STATE STREET.

November 24, 2014

BY ELECTRONIC SUBMISSION

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street, S.W.
Suite 3E-218, Mail Stop 9W-11
Washington, DC 20219
Docket ID OCC-2011-0008
Via Email: regs.comments@occ.treas.gov

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551
Docket No. R-1415/ RIN 7100 AD74
Via Email:
regs.comments@federalreserve.gov

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429
RIN 3064-AE21
Via Email: Comments@FDIC.gov

Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA45
Federal Housing Finance Agency
Constitution Center (OGC Eighth Floor)
400 7th Street, S.W.
Washington, DC 20024
Via Email: RegComments@fhfa.gov

Barry F. Mardock, Deputy Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102
Via Email: reg-comm@fca.gov

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581
RIN 3038-AC97
Via Electronic Submission:
http://comments.cftc.gov

Re: Margin and Capital Requirements for Covered Swap Entities; Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants

Dear Sirs and Madams:

State Street Corporation, the Bank of New York Mellon Corporation, and the Northern Trust Corporation (the "Custody Banks") appreciate the opportunity to provide comments on the proposed rules (the "Proposed Rules") to establish minimum margin and capital requirements for swap entities issued jointly by the Office of the Comptroller of the Currency, the Board of

Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the Federal Housing Finance Agency, (the "Prudential Regulators")[1] and also separately by the Commodity Futures Trading Commission[2] (collectively, the "Agencies").

Collectively, the Custody Banks hold over $62 trillion[3] in assets under custody and administration (approximately 44% of the over $140 trillion[4] global custody market), and expect to be significant providers of custodial accounts for segregation of initial margin for uncleared swaps under the Agencies' Proposed Rules. We agree with the Agencies' view that segregation of initial margin with an independent custodian provides the highest level of protection for counterparties to uncleared swaps. We are confident that the existing custodial infrastructure, technology and legal arrangements are well-suited to providing the high levels of protection the Agencies seek to impose, and that the global custody market has more than sufficient capacity to provide custody for the incremental initial margin expected to be required under the Agencies' and other regulators' uncleared swap margin rules.

We strongly support the mandatory use of independent third party custodians to segregate initial margin required under the Proposed Rules. Custody banks are highly regulated, with well-established processes and systems to provide safekeeping of client assets, and are uniquely suited to providing the type of segregation needed to protect counterparties to uncleared swaps.

Custody Bank Recommendation

The Custody Banks', and other custodians', ability to provide such services, however, depend on adoption of a final rule with requirements that are aligned with long-standing custodial practices and legal arrangements. This alignment is particularly critical given the aggressive implementation schedule proposed by the Agencies.

While the Proposed Rules are generally consistent with current custody industry practices, there are areas where further clarification is needed, primarily with regard to the treatment of cash margin maintained with custody banks. Specifically, we are concerned that the Proposed Rules may be read to prohibit the use of bank deposits for cash margin posted to segregated custody accounts, effectively making the use of cash for initial margin unavailable to swaps counterparties. It is critically important that the Agencies clarify the treatment of cash margin under the final rule.

As a result, we urge the Agencies to modify the Proposed Rules, §_.7(c)(1) and §23.157(c)(1) to read:

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[1] Margin and Capital Requirements for Covered Swap Entities. See 12 CFR Part 45.
[2] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants. See 17 CFR Parts 23 and 140.
[3] As of September 30, 2014, State Street Corporation has $28.4 trillion in assets under custody and administration; Bank of New York Mellon Corporation has $28.3 trillion in assets under custody and administration; and Northern Trust Corporation has $5.9 trillion in assets under custody.
[4] Based on assets under custody of the top 20 global custodians: BBH, BNY Mellon, BNP Paribas, CACEIS, Citi, HSBC, J.P. Morgan, Mitsubishi, National Australia Bank, Northern Trust, Pictet, Royal Bank of Canada, SEB, Six SIS, Societe Generale, State Street, Sumitomo, UBS, US Bank, Wells Fargo.

Prohibits the custodian from rehypothecating, repledging, reusing, or otherwise transferring (through securities lending, repurchase agreement, reverse repurchase agreement or other means) the funds or other property held by the custodian *<u>other than funds held on deposit with a bank custodian.</u>*

Our comments below provide further background on the role of custody banks, and the appropriate treatment of cash posted to custodial accounts.

Role of Custody Banks

In developing segregation standards, it is important for the Agencies to align the final rule with the traditional role custodians play in the financial markets. For custodians that are banks, this role is very limited and prescriptive.

The core function of a custodian is safekeeping of assets subject to the direction of the owner of the assets, or, in the case of a tri-party account subject to a control agreement, the two counterparties with an interest in the assets. The custody bank moves, releases, or otherwise transfers assets solely at the direction of the owner or, in the case of a tri-party account, one or both of the other parties to the tri-party control agreement, and never on the bank custodian's own initiative or for its own benefit. Except as discussed below for cash deposits, assets under custody are held off-balance sheet, with no ownership interest by the custody bank. A custody bank does not, for example, "rehypothecate" an asset held in custody for its own benefit, nor does a custody bank "repo" securities held in customers' custody accounts for the benefit of the custody bank. Any transfer or other use of assets under custody, other than cash deposits as described below, is done solely at the direction of the customer.

Similarly, a custody bank does not exercise judgment over properly constructed customer instructions. In the case of a margin account, for example, the custody bank does not determine, monitor or review whether a counterparty is in default under the parties' bilateral swap agreement; it is the responsibility of the counterparties to determine when a default has occurred, and to instruct the custodian to release margin as appropriate, as determined by the custody contract or, if applicable, tri-party control agreement. Nor does a custody bank verify the eligibility of collateral posted or substituted; such administrative review is also the duty of the holders of the account.[5]

Global custodians hold financial assets originating from numerous countries. Most financial assets are dematerialized and held through a chain of custody ending at a mandated central securities depository located in the country of issuance of the financial asset. The holding of assets in each country requires the use of a local custodian. Global custodians operate a network of subcustodians to provide such services in markets there they do not have a direct, local presence. These subcustodians are selected by the global custodian following significant due diligence and review, and act as a directed agent of the global custodian. The relationship of the

[5] Note custodians offer value-added "collateral management" services by which account holders can delegate such administrative services to the custody bank. Such arrangements, however, are ancillary, and not part of the core custody agreement.

custody client, however, is with the global custodian, not the subcustodian, and contractual arrangements are entered into at the global custodian level[6].

The highly prescriptive and directed nature of these custodial services is critical to the high level of protection provided by custodians, including in the context of holding margin posted by swap counterparties.

Custody banks are well positioned to service the expected incremental volume from mandated initial margin, including processing new margin, providing substitutions and releases with proper dual control, and providing transparency on margin activity and positions through online and other reporting mechanisms for both parties. The efficiency of processing transfers of margin can be greatly increased through broad adoption of standardized message flows on collateral instructions and release authorizations.

Treatment of Cash Margin

The custodial provisions of the Proposed Rules are generally consistent with existing banking practices. One critical exception, though, is the Proposed Rules' lack of clarity with respect to the treatment of cash collateral. Simply put, without clarification, the Proposed Rules' treatment of cash margin is unworkable and will significantly delay the ability of market participants to enter into the Agencies' mandated third party custody arrangements.

While securities are financial assets that are always held off balance sheet in bankruptcy remote custodial accounts, cash is treated differently. Cash itself is not held in custody; it is either reinvested in a suitable asset at the direction of the holder of the custody account or is placed on deposit with the custody bank. This custodial treatment of cash is common to all custody arrangements, including those from mutual funds, pension funds, etc., and is not limited to the swaps margin accounts that are the subject of the Proposed Rules.

As a commercial matter, the deposit of cash by a customer with its bank creates a debtor-creditor relationship, where the bank is the debtor and the customer is the creditor. Cash being fungible, the customer has no proprietary interest in any specific cash funds. Rather, the customer is merely a creditor of the bank for the amount of the deposit, whether the deposit is by legal tender, payment of a check or acceptance of payment order.[7]

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[6] We assume the requirement in the Proposed Rule that margin be segregated with custodians that "are not affiliates" of the swap counterparties would similarly be applied at the global custodian level.

[7] For example. New York law has historically recognized that a deposit of cash at a bank creates an ordinary debtor-creditor relationship with the depositor. Peoples Westchester Sav. Bank v. F.D.I.C., 961 F.2d 327, 330 (2d Cir. 1992); Miller v. Wells Fargo Bank Int'l Corp., 540 F.2d 548, 560 (2d Cir. 1976) ("Money deposited in a general account at a bank does not remain the property of the depositor . . . . the property of the depositor is the indebtedness of the bank to it, a mere chose in action."); Geler v. Nat'l Westminster Bank USA, 770 F. Supp. 210, 215 (S.D.N.Y. 1991); In re Trevor's Estate, 309 N.Y. 389, 393, 131 N.E.2d 561 (1955) (same); Solicitor for the Affairs of His Majesty's Treasury v. Bankers Trust Co., 304 N.Y. 282, 291, 107 N.E.2d 448 (1952) (same); In the Matter of Frank C. Delaney, 256 N.Y. 315, 320, 319, 176 N.E. 407 (1931) (money deposited with a bank belongs to the bank and is not the property of the depositor; the property of the depositor is the indebtedness of the bank); Baldwin's Bank of Penn Yan v. Smith, 215 N.Y. 76, 82 109 N.E. 138 (1915) (money deposited becomes a part of bank's general funds); accord N.Y. County Nat'l Bank v. Massey, 192 U.S. 138, 145 (1904) ("[M]oney deposited becomes a part of the general fund of the bank, to be dealt with by it as other moneys, to be lent to customers, and parted with at the

As deposits, uninvested cash associated with custody accounts is reflected as a liability on a custody bank's balance sheet. Deposit holders, including those maintaining margin accounts under the Proposed Rules, necessarily take on credit risk to the custody bank. Cash received on deposit by the custody bank, like other deposit funding, is invested by the custody bank in suitable assets for the custody bank's own account, under the bank's asset liability management plan, and subject to numerous regulatory requirements, particularly prudential liquidity rules and supervision. The custody bank remains, of course, a debtor of the depositor for the amount of cash deposited.

This treatment of cash in custody accounts is well understood in the financial markets, and holders of custodial accounts manage cash accordingly. Institutional investors generally minimize cash left on deposit, both to manage credit exposure to the custody bank and to generate higher yields than are available on custodial deposits. Custody banks have an interest in minimizing such deposits as well, due to the negative impact of such deposits on the bank's leverage ratio and other regulatory limitations.

Unfortunately, the Proposed Rules are unclear as to whether such traditional cash deposits with a custody bank will be permitted for segregated initial margin. Specifically, the Proposed Rules' restrictions on "reuse" of margin could be read to prohibit custody banks from accepting cash deposits from custody accounts, since the reinvestment for the custody bank's own account under the asset liability management plan of the custody bank of cash received on deposit might be considered improper "reuse" of margin.

We have serious reservations with the suggestion that cash in custodial accounts should, or could, be held by a custody bank outside of a traditional deposit arrangement. While there might be alternative arrangements that could, in theory, be used as alternatives to deposits with custody banks, they are not in use in today's bank custody market, would be costly and time-consuming to introduce, and would likely create new and as yet unknown sets of risk for market participants.

Some market participants are already assuming that the Agencies intend to prohibit custodians from accepting cash on deposit from margin accounts. Should this legal interpretation ultimately prevail, the Custody Banks will be unable to enter into contractual arrangements with swaps counterparties until new arrangements for cash margin can be agreed to and incorporated into legally binding contracts. Such fundamental changes will be especially difficult since they will only impact one relatively limited type of custody account, and not the custody market as a whole.

For the aforementioned reasons, we strongly urge the Agencies to clarify that cash margin posted to a custody account may be placed on deposit with the custody bank. This clarification could be accomplished by modifying the Proposed Rules, §_.7(c)(1) and §23.157(c)(1) to read:

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will of the bank . . . ."). The New York jurisprudence is consistent with international norms. See, e.g., UNCITRAL Legislative Guide on Secured Transactions (2008), Ch. II, para 123 ("Funds credited to a bank account are a particular form of receivable payable to the holder of the account. The bank is the debtor of the receivable, the value of which fluctuates according to the amount credited to the account.").

Prohibits the custodian from rehypothecating, repledging, reusing, or otherwise transferring (through securities lending, repurchase agreement, reverse repurchase agreement or other means) the funds or other property held by the custodian <u>*other than funds held on deposit with a bank custodian.*</u>

Conclusion

Once again, the Custody Banks appreciate the opportunity to comment on the Proposed Rule. We strongly support the mandatory segregation of margin with independent custodians, but are concerned that the lack of clarity on the treatment of cash margin could prove an impediment to rapid adoption of the Agencies final rules in the marketplace. As a result, we strongly urge the Agencies to clarify the treatment of cash margin, as described above.

Please to not hesitate to contact the undersigned with any questions:

State Street Corporation
Simon Zornoza, Senior Vice President and Chief Regulatory Counsel
(617) 664-1541

The Bank of New York Mellon Corporation
Eli Peterson, Managing Director
(202) 624-7925

The Northern Trust Corporation
James Roselle, Associate General Counsel
(312) 444-7565

Respectfully submitted,

Simon Zornoza
State Street Corporation

Eli Peterson
The Bank of New York Mellon Corporation

James Roselle
The Northern Trust Corporation