

Thematic review on the organisation of depository activities and the consideration of sustainability information in the supervisory duties of depositories

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1 Objectives and key findings

In autumn 2024, the Financial Supervisory Authority (“FIN-FSA”) conducted a thematic review of all depositaries of UCITS funds and alternative investment funds (AIFs) (hereinafter also “investment funds”) operating in Finland. Five depositaries participated in the thematic review, three of them being branches of foreign EEA credit institutions.

The depositaries were requested to provide information on their depositary activities in terms of:

- quality and scope;
- organisation, internal control and risk management;
- compliance with obligations regarding UCITS and AIF funds;
 - planning oversight procedures for assets in safekeeping;
 - verification of subscriptions and redemptions;
 - verification of valuation;
 - monitoring of cash flows and
 - outsourcing of safekeeping duties;
- compliance with regulatory obligations related to investment funds’ sustainability risks and sustainable investment.

The objective of the thematic review was to ascertain compliance with the most important regulatory requirements. Another objective was to review the organisation of the depositaries’ activities and the sufficiency of their resources. The thematic review partly covered compliance with the same requirements as in a thematic review of depositaries conducted by the FIN-FSA in 2019.

A new focus area for this thematic review was to find out how depositaries comply with their obligations pertaining to investment funds’ sustainability risks and sustainable investment. Although regulation concerning sustainability risks as well as sustainable investment and related requirements primarily apply to UCITS management companies and alternative investment fund managers (AIFMs), they have also introduced new obligations for depositaries.

The depositary markets are centralised to a significant degree among just a few depositaries:

- According to the five depositaries subject to the thematic review they had a total of EUR 180.8 billion of investment funds’ assets in safekeeping on 30 June 2024.
- About 95% of the investment funds’ assets held in safekeeping were held by three depositaries.

- The depositaries subject to the thematic review held assets in safekeeping for 408 UCITS funds (EUR 147.1 billion) and 253 AIFs (EUR 33.6 billion).
- By comparison, the thematic review in 2019 covered 12 depositaries, which held a total of EUR 101.3 billion of UCITS funds' assets in safekeeping and EUR 19.3 billion of AIFs' assets. Many depositaries have discontinued their operation as a depositary for investment funds during the period from 2019 to 2024.

Key findings of the thematic review:

Sufficiency of personnel resources

- According to the responses received in autumn 2024 to the thematic review, all depositaries had allocated at least two person-years to depositary oversight duties in Finland. In its thematic review in 2019, the FIN-FSA paid attention to the scarcity of personnel resources, stating that a depositary relying on the oversight effort of two persons is very scarcely resourced. Depositary activities have been automated further in recent years, but according to the FIN-FSA's view, based on findings made in the 2024 thematic review, the resources continue to be low.

Planning and implementing the oversight procedures required by regulation

- Based on the submitted descriptions of oversight and oversight plans, regulation related to the oversight of UCITS and AIF funds had been specifically taken into account. However, the fund-specific characteristics were partly at a general level, and in fact not entirely fund-specific.
- Room for further improvement was found in the description of the approval process for the oversight plans, indication of the date when these plans were last updated and identification of the party responsible for the oversight.
- Based on the responses, oversight of subscriptions and redemptions for the investment funds was appropriately organised in main respects. According to its response, in one of the depositaries, the investment funds of three management companies were not covered by the oversight of subscriptions and redemptions.
- The frequency of the depositaries' oversight checks was mainly consistent with the investment funds' subscription and redemption flows.
- Based on the responses, depositaries review the regulatory compliance and effectiveness of the subscription and redemption processes of management companies and AIFMs at least on an annual basis.
- Some of the depositaries did not verify valuation at a frequency required by regulation.

- The monitoring of the investment funds' cash flows mainly took place on an automated and daily basis. One of the depositaries did not include some investment funds in the scope of automatic monitoring.

Verification and monitoring of data related to investment funds' sustainability risks and sustainable investment

- Three depositaries reported they review fund managers' processes also with respect to sustainable investment and incorporate sustainability risks in their risks assessment. However, they failed to describe how these sustainability risks are considered in the risk assessment in practice.
- Only one depositary genuinely performed verifications of sustainability/ESG data concerning the investment funds' assets.
- Based on their responses, two depositaries have not reviewed processes at all or incorporated sustainability risks in their risk assessment.
- The depositaries named the availability of sustainability-related data and unclear regulation as particular challenges.

2 Background of the thematic review

Depositaries are a key part of the infrastructure for UCITS and AIF funds, since they are responsible for safekeeping the assets placed in the investment funds. Depositaries have extensive oversight obligations concerning the assets held in safekeeping by them. Therefore, they play an important role in investor protection by ensuring that the obligations imposed on UCITS and AIF funds are complied with. Ineffective or incomplete safekeeping and oversight functions can erode investor protection and confidence in the markets. The importance of the role of depositaries is highlighted due to the intensifying instability and technological evolution on the financial markets.

The depositary markets in Finland are centralised among just a few depositaries. A depositary is a prerequisite for investment funds managed by authorised management companies and AIFMs. From the perspective of market confidence and investor protection, it is particularly important that the activities of depositaries are organised appropriately and in compliance with regulation.

In 2019, the FIN-FSA conducted a thematic review of the organisation of depositaries' activities covering 12 market participants, five of them being branches of foreign EEA credit institutions. At the time, the FIN-FSA paid attention to the scarcity of the depositaries' personnel resources, the need to develop automated systems for oversight duties related to safekeeping, and in the development of planning and implementation of oversight of subscriptions and redemptions, oversight of valuation and monitoring of cash flows.

The duties of a depositary are defined in detail in EU-level regulations and domestic legislation. Regulation has evolved and become more stringent, also extending to obligations concerning sustainability risk and sustainable investment.

As the significance of the activities of depositaries increases, the FIN-FSA finds it important to monitor and assess how depositaries are complying with regulatory requirements. In its action plan for 2024, the FIN-FSA decided to conduct a thematic review focusing on depositaries to improve the effectiveness of the ongoing supervision of depositary activities, also taking into account the recently enforced obligations concerning investment funds' sustainability risk and sustainable investment.

3 Organisation of activities

3.1 Personnel resources

3.1.1 Key regulatory requirements

Regulation requires that any UCITS or AIF fund of an authorised management company or AIFM must have a depositary located in the home country of the investment fund.

In accordance with chapter 21, section 8 of the Mutual Funds Act and chapter 15, section 1 of the AIFM Act, the activities of a depositary shall be organised in a reliable manner. The depositary shall take appropriate actions to ensure the management of risks related to its operation, the effectiveness of its internal control and the continuity of its operation under any circumstances.

A depositary may not outsource its oversight duties which are prerequisites for its depositary activities (chapter 21, section 5 of the Mutual Funds Act and chapter 15, section 5 of the AIFM Act). A depositary may outsource the safekeeping of financial instruments and other assets only if the outsourcing meets all legal requirements.

A depositary must seek to organise its activities in such a manner that any conflicts of interest are identified and prevented (chapter 21, section 9 of the Mutual Funds Act and chapter 14, section 2 of the AIFM Act).

3.1.2 FIN-FSA's findings about personnel resources

The FIN-FSA requested the depositaries to provide a description of the organisation of the depositary activities as well as personnel resources related to the depositary activities and oversight of activities. Furthermore, they were requested to provide a description of the depositary activities if these are carried out on an outsourced basis by another company and outside Finland.

Based on the responses, the depositaries' risk management was mainly resourced and controlled at the group level in line with the operating model of the three lines of defence: operational risk management within the business lines; independent risk management units and the compliance function; and internal audit. Based on the responses, no shortcomings were found in the organisation of risk management and internal control. In one of the depositaries, the most recent internal audit had been carried out in 2021.

Based on the responses, the personnel resources allocated to depositary activities varied greatly depending on the structure and organisation of the depositary or its group, and any outsourcing. The depositary activities of three depositaries functioning as branches of a foreign credit institution were in practice carried out, to a significant degree, in group units outside Finland. The personnel resources of these depositaries in Finland ranged from 2 to 4 person-years, mostly engaged in depositary oversight-related duties. The responses described the outsourcing of duties pertaining to depositary activities at the group level, including the maintenance of systems related to depositary activities and the organisation of legal affairs and the compliance function.

In the FIN-FSA's previous thematic review concerning the organisation of depositaries' activities in 2019, it was concluded that a depositary functioning with the supervisory input of less than two persons is very scarcely resourced, with a view to its numerous highly regulated duties. According to the responses to the thematic review of 2024, all depositaries had personnel resources amounting to at least two person-years.

According to the responses given to the thematic review of 2024, the management of conflicts of interest within the depositaries was organised and instructed at the group level. The FIN-FSA had no remarks to make in this regard.

3.1.3 FIN-FSA's view

Depositaries must have a number of qualified personnel in depositary duties proportionate to the nature and scale of their activities.

The reliable organisation of a depositary's activities requires that the depositary employs an adequate number of personnel conducting oversight duties belonging to the depositary on a full-time basis. To be able to guarantee the continuity of operations in all circumstances, the depositaries must also have effective deputy arrangements in place. The FIN-FSA also requires that the deputies have sufficient competencies and that potential conflicts of interest regarding their other duties are taken into consideration.

Any further centralisation of depositary activities between a smaller number of service providers in Finland entails a higher number of investment funds in custody per depositary. Based on the responses, the FIN-FSA continues to find the depositaries' personnel resources scarce. In dividing or outsourcing depositary duties to separate units or several persons, the relevant duties must be assessed as a whole in terms of the number of person-years resourced for depositary duties. The personnel resources allocated to depositary duties pertaining to different types, and a large number, of investment funds must be adequate to meet the obligations under regulation applicable to depositaries.

According to the responses, depositaries' processes regarding oversight duties have been automated further, which is unavoidable due to the nature of the duties and related volumes. However, some of the depositaries continue to have manual steps in the process, and automation continues in this respect. According to the FIN-FSA's view, an internal audit regarding depositary activities must be carried out at an adequate frequency, as a rule on an annual basis. In addition, depositaries must pay particular attention to risks related to automation.

3.2 Independence of the depositary

3.2.1 Key regulatory requirements

To prevent conflicts of interests and to ensure proportionate oversight, a depositary must be independent of the management companies whose investment funds it safekeeps.

In accordance with Article 21 of the Commission Delegated Regulation (EU) 2016/438 (hereinafter the UCITS Regulation), no person may at the same time be both a member of the management body of the management company and a member of the management body of the depositary. No person may at the same time be both a member of the management body of the management company and an employee of the depositary, and no person may be a member of the management body of the depositary and an employee of the management company.

Where a group link exists between the management company and the depositary, at least one third, or two, of the members of the board of directors (whichever is lower) shall be independent within the meaning of Article 24 of the UCITS Regulation. Where there is another body within the management company or depositary in charge of the supervisory functions than its board of directors or management body, the independence requirements apply to that body.

Regulation concerning AIFMs does not impose equally detailed independence requirements on depositaries holding AIFs' assets in custody.

3.2.2 FIN-FSA's findings about depositaries' independence

The FIN-FSA requested companies holding UCITS funds in custody to report how they fulfil the independence requirement concerning depositaries in Articles 21 and 24 of the UCITS Regulation. One of the respondents holding UCITS funds in custody had a group link with a management company whose funds it holds in custody.

Based on the responses, the FIN-FSA had nothing to remark on the independence of the depositaries.

3.2.3. FIN-FSA's view

The FIN-FSA finds the provisions on independence crucial from the perspective of the oversight role of a depositary. When making a risk assessment, attention must be paid to independence already before entering into a depositary relationship and particularly in circumstance where the depositary safekeeps investment funds of a management company belonging to the same group.

4 Depositaries' duties

4.1. Planning of oversight

4.1.1. Key regulatory requirements

Article 3(1) of the UCITS Regulation and Article 92(1) of the Commission Delegated Regulation (EU) 231/2013 (hereinafter the AIFM Regulation) require that, when entering into a customer relationship, the depositary shall assess the risks associated with the nature, scale and complexity of the investment fund's investment policy and organisation of the management company.

As regards AIFs, the depositary shall assess the AIF's strategy and risks associated with the nature, scale and complexity of the AIFM's organisation.

Depositaries' oversight procedures shall be planned based on these assessments, and the plans shall be regularly updated.

4.1.2 FIN-FSA's findings about the planning of oversight

The FIN-FSA requested depositaries to describe of their oversight work is planned and to submit the most recent oversight plan to the FIN-FSA.

Two depositaries did not submit an actual oversight plan, but only described the processes and contents of the oversight.

In the plans and descriptions of oversight, regulation concerning the oversight of UCITS and AIF funds was considered separately. One of the respondents considered fund-specific characteristics at a general level, as the investment funds were of a very similar type. Other respondents accounted for their investment funds' special characteristics in the oversight plans in more detail, with some variation.

The review frequencies implemented by the depositaries were defined by all respondents with a view to the investment funds' special characteristics, albeit at a general level by one respondent. The review frequencies were also indicated in the oversight plans submitted by three respondents. The oversight frequencies defined by two respondents in their plans were integrated in a spreadsheet for the ongoing monitoring of oversight, which is considered good practice by the FIN-FSA.

Two respondents' oversight plans indicated the most recent update of the plan. The approval process for the oversight plans was not apparent in the plans received, and some of the descriptions of oversight only contained mentions of the approval. Three of the respondents indicated the body or person responsible for the oversight duty.

4.1.3 FIN-FSA's view

Regulation requires that the oversight plan is devised based on a risk assessment prepared by the depositary. The FIN-FSA points the depositaries' attention to the fact that they may not enter into a depositary contract before assessing and documenting the risks associated with the investment fund concerned or the management company or AIFM that manages it. When a depositary decides to enter into a custody agreement, the oversight plan for each investment fund must be based on a risk assessment by the depositary. The oversight plans must reflect the special characteristics of each investment fund and the resulting oversight needs. The FIN-FSA recommends that the plans indicate how each oversight duty will be performed and the party responsible for it.

According to the FIN-FSA's view, the requirement of regular update of the oversight plans entails that the need to update the plan is reviewed with respect to each investment fund at least on an annual basis and whenever material changes take place in the operation of the investment fund. The FIN-FSA recommends that the plans indicate their date of completion, updates, and parties within the depositary that contributed to devising the plan and related decision-making.

According to the FIN-FSA's findings and view, the depositaries continue to have room for development in some aspects of planning and documenting their oversight.

4.2 Duties regarding subscriptions and redemptions

4.2.1 Key regulatory requirements

In accordance with chapter 21, section 2 of the Mutual Funds Act, it is the depositary's duty to ensure that subscriptions and redemptions of fund units are carried out in compliance with law and the rules of the investment fund. In accordance with chapter 15, section 3 of the AIFM Act, it is the depositary's duty to ensure that the sale, issue, repurchase, redemption and cancellation of units in the AIF are carried out in compliance with law and the AIF rules.

In order to perform its duties, the depositary shall verify and ensure (Article 4 of the UCITS Regulation and Article 93 of the AIFM Regulation) that:

- The number of fund units issued corresponds with subscription proceeds.
- Subscription orders are reconciled with subscription proceeds to ensure that payments made by investors have been received. Corresponding reconciliations must also be made in respect of redemptions.
- Total number of units in the investment fund's accounts and the total number of outstanding units appearing in the register are consistent.

The frequency of the depositary's checks shall be consistent with the flow of subscriptions and redemptions. In addition, the depositary shall verify the subscription and redemption processes on a regular basis.

4.2.2 FIN-FSA's findings about duties regarding subscriptions and redemptions

The FIN-FSA requested the depositaries to describe how and how often they review investment funds' subscriptions and redemptions.

The consistency of the number of outstanding fund units and subscription proceeds was verified by all depositaries with respect to almost all investment funds. The reconciliation of subscription orders and subscription proceeds as well

as similar actions for redemptions were also carried out by all depositaries with respect to almost all investment funds. The consistency of the total number of fund units in the investment fund's accounts and the total number of outstanding units appearing in the register was verified by all depositaries with respect to almost all investment funds.

According to one depositary's response, three investment funds held in custody by the depositary were not yet included in the scope of the oversight of subscriptions and redemptions.

The frequency of the depositaries' reviews was mainly consistent with the investment funds' subscription and redemption flows. Based on the responses, depositaries review the regulatory compliance and effectiveness of the subscription and redemption processes of management companies and AIFMs at least on an annual basis, typically through company visits.

4.2.3. FIN-FSA's view

Regulation obliges the depositary to plan an appropriate oversight procedure for each investment fund.

Verifications related to the oversight procedure must be conducted at a frequency consistent with the investment funds' subscription and redemption flows. According to the FIN-FSA's view, this means for example that verifications pertaining to a fund open on a daily basis must be made more frequently than those for a fund that is open once a month. According to the FIN-FSA's view, it can be considered good practice that the verifications are made as a rule every time the fund is open for subscriptions and redemptions unless there is a justified reason to derogate from this and to verify the accuracy of subscriptions and redemptions.

4.3 Duties regarding the valuation of units

4.3.1 Key regulatory requirements

Duties regarding the valuation of units are defined, with respect to AIFs, in Article 94 of the AIFM Regulation, and with respect to UCITs, in Article 5 of the UCITS Regulation.

In accordance with the abovementioned regulations, it is the depositary's duty to ensure that the net asset value of an investment fund's units is calculated in compliance with law and the rules of the investment fund.

To fulfil this requirement, the depositary must take appropriate actions to ensure the appropriate valuation of the investment fund's assets either by performing

sample checks or comparing the change of the investment fund's net asset value (NAV) to the change of the value of its benchmark. The frequency of the verifications performed by the depositary must be consistent with the NAV calculation frequency of the investment fund.

In addition, the depositary must verify the subscription and redemption processes of the investment fund on a regular basis.

4.3.2 FIN-FSA's findings about duties regarding the valuation of units

The FIN-FSA requested the depositaries to describe how and how often they verify the valuation of investment funds' assets. The valuation of assets was reviewed separately with respect to UCITS and AIF funds.

As regards UCITS funds, four depositaries stated they verify investment funds' valuation by comparing the values reported by the investment fund to their own data or external service providers' data. Some of the depositaries described asset valuation at a more detailed level in contrast with other depositaries whose description was at a more generic level. One of the depositaries did not have any UCITS funds in safekeeping.

As regards UCITS funds, two depositaries stated they verify asset valuation once a month. One of the depositaries stated it monitors fund NAVs on a daily basis but verifies valuation against its own data or data from an external service provider on a quarterly basis. One of the depositaries stated it verifies valuation on a semi-annual basis.

As regards the verification of valuation for AIFs, three depositaries stated they compare data held by the depositary to data reported by the AIF. One of the companies responded to the question on a fund-specific basis: for one investment fund, it relied on external valuers employed by the management company, and for two funds, it verified valuation through spot checks. In addition, the company stated it performs other actions related to the verification of valuation on a regular basis.

As regards the frequency of verification of the valuation of AIFs, one of the depositaries stated it verifies the valuation of assets as a rule on a quarterly basis, and another depositary stated it does so on a semi-annual basis. One depositary also stated it verifies asset valuation on a semi-annual basis, but with respect to certain assets and investment funds, it verifies valuation more frequently.¹ One depositary did not respond how frequently it verifies the valuation of AIFs.

¹ In addition, the depositaries had such AIFs in custody whose value was determined for example once a year. As regards these funds, the valuation of the assets was verified by the depositaries on an annual basis.

In addition, all of the depositaries stated they review the valuation processes of the management companies or AIFMs on an annual basis. Some of the depositaries described the contents of the annual reviews in more detail than others.

4.3.3 FIN-FSA's view

Regulation requires that valuation is verified at a frequency consistent with the investment fund's valuation frequency. However, regulation does not require that such verifications are made on a daily basis, in contrast with the requirement concerning the monitoring of cash flows (see section 4.4). Therefore, the FIN-FSA does not find it necessary to perform verifications of valuation as often as the NAV of the investment fund is calculated.

If valuation is verified less frequently, the depositaries must have a justification based on the assessment of the risks of the investment fund. The justification must be documented for example in the oversight plan. However, a risk-based approach cannot justify a less frequent verification of the valuation of investment funds than the valuation frequency.

Based on the responses to the thematic review, the FIN-FSA was unable to ascertain that all depositaries verify the valuation of assets at a frequency required by regulation. According to the FIN-FSA's view, less frequent than monthly verification of the valuation of investment funds that are open daily is not sufficient. Correspondingly, semi-annual verification of valuation is inadequate for AIFs that are open monthly.

The FIN-FSA also emphasises that depositaries must review investment funds' valuation policies and procedures as required by regulation.

4.4 Duties regarding the monitoring of cash flows

4.4.1 Key regulatory requirements

Duties regarding the monitoring of cash flows are defined, with respect to AIFs, in Article 86 of the AIFM Regulation, and with respect to UCITs, in Article 10 of the UCITS Regulation.

The depositary must ensure that the investment fund's cash flows are monitored appropriately and that the subscription proceeds have been received and the fund's cash assets have been booked in cash accounts.

To perform the cash flow monitoring duty, the depositary must, among other things, reconcile the investment fund's cash flows on a daily basis or whenever cash flow movements take place, if more seldom.

The depositary must review the process on a regular basis and assess the outcomes of the reconciliations and the actions taken as a result.

4.4.2 FIN-FSA's findings about duties regarding the monitoring of cash flows

The FIN-FSA requested the depositaries to describe how and how often they reconcile UCITS funds' cash flows. Three of the depositaries had an automatic system for the reconciliations. One depositary had a mainly automated cash flow monitoring in place, but it did not include all investment funds in the scope of the automatic cash flow monitoring.

Three depositaries monitored cash flows on a daily basis. One depositary mainly relied on daily cash flow monitoring, but the automatic cash flow monitoring did not include all investment funds held in custody.

Based on the responses given to the thematic review, the quality and extent of the automatic cash flow monitoring could not be verified.

4.4.3 FIN-FSA's view

Depositaries must have systems and procedures in place to reconcile investment funds' cash flows on a daily basis. The procedures must be appropriate, and the nature, scale and complexity of the funds must be taken into consideration when devising and implementing these procedures. The reconciliation of cash flows means that each individual transaction booked in an account is matched with the bookkeeping of the investment fund. The reconciliation of balances or spot checks are not enough to satisfy the requirement of cash flow reconciliation, but according to regulation, the accuracy of cash flows must be verified completely.

The FIN-FSA notes that regulation requires depositaries to reconcile cash flows on a daily basis. Where an investment fund does not have daily transactions, the reconciliation must be made whenever there are cash flow movements. Hence, for example, monthly reconciliation is insufficient if the fund has cash flows more frequently than once a month.

4.5 Documentation of oversight findings

4.5.1 Key regulatory requirements

In accordance with chapter 21, section 1 of the Mutual Funds Act, a depositary keeping UCITS funds in custody shall perform its duties with diligence, independence and skill in the best interests of the investment fund and its unitholders. In accordance with chapter 15, section 1 of the AIFM Act, a depositary

keeping AIF funds in custody shall perform its duties independently, honestly, equally and professionally for the benefit of the AIF and the investors.

4.5.2 FIN-FSA's findings about the documentation of oversight findings

The FIN-FSA requested the depositaries to report in their response any findings made in the period from 1 January 2023 to 30 June 2024 concerning the oversight of subscriptions and redemptions, oversight of valuations and the reconciliation of cash flows. They were requested to report the number of findings by investment fund and provide examples of key findings and the actions taken by the depositary due to the findings.

In the responses, one of the depositaries reported all oversight findings made without breaking them down into significant and less significant ones by investment fund, with respect to all three categories.

Two respondents reported that they had not made any significant oversight findings during the period. Furthermore, the respondents made reference to having made daily checks with the management companies and AIFMs in connection with less significant uncertainties and deviations. Another respondent also provided lists of minor daily uncertainties that had required more detailed examination.

Two respondents reported one significant oversight finding during the period, one of which also made reference to the examination of minor daily uncertainties and deviations.

In their responses, the depositaries described their oversight processes and actions pertaining to deviations. Two depositaries also submitted in their response examples of deviation monitoring reports maintained based on oversight findings.

4.5.3 FIN-FSA's view

In the FIN-FSA's view, the documentation of oversight findings is a prerequisite for the appropriate and effective performance of the oversight duty. The documentation of oversight findings is fund-specific and also indicates circumstances where there are no oversight findings for an investment fund.

The FIN-FSA requires that if the reviews and verifications performed by the depositary do not generate any findings, the depositary must always ensure that its oversight methods are sufficient.

5 Depositaries' obligations regarding sustainability risks and sustainable investment

5.1 Key regulatory requirements

In accordance with chapter 21, section 2, subsection 1, paragraph 3 of the Mutual Funds Act:

It is the depositary's duty to carry out the assignments given to it by the management company unless they are contrary to this Act or another Act applicable to the activity of the management company, or the rules of the investment fund.

In accordance with chapter 15, section 3, subsection 2, paragraph 3 of the AIFM Act:

In addition, the depositary shall ensure the instructions given by the AIFM are carried out, unless they conflict with law, official regulations or the AIF rules.

In accordance with Article 3, paragraph 1 of the UCITS Regulation:

At the time of its appointment, a depositary shall assess the risks associated with the nature, scale and complexity of the investment policy and strategy of the UCITS and with the organisation of the management company or the investment company. On the basis of that assessment, the depositary shall devise oversight procedures which are appropriate to the UCITS and the assets in which it invests, and then implement and apply these procedures. Those procedures shall be regularly updated.

In accordance with Article 6:

A depositary shall be deemed to comply with the requirements set out in point (c) of Article 22(3) of Directive 2009/65/EC where it establishes and implements at least:

- a) appropriate procedures to verify that instructions of the management company or the investment company comply with applicable laws and regulations and with the UCITS' rules and instruments of incorporation;
- b) an escalation procedure where the UCITS has breached one of the limits or restrictions referred to in second subparagraph.

For the purposes of point (a), the depositary shall in particular monitor the UCITS' compliance with investment restrictions and leverage limits to which the UCITS is subject. The procedures referred to in point (a) above shall be proportionate to the nature, scale and complexity of the UCITS.

In accordance with Article 92, paragraph 1 of the AIFM Regulation:

At the time of its appointment, the depositary shall assess the risks associated with the nature, scale and complexity of the AIF's strategy and the AIFM's organisation in order to devise oversight procedures which are appropriate to the AIF and the assets in which it invests, and which are then implemented and applied. Such procedures shall be regularly updated.

In accordance with Article 95:

In order to comply with point (c) of Article 21(9) of Directive 2011/61/EU, the depositary shall at least:

- a) set up and implement appropriate procedures to verify that the AIF and AIFM comply with applicable laws and regulations and with the AIF's rules and instruments of incorporation. In particular, the depositary shall monitor the AIF's compliance with investment restrictions and leverage limits set in the AIF's offering documents. Those procedures shall be proportionate to the nature, scale and complexity of the AIF;
- b) set up and implement an escalation procedure where the AIF has breached one of the limits or restrictions referred to in point (a).

5.2. FIN-FSA's findings about obligations regarding sustainability risks and sustainable investment

In the thematic review, the FIN-FSA inquired the depositaries how they consider sustainability risks and sustainable investment in providing depositary services.

Three depositaries responded that they review the fund manager's sustainable investment process in connection with verifying that the investment funds and the fund manager comply with applicable laws, regulations and fund rules. Two depositaries reported they review the processes and policies of the investment fund to ensure that the fund operates in compliance with applicable regulation. One of the depositaries reported it requests the fund manager to confirm the investment fund's "ESG category" and whether the investment fund has complied with its investment restrictions. One of the depositaries reported it assesses the capability of the fund manager to comply with regulation through a survey. One

depositary also stated it included ESG-related investment restrictions as part of the control of investment restrictions where enabled by automatic monitoring. All three depositaries reported they review the fund managers' processes on an annual basis as part of the due diligence review.

Three depositaries responded they assess sustainability risks as part of the investment funds' risk assessments. One of the depositaries responded that their oversight procedures for sustainability risks are fully identical to the oversight of the sustainable investment process, and therefore the depositary's response does not indicate how sustainability risks are actually being controlled and how it differs from the oversight of the investment process. Two depositaries responded that they consider sustainability risks as part of the assessment of other risks and oversee risks line with the risk assessment, but their responses did not indicate how the sustainability risks are actually being overseen.

Two depositaries reported that they confirm, with respect to SFDR Article 8 and 9 funds that the sustainability/ESG data for each investment fund are consistent with the investment policy. As an example of these checks, however, the depositaries only described the process reviews of the fund managers that they had already mentioned previously and which are carried out, as a rule, on an annual basis. Based on the responses, these depositaries did not perform checks of sustainability/ESG data concerning the investment funds' assets.

One depositary stated it oversees compliance with restrictions based on fund documentation, including those based on the SFDR and related regulation. According to the depositary, it performs oversight to the extent enabled by automatic monitoring. The depositary reported performing oversight based on the NAV calculation frequency of the investment fund. According to the depositary, oversight is based on exclusion/inclusion lists provided by the fund manager.

In contrast to three other depositaries, two depositaries responded they do not perform checks referred to above or review or oversee sustainability risks related to investment funds. However, both depositaries had identified the oversight of sustainability/ESG factors and risks as a development area. Neither of these depositaries had set a deadline for the roll-out of the oversight. However, one of them had a plan to include in its reviews in the second half of 2024 how ESG restrictions are considered in investment decisions by the investment fund's portfolio manager.

As regards ESG oversight, the depositaries highlighted the importance of guidance by authorities in the prevailing somewhat unclear regulatory situation. One depositary stated it follows guidance by the FIN-FSA and ESMA about whether it should oversee something else besides the management company's compliance

with the processes. Three depositaries found the regulation and guidance by authorities unclear. One of the depositaries found it particularly unclear what kind of reviews of sustainability/ESG factors it should perform because sustainability/ESG factors and restrictions are not typically included in investment funds' rules and instruments of incorporation. According to the depositary, the inclusion of other document and processes would cause a significant administrative burden to the depositary. Requirements concerning reviews of the minimum share of sustainable investments were found particularly unclear by the depositary, on account of different definitions of sustainable investments and restrictions concerning disclosures on the Taxonomy alignment of investments. One depositary found the availability of data used in the reviews a challenge. This depositary was the only one of the five that actually performed sustainability/ESG reviews of the investment funds' assets. Another depositary also saw a challenge in the reliability of market data.

None of the depositaries had been in contact with the fund managers about findings made by the depositary in the context of sustainability/ESG review of the investment funds' assets.

5.3 FIN-FSA's view

Article 3(1) of the UCITS Regulation and Article 92(1) of the AIFM Regulation requires depositaries to assess the risks associated with each investment fund and devise appropriate oversight procedures. Regulation does not define in more detail the risks that must be reviewed by the depositary. According to the FIN-FSA's view, the depositary must also assess sustainability risks associated with each fund for which it functions as depositary. The risk assessment should also consider any reviews of the impacts of sustainability risks carried out by the fund manager itself as required by regulation.

Appropriate oversight procedures for sustainability risks depend on the sustainability risks concerned. According to the FIN-FSA's view, depositaries must at least assess the fund managers' processes related to sustainability risks and sustainable investment as part of their oversight procedures on a regular basis.

Article 6 of the UCITS Regulation and Article 95 of the AIFM Regulation require depositaries to oversee the investment of investment funds' assets. Depositaries must see that the investment funds' assets are invested in compliance with applicable investment restrictions.

At present, investment funds have a varying degree of restrictions concerning sustainable investment in their rules. Many investment funds apply exclusion methods in their investment operations, which means the exclusion of companies

operating, for example, in a given sector from the investment strategy of the investment fund.

For the time being, there exists no detailed European guidance or interpretations about the monitoring of sustainable investment restrictions for investment funds. Depositaries must oversee that investment funds' actual investment activities are consistent with the descriptions presented in the documentation for those funds. According to the FIN-FSA's view, depositaries must at least monitor all investment restrictions laid down in the rules of the investment fund. The European Securities and Markets authority ("ESMA") has also stated in its supervisory briefing of 31 May 2022,² that depositaries shall monitor all ESG-related investment restrictions.

In the same publication, ESMA also stated that depositaries must receive adequate information from fund managers to perform their regulatory obligations. This also applies to information enabling depositaries to monitor ESG-related investment restrictions.

In addition, the FIN FSA reminds depositaries of ESMA's new guidelines on funds' names, which began to be applied on 21 November 2024. The FIN-FSA has published a supervision release on the guidelines³.

The guidelines apply to investment funds and alternative funds whose names include a term related to transition, society and governance, environment or impacts/influence (ESG) or a term related to sustainability. In the opinion of the FIN-FSA, the investment restrictions according to the guidelines are mandatory restrictions that must be described in the fund rules.

The guidelines on funds' names may also affect the supervision performed by custodians when the guidelines cause changes to the rules of several funds. When the investment restrictions according to the guidelines are described in the rules, custodians must also supervise compliance with these limits.

² ESMA 34-45-1427, paragraph 46.

³ [FIN-FSA Supervision release 1 October 2024 – 60/2024](#)

6 Provision of depositary services to different kinds of investment funds

6.1 FIN-FSA's findings about the provision of depositary services

In the thematic review, the FIN-FSA asked the depositaries to what kind of investment funds or fund managers they provide depositary services; what the selection criteria are; whether the depositaries have different service model, what kind of future development plans they have, and which risks they have identified in the depositary business.

All depositaries responded they regard the asset class of the investments to be held in custody as the main factor in deciding to which investment funds or managers they will provide depositary services. One of the depositaries responded it does not, as a rule, provide depositary services to investment funds or fund managers falling below certain thresholds in terms of assets under management (AUM). One depositary responded it only provides depositary services to a fund manager belonging to the same group.

Three depositaries responded they assess the characteristics of the fund manager, such as authorisation and whether it is a well-established market participant as well as its level of know your customer (KYC)/anti-money laundering (AML) controls and resources.

Three depositaries responded they consider in particular whether the financial instruments to be held in custody can be booked in the depositary's financial instrument accounts. One depositary also responded it does not keep custody of physical commodities or instruments located in countries where valuation or the verification of ownership involves particular risks.

According to their responses, none of the depositaries provides depositary services for crypto-assets. Two depositaries responded they are able to provide services for indirect crypto-asset investments, where the underlying of the instrument is a crypto-asset and the instruments are in a book-entry form and listed on a marketplace. One depositary found the regulatory requirements for these instruments unclear and that their possible custody requires development.

Based on their responses, none of the depositaries offer depositary contracts with different main structure.

As regards their development plans for depositary services, the depositaries mainly highlighted responding to customer needs and internal systems development.

The main risks and challenges for depositary activities highlighted by the depositaries included alternative investments and related manual actions, including ELTIF funds and new obligations related to sustainable investment.

6.2 FIN-FSA's view

The FIN-FSA highlights that depositaries must ascertain, before entering into a customer relationship, that they are able to fulfil their regulatory obligations concerning specifically the investment fund in question. In making these assurances, it may be advisable to pay particular attention to the characteristics of the investment fund's investments and the fund's other characteristics.

The assurances must be made diligently in advance also for the reason that, from the perspective of investor protection, the depositary has a significant oversight role. If it turns out later that the depositary is unable to fulfil its obligation, replacing the depositary may be very challenging.

Depositaries must obtain adequate information from fund managers to perform their regulatory obligations.

If a depositary provides depositary service solutions with different contents, the FIN-FSA requires that the depositary always meets the regulatory minimum requirements in the provision of services. For example, the frequency of various reviews and verifications performed by the depositary must be defined in such a way that they fulfil regulatory requirements and are commensurate with the characteristics of the investment fund.

7 Subsequent actions

The FIN-FSA requires that the board of directors or another comparable body deemed appropriate by the depositary discusses this thematic review report and the findings of a depositary-specific supervision letter to be sent separately to each depositary. The minutes of the meeting of the board of directors or report by a comparable body must indicate the conclusions drawn about the report and supervision letter, which actions the depositary intends to take as well as the schedule in which the actions will have been completed.

Thematic review on the organisation of depositary activities and the consideration of sustainability information in the supervisory duties of depositaries

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After receiving the reports from the depositaries, the FIN-FSA will monitor the effectiveness of remedial actions taken by the depositaries. The FIN-FSA will also consider potential depositary-specific follow-up actions.

In addition, the FIN-FSA will review the outcomes and findings of the ESMA Peer Review regarding depositary activities and any interpretations concerning obligations related to depositary activities.