Comparing CNAV and VNAV funds

When looking at money market funds, investors often hear the terms "CNAV" and "VNAV". What do these terms stand for and what difference does it make for the investor?

Defining CNAV and VNAV

CNAV, or Constant Net Asset Value, refers to funds which use amortised cost accounting to value **all** of their assets. They aim to maintain a Net Asset Value (NAV), or value of a share of the fund, at €1 / £1 / $1 and calculate their price to 2 decimal places known as 'penny rounding'.

Most CNAV funds distribute income to investors on a regular basis (distributing share classes), though some may choose to accumulate the income, or add it on to the NAV (accumulating share classes). The NAV of accumulating CNAV funds will vary by the income received.

VNAV, or Variable Net Asset Value, refers to funds which use mark-to-market accounting to value **some** of their assets. The NAV of these funds will vary by a slight amount, due to the changing value of the assets and, in the case of an accumulating fund, by the amount of income received.

This means that a fund with an unchanging NAV is, by definition, CNAV, but a fund with a NAV that varies may be accumulating CNAV or distributing or accumulating VNAV.

Background on valuing assets

Normally one of the key differences between CNAV and VNAV funds is the accounting technique used to value the assets. Money market funds are allowed to use two separate accounting techniques to value their assets:

1) **Amortised cost accounting**, which values the asset at its purchase price, and then subtracts the premium / adds back the discount linearly over the life of the asset. The asset will be valued at par at its maturity.

2) **Mark-to-market accounting**, which values the asset at the price that could be obtained if the assets were sold (market price).

Funds which use amortised cost accounting compare the amortised cost price to the market price on a regular basis. If the variance is beyond a pre-set level, the fund manager needs to implement procedures to narrow the gap.

What is the difference for the investor?

For an investor, one of the primary differences between CNAV and VNAV funds will be the accounting and/or tax rules which apply to their investment. These rules frequently vary by domicile and should be discussed with the investor's usual advisors.

The investment risk of a fund cannot be determined simply by looking at the way its NAV is calculated. A fund manager who offers CNAV and VNAV funds may use the same investment process and choose to apply uniform investment guidelines for both types of fund. Whilst the NAVs for such funds would logically vary, given the different accounting techniques used, their risk exposure would be nearly identical.

Instead, investors in IMMFA funds can look to the IMMFA Code of Practice, which contains a set of risk-limiting provisions, as well as the criteria of the triple-A fund rating to help judge the fund's risk. This is complemented by a dashboard of summary risk indicators, which is published on a monthly basis.

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Choosing between CNAV and VNAV is only one part of the investment decision. Above all, investors should be sure to select a fund the exposure of which to interest rate, credit and liquidity risks best meets their needs.

IMMFA
65 Kingsway, London WC2B 6TD
+44 (0)20 7269 4669
admin@immfa.org
www.immfa.org