Consultation Paper CP5.1/2025: Valuation Standards – Review of existing Standards and proposal for addition of new Standards specific to Private Market Assets

The Standards Board for Alternative Investments (SBAI) invites comments on this Consultation Paper CP5/2024. **Comments should be submitted by 30 June 2025** electronically (Word, pdf-document) to brian.digney@sbai.org or by post to:

SBAI
CP5/2024
7 Henrietta Street
London, WC2E 8PS
United Kingdom

It is the SBAI's policy to make all responses to consultations available for public inspection unless the respondent requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure.

Executive Summary

To ensure the Alternative Investment Standards (*"Standards"*) remain fit for purpose and reflect changes in good practices within the industry, we are launching a fifth consultation process.

We seek to invite feedback from both our members, financial regulators, and the broader industry. This consultation provides an important opportunity to contribute to the ongoing development of the Standards, encourage transparency between institutional investors and investment managers, and improve industry outcomes.

The review of our existing Standards will include:

- Updating the standards to address emerging areas, including:
    - Closed-ended vehicles
    - Private market strategies
    - Digital assets
- Amending guidance to reflect changes in industry practices, such as the adoption of managed accounts
- Ensuring alignment with other industry bodies' guidance, such as the ILPA Principles
- Assessing the Standards against evolving regulatory expectations
- Simplifying the language of current Standards and guidance to better reflect a principles-based approach (see section 5, this is not intended to change their meaning)

The consultation process will focus on different thematic areas and sections of the Standards. This first consultation paper will focus on Valuation. In this paper we will review the existing Valuation Standards and outline proposed amendments which are intended to broaden existing Standards 5-8 to better account for valuation of private market assets.

We intend to achieve this by proposing amendments which (i) reduce conflicts of interest regarding related-party transactions and service provider engagements, (ii) provide investors with additional comfort on valuation methodology appropriateness and subjectivity of inputs/assumptions, and (iii) increase investor disclosure and transparency by managers.

The proposals set forth in this consultation paper have been developed by an international working group of managers and investors brought together by the SBAI to help investors improve the handling of valuations of private market assets. In addition, a number of third-party service providers who support the valuation of private market assets have provided input and feedback to this process. This proposal builds on the existing Standards and takes into account the existing regulation.

This consultation is part of the SBAI's mandate to update and improve the Alternative Investment Standards, responding to the needs of managers, investors, and public policy requirements. The Alternative Investment Standards complement the statutory rules and regulations in areas of complex and innovative practice, where standards can be a more effective way of influencing behaviours and achieving public policy aims than statutory rules.

1. Introduction

Private markets have grown significantly since the 2009 Financial Crisis and have become an important source of capital for companies and a significant allocation in many institutional investor portfolios. By their very nature, private markets lack public transparency, and there are material differences in how the value of private assets are formed, compared to public markets.

The process for acquiring or disposing of private market assets usually requires significant time and resources, can take many months and can be very costly. This fundamental difference between how public and private assets/securities are priced, results in a much higher reliance by the investors on the investment manager (and service providers) for the valuation of such assets.

The remainder of this consultation document is structured as follows:

1. Overview of specific investor concerns
2. Overview of existing regulations and standards
3. Proposed amendments to the Alternative Investment Standards
4. Review of the existing Valuation Standards and proposed wording changes
5. Consultation Questions

2. Specific Investor Concerns

In recent years, investors have raised concerns regarding the reliability of valuations of private market investments, including:

- Conflicts of interest (including manager involvement in valuation process)
- Accuracy/manipulation of marks including smoothed volatility, disconnect with public market valuations and broader macroeconomic environment, lagging marks, and inflation of marks during managers' fund-raising periods
- Inconsistency of marks (for identical assets) by different fund managers due to lack of standardisation and subjectivity of valuation inputs
- Lack of transparency for investors to conduct due diligence on valuations

Inaccurate valuations of private market funds can have far-reaching consequences for investors, including:

- Unfair treatment of:
    - *Investors* relative to other investors in the same fund where the investment fund is open-ended or can provide liquidity at certain points in time
    - *Pensioners* (beneficiaries) where redemptions or pension payments are based on fair value at plan level
- Overpayment of fees (when overvaluations occur, and where fund fee calculations are based on NAV)
- Portfolio rebalancing and FX hedging based on inaccurate valuation information
- Inaccurate performance assessments of investment teams

Large variations in quality of industry practices can allow bad actors go undetected, undermining confidence in the asset class and harming investors. Hence, the industry as a whole should have an interest in addressing these concerns.

3. What do regulations and the Alternative Investment Standards say?

Regulatory Influences

In the United States, funds registered with the Securities and Exchange Commission (SEC)[1] are required to follow US Generally Accepted Accounting Principles (GAAP)[2] for their financial reporting (some Foreign private Issuers may be exempt and are permitted to report using IFRS). This includes mutual funds, exchange-traded funds (ETFs), closed-end funds, and others.[3] US-based private funds, such as private equity funds, venture capital funds, or hedge funds, which are not registered with the SEC, also typically use US GAAP for financial

[1] *Good Faith Determinations of Fair Value*, SEC, see: https://www.sec.gov/files/rules/final/2020/ic-34128.pdf
[2] US GAAP is a set of accounting principles, standards, and procedures that public companies in the United States must follow when compiling their financial statements. These principles are established and administered by the Financial Accounting Standards Board (FASB), a private sector body.
[3] *Fund Valuation Under the SEC's New Fair Value Rule*, ICI (2021), see: https://www.ici.org/system/files/2021-12/21-ppr-fund-valuation-primer.pdf

reporting, primarily because their investors are accustomed to that standard.[4] Specific guidance is available for investment companies through the Financial Accounting Standards Board's (FASB's) Accounting Standards Codification (ASC) 946 Financial Services-Investments Companies. It covers a variety of special rules for both recognition and measurement of typical transactions entered into by investment companies, as well as financial reporting requirements. There are several factors that need to be considered to ascertain which accounting standards will apply including the registration status of the fund, what type of assets it holds, and the number of investments and investors.

In the European Union, the use of International Financial Reporting Standards (IFRS)[5] is mandatory for consolidated financial statements of publicly listed companies. This requirement extends to investment funds that are publicly listed. However, non-listed investment funds can choose between IFRS and local GAAP, although IFRS is commonly used due to its international recognition, especially by funds with international investors or aspirations.[6]

Under IFRS, fair value measurement is mandated for investment funds. IFRS 13 provides guidance on fair value measurement. Similarly, US GAAP requires investment funds to measure their assets at fair value. ASC 820 (formerly FAS 157) outlines the framework for fair value measurement.

The definitions of fair value under both IFRS[7] and US GAAP[8] are near identical, as they are both based on the exit price notion, i.e., the price which would be received at the valuation date to sell the asset or paid to transfer a liability.

Fair Value: The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

ASC 820 and IFRS 13 both establish a three-level hierarchy for fair value measurement:

- Level 1: Quoted prices in active markets for identical assets or liabilities
- Level 2: Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets
- Level 3: Unobservable inputs based on the reporting entity's own assumptions and estimates

[4] *Starting a Private Fund*, SEC, see: https://www.sec.gov/education/capitalraising/building-blocks/starting-a-private-fund
[5] IFRS is an international set of accounting standards that is developed and maintained by the International Accounting Standards Board (IASB). The goal of IFRS is to make international comparisons of financial statements easier for businesses and investors. It is used in more than 140 countries around the world, including those in the European Union, Australia, and Canada. Some countries, like India and Japan, have their own accounting standards that are converging towards IFRS.
[6] Review of Fair Value Measurement in the IFRS financial statements (2017), see: https://www.esma.europa.eu/sites/default/files/library/esma32-67-284_report_on_ifrs_13_fair_value_measurement.pdf
[7] IFRS 13 Fair Value Measurement, see: https://www.ifrs.org/issued-standards/list-of-standards/ifrs-13-fair-value-measurement/#standard
[8] 820 Fair Value Measurement, see: https://asc.fasb.org/820/showallinonepage

Most unlisted, private market assets will fall under Level 3. As such, investment managers may use various valuation techniques to determine fair value. The choice of technique depends on the availability of market data and the nature of the investment.

In recent years, regulatory authorities have become more focused on valuation practices in private markets, including the International Organization of Securities Commissions (IOSCO) who has raised concerns around transparency around conflicts of interest in valuation and other risks.[9] Similar concerns have prompted some investigation, including by the UK Financial Conduct Authority, which undertook a review of valuation practices in private markets through 2024.[10] In the case of the Australian Prudential Regulatory Authority (APRA), governance arrangements are of particular interest. APRA has highlighted that private market valuations can be more prone to error and subject to significant fluctuations, especially when markets are less liquid or when valuation practices are not as transparent as those in public markets. This makes it harder for financial institutions, such as superannuation funds, to accurately assess their exposure to risks associated with these assets. APRA has conducted surveys and published useful guidance on this subject.[11]

Summary of the Valuation Section of the Alternative Investment Standards

The valuation section of the Alternative Investment Standards complements the fair value frameworks and valuation techniques included in the accounting standards (US GAAP, IFRS), by setting out the key features of a robust valuation framework, focussing on:

- The *governance arrangements,* providing an overarching framework to establish and manage the valuation process (including segregation of functions, documentation) with a view to addressing conflicts of interest and ensuring fair treatment of investors.
- The *investor disclosure* requirements, to ensure that investors can inspect the valuation process and arrangement, as well as monitor the ongoing valuation of assets through ongoing reporting.
- A robust approach for dealing with hard-to-value (Level 3) assets, focussing on ensuring consistency in valuations (many valuation challenges arise in the context of hard to value assets).

Area	Standard	What the Standards say:
Governance	5.1	Put in place arrangements aimed at mitigating conflicts of interest
	5.2	Where a manager has inhouse valuation, segregate the valuation function
	6.1	Valuation policy document to cover all material aspects of the valuation process, controls and monitoring processes

[9] Financial Times: *Private capital sector too complacent about risks, says global regulatory body* (2023), see: https://www.ft.com/content/346ab921-2a51-4a74-9ab4-25dcc5d60c16

[10] FCA Asset Management & Alternatives Supervisory Strategy – interim update (Mar 2024), see: https://www.fca.org.uk/publication/correspondence/portfolio-letter-asset-management-alternatives-supervisory-strategy-interim-update.pdf

[11] *Observations from SPS 530 Valuation Governance Framework Self-Assessment Survey*, APRA (2024), see: https://www.apra.gov.au/observations-from-sps-530-valuation-governance-framework-self-assessment-survey

	8.4	Escalation of material valuation issues to the fund governing body
Disclosure	6.1	Disclosure of valuation policy document to investors (see below)
	6.2	Disclosure of portfolio manager involvement in valuation process
	8.1	% percentage of portfolio in “liquidity” buckets
	8.2	Investor notification of material increases in hard-to-value assets
	8.3	Periodic reporting of value of side pockets
	8.4	Disclosure of other material issues to investors
Hard-to-value assets	7.1	Where in-house valuation of hard to value assets is performed, valuation procedures to be aimed at ensuring consistent approach (with detailed guidance for use of pricing hierarchies, broker quotes and pricing models)
	7.2	Use of side pockets (incl. eligible assets, timing, fees)

The Standards enable investors to assess the arrangements the manager has put in place as part of their pre-investment due diligence, as well as the ongoing monitoring of valuations after the investment has been made. The starting point in the due diligence is the manager’s Valuation Policy Document, which covers all material aspects of the valuation process and controls in respect of the fund.

4. Proposed Amendments to the Alternative Investment Standards

The assessment of valuation techniques for Level 3 assets under US GAAP and IFRS highlights that while there are well-defined techniques and methods, many of the valuation inputs will be subjective and influenced by the assumptions taken by the valuation professional/service provider.

From an investor perspective, it will be difficult to assess the specific assumptions used in the valuation of individual assets in a fund, and the consistency of the approach over time.

This means that investors need to focus on the governance arrangements and procedures that managers and their valuation service providers put in place to oversee and manage the valuation process to gain a better understanding of how the conflicts of interest associated with the subjectivity and flexibility in relation to valuation methodologies is addressed and managed.

The objective of the proposed amendments to the Standards is to provide investors with comfort that the inherent conflicts of interest, transparency and disclosure and subjectivity concerns are addressed. We intend to achieve this by proposing amendments which cover:

- Manager-Led Secondaries, crossed-investments, or related party transactions Valuation methodology
- Valuation service providers

- Financial statements
- Valuation process and procedure evaluation
- Liquidity considerations
- Selection, appointment, and engagement with Auditors

Manager-Led Secondaries, Crossed-Investments, or Related Party Transactions

In situations where a private market investment manager cannot sell assets after a pre-determined investment period, for example, due to financial conditions or a lack of market activity, the manager may decide to sell these assets between one fund vintage to another to raise money to distribute to investors in the prior fund. This is also referred to as general partner (GP) led transactions.

GP-led transactions present an inherent conflict of interest due to the manager's position as both seller and buyer. This issue was also raised in the SEC's proposed Private Fund Adviser Rule (vacated in June 2024) which would have required managers to obtain an independent valuation or fairness opinion prior to closing any such deals.

We believe this proposed amendment has merit and would greatly reduce potential conflicts of interest in these types of transactions. **As such, we propose its inclusion under existing Standard 6.**

Exhibit 1: Proposed new Standard and Guidance - Manager-led secondaries, crossed-investments, or related party transactions

Standard: Manager-led secondaries, crossed-investments, or related party transactions, i.e., assets bought and sold between two vehicles managed by the same manager or transacted between related party entities, should be executed in accordance with managers' fiduciary obligations, disclosures to regulators and investors, and compliance policies and procedures governing the transactions.

Managers transacting in private market assets should commission an independent valuation or fairness opinion prior to the deal closing.

Guidance

When Managers initiate a sale process, they should be mindful of the following:

- Managers should disclose to investors about the possibility of cross trades in their fund documents and provide transparency in regular communications. This includes clear disclosure about how cross trades will be handled and what protections are in place to ensure fairness and proper pricing.
- There should be a reasonable and plausible logic for the proposed transaction.
- The process should be efficient and transparent, consideration could be given to any additional external competitive bids or auctions.
- Investors should be engaged as soon as reasonably possible and have adequate time to consider the proposal.

- Formal Investor consent, if required, should be sought.
- Managers should be transparent regarding any potential conflicts of interest.
- Managers should strive for best execution in all cases.
- Cross trades for listed securities should be executed at a fair market price (typically the last traded price or the midpoint of the bid-ask spread of the current market price).
- For listed securities, if there is low liquidity or low trading volumes, there is a heightened risk that the cross trade could negatively affect market prices. In such cases, careful consideration should be given to how the trade is structured and executed.
- Limited Partner Advisory Committees (LPAC) should be engaged where any Limited Partner Agreement requires some form of affirmative action or approval.
- Investors should be given access to the independent valuation report and should be given time to engage with the external valuer. Noting that Investors may wish to engage on an arms-length basis so not to breach any contractual or regulatory presumption that they are a passive investor.
- Managers should be clear who will bear the cost of any external valuation or opinion. Noting that current market practice is for advisory services to be paid from the proceeds of the transaction.
- Ongoing monitoring of cross trades should be conducted, and proper records should be maintained to ensure that the trade was executed in compliance with established policies and in the best interest of both funds.

Valuation Methodology

Managers may use various valuation techniques to determine fair value, for example the market approach, income approach, and cost/replacement approach. Venture capital investments can utilise multiple approaches including option pricing models. The choice of technique can depend on the availability of market data and the nature of the investment. Managers have some flexibility to decide on the approach that they will implement. Furthermore, managers can subjectively determine inputs and assumptions such as growth and discount rates. This subjectivity has the potential to impact valuations materially.

We propose amending the existing Standard 6 and accompanying guidance to enhance disclosure and transparency for investors around the use of methodologies by their managers – see all amendments under Exhibit 2 below.

Exhibit 2.1: Proposed new Standard and Guidance - Valuation methodology

Standard: Methodology selection

Managers should disclose in their Valuation Policy the valuation methodologies reasonably expected to be used during the life of the fund. Disclosure should be

sufficiently detailed, wording such as ‘any reasonable or justifiable methodology that the Managers chooses or sees fit’ etc., should be avoided.

Guidance

The selection of methodologies should be driven by the facts and circumstances of the investment and the market in which it would be transacted. Managers should give consideration to the appropriateness of the selection, ensuring that is does not differ materially from market or industry norms without good reason.

Managers should determine an appropriate valuation methodology for an asset upon acquisition and if it is likely that a change in methodology will be required in the future, to indicate what those methodologies may be, ahead of time.

Potential future changes of methodologies could include venture capital investments whereby an option pricing model may be appropriate when the asset is not yet revenue generating. If the business then evolved to generate revenue, then transitioning to an income-based valuation technique may be appropriate.

Exhibit 2.2: Proposed new Standard and Guidance - Valuation methodology

Standard: Methodology change

During the life of the fund, should the Manager depart from valuation methodologies outlined in the fund’s Valuation Policy then Investors should be notified.

Guidance

Managers should be prepared to provide a rationale for the introduction of any new methodology.

Managers should be prepared to provide scenarios or describe market conditions under which a change in methodology may be appropriate.

Exhibit 2.3: Proposed new Standard and Guidance - Valuation methodology

Standard: Methodology aggregation

Managers should be prepared to provide details where a valuation is reached that includes a weighting of several methodologies or valuation components. Managers should be prepared to explain the process to calculate and apply weightings to each selected methodology.

Guidance

Aggregation of valuation methodologies should be considered to be an appropriate mechanism for valuing an asset, as long as Managers are transparent about the weightings ascribed to each methodology and the logic for methodology selection and aggregation.

Exhibit 2.4: Proposed new Standard and Guidance - Valuation methodology

Standard: Valuation – Inputs, adjustments & assumptions

Managers should be prepared to provide details on significant inputs, adjustments and assumptions used in the valuation process that could have a material impact upon the outcome. i.e., discount factor, growth rate, EBITDA adjustments, future, or unrealized cash flows etc.

Guidance

Managers should be prepared to provide transparency and disclosure related to key or material inputs, adjustments and assumptions used to reach an asset valuation. Managers should be prepared to engage with Investors on this topic and allow for discussion. Managers should be prepared to defend their assumptions and inputs and be able to provide evidence to back up their assertions.

Managers should be mindful that assumptions and inputs not grounded in any sense of commercial or economic reality, undermine the confidence in private market valuations and raise doubts about the subjectivity inherent in the process.

Care should be given to portfolio level positions that have an outsized impact on NAV or are so significantly large that concentration is elevated.

Exhibit 2.5: Proposed new Standard and Guidance - Valuation methodology

Standard: Valuation - Inputs, adjustments & assumptions - sensitivity analysis

Managers should be prepared to provide details of any sensitivity analysis undertaken regarding major inputs, adjustments, and assumptions in the valuation modelling process.

Guidance

Managers should be prepared to discuss the sensitivity analysis with Investors.

Valuation Service Providers

The presence of Valuation Service Providers can provide comfort to investors that there is some degree of independence or oversight of the valuation process. However, investors need to understand the:

- type of valuation service provided, and how the valuations are being used in the manager's valuation process
- the qualifications/competency of the valuation service provider
- the conflicts of interest present through the contractual arrangements between the valuation service provider and the fund / Manager

We propose several Standards and accompanying guidance which we believe will enhance disclosure and transparency for investors around the use of valuation service providers by their managers. **We propose adding the Exhibits outlined below to existing Standard 5.**

Exhibit 3.1: Proposed new Standard and Guidance - Valuation service providers

Standard: External Valuer – Selection and competency

Managers should be prepared to provide evidence that appropriate due diligence and vendor selection has taken place before appointing an independent valuation provider.

Guidance

Managers should provide notice to the full partnership when the fund has engaged counsel or third parties to provide specialized advice, e.g., valuations experts.

Appropriate due diligence may include, but not be limited to:

- review and consideration of a range of possible providers
- assessment of the provider to be able to provide accurate and timely valuations of the type of assets in scope
- the resources available to the provider in terms of staffing
- the experience of the provider's staff
- industry references and feedback
- whether the provider is a member of a standard setting body such as the International Valuation Standards Council
- ensuring that vendor selection has been conducted independently of the investment team

Exhibit 3.2: Proposed new Standard and Guidance - Valuation service providers

Standard: External Valuer – Contractual engagement

Managers should disclose to Investors details of the service that will be delivered by any external provider such as externally calculated valuations, including what limitations in service provision may exist.

Guidance

This should include whether the independent valuation provider will, for example:

- value all portfolio positions, a sample of positions or materially large portfolio positions.
- provide defined valuations, a range of possible values, or verification that they see no material issue with the managers calculated mark.
- provide any verification of manager valuation models.

The above examples are not intended to be an exhaustive list of possible disclosures.

Exhibit 3.3: Proposed new Standard and Guidance - Valuation service providers

Standard: External Valuer – Obligation to adopt or implement valuation mark

Managers should disclose to Investors the legal or contractual requirement to accept or implement, independent valuations, when provided by an external third party. Managers should further disclose where independently derived valuations have been altered or ignored.

Exhibit 3.4: Proposed new Standard and Guidance - Valuation service providers

Standard: External Valuer – Conflicts of Interest

Managers should disclose to Investors the payment structure agreed with third party valuation agents and provide assurance that the individuals or groups determining the valuations are not unduly influenced by those who might benefit from a higher or lower valuation.

Exhibit 3.5: Proposed new Standard and Guidance - Valuation service providers

Standard: External Valuer – Conflicts of Interest

Managers should disclose to Investors where a valuation service provider is owned, partly or wholly, by private market investors. Disclosure of procedures to manage conflicts of interest related to such relationships should be made.

Financial statements

Financial statements are crucial to investors as they provide a comprehensive view of a fund's financial health. They enable investors to assess profitability, risk, and overall stability of the fund. Establishing a set of accounting standards by which the fund's financial position will be measured can provide comfort to investors and allow for comparison with similar funds. Failure to set an accounting standard at the outset of the fund's establishment creates uncertainly and raises questions as to why this is the case.

We propose several Standards and guidance which we believe provides flexibility for managers but also gives investors comfort. **We propose adding the Exhibits outlined below to existing Standard 6:**

Exhibit 4.1: Proposed new Standard and Guidance - Financial Statements

Standard: Accounting Standards - Implementation **Managers should disclose to Investors at the point of establishment of the fund or vehicle the accounting standards to be followed.** *Guidance* Explanation of any deviations from these standards should be explained to Investors with supporting evidence or materials provided.

Exhibit 4.2: Proposed new Standard and Guidance - Financial Statements

Standard: Accounting Standards - Divergence from recognised standards **Managers should be prepared to provide justification for not valuing assets in line with an industry recognised accounting standard.** *Guidance* Where a valuation process does diverge from recognised accounting standards, Managers should also provide guidance as to the circumstances or market conditions that would allow a recognised accounting standard to be implemented in the future.

Exhibit 4.3: Proposed new Standard and Guidance - Financial Statements

Standard: Accounting Standards - Alternative standards **If Managers oversee an asset or a fund in a jurisdiction that does not recognise or require globally recognised accounting standards such as US GAAP or IFRS, then Managers should adopt alternative standards such as the International Valuation Standards maintained by the International Valuations Standards Council.**

Selection, Appointment, and Engagement with Auditors

Investors take great comfort from the fact that financial statements are produced by a party independent (auditor) of the manager. Their primary responsibilities include ensuring the accuracy, completeness, and fairness of the financial statements, and providing assurance to investors and stakeholders about the fund's financial health and adherence to relevant accounting standards and regulations. In addition, the auditor should verify the existence of the fund's investments and other assets. However, investors should be wary of auditors who are not sufficiently qualified to hold the role.

We propose several Standards and guidance aimed at giving investors' confidence that the auditors selected are fit and competent to oversee the fund and the manager. We also cover their contractual engagement and reporting of issues or concerns. **We propose adding the Exhibits outlined below to existing Standard 5.**

Exhibit 5.1: Proposed new Standard and Guidance - Selection, appointment, and engagement with auditors

Standard: Auditor - Selection and competency

Managers should select auditors who are competent, capable and with sufficient experience in the auditing of financial statements for funds which invest in illiquid or non-listed assets.

Guidance:

Managers should provide notice to the full partnership when the fund has engaged a new Auditor.

Appropriate due diligence may include, but not be limited to:

- review and consideration of a range of possible providers
- assessment of the provider to be able to provide appropriate accounting scrutiny of the fund
- the resources available to the provider in terms of staffing
- the experience of the provider's staff, including specialist internal teams that may review valuations
- industry references and feedback
- whether the provider is a member of a standard setting body such as the Association of International Professional Accounts

Exhibit 5.2: Proposed new Standard and Guidance - Selection, appointment, and engagement with auditors

Standard: Auditor - Contractual engagement **Explanation of the role of external auditors in the valuation process should be provided to Investors, including to the extent the auditors will independently gather and assess underlying asset data and perform underwriting of asset valuations.**

Exhibit 5.3: Proposed new Standard and Guidance - Selection, appointment, and engagement with auditors

Standard: Auditor - Investor disclosure **Managers should disclose to Investors any qualifications, comments, or concerns raised by auditors regarding valuations in a timely manner.**

Valuation process and procedure evaluation

Valuation processes and procedures need to reviewed periodically to assess whether the models or approach utilised remains fit for purpose. Stress tests can also be a useful barometer for assessing the financial health of the fund and its asset valuations under various market environments.

We propose a few Standards and guidance to give investors better understanding and insight into the completeness of the valuation process and how valuations may perform under difference environments. **We propose adding the Exhibits outlined below to existing Standard 8 (Hard-to-Value Assets).**

Exhibit 6.1: Proposed new Standard and Guidance - Valuation process and procedure evaluation

Standard: Valuation - Stress Testing **Managers should conduct periodic stress testing and scenario analysis in relation to portfolio valuations.** *Guidance* Managers should be prepared to provide a summary of stress tests or scenario analyses performed to understand potential changes in asset values under different market conditions. Stress testing and scenario analysis is intended to be primarily a risk management exercise. Results of these reviews may or may not lead to a revaluation of a fund asset.

Stress testing of private market strategies may require specific scenario analysis to be considered for different asset classes. For example, liquidity stress testing may not be a useful measure to assess in a closed ended investment structure but may be relevant for hybrid structures which offer some limited form of liquidity to investors (e.g. evergreen structures). Private market managers may wish to consider scenarios which model changes in financing costs, margins and sales for leveraged buyout portfolio companies. Private credit managers may wish to understand how different scenarios may affect duration impact, debt recovery levels and impacts on the timings of debt repayments. Real estate managers may consider how changes in rental income could affect the value of the asset and cap rates. These examples are not intended to be exhaustive, and private market managers should consider a full range of scenarios that could be applicable to their strategy. We believe that managers and investors should discuss which scenarios and stress tests may be appropriate for implementation.

Exhibit 6.2: Proposed new Standard and Guidance - Valuation process and procedure evaluation

Standard: Valuation – Frequency of valuation

Managers should conduct regular valuation of fund assets, consummate with the redemption rights of the fund.

Guidance

Consideration should be given to the redemption rights of the fund; close-ended funds (whether valued internally or externally) should be valued at least annually. Evergreen structures (those which offer some degree of limited redemption rights) should be valued more frequently.

Managers should be mindful of the prevailing market and economic environment and may consider implementing ‘triggers’ or thresholds which would require an updated valuation to be conducted.

It is common for managers to produce valuation ‘estimates’ in the interim period between official valuations are conducted, this should be considered a good practice to follow.

Exhibit 6.2: Proposed new Standard and Guidance - Valuation process and procedure evaluation

Standard: Backtesting - Valuation review upon asset disposal

Managers should be prepared to provide a comparison of prior valuation estimates to actual outcomes (e.g., subsequent sale prices) to evaluate the accuracy of valuation methodologies over time.

Liquidity considerations

Liquidity can be described as the presence of active buyers and sellers in a market. Certain private market assets may suffer from less liquidity given their uniqueness or the market in which they are present.

We propose a Standard to provide investors with additional information regarding how valuations may be affected by lack of liquidity. **We propose adding the Exhibits outlined below to existing Standard 8.**

Exhibit 7: Proposed new Standard and Guidance - Liquidity considerations

Standard: Ad Hoc Considerations - Liquidity
Managers should be prepared to discuss how liquidity (or lack thereof) impacts the valuation of specific assets. Any special considerations or Discount for Lack of Marketability (DLOM).

5. Review of the existing Valuation Standards and proposed wording changes

We are proposing the following changes to the existing wording of the Standards to make them easier to read and use. These changes are not intended to alter the existing meaning of the Standards.

5. Segregation of Functions in Valuation – Governance Standards and Guidance			
Standard 5.1	Proposed Amended Standard 5.1	Guidance	Proposed Amended Guidance
Valuation arrangements aimed at addressing and mitigating conflicts of interest in relation to asset valuation should be put in place.	~~Valuation arrangements aimed at addressing~~Arrangements to address and ~~mitigating~~mitigate conflicts of interest in ~~relation to~~the asset valuation process should be put in place.	The SBAI believes that the most satisfactory way to achieve this is the appointment of an independent and competent third-party valuation service provider. The SBAI acknowledges, however, that in some cases it will not be possible in practice to achieve both independence and the required level of competence by appointing a third-party valuation service provider, in which case the involvement of the fund manager in the asset valuation process will, to a greater or lesser extent, be unavoidable.	~~The SBAI believes that the most satisfactory way to achieve this is the~~We believe appointment of an independent and competent third-party valuation service provider~~.~~ ~~The SBAI acknowledges, however, that in some cases it will not be possible in practice to achieve both independence and the required level of competence by appointing a third-party valuation service provider, in which case the involvement of the fund manager in the asset valuation process will, to a greater or lesser extent, be unavoidable.~~ is the most satisfactory way to achieve this.

Standard 5.2	Proposed Amended Standard 5.2	Guidance	Proposed Amended Guidance
Where a fund manager determines the value of any of the fund's assets (whether by performing valuations in-house or providing final prices to a valuation service provider), it should operate a valuation function which is segregated from the portfolio management function and should explain its approach to investors. If a smaller or start-up manager considers it impractical to do so, it should disclose this in its marketing documents. This should also be disclosed in the fund's offering documents.	Where a fund manager ~~determines the value of any of the fund's assets (whether by performing~~performs valuations in-house or ~~providing~~provides final prices to a valuation service provider~~), it should operate a~~ therefore determining the asset price, the valuation function ~~which is~~should be segregated from the portfolio management function~~ and should explain its~~. This approach should be explained to investors. If ~~a~~ smaller or start-up ~~manager considers it~~ managers consider this impractical ~~to do so, it~~this should ~~disclose this~~be disclosed in ~~its~~ marketing documents~~. This should also be disclosed in~~ and the ~~fund's~~fund's offering documents.	It is envisaged that this will, amongst other things, entail: – ensuring that the relevant employees operate independently of the portfolio management team and that potential conflicts of interest are minimised; – ensuring that the remuneration of the valuation team is not directly linked to fund performance; – in instances where the portfolio management team has necessary expertise and understanding, ensure that information provided by that team in connection with the valuation process is properly documented and recorded; and – assisting fund governing bodies to satisfy themselves regularly that in-house valuations are handled appropriately. Ways to achieve this might include:	~~It is envisaged that this~~This will~~,~~ involve amongst other things~~, entail:~~ ~~– ensuring that the relevant~~: - Relevant employees ~~operate~~operating independently ~~of~~from the portfolio management team and ~~that~~minimising potential conflicts of interest~~ are minimised;~~ ~~– ensuring~~, - Ensuring that ~~the~~ remuneration ~~of~~for the valuation team is not directly linked to fund performance~~;~~, ~~– in instances where~~- Where it is the case that the portfolio management team has necessary expertise and understanding~~,~~ ~~ensure that~~ required for asset valuation, information provided by that team ~~in connection with the valuation process is~~should be

		– ensuring that valuation staff provide periodically a report on the valuation process to the fund governing body; – the formation of a designated “valuation committee” (no member of which is involved in investment decisions); and – employing the services of an appropriate external party to evaluate the effectiveness and robustness of the valuation procedures in place and report to the fund governing body (or its valuation committee). Fund managers also could refer to The SBAI Toolbox Memos on Valuation for Alternative Credit and Insurance Linked Strategies, as well as publications by standard setters and regulators, including IOSCO’s Principles for the Valuation of Collective Investment Schemes (2013) and IOSCO’s Principles for the Valuation of	properly documented and recorded~~;~~, and ~~– assisting-~~ Assisting fund governing bodies to satisfy themselves regularly that in-house valuations are handled appropriately. Ways to achieve this might include: ~~– ensuring that valuation~~o Valuation staff ~~provide periodically a report~~providing periodic reporting on the valuation process to the fund governing body~~;~~, ~~– the formation of~~ o Forming a designated “valuation committee” (~~no member of which is involved in~~ with non-investment ~~decisions);~~personnel making up the majority of the committee's composition), and ~~– employing the services of~~ o Using an appropriate external party to evaluate the effectiveness and robustness of the valuation

		Hedge Funds (2007) for further guidance in this area.	procedures ~~in place~~ and report to the fund governing body ~~(~~or its valuation committee). Fund managers ~~also~~ could also refer to ~~The~~ SBAI Toolbox Memos on Valuation for Alternative Credit and Insurance Linked Strategies, as well as publications by standard setters and regulators, including IOSCO's Principles for the Valuation of Collective Investment Schemes (2013) and IOSCO's Principles for the Valuation of Hedge Funds (2007) for further guidance in this area. We acknowledge that in some cases it may not be practical to appoint a third-party valuation service provider. In these cases, the fund manager's involvement in the asset valuation process may be unavoidable.
6. Segregation of Functions in Valuation – Disclosure Standards and Guidance			

Standard 6.1	Proposed Amended Standard 6.1	Guidance	Proposed Amended Guidance
A document (a "Valuation Policy Document") covering all material aspects of the valuation process and valuation procedures and controls in respect of the fund should be prepared. The Valuation Policy Document (which it is acknowledged will contain information which is proprietary to the fund manager) should be reviewed regularly by the fund manager, in consultation with the fund governing body, and be made available to investors upon request on a confidential basis.	A ~~document (a "~~Valuation Policy Document~~") covering~~ that covers all material aspects of ~~the~~ valuation ~~process and valuation~~processes, procedures, and controls ~~in respect of~~for the fund should be prepared. The Valuation Policy ~~Document (which it is acknowledged will contain information which is proprietary to the fund manager)~~ should be reviewed regularly by the fund manager~~, in consultation with the~~ and fund governing body~~,~~ and be made available to investors ~~upon~~on request on a confidential ~~basis.~~ information (acknowledging it will contain proprietary information).	The SBAI envisages that in most circumstances the Valuation Policy Document will describe: – the responsibilities of each of the parties involved in the valuation process; – the processes and procedures in place that are designed to ensure that conflicts of interest are managed effectively; – the relevant material provisions of any service level agreements (SLAs) entered into with third parties responsible for or involved in the valuation process (excluding details of commercial aspects of any such SLAs); and – the controls and monitoring processes in place that are designed to ensure that the performance of any third party to whom the valuation function is outsourced is satisfactory.	~~The SBAI envisages that in~~In most circumstances the Valuation Policy Document ~~will~~should describe: ~~– the~~ - The responsibilities of ~~each of the~~all parties involved in the valuation process~~;~~, ~~– the~~- The processes and procedures in place ~~that are designed to ensure that~~for effectively managing conflicts of interest ~~are managed effectively;~~, ~~– the relevant~~ - Relevant material provisions of any service level agreements (SLAs) ~~entered into~~ with third parties responsible for or involved in the in the valuation process (excluding ~~details of~~ commercial ~~aspects of any such SLAs);~~provisions), and ~~– the controls~~

			- Controls and monitoring processes ~~in place that are designed~~ to ensure ~~that the~~satisfactory performance ~~of any third party to whom~~where the valuation function is outsourced ~~is satisfactory.~~ to a third party.
Standard 6.2	Proposed Amended Standard 6.2	Guidance	Proposed Amended Guidance
Where a fund manager is involved in the valuation process, it should disclose in its own marketing materials any actual or likely material involvement of the portfolio management team in the valuation process. Such disclosure should also be included in the fund's offering documents. Investors should then be informed, for example via manager newsletters, of any material changes to such level of involvement.	~~Where a~~A fund manager ~~is involved in the valuation process, it~~ should disclose ~~in its own marketing materials any actual or likely~~any material involvement of the portfolio management team ~~in the valuation process. Such disclosure should also be included in the fund's~~, actual or likely, in the fund offering documents~~.~~ and its marketing materials. Investors should ~~then~~ be informed, ~~for example via~~ e.g., in manager newsletters, ~~of~~ any material changes to ~~such~~this level of involvement.	This could be satisfied by disclosing an estimate of the percentage of the fund's assets which have been, or are expected to be, valued with some input from the portfolio management team or a description of components of the portfolio for which the portfolio management team usually makes a contribution to the valuation process.	~~This~~Examples of this disclosure could ~~be satisfied by disclosing an estimate of the percentage~~include: - Percentage of the fund's assets which ~~have been,~~ are (or are expected to be~~,~~) valued with some input from the portfolio management team, or ~~a~~ - A description of ~~components~~the types of ~~the portfolio for which~~assets where the portfolio management team would usually ~~makes a contribution~~contribute to the valuation process.
7. Hard-to-Value Assets – Governance Standards and Guidance [7]			

Standard 7.1	Proposed Amended Standard 7.1	Guidance	Proposed Amended Guidance
Where a fund manager performs in-house valuations of hard-to-value assets or is otherwise involved in providing final prices to the valuation service provider, valuation procedures for such assets which are aimed at ensuring a consistent approach to determining fair value should be adopted and such procedures should be set out in the Valuation Policy Document.	~~Where~~Procedures ensuring a consistent approach for determining fair value, where a fund manager performs in-house ~~valuations of hard-to-value assets or is otherwise~~valuation or is involved in providing final prices to the valuation service provider~~,~~ ~~valuation procedures for such assets which are aimed at ensuring a consistent approach to determining fair value~~ for hard to value assets, should be adopted and ~~such procedures should be set out~~included in the Valuation Policy Document.	The SBAI envisages that such procedures would in most circumstances include: - details of a hierarchy of pricing sources and models to be used for each asset type in a fund's portfolio (where relevant); – if using broker quotes: o making reasonable efforts to identify and draw upon multiple (typically 2-3) price sources (where available); o specifying the acceptable tolerance ranges when multiple pricing sources are used and the approach to handling "outliers"; o ensuring consistency and avoiding "cherry picking" of favourable price sources by using the same brokers at each valuation point; and	~~The SBAI envisages that such~~These procedures ~~would in most circumstances~~could include: ~~- details of a~~ - A hierarchy of pricing sources and models ~~to be used~~(where relevant) for each asset type~~ in a fund's portfolio (where relevant);~~ ~~– if using~~, - For broker quotes: o ~~making reasonable~~Reasonable efforts to identify and ~~draw upon~~use multiple (typically 2-3) price sources ~~—(~~where available~~);~~, o ~~specifying the~~Specifying acceptable tolerance ranges ~~when multiple~~for these pricing sources ~~are used~~ and the approach ~~to~~for

		o where the fund manager arranges the provision of broker prices (as opposed to the administrator or other third-party valuation service provider), the fund manager should instruct brokers to send the prices directly to the administrator (or other third party valuation service provider); – if using pricing models, a process specified in the Valuation Policy Document for: o approving pricing models including back-testing, documentation and approval by the fund governing body or its valuation committee; o monitoring and verification against observed market prices; and o governing manual overrides of the model inputs or results, including approval, documentation and reporting to the fund governing body or its valuation committee.	handling “outliers”~~;~~ , o ~~ensuring consistency and avoiding~~Being consistent to avoid “cherry picking” ~~of~~a favourable price ~~sources~~source by using the same brokers at each valuation point~~;~~, and o ~~where the fund manager arranges the provision of~~Instructing that any broker ~~prices (as opposed~~quotes are sent directly to the fund administrator or other third-party valuation service provider~~), the fund manager should instruct brokers to send the prices directly to the administrator (or other third party valuation service provider);~~ ~~– if using~~. - For pricing models~~, a~~ : o An approval process ~~specified in the Valuation Policy Document for:~~

			~~o approving~~for pricing models including back-testing, documentation, and approval by the fund governing body or ~~its~~ valuation committee~~;~~ . o A monitoring and verification ~~against~~ process to compare to observed market prices~~;~~, and o ~~governing~~ Governance of manual overrides of ~~the~~ model inputs or results~~,~~ including approval, documentation, and reporting to the fund governing body or ~~its~~ valuation committee
Standard 7.2	Proposed Amended Standard 7.2	Guidance	Proposed Amended Guidance

If using side pockets, a fund manager should ensure that the fund governing body has been consulted on, and consented to, the circumstances in which side-pockets may be used. Furthermore; – The types of asset eligible for side pocketing should be described in the Valuation Policy Document and the side pocketing process should be disclosed in the fund's offering documents. – Side-pocketing should occur either on or about the time the relevant asset is purchased or on or about the point at which the relevant asset becomes hard-to-value. The initial valuation of an asset on entering a side-pocket should be at cost, the last available market price (as appropriate) or a lower number or nil. – Where a limit to the total amount of assets which may be included in side-pockets is disclosed in the	~~If~~When using side pockets, ~~a~~the fund manager should ~~ensure that~~consult with the fund governing body ~~has been consulted on,~~ and ~~consented~~get its consent to~~,~~ the circumstances in which side~~-~~pockets may be used. ~~Furthermore;~~In addition: ~~–~~o The ~~types of asset eligible for~~ side pocketing process and eligible assets should be described in the Valuation Policy Document~~ and the side pocketing process should be disclosed in the fund's offering documents.~~ . ~~–~~o Side~~-pocketing~~ pockets should ~~occur~~be created either ~~on~~at or ~~about~~around the time of purchase or at or around the time the ~~relevant asset is purchased or on or about the point at which the relevant~~ asset becomes hard~~-~~ to~~-~~ value.~~ The initial valuation of~~ o On being side pocketed an asset ~~on entering a side-pocket~~ should be valued at cost, ~~-~~the last available	Fund managers could also refer to the SBAI Toolbox Memos on Valuation for Alternative Credit and Insurance Linked Strategies as well as publications by industry associations and regulators for further guidance on the valuation of hard-to-value assets.	Fund managers could also refer to the range of SBAI Toolbox Memos ~~on Valuation for Alternative Credit and Insurance Linked Strategies as well as publications by industry associations and regulators~~ for further guidance on the valuation of hard-to-value assets, which can be found here: https://www.sbai.org/toolbox.html~~.~~

fund's offering documents, such limit should not be breached. – Management fees, for the side pocketed assets, if charged, should be calculated on no more than the lower of cost (or last available market price in the case of a previously liquid asset) or fair value. – Any performance fees should accrue for the duration of the existence of the side pocket and should be paid only at the point at which the asset is finally disposed of or a liquid market price is available.	market price ~~(as appropriate)~~ or a lower number, or ~~nil.~~zero. ~~– Where a~~o Any limit ~~to the~~on total amount of assets ~~which may~~that can be included in the side~~-pockets is~~ pocket disclosed in the ~~fund's~~fund’s offering documents~~, such limit~~ should not be breached. ~~– Management~~o Side pocket management fees, ~~for the side pocketed assets,~~ if charged, should be calculated on ~~no more than~~ the lower of cost (or last available market price ~~in~~where the ~~case of a~~asset was previously liquid ~~asset)~~), or fair value. ~~– Any~~ o Side pocket performance fees should ~~accrue for the duration of the existence of the side pocket and should~~ be paid only at the point ~~at which~~ the asset is ~~finally~~ disposed of or a liquid market price is available. They should be accrued for the duration of the side pocket.		

	Note: Side pocketing of assets is a common feature of insurance linked strategies and can occur for a number of valid reasons. Creation of a side pocket immediately upon a loss event may not occur as there may be additional criteria a manager needs to consider before doing so. Additional guidance can be found in the SBAI's memo 'Side-Pocketing in ILS Funds'.		
8. Hard-to-Value Assets – Disclosure Standards and Guidance [8]			
Standard 8.1	Proposed Amended Standard 8.1	Guidance	Proposed Amended Guidance
The percentage of the fund's portfolio that falls into each of the three “levels” prescribed by ASC 820 or IFRS 7, or equivalent account standards or recognised definitions (and, where meaningful and applicable, the extent to which internal pricing models or assumptions are used to value certain components of the fund’s portfolio invested in hard-to-value assets) should be periodically disclosed (e.g. via newsletters).	The percentage of the ~~fund's~~fund’s portfolio that falls into each of the three ~~“~~levels~~”~~ prescribed by ASC 820~~ or~~, IFRS ~~7~~13, or equivalent ~~account~~accounting standards or recognised definitions ~~(and, where~~should be disclosed periodically e.g., via Administrator Transparency Reports. Where meaningful and applicable~~,~~ the extent ~~to which~~that internal pricing models or assumptions are	Fund managers should consult the SBAI’s ATR template which can be found here: https://www.sbai.org/toolbox/administrator-transparency-reporting-atr.html	

	used in the valuation of hard to value ~~certain components of the fund’s portfolio invested in hard-to-value~~ assets~~)~~ should also be ~~periodically~~ disclosed ~~(e.g. via newsletters).~~ .		
Standard 8.2	Proposed Amended Standard 8.2	Guidance	Proposed Amended Guidance
Notification of any material increase (as determined by the fund governing body) in the percentage of a fund's portfolio invested in hard-to-value assets should be disclosed to investors in a timely manner, e.g. via the manager's newsletters.	~~Notification of any~~Any material ~~increase (as determined by the fund governing body)~~ increases in the percentage of ~~a fund's~~the fund’s portfolio invested in hard~~-~~ to~~-~~value assets (as determined by the fund governing body) should be disclosed to investors in a timely manner~~,~~ e.g.~~ via the manager's~~., in manager newsletters.		
Standard 8.3	Proposed Amended Standard 8.3	Guidance	Proposed Amended Guidance
The value of side pockets should be reported periodically in the fund’s audited annual accounts in accordance with applicable accounting standards.	~~The value of side pockets~~Side pocket values should be reported ~~periodically~~ in the fund’s audited annual accounts in accordance with applicable accounting standards.		
Standard 8.4	Proposed Amended Standard 8.4	Guidance	Proposed Amended Guidance

A fund manager conducting valuations in-house should discuss with the fund governing body any material issues in relation to the valuation of hard-to-value assets (e.g. unavailability of a sufficient number of pricing sources or dispersion of broker quotes beyond tolerance levels). Such material issues in relation to the valuation of hard-to-value assets should be disclosed to investors.	~~A fund manager conducting valuations in-house should discuss with the fund governing body any material~~Material issues ~~in relation to the valuation of~~when valuing hard~~-~~ to~~-~~ value assets in-house (e.g~~.~~., unavailability of ~~a~~ sufficient number of pricing sources or ~~dispersion of~~ broker ~~quotes beyond~~ quote ranges outside of tolerance levels~~). Such material issues in relation to the valuation of hard-to-value assets~~) should be discussed with the fund governing body and disclosed to investors.		

6. Consultation Questions

1. Do you agree with the approach to widening the scope of the Standards to include valuation of private market assets? If not, please explain.

2. Do you agree with each of the proposed new Standards and guidance as described? If not, please explain.

3. Do you believe these proposals to be a full and complete representation of topical issues related to valuation of private market assets? If not, please explain.

4. What amendments should be made to the existing Standards to reflect industry change. Suggestions include adaptability of the Standards to:
    a. Closed ended investment vehicles
    b. Digital assets
    c. Separately managed accounts
    d. Regulatory change

5. Are there any additional Standards which you would like to propose for consideration?

6. Are there any additional guidance summaries or other industry representative bodies who have produced guidance in this area which you would like to propose for consideration?