

## **Notice to clients of HSBC Private Bank (Suisse) SA under Article 73(2) and Article 73(4) Swiss Financial Market Infrastructure Act ("FMIA") and Article 38(5) and (6) European Union's Central Securities Depositories' Regulation ("CSDR")**

### **Offer of choice of segregated accounts at CSD level under Article 73(2) FMIA and Article 38(5) CSDR**

HSBC Private Bank (Suisse) SA ("us", "we", "Bank" or "HSBC"), a Swiss bank domiciled in Switzerland, is a Participant of SIX SIS AG ("SIX SIS"), a Central Securities Depository ("CSD") domiciled in Switzerland. Art. 73(2) FMIA requires Bank to offer indirect participants<sup>1</sup> of a Swiss CSD (i.e. of SIX SIS) the possibility of Omnibus Client Segregated Accounts ("OSA") or Individual Client Segregated Accounts ("ISA"). Furthermore, according to Art. 73(4) FMIA, Bank shall publish the respective costs and specifics concerning the level of protection granted by different types of accounts.

HSBC is also a Participant of CSDs domiciled in the European Economic Area ("EEA"). CSDR is currently being implemented across the EEA. CSDR requires CSDs to become authorised by their National Competent Authority, which is generally the national regulator. Much of CSDR will become effective for a CSD when that CSD receives its authorisation.

One effect of Article 38(5) CSDR, which becomes effective upon CSD authorisation, is to require HSBC, as a participant of such CSDs, i.e., currently, Euroclear Bank SA/NV and Clearstream Banking SA, to offer you the choice of at least either an ISA or an OSA in respect of securities we hold for you at these CSDs as client assets in our capacity as a participant and to inform you of the costs and risks associated with each option, including a description of the main legal implications of the respective levels of segregation offered and information on the insolvency law applicable. In addition, Article 38(6) CSDR requires us to publicly disclose the levels of protection and costs associated with the different levels of segregation that the accounts provide and to offer those services on reasonable commercial terms.

The levels of protection and costs associated with the different levels of segregation that the accounts provide are set out in Appendix A to this notice. The fees for establishing and running segregated accounts are available from your relationship manager.

We are not required to offer the choice of ISAs and OSAs except where HSBC is the participant of a CSD in Switzerland and in the EEA. The offer is not made in respect of securities which we may hold for you through a sub-custodian who in turn is the CSD participant for your securities.

Therefore, subject to the limitations described in this notice, we offer you the choice to hold your securities in an ISA or an OSA in accordance with Art. 73(2) FMIA and Art. 38(5) CSDR. The offer becomes effective upon the authorisation of the CSD[s]. In the case of securities which we hold for you as client assets in our capacity as a participant in a Swiss or EEA CSD, please advise us:

- ☐ If you require us to set one or more ISAs at Swiss and EEA CSD level to hold your securities, where those securities are currently held in an OSA; or
- ☐ if you require us to move any of your securities into an OSA at Swiss and EEA CSD level to hold your securities, where those securities are currently held in an ISA<sup>2</sup>.

There is no need to respond to this notice if you wish to leave the structure(s) of your account(s) unchanged.

If you do wish to change your account structures, we will advise you of the associated charges, if any.

If you have any queries relating to CSDR and FMIA and how they affect your dealings with HSBC, please let us know.

<sup>1</sup> Only clients of a Participant acting themselves as providers of securities accounts are considered indirect participants under Art. 73 (2) FMIA

<sup>2</sup> Please note that there are markets where individual segregation is mandatory under local laws and regulations and for these cases the choice of segregation levels is not applicable.

## Appendix A

### Article 73(4) Swiss Financial Market Infrastructure Act (FMIA) and Article 38(6) CSDR CSD Participant Disclosure: HSBC Private Bank (Suisse) SA

#### 1. Introduction<sup>3</sup>

The purpose of this document is to disclose the levels of protection and costs associated with the different levels of segregation in respect of securities that HSBC Private Bank (Suisse) SA ("we") holds directly for clients with Central Securities Depositories ("CSDs") within Switzerland and 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 73(4) of the Swiss Financial Markets Infrastructure Act ("FMIA") in relation to CSDs domiciled in Switzerland and 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 Participant have their own disclosure obligations.

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 our website. You should ensure that you consider the most recent version of this document on our website, which will supersede and override any previous version.

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

#### 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 SIX SIS AG ("SIX SIS") and the EEA CSDs in our own name (i.e. the account is held in our name but designated as client account) in which we hold clients' securities. As a general rule, we currently make two types of accounts with SIX SIS and the 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 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

If a Swiss bank were to become insolvent, insolvency proceedings would take place in Switzerland and be governed by Swiss insolvency law. Nevertheless, foreign branches of a Swiss bank may also be subject to insolvency proceedings in the foreign location in question governed by local insolvency law.

Clients' legal entitlement to the securities that a Swiss bank holds for them directly with SIX SIS and EEA CSDs would generally (except in specific circumstances, some of which are discussed below) not be affected by the bank's insolvency (bankruptcy), regardless of whether those securities were held in ISAs or OSAs.

In practice, the exclusion of securities from a Swiss bank's bankruptcy estate would further depend on a number of additional factors, the most relevant of which are discussed below.

##### Exclusion from the bank's bankruptcy estate

Under Swiss insolvency laws, intermediated securities and certain other safe custody assets within the meaning of the Banking Act booked on safekeeping accounts held by clients with a Swiss bank, as well as certain readily

<sup>3</sup> At the end of this document is a glossary explaining some of the technical terms used in the document.

available claims of the bank to receive delivery of securities from third parties, do not form part of the bankruptcy estate. Instead, in an insolvency (bankruptcy) of a bank, they are designated to be excluded in favour of the relevant client, subject to any claims the bank has against the client.

According to Art. 11 FISA, a Swiss bank must hold with itself or with a sub-custodian or CSD intermediated securities (available securities) in a quantity and of a kind at least equal to, the total of intermediated securities credited to the securities accounts maintained by the bank for its client<sup>4</sup>. A bank is also subject to strict requirements as to maintenance of accurate books and records and as to reconciliation of its records against those of the CSDs and sub-custodians with which the intermediated securities are held. Accordingly, as long as a bank maintains sufficient holdings of intermediated securities in accordance with its statutory obligations, clients should receive the same level of protection in the bank's insolvency, regardless of whether the intermediated securities are held in an ISA or an OSA. However, ISA could contribute to swifter identification of client assets in a default scenario.

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

Although clients' securities are held in our name at SIX SIS and EEA CSDs, we hold them on behalf of our clients.

For securities that are held by SIX SIS directly or indirectly through one or several other CSD located outside Switzerland and for securities that are held in an EEA CSD, the nature of the entitlement embodied in a security also depends on the law, regulations and contractual framework applicable to such other CSDs and further parties involved in the custody chain. In such a case, entitlements that are available for exclusion may be limited to contractual claims against SIX SIS or any other CSD involved. Moreover, the ability of the client to exclude securities in the case of insolvency may depend on whether the CSD or any custodian in the custody chain could assert any right to set-off, retention right, security interest or similar right with respect to the securities (see also "Security interests" below).

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**

As described above, the statutory requirements are designed to ensure that a Swiss bank holds intermediated securities in a quantity and a kind at least equal to the intermediated securities credited to client accounts. If notwithstanding these requirements there were a shortfall between the number of intermediated securities that a bank is obliged to deliver to clients and the number of intermediated securities that the bank holds on their behalf in either an ISA or an OSA, this could result in fewer intermediated securities than clients are entitled to being returned to them on the bank's insolvency. The way in which a shortfall could arise and would be treated may be different as between ISAs and OSAs.

### **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. In most cases a shortfall occurs as a result of a mismatch between the time when a bank receives intermediated securities and the earlier time when the delivery is booked to the account of the receiving account holder. In Switzerland, typically for exchange traded transaction, banks credit the client accounts immediately on trade date while the effective delivery may not occur intraday but later (most markets have settlement cycles of 2 or 3 days). As a result, a recipient client could dispose of its intermediated securities as soon as they are credited to its securities account, irrespective of whether the bank has actually already received the intermediated securities. This process is referred to as contractual settlement. Contractual settlement may therefore cause a difference between the bank's number of intermediated securities at the CSD and the clients' higher number of aggregated securities credited to their securities accounts. In the normal course of the settlement this process-immanent difference disappears at the end of the settlement cycle. Contractual settlement increases market liquidity, accelerates deliveries and settlement, and is based on the fact that a failed settlement of an exchange traded transaction (and the risk that, as a result, a bank does not hold sufficient

<sup>4</sup> Available securities also include the bank's readily available rights to delivery of intermediated securities from other custodians during the regulatory or customary settlement period for the corresponding market, provided that this period does not exceed eight days.

available securities) is rare. The risk involved with shortfalls is further mitigated by the fact that, if a shortfall arises, a bank is obliged to acquire without delay securities if and to the extent the total number of available securities is less than the total number of securities credited to clients' accounts (see below).

In the case of an ISA, the securities held in the ISA can only be delivered out for the settlement of transactions made by the ISA client. As a matter of principle, this may reduce the risk of a shortfall in that account, but also increases the risk of settlement failure which, in turn, may incur additional costs (e.g. buy-in costs) and/or delay in settlements.

### **Treatment of a shortfall**

In the case of an ISA, although arguments could be made that the relevant client should not be exposed to a shortfall that is clearly attributable to an account held for another client or clients, it cannot be excluded that a shortfall on any other (ISA or OSA) account would be shared rateably among clients, including clients who do not have an interest in the relevant account.<sup>5</sup> Accordingly, a client holding whose securities are held in an ISA may still 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.

If a shortfall arises, the Bank has the obligation under Swiss law to acquire without delay securities if and to the extent the total number of available securities is less than the total number of securities credited to clients' accounts. If a shortfall arose and was not so covered, clients may have a claim for compensation against a Swiss bank. Furthermore, if the securities that may be excluded from the bank's bankruptcy estate (see above) are not sufficient to satisfy the claims relating to client accounts in full, securities of the same kind held by the bank for its own account will also be excluded for the benefit of the relevant clients.

If a Swiss bank 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 a Swiss bank's insolvency, including the risk that they may not be able to recover all or part of any compensation claimed.

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 in principle 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 group of 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 the clients' assets.

### **Security interests**

#### **Security interest granted to the CSD**

Where the CSD benefits from a security interest (either it benefits from a statutory right or a contractual right based on its terms and conditions) over securities held by the bank with it (including securities held for clients), there could be a delay in the return of securities to a client (and a possible shortfall) in the event that the bank failed to satisfy its obligations to the CSD and the security interest was enforced. This applies regardless of whether the securities are held in an ISA or an OSA. However, in practice, we would expect that the CSD would first seek recourse to any securities held in the bank's proprietary accounts to satisfy the bank's obligations and only then make use of securities in client accounts. We would also expect the CSD to enforce its security

<sup>5</sup> Cf. Art. 19 FISA.

rateably across client accounts held with it. Furthermore, Swiss law requires the liquidator to satisfy claims of the CSD arising out of the custody of intermediated securities or the financing of their acquisition<sup>6</sup>.

### Security interest granted to third party

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 (and a possible shortfall in the account).

However, in practice, Bank would expect that the beneficiary of a security interest (pledgee) over a client's securities would perfect its security by notifying Bank rather than the CSD and would seek to enforce the security against Bank rather than against the CSD, with which it had no relationship.

### 4. CSD disclosures (not applicable to the Swiss CSD)

In this section, we set out links to the websites of EEA CSDs in which we are a 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 assume no liability for such disclosures.

#### Central Securities Depositories and websites:

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Clearstream Banking SA

<http://www.clearstream.com>

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Euroclear Bank SA/NV

<https://www.euroclear.com/en.html>

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### 5. Costs disclosure

Typically, the set-up and maintenance costs for ISAs are greater than for OSAs. This is due to the additional operational complexity and expenditures involved in setting up and maintaining an ISA on an ongoing basis. Such costs will be charged to you. This section is intended to provide a summary of the factors which determine the overall costs of setting up and maintaining an ISA, or an OSA.

#### COSTS for OSAs and ISAs

The main factors which will determine the aggregate costs are likely to include:

- U whether the account type is ISA or OSA
- U how many accounts are required
- U technical set-up at the CSD, including the set-up and maintenance fees, charged by the CSD
- U the set-up and maintenance costs at HSBC internally (migrating your assets from OSA to ISA and position monitoring require additional time and operational efforts on our side)
- U the types of services you require in relation to the account(s).

The recurrent account maintenance fee will be charged in line with your selected account structure.

We do not expect changes to charges for clients who remain on the OSA set-up and we are happy to discuss and confirm the exact fees applicable for establishing and running an ISA for you. If you would like to take up this option please contact your Relationship Manager.

<sup>6</sup> Cf. Art. 17 para. 3 FISA

## 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.

**EEA** means the European Economic Area.

**Federal Act on Banks and Savings Banks (Banking Act or BA)**, a Swiss law which sets out the financial market legislation governing banks, private bankers and savings banks, dealing, amongst others, with operating licences and specifying rules for business conduct.

**Federal Act on Intermediated Securities (FISA)**, a Swiss law which regulates the custody of certificated and uncertificated securities by custodians and their transfer.

**Financial Markets Infrastructure Act (FMIA)**, a Swiss law which sets out rules applicable to CSDs domiciled in Switzerland and their participants.

**Individual Client Segregated Account (ISA)**, is used to hold the securities of a single client.

**Omnibus Client Segregated Account (OSA)**, is used to hold the securities of a number of clients on a collective basis.

**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.

## Disclaimer

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