

Money Market  
Funds:  
Proposed  
Change to  
Valuation Rules

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## MONEY MARKET FUNDS: PROPOSED CHANGE TO VALUATION RULES (AMORTISED COST VALUATION METHODOLOGY)

### Introduction

The Irish Financial Services Regulatory Authority (“Financial Regulator”) currently permits money market funds (UCITS/non-UCITS) to provide for the use of an amortised cost valuation methodology. The Financial Regulator proposes to establish new conditions under which a money market fund is permitted to follow an amortised cost valuation methodology and to use the words “money market fund” in its title. The requirements imposed by the Financial Regulator as regards the use of an amortised cost valuation process are currently set out in Guidance Note 1/00 (Valuation of Assets of Collective Investment Schemes). These are intended to be replaced by the new Guidance Note - /08 (Valuation of Assets of Money Market Funds).

### New Draft Guidance Note - /08 (Valuation of Assets of Money Market Funds)

The new conditions proposed by the Financial Regulator in the draft Guidance Note - /08 in respect of the use of the words “money market fund” in a fund’s title and the use of an amortised cost valuation methodology are set out below.

#### *General Principle/Use of Term “Money Market Fund”*



Funds which propose to use the words “money market fund” or “UCITS money market fund” in their title and which propose to follow an amortised cost valuation methodology must obtain a triple-A rating from an internationally recognised rating agency together with a supplementary market risk rating (for example, AAAM by Standards & Poors or Aaa/MR1+ by Moodys). Such funds must be established as constant net asset value funds or as accumulating net asset value funds with a principal objective to preserve principal and maintain liquidity.

Other types of money market funds may not use the words “money market fund” in their title and must value assets on a mark to market basis in accordance with Guidance Note 1/00.

### *Use of Amortised Cost Valuation Methodology*

A money market fund is permitted to provide for the use of amortised cost as a method of valuation of assets subject to the following conditions:

- (1) **Eligible assets:** Without prejudice to the requirements of the UCITS Regulations<sup>1</sup>, the assets of a money market fund are restricted to cash or high-quality money market instruments.
- (2) **Maturity:** The assets of a money market fund are restricted to securities which comply with one of the following criteria:
  - (a) have a maturity at issuance of up to and including 397 days;
  - (b) have a residual maturity of up to and including 397 days;
  - (c) undergo regular yield adjustments in line with money market conditions at least every 397 days; and/or
  - (d) the risk profile, including credit and interest rate risks, corresponds to that of financial instruments which have a maturity of up to and including 397 days or are subject to a yield adjustment at least every 397 days.

In the case of (c) and (d), the money market instruments must also meet with the final maturity requirements of the relevant rating agency.
- (3) **Weighted average maturity:** The weighted averaged maturity (WAM) of the portfolio must not exceed 60 days.
- (4) **Mark to market:** The money market fund must carry out a weekly review of discrepancies between the market value and the amortised cost value of the money market instruments. Escalation procedures must be in place to ensure that:
  -  material discrepancies between the market value and the amortised cost value of a money market instrument are brought to the attention of personnel charged with the investment management of the money market fund;
  -  discrepancies in excess of 0.1% between the market value and the amortised cost value of the portfolio are brought to the attention of senior management

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<sup>1</sup> European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2003, as amended.

within the management company, board of directors or general partner, as appropriate, the investment management company and the trustee;

- ▣ if discrepancies in excess of 0.3% between the market value and the amortised cost value of the portfolio occur a daily review must take place. The management company, board of directors or general partner must notify the Financial Regulator with an indication of the action, if any, which will be taken to reduce such dilution;
- ▣ weekly reviews and any engagement of escalation procedures are clearly documented.

The trust deed, deed of constitution, articles of association or partnership agreement must provide for these procedures or, alternatively, provide that review of the amortised cost valuation vis-à-vis market valuation will be carried out in accordance with the guidelines.

- (5) **Stress testing:** A money market fund is expected to carry out [monthly] portfolio analysis incorporating stress testing to examine portfolio returns under various market scenarios to determine if the portfolio constituents are appropriate to meet pre-determined levels of credit risk, interest rate risk, market risk and investor redemptions. The results of the periodic analysis must be available for inspection by the Financial Regulator.

## Summary

Pursuant to the proposed new Guidance Note -/08, only those money market funds which apply strict criteria to the construction and management of their portfolios are permitted to follow an amortised cost valuation methodology. The most significant change proposed is that money market funds wishing to use the amortised cost valuation methodology must have a triple-A rating from an internationally recognised rating agency and a supplementary market risk rating. The new Guidance Note -/08 is currently going through the Industry consultation process.

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