

GREAT FUND INSIGHTS

AIFMD II – impact on depositaries and their delegates

November 2023

On 10 November 2023, the Council of the EU published the final compromise text for AIFMD II, the proposed directive amending AIFMD and the UCITS Directive relating to delegation arrangements, liquidity risk management, supervisory reporting, provision of depositary and custody services, and loan origination by alternative investment funds.

This briefing focusses on the impact on depositaries and their delegates, such as central securities depositories (**CSDs**), custodians and prime brokers. Below, we give an overview of the most relevant changes and a high-level summary of their practical impact.

Key Changes

– Issuer CSDs not in scope of depositary delegation requirements

Delegation by a UCITS or AIF depositary to a CSD does not constitute a delegation of custody where the CSD is providing the services of (i) initial recording of securities in a book-entry system; or (ii) providing and maintaining securities accounts at the top tier level (an **'issuer CSD'**).

– Investor CSDs not subject to ex ante due diligence requirements

Delegation by a UCITS or AIF depositary to a CSD that (i) is a participant in a securities settlement system operated by another CSD; or (ii) is using a third party or intermediary that is participant in a securities settlement system operated by another CSD in relation to a securities issue (an **'investor CSD'**) will not trigger the requirement for the delegating depositary to carry out ex ante due diligence on the investor CSD.

Other changes and timing

In relation to the loan origination provisions set out in AIFMD II, AIFs are restricted from granting loans to depositaries or any entities to which the depositary has delegated functions in respect of that AIF.

Depositaries will be required to make certain information available on request not only to its own competent authority, but also the competent authorities of any AIF or AIFM it services.

More generally, AIFMD II makes changes to (or clarifies) the rules applying to AIFMs in relation to delegation, investor disclosure and reporting to regulators, and the framework for coordinating supervision and oversight, for NCAs and ESMA.

These changes may have an indirect impact on depositaries' operations where AIFMs may request more, or different, information flows in relation to the depositary, its delegates, and the custody of fund assets.

– New regime for provision of cross-border depositary services

Member States with smaller depositary markets may derogate from the rule that a depositary appointed in respect of an EU AIF in that Member State must be a depositary also established that same Member State.

Timing

Except for the regulatory reporting requirement changes, the above changes will need to be implemented by Member States within two years of AIFMD II coming into force. For depositaries, this means they will need to comply with the new requirements from early 2026, and may be indirectly impacted before then, where fund managers update their processes and documentation for their own compliance purposes.

The regulatory reporting requirement changes are due to be implemented within three years of AIFMD II coming into force.

Practical impact of key changes

Key change	What does it cover?
Issuer CSDs not in scope of depositary delegation requirements	<p>The scope of the depositary delegation requirements for CSD delegation is clearer.</p> <p>Depositaries and issuer CSDs should check any relevant delegation arrangements to confirm they are not applying depositary delegation requirements unnecessarily and if there are any contractual obligations or operational processes that can be removed or amended.</p> <p>Depositaries and CSDs may also consider whether any processes or documentation could be clearer, to ensure clear records of the nature and extent of the custody service so that regulatory obligations on both sides are understood, and met.</p>
Investor CSDs not subject to ex ante due diligence requirements	<p>Depositaries delegating custody to investor CSDs will be able to modify their due diligence process, and should review any current ex ante due diligence processes to identify any elements which can be streamlined.</p> <p>Investor CSDs, going forward, may be subject to less onerous due diligence requests by a delegating depositary.</p>
Member State ability to allow cross-border depositary services	<p>It will be possible for EU depositaries to service AIFs in other Member States, where allowed by the relevant AIF Member State's competent authority.</p> <p>This is only available where the AIF's home Member State depositary market does not exceed EUR 50 billion (or equivalent), in terms of assets safekept on behalf of AIFs managed by an EU AIFM.</p> <p>The aim of this change is to give AIFs established in Member State with smaller depositary markets the ability to benefit from more choice, and gain access to better and more effective depositary services.</p> <p>Depositaries interested in providing cross-border services may wish to consider how their business may take advantage of this change. Prime brokers may want to prepare for delegations from a wider range of depositaries. For example, considering how conflicts of law issues on matters such as security interests and depositary insolvency procedures could impact documentation structures.</p>

Third country depositaries and custody service providers

For third country depositaries and custody service providers, the nature of the impact of these changes will of course depend on the extent of their business and engagement with EU AIFs and AIFMs (or other AIFs marketed in the EU).

Third country depositaries will not be able to benefit from the new cross-border depositary services regime, as this is would only be available to depositaries in Member States. However, third country delegates of depositaries seeking to take advantage of this change may have access to business from new markets.

AIFMD II also makes technical changes to the conditions for appointment of depositaries in third countries, updating these to refer to the list of third-country jurisdictions with strategic deficiencies in their AML and CFT regimes (Annex I of Commission Delegated Regulation (EU) 2016/1675), and the EU list of non-cooperative jurisdictions for tax purposes. These changes mirror those made elsewhere in amending directive (in relation to marketing conditions).

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