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

State Street Corporation
1 Lincoln Street
P.O. Box 5225
Boston, MA 02206-5225

Telephone: 617-664-8673
Facsimile: 617-664-4270
smgavell@statestreet.com

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1265
Email: regs.comments@Federalreserve.gov

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RIN 3064-AD10
Email: comments@FDIC.gov

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 1-5
Washington, DC 20219
Docket Number 06-10
Email: regs.comments@occ.treas.gov

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: No. 2006-34
Email: regs.comments@ots.treas.gov

Dear Sir or Madam:

Thank you for providing State Street Corporation the opportunity to comment on proposed revisions to the market risk capital rule, as described in the joint notice of proposed rulemaking ("NPR") by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision (the "Agencies") published on September 25, 2006 (55958 Federal Register Vol. 71 No. 185).

State Street Corporation, a financial holding company headquartered in Boston, Massachusetts, holds as its primary subsidiary State Street Bank and Trust, a Massachusetts chartered, Federal Reserve member bank. State Street specializes in providing institutional investors with investment servicing, investment management and investment research and trading. With $11.85 trillion in assets under custody, and $1.75 trillion in assets under management, State Street operates in 26 countries and more than 100 markets worldwide. State Street expects to be designated a "core bank" under the currently proposed U.S. implementation of the Basel Committee's "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" ("Basel II").

Overall, State Street supports the Agencies' efforts to improve the risk sensitivity of the calculation of regulatory capital. We believe the adoption of Basel II provides the opportunity for considerable improvements over Basel I, and we urge the Agencies to move forward with a Basel II implementation that is consistent with the global accord.

State Street also supports the Agencies' emphasis on the importance of comprehensive market risk measurements supported by results of independent model validation, and we support many of the provisions of the pending proposal. For example, we agree with the proposed revisions to better align market risk-based capital rules with the purpose and intent of hedging transactions involving both covered and non-covered positions.

We are concerned, however, that the NPR generally expresses a more prescriptive approach to market risk measurement techniques, which could unintentionally impede innovation in this evolving area. In several areas State Street believes the proposed revisions to the market risk rule could be improved, both to enhance the effectiveness of the rule, and to reduce the regulatory burden on banks.

These suggested changes include:

- **Alignment of Implementation Dates with Basel II Implementation**

  As proposed, the revised market risk capital rules would be effective on January 1, 2008, compared with a likely effective date of 2009-2011 for the first possible transition periods for the credit and operational risk components of Basel II. State Street is concerned with two aspects of the proposed implementation schedule for the market risk rule revisions. First, given the likely timing of a final rule release in mid-2007, we are concerned that the January 1, 2008 effective date may not provide banks sufficient time to make the changes necessary to comply with the new rules. Second, in order to minimize the regulatory burden on banks, we urge the Agencies to align the implementation dates of the market risk rule revisions with the implementation dates for other elements of Basel II.

- **Pre-approval of Models**

  While we understand and agree with the importance of regulatory approval for models used to calculate market risk-based capital, we are concerned that the requirement for pre-approval of such models by regulators may impede our ability to innovate and proactively manage risks. In addition, depending upon the nature of a change, there may be no material distinction, from a risk governance perspective, between the introduction of a new model (requiring pre-approval in the NPR) versus a material change to an existing model (requiring notice in the NPR). We suggest the Agencies instead rely exclusively on a notice process supported by post-implementation supervisory review, as needed, in order to allow timely and efficient model development, including independent model validation programs and internal model approval processes.

- **Backtesting of Models**

  State Street agrees that backtesting can be a valuable tool in model validation. We are concerned, however, that the NPR adopts an overly prescriptive approach to backtesting, which, in some cases, could distort appropriate conclusions about model accuracy. Instead, we believe that it would be more appropriate to provide sufficient flexibility to construct backtests in accordance with the nature of different business activities and associated market risk measurement techniques.

- **Specific Risk for Foreign Exchange**

  While the proposed rule does not include an explicit specific risk requirement for exposures to foreign exchange, Question 10 of the NPR asks whether a specific risk requirement for such exposures should be developed. State Street acknowledges that risk characteristics can vary across different currencies and that some currencies may exhibit higher propensities for event risk than other currencies. However, State Street believes that risks posed by foreign exchange transactions are best addressed through the development and use of enhanced multi-factor risk measurement approaches supported by empirical confirmation of the model's underlying rationale, rather than the bifurcation of exposures into specific and general risk categories. As a result, we advise against the development of a specific risk capital requirement for foreign exchange exposures.

- **Disclosures and Internal Controls**

  State Street supports full and meaningful disclosure of all risks, including market risk. We are concerned, however, that the NPR may be adopting an unduly prescriptive approach to disclosures, and that the proposed certification requirements may be interpreted to create new, duplicative regulatory burdens in areas already addressed by FDICIA and the Sarbanes-Oxley Act. We are also concerned that some of the requirements of the proposed rule may fail to properly distinguish between the appropriate oversight role of the Board of Directors and the management role of senior management. We suggest the Agencies provide further clarification on these issues, and urge the Agencies to adopt an approach that provides the Board of Directors and senior management sufficient flexibility to determine appropriate market risk disclosure controls and processes in a manner consistent with the nature and magnitude of the bank's market risks.

As mentioned above, State Street generally supports the Agencies efforts to revise the current market risk capital rules, and believes the emphasis on comprehensive measurement of all aspects of market risk and associated verification of those measurements through independent model validation will generally result in a more modern, risk sensitive approach to calculating regulatory capital for market risk exposures. Moreover, leaving banks with flexibility regarding their approaches to market risk measurement will promote creativity and innovation in this evolving discipline.

Sincerely,