Mellon

Mellon Financial Corporation

Michael E. Bleier
General Counsel

July 8, 2004

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th and Constitution Avenue, NW
Washington, D.C. 20551

Attn: Norah Barger

Re: Docket No. R-1193; Risk-Based Capital Standards: Trust Preferred Securities and the Definition of Capital

Dear Ms. Johnson:

Mellon Financial Corporation, Pittsburgh, Pennsylvania ("Mellon"),appreciates the opportunity to comment on the proposed rule regarding the Tier One capital treatment of trust preferred securities and related matters. This is an important issue to Mellon and, therefore, we offer our comments for your consideration.

Treatment of Goodwill

The notion that "goodwill" is a non-economic asset that should be deducted from core capital elements is an outdated approach that is inconsistent with the concept of "economic capital" and unfairly singles out goodwill as an asset unlike other assets that must be specifically funded by pure equity. Goodwill is created when an acquisition is accounted for as a purchase (rather than a pooling, which was the basis on which virtually all major acquisitions were accounted for prior to June 30, 2001) and from an accounting standpoint, it represents the difference between the "fair value" of an enterprise and the purchase price.

To a large degree, goodwill reflects the franchise premium that is paid for a business that is in excess of tlie fair value of all the assets and liabilities of the enterprise. As a result, goodwill is clearly an economic asset that not only generates revenue, but under current accounting standards must be tested annually for impairment to ensure that the values assigned to it remain intact (FASB Statements Nos.141 and 142). The Federal Reserve Board's proposal requiring goodwill to be deducted froin core capital elements implies that an asset called "goodwill" is of such dubious quality that it cannot be funded by even deeply subordinated junior debt. As we note below, there are publicly traded companies with negative tangible equity, via goodwill and intangibles funded by debt, that are nevertheless viewed by the marketplace to be financially sound.

The passage of Gramm-Leach-Bliley has enabled US banking organizations to consider expanding into a number of businesses that are more fee-based than asset-intensive. Fee-based businesses have higher market to book ratios and, with the elimination of pooling of interests accounting, goodwill is likely to become a larger share of their total equity over time.

Accordingly, despite the fact that fee-based businesses appear to have a less volatile business life cycle and should be viewed more favorably from a safety and soundness standpoint, the proposed treatment of goodwill seems to deny those benefits to US banking organizations.

Uneven Playing Field

'This proposal would further create an "uneven playing field" between non-bank subsidiaries that compete against a variety of companies that are not subject to Federal Reserve regulation and as a consequence, to this type of tangible equity test. For example, those who compete with mutual funds such as Janus, Amvescap, and Waddell and Reed in the asset management sector and Bisys in the processing and administration sector, would be disadvantaged since they all carry a very high proportion of goodwill and intangibles relative to equity, and three of them have negative tangible equity: Amvescap ($1 52 million), Waddell&Reed ($75 million), and Bisys ($256 million). Thus, the imposition of a more stringent financing standard will put a number of Financial Holding Companies at a decided disadvantage in terms of financing potential acquisitions in the business sectors they compete. An alternative would be to allow a level playing field so there is no deduction for a fee-generating goodwill asset or the deduction is considerably less than the proposed full deduction.

Extended Phase-In Period

Although we appreciate the three year phase-in period contained in the proposal which will allow most institutions to retire some portion of their newly deemed Tier I ineligible trust preferred by exercising a call provision, we wish to point out that exercising the call will not be without cost because the call price will in all cases exceed par. Thus, we believe a longer phase-in period, such as five years would give the affected companies substantially more flexibility to manage their compliance with the new rules and also enable them to redeem their trust preferred securities after their no-call periods have expired and generate additional capital internally.

Proposed Alternatives

We would propose that bank and non-bank subsidiary originated goodwill be treated differently, or failing that, be subject to different limits. Goodwill stemming from certain non-bank acquisitions should either not be deducted from core capital elements or perhaps be subject to less than a full deduction. Also, the Federal Reserve Board should give serious consideration to providing capital credit for the tax deductions that have already been taken for goodwill as reflected in the permanent deferred tax account. This is a real source of capital for the industry and should be treated as such.

We appreciate the opportunity to comment and please feel free to call us if you believe additional input would be helpful.

Yours sincerely,

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cc: Joseph J. Abdelnour
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