

## FSC APPROVES RULES CHANGE TO GRADUALLY INTRODUCE MARK-TO-MARKET VALUATION ON CORPORATE MMFs

The FSC approved a revision to the regulation on financial investment business at the 6<sup>th</sup> regular meeting held on March 30 for gradually introducing the mark-to-market valuation method on corporate money market funds (MMFs) and to check relevant preparation and implementation to facilitate a soft-landing of the mark-to-market method in the market.

### **BACKGROUND**

The mark-to-market valuation method on corporate MMFs is scheduled to take effect from April 1, 2022, which was introduced through amendments to the Enforcement Decree of the Financial Investment Services and Capital Markets Act (FSCMA) and the regulation on financial investment business in March 2020. Although the mark-to-market valuation method is considered as the rule of the game in principle, prior to the amendments, the book value method was permitted on MMFs as long as the disparate rate in the market-to-book value is within 0.5 percent. However, when disparity in the market-to-book value widens, there is a possibility of causing an abrupt and large-scale redemption as the earlier the investor redeems his/her money, the higher valuation s/he will get on return. As such, the amendments have been introduced to bring about improvements by introducing and implementing the mark-to-market valuation method on corporate MMFs from April 2022. Some of the key changes include (a) making an exemption to allow the book value method on corporate MMFs with more than 30 percent of stable assets as prescribed by the regulation on financial investment business and (b) expanding the duration of corporate MMFs using the mark-to-market valuation method from 75 days previously to 120 days to promote a wider use.

However, with a growing potential of rising volatility in short-term money markets recently, there have been calls for a need to introduce the mark-to-market valuation method in a step-by-step manner in order to prevent corporate MMFs from turning into potential risk factors. With the MMFs' current preference for the book value method, making adjustments to their portfolios will be inevitable to meet the above 30 percent stable asset makeup requirement through the sales of commercial paper and electronic short-term bonds and the purchase of government bonds and public sector bonds, which may lead to volatility in short-term money markets. Therefore, the authorities have prepared the following measures in order to introduce the mark-to-market valuation method in stages through a revision to the regulation on financial investment business.

## **KEY DETAILS**

**(STEP-BY-STEP TRANSITION)** The revised rules will apply as planned on the newly launched MMFs on or after April 1, 2022. On the existing corporate MMFs, the mark-to-market valuation method will be applied in stages. For the existing corporate MMFs, the revised regulation will allow them to maintain the book value method for one year even if the proportion of stable assets in their portfolios stands at or below 30 percent as long as the level of acquisition in stable assets as prescribed by the regulation on financial investment business exceeds other types of assets in order to allow more time for making adjustments to their portfolios over one year.

**(PROVISION OF BUFFER ON STABLE ASSETS)** The revised regulation expands the scope of assets that can be qualified as stable assets and provides a buffer for making a transition to the mark-to-market valuation method on the qualifying MMFs using the book value method.<sup>1</sup>

- A. SCOPE OF STABLE ASSETS:** Under the revised regulation, deposits held at securities finance companies and the Korea Post, commercial paper and short-term bonds of special purpose companies, and purchases of repos that have satisfied the requirement of repo haircut<sup>2</sup> are also qualified as stable assets.
- B. PROVISION OF BUFFER (REGARDING ASSESSMENT OF STABLE ASSET PROPORTION):** Even when the proportion of stable assets in a portfolio falls to 30 percent or below, the book value method on MMFs will be allowed if the stable asset makeup recovers above the 30 percent threshold within three business days.
- C. PROVISION OF BUFFER (REGARDING LARGE-SCALE REDEMPTION):** As a result of a transient and one-off redemption in large-scale,<sup>3</sup> if the proportion of stable assets falls abruptly, making a transition to the mark-to-market valuation method can be deferred for ten business days. Nonetheless, when a large-scale redemption occurs that is transient and one-off in nature, prior steps should have taken place in advance for the management of early redemption triggers<sup>4</sup> by halting a book value method and so on.

## **FURTHER PLAN**

The Financial Supervisory Service will check the preparation and implementation status of the mark-to-market valuation method on corporate MMFs on a quarterly basis from September this year. The revised rules will go into effect from April 1, 2022.<sup>5</sup>

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<sup>1</sup> MMFs that have made an indication in their collective investment contracts.

<sup>2</sup> The requirement of repo haircut on purchase of repos, which is newly included as a stable asset class, will be determined through the operational rules for the implementation of the regulation on financial business (authority delegated to the Governor of the Financial Supervisory Service).

<sup>3</sup> For example, when cancellation requests in a single business day exceed more than 10% of the fund's total assets or when that number surpasses 15% over two business days.

<sup>4</sup> Collective investment asset and investor protection and management plans in the case of a drop in the stable asset makeup, a rise in the disparate ratio of market-to-book values and occurrence of redemption triggers.

<sup>5</sup> Full text of the revised regulation is available at [www.fsc.go.kr](http://www.fsc.go.kr) (available in Korean only).