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Consultation paper
ESMA's draft technical advice to the European Commission on possible
implementing measures of the
Alternative Investment Fund Managers Directive

Response of the
Royal Institution of Chartered Surveyors (RICS)

ID number of the European Commission's register of interest representatives:
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INVESTOR IN PEOPLE

The Royal Institution of Chartered Surveyors (RICS) has noted the publication of the consultation document 'ESMA's draft technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive' and welcomes the opportunity to comment.

About the RICS

RICS (Royal Institution of Chartered Surveyors) is the leading organisation of its kind in the world for professionals in property, land, construction and related environmental issues. We qualify members and guarantee standards all over the globe.

Over 120 000 RICS members, who are Chartered Surveyors, operate out of 146 countries, supported by an extensive network of regional offices located in every continent around the world. Our European Office is based in Brussels, and our European work is supported by a network of national associations.

Our members play a vital role throughout the entire property life cycle – from initial measurement, right through to investment in, and the use of, physical structures and other assets. We also provide impartial advice to governments, policymakers and Non Government Organisations.

RICS is an independent professional body originally established in the UK by Royal Charter. Since 1868, RICS has been committed to setting and upholding the highest standards of excellence and integrity – providing impartial, authoritative advice on key issues affecting businesses and society.

RICS is a regulator of both its individual members and firms enabling it to maintain the highest standards and providing the basis for unparalleled client confidence in the sector.

The general ethical principles for all RICS regulated members and firms are set out in our Rules of Conduct of which the following is an extract:

Professional behaviour

Members shall at all times act with integrity and avoid conflicts of interest and avoid any actions or situations that are inconsistent with their professional obligations.

Competence

Members shall carry out their professional work with due skill, care and diligence and with proper regard for the technical standards expected of them.

Service

Members shall carry out their professional work in a timely manner and with proper regard for standards of service and customer care expected of them.

RICS and valuation standards

A significant proportion of our members are involved in the provision of valuations of all types of assets. RICS originally developed valuation standards in 1976 and the current standards are 'RICS Valuation Standards – Global, Edition 7, May 2011'. The standards are generally known as 'the Red Book' and contain mandatory rules and best practice guidance for valuations of real estate and other assets.



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RICS also adopts the International Valuation Standards (IVS) 2011 and considers that valuations complying with the Red Book are also compliant with IVS. This is particularly relevant where valuations are provided for inclusion in financial statements that comply with International Financial Reporting Standards (IFRS). The adoption of IVS in the Red Book provides an implementation or practice framework for the application of IVS globally, ensuring that RICS members follow consistent methodologies throughout the world.

The Red Book is mandatory for all RICS members and regulated firms worldwide, and is also widely referred to by non-RICS valuers, making them the most widely used property valuation standards in the world. Members who provide valuations that must comply with the Red Book are also required to register with RICS following which they are entitled to use the designation 'RICS Registered Valuer'.

The global standards in the Red Book are generally recognised to be the gold standard of valuation practice worldwide and provide a broad ethical framework which can be applied to valuations of any asset type in any jurisdiction, in harmony with national legislation. They deal with the following issues:

- Compliance, competence and independence;
- Terms of engagement;
- Valuation bases (global);
- Valuation applications (global);
- Inspections and key considerations; and,
- Valuation reports.

More specifically the standards relating to application, competence, independence and objectivity are set out in Valuation Standards (VS) 1.2 to 1.9. For ease of reference we have reproduced these standards, but not their accompanying commentary, in the appendix to this response.

These global standards are accompanied by detailed national standards, which we seek to draw up wherever possible with national government agencies and market groups.

For more information, please visit <http://www.ricsvaluation.org/>

Detailed response to the consultation

It will be appreciated from the foregoing paragraphs that RICS will comment only on those matters that directly relate to the asset valuation requirements of Article 19 of Directive 2011/61/EC and the various valuation related questions in the consultation document.

Our detailed responses are to those matters raised in the consultation document and we expand, as required, on the relationship of the principles underlying our standards to the specific issue dealt with.

In our responses we make a distinction between the assessment of 'asset value' and 'net asset value'. We interpret the former as being the valuation of the value of the assets held by the fund and the latter as the value of the unit or share of the AIF as indicated in Article 19. 2 and 19.11 (a). In general terms we would not expect our members to provide the net asset value calculation unless they possessed the necessary expertise.

It is also important to make clear the distinction between the actions and judgement of the individual asset valuer and the actions and judgement of the fund manager in relation to the fund



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as a whole. These are related to consistency and transparency but also impact on our comments about the professional liability of the external valuer.

As a general principle we agree that there should be a framework for the valuation of both types of asset and detailed guidance will help to ensure consistency of approach between funds.

Box 1 and questions 1 to 5

- (1) Asset valuations can be provided at any reasonable date. We have no comment on the time to produce the net asset values.
- (2) To reflect accounting practices we would suggest that it would not be appropriate to fix a single date for the calculation of the threshold. Such a date should be linked to the entity accounting year.
- (3) We respond later in more detail on the form of asset valuation but do not comment on which valuation measure is the most appropriate for the calculation of the threshold.
- (4) We have no comment on this question.
- (5) We have no comment on this question.

Box 6, question 9

In principle we accept that the AIFM must be able to cover the liabilities arising from professional negligence and RICS members are required to confirm each year that they have adequate professional indemnity insurance related to the work they undertake.

The proposed requirements are in reasonably broad terms and in the case of an RICS member we would expect the individual's professional indemnity insurance to include specified limits of liability. However we are particularly concerned to note the proviso to sub paragraph 10 of Article 19:

‘Notwithstanding the first paragraph and irrespective of any contractual arrangements providing otherwise, the external valuer shall be liable for any losses suffered by the AIFM as a result of the valuer's negligence or intentional failure to perform its tasks’

It is normal practice for a Valuer to be liable for losses suffered as a result of his or her negligence and intentional failure to perform. However, this practice is generally capped at a suitable level in respect of the instruction involved.

RICS suggested that there are two issues with the above statement (subparagraph 10 of Article 19):

The first involves the level of liability of the external valuer appears to be greater than the internal valuer, particularly as the statement says that the external valuer is ‘liable for any loss’.

Secondly, the application of this clause begs the question as to the method by which negligence is established. So far as we are aware such a conclusion can only be reached by the Courts and even then may be qualified.



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As noted earlier, it is important that the respective responsibilities and accountabilities of valuer and fund manager, including those relating to risk and liability, are themselves consistent and transparent. The practical effect of the provisions as currently set out is to expose an external valuer to a greater risk – and potential liability – than that directly related to the valuation of the asset itself. This would be likely to restrict the number of firms who would be prepared to undertake valuations on this basis to those major firms who could cover the liability in their professional indemnity insurance as a firm - and even then they (and their insurers) may consider that such a risk is not reasonable and therefore would have to decline to act (ie) with the resultant consequence being that no external valuation is possible. This would run counter to the very consistency, transparency and underlying objectivity that the measures seek to achieve.

It is our suggestion that the practical implication of this requirement, and the steps to be taken to minimise negligence, is fully explained in the guidance in a form similar to that in the discussion in IV.II, Possible Implementing measures on general principles.

Box 9, question 15

We have no specific comments on this question but note that it discusses the level of claims to be insured. This would appear potentially to be a lesser amount than the external valuer liability referred to in our response to question 5 above.

Box 21, 22 and 23

These boxes deal with conflicts of interest and we support the comments made. The Red Book provides some general guidance on conflicts of interest but its application depends on the extent to which potential conflicts are specified and the extent to which they can be managed. Where conflicts can be managed the valuer is required to make an appropriate disclosure to ensure transparency.

Box 55

We agree with the outlined policies and procedures. Similar principles are incorporated into the Red Book.

Box 56

This box refers to a valuation model. Although valuers may follow established methods of valuation it is unlikely that a valuation will adopt a uniform model. Real estate valuation does not lend itself to standardised modelling, although some organisations have developed or make use of automated valuation models (AVM) as support tools within the valuation process. Whilst AVMs can be of considerable assistance in analysis of comparable transactions, great care is needed in the interpretation and application of their outputs. Generally speaking, relevance and use of such models are matters to be considered in the valuation process rather than as a source of valuations in their own right.

Box 57

We agree that valuation approaches should be consistent. However we do not agree with the comment in the explanatory paragraph (15) 'An AIFM shall select and apply the valuation



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methodologies’ This difference of view may arise from the use of the phrase ‘valuation methodologies’

In broad terms the valuer is requested to value on a specific basis of value – that is, a statement of the fundamental measurement assumptions of a valuation. Internationally there are four primary bases of value: Market value, Fair value, Investment value and Special value. The appropriate basis of value will be either specified by the AIFM or within the guidance. In most cases we would expect real estate to be valued at market value.

Having established the basis, the method of valuation (or approach to the valuation) will vary according to the type of property involved. As with basis of value there are three internationally recognised methods: Market approach, Income approach and Cost approach. The selection of any, or all, approaches is the responsibility of the valuer and cannot be determined by the AIFM. We recommend that this distinction is made.

Within the Red Book the valuer is required to set out the basis of valuation and make a statement on the valuation approach adopted.

Box 58

Apart from the proviso on ‘methodology’ we agree that the AIFM should review its valuation policy at least annually.

Box 59

Any holder of real estate must be certain that the values attributed are fair and appropriate and that reviews of those assets and their values should be undertaken at least once a year. More frequent reviews would be appropriate where markets are volatile and values may change significantly over a short period of time.

With regard to the controls we agree with the comments made.

Box 60

Agreed

Box 61

The professional guarantees incorporate all the principles set out in the annexe and the valuer will confirm them in the terms of engagement.

Box 62

We agree that assets should be valued once a year unless a shorter period is appropriate. This is a similar provision to Box 59.

Box 66

We agree the principles in this box. The combination of being an RICS Registered Valuer and the knowledge requirements of the Red Book will support the requirement for the AIFM to ensure that the delegate valuer has the appropriate experience and support. We accept that further enquiries in specific instances may be required.



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Box 71

This box deals with conflicts of interest between the AIFM and the delegate. Although it is not possible to identify all forms of conflict of interest an RICS valuer must identify any potential conflict and if that conflict is not capable of management must decline the instruction. Where a potential conflict can be managed the valuation report must include a statement to that effect.

Should you wish to discuss any of the points we have made, or would like to see the full text of the Red Book please contact one of the staff members named on the front page of this response.



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Appendix

This appendix reproduces those RICS Valuation Standards (VS) that deal with compliance, the valuer's qualifications, independence and certain disclosures.

The commentary to the standards has not been reproduced.

VS 1.2 Compliance, regulation and the requirement to disclose departures

All members undertaking valuations, whether practising individually or within an RICS regulated or a non-regulated firm, are required to comply with these standards.

Valuers must also comply with the requirements of the RICS Valuer Registration Scheme.

VS 1.3 RICS national association valuation standards

Standards published or adopted by an RICS national association have mandatory status in the states to which they apply.

VS 1.4 Terms of engagement

The member must always confirm to the client in writing, before any report is issued, the terms on which the valuation will be undertaken.

VS 1.5 Qualifications of the valuer

Each valuation to which these standards apply must be prepared by, or under the supervision of, an appropriately qualified valuer who accepts responsibility for it.

VS 1.6 Knowledge and skills

The valuer must have sufficient current local, national and international (as appropriate) knowledge of the particular market, and the skills and understanding necessary, to undertake the valuation competently.

VS 1.7 Independence and objectivity

Valuers undertaking valuations must act with independence, integrity and objectivity.

VS 1.8 Additional criteria for independence

Where the valuation is for a purpose that sets specific criteria for independence, valuers must establish the criteria required and confirm that they meet them in the *terms of engagement* and the *report*.



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VS 1.9 Additional disclosures for valuations in which the public has an interest or upon which third parties may rely

Where the valuation is provided for inclusion in a published document in which the public has an interest, or upon which *third parties* may rely, the valuer shall make the following disclosures:

1. where a valuation is of property that has previously been valued by the valuer, or the valuer's *firm*, for the same purpose:
 - in the *terms of engagement*, a statement about the *firm's* policy on the rotation of the valuer responsible for the valuation; and
 - in the *report*, and any published reference to it, a statement of the length of time the valuer has continuously been the signatory to valuations provided to the client for the same purpose as the *report* and, in addition, the length of time the valuer's *firm* has continuously been carrying out the valuation instruction for the client.
2. the extent and duration of the relationship of the valuer's *firm* with the client for any purpose;
3. where the *report*, and any published reference to it, includes one or more properties acquired by the client within the 12 months preceding the *date of valuation*, and the valuer, or the valuer's *firm*, has in relation to those properties:
 - received an introductory fee; or
 - negotiated that purchase on behalf of the client;
4. in the *report*, and any published reference to it, a statement that the proportion of the total fees payable by the client during the preceding year relative to the total fee income of the valuer's *firm* during the preceding year are minimal, significant or substantial.



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