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January 20, 2023

Via Electronic Mail

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

Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429
Attention: James P. Sheesley, Assistant Executive Secretary

Re: Comment Letter on the Advance Notice of Proposed Rulemaking on Resolution-Related Resource Requirements for Large Banking Organizations

Docket No. R–1786; RIN 3064–AF86; RIN 7100-AG44

Ladies and Gentlemen:

Northern Trust Corporation (**Northern Trust**) welcomes the opportunity to comment on the advance notice of proposed rulemaking (the **ANPR**) published on October 24, 2022 by the Board of Governors of the Federal Reserve System (the **Federal Reserve**) and the Federal Deposit Insurance Corporation (the **FDIC** and, together, the **Agencies**) on resolution-related resource requirements for large banking organizations (**LBOs**) that are not global systemically important banking organizations (**GSIBs**) (the **non-GSIB LBOs**).[1]

We support and join the comment letters of the Bank Policy Institute and American Bankers Association. We write separately because there are topics specific to Northern Trust that we

[1] Advance Notice of Proposed Rulemaking, *Resolution-Related Resource Requirements for Large Banking Organizations*, 87 Fed. Reg. 64170 (October 24, 2022).

believe are important additional factors for the Agencies' consideration. In particular we believe that the ANPR does not adequately consider:

- The fact that Northern Trust (as well as the other non-GSIB LBOs) are significantly smaller and less complex than the GSIBs;
- In a resolution scenario, acquisition of some or all of the operations of a non-GSIB LBO like Northern Trust by a GSIB or a non-GSIB LBO may be the most appropriate outcome and would not increase systemic risk; and
- The need for flexibility with respect to any requirements that the Agencies do consider in order to facilitate a multiple point of entry (**MPOE**) resolution strategy.

As discussed in this comment letter, Northern Trust believes the Agencies should reconsider the need for the proposal in light of the specific characteristics of the non-GSIB LBOs, such as Northern Trust's custody business model and smaller asset size, as well as perform further analysis of certain of the assumptions that the Agencies have made to justify this ANPR by taking into account the specific resolution strategy of each non-GSIB LBO to determine the actual impact of such a resolution before imposing a costly long-term debt (**LTD**) requirement. In furtherance of the foregoing, Northern Trust has provided potential alternative approaches for the Agencies to consider.

I. <u>Northern Trust is a custody bank that is significantly smaller in size than the U.S. GSIBs and by size alone, would be a Category IV firm.</u>

Northern Trust's business model is relatively low risk, with no material trading or investment banking activities. Despite Northern Trust's balance sheet being smaller than many U.S. regional banks, and its business model abroad having significantly less risk than non-custody banks, its international custody activities result in its status as a Category II firm. Notwithstanding Northern Trust's status as a Category II firm, it is significantly smaller in size than any of the U.S. GSIBs or the non-GSIB LBOs and has a balance sheet closer in size to a Category IV regional bank. The Agencies should take into account the lower risk profile and smaller scale of Northern Trust and the non-GSIB LBOs when considering the need for any additional requirements, especially costly LTD or other requirements that would impose significant costs or balance sheet impacts on the non-GSIB LBOs.

Northern Trust is a custody bank with approximately $160 billion in total consolidated assets as of Q3 2022. Northern Trust has two core business lines: custody and wealth management. Northern Trust's custody and asset servicing business provides custody and related services as agent on behalf of pension funds, mutual funds, index funds, exchange traded funds and similar investors and asset owners. Northern Trust's wealth management business focuses on high-net worth individuals and families, business owners, executives, professionals, retirees, and established privately held businesses in its target markets.

Custody and asset servicing is a stable and relatively low risk line of business.[2] As a custody bank, Northern Trust is engaged in custody activities that consist in large part of acting as agent for clients in effecting securities settlement and related asset servicing activities. Custody services consist of holding and servicing assets, primarily securities, as agent for the beneficial owners of the securities. As custodian, Northern Trust provides safekeeping, recordkeeping, reconciliation and monitoring services relating to clients' assets. Unlike large scale principal

[2] For additional information on the operations and business model of custody banks, see generally The Clearing House, The Custody Services of Banks (July 2016), available at https://www.theclearinghouse.org/-/media/tch/documents/research/articles/2016/07/20160728_tch_white_paper_the_custody_services_of_banks.pdf.

trading and investment banking activities, there is a relatively low level of risk associated with the firm's business model.

As a custodian, Northern Trust records client securities in the client's name and holds client securities in segregated securities accounts. These securities are beneficially owned by Northern Trust's clients, or clients of Northern Trust's clients (in other words not owned by Northern Trust), and are segregated from Northern Trust's own assets and would not be impacted by a resolution scenario affecting Northern Trust. Northern Trust bears no market or credit risk in respect of its clients' securities. Northern Trust facilitates transactions in client securities, but does not make markets in or underwrite the issuance of the securities. Clients with securities held under custody at a custody bank such as Northern Trust also need access to a cash account in order to hold cash used to purchase securities, receive cash from the sale of securities and from dividends and interest payments, and hold cash used for or resulting from various corporate actions by issuers of securities (such as repurchases, exchanges, mergers or spin-offs) and subscriptions and redemptions of, for example, mutual fund shares. Client cash is held on deposit in a cash account with Northern Trust and represents a liability of Northern Trust to the client for the amount of the deposit, and thus—unlike the client's securities held in custody—is reflected on Northern Trust's balance sheet. Whereas a custody client does not have credit exposure to Northern Trust for its securities held in custody, it does have a credit exposure to Northern Trust for the amount of its cash on deposit.[3] Therefore, as a custody bank, Northern Trust's balance sheet is driven primarily by its client cash deposits, and its assets generally reflect the volume of its clients' investment and transaction activities.

Even in stressed market conditions, clients' demand for custody services would remain unchanged. In fact, custody banks typically see an inflow of client deposits in periods of macroeconomic stress as custody banks are viewed by clients as safe havens. At the start of the Covid-19 pandemic, Northern Trust saw an increase in average client deposits resulting from the large inflows experienced at the end of the first quarter of 2020, and these balances were largely maintained throughout the year.

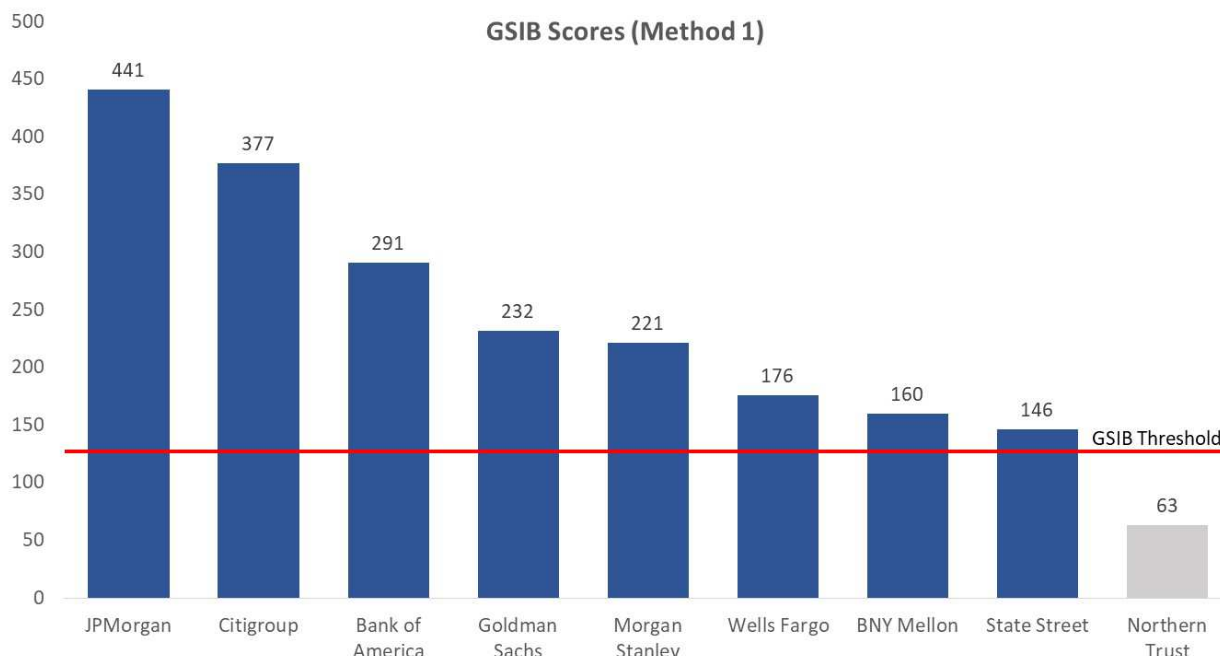
Northern Trust's custody business is international in scale, as it allows U.S. clients access to securities issued and traded in markets outside the United States and non-U.S. clients access to securities issued and traded in the United States. Northern Trust has operations in 23 countries. However, its cross-jurisdictional claims and cross-jurisdictional liabilities are concentrated primarily in five jurisdictions outside the United States, namely, the United Kingdom, Luxembourg, Canada, the Cayman Islands and Australia. 61% of the firm's cross-jurisdictional claims and 92% of the firm's cross-jurisdictional liabilities are concentrated in these five jurisdictions.

An internationally active custody bank by its nature must have deposits in a number of jurisdictions across the world, but these deposits and the assets they fund are inherently less risky than the cross-jurisdictional activity of other banking businesses. A custody bank's loans are generally of a much shorter term and higher quality—e.g., overnight credit to facilitate the settlement of a securities transaction that are fully collateralized by the securities in clients' securities accounts—than the long-term (secured or unsecured) loans a traditional bank may provide in a non-U.S. jurisdiction. These high-quality, short-term loans are generally a small portion of a custody bank's cross-jurisdictional activity, however, as a custody bank's balance sheet growth is typically driven by clients' decisions to make additional cash account deposits. As such cash account deposits remain on the balance sheet over time they become operational deposits that are empirically

[3] A portion of a client's cash deposit with Northern Trust may be insured by the FDIC or under an equivalent non-U.S. deposit guarantee scheme.

linked to operational services provided to clients; operational deposits are more sticky and less likely to be withdrawn even in times of stress because the operational deposits are needed by the clients in connection with their securities activity. Northern Trust's experience during periods of macroeconomic stress, such as the Covid-19 pandemic, is that deposits increase. Northern Trust's relative lack of complexity is illustrated by the gap between its Method 1 score[4] and the Method 1 scores of the GSIBs. As can be seen in Figure 1, Northern Trust's Method 1 score is less than half that of the score of the closest GSIB, and less than half the score necessary to cross the threshold for designation as a GSIB.

Figure 1



II. <u>Acquisition by a GSIB or another LBO is a sensible solution for a smaller custody bank in resolution.</u>

The Agencies have expressed concern in the ANPR that there should be other alternatives than relying on the sale of an LBO to a GSIB or another LBO in a resolution scenario. However, taking into account the specific characteristics of the custody bank business model as described above, which is unique and different from the business model of a large commercial bank, the Agencies should not simply dismiss the option of a GSIB or another LBO acquiring Northern Trust. A reasonable acquirer for Northern Trust is likely one that is already in the custody business. In a resolution scenario, the FDIC might find in its analysis that an acquisition of Northern Trust by a GSIB or another LBO is the least costly option. This would mean that one of the reasons offered

[4] The Basel Committee on Banking Supervision (**BCBS**) created a set of 12 financial indicators to identify GSIBs. A Method 1 score is a linear combination of these 12 systemic important indicators distributed into five categories: size, interconnectedness, cross-jurisdictional activity, substitutability, and complexity. The U.S. GSIB rule requires that a bank whose Method 1 score exceeds a certain threshold be identified as a GSIB and be subject to capital surcharges.

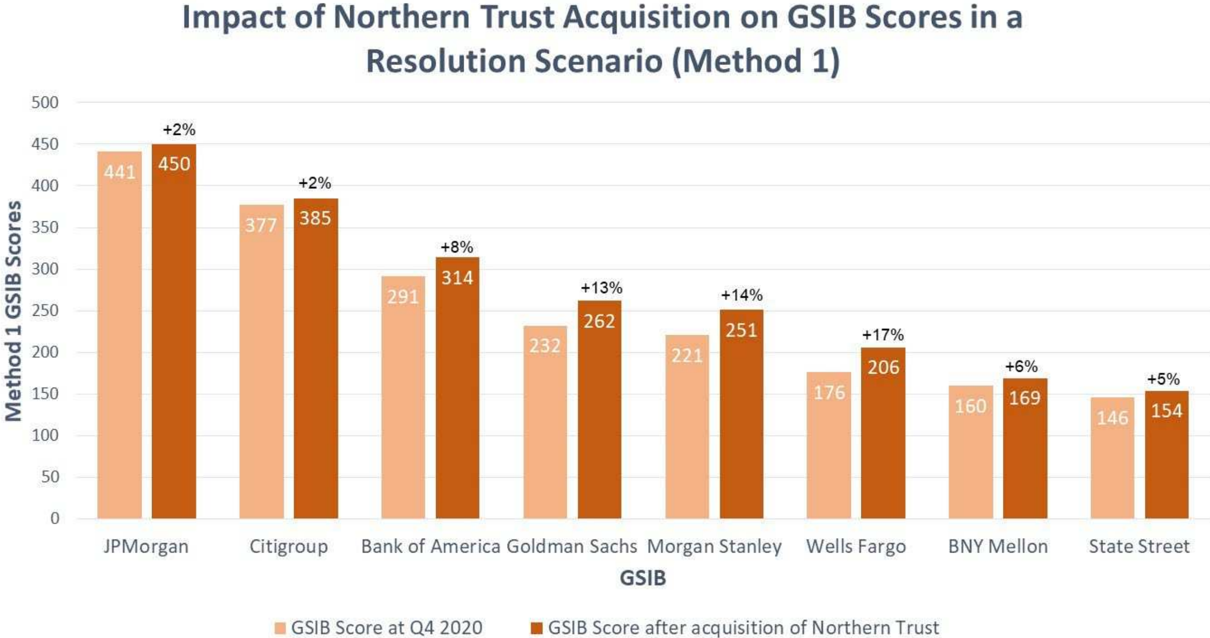
by the Agencies in support of the ANPR does not apply to Northern Trust, and the Agencies should perform further analysis to confirm if that reason also may not apply to other LBOs.

Even though the Northern Trust resolution strategy contemplates a break-up of the institution, based upon its business-as-usual balance sheet, an acquisition of Northern Trust in resolution *as a whole* would not have a significant impact on the GSIB scores of a potential acquirer.

- As illustrated in Figure 2, under an assumed resolution scenario,[5] all GSIBs would remain in the respective buckets, except Wells Fargo (overall, average GSIB score increase of 16) as reflected by Method 1. Under Method 2,[6] 2023 capital requirements would remain unchanged for all GSIBs with the exception of a 50 bps increase for Wells Fargo, as reflected by Method 2 (overall, average GSIB score increase of 11).

- On average, an acquisition of Northern Trust as a whole in resolution would increase Method 1 GSIB scores by 8%, which is less than the organic increases in scores observed by several GSIBs in recent years.[7]

Figure 2



The minimal impact an acquisition of Northern Trust in resolution would have on GSIB scores demonstrates that the Agencies' concern in the ANPR is not a reasonable basis to impose costly

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[5] The assumed resolution scenario refers to the period in resolution when stabilization begins, at which point Northern Trust's material entities would be sold or wound down in accordance with the resolution strategy, as further described in Section 4 – Bridge Bank Strategy of the Northern Trust 2021 Public Resolution Plan, *available at* https://www.fdic.gov/resources/resolutions/resolution-authority/resplans/plans/nt-165-2112.pdf.

[6] In addition to the BCBS methodology, the Federal Reserve developed its own methodology (**Method 2**) to calibrate the capital surcharge of domestic GSIBs. Method 2 weighs size, interconnectedness, cross-jurisdictional activity, complexity, and a measure of the firm's reliance on short-term wholesale funding. U.S. GSIBs are required to calculate their applicable surcharge under both Method 1 and Method 2 as the higher of the two surcharges will apply.

[7] *See* Office of Financial Research, "OFR Bank Systemic Risk Monitor" U.S. G-SIB Surcharges, *available at* https://www.financialresearch.gov/bank-systemic-risk-monitor/.

LTD requirements that would affect the composition of the non-GSIB LBO balance sheets. Northern Trust encourages the Agencies to undertake a similar analysis of the other non-GSIB LBOs with respect to their objects of sale and franchise components to see if it would yield a similar result.

In addition, there may be other potential acquirers domestic and foreign of Northern Trust. This would be particularly true in a resolution scenario, where the balance sheet should be expected to shrink such that a bank of Northern Trust's expected size at the time would be more easily digestible for a number of financial institutions, including smaller firms seeking opportunities to enter the custody business.

As the Agencies have stated their concern about the availability of potential acquirers for a non-GSIB LBO as a reason for an LTD requirement, Northern Trust requests that the Agencies reconsider the viability of a non-GSIB LBO sale in a resolution scenario, specifically with respect to Northern Trust and more generally for the non-GSIB LBOs. A whole bank sale, or sale in parts, as contemplated by Northern Trust's resolution plan, should not be dismissed as a viable option for a non-GSIB LBO resolution. These options are most likely the least costly strategies available in the resolution of a non-GSIB LBO, such as Northern Trust. The fact that a potential acquirer would get larger does not necessarily mean that the acquisition will make an existing GSIB more complex or increase systemic risk. As illustrated above with respect to Northern Trust, such an acquisition's impact on GSIB scores would not result in a significant change in this measure of an acquirer's systemic importance.

Notwithstanding that there would be minimal impact to a GSIB's scores of an acquisition of Northern Trust, the Northern Trust resolution strategy does not contemplate a whole bank acquisition. Instead, Northern Trust, similar to other non-GSIB LBOs, has a credible MPOE resolution strategy that contemplates the separation of its businesses and its sale in components. As a consequence, in an actual resolution scenario the acquisition of Northern Trust's operations would have an even smaller impact on the GSIB scores of any of the acquirers of the components. Similarly to Northern Trust, other non-GSIB LBOs complete a separability analyses in their resolution plans so that, in the event of a resolution scenario, those non-GSIB LBOs would be even smaller institutions that could be more easily acquired. Because a foundational reason offered by the Agencies for imposing GSIB-like resolution-related requirements on the non-GSIB LBOs does not apply to Northern Trust and may not apply to other non-GSIB LBOs, the Agencies should perform an analysis of other non-GSIB LBOs similar to what Northern Trust has done above—and take into account the specifics of each of the non-GSIB LBOs' resolution strategy—to reconsider the assumptions underpinning the ANPR. Northern Trust encourages the Agencies to consider the specific structure of each non-GSIB LBO, and in particular, to focus on the impacts of the actual strategy of each institution's resolution (i.e., franchise components, objects of sale) before imposing on the non-GSIB LBOs costly LTD requirements that were designed for the single point of entry (**SPOE**) resolution strategies of GSIBs.

III. Agencies should maintain flexibility in their analysis of potential changes to resolution-related requirements for non-GSIB LBOs.

Both as a general matter and because of the specific features of the non-GSIB LBOs, the Agencies should proceed gradually and thoughtfully in their analysis when considering approaches to strengthening the resolution-related requirements of non-GSIB LBOs. Before determining whether imposing such a requirement on non-GSIB LBOs is necessary, the Agencies should explore alternative resolvability enhancing options and support arrangements that would be more suitable to non-GSIB firms. The existing LTD requirements were designed based on the

complex organizational structures and specific characteristics of the U.S. GSIBs and any resolution-related requirements imposed on the non-GSIB LBOs should be tailored to those institutions.

If the Agencies determine that it is necessary to impose more burdensome resolution-related requirements on the non-GSIB LBOs, they should consider how best to tailor any requirements to support an MPOE strategy where each material entity is separately resolved. The Agencies should consider alternative ways of enhancing financial stability through mechanisms tailored to non-GSIB LBOs rather than applying LTD requirements that are ill-suited to the non-GSIB LBOs because those requirements were originally designed for GSIBs.

Other alternative mechanisms to LTD structures that would achieve the same goal of enhancing resolvability of the non-GSIB LBOs include various forms of internal support that could be provided by affiliates of the LBO and other potential options that may be available to institutions. If the Agencies do impose an LTD requirement, they should allow non-GSIB LBOs to have flexibility both as to how the requirement is satisfied and as to which level of its structure it satisfies the requirements. For example, a firm may preposition liquidity internally at its top-tier parent level or the level of its insured depository institution subsidiary or other material operating subsidiary. If a firm has other resources that can be subordinated to deposits, such as intercompany deposit liabilities or external debt, that should be acceptable as well. More generally, there are various ways of subordinating debt that should be considered as alternatives to an LTD requirement. A firm may also prefer to pursue support arrangements that are less about maintaining material entities as going concerns for more than a year post-failure, but rather on mitigating potential runs on the deposits of the bank so a quick sale can be arranged to a successor institution.

If the Agencies were to implement an LTD requirement on non-GSIB LBOs, the Agencies should take an approach that permits firms to maintain or strengthen their existing resolution strategies rather than, in effect, requiring the non-GSIB LBOs to change from an MPOE resolution strategy to an SPOE strategy. The LTD requirements for GSIBs address issues that arise from certain unique characteristics of the GSIBs, their SPOE resolution strategies, and the heightened systemic risk a GSIB's disorderly failure may present. GSIBs have many operating material entities outside of their bank chain and an SPOE strategy allows the material bank and non-bank operating subsidiaries of a U.S. GSIB to stay out of bankruptcy or other resolution proceedings in the United States and foreign jurisdictions, with only the top-tier parent entering a bankruptcy or other resolution proceeding. In contrast, non-GSIB LBOs have far fewer non-bank material entities and therefore, in a resolution scenario, are able to pursue an MPOE strategy that assumes the failure of the institution with multiple resolution proceedings at the level of the top-tier holding company and at the level of the material operating subsidiaries—which in the case of Northern Trust would be just two resolution proceedings: one for the top-tier holding company and one for the bank.

The LTD requirements of the GSIBs were designed with an SPOE resolution strategy in mind.[8] The non-GSIB LBOs, which are far less complex than the U.S. GSIBs, have and maintain credible resolution plans that pursue an MPOE strategy without the need for an extra layer of total capital in the form of additional subordinated LTD. The non-GSIB LBOs do not need to develop an SPOE strategy to be resolved without a material adverse effect on U.S. financial stability. Northern Trust requests that any LTD requirements be tailored to maintain or strengthen the existing MPOE

[8] "The [Total Loss Absorbing Capacity], long-term debt, and clean holding company requirements that the Board has applied to the U.S. GSIBs were generally designed to support an SPOE resolution strategy." 87 Fed. Reg. at 64172.

resolution strategies of the non-GSIB LBOs, instead of effectively requiring a non-GSIB LBO to adopt an SPOE strategy. Non-GSIB LBOs have less of a need for additional capital in a resolution scenario because in an MPOE strategy the goal is not to facilitate the long-term stand-alone operation of the material operating subsidiaries as it is in an SPOE strategy; the goal of an MPOE strategy is to maintain operations for a relatively quick sale. An LTD requirement for a non-GSIB LBO would not fulfill the same purpose that it does for a GSIB. Even in the event the Agencies decide to impose LTD requirements on the non-GSIB LBOs, those requirements should be calibrated at a lower level than existing GSIB requirements in order to address the differences in their need for an extra layer of loss-absorbing capacity in a resolution to support an SPOE strategy.

If the Agencies determine to apply resolution-related requirements on the non-GSIB LBOs, they should remain flexible and explore other options for strengthening the resolvability of these firms based on the specific structure and resolution plan of non-GSIB LBOs.

IV. Conclusion

Northern Trust believes the Agencies should reconsider the need to impose GSIB-like resolution-related requirements on the non-GSIB LBOs. As discussed in this comment letter, the specific characteristics of the non-GSIB LBOs, such as Northern Trust's custody business model and small size, as well as the specific resolution strategy of each non-GSIB LBO, requires that the Agencies reconsider certain of the assumptions made to justify this ANPR. If the Agencies determine to impose resolution-related requirements on non-GSIB LBOs, Northern Trust encourages the Agencies to have a flexible approach and consider the potential alternatives outlined in this comment letter.

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Northern Trust appreciates the opportunity to comment on the ANPR. Please feel free to contact Mark Eichelberger, at me42@ntrs.com, if you would like to discuss this comment letter.

Sincerely,

Jason J. Tyler