Press Release

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BNY Mellon research into OTC derivatives shows significant gaps in implementation of managing and mitigating counterparty credit risk

Substantial investment required to implement operational and risk management processes

NEW YORK, January 24, 2011 – Buy-side institutions face significant gaps in being able to accommodate the regulatory requirements emerging in the US and Europe, according to a BNY Mellon survey of institutional investors released today. Surveyed during the latter part of 2010, the research establishes how these institutions are addressing the challenges of counterparty credit risk and collateral management for OTC derivatives.

The analysis was conducted to show what the buy-side needs to do in the face of forthcoming industry regulatory changes, which are focused on the standardization of OTC derivatives and a migration to central clearing. Industry best practise in this area has to date been focused on banks and broker dealers, while institutional investors have some way to go to meet the on-going regulatory requirements as set out by Dodd Frank, the European Commission and other industry efforts.

Some of the limitations of the buy-side as set out in the research:

- **40% of institutions surveyed do not have an internal OTC derivatives pricing capability** – robust independent pricing is necessary to validate collateral demands.

- **Only 10% of participants report use of best practise Potential Future Exposure (PFE) calculations for counterparty credit risk measurement** – the 90% majority continue to use current mark to market valuation, which has no forward looking capability.

- **Over 75% of the survey group does not rehypothecate securities collateral** – Insurance and pensions fund institutions that are able to pool collateral actively re-use securities collateral.

- **Just under 50% of survey participants have outsourced their collateral management -** a further 25% have deployed vendor collateral management solutions internally, with the remainder reliant on bespoke applications.

BNY Mellon's research details a number of topic areas and sets out the survey findings in the report. These include:

- The OTC derivatives activity of asset managers, pension funds and insurance companies, the key drivers of the use of OTC derivatives and the principle operational obstacles faced by these institutions.

- OTC counterparty documentation standards, how they have become more standardized; the difference between cash and securities collateral and a discussion around initial margin.

- Proprietary analysis of the threshold and MTA terms of agreements between counterparties using the BNY Mellon DM Edge outsourced collateral management service.

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- A look at OTC derivatives operations, the systems used, pricing and valuation.
- The measurement and mitigation of counterparty risk: how institutions use and calculate mark-to-market exposure, PFE as a tool and stress testing of portfolios.
- A detailed analysis of the buy-side approach to collateral management, whether outsourced, managed by vendor applications, internally or by spreadsheets. The size of collateral received and delivered. How collateral is funded.
- Institutions attitudes towards central clearing and the cost implications of this move.
- A detailed outline of counterparty credit risk best practices for asset managers.

Commenting on the report, Patrick Tadie, BNY Mellon's global business head for Derivatives360 SM said, "The financial crisis re-emphasised the importance of counterparty credit risk and the subsequent industry-led program of reform has addressed many of the shortcomings of the OTC market. While the standardisation of OTC derivatives and migration to central clearing is welcomed, our current and potential clients from buy-side institutions have expressed a number of concerns that arise from this: loss of flexibility, increased cost of financing positions, management of exposure and disruption over the transition period. We look forward to addressing these concerns with our clients and helping them overcome potential problems in the implementation of the new rules."

The White Paper can be accessed at the following link: http://www.bnymellon.com/derivatives360

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Notes to editors

Derivatives360 SM is an integrated investment servicing solution that helps clients efficiently execute and manage derivatives transactions. Whether clients are using derivatives as a hedging tool or as a separate investment strategy, Derivatives360 offers a broad array of services for issuers and investors around the execution and processing of derivatives. These include trading and execution, middle- and back-office outsourcing, collateral management, accounting and recordkeeping, reporting, and performance and risk analytics. Derivatives360 also encompasses a range of outsourced services, including OTC trade affirmation and confirmation, trade settlement, independent (third-party) valuation, and counterparty and investment manager reconciliation.

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