December 31, 2003

Basel Committee on Banking Supervision
Bank for International Settlements
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Ms. Jennifer J. Johnson
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Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
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Regulation Office
Chief Counsel's Office
Office of Thrift Supervision
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Re: Proposed Regulatory Capital Treatment of Expected and Unexpected Losses

Ladies and Gentlemen:

FleetBoston Financial Corporation ("FleetBoston") is the seventh largest diversified financial holding company in the United States with total assets of US$196 billion. Headquartered in Boston, Massachusetts, FleetBoston has consumer and commercial banking platforms, as well as asset management and capital markets businesses, serving approximately 18 million customers worldwide.

Because the New Basel Capital Accord ("Basel II") will have a major impact on FleetBoston and the way we manage our business, we appreciate the continued opportunity to provide you with our comments on the new regulations. We believe that the October 11th effort to amend Basel II to make unexpected losses ("UL") the sole determinant of regulatory capital needs is a great step forward in the improvement of the regulatory capital rules ("proposed approach" or "proposal"). [1] It will simplify the rules, reduce misunderstandings, and align regulatory capital more directly with the "best practices" in the industry without losing any material risk sensitivity. We commend the Basel Committee on Banking Supervision ("BCBS" or the "Committee"), as well as our U.S. bank supervisory agencies ("Agencies"), for the recognition of the need to redefine regulatory capital and the willingness to act at this late stage of the Basel II process.

[1] From a Basel Committee on Banking Supervision press release of October 11, 2003 entitled "Basel II: Significant progress on Major Issues." Followed up by a joint U.S. banking regulator release of October 30, 2003 entitled "Proposed Treatment of Expected and Unexpected Losses Under the New Basel Capital Accord"

We believe that the proposal, while good in concept, still has some flaws in its design that warrant changes before final implementation, and which we will discuss in the remainder of this letter.

Summary of our modifications to the proposed approach

To better align this regulatory capital proposal with widely accepted financial theory and the industry's approach to internal economic capital "best practices," we offer the following:

- Remove expected losses ("EL") from the calculation of risk-weighted assets ("RWA") and regulatory capital.
- Remove future margin income ("FMI") from the regulatory capital definition conditional upon the removal of EL from RWA.
- Redefine Tier 1 regulatory capital to include all of the loan loss reserve ("LLR") and exclude all trust-preferred securities.
- Redefine Tier 2 regulatory capital to include all of the trust-preferred securities excluded from Tier 1.
- Recalibrate the risk-weight functions to insure that the changes suggested in the first four bullet points do not inadvertently alter an institution's risk-based capital ratio.

General discussion of the three resources designed to absorbed credit losses and capital for unexpected losses

A bank provides three primary forms of debt-holder and depositor protection against credit losses: (1) future margin income, (2) loan loss reserve ("LLR" or "reserves"), and (3) common equity. Each of these is available to absorb losses; whether expected or unexpected, before the repayment of any form of bank indebtedness (subordinated or senior debt and government-insured deposits) is jeopardized. Determination of adequate capital levels is made difficult because the underlying principle of "capital for unexpected losses" suggests that we need to eliminate the protection for expected or long-term average losses from the available resources. Also, accounting conventions guiding the financial categorization of credit losses and the establishment of reserves for those losses, which, from our understanding, can vary from jurisdiction to jurisdiction, introduces additional cloudiness.

It is interesting to note how the rating agencies and regulatory capital framework diverge in the assessment of a bank's ability to withstand credit or other loss events. In making the assessment of a bank's credit worthiness (i.e., assigning a specific credit rating), rating agencies seem to depend less upon the capital resources of an institution than on its "franchise, earnings power, and management strategy." [2] That is not to say capital and reserves are unimportant, it's just that the other resources are more important to an institution's ongoing viability. This is a "going concern" approach where the best protection against losses on debt instruments comes from the ability of a bank to "create excess capital from its recurring earnings." [3] Such arguments tend to support the inclusion of some if not all earnings as protection against losses. When assessing the safety and soundness of a bank, U.S. banking regulators also factor in the earnings potential and stability[4].

[2] Moody's Investors Service, "Basel 2's Main Benefit Should Be Strengthening Bank's Risk Culture Not Boosting Capital," October 2003, 2
[3] Moody's Investors Service, "Basel 2's Main Benefit Should Be Strengthening Bank's Risk Culture Not Boosting Capital," October 2003, 2
[4] Note the "E" in their CAMEL rating.

While earnings are certainly important to an institution's solvency, "best practice" among large banks is for EL to be incorporated into the coupon rates charged to borrowers while UL, or the volatility of losses around EL, is held by the bank as economic capital. This is not only true at FleetBoston, but also are other financial institutions judging from responses to CP3 and the U.S. Advanced Notice of Proposed Rulemaking ("ANPR"). Since Basel II is a capital proposal, the elimination of EL from risk-weighted assets, regulatory capital, and FMI from capital seems a reasonable approach.

All of the Loan Loss Reserve should be treated as Tier 1 capital

Simply put, we view the reserve to be on a par with common equity when it comes to providing protection to debt-holders and depositors against unexpected credit losses. Both are available to absorb losses first before any debt or deposit instrument is impacted, therefore both should be treated as Tier 1 capital, not Tier 2.

As you know, loan loss reserves are created by charging against a bank's earnings, which all else being equal, is equivalent to moving common equity to another area of the balance sheet and labeling it as loan loss reserves. Shifting where on the balance sheet those resources reside does not alter their ability to absorb credit losses. In fact, accounting conventions have losses charged against the reserve before any impact to common equity. We believe this is further evidence of the primary capital nature of the reserve and why it should count as Tier 1 capital.

In all cases, we do not support a limitation or cap on the amount of the LLR that can be counted as regulatory capital. We fail to understand why any amount of reserves, which have been created via a charge against a bank's earnings, should not be available to cover credit losses in the regulatory capital framework. Our belief is that this is an attempt to deal with differences in reserving methodology that exist across countries. If this is in fact true, then we believe that banks residing in countries with conservative policies, such as the U.S., will be disadvantaged. A credit portfolio under conservative reserving would show less regulatory capital because of the proposed cap than the same portfolio under more liberal policies. The reason for this is that while the financial resources provided for credit losses would be the same, the proportion covered by reserves versus common equity would be higher under the conservative interpretation, but reduced when the cap is enforced.

Trust preferred securities are not primary capital and should be included in Tier 2

We have always believed that these subordinated, coupon-bearing instruments were more debt-like in nature than common equity-like. That is, these securities provide second loss protection after reserves and common equity are exhausted and should not count as Tier 1 capital. Rating agencies and regulators ("15% limit on innovative Tier 1 instruments" [5]) have voiced similar views based on the-less-than-100% capital credit afforded these hybrid instruments.

There is a place in bank capital structures for subordinated instruments, whether true debt or preferred stock. They provide support for senior-rated instruments, such as insured deposits, in a much more cost-effective manner than common equity. In our opinion, Tier 2 regulatory capital is where these instruments belong.

[5] Basel Committee on Banking Supervision, "The New Basel Capital Accord," April 2003, 4

Need for recalibration of the risk-weight functions

If this proposed change in regulatory capital is instituted using the existing risk-weight functions, we are concerned that it may inadvertently lead to institutions falling below the minimum capital ratio of 8% without any alteration in their underlying risk profile. Therefore, we urge the Committee and Agencies to recalibrate the risk-weight functions to ensure not only internal consistency with the definition of regulatory capital but also to avoid a below-minimum capital ratio as a result of this change. After settling on the details of the proposal, we believe a logical next step, and as we understand, one the U.S. Agencies are seriously considering, is a fourth quantitative impact study ("QIS4") designed to ensure that no unintended consequences occur. No matter how the proposed rules on UL are finalized, this step must be undertaken.

Conclusion

We applaud the effort made by the international and U.S. bank regulatory bodies to improve upon the current Basel II capital proposal. Moving to a capital-for-UL-only principle is a major improvement in the New Basel Capital Accord over the CP3 version. In our view, however, several major enhancements are still needed. They are:

- EL and FMI should be removed from RWA and regulatory capital.
- All loan loss reserves should count as Tier 1, not Tier 2, capital without any cap.
- Trust preferred securities should be counted as Tier 2, not Tier 1, capital.
- All risk-weight functions should be recalibrated to insure that bank capital ratios do not decline because of this change in methodology.

FleetBoston continues to be prepared to provide further input to the deliberations on this or any other capital topic being addressed by the Committee and the Agencies. Please contact William Schomburg (617-434-6158 or *william_h_schomburg_iii@fleet.com*) with further questions or comments.

Sincerely,

/s/ Robert C. Lamb, Jr.

Robert C. Lamb, Jr.
Executive Vice President
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