

# Article 38 Central Securities Depositories Regulation

## Participant Disclosure:

### BNP Paribas Securities Corp., New York Head Office

*Belgium: Euroclear Bank*

#### 1. Introduction

This document describes the level of protection associated with the two types of Segregated Accounts that BNP Paribas Securities Corp. (hereinafter “**BNP Paribas**”) provides in respect of securities that it holds for its clients with Euroclear Bank (hereinafter referred to as the “**CSD**”). It includes a description of the main legal implications of the two types of Segregated Accounts, including applicable U.S. and Belgian insolvency rules.

The disclosure of the information contained in this document is required under Article 38 of the Central Securities Depositories Regulation (“**CSDR**”). BNP Paribas is subject to these disclosure obligations in its capacity as a Direct Participant of the CSD. The CSD has its own disclosure obligations under the CSDR.

Capitalized terms not defined in the text shall have the meanings given to them in the glossary at the end of this document.

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

#### 2. Background

The custody of each BNP Paribas client’s securities is kept through separate client accounts in BNP Paribas’ books and records. In its books, BNP Paribas segregates each client’s securities from the securities of other clients as well as from BNP Paribas’ proprietary assets.

BNP Paribas also opens securities accounts at the level of the CSD and ensures that its clients’ securities are segregated from BNP Paribas’ own securities in the books of the CSD, irrespective of the type of account described below. The CSD is not permitted to commingle its assets with securities of Direct Participants.

BNP Paribas offers the option of establishing two types of client securities accounts with the CSD: Individual Client Segregated Accounts (“**ISAs**”) and Omnibus Client Segregated Accounts (“**OSAs**”).

An OSA is used to hold the securities of a number of BNP Paribas clients on a collective basis.

An ISA is used to hold the securities of a single BNP Paribas client and therefore the securities of that single client are held separately from the securities of BNP Paribas' other clients.

Although each ISA may be named in a way that identifies the client for whom it is maintained, the client does not have any right or ability to give instructions to the CSD with respect to that ISA and therefore holding securities through an ISA does not give a client any operational rights with respect to that ISA.

Furthermore, the US Uniform Commercial Code does not recognize any special property interest in the assets maintained for a client in an ISA as distinguished from an OSA or any other segregated account.

### **3. Legal implications of segregation**

#### **3.1 Rules regarding ownership of securities**

Euroclear Bank is the Belgian Central Securities Depository for international securities.

The ownership rights in securities held in accounts with the CSD and opened by clients with BNP Paribas acting on behalf of those clients are governed by U.S. law and any legal issues concerning title to the securities held in custody shall be decided under New York law.

#### **3.2 Insolvency**

##### Insolvency of the CSD

In accordance with its co-ownership right, BNP Paribas has specific rights with respect to the securities credited to its CSD account, namely:

- a. a right to vote; and
- b. a right of recovery (*droit de revendication/terugvorderingsrecht*), which is a proprietary right to receive back the relevant quantity of securities in the event of the CSD's bankruptcy (or any other proceedings in which the rule of equal treatment of creditors applies).

These two rights are regarded as two essential attributes of ownership under Belgian law and derive from the right *in rem* recognised over the book-entry securities.

Owing to the fungibility of the book-entry securities, Belgian law provides that the above-mentioned right of recovery is a collective right, to be exercised by all Direct

Participants that have deposited the relevant securities with the CSD, rather than an individual right to be exercised by each Direct Participant.

Under Belgian law, if BNP Paribas holds securities for its own account, it may assert its co-ownership right against the CSD. BNP Paribas is, however, also in a position to:

- a. assert the rights attached to the securities (e.g. the right to vote or to receive dividends) against the issuer;
- b. in the event of the issuer's bankruptcy or any other proceedings in which the rule of equal treatment of creditors applies, exercise its right of recourse directly against the issuer; and
- c. in the event of the CSD's bankruptcy or any other proceedings in which the rule of equal treatment of creditors applies, bring – together with the other Direct Participants holding the same category of securities – a claim for recovery against the pool of securities of the same category held with the CSD or with the CSD's depository (where applicable) on behalf of the Direct Participants. Subject to any possibly applicable foreign conflict of law rules, the enforcement of this proprietary right shall not be affected by the deposit of such securities, in book-entry form or otherwise, by the insolvent CSD with a Belgian or foreign Central Securities Depository.

Additionally, the CSD is under strict prudential supervision by the National Bank of Belgium in its capacity as Belgian supervisory authority. If the CSD does not function properly, does not comply with the law, is at risk of becoming insolvent or could disrupt the Belgian or international markets, the government can impose several measures on the CSD, such as the disposal (i.e. transfer or sale) of assets and liabilities, including the transfer of its clients' financial instruments.

### Insolvency of BNP Paribas

When a broker-dealer becomes insolvent or near-insolvent, U.S. regulators generally seek to transfer customer accounts to a financially sound broker-dealer. A broker-dealer that is in compliance with the Customer Protection Rule should have the assets necessary to move all customer accounts and related assets to the new broker-dealer. If there are customer accounts remaining at the time of the commencement of an insolvency proceeding, then the remaining customers would be subject to the provisions of U.S. insolvency law described below.

The Customer Protection Rule requires BNP Paribas to segregate customer cash and securities from its own assets and establishes requirements for Segregated Accounts to satisfy claims by customers for the return of their assets even if it becomes insolvent. As described below, applicable U.S. insolvency laws complement this framework by requiring assets held in Segregated Accounts to be distributed to

customers, and by allowing such assets to be distributed to other (non–customer) creditors only if all customer claims have been satisfied. If a Segregated Account is subject to a lien that is permitted under the Customer Protection Rule, 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.

If BNP Paribas were to become insolvent, insolvency proceedings would take place in the U.S. and be governed by U.S. insolvency law. More specifically, if BNP Paribas held customer assets at the time of insolvency, insolvency proceedings would be governed by the SIPA or by the Dodd-Frank Orderly Liquidation Authority.

In a SIPA proceeding, the SIPC would appoint a trustee to liquidate BNP Paribas' assets for distribution to customers and creditors. These actions would take place under court supervision. In a proceeding under the Dodd-Frank Orderly Liquidation Authority, the Federal Deposit Insurance Corporation (“**FDIC**”) and SIPC would liquidate BNP Paribas' assets and distribute them to customers and creditors with limited court oversight.

Under both SIPA and the Dodd-Frank Orderly Liquidation Authority, clients that are “customers” are entitled to file customer claims for securities BNP Paribas holds on their behalf. Securities held in Segregated Accounts for customers (including securities held at an EEA Central Securities Depository) are distributed to customers to satisfy customer claims. Alternatively, securities held for customers may be sold by the trustee 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. In addition, advances would be available from SIPC to augment distributions to customers and to facilitate account transfers to a financially sound broker-dealer. Please see section 3.3 below for further detail on advances.

Subject to strict limitations imposed by the Customer Protection Rule, BNP Paribas may use customer securities to facilitate financing for BNP Paribas' customers, including pledging such securities to secure credit extended to BNP Paribas. BNP Paribas' use of customer securities is subject to limits based on the amount of credit extended to the individual customer, as well as aggregate limits based on the total amount of credit extended to all customers. Any securities that are eligible to be rehypothecated or otherwise used are not required to be held in a Segregated Account.

Securities held in Segregated Accounts as required by the Customer Protection Rule may be pledged to a European Central Securities Depository or certain other permitted custodians to secure BNP Paribas' obligation to pay custodial and administrative fees related to Segregated Accounts, but otherwise cannot be subjected to any lien or other encumbrance that would prevent a trustee or receiver from recovering such securities for distribution to customers in the event of BNP Paribas' insolvency.

Customers are entitled and required to make a claim in the event of BNP Paribas' insolvency in respect of securities held by BNP Paribas. Such claims may be satisfied pro rata from the pool of available cash and securities held in Segregated Accounts irrespective of whether the securities/cash are held in an OSA or an ISA. The treatment of securities held in ISAs is identical to the treatment of securities held in OSAs under U.S. insolvency law. As a result, there is no legal benefit under U.S. insolvency law to a customer's securities being in ISAs, as opposed to OSAs. Please note that the distribution of securities in practice would depend on a number of factors.

### **3.3 Shortfall**

#### At the level of the CSD

In the unlikely event there is a discrepancy between the number of securities that BNP Paribas is required to deliver to a client and the number of securities held by BNP Paribas with the CSD or CSD's depository (where applicable) in either an ISA or OSA, fewer securities may be returned to the client than those to which the client is actually entitled.

While BNP Paribas takes steps to reduce the chances of a shortfall, a shortfall could still result from, among other things, inadvertent administrative errors or operational issues at the CSD level.

There is no distinction in treatment between assets maintained for a client in an ISA as opposed to an OSA. Accordingly, BNP Paribas understands that in the case of a shortfall on accounts at the CSD, the shortfall would likely be shared among all affected clients on a pro rata basis and regardless of whether the securities are held through an ISA or an OSA at an EEA Central Securities Depository. Therefore, a client may be exposed to a shortfall even where securities have been lost in circumstances which are unrelated to that client.

A number of factors would be taken into account in order to determine a client's share of any shortfall. Each client's entitlement to securities within an account would need to be established and any shortfall would then be allocated among clients with an interest in that security in the account. There are arguments which can be made that in certain circumstances a shortfall in a particular security should be attributed to a particular client or clients. This could be a lengthy process which may cause delays in returning securities.

#### At the level of BNP Paribas

The Customer Protection Rule requires BNP Paribas to segregate customer cash and securities from its own assets to satisfy claims by customers for the return of their assets, even if it becomes insolvent. SIPA and the Dodd-Frank Orderly

Liquidation Authority provide for such assets to be distributed to customers and not be subject to general creditor claims until customer claims are satisfied in full.

In spite of this, there may be instances where there is a shortfall and which may result in less cash and fewer securities being returned to a client than that to which they would otherwise be entitled. As stated above, there is no distinction in treatment between assets maintained for a client in an ISA as opposed to an OSA. Accordingly, BNP Paribas understands that in the case of a shortfall on accounts, the shortfall would likely be shared among all affected clients on a pro rata basis and regardless of whether the securities are held through an ISA or an OSA at an EEA Central Securities Depository. Therefore, a client may be exposed to a shortfall even where securities have been lost in circumstances which are unrelated to that client.

SIPC advances are also available to reduce any shortfall. SIPC advances are presently limited to USD 500,000 per customer, up to USD 250,000 of which can be used to satisfy a claim for cash. However, advances are not available to broker-dealers, banks, individuals who are officers or directors of, or who otherwise can exert control over, the broker-dealer, or individuals or entities who have an ownership interest in the broker-dealer or who have subordinated their claims against the broker-dealer. If you are uncertain whether you would qualify as a "customer" for the purposes of the Customer Protection Rule, SIPA or the Dodd-Frank Orderly Liquidation Authority, you should obtain legal advice.

In the case of any shortfall of customer property, whether in an ISA, an OSA, or another segregated account, the shortfall would be shared among all clients proportionately to their customer claims. Moreover, a shortfall in cash could affect customers with claims to securities, and a shortfall in one security could affect customers with claims to a different security, because the aim of SIPA is to impose any losses pro rata among customers.

Even if a particular customer could identify or "trace" securities corresponding to its customer claim, this would not entitle such a customer to receive those securities. The customer would be subject to the same losses as all other customers, and the customer's claim could be satisfied with cash instead of securities. This applies with equal force to ISAs and therefore the fact that securities are held in an ISA that is identifiable to a particular customer does not give that customer any special claim to receive those securities under SIPA or the Dodd-Frank Orderly Liquidation Authority.

All customers must share losses (if any) equally, in an amount that is proportionate to their customer claims. The same result would occur to losses caused by a permitted lien asserted by a European Central Securities Depository or other custodian. As indicated, BNP Paribas is permitted to pledge the assets in Segregated Accounts to secure custodial and administrative fees owed to European Central Securities Depositories in respect of Segregated Accounts. Such a lien would have to be satisfied before customer property could be distributed to customers, and therefore it could result in a shortfall in customer property. However, any such shortfall would be

subject to the general rule described above. The shortfall would be borne by all customers proportionately to their customer claims, so that a lien might affect all customers collectively, but a given customer would be indifferent to whether its particular securities were subject to the lien. As a result, the possibility that such a security interest will be asserted against customer property has no bearing on the choice between an OSA or an ISA.

If BNP Paribas were to become insolvent during a time when there is a shortfall of assets held in Segregated Accounts, customers could be treated as general unsecured creditors for any amounts that remain unsatisfied after distribution of all customer property from Segregated Accounts. Customers would therefore be exposed to the risks of BNP Paribas' insolvency, including the risk that they may not be able to recover all or part of the amounts claimed.

## **Glossary**

**Central Securities Depository** means an entity that operates a securities settlement system and provides at least one other core service listed in Section A of the Annex of the CSDR.

**Central Securities Depositories Regulation** or **CSDR** means Regulation (EU) 909/2014 of the European Parliament and of the Council dated 23 July 2014 on improving securities settlement in the European Union and on central securities depositories.

**Customer Protection Rule** means Rule 15c3-3 of the Securities Exchange Act of 1934.

**Direct Participant** means an entity that holds securities in an account with a Central Securities Depository and is responsible for settling transactions in securities that take place within a Central Securities Depository. A Direct Participant should be distinguished from an Indirect Participant.

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

**Indirect Participant** means an entity, such as a global custodian, that appoints a Direct Participant to hold securities for it with a Central Securities Depository.

**Segregated Account** means the custody of client cash and securities held in European Central Securities Depositories or other custodians and depositories consisting of ISAs and OSAs, and which exclude BNP Paribas's proprietary securities.

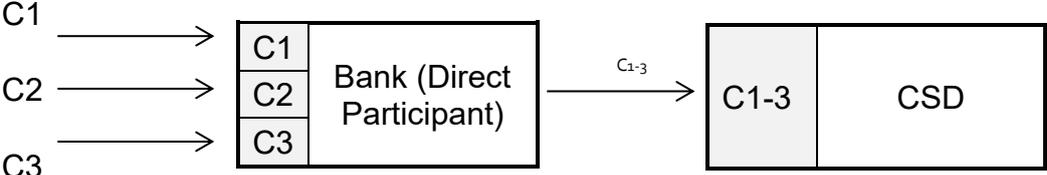
**SIPA** refers to the U.S. Securities Investor Protection Act.

**SIPC** refers to the U.S. Securities Investor Protection Corporation.

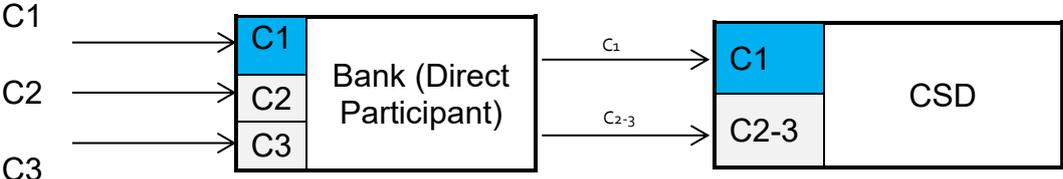
**Participant** means, as applicable, a Direct Participant or an Indirect Participant.

**Graphic representation of OSAs and ISAs:**

OSA (example with three clients C1-C3)



ISA (Example with client C1 while clients C2's and C3's securities are held through an OSA)



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