Commission Delegated Regulation (EU) 2018/1618 of 12 July 2018 amending Delegated Regulation (EU) No 231/2013 as regards safe-keeping duties of depositaries (Text with EEA relevance)

COMMISSION DELEGATED REGULATION (EU) 2018/1618

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amending Delegated Regulation (EU) No 231/2013 as regards safe-keeping duties of depositaries

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers[(1)], and in particular Article 21(17) thereof,

Whereas:

(1) As a result of differing national securities and insolvency laws, which are not harmonised at Union level, there is a divergence in the level of protection for financial instruments held in custody by third parties for Alternative Investment Funds ('AIFs') clients from insolvency risks. In seeking to ensure strong client asset protection as provided for under Directive 2011/61/EU while accommodating more robust national law requirements in relation to those non-harmonised areas, it is necessary to clarify the obligations relating to the safe keeping of assets laid down in Directive 2011/61/EU.

(2) Currently competent authorities and industry apply the asset segregation requirements laid down in Commission Delegated Regulation (EU) No 231/2013[(2)] differently. While depositaries, which are at the first level of a custody chain, have the obligation to provide an individual account to hold financial instruments for each AIF client, it is necessary to clarify that where the custody function is delegated to a third party, the latter should be able to hold assets of one depositary's clients, including the assets for AIFs and Undertakings for Collective Investment in Transferable Securities ('UCITS'), in an omnibus account. This omnibus account should always exclude the proprietary assets of the depositary and the third party's proprietary assets as well as assets belonging to other clients of the third party. Correspondingly, in cases where custody function is further delegated, the sub-custodian should be able to hold assets of the delegating custodian's clients in an omnibus account. This omnibus account should always exclude the sub-custodian's proprietary assets and proprietary assets of the delegating custodian as well as assets belonging to other clients of the sub-custodian. This is necessary in order to achieve a healthy balance between the market efficiency and investor protection.

(3) In order to minimise the risk of loss of assets held in omnibus financial instruments accounts provided by third parties, to whom the custody function has been delegated, the frequency of reconciliations between the financial securities accounts and the records

of the depositary of an AIF client and the third party or between the third parties, where the custody function has been delegated further down the custody chain, should ensure a timely transmission of the relevant information to the depositary. Moreover, the frequency of those reconciliations should depend on any movement in that omnibus account, including transactions relating to the assets belonging to other clients of the depositary that are kept in the same omnibus account as the AIF's assets.

(4) The depositary should be able to continue to carry out its duties effectively where the custody of assets belonging to its AIF clients is delegated to a third party. It is therefore necessary to require that the depositary maintains a record in the financial instruments account it has opened in the name of its AIF client or in the name of the AIFM, acting on behalf of the AIF, showing that the assets kept in custody by a third party belong to that particular AIF.

(5) To strengthen the depositaries' standing in relation to third parties to whom the custody of assets is delegated, that relationship should be documented by a written delegation contract. That contract should allow the depositary to take all the necessary steps ensuring that the assets kept in custody are properly safeguarded and that the third party complies at all times with the delegation contract and the requirements of Directive 2011/61/EU and Delegated Regulation (EU) No 231/2013. Furthermore, the depositary and the third party should formally agree whether the third party is allowed to further delegate the custody functions. In that instance, the arrangement or contract between the delegating third party and the third party to whom the custody functions are further delegated should be subject to rights and obligations which are equivalent to those established between the depositary and the delegating third party.

(6) In order to enable the depositary to fulfil its functions it is necessary to strengthen depositaries' oversight over the third parties, regardless of whether they are located inside or outside the Union. It should be required that depositaries verify whether financial instruments of AIFs are correctly recorded in the books of a third party and that the records kept are sufficiently accurate in order to be able to identify the nature, location and ownership of the assets held in custody. To facilitate effective fulfilment of the depositaries' duties, third parties should provide them with a statement on any change affecting the assets held in custody for the depositaries' AIF clients.

(7) As part of the depositaries' obligations to exercise care and diligence in cases of delegation of the custody functions, before delegating this function to a third party located outside of the Union, the depositary should receive an independent legal opinion assessing the insolvency law of the third country where that third party is located this includes an evaluation of the level of protection afforded by segregated financial instruments accounts in that jurisdiction. The opinion provided for each jurisdiction by relevant industry federations or by law firms for the benefit of several depositaries should be acceptable. Furthermore, the depositary should ensure that the third party located outside the Union informs it of any change in circumstances or in that third country's insolvency law that may affect the status of the assets of the depositary's AIF clients.

(8) In order to allow depositaries time to adapt to the new requirements contained in this Regulation, the starting date of application of this Regulation should be deferred for eighteen months after publication in the *Official Journal of the European Union*.

(9) The measures introduced by this Regulation are in accordance with the opinion of the European Securities and Markets Authority.[(3)]

(10) The measures introduced by this Regulation are in accordance with the opinion of the expert group of the European Securities Committee.

(11) Delegated Regulation (EU) No 231/2013 should therefore be amended accordingly,

HAS ADOPTED THIS REGULATION:

Article 1

Delegated Regulation (EU) No 231/2013 is amended as follows:

(1) Article 89 is amended as follows:

(a) paragraph 1 is amended as follows:

(i) point (c) is replaced by the following:

(c) reconciliations are conducted as often as necessary between the depositary's internal accounts and records and those of any third party to whom custody functions are delegated in accordance with Article 21(11) of Directive 2011/61/EU.;

(ii) the following second subparagraph is added:

In relation to point (c) of the first subparagraph, the frequency of the reconciliations shall be determined on the basis of the following:

(a) the normal trading activity of the AIF;

(b) any trade occurring outside the normal trading activity;

(c) any trade occurring on behalf of any other client whose assets are held by the third party in the same financial instruments account as the assets of the AIF.;

(b) paragraph 2 is replaced by the following:

2. Where a depositary has delegated its custody functions to a third party in accordance with Article 21(11) of Directive 2011/61/EU, it shall remain subject to the requirements of points (a) to (e) of paragraph 1 of this Article. It shall also ensure that the third party complies with the requirements of points (b) to (g) of paragraph 1 and segregation obligations laid down in Article 99.;

(2) in Article 98, the following paragraph 2a is inserted:

2a. A contract, by which the depositary appoints a third party to hold assets of that depositary's AIF clients in custody, shall contain at least the following provisions:

Changes to legislation: *There are currently no known outstanding effects for the Commission Delegated Regulation (EU) 2018/1618. (See end of Document for details)*

a a guarantee of the depositary's right to information, inspection, and access to the relevant records and accounts of the third party holding assets in custody to enable the depositary to fulfil its oversight and due diligence obligations and in particular allow the depositary to:

(i) identify all entities within the custody chain;

(ii) verify that the quantity of the identified financial instruments recorded in the financial instruments accounts opened in the depositary's books in the name of the AIF or in the name of the AIFM, acting on behalf of the AIF, matches the quantity of the identified financial instruments held in custody by the third party for that AIF as recorded in the financial instruments account opened in the third party's books;

(iii) verify that the quantity of the identified financial instruments, which are registered and held in a financial instruments account opened at the issuer's Central Securities Depository (CSD) or its agent, in the name of the third party on behalf of its clients, matches the quantity of the identified financial instruments recorded in the financial instruments accounts opened in the depositary's books in the name of each of its AIF clients or in the name of the AIFM acting on behalf of the AIF;

b details of equivalent rights and obligations agreed between the third party and another third party, in the event of a further delegation of custody functions.;

(3) Article 99 is amended as follows:

(a) paragraph 1 is replaced by the following:

1. Where safekeeping functions have been delegated wholly or partly to a third party, a depositary shall ensure that the third party, to whom safe-keeping functions are delegated pursuant to Article 21(11) of Directive 2011/61/EU, acts in accordance with the segregation obligation laid down in point (iii) of Article 21(11)(d) of that Directive by ensuring and verifying that the third party:

a correctly records all identified financial instruments in the financial instruments account, which is opened in the third party's books, in order to hold in custody the financial instruments for the depositary's clients, which excludes proprietary financial instruments of the depositary and of the third party and of the third party's other clients, to enable the depositary to match the quantity of the identified financial instruments recorded in the accounts opened in the depositary's books in the name of each of its AIF clients or in the name of the AIFM acting on behalf of the AIF;

b keeps all necessary records and financial instruments accounts to enable the depositary at any time and without delay to distinguish assets of the depositary's clients from the third party own assets, assets of the third party's other clients and assets held for the depositary for its own account;

c maintains records and financial instruments accounts in a way that ensures their accuracy, and in particular their correspondence to the assets kept safe for the depositary's AIF clients and on the basis of