



## Fair valuation pricing survey 22nd edition

**Building and strengthening the valuation  
operating model amid complexity,  
technology, and regulatory headwinds**

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# Introduction

The 22nd edition of Deloitte's Annual Fair Valuation Pricing Survey (the "FV survey") affirms that valuation remains top of mind for the industry, as more than 100 fund groups participated in the survey for the second consecutive year. Registered investment companies and business development companies (collectively, "fund groups"), their respective board of directors/trustees (the "Board(s)" or "mutual fund directors"), and regulators share the goal of enhancing the accuracy and reliability of valuations, and all parties contributed to build and strengthen the valuation operating model in the current year. Fund group management continued to build off a successful year of adoption of the US Securities and Exchange Commission's (SEC) Rule 2a-5 ("Rule 2a-5" or the "Rule"),<sup>1</sup> taking measured steps to refine Rule 2a-5 compliance, thereby enhancing their valuation controls and processes. Further, fund group management strengthened the valuation operating model through the use of technology, while digesting complexity from hard-to-value securities such as private credit and private equity, and considering lurking SEC risk.

The race to bring alternatives to the retail distribution channel has introduced risks that the valuation team will need to manage to avoid reputational and brand harm. Mutual fund directors looked to strengthen their active oversight role by embracing Rule 2a-5 and working with fund group management to enhance reporting and develop key valuation indicators (KVIs), which will increase the likelihood that the mutual fund directors are at the table when price uncertainty enters the market. Lastly, the regulators, while proposing and adopting new rules at a record pace to address a number of perceived industry concerns and issues, continued to keep valuation in their sights through the inspection and examination program.

Valuation again topped the list of SEC focus, as noted in the 2024 Examination Priorities released by the Division of Examinations.<sup>2</sup> The report states that "the Division will review registered investment company valuation practices, particularly for those addressing fair valuation practices (e.g., implementing board oversight duties, setting recordkeeping and reporting requirements, and overseeing valuations designees)"<sup>3</sup>—basically, Rule 2a-5 compliance. FV survey participants noticed the SEC following through on this focus as there has been a marked change in SEC inspection activity regarding valuation and Rule 2a-5 compliance, which we would not expect this to let up for the

foreseeable future. The opportunity to build and strengthen both the valuation operating model and governance oversight model was evident throughout the insights and emerging, maturing, and industry trends found in the 22nd edition of the FV survey.

It has been two years since the adoption of Rule 2a-5, and the industry continues to feel its impact. Fund groups have now had time to reflect on the changes they made to valuation policies and procedures, technology, use of vendors and third-party valuation specialists, and board reporting. Key stakeholders are now asking, "What's next?" A high number of participants in this year's FV survey suggest that fund groups are intently focused on their valuation process and eager to see how they benchmark against their peers. Knowledge and preparation to build solid controls and processes are key, as valuations are most challenging during times of uncertainty, volatility, and change.

Valuations within the investment management industry are increasingly being put to the test by rapid growth and diversification of asset classes, including alternative asset classes such as private credit, cryptocurrencies, and private equity. These emerging asset classes present unique challenges and opportunities for valuation teams due to their distinct characteristics and market dynamics. As these asset classes continue to evolve, fund groups must evaluate their current policies and procedures to ensure accurate and reliable valuations, thereby maintaining investor confidence and optimizing portfolio performance.

As we examine the results of the 22nd edition of the FV survey, we continue to monitor these headwinds. Rule 2a-5's impact on the valuation operating model has been the most significant that the SEC has adopted for fund groups in more than 50 years, and the aftermath will be felt in the coming years. Today, fund groups must look ahead as they build and strengthen their valuation operating and valuation governance models in light of these industry and regulatory headwinds. Consistent with our mission, investing in what matters will be key for stakeholders. Finally, to our 100-plus FV survey participants, thank you for your participation in this year's survey. Your time and insights are what have made this survey a resounding success for more than two decades.

# Continued impact and evolution of Rule 2a-5

The implementation and oversight of the valuation operating model is continuously evolving as a result of Rule 2a-5. By enhancing governance structures, developing comprehensive policies, conducting rigorous testing, and improving board reporting practices, fund groups are striving to ensure the accuracy and reliability of asset valuations. This evolution reflects the industry's commitment to maintaining high standards of transparency and integrity in the valuation process. The FV survey captures how fund groups are strengthening their valuation operating models and determining when change is needed.

## Risk assessment process takes center stage

One area that continues to evolve is FV survey participants' approach to the Rule 2a-5 requirement for a valuation risk assessment. As figure 1 highlights, fund groups enhanced the risk assessment process with the continued increase in the valuation risks identified in various areas since the 20th edition of the FV survey.

**Figure 1. Areas with identified valuation risks (pre- and post-Rule 2a-5 adoption)**

Valuation area	22nd edition	21st edition	20th edition
Market closure	80%	74%	70%
Halted securities	78%	74%	68%
Military action/civil unrest/other conflicts	59%	57%	52%
Illiquid securities	82%	75%	70%
Valuation models	70%	68%	74%
Issuer/industry-specific matters/trends	52%	52%	50%
Change in correlation of factors/proxies/benchmarks	16%	19%	0%
Other	11%	9%	16%

Recent global events such as the COVID-19 pandemic, extreme market volatility, government intervention in the economy, civil unrest, and other conflicts are reflected in the trends where more fund groups are identifying related valuation risks in market closure (80%), halted securities (78%), and military action/civil unrest/other conflicts (59%). These global events seem to be leading to more overall valuation risks being identified.

Additionally, there is a concerted focus on illiquid securities, which aligns with the proliferation of new asset classes and increased demand for alternative fund products. These products offer access to illiquid investments, such as private credit, which cannot be easily held in traditional registered mutual funds and exchange-traded funds (ETFs), but make them appealing to institutional and retail investors alike through retail distribution channels offering business development companies (BDCs) that can be publicly traded and closed-end funds such as interval or tender-offer funds. In addition, the expanded use of these investments is facilitated by advancements in financial technology and greater access to market information, enabling more sophisticated investment strategies that have specific private equity or private credit allocations and broader mutual fund participation in those aforementioned investments. As a result, we have seen a maturing trend whereby 76% of FV survey participants have enhanced their risk assessment process to include qualitative consideration of changes in fund attributes, as compared to 74% and 59% in 2023 and 2022, respectively. Such fund attributes being monitored include new funds, new investment types, and strategy changes to assess potential changes in and manage the impact of valuation risk.

## Refining valuation risks and related responses

As noted above, FV survey participants are focused on fine-tuning valuation risk assessment, as effective risk assessment and appropriate responses can facilitate the accuracy and reliability of asset valuation procedures. This granular understanding of risks enables managers to implement more precise and effective controls. Moreover, a robust risk assessment framework can help in anticipating and managing the impact of adverse market conditions on the valuation process. Against this backdrop, there is no consensus answer for the format of the risk assessment process among FV survey participants. Some include heat maps (19%), numerical scoring (13%), or qualitative rating (23%), while some use a combination of all formats (10%), and, finally, others have descriptions of assessed risks, without any rating or scoring (35%). While the approach and format may vary, the underlying goal of managing valuation risk remains the same.

**Figure 2. Mapping specific procedures (controls) to assess/ manage valuation risks**

Procedure to map risk	22nd edition	21st edition	20th edition
Yes, we have identified and mapped such procedures	60%	55%	43%
Yes, we have identified them (procedures), although we have not specifically mapped them to risks	28%	32%	39%
No, we have not identified them (procedures)	12%	13%	18%

Designing appropriate controls and procedures to manage valuation risks is crucial in the context of Rule 2a-5. These should include a comprehensive set of policies and practices that address identified risks and ensure consistent application of valuation methodologies. For instance, investment managers should establish clear guidelines or policies overseeing third-party pricing services, conduct regular back-testing and stress testing of valuation models, and maintain thorough documentation of all valuation decisions and assumptions. As shown in figure 2, FV survey participants have become more specific and detailed over the past two years, with 60% mapping controls and procedures to certain valuation risks today, as compared to 55% and 43% in 2023 and 2022, respectively.



## Identifying conflicts of interest

Addressing conflicts of interest is a fundamental requirement under Rule 2a-5 to ensure the integrity and objectivity of the valuation process. The Rule mandates that Boards and their valuation designees implement policies and procedures to assess and manage material conflicts of interest. Additionally, the Rule requires regular reporting to the Board on any identified conflicts and the measures taken to address them, ensuring ongoing oversight and accountability. As a result of Rule 2a-5, fund groups are taking a more formal approach to identifying and addressing conflicts of interest, with 72% of FV survey participants documenting conflicts of interest in writing, compared to 60% two years ago.

Additionally, fund groups must consider conflicts of interest in the context of service providers, including third-party valuation specialists. Fund groups are increasingly using external valuation specialists in some capacity to price certain asset classes such as private equity (63%) and private credit (52%). This has a direct impact on the conflicts of interest procedures, as 32% of FV survey

participants are now identifying conflicts of interest related to pricing services providing valuations, compared to 16% of participants in 2022. The SEC noted<sup>4</sup> there is not one exact way to provide proper oversight of third-party service providers and mitigate conflicts of interest, but specifically called out calibration and back-testing as particularly useful methods. Of FV survey participants that use calibration, 87% use it to evaluate prices supplied by pricing vendors, and 90% of FV survey participants employ back-testing as part of their valuation procedures. That includes fund management building an internal back-testing report (73%), reviewing pricing vendor reports (59%), and/or engaging a third-party provider to provide back-testing and exception reporting (20%). Thus, the industry trend would say that fund groups are addressing the SEC's expectations by employing such methods.



### Adequacy of resources still lacks comparability

Rule 2a-5 recognized that a strong valuation operating model is supported by the collective experiences and judgment of the people and resources that drive day-to-day activities within it. As such, Rule 2a-5 requires valuation designees to annually report to their respective fund group’s Board on the adequacy of valuation resources. The Rule does not provide clarity on how the valuation designee should perform such assessment nor how the Board should assess its adequacy. It also does not provide context as to what would be “normal or sufficient” in terms of the level or experience of resources.

The FV survey results highlight an emerging trend of how difficult it is to define this, as only 6% of FV survey participants indicate that they have established sets of criteria or metrics to aid in evaluating the adequacy of valuation resources. Among these participants, examples of criteria include data around headcount, qualifications, experience (i.e., in years) and general accuracy and timeliness in performance metrics.

The FV survey again offers data points based on the size of fund groups as to what might be typical, although there are different facts and circumstances that impact each fund group. There may be smaller-sized fund groups with many illiquid or hard-to-value securities that would require more resources and effort compared to a larger-sized fund group that holds primarily exchange-traded securities. Individual differences aside, figure 3 shows the industry trend that smaller fund groups have fewer valuation full-time equivalents (FTEs), as compared to larger fund groups.

**Figure 3. Full-time equivalents (FTEs) based on size of fund group**

AUM in billions	Fewer than 5 FTEs	5 or more but fewer than 10 FTEs	10-15 FTEs	More than 15 FTEs
Greater than \$500	11%	18%	24%	47%
\$101-\$500	48%	30%	9%	13%
\$51-\$100	50%	22%	17%	11%
\$10-\$50	71%	29%	0%	0%
Less than \$10	69%	25%	0%	6%

Determining where valuation resources should reside is another consideration. Offshore resources (excluding those that may be employed by the fund accountant) are used by 19% of FV survey participants, an increase from 17% in the prior year. Common tasks for offshore resources include daily price checks, escalation of price exceptions, and monthly reporting, which not only provide a deeper pool of resources but also enhance business continuity and resiliency. The use of offshore resources is most prevalent among larger fund groups, where 38% of participants with AUM in excess of \$500 billion are utilizing them.

### Board reporting on a steady glidepath

Last year left us with the question of how the implementation of Rule 2a-5 may potentially continue to influence Board oversight and the funds' governance model. Were Boards satisfied with initial implementation, and would the coming years see a continued move toward a risk-based oversight approach? And if so, would that ultimately result in Boards shifting time away from focus on valuation matters? All of this will be considered in the context of the SEC's expectation for "active" oversight.

Boards that have appointed a valuation designee receive required reporting that supports oversight of the fair value determinations performed by the valuation designee. However, Rule 2a-5 allows each Board the flexibility to determine other reporting that it would like to receive in carrying out its active oversight duties regarding valuation. Now, two years after the adoption of Rule 2a-5, the wave of change has stabilized. The amount of time spent on valuation by the funds' Boards remained the same for 82% of participants, as compared to last year, while 13% said that there was an increase in the Board's time on this topic. This seems to suggest that the heavy lifting is complete and that Boards have largely determined what they are comfortable with in regard to the level of monitoring and reporting received from fund management and outside providers. Similarly, 98% of participants said that there was no change in the frequency (i.e., number of meetings) of the Board's valuation oversight process.

For 92% of FV survey participants, the Board and/or its committees are not receiving additional reporting beyond what was provided last year. In the 21st edition of the FV survey, the majority of participants (54%) indicated that the Board was receiving valuation-focused reporting that had not been provided in prior years (figure 4).

**Figure 4. Boards receiving additional/new reporting in the last 12 months**

	22nd edition	21st edition	20th edition
Yes	8%	54%	16%
No	92%	46%	84%

There has also been minimal change in the extent of detail provided in these valuation materials for the Board. Eighty-two percent of FV survey participants said that there was no change in the level of detail this year, as compared to last year, when 62% of FV survey participants had some degree of change. Ninety-nine percent of FV survey participants provide summarized reporting to their Boards. Among those, there's a maturing trend of the Boards not requesting or receiving the full supporting detail. This was the case for 59% of FV survey participants this year, up from 39% last year and 34% two years ago.

This year's FV survey results suggest that most Boards have found the right balance with allocation of responsibilities between themselves and the valuation designee. Ninety-nine percent of FV survey participants indicate that there has been no change in the Board's delegation of responsibilities to management in the past year, up from 65% in the previous year. In other words, just 1% of FV survey participants delegated more responsibility from the Board to fund group management in 2024, a sharp decline from 35% in 2023.

Further, this year's FV survey continues to show a maturing trend regarding the use of dashboard reporting. Many fund groups report their Boards using dashboard reporting, with growing popularity in 2024. Fifty-five percent of FV survey participants reported providing them to their Boards, up from the 45% to 47% range seen over the past five years. However, the information identified and reported as KVIs within this dashboard reporting has remained fairly consistent over the past three years. The most common key valuation indicators are listed in figure 5.

**Figure 5. Most common reported KVIs**

KVIs	22nd edition	21st edition	20th edition
Percentage of level 3* investments	89%	90%	71%
Number of price challenges	91%	85%	74%
Back-testing results of trades	80%	79%	86%
Unchanged (stale) prices	76%	75%	76%
Back-testing results of foreign equity fair value factors	80%	67%	71%

\*As defined in US GAAP, Accounting Standards Codification 820.



In addition to the quarterly and annual board reporting requirements of Rule 2a-5, fund groups are now required to provide prompt notifications. The prompt notification aspect of the Rule requires “the valuation designee to provide a written notification of the occurrence of material matter...This notification must take place within a time period determined by the Board, but in no event later than five business days after the valuation designee becomes aware of the material matter.”<sup>5</sup> The FV survey continues to benchmark several aspects of fund groups’ approach to reporting matters to the Board under the prompt notification provision. Thirty-four percent of FV survey participants noted that they reported matters under the prompt notifications requirement in 2024, relatively consistent with the 38% reporting matters in the prior year. In addition, 56% have had detailed conversations with the Board to understand their prompt notification expectations to reduce the risk of underreporting and confusion or uncertainty as to next steps once the designee has identified a potential matter.

Lastly, a quick update on the three ways Boards can demonstrate “active” oversight:

1. Ad hoc valuation meetings;
2. Specific valuation policies and procedures that address when the Board “must be involved” or “must be notified” to discuss a valuation matter; and
3. Board reporting.

Ad hoc meetings, or those where the Board holds a valuation discussion with management outside of a regularly scheduled meeting, were only held by 12% of participants this year, as shown in figure 6. This is a drop from 39% of FV survey participants in the 20th edition and 20% in the 21st edition. Again, this could be a result of the prescriptive nature of Rule 2a-5. Further, as it relates to the Board oversight tool in which fund groups have established up-front scenarios whereby the valuation policies and procedures identify specific circumstances under which the Board “must be involved” or “must be notified,” the past three FV surveys showed a drop from 8% to 5% to 2%, respectively, in the “must be involved” circumstances and a very slight decrease from 34% to 33% to 32%, respectively, as to the “must be notified” circumstances. This is certainly an emerging trend worth watching, as it seems like

the Rule’s prescriptive reporting requirements (prompt, quarterly, and annual) may be diluting some of the robust, free-flowing conversations and expectations that have serviced the valuation operating model in past years.

**Figure 6. In the last 12 months, did the Board hold a valuation discussion with management outside of a regularly scheduled meeting, i.e., an “ad hoc” meeting?**

	22nd edition	21st edition	20th edition
Yes	12%	20%	39%
No	88%	80%	61%

After a flurry of change to Board reporting over the past two years in connection with Rule 2a-5 adoption, this year’s survey suggests that Boards have found a new equilibrium and settled on how they plan to execute on their governance responsibilities and demonstrate active oversight.



# Enhancing the valuation operating model through the continued use of technology

FV survey results suggest a continuing industry trend toward the adoption of or the increase in use of technology in the valuation operating model. Fifty-four percent of FV survey participants report they began to use or increased their use of at least one form of technology in the past 12 months. Figure 7 depicts the technologies and the percentage of FV survey participants who indicated an increase usage of multiple technologies. Also, shown in figure 8, there is a maturing trend toward use of certain technologies in the valuation operating model, with overall increases over the past three years in all categories of technology except robotic process automation.

The FV survey also illustrates that technology has been implemented by fund groups of all sizes. Ninety-six percent of participants indicated their fund group used at least one of the technologies listed in figure 8. The largest fund groups (those with greater than \$500 billion in AUM) continued to lead in the use of technology, with more than 60% of these fund groups using data lake/data management, workflow, and/or data analytics tools. Only a minority of fund groups of smaller size use such tools.

An emerging trend regarding the increased use of workflow management tools is that nine fund groups indicated they either implemented or increased usage of workflow tools and now have their full end-to-end valuation process and controls automated by a workflow management tool.

Lastly, a potential emerging trend related to technology is the adoption by fund groups of cognitive automation, natural language processing, machine learning, and/or artificial intelligence. In last year's FV survey, two participants indicated that they used these tools in their valuation operating model. This was a FV survey first! The specific use cases of advanced technologies were to perform advanced analytics as part of the valuation operating model. In this year's FV survey, participants identified the use of Generative AI for the first time. The use cases for Generative AI were to produce valuation memos and gather information to support the fair valuation process within the valuation operating model. Thus, we cannot wait to see what next year's survey brings as more use cases are developed and adopted more broadly across the investment management industry.

**Figure 7. Areas in which the use of technology began or increased in the past 12-months**

Technology	Percentage reporting increase in use		
	22nd edition	21st edition	20th edition
Spreadsheet tools (i.e., macros/queries/pivot tables)	32%	36%	36%
Data analytics	20%	23%	21%
Data management/data lake for valuation data	18%	22%	16%
Data visualization tools	18%	23%	22%
Workflow management tools	16%	17%	19%
Robotic process automation	3%	10%	10%
Software programming language	0%	10%	11%

**Figure 8. Technology in use today**

Technology	Percentage reporting use		
	22nd edition	21st edition	20th edition
Spreadsheet tools (i.e., macros/queries/pivot tables)	95%	90%	97%
Data analytics	38%	36%	38%
Data management/data lake for valuation data	35%	34%	34%
Data visualization tools	38%	32%	28%
Workflow management tools	31%	27%	29%
Robotic process automation	12%	15%	19%
Software programming language	17%	14%	11%

# Addressing the headwinds that come with increasing complexity and regulatory focus

Many fund groups are experiencing ever-increasing levels of complexity, driven by the evolving dynamics of private equity and private credit. As private equity (PE) firms diversify their strategies and expand their global footprints, the intricacies of deal structures and valuation methodologies have grown more sophisticated. Concurrently, the rise of private credit as a significant asset class has introduced new layers of valuation and financial reporting challenges. Overlaying these developments is an increasingly stringent regulatory environment and focus in which compliance requirements and oversight mechanisms are continually evolving to address the complexities of modern financial markets. This confluence of factors is challenging fund groups and mutual fund directors to respond in a timely and agile manner to properly manage and oversee the valuation operating model.

## Trends across the valuation of private investments

This year's FV survey provides insights into the current practices and trends of fund groups investing in private equity investments. Valuation remains challenging, as private equities are often illiquid, complex, and obtaining access to all relevant information is challenging. The survey covers topics such as:

- The valuation approaches and methods used,
- The frequency and format of valuations,
- The use of external specialists,
- The oversight and due diligence procedures over external valuation providers.

The survey also explores the emerging asset class of private credit, which has seen an increase in usage among fund groups.

Private equity continues to be an asset class in which fund groups invest. In fact, the percentage of fund groups investing in private equities in their mutual fund portfolios has remained relatively stable for the past three years ranging between 50% and 52% (figure 9). However, their prevalence across individual fund groups/funds is still relatively limited, as 69% of respondents with private equity investments indicated that 4% or less of regulated investment companies in their fund complex hold private equity. Further, among these fund groups/funds with private equity holdings, the amount invested has remained steady or mixed: 56% indicated no change from year to year, while 20% reported an increase, and 24% noted a decrease.

**Figure 9. Does your fund complex invest in private equity?**

	22nd edition	21st edition	20th edition
Yes	50%	50%	52%
No	50%	50%	48%

On the private equity valuation front, 50% of fund groups use multiple valuation techniques to value private equity positions; however, there is a maturing trend toward the use of just one valuation technique growing from 43% in the prior year to 49% this year. The most common methodology continues to be comparable company analysis, including the use of market multiples, which is utilized by 64% of participants, as shown in Figure 10.

**Figure 10. Methodology used for the majority of private equity investments**

Valuation methodology	22nd edition	21st edition
Discounted cash flow analysis	9%	11%
Comparable company analysis	64%	65%
Precedent transaction analysis	9%	11%
Cannot generalize	18%	13%

There has also been a heightened reliance on external experts as 63% of FV survey participants use valuation specialists as part of their valuation operating model, compared to 54% last year. When such external experts are used, the frequency of obtaining valuations displays a wide dispersion. Results indicate that most fund groups appraise their private equity holdings on a monthly basis (43%), with quarterly evaluations coming in second (27%). Along with the increased usage of external experts, fund groups are also intensifying oversight of such providers (35%) and are conducting due diligence more often (18%) to confirm the precision and dependability of their valuations.

The standardization of private equity valuations continues to face headwinds with approximately two-thirds of survey participants saying they apply different valuation techniques and formats for private equity investments. These valuation techniques vary based on several factors, such as the entity conducting the valuation (i.e., fund group or external specialist) and the industry of the investment. This is up from 57% applying different valuation techniques and formats in the prior year. Consequently, there's been a marked decline in the number of investor groups applying a standard valuation model in accordance with generally accepted accounting principles (GAAP), specifically the fair value framework as defined in Accounting Standards Codification (ASC) 820, to all their private equity holdings, which decreased from 34% last year to only 23% this year (figure 11).

**Figure 11. How would you describe your firm's preparation of private equity investment valuations?**

We use a standardized format for all investments	<b>23%</b>
We use a standardized format for some but not all investments	<b>9%</b>
The format of each valuation varies depending on a variety of factors (e.g., different preparers, different industries)	<b>68%</b>

A significant hurdle in valuing private equity investments is often the lack of visible market pricing or similar deals. To tackle this obstacle, fund groups frequently employ a method known as calibration. This technique fine-tunes the valuation parameters and presumptions to align with market prices or transactions observed at specific moments, such as the purchase date or during the latest capital raise. Calibration serves to enhance the dependability and uniformity of the evaluated values and valuation model, and moderates the risk of partiality or distortion. In line with the previous year's data, 59% of respondents in the FV survey with investments in private equity maintained internal documentation for their calibration methods applied to their investments. This compares to 50% two years ago and 34% three years ago.

Valuing private equity investments is intricate and ever-changing, prompting fund managers to stay abreast of market dynamics while

also adhering to regulatory requirements. As the private equity sector and its investors continue to pursue value creation in private markets, valuation methods are adapting accordingly, blending judgment with analysis. The findings from this year's FV survey indicate that fund managers employ a variety of approaches to value their private equity investments, with a preference shown for using comparable companies (figure 10). It also notes increased engagement with external valuation providers, which also led to an uptick in the levels of documentation, oversight, and due diligence of such providers.

The rise in prominence of private credit includes various types of nonbank loans such as direct lending, mezzanine financing, distressed debt, and special situations. While the proportion of FV survey participants that invest in private equity has stayed consistent over the past few years, there's been a marked increase in the number of fund groups investing in private credit, jumping to 32% from the prior year's 21% (figure 12).

**Figure 12. Do you invest in private credit?**

	<b>22nd edition</b>	<b>21st edition</b>	<b>20th edition</b>
Yes	32%	21%	20%
No	68%	79%	80%

Private credit can offer investors access to a large and diverse market that is less correlated to public markets and has the potential to generate higher returns and lower volatility. Figure 13 outlines how fund groups obtain pricing for private credit holdings, with a maturing trend toward receiving a price or range of prices from a third-party provider (52%). Focus on future developments in valuation of private credit investments will be important as managers look to refine their valuation operating model and consideration of trends such as utilizing multiple valuation techniques and methodologies, calibration, and using third-party valuation specialists.

**Figure 13. Pricing of private credit investments**

<b>Valuation methodology</b>	<b>22nd edition</b>	<b>21st edition</b>	<b>20th edition</b>
Receive a price from a third-party provider	39%	27%	41%
Receive a range of prices from a third-party provider	13%	5%	0%
Use a price from an internal model by itself	23%	32%	18%
Use a price from an internal model price, if it falls within a price range provided by a third-party provider	10%	18%	18%
Other	15%	18%	23%

### Sharper focus by the regulator on the valuation process

The 2024 SEC Examination Priorities highlighted the increased complexity combined with growth in the industry and made clear that the Division of Examinations is updating its priorities to match the changing landscape. As a result, the Division of Examinations continues to prioritize review of valuation practices, including board oversight and recordkeeping for investment companies, and increase scrutiny of investment in illiquid investments (e.g., real estate, private equity) by advisers.

Further, in June 2024, an SEC official participated in an interview and noted that they are concerned about the private-lending industry, specifically “valuation issues: how they’re marking these investments because they are illiquid ... concerned about—as we would be with other private funds—fee and expense issues, and with conflict-of-interest issues.”<sup>6</sup> Historically, there has not been a large precedent of enforcement actions regarding private lending, but the industry pays close attention to comments made by the SEC. It will be interesting to monitor as private credit has ties to the banking and insurance industries, both of which are already heavily regulated by other government agencies.

Additionally, exams over the past few years have included reviews of recently adopted rules soon after their compliance dates instead of waiting a period of time. Recent examples are the

marketing rule and liquidity risk management rule (which continue to be focus areas). The SEC has previously issued risk alerts, as it has found issues with firms’ compliance programs over the rules. This change in exam focus could be a trend as we now turn to Rule 2a-5 compliance examinations.

In fact, this is already happening. Among FV survey participants for which the SEC’s Division of Examinations conducted an examination or sweep involving their fund group 22% of the examinations included questions on Rule 2a-5 compliance (figure 14). This further enhances what the SEC stated in its annual Examination Priorities, with a continued focus on valuations.

**Figure 14. SEC examinations in last 12 months**

**For respondents where the SEC conducted an examination of the fund complex or involved in a sweep examination, was your fund complex valuation process part of the visit and what areas did the SEC’s Division of Examinations focus upon?**

	22nd edition	21st edition
Yes, there were questions on our valuation policies and procedures	39%	40%
Yes, there were questions on our fund governance and Board reporting process over the valuation process	22%	20%
Yes, there were questions on Rule 2a-5 compliance	22%	0%



## Additional key FV survey findings

The FV survey contains questions on many valuation topics—too numerous to capture all within this executive summary. Additional key FV survey findings, as determined by the survey authors, are highlighted below.

### *Board governance*

- Seventy-nine percent of participants report price challenge information to the Board at each meeting, while others report it ad hoc or as needed (10%), annually (9%), or more frequently than annually but less frequently than at each meeting (2%).
- The Board, a committee of the Board, or one or more Board members receive the results of back-testing for the following security types: foreign equities (81%); fixed-income vendor prices (63%); illiquid or fair-valued securities that traded within the fund's fiscal quarter (49%); and broker-quoted prices (26%).
- For 76% of FV survey participants, the governance model involves delegating the responsibility for overseeing valuation matters to a separate committee (e.g., audit committee, valuation committee, risk committee), subject to the Board's oversight. Of those, some have a separate valuation committee (44%) or delegate that responsibility to the audit committee (39%) or another committee of the Board (17%). Thirty-six percent of FV survey participants specifically have a Risk Oversight Committee.

### *Pricing sources*

- Seventy-nine percent of participants perform due diligence visits annually for all pricing vendors used as a primary pricing source. Only 6% of participants perform more frequently than annually. For those who only visit some of the pricing sources, the predominant criteria for determining which to visit are the following: primary pricing sources (38%); pricing sources that are used to price a predetermined threshold of the portfolio (25%); and pricing sources for which there has been a deterioration of service quality (13%).

### *Foreign equities*

- Sixty-three percent of FV survey participants reported using a zero trigger to determine when to adjust the prices of all or a subset of fair value equities that trade on all foreign exchanges closing before 4 p.m. ET. This percentage is unchanged from the prior year's survey.
- Sixty-one percent of FV survey participants managing passively managed ETFs reported performing an analysis on an ad hoc or case-by-case basis to determine if a foreign equity price should be adjusted from the closing exchange price. This percentage is up from 44% in the prior year's survey.

### *Fixed-income investments*

- Ninety-five percent of FV survey participants report no change in the past year, relative to their use of bid or mean pricing, and similarly, 85% of participants said that policies and procedures related to odd-lot pricing have not changed in the past year.
- On Columbus Day/Indigenous Peoples' Day and Veterans Day, when the bond market is closed, 63% of participants receive a vendor price for bonds as of the current day and 31% use the previous day's price.
- Fifty-seven percent of FV survey participants use bid pricing exclusively when valuing fixed-income securities (compared to 63% in prior year), 28% use mean pricing (compared to 27% in the prior year), and 15% reported that their use varies based on the type of fixed-income instrument (compared to 10% in the prior year).

### *Derivative contracts*

- Fifty-five percent of participants indicated that on dates in which the New York Stock Exchange (NYSE) is open but bond markets are closed, they use the most recent price from when the bond market was open to value bond futures.

### *Exchange-traded funds*

- Fifty percent of participants manage or offer actively managed ETFs, up from 40% in the prior year. Only 48% of FV survey participants do not offer any ETFs, down from 53% in the prior year.
- Fifty-seven percent of participants use bid pricing for pricing in fixed-income ETFs, while 32% use mean pricing, and 11% differ based on security type.

### *General policies and procedures*

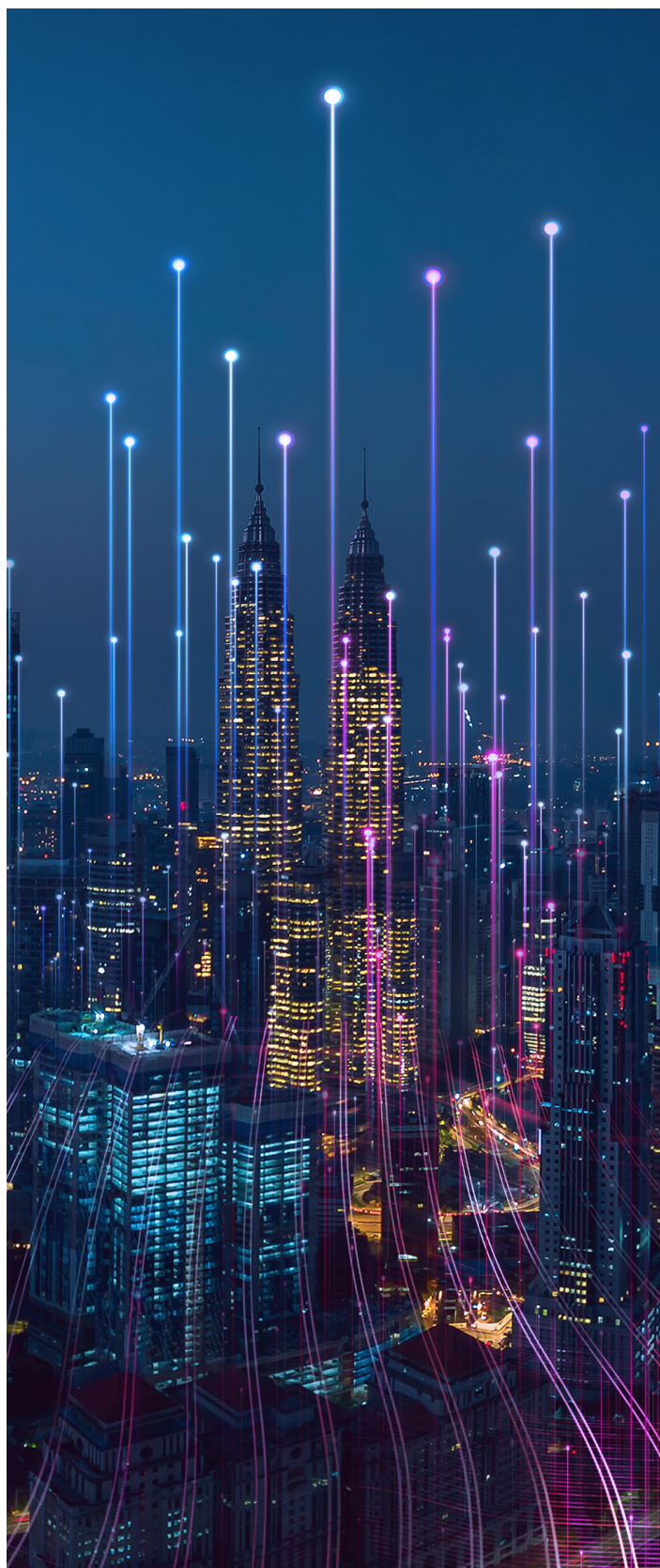
- Forty-four percent of FV survey participants changed their fair valuation policies and procedures in the last year, compared to 54% last year. The most common changes were related to pricing committee composition, responsibilities, and/or meeting frequency (42%), and adding more investment types (35%) and more pricing sources (35%).
- Six percent of FV survey participants are investing in cryptocurrencies or digital assets and 50% of those fund groups report that they have established a monitoring process specific to these asset classes.

#### *Private equity and private credit*

- Of participants that hold PE positions among their fund group, 45% actively purchase private equity investments, down from 50% in the prior year. Consequently, 40% of participants passively acquire private equity investments through restructurings or other such means, up from 34% in the prior year.
- Sixty-four percent of FV survey participants indicated that a comparable company's analysis is the most common way that they value the largest percentage of their private equity holdings, which is consistent with the prior year.
- For a comparable company's approach, a mean/median of comparable sets of companies is the most common approach used by 41% of participants. Comparative analysis of relevant factors (e.g., size, growth, and profitability) to adjust from the mean/median is the second most common response at 33%.
- Thirty-two percent of participants invested in private credit—an increase from 21% in the previous year.
- For participants with private credit holdings, valuation practices include receiving a price from a third-party provider (39%); receiving a range of prices from a third-party provider (13%); using a price from an internal model by itself (23%); using a price from an internal model price if it falls within a price range provided by a third-party provider (10%); and using other approaches (15%).

#### *Russian-based investments and currency*

- Eighty-six percent of FV survey participants are valuing Russian-based local equities at zero, and 77% are valuing Russian-based depositary receipt equities at zero. These percentages are unchanged from the prior year's survey.
- Eighty-one percent of FV survey participants are not accruing dividends on Russian-based local equities, with the remaining 19% only accruing when cash is received and able to be repatriated to US dollars.
- Thirty-three percent of FV survey participants holding Russian rubles indicated that they are valuing them using current foreign exchange rates, compared to 49% reporting such last year. The movement away from using the current rates has resulted in some FV survey participants (59%) reporting that Russian rubles are valued at zero.



# Looking ahead



## Continued Rule 2a-5 benefits

Fund groups have come a long way since the Rule 2a-5 compliance date and made significant efforts to comply and enhance their valuation operating model and governance oversight process. However, the question has never been whether fund groups would be able to comply. The real curiosity is whether the benefits outlined within the adopting release of the Rule will be realized at some point. Those benefits included items such as less-biased valuations, clarification of roles and responsibilities, and more risk-based “active” Board oversight.

Putting those goals aside, there may be other benefits from the Rule. The Rule’s requirement for a valuation risk assessment may lead some fund groups to change or replace certain procedures because they do not really address identified risks squarely or because automation might make them irrelevant. Incremental gains may make the valuation operating model more resilient.



## SEC alert: Implications of SEC examinations

As noted in the FV survey, the SEC focus on Rule 2a-5 compliance has increased, with 22% of those fund groups where the SEC conducted an examination receiving inquiries into Rule 2a-5 compliance. Given the SEC’s continued emphasis on valuation as part of its exam priorities, we do not expect this to change in the near term. Thus, what will be the impact? Will we see additional SEC guidance, enforcement actions, or convergence of industry governance and valuation operating models? The FV survey results show some diversity in the application of many Rule 2a-5 requirements, including the timing and extent of Board reporting, the involvement of Boards in certain matters, performing risk assessments, evaluating conflicts of interest, and how fund groups test fair value methodologies. Some of these differences may change over time based on regulatory feedback or the sharing of perspectives by industry participants.

Industry participants may find it helpful to be prepared and proactively benchmark valuation practices relative to Rule 2a-5 requirements. This exercise may be something that many undertake to fine-tune their valuation policies and procedures as well as their valuation operating models. Some changes may also come about naturally as fund groups and their Boards identify tasks and reporting that lack meaningful substance or fail to achieve desired results. They may also simply develop certain preferences that may result in the evolution of their valuation operating models.





### **An opportunity with valuing illiquid positions**

As noted in the FV survey, many fund groups hold investments that are less liquid, such as private equity for 50% of participants and private credit for 32% of participants. Some positions are acquired directly, and some are acquired as a result of corporate actions, restructurings, or regulatory actions. Estimating fair value of private equity, private credit, and halted/delisted securities remains a challenging area for fund groups, especially because there are neither quoted prices available nor a perfect way to develop fair values. Thus, it is no surprise that the FV survey shows a maturing trend of fund groups using third-party valuation experts to value these types of instruments. The FV survey indicated an increase in using external valuation specialists in some capacity to price certain asset classes, including 65% for private equity and 52% for private credit. As noted previously, the fund group is still responsible for providing accurate data and inputs, and the environment must be well-controlled. In addition, oversight and responsibility of the process and outcomes cannot be left unattended.



### **Emergence of artificial intelligence technologies may reverse the tech trends**

In business today it is not hard to find discussion of artificial intelligence and its future impact on the workplace, whether it is AI-based technology to enhance the day-to-day productivity of human resources or to generate AI capabilities for content creation. While the full potential of this emerging technology is still to be determined, it is possible to see where AI can provide efficiency in the valuation process. One survey participant reported the use of Generative AI, noting that it is used to prepare documentation (e.g., valuation memos) and gather information to support the fair valuation process. It remains to be seen how this will evolve, but it is clear that there is a future where the valuation operating model may be enhanced using AI.

However great the possibilities are, technologies are not infallible. Human oversight will need to remain to ensure the output from any technology is consistent with the facts and circumstances in place. Continued investment in human capital will remain imperative to maintain oversight of technology.

While AI-based technology is being considered by the industry, the industry is simultaneously experiencing a leveling off in the pace of implementing new technology. Fifty-four percent of FV survey participants report they began to use or increased use of at least one form of technology for valuation purposes. This is a decline from 68% in the prior year. A possible explanation for this slowing growth is the limits on current technology and previous implementations. The largest fund groups (those with greater than \$500 billion in AUM) have slowed the rate at which they are implementing or increasing the use of technology.

With the conflicting signals being seen in the data, there is an inherent amount of uncertainty on what is next for the use of technology in the valuation operating model. With the slowing rate at which technology is being implemented, specifically for the largest fund groups, and with the first indication that Generative AI has been adopted, perhaps it is a suggestion that the industry has reached a plateau on the climb up the technology mountain.

# About the FV survey and its authors

We conducted the FV survey in summer 2024, and it was completed by participants representing 103 registered investment company fund groups. FV survey participants included small, midsize, and large fund groups. Thirty-five percent have more than 100 funds within the fund group, and 23% have fewer than 15 funds. Approximately 11% of them manage mainly equities, 4% manage mainly fixed-income securities, and the remaining 85% manage a balanced array of strategies. Percentages reported are generally based on the number of survey participants responding to the specific question, unless otherwise noted.

## Authors



**Paul Kraft**

[pkraft@deloitte.com](mailto:pkraft@deloitte.com)

Paul Kraft is an Audit & Assurance partner in Deloitte & Touche LLP's Investment Management practice and serves as the Investment Management Marketplace Excellence leader. He has more than 30 years of experience providing audit and related services to some of Deloitte's largest investment management, insurance, and banking clients. Paul has led Deloitte's annual Fair Valuation Pricing Survey since its inception and is a frequent speaker and writer on the topic of fair valuation, as well as other financial services and governance topics.



**Michelle Coombs**

[mcoombs@deloitte.com](mailto:mcoombs@deloitte.com)

Michelle Coombs is an Audit & Assurance senior manager at Deloitte & Touche LLP in the firm's Financial Services Industry practice. She has more than 10 years of experience serving a variety of investment management clients, including mutual funds, ETFs, hedge funds, collective investment trusts, and UCITS.



**Katie Yorra**

[kyorra@deloitte.com](mailto:kyorra@deloitte.com)

Katie Yorra is an Audit & Assurance partner at Deloitte & Touche LLP in the firm's Financial Services Industry practice. During her 16 years with the firm, Katie has served in roles with progressively increasing responsibilities on audit engagements of mutual funds, collective investment trusts, and family offices. She creates a collaborative and interactive environment among the client, engagement team, and specialists, while bringing valuable insights to her clients from her extensive industry experience. Katie also serves as a trusted advisor for asset managers within Deloitte's Accounting & Reporting Advisory Services practice, helping clients solve their most complex issues and navigate a rapidly evolving regulatory landscape using a risk intelligent, integrated approach.



**Matt Morlock**

[mmorlock@deloitte.com](mailto:mmorlock@deloitte.com)

Matt Morlock is an Audit & Assurance senior manager at Deloitte & Touche LLP in the firm's Financial Services Industry practice. He has more than 10 years of experience serving investment management clients ranging from registered mutual funds to private equity and private credit.

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# Endnotes

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