



THE BANK OF NEW YORK MELLON

March 2009

THE BANK OF NEW YORK MELLON'S RESPONSE TO THE CEBS QUESTIONNAIRE FOR CUSTODIAN BANKS ON INTERNALISATION OF SETTLEMENT

INTRODUCTION

This paper is The Bank of New York Mellon's formal response to the CEBS questionnaire for custodian banks that was published on 2 February 2009 by CEBS and that relates to internalisation of settlement.

This response relates to the core custodian business of BNY Mellon in Europe for European securities. It does not relate to other entities within the BNY Mellon group, such as Pershing, which does have CCP-related activity.

Questions relating to internalisation of settlement

1. Of those Central Securities Depositories (CSD) you have access to, how many of them allow you to hold an omnibus account (the prerequisite for internalising settlement)?

BNY Mellon response :

All the CSDs to which we have direct access allow us to hold omnibus accounts.

It should, however, be said that even if the ability to hold an omnibus account is a prerequisite for internalisation of settlement it is not the only prerequisite.

2. What percentage of trades to be settled that enter your system is passed on to a CSD, and what percentage is internally settled?

BNY Mellon response :

For the core custodian business of BNY Mellon, we pass on virtually all trades to the next provider in the custodian chain (whether that be a CSD or another intermediary). We believe that the percentage of real trades that we settle internally is very substantially below 1%.

There are two basic reasons why this is the case.

The first is that a prerequisite for significant internalisation of settlement is that a custodian bank has among its client base both the buy-side and the sell-side; it so happens that for the CSDs to which we have direct access the general pattern is for significant sell-side firms to operate direct accounts with the CSD.

The second reason is that where we have a sell-side firm as a client, and as a general matter of BNY Mellon policy, we shall choose to place the activity of this client in a segregated account at our account provider (CSD or another provider); this is because such firms usually have high volumes of risky, time-sensitive turn-around activity; segregation of such activity allows us to monitor this activity more closely, to improve the settlement efficiency, and to ensure that there is no risk of "drawing from the pool".

Discussion of Figure of Less than 1%

As a general rule, all trade-related settlement instructions that we receive are passed on to the next provider in the custody chain. We do not have specific automated functionalities that would allow us to identify trade-related instructions that do not need to be sent on (as settlement should occur within a single omnibus account).

We have reviewed the total transaction activity that was recorded on our main custody platform during the month of January 2009 for most European markets.

Of this total activity, we excluded some specific activities, such as corporate actions related movements, realignments for common depository activity, and movements related to triparty collateral management. The rationale behind these exclusions was to arrive at statistics that relate more closely to real securities trades.

Of the total number of securities movements, we identified those movements for which the booking in our system was not dependent on a transfer at our account provider; these movements represented a total of 4.69% of the total.

This figure is a very considerable overestimate of the real degree of internalisation of settlement.

Within this figure of 4.69% are many kinds of transfer that do not represent real trades; one major category of such transfers are securities transfers instructed by a client to move securities from one of its accounts in our books to another of its accounts in our books; such transfers can occur for a whole variety of reasons; there may well be tax reasons (provision of tax documentation to benefit from relief at source, change of tax status of underlying client), account rebalancing reasons, a reallocation of positions between different funds of the same fund manager, etc etc.

As we do not always have a full view on the underlying rationale for a particular transfer, we are not in a position to give fully precise figures.

However, based on a manual and partial review of our activity, we believe that of the figure of 4.69% only a very tiny proportion, if any at all, amounts to internalisation of settlement in our books of real securities trades.

3. Do you aggregate all your clients in such omnibus accounts where they exist? If not, how many of your clients are held in such accounts and how do you decide whether or not they should be included (please also indicate the total number of clients)? Does the allocation depend on the underlying nature of the client (i.e. institutional, retail, ...)? If yes, please indicate the nature of the clients.



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BNY Mellon response :

As a general rule, and for reasons of cost and of operational efficiency, BNY Mellon prefers to operate omnibus accounts. We will, however, use segregated accounts if there are specific reasons for their use. Such specific reasons may be of a legal or regulatory nature; in some countries, such reasons may be more operationally-related, and may, for example, deal with registration or tax processes.

As mentioned above, and for clients with significant turnaround activity, we systematically use segregated accounts.

4. How do you monitor the trades that get settled internally? Do you have specific rules and procedures relating to these processes?

BNY Mellon response :

We do have a specific facility that allows a client to instruct a securities transfer between two of its accounts in an easy and efficient manner. Such transfers can be monitored using an internal transfer module; under a restrictive set of conditions, such transfers can be booked automatically on our systems; if the transfers do not meet these conditions, then the booking on our systems is manual.

We do not have a general process relating to internalisation of settlement, as, for the reasons set out above, and based on our experience, we believe such internalisation of settlement in our books to be a marginal phenomenon, if it exists at all.

5. Do you inform your customers explicitly when you internalise settlement rather than passing trades on to the CSD? How much information do you provide to your client on the process of internalisation?

BNY Mellon response :

In the event of internalisation of settlement, we would in general not explicitly inform clients. However, it would usually be apparent to the client from the details of the settlement instruction that settlement is internal.

6. Is there a difference in the degree of internalisation between different product classes (e.g. homogenous products, such as bonds, versus more heterogeneous products, such as equities) and/or different type of trades (e.g. exchange traded versus OTC)?

BNY Mellon response :

Not applicable.

Questions relating to CCP-like activities

7. Do you undertake any activity whereby you take on the counterparty risk of a party to a trade and assume all losses that may derive from such a position? If yes, is the volume of such activity significant to your business? Are your clients aware of such activity?

BNY Mellon response :

No

8. Do you provide services whereby you act as an intermediary between a client and a CCP (i.e. you act as General Clearing Member)? If yes, is such activity significant to your business?

BNY Mellon response :

No.

9. In either of the above cases, how do you monitor and protect yourself and your clients from the risks arising from such activities?

BNY Mellon response :

Not applicable.

10. Do you differentiate between products (including derivatives) and trading types when deciding whether to provide such services?

BNY Mellon response :

Not applicable.