Central Securities Depositories Regulation (CSDR), Article 38(5) and Article 38(6) Participant Disclosure Document: JPMorgan Chase Bank N.A., London Branch

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 (CSDs) within the EEA (see glossary) and the United Kingdom, including a description of the main legal implications of the respective levels of segregation offered and information on the applicable insolvency law. 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) and CSDR as implemented in the United Kingdom by section 3 of the European Union (Withdrawal) Act 2018 (as amended by Section 16 of The Central Securities Depositories (Amendment) (EU Exit) Regulations 2018) (in relation to CSDs in the United Kingdom).

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 or a nominee of our affiliates) 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 (which can be a single legal entity or an institution representing multiple legal entities) 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. 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 U.S. insolvency law

Were we to become insolvent, our insolvency proceedings would take place in the United States of America and be governed by U.S. insolvency law. Specifically, if we held customer assets at the time of our insolvency, then our insolvency proceedings would be governed by the FDIA (see glossary) or by the Dodd-Frank Orderly Liquidation Authority (see glossary). In an FDIA proceeding, the FDIC (see glossary) acts as the receiver for the failed bank. It succeeds to the assets of the entity and either transfers those assets to a bridge bank which it creates, sells the assets to another banking entity or liquidates and distributes the assets to creditors. As receiver, the FDIC succeeds to only the assets that the failed bank owns and not to securities which it holds as custodian. In a proceeding under the Dodd-Frank Orderly Liquidation Authority, the FDIC would liquidate our assets and distribute them to customers and creditors with limited court oversight.

Under the Dodd-Frank Orderly Liquidation Authority, clients that are “customers” are entitled to file customer claims for securities that we hold on their behalf. Securities that we hold in Segregated Accounts for customers (including securities held at a CSD located in the EEA) form part of our estate and are distributed to customers in satisfaction of their customer claims. Securities held for customers can also be sold by the trustee or receiver to generate cash for distribution to customers. Property held in Segregated Accounts is not available for distribution to general creditors unless all customer claims have been satisfied. (If a Segregated Account is subject to a lien that is permitted under the Customer Protection Rule, such as the lien that a CSD located in the EEA is permitted to impose for custodial and administrative fees arising in connection with Segregated Accounts, then the secured creditor is permitted to satisfy such lien before turning the remaining assets over to the trustee or liquidator for distribution to customers).

Customers may be required to make a claim in the event of our insolvency in respect of securities held by us. Such claims may be satisfied pro rata from the pool of available cash and securities held in Segregated Accounts regardless of whether such property is held in an OSA or an ISA. Because the treatment of securities held in ISAs is identical to the treatment of securities held in OSAs under U.S. Insolvency law, there is no legal benefit under U.S. insolvency law to a customer’s securities being in ISAs, as opposed to OSAs. The distribution of securities in practice on an insolvency would depend on a number of factors.

Application of English insolvency law

Were we to become insolvent, insolvency proceedings relating to our London branch may also take place in England and be governed by English insolvency law.

Under English 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 proprietary interests 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. Securities that we held on behalf of 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.

**Nature of clients’ interests**

Although our clients’ securities are registered in our name or in our nominee’s or a nominee of our affiliate’s name at the relevant CSD, we hold them on behalf of our clients, who are considered as a matter of law to have a beneficial proprietary interest in those securities. This is in addition to any contractual right a client may have against us to have the securities delivered to them.

This applies both in the case of ISAs and OSAs. However, the nature of clients’ interests in ISAs and OSAs is different. In relation to an ISA, each client is beneficially entitled to all of the securities held in the ISA. In the case of an OSA, as the securities are held collectively in a single account, each client is normally considered to have a beneficial interest in all of the securities in the account proportionate to its holding of securities.

Our books and records constitute evidence of our clients’ beneficial interests 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 U.K. Financial Conduct Authority (CASS Rules), which contain strict and detailed requirements as to the maintenance of accurate books and records and 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 CASS Rules, clients should receive the same level of protection from both ISAs and OSAs.

**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 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

In the case of an ISA\(^1\), the whole of any shortfall on that ISA would be attributable to the client for whom the account is held and would not be shared with other clients for whom we hold securities. Similarly, the client would not be exposed to a shortfall on an account held for another client or clients.

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

The risk of a shortfall arising is, however, mitigated as a result of our obligation under the CASS Rules in certain situations to set aside our own cash or securities to cover shortfalls identified during the process of reconciling our records with those of the CSDs with which securities are held.

If a shortfall arose and was not covered in accordance with the CASS Rules, clients may have a claim against us for any loss suffered. If we 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 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 would be borne by the client for whom the relevant account was held. If securities were held in an OSA, the loss would be allocated between the clients with an interest in that account.

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 in an OSA 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. Ascertaining clients’ entitlements could also give rise to the expense of litigation, which could be paid out of clients’ securities.

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.

\(^1\) 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.
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 other J.P. Morgan assets which may include 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 CASS Rules restrict the situations in which we may grant a security interest over securities held in a client account.
Glossary

**Bail-in** refers to the process under the Banking Act 2009 applicable to failing U.K. 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 dematerialised 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.


**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.

**Dodd-Frank Orderly Liquidation Authority** refers to Title II if the U.S. Dodd Frank Wall Street Reform and Consumer Protection Act.

**EEA** means the European Economic Area.

**FDIA** refers to the U.S. Federal Deposit Insurance Act.

**FDIC** refers to the U.S. Federal Deposit Insurance Corporation.

**Resolution proceedings** are proceedings for the resolution of failing U.K. banks and investment firms under the Banking Act 2009.

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

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