

## European Commission Proposals on Asset Segregation

July 2018

The European Commission has published proposed amendments to the implementing measures under both the UCITS Directive and the AIFMD relating to the safe-keeping duties of depositaries of UCITS and alternative investment funds. The proposals aim to clarify the requirement under the UCITS Directive and Alternative Investment Fund Managers Directive that, where a depositary delegates safe-keeping functions to third parties, the assets need to be segregated at the level of the delegate.

On 12 July 2018, the European Commission ("**Commission**") published amending delegated regulations relating to the safe-keeping duties of depositaries of UCITS and alternative investment funds ("**AIFs**").

### Background

The Alternative Investment Fund Managers Directive ("**AIFMD**") and UCITS Directive require that, where a depositary delegates safe-keeping functions to third parties, the assets need to be segregated at the level of the delegate. Level 2 regulations under both the AIFMD and the UCITS Directive detail how this obligation is to be fulfilled. The Commission states in its explanatory memorandum that experience gained since the date of application of the relevant provisions of the AIFMD and UCITS Directive has shown that further clarification is needed.

The Commission proposal follows up on the [opinion](#) of ESMA on asset segregation, issued in July 2017, which followed two consultations on asset segregation and in which ESMA invited the Commission to clarify certain issues. ESMA recommended that asset segregation requirements be better defined and supplemented by additional safeguards, in particular the requirement to contractually ensure a sufficient flow of information between the depositary and the custodian / sub-custodian. ESMA also suggested strengthening the requirement to maintain accurate record-keeping and reconciliation systems, including calibrating the frequency of reconciliations to the frequency of trading activities relating to all the assets that may be kept in an omnibus account. The due diligence obligations of depositaries should be supplemented by requiring them to have a good understanding of the implications that the insolvency laws of a third country could have if safe-keeping is delegated to custodians outside the EU.

### The Commission's Proposals

The asset segregation provisions in the AIFMD and UCITS Directive had been interpreted by some as requiring separate accounts per depositary per type of fund to be created at each level of the custody chain. This proposal clarifies that assets of UCITS, AIFs and other clients can be comingled at the level of the first custodian provided that they are initially held by the same depositary (or are initially held by the same custodian where the latter further delegates the custody of assets down the custody

chain). A custodian can hold assets of UCITS or AIFs client and other clients of one depositary in the same omnibus account, provided its own assets, proprietary assets of the depositary and assets belonging to other clients of the third party are held in segregated financial instrument accounts. Therefore, custodians can use omnibus accounts to hold assets of one depositary client only.

Further clarifications concern, for example, the conditions for the frequency of reconciliation between the depositary's own financial instruments accounts, its internal records and those of the third-party custodian. This will depend on the frequency of trading by the depositary's clients. Where a custodian is based outside the EU, the depositary will also be required to obtain a legal opinion on the insolvency laws of the third country, assessing the protection provided through segregated accounts.

### Next Steps

The delegated regulations will now be considered by the European Parliament and Council of the EU.

The proposed regulation amending the AIFMD level 2 regulation may be accessed [here](#). The proposed regulation amending the UCITS Directive level 2 regulation may be accessed [here](#).

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Full details of the Asset Management and Investment Funds Group, together with further updates, articles and briefing notes written by members of the Asset Management and Investment Funds team can be accessed at [www.matheson.com](http://www.matheson.com).

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