



**Financial Services
Commission**

Information page

Alternative Investment Fund Managers Directive Organisational requirements - Valuation

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Any advice or interpretation covered in this information page represents the views of the FSC as to its expectations of how the requirements of the AIFMD are to be complied with and/or how it fails to be applied. This however is not intended as a definitive interpretation of the AIFMD which is ultimately a matter for the courts to determine. The FSC does not provide, or purport to offer, legal advice.

1. Introduction

- 1.1 In this information page, reference is made to the Alternative Investment Fund Managers Directive 2011/61/EU (“AIFMD”) and to the supplementing Level 2 Delegated Regulation (“Level 2”).
- 1.2 There is a large focus in the AIFMD on the procedures implemented by AIFMs to ensure proper and independent valuation of the assets it manages. Recall that ‘valuation’ is one of the functions imposed on AIFMs under the AIFMD. AIFMs may however delegate the valuation function in accordance with Article 20 of the AIFMD (see the FSC information page on AIFMD – Delegation for further information).
- 1.3 The purpose of this information page is to provide AIFMs, or any entity to which they delegate the valuation function (in particular fund administrators), with a clear picture of the valuation procedures to be implemented by AIFMs under the AIFMD.

2. Valuation

(Article 19 of the AIFMD)

- 2.1 AIFMs must ensure that, for each AIF that they manage, appropriate and consistent procedures are established so that a proper and independent valuation of the assets of the AIF can be performed in accordance with:
 - (a) Article 19 of the AIFMD on valuation,
 - (b) any relevant law of Gibraltar,
 - (c) the AIF rules or instruments of incorporation.
- 2.2 AIFMs must also ensure that the net asset value per unit or share of AIFs is calculated and disclosed to the investors in accordance with:
 - (a) Article 19 of the AIFMD on valuation,
 - (b) any relevant law of Gibraltar,
 - (c) the AIF rules or instruments of incorporation.
- 2.3 The valuation procedures used shall ensure that the assets are valued and the net asset value per unit or share is calculated at least once a year.
- 2.4 If the AIF is of the open-ended type, such valuations and calculations shall also be carried out at a frequency which is both appropriate to the assets held by the AIF and its issuance and redemption frequency.
- 2.5 If the AIF is of the closed-ended type, such valuations and calculations shall also be carried out in case of an increase or decrease of the capital by the relevant AIF.
- 2.6 The investors shall be informed of the valuations and calculations as set out in the relevant AIF rules or instruments of incorporation.
- 2.7 Rules applicable to the valuation of assets and the calculation of the net asset value per unit or share of an AIF may be made:

- (a) by the Minister by order, or
 - (b) subject to provision made under paragraph (a), in the AIF rules or instruments of incorporation.
- 2.8 AIFMs must ensure that the valuation function is either performed by:
 - (a) an external valuer, being a legal or natural person independent from the AIF, the AIFM and any other persons with close links to the AIF or the AIFM; or
 - (b) the AIFM itself, provided that the valuation task is functionally independent from the portfolio management and the remuneration policy and other measures ensure that conflicts of interest are mitigated and that undue influence upon the employees is prevented.
- 2.9 The depositary appointed for an AIF shall not be appointed as external valuer of that AIF, unless it has functionally and hierarchically separated the performance of its depositary functions from its tasks as external valuer and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the AIF.
- 2.10 Where an external valuer performs the valuation function, the AIFM must demonstrate that:
 - (a) the external valuer is subject to mandatory professional registration recognised by law or to legal or regulatory provisions or rules of professional conduct;
 - (b) the external valuer can provide sufficient professional guarantees to be able to perform effectively the relevant valuation function in accordance with this section; and
 - (c) the appointment of the external valuer complies with the requirements of Articles 20(1) and (2) of the AIFMD on delegation.
- 2.11 An appointed external valuer may not delegate the valuation function to a third party.
- 2.12 AIFMs must notify the appointment of the external valuer to the FSC, which may require that another external valuer be appointed instead, where the conditions laid down in this section are not met.
- 2.13 The valuation must be performed impartially and with all due skill, care and diligence.
- 2.14 Where the valuation function is not performed by an independent external valuer, the FSC may require the AIFM to have its valuation procedures or valuations (or both) verified by an external valuer or, where appropriate, by an auditor.
- 2.15 AIFMs are responsible for the proper valuation of AIF assets, the calculation of the net asset value and the publication of that net asset value; and:
 - (a) an AIFM's liability towards the AIF and its investors shall, therefore, not be affected by the fact that the AIFM has appointed an external valuer; and
 - (b) notwithstanding paragraph (a) and irrespective of any contractual arrangements providing otherwise, the external valuer shall be 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.

3. Policies and procedures for the valuation of the assets of the AIF

(Article 67 of Level 2)

- 3.1 AIFMs shall establish, maintain, implement and review, for each AIF they manage, written policies and procedures that ensure a sound, transparent, comprehensive and appropriately documented valuation process. The valuation policy and procedures shall cover all material aspects of the valuation process and valuation procedures and controls in respect of the relevant AIF.

Without prejudice to requirements under national law and the AIF rules and instruments of incorporation, the AIFM shall ensure that fair, appropriate and transparent valuation methodologies are applied for the AIFs it manages. The valuation policies shall identify and the procedures shall implement the valuation methodologies used for each type of asset in which the AIF may invest in accordance with applicable national law and the AIF rules and instruments of incorporation. The AIFM shall not invest in a particular type of asset for the first time unless an appropriate valuation methodology or methodologies have been identified for that specific type of asset.

The policies and procedures setting out valuation methodologies shall include inputs, models and the selection criteria for pricing and market data sources. They shall provide that prices shall be obtained from independent sources whenever possible and appropriate. The selection process of a particular methodology shall include an assessment of the available relevant methodologies, taking into account their sensitivity to changes in variables and how specific strategies determine the relative value of the assets in the portfolio.

- 3.2 The valuation policies shall set out the obligations, roles and responsibilities of all parties involved in the valuation process, including the senior management of the AIFM. The procedures shall reflect the organisational structure as set out in the valuation policies.

The valuation policies and procedures shall address at least the following:

- (a) the competence and independence of personnel who are effectively carrying out the valuation of assets;
 - (b) the specific investment strategies of the AIF and the assets the AIF might invest in;
 - (c) the controls over the selection of valuation inputs, sources and methodologies;
 - (d) the escalation channels for resolving differences in values for assets;
 - (e) the valuation of any adjustments related to the size and liquidity of positions, or to changes in the market conditions, as appropriate;
 - (f) the appropriate time for closing the books for valuation purposes;
 - (g) the appropriate frequency for valuing assets.
- 3.3 Where an external valuer is appointed, the valuation policies and procedures shall set out a process for the exchange of information between the AIFM and the external valuer to ensure that all necessary information required for the purpose of performing the valuation task is provided.

The valuation policies and procedures shall ensure that the AIFM conducts initial and periodic due diligence on third parties that are appointed to perform valuation services.

- 3.4 Where the valuation is performed by the AIFM itself, the policies shall include a description of the safeguards for the functionally independent performance of the valuation task in accordance with sections 2.8 and 2.9 above. Such safeguards shall include measures to prevent or restrain any person from exercising inappropriate influence over the way in which a person carries out valuation activities.

4. Use of models to value assets

(Article 68 of Level 2)

- 4.1 If a model is used to value the assets of an AIF, the model and its main features shall be explained and justified in the valuation policies and procedures. The reason for the choice of the model, the underlying data, the assumptions used in the model and the rationale for using them, and the limitations of the model-based valuation shall be appropriately documented.
- 4.2 The valuation policies and procedures shall ensure that, before being used, a model is validated by a person with sufficient expertise who has not been involved in the process of building that model. The validation process shall be appropriately documented.
- 4.3 The model shall be subject to prior approval by the senior management of the AIFM. Where the model is used by an AIFM that performs the valuation function itself, the approval by the senior management shall be without prejudice to the competent authority's right to require, under section 2.14 above, that the model be verified by an external valuer or an auditor.

5. Consistent application of valuation policies and procedures

(Article 69 of Level 2)

- 5.1 An AIFM shall ensure that the valuation policies and procedures and the designated valuation methodologies are applied consistently.
- 5.2 The valuation policies and procedures and the designated methodologies shall be applied to all assets within an AIF taking into account the investment strategy, the type of asset and, if applicable, the existence of different external valuers.
- 5.3 Where no update is required, the policies and procedures shall be applied consistently over time and valuation sources and rules shall remain consistent over time.
- 5.4 The valuation procedures and the designated valuation methodologies shall be applied consistently across all AIFs managed by the same AIFM, taking into

account the investment strategies and the types of asset held by the AIFs, and, if applicable, the existence of different external valuers.

6. Periodic review of valuation policies and procedures

(Article 70 of Level 2)

- 6.1 Valuation policies shall provide for a periodic review of the policies and procedures, including of the valuation methodologies. The review shall be carried out at least annually and before the AIF engages with a new investment strategy or a new type of asset that is not covered by the actual valuation policy.
- 6.2 The valuation policies and procedures shall outline how a change to the valuation policy, including a methodology, may be effected and in what circumstances this would be appropriate. Recommendations for changes to the policies and procedures shall be made to the senior management, which shall review and approve any changes.
- 6.3 The risk management function referred to in Article 38 of Level 2 (see the FSC information page on Operating conditions for AIFMs - Risk Management) shall review and, if needed, provide appropriate support concerning the policies and procedures adopted for the valuation of assets.

7. Review of individual values of assets

(Article 71 of Level 2)

- 7.1 An AIFM shall ensure that all assets held by the AIF are fairly and appropriately valued. The AIFM shall document by type of asset the way the appropriateness and fairness of the individual values is assessed. The AIFM shall at all times be able to demonstrate that the portfolios of AIFs it manages are properly valued.
- 7.2 The valuation policies and procedures shall set out a review process for the individual values of assets, where a material risk of an inappropriate valuation exists, such as in the following cases:
 - (a) the valuation is based on prices only available from a single counterparty or broker source;
 - (b) the valuation is based on illiquid exchange prices;
 - (c) the valuation is influenced by parties related to the AIFM;
 - (d) the valuation is influenced by other entities that may have a financial interest in the AIF's performance;
 - (e) the valuation is based on prices supplied by the counterparty who originated an instrument, in particular where the originator is also financing the AIF's position in the instrument;
 - (t) the valuation is influenced by one or more individuals within the AIFM.
- 7.3 The valuation policies and procedures shall describe the review process including sufficient and appropriate checks and controls on the reasonableness of individual values. Reasonableness shall be assessed in terms of the existence of an appropriate degree of objectivity. Such checks and controls shall include at least:

- (a) verifying values by a comparison amongst counterparty-sourced pricings and over time;
- (b) validating values by comparison of realised prices with recent carrying values;
- (c) considering the reputation, consistency and quality of the valuation source;
- (d) a comparison with values generated by a third party;
- (e) an examination and documentation of exemptions;
- (f) highlighting and researching any differences that appear unusual or vary by valuation benchmark established for the type of asset;
- (g) testing for stale prices and implied parameters;
- (h) a comparison with the prices of any related assets or their hedges;
- (i) a review of the inputs used in model-based pricing, in particular of those to which the model's price exhibits significant sensitivity.

7.4 The valuation policies and procedures shall include appropriate escalation measures to address differences or other problems in the valuation of assets.

8. Calculation of the net asset value per unit or share

(Article 72 of Level 2)

- 8.1 An AIFM shall ensure that for each AIF it manages the net asset value per unit or share is calculated on the occasion of each issue or subscription or redemption or cancellation of units or shares, but at least once a year.
- 8.2 An AIFM shall ensure that the procedures and the methodology for calculating the net asset value per unit or share are fully documented. The calculation procedures and methodologies and their application shall be subject to regular verification by the AIFM, and the documentation shall be amended accordingly.
- 8.3 An AIFM shall ensure that remedial procedures are in place in the event of an incorrect calculation of the net asset value.
- 8.4 An AIFM shall ensure that the number of units or shares in issue is subject to regular verification, at least as often as the unit or share price is calculated.

9. Professional guarantees

(Article 73 of Level 2)

- 9.1 External valuers shall provide upon request professional guarantees to demonstrate their ability to perform the valuation function. Professional guarantees to be furnished by external valuers shall be in written form.
- 9.2 The professional guarantees shall contain evidence of the external valuers qualification and capability to perform proper and independent valuation, including, at least, evidence of:
 - (a) sufficient personnel and technical resources;
 - (b) adequate procedures safeguarding proper and independent valuation;

- (c) adequate knowledge and understanding of the investment strategy of the AIF and of the assets the external valuer is appointed to value;
 - (d) a sufficiently good reputation and sufficient experience with valuation.
- 9.3 Where the external valuer is subject to mandatory professional registration with the competent authority or another entity of the state where it is established, the professional guarantee shall contain the name of this authority or entity, including the relevant contact information. The professional guarantee shall indicate clearly the legal or regulatory provisions or rules of professional conduct to which the external valuer is subject.

10. Frequency of valuation of assets held by open-ended AIFs

(Article 74 of Level 2)

- 10.1 The valuation of financial instruments held by open-ended AIFs shall take place every time the net asset value per unit or share is calculated pursuant to section 8.1.
- 10.2 The valuation of other assets held by open-ended AIFs shall take place at least once a year, and every time there is evidence that the last determined value is no longer fair or proper.

11. Application of implementing measures

Any measures adopted by the European Union Commission under Article 19 of the AIFMD (valuation) shall also be applicable.