

MEMO# 25921

February 17, 2012

IOSCO Consults on Fund Valuation

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TO: INTERNATIONAL COMMITTEE No. 5-12

SEC RULES COMMITTEE No. 13-12 RE: IOSCO CONSULTS ON FUND VALUATION

On February 16, 2012, the Technical Committee of the International Organization of Securities Commissions (“IOSCO”) published a consultation report, Principles for the Valuation of Collective Investment Schemes (the “Report”). [\[1\]](#) The Report sets forth proposed principles regarding the valuation of collective investment schemes (“CIS”). IOSCO states that, because a CIS must redeem and issue its shares at net asset value (“NAV”), it is critical that a CIS properly value its assets, including those for which market quotations are not readily available. In the Report, IOSCO notes that there have been a number of developments that have impacted valuation since its prior work in the area, including the availability of many complex and hard to value securities. The Report therefore is intended to update and modernize principles for valuation taking into account IOSCO’s prior work and recent market developments. [\[2\]](#)

The Report sets forth the following proposed principles:

1. The Responsible Entity [\[3\]](#) should establish comprehensive, documented policies and procedures to govern the valuation of assets held or employed by a CIS.
2. The policies and procedures should identify the methodologies that will be used for valuing each type of asset held or employed by the CIS.
3. The valuation policies and procedures should seek to address conflicts of interest;
4. The assets held or employed by CIS should be consistently valued according to the policies and procedures.
5. A CIS should have policies and procedures in place that seek to detect and prevent pricing errors. Pricing errors that result in a material harm to CIS investors should be addressed promptly, and investors fully compensated.
6. The Responsible Entity should provide for the periodic review of the valuation policies and procedures to seek to ensure their continued appropriateness.
7. The Responsible Entity should provide for the periodic review of the valuation policies and procedures to seek to ensure that they are being implemented effectively.
8. A third-party should review the CIS’s valuation process at least annually. [\[4\]](#)
9. The Responsible Entity should conduct initial and periodic due diligence on third parties that are appointed to perform valuation services.
10. The Responsible Entity should seek to ensure that arrangements in place for the

valuation of the assets in the CIS's portfolio are disclosed appropriately to investors in the CIS offering documents or otherwise made transparent to investors.

11. The purchase and redemption of CIS interests should not be effected at historic NAV, i.e., the last calculated NAV. [5]
12. A CIS's portfolio should be valued on any day that CIS units are purchased or redeemed.
13. A CIS's NAV should be available to investors at no cost.

IOSCO seeks comment on the proposed principles as well as on the following:

- Do these principles adequately address the regulatory issues raised by the valuation of CIS?
- Are conflicts of interest appropriately addressed? Is there a need for more stringent principles in this area?
- Does the principle regarding the NAV at which the purchase and redemption of CIS interests should be effected adequately cover the issues?
- Are there other areas that IOSCO should address?

Comments are due May 18, 2012. The Institute intends to submit a comment letter.

If you have any questions about this Report, please contact me (202-326-5813; solson@ici.org) or Dorothy Donohue (202-326-3563; ddonohue@ici.org).

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endnotes

[1] IOSCO, Principles for the Valuation of Collective Investment Schemes: Consultation Report, CR01/12 (February 2012) available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD370.pdf>.

[2] See IOSCO, Regulatory Approaches to the Valuation and Pricing of Collective Investment Schemes (May 1999) and IOSCO, Principles for the Valuation of Hedge Fund Portfolios (November 2007).

[3] The term "Responsible Entity" is described as the entity or entities responsible for the overall operation of the CIS and, in particular, its compliance with the legal and regulatory framework of the respective jurisdiction. Report at 10.

[4] Examples of third parties include an independent or external auditor as part of its periodic review of a CIS's financial statements, the depositary, custodian or accountant. The Report states that a third party can provide an independent review of the CIS valuation process, as relevant to the particular jurisdictions' regulations. In particular, IOSCO notes that a third party can verify the consistency of the CIS's NAV calculations and test the CIS' valuation procedures. Report at 15.

[5] Forward pricing, effecting purchases and sales of CIS interests at the next computed NAV after receipt of an order, ensures incoming and outgoing investors are treated equitably. Historical pricing would most likely have to be justified only if the risk of abusive trades by insiders and resulting dilution are minimized. Report at 16.

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