



## Fair valuation pricing survey, 19th edition, executive summary

**Opportunity on the horizon**

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# Opportunity on the horizon

Our 19th edition of the Deloitte Fair Valuation Survey (the FV survey) is released at a time when valuation policies and procedures, the role of board governance, and the valuation operating model and use of technology solutions are being challenged, disrupted, and innovated more than ever. This seems incredible to think about, as the industry has dedicated a lot of time, resources, and energy to put in place high-quality valuation processes aimed at “getting daily security valuations right” so that shareholder transactions are executed using an accurate net asset value per share (NAV). A number of recent events and activities have created a confluence of opportunities for fund groups to digest, evaluate, and continue the valuation journey, preparing for change and better outcomes for all industry stakeholders.

One of the most significant events in recent times is the COVID-19 pandemic. Our latest FV survey was conducted and completed in a year in which most fund personnel continued to primarily work virtually from their homes. As noted in last year’s survey, the quick transition of the valuation operating model to a remote environment created the need for fund groups to adopt some temporary controls and procedures and ramp up their use of technology, as well as their ability to digitize the valuation process where opportunities presented themselves. Today, fund groups need to continue to balance plans to return to work and the implications of the Delta variant.

Should the valuation team come to the office five days a week? Operate on a hybrid model and commute two to three days a week? Or continue to operate on a fully remote basis? The latter back-to-work model has some desirable characteristics beyond the personal satisfaction of no commute. Valuation teams occasionally need to work late to wrap up the valuation process due to late pricing or data feeds. Working on a remote basis may make it easier for them to balance their personal lives with their job responsibilities when such information becomes available and complete the valuation process more efficiently. The continued expansion of technology solutions such as workflow tools continues to present opportunities to optimize the process. Whatever the valuation operating model,



fund groups should always challenge the adequacy of the controls in place, the security of information being accessed on a remote basis, and the integrity of the overall valuation process.

The most significant recent regulatory event affecting the valuation process was the US Securities and Exchange Commission’s (SEC) Rule 2a-5, Good Faith Determinations of Fair Value (the FV Rule).<sup>1</sup> Given the new FV Rule reporting requirement that fund boards evaluate valuation resources, the final back-to-work model may continue to add complexity and uncertainty to the process. Importantly, the need for and availability of valuation talent seems to be hitting a tipping point. Demand is high for talent specifically to support the valuation of ever-more-complex mutual fund portfolios. Risk managers will need to continue to assess and manage talent risks as fund groups look for opportunities to streamline the valuation process and leverage their current resources.

Since the adoption of the new rule, the SEC has experienced significant turnover, including in its Division of Investment Management. The departure of some SEC staff members who played a key role in drafting the FV Rule creates some uncertainty. Will the SEC staff be able to help the industry interpret key provisions?

There may be an opportunity to work with the SEC staff to publish additional interpretive guidance through additional frequently asked questions and to clarify some FV Rule implementation issues that the industry has been discussing. Some opportunities to provide clarity include the definition of material; the risk assessment process and depth of analysis required; who can be the valuation designee (especially in a series trust and sub-adviser structure); the degree to which conflicts of interest need to be identified and monitored; and the active oversight and reporting necessary for level 2 securities, which are commonly evaluated by pricing vendors. Understanding the importance of this up-front work will go a long way to facilitate efficient implementation and minimize the amount of potential divergence in industry practice that may result upon adoption of the rule. The FV survey asked participants many probing questions about how they will adopt Rule 2a-5, which we will discuss more in upcoming sections.

In the end, those fund groups who have demonstrated organizational discipline and have been proactive in looking for opportunities to innovate their valuation operating model, while implementing the FV Rule, may have the advantage of more seasoned technology solutions. These solutions support the emergence of a stronger, improved, controlled valuation process that will sustain future regulatory inspection headwinds, as well as scale, as the fund industry continues to evolve in complexity and work on a remote or hybrid basis. This may go beyond the use of technology to looking to outsource some key aspects of the valuation process, such as private equity valuations, board reporting, vendor due diligence, and valuation methodologies testing. As the FV survey highlights, in this time of disruption, why not challenge the current valuation process to enhance future resilience for years to come?



# Finalized regulatory rules will require change

The SEC's finalization of the FV Rule in December 2020 marked more than 50 years since the SEC last adopted a major change in fair valuation guidance. It comes as no surprise, then, that 80% of FV survey participants indicated that the FV Rule will have the biggest impact on and pose the largest challenge to the valuation process in the next 12 months. FV survey results suggest that participants are working specifically on developing a more formal risk assessment exercise, enhancing the evaluation of fair value methodologies and third-party pricing providers, improving board reporting, and complying with recordkeeping requirements. Preparing for such change and creating opportunities in the valuation process is clearly top of mind today (and will be going forward) in order to meet the compliance deadline of September 8, 2022.

As a first step, many fund groups have performed a gap assessment against their current practices to measure the impact of adopting the FV Rule. Among FV survey participants, 66% indicated they had thus far completed a gap assessment by comparing their current valuation practices with FV Rule requirements. Notably, this finding rises to 84% among larger fund groups with AUM of more than \$100 billion. Less than 50% of FV survey participants with AUM of less than \$10 billion have performed a gap assessment to date. The FV survey identified certain aspects of the FV Rule where gaps exist with current practices (Figure 1), based on those who had completed a gap assessment.

## Assessment process

As identified by FV survey participants, the risk assessment aspect of the FV Rule will likely require industry attention. Specifically, the FV Rule includes a requirement to:

*"assess periodically any material risks associated with the determination of the fair value of the fund's investments, including material conflicts of interest, and to manage those identified valuation risks."*

The FV Rule also adds a reporting element to the risk assessment process by specifying that quarterly reports are required to evidence the assessment and management of any material valuation risks, including material conflicts of interest.

**Figure 1. Areas where current practice differs from requirements of the FV Rule**

Aspect addressed in FV Rule	Percentage identifying gap
Board reporting	69%
Risk assessment procedures	67%
Periodic testing procedures	45%
Evaluation of fair value methodologies	40%
Assessment of third-party pricing providers	33%
Recordkeeping	33%

While the FV Rule does not identify specific valuation risks other than conflicts of interest that fund groups must address, the adopting release does provide a nonexhaustive list of sources or types of valuation risks, such as the types of investments held or intended to be held by a fund, the characteristics of those investments that may affect associated risks, and the extent to which each fair value methodology uses unobservable inputs. The extent to which fund groups will identify additional risks and document an assessment for them is unclear. As of now, 70% of FV survey participants describe the risks they have identified as "a few high-level risks," made up of five or fewer valuation risks. Only 33% have described their valuation risks in writing, and only 5% responded that they have identified additional risks beyond those identified by the SEC. Considering that 67% of FV survey participants identified risk assessment as a gap between existing procedures and Rule 2a-5, it is likely that these percentages will change. However, the FV Rule is not as prescriptive in this area, and this may be an area of divergence based on each fund group's preference and assessment of its legal requirements.

Another key component of the FV Rule is the requirement to select and consistently apply appropriate valuation methodologies for determining and calculating fair value, including key inputs and assumptions specific to each asset class or portfolio holding. This is consistent with generally accepted accounting principles in the United States of America (GAAP) under ASC 820 – *Fair Value Measurement*, which require valuation methodologies to be applied using a “consistent and appropriate basis over time.” The FV survey identified that 68% of FV survey participants do not currently have documentation in place that identifies key inputs and assumptions specific to each asset class or portfolio holding. Yet, the FV Rule suggests that, at least for some asset classes, additional granularity is required, as stated in footnote 51:

*“It would not be sufficient, for example, to simply state that private equity investments are valued using a discounted cash flow model, or that options are valued using a Black-Scholes model, without providing any additional detail on the specific qualitative and quantitative factors to be considered, the sources of the methodology’s inputs and assumptions, and a description of how the calculation is to be performed (which may, but need not necessarily, take the form of a formula).”*

This is another area where some divergence in practice may result, and it is also an area where fund groups might request enhanced documentation from third-party pricing providers to assist in complying with this requirement.

The FV Rule acknowledges the important role pricing services play in the fair value process and provides that determining fair value in good faith requires the oversight and evaluation of pricing services, where used. As written:

*“For funds that use pricing services, the final rule will require that the board or valuation designee, as applicable, establish a process for approving, monitoring, and evaluating each pricing service provider. The final rule also will require that the board or valuation designee, as applicable, establish a process for initiating price challenges as appropriate.”*

FV survey participants appear to be relatively prepared to comply with this requirement, with 90% responding that they currently ask their pricing vendors to describe how they incorporate information received from pricing challenges into their pricing process. Similarly, 85% responded that they have established a process for initiating price challenges. Additionally, the FV survey has captured a trend emphasizing price challenges over the past decade; the number of fund groups reporting price challenge information to their boards increased from 40% in 2013 to 67% in 2021.

#### **Conflicts of interest**

Predominant throughout the FV Rule is its requirement for boards to identify and monitor potential conflicts of interest as part of their oversight duties. The FV Rule states:

*“Boards should approach their oversight of the performance of fair value determinations by the valuation designee of the fund with a skeptical and objective view that takes account of the fund’s particular valuation risks, including with respect to conflicts, the appropriateness of the fair value determination process, and the skill and resources devoted to it.*

*“The valuation designee must provide at least quarterly, in writing, a summary or description of material fair value matters that occurred in the prior quarter. This summary or description must include (1) any material changes in the assessment and management of valuation risks, including any material changes in conflicts of interest of the valuation designee (and any other service provider).”*

Most survey respondents (36%) stated that conflicts of interest are orally discussed, 20% indicated they have not specifically identified conflicts of interest relating to the valuation process at all, and 32% responded that conflicts of interest are in writing, with a description of control procedures that address or mitigate those conflicts. Considering the FV Rule may suggest a requirement to report any material changes in conflicts of interest to the board, responses to this question may well change in future surveys as rule adoption occurs.

When considering conflicts of interest, the majority (94%) of FV survey participants focused on the role of the portfolio manager. This is not surprising, given that the SEC made clear in the FV Rule that certain steps should be taken to reasonably segregate portfolio management from fair value determinations. On the other hand, there may be differing views or interpretations with respect to other potential conflicts of interest, as only 28% identified brokers and only 21% identified pricing services as having potential conflicts of interest. A number of SEC conflict-of-interest examples in the FV Rule are focused on the role of pricing services. Some commenters on the proposed rule questioned the significance of a pricing service's conflicts of interest, stating that pricing services maintain relationships with a wide variety of investment advisers and generally are expected to provide the same valuation information for a particular security to all funds. However, the SEC made it clear that the conflict is not necessarily one of responding to pressure from a particular investment adviser; rather, a pricing service might generally provide higher or more aggressive valuations to retain business. This focus may also result in a bit of unwelcome tunnel vision, too, if fund groups focus more on what the rule text says as opposed to its spirit. There very well may be other conflicts of interest in the entire valuation process that fund groups and their board could identify during a brainstorming session that may be of greater significance and that really should not be overlooked.

### Valuation reporting

The SEC has also stressed that board oversight should be active, including several open-ended statements that require board judgments on the amount of information, reporting, and input they provide, respectively, to each fund group's final framework. The FV Rule will:

*"require the valuation designee to report to the board with respect to matters related to the valuation designee's fair value process, in part to ensure that the board has sufficient information to conduct this oversight. Boards should also request follow-up information when appropriate and take reasonable steps to see that matters identified are addressed."*

In many respects, this appears to be a common industry practice in place within a majority of fund groups. The FV survey indicates that 69% of fund groups already provide

**Figure 2. Elements currently included in written reports to boards**

Required element	Percentage indicating current report discusses element
Testing results	82%
Material changes to or material deviations from approved methodologies	72%
Pricing services	61%
Material valuation risks	28%
Valuation resources	14%

a written report on a quarterly basis to the board to address valuation matters, and those reports clearly cover some elements that the FV Rule requires as shown in Figure 2 (although there still may be areas within one of the elements that a fund group's current reporting does not fully address).

These percentages suggest that there are, unsurprisingly, some current gaps in board reporting, and fund groups may collaborate with mutual fund boards to eliminate expectation gaps between written reports generated for FV Rule compliance and mutual fund boards' preferences and desire for information to meet the SEC's expectation of active oversight.

Under the FV Rule, the valuation designee will also be required to promptly notify the board, at a time determined by the board, but no more than five business days after the designee becomes aware, of material matters that may affect the fair value of the portfolio of investments. The FV Rule noted that such material matters could include a significant deficiency or material weakness in the design or effectiveness of the valuation designee's fair valuation determination process or material errors in the calculation of a fund's NAV. As it stands, only 58% of fund groups do this today. Notably, the industry is making progress in this regard, as only 33% reported such prompt reporting in last year's FV survey.

Percentage of FV survey participants

There continues to be a desire for clarity on what would constitute a “material” matter requiring prompt notification. While the SEC did provide some definitional guidance on material matters and errors, consensus has not yet formed within the industry, as illustrated in Figure 3.

While there may not be consensus on the definition of “material,” it appears that the majority will consider the impact on NAV.

**Figure 3. What constitutes “material”?**

Under which of the following circumstances, if any, will the valuation designee notify the board of a matter that materially affects the fair value of a portfolio investment?	Percentage of FV survey participants indicating that circumstance is material
A fair value pricing error that results in an error in the calculation of the fund’s net asset value that exceeds \$0.01 per share and half of 1% of the fund’s net asset value	67%
A fair value pricing error that results in an error in the calculation of the fund’s net asset value that requires reimbursement to the fund and/or reprocessing of shareholder transactions	64%
A fair value pricing error that results in an error in the calculation of the fund’s net asset value that exceeds \$0.01 per share	59%
A preliminary determination by management that the fund may have a significant deficiency or material weakness in the design or effectiveness of its fair valuation determination process	58%
Deviation from a previously approved fair valuation methodology	36%

**All hands on deck**

As mentioned, implementing and complying with the FV Rule within the 18-month transition period is top of mind and will not be without its challenges. The FV survey depicts a few of these challenges (Figure 4).

**Figure 4. FV Rule implementation challenges**

What requirements do you think would create the most challenge and/or SEC risk to the current valuation process?	Percentage of FV survey participants indicating that such is a challenge or risk
Development and assessment of valuation risks and related reporting	65%
Management requirement to provide “prompt” notification of material changes to the board	38%
Board requirement to provide “active” oversight of the valuation process	35%
Board requirement to periodically review the financial resources, technology, staff, and expertise of the valuation designee	29%
Board evaluation and due diligence over pricing services and related reporting	20%
Board evaluation of fund group conflicts of interest and related reporting	19%



As a reflection of these challenges, only 25% indicated that they will voluntarily comply with the FV Rule in advance of its compliance date. As fund groups contemplate and continue to assess the FV Rule's requirements and challenges, we are seeing (and expect to continue to see) fund groups finding it prudent to seek help. This may include third-party assistance with implementation of the FV Rule or with ongoing compliance, as we see many fund groups changing their valuation operating models. Though in its early days given the September 2022 compliance date, 10% have either engaged or plan to engage a third party to assist with implementation of the FV Rule. We noted that 28% of FV survey participants indicated they anticipate making changes to their current financial resources, technology, staff, and expertise. As noted from survey responses and observed in the marketplace, outsourcing portions of valuation operations is being considered. Only 9% of FV survey participants indicated that they would use a third party to perform valuations or outsource certain requirements of the rule. We expect this percentage to increase as we reach the September 2022 compliance date.

Finally, who within a fund group is responsible for initial implementation of the FV Rule? The FV survey offers no clear consensus; however, it does seem to indicate the

responsibility primarily falling on the fund treasurer's office, chief compliance officer(s), and/or chief risk officer(s). For example, 41% of FV survey participants said that the process for reviewing and updating the assessment of valuation risks will be performed by the chief compliance officer(s), and 38% responded that the fund treasurer's office will lead this process. Regardless, the formation of a working group might help drive the implementation of the FV Rule. We believe the emerging trend and long-term impact of the FV Rule will lead to opportunities for fund groups to innovate their valuation operating models. Thus, an all-hands-on-deck approach with many perspectives and points of view will enhance the generation of such opportunities.



## What are the TOP FIVE actions fund groups are doing now or have already done relative to requirements of Rule 2a-5?

1. **94%** have already reasonably segregated fair value determinations from the portfolio management of the fund.
2. **66%** have already reassessed current valuation practices to assess whether any gaps exist between them and what is required under Rule 2a-5.
3. **58%** currently report that the adviser promptly reports to the board in writing on matters associated with the adviser's process that materially affect, or could have materially affected, the fair value of the assigned portfolio of investments.
4. **32%** have created documentation that identifies key inputs and assumptions specific to each asset class or portfolio holding, as well as the appropriate application of fair value methodologies.
5. **10%** have or will engage a third-party adviser to help with implementation of the rule.



## What are the TOP FIVE actions fund groups may consider doing in the future to get ready for Rule 2a-5?

This could include challenges or open interpretations from the SEC.

1. **65%** identified development and assessment of valuation risks and related reporting as challenging.

Fund groups may consider creating working groups to assess risks at the investment-type level and evaluate how best to manage those risks.
2. **38%** identified management's requirements to provide "prompt" notification of material changes to the board as challenging.

Fund groups may wish to collaborate with board members to proactively identify what events or issues constituting material changes and requiring "prompt" notification would be challenging. Currently, only 13% have defined what would be considered a "material" valuation risk.
3. **35%** identified the board requirement to provide "active" oversight over the valuation process as challenging.

The FV Rule states that boards must be active in their oversight role by probing reports written by investment advisers and being inquisitive. However, the line between active oversight and active management may be blurry at times. The SEC may want to provide further guidance on how best to evidence this type of active oversight without assuming the role of management.
4. **29%** identified the board requirement to periodically review the financial resources, technology, staff, and expertise of the valuation designee as challenging.

Twenty-eight percent anticipate making changes due to this requirement. Should the SEC provide benchmarking for boards to use in this evaluation? Will there be an expectation that certain individuals hold certain certifications, such as the recently created Certified in the Valuation of Financial Instruments (CVFI) designation?
5. **20%** identified the board evaluation and due diligence over pricing services and related reporting as challenging.

The SEC declined to adopt a specific list of criteria for who may qualify as a pricing service. Instead, the FV Rule refers to pricing services as *"third parties that regularly provide funds with information on evaluated prices, matrix prices, price opinions, or similar pricing estimates or information to assist in determining the fair value of fund investments."* While some pricing services are obvious, it may be challenging to identify and perform due diligence on less obvious ones that "provide information," such as a third party whose inputs are used for a model.

# Use of technology solutions is maturing and providing opportunities

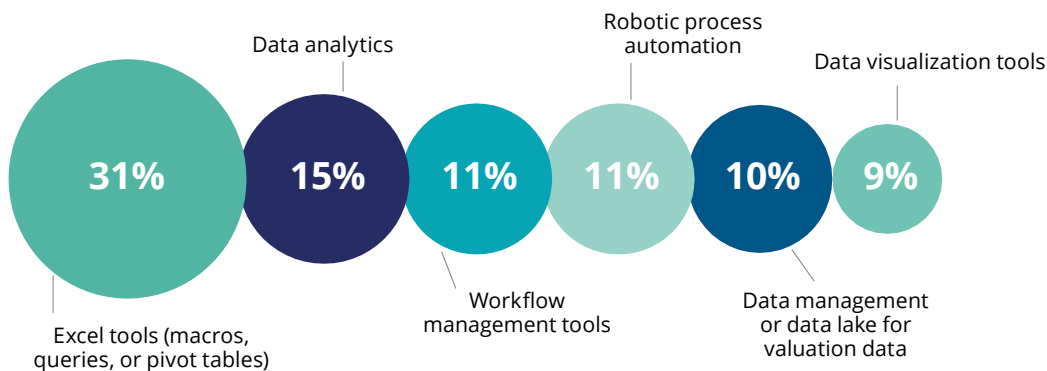
We continue to see the maturing use of technology solutions in the fair value process and operating model. Working remotely accelerated this trend, and FV Rule opportunities lend themselves to further encourage automation and use of technology. As noted in the FV survey, the percentage of FV survey participants that recently adopted the technology solutions shown in Figure 5 increased, with the biggest jumps in the adoption of data analytics and Excel tools. What is clear is that the value proposition of innovating the valuation operating model through the use of technology in the remote work environment has become a strong trend.

Overall, 93% of FV survey participants indicated they currently use Excel-based tools in their valuation process. Workflow tools and data analytics are now used by 35% and 36% of FV survey participants, respectively, and use of data visualization has made a year-over-year jump to 26% from 21%. Given the extended period of working from home (and the possibility of it being part of the future of work), a

continued increased focus on workflow management tools may be prudent. Workflow management tools can be used for certain aspects of many processes and controls, such as facilitating and securing approvals. However, about 23% of FV survey participants indicated their workflow tools are much broader, covering the full end-to-end valuation process. Perhaps, given the practical benefits of workflow management tools in a remote environment, we may see increased development of this technology solution in the near future. Overall, general year-over-year adoption increased with 21% reporting their use of automation has increased over the past year. This trend may well continue as 66% of FV survey participants indicated they are exploring new valuation-related technology solutions with workflow management tools being the most popular at 31%. While exploration is different from implementation, we believe technological adoption will continue in the form of quick-hit items that are lower-cost, easier to develop and implement, and based on industry use cases.

**Figure 5. Recent adoption of technological solutions**

Percentage of participants who said their firms began using or added applications to these technologies in the past year



# Board governance remains in all stakeholder sights

The FV Rule further clarifies the responsibilities of a mutual fund board and may have been more prescriptive than many anticipated. As it pertains to valuation, mutual fund boards have increased expectations to perform their duties in the form of active oversight. As in years past, the FV survey provides trends in maturing practices when it comes to active oversight, including the initiation of “ad hoc meetings,” explicit valuation policies and procedures that highlight when mutual fund directors “must be involved” and/or “must be notified,” and risk-based reporting. See Figure 6 and Figure 7.

However, as shown in Figure 6, there were no significant changes in board processes year-over-year, likely in anticipation of making changes in conjunction with adoption of the FV Rule.

Nonetheless, as the fund industry continued to respond to the unanticipated risk of the pandemic, boards made significant pivots as well. Almost all mutual fund board meetings went

virtual. In fact, only 1% of FV survey participants noted that there was no impact and that their board meetings have been in person over the past 12 months. As of completion of the FV survey, 49% of participants had scheduled a fall or winter live board meeting, whereas 44% are unclear when they plan to return to live board meetings. In cases where in-person meetings were scheduled, 98% expected that management or, in some instances, potentially all regular board meeting participants would attend live.

It should be noted that FV survey data was collected during the summer, and we know that the Delta variant has negatively affected fall and winter live meeting percentages. However, survey participants were loud and clear in noting that no fund groups concluded that live, in-person board meetings were no longer necessary, as well as indicating (66%) that they do not anticipate any changes to the boardroom postpandemic versus prepandemic.

**Figure 6. Signs of “active” oversight**

	2021	2020	2019
Ad hoc meetings (held in past 12 months)	30%	37%	26%
Valuation policies and procedures that highlight when mutual fund directors			
• “Must be involved”	11%	11%	9%
• “Must be notified”	37%	36%	37%
• Both	5%	4%	3%
Risk-based summarized reporting	98%	99%	99%

**Figure 7. Board oversight: Risk-based reporting**

	2021	2020	2019
Dashboard reporting, including Key Valuation Indicators (KVIs)	46%	46%	45%
Summaries of price challenges	67%	63%	74%
Reports on the number of securities whose fair values were determined based on information provided by broker-dealers	59%	59%	59%
Reports regarding portfolio holdings for which there has been no change in price or for which investments have been held at cost for an extended period of time	68%	68%	72%
Back-testing of foreign equities	82%	89%	87%
Back-testing of broker prices	33%	32%	23%
Back-testing of level 3 investments	36%	29%	23%

# Additional key FV survey findings

The FV survey contained questions and other key FV survey findings, as follows.

- Sixty-one percent of FV survey participants reported using zero triggers to determine when to adjust the prices of fair value equities that trade on foreign exchanges closing before 4 p.m. ET, compared with 56% last year. This seems to be a result of a slight change in composition of survey participants, as just one participant indicated that it had moved to a zero trigger, and none reported that they were moving away from a zero trigger. However, one participant also reduced their trigger percentage, and one changed the pricing vendor they used to supply these factors.
- Thirty-five percent of FV survey participants whose firms offer both mutual funds and ETFs said their procedures for determining whether a foreign equity price should be adjusted from its closing exchange price differed significantly between both product types, and 22% indicated that they are slightly different. Forty-three percent indicated they are exactly the same.
- Fifty-five percent and 71% of FV survey participants indicated that their policies and procedures differ between mutual funds and private funds and separate accounts, respectively. Nearly half of those indicating differences noted that a fair value factor was not applied outside of their mutual funds.
- Eleven percent of FV survey participants changed their primary source for certain fixed-income securities in the past 12 months, compared with 31% who made the change last year. Seventeen percent added or changed secondary pricing sources for certain fixed-income securities, which is much lower than the 34% who reported such in the prior year. These are the lowest percentages we have seen for these questions in multiple recent surveys. It's uncertain whether this is a result of the impact of the pandemic, the finalization of the new rule, or other factors.
- Sixty percent of FV survey participants use bid pricing exclusively when valuing fixed-income securities, nearly unchanged from the prior year.
- Seventy-nine percent value fixed-income investments using a price that considers information through 4 p.m. ET, an increase from the 69% reporting it last year.
- Just one FV survey participant changed policies or procedures relating to non-institutional-sized lots (odd lots). This is the smallest change in the past four surveys, likely signaling that ongoing analysis does not reveal the need for any additional changes.
- Fifty percent of FV survey participants holding private equities indicated that their volume of private equity positions has increased in the past 12 months as a result of new market acquisitions or through restructurings.
- Thirty-six percent of those FV survey participants holding investments in equity commitments (including, but not limited to, those associated with SPAC transactions) that are contingent on future events primarily focus on a probability analysis to assess the likelihood that contingencies will be met and determine whether any value exists. Twenty-four percent focus their analysis on a forward-looking method that considers future outcomes or scenarios and may assess potential volatility factors to determine the value of the commitment, highlighting an area where a clear common practice does not yet exist.
- Fifty-four percent of FV survey participants noted that they made some changes to their policies and procedures over the past year.



# Looking ahead



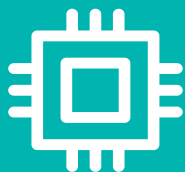
## September 8, 2022

As the fund groups have the opportunity to make changes now and through the FV Rule compliance date of September 8, 2022, we believe the formation of a working group made up of many voices and functions may be the best way to optimize implementation of the FV Rule. Looking beyond the mere goal of being in regulatory compliance with the FV Rule to opportunities to strengthen the valuation operating model through, among other levers, technology tools and outsourcing specific activities will provide long-lasting efficiency and control. Along the valuation journey, frequent touchpoints and collaboration with the fund board will be necessary to avoid any expectation gaps and provide comfort that the board will be in a position to achieve active oversight and that the fund group will be able to manage SEC risk. It is important to continue to keep an eye on the SEC (especially true today, as the Division of Investment Management has not hired a division director) and other industry organizations to look for interpretive guidance that will not only seek to manage implementation risk, but also reduce the amount of divergence in industry practice on day one.



## Third-party provider due diligence and extended enterprise risk

Sixty-seven percent of FV survey participants indicated they have performed a virtual visit of third-party pricing vendors. This is up from 36% the year before. Given the importance of pricing vendor due diligence in the FV Rule, we would expect this maturing trend to continue. Also, as fund groups make strategic decisions to outsource portions of the valuation process, heightened awareness should be placed on understanding vendor controls in areas such as application and general system controls (i.e., access and change management), cybersecurity, and business continuity. Fund groups should also understand if any third-party vendor services are outsourced to a fourth party or offshored. A clear understanding of where fund groups' data resides, how it is shared, and who ultimately performs services is critical in a time of crisis. Internal pricing committees (IPCs), the risk function, the chief compliance officer(s), and fund boards may reconvene to collectively agree on a different due diligence model going forward.



### The continuing role of technology

It seems clear that technological adoption and advancement will continue to affect the valuation process. They may be quick fixes to solve an immediate problem or make something easier. They may improve the overall workflow and control environment. Regardless of what they do, the work-from-home environment and future of work will likely cause at least a somewhat different approach and mindset for the fund group's operations, including the valuation function, and technology will likely be part of that evolution, just as it has been during the pandemic. Ensuring that adequate controls remain in place during the moments and activities outside core day-to-day processes will be key to avoid issues. Fund groups should also bring teams back more effectively by taking advantage of lessons learned during the pandemic and incorporating them into today's valuation operating model.



### Business continuity planning (BCP)

In the current year, 11%, versus 14% in 2020, made changes to their valuation function's BCP related to the investment valuation process. For example, one FV survey participant noted the creation of a new process using proxies in the event a vendor is unable to deliver prices on a given day. Another 14% indicated that they plan to adjust their BCP in the future.

Many matters associated with the pandemic discussed in last year's FV survey may represent continued risks in the future. The FV Rule will provide fund groups another opportunity to reassess valuation risks and consider how to manage them. In doing so, they can take what they have learned from the pandemic and reconsider whether new procedures should be developed, or existing processes modified, to improve their identification of and response to similar challenges in the future. For example, many fund groups have instituted flexible or dynamic price tolerances, as opposed to static tolerances used in the daily valuation process, to eliminate exceptions for positions where price may have moved significantly, albeit consistently with other similar securities or proxies. Management may also want to seek preapproval from boards for certain planned responses during a crisis, which could minimize the need for more detailed discussions on a real-time basis when time is of the essence. However, this type of planning takes time, and some fund groups may feel they do not have the ability to devote resources to such an endeavor. Perhaps the key to success is the extent of testing performed up front.



### Collaboration

Planning and being prepared for the next disruptive event are necessary to manage risk. The peer-to-peer sharing of information has always been critical to successfully weathering unexpected storms in the past. Whether it is in the face of the next storm or in working on the adoption of the FV Rule, understanding what others are learning, what they are exploring, and what they are actually doing will remain valuable to those responsible for maintaining an efficient and effectively functioning valuation process.

# Endnote

1. SEC, [Final Rule 2a-5 – Good Faith Determinations of Fair Value](#), December 3, 2020.

## About the FV survey and its authors

We conducted the FV survey in summer 2021, and participants representing 94 registered investment company fund groups completed it. FV survey participants included small, midsize, and large fund groups. About 14% of them managed mainly equities, 9% managed mainly fixed-income securities, and the remainder managed a balanced array of strategies.

More details on the matters addressed within this executive summary and full results were provided exclusively to participants in a separate document.

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## *Industry leadership*



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