



State Street Corporation

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March 11, 2016

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Via electronic submission: www.bis.org/bcbis/commentupload.htm

Second Consultative Document – Revisions to the Standardized Approach for Credit Risk

Dear Sir/ Madam:

State Street Corporation (“State Street”) welcomes the opportunity to comment on the second consultative document (“second consultation”) issued by the Basel Committee on Banking Supervision (“Basel Committee”) regarding revisions to the standardized approach for credit risk (“standardized approach” or “standardized framework”). The second consultation aims to address limitations identified by the Basel Committee in its ongoing review of the existing standardized framework, including excessive variability in risk-weighted assets (“RWA”) across banks and national jurisdictions, and the need for improved risk-sensitivity in standardized measures of risk, while also addressing issues raised by respondents during the first consultation on the standardized approach published in December 2014.¹ State Street is among those who submitted comments to the Basel Committee in response to its first consultation.²

We would like to thank the Basel Committee for the thoughtful and deliberate manner in which it has approached its policy mandate. This includes a willingness to engage with the industry on matters of concern and to consider alternative solutions which are responsive to its underlying policy objectives. We believe that substantial progress has been made by the Basel Committee in the development of an appropriately structured standardized approach. This includes the

¹ ‘Consultative Document: Revisions to the Standardized Approach for Credit Risk’, Basel Committee on Banking Supervision (December 2014).

² ‘Consultative Document – Revisions to the Standardized Approach for Credit Risk’, State Street Corporation Comment Letter (March 27, 2015).

incorporation of a revised methodology for the measurement of exposures to securities financing transactions (“SFTs”) which addresses major limitations in the prevailing haircut-based Comprehensive Approach, and the introduction of the ‘investment grade’ concept in the assessment of exposures to corporate entities for banks in jurisdictions that do not permit the use of credit ratings for regulatory purposes. Furthermore, we welcome the Basel Committee’s decision to conduct an additional quantitative impact study (“QIS”) in early-2016 to help inform final calibration.

Nevertheless, we continue to have pressing concerns regarding the intended approach for unfunded commitments which does not properly account for the particular characteristics and risk profile of the committed facilities which custody banks provide to their regulated investment fund clients, such as United States (“US”) mutual funds, European Union (“EU”) Undertakings for Collective Investment in Transferable Securities (“UCITS”) and other similar national equivalents. In addition, we offer comment on certain technical matters specific to the measurement of exposures to SFTs, the calibration of exposures to ‘investment grade’ corporates, and the criteria used to determine eligibility for such treatment, which we believe can help to further strengthen the intended framework.

Headquartered in Boston, Massachusetts, State Street 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 \$27.51 trillion in assets under custody and administration and \$2.25 trillion in assets under management as of December 31, 2015, State Street operates in 29 countries and in more than 100 geographic markets. State Street is organized as a US bank holding company (“BHC”), with operations conducted through several entities, primarily its wholly-owned bank subsidiary, State Street Bank and Trust Company. As a US BHC, we are subject to Section 171 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, also known as the ‘Collins Amendment’, which imposes a statutory capital floor on certain US banking institutions based upon the ‘generally applicable risk-based capital requirement’. We therefore report and are subject to the lowest of our risk-based capital ratios calculated under both the standardized and advanced approaches. As of December 31, 2015, our Basel III advanced approach common equity Tier 1 (“CET1”) ratio was 12.5% and our Basel III standardized approach CET1 ratio was 12.9%.

Our perspective in respect of the second consultation continues to be informed by our status as one of the world’s largest providers of custody services to institutional investor clients. Global custody banks, such as State Street, employ a highly specialized business model focused on the provision of operational services to institutional investor clients, rather than the generation of yield from credit risk assets. These clients, which include asset owners, asset managers and official institutions, 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. These services include 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 in order to facilitate day-to-day transactional activities. In addition, custody banks provide a series of value added services that result from client assets held in custody, including agency-indemnified SFTs and committed lines of funding to regulated investment funds. The importance of financial services to the custody bank business model can be seen in the large amount of revenue derived from fee-related services. As an example, in Q4 2015 fee revenue comprised 80.5% of total revenue at State Street.

Furthermore, the stand-alone custody banks have balance sheets which are constructed differently than other more traditional banks with extensive retail, commercial and investment banking operations. Indeed, 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 highly stable deposits. These deposits, rather than various sources of wholesale funding, provide the largest part of the custody banks' liabilities. For instance, as of Q4 2015, client deposits made up 78.2% of State Street's total balance sheet. Importantly, custody banks acquire deposit liabilities as a direct result of the financial services they provide. In other words, the cash deposits that come on to the custody bank balance sheet are driven by customer-related needs and not by the custody banks' financing decisions.

We appreciate the opportunity to offer insight relative to the implications of the second consultation on our role as a custodial entity, a role that is widely understood by the market and by the supervisory community as providing important benefits for the safety of client assets and the stability of the financial system. Our policy recommendations, which are discussed in greater detail below, can be summarized as follows:

- Adjustment to the criteria for the exclusion of certain securities issuances from the netting set in the formula for the measurement of exposures to SFTs, so that minimum size is calculated relative to the average size of securities issuances in the netting set rather than on the basis of the largest securities issuance, along with clarification of the definition of settlement currency;
- Recalibration of the RWA for exposures to 'investment grade' corporates in jurisdictions that do not permit the use of credit ratings (from 75% to 60%), so as to improve alignment with risk-weights in jurisdictions that do permit the use of such ratings, and clarification of the definition of 'investment grade' in order to better accommodate non-traditional corporate exposures; and
- Introduction of a 20% credit conversion factor ("CCF") for committed lines of funding to regulated investment funds, such as US mutual funds, EU UCITS and other similar national equivalents, or alternatively, calibration of a uniform CCF at the lower end of the range foreseen by the Basel Committee, or 50%.

We have participated in the development of the responses prepared by various financial services trade groups, notably the joint submission from The Clearing House Association, the Securities Industry and Financial Markets Association and the American Bankers Association, and we broadly support the observations and recommendations made therein. Our intention

with this letter is to highlight issues of particular interest to State Street that result from our custody bank business model.

SECURITIES FINANCING TRANSACTIONS

In its first consultation on the review of the standardized approach, the Basel Committee proposed to require banks to measure their exposures to SFTs using an amended version of the existing haircut-based Comprehensive Approach, with more conservative volatility assumptions. This triggered widespread concern from the industry, notably from the custody banks, who emphasized that because of certain structural limitations, the intended approach would vastly overstated credit risk in SFTs, and therefore the 'maximum possible loss' that a bank could incur. In response, the Basel Committee is now proposing to revise the formula used to measure exposures to SFTs in the Comprehensive Approach; specifically the add-on for potential price changes in the value of securities in the netting set. This is designed to address three major concerns: the lack of recognition for the correlation that exists between securities placed on loan and the collateral received, the lack of recognition for the impact of portfolio diversification, and the inability to net transactions at the level of the individual counterparty.

As one of the custody bank respondents to the first consultation, we would like to express our appreciation to the Basel Committee for the attention which it has paid to the concerns raised by the industry in respect of SFTs, including its openness to suggestions for alternative non-internal-based methodologies. We welcome the revised approach which has been proposed and agree that it addresses material flaws in the existing standardized framework. This centers on the ability to net loans and offsetting collateral, the use of a factor to approximate correlation on a market-wide basis without the need to consider individual trading pairs, and the use of a factor designed to approximate portfolio diversification while addressing the potentially outsized impact of exposures to less significant securities issuances. As such, the revised approach provides for a far more granular and appropriate assessment of credit risk.

Indeed, we estimate exposure amounts using the revised approach which are 7x to 10x greater than simple value-at-risk ("VaR") methodologies.³ This compares with exposure amounts using the existing haircut-based Comprehensive Approach which are 25x to 30x greater than simple VaR. Although still quite conservative, we view these outcomes as reasonable in a standardized measure of credit risk and note that they are generally consistent with the exposure amounts observed by the US custody banks in the context of the annual Federal Reserve Bank's ("FRB") stress test of banks.⁴

³ The revised approach for SFT produces RWAs which are approximately 14x to 16x greater than simple VaR methodologies.

⁴ The Board of Governors of the Federal Reserve System Comprehensive Capital Analysis and Review (CCAR) program.

Nevertheless, we believe that the intended approach would benefit from two technical corrections. First, we recommend an adjustment to the methodology used for the exclusion of certain securities issuances from the netting set in the formula for SFTs. As currently designed, securities issuances are excluded if they represent less than one-tenth, or 10% of the value of the largest securities issuance. While we recognize the need to limit the presence of smaller securities issuances from the parameter used to measure portfolio diversification, the use of an approach based on the largest issuance may, and often does, result in an unwarranted skewing of the data. This occurs most frequently within netting sets that include sovereign debt securities, where there may be a small number of very high value trades that can overwhelm and therefore obscure other securities issuances which otherwise provide for appropriate diversification.

Consider for example, a netting set made up of two loans: a US Treasury worth \$100 and 20 equity securities issuances worth \$5 each. This is backed, in turn, by 40 equity securities issuances worth \$5 each, for a total of 61 positions with an aggregate value \$400 (for the sake of simplicity, we are ignoring the excess collateral that would back the two securities loans). Using the methodology proposed by the Basel Committee, any equity securities issuance worth less than \$10 would be excluded from the netting set, which would result in the exclusion of all but the US Treasury. In order to correct this limitation, we suggest that minimum size be defined on the basis of the average size of all securities issuances within the netting set. Using our above example and assuming calibration of the methodology at 20%, this would mean that a securities issuance would only be excluded if it were worth less than \$1.31, a far more proportional standard that is nonetheless consistent with the intent of the underlying methodology.

Second, in order to mitigate potential variability in the measurement of exposures to SFTs, we recommend that the Basel Committee include a specific definition of the term 'settlement currency'. This is designed to avoid the potential imposition of a 'double haircut' for certain transactions, based not on underlying differences in risk-exposure but on the interpretation of 'settlement currency' across banks and national jurisdictions. An example of the substantial impact which differences in the interpretation of settlement currency can have on total exposure is included in the attached Annex 1. Consistent with the way in which a securities lender would liquidate collateral and buy-in securities in the event of a counterparty default, we recommend that the term 'settlement currency' be defined as the currency of the lent security in a securities lending or repurchase transaction, and the currency of the cash leg in a securities borrowing or reverse repurchase transaction.

INVESTMENT FUND COUNTERPARTIES

In its first consultation on the review of the standardized approach, the Basel Committee proposed to revise the existing methodology for the measurement of exposures to corporates by removing the reference to external ratings and the use of a flat RWA for unrated entities, in favor of a look-up table based upon a combination of revenue and leverage. Under the

proposed methodology, corporate exposures were broadly defined to include ‘incorporated entities, associations, partnerships, proprietorships, trusts, funds and other entities with similar characteristics that do not meet the requirements of any other exposure class’.⁵

This novel and highly heterogeneous approach prompted widespread commentary from industry participants, including in the case of the custody banks’ concern that the proposed methodology was not well-adapted to the measurement of exposures to investment fund counterparties, such as pension plans, mutual funds and sovereign wealth funds, which form the core of our institutional investor client base. Recognizing these concerns, but also faced with the need to accommodate differences among regulatory regimes globally, the Basel Committee is now proposing a bifurcated approach which involves either the use of credit ratings, or in jurisdictions that do not permit the use of such ratings, a base RWA of 100% along with the ability to assign a lower RWA of 75% to corporate exposures which are identified as ‘investment grade’. This identification is based upon a series of criteria specified in Paragraph 173, including the requirement that the corporate entity ‘must have securities outstanding on a recognized securities exchange.’⁶

As an initial matter, we wish to express our strong support for the Basel Committee’s decision to develop a framework for corporate exposures which allows banks in jurisdictions that do not permit the use of credit ratings to make use of the ‘investment grade’ concept in their assessment of credit risk. This reflects the importance of an approach which acknowledges that not all risk exposures are the same and which provides incentives for banks to monitor and manage their counterparty exposure. Indeed, absent this distinction, banks in jurisdictions such as the US would be forced to rely on a uniform measure of risk for their corporate exposures which does not support the Basel Committee’s policy goal of enhanced risk-sensitivity. Nevertheless, we have reservations regarding calibration of exposures to ‘investment grade’ corporates at 75%. This reflects the equally essential policy goal of promoting consistency in the measurement of RWA across banks and jurisdictions.

Under the prescribed table for corporate exposures in jurisdictions that permit the use of credit ratings for regulatory purposes, banks would be able to apply an RWA of as little as 20% for corporates rated AAA to AA- and 50% for corporates rated A+ to A-. This creates an immediate and pressing discrepancy in the calculation of risk-based capital which is likely to create broad competitive inequities among banks, and therefore the migration of financial activities in ways that could disrupt rather than promote long-term financial stability. This includes the sub-optimal distribution of financial assets across the industry since certain banks will have no incentive to consider the relative risk-return profile of highly-rated corporate exposures that might otherwise fall below the prescribed 75% RWA floor.

⁵ First Basel Committee Consultation on the Standardized Approach for Credit Risk, section 2.2, page 10.

⁶ Second Basel Committee Consultation on the Standardized Approach for Credit Risk, paragraph 173, pages 60-61.

In its initial review of the standardized approach, the Basel Committee determined that the lowest RWA that should apply to a corporate exposure is 60%. This stemmed from an assessment of available statistical analysis, with the Basel Committee noting that calibration was ‘based on probability-of-default estimates and an assumed loss-given default of 45%, consistent with the loss-given default applied under the foundation IRB’.⁷ We see no reason why this view of the relative risk profile of the highest rated corporate exposures should no longer apply in the standardized framework. As such, in order to improve the comparability of risk-based outcomes among banks globally, we recommend that the RWA for ‘investment grade’ corporate exposures be reduced from 75% to 60%.

Paragraph 173 of the second consultation specifies that in order for a corporate exposure to be deemed investment grade, the corporate entity ‘must have securities outstanding on a recognized securities exchange’.⁸ While we recognize the Basel Committee’s desire to ensure that the ‘investment grade’ designation is subject to appropriate standards, we note that this requirement assumes a highly traditional view of corporate exposures that is not well-adapted to the broad range of entities that fall within the definition of ‘corporates’. In the case of the custody banks, this includes pension funds and sovereign wealth funds which are not structured as commercial entities and which have no compelling reason, or even ability, to issue securities into the market. This also includes open-ended investment funds, such as US mutual funds, EU UCITS and other similar national equivalents, which although registered, are not structured as securities issuances.

We therefore recommend that this portion of Paragraph 173 be deleted so that the standard for designation as ‘investment grade’ is based upon whether the corporate entity has ‘adequate capacity to meet (its) financial commitments (including the repayments of principal and interest) in a timely manner, irrespective of the economic cycle and business conditions.’ Consistent with the standards which apply in US prudential regulation, this could be augmented with clarification that the term ‘adequate capacity’ means a situation in which the risk of counterparty default is low and the full and timely repayment of the exposure is expected.⁹ Alternatively, we recommend clarification by the Basel Committee that the ‘securities outstanding’ requirement is not intended to apply to corporate entities, including regulated investment funds, bank collective funds, public and private pension plans, charitable foundations, endowments and sovereign wealth funds, that by virtue of their purpose and structure, do not in the normal course of business issue securities in the financial markets.

⁷ Second Basel Committee Consultation on the Standardized Approach for Credit Risk, section 2.2, page 11.

⁸ Second Basel Committee Consultation on the Standardized Approach for Credit Risk, paragraph 173, page 60.

⁹ ‘Final Rule - Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-Weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule and Market Risk Capital Rule’, Board of Governors of the Federal Reserve System, Federal Register, Volume 78, Number 198, page 62165.

UNFUNDED COMMITMENTS TO INVESTMENT FUNDS

In its first consultation on the revised standardized approach, the Basel Committee proposed to abandon the differentiation of CCFs for unfunded commitments based upon length to maturity (*i.e.* 20% for original maturities of up to one year and 50% for original maturities of more than one year), in favor of a uniform CCF of 75%.¹⁰ The stated logic for this change was to ensure consistency with the parameters used in the foundation IRB approach. This proposal generated a substantial amount of industry concern, driven by the view that a ‘one-size fits all’ approach for unfunded commitments lacks appropriate risk-sensitivity and is therefore likely to result in a dramatic overstatement of risk for various types of commitments that provide important benefits to the economy and the orderly functioning of the financial markets. In the case of the custody banks, this includes the highly disproportionate treatment of committed lines of funding provided to regulated investment funds, such as US mutual funds, EU UCITS and other similar national equivalents.

Nevertheless, the Basel Committee continues to propose in its second consultation a uniform CCF for unfunded commitments calibrated at somewhere between 50% and 75%, based upon a further analysis of results from the forthcoming QIS. While we welcome the Basel Committee’s commitment to a closer review of industry data, we continue to believe as a threshold matter that the Basel Committee’s goal of ensuring appropriate risk sensitivity in the standardized framework cannot be met with a ‘one-size fits all’ approach to unfunded commitments, and that reasonable efforts must be made to accommodate certain types of commitments that can objectively be demonstrated to have historical draw-down rates well below the intended threshold.

As noted above, in the case of the custody banks, this involves committed facilities provided to regulated investment funds, such as US mutual funds, EU UCITS and other similar national equivalents. Regulated funds are specifically structured for sale primarily to the retail investor community and are governed by detailed transparency, asset quality and diversification requirements. Furthermore, they are required by regulation to adhere to specific limits on both borrowed funds and leverage. As an example, US mutual funds are not permitted to incur indebtedness that exceeds 33% of the fund’s total assets. Similarly, retail UCITS are prohibited from borrowing more than 10% of the value of the fund’s assets. For other types of UCITS, limits are set by the fund’s investment profile, but generally do not exceed 25% to 40%. Regulated funds therefore have limited and well-defined credit needs. They are also subject to ongoing supervision.

Custody banks provide committed facilities to regulated funds on contractual terms to accommodate routine day-to-day operational matters. This includes unanticipated movements of cash, client redemptions, and the payment of management fees and other expenses.

¹⁰ ‘Basel III Leverage Ratio Framework and Disclosure Requirements’, Basel Committee on Banking Supervision (January 2014), page 19.

Committed facilities to regulated funds therefore play an important role in ensuring the efficient operation of the financial markets. If custody banks, such as State Street, were subject to significant restrictions in their ability to offer such facilities to their regulated fund clients due to poorly-calibrated credit risk-parameters, this would necessitate special operational processes regarding the movement of cash, including client redemptions, that would heighten potential transaction risk, increase investor costs and disrupt market efficiencies.

Committed facilities to regulated funds have features that carefully limit their tenor and usage. This includes asset quality and diversification minimums and short repayment obligations, typically 30-60 days. As a result, our experience is that committed facilities provided to regulated funds represent limited credit risk and are unlikely to experience significant draw-downs, even during periods of financial market stress. This is validated by State Street's experience during the financial crisis, where utilization rates for liquidity facilities provided to US mutual funds reveal total draw-down rates substantially below 10%.¹¹ This information, which we have previously provided to the Basel Committee in the context of its work on the Basel III Liquidity Accord, has been provided to the Task Force on the Standardized Approach ("TFSA") via a separate confidential annex.¹²

We therefore recommend that the Basel Committee incorporate within the revised standardized approach, a specific and more granular CCF for committed facilities to regulated investment funds. Consistent with the approach adopted for trade finance commitments, we recommend the use of a CCF of 20%. This reflects the essential role which these low-risk obligations play in promoting the smooth and efficient operation of the financial markets, and therefore the importance of a standardized methodology that properly accounts for their inherent level of risk.

Alternatively, if the Basel Committee determines that it is necessary to proceed with a 'one-size fits all' approach for unfunded commitments, we strongly recommend calibration of the CCF at the low end of the range envisioned in the second consultation, or 50%. This reflects two considerations. First, and barring the development of a more granular approach for certain value added commitments that can be demonstrated to be of lower risk, the use of a 50% CCF is the only way to ensure that a reasonable balance is achieved across the range of commitments which are offered by internationally active banks.¹³ While we acknowledge that this may open the door to the underestimation of credit risk in certain unfunded commitments, we believe that this can effectively be addressed via clarification in the Basel Committee

¹¹ This include both committed and uncommitted lines of funding since data on historical usage by our regulated US mutual fund clients does not distinguish between the two.

¹² 'Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools', Basel Committee on Banking Supervision (January 2013), paragraph 131.

¹³ In support of this observation, State Street has also included in its confidential submission to the Basel Committee, data on utilization rates for committed lines of funding provided to US municipal entities, such as states, municipal subdivisions and towns. This data reveals incremental draw-down rates substantially below 10%, even at the height of the financial crisis.

standardized approach, that banks must validate the sufficiency of the 50% CCF for their specific exposure types and that a higher CCF must be assigned in instances where the 50% CCF is inadequate to mitigate the underlying risk. Furthermore, the Basel Committee should also affirm that the process of assigning CCFs to unfunded commitments is subject to supervisory review, as well as peer assessment under the Regulatory Consistency Assessment Program.

Second, the use of a 50% CCF is necessary to address the down-stream implications of a risk-insensitive approach on other components of the regulatory capital framework. While the Basel Committee's second consultation is understandably focused on the development of a standardized framework for risk-based capital, it is essential that the TFSA not lose sight of the fact that the treatment of unfunded commitments has a direct bearing on required amounts of leverage capital (*i.e.* the Basel III leverage ratio), the capital surcharge for global systemically important banks ("G-SIBs"), and required amounts of total-loss absorbing capacity ("TLAC"). This reflects both the impact of CCFs on 'total exposure', which is the denominator of the Basel III leverage ratio, and the use of the Basel III leverage ratio denominator in other regulatory capital standards. As an example, 'size', which is one of the five categories within the G-SIB surcharge indicator-based methodology, is measured on the basis of 'total exposure'.¹⁴ Similarly, the Financial Stability Board's ("FSB") TLAC standard incorporates a minimum Basel III leverage ratio requirement of 6% beginning in January 2019, rising to 6.75% as of January 2022.

By materially increasing the prescribed CCF for unfunded commitments in the revised standardized approach, the Basel Committee will therefore necessarily impact other components of the regulatory capital framework in ways that may not be fully anticipated. This is especially the case in instances involving national implementation of standards which are higher than those foreseen by the Basel Committee. As an example, US G-SIBs are subject to a leverage ratio requirement (*i.e.* the enhanced supplementary leverage ratio) that is twice the Basel III leverage ratio, or 5% at the level of the BHC and 6% at the level of the insured depository institution.¹⁵ Similarly, the US FRB has proposed the implementation of a TLAC framework for the US G-SIBs with a minimum leverage ratio requirement of 9.5%, or approximately 40% higher than the FSB standard on a fully-phased in basis, along with a complementary long-term debt leverage ratio requirement of 4.5% not contemplated in the international standard.

These requirements already have a disproportionate impact on banking organizations, such as the stand-alone custody banks, with lower levels of embedded balance sheet risk, and we are concerned that the introduction of an insufficiently risk-sensitive standardized framework for unfunded commitments will only aggravate this trend. In our view, the potential for broad-based knock-on effects across the regulatory capital framework should weigh heavily in favor of

¹⁴ 'The G-SIB Assessment Methodology – Score Calculation', Basel Committee on Banking Supervision (November 2014).

¹⁵ 'Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies', Board of Governors of the Federal Reserve System, Federal Register, Volume 80, Number 157, page 49082.

an incremental approach to changes in the calibration of CCFs, and therefore a lower 50% standard.

Finally, we wish to draw the Basel Committee's attention to what we believe is an unintentional consequence of the revised framework for unfunded commitments. By substantially increasing the applicable CCF, particularly for unfunded commitments with an original maturity of up to one year (from 20% to between 50% and 75%), the Basel Committee has created a framework in which the risk exposure of an unfunded but secured commitment, such as an SFT or margin loan, is likely to be substantially greater than the risk exposure of the same commitment if fully funded. This reflects the impact of the underlying collateral in a secured funding transaction, which is not explicitly recognized for purposes of the CCF. In order to address this anomaly, we request that the Basel Committee permit the use of an offset for 'implied collateral' in the CCF framework, or that it clarify that in no circumstance should the exposure of a bank to an unfunded commitment be greater than the exposure to that same commitment if fully funded.

CONCLUSION

Thank you once again for the opportunity to comment on the important matters raised within this Consultation. To summarize, we would like to thank the Basel Committee for the thoughtful and constructive manner in which it has approached the development of a revised standardized framework. While we believe that the second consultation incorporates areas of substantial improvement, notably the introduction of a revised methodology for the measurement of exposures to SFTs, we continue to believe that further progress is required in order to achieve the Basel Committee's goal of an approach which successfully balances risk-sensitivity and simplicity, and which addresses excessive variability in RWA across banks and national jurisdictions.

We therefore recommend a series of adjustments to certain aspects of the intended framework, designed to improve the overall assessment of credit risk and to more fully account for the unique features of the custody bank business model. First, we recommend a technical revision to the criteria used to define the minimum size of a securities issuance in the netting set for SFT exposures, so that it is based upon the average size of all issuances in the netting set rather than on the size of the largest issuance. Furthermore, we recommend that the Basel Committee incorporate within the methodology for SFTs a specific definition of settlement currency based upon the currency of the lent security in a securities lending or repurchase transaction, and in the case of a securities borrowing or reverse repurchase transaction, the currency of the cash leg.

Second, we recommend that the RWA for 'investment grade' corporate exposures for banks in jurisdictions that do not permit the use of credit ratings be decreased from 75% to 60% in order to improve the comparability of exposures with banks in jurisdictions that permit the use of such ratings. In addition, we recommend removal of the reference to 'securities outstanding on a recognized securities exchange' from the definition of an 'investment grade' corporate so that

the intended framework appropriately accommodates corporate entities that do not in the normal course of business issue securities into the market.

Third, we recommend the introduction of a CCF of 20% for unfunded commitments provided to regulated investment funds, such as US mutual funds, EU UCITS and other similar national equivalents, or alternatively, calibration of the proposed 'one-size fits-all' CCF at 50%, along with clarification that the exposure amount of an unfunded commitment should never exceed the exposure amount that would apply if that exposure were fully funded.

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

Sincerely,

A handwritten signature in black ink, appearing to read 'Stefan M. Gavell', written in a cursive style.

Stefan M. Gavell

Annex 1
Impact of Differences in the Definition of ‘Settlement Currency’ for SFTs

The impact of the definition of ‘settlement currency’ on the measurement of exposures for SFTs can be depicted by the following example:

Transaction List (loan by loan basis)

	Lent Security		Collateral		
Loan #	Denom. (CCY)	Value (USD)	Denom. (CCY)	Value (USD)	Collat. Ratio
1	GBP	100	GBP	75	105%
1			USD	30	
2	GBP	100	GBP	105	105%
3	EUR	150	JPY	162	108%
4	EUR	150	EUR	37	108%
4			GBP	125	
5	USD	250	USD	255	102%
6	USD	250	JPY	270	108%
7	JPY	50	USD	54	108%
8	JPY	50	EUR	54	108%

The loan and collateral currency exposures can be consolidate into the following positions:

Net Positions by Currency

CCY of Position		Security Loaned		Collateral Rec'd	Net Position
USD		500		339	(161)
EUR		300		91	(209)
GBP		200		305	105
JPY		100		432	332
		1,100		1,167	67

In the event of default, the agent lender would be required to convert excess GBP and JPY into the shortfall for USD and EUR.

If the ‘Settlement Currency’ is assumed to be the home currency of the agent lender (USD in this case) then the excess GBP and JPY would be converted into USD, thereby creating a currency conversion charge, and additionally a conversion charge from USD to EUR would be incurred to cover the EUR shortfall.

Settlement Currency assumed to be Bank Home Currency (USD)

CCY of Pos.	Value of Securities Lent	Value of Collateral Rec'd	Value of Net Position	FX Haircut Rate	Mismatched CCY Exposure
USD	500	339	(161)	N/A	0.0
EUR	300	91	(209)	5.7%	11.91
GBP	200	305	105	5.7%	5.99
JPY	100	432	332	5.7%	18.92
Aggregate Currency Mismatch					36.82

If the 'Settlement Currency' is assumed to be the base currency of the Global Master Securities Lending Agreement ("GMSLA") (EUR in this case) then the excess GBP and JPY would be converted into EUR, thereby creating a currency conversion charge, and additionally a conversion charge from EUR to USD would be incurred to cover the USD shortfall.

Settlement Currency assumed to be GMSLA Base Currency (EUR)

CCY of Pos.	Value of Securities Lent	Value of Collateral Rec'd	Value of Net Position	FX Haircut Rate	Mismatched CCY Exposure
USD	500	339	(161)	5.7%	9.18
EUR	300	91	(209)	N/A	0.0
GBP	200	305	105	5.7%	5.99
JPY	100	432	332	5.7%	18.92
Aggregate Currency Mismatch					34.09

If the 'Settlement Currency' is assumed to be the currency of the securities loan, then the excess GBP and JPY would directly be converted into the required USD and EUR, with any excess (\$67) then being converted to the base currency under the GMSLA. This approach is more reflective of how an agent bank would liquidate collateral and buy-in lent securities, thereby capturing the true economic exposure of currency mismatches within a netting set.

Settlement Currency assumed to Loan Currencies

CCY of Pos.	Value of Securities Lent	Value of Collateral Rec'd	Value of Net Position	FX Haircut Rate	Mismatched CCY Exposure
USD	500	339	(161)	N/A	0.0
EUR	300	91	(209)	N/A	0.0
GBP	200	305	105	5.7%	5.99
JPY	100	432	332	5.7%	18.92
Aggregate Currency Mismatch					24.91