



# TRADE TALK

OCTOBER 2012 EDITION

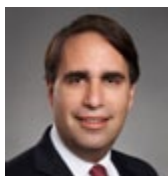
Reporting on CIBC Mellon initiatives and developments within the securities industry

## What's Inside?



Innovation,  
leading  
technology and  
outstanding  
service

The dynamic state of today's global economy means that as investors move out of their domestic markets they face a new - and sometimes unpredictable - set of challenges.



Is Canada still next  
to hike?

A steep September drop in the U.S. jobless count and a nudge higher in Canada's materially closed the divide across the 49th parallel. Is it now as certain that the Bank of Canada's next rate hike will come a year or more before the Fed's first one?



An update  
on FATCA

As a Canadian custodian, CIBC Mellon is studying FATCA. We are also working very closely with our U.S. parent BNY Mellon, and actively preparing the build for FATCA implementation.



Asset allocation  
now available  
through PrimeBase

Through the PrimeBase back-end platform, investment fund clients now have the option of setting rebalancing criteria and transaction-splitting instructions. Additionally, clients have the option of creating/defining phantom and child fund relationships - a powerful feature for investment funds considering offering fund-of-funds products to their underlying clients.



Forward-looking  
analysis and  
operational risk  
mitigation best  
practices

Operational risk is a discipline that is still evolving, and doing so in a challenging time given a more volatile market environment and increasing regulatory and governance requirements.

## IN BRIEF

### CIBC Mellon's 2012 survey results:

**"Best sub-custodian in Canada" for the sixth consecutive year**

- Global Finance Magazine 2012

**"Top-rated" by cross-border and domestic clients**

- Global Custodian, 2012 Agent Banks in Major Markets survey

**"#1 in the world for relationship management"**

- Global Investor/isf, 2012 Equity Lending survey



"Clients strongly endorsed CIBC Mellon's performance in prestigious surveys administered by Global Finance, Global Custodian and Global Investor/isf magazines. We are extremely pleased with our 2012 results, and grateful to our clients for taking the time to participate.

As always, we remain committed to continuous improvement, to partnering with clients and regulators to develop industry best practices, and to delivering an outstanding client service experience."

- Alistair Almeida  
Vice President, Business Development  
and Relationship Management



## Innovation, leading technology and outstanding service set CIBC Mellon apart

CIBC Mellon is pleased to participate in the annual Sibos conference - held this year in Osaka, Japan. Sibos brings together leading financial services professionals from around the world, and provides outstanding opportunities to share innovative thinking, explore how best to deliver enhancements, and continue to build a vision for the future. As always, we are looking forward to connecting with clients, colleagues and industry thought leaders.

The dynamic state of today's global economy means that as investors move out of their domestic markets they face a new - and sometimes unpredictable - set of challenges. As Canada's leading asset servicing provider, we service investors coming into Canada and those Canadian-based investors expanding their portfolio into foreign markets. We consider it a great point of pride to partner with our clients to create solutions that work for their business. Our strong, stable joint venture relationship enables us to offer clients access to BNY Mellon's global custody network in more than 100 markets - a truly unique offering.

Being part of a world-leading network or having a headquarters in one of the most stable economies in the world is not enough make you great asset servicer. From consistently regular depository and market updates to mobile information delivery apps, we stay focused on bringing our clients new thinking, relevant technology and reliable market news. Clients choose CIBC Mellon not only for the latest information and technology, but also for our best-in-class client service experience.

Don't just take my word for it: market participants named CIBC Mellon number one in the world for relationship management in the 2012 Global Investor/isf magazine Equity Lending survey - where CIBC Mellon scored in the top 10 in 16 operational/functional categories. Global Finance named us sub-custodian of the year for Canada for the sixth consecutive year. We also were rated best-in-class in client service, value and commitment, cash management, settlement, and account administration by leading, cross-border, and domestic clients in Global Custodian's 2012 Agent Banks in Major Markets survey. These awards - along with so many new and renewed mandates - reaffirm that CIBC Mellon delivers the service and solutions clients need to move forward in Canada and around the world.

Warm regards,



David Linds  
Senior Vice President,  
Business Development and  
Relationship Management

**"CIBC Mellon delivers the service and solutions clients need to move forward in Canada and around the world."**

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Avery Shenfeld  
Managing Director and Chief  
Economist, CIBC World Markets



## Is Canada still next to hike?

On the surface, the divide across the 49th parallel just got a lot smaller. Canada's unemployment rate had been tracking a full point lower than that of its southern neighbour. But as of September, a steep drop in the US jobless count, to 7.8%, and a nudge higher in Canada's, to 7.4%, materially closed that gap. Is it now as certain that the Bank of Canada's next rate hike will come a year or more before the Fed's first one?

Canada's healthy jobs gain underscored that rate cuts are nearly unthinkable, and the economy isn't that far off the pace needed to justify a rate hike. But we're not there yet, at least in terms of where GDP and the output gap have headed. If fiscal tightening prevents the US from picking up next year, other export markets remain sluggish, and housing turns softer in Canada, Carney could still be on hold for several more quarters.

As for the US, forgive us for being a bit skeptical of America's September Surprise, and not because we give any credence to accusations that the numbers were "fixed." There was some credibility to the drop in the unemployment rate, since this time it was not caused by people giving up on the jobs hunt, and there was at least a 0.2%-point decline in the jobless rate for each age and race demographic group.

But the BLS household survey, like Canada's monthly survey, is notorious for producing fleeting outliers, albeit not this large. Based on grossing up the results of a monthly sample of Americans, and comparing it to the prior month's sample, the resulting count is not nearly as reliable as the payrolls report. By including virtually all of the largest employers, the payrolls sample data capture a much higher share of actual employment. It seems doubtful that so many Americans found work in a month in which employers were only reporting modest increases in their headcount.

Still, until we have an October count, the data are what they are. Just how close is the Fed to tightening if the jobless rate is really 7.8%? While the Fed hasn't spelled it out that clearly, FOMC member's forecasts for when tightening would be appropriate have typically lined up with when they saw unemployment reaching 7%. The question is, however, 7% of what?

The rate is measured as a share of those either working or taking steps to find work. The US measurement system has a more rigorous definition of what constitutes active job seeking than Canada, and thereby counts more of those not working as "not in the labour force" rather than "unemployed". And the severity of the recession left seven million discouraged workers stateside who are still not looking. The result is that the US is still miles behind Canada in the share of its working age population with a job: 61.9% in Canada, and only 58.7% in the US.

The Fed won't tighten until the jobless rate hits 7% of those who would typically be on the job or looking for work in good times. There's ample room for the labour force participation rate to climb, so a "real" 7% unemployment rate could still be several years off. The Bank of Canada might also start hiking when unemployment gets a bit below 7%, but in all likelihood, that's not as far off as a true 7% jobless rate for the U.S. ■

October 12, 2012

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"Canada's healthy jobs gain underscored that rate cuts are nearly unthinkable, and the economy isn't that far off the pace needed to justify a rate hike. But we're not there yet, at least in terms of where GDP and the output gap have headed."

- Avery Shenfeld, Managing Director and  
Chief Economist, CIBC World Markets





Simon Lee  
Assistant Vice President, Tax

## An update on FATCA

The Foreign Account Tax Compliance Act (FATCA) was enacted into U.S. law in March 2010 as part of the U.S. government's attempt to discover U.S. taxpayers who have attempted to hide their income from U.S. taxation by investing and earning income through non-U.S. institutions.

While final regulations have not yet been released, CIBC Mellon has prepared this article based on draft regulations as at June 2012.

The information below briefly addresses the following questions:

- **Who is affected by FATCA?**
- **When?**
- **How is CIBC Mellon currently addressing FATCA?**

### WHICH "FOREIGN FINANCIAL INSTITUTIONS" OR "FFIs" ARE AFFECTED BY FATCA?

FATCA will impact both financial and non-financial entities. This update focuses on its impacts to foreign financial institutions (FFIs). The U.S. Internal Revenue Service (IRS) has defined FFIs as:

- Non-U.S. institutions that accept deposits from investors/institutions in the course of banking or a similar business;
- Non-U.S. institutions that hold financial assets for the accounts of others (as in the case of broker/dealers or custody banks, etc.); or,
- Non-U.S. institutions that are engaged primarily in the business of investing, reinvesting or trading in securities, partnership interests, commodities or any interest (including a futures or forward contract or option) in such securities, partnership interests or commodities.

### WHAT DOES FATCA MEAN TO CIBC MELLON, AS A CANADIAN CUSTODIAN?

According to FATCA provisions (outlined in IRS public documents): FATCA will require foreign financial institutions, like CIBC Mellon, to report directly to the IRS certain information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest.

The timeline below is based on information current to October 19, 2012. For updates occurring past this date, please refer to IRS announcement 2012-42. ▼

2012			2013			2014			2015			2016		2017	
February	April	November	January	June	July	January	July	September	January	March	July	March	January	March	
Draft regulations	IRS issued clarification to draft regulations	It's anticipated final regulations will be published by the IRS/US Treasury	Cut-off date for grandfathered obligations is January 1, 2013	Deadline for FFIs to enter into an FFI agreement with the IRS to avoid 30 per cent withholding on U.S. sourced FDAP <sup>1</sup> payments as of January 1, 2014	New account opening procedures to be in effect	<b>Withholding begins on U.S. source fixed or determinable annual or periodical income (FDAP)</b> <sup>1</sup> such as interest and dividends -to new accounts which are recalcitrant <sup>2</sup> ; as well as NPFFIs or FFIs that have elected to be withheld upon	Complete due diligence for all pre-existing individual accounts and pre-existing entity accounts that are prima-facie FFIs (assuming FFI signs their agreement by June 30, 2013)	Reporting of U.S. accounts to the IRS begins	<b>Withholding begins on gross proceeds</b> from the sale or disposition (in a taxable transaction) of securities that produce U.S.-source interest or dividends to NPFFIs, high value and prima-facie FFI accounts; and new accounts that have not provided the required information	Reporting to be filed on the <b>U.S. account and balance including</b> - the name, address, TIN <sup>3</sup> of the U.S. account holder; account number and account balance (in local currency or U.S. dollars) for U.S. accounts and recalcitrants for the 2014 tax year	Complete due diligence on all other pre-existing accounts (assuming FFI signs their agreement by June 30, 2013)	Reporting to be filed <b>on income (i.e. gross interest and dividends, gross amounts paid in the case of income</b> from investment vehicles) associated with payments to U.S. accounts and recalcitrants and on aggregate of certain payments to non-participating FFIs for the 2015 tax year	Earliest potential date for withholding on foreign passthrough payments made to pre-existing and new accounts	Reporting to be filed on <b>gross proceeds</b> from sales/redemptions for U.S. persons (for the 2016 tax year)	

<sup>1</sup>FDAP Income = Fixed or determinable, annual or periodical gains, profit and income and includes payments such as interest (including original issue discount), dividends, rents, salaries, wages, premiums and annuities.

<sup>2</sup>Recalcitrant Account Holder = recalcitrant account holders (or "recalcitrants") are those who fail to comply with reasonable requests for information in accordance with IRS mandated verification and due diligence procedures to identify U.S. accounts to provide a name, address and TIN or those who fail to provide a bank secrecy waiver upon request.

To properly comply with these new reporting requirements, CIBC Mellon (as an FFI) will have to enter into an agreement with the IRS by June 30, 2013. Under this agreement, CIBC Mellon will be a participating FFI (PFFI) and will be obligated to:

1. Undertake certain identification and due diligence procedures with respect to its account holders.
2. Report annually to the IRS on its account holders who are U.S. persons or foreign entities with substantial U.S. ownership.
3. Withhold and pay over to the IRS 30 per cent of any payments of U.S. source income, as well as gross proceeds from the sale of securities that generate U.S. source income, made to:
  - a) Non-participating FFIs (NPFFI).
  - b) Individual account holders who fail to provide sufficient information to determine whether or not they are a U.S. person.
  - c) Foreign entity account holders who fail to provide sufficient information about the identity of its substantial U.S. owners.

### HOW DOES FATCA IMPACT CIBC MELLON'S CLIENTS?

CIBC Mellon has clients across a number of segments and each of the services we provide to clients is unique. We will contact our clients at a future date (to be determined) at which time we will record each client's FATCA classification, should this be required.

**In the interim, we recommend that our clients consult with their own tax and legal/compliance advisors to understand FATCA requirements. CIBC Mellon does not provide tax, financial or legal advice.**

**Once FATCA rules are finalized and implemented, CIBC Mellon (as a custodian) will be required to withhold and pay over to the IRS 30 per cent of any payments of U.S.-source income, as well as gross proceeds from the sale of securities that generate U.S.-source interest or dividend income made to recalcitrant account holders or non-participating FFIs.**

**To avoid 30 per cent withholding, an FFI must enter into an agreement with the IRS to comply with certain requirements.** Clients should consult with their tax advisors to determine whether they meet the definition of an FFI and if/how FATCA rules apply to their business.

### IN SUMMARY

As a Canadian custodian, CIBC Mellon is studying FATCA. We are also working very closely with our U.S. parent BNY Mellon, and actively preparing the build for FATCA implementation.

**We will provide information to affected clients as soon as we can, pending clarification of FATCA implementation details and dates.**

**When determined, CIBC Mellon will request additional and specific documentation and/or information from clients (with respect to classifications) required under FATCA. According to the IRS, the proposed FATCA regulations layout out approximately 60 different types of classifications and sub-classifications for entities.**

**CIBC Mellon cannot file FFI agreements with the IRS on behalf of clients.** In other words, our clients must discuss FATCA obligations with their tax, legal and compliance advisors.

Clients should note that, in our role as custodian, CIBC Mellon will be required to withhold and pay over to the IRS 30 per cent of any payments of U.S. source income, as well as gross proceeds from the sale of securities that generate U.S. source income made to any of our clients who are recalcitrant account holders or non-participating FFIs. ■





Mike Bean  
Director, Investment Funds  
Product Management

## Asset allocation now available through PrimeBase

Asset allocation and account rebalancing are important considerations when creating investment strategies. Delivering incremental returns/gains while adhering to defined investment objectives is no small task: that's why CIBC Mellon has launched a new asset allocation tool. Now clients can take advantage of fully automated rebalancing, the flexibility of timing and choice, and the freedom to focus on investment strategies.

Asset allocation is an exciting new tool available to CIBC Mellon's investment fund clients. Through the PrimeBase back-end platform, investment fund clients now have the option of setting rebalancing criteria and transaction-splitting instructions. Additionally, clients have the option of creating/defining phantom and child fund relationships - a powerful feature for investment funds considering offering fund-of-funds products to their underlying clients.

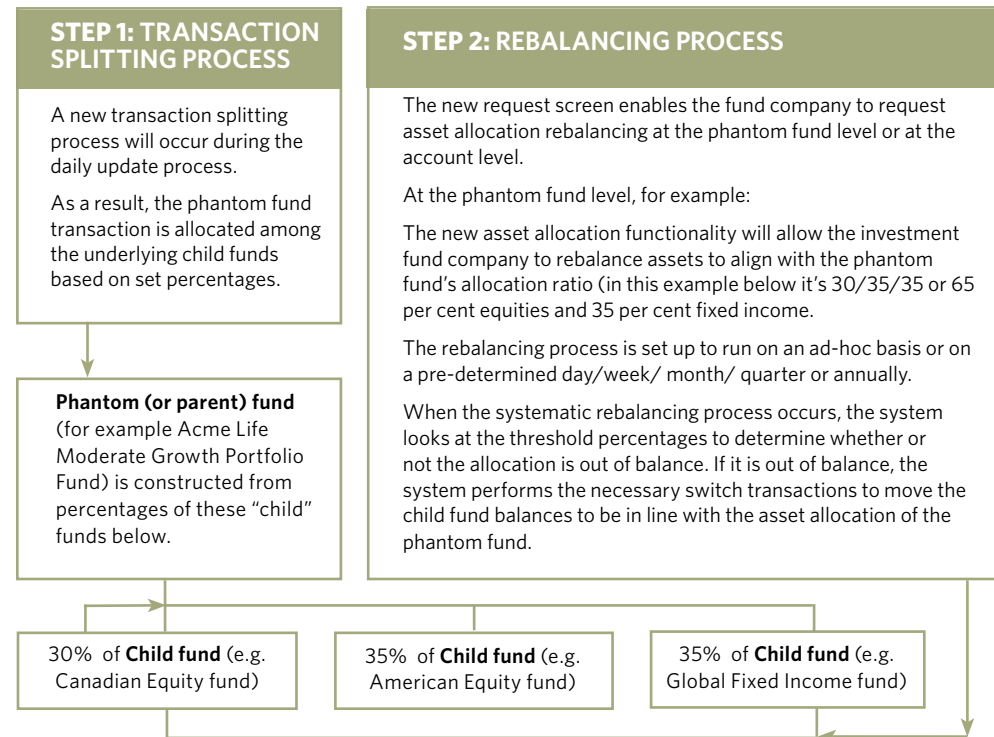
### SOME PARTICULARLY EXCITING FEATURES OF THIS NEW SERVICE INCLUDE:

- 1. Flexibility at all levels.** Clients can now set account thresholds, maintain both phantom and child fund relationships, and suppress funds or accounts from systematic rebalancing. CIBC Mellon's new asset allocation tool gives clients the flexibility they need.
- 2. Control.** Clients have the control they need to adhere to defined investment strategies. This new tool enables clients to decide whether rebalancing transactions are taxable or non-taxable events and set the corresponding effective dates. Rebalancing processes can also be scheduled to run at pre-determined times or on-demand.

Supporting three FundSERV-supported models, clients have the freedom to choose the process that works best for them. Whether working only with phantom funds, or with a combination of phantom and child fund relationships, clients can select which model works for them. Trades are entered through the FundSERV and PrimeBase transaction entry screens.

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With CIBC Mellon's new asset allocation tool, investment fund clients get the confidence and peace of mind that comes with bringing great service to their clients.

Asset allocation is now available for PrimeBase investment fund clients. Contact your relationship manager to learn more. ■

"Supporting three FundSERV-supported models, clients have the freedom to choose the process that works best for them. Whether working only with phantom funds, or with a combination of phantom and child fund relationships, clients can select which model works for them."



Kelly Hastings  
Vice President and Chief Risk Officer

## Forward-looking analysis and operational risk mitigation best practices

Operational risk is a discipline that I believe is still evolving, and doing so in a challenging time given a more volatile market environment and increasing regulatory and governance requirements.

The focus in managing operational risk is often to prepare for, or react to, significant events. These events are high-profile and therefore attract the attention of both senior management and Boards of Directors. Clearly, institutions must be prepared, and help their clients prepare, to address these events. However, it is also true that the majority of operational losses come from day-to-day processing. A focus on managing these ongoing risks is therefore critical for organizations.

How best to manage day-to-day operational risk? CIBC Mellon has an operational risk program with three key components to limit potential losses.

The first component of this operational risk management program to identify operational risk is the risk and control self-assessment (the RCSA). The RCSA is the industry-wide standard to facilitate the measurement of operational risk. In its basic form the RCSA is an inventory and assessment of all business risks, and the controls in place to mitigate each risk. At CIBC Mellon, designated risk officers in each of the business units self-identify risk and assess the risk profiles of their own business units. Although CIBC Mellon's risk management function provides oversight of the RCSA process, it is the individual lines of business that are held responsible for identifying and assessing operational risk and which are accountable for such operational risks. In overview the business units themselves are in the best position to understand the day-to-day risks that must be managed.

Regular reviews enforce the discipline to keep the RCSAs updated, to include changes such as new business processes, new product launches, or new regulations, and to ensure that risk has been reassessed as a result of such changes. Risk is always heightened during periods of transition or change and there must be a greater focus on business processes during such periods.

CIBC Mellon's risk management team members also participate on both the company's program steering committee and its new business committee, which enables the risk team to assess relevant risks before a new project is undertaken or a new client is brought into the firm. Being involved from the start of the product and business cycle enables the risk team to provide valuable input and to suggest controls to reduce risk at the design/structural stage: better information leads to better controls. This involvement also ensures that the risk team is aware of the changes and the resulting processes which require updating a business unit's RCSA.

The second component of CIBC Mellon's program used to manage operational risk is the operational risk event (ORE) report. At CIBC Mellon, business units are required to complete an ORE report whenever an error occurs, regardless of whether there is a financial impact, and regardless of the size of the impact. This ensures the capture of "near miss" scenarios (operational events that did not result in a loss). ORE reports are then used to categorize operational errors. This data is analyzed for patterns or trends, to help identify future errors before they occur. The analytical approach has enabled CIBC Mellon to turn a traditionally reactive tool into a proactive means to reduce future errors.

The final component of CIBC Mellon's operational risk program focuses on evaluation of risk, through a strategic review of risk by the company's operational risk committee. CIBC Mellon has used similar committees to present credit and market risk information, but it is a new and recent concept to apply a committee structure to a senior review of operational risk.

What is the purpose of the operational risk committee at CIBC Mellon? The committee serves as a forum to identify and address current and emerging operational and technology risk issues, particularly those issues which impact multiple groups. All CIBC Mellon business units - including non-operational groups such as relationship management, finance, and marketing - present to the operational risk committee on a rotating basis. Each unit addresses the key inherent risks in their areas, the control strategies to manage these risks and their performance against key risk indicators.

Frank and open discussion with the business units has helped the operational risk committee identify cross-functional risks by looking for common areas of concern across numerous business units. The strategic perspective has strengthened the review and visibility of operational risk at CIBC Mellon.

Operational risk management is a key focus for CIBC Mellon. The three key components of the CIBC Mellon program put in place a structure to ensure a continued discipline with respect to day-to-day operational risk and ensure a strong program foundation. ■

**CIBC Mellon has an operational risk program with three key components to limit potential losses.**

1. Risk and Control Self-assessment (the RCSA)
2. Operational Risk Event (ORE) report
3. Operational risk committee review of business unit risk

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“Clients choose CIBC Mellon not only for the latest information and technology, but also for our best-in-class client service experience.”

- David Linds, Senior Vice President, Business Development and Relationship Management

#### **About CIBC Mellon**

CIBC Mellon provides asset servicing solutions, including custody, multicurrency accounting, fund administration, unitholder recordkeeping, pension services and securities lending services, for institutions and corporations. We have over 1,100 people dedicated to supporting more than 1,200 client relationships with Canadian banks, pension funds, investment funds, corporations, governments, insurance companies, foreign insurance trusts, foundations and global financial institutions whose clients invest in Canada. As at September 30, 2012, CIBC Mellon held more than CAD\$1.1 trillion of assets under administration on behalf of our clients. CIBC Mellon is headquartered in Toronto, with offices across Canada in Vancouver, Calgary, London, Montreal and Halifax. Founded in 1996, CIBC Mellon is 50-50 jointly owned by Canadian Imperial Bank of Commerce (CIBC) and The Bank of New York Mellon Corporation (BNY Mellon), the world's largest custodian. CIBC Mellon is part of the BNY Mellon network, which as at September 30, 2012 had USD\$27.9 trillion in assets under custody and administration, USD\$1.4 trillion in assets under management and global payments processed averaging USD\$1.4 trillion per day.

For further information about CIBC Mellon, please visit [cibcmellon.com](http://cibcmellon.com).

**Follow @CIBCMellon on Twitter for insights and updates on asset servicing, custody and financial services in Canada.**

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