INTERNATIONAL VALUATION STANDARDS COUNCIL
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European Securities and Markets Authority

By email

Dear Sirs

Call for Evidence
Implementing Measures on the Alternative Investment Fund Managers (AIFM) Directive

The IVSC has read with interest the above request to ESMA and the questions being asked of stakeholders. We have particular interest in Issue 9, Article 19 Valuation.

The IVSC dates from the early 1980s and is established as the global standard setter for valuation. We are a not for profit organisation with a remit to act in the public interest. The IVSC is funded by its membership of sixty eight professional valuation institutes from fifty countries and by support from major international valuation providers and users. The Council is overseen by a Board of Trustees and has two operational boards, the Standards Board and the Professional Board.

The Standards Board develops and promulgates the International Valuation Standards (IVS) which are intended to set principles for undertaking valuations of all major asset types and for all common purposes. The Professional Board acts as a focal point for the global valuation profession. It promotes ethical conduct and encourages best practice through the development of practice guides and technical information. More information on the work of the IVSC can be found on our web site www.ivsc.org.

The IVSC agrees with the Commission that the accurate and independent valuation of the assets held by an AIF is of critical importance for investor decision-making and hence for the protection of investors.

We note that the AIFM Directive makes provision for an extensive set of technical standards and guidelines and that ESMA is invited to consider how to co-ordinate work on these standards and guidelines. We also note that ESMA is invited to advise the Commission on certain matters specifically relating to valuation. We provide our comments on these requests later in this letter.

As an overriding principle the IVSC strongly supports the principles of independent and professional based valuations of the assets held in an AIF. We also consider it important that valuations should be undertaken using procedures and methods that are established and accepted by investors and other participants in the relevant markets.

The IVS have been in existence for many years with the most recent edition published in 2007. However, over the past two years the Standards Board has been engaged in a project to improve the standards with the objective of both widening their relevance and simplifying their presentation. After extensive due process including the issuing of an Exposure Draft and outreach activities, including round table discussions and consultation with constituents and other standard setters, publication of the revised IVS is anticipated in mid 2011.

The objective of the IVS is to provide a robust procedural framework aimed at providing transparency and consistency in the valuation process. The standards are designed to be capable of mandatory application, although enforcement of compliance is a matter for those adopting the standards or otherwise requiring their use.

Although generally recognised valuation methods are identified and discussed, the IVS do not prescribe their methods for use in any given situation. IVSC recognises that good valuation depends on the proper exercise of judgement in selecting and applying the most appropriate method or methods to provide a result that is relevant to the market. Separately from the IVS, the practice guidance issued by the Professional Board is not intended to be mandatory but is designed to raise awareness among valuation professionals of methodology and recognised best practice. There is a programme of updating and reviewing this practice guidance and new projects are likely to be added, particularly relating to financial instruments.

Turning to the matters that ESMA has been invited to consider we offer the following comments:

1. **The criteria concerning the procedures for the proper valuation of the assets and the calculation of the net asset value per share or unit to be used by competent authorities in assessing whether an AIFM complies with its obligations under Article 19(1) and Article 19(3).**

   CESR is invited to consider how these procedures should be differentiated to reflect the diverse characteristics of the assets in which an AIF may invest.

   IVSC Comment:
   We support the objectives set out in Article 19 (1) and (3), but subject to the proviso that the references to "procedures for the valuation" are intended to include only:
   a. the required frequency of valuation,
   b. protocols for the frequency at which external valuers are required to undertake valuations or review internally sourced valuations,
   c. measures to ensure independence and professionalism of the valuer,
   d. the information that needs to be disclosed to investors, and
   e. measures to ensure compliance with the above.

   For the same reasons that IVS do not stipulate how an asset must be valued we believe that it would be a serious error for any state to attempt to prescribe the methods that may be used to value different classes of asset. We are aware of examples where excessive prescription in legislation requires the adoption of practices that are no longer recognised as relevant in the markets and which therefore provide information that is little help to investors.

IVSC and its constituents have had many years experience in developing valuation standards for a wide range of asset classes that provide transparency and protection for valuation users whilst remaining operational and relevant.

We recommend that ESMA consider the revised IVS as providing a suitable framework for valuation practice under the AIFM Directive. Promoting the use of IVS would also be consistent with the call of the G20 in April 2009 for clarity and consistency in the application of valuation standards internationally.

2. **The type of specific professional guarantees an external valuer should be required to provide so as to allow the AIFM to fulfil its obligations under Article 19(5).**

   CESR is asked to consider the impact of the required guarantees on the availability of external valuers to the AIFM industry.

   IVSC Comment:
   We believe that both internal and external valuers should be working to the same standards of professionalism.

   There is currently significant inconsistency in both the training and professional organisation of valuation professionals, not only in Europe but internationally. In certain market sectors, eg real estate, there are strong national or international professional bodies that accredit and regulate their members, but in other sectors most valuation specialists have obtained a primary qualification in another discipline and have no professional accreditation in valuation nor are they subject to any regulation. While experienced and competent valuers may be operating in a particular sector, there could be difficulties in their meeting the requirements of Article 19 5(a).

   Another potential problem affecting availability is that in certain member States there are statutory restrictions on who may value certain asset classes for different purposes. While the principle that a state should only permit suitably qualified and regulated persons to undertake valuations which have a public interest element is sound, in practice some of these restrictions are based on old legislation that does not reflect the evolution of investment products or of the valuation profession. This constrains availability and competition across the EU and results in uneven requirements for different asset classes.

   One of the objectives of IVSC is to encourage the development of the valuation profession. We would be interested in working with ESMA and others to identify and prioritise projects that would assist in developing valuation capabilities where these are needed to provide the valuation resources needed for effective implementation of the AIFM directive.

   It is not clear as to what is meant by “professional guarantees” in 19(5) b. If it only is intended to refer to the capability of a valuer to provide the services referred to in paras 1-3 then this is unlikely to affect the availability of external valuers, although availability is uncertain in some asset classes for the reasons explained in the preceding paragraphs. However, we are aware that some commentators are interpreting this as meaning that an external valuer will have to guarantee the valuation by indemnifying investors.

We believe that this is not intended given that the AIFM remains ultimately responsible but if this is not clarified it could affect the availability of valuers. While most external valuers will accept liability for negligence or wilful wrong doing, few if any would accept liability for losses incurred by investors acting upon valuation advice that has been properly given.

3. **The frequency of valuation carried out by open-ended funds that can be considered appropriate to the assets held by the fund and its issuance and redemption frequency.**

   In particular, CESR is invited to consider how the appropriate frequency of valuation should be assessed for funds investing in different types of assets and with different issuance and redemption frequencies, taking into account different (and varying) degrees of market liquidity. CESR is invited to take account of the fact that such valuations shall in any case be performed at least once a year.

   IVSC Comment:
   We agree that as a general principle a valuation should be undertaken at least annually. In many cases annual valuations are required for financial reporting purposes and therefore for these asset classes the additional work and cost should not be significant. For many asset classes more frequent valuations will be necessary. The desirable frequency will depend on asset type and market conditions and therefore flexibility is important. With regular valuations of similar portfolios, sampling or limited scope reviews may be sufficient to meet the potentially conflicting requirements of maximising investor protection and minimising management costs.

   Identifying best practice based on the experience of different States' valuation frequency and disclosure regulations under the UCITS Directives would be a useful step. IVSC may be able to provide useful input to ESMA in this regard. Once the best procedures for the type and frequency of external valuation are established for each asset class IVSC could also consider projects to develop any additional practice guidance that is required for assets held within AIFs to help ensure consistency of approach both within and without the European Union.

We hope that you find our comments helpful and we confirm that we are willing to assist ESMA in identifying best practice using our worldwide network of members and supporters and if there are gaps in our existing valuation standards and practice guidance that need addressing to provide better investor assurance in AIFs then we can consider developing appropriate projects

If you would like to discuss any aspect of this letter please do not hesitate to contact the writer

Yours faithfully

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