Intro

The AIFM Directive
challenges and opportunities for Prime Brokers and independent service providers

Market Infrastructures update: January 2015 News
from the financial & securities industry

Event calendar
Dear Clients,

“I declare that I will act as banker with integrity and conscientiously. I will carefully consider the interests of all stakeholders of the bank, such as clients, shareholders, employees and the society in which the bank operates. When considering these interests, I will prioritise the interests of clients and will inform them to my best ability. I will operate in compliance with the laws, regulations and codes of conduct that are applicable to me as a banker. I will keep confidential what is entrusted to me. I will not abuse my knowledge as a banker. I will position myself in an open and accountable way and I know my responsibility towards society. I will make a sincere effort to preserve and promote the trust in the banking sector. I will honour the profession of banker”

This is the verbatim text of the bankers oath the Board Members of ABN AMRO Clearing Bank NV took last year. The bankers oath is embedded in Dutch Financial Supervision Act, is taken by all Board Members of Dutch Banks and from this year onwards will become compulsory for all banking employees. I want to share this with you as taking the oath was a conscious decision on my part and only has true value as we are open and proud about us taking the oath. The Global Financial Crisis and its impact on society created the need for this instrument. No matter if we already acted in compliance with these standards in the past or not, from now on you may challenge me if you feel we do not comply. It is not your typical new year’s resolution but it is mine for 2015!

We at ABN AMRO Clearing wish you all a prosperous, happy and healthy 2015!!

Jan Bart de Boer
Chief Commercial Officer
ABN AMRO Clearing
The landscape in the clearing industry has fundamentally changed in the EU due to the introduction of new European legislation last year: the Alternative Investment Fund Management Directive (AIFMD). The directive increases supervision by financial authorities over alternative investment funds, mostly hedge funds, private equity and real estate funds. The directive poses challenges for ABN AMRO Clearing, but at the same time offers opportunities. We’re tackling these through our Prime program and via cooperation with other parties offering services aimed at investment fund managers that are complementary to our own. In this article we’d like to put these changes, challenges and opportunities into perspective.

“Being independent means that we will never be tempted to gloss over questionable behaviour in any other part of the service chain”

Developing Prime Services: a natural continuation

“For many years, we’ve grown in the proprietary trading space and are now moving into a new segment,” says Gildas Le Treut, Global Head of Prime Services at ABN AMRO Clearing. “It’s what we call the alternative space, like hedge funds. There are about 10,000 funds with currently USD 3.1 trillion in assets in this market. As clearing organization we offer the services alternative investment funds need. Until recently we did not expand into this client segment.”

“As clearing organization we offer the services alternative investment funds need”

Gildas Le Treut, Global Head of Prime Services at ABN AMRO Clearing

“The services these clients require are basically the same as what we deliver elsewhere, but the way they are delivered is different,” adds Gary John-Baptiste, European Sales Director Prime Services. “Practically speaking this means for instance different ways of reporting. But more important is that these clients are high-touch. We need to deliver the best services possible. We have to act on new developments before clients ask us to. We have to adapt to the evolving needs of investment managers, which is a profound adjustment.”

The AIFM Directive: challenges and opportunities for Prime Brokers and independent service providers
And then there was AIFMD…

Introduced more than a year ago, this directive aims to close a perceived gap in regulation for alternative investment funds. These funds were not subjected to the same type of regulation as for instance pension funds or mutual funds governed under UCITS. The financial crisis of 2008 motivated European legislators to increase supervision over alternative investment funds. Regulators want to know where fund managers invest and safeguard their capital, and they want to make certain investors’ money is in safe hands.

One core obligation for every fund manager subject to the AIFMD is the obligation to appoint a depositary for each of his funds. The depositary’s duties are threefold:

▶ checking cash flows,
▶ safekeeping of assets or custody, and
▶ oversight.

The duty of oversight includes checking net asset value, checking the timely settlement of transactions and keeping an eye on whether a fund sticks to the investment policies set forth in its prospectus for investors.

Pivotal role for the depositary

Depositaries have high responsibilities for any alternative investment fund. Where does the investors’ money end up? Are the fees paid by the investment fund legitimate? Does the investor get his money back when exiting a fund? What if a depositary has doubts about a transaction and doesn’t receive a satisfying explanation from the fund manager? In a worst-case scenario the depositary is obliged to report this potential dysfunction to the supervising authorities. So, the almost empty shoebox that investors to their great surprise found in Madoff’s safe should be an issue of the past.

These new rules have created a whole new market in the EU: the market for depositaries. Fund managers need to select a depositary, as well as a fund administrator and one or more prime brokers, before requesting approval from authorities for their fund. Depositaries are obliged to perform a due diligence check of every service provider a fund wants to enlist. And the relevant authorities need to approve the complete list of providers.

This has created a challenge for independent service providers like ABN AMRO Clearing as Prime Broker, offering only part of the full services a fund requires. The depositaries have become the proverbial spider in the web of the various service providers. A depository bank is now responsible for the safety of assets; it needs to keep an eye on the transactions performed by brokers, on the money flows registered by the administrator, and on the overall performance of the fund.

The one-stop-shop looks convenient

The opportunity this creates for large financial institutions offering depositary services, as well as other services is obvious. They might say to a fund manager: we won’t be just your depositary, but we will also handle fund administration and Prime Brokerage so you won’t need to deal with different entities. They claim to offer the convenience of a one-stop-shop in an integrated model.

Image 1. Integrated versus independent proposition
"The choice between one-stop shopping or enlisting several independent service providers depends largely on the critical look of the fund manager", says Gerben Oldekamp, Managing Director at Circle Partners. Circle is an independent fund administrator based in Amersfoort and works together with ABN AMRO Clearing for several fund managers. “Some fund managers opt for the convenience of all services provided by one financial institution. The more critical ones, taking a closer look at specific capacities of different providers, might conclude that enlisting several independent service providers is more suitable to their needs. The choice depends more on the individual considerations of the fund manager than on, for instance, the type of fund and its strategy.”

See image 1, Integrated versus independent proposition.

"more critical fund managers take a closer look at specific capacities of different providers"

Gerben Oldekamp, Managing Director at Circle Partners

Specific roles & responsibilities
ABN AMRO Clearing is specialised in Prime Brokerage services, and has opted for close cooperation with independent providers that offer complementary services. “What AIFMD has brought to the table,” says Le Treut, “is that the depositary, the fund administrator and the Prime Broker need to work together very efficiently. Especially the depositary and Prime Broker need to understand each other and each other’s importance. The depositary takes the responsibility for the assets and is liable for any mishaps, while the Prime Broker takes risks on the overall portfolio because he’s providing leverage and financing. The two have aligned interests and need to understand how to manage these risks together.”

To emphasize the need for this understanding ABN AMRO Clearing organised meetings with depositary banks. “At the start cooperation was fairly low,” says Le Treut. “But gradually a common understanding was reached. It started with the Prime Broker beginning to understand the role and importance of the depositary with regard to liability for assets. The depositary in turn started to understand the importance of the Prime Broker in making a fund successful.”

See image 2, connections between independent service providers.

Image 2. Connections between independent service providers.

It is all about best meeting a fund’s needs
If you look at business strategy from a banking perspective you might say: I’m a depositary, and considering AIFMD requirements, why not become a Prime Broker for the fund as well? But then one might end up with a model that does not necessarily suit a particular fund’s needs best. A depositary cannot afford to force a fund to work with the wrong partner as Prime Broker. “It’s all about who’s best adapted to a fund’s needs,” says Le Treut. “We reached an understanding that we’re all working for the benefit of the same fund manager and we need a matching quality in Prime brokerage, financing, execution and risk management. From that moment on it was about finding a common ground to move forward.”
Co-operation is key

Northern Trust is one of those independent Depositaries ABN AMRO Clearing has established a close relationship with. “We want to be as helpful to each other as we can,” says Robert Angel, Senior Vice President in the London office of Northern Trust. “So I’ve ensured that we keep them informed as much as can be, even though there would be no obligation to do so.” Practically speaking this means ABN AMRO Clearing is familiar with for instance Northern Trust’s reporting template, due diligence questionnaire or sub-custody agreement. “ABN AMRO Clearing is the only Prime Broker we’re liaising this kind of information with while we do not currently have a working relationship,” says Robert Angel. “We do appreciate the relationship and we would be delighted on both sides to start cooperating for a mutual client.”

“\textit{We want to be as helpful, to each other as we can}”

Robert Angel, Senior Vice President in the London office of Northern Trust

The challenge for independent providers is to convince fund managers of the advantages of their independence and of the high quality of their services. In this market segment specialised knowledge makes the difference between success and failure. For an independent Prime Broker like ABN AMRO Clearing this means convincing a fund manager of our service differentiators and the advantages of true independence from other providers involved. At the same time we need to maintain good relations with the depositary and fund administrator, therefore a fund manager doesn’t need to worry about the possibility of hick-ups between these different, independent players. Flows of information need to be seamless. Reporting systems need to be compatible and integrated so the fund administrator and depositary, and thus the fund manager, have immediate access to the latest data: today’s data. See image 3, Funds - Operational process flow.

Image 3. Funds - Operational process flow.

1. Investment Manager orders Prime Broker to execute on market
2. Market order transmitted and execution received
3. Prime Broker reports to Fund Administrator, Investment Manager and Depositary
4. Fund Administrator calculates NAV, reports to Investment Manager who informs investors
5. Depositary receives information and performs its duties like a.o. cash flow monitoring and reconciliation and reports if not correct
Truly independent and transparent

“There’s an advantage to being independent in itself”, says Peter van Schaik. He is one of the three directors of Darwin Depositary Services, another independent depositary that ABN AMRO Clearing works with. The firm is based on the Zuidas in Amsterdam, a stone’s throw away from the ABN AMRO Clearing head office. Darwin was set up not too long ago with the introduction of the AIFM Directive in mind and offers fund managers depositary services only. It is thus truly independent.

“Being independent means that we will never be tempted to gloss over questionable behaviour in any other part of the service chain. The reason is simple: we’re not part of the same firm as an entity showing questionable behaviour. There’s not only a formal separation of responsibilities, like a Chinese Wall, between the fund administrator, the brokers and us, but a complete separation of businesses, true independence. We can be completely transparent in the way we perform our duties.”

Frank Hand, co-founder and director at Darwin Depositary Services

Complementary partners need each other

The cooperation between Darwin and ABN AMRO Clearing started when a fund working with ABN AMRO Clearing as Prime Broker when the AIFMD came into effect. This fund appointed Darwin as depositary. “This created a win-win situation,” says Mark Bouw, co-founder and director of Darwin. “We’re independent and ABN AMRO Clearing needs a partner like us.” And Darwin needs a partner like ABN AMRO Clearing.

One of three responsibilities of a depositary is safekeeping a funds’ assets, i.e. acting as custodian. But, as Peter van Schaik points out, “Darwin is a small outfit and we’d like to stay lean and mean. We do not want a large safe to keep assets. We outsource this responsibility, for instance to a partner like ABN AMRO Clearing. So it’s extremely important how a Prime Broker is organised.” This means in particular, adds Mark Bouw, that “a fund’s assets must be segregated from a bank’s own assets, as is the case with ABN AMRO Clearing.” No fund manager would like to see its assets mixed up with a Prime Broker’s own assets if the broker runs into problems itself.

Mark Bouw, co-founder and director of Darwin Depositary Services

Darwin enjoys cooperating with ABN AMRO Clearing, says director Peter van Schaik, as does fund administrator Gerben Oldekamp at Circle Partners. But gaining alternative investment funds as clients requires more than good cooperation with complementary service providers.
We take the holistic view

"Alternative investment funds are demanding clients. They have significant responsibilities to their clients, which makes them far more demanding regarding the level of service they expect from a Prime Broker," says Gildas Le Treut. "They require us to timely deliver information, to recognise their constraints, to anticipate their needs, and to understand their trading strategy. We’re almost like an extension of their own functioning. They really expect a true partnership."

The task ahead is convincing them of the superiority of ABN AMRO Clearing’s services. "We position ourselves as having a holistic view of the portfolio under one risk management system and credit overview," Le Treut continues. "All our clearing services for one client are within one legal entity, not in different legal entities with sometimes conflicting P&L interests. We look at the overall profitability at client level first, then at the profitability of different products. So we have a complete view of the client’s business and focus on what’s important for him."

Secondly it’s about identifying and focussing on the trading strategies where ABN AMRO Clearing can show a positive track record. ”Our capacity to correlate all asset classes across all markets is in our DNA,” says Le Treut. This is where the holistic view on the portfolio of the clients comes into play: providing risk offset within the portfolio strategy. "It’s taking a position and hedging it with other instruments in other markets or other asset classes. It might be a delta neutral position in the end, but that needs to be administered,” explains John-Baptiste. "An example might be a fund trading futures on the German derivatives market, hedged with French equity on Euronext. A certain Prime Broker will look at every market separately and ask collateral for every product in every segment. We have a portfolio view, analysing the risk in liquidating this strategy anytime.” See image 4, Correlation haircut model

Image 4. Correlation haircut model.

Click [here](#) for more info on the correlation haircut system
It is about our clients

The focus on a client's needs also means ABN AMRO Clearing would not necessarily aim to be the single Prime Broker for a fund. Large investment funds do not rely on just one strategy. For any specific strategy they will go to the Prime Broker that fits its needs best and will provide the right services and finance. No Prime Broker has the knowledge or capacity to be good in every strategy.

The focus on specialised services at top level geared towards hedge funds does mean ABN AMRO Clearing needs to step up its game. This is where our Prime program comes into play. Prime refers specifically to our services for hedge funds. The difference when working in the alternative space is that the client’s expectations are different. Hedge funds are high-touch clients that require a different type of attention and some additional, more sophisticated services.

So at ABN AMRO Clearing we realise the need to improve in certain fields. We’re working on an interactive client portal, offering real time trading information and customized report generation facilities. We need to further enhance our synthetic products offering. We need to adjust our legal documentation and gear our set up to the needs of hedge funds. We need to enhance our execution services by offering connectivity to execution tools that are the most commonly used by the hedge funds industry. Hedge funds expect their Prime Broker to help them in raising their profile towards investors, and to be introduced to potential allocators. Last but not least we need recognition from clients that will serve as active reference.

“In the end,” says Gary John-Baptiste, “it’s about protecting our clients better because clients are informed exactly on where they stand.”

Gary John-Baptiste, European Sales Director Prime Services at ABN AMRO Clearing

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hans@bureaudecommunicatie.nl
European Central Bank

**Status of TARGET2 Securities (T2S) project**
A version of the T2S FAQ document was published last week on the T2S Knowledge Repository on the ECB website. The aim of the document is to answer T2S-related questions on access rights, billing, collateral, connectivity, instructions, matching, queries, reports, static data and validation. This FAQ document answers over 100 questions. Here is the link to the latest version of the T2S FAQ document:

http://www.ecb.europa.eu/paym/t2s/progress/pdf/t2s_functional_faq.pdf??5978a497626416435aece5ec6bf3aa51

A single point of access to all the T2S-related information from each CSD is available on the following website:


**Upcoming future T2S Advisory Group meetings:**
- 16-17 March 2015
- 2 July 2015 (followed by go-live event in Milan)
- 16-17 November 2015

T2S website:

**Trading venues**

**Euronext (EN)**

**T+2**
On 6 October, France, Belgium, the Netherlands, Sweden, Finland, the UK, Ireland, and 18 other countries shortened their settlement cycle to T+2. The move anticipated the European Union’s impending CSDR regulation, under which all European central securities depositories will have to move to T+2 by 2016. The change from a T+3 to a T+2 settlement cycle was a successful operation without any major operational issues or effects on settlement discipline.

**Dairy derivatives**
Euronext announced on 27 November that it would be launching a dairy derivatives complex in the spring of 2015. The full suite of futures and options will cover the three key dairy products currently traded in Europe and internationally, i.e. butter, skimmed milk powder and whey powder. The derivatives will enable the European dairy community to hedge its exposure to price fluctuations in this volatile market, just as milk quotas expire in the European market. This launch is subject to regulatory review.


Euronext website: [www.euronext.com](http://www.euronext.com)

**Deutsche Börse (DB)**
Deutsche Börse announced on 14 November that the Frankfurt branch of Bank of China had been authorised as a trading and clearing participant on the Deutsche Börse Group cash market. This gives Chinese issuers and Asian investors direct access to the German and European capital markets. The Bank of China’s Frankfurt Branch is the first Chinese clearing participant in the Deutsche Börse based in the euro area.


**London Stock Exchange Group (LSEG)**
LSE announced on 20 November that, following an application to the SEC, it had received class no-action relief status for its UK and IOB (International Order Book) stock, depositary receipt and index options. This new status enables the London Stock Exchange Derivatives Market and its eligible members to offer these products to certain US-registered broker-dealers and large financial institutions, further enhancing the market’s global offering.

Website: [http://www.londonstockexchangegroup.com/](http://www.londonstockexchangegroup.com/)
Central counterparties (CCPs)
The list with central counterparties (CCPs) authorised to offer services and perform activities in the European Union in accordance with the European Market Infrastructure Regulation (EMIR) is available at:


LCHClearnet Group (LCG)
LCG informed its members on 27 October that LCH.Clearnet S.A., LCH.Clearnet Group’s French central counterparty, had comfortably passed the recent stress tests conducted by the European Central Bank and the European Banking Authority (EBA). The market-wide review* was completed using the EBA common methodology, which includes a static balance sheet assumption as of the end of 2013.

*LCH.Clearnet S.A. completed the review under its registered name, Banque Centrale de Compensation.

Website: [http://www.lchclearnet.com/home](http://www.lchclearnet.com/home)

Eurex Clearing AG
Eurex announced on 14 October that Morgan Stanley, one of the leading global investment banks, is to become a clearing member of the Securities Lending CCP. Both partners aim to have finalised the process by the end of October. The Securities Lending CCP service is based on Eurex Clearing’s established systems and industry-leading risk management standards. Eurex Clearing can clear securities lending transactions from Eurex Repo’s SecLend Market or via Pirum’s CCP Gateway. The service is integrated with two tri-party collateral agents, Clearstream Banking Luxembourg and Euroclear Bank.


EU regulatory news
European Market Infrastructures Regulation (EMIR) in force since 16 August 2012

Open consultation:
There will be an open consultation on the revised EMIR standards on reporting to trade repositories until 13 February 2015. The Consultation Paper seeks input from stakeholders on revised RTS and ITS for trade reporting.

‘Equivalence’ decisions for central counterparty regulatory regimes
The European Commission adopted its first ‘equivalence’ decisions for the regulatory regimes of central counterparties (CCPs) in Australia, Hong Kong, Japan and Singapore on 30 October. The CCPs in these non-EU jurisdictions will be able to obtain recognition in the EU, and can therefore be used by market participants to clear standardised OTC derivatives as required by EU legislation, whilst remaining subject solely to the regulation and supervision of their home jurisdiction.

ESMA publishes letter to European Commission on EMIR clearing obligation
ESMA wrote to the European Commission on 30 October 2014. The letter contained the following key message: the European Commission’s assessment of certain aspects of the first Regulatory Technical Standards (RTS) on OTC interest-rate derivatives could affect the contents of the second RTS. ESMA will therefore defer submission of the forthcoming RTS on the clearing obligation until the European Commission has completed the assessment process.


Central Securities Depositories (CSDs) and certain aspects of securities settlement (CSDR Regulation)

Status
Following publication in the Official Journal on 28 August, the Central Securities Depositories Regulation (CSDR) officially entered into force on 17 September. ESMA will draft the appropriate draft regulatory technical standards and issue a Consultation Paper on them. The timeline for the consultation process will depend on the entry into force of the CSDR, which will determine the deadline for ESMA’s delivery of the draft RTS. ESMA also received a mandate in a letter from the European Commission to provide technical advice under CSDR on penalties for settlement fails. The deadline for submission of the technical advice and the relevant technical standards provided in CSDR has been fixed for 18 June 2015. Click [here](http://www.esma.europa.eu/system/files/ESMA%E2%80%99s+Letter+to+the+European+Commission+on+the+Central+Securities+Depositories+Regulation+in+force+on+17+September+2014%5B1%5D.pdf) for the full text of the CSDR:
Reviews of the Markets in Financial Instruments Directive/Regulation (MiFID/MiFIR) and Market Abuse Directive (MAD)

Status of MAD

The regulation on market abuse and the directive on criminal sanctions for market abuse were published in the Official Journal on 12 June. The regulation is due to enter into force in July 2016. The EU member states have two years in which to transpose the directive into national law.

Website: [http://ec.europa.eu/internal_market/securities/abuse/index_en.htm](http://ec.europa.eu/internal_market/securities/abuse/index_en.htm)

ESMA distributed Consultation Papers with a draft technical advice on possible delegated acts concerning the Market Abuse Regulation and draft technical standards on the Market Abuse Regulation. The deadline was 15 October.

The next step is for ESMA to submit the final technical advice on delegated acts and the technical standards to the European Commission.

Status of MiFID II

The MiFID 2 regulation and directive were published in the Official Journal on 12 June. MiFID/MiFIR 2 entered into force on 2 July. EU member states are required to implement MiFID II in their national legislation within 24 months of the entry into force of MiFID II, i.e. by June 2016.

MiFID II/MiFIR will apply within 30 months of the entry into force of MiFID II, i.e. in January 2017.


ESMA is required submit draft Regulatory Technical Standards (RTS) and Implementing Technical Standards(ITS) within 12 and 18 months of 2 July 2014 respectively.

Indicative timeline:

December 2014-March 2015:
Public consultation on Consultation Papers (RTS and ITS)

December 2014:
Final technical advice on Delegated Acts

June 2015:
Final RTS submitted to European Commission

December 2015:
Final ITS submitted to European Commission


All MiFID/R II timelines are indicative.
Securities Financing Transactions

Regulation (SFTR)

On 29 January of this year, the European Commission published a proposal for a Regulation on the reporting and transparency of securities financing transactions (SFTs). This proposal is part of a broader discussion on the regulation of shadow banking. The focus is on three main areas:

1. highly granular and frequent reporting of SFTs to trade repositories;
2. enhanced disclosure to fund investors of the use of SFTs;
3. imposing rules on rehypothecation, raising the level of disclosure to clients and counterparties.

What sort of SFTs are in scope?

▶ securities lending and borrowing;
▶ repos and reverse repos;
▶ buy/sell-backs and sell/buy-backs.

Coming as it does in the wake of EMIR, the SFT reporting regime is another example of a reporting requirement applying to all market participants, and not just to intermediaries. The growing trend towards the direct regulation of end-users marks a sea change in the regulatory approach.


Under the Italian Presidency, the Council has now reached a compromise on the text of the SFT Regulation. The European Parliament started examining the proposal in November, and a vote in the ECON Committee has provisionally been scheduled for 23 March.

Indicative timeline for discussion of the SFT file in the ECON Committee and Parliament:

- 18 December 2014: Deadline for draft report
- 21 January 2015: Consideration of draft report in ECON
- 30 January 2015: Deadline for amendments
- 23 February 2015: Consideration of amendments
- 23 March 2015: Vote in ECON
- 27 April 2015: Indicative plenary sitting date, 1st reading/single reading

Follow us on
Below an overview of events in each region in where ABN AMRO Clearing participated or will participate and has representatives attending.

**Europe**

**4-5 December**
Collateral Management Event 2014
Location: Amsterdam
Alexander Jacobs, our Global Head of OTC Derivatives Clearing, was the chairman and one of the moderators.

**19 January**
Webinar: Are you ready for the clearing of OTC Derivatives in Europe?
Sponsored by ABN AMRO Clearing
Alexander Jacobs, our Global Head of OTC Derivatives was one of the panellists.

**22 January**
CTA Intelligence UK Breakfast Meeting
Location: London
Sponsored by ABN AMRO Clearing

**3-5 February**
Collateral Management in Banking Summit
Location: Vienna
Alexander Jacobs, our Global Head of OTC Derivatives will speak about Collateral Management and Collateral Safety on the 4th of February.

**14-15 April**
TradeTech
Location: Paris

**19 May**
OTC Derivatives and Regulation conference, hosted by Markit and ABN AMRO
Location: Amsterdam
What’s Next?
Is a quarterly publication of Corporate Banking.

Editors
Jan Bart de Boer
Jan van der Lugt
Geert Vanderbeke
Henk van Vliet
Lammert Bos
Laura de Haan

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