J.P.Morgan

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

Introduction

The purpose of this document is to disclose the levels of protection associated with the different levels of segregation that we provide in respect of securities that we hold directly for clients with Central Securities Depositories within the EEA (CSDs), including a description of the main legal implications of the respective levels of segregation offered and information on the insolvency law applicable. This disclosure is required under Article 38(5) and Article 38(6) of the Central Securities Depositories Regulation (CSDR) (in relation to CSDs in the EEA).

This document is not intended to constitute legal or other advice and should not be relied upon as such. Clients should seek their own legal advice if they require any guidance on the matters discussed in this document.

Background

In our own books and records, we record each client's individual entitlement to securities that we hold for that client in a separate client account. We also open accounts with CSDs in our own (or in our nominee's) name in which we hold clients' securities. We currently make two types of accounts with CSDs 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 our own proprietary securities.

An OSA is used to hold the securities of a number of clients on a collective basis. However, we do not hold our own proprietary securities in OSAs.

Main legal implications of levels of segregation

Insolvency

Clients' legal entitlement to the securities that we hold for them directly with CSDs would not be affected by our insolvency, whether those securities were held in ISAs or OSAs.

The distribution of the securities in practice on an insolvency would depend on a number of factors, the most relevant of which are discussed below.

Application of German insolvency law

Were we to become insolvent, insolvency proceedings take place in Germany and are governed by German insolvency law, including for our branches in Dublin and Luxembourg.

Under German insolvency law, securities that we held on behalf of clients would not form part of our estate on insolvency for distribution to creditors, provided that they remained the property of the clients. Rather, they would be deliverable to clients in accordance with each client's ownership or fractional co-ownership interest in the securities. As a result, it would not be necessary for clients to make a claim in our insolvency as a general unsecured creditor in respect of those securities. Rather, the holder of the securities account would be entitled to a claim for segregation (Aussonderungsrecht) of his securities. Securities that we held on behalf of clients and that remain the property of the clients would also not be subject to any bail-in process (see glossary), which may be applied to us if we were to become subject to resolution proceedings (see glossary).

Accordingly, where we hold securities in custody for clients and those securities are considered the property of those clients rather than our own property, they should be protected on our insolvency or resolution. This applies whether the securities are held in an OSA or an ISA.

In addition, the German Safe Custody Act (DepotG) establishes a priority right for clients in insolvency proceedings in certain situations where the client does not hold the ownership or a fractional co-ownership interest in the securities at the time of our insolvency proceedings but has met its obligations to us under the respective agreement.

These situations can occur where a client acquires securities as part of a securities transaction (see glossary) but the client has not yet received ownership or a fractional co-ownership interest in these securities. The client may also have a priority right if we have unlawfully infringed on the clients' ownership or fractional co-ownership interest in the securities (for example, if we transferred the ownership interest over a security held in a client account without the client's consent).

In these cases, a client would have a priority right, if upon commencement of the insolvency proceedings:

- the client has fully satisfied its obligations to us under the respective agreement; or
- the client has not fully satisfied its obligations, but the non-performed part does not exceed 10 percent of the value of its securities delivery claim and the client fully satisfy its obligations within one week following request by the insolvency administrator.

The client's priority claim will be settled separately prior to the claim of general unsecured creditors. The claim will be settled from securities of the same type that form part of our estate or claims that wehave for the delivery of securities of the same type to our estate. Clients would be required to make a claim in our insolvency as a priority creditor in respect of those securities.

Nature of clients' interests

Although our clients' securities are registered in our name at the relevant CSD, we hold them on behalf of our clients. Our clients are considered as a matter of law to have ownership or a fractional co-

ownership interest in those securities that we hold with a CSD located in Germany[1]. This is in addition to any contractual right a client may have against us to have the securities delivered to them.

In most cases, our clients' securities that we hold with a CSD located in Germany are held in the form of collective safe custody (Sammelverwahrung) by the CSD (section 5 para. 1 DepotG). In these cases, under the rules of the DepotG, our clients have a co-ownership interest in all securities of the same type that are held in collective safe custody (Sammelverwahrung) by the CSD according to the proportionate share of the client's holding of securities of this type (section 6 para. 1 DepotG).

This applies both in the case where the proportionate share of the client's holding in these securities is held in an ISAs and where it is held in an OSA.

Our books and records constitute evidence of our clients' ownership interest in the securities. The ability to rely on such evidence would be particularly important on insolvency. In the case of either an ISA or an OSA, an insolvency practitioner may require a full reconciliation of the books and records in respect of all securities accounts prior to the release of any securities from those accounts.

We are subject to the client asset rules of the DepotG and the Official Requirements regarding Safe Custody Business (Amtliche Anforderungen an das Depotgeschäft – Bekanntmachung über die Anforderungen an die Ordnungsmäßigkeit des Depotgeschäfts und der Erfüllung von Wertpapierlieferungsverpflichtungen) which require us to maintain complete, accurate and verifiable books and records and which allow the reconciliation of our records against those of the CSDs with which accounts are held. We are also subject to regular audits in respect of our compliance with those rules. As long as books and records are maintained in accordance with the DepotG and the Official Requirements regarding Safe Custody Business, clients should receive the same level of protection from both ISAs and OSAs.

Where book entry securities are held with our branches in Dublin and Luxembourg, it is possible that the nature of clients' interests in the securities would be determined in accordance with the law of the country where the relevant branch is located. The specific nature of the client's interests under the applicable law may differ from the nature of the client's interests under German law but in all cases clients would have a proprietary interest in the relevant securities and not merely a personal claim against us. Accordingly, the description above regarding the impact of our insolvency would not be affected.

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 on our insolvency. The way in which a shortfall could arise would be different as between ISAs and OSAs (see further below).

[1] Please note that the nature of the client's interest may be different when securities are held with a CSD located outside Germany. While the client may not necessarily receive ownership or a fractional co-ownership interest in these cases, we are required to provide the client with a position equivalent to ownership or a fractional co-ownership interest under German law.

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 following the exercise of rights of reuse.

We do 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 obligations to reimburse the OSA for the securities used or borrowed.

Treatment of a shortfall

Under German law if the number of securities of a certain type held in collective safe custody (Sammelverwahrung) with a depositary falls short of the aggregate number of securities of the same type to which the depositors are entitled, such shortfall will generally be apportioned in proportion to the share of each depositor in the aggregate number of securities of this type held with the depositary. 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 between the number of securities that we hold on behalf of our clients according to our books and records and the number of securities that we hold with the CSD, an argument can be made that the following allocation should take precedent:

In the case of a shortfall in relation to an ISA[2], the whole of any shortfall on that ISA should be attributable to the client for whom the account is held and should not be shared with other clients for whom we hold securities. Similarly, the client should not be exposed to a shortfall on an account held for another client or clients.

In the case of a shortfall in relation to an OSA, the shortfall should be shared among the clients with an interest in the securities held in the OSA (see further below).

If a shortfall arose, clients may have a claim against us for any loss suffered. If we were to become insolvent prior to covering a shortfall, clients may in certain situations have a priority claim in our insolvency proceedings (see above, under 3. “Application of German Insolvency Law”). Where this is not the case, 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 our insolvency, including the risk that they may not be able to recover all or part of any amounts claimed.

In these circumstances, clients could be exposed to the risk of loss on our insolvency. If securities were held in an ISA, the entire loss should be borne by the client for whom the relevant account was held. If securities were held in an OSA, the loss should be allocated between the clients with an interest in that account.

[2] 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.

In order to calculate clients' shares of any shortfall in respect of an OSA, each client's entitlement to securities held within that account would need to be established as a matter of law and fact based on our books and records. Any shortfall in a particular security held in an OSA would then be allocated among all clients with an interest in that security in the account. It is likely that this allocation would be made rateably between clients with an interest in that security in the OSA, although arguments could be made that in certain circumstances a shortfall in a particular security should be attributed to a particular client or clients. It may therefore be a time-consuming process to confirm each client's entitlement. 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

Security interests granted over clients' securities could have a different impact in the case of ISAs and OSAs.

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 the CSD with which the account was held, there could be a delay in the return of securities to all clients holding securities in the relevant account, including those clients who had not granted a security interest, and a possible shortfall in the account. However, in practice, we would expect that the beneficiary of a security interest over a client's securities would perfect its security by notifying us rather than the relevant CSD and would seek to enforce the security against us rather than against such CSD, with which it had no relationship. We would also expect CSDs to refuse to recognise a claim asserted by anyone other than ourselves as account holder.

Security interest granted to CSD

Where the CSD benefits from a security interest over securities held for a client, there could be a delay in the return of securities to a client (and a possible shortfall) in the event that we failed to satisfy our obligations to the CSD and the security interest was enforced. This applies whether the securities are held in an ISA or an OSA. However, in practice, we would expect that a CSD would first seek recourse to any securities held in our own proprietary accounts to satisfy our obligations and only then make use of securities in client accounts. We would also expect a CSD to enforce its security rateably across client accounts held with it.

Furthermore, the DepotG restrict the situations in which we may grant a security interest over securities held in a client account.

Priority right in insolvency proceedings

Clients may have a priority claim in our insolvency proceedings in certain situations where we have granted a security interest over securities held in a client account to a depositary (including a CSD) and the depositary has fully or partly realised its security interest. The client's priority right may only arise in specific circumstances and would generally require that we have granted a loan to the client and, following the client's authorisation, have granted a security interest over the client's securities to the depositary, in relation to a loan of the depositary to us. The client's priority claim will be settled separately prior to the claim of general unsecured creditors and from a separate pool of assets, including

- to the extent that the depositary has not realised its security interest, the securities that are subject to the security interest that we have granted to the depositary;
- where the depositary has realised its security interest, any proceeds to which the depositary is not legally entitled; and
- any claims we may have resulting from loans granted to other clients who are involved in this separate settlement process.

Clients would be required to make a claim in our insolvency as a priority creditor in respect of those assets.

Glossary

Bail-in refers to the process under the German Recovery and Resolution Act 2014 applicable to failing German banks and investment firms under which the firm's liabilities to clients may be modified, for example by being written down or converted into equity.

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

Central Securities Depositories Regulation or CSDR refers to EU Regulation 909/2014 which sets out rules applicable to CSDs and their participants.

DepotG refers to the German Safe Custody Act of 1995.

Direct 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. A direct participant should be distinguished from an indirect participant, which is an entity, such as a global custodian, which appoints a direct participant to hold securities for it with a CSD.

EEA means the European Economic Area.

Official Requirements regarding Safe Custody Business refers to "Amtliche Anforderungen an das Depotgeschäft – Bekanntmachung über die Anforderungen an die Ordnungsmäßigkeit des Depotgeschäfts und der Erfüllung von Wertpapierlieferungsverpflichtungen", 21 December 1998, guidelines on safe custody business originally published by the German Federal Banking Authority (BaKred) but maintained by the BaFin.

Resolution proceedings are proceedings for the resolution of failing German banks and investment firms under the German Recovery and Resolution Act 2014.

Securities transactions are transactions where a client acquires securities from us as part of a fixed-price transaction (the client is the buyer and we are the seller) or where we acquire securities in our own name on behalf of the client.

Segregated Accounts means an ISA and/or a OSA, as the case may be.