

## ICRA Analytics Valuation policy guidelines

### **SUB:1) Valuation of Money Market and Debt Securities**

#### **2) Polling process for money market and debt securities**

#### **3) Other points**

As per SEBI circular no. SEBI/HO/IMD/DF4/CIR/P/201 9/102 dated September 24, 2019 on Valuation of money market and debt securities valuation agency should have documented valuation policy in line with SEBI circular issued in this context and in accordance with the best practices issued by AMFI on the subject.

In line with above mandate, AMFI guidelines and circular, ICRA Analytics adopts the below valuation policy with effect from 17-02-2020 for the valuation of Money market and Debt Securities.

This policy is divided into two sections as follows:

- I. Waterfall approach for valuation of money market and debt securities
- II. Polling process for money market and debt securities

And subdivided into details in the following segment-

1. Waterfall mechanism for valuation of money market and debt securities
2. Definition of tenure buckets for similar maturity
3. Process for determination of similar issuer
4. Recognition of trades and outlier criteria
5. Process for construction of spread matrix

### **Part A: Valuation of Money Market and Debt Securities other than G-Secs**

#### **1. Waterfall Mechanism for valuation of money market and debt securities:**

The following shall be the broad sequence of the waterfall for valuation of money market and debt securities:

- i. Volume Weighted Average Yield (VWAY) of primary reissuances of the same ISIN (whether through book building or fixed price) and secondary trades in the same ISIN
- ii. VWAY of primary issuances through book building of same issuer, similar maturity (Refer Note 1 below)
- iii. VWAY of secondary trades of same issuer, similar maturity
- iv. VWAY of primary issuances through fixed price auction of same issuer, similar maturity
- v. VWAY of primary issuances through book building of similar issuer, similar maturity (Refer Note 1 below)
- vi. VWAY of secondary trades of similar issuer, similar maturity.
- vii. VWAY of primary issuance through fixed price auction of similar issuer, similar maturity
- viii. Construction of matrix (polling may also be used for matrix construction)
- ix. In case of exceptional circumstances, polling for security level valuation (Refer Note 2 below)

**Note 1**

Except for primary issuance through book building, polling shall be conducted to identify outlier trades. However, in case of any issuance through book building which is less than INR 100 Cr, polling shall be conducted to identify outlier trades.

However, in case the information on fees is not given/ announced on the EBP platform/book building/fixed price auction, all trades which are outlier as per given band may be polled

**Note 2**

Some examples of exceptional circumstance would be stale spreads, any event/news in particular sector/issuer, rating changes, high volatility, corporate action or such other event as may be considered by ICRA Analytics(earlier IMA CS). Here stale spreads are defined as spreads of issuer which were not reviewed/updated through trades/primary/polls in same or similar security/issuers of same/similar maturities in waterfall approach in last 6 months.

Further, the exact details and reasons for the exceptional circumstances which led to polling shall be documented and reported to AMCs.

Analysis of the stale spread shall be done monthly to identify issuers which are not reviewed/updated through trades/primary/polls in same or similar security/issuers of same/similar maturities in waterfall approach in last 6 months

**Note 3**

All trades on stock exchanges and trades reported on trade reporting platforms till end of trade reporting time (excluding Inter-scheme transfers) should be considered for valuation on that day.

**Note 4**

It is understood that there are certain exceptional events, occurrence of which during market hours may lead to significant change in the yield of the debt securities. Hence, such exceptional events need to be factored in while calculating the price of the securities. Thus, for the purpose of calculation of VWAY of trades and identification of outliers, on the day of such exceptional events, rather than considering whole day trades, only those trades shall be considered which have occurred post the event (on the same day).

The following events would be considered exceptional events:

- i. Monetary /Credit Policy
- ii. Union Budget
- iii. Government Borrowing / Auction Days
- iv. Material Statements on Sovereign Rating
- v. Issuer or Sector Specific events which have a material impact on yields
- vi. Central Government Election Days
- vii. Quarter end days

In addition to the above, ICRA Analytics may determine any other event as an exceptional event.

All exceptional events along-with valuation carried out on such dates shall be documented with adequate justification.

**2 Definition of tenure buckets for Similar Maturity**

When a trade in the same ISIN has not taken place, reference should be taken to trades of either the same issuer or a similar issuer, where the residual tenure matches the tenure of the bond to be priced. However, as it may not be possible to match the exact tenure, it is proposed that tenure buckets are created and trades falling within such similar maturity be used as per table below.

<b>Residual Tenure of Bond to be priced</b>	<b>Criteria for similar maturity</b>
Upto 1month	Calendar Weekly Bucket
Greater than 1month to 3 months	Calendar Fortnightly Bucket

Greater than 3 months to 1year	Calendar Monthly Bucket
Greater than 1year to 3 years	Calendar Quarterly Bucket
Greater than 3 years	Calendar Half Yearly or Greater Bucket

ICRA Analytics adopts half yearly bucket for 3-5 years and yearly bucket from greater than 5 year.

In addition to the above:

- a. In case of market events, or to account for specific market nuances, valuation agencies may be permitted to vary the bucket in which the trade is matched or to split buckets to finer time periods as necessary. Such changes shall be auditable. Some examples of market events / nuances include cases where traded yields for securities with residual tenure of less than 90 days and more than 90 days are markedly different even though both may fall within the same maturity bucket, similarly for less than 30 days and more than 30 days or cases where yields for the last week vs second last week of certain months such as calendar quarter ends can differ.
- b. In the case of illiquid/ semi liquid bonds, it is proposed that traded spreads be permitted to be used for longer maturity buckets (1 year and above). However, the yield should be adjusted to account for steepness of the yield curve across maturities. ICRA Analytics shall maintain steepness based on carry forward of the inter tenor spread and/or adjusted with steepness and flattening of the curve on longer end to represent normal curve. Market poll on spread may be the used.
- c. The changes / deviations mentioned in clauses a and b, above, should be documented, along with the detailed rationale for the same.
- d. Process for making any such deviations shall also be recorded. Such records shall be preserved for verification.

### **3. Process for determination of similar issuer**

Valuation agencies shall determine similar issuers using one or a combination of the following criteria. Similar issuer do not always refer to issuers which trade at same yields, but may carry spreads amongst themselves & move in tandem or they are sensitive to specific market factor/s hence warrant review of spreads when such factors are triggered.

- i. Issuers within same sector/industry and/or
- ii. Issuers within same rating band and/or
- iii. Issuers with same parent/ within same group and/or
- iv. Issuers with debt securities having same guarantors and/or
- v. Issuers with securities having similar terms like Loan Against Shares (LAS)/ Loan Against Property (LAP)

The above criteria are stated as principles and the final determination on criteria, and whether in combination or isolation shall be determined by the valuation agencies.

The criteria used for such determination should be documented along with the detailed rationale for the same in each instance. Such records shall be preserved for verification.

Similar issuers which trade at same level or replicate each other's movements are used in waterfall approach for valuations. However, similar issuer may also be used just to trigger the review of spreads for other securities in the similar issuer category basis the trade/news/action in any security/ies within the similar issuer group.

#### 4. Recognition of trades and outlier criteria

##### i. Volume criteria for recognition of trades (marketable lot)

In this regard, marketable lot is defined as under.

The following volume criteria shall be used for recognition of trades by valuation agencies:

Parameter	Minimum Volume Criteria for marketable lot	
Primary	INR 25 cr for both Bonds/NCD/CP/ CD and other money market instruments	
Secondary	INR 25 cr for CP/ CD, T-Bills and other money market instruments	
Secondary	INR 5 Cr for Bonds/NCO/ G-secs	

Trades not meeting the minimum volume criteria i.e. the marketable lot criteria as stated above shall be ignored.

##### ii. Outlier criteria

It is critical to identify and disregard trades which are aberrations, do not reflect market levels and may potentially lead to mispricing of a security or group of securities. Hence, the following broad principles would be followed by valuation agencies for determining outlier criteria.

- Outlier trades shall be classified on the basis of liquidity buckets (Liquid, Semi-liquid, Illiquid). Price discovery for liquid issuers is generally easier than that of illiquid issuers and hence a tighter pricing band as compared to illiquid issuers would be appropriate.
- The outlier trades shall be determined basis the yield movement of the trade, over and above the yield movement of the matrix. Relative movement ensures that general market movements are accounted for in determining trades that are outliers. Hence, relative movement over and above benchmark movement shall be used to identify outlier trades.
- Potential outlier trades which are identified through objective criteria defined above will be validated through polling from market participants. Potential outlier trades that are not validated through polling shall be ignored for the purpose of valuation.
- The following criteria shall be used by valuation agencies in determining Outlier Trades

Liquidity Classification	Bps Criteria (Yield movement over Previous Day yield after accounting for yield movement of matrix)		
	Upto 15 days	15-30 days	Greater than 30 days
Liquid	30 bps	20 bps	10 bps
Semi-liquid	45 bps	35 bps	20 bps
Illiquid	70 bps	50 bps	35 bps

The above criteria shall be followed consistently and would be subject to review on a periodic yearly basis or as and when required depending on trading pattern by ICRA Analytics and any change would be carried in consultation with AMFI.

- e. In order to ensure uniform process in determination of outlier trades the criteria for liquidity classification shall be as detailed below.

Liquidity classification criteria – liquid, semi liquid and illiquid definition

Valuation agencies shall use standard criteria for classifying trades as Liquid, Semi-Liquid and illiquid basis the following two criteria

- a. Trading Volume
- b. Spread over reference yield

Such criteria shall be reviewed on periodic basis in consultation with AMFI.

Trading Volume (Traded level based criteria:

Number of unique days an issuer trades in the secondary market or issues a new security in the primary market in a calendar quarter

- Liquid >=50% of trade days
- Semi liquid >=10% to 50% trade days
- Illiquid <10 % of trade days

Spread based criteria:

Spread over the matrix shall be computed and based on thresholds defined, issuers shall be classified as liquid, semi liquid and illiquid. For bonds thresholds are defined as upto 15 bps for liquid; > 15-75 bps for semi-liquid; > 75 bps for illiquid. (Here, spread is computed as average spread of issuer over AAA Public Sector Undertakings/Financial Institutions/Banks matrix), For CP/ CD- upto 25 bps for liquid; >25-50 bps for semiliquid; > 50 bps for illiquid. (Here, spread is computed as average spread of issuer over AI+/AAA CD Bank matrix).

The thresholds shall be periodically reviewed and updated having regard to the market.

The review shall be done monthly on three month data on rolling basis.

The best classification (liquid being the best) from the above two criteria (trading volume and spread based) shall be considered as the final liquidity classification of the issuer. The above classification shall be carried out separately for money market instruments {CP/ CDs) and bonds.

5. Process for construction of spread matrix

Valuation agencies shall follow the below process in terms of calculating spreads and constructing the matrix:

Steps	Detailed Process
Step 1	<p>Segmentation of corporates -</p> <p>The entire corporate sector is first categorised across following four sectors i.e. all the corporates will be catalogued under one of the below mentioned bucket:</p> <ol style="list-style-type: none"> <li>1. Public Sector Undertakings/Financial Institutions/Banks;</li> <li>2 Non-Banking Finance Companies -except Housing Finance Companies;</li> <li>3 . Housing Finance Companies;</li> <li>4. Other Corporates</li> </ol>
Step 2	<p>Representative issuers -</p> <p>For the aforesaid 4 sectors, representative issuers (Benchmark Issuers) shall be chosen by ICRA Analytics for only higher rating {i.e. "AAA" or AA+). Benchmark/Representative Issuers will be identified basis high liquidity, availability across tenure in AAA/AA+ category and having lower credit/liquidity premium. Benchmark Issuers can be single or multiple for each sector.</p> <p>It may not be possible to find representative issuers in the lower rated segments, however in case of any change in spread in a particular rating segment, the spreads in lower rated</p>

	segments should be suitably adjusted to reflect the market conditions. In this respect, in case spreads over benchmark are widening at a better rated segment, then adjustments should be made across lower rated segments, such that compression of spreads is not seen at any step. For instance, if there is widening of spread of AA segment over the AAA benchmark, then there should not be any compression in spreads between AA and A rated segment and so on.
Step 3	<p><b>Calculation of benchmark curve and calculation of spread –</b></p> <ol style="list-style-type: none"> <li>1. Yield curve to be calculated for representative issuers for each sector for maturities ranging from 1month till 20 years and above.</li> <li>2. Waterfall approach as defined in Part A (1) above will be used for construction of yield curve of each sector.</li> <li>3. In the event of no data related to trades/primary issuances in the securities of the representative issuer is available, polling shall be conducted from market participants</li> <li>4. Yield curve for Representative Issuers will be created on daily basis for all 4 sectors. All other issuers will be pegged to the respective benchmark issuers depending on the sector, parentage and characteristics. Spread over the benchmark curve for each security is computed using latest available trades/primaries/polls for respective maturity bucket over the Benchmark Issuer.</li> <li>5. Spreads will be carried forward in case no data points in terms of trades/primaries/polls are available for any issuer and respective benchmark movement will be given</li> </ol>
Step 4	<ol style="list-style-type: none"> <li>1. The principles of VWAY, outlier trades and exceptional events shall be applicable while constructing the benchmark curve on the basis of trades/primary issuances.</li> <li>2. In case of rating downgrade/credit event/change in liquidity or any other material event in Representative Issuers, new Representative Issuers will be identified. Also, in case there are two credit ratings, the lower rating to be considered.</li> <li>3. Residual tenure of the securities of representative issuers shall be used for construction of yield curve.</li> </ol>

ICRA Analytics shall choose the benchmark based on trading pattern of the issuer w.r.t to volume traded, number of days traded, and number of trades and availability of issuance across tenor. Feedback from market participants to be collected to choose the benchmark issuer. Also the spread compression and widening across rating shall be done on monthly interval with average spread and issuer wise comparison b/w 2 dates.

### **Part B : Valuation of G-Secs {T-Bill, Cash management bills, G-Sec and SDL}**

The following is the waterfall mechanism for valuation of Government securities:

- VWAY of last one hour, subject to outlier validation
- VWAY for the day to be analysed vis-à-vis available two quote, not wider than 5 bps on NDSOM), subject to outlier validation
- Two quote, not wider than 5 bps on NDSOM, subject to outlier validation
- Carry forward of spreads over the benchmark
- Polling etc.

#### **Note:**

1. VWAY shall be computed from trades which meet the marketable lot criteria stated in Part A of these Guidelines.
2. Outlier criteria: Any trade deviating by more than +/- 5 bps post factoring the movement of benchmark security shall be identified as outlier. Such outlier shall be validated through polling for inclusion in valuations. If the trades are not validated, such trades shall be ignored.

## **POLLING PROCESS FOR MONEY MARKET AND DEBT SECURITIES**

Please refer to Paragraph 2.2.5 of SEBI vide circular no. SEBI/HO/IMD/DF4/CIR/P/2019/102 dated September 24, 2019 on Valuation of money market and debt securities, which prescribes that considering the importance of polling in the valuation process, guidelines shall be issued by AMFI on polling by valuation agencies and on the responsibilities of Mutual Funds in the polling process, as part of the waterfall approach for valuation of money market and debt securities. In this regard, the following Guidelines were approved by the Board of AMFI, in consultation with SEBI which is being included in our valuation policy..

### **Polling Guidelines:**

L Valuation agency shall identify the Mutual Funds who shall participate in the polling process on a particular day, taking into account factors such as diversification of poll submitters and portfolio holding of the Mutual Funds. Mutual Funds who are identified by the valuation agencies shall necessarily participate in the polling process. Polling will be carried out on a daily basis by the valuation agencies, in terms of points 9-11 below.

Proposed to valcom is –

### **For benchmark and Liquid issuer-**

Step 1# Entire universe of companies to be divided into 3 categories depending upon AUM- highest to lowest.

Step 2# Top three from each group.

### **For Semi-liquid and Illiquid and specific issuer**

Step 1# MFs would be categorised into Holder and Non holder category .

Step 2# Top 2 and bottom 2 among the holder category( subject to availability of such number of holders) & 4 random selection from non-holder(MFs) category would be polled.

Subsequent day if required to poll, the holders not polled in step 2# above would be considered

2. ICRA Analytics needs to take polls from at least 5 unique Mutual Funds on a daily basis and may cover more Mutual Funds, over and above this.  
For benchmark securities a poll constituting at least 5 responses will be considered as valid.  
In case of non-benchmark securities a poll constituting at least 3 responses will be considered as valid.  
The responses received by each valuation agency will be shared with the other agency also.
3. Median of polls shall be taken for usage in valuation process.
4. ICRA Analytics will also need to cover as many non- Mutual Fund participants as possible, over and above the Mutual Funds, to improve on the polling output quality.
5. Endeavour would be made to have adequate representation of both holders and non-holders of the same bond/same issuer for non-benchmark securities in the poll process. Where this is not possible, ICRA Analytics may seek polls from holders of bonds with a similar structure.
6. In the case of issuers with multiple notch rating upgrades / downgrades over short periods of time, ICRA Analytics shall:
  - a. Conduct polls with a larger universe of pollers.
  - b. Increase the frequency of polling
7. Suo moto feedback on valuations should be entertained only through formal mails from persons designated by AMC for said purpose, and the same shall be validated through repolling.  
  
Any such feedback shall be duly recorded by ICRA Analytics, including the reason for the challenge, results of repolling and subsequent changes in valuation on repolling, if any. Such records shall be preserved by the valuation agencies, for verification.
9. Polling will be done for two sets of securities, Benchmark & Others.
10. Benchmark will be defined for the following categories across tenors.

- a) Treasury Bills
  - b) Central Government securities
  - c) State Government Securities
  - d) AAA PSU/PFI/PSU Banks
  - e) AAA Private
  - f) NBFC
  - g) HFC
  - h) Any other as required for improving fair valuations .
11. Polling shall be conducted in the following two scenarios:
- a) Validation of traded levels if they are outlier trades.
  - b) Non traded Securities (in exceptional circumstances as defined in the waterfall mechanism for valuation of money market and debt securities).
  - c) In other cases as may be deemed necessary by ICRA Analytics for fair valuation of securities.
12. The polling process will be revalidated by external audit of the valuation agencies with at least an annual frequency
- a. All polling should be preferably over email. In case for any reason, the polling is done by way of a telephonic call then such a call should be over recorded lines, followed subsequently by an email.
  - b. ICRA Analytics should have adequate business continuity arrangements for polling, with the necessary infrastructure / skill to ensure that consistent of poll is made without material interruption due to any failure, human or technical.

Polling entity selection method-

**For benchmark and Liquid issuer-**

Step 1# Entire universe of companies to be divided into 3 category depending upon AUM- highest to lowest.

Step 2# Three from each group to be selected .

**For Semi-liquid and Illiquid and specific issuer**

Step 1# MFs would be categorised into Holder and Non holder category .

Step 2# Top 2 and bottom 2 among the holder category( subject to availability of such number of holders) & 4 random selection from non-holder(MFs) category would be polled.

Subsequent day if required to poll, the holders not polled in step 2# above would be considered.

ICRA Analytics shall poll from different non-MF participants to increase the diversity of poll with the objective of doing a fair valuation. However, all polls shall be collected on recorded line and all records shall be maintained for audit purpose.

**Valuation of OIS/Tripartite Repo and other instrument.**

- a) **OIS-** The valuation shall be done as per the methodology approved by AMFI Valcom. The valuation shall be done for fixed leg and the net price shall be sent to AMC.  
For Fixed leg valuation is done basis the curve available. Inter-period valuation shall be done based on interpolation
- b) **Tripartite Repo-** TREPS are to be valued based on the valuation of same maturity/similar maturity T-Bills with the applicable spread
- c) **For, Other instrument not mentioned above, the valuation methodology shall be drafted and discussed with VALCOM- AMFI and shall be adopted**

i) **Valuation Committee-**

Valuation committee shall be constituted to ensure that all valuation shall be done on the principles of fair valuation, in line with the directives issued by SEBI/AMFI. Internal Valuation committee shall meet at-least once a month and all the records shall be kept for reference and audit purpose.

ii) **Business continuity Plans**

ICRA analytics shall have robust Business Continuity plan and shall be conducted atleast once a year. The observation shall be documented and preserved for reference and audit

iii) **Valuation policy on website-**

Updated valuation methodology shall be uploaded on the website.  
Also the valuation of all securities shall be uploaded on the website with the lag of 30 days.