IMMFA

INSTITUTIONAL MONEY MARKET FUNDS ASSOCIATION

IMMFA Insights

Accumulating Share Classes

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ACCUMULATING SHARE CLASSES:

What Do Investors Need to Know?

INTRODUCTION

In light of the possibility of negative yields in both the UK and the US, asset managers and investors alike need to be prepared for what this means for money market funds ("MMFs"). This Insight piece focuses primarily on Low Volatility NAV (LVNAV) funds as these constitute the majority of IMMFA member funds, but the principles also apply to the other Constant NAV fund type, the Public Debt Constant NAV (PDCNAV) MMF.

BACKGROUND

When the returns of Euro-denominated MMFs moved to a negative yield in 2015, the industry introduced the reverse distribution mechanism, the so-called "RDM", as a solution. The RDM allowed funds to deduct a number of shares from an investor's account equal to the negative yield due on their investment, on a daily basis. This replaced the monthly dividend distribution investors were familiar with in a positive yield environment and continued the stable price of 1.00 per share.

Since the new Money Market Fund regulations became effective in 2019, European MMFs are no longer able to offer share classes that utilise "RDM" to handle negative yields. Instead, the funds may only offer accumulation classes which roll the negative income into the daily price. The price of an accumulation class changes every day and can come in differing conventions, both in base price and number of decimal places, for example 1.0000000 or 10,000.00.

Many European MMFs have offered both distribution and accumulation classes side by side for many years. The choice between investing in either a distribution or accumulation class is down to investor preference, with some investors opting to utilise accumulation classes as they better serve their operational requirements. As the guidelines of the relevant fund type (e.g. LVNAV) apply at the fund level, those guidelines continue to apply and therefore apply equally to both share class types.

Should we see yields fall further within the UK and / or US markets, resulting in a negative yield on Sterling and / or US Dollar MMFs, MMFs will need to cease paying distributions and instead offer accumulation classes, until such time that the fund is able to achieve a positive yield once again.

Valuation Methodology of Accumulating and Distributing Share Classes

The features of an accumulation class vary from that of a distribution class. The table below highlights the key areas of difference between distribution and accumulation share classes in an LVNAV fund.

	Low Volatility NAV Fund	
	Distributing	**Accumulating**
Unit pricing	Stable (constant) price (assuming mark-to-market price +/- 0.20% from 1.00)	Daily change in price to reflect accumulation of income.
Accounting method	Amortised cost accounting up to 75 days* mark-to-market over 75 days	
Settlement	Either Same day or T+1**	
NAV method	Priced to two decimal places	Usually priced to at least 6 significant figures in order to reflect income accruals
Effect in a positive yielding fund	Income distributed on a monthly basis	Accrual of income reflected in daily increase in price
Effect in a negative yielding fund	Not possible without RDM	Accrual of income reflected in daily decrease in price

*Amortised cost may be used to value assets maturing within 75 days provided the amortised cost price is within 10 basis points of the mark-to-market price

**Check with your MMF provider

Unit Pricing and Daily Change

The most significant difference between an LVNAV distributing share class and an LVNAV accumulating share class is the price per share. LVNAV distribution shares may, subject to the regulatory requirements of an LVNAV fund being met, transact using shares priced at a stable unit value of 1.00 (unless the mark-to-market price, calculated at least daily, is +/- 0.20% from the stable price of 1.00). By contrast, LVNAV accumulation shares will have a price that changes on a daily basis to reflect any interest that has accrued, be that positive or negative.

In a positive yield environment, this means that an LVNAV accumulation share will typically see an upwards trend in price. **However, in the case of negative yields this means that an LVNAV accumulation share will typically see a downward trend in price, reflecting the negative accrued interest.**

An LVNAV distribution share can be priced to two decimal places. (This would change to four decimal places in the event of a breach of the 0.20% fund collar). In contrast, an LVNAV accumulation share would typically be priced with at least 6 significant figures. This allows the price of the share to reflect small daily accruals in interest accurately.

As illustrated in the table above, all assets with 75 days or less to maturity can be priced on an amortised cost basis provided they are within 10 basis points of their mark-to-market, whilst any assets with maturities greater than 75 days have to be priced on a mark-to-market basis.

Looking Ahead - What to Do

As and when an LVNAV MMF looks likely to start generating a negative yield, asset managers will need to engage with their clients so that the clients understand the steps being taken within their specific funds. These processes may vary from manager to manager. It is recommended that you speak to your MMF managers to understand their processes should this event occur.

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