

asset servicing times

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Moving from theory to practice

ISSA's Urs Sauer and Glen Fernandes discuss what needs to be done in order for crypto assets and DLT to achieve mainstream adoption at scale within the financial services industry

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CSDR buy-in provisions delay ‘anticipated’

The deadline for the buy-in provisions of the EU’s Central Securities Depositories Regulation (CSDR) is expected to be pushed back until November 2020 to allow for technical updates to be completed on the SWIFT messaging framework, according to the International Capital Market Association (ICMA).

The CSDR buy-in provisions, which are currently due to come into force in September 2020, create a mandatory obligation for trading parties to execute buy-ins against counterparties who fail to settle their trades within a required period.

The requirements will apply to trades that are intended to settle on EU international central securities depositories (ICSD) and CSDs.

ICMA’s senior director in market practice and regulatory policy team, Andrew Hill, said that although no official delay had been announced by the European Securities and Markets Authority (ESMA), the association “anticipated” one was forthcoming as technology framework around the regulation would not be in place by the original deadline.

Hill explained that the need for a delay is related to the cash penalties element of CSDR, which has the knock-on effect of also delaying the buy-in provisions.

According to Hill, the application of cash penalties on the Target2-Securities (T2S) platform requires an update to the SWIFT messaging protocol that is not scheduled to be released until November.

“Because of the way the settlement discipline package is written, the penalties and the buy-ins go together so if one gets delayed then they both get delayed – it’s purely technical,” he said.

Messages related to CSDR cash penalties will be conducted on the ISO 20022 framework between T2S and CSDs and via ISO 20022 or ISO 15022 between CSDs and sub-custodians or participants and clients.

A spokesperson for ESMA said it is aware that CSDR’s settlement discipline “requires significant IT developments for market participants, including the adoption of ISO standards the publication of which depends on the SWIFT standard release yearly schedule (November 2020)”.

ESMA also confirmed it was “working towards a solutions” with the European Commission but indicated no official decision would be offered this year.

SWIFT did not immediately respond to questions on the matter.

The news of an expected delay comes as ICMA produces plans to update its ‘buy-in rules’ to support the implementation of the CSDR mandatory buy-in provisions in the international bond markets.

The association’s buy-in rules are part of its report on ‘secondary market rules & recommendations’.

The ICMA rules apply automatically to trades in international securities between ICMA members. As part of the proposed changes, ICMA intends to consult with members in early 2020 on any proposed revisions.

ICMA says it is also exploring contractual provisions to address the asymmetric treatment to the settlement of the executed buy-in or cash compensation differential and the absence of a pass-on mechanism in the regulation.

On the proposed rule changes, ICMA CEO Martin Scheck said: “Participants in the international bond markets have relied upon the ICMA buy-in rules to manage their settlement risk for decades. The introduction of the CSDR mandatory buy-in regime creates some problematic anomalies and another level of complexity, however, we expect the ICMA buy-in rules to continue to provide a contractual framework and best practice for executing buy-ins, while also addressing some of the issues presented by the regulation.”

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Latest News

Ledger has obtained a crime insurance policy covering digital assets secured by the Ledger Vault platform

p8



Initial Margin

Neil Murphy and Gemma Bailey of TriOptima discuss regulatory IM collateral segregation and the choice of triparty vs third-party

p10



US Regulation

The US is full-throttling towards its 2020 election. But what does the future hold for the financial services industry?

p14



ISSA Insight

Urs Sauer and Glen Fernandes discuss what needs to be done in order for crypto assets and DLT to achieve mainstream adoption

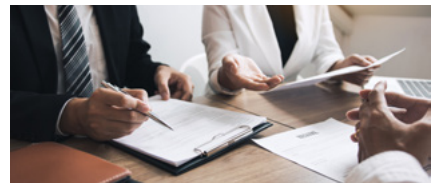
p17



Trading Services

Ben Challice of J.P. Morgan discusses the advantages of outsourcing services

p21



Industry Appointments

Comings and goings at Société Générale, BNY Mellon and more

p23

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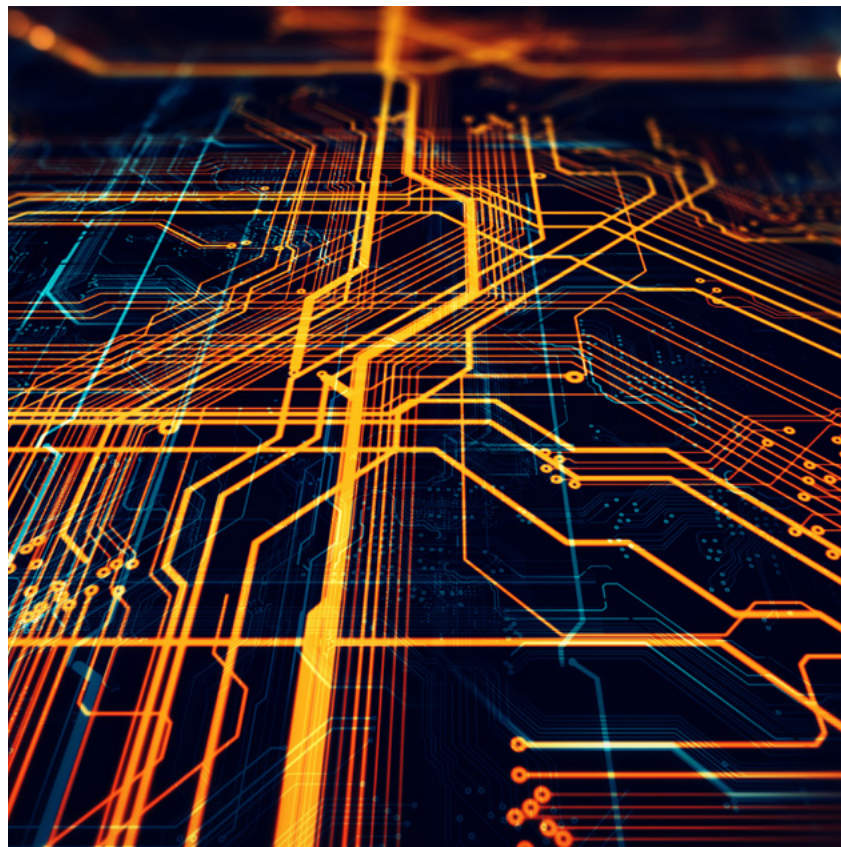
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Building Responsible Partnerships



Baton Systems and J.P. Morgan to automate derivatives margin payments

Baton Systems has teamed up with J.P. Morgan to develop a distributed ledger technology platform to help redeploy cash and collateral balances more effectively to global clearinghouses.

The new service addresses the challenge of having to tie-up excess funds across the clearing workflow by integrating settlement instructions for custodians and other funding sources into existing optimisation and treasury systems.

In addition, it eliminates the need to coordinate multiple systems, reports, and spreadsheets.

The resulting end-to-end automation of the margining and collateral workflows provides visibility of the asset flows between J.P. Morgan and clearinghouses,

with complete audit trails and real-time notifications, reducing the need to pre-fund margin payments under the current market infrastructure related to margin settlements.

Anthony Fraser, head of global clearing operations and trading cost management at J.P. Morgan, said: “We’re already seeing faster, more efficient payments, reconciliation and reporting for all parties in the collateral lifecycle.”

Arjun Jayaram, CEO and founder at Baton Systems, said: “Our collaboration with J.P. Morgan is accelerating the movement of assets. This is a truly ground-breaking solution that removes the need for manual intervention in the collateral process by integrating with financial institutions’ collateral and cash systems, leaving their existing processes and systems in place.”

HSBC to provide global custody Kommunalbanken

HSBC Securities Services has been named global custody provider for Kommunalbanken, a local government funding agency in Norway.

Kommunalbanken is 100 percent owned by the Royal Ministry of Local Government and Regional Development on behalf of the Kingdom of Norway.

As part of the agreement, HSBC Securities Services will provide global custody for Kommunalbanken’s international assets across Europe, the US, the UK and Asia.

AFME sets out recommendations for supervisory convergence on crypto-asset regulations

The Association for Financial Markets in Europe (AFME) has called for greater supervisory convergence in European crypto-asset regulation as part of a new paper it has published.

In the paper, the association set out five recommendations to help encourage collaboration between regulators in Europe and work towards a common approach to the regulation and development of crypto assets in financial services.

The five recommendations include establishing a pan-European crypto-asset taxonomy, providing clear expectations for market participants on the process for issuing crypto assets, applying activities-based and technology agnostic regulation, applying existing regulation for regulated activities, with any necessary amendments if required and finally to prioritise convergence of regulatory frameworks with other global and regional initiatives.

The paper found that while there is some convergence on the methods used to classify different types of crypto-assets, there is a significant divergence in the methods used to regulate crypto-assets. This creates uncertainty for market participants, which limits innovation.



HSBC supports first GDR conversion under Shanghai-London Stock Connect

HSBC China has supported the conversion of the first global depository receipt (GDR) for Huatai Securities under the Shanghai-London Stock Connect Scheme.

Huatai Securities is the first issuer to list GDR on the London Stock Exchange.

The Shanghai-London Stock Connect is a new investment scheme designed to deepen financial cooperation between China and the UK.

It allows listed companies on the Shanghai Stock Exchange to raise funds in London through GDR and allows London Stock Exchange-listed companies to broaden

their investor base by selling existing shares in Shanghai through Chinese depository receipt.

Brian Godins, head of HSBC Securities Services Asia Pacific, said: “We are delighted to have implemented the first GDR conversion under the Shanghai-London Stock Connect scheme. Our collective expertise, in-depth understanding of the market and client-centric mindset have reinforced HSBC’s market-leading position in China.”

HSBC China has been appointed as the local custodian for the three UK designated brokers and is working closely with them on upcoming opportunities.

AFME explained that it is crucial that market participants and regulators collaborate further to better understand the market and end-user needs, the underlying technology, the benefits provided and the risks involved with crypto-asset activity in order to develop an appropriate response.

It suggested that this will support Europe becoming a leader in financial innovation and contribute to the European Commission’s ambition to make “Europe fit for the digital age”.

AFME said: “It is our aim that these recommendations will help protect the financial system, mitigate risks to end-users and encourage innovation and competition in relation to crypto-assets.”

“AFME and its members look forward to continuing to work with regulators and other market participants to achieve this aim.”

Diginex launches digital asset custody services

Blockchain financial services firm Diginex has launched a digital asset custody services offering.

Digivault will provide a vaulted cold storage solution for a range of digital asset holdings including blockchain and ethereum through its Kelvin offering.

Kelvin will offer secure, digital asset deep cold storage infrastructure inside the vaults of Malca-Amit.

Robert Cooper, CEO of Digivault, commented: “Our goal is to provide air-tight cold storage custody solutions for sophisticated investors with Kelvin.”

Cooper suggested that there is “a gap in the market for a top-calibre custody cold storage solution that nullifies human risk, removes the ability for staff exploitation through criminal action such as kidnapping and removes all online electronic attack vectors, which we see as the key points of compromise in market offerings to date”.



Ocorian authorised as AIF depositary in Luxembourg

Ocorian has been authorised to act as a depositary to Alternative Investment Funds (AIFs) in Luxembourg after approval from the Ministry of Finance.

The depositary service is open to EU Alternative Investment Fund Managers (AIFMs) managing EU AIFs and non-EU based investment managers wishing to market their EU or non-EU AIFs in the EU.

Ocorian already offers depositary capabilities in London and Jersey to closed-ended structures holding non-financial instruments.

Ocorian is also authorised to provide depositary lite services to AIFMs looking to market their AIFs in accordance with AIFMD rulings.

Philip Bolton, managing director of alternative investments, Europe at Ocorian,

said: “Obtaining this license is a testament to the high standard of work Ocorian has been doing as a depositary across our European network to date, and our ability to meet shifting market demands. This expanded service offer is in complement to the other fund administration and accounting services we have been providing in Luxembourg for a number of years.”

Jean-Marie Bettinger, head of Luxembourg and the Netherlands at Ocorian, commented: “This approval enables Ocorian to add another facet to its local toolbox and is a fantastic opportunity to strengthen the full value chain in our funds services offering in Luxembourg.”

She added: “Our fund service offering is now fully aligned with the market’s expectations and enables our clients to leverage on our experience in the alternative investments sector.”

The product will operate to global standards and provide a secure means of processing and storing digital assets.

Richard Byworth, CEO of Diginex, explained that a lack of “highly secure, institutional-grade custody solutions has prevented widespread adoption of this asset class by institutional players. Our unparalleled security measures will provide peace of mind to investors who have an appetite for this burgeoning asset class”.

James Byrne, chief technical officer at Digivault, added: “In order to develop this infrastructure, we have leveraged the custody practices employed in the safekeeping of rare diamonds and ultra-precious metals. We have developed the Digivault infrastructure with 360-degree view of security, this nexus of security protocols have been devised leveraging the expertise of cross-sector finance as well as digital asset and security experts.”

Eurex’s ISA Direct gains first EU-domiciled bank as member

Eurex Clearing has welcomed its first EU-domiciled bank, Raiffeisenlandesbank Niederösterreich-Wien AG (RLB NÖ-Wien), as a member of its direct-access model for the buy side, ISA Direct.

The ISA Direct was launched to support the buy and sell sides in addressing today’s more onerous capital requirements, which have sometimes led to higher fees and wider spreads in the clearing space.

It brings together elements of the traditional client clearing service relationship with direct access for the buy side, allowing a new principal-client relationship between these market participants and the central counterparty.

RLB NÖ-Wien is now a direct clearing member of the central counterparty’s ISA Direct service, with ABN Amro acting as a clearing agent.

According to Alexander Jacobs, head of over the counter (OTC) clearing at ABN Amro



Ledger Vault obtains custom crime insurance policy

Ledger has obtained a crime insurance policy covering digital assets secured by the Ledger Vault platform.

The programme follows an evaluation of Ledger Vault’s hardware and software security infrastructure as well as governance policies.

Last year, Ledger Vault worked with Marsh and Arch Insurance (UK) to develop the custom programme at the behest of Vault clients.

The customised crime insurance programme insures crypto assets for up to \$150 million including third-party theft of the master seed and private keys following a physical breach of a hardware security module in a secure data centre; secure transmissions of the master seed fragments as part of the client onboarding; and insider Ledger employee theft caused by collusion.

All the coins and tokens currently supported by the Vault platform are covered by

the Ledger Vault policy. There is also a mechanism to add new coins/tokens to the policy coverage as may be necessary.

Pascal Gauthier, CEO at Ledger, said: “We consider insurance a crucial part of a comprehensive plan as digital assets gain a foothold in institutional portfolios. As a new class of assets, securing digital currencies has become a complex challenge for both institutions and insurers. Through our efforts with Marsh and Arch to curate this comprehensive crime insurance policy, we are playing a pivotal role in the movement to secure and insure all critical digital assets.”

Jennifer Hustwitt, senior vice president with Marsh’s global digital asset risk transfer team, said: “As this asset class matures, we are focused on structuring insurance programmes that align with how the underlying technology functions. This Ledger insurance programme marks the next chapter in the burgeoning insurance market for digital asset risks.”

Clearing, acting as clearing agent, rather than a clearing member, optimises the impact on ABN Amro’s balance sheet and creates opportunities to further expand its central clearing services.

Jochen Bonk, head of fixed income management at RLB NÖ-Wien, commented: “Having a direct relationship with Eurex Clearing provides us with a range of advantages in terms of both costs and collateral management.”

“Alongside lower fees, we can now make use of a much wider variety of collateral compared to our previous arrangements with intermediaries,” he added. “Improving the portability of our assets in this way has opened up significant capital and operational efficiencies.”

RLB NÖ-Wien’s addition to the programme follows Swiss Life Asset Managers and PGGM, the Dutch pension fund, who both joined ISA Direct earlier this year.

There are now eight basic clearing members and four agents live on OTC interest rate swaps and repo.

Citi joins Tadawul and expands Saudi Arabia presence

Citi has joined Tadawul, the Saudi Stock Exchange, and expanded its direct custody and clearing (DCC) services to Saudi Arabia.

The two developments will enable Citi to offer its institutional investor clients services in Saudi Arabia, including trading execution and clearing.

Citi provides clearing and settlement services for the trading and investing activities of broker-dealers as well as access to securities trading in local markets.

The addition of Saudi Arabia to Citi’s proprietary direct custody and clearing network will expand its local presence to 63 markets globally.

Murray Roos, global co-head of equities and securities services at Citi, said: “Clients



Electra expands reconciliation platform offering

Electra Information Systems has expanded its Electra Reconciliation platform to enable firms to process investigations by identifying the root causes of trade breaks or exceptions.

Electra Reconciliation has been designed to assist asset managers and service providers improve efficiency, accuracy and transparency across reconciliation, exception management and the entire post-trade process.

The platform will see an expansion on its integration of cash, positions and transactions to include research data—such as failed trades, corporate actions, securities lending and collateral—into the investigation process.

The system provides access to a research data repository that serves as a single point of reference to help accelerate investigations, reduce manual intervention and errors, and foster cross-functional collaboration and transparency throughout post-trade operations. As part of the upgrade, machine learning will also be

used for automatic source data mapping, which will recognise behaviour patterns on external events and third-party data to integrate these patterns into the investigation workflow in a future release.

John Landry, CEO of Electra, said: “Identifying exceptions is easy, but investigating their root causes is where the real work begins. One failed trade can impact multiple post-trade functions, potentially reaching a net asset value, corporate action, position or cash balance.”

Landry added: “With increased margin compression and greater competition, investment managers can no longer tolerate high error rates and redundancy in the investigations process due to the same work being performed across different reconciliation solutions and outside sources. They must eliminate investigation silos which impose greater risk as product complexity and transaction volumes increase. Electra Reconciliation 6.0 raises the bar for improving efficiency and transparency across the entire investigations process, and across the firm.”

are looking to Citi to leverage its franchise breadth, global reach and local depth to deliver meaningful financial solutions. Citi has a unique set of capabilities to offer clients across the entire trade lifecycle: from pre-trade, to trade, to post-trade, and we can bring those capabilities to bear in Saudi Arabia.”

Reto Faber, the Europe, the Middle East, Africa, head of direct custody and clearing at Citi, commented: “We are delighted to announce this strategically important addition to our growing network of markets globally. We look forward to working with our local partners to help build the franchise and to represent our client’s interests in this important market as it continues to grow and attract more international investment.”

AAX digital asset exchange goes live on LSEG platform

LSEG Technology’s Millennium Exchange has been deployed as part of the go-live of the AAX digital asset exchange, making it the first digital asset exchange to use the platform.

Based in Malta, AAX is part of Atom International Technology Limited and has technology operations in London and Hong Kong.

LSEG Technology’s trading and post-trade products are used by financial market infrastructure and financial services firms, including The London Stock Exchange, The Stock Exchange of Hong Kong, The Johannesburg Stock Exchange, and The Singapore Exchange.

Ann Neidenbach, CIO at LSEG Technology, said: “LSEG Technology is delighted to have successfully deployed our world-class Millennium Exchange matching engine at AAX. This is the first time Millennium Exchange has been deployed in the cloud, bringing its performance, scalability, reliability and seamless direct market access to AAX.”

Thor Chan, CEO and co-founder of AAX, commented: “LSEG Technology’s Millennium Exchange matching engine provides the performance and reliability to power AAX’s 24-hour trading platform all in a cloud-based environment.”

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It's not all about SIMM vs schedule

Neil Murphy and Gemma Bailey of TriOptima discuss regulatory initial margin collateral segregation and the choice of triparty vs third-party

While the need to calculate and post initial margin grabs the headlines, so to speak, in terms of priorities for firms looking to comply with uncleared margin rules (UMR), there are many other issues for firms to consider.

Not least is the requirement that the initial margin is segregated in a bankruptcy-remote account. Firms coming into scope and obliged to exchange initial margin must work out how they will segregate collateral. The fact that many of these firms will be using non-cash collateral for the first time adds to the challenge.

There are two segregation structures in play today: triparty and third-party, and there are multiple factors to consider before deciding what's best for a firm. This choice impacts the new legal documentation to be put in place, including clauses in the account control agreement with each custodian, as well as the new International Swaps and Derivatives Association credit support documentation with each counterparty. It also has direct consequences on a firm's operational model.

For many firms coming into scope in phase 5/6 of the rules, the triparty model is an entirely new process given the wider reliance on the traditional custody model. For those not currently utilising a segregation model for collateral held as variation margin, this may mean a steep learning curve, and you must weigh the relative cost versus operational process requirements of each model.

Triparty

Triparty structures are generally more expensive than third party structures. This is because in the triparty model the custodian provides a broader range of services, taking on more of the operational process on behalf of the client. Clients must each maintain a 'long box' of potential collateral at the triparty custodian. Upon agreement of the initial margin margin call, each party must instruct the custodian of the required values (RQVs) variation margin settlement, where each party will also agree the collateral to be pledged before instructing the custodian. Upon receipt of the RQV, the custodian will check the existing balance of the segregated account, look in the pledgor's long box to see available securities and determine which securities in the long box are eligible to be pledged for this agreement, before calculating how much collateral must be moved to get to the required balance. It will then move/settle the appropriate collateral to the segregated account. In this case, the triparty custodian selects the asset to pledge, applies a haircut and calculates the collateral value. It may also provide optimisation services to provide the best use of a client's long box, as well as perform collateral substitutions on the client's behalf.

Third-party

Third-party structures are generally less expensive because they require clients to 'own' more of the operational workflow steps

TriOptima launched triResolve Margin to help clients meet the challenges of uncleared margin rules—across both variation margin and initial margin—including support for both triparty and third-party models. triResolve Margin offers an award-winning, fully automated margin call process that provides complete support for the collateral lifecycle: collateral valuation, haircut calculation, concentration limit monitoring, collateral inventory optimisation, corporate action monitoring and collateral substitution workflow. The enhancement of triResolve Margin to support SWIFT settlement in H1 2020 will further expand the tools provided to clients, enabling an automated flow from margin call to settlement, regardless of whether cash, securities or tri-party.

Solving the initial margin challenge will require many firms to build an entirely new collateral settlement and segregation process. TriOptima is experienced in supporting clients across all earlier phases of initial margin compliance, and seeks to provide firms with a range of options to solve the challenges in a low-cost and automated way. See why 200 firms have made triResolve Margin the heart of their collateral process in just three short years—call us today!

involved in collateral selection and settlement. Under the third-party structure, firms and their counterparties must first agree on the initial margin call amount and then the collateral to be pledged, before instructing settlement to the custodian. In other words, when firms use a third-party custodian they are responsible for calculating the amount of additional collateral required, selecting an asset, verifying collateral eligibility, applying haircuts, valuing collateral, performing optimisation, managing substitutions and instructing settlement to the custodian. This is the same process that would be used to post securities if the collateral was not segregated.

What to do?

If you are using a third-party structure today for segregation of Variation Margin or Independent Amount, you likely already have a process in place to support non-cash collateral. Your experience with these processes, as well as your relationship(s) with the existing custodian(s), may make a third-party model a natural choice.

However, if you are only using cash collateral today, the additional operational requirements brought about to segregate non-cash collateral may seem unattainable in a short timeframe. Firms need to clearly understand each model and assess not only their operational capacity but systems capability too. The challenge of meeting an entirely new collateral segregation process using legacy technology—which was probably built long before the requirement to exchange Initial Margin evolved—must not be overlooked.

Gemma Bailey
Business manager
triCalculate



Neil Murphy
Business manager
triResolve



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Regulation in the free world

The US is full-throttling towards its 2020 election. But what does the future hold for the financial services industry either with a Republican or Democrat president?

Jenna Lomax Reports

Now is an unprecedented time for the financial markets in the US. This time next year, we will know who the 46th president of the US will be. Whichever way the vote goes, the US faces a new wave of governmental uncertainty; current president of the US Donald Trump could step-down for ex vice-president, Joe Biden, or socialist candidates such as Elizabeth Warren or Bernie Sanders, among other possibilities.

The result could see a continued tenure of one of the most controversial US presidents in modern history—Trump who, over the last two and a half years of his presidential term, has radically attempted to deregulate US financial services.

In his first 10 months alone, Trump signed over 50 executive orders, of which quite a few focus on dramatically changing the rules surrounding US regulation.

Although, the Obama administration brought in the Dodd-Frank Reform Act to damage control the crisis; making US financial services follow investor guidelines, it is clear Obama's successor, Trump, has had a different agenda through his executive orders, most notably the signing of the Financial CHOICE Act back in 2017.

While the Obama administration brought in the Dodd-Frank Act to damage control the crisis; the Financial CHOICE Act aimed to move the financial industry towards a culture of self-regulation—one that looks to be centrally regulated through investor guidelines.

Looking forward to 2020, only time will tell how future US government legislation—be that Republican- or Democratic-led—will change the rules for asset management and asset servicing, specifically.

Right now, however, on a national level, the US has the Volcker Rule on its hands, which refers to Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Just in the last few weeks, the Federal Reserve and four other regulatory agencies announced final approval to changes in the Volcker Rule.

The new ruling would continue to prohibit banks from engaging in proprietary trading or investing in or sponsoring hedge funds or private equity funds.

The five agencies said the new rule would take effect on 1 January 2020.

A matter of regulation

Elsewhere, looking slightly more inwardly—into the day-to-day business of asset servicing—Sean Tuffy, director, head of market and regulatory intelligence, custody and fund services company of Citi, states: “Looking forward to 2020, there are a number of regulations coming into effect that will impact upon the industry and require changes to their operational workflows and, of course, require more reporting.”

Lisa Shea, manager of North American fund governance solutions at Northern Trust, says in recent years, “regulation has impacted multiple aspects of the business—oversight, disclosure, and reporting have all been impacted by rulemaking and guidance from the regulators.”

Take for instance US Securities and Exchange Commission’s (SEC’s) share-class initiative, which incentivised investment advisers to self-report violations of the Advisers Act resulting from undisclosed conflicts of interest, promptly compensate investors, and review and correct fee disclosures.

Tuffy explains: “There has been growing regulatory fee pressure with things like the SEC’s share-class initiative which forces managers and distributors to review share-class selection and revenue sharing arrangements. This includes determining if investors have been overcharged when placed in more expensive share classes if cheaper alternatives were available.”

Data and technology

The focus is not only on regulation but the challenges—and opportunities—of technology to consider, and especially the digitisation of that data.

Tuffy explains that data privacy is “a growing trend within regulatory circles. We saw this last year with the introduction of the EU’s General Data Privacy Regulation, which had a big extraterritorial impact. We’re also seeing similar rules cropping up in the US, with initiatives like California’s new privacy rules.”

These rules are forcing firms to focus on how they handle personal data and reinforcing the importance of having a well-developed data strategy, according to Tuffy.

He adds: “For asset managers, one of the biggest impacts of regulation has been on their reporting and data capabilities. Further complicating matters is many US managers had to navigate both US requirements as well as European rules that had extraterritorial impacts.”

Shea suggests how AI can help the management of data—and how it is key—particularly from a regulatory perspective. She says: “AI makes it possible for regulators to review large volumes of information more efficiently, and to identify anomalies. The use of technology to analyse data will be increasingly important, to assist in spotting and addressing areas of potential risk.”

Predicting the future

As we look forward to the US election of 2020, the question of who will be the next president lingers; will it be a Democratic candidate; moderate Joe Biden, or a more left-winger runner such as Elizabeth Warren or Bernie Sanders? Or will Trump be a two-term president—can the US expect more de-regulation?

As that question still remains a year away, it’s difficult at this early stage to tell what a Democrat-controlled government will mean for asset management and servicing, or what Trump’s second terms move could be for the financial markets.

Whoever the winning candidate, looking forward to 2020 and beyond, there seems to be an understanding of a re-shaping of, not just of regulation, but of financial services as an industry, regardless of who is in the White House.

The increasing global interest in environmental, social and corporate governance, not just among the US public, but also among investors, globally, could sway voters. The Democrats in particular are tapping into voter’s consciences, Sander’s radical Green New Deal, for one reflects this.

Shea indicates, for asset management and asset servicing in particular, “the continued trends are focused on risk mitigation, transparency and effective disclosures, and protection of the end investors”.

Tuffy reflects, suggesting that there has been a “period of calm” on the regulatory front for the last year or so. However, he says there are signs that the regulatory pressure is going to increase.

He adds: “Looking forward to 2020, there are a number of regulations coming into effect that will impact the industry and require changes to their operational workflows and, of course, require more reporting.”

“Overall, one major trend that we’ve seen is that most firms have elevated the regulatory change function within their organisations and now consider the operational, compliance, and strategic implications of new regulation more holistically.”

He concludes: “This should mean that firms are better placed to deal with the next round of regulatory change and, more importantly, are better positioned to take advantage of potential opportunities for new products and solutions.”



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Moving from theory to practice

Distributed ledger technology is taking over the world and is finding applications in a number of industries. Urs Sauer of SIX and Glen Fernandes of Euroclear discuss what needs to be done in order for crypto assets and DLT to achieve mainstream adoption at scale within the financial services industry

What is the ISSA DLT working group currently working on? What trends are you seeing in the market?

Glen Fernandes: We have just released a whitepaper on crypto assets, which discusses how the industry could move from theory to practice on crypto assets and DLT. The paper is a result of in-depth discussions and workshops over the last eight months with our members which include global central securities depositories (CSDs), custodians, fintechs and other financial market infrastructures (FMIs). It helps set the picture on the best practices and considerations on issuing, settling, safekeeping and servicing crypto assets including securities tokens. We wanted to also highlight the challenges in terms of interoperability and the elements of law and regulation that need further clarification.

What advantages do crypto assets offer over traditional securities?

Fernandes: Crypto assets are held in a digital form on a database that is distributed across participants, whereas traditional securities are held digitally in centralised databases and in book-keeping form. Distributed ledgers by nature allow for a more distributed governance compared to what currently exists. On one side, this brings the convenience and transparency of directly interacting with counterparties and naturally pushes for efficiencies and

harmonisation of data standards. On the flip side, it brings challenges, amongst others in terms of how can such governance be regulated and how can market participants be held accountable within this new kind of governance structure. It also introduces a number of risks. The industry needs to understand how they can extract the benefits while still having the same level of safety and efficiency that exists today in capital markets.

What kind of risks are associated with using crypto assets?

Fernandes: If you look at the safekeeping of assets today in traditional form, the assets are first issued in the CSD, then held via the custodian and the custodian and CSD ensures that there is asset protection. In the case of crypto assets, you have the possibility of holding the assets directly on the ledger through private keys. However, self-custody of private keys also introduces a risk, where they can be stolen and then assets transferred to a different address. This is similar to the risk of losing bearer instruments in capital markets. There needs to be an industry solution that can be acceptable to institutional investors from a custody perspective. Similarly, you also have other risks around the issuance and settlement of crypto assets. These risks are similar to risks in capital markets that have been mitigated by FMIs like CSDs, by custodians and intermediaries. They are different in form but essentially same in substance.

Urs Sauer: The risks we have today will not magically disappear. Know your customer (KYC) and anti-money laundering (AML) will all still have to be done no matter what technology is behind it. The promise that it holds is certainly more efficiency and reduced reconciliation, as well as reduced risks if services are provided in a regulated environment. We have seen the non-regulated part dealing with cybersecurity and break-ins with little end-investor protection.

What are the legal and regulatory implications of developing services and platforms for the issuance and trading of crypto assets?

Sauer: There are quite a few things that need to be looked at, for example, internationally the regulations are not standardised. Certain jurisdictions are further ahead or further behind. This starts at the very basics, such as the definition of a securities token, if you have different definitions you will have different regulatory approaches—this part remains one of the main headaches. You have to look at regulation jurisdiction by jurisdiction—there is not a separate regulatory approach just for crypto assets or securities tokens, the whole handling has to fit in with the regulatory environment, which in itself brings challenges.

Fernandes: There are areas that need to be clarified, the first one is what are the legal qualifications of a crypto asset, for example, does a token qualify as a security under specific jurisdiction. This also has implications on the qualification of service providers, for example, in the EU if you are dealing with the Markets in Financial Instruments Directive transferable securities you would need to have the relevant qualifications to custody a crypto asset or transfer crypto asset or if you wanted to settle it with legal finality, you would need to have the relevant qualifications to be a CSD. So implications around the qualification of the asset determines the licensing needs of the service providers.

Clarity is also needed around how legal title is achieved through the holding of private keys—do they actually give you ownership and entitlement to the asset? There are a number of areas from a regulatory perspective that need to be clarified such as qualification as property, tax treatment, asset protection, compliance around AML and KYC is also important.

Are regulators currently reviewing existing securities laws and regulations to ensure they remain suitable for the crypto asset markets? What should their concerns be and how can they move forward without jeopardising innovation?

Fernandes: Indeed a number of regulators are reviewing existing securities laws and regulations to ensure that they are suitable to support the development of DLT based ecosystems and securities tokens in particular. Many have already provided guidance of the taxonomy and possible treatment of tokens. Some have even provided frameworks or provided clarifications on existing laws and regulations with respect to DLT and crypto-assets.

There is not a separate regulatory approach just for crypto assets or securities tokens, the whole handling has to fit in with the regulatory environment, which in itself brings challenges

Urs Sauer, SIX

Regulators are actively working to create balance and ensure investor protection and market stability while at the same time not stifling innovation. The way in which regulators are looking at it is very pragmatic, they seem to be taking a substance over form approach, which should ensure we have technology-neutral regulation.

Moreover, many regulators are also using the principle of “same activity, same risk, same regulation”. So if a crypto asset token behaves like security and provides the same entitlements we should expect such assets would be regulated in the same way as securities and participants providing the same service on these assets as other regulated service providers would need to obtain the same regulatory qualifications. This will avoid the market being in a situation where essentially the same asset or service is regulated in two different ways, one more robust than the other.

How is the servicing of crypto assets different from traditional securities? And how will the role of the asset servicer change?

Sauer: Asset servicing will need to be provided to the customers similarly to today’s environment. Forks in a crypto asset environment need to be looked at as they can not be equated one-to-one to a corporate action, or a regular asset servicing issue because it might involve IT upgrades and IT changes where a provider would need the option to not implement the necessary updates.

In the asset servicing corporate actions side, there is a great promise that everyone sits on the same information that is shared. If this is the case, the efficiency on how you process it will be tremendous because there will be no more reconciliation, no more handling of items, everyone has the same information. There is also the smart contract set up which will enhance it further and bring the rise to control and responsibility factors.

Fernandes: That point is very important because there is an implication in terms of what roles we can expect within the digital asset world and a number of those roles might be typically similar to what you see today and existing service providers such as custodian banks or CSDs, and given the experience in the securities services

There are two levels with interoperability, the first is a technology level because you have a number of these providers that have come up, but there isn't one standard across the market

Glen Fernandes, Euroclear

market would be well-placed to play those roles, although they will possibly need to adapt. However, you might also have new roles that emerge for example a verification agent for smart contracts and you have to consider the accountability of those roles and the new risks they introduce or mitigate.

How do firms ensure the safekeeping of crypto assets? What services are currently available? And what risks would safekeeping services entail?

Fernandes: When we talk about safe keeping, there is a differentiation that needs to be made between the safekeeping of crypto assets that are held on public blockchains and where investors can directly hold and transact these assets, versus safekeeping that exists on private permission blockchains where a consortium of banks are trying to create a private blockchain ecosystem. For example, if you are accessing assets on a public blockchain through the internet, there is a high chance of private keys being stolen. Private key safekeeping becomes less relevant on private permissioned blockchains as other security, control and service measures can be used to mitigate the risk.

The second part is to think about what it means from a service provider point of view. For example, if I was holding a crypto asset on a public blockchain and I asked a custodian to safe keep my

private key, they wouldn't be able to guarantee that my assets would be safe because somebody could copy the private key from me and then steal the asset and the custodian would have no control over that. The typical custody model would see the transfer of the assets to a custodian address and the custodian would then have the ability to control/protect the asset and provide transaction services to the underlying clients.

Sauer: In the current environment, I don't think we have an institutional-grade asset servicing safekeeping service, and that's what is hindering a lot of development. The industry is aiming for an institutional-grade asset servicing safekeeping service. The industry has suggested that crypto-assets are here to stay and we need to deal with them and bring institutional-grade reliability to it. There are a few projects on the way that holds the promise that they will deliver. It will take a lot of time for the current infrastructure to disappear, there are a lot of services that the current infrastructure provides so the current set up is not there yet. By the end of 2020, I would expect to see a few clear pointers on what works and what doesn't work on an institutional-grade level.

What work is currently being done to devise market standards and other tools that will enable crypto asset service providers and platforms to interoperate with each other?

Sauer: We have an ISO working group that is working on it, we have 20022 data standards that holds the promise that the demand for data is clearly structured. The ISO/TC 307 'Blockchain and DLT' was set up in 2016. However, the working group doesn't believe this work is sufficient. If we don't see more work with this, the industry might see some distributed ledger technologies that cannot talk to each other.

Fernandes: There are two levels with interoperability, the first is a technology level because you have a number of these providers that have come up, but there isn't one standard across the market.

There are some standards being set but there is much more that needs to be done. The second is standards from a business perspective, in terms of business definitions.

Glen Fernandes
Euroclear
Co-chair ISSA DLT Working Group



Urs Sauer
SIX Securities & Exchanges
Co-chair ISSA DLT Working Group





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The changing dynamics of outsourced trading services

Ben Challice of J.P. Morgan discusses the advantages of outsourcing services

As the industry continues to respond to changing market conditions and the implementation of additional regulation—such as the final phases of uncleared margin rules (UMR), the Securities Financing Transactions Regulation (SFTR) and the Central Securities Depositories Regulation (CSDR)—we are seeing record interest in outsourced services such as securities financing and collateral management. The ability to look across standalone services, or integrate them operationally, is a major topic with both the buy and sell side.

What does the term ‘trading services’ mean as it relates to securities services, collateral management and agency lending?

Trading services businesses, in the context of securities services, are those with a transactional nature or that have a trading bias to them, but where the provider acts as agent for the client. While they complement the activities that are post-trade in nature—such as custody or fund services—they can also be undertaken independently.

Securities lending and collateral management have been outsourced to agents for many years, but now firms are increasingly looking to agents for help in managing other activities such as repo/reverse repo, middle-office functions and even cash trade execution. A heavier regulatory burden on the buy-side, narrowing margins and rapid technological developments are fueling this expansion.

Similarly, in securities financing, regulatory and market changes in the last decade have been the primary drivers of this evolution. With heightened demands for collateral and the need to mobilise inventory across borders and entities to make sure that it's in the right place or of the right type, securities financing and collateral management are increasingly two sides of the same coin. As UMR nears the final phases of implementation, the need to deploy an integrated approach to financing and an end-to-end approach to managing collateral will be critical for clients needing to meet their new margin requirements.

How does this relate to securities financing?

First, securities financing is experiencing extraordinary interest, mostly driven by industry evolution in response to regulation. However, the experience of market participants can be quite different based on where they sit.

The buy side is coping with well-publicised pressure on fees, especially in the passive/exchange-traded funds space. With the search for yield high on everyone's agenda, the alpha that lending securities can provide can no longer be ignored—even by those who have traditionally been anti-short selling. Furthermore, the need to think about and mobilise collateral is ever more pertinent in the face of uncleared margin rules. Securities financing transactions provide an important mechanism to achieve readiness and maintain compliance.

Meanwhile, sell-side activity is continuing to demonstrate shifts in demand and banks and broker dealers are becoming ever more sophisticated in managing their different, variable constraints, such as balance sheet, liquidity and capital. While these manifest themselves in changing types and sizes of demand, these firms are simultaneously focused intently on other parameters such as counterparty type, collateral eligibility and tenure, etc. As a result, sell-side firms are demanding an ever-increasing range of solutions, such as collateral pledge and central clearing, in order to meet their evolving needs.

Second, the conundrum of expanding supply versus more sophisticated, targeted demand, whilst the markets lack conviction and there is a dearth of corporate activity, means that spreads, and thus lending revenues, are compressed.

Third, technology and data continue to change the way business gets done. While often beneficial, this could also be disruptive—and this is just as true in securities financing as it is in our daily lives. Specifically, the need for better automation and improved data analytics are in great demand across the board. These

services will become even more important as the industry grapples with the transaction reporting that comes with SFTR for the first time. Although that starts in Europe, it's evident that the effects will not only be felt globally but will also be compounded once the increased burden of settlement efficiency through CSDR ultimately begins.

How are these trends affecting client behaviour?

The increased complexity that market participants are dealing with across the board has meant that the role played by securities lending has moved upstream in clients' investment and collateral decision-making process and framework. The old approach of an operational 'turn my programme on and let it run' approach to lending is waning. Now client dialogue is focused on how securities financing and its associated data can be incorporated into pre-trade decision making, and agent lenders are constantly challenged to service an ever-expanding list of client requirements.

More firms are also evaluating their outsourcing options and thinking through those decisions much earlier. They are focused on whether and how a service provider can provide front-to-back, pre- and post-trade turnkey solutions, rather than carry the immense operational burdens associated with building and managing a sophisticated financing function in-house. Moreover, with additional regulations such as SFTR, CSDR and UMR coming into force, the demand for outsourced and unified agent lending and collateral management solutions is likely to increase.

As the interplay between financing and collateral becomes more complex, how is that relationship changing?

Over recent years, banks and broker dealers have become much more efficient in managing their inventory, or collateral, and thus their financing needs, in the face of the various financial resource constraints. They do this by constantly evaluating the sources and uses of their pools of long and short inventory and using SFTs or derivatives to ensure the inventory is being utilised in the most efficient manner, i.e. by moving it around or transforming it.

The buy-side is now having to think about this, perhaps for the first time, as their activities fall in-scope for phases four, five, and now six, of the uncleared margin rules. They will need to post segregated initial margin, likely in the form of securities (as opposed to their variation margin which is mostly in the form of cash). Therefore, the traditional premise of a buy and hold asset manager—who lends securities but doesn't expect that process to interfere with his investment process—now has an additional driver of demand for that same pool of securities if they intend to use them to meet their margin obligations. In that case, the asset manager, or their agent, needs to understand the dynamic between alpha generation from lending securities and the cheapest-to-deliver

requirements for posting collateral. This dynamic is constantly evolving, so real-time data, analytics and a mobilisation mechanism are essential.

A simple example is one where a security posted as collateral becomes hard to borrow. In this instance, one would clearly want to replace it as a collateral asset and lend it into the market for a fee. This becomes very difficult if there is not clear visibility into where your assets are at all times. Additionally, if you have different actors involved, such as an agent lender, agent collateral manager or an in-house repo trading desk, as well as multiple custodians, then further complexity arises. They could easily begin 'bumping' into one another by having different demands over the same pool of inventory; failing on a stock loan or repo is very bad, but failing on a margin call would be substantially worse.

The ideal solution for a buy-side firm would be to have the ability to view and manage the pool of assets holistically, like many banks and broker dealers do today, to determine the optimal use. If a firm doesn't have the appetite to manage this increasingly burdensome process in-house, whether that be from an expertise or cost point of view, then utilising an agent who has the appropriate product set across lending, financing and collateral should be its goal.

As an agent, how are you addressing these demands?

At J.P. Morgan, we've made significant investments in creating a fully flexible, custody-agnostic platform which allows us to handle a range of pre- and post-trade activities on behalf of our clients, helping them achieve their individual financing, collateral and middle-office objectives.

In addition, we are creating a collateral transport layer that offers for the most efficient use of asset allocation across lending and collateral, including a fully automated post-trade lifecycle. This gives institutions the flexibility they need to manage a variety of securities financing requirements, singly or in combination, based on their specific needs.

Ben Challice
Managing director
J.P. Morgan





Comings and goings at Société Générale, BNY Mellon and more

Etienne Deniau has started a new business strategy position within the securities services team at Société Générale, based in Paris.

Most recently, Deniau served as head of strategic marketing for securities services. He has also worked in various other roles at Société Générale, including head of business development for asset managers and asset owners, and global head of custody and depositary services and head of investor services.

Deniau first joined Société Générale in 1998 before leaving and rejoining in 2004.

During 1999 and 2004, Deniau worked as operations and IT director at Zebank and marketing IS manager at Bred Banque Populaire.

BNY Mellon has appointed Jane Mancini as head of sales for asset servicing Americas.

In her new role, Mancini is responsible for leading the sales and business development effort for the bank's asset servicing business in the Americas region, which includes the US, Latin America and BNY Mellon's interest in the CIBC Mellon joint venture in Canada. She will oversee new revenue development, pipeline management, designing market strategies and overseeing enterprise growth initiatives.

Mancini has more than 30 years of experience across sales, relationship management, product management and distribution.

She most recently worked as head of global client solutions at State Street. In addition, Mancini led the bank's corporate CEO leadership series and was a global advisory board member for the Professional Women's Network.

Emily Portney, head of asset servicing for the Americas, commented: "Jane Mancini brings a unique combination of skills to the firm. Her robust experience, deep client relationships and outstanding leadership will be invaluable as we continue to advance our strategic dialogue with clients and enhance our suite of innovative solutions."

Commenting on her appointment, Mancini said: "I am excited to join BNY Mellon as the company continues its business transformation. The firm's global market position is unrivalled and I look forward to working closely with my new colleagues and leveraging my broad background to drive growth for the business."

Citi has appointed Joerg Guenther as global head of securities services and issuer technology.

Guenther will be responsible for the technology teams supporting custody and fund services, direct custody and clearing, securities services data, quality assurance for securities services, and issuer technology.

Based in New York, he will report directly to Nina Das, director of treasury and trade solutions.

Guenther brings more than 25 years of experience in the financial services industry.

Prior to joining Citi, Guenther was the global CIO of corporate and institutional services at Northern Trust, responsible for the technology agenda for fund accounting, custody, middle and back office.

He also spent 20 years in senior roles at Artio Global Investors (formerly known as Julius Baer Investment Management), KPMG Consulting and Zuercher Kantonalbank.