National Scale Money Market Fund Rating Criteria

Sector Specific Criteria Report

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

The primary focus of this report involves funds domiciled in India, 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: At the 'IND AAAmfs' rating level, Ind-Ra generally expects the fund sponsor to have a sound financial standing, as measured for example by a high rating on the national scale. Ind-Ra expects the investment manager to benefit from proper resources, notably credit research and risk management.

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 national scale MMF Ratings.

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Figure 1

Summary of National Scale Money Market Fund Rating Criteria

	IND AAAmfs	IND AAmfs
Asset and counterparty credit quality		
IND A1+ and IND A1 (or equivalent, minimum %)	100	Case-by-case
IND A2 or IND A3 (or equivalent, maximum %)	0	Case-by-case
IND A1+ (minimum %)	50-70	30-50
Issuer diversification (maximum aggregate %)		
Single state-owned entity	35	35
IND A1+ or equivalent, total	10-15	15-30
Of which greater than seven days	5-10	10-15
IND A1 or equivalent, total	5 -10	5 -15
IND A2 or equivalent, total	0	Case-by-case
IND A3 or equivalent, total	0	Case-by-case
Counterparty credit risk		
Repurchase agreement counterparty	IND A/IND A1	IND A/IND A1
Derivative contract counterparty	IND A/IND A1	IND A/IND A1
Custodian bank	IND A/IND A1	IND A/IND A1
Other diversification (maximum %)		
Repurchase agreement counterparty[a]	25	25-30
Maximum asset maturity		
All securities, except floating rate 'IND AAA' sovereign securities	397 days	397 days
Floating rate and highly liquid sovereign securities	2-3 years	2-3 years
WAM (maximum)	**2-3 months**	**3-4 months**
WAL (maximum)	**3-4 months**	**4-6 months**
Portfolio liquidity (baseline)		
Overnight maturities and highly liquid assets (minimum %)	10-20	Case-by-case
Seven-day maturities and highly liquid assets (minimum %)	25-40	Case-by-case
Less conventional assets or with limited/non-existent secondary market liquidity (%)[b]	10-20	Case-by-case
T-bill or assets from highly rated (typically 'IND AAA') issuers Ind-Ra considers highly liquid and systemically important (minimum %)	50	Case-by-case

[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

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).

Applicable Criteria

Bond Fund Rating Criteria (October 2015)

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.

Sovereign Ratings, Banking Sector and Systemic Banking Risk

As ratings are assigned to funds denominated in the local currency and essentially investing in assets of the same currency - or not otherwise exposed to exchange rate risk - the risk of capital and exchange controls being imposed by the sovereign authorities (transfer and convertibility risk) is not part of the rating. Therefore, country ceilings are not directly relevant. Similarly, the risk of default of the sovereign on its foreign debt does not directly impact domestic short-term markets and funds. Nevertheless, sovereigns usually default when the economy is in a very difficult situation, where domestic capital flows can be affected.

In most markets, short-term funds invest in bank debt. Ind-Ra therefore incorporates any Outlook it may maintain on the relevant banking system into its rating analysis. For rated MMFs, particular emphasis is placed on Short-Term National Scale Ratings, with higher rated funds primarily investing in 'IND A1+' or 'IND A1' rated securities.

Ind-Ra also evaluates the dynamics of the capital markets and how MMFs can be affected by investor flows. Indeed, in markets where yields are the main decision drivers for investors, opportunistic behaviour may trigger commercial pressure and unsustainable yield picking strategies, not consistent with highly rated MMFs. Such activity can create excessive volatility in fund flows, putting stability of principal and shareholder liquidity at risk. While Ind-Ra's criteria emphasises portfolio-level liquidity (see below) and therefore, can mitigate such risks, the presence of a stable, core investor base is also important.

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 AAAmfs' level.

Fund Sponsor

In a national context, the strategic importance of a MMF, and more generally, the reputational risk of a fund failure to the sponsor, may not be as high as in an international environment. Furthermore, the ability of a fund's sponsor to support a fund in times of need may not be as great in a national context, given that sponsoring entities may have a narrower range of available resources. Therefore, Ind-Ra may give less credit to the role and standing of the sponsor and focus more on the intrinsic quality of the fund. Yet, at the 'IND AAAmfs' rating level, Ind-Ra generally expects the fund sponsor to have a sound financial standing, as measured for example by a high rating on the national scale. A relatively weak sponsor may lead to a lower rating, or more conservative fund rating guidelines at the same rating 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. In a national context, Ind-Ra places particular emphasis on controls over operational risk and pricing.

Given that conservative MMFs are often new in many markets, 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 national credit ratings assigned by Ind-Ra, if available; if not, the lowest public rating from other global rating agencies may be applied. The use of ratings from domestic-only rating agencies will be assessed on a case-by-case basis, on the basis of their consistency with Ind-Ra's criteria and outstanding ratings in the country.

At the highest rating levels, Ind-Ra's criteria is applicable to national MMFs that mainly invest in securities issued by the state, state-related entities, or strong financial institutions. This includes bank counterparties that are nationally rated 'IND A1+' or 'IND A1' at the 'IND AAAmfs' level, and minimal exposure to 'IND A2' or below at the 'IND AAmfs' level and lower. In many markets, 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 (eg repurchase agreements), Ind-Ra seeks to understand the legal and operational frameworks (margining frequency, overcollateralisation, access to collateral), the history of the market, 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

Less mature markets generally exhibit more concentration, with fewer issuers available in short-term markets. Concentration in state and quasi-state issuers is logically expected in nationally rated MMF. For such issuers, 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, particularly in countries dominated by a handful of banks acting as short-term issuers. 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 (ie 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) nationally rated 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, ie WAM, should reflect the historical and anticipated rate volatility (base rate and MIBOR-equivalent curves). For 'IND AAAmfs' rated funds, WAM and WAL typically would not exceed two to three months and three to four months respectively, but are expected to be much shorter in more structurally volatile markets. Ind-Ra also reviews the yield volatilities along the curve. In certain markets, short-term rates are much more volatile than longer-term rates; therefore, too short WAM limits may lead to increased risk.

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

As for global MMFs, 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 (which can be high in less mature or yield-driven markets) 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 the relevant sovereign entity 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. In some markets, 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, particularly for less well-developed markets, can be unpredictable and volatile. For this reason, Ind-Ra's criteria emphasise the maintaining a significant exposure to truly liquid assets on top of the primary liquidity explained above. In most markets, 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 local 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 (eg recently developed segments) or non-exchangeable assets are subject to limitations - generally between 10% and 20% of the total portfolio. In most markets, such assets include, but are not limited to, non financial corporate issues, term repo, or unbreakable deposits above seven days.

Given basis and convertibility risks, investment in assets denominated in a foreign currency is generally inconsistent with a highly rated national MMF - with the exception of investments in short term highly liquid international treasuries (such as US treasuries and securities issued by other sovereigns rated in the 'AA' and above long-term issuer default rating categories and benefitting from strong market liquidity) which are expected to be fully hedged back to the fund's base currency. Investments in non-domestic assets with maturities exceeding seven days are treated as "less liquid", alongside non-conventional and non-exchangeable assets.

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 rated on a National Scale 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 national MMF rating scale ranks the degree of principal and liquidity risk relative to the highest credit quality and liquidity in that country. National ratings exclude the effects of sovereign and transfer risk and also exclude the possibility that investors may be unable to repatriate any due repayments. They are not related to the rating scale of any other national market.

The national rating scale provides a relative measure of principal protection and timely return of capital (liquidity) for rated MMFs only within the country concerned. The term "liquidity" - as used throughout this report and the rating definitions - refers to the timely return of capital (within a few days maximum in most markets), which, on a national scale, 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 fulfill these objectives are rated using Ind-Ra's bond fund rating methodology, (see *Bond Fund Rating Criteria*, published October 2015).

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' view that the risk profile of such funds is inconsistent with its expectations for MMFs. This may be driven by differences between the applicable local regulatory regime and international or national best practices and structural characteristics of the relevant local market which limit the potential for the fund to effectively diversify, among other factors.

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.

Appendix

Rating Definitions

IND AAAmfs

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

IND AAmfs

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

IND Amfs

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

IND BBBmfs

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

IND BBmfs

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

IND Bmfs

Schemes with this rating are considered to have high risk of default regarding timely receipt of timely receipt of payments from the investments that they have made.

IND Cmfs

Schemes with this rating are considered to have very high risk of default regarding timely receipt of timely receipt of payments from the investments that they have made.

Ind-Ra utilises long-term to short-term rating mapping to rate MMFs at the short term.

IND A1mfs

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

IND A4mfs

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