September 2020

**CSDR Article 38(6) CSD Participant Risks Disclosure – HSBC Securities (Japan) Limited**

## 1. Introduction

The purpose of this document is to disclose the levels of protection associated with the different levels of segregation that HSBC Securities (Japan) Limited (**"we", "us", "our" or "HSBC"**) provides in respect of securities that we hold 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. 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 (see glossary below) have their own disclosure obligations.

This document should be read in conjunction with HSBC's CSDR Article 38(6) CSD Participant Costs Disclosure as made available on HSBC Group website. (https://www.gbm.hsbc.com/financial-regulation/market-structure/csdr/account-segregation) 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.

This document may be updated from time to time, with the most recent version being made available on HSBC Group website. You should ensure that you consider the most recent version of this document on HSBC Group website, which will supersede and override any previous version.

Additionally, the disclosures included in this document are for information purposes only and do not constitute part of any agreement between you and us.

## 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 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.

## 3. Main legal implications of levels of segregation

***Insolvency***

Subject to applicable local insolvency laws, 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 insolvency law in our jurisdiction*

Were we to become insolvent, insolvency proceedings would take place and be governed by local insolvency law in our jurisdiction. Under relevant local insolvency law, securities that we held on behalf of clients would generally 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.

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*

Where our clients' securities are registered in the name of an HSBC or an HSBC nominee company as applicable 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 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 considered to have a beneficial interest in 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.

Subject to applicable local laws and regulations, 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.

As a professional custodian, we maintain accurate books and records and conduct 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.

***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 (of the type where a shortfall has arisen) than clients are entitled to being returned to them on 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. However, 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. The systems and controls that operationalise this reduce the chances of a shortfall arising as a result of the relevant client having insufficient securities held with us to carry out that settlement. In this respect we believe the protection offered to OSAs and ISAs is not substantially different. The impact of this approach is increased 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 ISA, 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 client asset policy in certain situations to set aside our own cash or securities to cover shortfalls however identified, including 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 our client asset policy due to our fault, clients may have a claim against us for any loss suffered, subject to the relevant custody agreement between the client and us. 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.

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.

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.

*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, local laws and/or regulations restrict the situations in which we may grant a security interest over securities held in a client account.

## 4. CSD disclosures

In this section, we set out links to the websites of the relevant CSDs in which we are a direct participant as of the date of this document. We expect relevant CSDs to make their own disclosures in respect of CSDR Article 38. Any disclosures on these websites are provided by the relevant CSDs. We have not investigated or performed due diligence on the disclosures and clients rely on the CSD disclosures at their own risk.

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| Euroclear Bank SA/NV | Home page:<br>https://www.euroclear.com/en.html |

## 5. 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 for the purposes of the CSDR.

***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.

## 6. Disclaimer

This document is issued by HSBC (as defined in this document). HSBC has based this document on information obtained from sources it believes to be reliable but which have not been independently verified. However, some of the information in this document may relate to certain regulations, rules and legislation which may not have been tested and are subject to change. Except in the case of fraudulent misrepresentation, no liability is accepted whatsoever for any direct, indirect or consequential loss arising from the use of this document. You are solely responsible for making your own independent appraisal of and investigations into the products, investments and transactions referred to in this document and you should not rely on any information in this document as constituting investment or other advice. Neither HSBC nor any of its affiliates are responsible for providing you with legal, tax or other specialist advice and you should make your own arrangements

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