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Implementation of AMA Within Business Line Risk Management

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Risk Management Objectives

- Prevent or Minimize
  - Errors or service delivery failures with visible impact on customers
  - Financial losses
  - Compliance breaches
  - Reputation damage

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Risk Committee of The Board

PURPOSE

The Risk Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities in respect of:

- Risks inherent in the businesses of the Company and the control processes with respect to such risks, including reputation risk
- Risk profile of the Company
- Risk management, compliance and control activities of the Company, including review of operational audit findings
- Integrity of the Company's systems of operational controls regarding legal and regulatory compliance
- Compliance with legal and regulatory requirements, including without limitation, with respect to the conduct of the Company's businesses

Tone From the Top

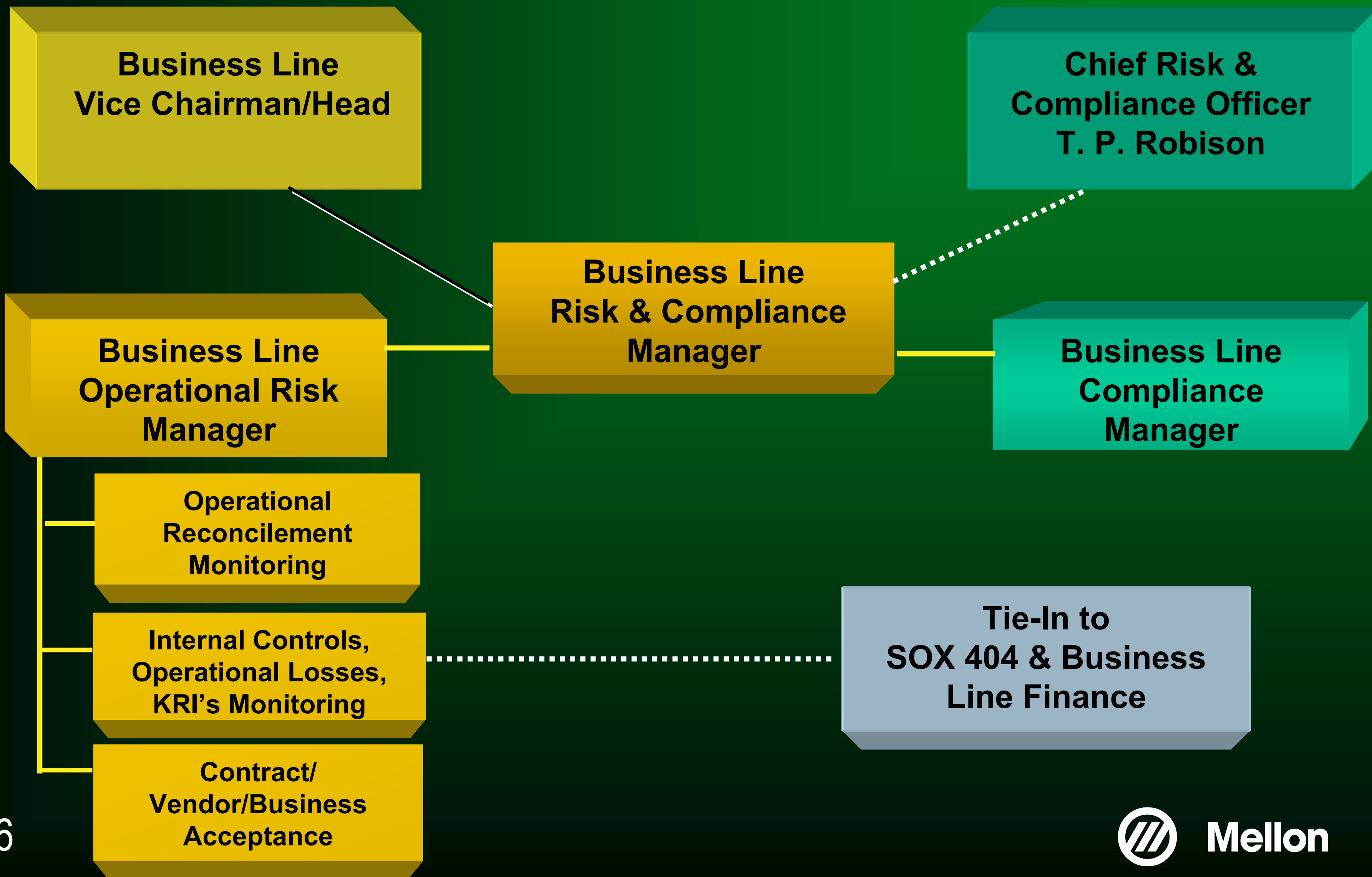
- CEO support of risk management sends a message that protecting Mellon's reputation is a key goal;

- Frequent reinforcement to the business lines of the message that tackling their major risks keeps reputational harm at bay and losses down

Management Responsibilities for Risk

- Business Line:
  - Owns risks of the business
- Business Line Risk Management:
  - Owns responsibility to identify, monitor and ensure management of risk within business
  - Responsible to and accountable for developing and implementing: standards, policies, programs and processes to identify, communicate, monitor and mitigate the risks within the business
- Corporate Risk Management:
  - Provides oversight and support to Chairman/CEO and LOB management
  - Establishes overall policy and process framework
  - Provides indirect supervision of LOB Risk Managers to ensure risks are properly identified and managed
  - Independently approves credit risk, market risk policies and limits
  - Coordinates cross line-of-business operational risk management training

Risk Management Oversight Model



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Risk Management Execution Priorities

- Instituted indirect reporting line to Risk Management for Sector Risk Managers in December 2003
- Prescribed core functions to be performed by Sector Risk Management in Risk Management Policy
- Monthly one-on-one's with Sector Risk Managers:
  - New or Emerging Risks/Products/Process Changes
  - Key Risk Indicators – Implications and Actions
  - Losses – Root Cause and Actions
  - Operational Reconcilements
  - Status of Current Risk Management initiatives
- Created Group of 12 Senior Corporate and Business Line Risk Manager working group – to prioritize and coordinate Risk Management activities across the Enterprise

Continuous Risk Management Process

- **Identify and Understand** key business processes and inherent risks
- **Design and Document** appropriate and cost effective controls, including policies, procedures, tools and training to mitigate all material risks
- **Execute** the controls at the business process and operational level
- **Monitor** key risk and performance indicators against standards
- **Elevate**, in a transparent manner, key indicator performance, aged reconcilement items, errors, losses and near misses
- **Analyze** key risk indicators that have breached standards, aged reconcilement items, errors, losses and near misses and determine their root cause
- **Strengthen** controls to minimize the impact of the item going forward
- **Reassess** the impact on risk and controls of any business process changes, new or modified products and update appropriately

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Continuous Risk Management Process

- **Change Equals Risk X 10**
  - Be aware of all business process changes, new products and system conversions in your business
  - Get in the flow and assess the risk and control implications of the changes
  - Ensure new risks or comprising of existing controls are identified, elevated and mitigated
  - Develop tracking of risk mitigation actions to ensure completion
  - Raise your voice if you have to!

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Culture & Tone from Chief Risk Officer

- Enterprise Focus in everything we do
- Creation of Shareholder Value Focus
- Process is Important – know when 80/20 is good enough
- Consistency and Intensity are More Important
- Good Judgment and Results are Most Important!

Risk Management Value Proposition

Operational Losses	$24mm
Profit Margin	30%
New Revenue Equivalent	$80mm
New Revenue Equivalent per $5 million in error reduction	$16mm

Operational Risk Modeling

- **Model is a hybrid between a Loss Distribution Approach and a Scorecard Approach:**
  - External data to model large losses
  - Internal data to model small losses
  - Scorecards to assess internal risk environment
  - Actual information on insurance coverage to measure mitigation
  - Monte Carlo simulation is used to develop a loss distribution
  - Capital is allocated to business sectors and risk categories and then to business units via scorecards
  - No scenario analysis at this time

Operational Risk Modeling

- Subsequent model runs revised business units' capital based on scorecard changes
  - Results will be rolled up as opposed to allocated down
  - Encourages business units to lower risk
  - Scorecards validated by independent reviewer
  - High-level loss distribution run updated to validate consolidated results

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Operational Risk Modeling

Relevant Regulatory Issues

- Tax NOL Carryback position should be recognized as a deduction from capital for all Risk categories
- Expected loss should be deducted from Operational Risk capital
- Insurance mitigation inconsistent with credit risk mitigation
  - 20% cap – arbitrary and should be eliminated
  - Recovery of valid claims beyond 1 year should be permitted