STATE STREET
For Everything You Invest In

Stefan M. Gavell
Executive Vice President
and Treasurer

State Street Corporation
225 Franklin Street
Boston. MA 02110 2804

Telephone: 617 664 8673
Facsimile: 617 664 4270
smgavell@statestreet com

July 9, 2004

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

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

Dear Ms. Johnson:

We appreciate this opportunity to comment on the notice of proposed rulemaking (NPR) by the Board of Governors of the Federal Reserve System (the Board) related to the treatment of trust preferred securities as tier 1 capital for bank holding companies (BHCs).

State Street Corporation (NYSE: STT - News) is the world's leading specialist in providing institutional investors with investment servicing, investment management and investment research and trading. With $9.4 trillion in assets under custody and $1.2 trillion in assets under management (as of March 31, 2004), State Street is headquartered in Boston, Massachusetts and operates in 24 countries and over 100 markets worldwide.

State Street is supportive of the Board's decision in 1996 to approve the inclusion in BHC's tier 1 capital of minority interest in the form of trust preferred securities. We believe trust preferred securities have functioned well as efficient, lower cost sources of capital.

Overall, we support the Board's proposal to continue to allow the inclusion of trust preferred securities in tier 1 capital, despite the Financial Accounting Standards Board's (FASB) decision to change the consolidated accounting treatment for such securities. We strongly agree with the Board's view that GAAP accounting changes need not result in changes in regulatory capital treatment of a capital instrument, as well as its assessment of the important role of trust preferred securities in ensuring the safety and soundness of the banking system. The economic substance of trust preferred securities is unchanged by the recent change in accounting rules, and trust preferred securities should remain an available option for cost efficient tier 1 capital.

In addition, we appreciate the Board's explicit acknowledgement of the competitive impacts of potential changes in allowable tier 1 capital, and its goal of creating a level playing field among banks, and between banks and non-banks. Retaining the ability to include trust preferred securities as tier 1 capital is critical to meeting this goal.

While we strongly support the Board's proposal to retain trust preferred securities as a component of tier 1 capital, we believe there are some areas where the proposal can be improved. Specifically:

- In response to the Board's request for input on the proposed explicit adoption of a 15% limit, net of goodwill, on the use of restricted core capital elements for internationally active banks, we see no compelling need to take such action at this time. As the Board correctly notes in the NPR, "excessive reliance has not been a concern at large banking organizations because they are subject to much more rigorous market discipline, which works to limit the amount of trust preferred securities a BHC may issue." The internationally active banks which would be subject to the 15% limit will also, under the U.S. regulators' proposed Basel 2 implementation, be subject to Basel 2's most advanced regulatory capital approaches by 2008. Given the ongoing domestic rulemaking to implement Basel 2, and the lack of linkage between the 15% limit and the NPR's focus on addressing issues raised by FIN 46, we suggest the Board defer a decision on making the 15% limit explicit until it can be considered in the overall context of final Basel 2 regulatory capital rules.

- Should the Board decide to make the 15% limit for internationally active banks explicit, we believe the combination of a 15% limit and the new requirement that the limit be applied "net of goodwill'' is an excessive restriction. As noted above, we agree with the Board's assessment that large banks have not demonstrated undue reliance on trust preferred securities. Goodwill is an economic asset, which must be tested annually for impairment. We do not believe that including goodwill in the calculation of the limits for restricted core capital elements has resulted in undue leveraging of tangible equity to date, or will in the future. Overly constraining the use of lower cost capital will unnecessarily increase costs for U.S. banks, particularly banks specializing in fee-based lines of businesses like State Street, where acquisitions often result in higher relative levels of goodwill. In addition, tightening the 15% limit for internationally active banks will add to the competitive imbalance between such banks, domestic banks subject to the 25% limit, and non-banks with no similar regulatory capital requirement. We urge the Board not to further restrict the 15% limit by applying it "net of goodwill."

- As we have noted in our comment letter on the Basel 2 ANPR, the U.S. regulators' proposed Basel 2 definition of "internationally active," which is adopted by reference in the trust preferred NPR, is itself problematic. Consistent with its goal of maintaining a level playing field, we suggest the Board consider any changes to the current composition of tier 1 capital separate from, and independent of, discussions concerning the criteria for "core bank" under Basel 2.

- With regard to the various limits on categories of minority interest being contemplated and the types of securities that would be included in those categories, we suggest that the Board consider allowing trust preferred securities issued in conjunction with mandatory convertible units to qualify as tier 1 capital without limit. As BHCs continue to grow through acquisitions, a cost effective acquisition currency is necessary to compete with non-bank competitors. A properly structured mandatory conversion requirement should allay any concern the Board may have with respect to the trust preferred component as tier 1 capital.

- The Board's proposal to restrict the allowable composition of tier 1 capital exacerbates State Street's ongoing concern with the Board's intention of retaining the non-risk sensitive tier 1 leverage ratio requirement under Basel 2. Restricting access to lower cost tier 1 capital elements unnecessarily adds to this burden, by increasing the cost of holding capital to meet the leverage ratio requirements. State Street continues to recommend to the Board that the tier 1 leverage requirement be eliminated under U.S. implementation of Basel 2.

- Consistent with the Board's desire to create a level playing field, we urge the Board to reach consensus with regulators worldwide on the types of instruments includable in tier 1 capital. The current variances in allowable composition of tier 1 capital across jurisdictions leads to competitive imbalance. For example, the Board's disallowance of the use of "step-up" securities may provide a competitive advantage for foreign banks with respect to the numerator of the various capital ratios. The Basel Committee, in its recently released Basel 2 Framework, indicated that such a convergence was a long-term priority of the Committee.

- We appreciate the Board's request for input on the continued requirement for a call option on trust preferred securities qualifying for inclusion in tier 1 capital. While such a requirement may have been prudent when the Board first approved the inclusion of trust preferred securities in tier 1 capital, and were somewhat untested, the experience with trust preferred securities since 1996 has been very positive, making a mandatory call feature unnecessary. We suggest the Board adopt a more flexible approach, and permit banks to adopt call options which best meet their individual circumstances.

Finally, given the significant potential impacts of the Board's proposal, the ongoing evolution of the Basel 2 Capital Accord, and the continuing work by the Basel Committee on the standardization of the composition of capital, we recommend that the effective date of the final rules be extended beyond the three years proposed in the NPR. A five-year transition period, for example, would allow sufficient time to appropriately manage trust preferred securities portfolios in the context of the new rules, and would time the application of the new rules related to allowable capital with the Basel 2 changes in measurement of the underlying risks the capital is intended to support.

Once again, State Street strongly supports the overall decision of the Board to continue to permit trust preferred securities to be included in tier 1 regulatory capital, as well as the Board's efforts to reduce the overall risk in the global financial system. We welcome the opportunity to comment on this proposal, and we stand ready to discuss in greater detail this issue or any of the other issues related to the implementation of Basel 2. You may contact David Gutschenritter (617-664-0363 or djgutschenritter@statestreet.com) with further comments or questions.

Very truly yours,

Stefan M. Gavell
Executive Vice President and Treasurer

cc: Allan T. Howe, Federal Reserve Bank of Boston