THE INVESTMENT ASSOCIATION

Response to consultation

IOSCO VALUING COLLECTIVE INVESTMENT SCHEMES (CIS) CONSULTATION REPORT

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £10 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 51% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

Executive summary

We welcome IOSCO's consultation report and support the proposals therein. In particular, we agree with merging the Principles which share a lot of common ground. We also agree with updating the Recommendations to reflect the growing interest in private markets and to ensure arrangements are in place to respond appropriately to the onset of market turbulence.

Our responses to individual questions are set out below. Generally, these reflect opportunities to clarify the scope and policy intentions. However, there is one aspect with which we disagree – we do not agree with the recommendation to disclose conflicts to investors. Instead of disclosure, a more appropriate approach is to require documentation of conflicts in order to demonstrate to Securities Regulators that appropriate steps are being taken to address them.

1. Do you agree that the 2013 CIS Principles and the 2007 Hedge Fund Principles should be merged into a combined set of Recommendations?

Yes, we agree with merging the Principles into a combined set of Recommendations.

2. Do you agree with the scope of the Recommendations to focus on registered / authorized / public OEFs and is it sufficiently clear?

In our view, the scope of the Recommendations should be more widely cast and more robustly defined. Paragraph 15 sets out that robust valuation practice is critical for funds where investors transact in units at a price based on NAV and goes on to list reasons why proper valuation is important to a wider set of funds. It would be preferable for the Recommendations to be applicable to all funds with relevant exceptions only where a Recommendation is clearly not relevant – for example, Recommendation 8 is only relevant for OEFs.

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Where IOSCO considers exclusions from scope to be appropriate, these should be based on specific characteristics not jurisdictional practices. This is to ensure that any jurisdiction considered to have implemented the Recommendations can be viewed as achieving the same standards of valuation practice. There may be jurisdictional differences, but these are a matter for individual Securities Regulators to identify and if there are differences, it should be clear that the local standards are not those embodied in the Recommendations. For example, if IOSCO considers that hedge funds or private funds should be excluded from scope (footnotes 11 and 12), this exclusion should be universal, not just in relation to a specific jurisdiction.

There is circularity in the scope specification and the defined terminology – paragraph 21 sets out that the Recommendations apply to OEFs and the terminology (pages 11/12) defines an OEF as a Fund within the intended scope of the Recommendations. The terminology should define OEFs directly such as by reference to the ability of investors to exercise the right to redeem at a price based on the NAV. A robust definition of an OEF can then be used coherently throughout the Recommendations or, if the proposed scope is retained, to define that scope more robustly.

3. Do you agree with the proposed scope of registered / authorized / public OEFs? Similarly, should there be any changes to the scope of Other Funds?

Greater clarity could be achieved by simplifying the scope to refer to the intended type of investor rather than the regulated nature of the CIS. Rather than referring to "registered / authorised / public" funds, which may have different jurisdictional boundaries, and requires footnotes to further clarify the intended scope (footnote 13), it may be clearer to refer, for example, to "OEFs intended for the general public".

4. In order to facilitate flexible implementation, do you agree that the Recommendations should only serve as good practices (please refer to footnote 9 above) to Other Funds?

For the reasons set out in paragraph 15, and our answer to question 2, it would be preferable for the Recommendations to be applicable to all funds with relevant exceptions only where a Recommendation is clearly not relevant. If IOSCO proceed with a two-tier approach for OEFs and Other Funds, we would agree that the Recommendations should serve as good practices for Other Funds.

5. Do you agree that MMFs should be out of scope?

We agree, MMFs should be out of scope. MMFs serve a different purpose, and their unique characteristics are better supported through separate Recommendations, as is currently the case.

6. Should ETFs be in or out of scope? Should only certain types of ETFs be included, such as ETFs that transact primarily on a cash basis but not in-kind ETFs? Are there any specific Recommendations that are not applicable to ETFs? Should the Recommendations only apply as good practices to ETFs, to allow sufficient flexibility given the distinct characteristics of ETFs?

ETFs should be fully within the scope of the Recommendations alongside other OEFs for the reasons set out in point 15 of the report. The valuation issues discussed in point 15 are as relevant to ETFs as they are to any other OEFs because ETFs are OEFs that issue and cancel shares at NAV, notwithstanding that individual investors can trade their shares in the secondary market. Improper valuations will lead to inaccurate NAVs and an ETF issuing or cancelling shares at an inappropriate NAV will be at risk of losing value to the detriment of the interests of its investors. Therefore, it is essential that valuations underpinning the NAV of an ETF should be subject to the same rigor and standards as any other OEF and should be no different for ETFs that settle on a cash or an in-kind basis.

7. Have the key elements of documented policies and procedures been captured?

Yes, but point 34(c) should be amended to refer to documentation instead of disclosure for the reasons given in our answer to question 12.

8. Do you agree that a valuation committee or equivalent arrangements may be helpful?

Yes, we agree and we welcome the recognition in the report that an equivalent arrangement may sometimes be the most appropriate approach.

9. Have the key features for the structure and responsibilities of a valuation committee or equivalent been accurately described? If not, what changes or additions should be included? Are there any other good practice examples for a valuation committee that would be useful to include?

Yes, there is a good description of governance arrangements in the report, but its significance is diminished by its inclusion under Recommendation 1 concerning policies and procedures. Currently, when reading the Recommendations in isolation, there is no mention of governance arrangements. In our view, the importance of good governance arrangements should be emphasised by including a specific recommendation about governance, such as is included as Recommendation 13 of IOSCO's Revised Recommendations for Liquidity Risk Management for Collective Investment Schemes (FR/10/2025).

10. Do you agree with the proposed approach to stressed market conditions and exceptional circumstances?

Yes

11. Are there any other good practices or examples of governance practices under stressed market conditions that would be useful to include?

We have not identified other relevant practices.

12. Do you agree with the overall framework that conflicts of interest should be identified and documented, and conflicts of interest that cannot be avoided are to be mitigated, managed and monitored, and disclosed?

We agree with the overall framework concerning conflicts of interest, although the wording in the question is an improvement on that in the Recommendation itself. In our view conflicts should be identified and if they cannot be avoided, they should be mitigated, managed and monitored. Conflicts, their mitigations, and the processes for managing and/or monitoring them should be documented. Such documentation should be to support internal processes and oversight and should not be disclosed externally except as required for supervisory activities by Securities Regulators. We do not agree that residual conflicts should be required to be disclosed as this may compromise commercial arrangements. The example of disclosure used in the report (point 55) illustrates an approach to mitigating a potential conflict – it is a disclosure of the extent to which performance is subject to valuation judgements rather than a disclosure of a conflict.

13. Do you agree with the list of conflicts and mitigations?

We agree with the overall approach.

14. Do you agree with the guidance set out in relation to fair value, methodology selection and use of amortised cost?

Overall, we agree with the guidance. However, it is unclear in what circumstances the use of amortised cost is appropriate if the Recommendations are not applied to MMFs.

In our view, the use of the term "private finance" in Box 1 introduces unnecessary ambiguity. Elsewhere in the report the term "private assets" is used, and it would be preferable to use this term consistently throughout (for example, see paragraph 13) by amending the first sentence of Box 1 to *"…, retail investor participation in private ~~finance~~ assets has increased in certain jurisdictions."* This approach would also allow the definition of private assets on page 12 to be simplified by removing the need to explain private finance (noting that the term is not used anywhere else in the report).

We also recommend refining the definition of illiquid assets to remove the subjectivity inherent in the word "difficult" as follows: *"… buying and selling assets is ~~difficult and~~ usually time consuming …"*.

15. Do you agree that back testing and calibration can be important tools to test the appropriateness and accuracy of fair value methods and processes?

We agree that back testing and calibration are important to ensure valuation methods and processes are appropriate but must not be used to apply hindsight to challenge the accuracy of valuations prepared in good faith.

16. What other tools should be highlighted in this report that responsible entities could use to review their valuation methodologies?

We have not identified other relevant tools.

17. Are there any other good practice examples, including in applying fair value adjustments that would be useful to include here?

No response

18. Are there any other considerations for pricing overrides?

No response

19. Are there any other considerations for consistent application of valuation policies and procedures?

No response

20. Are there any other key considerations for periodic review of valuation policies and procedures that should be addressed?

No response

21. Do you agree with the overall framework for the use of third party valuation service providers, including specifying the use of third party valuation service providers in the valuation policies and procedures, undertaking due diligence and exercising appropriate oversight?

Yes. We also suggest that the following additions are included to enhance the operational resilience of due diligence processes:

- The due diligence processes required of responsible entities cannot be required in an absolute way. If the given provider makes use of other underlying providers in a chain, there should be a limitation of responsibility in terms of due diligence to be carried out by the responsible entities themselves.
- Some limitation on due diligence should also be given in case a given provider shows reluctance to fully open its way of functioning. So, some appropriate and new IOSCO's Recommendation should apply on those providers, to make them responsible if they show reluctance to let the responsible entities carry out their due diligence on them.

22. Do you agree with the incorporation of a defined process for addressing stale valuations into the policies and procedures?

Yes

23. Are there other aspects of timely valuation that this Recommendation should address?

No response

24. Are there other aspects of valuation-related disclosure that should be addressed in this Recommendation?

We would recommend expanding the guidance under Recommendation 10 to ensure that the obligation to make the NAV available does not create a situation where it could be deemed to be an obligation to recalculate the NAV at the request of investors between regular valuation points. The NAV disclosure frequency should be as set out in the relevant fund documentation.

We do not agree with point 118. Valuation uncertainty is a matter for risk disclosures. Conflicts should be documented but not routinely disclosed for the reasons given in our answer to question 12. Disclosures about the extent to which performance is based on unrealised valuations demonstrate the extent to which valuations may be uncertain and contributes to the mitigation of a potential conflict.

25. Are there other aspects of pricing errors that should be addressed in this Recommendation?

No response

26. Do you agree with the creation of a new Recommendation on record keeping?

Yes

27. Are there other aspects of recordkeeping that this Recommendation should address?

No response