



BNY MELLON



# **BNY Holdings UK Limited**

## **Pillar 3 Disclosures for the year ended 31<sup>st</sup> December 2009**

**Published 31st March 2010**

## About Pillar 3 Disclosure

### Alignment of disclosures within UK regulated entities

*The British Bankers Association Pillar 3 Working Party, comprised of a number of UK banks has published guidelines for preparers of Pillar 3 disclosures to better align content, definitions and approaches and to drive comparability and consistency wherever possible. These disclosures have been produced with reference to the outcome of this Working Party. Where necessary, footnotes have been added to the data tables to explain content. However, whilst disclosures are intended to provide transparent information on a common basis, different assumptions may apply to other banking groups especially outside the UK so a reader must understand the basis of each firm's disclosures before making comparisons.*

### 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, there is currently no comparable disclosure provided on a consolidated basis by the firm's parent undertaking. As such, this disclosure has been prepared for the BNY Holdings UK Limited and its principal UK regulated entity BNY Mellon International Limited.*

*These disclosures have been approved by the Board of Directors (BOD) who have verified that they are consistent with formal policies adopted regarding production and validation.*

*Information in this report has been prepared solely to meet the disclosure requirements about Basel II and to provide certain specified information about capital and other risks and details about the management of those risks, and for no other purpose. This paper does not constitute any form of financial statement on the business nor does it constitute any form of contemporary or forward looking record or opinion about the business.*

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

*Pillar 3 disclosures will henceforth be published annually as at the company Accounting Reference Date, 31<sup>st</sup> December and publication will take place as soon as practicable. The company 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.*

*The BOD at its discretion may omit one or more of the disclosures if the information provided by such disclosures is not regarded as material. The criterion for materiality used in these disclosures is that the firm 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 BOD at its discretion may omit one or more of the disclosures if those items include information which, in the light of requirements is regarded as proprietary or confidential. In this circumstance, the BOD 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 company undertakes no obligation to revise or to update any forward looking or other statement contained within this paper regardless of whether or not those statements are affected as a result of new information or future events.*

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

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

*Further information about the company can be found in the latest Annual Report & Accounts.*

# **BNY Holdings UK Limited**

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# 1. Introduction

These disclosures are about **BNY Holdings UK Limited** ('BNYH') and are published in accordance with the requirements of the Financial Services Authority ('FSA') Prudential Sourcebook for Banks, Building Societies and Investment Firms, BIPRU 11 (*Pillar 3*). Pillar 3 disclosures are made in respect of BNY Holdings UK Limited and its subsidiary undertakings (together the 'group'). BNYH implemented the Basel II Standardised Approach for calculating credit, market and operational risk on 1<sup>st</sup> January 2008. The company first prepared Pillar 3 disclosures for year end 31<sup>st</sup> December 2008.

## 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 EU through the Capital Requirements Directive (CRD) which is now law. 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 for Credit, Market and Operational Risk.
- **Pillar 2** is an internal discipline to evaluate the adequacy of the regulatory capital requirement under Pillar 1 and other non pillar 1 risks. This pillar requires the FSA to undertake a supervisory review to assess the robustness of the company's internal assessment.
- **Pillar 3** complements the other pillars and effects market discipline through public disclosure. Expanded disclosure about capital and risk enables interested parties to better understand the risk profile of individual banks and to make comparison.

## 2. Scope and Application of Directive Requirements

BNYH is a wholly owned subsidiary of BNY International Financing Corporation which is, in turn, a subsidiary of The Bank of New York Mellon Corporation. BNYH is an intermediate holding company only with no direct operational activities and it consolidates the financial impact of activities mainly arising from its principal wholly owned UK registered subsidiary **The Bank of New York Mellon (International) Limited**

('BNYMI'). Reference to BNYH in an operating capacity in this paper essentially refers to BNYMI which, from a consolidated perspective comprises substantially all of the group activity.

Other consolidated subsidiaries include: BNY Trust Company Limited and The Bank of New York Trust & Depository Limited) and, the following Irish subsidiaries, BNY Securities (Ireland) Limited, BNY Trust Company (Ireland) Limited, BNY Fund Services (Ireland) Limited and Renvy Limited.

Through its operating subsidiaries, BNYH group provides custody services, fund administration and transfer agency services, investment administration services, trustee services to both authorised and unauthorised unit trusts and, depository services to open-ended investment companies. The capital and exposures of all subsidiary undertakings are included in these disclosures. There is no difference in the basis of subsidiary consolidation for accounting and regulatory purposes.

There are no current or foreseen material practical or legal impediments to the prompt transfer of capital resources or repayment of liabilities when due between the parent undertaking and its subsidiaries

There were no instances during 2009 where Capital resources were less than the required minimum in any subsidiary undertakings not included in the consolidation (2008: nil).

The BNYH group does not make use of the Solo consolidation waiver provisions laid down in BIPRU 2.1.

## 2.1. 2009 highlights

To further strengthen BNYMI governance, two new experienced board members were appointed. No significant changes were made to the firm's risk management operating practices, which continue to develop in line with group policy and to reflect the growth of the business.

Following significant growth levels experienced during 2009 within the UK Transfer Agency business, a period of consolidation and stabilisation of new services and clients is a focus for 2010. In the post Lehman / Madoff world, Trustee and Administration businesses generally are under the regulatory spotlight and changes to regulatory requirements are anticipated. The firm continues to monitor developments to determine whether this will have a material impact on these activities.

## **3. BNYH Risk Management Objectives and Policies**

### **3.1. Risk Objectives**

BNYH, through its operating entities proactively identifies, assesses and manages risks, principally operational, credit, market, liquidity, compliance and business risks. The risk management framework includes the application of risk management policies agreed by the Board which are overseen by its independent risk management resources.

BNYMI operates primarily in the Asset Servicing sector of The Bank of New York Mellon Corporation (BNYMC).

The designated independent risk resources for the Sector have been closely involved in the risk assessment processes (further described in the Internal Capital Adequacy Assessment Process (ICAAP)).

The 2009 ICAAP document was reviewed and approved by the Board of BNYH and additionally reviewed by the senior risk governance committee in the region, the EMEA Risk Committee (EMEA Risk Co). Both the Board and the EMEA Risk Co have reviewed this Pillar 3 disclosure document.

BNYH considers that the regulatory capital treatments generally provide an adequate cushion to meet 'business as usual' risks or risks arising from stressed events.

Notwithstanding the above, BNYH considers the ICAAP to be a continuous development and monitoring process and will therefore continue to enhance its process as best practices emerge globally together with ongoing feedback on the process from the Regulatory bodies.

#### **3.1.1. Credit Risk**

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

Credit risk exposure is seen as relatively low given a BNYH deposit focused liability driven balance sheet. No wholesale funding is currently required. Placements are short term in tenor and are provided to credit assessed, high quality counterparties only. Limits and tolerances are used daily to monitor counterparty exposures

#### **3.1.2. Market Risk**

Market risk is the potential adverse change in income or in the value of assets and liabilities arising from movements in market rates, including interest rates, exchange rates, equity prices and indexes.

BNYH market risk reflects exposure to interest rate and foreign exchange mismatches. The Board assess this as low risk to the capital of the group. BNYMI seeks to keep mismatch interest rates to a minimum. Daily controls are in place to evaluate exposure and metrics are provided to Senior Management for comparison against risk tolerance.

#### **3.1.3. Operational Risk**

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events including the potential for loss that arises from problems with operational processing, human error or omission breaches in internal controls, fraud, and unforeseen catastrophes

The line of business is responsible and accountable for Operational Risks and operates in accordance with the BNYMC's corporate policies as agreed by the board. In addition, an independent Operational Risk Management function exists to both develop and ensure implementation of policies. The Operational Risk function is responsible for overseeing the appropriate mitigation of significant operational risks.

Key aspects of the Operational Risk Framework include policies covering the application of Risk Control Self Assessments (RCSAs); Key Risk Indicators (KRIs); Operational Risk Event reporting and analysis (losses; near misses and fortuitous gains) together with the risk assessments of major change and new client initiatives.

#### **3.1.4. Liquidity risk**

BNYM firms are required to have in place robust strategies, policies, processes and systems to identify, measure, manage and monitor the liquidity risks to which they may be exposed, including intra-day liquidity risk. Firms must have reliable management information to ensure appropriate and timely forward-looking information on the liquidity risk of the firm and early warning indicators to identify increases in liquidity risk.

Senior management is responsible for establishing appropriate liquidity risk tolerances; for approving, reviewing and updating the firm's

approach to managing liquidity risk; and for reviewing the firm's liquidity position including compliance with the UK FSA liquidity adequacy rule and regularly reporting this information to the governing body.

BNYH is a holding company and does not carry out any trading activities.

The main operating entity, BNYMI is self-sufficient within the group liquidity framework and complies with local liquidity regulations. The firm will at all times maintain liquidity resources which are adequate both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met in full as they fall due. On a semi annual basis entity, stress testing is undertaken to demonstrate continued liquidity adequacy and to evaluate the impact under stress conditions. BNYMI maintains daily liquidity ratios and tracks its depositors demands in terms of tenor, thus minimising liquidity mismatch risk. Metrics about the firm's liquidity position are reported to EMEA ALCO. On a day to day basis, liquidity and funding requirements are actively managed under delegated authority by BNY Mellon London branch Treasury.

BNYMI falls under an EMEA Programme designed to ensure that it complies with new FSA Liquidity Standards (PS 09/16) issued in October 2009 (BIPRU 12). This is an ongoing programme of work designed to upgrade and embed senior management governance and oversight capability, to establish procedures around measurement and monitoring of risk, to prepare an Individual Liquidity Adequacy Assessment for review with FSA in 2010 and, for the start of reporting under the new regime from November 2010.

In summary, FSA Systems and Control requirements oblige the firm's governing body (i.e. Board of Directors (BOD)) to express and check conformity with the firm's liquidity risk appetite. The outputs of the firm's Stress testing informs the governing body's decisions on whether the firm's liquidity risk appetite should be amended and forms the basis of a Contingency Funding Plan.

In this matter, a common *Liquidity Risk Management Framework* (LRM) and Operating Model applies to all UK regulated firms including BNYMI. In overview, this LRM framework sets out the principles and elements of the regime and the components thereof. In meeting these requirements, the firm has in place:

- A regime of senior management oversight and governance (including defining risk strategy, setting risk appetite and tolerance (limits and triggers)) and tracking performance;

- A firm Liquidity Policy that conforms with Group requirements (including pricing of liquidity, management of intra-day liquidity risk and funding diversification and market access);
- A regime of periodic reporting to senior management of liquidity ratios and metrics; and,
- Stress testing covering idiosyncratic, market wide and combination (worst case) events with behavioural assumptions that are approved by the BOD and which are modelled across short term (up to two weeks) and protracted (from two weeks to 3 months) time horizons; and, a Contingency Funding Plan.

BNYMI does not have any collateral positions to manage, nor given the business model and organisation is it necessary to actively manage liquidity across legal entities, business lines or currencies. Metrics about each firm's liquidity position are reported to EMEA ALCO.

In terms of global liquidity management, BNYMC enjoys a strong base of core client deposits for its funding which arises from its role as a leading asset custodian and trustee. BNYMC does not rely on either retail funding or wholesale funding in its business model. Asset/liability management is managed globally through treasury activities in key financial centres, such as New York, London and Brussels, and is driven by client cash needs and transactions.

### 3.1.5. *Compliance Risk*

Compliance Risk covers the impact on earnings or capital from violation, or non-conformance with laws, rules, regulations, prescribed practices or ethical standards which may, in turn, expose the firm and its executors to fines, payment of damages, the voiding of contracts and damaged reputation (with accompanying indirect costs).

The goal of BNYMC's compliance process is to ensure that all compliance responsibilities, enterprise-wide, are defined, understood, and met effectively through well-designed policies and procedures, by knowledgeable and trained employees, and through effective controls, including appropriate assessment, testing and documentation of procedures and remediation of any weakness.

As a subsidiary of BNYMC, BNYH and its Group is subject to a number of corporate compliance policies and benefits from corporate wide training around compliance and ethics matters. An independent Compliance function oversees the regulated firms operating within BNYH and its Group. The role of the Compliance function is to

provide leadership, guidance, and oversight to help business units identify applicable laws and regulations and implement effective measures to meet the specific requirements, including the execution of a risk based compliance monitoring programme, the results of which are escalated to senior management. Compliance takes a proactive approach by anticipating evolving regulatory standards and being aware of industry best practices, legislative initiatives, competitive issues, and public expectations and perceptions.

The Compliance function is part of a global compliance organisation which reports through the Head of International Compliance to the Chief Compliance and Ethics Officer for The Bank of New York Mellon Corporation. The Chief Compliance and Ethics Officer reports to the Chief Risk Officer, is a member of all critical committees of BNYMC and provides regular updates to the group Audit & Examining Committee of the Board of Directors.

### **3.1.6. Business Risk (Client Concentration)**

Business Risk is the current or prospective risk to earnings and capital arising from changes in the business environment and from adverse business decisions, improper implementation of decisions or lack of responsiveness to changes in the business environment. The primary risk is a fall in revenue arising from a loss of a concentration of clients exiting from the Custody, Fund Administration and Trustee business. As part of the ICAAP Pillar 2 scenario testing, concentration risk is considered and mitigating action is identified.

BNYH has limited tolerance towards client concentration risk and has taken steps to reduce this internally and through widening its client base, particularly in relation to Fund Administration.

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

All of BNYH group business activities are included in Basel II capital reporting, with the group utilising standardised (rather than advanced or advanced internal model) approaches to Pillar 1 capital determination.

BNYH utilizes the BNYMC group risk reporting systems in accordance with group risk policy and therefore the measurement and monitoring of the major risks encountered by the company are to the most part delivered by central systems or, where for sound business reasons this is not the case, through structures and processes that support comprehensive oversight by senior management.

The purpose of the company's risk measurement and reporting systems is to ensure that all risks and exposures are comprehensively captured, with all of the attributes necessary to support robust decision making by senior management and risk mitigation within approved risk appetite levels.

Risk measurement and reporting systems are subject to a robust governance framework, to ensure that their design is fit for purpose and that they are functioning properly and that controls are effective. There is regular reporting on risk to business line management, to specialist functions and to the senior management of the company.

### **3.3. Governance, Policies & Risk Management Structure**

Policies and procedures in place to govern and manage the business are common to all BNY Mellon entities. Suitable policies and procedures have been adopted by BNYMI to ensure that an appropriate level of risk management is directed at each element of the business.

The Board has both governance and decision making functions. In the opinion of the Board, such arrangements and independent oversight activities are adequate for the effective management of risks to the business.

The Risk Management organisation is based on a tiered approach, including Corporate, Sector, Line of Business and risk specialists (e.g.: credit risk). Within EMEA, the EMEA Chief Risk Officer provides a further oversight layer.

The Board has delegated to the The BNYM EMEA (Europe, Middle East, and Africa) Risk Committee ('EMEA RC') oversight of risk management, while retaining ownership and responsibility. To further strengthen this framework, embedded Risk Managers working closely with business line management oversee day to day risk management controls, monitor Key Risk Indicators and oversee the effective management of operational events. As a global business, BNYMC organises its activities into sectors e.g.: Asset Servicing. Each Sector has its own independent risk management arrangements covering, amongst other things the implementation of corporate risk policies and processes that identify risk.

The BNYMI Board meets formally on a quarterly basis and receives reports from Risk Management, Compliance, Finance and Audit to evaluate the effectiveness of the existing control environment and, to ensure that any issues are resolved appropriately, effectively and in a timely manner. In the opinion of the Board such arrangements and monitoring activities are adequate for the effective operation of the businesses within the U.K.

## 4. Capital Resources

During the year ended 31<sup>st</sup> December 2009, the BNYH group and individual entities within the group complied with all of the externally imposed capital requirements to which they were subject.

The following table summarises the composition of the BNYH group and significant subsidiary

company's regulatory capital as reported to the FSA as at 31<sup>st</sup> December 2009. The group did not have any Innovative Tier 1 capital resources or Tier 3 capital as at 31<sup>st</sup> December 2009 (2008: nil).

### 4.1 Regulatory Capital for BNYH and BNYMI

As at 31<sup>st</sup> December 2009

Capital Resources (unaudited)	Notes	BNYH group	BNYMI
		£000's	£000's
<b>Tier 1 capital</b>			
Called up share capital		264,902	202,484
Retained earnings and other reserves		-72,914	-70,452
Unaudited net profits	<i>1</i>	191,988	132,032
Deductions from Tier 1 capital			
Intangible assets	<i>2</i>	-64,306	-770
<b>Total Tier 1 capital after deductions</b>		<b>127,682</b>	<b>131,262</b>
<b>Tier 2 capital</b>			
<i>Lower Tier 2 capital</i>			
Dated subordinated debt		40,000	
<b>Total Tier 2 capital</b>		<b>40,000</b>	<b>0</b>
<b>Total capital resources</b>		<b>167,682</b>	<b>131,262</b>

1. Unaudited Profits are not reported to the FSA as part of Tier one capital. As of the date of this report, 2009 profits have not been audited and are therefore excluded from capital.

2. Intangible assets comprise mostly goodwill.

3. Information about Capital terms and conditions is set out in the Companies Annual Report and Accounts 2009

As at 31<sup>st</sup> December 2008

Capital Resources (unaudited)	Notes	BNYH group	BNYMI
		£000's	£000's
<b>Tier 1 capital</b>			
Called up share capital		264,902	202,484
Retained earnings and other reserves		-71,122	-70,452
Unaudited net profits	<i>1</i>	193,780	132,032
Deductions from Tier 1 capital			
Intangible assets	<i>2</i>	-47,658	-910
<b>Total Tier 1 capital after deductions</b>		<b>146,122</b>	<b>131,122</b>
<b>Tier 2 capital</b>			
<i>Lower Tier 2 capital</i>			
Dated subordinated debt		40,000	
<b>Total Tier 2 capital</b>		<b>40,000</b>	<b>0</b>
<b>Total capital resources</b>		<b>186,122</b>	<b>131,122</b>

1. Unaudited Profits are not reported to the FSA as part of Tier one capital. As of the date of this report, 2009 profits have not been audited and are therefore excluded from capital.

2. Intangible assets comprise mostly goodwill.

3. Information about Capital terms and conditions is set out in the Companies Annual Report and Accounts 2009

### Capital ratios

	2009		2008	
	BNYH group	BNYMI	BNYH group	BNYMI
Tier 1 ratio	14.9%	19.0%	15.7%	16.1%
Total capital ratio	19.6%	19.0%	20.0%	16.1%

## 5. Capital Requirements and Adequacy

### 5.1. Overview

The Group's capital management approach is driven by a desire to maintain a strong capital base to support the development of the business and, to meet regulatory capital requirements at all times. The BOD, through setting its risk appetite and focusing on risk assessment evaluates its current and projected capital requirements under business as usual and stress conditions.

For BNYH the Pillar 2 Internal Capital Adequacy Assessment Process (ICAAP) has determined that currently there is sufficient capital to support the ongoing and pipeline projected business. The main sources of risk have been identified, assessed (*impact & likelihood* methodology) and approved by the relevant senior managers after taking into account the mitigating controls and rationale for direction of risk, in light of the risk appetite set by the Board.

### 5.2. Capital requirements and adequacy

The following table summarises the BNYH group and BNYMI significant subsidiary company's capital

requirements by exposure class and capital adequacy surplus.

#### 5.2.1 Capital Requirements by exposure class and capital adequacy surplus As at 31 December 2009

Exposure class (unaudited)	Notes	Capital requirements	
		BNYH group	BNYMI
		£000's	£000's
<b>Credit Risk - Standardised approach</b>			
Institutions		0	0
Corporates		1,862	1,878
Short term claims on Institutions & Corporates		21,202	20,075
Collective Investment undertakings		3,586	3,586
Other Items	1	10,423	7,800
<b>Total Credit risk capital requirements</b>		<b>37,073</b>	<b>33,339</b>
<b>Operational Risk - Standardised approach</b>		<b>29,140</b>	<b>19,759</b>
<b>Market Risk</b>			
Foreign currency Position Risk Requirement	2	2,144	2,144
<b>Total Market risk capital requirements</b>		<b>2,144</b>	<b>2,144</b>
<b>Total Pillar 1 capital requirement</b>		<b>68,357</b>	<b>55,242</b>
<b>Capital surplus</b>		<b>99,325</b>	<b>76,020</b>
<b>Solvency ratio</b>			
Capital Resources / Capital Requirements		<b>245.30%</b>	<b>237.61%</b>

1. Other Items capital requirement is principally with respect to miscellaneous Trade and other debtors, interest and accounts receivable and prepayments and a capital charge in respect of fixed assets

As at 31<sup>st</sup> December 2008

Exposure class (unaudited)	Notes	Capital requirements	
		BNYH group	BNYMI
		£000's	£000's
<b>Credit Risk - Standardised approach</b>			
Institutions		786	13
Corporates		192	240
Short term claims on Institutions & Corporates		28,761	28,761
Collective Investment undertakings		1,337	1,337
Other Items	1	20,500	15,363
<b>Total Credit risk capital requirements</b>		<b>51,576</b>	<b>45,714</b>
<b>Operational Risk - Standardised approach</b>		<b>21,156</b>	<b>17,650</b>
<b>Market Risk</b>			
Foreign currency Position Risk Requirement	2	1,831	1,831
<b>Total Market risk capital requirements</b>		<b>1,831</b>	<b>1,831</b>
<b>Total Pillar 1 capital requirement</b>		<b>74,563</b>	<b>65,195</b>
<b>Capital surplus</b>		<b>111,559</b>	<b>65,927</b>
<b>Solvency ratio</b>			
Capital Resources / Capital Requirements		<b>249.62%</b>	<b>201.12%</b>

1. Other Items capital requirement is principally with respect to miscellaneous Trade and other debtors, interest and accounts receivable and prepayments and a capital charge in respect of fixed assets

2. The group does not take trading positions and does not have market risk exposure except for Foreign currency exposure arising from day to day activities.

### 5.3 *Minimum capital requirements and Risk Weighted assets*

Disclosure about Risk Weighted Assets (RWAs) is not a requirement of Pillar 3. However, RWAs are included in the following table as they remain an

important part of the internal management information about minimum capital requirements used by the group and BNYMI. The following table details the group and BNYMI underlying RWAs by risk type consistent with Minimum capital requirements reported above.

#### **Risk Weighted Assets by risk type**

	2009		2008	
	BNYH group	BNYMI	BNYH group	BNYMI
<b>Risk weighted assets</b>	£000's	£000's	£000's	£000's
Credit risk	463,413	416,738	644,700	571,425
Operational risk	364,250	246,988	264,450	220,625
Market risk	26,800	26,800	22,888	22,888
<b>Total RWAs</b>	<b>854,463</b>	<b>690,525</b>	<b>932,038</b>	<b>814,938</b>

Minimum capital requirements are defined as 8% of the RWAs.

### 5.4 *Retail and Equity exposures*

The BNYH group had no retail or material equity exposures as at 31<sup>st</sup> December 2009 (2008: nil).

## 6. Counterparty Credit Risk

Counterparty credit risk (CCR) in the context of Pillar 3 disclosure is the risk that a counterparty to a derivative contract recorded in either the Trading Book or Banking Book could default before settlement of the transaction's final cash flows. As at 31<sup>st</sup> December 2009, the group did not have a Trading book and did not have any derivatives in a Banking book and therefore no further disclosure is required (2008: nil).

## 7. Credit Risk and Dilution Risk

### 7.1. Structure

Credit risk is the risk of loss arising from a customer or counterparty failing to meet their financial obligations to the bank as and when they fall due.

BNYMI Credit unit is strongly embedded in the Risk Sector of the parent bank with certain Credit Officers having responsibilities across both the parent and the subsidiary. The Risk Sector identifies two broad types of Credit Risk:

- 'A' Credit, where formal facilities are agreed and, usually, advised to the counterparty; and
- 'B' Credit, where credit exposures arise through operational activity in support of activities which do not, of themselves, require formal credit facilities, most typically securities settlements.

The majority of bank counterparty exposures falls under 'A' Credit, whilst most client exposure arises under 'B' Credit.

'A' Credit exposures are managed by dedicated teams specialising in geographic areas or sector, as appropriate. 'B' Credit is managed by teams who have experience in the processing flows to understand and recognise risks which may arise. Informal, internal Guidance limits are established where appropriate to manage these risks. All credit limits are approved by Risk Sector officers. A specific Credit Officer in the United Kingdom is designated as 'gatekeeper' of all credit within BNYMI.

Credit exceptions, should they occur, are reported to EMEA Risk Committee along with other European exceptions.

BNYMI does not actively seek to assume Credit Risk, but does so as a result of its Securities

Processing activity. It will, however, assume Credit Risk to support its Clients in connection with their Securities holdings.

All clients and banks are assessed and allocated a borrower rating in accordance with the parent's rating system. This utilises a variety of inputs to achieve a consistent rating across all counterparty types on a 1 -18 scale. Credit decisions are based on independent credit risk analysis, supplemented by the output of internal ratings tools and external rating agency analysis, where available. Use of outputs from external agency ratings are always open to revision by the Credit Officer. Limits are set against each client as necessary using a combination of system driven tools and individual assessment by the bank's credit officers.

Monitoring & Control is conducted via a number of real-time systems to ensure that approved exposure levels are not exceeded, or are pre-approved by a suitable credit officer in the light of individual circumstances. Post event monitoring is also conducted by both Client Service areas and the Credit function.

There are two principal types of Credit Risk counterparties:

#### Banks

##### • Money Market

The majority of Credit Risk assumed by BNYMI is in placing monies with banks for fixed terms or overnight; this may be by way of cash placement or by purchase of Certificates of Deposits issued by these banks. Currently no Certificates of Deposit are held.

BNYMI makes extensive use of The BNY Mellon Group's expertise and knowledge in assessing the credit quality of these banks. The parent has relationships with, and limits for, all banks for which BNYMI has limits established. BNYMI limits are operated as sub-limits within the overall limit approved by the parent. Utilisation is monitored intraday and any requests to exceed a limit are referred to and decided upon by a dedicated credit officer.

##### • Nostros

BNYMI utilises a number of banks around the world to maintain accounts to enable it to transfer monies cross-border. These accounts are maintained at the minimum possible level, commensurate with smooth operation of client and own funds needs. The banks used are all major banks in the relevant country.

## Clients

- **Daylight (intraday) Overdrafts**

Daylight overdraft limits are set for each client as a percentage of a client's assets under custody (subject to certain maximum levels); all cash payments are checked against this limit on a real-time basis. Any excesses are referred to a Credit Officer for approval or otherwise, depending on circumstances. In rare instances a specific manual fixed limit may be agreed after due consideration by an appropriate Credit Officer; again all cash payments are checked against this limit, prior to payment.

These arrangements allow clients to access proceeds of sales, or other expected funds, even though in many markets the proceeds are not formally received until late in the day.

- **Overdrafts**

BNYMI makes full use of its parent's expertise in securities-related lending. In a few instances formal overdraft facilities have been agreed for specific clients at their request to allow some gearing of the portfolio. Each request is considered individually by specialist analysts in relation to the make up of the portfolio, amount requested, percentage of assets value requested and other factors. Approval is in the hands of a totally independent Credit Officer, with specialist understanding of the collective funds/investment industry. Such overdrafts are restricted to 35% of asset value.

BNYMI 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, BNYMI could call upon the expertise of its parent in these matters.

## ***7.2. Credit risk exposure under Basel II***

Credit exposure is computed under the Standardised approach. This method for calculating credit risk capital requirements uses ECAI ratings and supervisory risk weights.

In outline, exposures are allocated to specific standardised exposure classes as determined by FSA BIPRU 3 and it is these classes that determine the risk weight used. For exposures to corporates, sovereigns and institutions, BNYMI uses the external credit assessments of recognised credit rating agencies (i.e. Moody's, Standard & Poor's and Fitch, where appropriate). See section 7.4 for details.

## Exposure

The definition of exposure used in this report is consistent with that recommended by the BBA Pillar 3 Working party. 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.

## Credit Exposures

The following credit risk tables (i-iv) (unaudited) are about **The Bank of New York Mellon (International) Limited** ('BNYMI') which is the principal operating entity within the group.

### i. Standardised gross Credit exposure (EAD pre CRM)

Standardised exposure classes	BNYMI EAD pre CRM	BNYMI Average EAD pre CRM	BNYMI EAD pre CRM	BNYMI Average EAD pre CRM
	31 <sup>st</sup> Dec 2009	31 <sup>st</sup> Dec 2009	31 <sup>st</sup> Dec 2008	31 <sup>st</sup> Dec 2008
	£000's	£000's	£000's	£000's
Central governments & central banks	3,988	11,363	11,801	19,815
Regional governments & Local authorities	0	16	0	75
Institutions	0	0	0	0
Corporates	3,210	20,838	8,091	49,150
Short term claims on Institutions & Corporates	1,254,709	1,535,255	1,798,235	2,037,416
Collective Investment Undertakings	65,845	27,864	16,707	58,723
Other items	97,492	112,980	183,850	159,449
<b>Total</b>	<b>1,425,244</b>	<b>1,708,316</b>	<b>2,018,684</b>	<b>2,324,628</b>

1. Standardised exposure classes are defined by FSA in BIPRU 3
2. Other items principally comprises Trade and other debtors, interest and accounts receivable and prepayments
3. Average exposure is computed on a 13 month average, December 2008 to December 2009.

## ii. Standardised gross Credit exposure (EAD pre CRM) by geographic area

As at 31<sup>st</sup> December 2009

Standardised exposure classes	UK	Europe, Middle East & Africa	North America	Asia Pacific	BNYMI Total
	£000's	£000's	£000's	£000's	£000's
Central governments & central banks		3,988			3,988
Institutions					
Corporates	2,227	983			3,210
Short term claims on Institutions & Corporates	1,079,405	165,139		10,165	1,254,709
Collective Investment Undertakings	44,830	10,580		10,435	65,845
Other items	97,492				97,492
<b>Total</b>	<b>1,223,954</b>	<b>180,690</b>	<b>0</b>	<b>20,600</b>	<b>1,425,244</b>

1. Geographic distribution is based on the domicile of the borrower or obligor

As at 31<sup>st</sup> December 2008

Standardised exposure classes	UK	Europe, Middle East & Africa	North America	Asia Pacific	BNYMI Total
	£000's	£000's	£000's	£000's	£000's
Central governments & central banks		11,801			11,801
Institutions					0
Corporates	5,262	2,829			8,091
Short term claims on Institutions & Corporates	1,418,448	365,983	2,478	11,326	1,798,235
Collective Investment Undertakings	14,855	1,852			16,707
Other items	183,850				183,850
<b>Total</b>	<b>1,622,415</b>	<b>382,465</b>	<b>2,478</b>	<b>11,326</b>	<b>2,018,684</b>

1. Geographic distribution is based on the domicile of the borrower or obligor

### iii. Standardised gross Credit exposure (EAD pre CRM) by Industry sector

As at 31<sup>st</sup> December 2009

Industry sector	Central gov'ts & central banks	Institutions	Corporates	Short term claims on Institutions & Corporates	Collective Investment Undertakings	Other items	BNYMI Total
	£000's	£000's	£000's	£000's	£000's	£000's	£000's
Central & local government	3,988						3,988
Insurance companies & Pension funds			2,136				2,136
Banks & Other financial			1,056	1,254,709	65,845		1,321,610
Other business activities			9			97,492	97,501
Other individual Loans & Advances			9				9
<b>Total</b>	<b>3,988</b>	<b>0</b>	<b>3,210</b>	<b>1,254,709</b>	<b>65,845</b>	<b>97,492</b>	<b>1,425,244</b>

1. Industry sectors are based on the Standard Industry Classification (SIC) code of the counterparty

As at 31<sup>st</sup> December 2008

Industry sector	Central gov'ts & central banks	Institutions	Corporates	Short term claims on Institutions & Corporates	Collective Investment Undertakings	Other items	BNYMI Total
	£000's	£000's	£000's	£000's	£000's	£000's	£000's
Central & local government	11,801						11,801
Insurance companies & Pension funds			8,061		16,707		24,768
Banks & Other financial				1,798,235			1,798,235
Other business activities						183,850	183,850
Other individual Loans & Advances			30				30
<b>Total</b>	<b>11,801</b>	<b>0</b>	<b>8,091</b>	<b>1,798,235</b>	<b>16,707</b>	<b>183,850</b>	<b>2,018,684</b>

1. Industry sectors are based on the Standard Industry Classification (SIC) code of the counterparty

#### iv. Standardised gross Credit exposure (EAD pre CRM) by residual maturity

As at 31<sup>st</sup> December 2009

Standardised exposure classes	On demand	Up to 1 year ex on demand	BNYMI Total
	£000's	£000's	£000's
Central governments & central banks		3,988	3,988
Institutions			
Corporates	3,210		3,210
Short term claims on Institutions & Corporates	122,563	1,132,146	1,254,709
Collective Investment Undertakings	65,845		65,845
Other items		97,492	97,492
<b>Total</b>	<b>191,618</b>	<b>1,233,626</b>	<b>1,425,244</b>

- Exposures are allocated to maturity bands based on the residual contractual maturity dates and not expected or behaviourally adjusted dates.

As at 31<sup>st</sup> December 2008

Standardised exposure classes	On demand	Up to 1 year ex on demand	BNYMI Total
	£000's	£000's	£000's
Central governments & central banks	11,801		11,801
Institutions			0
Corporates	8,091		8,091
Short term claims on Institutions & Corporates	1,068,872	729,363	1,798,235
Collective Investment Undertakings	16,707		16,707
Other items		183,850	183,850
<b>Total</b>	<b>1,105,471</b>	<b>913,213</b>	<b>2,018,684</b>

- Exposures are allocated to maturity bands based on the residual contractual maturity dates and not expected or behaviourally adjusted dates.

### ***7.3. Impaired and Past Due Assets and Provisions***

For BNYMI, specific provisions are made against an asset when, in the opinion of the Directors, recovery in full is doubtful. A general provision may be made to cover bad and doubtful debts that have not been separately identified at the balance sheet date.

As at 31<sup>st</sup> December 2009, BNYMI had no impaired assets for which a specific or general provision had been raised (2008: Nil). There were no assets Past due greater than 90 days. BNYMI did not incur any write-offs of bad debts or make any recovery of amounts previously written off during the year to 31<sup>st</sup> December 2009 (2008: nil).

### ***7.4. Credit Risk Standardised Approach***

Credit exposure is computed under the Standardised Approach pursuant to fixed risk weights. The Standardised approach for measuring credit risk is the least sophisticated of the capital calculation methods. Risk weights applied under the Standardised method are given by the FSA and are based on the asset class to which the exposure is assigned.

The group uses external credit assessments provided by Fitch, Moody's, and Standard and Poor's to determine the risk weighting of exposures in its portfolios depending on counterparty type and coverage. Fitch is preferred for banks. Fitch, Moody's and Standard and Poor's are all recognised by the FSA as eligible External Credit Assessment Institutions (ECAIs) for the purpose of calculating credit risk requirements under the standardised approach.

All ECAI ratings for a counterparty are determined as soon as a relationship is established and these ratings are tracked and kept up to date. Ratings are subject to validation or amendment by a Credit Officer.

## Standardised exposure by Credit Quality Step

and reflects exposures pre and post CRM associated with each credit quality step prescribed in BIPRU 3.

The following disclosure (i) about BNYMI is presented for the most significant exposure class

### i. Standardised exposure by Credit Quality Step Short term claims on Institutions and Corporates

Exposures as at 31<sup>st</sup> December 2009

Credit Quality Steps	Risk weight	BNYMI EAD pre CRM	BNYMI EAD post CRM
	%	£000's	£000's
CQS 1	20%	993,493	993,493
CQS 2	20%	261,216	261,216
CQS 3	20%	0	0
<b>Total</b>		<b>1,254,709</b>	<b>1,254,709</b>

Exposures as at 31<sup>st</sup> December 2008

Credit Quality Steps	Risk weight	BNYMI EAD pre CRM	BNYMI EAD post CRM
	%	£000's	£000's
CQS 1	20%	1,115,777	1,115,777
CQS 2	20%	532,449	532,449
CQS 3	20%	150,009	150,009
<b>Total</b>		<b>1,798,235</b>	<b>1,798,235</b>

### ECAI grades

The above credit quality steps are equivalent to the following ECAI grades

Credit Quality Step	Fitch	Moody's	S&P
CQS 1	AAA to AA-	Aaa to Aa3	AAA to AA-
CQS 2	A+ to A-	A1 to A3	A+ to A-
CQS 3	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-

## **8. Market Risk**

The majority of market risk exposure relating to BNYMI's business is borne by its clients.

BNYMI does not take trading positions and therefore does not have market risk exposure apart from foreign currency position risk arising from day to day activities.

BNYH and its operating entities have limited tolerance for market risk and do not engage in proprietary trading. The firm uses the U.S. Group Value at Risk (VaR) modelling techniques to monitor on a daily basis its exposures to foreign exchange mismatches. At least annually it also undertakes multiple sensitivity limits and stress testing across such exposures.

## **9. Operational Risk**

For the purposes of calculating a Pillar 1 capital charge under the Basel II Standardised Approach it has been determined that BNYMI falls under the Agency Services Basel business line which is weighted at 15%.

The BNYMC group has set extensive Operational risk policies that have been adopted by the operating entities within the BNYH group. Risk Management governance and oversight is organised on a global platform and within Europe at both the country and sector levels. Risk managers embedded within the operating entities work closely with business line management to identify risks, monitor key risk indicators and record and evaluate any operational events that arise.

Corporate Risk Management has developed the methodology that supports the risk assessment process. The Board has approved the methodology as a basis of input into the Pillar 2 processes. Independent Sector Risk Managers, in conjunction with the Business management, are responsible for advising on the completion and findings of the risk self assessment process.

The self assessment process is aligned against global sector lines of business. BNYH and its subsidiaries operate within the Asset Servicing sector. The performance of self assessment by line of business is recorded on a globally maintained platform. Platforms also capture key risk indicators and operational risk events (losses, gains and near misses). Business managers are responsible for performance of self assessment, which is identifying the risks associated with key

business processes, identifying and assessing the quality of controls in place to mitigate risk, and assigning accountability for maintaining the effectiveness of those controls and remediation of any weakness. The Sector Risk Manager oversees the output and recording of this assessment with support and approval of Senior Management.

The objective of operational risk management is to prevent or minimise: errors or service delivery failures; financial Losses or near miss events; compliance breaches; and reputation damage.

## **10. Non-trading book exposures in equities**

As at 31<sup>st</sup> December 2009, BNYMI had equity shares amounting to £56,000 (2008: £56,000) intended for use on a continuing basis in the group's activities and which were classified as investment securities and were stated at cost less provision for any impairment in value. All equity shares are unlisted. In the opinion of the directors, the fair value of the investment is the same as the balance sheet carrying value and market value. The company did not recognise any gains or losses from the sale of equities in the non-trading book during the year ended 31<sup>st</sup> December 2009 (2008: nil).

## 11. Interest Rate Risk in the non-trading book

Interest rate risk in the banking book (IRRBB) represents non-traded product exposures of the company whose values vary with the level or volatility of interest rates. These exposures include, but are not limited to loans, debt securities, deposits, certificates of deposits and other debt securities issued, loan capital and derivatives.

Interest rate risk in the banking book arises from the following factors:

- *yield curve risk*: as a result of non-parallel changes in the yield curve
- *repricing risk*: as a result of differences in the repricing terms of the company's assets and liabilities
- *basis risk*: as a result of , for example one month LIBOR used to fund base rate assets
- *optionality*: where a customer has an option to exit a deal early.

Senior management is responsible for setting and monitoring the adequacy and effectiveness of the IRRBB management process, using a framework that identifies, measures, monitors and controls the underlying risk. Senior management approves the company's IRRBB appetite.

From an economic perspective, it is the company's policy to minimise the sensitivity of net accrual earnings to changes in interest rates and, where interest rate risk is retained, to ensure that appropriate resources, measures and limits are applied.

BNYMI incurs interest rate risk in its non-trading book in placing funds with a range of high quality banks for periods up to one year, although in practice much shorter terms are invariably used. The majority of funding for such placements arises from overnight client funds, representing a mismatch risk.

This risk is measured and controlled by means of a Value at Risk (VaR) limit, incorporating all relevant and material data. The VaR exposure is calculated in accordance with the parent bank's methodology which is subject to continuous validation by a team of specialists in the USA. Briefly, the VaR methodology employs a Monte Carlo simulation using 1000 scenarios and provides a 99.9% confidence level. The VaR limit

is set at a level which will not materially impact BNYMI's capital position.

In addition to the VaR methodology, a number of nominal limits are in place to limit the extent of any Interest Rate mis-match. These limits are linked to levels of client deposit and time-bands.

These exposure are monitored daily by a Risk Officer with regular reports made to EMEA Risk Committee.

The following table shows the change in earnings as at 31<sup>st</sup> December 2009 given a 200 basis point

shift in interest rates up and down, by currency and reflects a substantially matched book

### Increase / (decrease) in earnings at 31<sup>st</sup> December

Currency	+200 basis point increase in yield curve	-200 basis point decrease in yield curve	+200 basis point increase in yield curve	-200 basis point decrease in yield curve
	2009	2009	2008	2008
	£000's	£000's	£000's	£000's
£ Sterling	+99	(99)	+168	(168)
\$ US	+12	(12)	+32	(32)
Euro	+1	(1)	+1	(1)
Other	Nil	Nil	+1	(1)

## 12. Securitisation

As at 31<sup>st</sup> December 2009, neither BNYH nor any of its subsidiaries had any risk weighted exposure calculated under BIPRU 9 (2008: nil). During the year ended 31<sup>st</sup> December 2009, neither BNYH nor any of its subsidiaries was active as originator or sponsor of any traditional or synthetic securitisation including securitised revolving exposures (2008: nil). As a result, at year end there were no impaired or past due assets previously securitised or associated gains or losses recognised during the year. BNYH and its subsidiaries did not have any investments in third party securitisations on its balance sheet at year end (2008: nil).

## 13. Credit Risk Mitigation

BNYMI's netting policy is designed to reduce large credit exposures to counterparties. Netting refers to the measurement of credit risk arising from on or off balance sheet market-related transactions with a single counterparty on a netted basis. Market-related transactions include foreign exchange contracts. The standard custody agreement in use by BNYMI gives a right of set

off for cash which is applied when calculating capital under Pillar 1. At 31<sup>st</sup> December 2009, the company did not have any third party off balance sheet exposure (2008: nil).

The company does not typically hold collateral to mitigate credit risk exposure in respect of banks. For clients, the standard custody agreement also gives a lien over custody assets including equities, bonds, gilts but this is not applied to reduce capital under Pillar 1.

As at 31<sup>st</sup> December 2009, BNYMI did not apply any financial collateral, third party guarantees, credit derivatives or other collateral as credit risk mitigation within the Pillar 1 calculation (2008: nil).

## 14. Insurance for the purpose of mitigating Operational Risk

This disclosure is not relevant since the group does not use the *advanced measurement approach* for the calculation of an operational risk capital requirement.

## 15. Glossary of terms

The following terms are used in this paper

- **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'.
- **BIPRU:** The FSA's rules, as set out in Prudential Sourcebook for Banks, Building Societies and Investment Firms.
- **CCF:** Credit Conversion Factor
- **CCR:** Counterparty Credit Risk
- **Core equity tier 1 capital:** Tier 1 capital less innovative tier 1 securities and preference shares.
- **CRD:** Capital Requirements Directive
- **Credit quality step:** A step in the FSA credit quality assessment scale which is based on the credit ratings of External Credit Assessment Institutions ('ECAIs'). It is used to assign risk weights under the standardised approach.
- **Credit risk mitigation:** 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.
- **ECAI:** External Credit Assessment Institution, such as Moody's Investors Service, Standard & Poor's Ratings Group or Fitch Group.
- **Equity risk:** The risk arising from positions, either long or short, in equities or equity-based instruments, which create exposure to a change in the market price of the equities or equity instruments
- **Expected loss (EL):** A regulatory calculation of the amount expected to be lost on an exposure using a 12 month time horizon and downturn loss estimates. EL is calculated by multiplying the Probability of Default (a percentage) by the Exposure at Default (an amount) and Loss Given Default (a percentage).
- **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.
- **Fair value:** Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
- **FSA:** The Financial Services Authority of the United Kingdom.
- **IFRS:** International Financial Reporting Standards
- **Institutions:** Under the Standardised approach, Institutions are classified as credit institutions or investment firms.
- **(ICAAP):** **Internal Capital Adequacy Assessment Process** 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.
- **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.
- **Securitisation:** A transaction or scheme whereby the credit risk associated with an exposure, or pool of exposures, is tranching and where payments to investors in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures. A traditional securitisation involves the transfer of the exposures being securitised to an SPE which issues securities. In a synthetic securitisation, the tranching is achieved by the use of credit derivatives and the exposures are not removed from the balance sheet of the originator.
- **Standardised approach:** In relation to credit risk, a method for calculating credit risk capital requirements using ECAI 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.
- **Tier 1 and Tier 1 capital:** Have the meanings given to such terms in the General Prudential Sourcebook (as set out in the FSA's Handbook).
- **Tier 2 capital:** Has the meaning given to this term in the General Prudential Sourcebook (as set out in the FSA's Handbook).
- **Value at risk (VAR):** An estimate of potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence.
- **Wrong-way risk:** Defined by the FSA as a situation where there is an adverse correlation between the counterparty's probability of default and the mark-to-market value of the underlying transaction.

## 16. Contacts

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