Money Market Fund Rating Criteria

Sector Specific Criteria Report

This criteria report updates and replaces the previous version, dated 28 October 2015

Focus of Report: This report reflects India Ratings and Research's (Ind-Ra) criteria for assigning ratings to money market funds (MMFs) in India.

The primary focus of this report involves funds with the investment objectives of preservation of capital and timely return of shareholder investments. These objectives are typically met by investing in high quality short-term debt instruments issued by sovereigns, financial institutions, non-financial corporations, and asset-backed commercial paper (ABCP) programmes.

Key Rating Drivers

Fund Operating Environment: Ind-Ra reviews, among other factors, applicable fund regulation, track record of the fund industry, industry standards and practices.

Sponsor and Investment Manager: To rate an MMF, Ind-Ra performs an assessment of the asset manager and fund sponsor, which typically is the ultimate parent of the asset manager. The agency seeks to establish that the asset manager is suitably qualified, competent and capable of managing the portfolio consistent with the assigned rating, and together with the sponsor has sufficient operational resources and expertise.

Investment Guidelines: An Ind-Ra MMF rating is primarily based on an analysis of the fund's investment policy. Ind-Ra expects MMFs to be diversified and to adhere to conservative guidelines limiting credit, market and liquidity risks.

Active Ratings Surveillance: Ind-Ra typically requests monthly portfolio holdings and relevant performance statistics to actively monitor MMF Ratings.

Evaluating a Fund's Operating Environment

Regulatory and Operational Framework

Ind-Ra reviews the overall regulatory and operational framework in which the fund operates. The agency's review includes, but is not limited, to the following considerations:

- history and track-record of the fund industry;
- level of standards within the industry, in terms of clarity of funds' investment objectives, investor communication, and separation of duties within asset management firms;
- practices, in terms of fund set-up, custody or valuation, ensuring segregation of assets, independent book keeping and valuation

Short-Term Markets

Reasonably developed short-term markets typically need to exist for MMFs to meet their objectives of liquidity and capital preservation. Such markets are typically T-bills, bank commercial paper, time deposits and certificates of deposit, corporate commercial paper, bank bonds and notes, or asset backed short-term paper (such as ABCP).

When assigning MMF ratings, Ind-Ra considers the depth and liquidity of the market in terms of its history, overall size, level of issuance, number of issuers and counterparties, and trading activity.

Short-term markets also generally require reliable and frequently updated benchmarks. When analysing the operating environment of funds, Ind-Ra evaluates the availability of established short-term reference indices, against which, short-term assets may be referenced and re-priced. MMFs invest in assets that closely track such indices.

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Evaluating the Roles of the Fund Sponsor and Investment Advisor

While the credit quality, maturity and liquidity of underlying assets serve as the primary sources of protection to fund investors, Ind-Ra's rating analysis also considers the roles of the fund sponsor and investment advisor, especially for funds rated 'IND A1+mfs' level.

Investment Advisor

To rate a MMF, Ind-Ra performs an assessment of the investment advisor. With this assessment, the agency seeks to establish that the manager is suitably qualified, competent and capable of managing the fund. If the agency is not satisfied following this assessment, it will not rate the fund.

Ind-Ra's assessment of the investment advisor is based on periodic meetings with the advisor to review policies and procedures to meet investment objectives as well as the supporting organizational structure, internal controls, and risk management and reporting systems. Ind-Ra places particular emphasis on controls over operational risk and pricing.

Ind-Ra seeks to assess whether the manager is fully aware of the challenges of managing short-term money and has appropriate resources (research, control, etc) and investment policies in place. Notably, the fund should unequivocally aim at liquidity and capital preservation in its investment objectives and policies.

Credit Risk

Ind-Ra focuses on the overall credit quality of the individual holdings, as well as the overall diversification. The credit quality assessment is based on the credit ratings assigned by Ind-Ra, if available; if not, the lowest public rating from other rating agencies may be applied.

At the highest rating levels, Ind-Ra's criteria is applicable to MMFs that mainly invest in securities issued by the state, state-related entities, or strong financial institutions. This includes bank counterparties that are rated 'IND A1+' or 'IND A1' at the 'IND A1+mfs' level, and minimal exposure to 'IND A2' at the 'IND A2mfs' level and lower. Relative to financial issuers and the state, the segment of non-financial and non-bank corporate issuers is generally less developed, less liquid and rated at a lower level. Any such investments by highly rated funds would therefore be on a selective basis, with a particular emphasis on any mitigating factors, such as a very short maturity horizon.

For secured investments (e.g. repurchase agreements), Ind-Ra seeks to understand the legal and operational frameworks (margining frequency, overcollateralisation, access to collateral), as well as the types of collateral. If collateralisation rules ensure high recovery in case of default of the transaction counterparty, and if the collateral can be recovered on a timely basis, Ind-Ra may reflect the rating of the collateral in its analysis of the counterparty credit risk and/or tolerate greater concentration.

Diversification

Ind-Ra will review concentration at the single issue level for liquidity purposes. A focus on an extremely short maturity profile (via deposits) could also lead to a concentration in bank-related exposures. As per Ind-Ra's criteria, the exposure to a single non state-related bank/corporate issuer typically would not exceed 10% of the total portfolio assets, with some concentration (15%) allowed for very short maturities (i.e. less than seven days or fully breakable deposits) or on a temporary basis for operational reasons.

Maturity

To limit market risk (primarily interest rate risk) MMFs are expected to maintain a low weighted average maturity to reset date (WAM, limiting interest rate risk) and a low weighted average life (WAL, measuring the weighted average days to final maturity, limiting spread risk).

The limit on the sensitivity to interest rates, i.e. WAM, should reflect the historical and

Applicable Criteria

Bond Fund Rating Criteria

anticipated rate volatility (base rate and MIBOR-equivalent curves). For ‘IND A1+mfs’ rated funds, WAM and WAL typically would not exceed three to four months and four to six months respectively,

Ind-Ra’s criteria for highly rated funds calls for a maximum asset maturity of one year or less, with the exception of floating-rate government or quasi-government securities, which may have up to three years maximum maturity.

Liquidity

Ind-Ra’s rating criteria focuses on primary liquidity, ie the natural roll-off of assets, as well as the presence of highly liquid assets, if any. A MMF’s maturity breakdown should be consistent with anticipated redemption volatility and the base case remains 10% overnight and 25% at seven days, linked to largest investor exposure.

Ind-Ra may consider direct obligations issued by governments or issuers which Ind-Ra considers systemically important- to be eligible for overnight or seven day liquidity provided such issues have a short remaining maturity of (typically 95 days or less) and benefit from strong market liquidity (as measured by relative market size, trading volumes and any metric Ind-Ra may consider relevant).

However, depending on other market-specific variables - such as issuer credit quality, diversification and secondary market liquidity - larger bases of overnight and seven-day maturities may be expected at higher rating levels. Contractual limitations on redemptions may be a conventional and well-understood feature of the market. If so, this could serve as a mitigant against redemption risk and the need for higher amounts of liquidity.

Ind-Ra reviews the investor base, the distribution channels and the historical redemption level and considers the sensitivity to yield differentials (ie opportunistic behaviour), as measured, for example, by the correlation of flows in MMF with yields.

The secondary liquidity of assets can be unpredictable and volatile. For this reason, Ind-Ra’s criteria emphasise maintaining a significant exposure to truly liquid assets on top of the primary liquidity explained above. Ind-Ra considers investments in plain vanilla securities - such as those issued by governments or issuers which Ind-Ra considers systemically important - to offer greater relative liquidity and generally expects more than 50% of the portfolio to consist of such securities.

Ind-Ra would typically expect around a third of the fund’s allocation to such liquid securities to consist of direct Government obligations and the remainder to consist of other highly liquid securities, although the relative importance of the two components in Ind-Ra’s analysis will depend on market characteristics. Lower exposures to T-bills or highly liquid systemically important issuers can be mitigated by higher level of primary liquidity as explained above. Conversely, investments in non-conventional (e.g. recently developed segments) or non-exchangeable assets are subject to limitations - generally between 10% and 20% of the total portfolio. Such assets include, but are not limited to, non-financial corporate issues, term repo, or unbreakable deposits above seven days.

Active Surveillance

Ind-Ra periodically examines a rated fund’s portfolio, the credit quality, liquidity and maturity characteristics of portfolio holdings, and the capabilities and resources of the related investment advisor to ensure existing ratings remain appropriate.

Ind-Ra typically examines the portfolios of MMFs monthly to assess the credit quality, liquidity, and maturity characteristics relative to assigned ratings. Surveillance reports include portfolio holdings, redemption/subscription activity, portfolio NAV, WAM, WAL, and yield, among other data items. At any time, and in particular during periods of heightened credit and/or liquidity stress or material NAV deviation, Ind-Ra reserves the right to seek information on a more frequent basis.

Limitations

The rating scale provides a relative measure of principal protection and timely return of capital (liquidity) for rated MMFs. The term “liquidity” - as used throughout this report and the rating definitions - refers to the timely return of capital which is relative to other short-term obligations of the highest credit quality.

MMF ratings are typically assigned to funds whose objectives are capital preservation and timely return of capital, albeit often with gate provisions in the applicable governing documentation. Fixed-income funds that are not managed to fulfil these objectives are rated using Ind-Ra’s bond fund rating methodology.

In certain cases, Ind-Ra may elect to rate funds marketed as MMFs and with MMF-like objectives under its Bond Fund Rating Criteria. This reflects Ind-Ra’s view that the risk profile of such funds is inconsistent with its expectations for MMFs.

Not all rating factors in these criteria may apply to each rating action. Each specific rating action commentary or rating report will discuss those factors most relevant to the individual rating action.

Figure 1

Summary of Money Market Fund Rating Criteria

	IND A1+
Asset and counterparty credit quality	
IND A1+ and IND A1 (or equivalent, minimum %)	100
IND A2 (or equivalent, maximum %)	0
IND A1+ (minimum %)	50-70
Issuer diversification (maximum aggregate %)	
Single state-owned entity	35
IND A1+ or equivalent, total	10-15
Of which greater than seven days	5-10
IND A1 or equivalent, total	5-10
IND A2 or equivalent, total	0
Other diversification (maximum %)	
Repurchase agreement counterparty[a]	25-30
Maximum asset maturity	
All securities, except sovereign securities	397 days
Floating rate and highly liquid sovereign securities	2-3 years
WAM (maximum)	**3-4 months**
WAL (maximum)	**4-6 months**
Portfolio liquidity (baseline)	
Overnight maturities and highly liquid assets (minimum %)	**10-20**
Seven-day maturities and highly liquid assets (minimum %)	**25-40**
Less conventional assets or with limited/non-existent secondary market liquidity (%)[b]	**10-20**
T-bill or assets from highly rated (typically ‘IND AAA’) issuers Ind-Ra considers highly liquid and systemically important (minimum %)	**50**

[a] Applicable to treasury collateral with overcollateralisation. Otherwise, unsecured guidelines are applicable
[b] Refers to assets such as non-bank corporates, repo or unbreakable deposits above seven days, foreign assets with maturity above seven days
Source: Ind-Ra

Appendix

Rating Definitions

IND A1mfs

Schemes with this rating are considered to have very strong degree of safety regarding timely receipt of payments from the investments they have made.

IND A2mfs

Schemes with this rating are considered to have strong degree of safety regarding timely receipt of payments from the investments they have made.

IND A3mfs

Schemes with this rating are considered to have moderate degree of safety regarding timely receipt of payments from the investments they have made.

IND A4mfs

Schemes with this rating are considered to minimal degree of safety regarding timely receipt of payments from the investments they have made.

Modifiers {"+" (plus)} can be used with the rating symbols for the categories IND A1mfs to IND A4mfs. The modifier reflects the standing within the category.