

Trading activities

Mellon has established trading limits and related monitoring procedures to control trading risk. These limits are approved by the Market Risk Committee and reviewed by the Risk Committee of the Board of Directors. All limits are monitored for adherence to these limits by the Risk Management & Compliance Department. Exceptions to limits are reported regularly to the Market Risk Committee.

The financial risk associated with trading positions is managed by assigning position limits and stop-loss guidance amounts to individual activities. We use a value-at-risk methodology to estimate the potential gain or loss in a portfolio of trading positions that is associated with a price movement of given probability over a specified time frame. Position limits are assigned to each family of financial instruments eligible for trading, such that the aggregate value-at-risk in these activities at any point in time will not exceed a specified limit given a significant market movement. The extent of market movement deemed to be significant is based upon an analysis of the historical volatility of individual instruments that would cover 95% of likely daily market movements. The loss analysis includes the derivative instruments used for trading activities as well as the financial assets and liabilities that are classified as trading positions on our balance sheet. Using our methodology, which considers such factors as changes in currency exchange rates, interest rates, spreads and related volatility, the aggregate average value-at-risk for trading activities and credit default swaps was approximately \$5 million for the 60 business-day periods ended Dec. 31, 2006 and Dec. 31, 2005. The average daily value-at-risk for trading activities in 2006 was approximately \$6 million.

Trading activities are generally limited to products and markets in which liquidity is sufficient to allow positions to be closed quickly and without adversely affecting market prices, which limits loss potential below that assumed for a full-day adverse movement. Loss potential is further constrained in that it is highly unusual for all trading areas to be exposed to maximum limits at the same time and extremely rare for significant adverse market movements to occur in all markets simultaneously.

Stop-loss guidance is used when a certain threshold of loss is sustained. If stop-loss guidance amounts are approached, open positions may be liquidated to avoid further risk to earnings. The use of stop-loss guidance in tandem with position limits reduces the likelihood that potential trading losses would reach imprudent levels in relation to earnings.

Derivative instruments used for trading purposes

Mellon enters into various foreign exchange and interest rate contracts, and, to a lesser extent, equity derivative contracts for trading purposes. Trading activities primarily involve providing various derivative products to customers to assist them in managing foreign currency exchange risk, interest rate risk and equity price risk and for managing our risks in certain trading portfolios and as part of our proprietary trading activities. All of these instruments are carried at market value with realized and unrealized gains and losses included in foreign exchange trading revenue and other revenue. For a description and table of derivative instruments used for trading activities, see Note 27 of Notes to Financial Statements.

Credit risk

Mellon's hedging and trading derivative products are subject to credit risk. We enter into netting agreements to reduce credit risk. Netting agreements generally permit us to net gains and losses on derivative contracts with the same counterparty. For a discussion of gross credit risk and the corresponding netting impact of derivative instruments, see Note 27 of Notes to Financial Statements.

Off-balance sheet arrangements

Guarantees and indemnities

In the normal course of business, Mellon offers standby letters of credit and foreign and other guarantees to customers as well as other guarantees in support of certain joint ventures and subsidiaries.

Standby letters of credit and foreign and other guarantees totaled \$1.5 billion at Dec. 31, 2006, an increase of \$55 million compared with Dec. 31, 2005. Standby letters of credit and foreign and

other guarantees are used by the customer as a credit enhancement and typically expire without being drawn upon. We generated \$7 million of fee revenue in 2006 and 2005 related to the letters of credit and foreign guarantees. Cash is disbursed only when standby letters of credit are drawn upon. We believe the market risk associated with these instruments is minimal.

A securities lending transaction is a fully collateralized transaction in which the owner of a security agrees to lend the security through an agent (Mellon) to a borrower, usually a broker/dealer or bank, on an open, overnight or term basis, under the terms of a prearranged contract, which generally matures in less than 90 days. We recorded \$120 million of fee revenue from securities lending transactions in 2006 compared with \$108 million in 2005. Securities are lent with and without indemnification against broker default. Custodian securities lent with indemnification against broker default of return of securities totaled \$123 billion at Dec. 31, 2006, a \$17 billion increase compared with Dec. 31, 2005, reflecting growth in this line of business. These transactions were primarily collateralized by cash and U.S. government securities. Market risk can also arise in securities lending transactions. These risks are controlled through policies, approved by our Board of Directors, limiting the level of risk that can be undertaken.

Mellon's primary banking subsidiary, Mellon Bank, and ABN AMRO Bank N.V. (ABN AMRO) entered into a joint venture to provide global securities services, with operations commencing in January 2003. Each of the two partners signed a statutory declaration under Dutch law to be jointly and severally liable with the joint venture to parties that have a provable contractual debt or damage claim. The benefit of this declaration is potentially available to all creditors and customers of the joint venture with valid legal claims if the joint venture defaults. The guarantee totaled \$78 billion at Dec. 31, 2006 compared with \$43 billion at Dec. 31, 2005. Agency securities lending represented \$72 billion of this guarantee at Dec. 31, 2006, primarily related to the indemnification of the owner of the securities against broker default. These securities lending transactions were collateralized primarily with cash and Organisation for Economic

Co-operation and Development (OECD) government securities totaling \$70 billion. The joint venture also indemnifies \$483 million of cash collateral reinvested in repurchase agreements for risk of market or credit loss. The potential exposure of this guarantee assumes that there is no capital or assets of the joint venture to satisfy such claims, and that there is no level of contribution by ABN AMRO, which has an S&P long-term credit rating of AA- and a Moody's senior debt rating of Aa3.

For additional information on standby letters of credit and foreign and other guarantees, and custodian securities lent with indemnification against broker default of return of securities see Note 26 of Notes to Financial Statements.

Mellon Bank has a referral relationship with, and provides administrative services to, Three Rivers Funding Corp. (TRFC), a special purpose entity that issues commercial paper. TRFC is owned by an independent third party and is not a subsidiary of either Mellon Bank or Mellon. Its financial results are not included in the financial statements of Mellon Bank or Mellon. Fee revenue of \$3 million was received from this entity in 2006 and \$2 million in 2005. At Dec. 31, 2006, TRFC's receivables totaled \$3.200 billion and commercial paper outstanding totaled \$3.213 billion, compared with receivables and commercial paper outstanding each totaling \$1.550 billion at Dec. 31, 2005. A letter of credit provided by Mellon Bank in support of TRFC's commercial paper totaled \$149 million at Dec. 31, 2006, compared with \$191 million at Dec. 31, 2005. Mellon's maximum loss exposure related to TRFC is the full amount of the liquidity facility provided to TRFC, or \$3.213 billion, at Dec. 31, 2006. However, the probability of this loss scenario is remote as it would mean that all of TRFC's receivables were wholly uncollectible. For additional information about TRFC, see the TRFC discussion in Note 7 of Notes to Financial Statements.

Retained interests

From time to time, Mellon has securitized certain loans. We retain servicing responsibilities as well as subordinated interests in loan securitizations, specifically home equity lines of credit loans

CORPORATE RISK MANAGEMENT

(HELOC). All securitized loans are removed from our balance sheet upon securitization. The investors and the securitization trusts have no recourse to Mellon for failure of debtors to pay when due. Our retained interests, which totaled \$2 million at Dec. 31, 2006 and Dec. 31, 2005, are subordinate to investor's interests. Their value is subject to credit, prepayment and interest rate risks on the transferred assets.

Contractual obligations

Mellon is contractually obligated to make future payments according to various contracts. The following table presents the expected future payments of our significant contractual obligations.

Contractual obligations at Dec. 31, 2006 ^(a) (in millions)	Total	Payments due			
		< 1 year	1-3 yrs.	3-5 yrs.	5+ yrs.
Long-term debt ^(b)	\$3,632	\$791	\$550	\$1,091	\$1,200
Operating leases ^(c)	1,501	166	299	231	805
Junior subordinated debentures ^(d)	1,423	-	-	-	1,423
Purchase obligations ^(e)	349	190	110	42	7
Other long-term liabilities ^(f)	18	18	-	-	-
Acquisition obligations ^(g)	6	6	-	-	-
Total	\$6,929	\$1,171	\$959	\$1,364	\$3,435

Contractual obligations at Dec. 31, 2005 ^(a)					
	Total	< 1 year	1-3 yrs.	3-5 yrs.	5+ yrs.
Long-term debt ^(b)	\$3,628	\$ 300	\$1,041	\$650	\$1,637
Operating leases ^(c)	1,568	158	333	225	852
Junior subordinated debentures ^(d)	1,031	-	-	-	1,031
Purchase obligations ^(e)	344	178	105	50	11
Other long-term liabilities ^(f)	15	15	-	-	-
Acquisition obligations ^(g)	18	13	5	-	-
Total	\$6,604	\$ 664	\$1,484	\$925	\$3,531

(a) Includes discontinued operations.

(b) See Note 14 of Notes to Financial Statements for more information. Does not include interest.

(c) See Note 9 of Notes to Financial Statements for more information.

(d) See Note 15 of Notes to Financial Statements for more information.

(e) Purchase obligations are defined as agreements to purchase goods or services that are enforceable and legally binding and specify all significant terms.

(f) Represents contributions to funded defined benefit pension plans. See Note 23 of Notes to Financial Statements for more information on our pension plans.

(g) At Dec. 31, 2006 and Dec. 31, 2005, includes the obligation to purchase the 30% minority interest of Mellon Financial Services Asset Management S.A. For purposes of this table, a purchase price of \$6 million was used for this payment obligation at Dec. 31, 2006 and \$5 million at Dec. 31, 2005. See Note 3 of Notes to Financial Statements for more information on the 2006 activity. At Dec. 31, 2005, also includes deferred consideration for the purchase of Standish Mellon (\$12.5 million).