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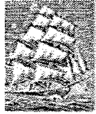

STATE STREET
For Everything You Invest In

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December 17 , 2003

Office of the Comptroller of the Currency
250 E Street, S.W.
Public Information Room, Mailstop 1-5
Washington, D.C. 20219
Attention: Roger Tufts

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Attention: Jason Cave
Reference: Comments

Board of Governors of
the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Attention: Barbara Bouchard

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552
Attention: Fred Phillips-Patrick

Dear Sir or Madam:

State Street Corporation is pleased to have the opportunity to comment to 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 (collectively, the Agencies) on proposed revisions to the New Basel Capital Accord (New Accord) related to the treatment of expected losses (EL) and unexpected losses (UL) under the internal ratings-based (IRB) approach to credit risk.

In general, State Street is supportive of the proposed changes to the internal ratings-based (IRB) approach, and agrees with the Agencies' assessment that a separation of UL and EL within the IRB approach would be an improvement over previous versions of the credit risk proposal. We also agree that the measurement of risk-weighted assets should be based solely on the UL portion of the IRB calculations.

While we are generally supportive, it is not possible to provide a full evaluation of the proposed changes until the Agencies provide a more detailed proposal, including specifics regarding the definition of EL and any proposed re-calibration of the overall IRB approach. Once these details are available, we would be pleased to make further comments.

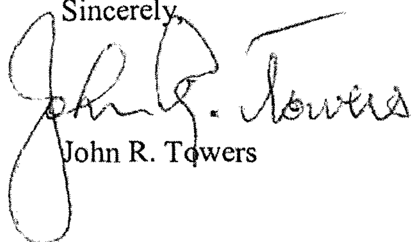
However, it is clear from the general description of the proposal currently available that considerable effort will be necessary to conform the proposed new capital regime to U.S. accounting principles and requirements. The concepts underlying the Agencies' proposal, including UL and "excess" provisions, are not recognized under GAAP accounting, creating significant uncertainty regarding the coordination between regulatory capital calculations and financial reporting. In addition, the Agencies' proposed bifurcated approach to implementation of the New Accord, which will divide U.S. banks between two regulatory capital regimes, will further reduce comparability between institutions. Finally, as the Agencies have noted in the past (for example, in their August, 2003 Advance Notice of Proposed Rulemaking), accounting practices related to provisions and impairment vary considerably by jurisdiction, raising considerable obstacles to comparability and transparency. We urge the Agencies to address these critical issues prior to agreeing to a final New Accord.

While the Agencies are seeking comment on a specific change to the IRB credit risk regime, we urge the Agencies to also consider ensuring that the same distinction between UL and EL is reflected in the treatment of operational risk. While the proposed New Accord does provide, in some circumstances, an EL offset, it is unclear to what extent such offsets will be available to U.S. banks. For example, the Agencies noted in their August, 2003 Draft Supervisory Guidance that "establishing a reserve for operational risk EL is not likely to meet U.S. accounting standards." We urge the agencies to ensure full recognition of EL offsets in any final Basel Accord, and in the subsequent U.S. rulemaking.

As we have noted in the past, we remain concerned by the overall competitive impacts of the Agencies' proposed new regulatory capital requirements for operational risk. As with the competitive issues raised by the proposal, the technical challenges to providing suitable distinctions between UL and EL for operational risk, and the difficulty in ensuring full recognition of EL, could be better addressed through a Pillar 2 supervisory regime, rather than the new Pillar 1 capital requirement for operational risk proposed by the Agencies.

Once again, thank you for providing State Street the opportunity to comment on this important proposal.

Sincerely,



John R. Towers

cc: Cathy E. Minehan, President and CEO, Federal Reserve Bank of Boston
Basel Committee on Banking Supervision