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in 2011. This charge was comprised of \$78 million of severance costs and \$29 million primarily for operating lease-related items and consulting costs. In 2012, we recorded a net recovery of \$2 million associated with the operational excellence initiatives. The net recovery in 2012 reflects additional severance charges and a lease restructuring, which were more than offset by a gain on the sale of a property. The following table presents the activity in the restructuring reserve related to the operational excellence initiatives through Dec. 31, 2012.

<b>Operational excellence initiatives 2011 – restructuring reserve activity</b>			
<i>(in millions)</i>	Severance	Other	Total
Original restructuring charge	\$ 78	\$ 29	\$107
Utilization	(4)	(29)	(33)
Balance at Dec. 31, 2011	74	-	74
Net additional charges (net recovery/gain)	55	(57)	(2)
Utilization	(37)	57	20
Balance at Dec. 31, 2012	\$ 92	\$ -	\$ 92

The table below presents the restructuring charge if it had been allocated by business.

<b>Operational excellence initiatives 2011 – restructuring charge (recovery) by business</b>			
<i>(in millions)</i>	2012	2011	Total charges since inception
Investment Management	\$ 31	\$ 17	\$ 48
Investment Services	19	41	60
Other segment (including Business Partners)	(52)	49	(3)
Total restructuring charge (recovery)	\$ (2)	\$107	\$105

### Global location strategy

The 2009 global location strategy focused on migrating positions to our global growth centers. In 2012, we recorded a recovery of \$12 million associated with the global location strategy. The global location strategy program was substantially complete at Dec. 31, 2012.

The following table presents the activity in the restructuring reserve related to the global location strategy through Dec. 31, 2012.

<b>Global location strategy 2009 – restructuring reserve activity</b>			
<i>(in millions)</i>	Severance	Asset write-offs/ other	Total
Original restructuring charge	\$102	\$ 37	\$139
Additional charges	29	6	35
Utilization	(50)	(24)	(74)
Balance at Dec. 31, 2010	81	19	100
Net (recovery)	(15)	-	(15)
Utilization	(39)	(8)	(47)
Balance at Dec. 31, 2011	27	11	38
Net (recovery)	(12)	-	(12)
Utilization	(14)	-	(14)
Balance at Dec. 31, 2012	\$ 1	\$ 11	\$ 12

The table below presents the restructuring charge if it had been allocated by business.

<b>Global location strategy 2009 – restructuring charge (recovery) by business</b>				
<i>(in millions)</i>	2012	2011	2010	Total charges since inception
Investment Management	\$ (1)	\$ -	\$15	\$ 54
Investment Services	(12)	(18)	26	64
Other segment (including Business Partners)	1	3	(6)	29
Total restructuring charge (recovery)	\$ (12)	\$ (15)	\$35	\$147

## Note 13—Income taxes

<b>Provision (benefit) for income taxes</b>			
<i>(in millions)</i>	Year ended Dec. 31,		
	2012	2011	2010 (a)
Current taxes (benefits):			
Federal	\$271	\$ 691	\$ (670)
Foreign	236	317	408
State and local	20	28	110
Total current tax expense (benefit)	527	1,036	(152)
Deferred tax expense (benefit):			
Federal	130	(34)	1,278
Foreign	39	(16)	(75)
State and local	83	62	(4)
Total deferred tax expense	252	12	1,199
Provision for income taxes	\$779	\$1,048	\$1,047

(a) Based on continuing operations for 2010.

The components of income before taxes are as follows:

<b>Components of income before taxes</b>			
<i>(in millions)</i>	Year ended Dec. 31,		
	2012	2011	2010 (a)
Domestic	\$1,962	\$2,336	\$2,363
Foreign	1,340	1,281	1,331
Income before taxes	\$3,302	\$3,617	\$3,694

(a) Based on continuing operations for 2010.



## Notes to Consolidated Financial Statements (continued)

The components of our net deferred tax liability are as follows:

Net deferred tax liability (in millions)	Dec. 31,	
	2012	2011
Depreciation and amortization	\$2,672	\$2,599
Lease financings	932	1,040
Pension obligation	45	(49)
Reserves not deducted for tax	(397)	(401)
Credit losses on loans	(230)	(290)
Net operating loss carryover	(105)	(126)
Employee benefits	(570)	(544)
Equity investments	256	238
Securities valuation	545	(15)
Other assets	(128)	(193)
Other liabilities	353	297
Net deferred tax liability	\$3,373	\$2,556

As of Dec. 31, 2012, we have net operating loss carryforwards for state and local income tax purposes of \$915 million which will expire in 2029. We have a German net operating loss carryforward of \$198 million with an indefinite life. We have not recorded a valuation allowance because we expect to realize our deferred tax assets including these carryovers.

As of Dec. 31, 2012, we had approximately \$4.3 billion of earnings attributable to foreign subsidiaries that have been permanently reinvested abroad and for which no incremental U.S. income tax provision has been recorded. If these earnings were to be repatriated, the estimated U.S. tax liability as of Dec. 31, 2012 would be up to \$930 million. Management has no intention of repatriating these earnings to the U.S. in the foreseeable future.

The following table presents a reconciliation of the statutory federal income tax rate to our effective income tax rate.

Effective tax rate	Year ended Dec. 31,		
	2012	2011	2010
Federal rate	35.0%	35.0%	35.0%
State and local income taxes, net of federal income tax benefit	2.1	1.6	2.4
Tax credits	(4.8)	(2.1)	(1.8)
Tax-exempt income	(3.2)	(2.6)	(2.3)
Foreign operations	(5.0)	(3.2)	(5.2)
Other – net	(0.5)	0.3	0.2
Effective rate	23.6%	29.0%	28.3%

Unrecognized tax positions (in millions)	2012	2011	2010
Beginning balance at Jan. 1, –gross	\$250	\$290	\$ 335
Prior period tax positions:			
Increases	163	24	98
Decreases	(66)	(13)	(60)
Current period tax positions	21	16	41
Settlements	(28)	(64)	(119)
Statute expiration	-	(3)	(5)
Ending balance at Dec. 31, – gross	\$340	\$250	\$ 290

Our total tax reserves as of Dec. 31, 2012 were \$340 million compared with \$250 million at Dec. 31, 2011. If these tax reserves were unnecessary, \$340 million would affect the effective tax rate in future periods. We recognize accrued interest and penalties, if applicable, related to income taxes in income tax expense. Included in the balance sheet at Dec. 31, 2012 is accrued interest, where applicable, of \$35 million. The additional tax expense related to interest for the year ended Dec. 31, 2012 was \$11 million compared with \$31 million for the year ended Dec. 31, 2011.

As previously disclosed, on Nov. 10, 2009 BNY Mellon filed a petition with the U.S. Tax Court challenging the IRS' disallowance of certain foreign tax credits claimed for the 2001 and 2002 tax years. Trial was held from April 16 to May 17, 2012.

On Feb. 11, 2013 BNY Mellon received an adverse decision from the U.S. Tax Court. We continue to believe the tax treatment of the transaction was correct and will appeal the Court's decision. As a result of the ruling and in accordance with the accounting for uncertain tax positions under ASC 740, BNY Mellon expects to record a tax charge of approximately \$850 million during the first quarter of 2013. Excluding this charge, it is reasonably possible the total reserve for uncertain tax positions could decrease within the next 12 months by an amount up to \$67 million as a result of adjustments related to tax years that are still subject to examination. See Note 23 of the Notes to Consolidated Financial Statements for additional information.

Our federal income tax returns are closed to examination for all periods through 2002. The years 2003 through 2006 remain open to examination. The years 2007 and 2008 are closed for further examination, however one matter is before the Internal Revenue Service ("IRS") appeals. Our New York State and New York City income tax returns are closed to examination through 2010. Our UK income tax returns are closed to examination through 2008.

## Note 14—Long-term debt

Long-term debt (in millions)	Dec. 31, 2012			Dec. 31, 2011	
	Rate	Maturity	Amount	Rate	Amount
Senior debt:					
Fixed rate	0.70-6.92%	2013-2021	\$13,184	1.50-6.92%	\$12,367
Floating rate	0.11-1.16%	2013-2038	1,979	0.35-1.40%	2,679
Subordinated debt (a)	4.75-7.50%	2014-2033	2,732	4.75-7.50%	3,201
Junior subordinated debentures (a)	6.37-7.78%	2026-2036	635	5.95-7.78%	1,686
Total			\$18,530		\$19,933

(a) Fixed rate.

Total long-term debt that matures during the next five years for BNY Mellon is as follows: 2013 – \$1.61 billion, 2014 – \$4.36 billion, 2015 – \$3.66 billion, 2016 – \$1.85 billion and 2017 – \$1.25 billion. At Dec. 31, 2012, subordinated debt of \$407 million may be redeemable at our option in 2013.

*Trust-preferred securities*

At Dec. 31, 2012, two wholly owned subsidiaries of BNY Mellon (the “Trusts”) have issued cumulative Company-Obligated Mandatory Redeemable Trust Preferred Securities of Subsidiary Trust Holding Solely Junior Subordinated Debentures (“trust preferred securities”). The sole assets of these two trusts are junior subordinated deferrable interest debentures of BNY Mellon with maturities and interest rates that match the trust preferred securities. Our obligations under the agreements that relate to the trust preferred securities, the Trusts and the debentures constitute a full and unconditional guarantee by us of the Trusts’ obligations under the trust preferred securities.

Additionally, at Dec. 31, 2012, we also owned Mellon Capital IV, whose sole assets were originally junior subordinated debentures and a stock purchase contract for preferred stock. Through a remarketing in May 2012, the junior subordinated debentures issued by BNY Mellon and held by Mellon Capital IV were sold to third party investors and then exchanged for BNY Mellon’s senior notes, which were sold in a public offering. The proceeds of the sale of the senior notes were used to fund the purchase by Mellon Capital IV of \$500 million of BNY Mellon’s Series A preferred stock, which was issued on June 20, 2012. At Dec. 31, 2012, the Series A preferred stock was the sole asset of Mellon Capital IV. See Note 16 of the Notes to Consolidated Financial Statements for additional disclosures related to preferred stock, including the Series A preferred stock.

On Nov. 26, 2012, BNY Mellon redeemed all outstanding 6.875% Trust Preferred Securities, Series E, issued by BNY Capital IV (liquidation amount \$25 per security and \$200 million in the aggregate) and all outstanding 5.95% Trust Preferred Securities, Series F, issued by BNY Capital V (liquidation amount \$25 per security and \$350 million in the aggregate).

The following tables set forth a summary of the trust preferred securities issued by the Trusts as of Dec. 31, 2012 and Dec. 31, 2011:

Trust preferred securities at Dec. 31, 2012 (dollar amounts in millions)	Amount of junior subordinated debentures	Interest rate	Assets of trust	Due date	Call date	Call price
BNY Institutional Capital Trust A	\$300	7.78%	\$ 309	2026	2006	101.56% (a)
MEL Capital III (b)	323	6.37%	316	2036	2016	Par
MEL Capital IV	-	-	500	-	-	-
<b>Total</b>	<b>\$623</b>		<b>\$1,125</b>			

(a) Call price decreases ratably to par in the year 2016.

(b) Amount was translated from Sterling into U.S. dollars on a basis of U.S. \$1.62 to £1, the rate of exchange on Dec. 31, 2012.

## Notes to Consolidated Financial Statements (continued)

Trust preferred securities at Dec. 31, 2011	Amount of junior subordinated debentures	Interest rate	Assets of trust (a)	Due date	Call date	Call price
<i>(dollar amounts in millions)</i>						
BNY Institutional Capital Trust A	\$ 300	7.78%	\$ 309	2026	2006	101.95% (b)
BNY Capital IV	200	6.88%	206	2028	2004	Par
BNY Capital V	350	5.95%	361	2033	2008	Par
MEL Capital III (c)	309	6.37%	300	2036	2016	Par
MEL Capital IV	500	6.24%	500	-	2012	Par
<b>Total</b>	<b>\$1,659</b>		<b>\$1,676</b>			

(a) Junior subordinated debentures and interest in stock purchase contracts for Mellon Capital IV.

(b) Call price decreases ratably to par in the year 2016.

(c) Amount was translated from Sterling into U.S. dollars on a basis of U.S. \$1.54 to £1, the rate of exchange on Dec. 31, 2011.

### Note 15—Securitizations and variable interest entities

BNY Mellon's VIEs generally include retail, institutional and alternative investment funds offered to its retail and institutional customers in which it acts as the fund's investment manager. BNY Mellon earns management fees on these funds as well as performance fees in certain funds. It may also provide start-up capital in its new funds. These VIEs are included in the scope of ASU 2010-10 and are reviewed for consolidation based on the guidance in ASC 810.

BNY Mellon has other VIEs, including securitization trusts, which are no longer considered qualifying special purpose entities, and CLOs, in which BNY Mellon serves as the investment manager. In addition, we provide trust and custody services for a fee to entities sponsored by other corporations in which we have no other interest. These VIEs are evaluated under the guidance included in ASU 2009-17. BNY Mellon has two securitizations and several CLOs, which are assessed for consolidation in accordance with ASU 2009-17.

The following tables present the incremental assets and liabilities included in BNY Mellon's consolidated financial statements, after applying intercompany eliminations, as of Dec. 31, 2012 and Dec. 31, 2011, based on the assessments performed in accordance with ASC 810 and ASU 2009-17. The net assets of any consolidated VIE are solely available to settle the liabilities of the VIE and to settle any investors'

ownership liquidation requests, including any seed capital invested in the VIE by BNY Mellon.

#### Investments consolidated under ASC 810 and ASU 2009-17 at Dec. 31, 2012

<i>(in millions)</i>	Investment Management funds	Securitizations	Total consolidated investments
Available-for-sale	\$ -	\$499	\$ 499
Trading assets	10,961	-	10,961
Other assets	520	-	520
<b>Total assets</b>	<b>\$11,481</b>	<b>\$499</b>	<b>\$11,980</b>
Trading liabilities	10,152	-	10,152
Other liabilities	29	461	490
<b>Total liabilities</b>	<b>\$10,181</b>	<b>\$461</b>	<b>\$10,642</b>
Non-redeemable noncontrolling interests	\$ 833	\$ -	\$ 833

#### Investments consolidated under ASC 810 and ASU 2009-17 at Dec. 31, 2011

<i>(in millions)</i>	Investment Management funds	Securitizations	Total consolidated investments
Available-for-sale	\$ -	\$479	\$ 479
Trading assets	10,751	-	10,751
Other assets	596	-	596
<b>Total assets</b>	<b>\$11,347</b>	<b>\$479</b>	<b>\$11,826</b>
Trading liabilities	10,053	-	10,053
Other liabilities	32	443	475
<b>Total liabilities</b>	<b>\$10,085</b>	<b>\$443</b>	<b>\$10,528</b>
Non-redeemable noncontrolling interests	\$ 670	\$ -	\$ 670

BNY Mellon is not contractually required to provide financial or any other support to any of our VIEs. Additionally, creditors of any consolidated VIEs do not have any recourse to the general credit of BNY Mellon.

## Notes to Consolidated Financial Statements (continued)

### Non-consolidated VIEs

As of Dec. 31, 2012 and Dec. 31, 2011, the following assets related to the VIEs, where BNY Mellon is not the primary beneficiary, are included in our consolidated financial statements.

Non-consolidated VIEs at Dec. 31, 2012			Maximum loss exposure
(in millions)	Assets	Liabilities	
Other	\$100	\$-	\$100

Non-consolidated VIEs at Dec. 31, 2011			Maximum loss exposure
(in millions)	Assets	Liabilities	
Trading	\$ 1	\$-	\$ 1
Other	41	-	41
Total	\$42	\$-	\$42

The maximum loss exposure indicated in the above tables relates solely to BNY Mellon's seed capital or residual interests invested in the VIEs.

### Preferred stock

BNY Mellon has 100 million authorized shares of preferred stock with a par value of \$0.01. The table below presents a summary of BNY Mellon's preferred stock issued and outstanding at Dec. 31, 2012.

Preferred stock summary		Total shares issued and outstanding	Liquidation preference per share (in dollars)	Carrying value at Dec. 31, 2012	Per annum dividend rate	Dividends paid per share in 2012 (in dollars)
Series	Description					
Series A	Noncumulative Perpetual Preferred Stock	5,001	\$100,000	\$500	Greater of (i) three-month LIBOR plus 0.565% for the related distribution period; or (ii) 4.000%	\$2,033
Series C	Noncumulative Perpetual Preferred Stock	5,825	\$100,000	\$568 (a)	5.2%	\$1,314

(a) The carrying value is recorded net of issuance costs.

On June 20, 2012, BNY Mellon issued the Series A preferred stock for \$500 million. On Sept. 19, 2012, BNY Mellon issued 22 million and on Oct. 10, 2012, BNY Mellon issued an additional 1.3 million of Series C Depositary Shares, each representing a 1/4,000th interest in a share of BNY Mellon's Series C preferred stock for an aggregate of \$568 million, net of issuance costs. Holders of both the Series A and Series C preferred stock issues are entitled to receive dividends on each dividend payment date (March 20, June 20, Sept. 20 and Dec. 20 of each year), if declared by BNY Mellon's Board of Directors. BNY Mellon's

### Consolidated credit supported VIEs

At Dec. 31, 2012, BNY Mellon had no remaining consolidated credit supported VIEs. At Dec. 31, 2011, BNY Mellon's financial statements included certain funds created solely with securities subject to credit support agreements where we agreed to absorb the majority of loss.

Consolidated credit supported VIEs at Dec. 31, 2011			Maximum loss exposure
(in millions)	Assets	Liabilities	
Available-for-sale	\$14	\$ -	\$14
Other	-	22	10
Total	\$14	\$22	\$24

## Note 16—Shareholders' equity

### Common stock

BNY Mellon has 3.5 billion authorized shares of common stock with a par value of \$0.01 per share. At Dec. 31, 2012, 1,163,490,341 shares of common stock were outstanding.

ability to declare or pay dividends on, or purchase, redeem or otherwise acquire, shares of our common stock or any of our shares that rank junior to the preferred stock as to the payment of dividends and/or the distribution of any assets on any liquidation, dissolution or winding-up of BNY Mellon will be prohibited, subject to certain restrictions, in the event that we do not declare and pay in full preferred dividends for the then current dividend period of the Series A preferred stock or the last preceding dividend period of the Series C preferred stock.

All of the outstanding shares of the Series A preferred stock are owned by Mellon Capital IV, which will pass through any dividend on the Series A preferred stock to the holders of its Normal Preferred Capital Securities. All of the outstanding shares of the Series C preferred stock are held by the depository of the depository shares, which will pass through the applicable portion of any dividend on the Series C Preferred Stock to the holders of record of the depository shares.

The preferred stock is not subject to the operation of a sinking fund and is not convertible into, or exchangeable for, shares of our common stock or any other class or series of our other securities. Subject to the restrictions in BNY Mellon's 2007 replacement capital covenant, subsequently amended on May 8 and Sept. 11, 2012, we may redeem the Series A preferred stock, in whole or in part, at our option. We may also, at our option, redeem the shares of the Series C preferred stock in whole or in part, on or after the dividend payment date in September 2017, or in whole but not in part at any time within 90 days following a regulatory capital treatment event (as defined in the Certificate of Designations of the Series C preferred stock).

The terms of the Series A preferred stock and the Series C preferred stock are more fully described in each of their Certificate of Designations, each of which is filed as an exhibit to BNY Mellon's Annual Report on Form 10-K for the year ended Dec. 31, 2012.

#### *Temporary equity*

Temporary equity was \$178 million at Dec. 31, 2012 and \$114 million at Dec. 31, 2011. Temporary equity represents amounts recorded for redeemable non-controlling interests resulting from equity-classified share-based payment arrangements that are currently redeemable or are expected to become redeemable. The current redemption value of such awards is classified as temporary equity and is adjusted to its redemption value at each balance sheet date.

#### *Common stock repurchase program*

On Dec. 18, 2007, the Board of Directors of BNY Mellon authorized the repurchase of up to 35 million shares of common stock. On March 22, 2011, the Board of Directors of BNY Mellon authorized the repurchase of up to an additional 13 million shares of common stock. On Feb. 14, 2012, in order to continue

with share repurchases under our 2011 capital plan, the Board of Directors authorized the repurchase of an additional 12 million shares of common stock, of which 6.8 million shares of common stock remained available for repurchase under the Feb. 2012 board authorization. While there are no expiration dates on the prior share repurchase authorizations, BNY Mellon does not intend to use the prior authorizations for any future share repurchases. On March 13, 2012, in connection with the Federal Reserve's non-objection to our 2012 capital plan, the Board of Directors authorized a new stock purchase program providing for the repurchase of an aggregate of \$1.16 billion of common stock. The new share repurchase program may be executed through open market purchases or privately negotiated transactions at such prices, times and upon such other terms as may be determined from time to time. At Dec. 31, 2012, the maximum dollar value of shares that may yet be purchased under the program totaled \$416 million. There is no expiration date on the share repurchase authorizations. In 2012, we repurchased 49.8 million common shares in the open market, at an average price of \$22.38 per share for a total of \$1.12 billion.

#### *Capital adequacy*

Regulators establish certain levels of capital for bank holding companies and banks, including BNY Mellon and our bank subsidiaries, in accordance with established quantitative measurements. For the Parent to maintain its status as a financial holding company, our bank subsidiaries and BNY Mellon must, among other things, qualify as well capitalized.

As of Dec. 31, 2012 and 2011, BNY Mellon and our bank subsidiaries were considered well capitalized on the basis of the Basel I Total and Tier 1 capital to risk-weighted assets ratios and the leverage ratio (Basel I Tier 1 capital to quarterly average assets as defined for regulatory purposes).



## Notes to Consolidated Financial Statements (continued)

Our consolidated and largest bank subsidiary, The Bank of New York Mellon, capital ratios are shown below.

Consolidated and largest bank subsidiary capital ratios (a)	Dec. 31,	
	2012	2011
Consolidated capital ratios:		
Tier 1 capital	15.0%	15.0%
Total capital	16.3	17.0
Leverage – guideline	5.3	5.2
The Bank of New York Mellon capital ratios:		
Tier 1 capital	14.0%	14.3%
Total capital	14.6	17.7
Leverage	5.4	5.3

(a) Determined under Basel I guidelines. For a banking institution to qualify as “well capitalized,” its Basel I Tier 1, Total (Tier 1 plus Tier 2) and leverage capital ratios must be at least 6%, 10% and 5%, respectively. For The Bank of New York Mellon, our largest bank subsidiary, to qualify as “adequately capitalized,” Basel I Tier 1, Total and leverage capital ratios must be at least 4%, 8% and 3%, respectively.

If a financial holding company such as BNY Mellon fails to qualify as well capitalized, it may lose its status as a financial holding company, which may restrict its ability to undertake or continue certain activities or make acquisitions that are not generally permissible for bank holding companies without financial holding company status. If a bank holding company such as BNY Mellon or bank such as The Bank of New York Mellon or BNY Mellon, N.A. fails to qualify as “well capitalized,” it may be subject to higher FDIC assessments.

If a bank holding company such as BNY Mellon or bank such as The Bank of New York Mellon or BNY Mellon, N.A. fails to qualify as adequately capitalized, regulatory sanctions and limitations are imposed.

At Dec. 31, 2012, the amounts of capital by which BNY Mellon and The Bank of New York Mellon, exceed the well-capitalized guidelines are as follows:

(in millions)	Capital above guidelines at Dec. 31, 2012	
	Consolidated	The Bank of New York Mellon
Tier 1 capital	\$10,023	\$7,745
Total capital	7,023	4,461
Leverage	930	932

The following table presents the components of our Basel I Tier 1 and Total risk-based capital at Dec. 31, 2012 and 2011.

Components of Basel I Tier 1 and total risk-based capital (a) (in millions)	Dec. 31,	
	2012	2011
Tier 1 capital:		
Common shareholders’ equity	\$ 35,363	\$ 33,417
Preferred stock	1,068	-
Trust preferred securities	623	1,659
Adjustments for:		
Goodwill and other intangibles (b)	(20,445)	(20,630)
Pensions/cash flow hedges	1,454	1,426
Securities valuation allowance	(1,350)	(450)
Merchant banking investments	(19)	(33)
Total Tier 1 capital	16,694	15,389
Tier 2 capital:		
Qualifying unrealized gains on equity securities	2	2
Qualifying subordinated debt	1,058	1,545
Qualifying allowance for credit losses	386	497
Total Tier 2 capital	1,446	2,044
Total risk-based capital	\$ 18,140	\$ 17,433
Total risk-weighted assets	\$111,180	\$102,255
Average assets for leverage capital purposes	\$315,273	\$296,484

(a) On a regulatory basis as determined under Basel I guidelines.

(b) Reduced by deferred tax liabilities associated with non-tax deductible identifiable intangible assets of \$1,310 million at Dec. 31, 2012 and \$1,459 million at Dec. 31, 2011, and deferred tax liabilities associated with tax deductible goodwill of \$1,130 million at Dec. 31, 2012 and \$967 million at Dec. 31, 2011.

**Notes to Consolidated Financial Statements** (continued)

**Note 17—Other comprehensive income (loss)**
**Components of other comprehensive income**

	Year ended								
	Dec. 31, 2012			Dec 31, 2011			Dec. 31, 2010		
	Pre-tax amount	Tax (expense) benefit	After-tax amount	Pre-tax amount	Tax (expense) benefit	After-tax amount	Pre-tax amount	Tax (expense) benefit	After-tax amount
<i>(in millions)</i>									
Foreign currency translation adjustments:									
Foreign currency translation adjustments arising during the period	\$ 80	\$ 50	\$ 130	\$(184)	\$ (11)	\$(195)	\$ (295)	\$ (68)	\$(363)
Reclassification adjustment (a)	-	-	-	-	-	-	(18)	-	(18)
Total foreign currency translation adjustments	80	50	130	(184)	(11)	(195)	(313)	(68)	(381)
Unrealized gain (loss) on assets available-for-sale:									
Unrealized gain (loss) arising during period	1,611	(604)	1,007	483	(177)	306	1,216	(469)	747
Reclassification adjustment (a)	(162)	56	(106)	(48)	22	(26)	6	12	18
Net unrealized gain (loss) on assets available-for-sale	1,449	(548)	901	435	(155)	280	1,222	(457)	765
Defined benefit plans:									
Prior service cost arising during the period	98	(41)	57	-	-	-	22	3	25
Net loss arising during the period	(298)	108	(190)	(741)	298	(443)	(91)	39	(52)
Foreign exchange adjustment	-	-	-	(4)	1	(3)	2	-	2
Amortization of prior service credit, net loss and initial obligation included in net periodic benefit cost	173	(69)	104	114	(45)	69	76	(30)	46
Total defined benefit plans	(27)	(2)	(29)	(631)	254	(377)	9	12	21
Unrealized gain (loss) on cash flow hedges:									
Unrealized hedge gain (loss) arising during period	6	(2)	4	5	(2)	3	12	-	12
Reclassification adjustment	(3)	-	(3)	(2)	2	-	(7)	2	(5)
Net unrealized gain (loss) on cash flow hedges	3	(2)	1	3	-	3	5	2	7
Total other comprehensive income (loss)	\$1,505	\$ (502)	\$1,003	\$(377)	\$ 88	\$(289)	\$ 923	\$(511)	\$ 412

(a) Includes a net reclassification adjustment of \$14 million to retained earnings from other comprehensive income in 2010.

**Changes in accumulated other comprehensive income (loss) attributable to The Bank of New York Mellon Corporation shareholders**

	Foreign currency translation	ASC 820 Adjustments		Unrealized gain (loss) on assets available-for-sale	Unrealized gain (loss) on cash flow hedges	Total accumulated other comprehensive income (loss), net of tax
		Pensions	Other post-retirement benefits			
<i>(in millions)</i>						
2009 ending balance	\$(136)	\$(1,002)	\$(67)	\$ (619)	\$(11)	\$(1,835)
Adjustments for the cumulative effect of applying ASC 810	-	-	-	24	-	24
Adjusted balance at Jan. 1, 2010	(136)	(1,002)	(67)	(595)	(11)	(1,811)
Change in 2010	(337)	9	12	765	7	456
2010 ending balance	\$(473)	\$(993)	\$(55)	\$ 170	\$ (4)	\$(1,355)
Change in 2011	(178)	(336)	(41)	280	3	(272)
2011 ending balance	\$(651)	\$(1,329)	\$(96)	\$ 450	\$ (1)	\$(1,627)
<b>Change in 2012</b>	<b>112</b>	<b>(65)</b>	<b>36</b>	<b>900</b>	<b>1</b>	<b>984</b>
<b>2012 ending balance</b>	<b>\$(539)</b>	<b>\$(1,394)</b>	<b>\$(60)</b>	<b>\$1,350</b>	<b>\$ -</b>	<b>\$ (643)</b>

**Note 18—Stock-based compensation**

Our Long-Term Incentive Plans provide for the issuance of stock options, restricted stock, restricted stock units (“RSUs”) and other stock-based awards to employees and directors of BNY Mellon. At Dec. 31, 2012, under the Long-Term Incentive Plan approved in April 2011, we may issue 32,994,545 new options. Of this amount, 20,144,378 shares (subject to potential increase as provided in the Long-Term Incentive Plan) may be issued as restricted stock or RSUs. Stock-based compensation expense related to retirement eligibility vesting totaled \$64 million in 2012, \$31 million in 2011 and \$25 million in 2010.

*Stock options*

Our Long-Term Incentive Plans provide for the issuance of stock options at fair market value at the date of grant to officers and employees of BNY Mellon. Generally, each option granted is exercisable between one and ten years from the date of grant.

The compensation cost that has been charged against income was \$70 million for 2012, \$96 million for 2011 and \$87 million for 2010. The total income tax benefit recognized in the income statement was \$29 million for 2012, \$40 million for 2011 and \$35 million for 2010.

We used a lattice-based binomial method to calculate the fair value on the date of grant. The fair value of each option award is estimated on the date of grant using the weighted-average assumptions noted in the following table:

Assumptions	2012	2011	2010
Dividend yield	3.0%	2.2%	2.2%
Expected volatility	34	32	32
Risk-free interest rate	1.38	2.75	2.94
Expected option lives (in years)	6.9	6.7	6.6

For 2012, 2011 and 2010, assumptions were determined as follows:

- Expected volatilities are based on implied volatilities from traded options on our stock, historical volatility of our stock, and other factors.
- We use historical data to estimate option exercises and employee terminations within the valuation model.
- The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve at the time of grant.
- The expected term of options granted is derived from the output of the option valuation model and represents the period of time that options granted are expected to be outstanding.

A summary of the status of our options as of Dec. 31, 2012, and changes during the year, is presented below:

Stock option activity	Shares subject to option	Weighted-average exercise price	Weighted-average remaining contractual term (in years)
Balance at Dec. 31, 2011	86,803,492	\$33.32	5.2
Granted	10,263,505	22.03	
Exercised	(1,959,313)	20.86	
Canceled/Expired	(12,747,818)	38.62	
<b>Balance at Dec. 31, 2012</b>	<b>82,359,866</b>	<b>\$31.39</b>	<b>5.4</b>
<b>Vested and expected to vest at Dec. 31, 2012</b>	<b>81,697,966</b>	<b>31.45</b>	<b>5.4</b>
<b>Exercisable at Dec. 31, 2012</b>	<b>57,710,802</b>	<b>33.95</b>	<b>4.2</b>



## Notes to Consolidated Financial Statements (continued)

### Stock options outstanding at Dec. 31, 2012

Range of exercise prices	Options outstanding			Options exercisable (a)	
	Outstanding at Dec. 31, 2012	Weighted-average remaining contractual life (in years)	Weighted-average exercise price	Exercisable at Dec. 31, 2012	Weighted-average exercise price
\$ 18 to 31	48,654,831	6.6	\$25.40	24,046,935	\$25.40
31 to 41	19,829,909	3.0	37.02	19,788,861	37.03
41 to 51	13,875,126	4.6	44.36	13,875,006	44.36
<b>\$ 18 to 51</b>	<b>82,359,866</b>	<b>5.4</b>	<b>\$31.39</b>	<b>57,710,802</b>	<b>\$33.95</b>

(a) At Dec. 31, 2011 and 2010, 60,158,853 and 62,801,038 options were exercisable at an average price per common share of \$35.21 and \$37.93, respectively.

### Aggregate intrinsic value of options (in millions)

	2012	2011	2010
Outstanding at Dec. 31,	\$123	\$22	\$193
Exercisable at Dec. 31,	\$ 64	\$11	\$ 77

The weighted-average fair value of options at grant date was \$5.50 in 2012, \$8.47 in 2011 and \$8.38 in 2010.

The total intrinsic value of options exercised was \$8 million in 2012, \$7 million in 2011 and \$12 million in 2010.

As of Dec. 31, 2012, \$92 million of total unrecognized compensation cost related to nonvested options is expected to be recognized over a weighted-average period of 1.5 years.

Cash received from option exercises totaled \$40 million in 2012, \$18 million in 2011 and \$31 million in 2010. The actual tax benefit realized for the tax deductions from options exercised totaled less than \$1 million in 2012, \$2 million in 2011 and \$1 million in 2010.

### Restricted stock and RSUs

Restricted stock and RSUs are granted under our long-term incentive plans at no cost to the recipient. These awards are subject to forfeiture until certain restrictions have lapsed, including continued employment, for a specified period. The recipient of a share of restricted stock is entitled to voting rights and generally is entitled to dividends on the common stock. An RSU entitles the recipient to receive a share of common stock after the applicable restrictions lapse. The recipient generally is entitled to receive cash payments equivalent to any dividends paid on the underlying common stock during the period the RSU is outstanding but does not receive voting rights.

The fair value of restricted stock and RSUs is equal to the fair market value of our common stock on the date of grant. The expense is recognized over the vesting period, which is generally three years. The total compensation expense recognized for restricted stock and RSUs was \$185 million in 2012, \$134 million in 2011 and \$119 million in 2010. The total income tax benefit recognized in the income statement was \$76 million for 2012, \$52 million for 2011 and \$46 million for 2010.

BNY Mellon's Executive Committee members were granted 817,698 RSUs in 2011 which contained certain performance criteria that were achieved in 2011. The actual number of units that will ultimately vest is subject to negative discretion by BNY Mellon's Human Resources Compensation Committee and as a result, are subject to variable accounting.

The following table summarizes our nonvested restricted stock and RSU activity for 2012.

Nonvested restricted stock and RSU activity	Number of shares	Weighted-average fair value
Nonvested restricted stock and RSUs at Dec. 31, 2011	13,133,458	\$26.44
<b>Granted</b>	<b>8,595,973</b>	<b>22.04</b>
<b>Vested</b>	<b>(4,093,190)</b>	<b>20.57</b>
<b>Forfeited</b>	<b>(217,102)</b>	<b>26.01</b>
<b>Nonvested restricted stock and RSUs at Dec. 31, 2012 (a)</b>	<b>17,419,139</b>	<b>\$25.93</b>

(a) Includes 817,698 shares granted to members of BNY Mellon's Executive Committee that are marked-to-market based on the closing stock price at Dec. 31, 2012 of \$25.70.

As of Dec. 31, 2012, \$142 million of total unrecognized compensation costs related to nonvested restricted stock and RSUs is expected to be recognized over a weighted-average period of 1.7 years.

## Notes to Consolidated Financial Statements (continued)

The total fair value of restricted stock and RSUs that vested was \$84 million in 2012, \$100 million in 2011 and \$96 million in 2010.

### Subsidiary Long-Term Incentive plans

BNY Mellon also has several subsidiary Long-Term Incentive Plans which have issued restricted subsidiary shares to certain employees. These share awards are subject to forfeiture until certain restrictions have lapsed, including continued employment for a specified period of time. The shares are non-voting and non-dividend paying. Once the restrictions lapse, which generally occurs in three to five years, the shares can only be sold, at the option of the employee, to BNY Mellon at a price based generally on the fair value of the subsidiary at the time

of repurchase. In certain instances BNY Mellon has an election to call the shares.

### Note 19—Employee benefit plans

BNY Mellon has defined benefit and/or defined contribution retirement plans covering substantially all full-time and eligible part-time employees and other post-retirement plans providing healthcare benefits for certain retired employees.

#### Pension and post-retirement healthcare plans

The following tables report the combined data for our domestic and foreign defined benefit pension and post-retirement healthcare plans.

	Pension Benefits				Healthcare Benefits			
	Domestic		Foreign		Domestic		Foreign	
	2012	2011	2012	2011	2012	2011	2012	2011
<i>(dollar amounts in millions)</i>								
<b>Weighted-average assumptions used to determine benefit obligations</b>								
Discount rate	4.25%	4.75%	4.49%	4.97%	4.25%	4.75%	4.50%	5.00%
Rate of compensation increase	3.00	3.00	3.49	3.57	3.00	3.00	-	-
<b>Change in benefit obligation (a)</b>								
Benefit obligation at beginning of period	\$(3,639)	\$(3,139)	\$(684)	\$(626)	\$(288)	\$(232)	\$ (4)	\$ (3)
Service cost	(59)	(64)	(32)	(33)	(2)	(2)	-	-
Interest cost	(169)	(174)	(35)	(36)	(12)	(13)	-	-
Employee contributions	-	-	(1)	(1)	-	-	-	-
Amendments	-	-	-	-	98	-	-	-
Actuarial gain (loss)	(378)	(397)	(105)	(5)	(43)	(67)	1	(1)
(Acquisitions) divestitures	-	-	(12)	-	-	-	(3)	-
Curtailments	-	(5)	-	-	-	-	-	-
Benefits paid	152	140	16	12	21	26	-	-
Foreign exchange adjustment	N/A	N/A	(27)	5	N/A	N/A	-	-
Benefit obligation at end of period	(4,093)	(3,639)	(880)	(684)	(226)	(288)	(6)	(4)
<b>Change in fair value of plan assets</b>								
Fair value at beginning of period	3,529	3,628	681	611	73	71	-	-
Actual return on plan assets	487	26	60	30	5	2	-	-
Employer contributions	414	15	26	56	21	26	-	-
Employee contributions	-	-	1	1	-	-	-	-
Acquisitions (divestitures)	-	-	-	-	-	-	-	-
Benefit payments	(152)	(140)	(16)	(12)	(21)	(26)	-	-
Foreign exchange adjustment	N/A	N/A	30	(5)	N/A	N/A	-	-
Fair value at end of period	4,278	3,529	782	681	78	73	-	-
Funded status at end of period	\$ 185	\$ (110)	\$ (98)	\$ (3)	\$(148)	\$(215)	\$ (6)	\$ (4)
<b>Amounts recognized in accumulated other comprehensive (income) loss consist of:</b>								
Net loss (gain)	\$ 2,122	\$ 2,126	\$ 266	\$ 188	\$ 159	\$ 124	\$ (1)	\$ (2)
Prior service cost (credit)	(62)	(78)	3	3	(99)	(3)	-	-
Net initial obligation (asset)	-	-	-	-	-	3	-	-
Total (before tax effects)	\$ 2,060	\$ 2,048	\$ 269	\$ 191	\$ 60	\$ 124	\$ (1)	\$ (2)

(a) The benefit obligation for pension benefits is the projected benefit obligation and for healthcare benefits, it is the accumulated benefit obligation.

## Notes to Consolidated Financial Statements (continued)

### Net periodic benefit cost (credit)

<i>(dollar amounts in millions)</i>	Pension Benefits						Healthcare Benefits					
	Domestic			Foreign			Domestic			Foreign		
	2012	2011	2010	2012	2011	2010	2012	2011	2010	2012	2011	2010
<b>Weighted-average assumptions as of Jan. 1:</b>												
Market-related value of plan assets	\$3,763	\$3,836	\$3,861	\$ 698	\$ 624	\$ 529	\$ 78	\$ 78	\$ 76	N/A	N/A	N/A
Discount rate	4.75%	5.71%	6.21%	4.97%	5.29%	5.74%	4.75%	5.71%	6.21%	5.00%	5.40%	5.85%
Expected rate of return on plan assets	7.38	7.50	8.00	6.30	6.38	6.69	7.38	7.50	8.00	N/A	N/A	N/A
Rate of compensation increase	3.00	3.50	3.50	3.57	4.47	4.64	3.00	3.50	3.50	N/A	N/A	N/A
<b>Components of net periodic benefit cost (credit):</b>												
Service cost	\$ 59	\$ 64	\$ 90	\$ 32	\$ 33	\$ 28	\$ 2	\$ 2	\$ 2	\$ -	\$ -	\$ -
Interest cost	169	174	171	35	36	30	12	13	14	-	-	-
Expected return on assets	(272)	(282)	(303)	(45)	(43)	(37)	(6)	(6)	(6)	-	-	-
Amortization of:												
Net initial obligation (asset)	-	-	-	-	-	-	3	5	4	-	-	-
Prior service cost (credit)	(16)	(16)	(14)	-	-	-	(2)	(1)	-	-	-	-
Net actuarial (gain) loss	167	109	71	12	14	11	9	3	5	-	(1)	(1)
Settlement (gain) loss	-	-	-	-	-	-	-	-	-	-	-	-
Curtailement (gain) loss	-	5	-	-	-	-	-	-	-	-	-	-
Other	-	-	-	-	(1)	-	-	-	-	-	(1)	-
Net periodic benefit cost (credit)	\$ 107	\$ 54	\$ 15	\$ 34	\$ 39	\$ 32	\$ 18	\$ 16	\$ 19	\$ -	\$ (1)	\$ (1)

### Changes in other comprehensive (income) loss in 2012

<i>(in millions)</i>	Pension Benefits		Healthcare Benefits	
	Domestic	Foreign	Domestic	Foreign
Net loss (gain) arising during period	\$ 163	\$ 90	\$ 44	\$ 1
Recognition of prior years' net gain (loss)	(167)	(12)	(9)	-
Prior service cost (credit) arising during period	-	-	(98)	-
Recognition of prior years' service (cost) credit	16	-	2	-
Recognition of net initial (obligation) asset	-	-	(3)	-
Foreign exchange adjustment	N/A	-	N/A	-
Total recognized in other comprehensive (income) loss (before tax effects)	\$ 12	\$ 78	\$ (64)	\$ 1

### Amounts expected to be recognized in net periodic benefit cost (income) in 2013 (before tax effects)

<i>(in millions)</i>	Pension Benefits		Healthcare Benefits	
	Domestic	Foreign	Domestic	Foreign
(Gain) loss recognition	\$205	\$27	\$ 12	\$-
Prior service cost recognition	(16)	-	(10)	-
Net initial obligation (asset) recognition	-	-	-	-

<i>(in millions)</i>	Domestic		Foreign	
	2012	2011	2012	2011
<b>Pension benefits:</b>				
Prepaid benefit cost	\$ 409	\$ 103	\$ 10	\$ 41
Accrued benefit cost	(224)	(213)	(108)	(44)
Total pension benefits	\$ 185	\$(110)	\$ (98)	\$( 3)
<b>Healthcare benefits:</b>				
Accrued benefit cost	\$(148)	\$(215)	\$ (6)	\$( 4)
Total healthcare benefits	\$(148)	\$(215)	\$ (6)	\$( 4)

The accumulated benefit obligation for all defined benefit plans was \$4.8 billion at Dec. 31, 2012 and \$4.1 billion at Dec. 31, 2011.

### Plans with obligations in excess of plan assets

<i>(in millions)</i>	Domestic		Foreign	
	2012	2011	2012	2011
Projected benefit obligation	\$245	\$234	\$342	\$35
Accumulated benefit obligation	241	233	320	29
Fair value of plan assets	21	20	255	3

For information on pension assumptions see the “Critical accounting estimates” section.

*Assumed healthcare cost trend—Domestic post-retirement healthcare benefits*

The assumed healthcare cost trend rate used in determining benefit expense for 2013 is 7.50% decreasing to 4.75% in 2022. This projection is based on various economic models that forecast a decreasing growth rate of healthcare expenses over time. The underlying assumption is that healthcare expense growth cannot outpace gross national product (“GNP”) growth indefinitely, and over time a lower equilibrium growth rate will be achieved. Further, the growth rate assumed in 2022 bears a reasonable relationship to the discount rate.

An increase in the healthcare cost trend rate of one percentage point for each year would increase the accumulated post-retirement benefit obligation by \$14 million, or 8%, and the sum of the service and interest costs by \$1 million, or 8%. Conversely, a decrease in this rate of one percentage point for each year would decrease the benefit obligation by \$12 million, or 7%, and the sum of the service and interest costs by \$1 million, or 7%.

*Assumed healthcare cost trend—Foreign post-retirement healthcare benefits*

An increase in the healthcare cost trend rate of one percentage point for each year would increase the accumulated post-retirement benefit obligation by less than \$1 million and the sum of the service and interest costs by less than \$1 million. Conversely, a decrease in this rate of one percentage point for each year would decrease the benefit obligation by less than \$1 million and the sum of the service and interest costs by less than \$1 million.

The following benefit payments for BNY Mellon’s pension and healthcare plans, which reflect expected future service as appropriate, are expected to be paid:

<b>Expected benefit payments</b> <i>(in millions)</i>	Domestic	Foreign
<b>Pension benefits:</b>		
Year 2013	\$ 200	\$ 13
2014	209	11
2015	222	13
2016	241	16
2017	252	16
2018-2022	1,338	104
<b>Total pension benefits</b>	<b>\$2,462</b>	<b>\$173</b>
<b>Healthcare benefits:</b>		
Year 2013	\$ 17	\$ -
2014	17	-
2015	17	-
2016	17	-
2017	16	-
2018-2022	79	1
<b>Total healthcare benefits</b>	<b>\$ 163</b>	<b>\$ 1</b>

*Plan contributions*

BNY Mellon expects to make cash contributions to fund its defined benefit pension plans in 2013 of \$20 million for the domestic plans and \$25 million for the foreign plans.

BNY Mellon expects to make cash contributions to fund its post-retirement healthcare plans in 2013 of \$17 million for the domestic plans and less than \$1 million for the foreign plans.

*Investment strategy and asset allocation*

BNY Mellon is responsible for the administration of various employee pension and healthcare post-retirement benefits plans, both domestically and internationally. The domestic plans are administered by BNY Mellon’s Benefits Administration Committee, a named fiduciary. Subject to the following, at all relevant times, BNY Mellon’s Benefits Investment Committee, another named fiduciary to the domestic plans, is responsible for the investment of plan assets. The Benefits Investment Committee’s responsibilities include the investment of all domestic defined benefit plan assets, as well as the determination of investment options offered to participants in all domestic defined contribution plans. The Benefits Investment Committee conducts periodic reviews of investment performance, asset allocation and investment manager suitability. In addition, the Benefits Investment Committee has oversight of the

Regional Governance Committees for the foreign defined benefit plans.

Our investment objective for U.S. and foreign plans is to maximize total return while maintaining a broadly diversified portfolio for the primary purpose of satisfying obligations for future benefit payments.

Equities are the main holding of the plans. Alternative investments (including private equities) and fixed income securities provide diversification and, in certain cases, lower the volatility of returns. In general, equity securities and alternative investments within any domestic plan's portfolio can be maintained in the range of 30% to 70% of total plan assets, fixed-income securities can range from 20% to 50% of plan assets and cash equivalents can be held in amounts ranging from 0% to 5% of plan assets. Actual asset allocation within the approved ranges varies from time to time based on economic conditions (both current and forecast) and the advice of professional advisors.

Our pension assets were invested as follows at Dec. 31, 2012 and 2011:

Asset allocations	Domestic		Foreign	
	2012	2011	2012	2011
Equities	52%	52%	65%	64%
Fixed income	30	38	29	29
Private equities	2	3	-	-
Alternative investment	6	6	5	3
Real estate	-	-	1	3
Cash	10 (a)	1	-	1
Total pension benefits	100%	100%	100%	100%

(a) Reflects the \$400 million discretionary contribution to The Bank of New York Mellon Corporation Pension Plan on Dec. 31, 2012. Excluding this contribution, the percentage of domestic plan assets held in cash was less than 1% at Dec. 31, 2012.

We held no The Bank of New York Mellon Corporation stock in our pension plans at Dec. 31, 2011 and 2012. Assets of the U.S. post-retirement healthcare plan are invested in an insurance contract.

#### *Fair value measurement of plan assets*

In accordance with ASC 715, BNY Mellon has established a three-level hierarchy for fair value measurements of its pension plan assets based upon the transparency of inputs to the valuation of an asset as of the measurement date. The valuation hierarchy is consistent with guidance in ASC 820 which is detailed in Note 21 of the Notes to Consolidated Financial Statements.

The following is a description of the valuation methodologies used for assets measured at fair value, as well as the general classification of such assets pursuant to the valuation hierarchy.

#### *Cash and currency*

This category consists primarily of foreign currency balances and is included in Level 1 of the valuation hierarchy. Foreign currency is translated monthly based on current exchange rates.

#### *Common and preferred stock, exchange traded funds and equity funds*

These investments include equities, exchange traded funds and equity funds and are valued at the closing price reported in the active market in which the individual securities are traded, if available. Where there are no readily available market quotations, we determine fair value primarily based on pricing sources with reasonable levels of price transparency.

#### *Venture capital investments and partnership interests*

There are no readily available market quotations for these funds. The fair value of the investments is based on the pension plan's ownership percentage of the fair value of the underlying funds as provided by the fund managers. These funds are typically valued on a quarterly basis. The pension plan's venture capital investments and partnership interests are valued at NAV as a practical expedient for fair value and classified as Level 3 of the valuation hierarchy.

#### *Collective trust funds*

Collective trust funds include commingled and U.S. equity funds that have no readily available market quotations. The fair value of the funds are based on the securities in the portfolio, which typically are the amount that the fund might reasonably expect to receive for the securities upon a sale. These funds are valued using observable inputs on either a daily or monthly basis. Collective trust funds are included as Level 2 of the valuation hierarchy.

#### *Fixed income investments*

Fixed income investments include U.S. Treasury securities, U.S. Government agencies, sovereign government obligations, U.S. corporate bonds and foreign corporate debt funds. U.S. Treasury securities



## Notes to Consolidated Financial Statements (continued)

are valued at the closing price reported in the active market in which the individual security is traded and included as Level 1 of the valuation hierarchy. U.S. Government agencies, sovereign government obligations, U.S. corporate bonds and foreign corporate debt funds are valued based on quoted prices for comparable securities with similar yields and credit ratings. When quoted prices are not available for identical or similar bonds, the bonds are valued using discounted cash flows that maximize observable inputs, such as current yields of similar instruments, but includes adjustments for certain risks that may not be observable, such as credit and liquidity risks. U.S. Government agencies, sovereign government obligations, U.S. corporate bonds and foreign corporate debt funds are primarily included as Level 2 of the valuation hierarchy with a small portion of foreign corporate debt funds included as Level 3.

### *Funds of funds*

There are no readily available market quotations for these funds. The fair value of the fund is based on NAVs of the funds in the portfolio, which reflects the value of the underlying securities. The fair value of the underlying securities is typically the amount that the fund might reasonably expect to receive upon selling those hard to value or illiquid securities within the portfolios. These funds are valued using unobservable inputs on a monthly basis and are included as Level 3 of the valuation hierarchy.

The following tables present the fair value of each major category of plan assets as of Dec. 31, 2012 and Dec. 31, 2011, by captions and by ASC 820 valuation hierarchy. There were no transfers between Level 1 and Level 2.

### Plan assets measured at fair value on a recurring basis-domestic plans at Dec. 31, 2012

<i>(in millions)</i>	Level 1	Level 2	Level 3	Total fair value
Common and preferred stock:				
U.S. equity	\$ 947	\$ -	\$ -	\$ 947
Non-U.S. equity	118	-	-	118
Collective trust funds:				
Commingled	-	734	-	734
U.S. equity	-	841	-	841
Venture capital and partnership interests	-	-	105	105
Fixed income:				
U.S. Treasury securities	162	-	-	162
U.S. Government agencies	-	143	-	143
Sovereign government obligations	-	112	-	112
U.S. corporate bonds	-	892	-	892
Other	-	26	-	26
Exchange traded funds	68	-	-	68
Funds of funds	-	-	130	130
<b>Total domestic plan assets, at fair value</b>	<b>\$1,295</b>	<b>\$2,748</b>	<b>\$235</b>	<b>\$4,278</b>

### Plan assets measured at fair value on a recurring basis-foreign plans at Dec. 31, 2012

<i>(in millions)</i>	Level 1	Level 2	Level 3	Total fair value
Equity funds	\$379	\$116	\$ -	\$495
Sovereign/government obligation funds	38	123	-	161
Corporate debt funds	-	62	17	79
Cash and currency	6	-	-	6
Venture capital and partnership interests	-	-	41	41
<b>Total foreign plan assets, at fair value</b>	<b>\$423</b>	<b>\$301</b>	<b>\$58</b>	<b>\$782</b>

## Notes to Consolidated Financial Statements (continued)

### Plan assets measured at fair value on a recurring basis-domestic plans at Dec. 31, 2011

<i>(in millions)</i>	Level 1	Level 2	Level 3	Total fair value
Common and preferred stock:				
U.S. equity	\$ 802	\$ -	\$ -	\$ 802
Non-U.S. equity	91	-	-	91
Collective trust funds:				
Commingled	-	289	-	289
U.S. equity	-	781	-	781
Venture capital and partnership interests	-	-	121	121
Fixed income:				
U.S. Treasury securities	235	-	-	235
U.S. Government agencies	-	100	-	100
Sovereign government obligations	-	97	-	97
U.S. corporate bonds	-	805	-	805
Other	-	23	-	23
Exchange traded funds	57	-	-	57
Funds of funds	-	-	128	128
<b>Total domestic plan assets, at fair value</b>	<b>\$1,185</b>	<b>\$2,095</b>	<b>\$249</b>	<b>\$3,529</b>

### Plan assets measured at fair value on a recurring basis-foreign plans at Dec. 31, 2011

<i>(in millions)</i>	Level 1	Level 2	Level 3	Total fair value
Equity funds	\$312	\$121	\$ -	\$433
Sovereign/government obligation funds	22	102	-	124
Corporate debt funds	-	63	14	77
Cash and currency	7	-	-	7
Venture capital and partnership interests	-	-	40	40
<b>Total foreign plan assets, at fair value</b>	<b>\$341</b>	<b>\$286</b>	<b>\$54</b>	<b>\$681</b>

### Changes in Level 3 fair value measurements

The table below includes a rollforward of the plan assets for the years ended Dec. 31, 2012 and 2011 (including the change in fair value), for financial instruments classified in Level 3 of the valuation hierarchy.

#### Fair value measurements using significant unobservable inputs-domestic plans-for the year ended Dec. 31, 2012

<i>(in millions)</i>	Funds of funds	Venture capital and partnership interests	Total plan assets at fair value
Fair value at Dec. 31, 2011	\$128	\$121	\$249
Total gains or (losses) included in earnings (or changes in net assets)	6	16	22
Purchases, issuances, sales and settlements:			
Purchases	-	9	9
Sales	(4)	(41)	(45)
<b>Fair value at Dec. 31, 2012</b>	<b>\$130</b>	<b>\$105</b>	<b>\$235</b>
Change in unrealized gains or (losses) for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period	\$ 5	\$ (4)	\$ 1

#### Fair value measurements using significant unobservable inputs-foreign plans-for the year ended Dec. 31, 2012

<i>(in millions)</i>	Corporate debt funds	Venture capital and partnership interests	Total plan assets at fair value
Fair value at Dec. 31, 2011	\$14	\$40	\$54
Total gains or (losses) included in earnings (or changes in net assets)	3	1	4
Purchases, issuances, sales and settlements:			
Purchases	-	1	1
Sales	-	(1)	(1)
<b>Fair value at Dec. 31, 2012</b>	<b>\$17</b>	<b>\$41</b>	<b>\$58</b>
Change in unrealized gains or (losses) for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period	\$ 3	\$ 1	\$ 4

## Notes to Consolidated Financial Statements (continued)

### Fair value measurements using significant unobservable inputs-domestic plans-for the year ended Dec. 31, 2011

<i>(in millions)</i>	Funds of funds	Venture capital and partnership interests	Total plan assets at fair value
Fair value at Dec. 31, 2010	\$134	\$115	\$249
Total gains or (losses) included in earnings (or changes in net assets)	(2)	20	18
Purchases, issuances, sales and settlements:			
Purchases	-	7	7
Sales	(4)	(21)	(25)
<b>Fair value at Dec. 31, 2011</b>	<b>\$128</b>	<b>\$121</b>	<b>\$249</b>
Change in unrealized gains or (losses) for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period	\$ 2	\$ 8	\$ 10

### Fair value measurements using significant unobservable inputs-foreign plans-for the year ended Dec. 31, 2011

<i>(in millions)</i>	Corporate debt funds	Venture capital and partnership interests	Total plan assets at fair value
Fair value at Dec. 31, 2010	\$14	\$41	\$55
Total gains or (losses) included in earnings (or changes in net assets)	-	1	1
Purchases, issuances, sales and settlements:			
Purchases	-	4	4
Sales	-	(6)	(6)
<b>Fair value at Dec. 31, 2011</b>	<b>\$14</b>	<b>\$40</b>	<b>\$54</b>
Change in unrealized gains or (losses) for the period included in earnings (or changes in net assets) for assets held at the end of the reporting period	\$ -	\$ 1	\$ 1

#### *Venture capital and partnership interests and funds of funds valued using net asset value per share*

BNY Mellon had pension and post-retirement plan assets invested in venture capital and partnership interests and funds of funds valued using net asset value. The fund of funds investments are redeemable at net asset value under agreements with the fund of funds managers.

#### **Venture capital and partnership interests and funds of funds valued using NAV—Dec. 31, 2012**

<i>(dollar amounts in millions)</i>	Fair value	Unfunded commitments	Redemption frequency	Redemption notice period
Venture capital and partnership interests (a)	\$146	\$18	N/A	N/A
Funds of funds (b)	130	-	Monthly	30-45 days
<b>Total</b>	<b>\$276</b>	<b>\$18</b>		

#### **Venture capital and partnership interests and funds of funds valued using NAV—Dec. 31, 2011**

<i>(dollar amounts in millions)</i>	Fair value	Unfunded commitments	Redemption frequency	Redemption notice period
Venture capital and partnership interests (a)	\$161	\$36	N/A	N/A
Funds of funds (b)	128	-	Monthly	30-45 days
<b>Total</b>	<b>\$289</b>	<b>\$36</b>		

(a) *Venture capital and partnership interests do not have redemption rights. Distributions from such funds will be received as the underlying investments are liquidated.*

(b) *Funds of funds include multi-strategy hedge funds that utilize investment strategies that invest over both long-term investment and short-term investment horizons.*

#### *Defined contribution plans*

We have an Employee Stock Ownership Plan (“ESOP”) covering certain domestic full-time employees with more than one year of service. The ESOP works in conjunction with the defined benefit pension plan. Employees are entitled to the higher of their benefit under the ESOP or such defined benefit pension plan at retirement. Benefits payable under the defined benefit pension plan are offset by the equivalent value of benefits earned under the ESOP.

At Dec. 31, 2012 and Dec. 31, 2011, the ESOP owned 6.9 million and 7.1 million shares of our stock, respectively. The fair value of total ESOP assets was \$181 million at Dec. 31, 2012 and \$146 million at Dec. 31, 2011. Contributions are made equal to required principal and interest payments on borrowings by the ESOP. There were no contributions and no ESOP related expense in 2012, 2011 or 2010.

We have defined contribution plans, excluding the ESOP, for which we recognized a cost of \$180 million in 2012, \$182 million in 2011 and \$163 million in 2010.

The Benefits Investment Committee appointed Fiduciary Counselors, Inc. to serve as the independent fiduciary to (i) make certain fiduciary decisions related to the continued prudence of offering the common stock of BNY Mellon or its affiliates as an investment option under the plans other than with



respect to plan sponsor decisions, and (ii) select and monitor any managed investments (active or passive, including mutual funds) of BNY Mellon or its affiliates to be offered to participants as investment options under the Plan.

## Note 20—Company financial information

Our bank subsidiaries are subject to dividend limitations under the Federal Reserve Act, as well as national and state banking laws. Under these statutes, prior regulatory consent is required for dividends in any year that would exceed the bank's net profits for such year combined with retained net profits for the prior two years. Additionally, such bank subsidiaries may not declare dividends in excess of net profits on hand, as defined, after deducting the amount by which the principal amount of all loans, on which interest is past due for a period of six months or more, exceeds the allowance for credit losses.

The payment of dividends also is limited by minimum capital requirements imposed on banks. As of Dec. 31, 2012, BNY Mellon's bank subsidiaries exceeded these minimum requirements.

Subsequent to Dec. 31, 2012, our bank subsidiaries could declare dividends to the Parent of approximately \$2.7 billion without the need for a regulatory waiver. Including the impact of the approximately \$850 million charge related to the Feb. 11, 2013 U.S. Tax Court ruling, dividend paying capacity at our bank subsidiaries would decrease to \$1.9 billion. In addition, at Dec. 31, 2012, non-bank subsidiaries of the Parent had liquid assets of approximately \$1.4 billion.

The bank subsidiaries declared dividends of \$679 million in 2012, \$156 million in 2011, \$239 million in 2010. The Federal Reserve Board and the OCC have issued additional guidelines that require bank holding companies and national banks to continually evaluate the level of cash dividends in relation to their respective operating income, capital needs, asset quality and overall financial condition.

The Federal Reserve Board policy with respect to the payment of cash dividends by bank holding companies provides that, as a matter of prudent banking, a bank holding company should not maintain a rate of cash dividends unless its net income available to common shareholders has been sufficient to fully fund the dividends, and the prospective rate of earnings retention appears to be consistent with the

holding company's capital needs, asset quality and overall financial condition. The Federal Reserve Board can also prohibit a dividend if payment would constitute an unsafe or unsound banking practice. Any increase in BNY Mellon's ongoing quarterly dividends would require approval from the Federal Reserve. The Federal Reserve's current guidance provides that, for large bank holding companies like us, dividend payout ratios exceeding 30% of projected after-tax net income will receive particularly close scrutiny.

On Nov. 22, 2011, the Federal Reserve issued a final rule requiring U.S. bank holding companies with total consolidated assets of \$50 billion or more, like BNY Mellon, to submit annual capital plans for review. The Federal Reserve will evaluate the bank holding companies' capital adequacy, internal capital adequacy assessment processes, and their plans to make capital distributions, such as dividend payments or stock repurchases.

BNY Mellon and other affected BHCs may pay dividends, repurchase stock, and make other capital distributions only in accordance with a capital plan that has been reviewed by the Federal Reserve and as to which the Federal Reserve has not objected. The Federal Reserve may object to a capital plan if the plan does not show that the covered BHC will meet all minimum regulatory capital ratios and maintain a ratio of Basel I Tier 1 common equity to risk-weighted assets of at least 5% on a *pro forma* basis under expected and stressful conditions throughout the nine-quarter planning horizon covered by the capital plan. The capital plan rules also stipulate that a covered BHC may not make a capital distribution unless after giving effect to the distribution it will meet all minimum regulatory capital ratios and have a ratio of Basel I Tier 1 common equity to risk-weighted assets of at least 5%. As part of this process, BNY Mellon also provides the Federal Reserve with estimates of the composition and levels of regulatory capital, risk-weighted assets and other measures under Basel III under an identified scenario. BNY Mellon's most recent capital plan was submitted to the Federal Reserve on Jan. 7, 2013.

The Federal Reserve has indicated that it expects to publish its objection or non-objection to the capital plan and proposed capital actions, such as dividend payments and share repurchases, no later than March 14, 2013.

The Federal Reserve Act limits and requires collateral for extensions of credit by our insured subsidiary

banks to BNY Mellon and certain of its non-bank affiliates. Also, there are restrictions on the amounts of investments by such banks in stock and other securities of BNY Mellon and such affiliates, and restrictions on the acceptance of their securities as collateral for loans by such banks. Extensions of credit by the banks to each of our affiliates are limited to 10% of such bank's regulatory capital, and in the aggregate for BNY Mellon and all such affiliates to 20%, and collateral must be between 100% and 130% of the amount of the credit, depending on the type of collateral.

Our insured subsidiary banks are required to maintain reserve balances with Federal Reserve Banks under the Federal Reserve Act and Regulation D. Required balances averaged \$5.4 billion and \$4.3 billion for the years 2012 and 2011, respectively.

In the event of impairment of the capital stock of one of the Parent's national banks or The Bank of New York Mellon, the Parent, as the banks' stockholder, could be required to pay such deficiency.

The Parent guarantees the debt issued by Mellon Funding Corporation, a wholly-owned financing subsidiary of the Company. The Parent also guarantees committed and uncommitted lines of credit of Pershing LLC and Pershing Limited subsidiaries. The Parent guarantees described above are full and unconditional and contain the standard provisions relating to parent guarantees of subsidiary debt. Additionally, the Parent guarantees or indemnifies obligations of its consolidated subsidiaries as needed. Generally there are no stated notional amounts included in these indemnifications and the contingencies triggering the obligation for indemnification are not expected to occur. As a result, we are unable to develop an estimate of the maximum payout under these indemnifications. However, we

believe the possibility is remote that we will have to make any material payment under these guarantees and indemnifications.

The Parent's condensed financial statements are as follows:

**Condensed Income Statement—The Bank of New York Mellon Corporation (Parent Corporation)**

<i>(in millions)</i>	Year ended Dec. 31,		
	2012	2011	2010 (a)
Dividends from bank subsidiaries	\$ 645	\$ 120	\$ 200
Dividends from nonbank subsidiaries	199	54	74
Interest revenue from bank subsidiaries	120	211	211
Interest revenue from nonbank subsidiaries	126	130	131
Gain on securities held for sale	11	17	5
Other revenue	47	51	73
Total revenue	1,148	583	694
Interest (including \$30, \$13, \$14 to subsidiaries)	340	282	285
Other expense	103	138	221
Total expense	443	420	506
Income before income taxes and equity in undistributed net income of subsidiaries	705	163	188
Provision (benefit) for income taxes	(83)	66	(465)
Equity in undistributed net income:			
Bank subsidiaries	936	1,781	1,630
Nonbank subsidiaries	721	638	235
Net income	2,445	2,516	2,518
Preferred dividends	(18)	-	-
Net income applicable to common shareholders of The Bank of New York Mellon Corporation	\$2,427	\$2,516	\$2,518

(a) Includes the results of discontinued operations.

**Condensed Balance Sheet—The Bank of New York Mellon Corporation (Parent Corporation)**

<i>(in millions)</i>	Dec. 31,	
	2012	2011
<b>Assets:</b>		
Cash and due from banks	\$ 4,182	\$ 4,884
Securities	112	188
Loans—net of allowance	13	20
Investment in and advances to subsidiaries and associated companies:		
Banks	28,371	29,169
Other	24,273	20,930
Subtotal	52,644	50,099
Corporate-owned life insurance	682	666
Other assets	3,024	3,009
Total assets	\$60,657	\$58,866
<b>Liabilities:</b>		
Deferred compensation	\$ 489	\$ 492
Commercial paper	338	10
Affiliate borrowings	3,338	3,407
Other liabilities	2,647	2,735
Long-term debt	17,414	18,805
Total liabilities	24,226	25,449
<b>Shareholders' equity</b>	<b>36,431</b>	<b>33,417</b>
Total liabilities and shareholders' equity	\$60,657	\$58,866

**Condensed Statement of Cash Flows—The Bank of New York Mellon Corporation (Parent Corporation)**

<i>(in millions)</i>	Year ended Dec. 31,		
	2012	2011	2010
<b>Operating activities:</b>			
Net income	\$ 2,445	\$ 2,516	\$ 2,518
Adjustments to reconcile net income to net cash provided by/ (used in) operating activities:			
Amortization	13	13	14
Equity in undistributed net (income)/loss of subsidiaries	(1,657)	(2,419)	(1,865)
Change in accrued interest receivable	13	(22)	2
Change in accrued interest payable	(16)	11	2
Change in taxes payable (a)	177	168	(321)
Other, net	(179)	(80)	179
Net cash provided by operating activities	796	187	529
<b>Investing activities:</b>			
Purchases of securities	-	(50)	(5)
Proceeds from sales of securities	86	101	43
Change in loans	7	32	61
Acquisitions of, investments in, and advances to subsidiaries	175	(611)	(1,002)
Other, net	17	-	208
Net cash provided by/(used in) investing activities	285	(528)	(695)
<b>Financing activities:</b>			
Net change in commercial paper	328	-	(2)
Proceeds from issuance of long-term debt	2,761	5,042	1,347
Repayments of long-term debt	(4,163)	(1,911)	(2,614)
Change in advances from subsidiaries	(53)	63	(10)
Issuance of common stock	65	43	728
Treasury stock acquired	(1,148)	(873)	(41)
Issuance of preferred stock	1,068	-	-
Cash dividends paid	(641)	(593)	(440)
Tax benefit realized on share based payment awards	-	2	1
Net cash provided by/(used in) financing activities	(1,783)	1,773	(1,031)
Change in cash and due from banks	(702)	1,432	(1,197)
Cash and due from banks at beginning of year	4,884	3,452	4,649
Cash and due from banks at end of year	\$ 4,182	\$ 4,884	\$ 3,452
<b>Supplemental disclosures</b>			
Interest paid	\$ 324	\$ 293	\$ 284
Income taxes paid	\$ 401	\$ 212	\$ 442(b)
Income taxes refunded	\$ 1	\$ 123	\$ 178(b)

(a) Includes payments received from subsidiaries for taxes of \$648 million in 2012, \$501 million in 2011 and \$900 million in 2010.

(b) Includes discontinued operations.

## Note 21—Fair value measurement

The guidance related to “Fair Value Measurement” included in ASC 820 defines fair value as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date and establishes a framework for measuring fair value. It establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date and expands the disclosures about instruments measured at fair value. ASC 820 requires consideration of a company’s own creditworthiness when valuing liabilities.

The standard provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The objective is to determine from weighted indicators of fair value a reasonable point within the range that is most representative of fair value under current market conditions.

### *Determination of fair value*

Following is a description of our valuation methodologies for assets and liabilities measured at fair value. We have established processes for determining fair values. Fair value is based upon quoted market prices in active markets, where available. For financial instruments where quotes from recent exchange transactions are not available, we determine fair value based on discounted cash flow analysis, comparison to similar instruments, and the use of financial models. Discounted cash flow analysis is dependent upon estimated future cash flows and the level of interest rates. Model-based pricing uses inputs of observable prices, where available, for interest rates, foreign exchange rates, option volatilities and other factors. Models are benchmarked and validated by an independent internal risk management function. Our valuation process

takes into consideration factors such as counterparty credit quality, liquidity, concentration concerns, and observability of model parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value.

Most derivative contracts are valued using internally developed models which are calibrated to observable market data and employ standard market pricing theory for their valuations. An initial “risk-neutral” valuation is performed on each position assuming time-discounting based on a AA credit curve. Then, to arrive at a fair value that incorporates counter-party credit risk, a credit adjustment is made to these results by discounting each trade’s expected exposures to the counterparty using the counterparty’s credit spreads, as implied by the credit default swap market. We also adjust expected liabilities to the counterparty using BNY Mellon’s own credit spreads, as implied by the credit default swap market. Accordingly, the valuation of our derivative position is sensitive to the current changes in our own credit spreads as well as those of our counterparties.

In certain cases, recent prices may not be observable for instruments that trade in inactive or less active markets. Upon evaluating the uncertainty in valuing financial instruments subject to liquidity issues, we make an adjustment to their value. The determination of the liquidity adjustment includes the availability of external quotes, the time since the latest available quote and the price volatility of the instrument.

Certain parameters in some financial models are not directly observable and, therefore, are based on management’s estimates and judgments. These financial instruments are normally traded less actively. We apply valuation adjustments to mitigate the possibility of error and revision in the model based estimate value. Examples include products where parameters such as correlation and recovery rates are unobservable.

The methods described above for instruments that trade in inactive or less active markets may produce a current fair value calculation that may not be indicative of net realizable value or reflective of future fair values. We believe our methods of determining fair value are appropriate and consistent with other market participants. However, the use of different methodologies or different assumptions to value certain financial instruments could result in a different estimate of fair value.



### Valuation hierarchy

ASC 820 established a three-level valuation hierarchy for disclosure of fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are described below.

*Level 1:* Inputs to the valuation methodology are recent quoted prices (unadjusted) for identical assets or liabilities in active markets. Level 1 assets and liabilities include debt and equity securities and derivative financial instruments actively traded on exchanges and U.S. Treasury securities that are actively traded in highly liquid over-the-counter markets.

*Level 2:* Observable inputs other than Level 1 prices, for example, quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs that are observable or can be corroborated, either directly or indirectly, for substantially the full term of the financial instrument. Level 2 assets and liabilities include debt instruments that are traded less frequently than exchange traded securities and derivative instruments whose model inputs are observable in the market or can be corroborated by market observable data. Examples in this category are certain variable and fixed rate agency and non-agency securities, corporate debt securities and derivative contracts.

*Level 3:* Inputs to the valuation methodology are unobservable and significant to the fair value measurement. Examples in this category include interests in certain securitized financial assets, certain private equity investments, and derivative contracts that are highly structured or long-dated.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Following is a description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy.

### Securities

Where quoted prices are available in an active market, we classify the securities within Level 1 of the valuation hierarchy. Securities include both long and

short positions. Level 1 securities include highly liquid government bonds, money market mutual funds and exchange-traded equities.

If quoted market prices are not available, we estimate fair values using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Examples of such instruments, which would generally be classified within Level 2 of the valuation hierarchy, include certain agency and non-agency mortgage-backed securities, commercial mortgage-backed securities, sovereign debt, corporate bonds and foreign covered bonds.

For securities where quotes from recent transactions are not available for identical securities, we determine fair value primarily based on pricing sources with reasonable levels of price transparency that employ financial models or obtain comparison to similar instruments to arrive at "consensus" prices.

Specifically, the pricing sources obtain recent transactions for similar types of securities (e.g., vintage, position in the securitization structure) and ascertain variables such as discount rate and speed of prepayment for the types of transaction and apply such variables to similar types of bonds. We view these as observable transactions in the current marketplace and classify such securities as Level 2. Pricing sources discontinue pricing any specific security whenever they determine there is insufficient observable data to provide a good faith opinion on price.

In addition, we have significant investments in more actively traded agency RMBS and other types of securities such as sovereign debt. The pricing sources derive the prices for these securities largely from quotes they obtain from three major inter-dealer brokers. The pricing sources receive their daily observed trade price and other information feeds from the inter-dealer brokers.

For securities with bond insurance, the financial strength of the insurance provider is analyzed and that information is included in the fair value assessment for such securities.

In certain cases where there is limited activity or less transparency around inputs to the valuation, we classify those securities in Level 3 of the valuation hierarchy. Securities classified within Level 3 primarily include other debt securities and securities of state and political subdivisions.

At Dec. 31, 2012, more than 99% of our securities were valued by pricing sources with reasonable levels of price transparency. Less than 1% of our securities were priced based on economic models and non-binding dealer quotes, and are included in Level 3 of the ASC 820 hierarchy.

#### *Consolidated collateralized loan obligations*

BNY Mellon values assets in consolidated CLOs using observable market prices observed from the secondary loan market. The returns to the note holders are solely dependent on the assets and accordingly equal the value of those assets. Based on the structure of the CLOs, the valuation of the assets is attributable to the senior note holders. Changes in the values of assets and liabilities are reflected in the income statement as investment income and interest of investment management fund note holders, respectively.

#### *Derivatives*

We classify exchange-traded derivatives valued using quoted prices in Level 1 of the valuation hierarchy. Examples include exchanged-traded equity and foreign exchange options. Since few other classes of derivative contracts are listed on an exchange, most of our derivative positions are valued using internally developed models that use as their basis readily observable market parameters and we classify them in Level 2 of the valuation hierarchy. Such derivatives include basic swaps and options and credit default swaps.

Derivatives valued using models with significant unobservable market parameters in markets that lack two-way flow are classified in Level 3 of the valuation hierarchy. Examples include long-dated interest rate or currency swaps and options, where parameters may be unobservable for longer maturities; and certain products, where correlation risk is unobservable. The fair value of these derivatives compose less than 1% of our derivative financial instruments. Additional disclosures of derivative instruments are provided in Note 24 of the Notes to Consolidated Financial Statements.

#### *Loans and unfunded lending-related commitments*

Where quoted market prices are not available, we generally base the fair value of loans and unfunded lending-related commitments on observable market prices of similar instruments, including bonds, credit derivatives and loans with similar characteristics. If

observable market prices are not available, we base the fair value on estimated cash flows adjusted for credit risk which are discounted using an interest rate appropriate for the maturity of the applicable loans or the unfunded lending-related commitments.

Unrealized gains and losses, if any, on unfunded lending-related commitments carried at fair value are classified in Other assets and Other liabilities, respectively. Loans and unfunded lending-related commitments carried at fair value are generally classified within Level 2 of the valuation hierarchy.

#### *Seed capital*

In our Investment Management business we manage investment assets, including equities, fixed income, money market and alternative investment funds for institutions and other investors; as part of that activity we make seed capital investments in certain funds. Seed capital is included in other assets. When applicable, we value seed capital based on the published NAV of the fund. We include funds in which ownership interests in the fund are publicly traded in an active market and institutional funds in which investors trade in and out daily in Level 1 of the valuation hierarchy. We include open-end funds where investors are allowed to sell their ownership interest back to the fund less frequently than daily and where our interest in the fund contains no other rights or obligations in Level 2 of the valuation hierarchy. However, we generally include investments in funds that allow investors to sell their ownership interest back to the fund less frequently than monthly in Level 3, unless actual redemption prices are observable.

For other types of investments in funds, we consider all of the rights and obligations inherent in our ownership interest, including the reported NAV as well as other factors that affect the fair value of our interest in the fund. To the extent the NAV measurements reported for the investments are based on unobservable inputs or include other rights and obligations (e.g., obligation to meet cash calls), we generally classify them in Level 3 of the valuation hierarchy.

#### *Certain interests in securitizations*

For certain interests in securitizations which are classified in securities available-for-sale, trading assets and long-term debt, we use discounted cash flow models which generally include assumptions of

projected finance charges related to the securitized assets, estimated net credit losses, prepayment assumptions and estimates of payments to third-party investors. When available, we compare our fair value estimates and assumptions to market activity and to the actual results of the securitized portfolio.

*Private equity investments*

Our Other segment includes holdings of nonpublic private equity investment through funds managed by third-party investment managers. We value private equity investments initially based upon the transaction price, which we subsequently adjust to reflect expected exit values as evidenced by financing and sale transactions with third parties or through ongoing reviews by the investment managers.

Private equity investments also include publicly held equity investments, generally obtained through the initial public offering of privately held equity investments. These equity investments are often held in a partnership structure. Publicly held investments

are marked-to-market at the quoted public value less adjustments for regulatory or contractual sales restrictions or adjustments to reflect the difficulty in selling a partnership interest.

Discounts for restrictions are quantified by analyzing the length of the restriction period and the volatility of the equity security. Publicly held private equity investments are primarily classified in Level 2 of the valuation hierarchy.

The following tables present the financial instruments carried at fair value at Dec. 31, 2012 and 2011, by caption on the consolidated balance sheet and by ASC 820 valuation hierarchy (as described above). We have included credit ratings information in certain of the tables because the information indicates the degree of credit risk to which we are exposed, and significant changes in ratings classifications could result in increased risk for us. There were no material transfers between Level 1 and Level 2 during 2012.

## Notes to Consolidated Financial Statements (continued)

### Assets and liabilities measured at fair value on a recurring basis at Dec. 31, 2012

<i>(dollar amounts in millions)</i>	Level 1	Level 2	Level 3	Netting (a)	Total carrying value
<b>Available-for-sale securities:</b>					
U.S. Treasury	\$18,003	\$ -	\$ -	\$ -	\$ 18,003
U.S. Government agencies	-	1,074	-	-	1,074
Sovereign debt	41	9,383	-	-	9,424
State and political subdivisions (b)	-	6,077	45	-	6,122
Agency RMBS	-	34,193	-	-	34,193
Alt-A RMBS	-	279	-	-	279
Prime RMBS	-	728	-	-	728
Subprime RMBS	-	452	-	-	452
Other RMBS	-	2,794	-	-	2,794
Commercial MBS	-	3,139	-	-	3,139
Asset-backed CLOs	-	1,282	-	-	1,282
Other asset-backed securities	-	2,131	-	-	2,131
Equity securities	27	-	-	-	27
Money market funds (b)	2,190	-	-	-	2,190
Corporate bonds	-	1,585	-	-	1,585
Other debt securities	-	2,368	-	-	2,368
Foreign covered bonds	2,995	723	-	-	3,718
Alt-A RMBS (c)	-	1,970	-	-	1,970
Prime RMBS (c)	-	1,010	-	-	1,010
Subprime RMBS (c)	-	130	-	-	130
<b>Total available-for-sale</b>	<b>23,256</b>	<b>69,318</b>	<b>45</b>	<b>-</b>	<b>92,619</b>
<b>Trading assets:</b>					
Debt and equity instruments (d)	912	4,116	48	-	5,076
<b>Derivative assets (e):</b>					
Interest rate	36	22,734	19	N/A	
Foreign exchange	3,364	148	1	N/A	
Equity	121	152	38	N/A	
<b>Total derivative assets</b>	<b>3,521</b>	<b>23,034</b>	<b>58</b>	<b>(22,311)</b>	<b>4,302</b>
<b>Total trading assets</b>	<b>4,433</b>	<b>27,150</b>	<b>106</b>	<b>(22,311)</b>	<b>9,378</b>
Other assets (f)	135	1,044	120	-	1,299
<b>Subtotal assets of operations at fair value</b>	<b>27,824</b>	<b>97,512</b>	<b>271</b>	<b>(22,311)</b>	<b>103,296</b>
Percentage of assets prior to netting	22%	78%	-		
<b>Assets of consolidated investment management funds:</b>					
Trading assets	182	10,735	44	-	10,961
Other assets	390	130	-	-	520
<b>Total assets of consolidated investment management funds</b>	<b>572</b>	<b>10,865</b>	<b>44</b>	<b>-</b>	<b>11,481</b>
<b>Total assets</b>	<b>\$28,396</b>	<b>\$108,377</b>	<b>\$315</b>	<b>\$(22,311)</b>	<b>\$114,777</b>
Percentage of assets prior to netting	21%	79%	-		
<b>Trading liabilities:</b>					
Debt and equity instruments	\$ 1,121	\$ 659	\$ -	\$ -	\$ 1,780
<b>Derivative liabilities (e):</b>					
Interest rate	-	23,173	168	N/A	
Foreign exchange	3,535	97	-	N/A	
Equity	91	266	56	N/A	
<b>Total derivative liabilities</b>	<b>3,626</b>	<b>23,536</b>	<b>224</b>	<b>(20,990)</b>	<b>6,396</b>
<b>Total trading liabilities</b>	<b>4,747</b>	<b>24,195</b>	<b>224</b>	<b>(20,990)</b>	<b>8,176</b>
Long-term debt (b)	-	345	-	-	345
Other liabilities (g)	224	354	-	-	578
<b>Subtotal liabilities at fair value</b>	<b>4,971</b>	<b>24,894</b>	<b>224</b>	<b>(20,990)</b>	<b>9,099</b>
Percentage of liabilities prior to netting	17%	82%	1%		
<b>Liabilities of consolidated investment management funds:</b>					
Trading liabilities	-	10,152	-	-	10,152
Other liabilities	-	29	-	-	29
<b>Total liabilities of consolidated investment management funds</b>	<b>-</b>	<b>10,181</b>	<b>-</b>	<b>-</b>	<b>10,181</b>
<b>Total liabilities</b>	<b>\$ 4,971</b>	<b>\$ 35,075</b>	<b>\$224</b>	<b>\$(20,990)</b>	<b>\$ 19,280</b>
Percentage of liabilities prior to netting	12%	87%	1%		

(a) ASC 815 permits the netting of derivative receivables and derivative payables under legally enforceable master netting agreements and permits the netting of cash collateral. Netting cannot be disaggregated by product.

(b) Includes certain interests in securitizations.

(c) Previously included in the Grantor Trust.

(d) Includes loans classified as trading assets and certain interests in securitizations.

(e) The Level 1, 2 and 3 fair values of derivative assets and derivative liabilities are presented on a gross basis.

(f) Includes private equity investments, seed capital, a brokerage account, and derivatives in designated hedging relationships.

(g) Includes derivatives in designated hedging relationships.

























































