



# **Mellon International Holdings S.A.R.L.**

**Basel II Pillar 3 Disclosures**

**For the year ended 31<sup>st</sup> December 2010**

**Published 1st April 2011**

# About Pillar 3 Disclosure

## Alignment of disclosures within UK regulated entities

*The Investment Management Association's Pillar 3 working party, comprised of a number of industry members 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 Investment managers 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 Mellon International Holdings S.A.R.L. and its regulated UK subsidiaries.*

*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 of content.*

*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 be published annually as at the company's 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)). See 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.*

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### **For the year ended 31<sup>st</sup> December 2010**

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# 1. Introduction

These disclosures are about **Mellon International Holdings S.A.R.L. ('MIH')** 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 Mellon International Holdings S.A.R.L. and its subsidiary undertakings (together the 'group').

MIH implemented the Basel II standardised approach for calculating credit and market risk on 1<sup>st</sup> January 2008. The company first made Pillar 3 disclosure for the year ended 31<sup>st</sup> December 2008.

The MIH group builds focused, capacity managed portfolios, offering clients access to an advanced yet transparent investment process through a range of funds. The core components of MIH group's investment philosophy are a combination of: top down investment strategy analysis, rigorous manager evaluation and, detailed ongoing performance monitoring.

The Board of Directors approved publication of these disclosures in March 2011.

Annual Report and Accounts include a range of group risk factors and provides in-depth analysis on the specific risks to which the Group is exposed.

These Pillar 3 disclosures provide additional information over and above the group's Annual Report and Accounts. Specifically, Pillar 3 provides additional information on the minimum capital requirements under Pillar 1, credit risk and market risk exposures. Liquidity risk, which does not form part of the minimum capital requirements, is however discussed herein and in the group's Annual Report and Accounts.

## 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).

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 for Credit risk, Market risk and Fixed Overhead Requirement.
- **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 MIH'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 companies and to make comparison.

Firms are required to disclose all their material risks as part of the Pillar 3 framework. Some of these requirements have already been satisfied within the MIH group's Annual Report and Accounts. The

## 2. Scope and Application of Directive Requirements

MIH is a Luxembourg registered holding company and a wholly owned subsidiary of The Bank of New York Mellon Corporation.

### Principal activities

#### MIH

The Company acts as a holding company for the international asset management operations of The Bank of New York Mellon Corporation, whose principal activity is the provision of a broad range of financial products and services.

### Operating subsidiaries

The principal business activities of the main operating subsidiary undertakings are investment management of pension, charity, institutional client and private client portfolios.

### Investment in joint venture

MIH has a 50% investment in a joint venture with WestLB Mellon Asset Management Holdings Limited, a holding company for the joint venture between The Bank of New York Mellon and WestLB AG. The principal activity of the joint venture is the provision of a broad range of asset management financial products and services.

The MIH group is subject to consolidated supervision by UK Financial Services Authority. MIH's major operating subsidiaries have regulatory permissions to operate as investment advisors and discretionary fund managers. Such *limited licence firms* under Basel II are not authorised to (i) deal on their own account; or (ii) provide investment services such as underwriting or placing financial instruments on a firm commitment basis.

### Significant subsidiaries

MIH consolidates the financial impact of its subsidiaries, associates and joint ventures. MIH has considered the Pillar 3 requirements for disclosure about firms designated as '*significant subsidiaries*' and has concluded that, in the context of these disclosures, the following wholly owned, fully consolidated UK regulated investment management operating entities are in scope:

UK regulated entity
BNYM Asset Management International Limited ( <i>BNYM AMI</i> )
Newton Investment Management Limited ( <i>NIM</i> )
Pareto Investment Management Limited ( <i>PIM</i> )
Insight Investment Management (Global) Limited ( <i>Insight</i> )
Blackfriars Asset Management Limited ( <i>Blackfriars</i> )
Walter Scott & Partners Limited ( <i>WSP</i> )
BNYM Asset Management (UK) Limited ( <i>AM UK</i> )

The capital and exposures of all subsidiary undertakings, associates and Joint venture are included in these Pillar 3 disclosures. Capital data about the significant subsidiaries reported in this paper does not aggregate to the overall group position.

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 where Capital resources were less than the required minimum in any subsidiary undertakings not included in the consolidation.

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

## 3. Risk Management Objectives and Policies

### 3.1 Risk Management Framework

In 2010, following a region-wide review of the EMEA risk management process, an integrated *Enterprise Risk Management Framework* was introduced that is consistent with the developing regional regulatory environment.

The main focus of the ERM framework is consistency of Management Information reporting, development of Risk Appetite methodology, and strengthening of capital adequacy processes and ICAAP standards. As a result, a streamlined risk management structure was introduced with three distinct components: Risk Oversight, Risk management hierarchy, and Risk and capital reporting.

The firm and its subsidiaries already have a strong embedded risk management culture which satisfies the needs of the new ERM framework.

#### 3.1.1 Risk Oversight

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 MIH to ensure that an appropriate level of risk management is directed at each element of the business.

The regulated firm Boards have primary and ultimate responsibility for both the management and the oversight of risks together with the quality and effectiveness of risk management, compliance and regulatory frameworks. Each BOD meets at least quarterly and considers reports and issues escalated by the delegated groups and committees.

The Boards are supported by executive and management committees. Each regulated firm has its own risk committee, which usually takes the form of a Business Risk committee or Risk & Compliance committee.

These committees meet regularly, at least quarterly, and are attended by senior staff from Legal, IT, Risk and Audit. In addition, depending on size and business activity, some regulated firms have senior management, investment, credit and other committees. The risk management process operates at a legal entity level, globally at a line of business level and regionally through the EMEA regional committee structure.

#### 3.1.2 Risk Appetite

##### BNY Mellon group

The BNY Mellon Group Board of Directors define risk appetite as '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.'

This message was re-enforced in 2010 by the Group Chairman and CEO with the issuance of the following statement:

*"Given the critical role that BNY Mellon plays in supporting our clients and providing infrastructure for the global capital markets, our financial stability throughout market cycles is essential. Clients and market participants need to be able to have confidence that we will remain strong and continue to deliver uninterrupted service, globally. Consistent with that imperative, we focus on maintaining a "fortress" balance sheet. Consequently, we assume less risk than most financial service companies. Our primary risk is operational, consistent with our business model as a leading provider of asset management and Securities services."*

All BNY subsidiaries have a responsibility through their respective boards to articulate and communicate a clear set of metrics that define its risk appetite. Each firm produces a risk appetite statement and supporting tolerance metrics that are appropriate for the business. All risk appetite and tolerance limits are monitored, measured and used to manage risk within the business.

##### MIH & subsidiary firms

Consistent with the Company approach, the risk appetite of MIH and its' regulated subsidiary firms is a definition of the types and quantum of risks to which the group wishes to be exposed in executing its business strategy. Defining risk appetite is a central factor in an integrated approach to risk, capital and business management thereby enabling the group to achieve its objectives. Risk appetite definition is a key element of the Basel II supervisory review framework.

In setting its' risk appetite, MIH and its' regulated subsidiary firms consider the risk capacity, financial position, the strength of core earnings and the resilience of the firms reputation and brand. Risk appetite is expressed both qualitatively, describing which risks are taken and why, and quantitatively.

In defining risk appetite, firm senior management attach specific qualitative and quantitative measures and metrics to individual risks to ensure that:

- business activity is controlled so it continues to be aligned to the risk appetite framework;
- key assumptions underpinning risk appetite are monitored and, as necessary, adjusted through subsequent business planning cycles; and
- business decisions necessary to mitigate risk are identified and are acted upon promptly.

On a regular basis, each firm's risk exposures are measured by the BOD against the defined risk appetite.

The principal risks to which MIH and its subsidiaries are exposed are described hereafter.

### 3.1.3 Business Risk

MIH's main *business risk* drivers are: key man risk, a prolonged bear market and persistent poor performance of managed funds. The MIH Board accepts these risks as a necessary feature of its operating model and has set its' risk appetite accordingly.

Business risk is defined as the risk of loss caused by unexpected changes in the external macro environment, client behaviour or events that impact earnings, including contracting markets, reduced margins from competitive pressure, adverse customer selection and business concentration.

The wide diversity of investment strategies managed by BNY Mellon help mitigate the impact of a prolonged bear market as capital flight from equities is often offset by increases in assets under management in cash, fixed income and alternative investment strategies. Close oversight and monitoring of investment performance means that any persistent underperformance is carefully analysed and remedial action taken wherever necessary.

#### Key man risk

BNY Mellon accords strategic importance to attracting and retaining the best talent. The group (including MIH and all of its subsidiaries) seeks to achieve this by being a '*best in class*' provider of services to its clients. Firm's provide all staff with personal training and development opportunities and market -competitive compensation packages. The Group prides itself on being an equal opportunities employer that values diversity in the workforce. The combination of these efforts results in a low turnover and a high degree of employee continuity. Firm's regularly review succession planning and maintain a depth of skills to protect against unexpected departures.

### 3.1.4 Credit Risk

Credit Risk is the risk of default from counterparties or clients with respect to payment of fees or realisation of other assets.

For MIH and its subsidiaries, credit risk exposure is relatively low, considering that a majority of assets are either cash deposits or outstanding fees from institutional clients of the underlying Asset Management entities.

### 3.1.5 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 level of residual operational risk is managed by rigorous operating policies, procedures and controls set by BNYMC and implemented by Sector Risk Management.

MIH business managers are responsible for risk control self assessment, which includes identification of the risks associated with key business processes, identifying and measuring the effectiveness of controls in place to manage risk and for remediation of any gaps or weakness.

The Sector Risk Manager oversees the output and recording of this assessment with support and approval of Senior Management.

### 3.1.6 Liquidity Risk

BNYM defines liquidity as its access to funding and ability to convert assets to cash quickly and efficiently, especially during periods of market stress. Liquidity risk is the risk that the firm cannot meet its cash and collateral obligations at a reasonable cost for both expected and unexpected cash flow and collateral needs without adversely affecting daily operations or financial conditions.

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.

As regards 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.

#### **MIH S.A.R.L.**

MIH is a holding company for several investment management subsidiaries. It does not carry out any trading activities. To make new acquisitions, MIH may raise funds from BNYM group on a match funded basis through debt, equity or a mix of sources or, utilise existing resources.

#### **MIH Regulated subsidiaries**

Individual regulated subsidiaries of MIH 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.

Under devolved authority from MIH, each UK regulated subsidiary is self sufficient in terms of liquidity resources and funding. In outline, MIH limited licence investment management subsidiaries have an appetite for liquidity risk that is consistent with the limited business model. Typically, firms receive investment management and performance fees, pay out overheads and other expenses and hold surplus cash balances at short notice with group companies and third party banks. Firms do not hold client cash on their balance sheet, have no retail deposits and do not make loans to clients. Firms do not have any off balance sheet or derivatives exposures. Sources of liquidity *risk* are mostly inter group and franchise viability related.

#### *Regulatory Changes*

The FSA issued its policy document on '*strengthening liquidity standards*' ((PS 09/16 and BIPRU 12) on 5th October 2009 detailing the requirements for liquidity governance to be in place by 1<sup>st</sup> December 2009. This is the most comprehensive liquidity regime imposed by any regulator globally, requiring additional evidential reporting to demonstrate adherence to new qualitative requirements.

In summary, FSA BIPRU 12 Systems and Control requirements oblige the firm's governing body (i.e. Board of Directors) to express and check conformity with the firm's liquidity risk appetite. The outputs of the firm's Stress testing inform the BOD's decisions on whether the firm's liquidity risk appetite should be amended and form the basis of a Contingency Funding Plan.

In meeting these new requirements, all MIH Regulated Limited Licence (non-ILAS) subsidiaries comply with EMEA's *Liquidity Risk Management Framework & Operating Model* which sets out the principles, elements, components and standards for liquidity risk management. This Operating Model is customised to fit local circumstances and is proportionate to and reflective of individual firms' business models. In overview, each firm has:

- A regime of firm BOD oversight and governance (including defining risk strategy, setting risk appetite and limits) and tracking performance. Each firm's liquidity risk appetite and tolerance (limits) are consistent with and proportionate to its' limited-scope business model.
- A firm Liquidity Policy & Contingency Funding Plan that conforms with Group requirements.
- Regular reporting to senior management of contractual Mismatch Cash flow data under normal conditions across a 12 month time horizon plus firm-specific liquidity ratios and metrics including an assessment of the firms likely survival period.
- Firm bespoke Stress testing with results reported to the BOD, parent and sector management.
- External reporting to regulators (commencing in January 2011 with submission of an annual FSA Systems & Controls Questionnaire).

#### **Concentration risk**

On a day to day basis, each regulated subsidiary holds a minimum cash balance equivalent to *two times* Fixed Overhead Requirements with a reputable financial institution outside of the BNY Mellon Corporation which amount is considered sufficient to enable the firm to meet its contractual obligations in stress scenarios

At 31<sup>st</sup> December 2010, MIH regulated subsidiaries generally had a strong liquidity base. These firms do not have any collateral positions to manage, nor is it necessary for them to actively manage liquidity across legal entities, business lines or currencies.

### **3.1.7 Group (and franchise) risk**

Group risk is the risk that the financial position of a firm may be adversely affected by its relationships (financial or non-financial) with other entities in the same group or by risks which may affect the financial position of the whole group, for example reputational contagion or parent default which might effect the firm's franchise and ability to do business.

For MIH, Group risk includes business leadership, certain IT systems and support services plus availability of funds held with group companies.

### **3.1.8 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, MIH 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 MIH 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.

### **3.1.9 Strategic Risk**

Strategic risk is defined as the risk of direct or indirect loss arising from the adverse effects or the improper implementation of business decisions. Business Risk and Reputation risk faced by MIH also fall under strategic risk.

### **3.1.10 Reputation Risk**

Reputation risk covers the risk to the bank's brand and relationships which might arise from any given exposure or event.

### **3.1.11 Fiduciary Risk**

Fiduciary risk is the risk arising from not serving in the best interests of clients as trustee, executor, investment agent or guardian in accordance with governing documents, "prudent person" principles and applicable laws, rules and regulations. Fiduciary risk is directly impacted by the management of other risk factors such as Market, Compliance and Transaction risk.

## 3.2 Scope and Nature of Risk Reporting Systems

All of MIH group's activities are included in Basel II capital reporting (using credit and market risk Standardised approach). Operational Risk data is captured on an internally developed risk management platform.

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. Risk systems development is a key responsibility of group IT while the operation and development of risk rating and management systems and processes are subject to oversight by various levels of management up to the Board of Directors.

The measurement and monitoring of the major risks encountered by the company including operational risks, are increasingly delivered by a central platform or, where for sound business reasons this is not the case, through structures and processes that support comprehensive oversight by senior management.

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 that are in place to govern and manage the business are common to all BNY Mellon entities. Suitable policies and procedures have been adopted by MIH to ensure that an

appropriate level of risk management is directed at each element of the business. On an ongoing basis, MIH management seeks to improve the effectiveness of the governance process through upgrade of policies and risk management procedures.

The MIH 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 region there is a further EMEA Risk Management oversight layer whose responsibilities include ensuring that Line of Business implement policies and procedures on a consistent basis.

The MIH 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 others the implementation of corporate risk policies and processes that identify risk.

The MIH 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 2010, the MIH group and individual entities within the group complied with all of the externally imposed capital requirements to which they were subject.

The table below summarises the composition of regulatory capital for the MIH group and significant subsidiary companies as reported to the FSA as at

31<sup>st</sup> December 2010. The group did not have any Innovative Tier 1 capital resources, Tier 2 or Tier 3 capital as at 31<sup>st</sup> December 2010 (2009: nil).

Capital data about the firms designated as 'significant subsidiaries' disclosed in this paper does not aggregate to the overall group position.

### 4.1 Regulatory Capital for MIH group and regulated UK subsidiaries

As at 31<sup>st</sup> December 2010

Capital resources (unaudited) As at 31 <sup>st</sup> December	MIH group (consolidated)	Significant subsidiaries (UK regulated)						
		BNYM AMI	NIM	PIM	Insight	Blackfriars	WSP	AM UK
	£000s	£000s	£000s	£000s	£000s	£000s	£000s	£000s
<b>Tier 1 capital</b>								
Called up share capital	234,691	31,300	35,500	7,943	36,000	46,000	25	3,750
Share premium account	1,175,111			16,411	1	12,432		
Retained earnings and other reserves	295,187	47,967	79,172	27,976	14,864	-41,341	51,500	4,421
Unaudited net profits (1)						-2,693		-1,671
<b>Total Tier 1 capital (T1)</b>	<b>1,704,989</b>	<b>79,267</b>	<b>114,672</b>	<b>52,330</b>	<b>50,865</b>	<b>14,398</b>	<b>51,525</b>	<b>6,500</b>
<b>Deductions from Tier 1 capital</b>								
Intangible assets (2)	-1,066,794		-4,668					
<b>Total Tier 1 capital after deductions (T1)</b>	<b>638,195</b>	<b>79,267</b>	<b>110,004</b>	<b>52,330</b>	<b>50,865</b>	<b>14,398</b>	<b>51,525</b>	<b>6,500</b>
<b>Deduction from total of Tier 1 capital</b>								
Material Holdings (3)	-78,084	-10,611		-131				
Illiquid assets								
<b>Total Capital Resources (TCR)</b>	<b>560,111</b>	<b>68,656</b>	<b>110,004</b>	<b>52,199</b>	<b>50,865</b>	<b>14,398</b>	<b>51,525</b>	<b>6,500</b>

1. Unaudited Profits are not reported to the FSA as part of Tier1 capital.  
As of the date of this report, 2010 profits have not been audited and are therefore excluded from capital.  
Forecast losses are however included as a deduction from Tier 1 capital.
2. Group Intangible assets comprise mostly goodwill.
3. Group Material holdings are in respect of a 50% investment in WestLB Mellon Asset Management Holdings Ltd.
4. Information about Capital terms and conditions is set out in the Company's Annual report & Accounts.
5. Other Non-UK regulated subsidiaries include BNYM AMI Japan with total capital of £54.7 million

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

Capital resources (unaudited) As at 31 <sup>st</sup> December	MIH group (consolidated)	Significant subsidiaries (UK regulated)						
		BNYM AMI	NIM	PIM	Insight	Blackfriars	WSP	AM UK
	£000s	£000s	£000s	£000s	£000s	£000s	£000s	£000s
<b>Tier 1 capital</b>								
Called up share capital	70	31,300	35,553	7,643	36,000	37,000	25	3,750
Share premium account	1,402,730			15,792	1	12,431		
Retained earnings and other reserves	245,785	45,259	111,372	32,143	9,189	-34,962	52,670	4,623
Unaudited net profits (1)			-33,921	-5,222		-6,721		
<b>Total Tier 1 capital (T1)</b>	<b>1,648,585</b>	<b>76,559</b>	<b>113,004</b>	<b>50,356</b>	<b>45,190</b>	<b>7,748</b>	<b>52,695</b>	<b>8,373</b>
<b>Deductions from Tier 1 capital</b>								
Intangible assets (2)	-1,068,597		-6,671					
<b>Total Tier 1 capital after deductions (T1)</b>	<b>579,988</b>	<b>76,559</b>	<b>106,333</b>	<b>50,356</b>	<b>45,190</b>	<b>7,748</b>	<b>52,695</b>	<b>8,373</b>
<b>Deduction from total of Tier 1 capital</b>								
Material Holdings (3)	-87,253	-1,181		-126				
Illiquid assets							-3,773	
<b>Total Capital Resources (TCR)</b>	<b>492,735</b>	<b>75,378</b>	<b>106,333</b>	<b>50,230</b>	<b>45,190</b>	<b>7,748</b>	<b>48,922</b>	<b>8,373</b>

1. As previously reported, unaudited Profits are not reported to the FSA as part of Tier 1 capital. This table has not subsequently been restated.
2. Group Intangible assets comprise mostly goodwill.
3. Group Material holdings are in respect of a 50% investment in WestLB Mellon Asset Management Holdings Ltd.
4. Information about Capital terms and conditions is set out in the Company's Annual report & Accounts.
5. Non-UK regulated subsidiaries include BNYM AMI Japan with total capital of £40 million.

## 5. Capital Requirements and Adequacy

### 5.1 Overview

BNYM 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 MIH Board, 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 MIH, the 2010 Pillar 2 Internal Capital Adequacy Assessment Process (ICAAP) 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.

## 5.2 Capital Requirements and Adequacy

The following table shows the MIH group and significant subsidiary company's capital requirements by exposure class and capital adequacy surplus as at 31<sup>st</sup> December 2010.

### 5.2.1 Capital requirements by exposure class and capital adequacy surplus

As at 31<sup>st</sup> December 2010

Capital resources (unaudited) As at 31 <sup>st</sup> December	MIH group (consolidated)	Significant subsidiaries (UK regulated)						
		BNYM AMI	NIM	PIM	Insight	Blackfriars	WSP	AM UK
	£000s	£000s	£000s	£000s	£000s	£000s	£000s	
<b>Credit risk – standardised approach</b>								
Institutions	8,586	1,265	2,984	849	431	265	2,123	83
Corporates	11,033	1,011	687	216	513	1	0	54
Other items (1)	30,872	804	2,409	819	3,009	137	3,308	59
<b>Total Credit Risk -1</b>	<b>50,491</b>	<b>3,080</b>	<b>6,080</b>	<b>1,884</b>	<b>3,953</b>	<b>403</b>	<b>5,431</b>	<b>196</b>
<b>Market risk (2)</b>								
Foreign currency Position Risk requirement -2	1,505	716	135	75	219	13	1,081	63
<b>Total Credit &amp; Market risk requirements 1+2</b>	<b>51,996</b>	<b>3,796</b>	<b>6,215</b>	<b>1,959</b>	<b>4,172</b>	<b>416</b>	<b>6,512</b>	<b>259</b>
<b>Fixed Overhead Requirement (3)</b>	<b>86,727</b>	<b>11,063</b>	<b>18,154</b>	<b>3,289</b>	<b>13,322</b>	<b>1,975</b>	<b>3,858</b>	<b>520</b>
<b>Total Pillar 1 Capital requirement (TP1) (3)</b>	<b>138,723</b>	<b>11,063</b>	<b>18,154</b>	<b>3,289</b>	<b>13,322</b>	<b>1,975</b>	<b>6,512</b>	<b>520</b>
<b>Capital surplus (TCR-TP1)</b>	<b>421,388</b>	<b>57,593</b>	<b>91,850</b>	<b>48,910</b>	<b>37,543</b>	<b>12,423</b>	<b>45,013</b>	<b>5,980</b>
<b>Solvency ratio</b>								
<b>Total Capital Resources (TCR) / Total Pillar 1 Capital requirements (TP1)</b>	<b>403.7%</b>	<b>620.6%</b>	<b>605.9%</b>	<b>1587.0%</b>	<b>381.8%</b>	<b>729.0%</b>	<b>791.2%</b>	<b>1250.0%</b>

1. Other items credit risk Capital requirements is predominantly in respect of Trade and other debtors, interest and accounts receivable, prepayments and includes a capital charge for 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.
3. For individual firms, the minimum Total Pillar 1 Capital Requirement (TP1) is established with reference to the Credit, Market and Fixed Overhead requirements under Pillar 1 rules for limited licence groups in the UK. The firm's Fixed Overhead Requirement is calculated as 25% of its annual expenditure. The Total Pillar 1 Capital Requirement for individual subsidiary firms is the *higher of* Credit plus Market risk or FOR. For the MIH consolidated group, the Total Pillar 1 Capital Requirement is the *sum of* Credit plus Market risk requirements *plus* FOR.

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

Capital resources (unaudited) As at 31 <sup>st</sup> December	MIH group (consolidated)	Significant subsidiaries (UK regulated)						
		BNYM AMI	NIM	PIM	Insight	Blackfriars	WSP	AM UK
	£000s	£000s	£000s	£000s	£000s	£000s	£000s	£000s
<b>Credit risk – standardised approach</b>								
Institutions	8621	1,276	2,108	595	346	163	791	165
Corporates	5,053	915	495	258	287	0	759	27
Other items (1)	17,277	563	2,489	722	2,873	67	2,158	17
<b>Total Credit Risk -1</b>	<b>30,951</b>	<b>2,754</b>	<b>5,092</b>	<b>1,575</b>	<b>3,506</b>	<b>230</b>	<b>3,708</b>	<b>209</b>
<b>Market risk (2)</b>								
Foreign currency Position Risk requirement -2	4,887	1,657	276	37	173	124	0	57
<b>Total Credit &amp; Market risk requirements 1+2</b>	<b>35,838</b>	<b>4,411</b>	<b>5,368</b>	<b>1,612</b>	<b>3,679</b>	<b>354</b>	<b>3,708</b>	<b>266</b>
Fixed Overhead Requirement (3)	57,689	13,102	17,879	3,589	23,161	2,213	1,472	484
<b>Total Pillar 1 Capital requirement (TP1) (3)</b>	<b>93,527</b>	<b>13,102</b>	<b>17,879</b>	<b>3,589</b>	<b>23,161</b>	<b>2,213</b>	<b>3,708</b>	<b>484</b>
Capital surplus (TCR-TP1)	399,209	62,276	88,454	46,640	22,029	5,535	45,214	7,889
<b>Solvency ratio</b>								
<b>Total Capital Resources (TCR) / Total Pillar 1 Capital requirements (TP1)</b>	<b>526.8%</b>	<b>575.3%</b>	<b>594.7%</b>	<b>1399.5%</b>	<b>195.1%</b>	<b>350.1%</b>	<b>1319.3%</b>	<b>1729.9%</b>

1. Other items credit risk Capital requirements is predominantly in respect of Trade and other debtors, interest and accounts receivable, prepayments and includes a capital charge for 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.
3. For individual firms, the minimum Total Pillar 1 Capital Requirement (TP1) is established with reference to the Credit, Market and Fixed Overhead requirements under Pillar 1 rules for limited licence groups in the UK. The firm's Fixed Overhead Requirement is calculated as 25% of its annual expenditure. The Total Pillar 1 Capital Requirement for individual subsidiary firms is the *higher of* Credit plus Market risk *or* FOR. For the MIH consolidated group, the Total Pillar 1 Capital Requirement is the *sum of* Credit plus Market risk requirements *plus* FOR.

### 5.3 Retail and Equity exposures

The MIH group had no retail or material equity exposures as at 31<sup>st</sup> December 2010 (2009: 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 2010, MIH and its subsidiaries did not have a Trading book and did not have any derivatives in its' Banking book (2009: nil). As such, no further disclosure is required.

## 7. Credit Risk

Credit Risk for MIH is calculated using 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, the MIH group uses the external credit assessments of recognised credit rating agencies (i.e. Moody's, Standard & Poor's and Fitch, where appropriate).

### Classifications

The following classifications are generally used:

- *Institutions* exposure comprises cash at bank and in hand
- *Corporates* exposure comprises seed-money investments in various funds and intercompany assets. Seed money investments are reported as Corporate exposures (quoted investments carried as current assets on balance sheet at fair value with change in value reported in P&L) and not as non-trading book exposures in equities.
- *Other items* principally comprises trade and other debtors, interest and accounts receivable and prepayments

### 7.1 Risk management

For Investment Management companies in the MIH group, credit risk principally covers default risk from counterparties or clients for any asset where realisation of the value of the asset is dependent on counterparties ability to perform e.g. fees and interest receivable. Operational risk around collectability is managed within each company through rigorous operating policies, procedures and controls with emphasis on timely identification and follow up of *at risk* assets.

### 7.2 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 eg 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.

## 7.3 Credit Exposures

The following credit risk disclosures (i-iv) are about **MIH group (unaudited)**.

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

Standardised exposure classes At 31 <sup>st</sup> December Unaudited	Notes	MIH EAD pre CRM	MIH Average EAD pre CRM	MIH EAD pre CRM	MIH Average EAD pre CRM
		2010		2009	
		£000s	£000s	£000s	£000s
Institutions	2	536,876	540,961	538,506	472,046
Corporates	3	137,918	111,481	63,392	58,411
Other items	4	369,868	319,049	188,950	165,728
<b>Total</b>		<b>1,044,662</b>	<b>971,491</b>	<b>790,848</b>	<b>696,185</b>

1. Standardised exposure classes are defined by FSA in BIPRU 3.
2. Institutions exposure comprises cash at bank and in hand.
3. Corporates exposure comprises seed-money investments of £56 million in various funds (2009: £50million) and intercompany assets of £81 million (2009 £13 million). Seed money investments are reported as Corporate exposures (quoted investments carried as current assets on balance sheet at fair value with change in value reported in P&L) and not as non-trading book exposures in equities.
4. Other items principally comprises trade and other debtors, interest and accounts receivable and prepayments.
5. Average exposure is based on the last two quarters of each year.

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

As at 31<sup>st</sup> December 2010

Standardised exposure classes Unaudited	UK	Europe, Middle East & Africa	North America	Asia Pacific	MIH Total
	£000s	£000s	£000s	£000s	£000s
Institutions	502,275	25,823		8,778	536,876
Corporates	104,926	7,928	15,110	9,954	137,918
Other items	307,701	14,717	20,319	27,131	369,868
<b>Total</b>	<b>914,902</b>	<b>48,468</b>	<b>35,429</b>	<b>45,862</b>	<b>1,044,662</b>

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

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

Standardised exposure classes Unaudited	UK	Europe, Middle East & Africa	North America	Asia Pacific	MIH Total
	£000s	£000s	£000s	£000s	£000s
Institutions	475,566	27,292	8	35,640	538,506
Corporates	38,940	6,337	8,198	9,917	63,392
Other items	126,296	24,521	19,888	18,245	188,950
<b>Total</b>	<b>640,802</b>	<b>58,150</b>	<b>28,094</b>	<b>63,802</b>	<b>790,848</b>

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 2010

Industry sector Unaudited	Institutions	Corporates	Other items	MIH Total
	£000s	£000s	£000s	£000s
Banks & Other financial	536,876	137,918	369,868	1,044,662
<b>Total</b>	<b>536,876</b>	<b>137,918</b>	<b>369,868</b>	<b>1,044,662</b>

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

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

Industry sector Unaudited	Institutions	Corporates	Other items	MIH Total
	£000s	£000s	£000s	£000s
Banks & Other financial	538,506	63,392	188,950	790,848
<b>Total</b>	<b>538,506</b>	<b>63,392</b>	<b>188,950</b>	<b>790,848</b>

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 2010

Standardised exposure classes Unaudited	On demand	Up to 1 year ex on demand	MIH Total
	£000s	£000s	£000s
Institutions	536,876		536,876
Corporates	137,918		137,918
Other items		369,868	369,868
<b>Total</b>	<b>674,793</b>	<b>369,868</b>	<b>1,044,662</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 2009

Standardised exposure classes Unaudited	On demand	Up to 1 year ex on demand	MIH Total
	£000s	£000s	£000s
Institutions	538,506		538,506
Corporates	63,392		63,392
Other items		188,950	188,950
<b>Total</b>	<b>601,898</b>	<b>188,950</b>	<b>790,848</b>

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

## 7.4 Impaired and Past due assets and Provisions

MIH group does not make loans or advances to clients in the normal course of business.

### Impairment of loans and advances

As at 31<sup>st</sup> December 2010, MIH group had no significant impaired assets for which a provision had been raised (2009: Nil). There were no *Assets Past Due greater than 90 days*. MIH group 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 2010 (2009: nil).

### Provisions for liabilities and charges

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation as a result of past events, and a reliable estimate can be made of the amount of the obligation.

As at 31<sup>st</sup> December 2010, MIH group had no significant provisions for liabilities and charges (2009: Nil).

## 7.5 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

The following disclosures (i & ii) about MIH group are presented for the most significant exposure classes and reflect exposure value pre and post CRM associated with each credit quality step prescribed in BIPRU 3.

#### i. Institutions

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

Credit Quality Step	Risk weight	MIH EAD pre CRM	MIH EAD post CRM	MIH EAD pre CRM	MIH EAD post CRM
		2010		2009	
	%	£000s	£000s	£000s	£000s
1	20%	536,876	536,876	479,945	479,945
2	50%	0	0	58,560	58,560
<b>Total</b>		<b>536,876</b>	<b>536,876</b>	<b>538,506</b>	<b>538,506</b>

#### ii. Corporates

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

Credit Quality Step	Risk weight	MIH EAD pre CRM	MIH EAD post CRM	MIH EAD pre CRM	MIH EAD post CRM
		2010		2009	
	%	£000s	£000s	£000s	£000s
Unrated	100%	137,918	137,918	63,392	63,392
<b>Total</b>		<b>137,918</b>	<b>137,918</b>	<b>63,392</b>	<b>63,392</b>

Corporates exposure comprises seed-money investments of £56 million in various funds (2009: £50 million) and intercompany assets of £81 million (2009: £13 million). Seed money investments are reported as Corporate exposures (quoted investments carried as current assets on balance sheet at fair value with change in value reported in P&L) and not as non-trading book exposures in equities.

### 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-

## 8. Market Risk

Market Risk is the risk to a firm's financial condition arising as a result of adverse movements in markets, foreign currency exchange rates, interest rates and equity and commodity prices.

None of the regulated firms runs a proprietary trading position or has licence to trade on its own account or to underwrite issues of financial instruments on a firm commitment basis. As such, the group does not have market risk exposure except for Foreign currency exposure arising from day to day activities (2009: nil).

## 9. Operational Risk

There is no regulatory capital requirement for operational risk due to MIH group being represented solely by BIPRU limited licence firms with a fixed overhead capital requirement

The BNYMC group has set extensive Operational risk policies that have been adopted by the operating entities within the MIH 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 risk, monitor key risk indicators and to 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. MIH and its subsidiaries operate within the Asset Management 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 2010, neither MIH nor any of its subsidiaries had any equity exposure in the non-trading book (2009: nil). Seed money investments are reported as Corporate exposures (quoted investments carried as current assets on balance sheet at fair value with change in value reported in P&L) and not as non-trading book exposures in equities.

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

The group principally comprises Asset Management companies which do not run banking books for exposure management purposes and as such, interest rate risk is not a significant risk for the group as a whole or individual firms.

## 12. Securitisation

As at 31<sup>st</sup> December 2010, neither MIH nor any of its subsidiaries had any risk weighted exposure calculated under BIPRU 9 (2009: nil). During the year ended 31<sup>st</sup> December 2010, neither MIH nor any of its subsidiaries was active as originator or sponsor of any traditional or synthetic securitisation including securitised revolving exposures (2009: 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 (2009: nil). Neither MIH nor any of its subsidiaries had any investments in third party securitisations on its balance sheet at year end (2009: nil).

## 13. Credit Risk Mitigation

As at 31<sup>st</sup> December 2010, the group did not apply any financial collateral, third party guarantees, credit derivatives or other collateral as credit risk mitigation within the Pillar 1 calculation (2009: nil).

## 14. Remuneration

The FSA issued Policy Statement PS10/21 '*Implementing CRD3 requirements on the disclosure of remuneration*' in December 2010. Remuneration disclosure requirements came into effect on 1<sup>st</sup> January 2011 in line with the deadline imposed by CRD3. The FSA has set a deadline of 31<sup>st</sup> December 2011 for firms to make their first disclosure under the new provisions. Amendment has been made to FSA BIPRU 11 to expand the disclosure requirements to include remuneration

In this matter, the Firm BOD is considering options for making disclosure and is taking steps to meet the FSA timetable.

## 15. 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.

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## 16. Glossary of terms

The following terms are used in this paper

- **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 (ICAAP) is 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.
- **Limited licence firms:** Limited licence firms under Basel II are not authorised to (i) deal on their own account; or (ii) provide investment services such as underwriting or placing financial instruments on a firm commitment basis.
- **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).

## 17. Contacts

For further information about any matters contained in this report please contact:

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