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The UK's FCA Reports on Findings From Review of Valuations for Private Market Assets

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The UK's Financial Conduct Authority ("FCA") has published **findings from its multi-firm review of valuation processes for private market assets**.

Given the UK's status as the largest centre for private market asset management in Europe, and the importance of fair and robust valuation practices in private markets, the FCA has addressed its review to valuation practices in the fund and portfolio management sector, as well as advisory services in the private equity, venture capital, private debt and infrastructure sectors. FCA findings include:

1. Good valuation practices: Against benchmarks of independence, expertise, transparency and consistency, the FCA found that practices were generally robust. Areas for improvement included expanding conflicts identification beyond fees and remuneration to include other conflicts, including marketing, secured borrowing, asset transfers, redemptions and subscriptions, and uplifts and volatility. Other observations include the need for firms to assess whether their valuation functions and committees are sufficiently independent. In addition, firms need to put in place formal and consistent approaches to *ad hoc* valuations that are necessary for revaluation during market or asset-specific events.

2. What actions should firms take? The FCA recommends:

- assessing whether the firm has sufficient independence in their valuation functions and the voting membership of their valuation committees to enable and ensure effective control and expert challenge;
- ensuring the firm has defined processes or a consistent approach for ad hoc valuations to revalue assets during market or asset-specific events. The FCA encourages firms to consider the types of events and quantitative thresholds that could trigger ad hoc valuations and document how they are to be conducted;
- improvements in valuation committees' record keeping;
- expanding the universe of conflicts beyond fees and compensation issues and improving consideration and documentation processes around those issues;
- as part of this exercise in expanding the concept of conflicts, firms should be looking at: conflicts inherent when a manager prices the transfer valuation of an asset; issues that can arise for the pricing of redemptions and subscription when valuations are periodic and judgement-based; potential conflicts when firms include unrealised performance in marketing materials; identifying and documenting potential conflicts when borrowing on a secured basis using the borrower's own valuation of unrealised investments; the need to apply consistent valuation methodologies; and being alive to the conflicts that can arise when employee remuneration is linked to valuations;
- ensuring that valuations are performed by units that are functionally independent from portfolio management and in an impartial manner (note that the FCA "*observed a few firms very clearly demonstrating functional independence*" but that a number could not demonstrate independence or adequate expertise);
- re-examining policies, procedures and documentation of the valuation process to make sure these are robust and consistent. They should include rationales for using particular methodologies and rationales for key assumption changes;
- making sure that valuation cycles are frequent enough to remain current, and if necessary are performed *ad hoc*;
- considering whether reporting to investors could be improved;
- considering whether to apply a secondary methodology to corroborate valuation decisions; and
- exercising appropriate oversight over third-party valuation advisers and dealing with potential commercial conflicts.

3. *Next steps:* The FCA will continue to engage with firms and industry bodies and will follow-up with any firms identified as outliers in its review.