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Via Fax # 202-452-3819  
and 202-452-3102

Ben S. Bernanke, Ph.D.  
Chairman  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue, NW  
Washington DC, 20551

Re: Follow-up to My Call Last Week on the Bank of New York and its Parent

Dear Chairman Bernanke:

Last Wednesday, June 11, I called your office and left a message about what I consider to be a potential systemic issue regarding the Bank of New York and its parent company emanating from its ongoing Russian litigation. I also left a message on this same topic the following day with Lynn Fox, Special Advisor to the Board. Since I did not receive a return call from you, Ms. Fox, or anyone at the Board, I am writing this letter. I am also e-mailing a copy to Ms. Fox.

*Background*

By way of disclosure, I was retained by the Miami law firm of Podhurst Orseck, P.A. to provide an independent assessment of what financial safeguards were in place at Bank of New York Mellon Corporation (the "Company") in the event that a potential \$22.5 billion judgment was enforced against them by the Russian Federal Customs Service, which is represented by that law firm.

During the course of my analysis I independently concluded that this case involves a potential systemic issue. As an economist who has provided opinions and commentary to the Federal Reserve Board ("Fed") on numerous public policy matters over the last few decades, I felt compelled to bring this issue to your personal attention.

### *Potential Company and Systemic Risks of the Russian Litigation*

The Fed's June 14, 2007 Order approving the Bank of New York Mellon Corporation referenced this litigation under "Financial, Managerial, and Supervisory Considerations" (footnote #18, p. 9) and stated that "the Board will continue to monitor the suit by the Russian authorities."

Although the Fed and presumably other state and federal bank regulators are aware of this suit, it is not clear if the regulators have ensured that adequate financial safeguards are in place at the Company to address such an adverse judgment.

Assuming a \$22.5 billion judgment, which could reportedly happen as early as June 30, 2008, and assuming just a portion of it is enforced in the more than 90 countries in which the Company deals, this could have a significant adverse impact on it in several areas such as capital, liquidity, and reputation.

Most importantly, perhaps, is the potential systemic risk to domestic and even worldwide financial markets of such an adverse event. This is because of the Company's unique significance to U.S. and world financial markets.

### *Why the Company is Unique*

The commercial banking industry is the most heavily regulated of any industry. A traditional argument for regulation of the banking industry is its uniqueness. There is perhaps no more of a unique bank anywhere than the Bank of New York Mellon. This underscores the importance of carefully and effectively regulating it.

Perhaps the best argument for its uniqueness is the fact that the Bank of New York was established by Alexander Hamilton as New York's first bank. Its historic significance in this regard provides the Company with not only a unique marketing advantage but also a special responsibility to its many stakeholders.

The importance of this \$189 billion bank holding company, the 12<sup>th</sup> largest in the nation, goes far beyond any standard asset ranking. This is a truly global bank with a major worldwide presence and impact.

More than one fourth of its approximately 42,000 employees are located outside the United States. With a presence in some 34 countries, it reportedly serves more than 100 markets around the world.

The Company reports that it has more than \$23 trillion in assets under custody and administration, more than \$1.1 trillion in assets under management, and services \$12 trillion in outstanding debt. Also, the Company states it is one of the largest funds transfer banks in the U.S., transferring over \$1.8 trillion daily via more than 170,000 wire transfers. These metrics place the Company at or near the top of these important categories

The Company's web site claims it is "the world's largest securities servicing provider and a top asset management firm globally — a financial services growth company without peer." The web site further claims that its extensive client base includes 85% of the Fortune 500; 60% of the Fortune 1,000; and, 70% of the Global 500.

The June 2006 Federal Reserve Bank of Minneapolis article by Gary Stern and Ron Feldman titled "Managing Too Big To Fail by Reducing Systemic Risk: Some Recent Developments" points out that the Bank of New York and J.P. Morgan Chase are unique as the only two "clearing banks" offering critical settlement services involving U.S. Treasury security transactions for major market participants. The authors state that:

"Serious spillovers could result if either of these banks were suddenly unable to offer its settlement services for a sustained period. The U.S. government could have a challenge funding itself. The Federal Reserve's tool for implementing monetary policy could be impaired. And markets for fixed-income securities could be seriously strained. Faced with such systemic risk, policymakers would have incentive to do whatever it takes to keep the two banks up and running, and providing these services."

### *Reputational Risk*

Reputational risk is important for any bank but especially so for a unique international private bank like the Company. The Russian case reportedly is the largest civil suit ever brought by a foreign government against a U.S. corporation. Losing any case has an adverse reputational impact, but the risk of losing the largest civil suit ever by a foreign country against a U.S. company will be the subject of considerable worldwide attention.

The potential reputational risk of an adverse judgment exists in the event it is enforced in only a portion of the 90 countries in which it operates. For example, if 25% of the \$22.5 billion judgment is ultimately enforced, this would be \$5.6 billion or about one-third of the Company's \$17.2 billion of capital as of March 31, 2008. Even assuming a 10% outcome, we are talking about \$2.25 billion or more than 10% of their capital.

Assuming the best case (but highly unlikely) scenario for the Company that *none* of the more than 90 countries in which it operates enforces any adverse judgment, there is still substantial reputational risk to this global bank. This is because it may be perceived negatively by customers, investors, foreign governments, and other stakeholders for avoiding such a huge financial responsibility in so many parts of the world.

Any such judgment will certainly be enforced in Russia and likely several other countries where the Company operates. In this event it is not clear as to whether the Company would stop doing business in Russia, one of the most important and growing economies of the world, or other countries that enforce any adverse judgment.

The likelihood of other countries enforcing any adverse judgment against the Company is increased by the fact that Russia's importance on the world economic and political stage has been greatly enhanced in recent times. This is not only because of its status as a G8 and "BRIC" country but also its increased significance as the world's second largest oil producers during a turbulent period of record price increases.

The Company's reputational risk is especially important considering its recently adopted Corporate Social Responsibility Statement and Commitments and published Corporate Social Responsibility Report that promote a "high standard of accountability"; "the highest standards of good governance and ethics"; and, "decisions consistent with our reputation for integrity."

#### *Potential Systemic Impact*

The combination of the capital, liquidity, and reputational risk factors for such a huge private bank that is so important to the national and international financial markets suggest that any adverse ruling with the enforcement of just a small percentage of it could result in a systemic event.

The timing of any pending adverse judgment, which could be within a few weeks, could not be worse in the wake of the Bear Stearns crisis and increasing concern over the fragile condition of other firms like Lehman Brothers.

Because such a potential systemic event would also be of great concern to the Federal Reserve Bank of New York, I put in a call to President Geithner last Wednesday; although he did not return the call, I did receive a call from an economist in his office where this matter was discussed.

#### *Bank Analyst's Downgrade Research Report Due to the Russian Court Case*

There are some analysts who share my view that the Company is in fact facing a formidable risk with this case. Richard Bove, one of the nation's premier bank analysts, works with the firm Punk, Ziegel & Company. His March 27, 2008 research report downgraded the Company's stock and target price due to his "gaining a better understanding of the risks to the company posed by the Russian lawsuit."

1. "Ultimately [in a previous May 2007 research report], I came to believe that if the Russian Courts found [the Company] guilty there would be no way that the country could collect on the court ruling....However, new information now suggests that Russia could collect."
2. The referenced new information involves certain legal jurisdictional admissions by the Company involving Russian courts and a precedent-setting case he cites "which suggests that the United States and European courts will enforce rulings made by the Russians."
3. "Learning of these two developments has made me concerned that the Bank of New York Mellon could be attacked in this country and in Europe."
4. Referring to the Russian litigation, the Company "...is facing an extraneous event that may now drain management as much as the big Enron and WorldCom suits drained the universal banks."
5. "The risks all of a sudden have become very large in this investment."

*The Company's Press Release on the Russian Court Case*

Perhaps in response to this March 27, 2008 research report, the Bank of New York Mellon Corporation issued an April 7, 2008 Press Release about the Russian court case. It was headlined "Company Confident Any Adverse Judgment Could Not Be Enforced Since Claims Lack Merit and Company is Protected by Substantial, Well-Established Legal and Financial Safeguards Around the World" and "Company Confident There Will Be No Material Impact."

With reference to this Press Release:

1. The Company does not appear to have the claimed "substantial, well-established" financial safeguards in place in terms of special reserves or provisions in the event even a small portion of any judgment is enforced.
2. As noted above, there may very well be an "adverse material impact" in terms of the Company's reputational risk, rather than just its capital and liquidity financial risks, and it does not appear that the Company is "fully prepared for any adverse decision in the future" in this regard as it has claimed.

3. That same release notes in the concluding paragraph that all of the above headlines and statements about the “potential outcomes and impact of the claim made by the Federal Customs Service of the Russian Federation” are “forward-looking statements” which are “based on assumptions that involve risks and uncertainties and are subject to change based on various important factors (some of which are beyond the control of The Bank of New York Mellon Corporation).” The Company goes on to state that “Actual results may differ materially from those expressed or implied as a result of these risks and uncertainties.” In other words, the Company’s apparent optimism about the potential outcomes and impact of the claim in this release may be totally wrong!
4. So, what IF the Company’s predictions and assumptions are wrong? What IF the Company, like so many other commercial and investment banks during and after the subprime crisis, misjudged their exposure to various risks, especially off-balance sheet ones? Quite simply, the Company’s problems become everyone’s problem, because of the adverse public policy impact described above. Specifically, in the event the Company has erred in being overly optimistic about the potential outcomes and impact of the claim, the consequences of their misjudgment likely will reach well beyond the Company because of the systemic items noted above. This raises a moral hazard question as to the potentially adverse public policy impact of a private decision by the Company. While the Company may feel comfortable with its apparently optimistic outlook, state and federal bank authorities and other governmental bodies must do what they can now to ensure that there is no adverse public policy impact from these private decisions. The regulators, at a minimum, should require the Company to establish a specific reserve or other accounting provision as an appropriate financial safeguard for an unfavorable outcome and any resultant enforcement of the order. Also, because of the potential systemic implications of an adverse liquidity event as described above, the Federal Reserve System, especially the Federal Reserve Bank of New York, as “Lender of Last Resort” must be prepared with an emergency financing procedure even if the Company is not.
5. The Company’s release concludes that all statements are as of April 7, 2008 and it “undertakes no obligation to update any statement to reflect events or circumstances after April 7, 2008 or to reflect the occurrence of unanticipated events.” Again, the Federal Reserve System, the Federal Reserve Bank of New York, other state and federal bank regulators, and other governmental bodies (perhaps including the SEC to protect investor interests), should require the Company to disclose a periodic update of the Company’s position and any relevant developments on this matter,

especially with the imminent June 30 hearing. Also, the above-cited Federal Reserve merger approval order stated that it would “continue to monitor the suit,” so the Fed has a separate obligation in terms of protecting the public interest in this regard.

### *Recent Concern Over Systemic Risk*

The recent Bear Stearns rescue providing investment banks and others access to the Fed’s discount window has been the subject of considerable recent debate. This unprecedented action is also a reason for the upcoming hearings on financial market regulatory restructuring by Chairman Barney Frank’s House Financial Services Committee.

On June 19, 2008, the Fed’s Vice Chairman Kohn testified before the Senate Banking Committee’s Subcommittee on Securities, Insurance, and Investment on the subject of risk management and its implications for systemic risk. The following comments from Vice Chairman Kohn’s testimony are particularly relevant here:

1. On the subject of the Fed’s supervisory activities, he states that banks are being required to improve risk management: “We are ensuring that institutions take a more comprehensive and forward-looking approach to risk management across the entire firm, and are more intensely verifying assertions made by bank management about the robustness of their risk management capabilities.” Considering the uniqueness of the Company, the risks of the subject litigation, and management’s apparent optimism regarding same, are these risk-management supervisory activities being undertaken now at the Company?
2. On the subject of counterparty credit risk, he is correct in stating that: “More fundamentally, the proper management of counterparty credit risk--which is the risk of loss from a counterparty’s failure to perform its financial obligations--is a prerequisite for protecting the entire system from contagion when any one institution fails.” While I am not suggesting any such outcome, the Fed and especially the Federal Reserve Bank of New York must be vigilant in its continued monitoring of counterparty credit risk in these turbulent times.
3. On the subject of liquidity risk management, he reminds us that: “Financial institutions must understand their liquidity needs at both the legal entity and enterprise-wide level and be prepared for the possibility that market liquidity may erode quickly, unexpectedly, and for a protracted time.” He further notes that: “... we are reviewing banks’ contingent funding needs and sources of funding. We are ensuring that bankers develop appropriate short-term and long-term liquidity risk management strategies. Consistent with the

findings of recent reports, we are emphasizing the importance of appropriate stress testing of liquidity needs and maintenance of robust liquidity buffers.” Is the Fed and the Federal Reserve Bank of New York doing this now at the Company considering the previously identified liquidity risks associated with this case?

Thank you for this opportunity to once again provide my opinion to the Fed on an important public policy matter. I stand ready to discuss any aspect of the above at your convenience.

Kindest regards,

Sincerely,

A handwritten signature in black ink that reads "Ken Thomas". The signature is written in a cursive, slightly slanted style.

Kenneth H. Thomas, Ph.D.

cc: Lynn Fox