

UBS EUROPE SE

ARTICLE 38 (5) and 38(6) CSDR

PARTICIPANT DISCLOSURE

1. Introduction¹

The purpose of this document is to disclose the levels of protection associated with the different levels of segregation in respect of securities held 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 Art. 38(5) and 38(6) of the Central Securities Depositories Regulation (CSDR) in relation to CSDs established in the EEA.

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 stated herein.

UBS Europe SE (the "Bank"), registered as a Credit Institution in Germany, is a Participant of CSD(s) established in the EEA. According to Art. 38(5) and 38(6) of CSDR a Participant of such CSD shall offer its clients at least the choice between omnibus client segregation and individual client segregation and inform them 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.

Under CSDR, the CSDs of which the Bank is a Participant have their own disclosure obligations. We include links to those disclosures in this document.

2. Background

In the Bank's own books and records, the Bank records each client's individual entitlement to securities that it holds for that client in a separate client account. The Bank also opens accounts with EEA CSDs in its own name (i.e. the account is held in the name of Bank but designated as client account) or in the name of its nominees in which it holds clients' securities. As a general rule, the Bank makes 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 and therefore the client's securities are held separately from the securities of other clients and the Bank's own proprietary securities.

An OSA is used to hold the securities of a number of clients on a collective basis. However, the Bank does not hold its own proprietary securities in OSAs.

3. Main legal implications of levels of segregation

Insolvency (bankruptcy)

Clients' legal entitlement to the securities that the Bank holds for them directly with CSDs would typically not be affected by the Bank's insolvency, regardless whether those securities were held in ISAs or OSAs.

The distribution of the securities in the event of insolvency would depend on a number of factors, the most relevant of which are outlined below.

Application of German insolvency law

If a German bank were to become insolvent, the insolvency proceedings would take place in Germany and generally be governed by German insolvency law.

Under German insolvency law, securities that the Bank holds on behalf of clients would not form part of the Bank's estate on insol-

¹ At the end of this document is a glossary explaining some of the technical terms used in the document

veny for distribution to creditors, provided that the client keeps a proprietary interest in rem in such securities. Where a client has sold, transferred or otherwise disposed of its legal entitlement to securities that the Bank holds for them (for example, under a right to use or title transfer collateral arrangement), this will no longer be the case.

As a result, it would not be necessary for clients to make a claim in the Bank's insolvency as a general unsecured creditor in respect of those securities in which the client keeps a proprietary interest in rem.

Such securities should also not be subject to any bail-in process (see glossary), which may be applied to the Bank if it were to become subject to resolution proceedings (see glossary).

Accordingly, where the Bank holds securities in custody for clients and clients are considered as having a proprietary interest in rem in such securities, they should be protected on the Bank's insolvency or resolution. This applies whether the securities are held in an OSA or an ISA.

In addition, clients may also have a priority right in respect of certain of the Bank's assets in insolvency proceedings, in certain situations where the client does not hold a proprietary interest in a security at the time of the Bank's insolvency proceedings but has met its obligations to the Bank under the relevant securities transaction. These situations can occur where a client acquires securities as part of a securities transaction but has not yet received a proprietary interest in these securities, or the Bank has unlawfully infringed the client's proprietary interest in the securities.

If the client has a priority right, the client's priority claim may be settled separately prior to the claim of general unsecured creditors. The claim would be settled from existing securities of the same type that form part of the Bank's estate or claims that the Bank has for the delivery of securities of the same type to the Bank's estate. Clients would be required to make a claim in the Bank's insolvency as a priority creditor in respect of those securities.

Insolvency proceedings may delay the restitution of the securities to the client, amongst other because 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.

Nature of clients' interests

The Bank is required under the Official Requirements regarding Safe Custody Business to protect the client's legal position (proprietary interest in rem) in its securities which the Bank holds in custody, and to separate the client's legal position from its own rights. However, the specific nature of the client's legal position in these securities may differ according to the applicable law.

Where the existence or transfer of proprietary rights in financial instruments or other rights in such financial instruments presupposes their recording in a register, an account or a centralised deposit system held or located in a EEA Member State, these rights would generally be governed by the law of the EEA Member State where the register, account, or centralised deposit system in which those rights are recorded is held or located.

The books and records of the Bank constitute evidence of the clients' proprietary interests in rem 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.

The Official Requirements regarding Safe Custody Business require the Bank to maintain accurate books and records, which enable the Bank to distinguish securities held for one client from securities held for any other client, and from the Bank's own securities. The Bank is also subject to regular audits in respect of its compliance with those rules. In relation to an ISA, each client is beneficially entitled to 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. As long as books and records are maintained in accordance with the applicable rules, clients should receive the same level of protection from both ISAs and OSAs.

Shortfalls

The statutory requirements are designed to ensure that the Bank holds securities in a quantity and a kind at least equal to the securities credited to client accounts. If notwithstanding these requirements there were a shortfall between the number of securities that the Bank is obliged to deliver to clients and the number of securities that the Bank holds on their behalf in either an ISA or an OSA, this could result in fewer 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 e.g. following the exercise of rights of reuse.

In most cases a shortfall occurs as a result of a mismatch, i.e. the Bank may credit the client accounts immediately on a trade date while the effective delivery may not occur later (most markets have a settlement cycle of 2 or 3 days). As a result, a recipient client could dispose of its securities as soon as they are credited to its securities account, irrespective of whether the Bank has actually already received the securities. This process is referred to as contractual settlement. Contractual settlement may therefore cause a difference between the Bank's number of 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 difference is resolved 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 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, but also increases the risk of settlement failure which, in turn, may incur additional costs (e.g. buy-in costs) or penalties and/or delay in settlements as the Bank would be unable to settle where there are insufficient securities in the account.

Treatment of a shortfall

The treatment of shortfalls may vary depending on whether the securities are held by the Bank in an ISA or OSA.

In the case of an ISA, 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 in exceptional situations 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. Accordingly, a client holding whose securities are held in an ISA may, in exceptional cases, still be exposed to a shortfall on an account held for another client or clients.

In the case of an OSA, a shortfall attributable to the OSA would be shared rateably among the clients in relation to the securities held in the OSA (and potentially other clients). Therefore, a client may be exposed to a shortfall even where securities have been lost in circumstances which are completely unrelated to that client. Any shortfall in a particular security held in an OSA be allocated among all clients with an interest in that security in the account. In order to calculate clients' shares of any shortfall in respect of an OSA, each client's interests with respect to securities held within that account would need to be established as a matter of law and fact based on the bank's books and records. 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.

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 own 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 rateably across client accounts held with it.

Furthermore, restrictions apply in relation to the situations in which we may grant a security interest over securities held in a client account.

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, the Bank would expect that the beneficiary of a security interest (e.g. a pledgee) over a client's

securities would perfect its security by notifying the Bank rather than the CSD and would seek to enforce the security against the Bank rather than against the CSD, with which it had no relationship. The Bank would also expect CSDs to refuse to recognise a claim asserted by anyone other than ourselves as account holder.

Priority right in insolvency proceedings

Clients may have a priority claim in the Bank's insolvency proceedings in certain situations where the Bank has granted a security interest over securities held in a client account to a depository (including a CSD) and the depository has fully or partly realised its security interest. Such priority right may only arise in limited circumstances and would generally require that the Bank has granted (i) a loan to the client and, (ii) with the client's authorisation, a security interest over the client's securities to the depository, in relation to a loan of the depository to us. The client's priority claim would be settled separately prior to the claim of general unsecured creditors and from a separate pool of assets, comprising:

- to the extent that the depository has not realised its security interest, the securities that are subject to the security interest that the Bank has granted to the depository;
- where the depository has realised its security interest, any proceeds to which the depository is not legally entitled;
- any claims the Bank may have resulting from loans granted to other clients who are involved in this separate settlement process, as well as any payments made to avert an imminent realisation of a security interest.

Clients would be required to make a claim in the insolvency of the Bank as a priority creditor in respect of those assets.

This priority settlement process may arise whether or not the client has an ISA or OSA.

4. Participation in CSDs and CSD disclosures

The rules applicable to the insolvency of a CSD are usually subject to the laws of the country in which the respective CSD has its seat. Specific information on the main legal implications of the respective levels of segregation offered and information on the insolvency law applicable to the CSD's the Bank is participant of, are provided below.

If a CSD offers its participants to maintain several types of individually segregated securities accounts, the Bank may decide, in accordance with any applicable national legal and regulatory requirements, to offer to its own clients' only one or several of the types of individually segregated securities accounts offered by the CSD. Where the Bank makes use of this option, this is stated hereinafter:

Clearstream Banking AG (CBF), Germany

Link: <https://www.clearstream.com/clearstream-en/strategy-and-initiatives/asset-safety/csdr-article-38-disclosure>

Monte Titoli, Italy

Link: https://www.lseg.com/sites/default/files/content/documents/2019_05_13%20E.6%20-%20Account%20Segregation%20Document%20FINAL_CLEAN.pdf

Euroclear, Luxemburg

Link: <https://www.euroclear.com/about/en/business/Disclosuresandquestionnaires.html>

If you click on the above links, you leave this information/website. These disclosures have been provided by the relevant CSDs. The Bank has not investigated or performed due diligence on the disclosures and websites and clients rely on the CSDs disclosures and websites at their own risk.

GLOSSARY

Bail-in refers to the process under the applicable national law implementing EU Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD) under which the firm's liabilities to clients may be modified, for example by being written down or converted into equity.

Central Securities Depository (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 (CSDR) refers to EU Regulation No 909/2014 on improving securities settlement in the European Union and on central securities depositories, which sets out rules applicable to CSDs and their direct participants. The CSDR is relevant for the European Economic Area (EEA) and is under scrutiny for incorporation into the EEA Agreement. Upon completion of the adoption process it will also be in force in the EEA.

EEA means the European Economic Area.

Official Requirements regarding Safe Custody Business refers to “Amtliche Anforderungen an das Depotgeschäft – Bekanntmachung über die Anforderungen an die Ordnungsmäßigkeit des Depotgeschäfts und der Erfüllung von Wertpapierlieferungsverpflichtungen“, 21 December 1998, guidelines on safe custody business originally published by the German Federal Banking Authority (BaKred) but maintained by the BaFin.

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

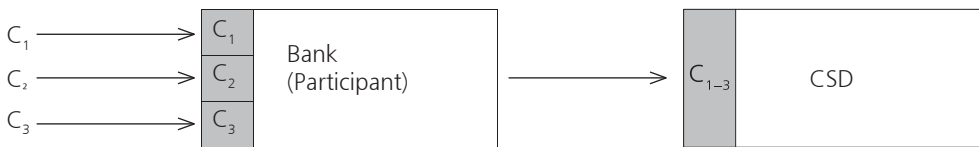
Omnibus Client Segregated Account (OSA), is used to hold the securities of a number of clients on a collective basis.

Participant means an entity which is a direct participant in a CSD, i.e. 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, which appoints a direct participant to hold securities for it with a CSD.

Resolution proceedings are proceedings for the resolution of failing banks and investment firms under the the applicable national law implementing EU Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD)

Graphic representation of OSA and ISA

OSA (example with three clients C1–C3)



ISA (Example with client C1)

