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New Stock Connect launches

The new Shenzhen-Hong Kong Stock Connect went live on 5 December.

Following approval of the launch from the Securities and Futures Commission and the China Securities Regulatory Commission, Hong Kong Exchanges and Clearing (HKEX) announced that conditions were in place for operations to commence on time.

HKEX had already completed three rounds of connectivity testing and market rehearsals to ascertain technical readiness of the market infrastructure and operational readiness of market participants.

The introduction of the Shenzhen-Hong Kong Stock Connect follows the success of the Shanghai-Hong Kong Stock Connect, which launched at the end of 2014.

Some 142 China connect exchange participants (CCEPs) were eligible to participate in the two Stock Connect programmes from 5 December.

Other exchange participants can also apply to become CCEPs later upon satisfaction of relevant requirements.

HKEX chief executive Charles Li said: "We're ready for another milestone in our mutual market access initiative."

"Shenzhen Stock Connect will open up another mainland market for international investors, give investors on both sides of the boundary more choices and enhance access [to our respective stock markets]."

The programme has also been hailed as a positive step by market participants.

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Hedge funds perform despite investor withdrawal

Hedge funds are continuing to grow overall assets under management (AUM) in 2016 in the face of skittish investor sentiment, according to Preqin's latest research.

Assets under management (AUM) captured by Preqin's data analysts rose to $3.24 trillion at the start of Q4, despite being hit by $66.7 billion net outflows, resulting in 2.9 percent of total AUM growth between January and September.

When breaking the hedge fund industry down by strategy, Preqin's data reveals that equity and macro strategy funds overcame net investor redemptions to see their AUM grow in the first three quarters of the year, while credit, relative value and multi-strategy funds all saw their total assets fall.

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R3 and Calypso partner for post-trade blockchain

Blockchain consortium R3 is seeking to recapture investor confidence after a spate of high-profile banks withdrew their support for the project by signing on Calypso Technology to develop a post-trade blockchain application for the capital markets.

Calypso Technology has become the first firm to connect with R3's distributed ledger-based smart contract platform, Corda, to launch a multi-party trade confirmation solution.

Corda, which went live on 30 November, is an open and inclusive smart contract platform that enables interoperability between users by allowing them to build and operate distributed ledger applications using common code and protocols, according to R3.

Continued on page 3

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New Stock Connect launches

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Matthew Chan, executive director for products and strategy in the Asia Pacific region at Depository Trust & Clearing Corporation, said: “Overall, the Shenzhen and Shanghai Stock Connect schemes are positive developments for China’s equity market, introducing extra liquidity while shining a light on differences in operational arrangements between China and Hong Kong and, by extension, global markets.”

“We expect the southbound channel to attract more attention immediately following the Shenzhen-Hong Kong Stock Connect launch, especially as qualified domestic Institutional Investor quota approval has been limited over the past nine months.”

Chan also noted, however, that international firms looking to trade on the programme could still see operational challenges.

“These include a complex and short settlement cycle, non-fungiblity of Chinese stock traded via Stock Connect versus other programmes and the complexities involved in managing multiple currency codes to distinguish RMB for the onshore versus offshore markets.”

“We recommend global investors pay close attention to developments surrounding the Shanghai and the new Shenzhen stock connect program. Familiarity with cross-border practices and rules will be the key to successful investing under these schemes, with the wider global investment community and international regulators contributing insights to help address common challenges.”

Hedge funds perform despite investor withdrawal, says Preqin

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Of those reviewed by Preqin, smaller hedge funds, categorised as under $100 million, saw less outflows in Q3 (38 percent) than their larger counterparts (49 percent) and also saw more inflows (45 percent) than funds over $100 million (37 percent).

By region, North American funds were marginally more likely to see outflows than inflows, by 42 percent to 40 percent respectively. All other regions saw more inflows than outflows.

Amy Bensted, head of hedge fund products at Preqin, said: “2016 has been a difficult year for the hedge fund industry; ongoing investor concerns about the performance of the asset class and the fees that funds charge have made both raising and retaining investor capital increasingly challenging for hedge fund managers.”

“As a result, outflows have increased over each of the three quarters in 2016 to date, and nearly every leading strategy has seen net redemptions from investors.”

R3 and Calypso partner for post-trade blockchain

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Counterparties will be able to see all trade tickets on the distributed ledger to ensure correct trade matching.

The partnership represents the first real integration between a leading distributed ledger platform and a leading financial software vendor.

David Rutter, CEO of R3, said: “R3 is the largest collaborative consortium of its kind in financial markets, now comprising over 70 members from all corners of the industry. Calypso is the first capital markets application partner to engage with R3, which reflects the unique synergy between the two firms.”

Pascal Xatart, CEO at Calypso, added: “We are thrilled to be working with R3 and honoured to be their first application partner. The alignment between the two firms is exceptional—our deep expertise in capital markets combined with their industry-leading distributed ledger technology will allow us to develop a range of innovative applications quickly and efficiently.”

“Our current matching solution is only the beginning,” he added.

The partnership comes shortly after several large banking members, including founding member Goldman Sachs, left the R3 consortium in quick succession.

Goldman Sachs’s exit on 21 November was immediately followed by Morgan Stanley’s the following day and Santander’s the day after that, calling the project into doubt.

Goldman Sachs was one of nine founding members of R3 in 2014.

The departures indicate a reversal of fortune for the consortium, which had previously increased its membership with the addition of Brazil’s BM&FBovespa as its first exchange, along with China Merchants Bank earlier in the year.

Small caps offer revenue through Russell 2000 ETFs

Savvy investors are leveraging exchange-traded funds (ETFs) that track the Russell 2000 Index to access revenue available in the US small cap equities market through securities lending programmes.

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In environments of slower economic growth small cap stocks, as measured by the Russell 2000 Index, have historically tended to outperform large cap stocks, as measured by the Russell 1000 Index, according a new FTSE Russell research paper.

Extensive FTSE Russell research highlighted that "the exceptional high liquidity" of Russell 2000 ETFs "continue to see strong demand for securities lending".

"For example, the historical gross lending yield on the iShares Russell 2000 ETF (IWM) averaged 63 basis points from 1 January 2010 through 1 March 2016."

IHS Markit Securities Finance estimated that the value of equities in securities lending programmes reached approximately $9.7 trillion at the end of Q1 2016.

As a consequence, FTSE Russell declared in its paper: "Securities lending has been shown to benefit financial markets by providing increased liquidity and to benefit market participants by providing a way to offset management fees and potentially enhance returns."

The Federal Reserve Bank of New York also stated that "the markets for repos and securities lending are crucial for the trading of fixed-income securities and equities" in a recent report.

The FTSE Russell paper also studied some of the largest US institutional investors that have established lending programmes, citing the California Public Employees' Retirement System, which had securities on loan with a fair value of approximately $14.9 billion as of 30 June 2015, and earned approximately $2 million in securities lending income for the 2014–2015 fiscal year.

African investors coming of age

The rise of local institutional investors in Africa has allowed for capital markets on the continent to continue to develop, despite overall market slowdown.

At the Global Custody Forum in London, one delegate from a global bank with significant African exposure explained: "The emergence of domestic institutional investors has been a big driver of growth."

He added: "The economic impact has not stopped capital market developments."

Of the 54 African nations, the speaker cited Nigeria, Kenya and Ghana as the fastest developing economies, although South Africa still stands head and shoulders above all others.

Not including South Africa, the emergence of homegrown insurance companies and pension funds now accounts for $500 billion worth of assets in sub-Saharan Africa.

The African banking delegate acknowledged that, on the global stage, this is still a comparatively small sum but explained that it represents a significant step forward for the region.

Another major driver of growth in African capital markets is the commitment of regulators to reforming and updating governing frameworks to allow for new financial structures, and opening their respective markets up to foreign investors. Unsurprisingly, Nigeria and Kenya were again cited as being front-runners in market reform.

Of an audience of global banking and technology representatives, roughly a third said they are already active in at least one African market.

AcadiaSoft takes over ProtoColl

AcadiaSoft, a provider of margin automation solutions for collateral management, has acquired ProtoColl, an end-to-end collateral and margin management service.

ProtoColl was purchased from the Depository Trust & Clearing Corporation (DTCC) in anticipation of the increasing market demand for risk management solutions that the second phase of non-cleared over-the-counter derivatives regulation will bring.

The specific terms of the deal were not disclosed. ProtoColl, which DTCC picked up when it took full ownership of Omgeo, is integrated with DTCC-Euroclear GlobalCollateral Limited's Margin Transit Utility.

Thousands of smaller buy-side firms and banks will be required to post variation margin as of March 2017 and many are expected to

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turn to vendor solutions as a cost-effective route to compliance.

The new requirement has been expected of the largest global banks since 1 September. All 24 users of the AcadiaSoft Hub were able to comply.

"The hub is running smoothly, managing significant volumes from the world's largest global banks," said Chris Walsh, CEO of AcadiaSoft. "The combination of AcadiaSoft and ProtoColl creates an end-to-end risk management solution that is a major step toward the industry's goal of automating the entire margining process on a single platform."

Mark Demo, product director for AcadiaSoft, added: "This expanded market infrastructure benefits all firms within the derivatives industry. Small to mid-sized firms now have the basic margin functionality required to automate; large banks get the long-term platform required to substantially reduce costs; and firms of all types and sizes can reduce disputes to manageable levels using standardised data, calculation methods and workflows."

Unlocking collateral key to shortage

Greater diversification of counterparties in the repo market can halt the decline in liquidity, according to Roberto Verrillo of trading platform Elixium.

Verrillo analysed the various regulatory and market trends putting a squeeze on the availability of collateral in a new whitepaper that positions the Elixium marketplace as alternative liquidity route for repo participants.

According to Verrillo, who cited multiples sources including the Bank of England, illiquidity in secured and unsecured markets is reported across the spectrum, causing capacity to stretch and fragmented pricing. There is more than ample liquidity in the form of cash as a result of global quantitative easing, collateral providers have significant reserves of previously un-lent and unencumbered inventory, and there is an increasing need for capacity on the back of new margining rules for over-the-counter products.

"The transmission mechanism for collateral transformation to be executed is severely impaired," Verrillo wrote, concluding that there is "potential for more serious market dislocations where collateral provision/transformation can be severely affected in stressed environments".

Elixium, which recently partnered with Pirum Systems to provide post-trade connectivity to their respective clients, aims to provide repo participants with liquidity on a fair, transparent, inexpensive and equitable basis.

"Via intelligent trading tools and analytics, Elixium enables institutions to qualify for credit slippage, view depth and liquidity across tenors and collateral baskets, and offer varied execution functionality," Verrillo wrote.

"Following mandatory margining of uncleared OTC products, demand for efficient initial and variation margin collateral transformation is set to increase dramatically."

"Elixium facilitates this process and will provide a marketplace through which cash or collateral can be sourced from a much more diverse counterparty base than is currently the norm."

"Over the coming months, Elixium will expand its initial offering to more than 40 collateral baskets covering fixed income and equities in GBP, EUR, USD, CAD, JPY and emerging markets."

HK proposes fresh liquidity rules

The Hong Kong Securities and Futures Commission (SFC) is aiming to reinforce market stability through new regulatory

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proposals that would require securities lending participants to ensure cash reinvestment strategies are “sufficiently liquid”.

In a consultation paper on asset management regulation, the SFC proposed that all cash collateral should be “sufficiently liquid with transparent pricing and low risk to meet reasonably foreseeable recalls of cash collateral”.

What constitutes “reasonably foreseeable” was not clarified in the paper.

Fund managers “should stress test the ability of a cash collateral reinvestment portfolio to meet foreseeable and unexpected calls for the return of cash collateral on an ongoing basis”.

The regulator focused its proposals on managers active in the securities lending, repo and over-the-counter markets, adding that “a collateral valuation and management policy which should include certain minimum valuation and margin requirements”.

The SFC also aimed enhance transparency, a comprehensive summary of all aspect of the fund’s lending strategy should be disclosed in the offering documents.

The SFC is now open to industry comment on the proposals until 22 February 2017

EquiLend shares SFTR plans

EquiLend is working on a solution to meet the reporting requirements for trades and collateral under the Securities Finance Transaction Regulation (SFTR).

The European Securities Markets Authority (ESMA) issued the level two consultation on SFTR in September, appearing to give market participants some hope that its requirements would be dialled back.

ESMA appeared to pull back on the requirement to report on collateral used

PIMCO fined $20 million for ETF ‘odd lots’ disclosure failure

Pacific Investment Management Company (PIMCO) has been fined $20 million by the US Securities and Exchange Commission (SEC) for misleading investors about the performance of one of its first actively managed exchange-traded funds (ETFs).

According to the SEC, PIMCO failed to accurately value small positions relating to 43 non-agency mortgage-backed securities through its total return Bond ETF, during the first four months of trading after its launch in February 2012.

The fund’s strong early performance attracted significant investor attention as it outperformed PIMCO’s flagship mutual fund in its first four months through its ‘odd lots’ strategy, which involved buying smaller-sized bonds to help bolster performance out of the gate.

The SEC argued that “the resulting performance from the odd lots strategy was not sustainable as the fund grew in size”, but that this fact was not disclosed accurately in monthly and annual reports to investors.

Following the investigation, the SEC stated in its order conclusion: “PIMCO valued these bonds using prices provided by a third-party pricing vendor for round lots, which are larger-sized bonds compared to odd lots.”

“By blindly relying on the vendor’s price for round lots without any reasonable basis to believe it accurately reflected what the fund would receive if it sold the odd lots, PIMCO overstated the total return ETF’s net asset value by as much as 31 cents.”

Andrew Ceresney, director of the SEC’s division of enforcement, said: “PIMCO misled investors about the true long-term impact of its odd lot strategy and denied them the opportunity to make fully informed investment decisions about the total return ETF.”

During the period, the Bond ETF in question was managed by PIMCO’s controversial co-founder and former co-chief investment officer William Gross. According to multiple reports, Gross resigned abruptly in September 2014 by leaving a brief note addressed to the CEO in the middle of the night.

Gross is now embroiled in a civil lawsuit with PIMCO, in which he is demanding $200 million in damages and claiming he was forced out by colleagues looking to further their own careers.

Following the ruling on the Bond ETF, PIMCO agreed to be censured and consented to the SEC’s order without admitting or denying the findings that the firm violated Sections 206(2) and 206(4) of the Investment Advisers Act of 1940, Rules 206(4)-7 and 206(4)-8, and Section 34(b) of the Investment Company Act of 1940.

PIMCO, which was acquired by Allianz in 2000, agreed to pay disgorgement of fees totalling $1.33 million, plus interest of $198,179 and a penalty of $18.3 million.

PIMCO said: “PIMCO is pleased to have resolved the Bond ETF matter with the SEC. PIMCO is committed to conducting its business in a manner that meets or exceeds the expectations of its regulators.”

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as part of a securities finance transaction on a T+1 basis, as well as admit that there were still some clashes with the European Market Infrastructure Regulation.

The feedback from this second stage will be used to finalise the draft technical standards, which will be submitted to the European Commission by the end of Q1 2017. The final version of SFTR will then come into force from 2018.

Despite some relaxations of the reporting requirements under SFTR being considered, their content and timing are still expected to cause significant challenges to market participants, particularly as both sides of the transaction must comply and supply unique transaction and legal entity identifiers.

A mandatory format has been suggested for SFTR reporting, according to EquiLend, due to the need for a comprehensive series of details throughout the lifecycle of the trade, as well as market participants' need to track, manage and report a large volume of data.

EquiLend said in a statement: "We are working with industry bodies, clients, triparty agents and trade repositories to provide an automated, consolidated, scalable solution that removes the necessity for manually intensive intervention from clients and provides transparency throughout the process."

The trading and post-trade service provider already captures much of the information required by SFTR, meaning it can create the unique transaction identifier immediately either at the point of trade or during the post-trade comparison process.

The ESMA consultation has also confirmed that timestamps remain a required field, "but a level of tolerance can be applied", according to EquiLend.

"The proposal is that several minutes can be applied to a timestamp field, such as execution timestamp. EquiLend provides a timestamp for all activity that clients undertake across the platform."

DekaBank goes to Clearstream for cross-border aid

DekaBank has picked Clearstream to support domestic settlement of its cleared trading activity on Euronext, tpREPO and BrokerTec across Belgium, France and the Netherlands.

Clearstream Banking Luxembourg will act as DekaBank's settlement agent for fixed income and equities to improve its liquidity and collateral management, which the international central securities depository achieves through pooling assets in one location for use elsewhere.

"We are delighted to have won DekaBank as a customer for our new cross-border settlement solution," commented Philip Brown, co-CEO of Clearstream Banking.

"This is an important step in the harmonisation of asset servicing across Europe, which enables market participants active in the Belgian, French and Dutch markets to benefit from improved and streamlined liquidity, collateral and risk management."

FSB updates G-SIB list

The Financial Stability Board (FSB) has revised its ranking list of globally systemically important banks (G-SIB) using year-end 2015 data.

The number and names of banks identified as G-SIBs remained the same (30 banks), but several banks were reclassified.

Four banks moved up a place. Citigroup rose to fourth, Bank of America moved up to third, and Industrial and Commercial Bank of China and Wells Fargo moved to second.

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Meanwhile, three banks moved down a step. HSBC went from fourth to third, Barclays dropped to second, and Morgan Stanley moved down to first.

G-SIBs have been allocated to buckets corresponding to the higher capital buffers that they would be required to hold by national authorities since an update to Basel III's framework in November 2012.

The lowest level-one G-SIBS are required to hold an additional 1 percent of capital on their books, with each level adding a further 0.5 percent up to the highest level (five), which requires 3.5 percent extra capital.

The most recent assignment will determine the additional buffer requirements that will apply from 1 January 2018.

G-SIBs will also be required to meet the total loss-absorbing capacity standard from the start of 2018.

The changes, which come in consultation with the Basel Committee on Banking Supervision and national authorities, reflect the improvement of data quality and changes in underlying activity.

Fintech funding feels the pinch

Venture capital-backed financial technology funding fell almost a fifth in Q3 2016, a new report has found.

Quarterly report The Pulse of Fintech from KPMG International and CB Insights noted investors continued to take a more cautious approach to fintech investments, with funding down 17 percent in Q3 2016 to $2.4 billion.

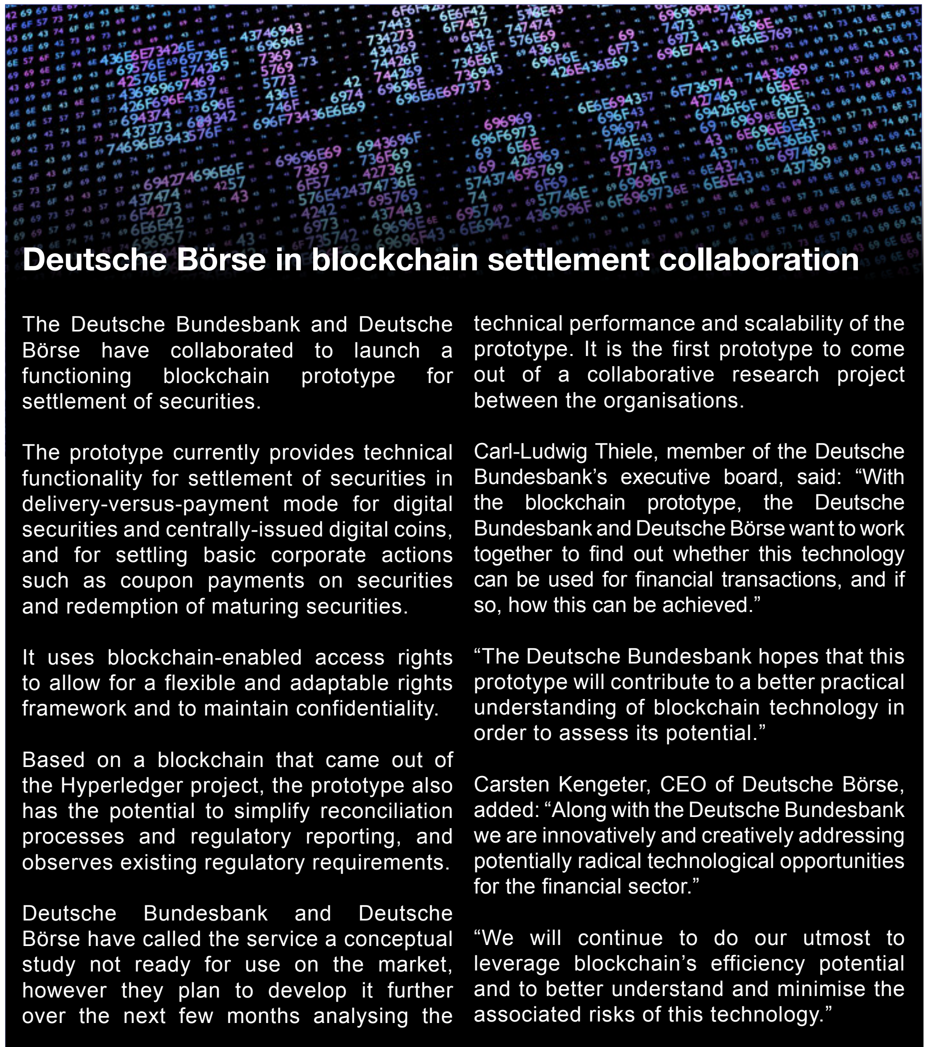
Deal activity fell 12 percent to 178 deals.

Overall global investment in fintech companies across both venture-backed and non-venture-backed companies totalled $2.9 billion in Q3 2016.

Anand Sanwal, CEO of CB Insights, commented: “While we continue to see significant investment into fintech companies globally, the euphoria for mega-deals that we saw into the latter half of 2015 has waned. Total investments to key areas like marketplace lending and blockchain technology have both seen declines heading into the tail-end of 2016.”

Q3 2016 saw European fintech deals fall 17 percent quarter-over-quarter as funding in Europe dropped 43 percent over the same time period to $233 million.

Germany outpaced the UK in terms of fintech funding for the second consecutive quarter, with 35 percent more funding raised by Germany-based venture-backed fintech



Deutsche Börse in blockchain settlement collaboration

The Deutsche Bundesbank and Deutsche Börse have collaborated to launch a functioning blockchain prototype for settlement of securities.

The prototype currently provides technical functionality for settlement of securities in delivery-versus-payment mode for digital securities and centrally-issued digital coins, and for settling basic corporate actions such as coupon payments on securities and redemption of maturing securities.

It uses blockchain-enabled access rights to allow for a flexible and adaptable rights framework and to maintain confidentiality.

Based on a blockchain that came out of the Hyperledger project, the prototype also has the potential to simplify reconciliation processes and regulatory reporting, and observes existing regulatory requirements.

Deutsche Bundesbank and Deutsche Börse have called the service a conceptual study not ready for use on the market, however they plan to develop it further over the next few months analysing the technical performance and scalability of the prototype. It is the first prototype to come out of a collaborative research project between the organisations.

Carl-Ludwig Thiele, member of the Deutsche Bundesbank's executive board, said: “With the blockchain prototype, the Deutsche Bundesbank and Deutsche Börse want to work together to find out whether this technology can be used for financial transactions, and if so, how this can be achieved.”

“The Deutsche Bundesbank hopes that this prototype will contribute to a better practical understanding of blockchain technology in order to assess its potential.”

Carsten Kengeter, CEO of Deutsche Börse, added: “Along with the Deutsche Bundesbank we are innovatively and creatively addressing potentially radical technological opportunities for the financial sector.”

“We will continue to do our utmost to leverage blockchain's efficiency potential and to better understand and minimise the associated risks of this technology.”

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companies than those in a UK hit by the Brexit vote in June.

North America saw both fintech funding and the number of deals fall on a quarter-over-quarter basis, as venture-backed startups raised just $900 million across 96 deals, a drop of 5 percent in deals from Q2 2016.

Funding in Q3 2016 to venture-backed fintech companies in North America fell 68 percent compared to the same quarter last year.

The news was better in Asia, where, despite the number of venture-backed fintech deals dropping to a five-quarter low, funding increased 50 percent on a quarter-over-quarter basis to reach $1.2 billion.

Corporates continue to be highly active in Asia's fintech investment environment, participating in more than half of all deals to venture-backed fintech startups in Q3 2016.

Asia's outpacing of the US in fintech funding is "a major shift from historical norms", according to Warren Mead, global co-leader of fintech at KPMG International.

He said: "The question is whether Asia will continue to set the pace headed into 2017. With the diversity of investments and widespread support for the growth of fintech hubs in the region, it's a very distinct possibility."

Calypso in tune with Canada's AIMCo

Alberta Investment Management Corporation (AIMCo), a Canadian institutional investment manager, has gone live with Calypso Technology's collateral management system.

Implementing the new collateral solution is intended to provide AIMCo with a platform that will better support new regulatory demands for both the over-the-counter and exchange-traded derivatives markets. The mandate follows AIMCo's decision to upgrade its existing Calypso technology system. In the course of the upgrade, client production environments are replicated on a remote server, allowing Calypso to execute upgrades and pre-test functionality before going live with the changes for real.

Calypso CEO Pascal Xatart: said "They [Calypso] understand that their long-term success depends on an integrated, real-time infrastructure that can evolve with their business, and we appreciate that they have entrusted us with such a strategically important initiative."

Michael Baker, senior vice president of investment operations at AIMCo, added: "This project is both strategically and operationally significant for us."

He said: "Replacing our manual collateral management system with a centralised, automated solution has already brought substantial benefits. We have greater control over our inventory, we can optimise our collateral, and going forward we will be able to comply with the new Basel Committee on Banking Supervision and International Organization of Securities Commissions initial margin regulations."

Short sellers round on retailers despite Trump bump-up

US retailer Restoration Hardware has attracted more than double the short interest than any other firm in North America in the week ahead of earnings, according to an IHS Markit research note.

Short sellers' interest in the home-furnishing company was peaked by a series of weak earnings results, which saw Restoration's shares lose two thirds of their value. Interest has remained high despite the retailer's latest earnings submission "outperforming expectations" and the emergence of a post-election rally in the retail industry's shares, explained the research note's author Simon Colvin.

Retailers made up over half of the most shorted firms analysed by IHS Markit, including Sears, Saks Fifth Avenue owner Husdon's Bay and Autozone.

The biggest jump in short interest leading up to earnings was with unmanned drone developer Aerovironment, which saw demand to borrow its shares surge by 25 percent over the past month.

Short sellers have more than doubled their positions in Aero, according to IHS Markit.

"This trend shows no signs of slowing down despite the fact that the post-election rally, which has boosted defense related shares, has seen Aero recover most of the ground lost in the wake of its last earnings update."

OCC sees new securities lending growth in November

OCC's securities lending central counterparty (CCP) activity was up 35 percent in new loans in November.

The clearinghouse recorded 160,540 transactions last month, while January to November loan activity also rose 38 percent with 1.7 million new loan transactions so far.

The average daily loan value cleared was $145 billion in November.

At the same time, cleared futures volume shot up 109 percent compared to November 2015.

The January to November average daily cleared futures volume for 2016 was up 58 percent so far, with 410,983 contracts.

Exchange-listed options volume reached 383.2 million contracts in November, a 19 percent increase from last November.

Year-to-date, average daily options volume is down 2 percent from 2015 with 16.2 million contracts.

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For more information, please contact Dennis Shikar, Managing Director, Head of Equity Finance Americas & Global Head, Client strategies Group, Equity Finance
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Equity options volume increased 16 percent last month from November 2015, while exchange-traded fund options volume grew significantly by 55 percent.

Index options volume was up 47 percent in November with 43.2 million contracts.

OneChicago enjoys volume boost

OneChicago, a securities finance exchange, saw its trading volume increase by 35 percent year-over-year as of November.

The exchange recorded 919,419 transactions last month alone.

Open interest decreased 26 percent between January and November, as of 30 November.

Almost all (97 percent) of month-end open interest for November was in OneChicago's flagship OCX.NoDivRisk.

REIT to increase securities lending pool

Real estate investment trust Two Harbors Investments is currently in the market for a new portfolio of mortgage-backed securities (MBS) that can open up to securities financing activities.

Two Harbors is looking to earn additional revenue through non-recourse term borrowing facilities and equity financing under the legacy loan programme and term asset-backed securities lending facilities. It will also participate in short-term repo transactions, known as agency repo MBS.

Despite posting Q3 results that were 14.2 percent down on Q3 2015, Two Harbors recently received a widespread vote of confidence from Credit Suisse Group, Deutsche Bank and J.P. Morgan. The fund earned $100.8 million in Q3 2016 and had a net margin of 15.46 percent.

Soc Gen CIB turns to fintech for CCP data solution

Societe Generale Corporate & Investment Banking (CIB) has become the latest major banking group to turn to a fintech firm to assist with the increasing burden of regulatory compliance.

The need for a cost-efficient solution that can be implemented quickly to ensure compliance with the Bank of International Settlement and European Central Bank's central counterparty exposure requirements meant that a vendor system proved more attractive than an in-house solution, according to Philippe De Brossard, head of fixed income clearing solutions at Societe Generale CIB.

Societe Generale CIB has committed to improving the collection and harmonisation of its group-wide central counterparty (CCP), exchange and broker data through a partnership with Message Automation.

Message Automation, a post-trade solutions provider for derivatives processing, has confirmed that implementation of its system will begin in December.

De Brossard said: "We have an ambitious implementation plan and speed to market was a key factor in our overall decision making process."

He explained: "Before partnering with Message Automation, we looked at various options including building everything in-house. However, after very careful evaluation of all the possibilities, we decided to engage the services of an external partner to support this high-profile project."

"Monitoring and reporting of CCP exposures is by nature a very complex process, particularly when having to collate and consolidate multiple information sources from a variety of subsidiary companies and over 80 external relationships."

"Our project objective is to streamline and simplify the entire process and we are working with the Message Automation team to satisfy two very specific initial requirements. The first being the desire to fully automate our complete exposure reporting capabilities, to reduce our overall operational risk exposure by dramatically reducing manual tasks."

"Our second is to create a centralised database to improve data quality. Consolidating the many diverse formats into a single harmonised data store will provide our internal consumers with immediate access to the information that they need in a consistent way, regardless of source, be it a CCP, exchange or clearing broker."

Hugh Daly, CEO of Message Automation, added: "Working in close partnership with our clients we have already significantly increased the number of CCPs, exchanges and clearing brokers our solution extracts data from as well as extending the range of data being received from each."

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Tred Talks:

Central counterparties in 2016

Tred McIntire, formerly head of Goldman Sachs Agency Lending and a member of the RMA executive committee, gives his thoughts how central counterparties in the securities lending market have evolved so far

The interest in using central counterparties (CCPs) for securities lending transactions in equities was largely driven by the need to address new regulations introduced after the 2008 financial crisis. As regulators required agents to quantify the potential risks around offering indemnification against borrower default and set aside capital for new risk-weighted asset (RWA) calculations and single counter counterparty limits (SCCLs), CCPs were viewed by some as the 'silver bullet' response. In the US broker-to-broker lending market, OCC's stock loan/hedge programme has gained a lot of traction and is generally viewed as a success. However, agent lenders and their beneficial owner clients have not yet found consensus around an attractive product to address their needs.

Current state of play

OCC's CCP product for agent lenders is still under development and will require more work before it can look forward to replicating the success of its broker-to-broker product. Unlike Eurex, OCC has not yet come to market with a 'specific lender licence' structure to offer beneficial owners a suitable means to access its platform.

It's currently working with key market players to develop a margining structure to meet the needs of beneficial owners and agent lenders while also maintaining its credit standards.

Additionally, in the US, any CCP is faced with an unclear regulatory landscape. They wrestle with a bit of a 'chicken and egg' situation. Without a fully developed CCP model, it is difficult to seek specific regulatory approval. The Risk Management Association has introduced the topic of CCPs with both the US Securities and Exchange Commission (SEC) in regard to '40 Act funds and CCP regulation and the Department of Labor with respect to Employee Retirement Income Security Act plans. However, these discussions are still at a relatively early stage.

In Europe, Eurex's CCP went live in 2012, covers five markets and has the backing of Deutsche Börse. Since its inception, Eurex has made substantial progress in developing its product, including:

- Introduction of the 'specific lender licence' to allow agents to participate in a manner that mirrors the traditional bilateral lending model without posting margin;
- Gaining the support of some of the largest players in the market including Morgan Stanley, State Street, and BNY Mellon and BlackRock;
- Establishing communication links with Pirum and EquiLend;
- Offering cross-netting with other cleared products; and
- Establishing collateral arrangements with Clearstream and Euroclear with the expectation that BNY Mellon's triparty programme will join as a collateral agent by year-end.

Eurex also plans to add the UK market in June 2017, and it is working on adding Italy, Spain, Portugal, Finland and the US.

A phased approach to entering the US market would allow for several benefits, including: allowing US beneficial owners to transact in European securities; European asset managers to transact in US securities; and US managers to transact in US securities. Although Eurex clearly has the most developed model and has made significant progress since its inception, at some point, they will need to generate positive returns for its parent organisation.

Recent developments

EuroCCP—the most recent development is the expected launch of a new CCP competitor in Europe. EuroCCP is rumored to have plans to cover as many as 15 markets as well as having the support of major players in the securities lending market. Unfortunately, it appears that this venture is still at a relatively early stage as it is not prepared to discuss specifics at this point.

Politics and regulation—the global political landscape is clearly undergoing a sea change. With the recent election of Donald Trump, and the impending elections in France, Italy and Germany, will the regulatory climate that has impacted the markets begin to moderate? President-Elect Trump has vowed to dismantle the US Dodd-Frank Act, and he has already appointed Paul Atkins, a former SEC commissioner, to "flesh out the new administration's plans for remaking the financial rule book". During his campaign, Trump also promised that for every new federal regulation, two existing regulations would have to be eliminated.

One specific area of interest in the US is the SCCLs. There is currently no specific timeframe for implementation of the SCCLs, however, uncertainty about the future direction of regulation would seem to be a new obstacle to be overcome.

How much of what Trump said during his campaign will actually find its way into law and regulation remains to be seen, however, he will have a Republican majority in both houses of Congress so there is a greater likelihood that he can move forward his agenda.

Questions surrounding possible regulatory change may slow progress on CCP development as well as acceptance by the regulatory establishment and among market participants.

In terms of disruptive technology, will blockchain or other distributed ledger technologies change the landscape of how financial transactions are structured and business is conducted?

This possibility is probably at least three to five years away, given the need for regulatory buy-in as well as market acceptance and trust for such a significant change to the flow of business. However, blockchain does offer a potential alternative, or even threat, to CCPs.

> US CCPs are wrestling with a bit of a 'chicken and egg' situation
>
> **Tred McIntire**
> Member of the RMA executive committee

What to watch for

Will any of the existing CCP offerings make substantive progress with product developments or gain support from market participants?

What happens on the regulatory front that encourages or facilitates broader adoption of CCPs for securities lending?

Perhaps most importantly, over the next several months, will we see indications of how the political winds may affect regulation as Trump's agenda comes into sharper focus, and political forces in major European countries begin to coalesce? **SLT**

Tesla: Short sellers' golden goose

Tesla shares were responsible for an astonishing 3 percent of the securities lending industry's total revenue. IHS Markit's Simon Colvin reports

No single US stock has derived more column inches or divided opinions over 2016 more than upstart electric carmaker Tesla. The last 11 months have produced as many twists, potentially ground-breaking product launches and controversies than many companies would expect in a decade, but this is what we have come to expect from a company whose CEO, Elon Musk, also dabbles in space exploration, among a host of other issues.

Much of this difference of opinion was expressed through short selling as investors tried to reconcile the enthusiasm around the company's ground-breaking product lineup with its ongoing cash burn in its efforts to pivot away from the niche market onto affordably priced mass production. These dueling forces ensured that the demand to borrow Tesla shares never fell below the 15-percent-of-shares-outstanding mark at any point throughout the year. This consistently strong demand to borrow Tesla shares from short sellers cemented their position as the top revenue generating asset of the securities lending industry. The $220 million generated by lenders of Tesla shares was responsible for an astonishing 3 percent of the securities lending industry's total revenue.

Short sellers started on the front foot as the market volatility experienced in Q1 2016 saw Tesla shares lose as much as 37 percent in the six weeks leading up to the 52-week low set on 10 February. Demand to borrow Tesla shares then quickly rose past the 25 percent of shares outstanding mark. Short sellers stayed resolute despite a rally that saw Tesla shares regain the near totality of the ground lost in the opening weeks of the year.

This rebound ensured that short sellers were roughly even for the year heading into arguably the most watched Tesla event of the year, the unveiling of the Model 3. This model will set the ground for Tesla's entry into the mass market and will see the company boost production from the current 80,000 vehicles per year to 500,000. Skepticism around Tesla's ability to deliver on this ambitious pledge and carve out a profit on the $35,000 price set for the Model 3 drove short selling to fever pitch as more than 80 percent of shares in lending programmes were out on loan ahead of the Model 3's unveiling.

The Model 3 was nonetheless well received with more than 350,000 potential purchasers lining up to reserve their spot in line for the initial deliveries estimated to start in late 2017. This sent Tesla shares rallying by 17 percent, which saw shorts sellers underwater for the year. Tesla's Musk was keen to press his upper hand on short sellers soon after the post-Model 3 surge when he warned his six million Twitter followers that shorting Tesla shares was "probably unwise". This comment was heeded by a third of Tesla's short sellers in a wave of short covering in the subsequent weeks.

This covering carried on in earnest over the following months despite the fact that Tesla's proposed purchase of ailing rooftop solar manufacturer SolarCity, which is controversially run by Musk's cousin, further emboldened its critics. Incredibly for momentum-driven short sellers, the covering occurred in the face of a renewed slide in Tesla's shares.

The final act for short sellers came in the wake of the 8 November US election, which saw demand to borrow Tesla bounce back to more than 20 percent of shares outstanding as investors pondered whether the incoming Trump administration would have the same appetite for subsidising solar and electric cars as the Democrats.

Beneficial owners that lend their shares have remained relatively steadfast throughout all of this volatility as the number of Tesla shares in lending programmes has stayed range-bound between 24 and 26 million shares since the start of the year.

These holders have been handsomely rewarded as the consistently high demand to borrow Tesla shares means that the average return delivered by every share in lending programmes since the start of the year has been 480 basis points. **SLT**

"The average return since the start of the year has been 480 bps"

Simon Colvin
Analyst
IHS Markit

That was the year that was

David Lewis of FIS Astec Analytics looks back at the wave of populism that swept across the EU and US this year and manifested itself in a series of controversial election and referendum results

This has been quite a year. Few adjectives can adequately describe the individual or indeed cumulative events that have occurred these last 12 months. One thing is for certain—pollsters will have to withdraw and reflect on their predictive models before venturing out onto the pundit stand once more.

Brexit came as quite a surprise to many, as perhaps did the change of political flavours in the US. Both changes have yet to come into effect, and their actual impacts are far from certain. In Europe, change also appears to be in the wind, with presidential elections looming for France and concluding in May next year, elections for the German chancellor at the end of next summer. This last weekend, the shock referendum loss for Prime Minister Matteo Renzi in Italy, forcing the resignation of the last premier left in Europe with a vision for the future of the EU. The European Central Bank (ECB) also meets this week to make a serious decision that will doubtless also affect the European economy in some way.

With increasing fears of a stalling recovery across Europe, the ECB must decide whether to continue its bond-buying programme beyond the current expected end-date of March next year. Purchasing around €80 billion of bonds per month, the ECB has already spent some €1.74 trillion on the centerpiece of its stimulus policy. Critics suggest that this policy has just created bond and

property price bubbles—that the economies cannot afford to have burst. Without the support of the ECB, it is hard to believe that the bubbles created won't, at the very least, deflate, if not burst. After 18 months of buying bonds, the ECB now owns more than 25 percent of German and other countries' debts. Soon, there will not be enough eligible paper to buy and the subject of scarce collateral will once again rear its head, especially in the world of securities finance.

Eighty percent of the bonds purchased by the ECB as part of its quantitative easing programme have been purchased by the European national central banks, which are then responsible for lending out those same securities as part of the securities lending programme.

Mario Draghi, the head of the ECB, has stated that it is "upgrading" the securities lending programme as it "was falling short of what would be optimal". Policy decisions will be made at the 8 December meeting, and options include extending loan duration limits, reducing late returns fines, and expanding the collateral eligibility criteria.

With increasing uncertainty across Europe, it seems unlikely that the ECB will squeeze off this stream of financial support, especially as inflation is finally starting to slowly pick up once more, reaching 0.5 percent in October and hitting 1 percent next year.

A recent Organisation for Economic Co-operation and Development report has encouraged increased government borrowing to stimulate the world economy, taking advantage of historically low borrowing rates, but seeming to ignore the need to support elevated levels of debt. If increased debt issuance is chosen to be the way forward, it may at least ease the strain of the supply of high-quality liquid assets in the financing markets.

Figure 1: European government bonds indexed to August 2015

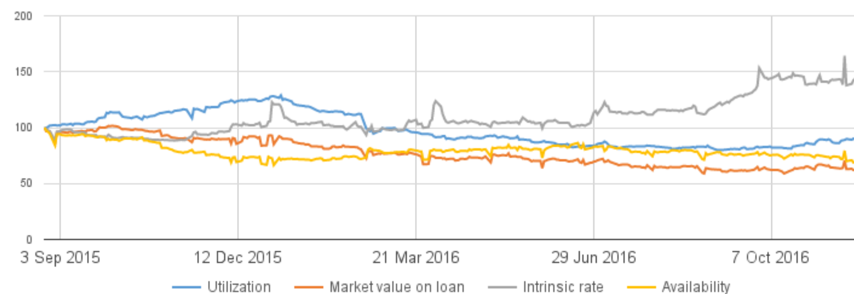

Figure 1 shows the indexed levels of European government debt over the past 15 months. Plotted on the graph are the indexed value on loan, availability, and the weighted average intrinsic borrow rates. Note that the index value for availability at the end of November is just under 70, compared with 15 months ago, suggesting that 30 percent of European government debt, by value, has been removed from the market. Given the increased demands on sourcing such high-quality assets, it is not surprising to note that the trend for the borrowing costs have risen, resulting in an index value of 144, indicating the increasing fee levels associated with the asset class.

The ECB is walking a dangerous tightrope with regards to its economic policies. It can either continue to artificially support asset prices and risk bursting national bank balance sheets, or reduce its involvement and let market forces retake control. Either path is problematic and given the impending political tests across Europe, it may even be largely academic.

This year has seen the start of potentially sweeping changes across both the European and the wider political and economic landscape. From the potential repealing of certain banking laws in the US, to the rise of the Chinese economy and the potential for them to fill any vacuum left by the US withdrawing from world trade agreements, there are many uncertainties to consider and be wary of.

The referendum in Italy, Europe's third largest economy, was the first test ahead of the next ECB policy meeting. The Italian's, having voted to reject the changes aimed at reducing the number of politicians while centralising power proposed by Prime Minister Renzi, have sent shockwaves through an already unsettled Europe.

When other countries in Europe are leaning towards change, the 'no' vote in Italy might be interpreted as Italians rejecting change, but it may be due more to the proposed changes not being anti-establishment enough.

The US has, most would say, elected a true anti-establishment president, and other countries around Europe may well follow in the next 12 months.

Two things appear clear from a markets standpoint: investment fundamentals now seem secondary to gaming the policies of central banks and politicians, and that if 2016 created tremors, 2017 will be truly seismic. **SLT**

> The ECB is walking a dangerous tightrope with its economic policies

David Lewis
Senior vice president
FIS Astec Analytics

Industry **Events**

IMN's 23rd Annual Beneficial Owners' International Securities Finance & Collateral Management

Florida

As we head into 2017, it's not business as usual within the securities finance industry. As new opportunities—and challenges—come to the forefront in this dynamically evolving market that may have a direct impact on securities finance.

14th Annual PASLA RMA Conference on Asian Securities Lending

Seoul

14th Annual PASLA and RMA will be held in Seoul, South Korea, at The Conrad Seoul.

Finadium Investors in Securities Lending Conference NY 2017

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Finadium Investors in Securities Lending Conference London 2017

London

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Industry **Recruitment**

Software Development Manager Banking, Securities

Recruiter: Alexander Ash
Location: London

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Compliance Manager (FX and Capital Markets)

Recruiter: Bruin
Location: London

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Recruiter: State Street
Location: Boston

Trading assistant required to support a North American team lending equities and fixed-income instruments in 32 markets from the Boston office.

Business Analyst

Recruiter: Alexander Ash
Location: Midlands

Defining business requirements in partnership and collaboration with the business and obtaining sign-off.

Comings and goings at OCC, ISLA, Ivaldi Capital and more

OCC has brought on former Optiver US CFO Amy Shelly as senior vice president and CFO.

Shelly, who replaces Kim McGarry, is now responsible for finance, accounting, strategic sourcing and facilities, as well as a new treasury function.

Prior to joining OCC, Shelly was the interim CFO for a private equity portfolio company.

From 2015 to 2016, she was a project manager for CF Industries, where she worked with the company's corporate controller to manage the integration of a large acquisition.

Additionally, James Pribel, formerly executive director and treasurer at CME Group, has been named first vice president of treasury, which is a new position at OCC.

OCC's current first vice president and deputy general counsel, Joe Adamczyk, has moved up a rung to become senior vice president and chief compliance officer, replacing Richard Wallace.

The International Securities Lending Association's (ISLA) Claire Davis has shifted gear to take on a new role as part of J.P. Morgan's agency lending programme.

Davis will continue in her current role as relationship manager for ISLA until mid December, before assuming her new position in J.P. Morgan's agency lending product development team in early January.

She continue to be based in London and will report to Stefano Bellani and Paul Wilson.

Davis served at ISLA for just under three years, and previously held positions at State Street and ABN Amro Mellon.

J.P. Morgan declined to comment on the appointment.

Mark Schilling has taken on a managing director role at Ivaldi Capital, an institutional investment manager.

Schilling most recently served as global head of sales at Pirum Systems. He left that role earlier this year.

Before Pirum, Schilling spent just over three years as managing director at Scotiabank.

He has also worked at Citi, Credit Suisse and Deutsche Bank.

According to various sources, Schilling's new firm, Ivaldi Capital, launched in 2009 and is based in London.

The investment management firm focuses on absolute return strategies for institutional investors.

Sander Baauw has joined EuroCCP as product manager.

The former ABN AMRO Bank executive joined the equities central counterparty last month. He is based in Amsterdam.

Baauw was responsible for equity finance trading in Europe at ABN AMRO. He left to join IT company Synechron in 2012. After leaving Synechron a year later, Baauw took on a product management role at ION Trading. He also worked at Fortis Bank until ABN AMRO took it over in 2010.

RBC has lured away Rebecca Bridgeman from BNP Paribas Securities Services after six years on the bank's securities financing desk.

Bridgeman, who continues to be based in London, now serves as associate director of global client coverage at RBC.

She previously held a front-office sales position as business development of securities financing. **SLT**

Do you have an appointment we should cover? Let us know via:

editor@securitieslendingtimes.com

Group Editor: Mark Dugdale
editor@securitieslendingtimes.com
+44 (0)203 750 6022

Deputy Editor: Stephanie Palmer
stephaniepalmer@blackknightmedialtd.com
+44 (0)203 750 6019

Reporter: Drew Nicol
drewnicol@securitieslendingtimes.com
+44 (0)203 750 6022

Contributors: Becky Butcher, Barney Dixon

Marketing Director: Steven Lafferty
design@securitieslendingtimes.com
+44 (0)203 750 6028

Designer: James Hickman
jameshickman@blackknightmedialtd.com
+44 (0)203 750 6028

Publisher: Justin Lawson
justinlawson@securitieslendingtimes.com
+44 (0)203 750 6028

Recruitment Manager: Chris Lafferty
chris@assetservicingtimes.com
+44 (0)203 750 6024

Office Manager: Chelsea Bowles
accounts@securitieslendingtimes.com
+44 (0)203 750 6020

Twitter: @SLTimes_

Office fax: +44 (0)20 8711 5985

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