

## Central Securities Depositories Regulation (CSDR), Article 38(5) and Article 38(6) Participant Disclosure Document: J.P. Morgan (Suisse) S.A.

---

### Introduction

---

The purpose of this document is to disclose the levels of protection associated with the different levels of segregation in respect of securities held directly for clients with Central Securities Depositories ("CSDs") within the European Economic Area ("EEA"), including a description of the main legal implications of the respective levels of segregation offered and information on the insolvency law applicable. At the end of this document is a glossary explaining some of the technical terms used in the document.

This disclosure is required under Article 38(5) and Article 38(6) of the Central Securities Depositories Regulation ("CSDR") in relation to CSDs domiciled in the EEA. The information provided herein is subject to Swiss law.

This document is not intended to constitute legal or other advice and should not be relied upon as such. You should seek your own legal advice if you require any guidance on the matters stated herein.

### Background

---

J.P. Morgan (Suisse) SA, a Swiss bank domiciled in Switzerland ("Bank"), is a Participant of CSD(s) domiciled in the EEA. According to Art. 38 para. 5 and 6 CSDR a Participant of such CSD shall offer its clients at least the choice between omnibus client segregation and individual client segregation and inform them of the costs and risks associated with each option including a description of the main legal implications of the respective levels of segregation offered and information on the insolvency law applicable.

In Bank's own books and records, Bank records each client's individual entitlement to securities that it holds for that client in a separate client account. Bank also opens accounts with CSDs in the EEA in its own name (i.e. the account is held in the name of Bank but designated as client account) in which it holds clients' securities. As a general rule, Bank makes two types of accounts with CSDs in the EEA available to clients: Individual Client Segregated Accounts (**ISAs**) and Omnibus Client Segregated Accounts (**OSAs**).

An ISA is used to hold the securities of a single client and therefore the client's securities are held separately from the securities of other clients and the Bank's own proprietary securities.

An OSA is used to hold the securities of a number of clients on a collective basis. However, Bank does not hold its own proprietary securities in OSAs.

## Main legal implications of levels of segregation

---

### **Insolvency (bankruptcy)**

If a Swiss bank were to become insolvent, the insolvency proceedings would take place in Switzerland and be governed by Swiss insolvency law.

Clients' legal entitlement to the securities that a Swiss bank holds for them directly with CSDs in the EEA would generally (except in specific circumstances, some of which are discussed below) not be affected by the bank's insolvency (bankruptcy), regardless of whether those securities were held in ISAs or OSAs.

In practice, the exclusion of securities from a Swiss bank's bankruptcy estate would depend on a number of factors, the most relevant of which are discussed below.

#### *Exclusion from the bank's bankruptcy estate*

Under Swiss insolvency laws, intermediated securities and certain other safe custody assets within the meaning of the Banking Act booked on safekeeping accounts held by clients with a Swiss bank, as well as certain readily available claims of the bank to receive delivery of securities from third parties, do not form part of the bankruptcy estate. Instead, in an insolvency (bankruptcy) of a bank, they are designated to be segregated in favour of the relevant client, subject to any rights of lien or any relevant claims the Swiss bank has against the client.

According to Art. 11 FISA, a Swiss bank must hold, with itself or with a sub-custodian or CSD, intermediated securities (available securities) in a type and quantity at least equal to the total of intermediated securities credited to the securities accounts maintained by the bank for its clients<sup>1</sup>. A bank is also subject to strict requirements as to maintenance of accurate books and records and as to reconciliation of its records against those of the CSDs and sub-custodians with which the intermediated securities are held. Accordingly, as long as a bank maintains sufficient holdings of intermediated securities in accordance with its statutory obligations, clients should receive the same level of protection in the bank's insolvency, regardless of whether the intermediated securities are held in an ISA or an OSA.

#### *Nature of clients' interests*

Although client's securities are held in Bank's name at CSDs in the EEA, Bank holds them on behalf of Bank's clients.

For securities that are held in EEA and other relevant CSDs outside of Switzerland, the nature of the entitlement embodied in a security also depends on the law, regulations and contractual framework applicable to such foreign CSDs and further parties involved in the custody chain. In such a case, entitlements that are available for segregation may be limited to contractual claims against the relevant

---

<sup>1</sup> Available securities also include the bank's readily available rights to delivery of intermediated securities from other custodians during the regulatory or customary settlement period for the corresponding market, provided that this period does not exceed eight days.

CSD involved. Moreover, the ability of the client to segregate securities in the case of insolvency may depend on whether the CSD or any custodian in the custody chain could assert any right to set-off, retention right, security interest or similar right with respect to the relevant securities (see also "Security interests" below).

## **Shortfalls**

If there were a shortfall between the number of securities that we are obliged to deliver to clients and the number of securities that we hold on their behalf in either an ISA or an OSA, this could result in fewer securities than clients are entitled to being returned to them in the event of our insolvency. The way in which a shortfall could arise would be different as between ISAs and OSAs (see further below).

### *How a shortfall may arise*

A shortfall could arise for a number of reasons including as a result of administrative error, intraday movements or counterparty default.

Bank does not permit clients to make use of or borrow securities belonging to other clients for intra-day settlement purposes, even where the securities are held in an OSA, in order to reduce the chances of a shortfall arising as a result of the relevant client failing to meet its obligation to reimburse the OSA for the securities used or borrowed.

### *Treatment of a shortfall*

In the case of an ISA<sup>2</sup>, although arguments could be made that the relevant client should not be exposed to a shortfall that is clearly attributable to an account held for another client or clients, it cannot be excluded that a shortfall on any other (ISA or OSA) account would be shared rateably among clients, including clients who do not have an interest in the relevant account. Accordingly, a client's securities held in an ISA may still be exposed to a shortfall on an account held for another client or clients.

In the case of an OSA, a shortfall attributable to the OSA would be shared rateably among the clients with an interest in the OSA (and potentially other clients). Therefore, a client may be exposed to a shortfall even where securities have been lost in circumstances which are completely unrelated to that client.

If a shortfall arises, the Bank has the obligation under Swiss law to acquire without delay securities if and to the extent the total number of available securities is less than the total number of securities credited to clients' accounts. If a shortfall arose and was not so covered, clients may have a claim for compensation against the bank. Furthermore, if the securities that may be excluded from the Bank's bankruptcy estate (see above) are not sufficient to satisfy the claims relating to client accounts in full, securities of the same kind held by the Bank for its own account will also be excluded for the benefit of the relevant clients.

---

<sup>2</sup> Clients should note that for the purposes of this section if a client elects for an ISA as part of an intra-fund arrangement whereby the assets of that client and any assets of any of its related funds are "ring-fenced" from the assets of other clients that are not related funds, then this type of ISA may be treated as an OSA if there is a shortfall notwithstanding the client's election of an ISA.

If a Swiss bank were to become insolvent prior to covering a shortfall, clients would rank as general unsecured creditors for any amounts owing to them in connection with such a claim. Clients would therefore be exposed to the risks of the Bank's insolvency, including the risk that they may not be able to recover all or part of any compensation claimed.

In order to calculate clients' shares of any shortfall in respect of an OSA (or possibly ISA, see above), each client's entitlement to securities held within that account would need to be established as a matter of law and fact based on the Bank's books and records. The shortfall would then be allocated among the clients as described above. It may therefore be a time-consuming process to confirm each client's entitlement and establish the securities available for segregation. This could give rise to delays in returning securities and initial uncertainty for a client as to its actual entitlement on an insolvency.

## **Security interests**

### *Security interest granted to third party*

Where a relevant CSD benefits from a security interest (either as a matter of statutory law or as a contractual right based on its terms and conditions) over securities held by the Bank with it (including securities held for clients), there could be a delay in the return of securities to a client (and a possible shortfall) in the event that the bank failed to satisfy its obligations to such CSD and the security interest was enforced. This applies regardless of whether the securities are held in an ISA or an OSA. However, in practice, we would expect that the relevant CSD would first seek recourse to any securities held in the Bank's proprietary accounts to satisfy the Bank's obligations and only then make use of securities in client accounts. We would also expect the relevant CSD to enforce its security rateably across client accounts held with it. Furthermore, Swiss law requires the liquidator to satisfy claims of the CSD arising out of the custody of intermediated securities or the financing of their acquisition.

### *Security interest granted to CSD*

Where a client purported to grant a security interest over its interest in securities held in an OSA and the security interest was asserted against a CSD with which the account was held, there could be a delay in the return of securities to all clients whose securities are held in the relevant account (and a possible shortfall in the account). However, in practice, Bank would expect that the beneficiary of a security interest (pledgee) over a client's securities would perfect its security by notifying Bank rather than the relevant CSD and would seek to enforce the security against Bank rather than such CSD, with which it had no relationship.

## Glossary

---

**Central Securities Depository (CSD)** is an entity which records legal entitlements to dematerialised securities and operates a system for the settlement of transactions in those securities.

**Central Securities Depositories Regulation (CSDR)** refers to EU Regulation No 909/2014 on improving securities settlement in the European Union and on central securities depositories, which sets out rules applicable to CSDs and their participants.

**Federal Act on Banks and Savings Banks (Banking Act)**, a Swiss law which sets out the financial market legislation governing banks, private bankers and savings banks, dealing, amongst others, with operating licences and specifying rules for business conduct.

**Federal Act on Intermediated Securities (FISA)**, a Swiss law which regulates the custody of certificated and uncertificated securities by custodians and their transfer.

**Individual Client Segregated Account (ISA)**, is used to hold the securities of a single client.

**Omnibus Client Segregated Account (OSA)**, is used to hold the securities of a number of clients on a collective basis.

**Participant** means an entity that holds securities in an account with a CSD and is responsible for settling transactions in securities that take place within a CSD.

### Disclaimer

This Material may not be relied upon as definitive, and shall not form the basis of any decisions. It is the user's responsibility to independently confirm the information presented in this Material, and to obtain any other information deemed relevant to any decision made in connection with the subject matter contained in this Material.

This Material is not intended as tax, legal, financial or equivalent advice and should not be regarded as or used as such. Users of this Material are should seek their own professional experts as they deem appropriate including, but not limited to, tax, financial, legal, investment or equivalent advisers, in relation to the subject matter covered by this Material. The Material should not be relied upon for compliance.

The provision of this Material does not constitute, and shall not be construed as constituting or be deemed to constitute, an invitation to treat in respect of, a solicitation of, or offer or inducement to provide or carry on, any type of investment service or activity by J.P. Morgan, including but not limited to the purchase or sale of any security.

Under all applicable laws, including, but not limited to, the U.S. Employee Retirement Income Security Act of 1974, as amended, or the U.S. Internal Revenue Code of 1986 or the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, as amended, no portion of this Material shall constitute, or be construed as constituting or be deemed to constitute "investment advice" for any purpose, and J.P. Morgan shall not be considered as a fiduciary of any person or institution for any purpose in relation to Material.

©2018 JPMorgan Chase & Co. All rights reserved.