

# **GOLDMAN SACHS BANK USA ARTICLE 38(6) CSDR PARTICIPANT DISCLOSURE: U.S. LAW**

## **1. Introduction**

The purpose of this document is to describe the protection associated with the two different types of segregation that we can provide in respect of securities that we hold for clients with Central Securities Depositories located within the EEA and Switzerland (*European CSDs*), including a description of the main legal implications of the two types of segregation offered and information on the U.S. insolvency law applicable. This disclosure is required under Article 38(6) of the Central Securities Depositories Regulation (*CSDR*) and Article 73 of the Swiss Financial Markets Infrastructure Act (*FMIA*).

The European CSDs of which we are a direct participant (see glossary) have their own disclosure obligations under the CSDR and we include links to those disclosures in this document.

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

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. To custody cash and securities for clients, we open accounts with European CSDs and other custodians and depositaries (*Segregated Accounts*). We are operationally able to establish two types of Segregated Accounts with European CSDs to custody clients' securities: Individual Client Segregated Accounts (*ISAs*) and Omnibus Client Segregated Accounts (*OSAs*). Proprietary securities cannot be held in ISAs, OSAs, or other Segregated Accounts.

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

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. Although each ISA may be named in a way that identifies the client for whom it is maintained,<sup>1</sup> the client does not have any right or ability to give instructions to the European CSD with respect to any ISA maintained on its behalf or the securities maintained in that account, and so holding assets in an ISA does not give a client any operational rights with respect to those assets. Moreover, the Uniform Commercial Code does not recognize any special property interest in the assets maintained for a client in an ISA as opposed to an OSA or other Segregated Account.

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### **3. Main legal implications of levels of segregation**

#### ***Insolvency***

In the event of our insolvency, we would be subject to an FDIA Proceeding (see glossary). The laws governing FDIA Proceedings do not include specific provisions governing the manner in which custodial securities would be distributed in such a proceeding. However, we would expect that custodial securities maintained by us would be distributed to their owners without regard to the recoveries obtained by our creditors. In other words, securities held in a custodial capacity would not be treated as creditor claims, and even if creditors were not paid in full, custodial securities would be returned to their owners without “haircuts.” (See below for a discussion of how securities would be distributed in the event of a shortfall.)

#### ***Shortfalls***

If a full return of securities to custodial customers is impossible due to a shortfall in the amount of securities we maintain in Segregated Accounts, it is not certain how the resulting losses would be apportioned. It is possible that securities maintained in an ISA would be distributed to the client whose name is associated with such account, in which case such client might be shielded from losses incurred by other clients with a claim to the same security. It is also possible that all securities of a given type would be distributed pro rata to clients with a claim to that type of security, regardless of whether such securities are held in ISAs or OSAs.

The treatment of losses stemming from shortfalls is uncertain because the federal insolvency law that would govern an FDIA Proceeding does not include specific provisions governing the distribution of custodial securities. In the absence of a specific insolvency law provision, Article 8 of the Uniform Commercial Code might provide some guidance. Article 8 vests custodial customers with a limited property interest in the “financial assets” maintained by us. This limited property interest is tied to the specific security held for each custodial customer, so that a given security would only be subject to a property interest in favour of the particular customers holding such security through us. Article 8 does not, by its terms, provide for any distinction between assets held in ISAs and OSAs. Under the literal terms of the Article 8, all securities of the same type held by the bank, wherever located, would be equally subject to the collective property interest of custodial customers with claims to that type of security.

It is important to note that the framework established by Article 8 is not necessarily intended to apply to the distribution of securities in an insolvency proceeding. The official commentary to the Uniform Commercial Code (as published by the Uniform Law Commission) states that Article 8 “does not necessarily determine how property held by a failed intermediary will be distributed in insolvency proceedings” and notes certain statutes that would override Article 8. However, in the absence of any other law setting forth a specific method for distributing such property, it is possible that Article 8 would be applied in an FDIA Proceeding.

If the framework established by Article 8 were used to govern the distribution of securities to custodial customers, then all customers with a claim to a particular security would share losses in respect of such security proportionately, without regard to whether those shares are held in ISAs or OSAs. Customer losses would not be

shared across different types of securities—if there were a shortfall in Security A, but no shortfall in Security B, then customers with claims to Security A would share losses proportionate to the claims for such security, but customers would incur no losses with respect to claims for Security B. In this distribution method, it would make no difference whether a client’s securities are held in an ISA or an OSA.

It is also possible that, in an insolvency proceeding, the courts or relevant regulators would assert that Article 8 does not apply or that it should be only partially applied. Under U.S. law, bank receivers have broad discretion in determining how particular rules should be applied. For instance, it is possible that clients who could “trace” or identify the financial assets maintained in respect of their claims would be able to obtain those securities, while clients who could not do so would be subjected to the Article 8 framework or some other distribution scheme. In that case, clients may benefit from holding their securities in an ISA as opposed to an OSA. It is also possible that the distribution of securities will depend on whether a given custodial customer has authorized the bank to rehypothecate the customer’s securities, or whether the bank has actually done so. Because of the wide array of outcomes that are permitted under the law, it is impossible to state with certainty whether a client would benefit from choosing to hold its assets in an ISA as opposed to an OSA.

If we were to become insolvent during a time when there is a shortfall of assets held in Segregated Accounts, clients could be treated as general unsecured creditors for any amounts that remain unsatisfied after the distribution of all property from Segregated Accounts. 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.

## 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 ***European CSD*** is an entity based in the EEA or in Switzerland which records legal entitlements to dematerialised securities and operates a system for the settlement of transactions in those securities. The great majority of securities issued in the EEA or Switzerland that we hold for clients are held with Central Securities Depositories.

***Central Securities Depositories Regulation*** or ***CSDR*** refers to EU Regulation 909/2014 which sets out rules applicable to EEA CSDs and their participants.

***direct participant*** means an entity that holds securities in an account with a European CSD and is responsible for settling transactions in securities that take place within a European 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 European CSD.

***FDIA Proceeding*** refers to a receivership commenced pursuant to the Federal Deposit Insurance Act of 1950, as amended (see 12 U.S.C. § 1821).

***Financial Markets Infrastructure Act*** or ***FMIA*** refers to FinfraG which sets out rules applicable to Swiss CSDs and their participants.