CSPI Ratings 中証鵬元國際

Money Market Fund Rating Criteria

Content

Introduction

CSPI Ratings' money market fund (MMF) rating provides a forward-looking opinion about an MMF's capacity to meet its objectives of preserving principal and providing liquidity. The MMF ratings, distinct from credit ratings, are opinions on the investment quality of shares in MMFs and similar investment vehicles. The "(mmf)" suffix is added to the MMF ratings in order to distinguish them from CSPI Ratings' conventional issuer or issuance credit ratings.

Our rating framework is built on four key pillars:

- Credit quality
- Portfolio concentration
- Market risk
- Liquidity risk

The preliminary MMF rating score is derived by aggregating the factor scores for the four key pillars. The criteria also take into account other factors that are not fully captured by the preliminary MMF rating score, such as the assessment of asset manager and fund sponsor, legal and regulatory environment, operating history and information disclosure, etc.

Scope of the Criteria

The criteria apply to MMF ratings globally. Money market funds typically invest in short-term and high-quality money market investments such as bank deposits, repurchase agreements, and short-term debt instruments, etc. The main objective of money market funds is to ensure high liquidity for investors while preserve principal. The criteria focus on assessing the total risk profile of the fund and the capabilities of the asset manager in evaluating an MMF's ability to meet its dual objectives of preserving principal and providing liquidity.

Money Market Fund Rating Symbols and Definitions

CSPI Ratings adds the suffix "(mmf)" to all MMF ratings to clearly differentiate them from conventional credit ratings for debt instruments. The MMF ratings are not and should not be deemed as investment recommendations. Instead,8 they only reflect our opinions on an MMF's capacity to meet its dual objectives of preserving principal and providing liquidity.

Exhibit 1: Rating Symbols and Definitions

Rating	Definition
AAA(mmf)	MMFs have extremely strong capacity to preserve principal and provide liquidity.
AA(mmf)	MMFs have very strong capacity to preserve principal and provide liquidity.
A(mmf)	MMFs have strong capacity to preserve principal and provide liquidity.
BBB(mmf)	MMFs have adequate capacity to preserve principal and provide liquidity.
BB(mmf)	MMFs have uncertain capacity to preserve principal and provide liquidity.
D(mmf)	MMFs fail to meet the dual objectives of preserving principal and providing liquidity.

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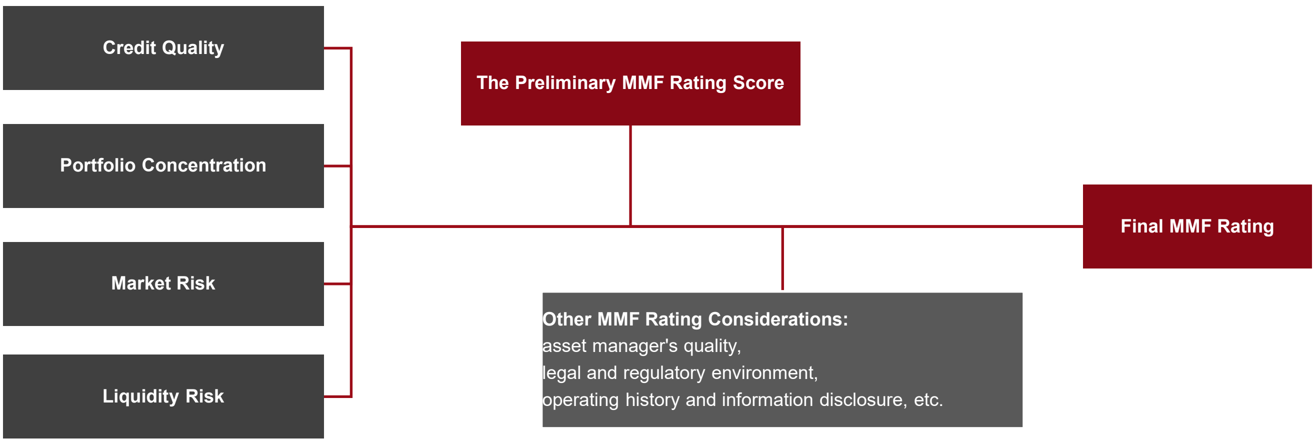
Rating Framework

The criteria framework, as illustrated in Exhibit 2, is composed of four key pillars: credit quality, portfolio concentration, market risk, and liquidity risk. We believe these pillars form the basis for assessing an MMF's investment portfolio risk profile and directly impact the MMF's ability to preserve principal and provide liquidity. We first assess each pillar individually to derive a preliminary MMF rating score. Subsequently, we incorporate other MMF rating considerations such as the quality of the asset manager and fund's sponsor, the legal and regulatory environment, operating history and information disclosure. The MMF final rating is determined by adjusting the preliminary MMF rating score based on these additional factors.

Exhibit 2: Rating Framework for Money Market Funds



Pillar 1: Credit Quality

The credit quality of an MMF's investment portfolio is a primary factor in evaluating the MMF's capability to maintain a stable net asset value (NAV). We believe that higher overall portfolio credit quality significantly reduces the risk of losses from security defaults or price declines, thereby enhancing the MMF's ability to preserve principal and maintain a stable NAV. Our assessment methodology employs a comprehensive approach that scrutinizes individual security risks, analyses portfolio composition, and evaluates risk mitigants. This approach enables us to gain a nuanced understanding of the fund's credit profile and its resilience across various market conditions.

In our evaluation process, we primarily utilize short-term international credit ratings to assess the credit quality of securities within MMFs. When necessary, we map long-term ratings to short-term equivalents to ensure consistency in our assessment framework. For unrated securities issued by rated entities, we may use the issuer rating as a proxy, subject to structural considerations. In cases where our own ratings are unavailable, we turn to publicly available ratings from recognized international agencies. In the absence of public ratings, we rely on our private ratings or internal credit assessments for the securities or issuers. In addition, bank deposits, an important component of MMF asset allocations, are evaluated by assessing both the short-term and long-term ratings of the banks, including deposit-specific ratings where applicable.

Our analysis includes examining the percentage of assets in various short-term rating categories, as well as the maximum allowable percentage of lower-rated securities. We generally view shorter-dated assets as presenting lower credit risk, while applying more stringent credit quality requirements to longer-dated securities. Sovereign and government-related issuers may be subject to special consideration, potentially allowing for higher concentration limits and differentiated credit quality assessment, particularly for highly-rated entities.

CSPI Ratings recognizes that temporary deviations from credit quality requirements may occur due to rating changes, market movements, etc. Short cure periods (e.g., 10-30 business days) are typically allowed to rectify deviations, provided the fund manager presents a credible plan to regain compliance without jeopardizing investor interests. In our assessment, we also consider mitigating factors such as the short tenor properties of assets, guarantees, seniority, and security measures applied to the assets or the portfolio. Credit enhancements, including guarantees, collateral, or other features enhancing credit quality, are evaluated by assessing the credit quality of the enhancement provider and the legal enforceability and operational effectiveness of the enhancement.

To further assess the robustness of an MMF's credit profile, we may conduct portfolio stress tests. These simulations of adverse scenarios, such as rating downgrades or defaults, help us evaluate the potential impact on the fund's credit profile under challenging market conditions. T

Pillar 2: Portfolio Concentration

Portfolio concentration represents a critical aspect of our risk assessment for MMFs. A highly concentrated portfolio can significantly impede effective credit risk diversification, potentially leading to substantial losses in the event of adverse credit events. Our evaluation of portfolio concentration encompasses several key factors to ensure a comprehensive understanding of the fund's risk exposure.

CSPI Ratings examines the proportion of debt financing instruments issued by individual institutions relative to the fund's NAV. This analysis extends to asset-backed securities, where we scrutinize the concentration of original equity holders. Additionally, we assess the proportion of bank deposits and interbank certificates of deposit from single commercial banks in relation to the fund's overall NAV. Our analysis is grounded in the understanding that excessive concentration in securities or bank deposits from a single institution can heighten credit risk. Such concentration limits the effectiveness of risk diversification strategies, potentially impacting the MMF's ability to preserve principal and provide liquidity.

However, we recognize that concentration risk can be mitigated by various factors. In our assessment, we consider the presence of assets with strong credit quality, which may offset some concentration concerns. Similarly, strongly collateralized exposures can provide an additional layer of security, potentially justifying higher concentration levels. We also take into account the liquidity profile and tenor of the assets, as highly liquid or short-term assets may present less risk even in concentrated positions.

Our holistic approach considers these mitigating factors alongside direct concentration metrics. This comprehensive and balanced assessment helps us to construct a more precise understanding of the real risks associated with portfolio concentration, ensuring our ratings reflect both the potential vulnerabilities and strengths of an MMF's investment strategy.

Pillar 3: Market Risk

Market risk refers to the potential for an MMF’s NAV to be affected by overall market conditions. MMFs are sensitive to changes in interest rates and credit spreads. When interest rates or credit spreads rise, the value of existing fixed-rate securities held by the fund may decline. This can result in a decrease in the fund's net NAV. The remaining maturity of securities in an MMF's portfolio is a critical factor in measuring market risk. Generally, the longer the average remaining maturity for a portfolio, the greater the potential market risk, and the higher the risk of not being able to preserve capital. Weighted average maturity (WAM) and weighted average life (WAL) are the two main metrics used to assess the maturity profile and interest rate sensitivity of the securities held in an MMF’s portfolio.

Weighted Average Maturity

WAM is a measure of the average time to maturity of the individual securities held in an MMF. It is calculated by assigning a weight to each security based on its share of the total portfolio value and then calculating the average time to maturity across all securities. For floating-rate notes, WAM is determined by calculating the weighted average number of days until the next interest rate reset, rather than to the maturity date as is done with fixed-rate instruments. A higher WAM suggests a longer average time to maturity, indicating a potentially higher sensitivity to changes in interest rates. Funds with a longer WAM may experience greater price fluctuations when interest rates change.

Weighted Average Life

WAL is similar to WAM but provides a more comprehensive measure of a fund's sensitivity to credit spreads and liquidity risks. WAL takes into account the expected life of securities within the portfolio rather than just their stated final maturity. It considers factors such as prepayment or call options that may impact the actual duration of the security's cash flows. This makes WAL a more precise tool for gauging the time it will likely take for the fund to realize principal and interest payments from its holdings.

A higher WAL suggests a longer duration until the securities are matured, increasing the fund's exposure to potential losses stemming from widened credit spreads of the underlying securities.

For MMFs exposed to basis risk, currency risk and the risk exposure of derivative financial instruments, CSPI Ratings will analyse the risks, taking into account their specific circumstances, and make appropriate adjustments to the assessment of market risk for the investment portfolio.

Exhibit 3: Rating Guidance for Market Risk Pillar (20% Weighting)

Attributes	AAA(mmf)	AA(mmf)	A(mmf)	Mitigating Factors
WAM	⩽60 days	⩽90 days	⩽180 days	Derivative hedging measures to manage interest rate risk and currency risk
WAL	⩽120 days	⩽180 days	⩽240 days	

CSPI Ratings also evaluates MMFs' exposure to various market risks beyond interest rate and credit spread risk. A particular area of scrutiny is basis risk, which can arise when there is a mismatch between prevailing benchmark short-term rates and the index an instrument uses to periodically reset its coupon rate. For currency risk, investments denominated in currencies other than the fund's base currency and not fully hedged are typically considered to have limited liquidity and may be subject to specific exposure limits. Derivatives are expected to be used solely for hedging purposes. We typically review the types of derivatives used, their purposes, counterparty risks, and overall exposure limits. CSPI Ratings may also consider how derivatives affect the MMF's WAM and WAL calculations. In all cases, CSPI Ratings analyses these risks, taking into account the specific circumstances of each fund, and makes appropriate adjustments to the assessment of market risks for the investment portfolio and their effects on the fund's overall rating.

Pillar 4: Liquidity Risk

MMFs aim to provide investors with easy access to collect their cash once MMFs are redeemed. However, in times of financial stress or market turbulence, the liquidity of certain money market instruments may decline. If the fund cannot meet redemption requests, it may impose liquidity restrictions or temporarily suspend redemptions, potentially causing inconvenience or financial losses for investors. CSPI Rating's assessment of liquidity risk considers both liquidity profile of the portfolio assets, as well as redemption risk.

The assessment of the liquidity profile of the portfolio assets focuses on overnight liquidity and weekly liquidity as percentages of total portfolio assets. Eligible assets for overnight liquidity include cash, overnight maturing securities, and securities that are highly liquid or available for timely redemption within one business day. Eligible assets for weekly liquidity include eligible daily liquidity assets and securities that mature or can be redeemed within 7 days. When assessing the liquidity profile of the portfolio assets, we may also analyse illiquid securities within the rated MMF. A lower liquidity level will be assigned if we deem the illiquid asset exposure may have a negative impact on a MMF's liquidity profile. Generally, a higher proportion of highly liquid assets or a lower proportion of restricted liquidity assets in the investment portfolio indicates a higher level of overall liquidity. This ensures that the fund has a greater ability to provide stable liquidity to investors.

Due to the fact that MMFs are typically open-ended funds, investors can generally redeem their shares at any time based on their own preferences. If the fund's investors are overly concentrated, the MMF may face increased redemption pressure. To meet large redemption demands, the MMF may need to sell its holdings, which can have a significant negative impact on the market value and stability of the fund. CSPI Ratings assesses redemption risk based on the stability of the investor base. We may adjust liquidity levels down if the rated MMF has high redemption risk under certain circumstances.

Exhibit 4: Rating Guidance for Liquidity Risk Pillar (20% Weighting)

Attributes	AAA(mmf)	AA(mmf)	A(mmf)	Mitigating Factors
Overnight liquidity (% of portfolio assets)	⩾10	⩾10	⩾5	Concentration of investor base
Weekly liquidity (% of portfolio assets)	⩾30	⩾20	⩾10	

Other MMF Rating Considerations

CSPI Ratings will take into account other considerations that are not included in the above four pillars but may affect an MMF's capacity to preserve principal and provide liquidity. Such factors include our assessments of the asset manager and fund sponsor, the legal and regulatory environment, the operating history and information disclosure, among others.

Asset Manager and Fund Sponsor

CSPI Ratings will conduct a qualitative assessment of the asset manager and fund sponsor with a focus on their investment capacity to ensure the stable operation of the rated MMFs. Asset managers play an integral role in the successful management of MMFs. Their expertise, strategic decision-making, risk management, regulatory compliance, investor relations, and performance monitoring collectively contribute to achieving the fund's objectives and maximizing investor returns. In addition, the fund sponsor should have sufficient operational resources and expertise to ensure the stable operation of funds. CSPI Ratings may lower the indicative score to derive a final MMF rating if we believe weaknesses in asset manager's capacity and fund sponsor's quality are material enough to have a negative impact on the MMF rating.

Legal and Regulatory Environment

The legal and regulatory environment for MMFs varies from region to region. In certain regions, the expansion of tools available to funds to address the risk of mass redemptions, such as redemption suspensions or the application of fees, is an important regulatory consideration when assessing MMFs. CSPI Ratings will take into account liquidity risk stemming from the mandatory suspension of redemptions and will lower the indicative score to derive a final MMF rating in this case. In addition, the legal and regulatory environment for MMF can evolve over time. Changes in regulations, such as amendments to investment restrictions, valuation methodologies, or redemption procedures, can have a significant impact on the fund's operations and risk profile. We may also lower the indicative score if we consider potential changes in regulation may harm the interests of investors.

Operating History and Information Disclosure

Our criteria are also applicable to unfounded or newly launched MMFs that have a limited track record. In this case, CSPI Ratings mainly focuses on the rated MMF's pre-defined investment policy, the proxy track record of a MMF that is managed by the same fund manager, as well as the MMF's pro forma portfolio in assessing the MMF rating. If we assign a rating to an unfunded MMF by considering a pro forma portfolio, we will subsequently review the actual composition of the portfolio after its launch to ensure it closely aligns with the pro forma portfolio. If there is a material difference, we may revise the MMF rating to reflect the quality of the actual portfolio.

CSPI Ratings relies on information about the rated MMF provided by the asset manager or fund sponsor to conduct a rating process. The information includes portfolio holdings, portfolio NAV, WAM, and WAL, among other data items. Poor quality of reporting or delays in reporting may result in a lower MMF rating, as we believe the quality and accuracy of a fund's financial reporting may affect our view of the investment quality and internal control effectiveness of the fund sponsor.

Limitations

CSPI Ratings has developed the criteria for assessing the investment quality of MMFs based on our rating knowledge and experience. The criteria do not include an exhaustive description of all factors that we may consider in assigning MMF ratings, as the factors that affect the capital preservation ability and liquidity ability of MMFs are very complicated. The criteria do not incorporate non-market event risk, as unexpected events such as natural disasters or other force majeure that may impact the fund redemption or subscription are usually unforeseeable. Similarly, our criteria exclude extreme tail-risk scenarios in analysis. As the MMF industry is continuously evolving, CSPI Ratings will closely pay attention to the dynamics and risk characteristics of the industry. If we observe that the rating framework or some rating elements of this rating method are no longer applicable, we will introduce a new rating framework with stronger applicability or revise the existing framework when we consider it necessary.

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