

Multi-Fund Portals in a Volatile and Changing World

by Justin Meadows, Head of Business Development, MyTreasury

It's been an exciting year in many areas of financial services as wave after wave of the fallout from each successive bank failure has rushed then rippled out across almost every area of the financial world. Within this broader context the progress of institutional money market funds has been relatively serene, despite the Lehmans' failure and subsequent Reserve Fund breaking the buck triggering an exodus from funds in the US. But even though MMFs have escaped relatively lightly, the experience of the industry during these turbulent times and in the changed world that has emerged on the other side has raised a number of questions regarding the role that portals do and should play in the MMF marketplace.

All portals are not the same

To explore this issue fully it's important to understand how portals work and the similarities and differences between their underlying models. In the same way that not all triple-A rated MMFs are the same, neither are all portals. There are actually fundamental differences between them which impact significantly on the effect they can and do have on the industry, particularly in times of turbulence and change. Since portals were first introduced there has often been a lack of clarity in the minds of many users about just how they work, and there has been no guidance published to help them understand clearly what the various models are, how they differ and their relative costs and benefits. So before

reviewing the potential impact of portals it's helpful to explain briefly how the models vary and why this makes a difference.

Whose client is it?

The basic distinction to be made is whether an investor has an account directly with the fund provider or with the portal provider, who then trades with the funds on behalf of the investor. The first of these is normally referred to as fully disclosed and the second as omnibus trading. Unfortunately, this terminology has given rise to a lack of transparency about exactly what model particular portals are using, sometimes as a result of the confusing use of these terms by the portal providers themselves.

Rather than fully disclosed it's probably easier to use the term direct. If a portal offers a direct trading model then it's clear that investors are clients of the fund providers and use the portal as a quick and effective means of trading with their selected funds. Investors open accounts directly with the funds and not with the portal provider. All direct portals are by definition fully disclosed and settlement takes place directly between the investor and the fund.

This contrasts sharply with the omnibus trading model when investors open an account with the portal, which then trades with the funds on their behalf on a nominee basis. This can be done either on a disclosed or undisclosed basis. If it is

disclosed then the portal will open a new nominee account in the name of the investor. Although this is frequently referred to as a fully disclosed model by omnibus portal providers, investors need to understand clearly that this is not the same as the direct model. The account may have their name somewhere in it but the account belongs to the portal provider not the investor; something investors have not always fully understood. The investor is a client of the portal not the fund and has only the beneficial ownership of any shares purchased through the portal, not the legal title. For some investors all this is an administrative convenience they are happy to live with. For others it gives rise to fundamental issues that prevent them from using omnibus portals.

And finally, just to make things more complicated, investors need to be even more careful about the terminology used as some omnibus portals use the term direct prominently in their promotional material. But the use of the term direct here refers to the settlement of trades. Before major issues arose with the use of third-party clearing agents, omnibus portals would typically settle trades through one of these. In fact this was always one of the major benefits of omnibus portals that helped to offset the loss of a direct relationship with the fund. However, following the well-publicised failure of one of these clearing agents, investors have become extremely reluctant to have their funds transferred via a third party and the omnibus portals have

responded by introducing a 'direct' model. But it should be clearly understood that the term direct here refers to settlement and not the investment relationship.

Why does it matter?

The major significance of the distinction between the direct and omnibus portal models is the level of granularity of investment decision making. With direct portals investment decision-making remains unambiguously in the hands of individual investors. With omnibus trading platforms this is not necessarily the case as the portal providers can make or influence investment decisions on behalf of their clients. This inevitably increases market volatility as a decision to go into or come out of a particular fund will not just relate to one investor but to all investors in that fund who use the portal, leading to potentially large swings in assets under management (AUM), which will obviously impact negatively on fund performance.

In the case of money being pulled out of a fund the problem is further compounded by the fact that the funds do not have a direct relationship with the investor and may not even know who they are when the omnibus trading is on an undisclosed basis. This means that the fund is not in a position to discuss any concerns directly with an investor and provide them with up-to-date and accurate information, sometimes to counter frequently ill-founded rumours that circulate from time to time.

The implications of this could be seen quite clearly in the US at the time of the Lehman's failure when very substantial sums were pulled from US funds in a short time via omnibus platforms. This was in sharp contrast to our own experience at MyTreasury as a direct, fully disclosed portal. None of our clients pulled all their money out of any fund. Only one client redeemed more than they invested in the month following the failure and all clients invested into at least one of their funds within three weeks. In combination this

behaviour actually led to an increase of just over 20% in the total assets under management on the portal, although some of this was due to new clients coming on board.

Although MyTreasury had a relatively small, although rapidly growing, share of total AUM the available evidence does suggest that when investment decision making is left with individual investors there is no increase in volatility simply from the use of portals. It is when omnibus trading is introduced into the equation that portals appear highly likely to cause this.

What do treasurers want?

In the post-Lehman world MMF portals are rapidly becoming more popular for a number of reasons, mostly related to the need for increased transparency and improved efficiency in the face of ever more cost and resourcing pressures.

Treasurers want to be more informed. In a rapidly changing market they want to be able to get an up-to-date, broad and deep understanding of the market place quickly and easily. One of the complaints against MMFs in the past has been the difficulties investors face in performing initial and ongoing due diligence on the funds they use or might use. One of the major benefits of good portals, such as MyTreasury, is that they bring together all the up-to-date data and documentation for all funds in a single place. Treasurers can find all the information they need including fund size, gross and net yields for each share class, weighted average maturities and portfolio composition. They can also access directly on the portal all the official fund documentation, including published portfolio

holdings and monthly fund fact sheets, without having to play detective and find this on each fund's own website. Transparency is the key and it is very difficult to achieve this in a dynamic world without portal support.

Treasurers also want easy and secure trading. It is not unfair to say that trading with MMFs, particularly outside the US, is still in the Dark Ages with billions being traded every day by phone or fax. Compared to electronic trading this is a time-consuming and highly non-secure operation. As treasurers have become more used to electronic trading in many other aspects of their daily activities they have become increasingly intolerant of relying on smudged faxes and misheard telephone calls as the basis of completing frequently very large investments and redemptions.

Treasurers are increasingly being asked to track and report their investments to senior management in more detail and with greater frequency. This has resulted in the reporting function turning into even more of an overhead than it was already and rapidly becoming unsustainable without the support of the kind of effective reporting tools that portals can provide. It is probably not unfair to say that this functionality has allowed some investors to provide the required level of transparency of fund performance and risk to allow them to remain invested in funds which they might otherwise have been required to leave.

Increasingly there have been two further drivers that have pushed treasurers in the direction of fund portals. Not surprisingly the first of these is risk management.

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Treasurers are looking to portals to help them manage the whole range of risks they face during the investment process. MyTreasury, for example, has in-built functionality to allow trading limits to be set at individual trader level and for second signatories to be introduced for all trades or just those above a certain value. Treasury policies such as maximum allowed percentage or value holdings in particular funds can also be captured by the platform and any trade which breaches these policies immediately raises a warning to the trader concerned. The platform can be set up to block any trade that breaches these limits or to allow the trader to override the warning and proceed with the trade as normal. Or it can trigger the need for senior level sign-off of the trade. These kinds of in-built risk and compliance management tools are seen as a major benefit by treasurers.

The other more recent driver is that of automation. As treasurers increasingly have to deliver more and more services with less and less resources it is inevitable that the issue of automation has come increasingly into the spotlight. There has been a noticeable increase in the number of organisations implementing treasury management systems for the first time or upgrading existing systems. Integration is the key to delivering automation and

portals will not be able to meet the needs of treasurers unless they provide full end to end straight through processing (STP) from initial trade request to settlement. And they will have to do this independently of the organisations and systems involved in the trade execution and settlement process. In this environment it is not surprising that SWIFT is seen as an important component of the solution by an increasing number of organisations. There are now over 400 registered corporate members of SWIFT and many more are currently looking at the benefits of signing up, precisely because it provides the level of flexibility required to handle automation in a complex world. MyTreasury has taken advantage of these developments and is the only platform to offer fully automated trading with fund providers and has used the SWIFT infrastructure to achieve this quickly and efficiently.

What have we learnt?

It has become increasingly clear during the last year that treasurers want to use portals. A substantial proportion of multi-fund users either already use a portal or are in the process of implementing one. The position is similar to that in the FX market about three to four years ago when FX portals hit critical mass and their use mushroomed across many treasury operations. Multi-fund platforms have now reached a similar position and there has been a rapid expansion in their use in the last year, particularly in the UK and increas-

ingly across the rest of Europe.

Treasurers want portals to inform and support their activities allowing them to get the most out of the resources available. But care needs to be taken to ensure that they do not stray into areas where they do not belong. Portals are there to support informed decision-making but they are not there to remove the responsibility of treasurers for making investment decisions. This is not a concern with direct portals where the investment decision clearly remains with treasurer, but it is a concern with omnibus portals where there is the possibility of investors abdicating responsibility and allowing the portal to make investment decisions on their behalf. Not only are portal providers not generally qualified to offer this kind of advice but they also do not have permission to do so. And on top of this there is a potential huge conflict of interest where the portal provider is being paid different, and frequently undisclosed, fees by the various fund providers on the platform.

There are many reasons to believe that the direct, fully disclosed portal model has many benefits for investors, individual fund providers and the fund industry as a whole. To get this message across it would be helpful if IMMFA, on behalf of the industry, set down recognised best practice guidelines for multi-fund portals. This would help treasurers to make the best possible choice of portal to maximise their own benefit and that of the industry as a whole. ■

MyTreasury Ltd

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