

**JM FINN**

# **Central Securities Depositories Regulation**

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Participant Disclosure

## 1. 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, 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(6) of the Central Securities Depositories Regulation (“CSDR”) in relation to CSDs in the EEA.

Under CSDR, the CSDs of which we are a direct participant have their own disclosure obligations and we have included links to those disclosures in this document.

**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.**

## 2. 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 (“ICSAs”) and Omnibus Client Segregated Accounts (“OCSAs”).

An ICSA 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 OCSA 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 OCSAs.

## 3. 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 ICSAs or OCSAs.

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 English insolvency law

Were we to become insolvent, insolvency proceedings would 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, subject to any security interest we may have and provided that they remained the property of the clients<sup>1</sup>. 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).

<sup>1</sup> When a client has sold, transferred or otherwise disposed of their legal entitlement to securities that we hold for them (for example, under a right to use or title transfer collateral arrangement), the securities will no longer be the property of the client.

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 OCSA or an ICSA.

### **Nature of clients' interests**

Although our clients' securities are registered in our name or in our nominee'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 ICSAs and OCSAs. However, the nature of clients' interests in ICSAs and OCSAs is different. In relation to an ICSA, each client is beneficially entitled to all of the securities held in the ICSA. In the case of an OCSA, 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 ICSA or an OCSA, 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 UK 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 ICSAs and OCSAs.

### **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 ICSA or an OCSA, 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 ICSAs and OCSAs (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. A shortfall may also arise in the case of an OCSA where securities belonging to one client are used or borrowed by another client for intra-day settlement purposes. Not all of these reasons will be applicable to all clients. In particular, we only permit the use or borrowing of client securities if the relevant clients have consented to this under the relevant legal documentation.

Where we have been requested to settle a transaction for a client and that client has insufficient securities held with us to carry out that settlement, in the case of both an ICSA and an OCSA, we will only carry out the settlement once the client has delivered to us the securities needed to meet the settlement obligation.

This increases the risk of settlement failure which in turn may incur additional buy in costs or penalties and/or may delay settlement as we would be unable to settle where there are insufficient securities in the account.

**Treatment of a shortfall**

In the case of an ICSA, the whole of any shortfall on that ICSA 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 OCSA, the shortfall would be shared among the clients with an interest in the securities held in the OCSA (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 ICSA, the entire loss would be borne by the client for whom the relevant account was held. If securities were held in an OCSA, 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 OCSA, 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 OCSA 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 OCSA, although arguments could be made that in certain circumstances a shortfall in a particular security in an OCSA 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 ICSAs and OCSAs.

Where a client purported to grant a security interest over its interest in securities held in an OCSA 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.

### Corporate actions

Where securities are held in an ICSA and the client is entitled to a fractional entitlement on a corporate action, it is possible that the client would not in practice benefit from that fractional entitlement.

However, where securities are held in an OCSA, fractional entitlements may be received on an aggregated basis and therefore it is more likely that the clients may be able to benefit from some or all of those fractional entitlements.

Our insolvency may also have an impact on our ability to collect any entitlements, such as dividends, due on clients' securities held in an ICSA or OCSA or exercise any voting rights in respect of those securities.

## 4. CSD Disclosures

When available, links to the disclosures made by the CSDs in which we are a participant will be included.

These disclosures will be provided by the relevant CSDs. We have not investigated or will not performed due diligence on the disclosures and clients rely on the CSD disclosures at their own risk.

1st September 2020

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## Glossary

**Bail-in** refers to the process under the Banking Act 2009 applicable to failing UK 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.

**EEA** means the European Economic Area.

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

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