December 30, 2003

Office of the Comptroller of the Currency
250 E Street, S.W.
Washington, D.C. 20219
Attention: Roger Tufts

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

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

Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552
Attention: Fred Phillips-Patrick

RE: Proposed Treatment of Expected and Unexpected Losses Under the New Basel Capital Accord

Dear Sir or Madam:

Mellon Financial Corporation, the parent of Mellon Bank, N.A., Pittsburgh, Pennsylvania, appreciates 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 the Proposed Treatment of Expected and Unexpected Losses Under the New Basel Capital Accord (the "Proposal").

Mellon Financial Corporation (Mellon) supports the exclusion of expected losses from the calculation of risk based capital. Expected losses – from whatever source - are adequately addressed through current and future income, pricing, risk mitigation and reserves. A firm's earnings stream is the key counterbalance for absorption of expected losses. Risk based capital is held to address unexpected losses.

It is the business of banks to understand expected losses and to manage them, with pricing set to anticipate expected losses and reserves, risk mitigants (including insurance) and current and future income in place to absorb it. Mandating that capital be held against expected losses needlessly compounds the complexity of the proposed new capital Accord. (In fact, given strong internal controls, expected losses are small in comparison to unexpected losses, less than 5% based upon our analysis.)

The Proposal should be broadened to clearly state that expected losses - whether they arise from credit or operational risks - should be absorbed by earnings or reserves. Excluding expected losses from the determination of risk-based capital in credit risk argues strongly for doing the same for operational risk. Expected losses should not be modeled as one of the elements driving risk based capital. In our response to the ANPR, we noted: "Operational risk capital … should only be required for unexpected events. At Mellon, expected operational losses are incorporated into the business planning cycle."

As with credit risk, expected losses in operational risk are best addressed through reserves, pricing, current and future income, insurance and other proven forms of risk mitigation. Many other comment letters have echoed this concern, and the AMA attempts to reflect them through very limited recognition of these factors. Failing to eliminate expected loss from the calculation of operational risk based capital will result in a discrepancy between regulatory and economic capital.

The measurement of unexpected operational losses is significantly different from unexpected credit losses. There is no accepted consistent methodology for modeling unexpected operational losses. We believe that unexpected operational losses do not merit a Pillar 1 approach to risk based capital. Rather, a Pillar 2 approach which is dependent upon the judgment of the individual institution and its regulator provides a much stronger approach to setting risk based operational capital.

We thank you for the opportunity to comment on the Proposal. If you should have any questions about our comments or would like to discuss them further, please call Michael Bleier, General Counsel, at 412-234-1537.

Sincerely,

Steven G. Elliott
Senior Vice Chairman
Mellon Financial Corporation

FAX and Email distribution list:

OCC: Roger Tufts at (202) 874-4925 or regs.comments@OCC.treas.gov
FRB: Barbara Bouchard at (202) 452-3072 or regs.comments@federalreserve.gov
FDIC: Jason Cave at (202) 898-3548 or comments@FDIC.gov
OTS: Fred Phillips-Patrick (202) 906-7295 or regs.comments@OTS.treas.gov.