State Street Corporation

Stefan M. Gavell
Executive Vice President and Head of
Regulatory, Industry and Government Affairs

State Street Financial Center
One Lincoln Street
Boston, MA 02111-2900

Telephone: 617.664.8673
Facsimile: 617.664.9339
smgavell@statestreet.com

www.statestreet.com

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Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street, SW
Suite 3E-218, Mail Stop 9W-11
Washington, DC 20219

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

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

Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Via Electronic Submission

Re: Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds – Docket No. OCC-2018-0010 (OCC); Docket No. R-1608 (Federal Reserve); RIN 3064-AE67 (FDIC); File Number S7-14-18 (SEC); RIN 3038-AE72 (CFTC)

Ladies and Gentlemen:

State Street Corporation ("State Street") appreciates the opportunity to comment on the notice of proposed rulemaking issued by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Securities and Exchange Commission and the Commodity Futures Trading Commission ("CFTC") regarding the five agencies' (the "Agencies") proposed amendments to the current rule (the "Final Rule") implementing Section 13 of the Bank Holding Company Act, commonly referred to as the "Volcker Rule."

Headquartered in Boston, Massachusetts, State Street, a U.S. Financial Holding Company, specializes in providing institutional investors with investment servicing, investment management, data and analytics, and investment research and trading. With $33.867 trillion in

assets under custody and administration, State Street operates in more than 100 geographic markets worldwide. State Street's primary banking subsidiary, State Street Bank and Trust Company, is a Massachusetts state-chartered bank and member of the Federal Reserve System, and is provisionally registered with the CFTC as a swap dealer and is a global dealer in foreign exchange ("FX"). State Street Global Advisors, a division of State Street Bank and Trust Company, is a global leader in asset management, managing $2.723 trillion in assets for institutional investors, including pension funds, endowments and foundations, and sovereign wealth funds.

Summary of Recommendations

State Street appreciates the Agencies' effort to revise the current implementation of the Volcker Rule, and, while we suggest various changes below, support many provisions included in the proposed rulemaking. While a complete rewrite of the Volcker Rule will likely require additional proposals and consultation, we strongly urge the Agencies to take immediate final action on elements of their proposal where there is substantial consensus, particularly the proposed new three-tier compliance program for banking entities. As we describe below, we believe this new compliance program, with some adjustments, will provide significant relief from undue compliance costs for banking entities with low or moderate trading activity, with no reduction in the effectiveness of the Volcker Rule or reduction in banking safety and soundness.

Our complete recommendations on the proposed rulemaking follow below, and include suggestions related to:

Compliance & Metrics:

- Strongly support the proposed three-tiered classification system ("significant", "moderate", and "limited" trading assets and liabilities) with modest adjustments;
- Eliminate or modify Volcker Rule-specific metrics and attestation requirements.

Proprietary Trading:

- Support elimination of the 60-day rebuttable presumption in the current "trading account" definition, but strongly oppose the new proposed "accounting prong";
- Expand the liquidity management exclusion to include FX forwards, FX swaps, physically-settled cross currency swaps, non-deliverable FX forwards ("NDFs"), and all activity undertaken for asset liability management ("ALM");
- Support the proposed presumption of compliance to streamline the "reasonably expected near term demand" ("RENTD") requirements;
- Support tailoring risk-mitigating hedging requirements by removing the correlation, "demonstrably reduce", and enhanced documentation requirements.

Covered Funds:

- Exclude funds from the definition of "covered fund" if the fund's investment strategies would be permitted for mutual funds under the Investment Company Act;
- Automatically grant the permitted 2-year extension for seeding for all bank investments in covered funds and provide a safe harbor for seeding activity undertaken by the fiduciary arm of a banking entity;

- Exclude credit exposures extended in the ordinary course of providing custody services from the Super 23A provisions.

Compliance & Metrics

Tailor the Volcker Rule's compliance regime:

Under the Agencies' Final Rule, all banking entities with $50 billion or more in total consolidated assets are subject to the Rule's "enhanced compliance" program, regardless of the banking entities' trading activity. This approach has resulted in an overly complex, costly compliance regime, consisting of multiple layers and duplicative requirements, even for banks with limited activities and risks in the areas the Volcker Rule is intended to address. It has had an outsized impact on firms with limited trading activities. Banking entities have extensive risk-based compliance programs in place, which can continue to be appropriately tailored to the bank's activities rather than requiring overly extensive, prescriptive Volcker Rule-specific requirements.

The Agencies' current proposal adopts a more tailored approach, and would create a new three-tiered classification system, which is more appropriately aligned with the true intent of the Volcker Rule by being based on trading assets and liabilities as opposed to total consolidated assets. Under this new proposal, banking entities with $10 billion or more in trading assets and liabilities would be classified in the "significant trading assets and liabilities" category and would be subject to the most intensive compliance program requirements. Banking entities with at least $1 billion but less than $10 billion would be classified in the moderate category, and those with less than $1 billion would be classified in the limited category, and would be subject to compliance programs more appropriately tailored to their Volcker Rule-related activities.

State Street strongly supports the proposed three-tiered compliance program, with some adjustments.

First, while State Street expects it would be classified in the "moderate" compliance category, which we believe appropriately matches our Volcker Rule-related risk profile, we are sufficiently close to the $10 billion threshold to create some uncertainty in forecasting future compliance requirements, given potential changes in measured trading assets and liabilities in certain conditions. As a result, we suggest an increase in the moderate threshold to $20 billion, which we expect will establish essentially the same subset of "moderate" banking entities, but reduce uncertainty around possible triggering of higher compliance burdens unrelated to increased risks. We note that the banking entities identified as "significant" under the proposal typically have trading assets and liabilities of well over $50 billion, so establishing a $20 billion threshold for the "moderate" compliance program creates no opportunities for regulatory arbitrage for banking entities with truly high Volcker Rule-related activities.

Second, the potential volatility in compliance requirements under the proposal could be mitigated by adding additional flexibility for banking entities hitting the relevant thresholds. While the Agencies' proposal helpfully addresses possible quarter-end fluctuations by applying the trading asset plus liabilities test using an average over the past four quarters, there is still potential for triggering unnecessary compliance program changes as banking entities approach a threshold. As a result, we suggest modification of the proposed three-tiered system to allow banking entities more flexibility to avoid increased compliance programs when there might be a modest, temporary breach of a compliance threshold, and to allow a suitable transition period when a banking entity enters a new compliance tier.

With these recommended changes, we believe the proposed rule will establish a Volcker Rule compliance regime consistent with the size and nature of a banking entity's activities, and consistent with regulatory safety and soundness objectives.

Recommendations:

- State Street urges the Agencies to immediately implement the new three-tiered classification system, with the following modifications:
    - Increase the "significant trading assets and liabilities" category threshold from $10 billion to $20 billion;
    - Provide that a banking entity will not be classified at an elevated compliance category if: 1) the entity's trading assets and liabilities do not exceed more than 10% of the higher category's threshold; and 2) the trading assets and liabilities fall back below the threshold within 180 days;
    - Provide a phase-in period of at least two years for a compliance transition to a higher threshold category given the significant difference in resources required to comply with an elevated compliance category.

Eliminate Volcker Rule-specific metrics and attestation requirements:

The current metrics reporting requirements associated with the Volcker Rule do not consider firms with narrowly focused lines of trading businesses and how Volcker Rule-related risks could be better managed by tailored requirements aligned to the types of instruments. State Street recommends leveraging existing industry practices and reporting requirements related to managing FX market-making inventory, such as daily Value at Risk ("VaR") by product and position limits. This is a superior approach to mandating metrics not directly linked to the FX business.

Overall, we believe that the Volcker Rule's Risk Management metrics (Risk and Position Limits and Usage, Risk Factor Sensitivities, VaR and Stress VaR) and Source of Revenue metrics (Comprehensive Profit & Loss Attribution) are the most appropriate metrics if any Volcker Rule-specific metrics are retained, as these most closely relate to industry practices of managing FX market-making inventory. Unlike the Customer-Facing metrics, the Risk Management and Source of Revenue metrics are more consistent with current FX banking entity risk management practices. Furthermore, as it relates to the Customer-Facing metrics, State Street appreciates the Agencies' proposal to limit inventory aging to securities, although the same principle should apply to inventory turnover as both metrics are unsuitable for FX trading and are more suitable for CUSIP-based securities. As it relates to any new metrics requirements in any Revised Final Rule, banking entities should be allowed an additional one year to complete the work necessary to provide additional metrics data to the Agencies. This additional time will enable banking entities to most efficiently incorporate the technology specifications required to comply with any new metrics requirements within their annual technology cycles as opposed to ad hoc cycles that are less efficient and more costly.

Lastly, as it relates to compliance and metrics, State Street recommends relying on existing internal controls and supervisory review standards rather than Volcker Rule-specific attestation standards. We agree with industry feedback that CEO attestation is not required by the statute. We also agree that if maintained, CEO attestation should only be applied to banking entities in the "significant trading assets and liabilities" category. The proposal would apply attestation

requirements to smaller banking entities that have not been previously subject to the requirement, which would not support the Agencies' goal of tailoring the requirements based on the activities and size of banking entities.

Recommendations: State Street strongly recommends eliminating Volcker Rule-specific metrics and attestation requirements.

- If metrics requirements are retained, focus on Risk Management and Source of Revenue metrics;
- If attestation requirements are maintained, limit application to banks in the "significant trading assets and liabilities" category.

Proprietary Trading

Amend the "trading account" definition to align with the underlying statutory intent:

State Street fully supports the Agencies' proposal to eliminate the Final Rule's rebuttable presumption, associated with the Short-Term Intent Prong, that an account is a trading account if used to purchase or sell a financial instrument that the banking entity holds for less than 60 days ("60-Day Rebuttable Presumption"). However, we are very concerned by the significant negative consequences associated with the proposed Accounting Prong. We urge the Agencies to abandon the proposed Accounting Prong. We believe retaining the existing Market Risk Capital Prong and revising the existing Dealer and Short-Term Intent Prongs will more appropriately meet the goals of the Agencies than adopting the Accounting Prong.

As proposed, the Accounting Prong is far too broad and, by incorporating fair value accounting standards unrelated to and unaligned with the statutory intent underlying the Volcker Rule, captures many longer-term investments not acquired principally for the purpose of selling in the near term or profiting from short-term price movements. Additionally, the proposed Accounting Prong would negatively impact ALM and liquidity management activities by adding undue complexity, restricting flexibility, and increasing costs of banking entities. As a result, the proposed Accounting Prong has the potential to restrict banking entities from undertaking beneficial risk-mitigating activities. Also, the increased compliance burdens placed on banking entities as a result of complicating the "trading account" definition further demonstrate that the proposed Accounting Prong should not be adopted.

Recommendations: With respect to the "trading account" definition, State Street recommends that the Agencies:

- Eliminate the 60-Day Rebuttable Presumption, and replace it with a reverse presumption that positions held for more than 60 days will be excluded from the "trading account" definition;
- Abandon the proposed "accounting prong",
- Provide a consultative process for positions held for fewer than 60 days by which banking entities may seek approval from their responsible examiner that certain positions are not entered into principally for the purpose of selling in the near term and are therefore excluded from the "trading account" definition.

Additional proprietary trading recommendations related to liquidity management, RENTD, and risk mitigating hedging:

State Street appreciates the Agencies' proposal to expand the exclusion from proprietary trading for liquidity management to include the purchase or sale of FX forwards, FX swaps, and physically-settled cross-currency swaps to the same extent that a banking entity may purchase or sell securities under the existing exclusion. We encourage the Agencies' to further broaden the exclusion to include NDFs. State Street uses FX swaps to manage mismatches through our global deposit-taking and investments. NDFs and deliverable FX forwards are viewed as equivalent products by the market because the net value transferred is the same in both structures. The difference relates solely to whether the trade closes out at maturity upon delivery by each party to the transaction of the gross amount (FX forward) or upon delivery of the net value of the underlying exchange (NDF). As a general matter, we encourage consistent treatment of physically-settled FX forwards and NDFs, including as it relates to the liquidity management exclusion.

We commend the Agencies for recognizing the expanded liquidity management exclusion will directly apply to banks like State Street, which, in the language of the notice of proposed rulemaking, "operat[e] in foreign jurisdictions" and engage in liquidity management activity through branches and correspondent banking relationships and sub-custody relationships without necessarily having their own legal entities in those jurisdictions. This liquidity management activity, which includes the use of FX derivatives, is properly within the scope of the liquidity management exclusion.

Furthermore, we encourage expanding the liquidity management exclusion to include all activity undertaken for ALM. The Volcker Rule's focus on identifying and limiting proprietary trading was not intended to hinder prudent, long-term risk management. An ALM exemption would not adversely impact banking entities' safety and soundness as there are rigorous risk management and control infrastructures governing ALM apart from the Volcker Rule.

We have previously advocated that the current approach to the RENTD framework is overly prescriptive. RENTD, as a one-dimensional proxy for near-term demand, constrains State Street Bank and Trust Company's ability as a FX dealer to estimate and manage inventory limits in a more holistic manner to allow for greater and more efficient liquidity and pricing for our clients. As with other market makers, we consider broader market and environmental factors *(e.g., ongoing changes measured related to client demand)* when managing for forward-looking demand. Additionally, banking entities already have approved risk appetite statements and are subject to capital and liquidity requirements related to market making and risk-mitigating hedging.

We appreciate the Agencies' goal to streamline and tailor RENTD requirements. We support allowing for a presumption of compliance where a banking entity holistically manages inventory limits and complies with its own internal risk limits as described above. This will more effectively leverage existing industry practices and reporting requirements related to managing FX market-making inventory, such as maintaining daily VaR metrics by product and position limits compared to relative levels of client activity.

However, we do not support the Agencies' proposal for additional reporting requirements whenever there are risk limit breaches and/or temporary or permanent increases to limits. As a general matter, we believe this could have an adverse effect, causing banks to potentially set

less conservative risk limits, resulting in fewer breaches and concomitant reports of breaches or increases. Instead, risk limits should be appropriately set and banks should continue to proceed with existing internal risk management processes when breaching a limit. The Agencies could replace their proposal with a requirement for banks to document and maintain records of breaches and related escalations and approvals, which most already do, and which records could be made available upon request and during regularly scheduled bank examinations. We believe this would more effectively accomplish the Agencies' goals of simplifying and tailoring the Volcker Rule's requirements while also ensuring that banks will continue to set appropriate risk limits for their business models rather than higher limits to avoid reporting breaches.

Lastly, State Street appreciates the Agencies' proposals related to risk-mitigating hedging. We specifically agree with the recommendations to remove the correlation requirement, remove the requirement that a hedge "demonstrably reduce" or otherwise significantly mitigate one or more specific risks, and reduce the enhanced documentation requirements.

Recommendations: As it relates to liquidity management, RENTD, and risk-mitigating hedging, State Street recommends the Agencies:

- Expand the liquidity management exclusion to include FX forwards, FX swaps, physically-settled cross-currency swaps, and NDFs; further expand this exclusion to include all activity undertaken for ALM;
- Streamline the RENTD requirements by allowing for a presumption of compliance where a banking entity complies with its own internal risk limits; require banks document and maintain records of breaches, which can be provided upon request and during bank examinations;
- Tailor the risk-mitigating hedging requirements by removing the correlation requirement, the requirement that a hedge "demonstrably reduce" / significantly mitigate one or more specific risks, and enhanced documentation requirements.

Covered Funds

While the statutory requirements of the Volcker Rule require limits on ownership interests and sponsorship of hedge funds or private equity funds, the Final Rule's overly broad implementation of the covered fund provisions has provided no financial stability benefits, has unnecessarily reduced the ability of bank-owned asset managers to offer comprehensive investment options, and has significantly complicated compliance programs for banks, such as global custodians, providing services to investment funds. We believe that there are a number of modifications that could be made that are both within the Agencies' rulemaking authority and consistent with the Congressional intent of the statute.

Definition of covered fund:

The Final Rule's overly broad definition of "covered fund" captures many funds that are not at all "similar" to hedge funds or private equity funds. Although the Final Rule refers to both "hedge funds" and "private equity funds" and defines these funds synonymously, it appears the primary purpose of the statutory limitation was to address high-risk investments such as indirect proprietary trading through funds, non-customer-related services and bail-out risks, rather than to prevent banks from offering traditional asset management products. This problem is particularly acute outside the U.S., where the statutory and rulemaking references to exceptions under the Investment Company Act of 1940 ("Investment Company Act") are inapplicable and inappropriate.

We believe the Final Rule could be considerably improved by a more targeted exclusion from the definition of "covered fund" for funds whose investment strategies are clearly far from the traditional understanding of those of hedge funds or private equity funds, such as those funds whose investment strategies would qualify as U.S. mutual funds.

> ***Recommendation:*** State Street recommends amendments to the rule or guidance to exclude from the definition of "covered fund" funds with investment strategies that would be permitted for U.S. mutual funds under the Investment Company Act.

Seeding of investment strategies:

Seeding of investment strategies is essential to efficient and transparent introduction of new investment funds by an asset manager. The Final Rule, as implemented, makes it exceedingly difficult for a bank-owned asset manager to seed and test new strategies, due to the 3% statutory limits on bank ownership, the unduly short and burdensome requirements around temporary seeding, and the lack of clarity on use of bank assets to fund separate account seeding structures under the proprietary trading rules.[1]

> ***Recommendation:*** Though many of the seeding issues are statutory and will require legislation, State Street recommends a two-pronged approach, which would greatly improve the Final Rule:
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> - Automatically grant the permitted 2-year extension for seeding (beyond the initial 1-year) for all bank investments in covered funds;
> - Provide a safe harbor from the definition of proprietary trading for seeding activity undertaken by the fiduciary arm of the banking entity.

Custody services to covered funds:

The Final Rule should be revised to exclude credit exposures incurred in the ordinary course of providing custody services to covered funds. Such short-term credit exposures, typically intraday or overnight, are essential to the operation of an investment fund and facilitate the efficient clearing and settlement of securities purchased and sold by the fund. They do not provide leverage to a fund or otherwise create the kind of potential banking entity support for a fund that Super 23A is intended to prevent. Nevertheless, under the Final Rule, bank-owned asset managers are effectively prohibited from using affiliated custodians by Super 23A, resulting in operational inefficiencies and reduced custody options for the often small subset of their fund offerings deemed covered funds. In addition, the lack of a custody exposure exception from Super 23A had required custody banks to implement extensive compliance programs to ensure that even custody services provided to their non-affiliated asset management customers do not inadvertently violate Super 23A, and custodians have been required to seek structural changes to certain customers' investment funds, particularly overseas, in order to provide custody services in compliance with the Final Rule.

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[1] State Street Global Advisors. "Prohibitions and Restriction on Proprietary Trading and Treatment of Separately Managed Accounts in Bona Fide Seeding Programs of Bank Owned Asset Managers." November 9, 2012. https://www.sec.gov/comments/s7-41-11/s74111-608.pdf

Recommendation: State Street recommends amending the rule or issuing guidance establishing that credit exposures extended in the ordinary course of providing custody services are not prohibited by the Super 23A provisions.[2]

Conclusion

State Street commends the Agencies for seeking to simplify and tailor the Volcker Rule's regulations through efforts to increase efficiency, reduce excess demands on compliance capacities at banking entities, and allow banking entities to more efficiently serve their clients. We appreciate the opportunity to comment on the proposed revisions, and we believe that our recommendations will strengthen these efforts.

Please feel free to contact me at smgavell@statestreet.com should you wish to discuss State Street's submission in further detail.

Sincerely,

Stefan M. Gavell

[2] State Street, Bank of New York Mellon and Northern Trust. "Comment Letter on Notice of Proposed Rulemaking Implementing the Volcker Rule – Hedge Funds and Private Equity Funds." February 13, 2012. https://www.sec.gov/comments/s7-41-11/s74111-248.pdf