banking book rules. This approach also deviates from the design of the Basel Committee Fundamental Review of the Trading Book ("FRTB"), where the use of banking book rules is the baseline assumption for the measurement of risk weighted assets for equity investments in funds, unless certain specific requirements are met.[13]

There are, in our view, two important advantages to the existing capital treatment of bank equity exposures to investment funds. First, this approach recognizes that certain equity investments in funds, in this case seed investments made by banks to help support the launch of new asset management products, are not entered into with any trading intent, but rather to help establish a performance track record, generally over a time limited period of 12 to 18 months. Second, this approach recognizes the broad differences which exist in industry business models, including the stand-alone custody banks, that do not have expansive and highly sophisticated trading

[12] 'Statement by Johnathan McKernan on the Proposed Amendments to the Capital Framework', Meeting of the Board of Directors of the FDIC (July 27, 2023).

[13] 'Minimum Capital Requirements for Market Risk', Basel Committee on Banking Supervision, RBC 25 Boundary Between the Banking Book and the Trading Book 25.8 (Page 4), (February 2019).

operations that might benefit from the ability to calculate risk weighted assets for equity investments in funds using the market risk rules.

Indeed, we estimate that the requirement in the proposed rule for banks to adopt the market risk framework for the measurement of their risk weighted assets for equity investments in funds would result in the case of specialized banks, such as State Street, in capital outcomes using the FRTB-SA sensitivities-based full look through approach, that are 2.5x to 3x greater for equity funds and 1.5x greater for fixed income funds than capital outcomes using current banking book rules.[14] To the extent that the same banking institution were required to make use of the FRTB-SA fallback method, the capital increase would be even steeper due to the required use of highly conservative standardized sector specific delta buckets and risk weights. This is true notwithstanding the lack of any change in the underlying economic risk of the exposure, a highly distortive outcome that would materially undermine the ability of specialized non-trading banks to support vibrant asset management franchises, as well as their ability to fairly compete with both non-bank asset managers and banking institutions located in jurisdictions outside of the US.

We therefore strongly recommend that the banking agencies amend their approach to allow, as is the case today, large bank institutions to make use of banking book rules to calculate their risk weighted assets for equity investments in funds, subject to supervisory approval and provided that the bank is able to demonstrate the lack of any trading intent. At the very least, this approach should be narrowly permitted for seed investments made as part of normal course asset management-related activities, a specialized business need undertaken by banking institutions that may not otherwise operate expansive and highly sophisticated trading businesses.

CONCLUSION

Thank you once again for the opportunity to comment on the important matters raised in the proposed rule. For the reasons described above, and in various comment letters from our trade associations, we have serious concerns with the rule as proposed. We urge the banking agencies to reconsider their approach, notably for the three issues described above, and, if needed re-propose the rule, in whole or in part, for additional public comment.

[14] Calculation is based on an investment grade fixed income fund with average duration of one year.

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

Sincerely,

Eric W. Aboaf
Vice Chairman and Chief Financial Officer

Annex A

STATE STREET.

Credit Benchmark

All Fund Types, US