CONSULTATION PAPER

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Draft Guidelines For Valuation Of Collective Investment Schemes

Monetary Authority of Singapore

INTRODUCTION

Currently it is the industry practice to use net asset value (“NAV”) to value collective investment schemes (“CIS”). MAS intends to formalise this practice through a proposed requirement in the Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations (“SFR”), in line with international standards[1].

2 This paper sets out MAS’ proposals:

(a) To formalise the use of NAV to value a CIS and briefly discusses the definition of NAV;

(b) To require rounding differences arising from computations for subscriptions or redemptions of a CIS to be credited to the CIS itself; and

(c) To determine when unit holders should be compensated for erroneous pricing of units bought or redeemed.

VALUATION BASED ON NAV

3 MAS intends to formalize the existing industry practice by amending the SFR to require units of a CIS to be issued or redeemed on any dealing day at a price based on the NAV of the scheme as at a predetermined valuation point. A commonly accepted definition of NAV is an entity’s total assets less its total liabilities.

4 MAS notes that jurisdictions such as the US, the UK, Hong Kong, Luxembourg and Ireland (the “reference jurisdictions”) require pricing of a CIS to be based on NAV. The US SEC website defines NAV of a company as the

company's total assets minus its total liabilities. In the other jurisdictions, no definition of NAV is published. In practice, NAV of a CIS is the summation of the value of assets held minus expenses, charges and other items payable.

MAS would like to know if you agree with the proposal to require that units of a CIS be priced at NAV. MAS would also like to have your comments on whether, and if so how, NAV should be specifically defined.

CALCULATING NAV

CALCULATING NAV USING MARKET QUOTATIONS AND FAIR VALUE

5 In respect of quoted investments of a CIS for which market prices are representative, it is proposed that valuation be based on the latest known market price i.e. the last transacted price under normal market conditions. MAS notes that this is common in the reference jurisdictions and has also been the industry practice in Singapore.

6 In respect of quoted investments of a CIS for which market prices are not representative, the suggestion is for valuation to be based on fair value determined in good faith by the fund manager. For example, where a significant event occurs after the close of the market, the last transacted market price may no longer be representative of the fair value of the securities. Alternatively, there may be cases where market quotations are not readily available or are unreliable due to sporadic trading. There are similar guidelines in all the reference jurisdictions except Hong Kong.

[1] IOSCO Principle 20: Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.

7 MAS is of the view that whether a price should be considered "representative" should be a matter for the manager to decide and notes that the term has not been defined in the guidelines of other jurisdictions. In practice, the manager should be ultimately responsible for determining fair value. If the manager is not qualified to do so in a particular circumstance, he can consult other professionals. The manager should, however, document the basis for any fair value used in calculating NAV.

8 In respect of unquoted investments of a CIS, we propose that valuation be based on fair value, i.e. the price the CIS would reasonably expect to receive upon the current sale of the investment, as determined on a regular basis by a professional person approved by the trustee as qualified to value such investments.

9 When the fair value of the investments cannot be determined, the manager should suspend valuation and trading in the units of the CIS.

> MAS seeks your views on the proposal for the calculation of NAV using market quotations and fair value. MAS would also like to know the situations when fund managers/trustees decide that quoted prices are not "representative" and fair value has to be substituted.

CALCULATING NAV USING BASIS OTHER THAN MARKET QUOTATIONS

10 To cater for funds such as money market funds, we propose allowing other methods for determining NAV provided the trustee agrees with such alternative method and MAS' approval is obtained at the time the fund is authorised or recognised. For example, money market funds may calculate

NAV on the basis of amortized cost, where investments are valued on the basis of accrued interest rather than market quotations.

11 MAS notes that this approach of valuation has been adopted in the US, the UK and Ireland and is subject to approval of the trustee (in the case of a unit trust)/board of directors (in the case of a fund company) and/or the regulatory authority.

MAS seeks your views on the proposed valuation method for money market funds and invites suggestions for other bases of calculating NAV for CIS.

FREQUENCY OF VALUATION

12 In general, a manager should value the units of a CIS every business day. This is already the practice for most CIS. We propose to formalise this by way of a Notice. Exceptions will be allowed for CIS which by the nature of their investment strategy, e.g. structured product funds and hedge funds, do not lend themselves to daily redemptions, rendering daily valuation unnecessary. MAS is of the view that structured product funds should be valued at least once a month and hedge funds should be valued at least once every quarter.

13 As it is impractical to have frequent valuation of properties, property funds are only required to have a full valuation done once a year. However, if a listed property fund is suspended from trading for more than 60 days **or** is delisted, it must have a full valuation done within 30 days.

14 For exchange-traded funds, it is proposed that their NAV, i.e. the value of shares comprising the creation basket and the estimated cash component divided by the number of units in the creation basket, be calculated at least daily.

15 MAS notes that while the UK, Luxembourg and Ireland require valuation to be performed at least twice a month, the US requires valuation to be performed on a daily basis except (a) on days where changes in the value of the securities held by the fund will not materially affect the current NAV[2]; (b) on days when no units are subscribed for or redeemed from the fund; or (c) on customary holidays listed in the prospectus.

MAS seeks your views on the proposed frequency of valuation of the various types of CIS and comments on whether there are other types of CIS that have not been discussed that warrant valuation at a different frequency.

ROUNDING

16 When a valuation agent calculates NAV per unit, it is necessary to round the resultant figure in order to obtain a finite dollar value. This NAV per unit is then used to calculate the number of units due to an investor who subscribes to the fund and the cash proceeds due to an investor who redeems his units from the fund. We understand that in some cases the rounding differences are credited to the manager. As rounding differences arise from the operations of the fund, MAS proposes that they, like returns

[2] This may happen on a day where there is little or no trading activity such that the price of the securities held does not change much from the previous day's price.

from investments for instance, should be credited to the fund and not to the manager.

MAS seeks your views on the proposal for differences arising from rounding to be credited to the CIS.

COMPUTATIONAL ERRORS AND COMPENSATION

17 Errors in computing NAV may occur at times. When an error occurs and subscriptions or redemptions of units in a CIS have been transacted based on an erroneous NAV, we propose to require the person responsible for the valuation to re-compute the NAV for the period when the error occurred and then ascertain if compensation to the affected investors or the fund is necessary. Corrective action should be taken if the error is material.

18 MAS notes that the criteria for materiality vary across jurisdictions. In the US and Luxembourg, quantitative benchmarks are provided. The UK, however, adopts a more flexible approach. Investors and the CIS (where applicable) will be compensated for material errors defined by a quantitative benchmark, but may also receive compensation for errors that fall below the benchmark after taking other factors e.g. duration of the error into account.

19 MAS proposes that where an error represents 0.5% or more of the scheme's NAV per unit, unit holders who, or the CIS which, incur losses must be compensated. This proposed 0.5% benchmark is similar to the benchmark used in the US, the UK and Hong Kong.

20 For an incorrect price that amounts to less than 0.5% of the scheme's NAV per unit, MAS proposes that the fund manager be required to determine if the error is nonetheless material and requires compensation. The factors that should be taken into consideration include the duration of the error and the level of compensation on a per lot basis. If the fund manager decides that the amount of compensation due to unit holders on a per lot basis is immaterial, notwithstanding the fact that one unit holder could have a large number of units resulting in the sum of the error being significant, the decision not to compensate should be applied to all unit holders.

21 MAS notes that whether the fund manager may demand compensation from unit holders who benefited from the error remains a controversial issue. In Hong Kong, fund managers are not allowed to seek compensation from the holders. In addition, UK and Luxembourg generally discourage fund managers from seeking compensation from holders for reasons such as preserving the reputation of the scheme.

MAS seeks your views on the proposed approach for managers to deal with computational errors and the instances where compensation to unit holders is necessary. MAS also invites comment as to whether fund managers should be seeking compensation from investors who have benefited from computational errors.

REQUEST FOR COMMENTS

22 MAS invites interested parties to forward their comments on the draft guidelines, and on the matters set out in paragraphs 3 to 21. Written comments may be submitted to:

Corporate Finance Division
Securities and Futures Supervision Department
Monetary Authority of Singapore
10 Shenton Way
MAS Building
Singapore 079117

Email: cisvaluation@mas.gov.sg
Fax: (65) 6225-1350

MAS requests that all comments and feedback be submitted by 22 Sept 2003.

23 Please note that all submissions received may be made public unless confidentiality is specifically requested for the whole or part of the submission.