PRIME RATE
CAPITAL MANAGEMENT

Regulatory Opportunities for Financial Intermediaries

Introduction

Client money rules have always put very specific conditions on what intermediaries and financial institutions can do in regard to client monies. Prior to the implementation of the Markets in Financial Instruments Directive (MiFID) in November 2007, although an intermediary could open an account in a Liquidity Fund (referred to in regulations as Qualifying Money Market Funds or QMMFs) for an individual investor, aggregated balances had to be placed in authorised bank accounts.

Following the implementation of MiFID in November 2007 intermediary firms with the relevant Part IV permissions (see below) can now invest aggregate client monies in Liquidity Funds which are QMMFs, allowing clients to benefit from the diversification and competitive returns offered by these funds.

Benefits of Liquidity Funds (QMMFs)

Liquidity funds offer key benefits to financial intermediaries, as described below.

Security

- Funds are invested in highly rated, liquid, short term money market securities. At least 50% of the assets must be rated A-1+, the balance must be rated A-1
- The fund must hold a highly diversified pool of assets. Typically the fund will have no exposure to an individual counterparty greater than 5% (other than for very short term deposits)
- The fund is a separate legal entity with its own Depositary. Exposure is therefore to the assets of the fund not to an individual entity (as is the case with a bank deposit)

Liquidity

- Same day access to funds
- Single transaction to invest/redeem
- No need to decide in advance on term for which funds can be invested

Return - Competitive Performance

- Net returns of in excess of one week LIBID (Base Rate) while still having same day access to funds
- Benefit from managed exposure to the yield curve
- Consistent performance in all market conditions
- Low management fees ensure best value returns for clients

Transparency

- Returns are published daily
- Single management fee deducted daily from returns

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- No additional charges
- Able to look through to the underlying assets in the fund

Administrative Efficiency

- Single transaction to invest/redeem
- No daily reconciliations
- All reporting produced within 24 hours

Background

In 2006, after strong lobbying from the Institutional Money Market Funds Association (IMMFA) and other industry participants, the Committee of European Securities Regulators (CESR) recognised AAA rated Liquidity Funds as a new asset class.

This was implemented in the UK in Article 18 of the MiFID implementing Directive (2006/73/EC). The funds are referred to as Qualifying Money Market Funds (QMMFs) and are defined as a collective investment undertaking authorised under the UCITS Directive (85/611/EEC) which meets the following conditions:-

- its primary investment objective must be to maintain the net asset value of the undertaking either constant at par, or at the value of the investors' initial capital plus earnings;
- it must invest exclusively in high quality money market instruments with a maturity or residual maturity of no more than 397 days, or regular yield adjustments consistent with such a maturity, and with a weighted average maturity of 60 days; and
- it must provide liquidity through same day or next day settlement.

It is IMMFA's opinion that the intermediary firm's Part IV permission should contain the following elements prior to being able to place client money in a QMMF:

- arranging (bringing about) deals in investments;
- dealing in investments as agent;
- managing investments; and
- safeguarding and administering investments.

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