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Northern Trust

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| Ms. Jennifer J. Johnson<br>Secretary<br>Board of Governors of the Federal Reserve System<br>20th Street and Constitution Avenue, NW.<br>Washington, DC 20551<br>regs.comments@federalreserve.gov<br>Docket Number R-1265 | Office of the Comptroller of the Currency<br>250 E. Street, SW.<br>Mail Stop 1-5<br>Washington, DC 20219<br>regs.comments@occ.treas.gov<br>Docket Number 06-10 |
| Regulation Comments<br>Chief Counsel's Office<br>Office of Thrift Supervision<br>1700 G Street, NW.<br>Washington, DC 20552<br>regs.comments@ots.treas.gov<br>Attention: No. 2006-34 | Mr. Robert E. Feldman<br>Executive Secretary<br>Attention: Comments<br>Federal Deposit Insurance Corporation<br>550 17th Street, NW.<br>Washington, DC 20429<br>comments@FDIC.gov |

Re: Risk-Based Capital Standards: Market Risk 71 FR 55958 (September 25, 2006)

Ladies and Gentlemen:

Northern Trust Corporation appreciates the opportunity to comment on the Market Risk Joint Notice of Proposed Rulemaking ("*NPRM*"). Northern Trust is subject to the 1996 *Market Risk Amendment* and to any subsequent revisions thereof, such as those proposed in the *NPRM*.

Northern Trust Corporation ("Northern Trust") is a multi-bank holding company with its headquarters in Chicago, Illinois. The corporation has a network of offices in 18 U.S. states and international offices in 13 countries. Northern Trust had balance sheet assets totaling over $60 billion and assets under custody totaling $3.5 trillion as of December 31, 2006. Northern Trust conducts its global activities through The Northern Trust Company, an Illinois-chartered bank, four national banks, a federal thrift institution, an Edge Act subsidiary, and a number of non-bank subsidiaries.

In this letter we offer one general comment and then cite six responses to selected questions in the NPRM. Several of our comments refer to a letter drafted by the Financial Services Roundtable ("FSR") in response to the *NPRM*. Northern Trust participated in the FRS's comment process and supports the points made in that letter. The comments we offer in this letter supplement the FSR's comments and reflect Northern Trust's own views.

**General Comment: Commensurate Requirements**

Northern Trust supports a regulatory framework whose requirements and sophistication are commensurate with the nature and complexity of the risk exposures being managed. We concur fully with a key point made by the FSR that the *NPRM*, like most of the Basel-based risk regulations, has naturally been drafted to cover the activities of large and complex banks. Such financial institutions engage in sophisticated risk structures, deal in large risk exposures, and create or trade complex structured derivatives; thus they would justify investing in comprehensive risk-management processes and expensive risk-measurement systems.

But, as the FSR letter states, some banks, like Northern Trust, engage in relatively simple activities using transparent operations and employing "plain-vanilla" instruments and positions. Therefore, Northern Trust agrees fully with the FSR that for many banks the *NPRM* may have underestimated the burden and costs of implementing the proposed regulation, and that any proposed regulations would serve the agencies' purposes better where they impose requirements whose costs are more consistent with and reflective of the materiality of the risk being managed.

**Specific Comments (by *NPRM* question number)**

**Question 4. Covered/Non-covered.** Northern Trust supports a regulatory framework that affords banks the flexibility either to include or exclude non-covered positions that are hedged by covered positions (or vice versa) in its VaR-based measure so long as the resulting measurement reflects the net risks accurately and consistently.

**Question 8. Clean backtesting.** We strongly agree with the FSR that, rather than defining in detail the elements that the backtesting calculation should *exclude*, the proposed language should state simply what it would *include*. In Northern Trust's view, clean backtesting should reflect a static set of end-of-day positions priced at the next day's closing prices; with that definition, any other adjustments are unnecessary.

**Question 7 (also involves 11, 12, and 13).** The proposed rules attempt to treat trading-book positions like banking-book positions. The motivation is that positions that banks place in their trading books might be in instruments (such as credit derivatives) that the original regulations intended to appear in the banking book.

Because such positions are managed by trading desks, however, any changes in their risk characteristics (such as changes in default risk, credit rating, basis risk, spread risk, prepayment risk, *etc.*) would be monitored and managed by the trading desk. Its prices, spreads, discount curves, volatilities, and correlations would adjust immediately in the market. Thus, its values and risks would be reflected in normal mark-to-market valuation and risk-measurement processes. A new requirement to mandate such adjustments or model them explicitly or separately would be redundant and, especially for Northern Trust, would be unreasonably expensive relative to the risks being managed.

Also, a trading position by definition is held for a short term and is not intended to be held to maturity. Therefore, the requirement of a one-year horizon for such risks -- while the instrument's markets risk are measured to a ten-day horizon – would be inappropriately long, inconsistent with the measurement of the other market risks, statistically awkward to aggregate, and systematically overstate risks and capital requirements.

Finally, the 99.9% confidence level suggested in the NPRM is not consistent with the 99% requirement for market risk.

Therefore, we are concerned that (a) this proposed rule would impose unnecessary complexity and impose unreasonable burdens on Northern Trust and other similarly-situated banks; (b) its provisions are statistically incompatible with existing market rules and market practices; and (c) it would offer little marginal benefit in the way of improved modeling, risk management, or capital adequacy.

**Question 9. Partial specific risk.** Northern Trust shares the FSR's concerns about the *NPRM*'s proposal to phase out partial modeling of specific risk. The removal of that approach is inconsistent with the goal that the regulations, where they are needed, should foster flexibility and allow a wide range of options in risk modeling.

**Question 14. (Other): Procedures.** We concur with the FSR's points regarding disclosure of procedures. Northern Trust agrees it is reasonable to disclose risk-management policies and risk-measurement methodologies, including descriptions of general modeling processes. But Northern Trust does not favor a requirement to disclose "procedures" documents, which describe the specific steps used to run risk-modeling processes.

First, those procedures and their documentation are *proprietary*; they are valuable to Northern Trust and represent company intelligence that ordinarily should not be released to competitors. Second, they are naturally *system-specific*, containing instructions and describing detailed steps unique to a bank's hardware and software; they would be of little value, if any, to the public investor or other stakeholder.

It is possible that the agencies have a different definition of the term "procedures" than Northern Trust uses. That being said, given our understanding and use of the term, we recommend the agencies remove that proposed requirement.

**Question 14. (Other): Board and officer requirements.** We support the FSR's position that the *NPRM*'s proposed requirements for Board verification and Chief Financial Officer certification would be duplicative of other existing regulations, would increase directors' and officers' exposures to legal risks (thus raising the cost of management), is inappropriate, and would offer little marginal benefit to investors or stakeholders.

**Conclusion**

Overall, Northern Trust supports the effort to update the market risk and capital rules, and it offers its comments in the spirit of advancing that effort and continuing to promote sound risk management.

Northern Trust Corporation appreciates the opportunity to comment on its primary concerns with the proposed revisions to the existing market-risk capital framework. Northern Trust appreciates the patience and diligence of the national supervisors in their efforts to consider and address the many important issues raised by all interested parties in this effort.

Respectfully Submitted,

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