Central Securities Depositories Regulation (CSDR), Article 38(5) and Article 38(6) Participant Disclosure Document: JPMorgan Chase Bank N.A., New York Participation in EEA CSDs

Introduction

The purpose of this document is to disclose the levels of protection associated with the different levels of segregation that JPMorgan Chase Bank, NA provides in respect of securities that its New York office holds directly for clients as a direct participant in a Central Securities Depositories (CSDs) within the EEA (see glossary), 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 (EEA CSDs). The New York office currently participates in two EEA CSDs: EuroClear and Clearstream. It holds the securities held through the EEA CSDs directly for clients who contract with us in the United States; it acts as subcustodian with respect to those securities for clients who contract with JPMorgan Chase Bank, NA outside the United States or with one of our affiliates.

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 EEA 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 EEA 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. However, the Uniform Commercial Code does not recognize any special property interest in the assets maintained for a client in an ISA as opposed to an OSA, and given our New York office’s role as a custodian for clients of JPMorgan Chase Bank, NA in the US and as subcustodian for other clients of J.P. Morgan, the Uniform Commercial Code is likely to apply with respect to the assets held through the EEA CSDs.

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 EEA 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 a FDIA proceeding, the FDIC 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 an EEA CSD) 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 applicable law, such as the lien that an EEA CSD 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.

Shortfalls

If there were a shortfall between the number of securities that we are obliged to deliver to clients and the number of the same securities that we hold on their behalf (a Shortfall), this could result in fewer securities than clients are entitled to being returned to them in the event of our insolvency.
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

As noted above, the Uniform Commercial Code does not recognize any special property interest in the assets maintained for a client in an ISA as opposed to an OSA. Accordingly, J.P. Morgan understands that in the case of a Shortfall on accounts subject to the Uniform Commercial Code, the Shortfall likely would be shared among all affected clients on a pro rata basis – regardless of whether the securities are held through an ISA or an OSA at an EEA CSD. Therefore, a client may be exposed to a Shortfall even where securities have been lost in circumstances which are completely unrelated to that client.

In these circumstances, clients could be exposed to the risk of loss on our insolvency. Additionally, it may 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 might 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. 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 EEA 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 EEA CSD and would seek to enforce the security against us rather than against such EEA CSD, with which it had no relationship. We would also expect EEA CSDs to refuse to recognise a claim asserted by anyone other than ourselves as account holder.

Security interest granted to EEA CSD

Where the EEA 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 EEA 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 an EEA 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 an EEA CSD to enforce its security rateably across client accounts held with it.

**Glossary**

**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 an EEA CSD and is responsible for settling transactions in securities that take place within an EEA 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 an EEA 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.

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

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