



In this economy and regulatory environment, understanding how your assets are maintained and safeguarded is an important topic. In this paper, we will provide an overview of the custodial responsibility for your financial assets, and how client assets are protected, maintained and safeguarded.

The Role of a Global Custodian

A custodian is a financial institution responsible for safeguarding a firm's or individual's financial assets. The role of a custodian in such a case is the following: to hold in safekeeping assets such as equities and bonds, arrange settlement of any purchases and sales of such securities, collect information on and income from such assets (dividends in the case of equities and interest in the case of bonds), provide information on the underlying companies and their annual general meetings, manage cash transactions, perform foreign exchange transactions where required and provide frequent reporting on client accounts. Custodian banks are often referred to as global custodians if they hold assets for their clients in multiple jurisdictions around the world, using their own local branches or other local custodian banks in each market to hold assets for their underlying clients.

The Role of Custodians

How Clients Assets Are Maintained & Safeguarded

Role of Subcustodians

What is a subcustodian?

A subcustodian is a bank utilized by a custodian to hold assets on its and its clients behalf.

Subcustody services are similar to services provided to a custodian including clearance and settlement, safekeeping, cash management, record keeping, and providing client portfolio and corporate action information.

The largest global custodians rely on networks of 100 or more subcustodians, which provide the essential services that keep markets from Argentina to the United Arab Emirates available to clients for investment. These subcustodians are often hidden to end-users of custody services, but they deliver the products and information that enable investors in foreign countries to facilitate the cross-border investing.

How We Review Subcustodian Standards

BNY Mellon Asset Servicing reviews subcustodian activity on a daily, weekly, and monthly basis, including:

- Daily reconciliation for cash and securities is performed between our Custody Management System and the subcustodians. The resolution of all discrepancies is closely tracked by weekly management reporting.
- Daily monitoring of the failure of trades due to the inability of the foreign subcustodian to promptly deliver a security previously confirmed as held and available for delivery.

Global custodians have the contractual responsibility to safekeep your assets and report those assets accurately on their systems.

- Daily monitoring of the causes of late settlements of securities and cash transactions.
- Daily monitoring of income and tax receivables, which are measured against standards.
- Daily monitoring of corporate actions. Independent corporate action reporting services are used to ensure that the subcustodians process corporate actions efficiently.
- Weekly control reports highlighting exceptions identified during the daily monitoring. The reports are reviewed collectively by the entire management team on a transaction basis.
- Monthly Control Reports are reviewed by senior management, including our Corporate Auditor.

Service Level Agreements with Subcustodians

We also maintain a Service Level Agreement (SLA) with each subcustodian. Each Service Level Agreement sets forth the operational services that a subcustodian has agreed to provide us, captures market-specific issues and acknowledges applicable standing instructions. The SLA makes it relatively easy to determine when a subcustodian has failed to meet our standards.

Our Network Management Department conducts due diligence on our subcustodians in each major market on a periodic basis. Subcustodians are reviewed on a rolling basis with reference to various determining factors including applicable regulators the size of the market, changes to market infrastructure, specific market concerns or issues, etc. During the due diligence inspection, a formal service review is presented to the subcustodian. Each service review documents the adherence by the subcustodian with each of the operational functions outlined in the SLA with each subcustodian. Additionally, interviews are conducted with the subcustodian's management and staff, the vault is inspected (where applicable), facilities are reviewed and both the business resumption and disaster recovery plans are reviewed. The reputation and capability of the subcustodian is gauged during meetings with regulatory agents, local depositories, and the stock exchange. Market initiatives, regulatory changes, key areas of risk and desired market improvements are also addressed with both the subcustodian and the external bodies. The review and report from each meeting are accessible to senior management, all operational departments, and all other interested parties.

How We Reconcile with Subcustodians

Global Reconciliations

BNY Mellon reconciles with all of our foreign subcustodian banks as well as the Euroclear and Clearstream central depositories on a daily basis using the SmartStream reconciliation product. Our Fiduciary Control department sources all exceptions to internal operations groups for prompt resolution. Subcustodians are contacted via SWIFT, e-mail, and/or telephone in researching variances.

All client assets are clearly identified and segregated from our own company assets. For depository held assets, the governing registration guidelines of each depository/country are followed.

We make full use of SWIFT's capabilities in both security and cash messages. Message type 900s are used for daily, automated cash reconciliation and confirmation processing. One of the selection criteria for new subcustodians is their ability to provide us with timely and accurate cash and security positions.

U.S. Depository Reconciliation

We perform daily reconciliations with the Depository Trust Company (DTC) and the Federal Reserve Bank (FED). These depositories send us a position and activity file nightly. Once these files are received, they are combined with position and activity files contained in our custody system. A variance file is created at the mainframe level by comparing the two position files. Our Fiduciary Control department runs all activity through an automatch process, which analyzes the data. All matched transactions are moved to a completed file. The remaining unmatched transactions are then reviewed by fiduciary control analysts and weekly management reports are sent to all authorized managers.

Physical (Vaulted) Security Reconciliations

We perform a random audit of vaulted securities on a daily basis. A program runs that randomly generates 85 CUSIPs out of our New York vault to be verified. It also pulls 30 previously verified CUSIPs to be counted for a second time. The count cycle is not refreshed until all positions have been counted once and 10% have been recounted. A list of these positions is reviewed by both the Fiduciary Control department and Vault Operations and our vault staff then physically verifies the actual certificates/positions for the CUSIPs on the list. Any exceptions are reported to management in the same manner in which the U.S. depository reconciliation variances are reported.

How Are Client Assets Protected?

As custodian of assets, global custodians have the contractual responsibility to hold your assets properly in safekeeping and to report those assets accurately on their systems. All client assets are clearly identified and segregated from our own company assets. For depository held assets, the governing registration guidelines of each depository/country are followed.

How BNY Mellon Protects Your Assets

Assets are protected in a variety of ways — a clear legal agreement with each subcustodian in the network that requires their books and records set forth that securities are held for global custodians on behalf of its customers and that such securities must be segregated from the subcustodian's own assets.

Assets under custody and assets under management are held by BNY Mellon in a custodial or fiduciary capacity and are not included in our assets. If we fail to perform these services in a manner consistent with our fiduciary, custodial and other obligations, existing and potential clients may lose confidence in our ability to properly perform these services and our business may be adversely affected. In addition, any such failure may result in contingent liabilities that could have an adverse effect on our financial condition or losses that could have an adverse effect on our results of operations.

When a subcustodian is hired, and during each annual compliance review, the subcustodian is required to provide details of its specific insurance coverage. Where possible, actual policies or statements from insurance brokers are obtained.

What protection do we have in the event of a subcustodian's bankruptcy?

Where permitted by law, clients' securities held by BNY Mellon and its subcustodians are segregated from BNY Mellon's (and its subcustodians') proprietary securities. We believe that such segregation generally (subject to local laws) should protect client-owned securities from claims by subcustodian's creditors (except for claims by subcustodians for payment of fees for safekeeping and administration). Annual legal opinions from external local law firms are also obtained to verify general protection of custodial securities and the bankruptcy laws of each country.

Foreign deposits are maintained at a non-US branch of BNY Mellon. In the unlikely event of BNY Mellon insolvency, a foreign deposit, under US Federal law, is subordinate to US domestic deposits and FDIC insurance is not available. Balances in local currencies may be maintained through local subcustodians as required by clients, local regulation or other reasons. These balances are subject to local regulation and may be subject to loss in the event of subcustodian insolvency.

To what extent does BNY Mellon stand behind the subcustodians?

We have clear language regarding any negligence, misconduct or breach of contract by a subcustodian in our client contracts. There is a clear difference however between a breach of contract and losses that may be incurred due to a political or market-related event which is outside the control of the parties.

What actions do you take to ensure the viability of subcustodians?

Under our agreements with our subcustodians, they are required to indemnify BNY Mellon for their actions that result in a loss to our clients. In addition, they are generally required to carry adequate insurance in support of that indemnification. When a subcustodian is hired, and during each annual compliance review, the subcustodian is required to provide details of its specific insurance coverage. Where possible, actual policies or statements from insurance brokers are obtained.

We also review the adequacy of the level of insurance maintained by the subcustodian. Factors considered include the level of assets held, the manner in which the securities are held, the replacement costs, the complexities of the market, and the overall capital adequacy of the subcustodian.

Visits are made to subcustodians in our global network to review operations and conduct on-site audits. These visits include emphasis on the subcustodian's controls and procedures as they involve custody, trade settlements, corporate actions, income collection, tax reclamations, and reconcilements. Insurance issues are also discussed, and, to the extent possible, visits are made to the actual vaults as well as any depository or clearing agency.

What insurance or other arrangements exist to protect the client's assets while held by a subcustodian?

With respect to any acts or omissions of its subcustodian causing losses to BNY Mellon or its clients, the provisions of SLA agreements with most of its subcustodians require indemnification for negligence or breach of the agreement. In our standard SLA's with our subcustodians, the subcustodian represents that they maintain adequate insurance in support of the indemnification provided for in the agreement, and otherwise covering any loss of property.

Our custody business is backed by a comprehensive audit system. This system is comprised of a two-pronged strategy, which encompasses internal and external audit resources.

As a standard policy, BNY Mellon will take appropriate action to recover losses incurred by its clients for the recovery of amounts received from its subcustodians (less BNY Mellon's costs and expenses).

BNY Mellon Audit Procedures

Our trust and custody business is backed by a comprehensive audit system. This system is comprised of a two-pronged strategy, which encompasses internal and external audit resources.

Internal Audit

The Internal Audit Department performs independent risk based audits of Asset Servicing in accordance with generally accepted auditing standards to determine the adequacy, effectiveness, and efficiency of internal controls, and compliance with corporate policies and procedures, laws, and regulatory requirements, as well as the reliability of financial information systems. The Audit Department has full and unrestricted access to conduct audits of all activities within the Corporation. The Department performs annual reviews designed to evaluate the adequacy and effectiveness of risk management systems, as well as adherence to internal operating procedures in place.

External Audit

The accounting firm of KPMG currently provides external audit services. KPMG has been engaged to conduct an examination of the internal control structure of our custody operations. The examination is conducted in accordance with Statement on Auditing Standards No. 70 (SAS 70) Reports on the Processing of Transactions by Service Organizations, issued by the American Institute of Certified Public Accountants. The Custody SAS 70 report is issued as of June 30th, September 30th, and December 31st each year. Other SAS 70 reports are produced as of December 31st each year.

The SAS 70 report issued by our external auditors contains management's description of control structure policies and procedures that may be relevant to a client organization's internal control structure and the evaluation by our external auditors on whether the policies and procedures tested were operating effectively. This report is intended to provide our clients with information sufficient to obtain an understanding of certain aspects of the domestic and international custody functions (which are comprised of securities settlement, safekeeping and reconciliation, income collection, corporate actions, and securities lending) for the custody operation within BNY Mellon. This report, when coupled with an understanding of the internal control structure policies and procedures in place at client organizations, is intended to assist our clients and their auditors in the assessment of the total internal control structure surrounding transactions processed through our custody functions.

BNY Mellon's Financial Strength & Stability

Learn How Our History Can Strengthen Your Future

The strength of our business is a direct reflection of the foresight with which we have managed and serviced our clients' assets for 225 years.

The strength of our business is a direct reflection of the foresight with which we have managed and serviced our clients' assets for 225 years. BNY Mellon is currently the world's largest custodian with total assets of more than \$22 trillion.

In these 225 years of operation, we remain highly liquid and have demonstrated our ability to rise above market fluctuations to provide our clients with the tools and capabilities they need to manage and secure their investments and effectively weather the storms ahead. In this environment, the key indicators of a financial company's fundamental strength are profitability, a resilient capital base and liquidity — and marketplace recognition of those strengths.

The marketplace recognized those strengths. BNY Mellon was the only major U.S. financial institution to receive a credit rating upgrade during 2008. The company is the highest rated holding company among U.S. financial services firms with Moody's (at Aa2), as well as being rated #1 by Standard & Poors (AA-).

Continued financial strength in a company's core businesses, despite a down market, indicates a successful business model. A successful business model ensures that a company will not have to divert executive talent and financial resources to redefining and transitioning its business model. Instead, the company can focus its attention on supporting its clients through difficult times and on providing superior customer service.

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