

**The Bank of New York Mellon (Luxembourg) S.A.**

**PILLAR 3 DISCLOSURE  
DECEMBER 31, 2014**



## Pillar 3 Disclosure

Pillar 3 disclosures are published in accordance with the requirements of the Commission de Surveillance du Secteur Financier (CSSF) Circular 06/273 (as amended by Circulars CSSF 07/317, CSSF 10/450, CSSF 10/475, CSSF 10/496, CSSF 11/501 and CSSF 13/568).

These disclosures will be published on The Bank of New York Mellon's website.

The disclosure is updated in August 2015.
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## Policy and Approach

Pillar 3 disclosures are required for a consolidated group and for those parts of the group covered by the Basel II framework. Pending implementation of the Basel II framework by The Bank of New York Mellon Corporation (BNYMC), there is currently no comparable disclosure provided on a consolidated basis by The Bank of New York Mellon (Luxembourg) S.A.'s parent undertaking. As such, the disclosures included in this report have been prepared for The Bank of New York Mellon (Luxembourg) S.A. (BNYML or the Bank) including its Italian Branch.

These disclosures have been approved by BNYML's Board of Directors who has verified that they are consistent with formal policies adopted regarding production and validation.

Information in this report has been prepared solely to meet Pillar 3 disclosure requirements of the entities noted, and to provide certain specified information about capital and other risks and details about the management of those risks, and for no other purpose. These disclosures do not constitute any form of financial statement on the business nor do they constitute any form of contemporary or forward looking record or opinion about the business.

Wherever possible and relevant, the Board will ensure consistency between Pillar 3 disclosure, Pillar 1 reporting and Pillar 2 ICAAP content e.g. disclosure about risk management practices and capital resources at year end.

Unless indicated otherwise, information contained within this document has not been subject to external audit.

Disclosure will be made annually based on calendar year end and will be published as soon as possible after publication of the annual accounts. The Bank will reassess the need to publish some or all of the disclosures more frequently than annually in light of any significant change to the relevant characteristics of its business including disclosure about capital resources and adequacy and information about risk exposure and other items prone to rapid change.

Disclosures will be published on The Bank of New York Mellon group website ([www.bnymellon.com](http://www.bnymellon.com)), see section Investor relations, Financial reports, other regulatory filings on the Company's website.

The Board may omit one or more disclosures if the information provided is not regarded as material. The criterion for materiality used in these disclosures is that the Bank will regard as material any information where omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions.

The Board may omit one or more disclosures if the information provided is regarded as confidential. In this circumstance, the Board will state in its disclosures the fact that specific items of information are not disclosed and the reason for non-disclosure, and will publish more general information about the subject matter of the disclosure requirement except where these are to be classified as secret or confidential.

The Bank undertakes no obligation to revise or to update any forward looking or other statement contained within this document regardless of whether or not those statements are affected as a result of new information or future events.

This policy will be periodically reassessed and updated in light of market developments associated with Pillar 3.

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# 1 Introduction

The Bank of New York Mellon (BNY Mellon) is a global investments company dedicated to helping its clients manage and service their financial assets throughout the investment lifecycle. Whether providing financial services for institutions, corporations or individual investors, BNY Mellon delivers informed investment management and investment services in 35 countries and more than 100 markets. As of December 31, 2014, BNY Mellon had \$28.5 trillion in assets under custody and/or administration, and \$1.71 trillion in assets under management.

These 2014 Basel II Pillar 3 disclosures relate to The Bank of New York Mellon (Luxembourg) S.A. (BNYML) and are published in accordance with the requirements of the Commission de Surveillance du Secteur Financier ("CSSF") circular 06/273 (as amended by Circulars CSSF 07/317, CSSF 10/450, CSSF 10/475, CSSF 10/496, CSSF 11/501 and CSSF 13/568). Pillar 3 disclosures are made in respect of BNYML and its Italian branch. BNYML uses the Basel II Standardised Approach for calculating credit, market and operational risk.

This disclosure is for The Bank of New York Mellon (Luxembourg) S.A. including its Italian branch as at December 31, 2014.

These disclosures were approved for publication by the BNYML Board of Directors (hereafter the 'Board') on March 27, 2015.

## 1.1 Purpose of Pillar 3

Basel II is the international banking accord intended to strengthen the measurement and monitoring of financial institutions' capital. The Basel II framework was implemented in the European Union (EU) through the Capital Requirements Directive (CRD). The Basel II framework establishes a more risk sensitive approach to capital management and is comprised of three pillars:

- **Pillar 1** establishes rules for the calculation of minimum capital requirements for Credit, Market and Operational Risk.
- **Pillar 2** requires firms and supervisors to take a view on whether a firm needs to hold additional capital against risks not adequately covered in Pillar 1 and to take action accordingly.
- **Pillar 3** complements the other pillars and effects market discipline through public disclosure. Expanded disclosure about capital and risk enables interested parties to gauge the capital adequacy and risk profile of individual banks and to make comparisons.

## 1.2 Highlights and Key Events

### European Bank Consolidation Project

Under the banner of BNY Mellon's European Bank Consolidation Project (Project UNA), the Bank is working on submitting an application with the National Bank of Belgium, under copy to the CSSF, which outlined its plans to surrender our banking license in Luxembourg, in exchange for integrating all of our activity and staff into the existing branch of the Bank of New York Mellon S.A./N.V. based in Brussels. The progress is dependent on Regulatory approval.

### New business

The development of the pipeline for new clients is focused mainly around the alternative fund sector. The organic growth is favored by the current external environment.

### Expected evolution of BNYML

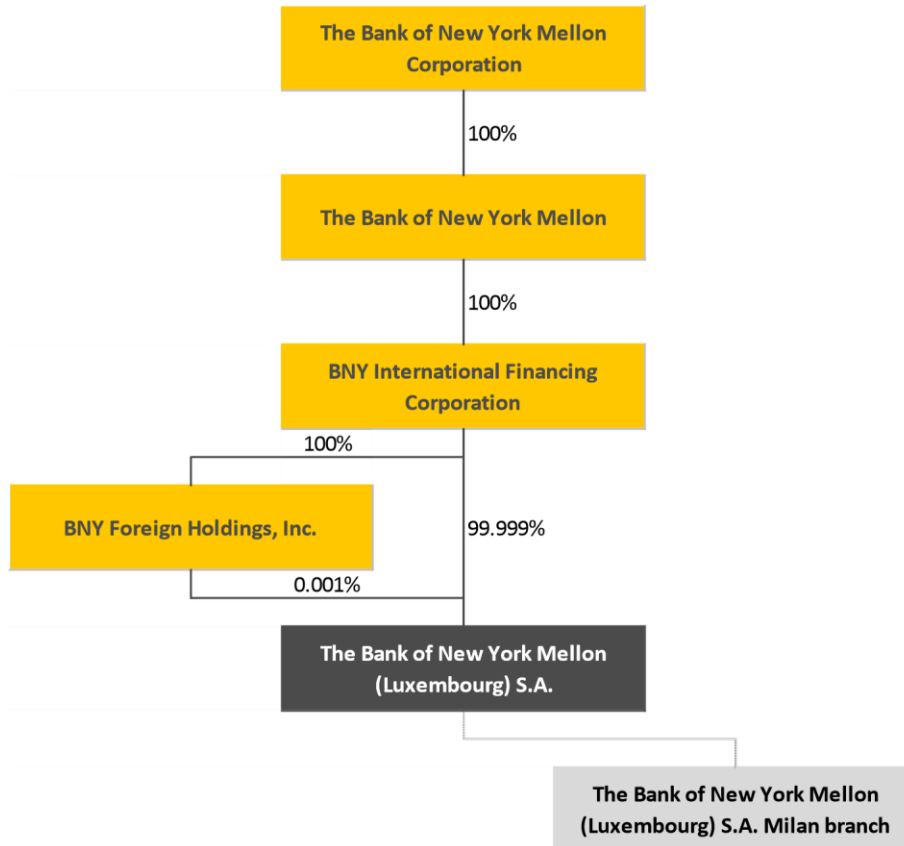
After the successful implementation of the Alternative Investment Fund Managers Directive (AIFMD) the focus is now on the implementation of the Undertakings for the Collective Investment in Transferable Securities (UCITS V) regulation, effective at March 2016.

## 2 Scope and Application of Directive Requirements

BNYML is a subsidiary of BNY International Financing Corporation which is, in turn, a subsidiary of The Bank of New York Mellon Corporation (“BNYMC”). BNYML has one foreign branch, The Bank of New York Mellon (Luxembourg) S.A., Italian Branch (the “Branch”).

The corporate structure of BNYML illustrated in Figure 1.

Figure 1: BNYML corporate structure



BNYML provides custody services, fund administration, transfer agency services, depository services to open-ended investment companies as well as corporate trust services.

## 3 Risk Management Objectives and Policies

### 3.1 Risk Management Framework

BNYML’s approach to risk management is to ensure that all material risks are defined, understood and effectively managed according to well-designed policies and controls.

BNYML’s risk appetite requires the maintenance of an appropriate Risk Management Framework that promotes a risk-aware and transparent culture and the identification, assessment, mitigation, measurement and escalation of risk and control issues.

BNYML’s risk appetite is aligned to the risk appetite of BNYMC which is to maintain a balance sheet that remains strong across market cycles to meet the expectations of its major stakeholders, including clients, shareholders, employees and regulators.

The Board adopts a prudent appetite to all elements of risk to which BNYML is exposed. BNYML uses a variety of metrics to measure and monitor its risk taking activities relative to its risk appetite. Articulating risk appetite through its metrics aids important decision-making by determining actions such as pursuing new products and enterprises, exiting businesses, and aligning resources to maximise potential gains given acceptable levels of risk.

### **3.2 Scope and Nature of Risk Reporting Systems**

BNYML's risk profile is recorded through a number of risk assessment tools. The risk management team prepares and updates the assessments which are reviewed and approved by the BNYML Risk Management Committee (RMC) monthly and the Board quarterly.

The BNY Mellon 'Risk Universe' defines the risk types (current or future) applicable to the business. Risk types are organised by categories according to industry standards to support the efficient classification and reporting of risks and risk events as they materialise.

#### **3.2.1 Risk and Control Self-Assessment**

The Risk and Control Self-Assessment (RCSA) is used by business lines to identify risks associated with their key business processes and to complete a detailed assessment of the risk and associated controls. RCSA control gaps and action plans form part of the standard risk management report to the RMC. This ensures that although the RCSA process is owned by the line of business in conjunction with the business risk managers, the RMC has oversight of the key exception items relating to BNYML on an on-going basis.

#### **3.2.2 Key Risk Indicators**

Key Risk Indicators (KRIs) are used by business lines to evaluate control effectiveness and residual risk within a business process. Material risks are monitored by appropriate KRIs. The Lines of Business utilise the corporate-wide KRI process to monitor the extent to which the probability of the high inherent risks materialising is changing and to ensure that appropriate actions are being taken. KRI reporting and monitoring is performed monthly at a minimum using a Red/Amber/Green rating.

#### **3.2.3 Operational Risk Events**

All operational losses and fortuitous gains exceeding \$10k are recorded in the Risk Management Platform, completeness being verified by reconciliation to the General Ledger. Risk events are categorised and reported to the RMC monthly.

#### **3.2.4 Risk Register**

In 2015, BNYML continues to develop a comprehensive Risk profile per business line. The Risk Register (RR) is a risk management tool used for the assessment and documentation of risks associated with a legal entity. It is best practice in financial services to maintain Risk Registers for legal entities and it has now become a regulatory necessity in many jurisdictions. Risk Registers are prepared and owned by the Head of Risk. Key representatives from the LOB are consulted as part of the assessment process, as well as risk functions heads. Risk Registers are presented, for information, through the legal entity governance structures. The RR is a living document and will be updated regularly, and at least annually. The BNYML risk register is currently in draft phase and its final implementation is targeted for 2015.

#### **3.2.5 Top Risks**

Top Risks are identified according to the assessment of the inherent risk, quality of controls in place to mitigate risk and likelihood to identify residual risk. Top Risks are rated as 'High,' 'Moderate to High,' 'Moderate,' 'Moderate to Low' and 'Low' with direction anticipated. The Top Risk assessed form part of the Risk Management Committee and Board meetings reporting. Top risks are also consolidated into the EMEA Regional top risk reporting process for reporting to the EMEA level Risk Committees.

### 3.2.6 Stress Testing

The process reflects stressed scenarios that identify an appropriate range of adverse circumstances of varying nature, severity and duration relevant to the BNYML risk profile. Stress testing is also undertaken on an ad hoc basis. Sources of risk information used to assist scenario development include Top Risk Reporting, financial sensitivity analysis, and output from the risk assessment tools, operational risk trends, macro-economic data, financial news, client management information or general business statistics.

Scenarios are derived from current, emerging, and plausible future risks and strategy, and reviewed, discussed and agreed by BNYML's Risk Management Committee (RMC) and the Board.

The conclusion of the stress testing process is a statement of the future risk(s) the business faces, control improvements to mitigate the impact should the risk arise and where appropriate, a recommendation for the capital held against each risk type.

### 3.3 Risk Management Governance

BNYML has established risk and stress testing governance to periodically review, challenge and approve risk and capital management processes.

BNYML's Risk Management framework helps ensure that all material risks in each business line are defined, understood, and effectively managed using well-designed policies and controls. Risk Management complies with corporate policies on Risk Appetite and Managing Risk culture centered on the Three Lines of Defence (figure 2) advocated by the BNYMC's Chief Risk Officer and described in the Risk Culture and Risk Management Overview Presentation. Within the EMEA region the EMEA CRO oversees the management of risk and is supported in this role by Senior Risk Managers operating at business line and/or functional level.

Figure 2: Three Lines of Defence



BNYML fully complies with the corporate culture of risk management as Risk is managed at:

- **First line of defence:** All managers and employees, the Business Acceptance Committee, the Executive Committee and the Board of Directors

- **Second line of defence:** Chief Risk Officer, Chief Compliance Officer and the Risk Management Committee (which has representation from Finance, Human Resources and Legal)
- **Third line of defence :** Internal Audit is involved in the Risk Management Committee, in the ICAAP Working Group, and audits the ICAAP Process

The risk management framework is established via policies to allow comprehensive coverage of the Company's business structure. BNY Mellon's policy is to manage risk at the business units and business process level. These policies and procedures have been adapted to comply with local regulation. The Bank's approach to Risk Management is to ensure that material risks in each business unit are effectively identified, assessed, monitored and controlled and any issue is escalated to senior management in a timely manner. BNYML risk governance framework has been developed in conjunction with BNY Mellon requirements. Key elements of the framework are:

- Formal governance committees, with mandates and representative membership
- Clear business as usual processes for identification, management and control of risks
- Regular reporting of risk issues
- Clearly defined escalation processes, both informally (management lines) and formally (governance committees, board, etc.)

At BNYML, the Board is responsible for both the management and the oversight of risks together with the quality and effectiveness of internal controls but has delegated risk management oversight to the General Management, supported by the Luxembourg and EMEA Risk Management Committees. The Board is responsible for reviewing, challenging and approving all risk management processes including risk identification and assessment, stress testing and capital adequacy. The various control functions provide further support for the management of risk within the business.

### **3.3.1 Business Unit Risk**

Business Acceptance Committees are responsible for aligning new business to appropriate business lines and subsidiaries and assessing and approving the associated risks.

Each Business has a Risk Manager aligned to the business. These Risk Managers are independent of the business and oversee the adherence to Corporate Risk policies and governance requirements. The Risk Management organisation is based on a three tiered structure beginning with Corporate Risk which creates the corporate policies, Risk Management form the second tier, and the third tier is the operational unit which is considered to be the primary owner of all risk relating to the business activities. The operational units may have dedicated Embedded Control Management (ECM) resources who at the direction of the business or the Global Operational Control management team will conduct testing on the operational activities and support internal and external audit work.

### **3.3.2 EMEA Risk Management Framework**

As a global organisation, BNYMC has established governance structures to monitor and assess risks on an enterprise-wide basis. BNY Mellon is organised on a regional basis, where BNYML forms part of the Europe, Middle East and Africa (EMEA) region. Oversight for EMEA is executed primarily through the following committees:

- EMEA Executive Committee
- EMEA Senior Risk Management Committee
- Investment Services Committee
- EMEA Asset and Liability Committee
- EMEA Operating Committee

## **3.4 Risk Appetite**

The Bank of New York Mellon (BNYM) Corporation defines risk appetite as being the level and type of risk a firm is able and willing to assume in its exposures and business activities, given its business objectives and obligations to stakeholders.



The Chairman, President and CEO sets the tone for the company's risk appetite with the following overview as detailed in Corporate Policy I-G-005 (January 15, 2015):

“Risk-taking is a fundamental characteristic of providing financial services and arises in every transaction we undertake. Our risk appetite is driven by the fact our company is the global leader in providing services that enable the management and servicing of financial assets in more than 100 markets worldwide and has been designated by international regulators as one of the 29 Global Systemically Important Financial Institutions (G-SIFIs). This designation recognizes our fundamental importance to the health and operation of the global capital markets and carries with it a responsibility to maintain the highest standards of excellence. As a result, we are committed to maintaining a strong balance sheet throughout market cycles and to delivering operational excellence to meet the expectations of our major stakeholders, including our clients, shareholders, employees and regulators. The balance sheet will be characterized as liquid, with strong asset quality, ready access to external funding sources at competitive rates and a strong capital structure that supports our risk-taking activities and is adequate to absorb potential losses. These characteristics support our goal of having superior debt ratings among the best within our peer group, which comprises other trust and investment firms. To that end, the company's Risk Management Framework has been designed to:

- Ensure that appropriate risk tolerances (“limits”) are in place to govern our risk taking activities across all businesses and risk types;
- Ensure that our risk appetite principles permeate the company's culture and are incorporated into our strategic decision-making processes;
- Ensure rigorous monitoring and reporting of key risk metrics to senior management and the Board of Directors;
- Ensure that there is an on-going, and forward looking, capital planning process to support our risk-taking activities.”

The risk appetite statement is an integral part of the management of the business within BNYML's Risk Management Framework document and aligned to BNYMC's risk appetite statements which are to commit to maintaining a balance sheet that remains strong and liquid throughout market cycles to meet the expectations of major stakeholders, including our clients, shareholder, employees and regulators.

The statement is owned and set by the BNYML Board of Directors (Board). The Board has adopted a principally prudent appetite to all elements of risk to which BNYML is exposed. All business activities will continue to be managed and controlled in a manner consistent with the Boards stated tolerances using defined quantitative and qualitative measurements.

The risk appetite is articulated through a comprehensive set of metrics; where capital represents one of the core elements of BNYML's risk appetite. Thresholds are established to measure the performance of the business against its risk appetite. These metrics are actively monitored, managed and mitigated through the monthly Risk Committee, to ensure that the performance of business activities remains within risk tolerance levels. Where residual risks remain (which are within BNYML's risk appetite), BNYML allocates capital as provision against potential financial loss.

The Risk Appetite Statement was defined and is owned and approved by the Board. The last revision of the statement was approved in December 2014. The risk appetite metrics are actively monitored, managed and mitigated through the monthly Risk Committee, to ensure that the performance of business activities remains within risk tolerance levels. Where residual risks remain (which are within BNYML's risk appetite), BNYML allocates capital as provision against potential financial loss.

### **3.5 Credit Risk**

Credit risk is the risk of default from counterparties or clients for deposits, loans, commitments, securities and other assets where the realisation of the value of the asset is dependent on its ability to perform. Credit risk could also

arise from off-balance sheet items including counterparty credit risk and securities lending indemnifications and letters of credit identifying exposures (balance sheet and non-balance sheet).

Credit risk for BNYML is the risk of payments against uncollected funds which may cause overdrafts. The Bank is also exposed to several counterparties and has a relationship with many sub custodians. BNYML does not have a trading book. Derivatives in the banking book concern FX swaps used to adequately manage its liquidity. Credit is not actively sold nor provided to clients to support operational activity. The majority of funds are placed with banks within BNYMC, or with the central bank. Daily net credit balances remain on Nostro accounts. Client overdraft activity is rare and limited to situations where payments are to be covered by immediately available funds from a verified source. Payments against uncollected funds have the potential to cause overdrafts on an overnight basis. Intraday timing differences and processing errors can lead to such exposures, which need measuring and monitoring. Although it does not anticipate significant overdraft exposure on a routine basis, from time to time such events do arise and BNYML may find itself in a position of seeking recovery of funds paid out to third parties.

BNYML does not typically hold collateral to mitigate credit risk exposure in respect of banks. For clients, the standard custody agreement gives a lien over custody assets including equities, bonds, gilts; or guarantees. As at December 31, 2014, BNYML applied financial collateral such as assets held on behalf of clients (off-balance sheet), third party guarantees or credit derivatives as credit risk mitigation within the Pillar 1 calculation.

BNYML also places substantial deposits with the Luxembourg Central Bank (deposits totaling €3.0bn with the Luxembourg Central Bank at December 31, 2014 or 76% of the total cash balances). Given that BNYML is compliance with its own risk appetite, General Management does not see this risk as significant over a one year period. Furthermore, if the rating were to worsen, cash assets could be distributed to alternative banks if required.

Since the implementation of the CSSF Circular 10/475 modifying the large exposure regime, additional daily controls are performed on interbank exposures, to ensure that these do not exceed the 100% of regulatory own funds limit.

BNYML does not engage in hedging its credit risk as it believes the policies in place are sufficient to ensure adequate credit quality. Should the situation arise where this became necessary, BNYML could call upon the expertise of its parent in these matters.

### **3.5.1 Credit Risk Exposure**

Credit exposure is computed under the Standardised approach. This method for calculating credit risk capital requirement uses supervisory risk weights.

Except where stated, exposure is defined as **Exposure at Default (EAD) pre Credit Risk Mitigation (CRM)** i.e. a regulatory exposure value after the application of Credit Conversion Factors (CCF) for off balance sheet items (including undrawn commitments) and, after netting but before application of Credit Risk Mitigation factors (e.g. property, other physical collateral). The calculation of EAD therefore takes into account both current exposure and potential drawings prior to default over a 12 month time horizon. As such, exposure in this context may differ from statutory GAAP accounting balance sheet carrying values.

The following credit risk exposure tables (1) to (4) summarise the credit exposure for BNYML.

i) *Standardised gross Credit exposure (EAD pre CRM)*<sup>1</sup>

The following table summarises the standardised gross credit exposure by class as at December 31, 2014.

**Table 1: Standardised gross credit exposure by exposure class**

Central Governments and Central Banks	3,030,013	710,229	2,788,139	877,156	-	-
Institutions	908,206	2,701,536	1,254,193	2,260,110	14,531	43,592
Corporates	28,836	14,046	84,255	36,307	503	567
Short term claims on Institutions and Corporates	-	-	-	-	-	-
Collective Investment Undertaking	-	-	-	-	-	-
Other	18,601	11,936	24,583	17,056	1,467	784

*ii) Standardised gross Credit exposure (EAD pre CRM) by industry sector<sup>1</sup>*

The following table summarises the standardised gross credit exposure by industry sector as at December 31, 2014.

**Table 2: Standardised gross credit exposure by industry sector**

Standardised gross credit exposure by exposure class (€000s)	Central Governments and Central Banks		Institutions		Corporates		Other		Total	
	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013
Central and local governments	3,030,013	710,229	-	-	-	-	-	-	3,030,013	710,229
Insurance companies and pension funds	-	-	-	-	-	-	-	-	-	-
Banks and other financial	-	-	908,206	2,701,536	28,836	14,046	18,601	11,761	955,643	2,727,343
Other business activities	-	-	-	-	-	-	-	-	-	-
Personal and community service activities	-	-	-	-	-	-	-	-	-	-
Other individual loans and advances	-	-	-	-	-	-	-	175	-	175
<b>Total</b>	3,030,013	710,229	908,206	2,701,536	28,836	14,046	18,601	11,936	3,985,657	3,437,747

*iii) Standardised gross Credit exposure (EAD pre CRM) by geographical area<sup>2</sup>*

The following table summarises the standardised gross credit exposure by geographic area as at December 31, 2014.

**Table 3: Standardised gross credit exposure by geographic area**

Standardised gross credit exposure by exposure class (€000s)	Luxembourg		EMEA		Americas		Asia Pacific		Total	
	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013
Central Governments and Central Banks	3,024,908	695,876	5,105	14,353	-	-	-	-	3,030,013	710,229
Institutions	8,129	11,532	739,572	2,568,649	86,520	89,369	73,985	31,986	908,206	2,701,536
Corporates	28,364	14,019	466	1	5	26	-	-	28,836	14,046
Short term claims on Institutions and Corporates	-	-	-	-	-	-	-	-	-	-
Collective Investment Undertaking	-	-	-	-	-	-	-	-	-	-
Other individual loans and advances	17,949	11,596	255	1	397	340	-	-	18,601	11,937
<b>Total</b>	3,030,013	710,229	908,206	2,701,536	28,836	14,046	18,601	11,936	3,985,657	3,437,747

*Standardised gross Credit exposure (EAD pre CRM) by residual maturity*

The following table summarises the standardised gross credit exposure by residual maturity as at December 31, 2014.

<sup>1</sup> Standardised exposure classes are per CSSF definitions. Other items principally comprise trade and other debtors, interest and accounts receivable and prepayments. Average exposure is based on 2014 quarterly capital adequacy reporting.

<sup>2</sup> Industry sectors are based on the CSSF economic classification of the counterparty.

<sup>3</sup> Geographic distribution is based on the domicile of the borrower or obligor. Europe, Middle East & Africa excludes Luxembourg (separately reported).

**Table 4: Standardised gross credit exposure by residual maturity**

Standardised gross credit exposure by residual maturity (€000s)	Less than 3months		3 months to 1 year		Over 1 year or undefined		Total	
	2014	2013	2014	2013	2014	2013	2014	2013
Central Governments and Central Banks	3,029,012	706,063	-	-	1,001	4,166	3,030,013	710,229
Institutions	908,206	2,701,536	-	-	-	-	908,206	2,701,536
Corporates	28,836	14,046	-	-	-	-	28,836	14,046
Short term claims on Institutions and Corporates	-	-	-	-	-	-	-	-
Collective Investment Undertakings	-	-	-	-	-	-	-	-
Other	18,514	11,784	32	59	55	93	18,601	11,936
<b>Total</b>	<b>3,984,569</b>	<b>3,433,429</b>	<b>32</b>	<b>59</b>	<b>1,056</b>	<b>4,259</b>	<b>3,985,657</b>	<b>3,437,747</b>

### **3.5.2 Impaired and Past due assets and Provisions**

For BNYML, specific provisions are made against loans and advances when, in the opinion of the Directors, recovery in full is doubtful. A general provision is made to cover bad debts that have not been separately identified at the balance sheet date but are known to be present in client receivables. Specific and general statistical provisions are deducted from loans and advances. Loans and advances and suspended interest are written off in part or in full when there is no realistic prospect of recovery.

As at December 31, 2014, BNYML has no material impaired assets for which a specific or general provision had been raised. There were no material assets past due greater than 90 days. BNYML did not incur any material write-offs of bad debts or make any recovery of amounts previously written off during the year to December 31, 2014.

### **3.5.3 Capital Resource Requirement**

BNYML calculates Pillar 1 credit risk capital resource requirement using the Standardised Approach, as defined in CSSF Circular 06/273. BNYML does not use external credit assessments provided by Fitch, Moody's, and Standard and Poor's (ECAIs) to determine the risk weighting of exposures in its portfolios depending on counterparty type and coverage. In accordance with CSSF Circular 06/273 Part VII, and given that all cash balances with institutions are on call, these balances are allocated a 20% risk weighting. Client overdrafts are totally allocated a 100% risk weighting.

## **3.6 Counterparty Credit Risk and Credit Value Adjustment**

Counterparty credit risk is the risk that a counterparty to a contract recorded in either the trading book or non-trading book defaults before fulfilment of cash-flow obligations.

The measure of credit risk associated to the FX swaps concerns counterparty credit risk and credit value adjustment (CVA). The exposure value is determined using the Mark-to-Market method (cf. article 274 of the CRR). At December 31, 2014, the FX swaps had a notional value of €1,777 Million and a fair value of €32 Million.

Own funds for CVA risk are calculated for these derivatives, using the standardized method (Art. 384) without eligible hedge (Art. 386).

## **3.7 Market Risk**

Market risk is the risk to a firm's financial condition arising as a result of adverse movements in the markets, such as foreign currency exchange rates, interest rates and equity and commodity prices. This risk can arise from market making, dealing, and position taking in bonds, securities, currencies, commodities, or derivatives on the above. This risk includes foreign exchange risk, defined as the current or prospective risk to earnings and capital arising from adverse movements in currency exchange rates.

BNY Mellon has established risk limits (including value at risk ('VaR') limits and stop loss advisory trigger amounts) and monitoring limits within the risk appetite tolerance. BNY Mellon's Global Markets Risk function distributes a daily VaR report. Daily limits are monitored through regular reporting to management and through a designated market risk officer.

### **3.7.1 Market Risk Exposure**

BNYML's exposure to market risk arises mainly from the impact on the Bank's balance sheet and impact on the Bank's revenues and therefore profitability. The Bank is exposed to two types of market risk:

- a) Foreign exchange risk: BNYML's revenues are denominated in a mix of currencies whereas a high proportion of its costs are denominated in Euro. Apart from the risk of an operational execution error and potential currency mismatch between revenues and cost, the bank is not significantly exposed to this risk. Foreign exchange risk in the Bank's non-trading book is managed by matching of assets and liabilities. Income received in foreign currencies is converted to Euro to avoid exposure to currency risk.
- b) Interest rate risk: while the Bank has no significant balance sheet interest rate risk exposure, its interest rate income is subject to the risk that market interest rates tend toward zero or lower, the Bank cannot pass all of the interest rates reduction to its client (interest rate spread compression). Interest rate risk in the non-trading book is discussed in Section 3.15.

BNYML does not run a trading book and matches its interest rate risk in its non-trading book.

### **3.7.2 Capital Resource Requirement**

BNYML calculates the Pillar 1 market risk capital resource requirement for Foreign Exchange based on Standardised approach as defined in CSSF Circular 06/273.

## **3.8 Operational Risk**

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, systems, or from external events (including legal risk but excluding strategic and reputation risk). It may arise from transaction processing, execution, delivery and process management errors, internal or external fraud, damage to physical assets, business disruption due to systems failures, defective product designs and unprofessional practices, and potential legal or regulatory actions as a result of regulatory, ethical or contractual breach.

The following categories of operational risks are considered for BNYML:

- Business Disruption & Systems Failure
- Clients, Products and Business Practices
- Execution, Delivery & Process Management
- External Fraud
- Internal Fraud
- Damage to Physical Assets

### **3.8.1 Operational Risk Coverage**

Operational risk is managed within BNYML risk appetite which states that BNYML will ensure adequate people; processes and technology are allocated to manage operational risk. Operational Risk is also managed under the Risk Governance Framework described in Section 3.3 of this Disclosure. BNYML Board monitors operational risks and the appropriateness of controls through the Executive Committee and independent reporting from risk managers. This requires BNYML to update regularly its Risk and Control Self Assessment's (RCSA), as well as monthly Key Risk Indicators (KRI) and prompt reporting of any significant financial impacts as a result of errors.

All internal risks are reviewed at least on a quarterly basis in partnership with the appropriate department heads of BNYML and focus on the risks faced and the controls in place to manage or mitigate any crystallisation of risks. In parallel, Risk Management performs monitoring appropriate to the business and identified risks, which includes KRI reporting, significant event analysis and ad hoc reviews. Moreover the key elements of the RCSA, internal control environment, monitoring and governance arrangements are routinely reviewed and challenged by the Risk Committee.

### **3.8.2 Capital Resource Requirement**

BNYML calculates the Pillar 1 operational risk capital resource requirement under the Basel II Standardised Approach. It has been determined that BNYML falls under the Agency Services Basel business line. The standard indicator approach for operational risks sets out a 15% risk rate for a single indicator that is determined by the sum of net interest income and net non-interest income. The operational risk is based on a 5 year projection.

### **3.9 Liquidity Risk**

BNY Mellon defines liquidity as the ability to access funding, convert assets to cash quickly and efficiently, or to roll over or issue new debt, especially during periods of market stress, in order to meet its short-term (up to one year) obligations.

BNY Mellon defines Funding Liquidity Risk as the risk that it cannot meet its cash and collateral obligations at a reasonable cost for both expected and unexpected cash flow and collateral needs without affecting daily operations or financial conditions. Liquidity risks can arise from funding mismatches, market constraints from inability to convert assets to cash, inability to raise cash in the markets, deposit run-off, or contingent liquidity events. Changes in economic conditions or exposure to credit, market, operational, legal, and reputational risks also can affect BNY Mellon's liquidity risk profile and are considered in the liquidity risk management framework.

BNY Mellon defines Intraday Liquidity Risk as the risk that it cannot access funds during the business day to make payments or settle immediate obligations, usually in real time, primarily due to disruptions or failures. The BNY Mellon Intraday Liquidity Policy is specifically dedicated to managing these risks.

BNYML aims to be self-sufficient for liquidity and seeks to maintain a very liquid balance sheet at all times. BNYML's balance sheet is liability driven in nature primarily due to the nature of client deposit taking activity. BNYML does not originate significant assets from lending activities, and therefore funding assets is not a significant use of liquidity. While sizable overdrafts can appear periodically, large deposits offset these amounts. Significant deposit balances are transactional in nature and exhibit a degree of "stickiness" and represents the transactional nature of the client relationship.

Due to its conservative liquidity risk management practice, BNYML maintains ample liquidity for day-to-day changes in deposit funding. Due to the set-up of the sub-custody and nostro network for BNYML, excess liquidity on its balance sheet is reflected as overnight (i.e. demand) balances with the Bank of New York Mellon S.A./N.V. Brussels, or is placed with Luxembourg Central Bank (EUR denominated).

### **3.10 Compliance Risk**

Compliance risk is comprised of:

- **Regulatory Risk:** Risk of loss arising from non-compliance with laws and regulations, and lack of adequate documentation to demonstrate compliance.
- **Monitoring & Reporting Risk:** Risk of loss arising from failure to comply with financial reporting standards, agreements or regulatory requirements, including risks resulting from action taken by stockholders, potential stockholders, regulators and the general investing public who may have been harmed by incomplete, inaccurate or untimely reporting of financial performance and including risk caused by senior management's inability to respond to economic opportunities available to the Corporation because of incomplete, inaccurate or untimely reporting.

BNYML aims to fully comply with the applicable laws, regulations, policies, procedures and BNYML's Code of Conduct. Emerging regulations are monitored by Compliance and Risk management and reported to senior management and the Board of Directors. Strategies and preparations to comply with regulations are put in place where necessary.

Regulatory risk is covered by Stress Tests on an ad-hoc basis where necessary, before a new regulation enters into force.

There are currently several regulatory initiatives or existing regulations that would largely impact BNYML's business:

- Alternative Investment Fund Managers Directive (AIFMD)
- Single European Payment Area (SEPA)
- European Market Infrastructure Regulation (EMIR)
- US Foreign Account Tax Compliance Act (FATCA)
- UCITS V
- Basel III Implementation

Evidence in the Bank's history of losses indicates that this level of risk is very low. BNYML has never suffered from a sanction event where the regulator has imposed a fine.

### **3.11 Business Risk**

Business risk is the risk of loss that the business environment poses to BNYML's profitability. It normally consists of items such as changes in the external macro environment or client behaviour, inappropriate management actions and performance of competitors. The list is not exhaustive.

The principal business risk for the Bank is within the Asset Servicing and Alternative Investment Services sector as this is mainly driven by the fact that fees are significantly based on the client's Net Asset Value (NAV) for Fund Accounting and Custody. As business risk is difficult to assess, it has been defined as the residual risks that confront the Bank, after taking all known and quantifiable risks into consideration.

Regular monitoring of Assets under Custody, revenue and profitability is a key control used to mitigate the risk.

BNYML has continually applied a successful client focused philosophy. This approach has resulted in long term client relationships. Clients' Key Performance Indicators are monitored on a regular basis. Clear lines of communication either via conference calls or face to face meetings are established.

### **3.12 Outsourcing Risk**

The risk of failure in respect of the provision of services received from third party provider(s) or from BNY Mellon entities that could potentially damage an entity's operations, or if contracts with any of the third party providers or BNY Mellon entities are terminated, the BNYML entities may not be able to find alternative providers on a timely basis or on equivalent terms.

According to BNYML's Outsourcing Policy, outsourcing is defined as a regulated entity's use of a third party (either an affiliated entity within a corporate group, a joint venture, a subsidiary, affiliate or an entity that is external to the corporate group) to perform core business activities on a continuing basis that would normally be undertaken by BNYML.

"Core business activities" is defined as the activities that may have a significant impact on the functioning of BNYML as further defined in the Luxembourg Grand-Ducal Regulation of July 13, 2007.

BNYML's operating model is largely based on the usage of BNY Mellon Group's operating hubs of excellence to which BNYML has delegated certain operational and administrative tasks, mainly in Ireland, in Belgium, United States, India and Singapore.

BNYML's Outsourcing policy details certain minimum, but not exhaustive, standards that should be adopted when considering or dealing with a service and/or activity that is outsourced to another legal entity, either within the Group or to an external provider and will establish a framework for evaluating and analysing outsourcing projects.

In addition, BNYML fully comply with Circular IML 91/75 (as amended by Circular CSSF 05/177).

### **3.13 Concentration Risk**

Concentration risk is the risk of loss associated with concentrations in risk exposure to clients, Business / Groups, industries, etc. The risk exposure can be within risk categories (e.g. credit risk to related parties), or between risk

categories (e.g. the simultaneous effect that was often witnessed in the recent financial crisis of decreasing credit quality, together with increased volatility in financial markets, reputational damage, etc.).

BNYML have acknowledged the CSSF Circular 13/574 issued on October 28, 2013, regarding the adherence to the guidelines set down in the EBA GL31 document. The key elements affecting BNYML are detailed below and further analysis of the document is under way to ascertain further impacts and applicability and necessary action plans to complete adherence and further management of the identified impacts.

BNYML is exposed to concentration through:

- Credit
- Client
- Operational

### **3.13.1 Credit Concentration Risk**

Credit concentration risk results from concentration of exposures to a single counterparty, borrower or group of connected counterparties or borrowers. This includes on and off-balance sheet exposures.

BNYML is exposed to credit concentration risk on account that the vast majority of its current assets are held with the Luxembourg Central Bank (deposits totaling €3.0bn with the Luxembourg Central Bank at December 31, 2014 or 67% of the total cash balances). Given that BNYML is compliant with its own risk appetite General Management is confident this risk is not significant over a one year period. Furthermore, if the rating were to worsen, General Management is confident that cash assets could be distributed to alternative banks if required.

### **3.13.2 Client Concentration Risk**

BNYML diversifies products and activities, changes the number of new client take-ons, reviews the pricing, possibly ceases relationship with unprofitable clients and seeks to increase productivity. In case of high volume or NAV decrease, the related expenses would be rationalized where practical.

### **3.13.3 Operational Concentration Risk**

Concentration risk in operations can arise from a number of operational risk factors, including external suppliers providing key products and services, external market counterparties, and the geographic concentration of operations.

BNYML has a number of operational dependencies on the BNY Mellon Group, for instance intra-group outsourcing (section 3.14).

## **3.14 Group Risk**

Group risk is the risk that the financial position of BNYML may be adversely affected by its relationships (financial and non-financial) with other entities within BNYMC or by risks which may affect the financial position of the whole Group, for example reputational contagion or Group default.

As part of a large complex and interconnected company, BNYML has a number of dependencies on BNY Mellon. These range from business leadership, dependency on certain IT systems and support services provided by central functions.

BNYML management have considered several possible scenarios where these services may be affected, these include IT services outage and other business continuity issues. Although these will cause operational issues they are not expected to have a significant cost impact and are therefore not modelled, but are included in the scenarios as part of operational risk assessment and in the liquidity stress testing.

## **3.15 Interest Rate Risk in Non-trading Book**

Interest rate risk (IRR) is the risk associated with changes in interest rates that affect net interest income (NII) from interest-earning assets and interest-paying liabilities. For regulatory purposes, interest rate risk is monitored in the trading portfolio and non-trading book separately. IRR exposure in the non-trading book arises from maturity or



repricing mismatches and from products that include embedded optionality, the risk could crystallise with changes in interest rate risk/the shape of the yield curve.

The Bank has no material assets and liabilities subject to interest rate risk. BNYML exposure to interest rate risk is principally related to interest earnings on its own cash deposits. BNYML seeks to earn competitive interest rates on the cash balances held but adopts a very low risk approach (on call deposits only). The Bank does not run a trading book and matches its interest rate risk on its non-trading book.

In February 2008, the CSSF issued Circular 08/338 stipulating that banks must submit their non-trading book activities to a stress test on interest rate risk. This test shows the extent to which interest rate risk is likely to result in a decline in the economic value of the institution by more than 20% of its own funds.

The Bank has performed this analysis and has concluded that no capital is required to cover interest risk on its non trading book activities.

### **3.16 Legal Risk**

Legal risk is the risk of loss arising from claims, lawsuits (including both costs of defence and adverse judgments), and inability to enforce contracts as expected.

BNYML's legal risks fall into the following four categories:

1. Corporate
2. Client
3. Employee
4. Suppliers

The legal risks here are associated with non-payment / non-performance. They are mitigated by the formal documents that lay out the responsibilities of both parties and the procedures for resolving disputes. The legal risk associated with Corporate, Client and Supplier legal risk are considered low, based on historical and current experience. Given the five year strategy, this is not envisaged to change on a business as usual basis. The legal risk relating to Employee is included in the operational risk.

### **3.17 Model Risk**

Model risk refers to the possibility of unintended business outcomes arising from the design, implementation or use of models. Model risk includes the potential risk that management makes incorrect decisions based either upon incorrect model results, or incorrect understanding and use of model results.

Model risk can result in material financial loss, inaccurate financial or regulatory reporting, misaligned business strategies or damage to the BNYML or BNY Mellon as a whole's reputation. BNYML uses models in its risk management framework. All models have been assessed in line with the relevant corporate policies and Model Risk Management Framework wherein the individual model is categorised into one of three tiers based on materiality complexity, and level of reliance. The tiers determine the controls applicable to the model classes. The Enterprise Model Risk Committee oversees model risk management at the enterprise level and approves the overall framework and standards, which are applicable across the organisation. The Model Risk Management Group, based in the US, retain ultimate responsibility for overall model governance.

Model Risk Management Governance has responsibility for the governance of inventory and provides a mechanism to report on models to key stakeholders.

Models that impact the capital assessment process are categorised as Tier 1 models and the execution of the validation of Tier 1 models is done by a designated Independent Model Validation function. Tier 1 models are required to be validated or reviewed, as per the Validation Standards, on at least an annual basis.

BNY Mellon Internal Audit provides independent reviews of compliance with the corporate Model Validation Policy.

### **3.18 Pension Obligation Risk**

Pension Obligation Risk is caused by contractual liabilities or moral obligation to a company's staff pension schemes.

BNYML only operates a Defined Contribution pension scheme for its staff, and has no Defined Benefit pension scheme.

BNYML is not exposed to the Pension Obligation risk.

### **3.19 Reputation Risk**

Reputation risk covers the current or prospective risk to earnings and capital arising from adverse perception of the image of the financial institution on the part of the customers, counterparties, shareholders, investors and regulators.

BNYML relies heavily on its reputation and standing in the market place to retain and attract clients. Through analysis of other risks, potential reputational impacts have been identified as follows:

- Group default or reputational event could lead to loss of confidence in BNYML
- Legal or operational event leading to publicised failure which impacts BNYML reputation. Regulatory change with particular regards to recent AIFMD and UCITS regulation. Key reputation risk for BNYML is risk of not being able to present a full service in the line with the AIFMD /UCITS requirements and the impact it could have on future strategy within Luxembourg. The risk of not being able to provide such service and the reputational damage that could be incurred is driven by the risks that the service operating model, primarily the new technology platforms that would capture cash monitoring, investment restrictions, and record keeping, not being ready on time for onboarding and/or migration of clients, and by the secondary risk of correct resourcing for such activity.

### **3.20 Strategic and Country Risk**

#### **3.20.1 Strategic Risk**

Strategic risk is defined as the risk of earnings reduction and capital loss arising from changes in the business environment and from adverse business decisions or improper implementation of decisions. Strategic risk can result from either a misalignment of business line decisions which impact the group, or failure to deliver business value through new strategic initiatives. M&A integration, the choice of business model, wrong product and poor due diligence have been identified as the most critical sub-risks within the strategic risk category. Strategic risk is based on management assessment.

#### **3.20.2 Country Risk**

Country Risk is the risk of unfavourable evolution of operating profits and/or value of assets due to changes in the business environment resulting from political or macroeconomic factors.

Country risk is a stabilising risk due to exposure to Italy and (to a lesser degree) to Russia. Italy, along with other Eurozone countries, is not currently experiencing the severe trials that impacted it in 2012 and that gave rise to questions around a sovereign debt crisis. Such a crisis would have severely impacted the BNYML Italian Branch that is active in the Corporate Trust Business.

BNYML offers Fiduciary Depository services to Russian based issuers, and could consequently be exposed to political risk. However, this risk is negligible as to date there remains just one Deposit Receipts client for Luxembourg Corporate Trust and there is a plan in place to move this to BNY Mellon (Cyprus Nominees) Limited.

BNYML Italian Branch provides Account Bank and Paying Agent services in plain vanilla and structured finance issuances on behalf of issuers on Italian market. The Branch does not grant credit facilities to its client at date. Clients of the Branch are Special Purpose Vehicles (SPV) for securitization incorporated in Italy under Law 130/99 (The Securitization Law).

### **3.21 Settlement Risk**

Settlement risk is the probability of loss arising from the failure of one counterparty to settle its end of a transaction, thus preventing other counterparties from settling their commitments. It arises usually when payments are not exchanged simultaneously.

Following the publication of CSSF Circular 10/496 which states that as from the December 31, 2011, Part VIII of CSSF Circular 06/273 covering capital requirements for settlement risk will no longer be limited to trading book transactions and thus will be applicable to all banking activities, the Bank performed an analysis to assess how its banking book could be subject to settlement risk.

It has been concluded that BNYML was not subject to settlement risk as it held no securities, or commodities commitments to settle. BNYML has no trading book.

The bank undertakes only FX trades since January 2014 for banking book purposes with intra group entities and trades are settled within a day. To date, the bank has not experienced any unsettled FX transactions.

### **3.22 Non-trading book exposures in equities**

BNYML did not have any non-trading book exposures in equities as at December 31, 2014.

### **3.23 Securitisation Risk**

Securitisation risk is the risk that the capital resources held in respect of assets which it has securitized is not adequate.

As at December 31, 2014, BNYML did not have any securitisation risk-weighted exposure calculated under CSSF circular 06/273 Part X.

## 4 Capital Resources

### 4.1 Available Capital Resources

The following table summarises the capital resources for BNYML and its Italian Branch, as at December 31, 2014. The summary Pillar 1 capital requirements are presented by exposure class, and the associated capital surplus and capital adequacy ratio.

The following table summarises the composition of the BNYML regulatory capital as reported to the CSSF as at December 31, 2014. The Bank does not have any Innovative Tier 1 capital nor Tier 3 capital as at December 31, 2014.

**Table 5: Capital resources & requirement**

Capital Resources As at 31 December (€000s)	The Bank of New York Mellon (Luxembourg)	
	2014	2013
<b>Tier 1 Capital</b>		
Called up Share Capital	74,831	74,831
Capital Retained Earnings and other Reserves	(952)	944
<b>Total Tier 1 Capital</b>	<b>73,880</b>	<b>75,775</b>
<b>Deductions from Tier 1 Capital</b>		
Intangible Assets - goodwill	(2,426)	(3,351)
Adjustments to other valuation differences affecting the eligible reserve	(1,001)	(4,166)
<b>Total Tier 1 Capital after deductions</b>	<b>70,452</b>	<b>68,258</b>
<b>Tier 2 Capital</b>		
Lower Tier 2 Capital		
Dated subordinated debt		
<b>Total Tier 2 Capital</b>	<b>0</b>	<b>0</b>
<b>Deductions from total of tiers 1 and 2 capital</b>		
Connected lending of a capital nature		
<b>Total Deductions from total of tiers 1 and 2 capital</b>	<b>0</b>	<b>0</b>
<b>Total Capital Resources</b>	<b>70,452</b>	<b>68,258</b>

<sup>4</sup> 2013 audited figures are used in these disclosures

<sup>5</sup> 2014 unaudited loss included in the Tier 1 capital computation

## 4.2 Reconciliation between own funds from regulatory disclosure and equity from financial statements

Table 6 Reconciliation of own funds

Own funds As at 31 December 2014 (€000s)	Amounts as reported in published financial statements	Amounts under regulatory scope
<b>Tier 1 Capital</b>		
Called up Share Capital	74,831	74,831
Capital Retained Earnings and other Reserves	1,013	(952)
Income from current year	(1,964)	
<b>Total Tier 1 Capital</b>	<b>73,880</b>	<b>73,880</b>
<b>Deductions from Tier 1 Capital</b>		
Intangible Assets		(2,426)
Adjustments to other valuation differences affecting the eligible reserve		(1,001)
<b>Total Tier 1 Capital after deductions</b>	<b>73,880</b>	<b>70,452</b>
<b>Tier 2 Capital</b>		
Lower Tier 2 Capital		
Dated subordinated debt		
<b>Total Tier 2 Capital</b>	<b>0</b>	<b>0</b>
<b>Deductions from total of tiers 1 and 2 capital</b>		
Connected lending of a capital nature		
<b>Total Deductions from total of tiers 1 and 2 capital</b>	<b>0</b>	<b>0</b>
<b>Total Capital Resources</b>	<b>73,880</b>	<b>70,452</b>

## 4.3 Description of the main features of own funds

BNYML does not have any capital instruments.

## 4.4 Risk Weighted Assets

The following table summarises the Risk Weighted Assets (RWAs) for BNYML and its Italian Branch by risk type.

Table 7: Risk Weighted Assets by risk type

As at 31 December Risk Weighted Assets (RWAs) by risk type (€000s)	The Bank of New York Mellon (Luxembourg) S.A.	
	2014	2013
Credit Risk	206,272	561,788
Operational Risk	61,652	56,365
Market Risk	14,500	3,686
<b>Total RWAs</b>	<b>282,424</b>	<b>621,839</b>

## 5 Capital Requirements and Adequacy

The following table details the Pillar 1 capital requirements by exposure class for BNYML and its Italian Branch as at December 31, 2014. For 2014, the capital requirements also include the Capital Conservation Buffer (CCB) of 2.5%.

**Table 8: Capital requirements by risk type**

Capital Requirements and Adequacy As at 31 December 2014 (€000s)	The Bank of New York Mellon (Luxembourg)	
	2014	2013
<b>Credit Risk Standardised Approach</b>		
Central Governments and Central Banks	-	-
Institutions	14,531	43,592
Corporates	503	567
Short term claims on Institutions and Corporates	-	-
Collective Investment Undertakings	-	-
Other	1,467	784
<b>Total Credit Risk capital requirement</b>	<b>16,502</b>	<b>44,943</b>
<b>Operational Risk - standardised approach</b>	<b>4,932</b>	<b>4,509</b>
<b>Market Risk</b>		
Foreign currency Position Risk Requirement	243	295
Credit value Adjustment	917	-
<b>Total Market Risk capital requirement</b>	<b>1,160</b>	<b>295</b>
<b>Capital conservation buffer</b>	<b>7,061</b>	<b>-</b>
<b>Total Pillar 1 Capital Requirements</b>	<b>29,655</b>	<b>49,747</b>
<b>Total Capital Resources</b>	<b>70,452</b>	<b>68,258</b>
<b>Capital surplus</b>	<b>40,798</b>	<b>18,511</b>
<b>Total Capital Resources / Total Risk Weighted Assets</b>	<b>24.95%</b>	<b>11.00%</b>

6 Other Items' Capital requirement is predominantly in respect of other accruals and prepayments.

7 The Standardised Approach has been adopted for Operational Risk. The capital charge for each business line is calculated by multiplying gross income by a factor (denoted Beta).

8 The Bank does not carry out any trading activities and therefore does not allocate capital for market risk exposure apart from foreign exchange risk. The foreign exchange risk capital charge is based on historic foreign currency balances using the calculation required by the CSSF.

## 6 Remuneration Disclosure

BNYML has a remuneration policy in existence which has been approved by the Board of the Bank as well as by the EMEA Remuneration Governance Committee (ERGC) of BNYMC, who are responsible for monitoring the application of the compensation plans of BNYMC in the EMEA region, and their compliance with regional and local regulations.

BNYML is a subsidiary of BNYMC and therefore the Staff Members, including Material Risk Takers participate in the compensation plans applicable for their line of business or business partner function. These plans are generally under the oversight responsibility of the Human Resources and Compensation Committee (HRCC) of BNYMC whose members are non-executive board members and who acts on behalf of the Board of BNYMC.

Any significant changes to compensation plans are reviewed and approved by the Compensation Oversight Committee (COC) of BNYMC. They also are responsible for the annual review of each incentive compensation plan and for advising the HRCC for any compensation related issues. COC is comprised of members of BNYMC management (i.e. Chief Human Resources Officer, Chief Risk Officer, Chief Financial Officer, Compliance Chief Administrative Officer and the Risk Management Chief Administrative Officer).

It has been decided not to establish a remuneration committee within the Board of the Bank taking into account the composition and responsibilities of the bodies listed above, as well as the size and complexity of BNYML. The remuneration policy statement and its implementation are the responsibility of the Board of BNYML.

This policy is reviewed every year and implements the laws of the Grand Duchy of Luxembourg and the regulations of the CSSF in application of Directive 2013/36/EU ("CRD IV") and any other applicable Directives, as well as the CEBS Guidelines on Remuneration Policies and Practices (December 2010), and any other EBA technical standards in application of these directives.

### 6.1 Remuneration for those Material Risk Takers

Material Risk Takers are those BNY Mellon employees specifically identified internally as whose professional activities have a material impact on the institution's risk profile under Article 94(2) of CRD IV, in accordance with the provisions of Commission Delegated Regulation (EU) N° 604/2014 of March 2014. .

The tables below provide aggregate remuneration data for the 25 staff members considered Material Risk Takers for 2014. For completeness, this group of staff is limited to those considered to be primarily regulated for their activities under BNYML and its Milan Branch.

**Table 1: Aggregate remuneration expenditure for Material Risk Takers in 2014**

	BNYMIL		
	Operations <sup>(*)</sup>	Shared <sup>(**)</sup>	Total
	€000s	€000s	€000s
Total Remuneration	2,721	1,919	4,640

Includes base salary and other cash allowances, plus any cash incentive and the total of any deferred awards made in BNY Mellon shares.

(\*) Material Risk Takers in the Asset Servicing, Corporate Trust operations and the CSD

(\*\*) Material Risk Takers who are responsible for independent control functions, senior management excluding heads of operations and Global Client Management.

**Table 2: Aggregate remuneration expenditure for Material Risk Takers relating to 2014 by remuneration type**

	Operations <sup>(*)</sup>	Shared <sup>(**)</sup>	Total
	€000s	€000s	€000s
Number of beneficiaries	14	11	25
Fixed Remuneration <sup>(*)</sup>	2,272	1,462	3,734
Variable Remuneration	449	457	906
Cash	404	347	751
Long Term Incentive	45	110	155

(\*) Fixed Remuneration includes base salary and any cash allowances.

**Table 3: Outstanding aggregate deferred remuneration for Material Risk Takers paid in 2014**

	BNYMIL
	# of Shares/Units
Unvested as of December 31, 2013 <sup>(*)</sup>	98,371
Awarded during the financial year <sup>(**)</sup>	8,456
Vested during the financial year <sup>(***)</sup>	(7,637)
Lapsed	(7,103)
Outstanding as of December 31, 2014	92,087

(\*) Number of options or RSUs.

(\*\*) Awarded in February 2014 in relation to the 2013 performance year.

(\*\*\*) Includes the vesting of restricted stock units and the exercise of options.

**Table 4: Aggregate sign-on, buy-out and severance payments for Material Risk Takers in 2014**

	BNYMIL
	€000s
Sign-on payments	-
Number of beneficiaries	-
Buy-out payments	-
Number of beneficiaries	-
Severance payments <sup>(*)</sup>	-
Number of beneficiaries <sup>(*)</sup>	-

(\*) Value of Severance payments not disclosed due to confidentiality issue.

Other employees who were considered to be Material Risk Takers for 2014 for their activities under BNYML and its Milan Branch, but whose remuneration expenditure were not borne by BNYML have been excluded from the data displayed in the tables above. These remuneration expenditures are included on an aggregate basis in the Pillar 3 remuneration disclosures for the respective BNY Mellon legal entities.



## **6.2 Governance**

The Bank's remuneration policy is approved by the Board and the ERGC. The decisions in respect of variable remuneration are proposed by the lines of business or business partner for each Material Risk Taker member and are approved by two non-executive directors on behalf of the Board.

## **6.3 Alignment of Remuneration**

The Bank's remuneration is comprised of both fixed and variable remuneration. The variable remuneration is decided taking into account the following factors:

- i. financial results;
- ii. current and future risks;
- iii. individual performance of the staff member, as documented in a formal appraisal system, against agreed goals set at the start of the plan year.
- iv. In the case of heads of control functions, such performance is always evaluated in light of the mission of their function, not on the basis of the results of the business or businesses they control.

In relation to the individual performances, these are assessed as part of the performance management program done on an annual basis. The performance management program includes one or more risk goals that helps employees to understand specific risks associated with their job.

The variable remuneration consists of a cash part proposed by the functional hierarchy of the business or business partner service to which the individual staff member belongs, and in accordance with the terms and conditions of the incentive compensation plan that is applicable for the business or business partner service. In order to align variable remuneration with the management of the longer term business risk, BNYMC has established a corporate deferral program. Under this program, a portion of the award will be granted under the form of Restricted Stock Units of BNYMC. The portion is determined according to (i) level of seniority of the recipient and (ii) amount of the award. Furthermore, BNYMC requires employees who receive cash bonuses to agree to repay all or part of the bonuses that have been awarded for performance under certain circumstances.

The Bank's equity based remuneration are intended to be a key element of the Bank's pay-for-performance compensation program by aligning the senior staff's portion of the remuneration with changes in our stock price over a multiple-year period.

## **6.4 Risk Adjustment measures**

The policy provides for risk adjustment of variable remuneration in line with the compensation plans applicable to each individual. The incentive compensation plans applicable in Luxembourg are funded based on a pre-tax net income basis, using the BNYMC's financial metrics.

Individuals are rewarded from the pools thus determined, on a discretionary basis. Variable compensation can be adjusted in function of certain risk and compliance criteria.

The vesting of deferred awards is subject to conditions and can be forfeited in case of voluntary termination of employment or misconduct.

## 7 Glossary of Terms

The following terms are used in this document:

- **ALCO:** Asset and Liability Committee
- **Basel II:** The June 2006 capital adequacy framework issued by the Basel Committee on Banking Supervision in the form of the 'International Convergence of Capital Measurement and Capital Standards'.
- **BNY Mellon:** The Bank of New York Mellon
- **BNYMC:** The Bank of New York Mellon Corporation
- **BNYML:** The Bank of New York Mellon (Luxembourg) S.A.
- **Compensation Oversight Committee (COC):** COC is responsible for reviewing each incentive compensation plan annually. COC approval is also required in connection with any amendment to or termination of any incentive compensation plan.
- **CRD:** Capital Requirements Directive
- **Credit risk mitigation (CRM):** A technique to reduce the credit risk associated with an exposure by application of credit risk mitigants such as collateral, guarantees and credit protection.
- **Derivatives:** A derivative is a financial instrument that derives its value from one or more underlying assets, for example bonds or currencies.
- **EMEA Remuneration Governance Committee (ERGC):** ERGC is a regional governance committee that reviews the compensation plans and their implementation in the different businesses and entities of the Company in Europe, the Middle East and Africa (EMEA) (including, but not limited to, the EU Member States), in order to ensure their compliance with the laws and regulations on remuneration issued by the relevant states and regulatory authorities.
- **Exposure:** A claim, contingent claim or position which carries a risk of financial loss.
- **Exposure at default (EAD):** The amount expected to be outstanding, after any credit risk mitigation, if and when a counterparty defaults. EAD reflects drawn balances as well as allowance for undrawn amounts of commitments and contingent exposures.
- **Human Resources and Compensation Committee (HRCC):** HRCC oversees the compensation plans, policies and programs in which the executive officers of the Bank participate and the other incentive, retirement, welfare and equity plans in which all employees of the Bank participate.
- **Institutions:** Under the Standardised approach, Institutions are classified as credit institutions or investment firms.
- **Internal Capital Adequacy Assessment Process (ICAAP):** The group's own assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.
- **Key Risk Indicator (KRI):** Key Risk Indicators are used by business lines to evaluate control effectiveness and residual risk within a business process.
- **Residual maturity:** The period outstanding from the reporting date to the maturity or end date of an exposure.
- **Risk appetite:** A definition of the types and quantum of risks to which the firm wishes to be exposed.
- **Risk and Control Self-Assessment (RCSA):** Risk and Control Self-Assessment is used by business lines to identify risks associated with their key business processes and to complete a detailed assessment of the risk and associated controls.
- **Risk Governance Framework:** The BNYML risk governance framework has been developed in conjunction with BNYMC requirements. Key elements of the framework are:
  - Formal governance committees, with mandates and attendees defined
  - Clearly defined escalation processes, both informally (management lines) and formally (governance committees, board, etc.)

- A clear BAU process for identification, management and control of risks
- Regular reporting of risk issues
- **Risk Management:** includes Luxembourg Chief Risk Officer, line of business Risk Managers, EMEA Risk Architecture and respective business line Embedded Control Managers.
- **Risk Management Committee (RMC):** Risk Management Committee which meets a minimum of ten times per calendar year (according to the Terms of Reference) to provide governance on risk related items arising from the business of the group.
- **Standardised approach:** In relation to credit risk, a method for calculating credit risk capital requirements using external credit assessment institution ratings and supervisory risk weights. In relation to operational risk, a method of calculating the operational capital requirement by the application of a supervisory defined percentage charge to the gross income of eight specified business lines.

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