

AIFMD – Cash monitoring & oversight

Directive 2011/61/EU on Alternative Fund Managers (AIFMD) includes a number of requirements to monitoring cash movements in relation to assets of alternative investment funds (AIFs) and oversight of AIF activities connected to cash movements.

Cash monitoring

Depositories are under a duty to ensure that cash flows into and out of an AIF, or through its manager (AIFM), are properly monitored and all payments made by or on behalf of investors for subscriptions of units or shares of an AIF are received and booked in appropriately designated cash accounts at a central bank, an EU-authorised bank or a non-EU authorised bank.

Cash monitoring is not the same as ownership verification and record keeping for "other assets", which includes cash. The duties under cash monitoring are more extensive and the depository takes an active role in the monitoring of cash movements to ensure their legitimacy and it does not just verify and keep a record of such movements. The main aspects of cash monitoring are that a depository:

1. is informed by the AIF or AIFM about any existing cash accounts or new cash accounts opened in connection with the AIF;
2. ensures that cash of an AIF is booked in appropriate cash accounts;
3. implements policies to reconcile cash flows;
4. reviews the adequacy of its and the AIF's or AIFM's cash reconciliation policies;
5. monitors reconciliations and notifies irregularities to the AIF, AIFM and regulators; and

6. checks the consistency of its own records of cash positions against those of the AIF or AIFM.

Information requirements

Since the depository may not be the exclusive bank where all of the cash related to an AIF is held, it is necessary that the depository has the appropriate information to ensure it can carry out its cash monitoring duties.

Obligation on AIFM to provide information

The AIFM must ensure that the depository is provided with all relevant information that it needs to conduct its cash monitoring duties.

The types of information necessary for the depository to be able to perform its cash monitoring duties include:

- the details of all existing cash accounts opened in the name of the AIF or its manager on the AIF's behalf;
- the details of any new cash account opened by the AIF or AIFM on the AIF's behalf; and
- all information related to the cash accounts opened at third party entities directly by those third parties.

The first two of these information requirements are within the control of the AIF or AIFM; however, the third information requirement is in connection with third parties with no relationship with the depository. Therefore, AIFs and AIFMs will need

to be able to ensure that third party banks are capable of providing information directly to depositories – and are instructed to do so, where necessary.

Monitoring cash flows

The requirement to monitor the AIF's cash flows is in relation to all cash coming into or going out of the AIF's or AIFM's control. This means that a depository will have to ensure that all cash of an AIF, from whatever source, is booked into an account at a central bank, an EU authorised bank or a

Key issues

- Cash monitoring is an active duty on depositories to ensure that money flowing into and out of an AIF is legitimate and is different from ownership verification duties for "other assets".
- Reconciliations of cash movements will need to ensure that cash entering or leaving an account matches the value of the assets or services bought or sold.
- Oversight duties will require depositories to verify the correct handling of subscriptions and redemptions, the valuation of shares or units in an AIF, the timely settlement of transactions and the distribution of an AIF's income.

non-EU authorised bank as well as develop procedures to reconcile cash flows daily and check the consistency of its own records against those of the AIFM.

Reconciliations

It will be necessary to perform reconciliations daily, or in the case of infrequent cash movements, when such cash movements occur. A reconciliation is a process used to compare two sets of records to ensure the figures are in agreement and are accurate and whether the money leaving an account matches the amount spent (e.g. for buying a financial instrument), ensuring that the two values are balanced.

If cash flows are identified as inconsistent with the AIF's operations, this should be raised with the AIF or the AIFM and potentially competent regulators if the depositary is not satisfied that such movements are legitimate.

Adequacy

Depositaries have a duty to review the adequacy of cash monitoring procedures periodically. This is to ensure that both the reconciliation procedure is performing adequately and to ensure that the AIF or AIFM is disclosing all the necessary information.

Oversight of AIFs

Depositaries are required to assess the risks associated with the nature, scale and complexity of the AIF's strategy and the AIFM's organisation. This is to develop general oversight procedures which are appropriate for the AIF and the assets in which the AIF or AIFM invests. A key component of such an assessment will be to understand how cash will flow to and from the AIF in light of the AIF's or AIFM's strategy and operational procedures.

Subscriptions and redemptions

While a depositary has no obligation to actively manage the subscriptions and redemptions of an AIF, it must ensure that the cash being received from subscriptions and paid out in redemptions is handled correctly. A depositary should verify that the AIF's or AIFM's procedures relating to such subscriptions and redemptions are carried out in accordance with relevant laws and the rules of the AIF in question, and verify that the AIF's or AIFM's procedures have been implemented effectively.

Depositaries must be able to check the consistency between the total number of units or shares in the AIF's or AIFM's accounts and the total number of outstanding units or shares that appear in the AIF's register on a regular basis.

Valuation of shares/units

The AIFMD does not place an obligation on depositaries to undertake the valuation of shares/units of an AIF itself. However, the AIFMD does require depositaries to ensure that the valuations performed by or on behalf of the AIFM are calculated in accordance with applicable national law, the AIF's rules or instruments of incorporation and the AIFM's valuation obligations under the AIFMD.

Depositaries must ensure that appropriate valuation policies and procedures are effectively implemented by the AIFM "through the performance of sample checks or by comparing the consistency of the change in the NAV calculation over time with that of a benchmark".

Timely settlement of transactions

Depositaries should be in a position to detect any situation where consideration related to the assets of the AIF is not remitted within usual time limits. This will involve monitoring of cash settlement of transactions in order to ensure that

cash is being made available in line with the liquidation horizon for relevant financial instruments

Income distributions

Depositaries must ensure that net income calculations and income distributions (including dividends), once declared by the AIFM, are applied in accordance with the AIF's rules and applicable laws. Depositaries will also need to consider what remedial actions should be taken in the event that income is distributed incorrectly, including reporting this to regulators.

Escalation processes

The cash management and oversight procedures make reference to depositaries having clear and comprehensive escalation procedures. These will need to be developed and agreed with AIFs and AIFMs. Ultimately, the aim of escalation procedures is to ensure that investors are protected from inappropriate or incorrect cash movements and that any irregularities are resolved.

The AIFMD does provide that, if a depositary is not satisfied through escalation procedures that cash movements and oversight have addressed issues satisfactorily, then such details shall be made available to regulators upon request.

This briefing paper is part of a series of five papers which summarise key issues that the AGC has been considering in relation to the AIFMD.