July 31, 2003

RE: Comments on the 3rd Consultative Package of The New Basel Capital Accord

Dear Sir or Madam:

Mellon Financial Corporation, the parent of Mellon Bank, N.A., Pittsburgh, Pennsylvania, has reviewed the third consultative paper on The New Basel Capital Accord (the “Accord”) as issued by the Basel Committee on Banking Supervision. We continue our strong objection to adoption of the Accord as contemplated in its current form.

We have submitted a number of comments to the Committee in relation to past consultative papers. In those comments we have emphasized the desirability of having the proposed charge for Operational Risk capital treated under a Pillar II vs. a Pillar I approach. Others share those concerns, and in this regard, we affirm and support those comments that you receive from both the Financial Guardian Group and the Financial Services Roundtable on this subject.

The most significant concerns with Basel II for Mellon continue to focus on an explicit Pillar I capital charge for operating risk, its inapplicability to many of our competitors and the limited recognition of mitigants other than capital for operating risk. Specifically, our concerns are:

**Measuring Operational Risk**
Although it is believed that Operational Risk can be modeled, this is highly controversial. There is limited evidence that it can be modeled accurately and with any predictive power. The availability of relevant and accurate operational risk data for external events is uncertain, and most institutions lack significant internal data – due in large part to their success in running effective operational units. As a result, a Pillar II approach which contemplates regulators working with institutions to best understand and dimension operational risks provides a much more attractive solution to the determination of required capital.

**Explicit Operational Risk Capital Charge**
The implementation of Basel II as contemplated under CP3 will result in an incremental capital charge for operational risk, which in the case of specialized trust and processing banks, will not be offset by a reduction in required capital for credit risk.
Competitive Equality
In the case of specialized trust and processing banks, they will be subject to a higher capital charge, which translates into higher costs that must either be absorbed or passed on to customers. Since many of the competitors of specialized trust and processing banks will not be subject to the Accord (e.g. investment managers, securities processors, employee benefit plan consultants and administrators, and brokers focusing on private wealth management), such a capital charge imposes an unfair competitive burden.

The gains that specialized processing banks have made through superior technology and service in areas such as global custody and funds services, will be negated as the incremental operational risk charge as a percentage of total required capital will be larger than the 11% of current required capital estimated in QIS3 for G10 banks.

Arbitrary Constraints on Mitigants
The written and unwritten conditions on an AMA approach continue to regard only capital, and to a very limited extent, insurance as the mitigants to potential operational losses. While “unprecedented flexibility” has been offered, fee based earnings power will only be considered as a mitigant to expected losses, and insurance, which is an appropriate mitigant to unexpected losses in all areas of commerce, is inappropriately limited to 20%.

Fee Based Earnings
Stable, recurring fee based earnings for lines of business which do not also contain significant credit or market risk should be considered as a mitigant for unexpected losses associated with a number of categories of operational risk where it is reasonable to assume that the event leading to the unexpected loss does not impair the future earnings power of the lines of business for which earnings are being used as a mitigant. In a diversified institution, a negative event in one business will not negatively impact the earnings of other businesses.

Complexity of the Overall Accord
The provisions of CP3 continue to be extremely complex. This is problematic at a number of levels. First, for banks attempting to understand and implement its provisions; secondly for regulators (in differing jurisdictions) consistently implementing its regulatory requirements; and thirdly, for the 3rd parties attempting to put meaning to disclosures and other publications resulting from the application of CP3.

Arbitrary Nature of the Internal Ratings Based Approach
The IRB approach to the calculation of credit capital is problematic. As the determination of the appropriate capital amount is left to each institution and its regulator, it is possible for two institutions holding exactly the same asset to hold differing capital amounts against that asset. Likewise, it is possible for two institutions with exactly the same risk portfolios to hold differing capital amounts against those portfolios. This approach will lead to inconsistent and inappropriate capital treatments, strong incentives for institutions to take advantage of the
system in order to hold minimal capital, and at the extreme, potentially threaten the safety and soundness of the banking system.

We thank you for the opportunity to comment on the third consultative paper on The New Basel Capital Accord. If you should have any questions about our comments or would like to discuss them further, please call me at 412-234-1537.

Sincerely,

Michael E. Bleier

cc: Office of the Comptroller of the Currency
Federal Reserve Board
Federal Deposit Insurance Corporation

(also delivered via email to BCBS.Capital@bis.org)