

AIFMD - Valuation

Directive 2011/61/EU on Alternative Investment Fund Managers (**AIFMD**) must be implemented by EU member states by 22 July 2013. AIFMD is supplemented by a delegated regulation (the **AIFMD Regulation**). AIFMD regulates the activities of Alternative Investment Fund Managers (**AIFMs**) and their Alternative Investment Funds (**AIFs**).

Overview

Article 19 of AIFMD sets out the valuation requirements applicable to each AIFM and this is supplemented by section 7 of the AIFMD Regulation.

AIFM must ensure that for each AIF it manages, procedures are established and consistently applied for the valuation of assets. The AIFMD Regulation lays down the main features of such valuation policies and procedures, including the use of models to value AIF assets. It also requires periodic reviews of the valuation policies and procedures, the values generated for individual assets, the calculation of the net asset value per unit/share, the provision of professional guarantees by external valuers, and the frequency of valuations.

Summary

Under the existing regime, the valuation of assets is carried out by the board of the existing AIF or its AIFM. Frequently, this function is delegated to the investment manager.

The procedures required under AIFMD seek to ensure proper and independent valuation of the AIF's assets can be carried out.

Valuer

The AIFMD Regulation provides that assets may be valued by either an external valuer (independent from the AIF or the AIFM) or by the AIFM itself, provided that this task is functionally independent from the portfolio management and that remuneration policy and other measures ensure that conflicts of interest are mitigated. By separating these functions, the AIFMD Regulation seeks to prevent conflicts of interest between those managing the portfolio and those valuing assets and, in addition, to prevent any undue influence on the employees in those roles.

The valuation function is separate from the function of calculating the net asset value of the AIF (the **NAV**). Similarly the depositary appointed to an AIF cannot be appointed as an external valuer of that AIF unless it has separated the performance of the depositary function from its tasks as an external valuer and any possible conflicts of interest are properly addressed.

For an external valuer, the AIFM must be able to demonstrate that it has complied with the delegation requirements of the AIFMD and that, in addition the external valuer:

- is subject to mandatory professional registration; and
- can provide professional guarantees that it is able to effectively value the assets as required, this requirement could be addressed in an agreement appointing the external valuer.

The AIFMD Regulation requires that the professional guarantee must contain evidence of qualification and capability to carry out the valuation function in respect of the assets of the AIF, including evidence of sufficient personnel and technical resources, procedures safeguarding proper and independent valuation, understanding of the investment policies of the AIF and a good reputation.

Where it is impossible to find an independent pricing source to provide valuations for certain complex financial instruments, controls should be put in place by the AIFM to address any conflicts for example, verification against counterparty sourced pricings, validating such values by comparing realised prices against recent values, and considering the reputation of the valuation source.

The AIFM must notify the Central Bank of the appointment of an independent external valuer to an AIF. If the external valuer cannot meet the above conditions, the Central Bank can require the AIFM to have the procedures or the valuations verified.

Policies and Procedures

The AIFM must establish, maintain, implement and review, for each AIF it manages, written valuation policies and procedures that ensure sound, transparent, comprehensive and appropriately documented valuation policies (the **Policy**).

The AIFMD Regulation provides that the Policy must identify the methodologies used for each asset class in which the AIF may invest, in accordance with local law and the AIF rules. An AIF may not invest in a particular asset type unless an appropriate valuation methodology has first been established for that asset class type.

The Policy, which must be reviewed periodically, and at least once a year, must set out the:

- obligations, roles and responsibilities of all parties involved in the valuation of assets, including the senior management/directors of the AIFM;

- competence and independence of those parties, including measures to prevent or restrain any person from exercising inappropriate influence;
- investment policies of the AIF and the assets the AIF will target;
- controls over the selection of valuation sources and methodologies;
- initial and periodic due diligence carried out by the AIFM on parties providing valuation services;
- procedure for resolving discrepancies in valuations;
- valuation of any adjustments required for maintenance of investment limits or for liquidity purposes;
- times for closing the valuations;
- frequency of valuations;
- process for reporting by the external valuer (if applicable) to the AIFM; and
- model used to value the assets (if applicable and as further described below).

Frequency

It is the responsibility of the AIFM to ensure, that for each AIF it manages:

- the NAV per share/unit is calculated on each dealing day (but at least once a year) and disclosed to the investors;
- the procedures and methodology for calculating the NAV per share/unit is documented and subject to regular verification by the AIFM;
- there are remedial procedures in place in the event of an incorrect calculation; and
- the number of shares/units in issue is subject to regular verification.

An open-ended AIF must value its assets each time that the NAV is calculated, at least once a year and whenever it is apparent that the last determined value is no longer fair or proper.

If the AIF is closed-ended, such valuations and calculations must be carried out in the event of an increase or decrease of the capital of the relevant AIF.

Models

If a valuation model is used to value the assets of an AIF, the model and its main features must be justified and explained in the Policy. It should also set out the underlying data, any assumptions, the rationale for the assumptions and the limitations of the model. The model must be validated by a suitable person and the validation process must also be set out in the Policy.

Liability

The AIFM is responsible for the valuation of the assets, the calculation of the NAV per share/unit and the publication of the NAV per share/unit. Its liability to the AIF and its investors is not affected by the fact that the AIFM has appointed an external valuer. An external valuer is liable to the AIFM for any losses suffered by the AIFM as a result of the external valuer's negligence or intentional failure to perform its tasks.

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