FINANCIAL REGULATOR
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# Guidance Note 1/08

## Valuation of Assets of Money Market Funds

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**Assistance Paper**

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## 1. Background and Overview

Both UCITS and non-UCITS collective investment schemes authorised by the Financial Regulator are permitted to invest in money market instruments. In the case of UCITS, eligible money market instruments are defined in Regulation 2(1) of the UCITS Regulations 2003.

The purpose of this Guidance Note is to establish the conditions under which a collective investment scheme, which proposes to establish as a money market fund, is permitted to:

- follow an amortised cost valuation methodology and/or
- refer to money market fund in its title.

**These money market funds are established as constant net asset value funds and/or accumulating net asset value funds with a principal objective to preserve principal and maintain liquidity.**

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. Other standards applicable to asset valuation are set out in Guidance Note 1/00 (Valuation of the Assets of Collective Investment Schemes) and should be read in conjunction with this document.

## 2. Relevant Legislation

In the case of UCITS, the following is a list of the key legislation in this area:

- European Communities (UCITS) Regulations 2003 ("*the Regulations*")
- CESR's guidelines concerning eligible assets for investment by UCITS (Ref:CESR/07-044)

- Notice UCITS 9 – Eligible Assets and Investment Restrictions. This Notice includes the requirements from the Regulations together with the CESR guidelines.

Non-UCITS[1] are subject to the NU series of Notices, including Notice NU 17 - Money Market Schemes.

# 3. General Principle

Money market funds which are permitted to follow an amortised cost valuation methodology and/or to use the term "money market fund" in their title are restricted to those funds which have management companies/investment managers with demonstrable expertise in the operations of money market funds which follow this method of valuation. This condition is satisfied where:

- the money market fund has obtained a triple-A rating[2] from an internationally recognised rating agency; or
- the management company or investment manager is engaged in the management, or has been engaged in the management, of a triple-A rated money market fund; or
- in exceptional circumstances, the management company or investment manager may provide sufficient information to the Financial Regulator to demonstrate appropriate expertise in the operation of this type of money market fund. Such applications will be considered on a case-by-case basis and should be submitted in advance of the application for authorisation of the money market fund.

The investment company, management company or general partner must be satisfied that the persons responsible for the operation of the money market fund including under any delegation arrangements have and continue to have the necessary expertise.

[1] Non-UCITS are authorised under the Unit Trusts Act, 1990, the Companies Act 1990 Part XIII, the Investment Limited Partnerships Act, 1994 and the Investment Funds, Companies and Miscellaneous Provisions Act, 2005.

[2] For example, AAAm by Standards & Poors, Aaa/MR1+ by Moodys or AAA/V-1+ by Fitch.

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

## 4. 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:

- **Eligible assets:** Without prejudice to the requirements of the Regulations, the assets of a money market fund are restricted to cash or high-quality money market instruments.

- **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 rated money market funds, the money market instruments falling under (c) and (d) must also meet with the final maturity requirements of the relevant rating agency.

- **Weighted average maturity:** The weighted averaged maturity (WAM) of the portfolio must not exceed 60 days.

- **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. In this regard it is recommended that:

- discrepancies in excess of 0.1% between the market value and the amortised cost value of the portfolio are brought to the attention of the management company or the investment manager;
- discrepancies in excess of 0.2% between the market value and the amortised cost value of the portfolio are brought to the attention of senior management/directors of the management company, the board of directors or general partner, as appropriate 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 must be clearly documented.

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

♦ **Stress testing:** A money market fund is expected to be subject to 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 to the Financial Regulator on request.

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