

# Report on Continuous Disclosure Review Program and Compliance of Money Market Mutual Funds

## Purpose of this Notice

The Autorité des marchés financiers (“AMF” or “we”) has performed an issue-oriented review on compliance of money market mutual funds<sup>1</sup> (“MMFs”) with securities legislation regarding the net asset value (“NAV”) calculation. This notice summarizes our findings and provides related guidance.

## Background

In October 2012, the International Organization of Securities Commissions (“IOSCO”) published a report<sup>2</sup> (“2012 Report”) containing a number of recommendations aiming to provide common standards for the regulation and management of MMFs across international jurisdictions, including valuation of portfolio assets, a stable NAV offer and disclosure to investors. In addition, the 2012 Report notes that IOSCO would conduct a review of the application of these recommendations within two years of publication (“Peer Review”).

In September 2015, IOSCO published the results of the Peer Review and the progress in adopting legislation, regulation and other policies in relation to MMFs in various areas (“Peer Review Report”).<sup>3</sup> The AMF participated in the Peer Review along with the Ontario Securities Commission.

The recommendations stated in the 2012 Report did not result in any amendment of Québec’s regulation mainly because the harmonized Canadian regulatory framework already required MMFs to use the fair value of all their assets when calculating their NAV (“fair value requirement”). It is important to mention that this requirement does not prohibit the common practice of Canadian MMFs to strive to maintain a constant NAV (usually set at \$10 per security).<sup>4</sup>

The 2012 Report recommends that the MMFs that are claiming to maintain a stable NAV should be subject to measures designed to reduce the specific risks associated with this feature. The Canadian Securities Administrators were generally of the view that it was not necessary to add such measures because of the fair value requirement. In order to confirm this statement, we took the initiative to conduct an issue-oriented review.

## Objectives and Scope of Our Review

The AMF assessed whether MMFs comply with the fair value requirement and have appropriate written policies and procedures in place for determining the fair value of portfolio assets.

For that purpose, all MMFs whose investment fund manager’s (“IFM”) head office is located in Québec were selected.

Our general observations and recommendations are detailed below.

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<sup>1</sup> Within the meaning of *Regulation 81-102 respecting Investment Funds*, CQLR, V-1.1, r. 39.

<sup>2</sup> *Policy Recommendations for Money Market Funds, Final Report*, IOSCO, October 2012.

<sup>3</sup> *Peer Review of Regulation of Money Market Funds: Final Report*, IOSCO, September 2015.

<sup>4</sup> The existence of this widespread industry practice is the reason why the Peer Review Report identifies Canada as a jurisdiction that permits stable NAV for MMFs. In order to take into account this practice, *Regulation 81-101 respecting Mutual Fund Prospectus Disclosure*, CQLR, V-1.1, r. 38 (“Regulation 81-101”), requires that disclosure in a MMF’s simplified prospectus state that there is no guarantee that the NAV will stay constant in all market conditions.

## Review Observations and Recommendations

### (a) Completeness and accuracy of policies and procedures

For their NAV calculation, 90% of MMFs disclosed that instead of using the fair value they used the amortized cost method,<sup>5</sup> for which the value is approximately equal to the fair value. During our review, we noted a general lack of completeness in the written policies and procedures for determining the fair value of portfolio assets. To that effect, we noted the following:

- In many instances, important information related to the reconciliation between the amortized cost used for the NAV calculation and the fair value was not disclosed in the written policies and procedures, including:
  - the frequency of the reconciliation between the amortized cost and the fair value for each portfolio asset;
  - the threshold used to determine if a difference between the amortized cost and the fair value for a portfolio asset is material or not; and
  - the details on how the value of a portfolio asset will be adjusted if a material difference is noted.
- In one case, the written policies and procedures dealt with controls in place regarding NAV accuracy, but did not deal specifically with the valuation of portfolio assets.
- In one case, the written policies and procedures were a copy of the relevant section of the annual information form ("AIF") of the MMF that included inaccurate information.

Although the AMF recognizes that MMFs may invest in portfolio assets that do not have a market value based on reported prices and quotations in an active market, all MMFs are nevertheless subject to the fair value requirement specified in subsection 14.2(1) of *Regulation 81-106 respecting Investment Fund Continuous Disclosure*, CQLR, V-1.1, r. 42 ("Regulation 81-106"). Paragraph 14.2(1.2)(b) of Regulation 81-106 stipulates that, if the market value is not available or if the IFM believes that it is unreliable, the fund may use a value that is fair and reasonable in all the relevant circumstances.

MMFs must establish and maintain appropriate written policies and procedures for determining the fair value of their portfolio assets and consistently follow them, in accordance with subsection 14.2(1.3) of Regulation 81-106. MMFs should ensure that these policies and procedures are complete and accurate.

Thus, the AMF expects MMFs to review their policies and procedures to ensure that the carrying value reflected in the NAV is representative of the fair value of a portfolio asset. Sections 9.2, 9.4, 9.5 and 9.6 of *Policy Statement to Regulation 81-106 Respecting Investment Fund Continuous Disclosure* provides additional guidance to this effect.

If the fair value is provided by a third party vendor, the IFMs should ensure that appropriate and documented controls are in place to assess the reliability of this external pricing. IFMs are responsible and accountable for all functions that they outsource to a service provider in accordance with part 11 of *Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations*, CQLR, c. V-1.1, r. 10.

### (b) Completeness and accuracy of the AIF

With respect to the disclosure required by item 6 of *Form 81-101F2 Contents of Annual Information Form* of Regulation 81-101 relating to the methods used to value the various types or classes of portfolio assets, the AMF noted in many instances a lack of clarity and/or completeness of information disclosed in the AIF of MMFs.

The AMF expects the description of the valuation methods in the AIF to be accurate, complete, clear and consistent with information included in the written policies and procedures in order to avoid misleading or incorrect information.

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<sup>5</sup> The amortized cost generally corresponds to the amortized cost for bonds and to cost plus accrued interests for money market instruments.

### **(c) Reconciliation between the amortized cost and the fair value**

We noted that most of the time reconciliation between the amortized cost and the fair value for portfolio assets was performed monthly, whereas the NAV calculation was done daily or weekly. In some cases, money market instruments (other than bonds) were excluded from this reconciliation.

We understand that there are generally non-significant differences between the amortized cost and the fair value for portfolio assets held by MMFs due to their short maturity and their quality. However, the AMF expects MMF written policies and procedures to be sufficient to demonstrate that, for each NAV calculation, all the assets held are valued at fair value.

### **Conclusion**

As mentioned above, the AMF noted that the vast majority of MMFs that are striving to maintain a stable NAV in Québec use the amortized cost method to value portfolio assets, but perform a periodic reconciliation with the fair value for each portfolio asset, thus complying with the fair value requirement.

The AMF would like to remind IFMs that the use of the amortized cost method alone is not sufficient and that the fair value requirement is mandatory for all MMFs as per Regulation 81-106.

If the amortized cost method is used by a MMF, we strongly encourage chief compliance officer to ensure that the written policies and procedures in place clearly address how the MMF complies with the fair value requirement.

The AMF expects IFMs to use the guidance provided in this notice.

### **Contact Persons**

For more information, please contact any of the following persons:

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