AMFI

Association of Mutual Funds in India

135/BP/29/2012-13 **May 15, 2012**

To all members,

Dear Sir/ Madam,

AMFI Best Practice Guidelines Circular No.29/2012-13

Guidelines on Valuation Principles for valuing Debt and Money Market Instruments

1. Background

SEBI vide its circular No.Cir/IMD/DF/6/2012 dated February 28, 2012 forwarded a copy of the Gazette Notification No. LAD-NRO/GN/2011-12/38/4290 dated February 21, 2012 amending SEBI (Mutual Funds) Regulations, 1996. One of the amendments was pertaining to the Valuation of Debt and Money Market Instruments encompassing Principle of Fair Valuation. It envisages AMC Board to approve the policies and procedure identifying methodology that will be used for valuing each type of securities held by the mutual fund schemes

The AMFI Committee on Valuation has suggested valuation methodology for valuing Debt and Money Market instruments as guiding principle for AMCs to facilitate smooth implementation of the SEBI circular as under:

2. Principles for Fair Valuation / Fair Treatment

The guiding principles for fair valuation would be to minimize the difference in valuation of mutual fund assets relative to market values. This would enable fair treatment across all classes of investors (those investing, redeeming and staying in the fund).

As differences in valuation mostly impact debt and money market instruments due to the relative illiquidity of these markets, this paper discusses valuation methods to reflect fair values of debt and money market instruments.

3. Instruments maturing up to 91 days (60 days from 30 Sep 2012)

Instruments may be valued by amortisation on a straight-line basis to maturity from cost or last valuation price whichever is more recent. However the AMCs should ensure that the amortised price is reflective of fair value by comparing it to the reference price.

Traded prices are to be considered for construction of the benchmark yield curve. In arriving at the benchmark yields, traded prices/yields across all public platforms are to be considered. The benchmark yields currently being provided for tenors above 91 days will be extended down. For tenors below 91 days, benchmark yields will be provided for each fortnightly interval.

At the time of first purchase the spread between the purchase yield and the benchmark yield should be fixed. This spread should remain fixed through the life of the instrument & should be changed only if there is justification for the change. For example, market trades / AMC's trades (as in para 4(a) below) at a different spread could be reflected through a change in the spread. Irrespective of amortisation, a change in the credit rating or credit profile of the issuer would require a re-evaluation of the appropriateness of the spread.

The amortised price may be used for valuation as long as it is within ±0.10% of the reference price. In case the variance exceeds ±0.10%, the valuation shall be adjusted to bring it within the ±0.10% band.

In case of subsequent trades by the fund in the same security, the valuation must reflect the most recent trade as long as the trade is of market lot. The security such valued would be amortised to maturity with such amortised prices to be in line with ± 0.10% of the reference price as above.

4.Instruments having maturity greater than 91 days (60 days from 30 Sep 2012)

In case of traded instruments the traded price would be used for valuation; and in case of non-traded instruments, the valuation price would be the reference price calculated using benchmark yields.

a) Traded instruments

It has been observed that prices & yields reported on public platforms may not always be reflective of current market trading levels. To prevent frivolous and dated prices from distorting the valuation of mutual fund assets, it is proposed that:

a. For instruments maturing above 1 year, the traded price may be taken if there are at least two trades aggregating to Rs. 25 crores or more.
b. For instruments maturing between 92 days and 1 year, the traded price may be taken if there are at least three trades aggregating to Rs. 100 crores or more.

In the case of the AMC's own trades, only a trade of a market lot or more is to be taken as reflective of the realizable value of the total holding in a single instrument.

All the amounts above refer to face value of securities. In addition, as the price may be distorted in case of forward settlement dates (e.g. across a weekend/holidays), the traded yields may be used to arrive at a price for valuation. In case of multiple trades, the weighted average price may be used for valuation.

In case there are both qualifying market trades and AMC trades, the market trades should be given a higher priority. In case of multiple platforms reporting trades on the same day, the order of preference would be FIMMDA, Exchange (NSE WDM, BSE) and own trades. The qualifying criteria are to be observed at the exchange/platform level (as the same trades may be reported on multiple platforms).

b)Non-traded instruments

In the absence of traded prices, the current matrix-based valuation may be continued to determine the valuation price for instruments maturing beyond 91 days (60 days post 30 Sep 2012). However in the interest of fair reflection of market levels, there would be no restriction on the allowed spread relative to the benchmark curve in respect of different issuers & instruments. Each AMC would set its own internal guidelines (e.g. mechanism to determine spreads) to ensure fair valuation. For example, market trades / AMC's trades (as in para 4(a)) at a different spread could be reflected through a change in the spread. Similarly a change in the credit rating or credit profile of the issuer would require a re-evaluation of the appropriateness of the spread.

5. Guidelines for inter-scheme transfer of debt and money market instruments

Transfer of securities between schemes should ensure fair treatment of investors in both schemes. Such transfers must take place at current market prices.

6. Abnormal situations & market disruptions

In normal situations the above methods may be used for valuation. However in abnormal market conditions, due to lack of market trading or otherwise it may not be possible to obtain fair valuation using "normal" means. In such a situations, the realizable value may be substantially different from the benchmark-based prices obtained. This could lead to, for example, an overvalued portfolio which could be used by some investors to redeem their holdings having an adverse impact on residual investors.

As by definition, abnormal events are abnormal, no prescriptive guidelines are proposed to value securities/portfolios during such events. Events such as monetary policy or other regulatory related events, large redemptions, or other external factors could constitute abnormal events. Each AMC shall put in place a mechanism/process to identify the occurrence and end of such events, and to handle valuation in such situations.

The AMCs may take in to consideration these guiding principles while formulating the Policy on valuation.

Yours Sincerely,

V RAMESH

Deputy Chief Executive