6. Specific thematic article: Targeted Supervision further maturing in 2023 with a proper assessment of restitution risk

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Custodian banks are licensed as credit institutions under Article 4(1) of the Capital Requirements Regulation as they collect deposits from their clients and grant (mostly intraday) credit for operational purposes. Yet, they offer far fewer traditional banking services like loan origination or maturity transformation. Instead, as their name implies, custodians hold and service assets under custody from their clients. This specific business model brings its own risk profile. Despite the differences, custodian banks are subject to same prudential requirements as all other licensed credit institutions under the CRD/CRR. The SSM will accordingly monitor compliance with these requirements, with the objective of ensuring equal treatment of all supervised institutions in a level playing field perspective.

However, making sure of this level playing field and equal treatment of all supervised institutions, requires not only a standardised methodology to be applied, but also account to be taken of the specific risks an institution may face owing to their specific business model or environment. The Bank has accordingly raised awareness and contributed to developing a specific methodology to assess restitution risk within the relevant SSM working groups.

Restitution risk was introduced by the Alternative Investment Fund Managers Directive (AIFMD) and the Undertakings for Collective Investments in Transferable Securities Directive (UCITS)[1]. These Directives, dating from more than a decade ago, both introduce the so-called restitution liability. Depositories are liable to fund any loss of financial instruments held in custody. Delegation of the safeguarding duties to a third party has no impact on the liability unless certain conditions have been met or when a contract expressly transfers the liability. Legislation also further clarifies that credit institutions are not liable in all circumstances. The depositories are not liable when they can prove that the loss has arisen as a result of an external event beyond reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts.

The Directives set out precisely all aspects related to the liability, such as when a loss is deemed to have taken place and how such a loss shall be ascertained by the fund manager. Also, more precise definitions of what constitutes *external events* and what triggers an event to be *beyond reasonable control* are provided.

Custodian banks safeguard the lion's share of all assets held under custody, yet not all of them. So, they are not the only credit institutions to which these Directives apply. Among other credit institutions impacted by this legislation are some of the larger European universal banks. Also, depositories are not liable to 'restitute' all

1 These Directives set out a clear framework for the regulation and supervision of European fund classes and thus ensure greater investor protection.

assets they hold in custody. Only those assets, or more precisely funds, that are subject to the AIFMD and UCITS have to be compensated when lost.

The CRR, the Regulation defining the scope and methodology for determining the capital requirements for all licensed credit institutions, currently does not cover restitution risk and does not provide any methodology to determine the corresponding capital charge. So, credit institutions often cannot prove that they hold (adequate) capital to cover their exposure to restitution risk.

In 2022, the National Bank helped the SSM raise awareness of restitution risk within the appropriate working groups. By 2023, all credit institutions will have been advised to consider that risk – wherever relevant – in their internal capital requirement calculations. Based on these calculations, a dedicated horizontal assessment of the risk should be carried out for the first time in 2023. Targeted supervision, which enables JSTs to better focus on those risks which contribute to credit institutions' risk profiles is further maturing this year.