Mutual Funds Directors Forum - Valuation Challenges & Practices Unfolding for Boards of Directors

Liz Duggan
Interactive Data Corporation
Managing Director,
Global Evaluated Pricing Services

Paul Kraft
Deloitte
Financial Services Industry Partner

June 20, 2013
Agenda: Valuation Practices Unfolding

1. The Current Landscape

2. Challenges for Mutual Fund Directors

3. Glimpse of an Evaluated Pricing Vendor Due Diligence

- Industry event: **Valuation Oversight for Fund Directors**
  **Scheduled for June 27**\textsuperscript{th} at Interactive Data
  100 Church St, NYC
  1-5 pm.

- [http://go.interactivedata.com/funddirectors.html](http://go.interactivedata.com/funddirectors.html)
SEC and Valuations

• Points from the SEC Staff Speech at the Dec. 2011 AICPA conference

When utilizing third party valuations management should remember its existing obligations to:

1. Comply w/ US GAAP, including disclosure requirements
   - Sufficiently understand the valuation methods/techniques, assumptions and other inputs used by third party pricing services to arrive at valuations provided

2. Maintain appropriate internal controls to prevent or detect material misstatements

3. Assess effectiveness of internal controls over financial reporting
   - An independent auditor’s report on controls at a pricing service may be useful to management in designing and assessing ICFR (Internal Controls over Financial Reporting)
SEC and Valuation Policies and Procedures

• December 2012: The SEC brought suit against the directors of five funds sponsored by Morgan Keegan, alleging that they had failed to satisfy their valuation and other obligations in violation of Rules 22c-1, 30a-3(a) and 38a-1 under the Investment Company Act.

• June 2013: Morgan Keegan directors settled without admitting or denying the SEC findings. SEC ordered directors to cease and desist from violations of the compliance rule (Rule 38a-1) and made the following findings:

  • “It remains the board’s duty to establish the fair value methodology to be used and to continuously review both the appropriateness of the methods used in valuing each issue of security and the valuation findings resulting from such methods.”

  • “the Directors did not calculate the valuations themselves, and neither established clear and specific valuation methodologies nor followed up their general guidance to review and approve the actual methodologies used and the resulting valuations.”

  • “Instead, they approved policies generally describing the factors to be considered but failed to determine what was actually being done to implement those policies.”

  • As a result, Fund Accounting implemented deficient procedures, effectively allowing the Portfolio Manager to determine valuations without a reasonable basis. “In this regard, the Directors failed to exercise their responsibilities with regard to the adoption and implementation by the Funds of procedures reasonably designed to prevent violations of the federal securities laws.”
The Heat is On ……..

- Morgan Keegan Case against Independent Mutual Fund Directors

  - What if anything has changed?

  - Mutual Fund Directors have challenges that they can think about:
    1. What is the right balance of involvement and delegation?
    2. What is the right amount of due diligence needed?
    3. What should valuation policies and procedures look like?
    4. What reporting should Mutual Fund Directors look for?
    5. What is the control environment within which the Mutual Fund operates?

  - Other considerations
The Heat is On………..

- Doug Scheidt, Division of Investment Management, SEC – September 2012, Mutual Funds Directors Forum

  ▪ “Board must consider all appropriate factors”
  ▪ Boards are required to determine valuation but may discharge their duty;
    ✓ “determine FV 100% by themselves”
    ✓ “Boards may delegate some aspects of the FV process; appoint a person to assist them. Boards determine the methods, etc. and those delegated can execute from there”
    ✓ “Board and Adviser agree on methodology but from time to time Adviser changes method not determined by Board until ratified. Board must take step to approve”. Adviser determined vs. Board determined?
  ▪ “Board must determine that 3\textsuperscript{rd} party methodologies are appropriate”

- Future SEC & PCAOB Guidance – pending
Recent Observations from the SEC

1. Valuation is a main focus of SEC examinations; there is particular interest in hard to value assets.

2. Recent valuation exams are “a new kind of exam compared with what might have occurred 5 years ago.” * Very extensive & granular.

3. Examiners are interested in items such as **valuations, valuation procedures; valuation committee minutes & materials; valuations expertise** within the board/valuation committee.

4. The SEC is interested in erroneous valuations & in the compliance policies related to valuations
   • Particular attention is being paid where problematic valuations were “kicked-up” to the valuation committee for resolution. (how situations are addressed.)

5. The cases being brought are not limited to credit crisis/dislocated market situations from 2007-2008 (as many in the industry expected); they are concerned about potentially erroneous mutual fund NAVs, as well as hedge fund redemptions, fees, and marketing practices.

The Heat is On………

**Mutual Fund Directors have challenges that they can think about…**

1. **What is the right balance of involvement and delegation?**
# Phases of Fair Value Compliance

<table>
<thead>
<tr>
<th>Documentation</th>
<th>Board Involvement</th>
<th>Documentation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Phase 1 - Due Diligence</strong></td>
<td><strong>Phase 2 – Prepare &amp; Implement Valuation Policies</strong></td>
<td><strong>Phase 3 – Monitoring Valuation and Reassessing Process &amp; Resources</strong></td>
</tr>
<tr>
<td>- Mission statement</td>
<td>- Identify and document valuation events, securities &amp; products</td>
<td>- Next days price, sales price</td>
</tr>
<tr>
<td>- Pricing vendors</td>
<td>- Document procedures</td>
<td>- Challenge valuation assumptions</td>
</tr>
<tr>
<td>- Market correlations</td>
<td>- <strong>Board approval &amp; reporting</strong></td>
<td>- <strong>Board approval &amp; reporting</strong></td>
</tr>
<tr>
<td>- Define significant events</td>
<td>- Source of info/use of experts</td>
<td>- Reassess and update policies for new events, securities or products, lessons learned</td>
</tr>
<tr>
<td>- Establish triggers</td>
<td>- Establish controls</td>
<td></td>
</tr>
<tr>
<td>- Use of experts</td>
<td>- Leverage technology &amp; automation</td>
<td></td>
</tr>
<tr>
<td>- Testing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- <strong>Board approval &amp; reporting</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Select Fair Valuation Survey Questions

Which best describes the Board’s fair valuation governance model?

<table>
<thead>
<tr>
<th>Description</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Board has delegated responsibility for overseeing valuation matters to a separate committee (valuation committee, audit committee, risk committee, etc.) of the Board</td>
<td>69%</td>
</tr>
<tr>
<td>The Board has not delegated responsibility for overseeing valuation matters to a separate committee of the Board; however, one or more Board members have been designated to focus on valuation matters and to report to the rest of the Board members</td>
<td>5%</td>
</tr>
<tr>
<td>The Board has not delegated responsibility for overseeing valuation matters to a separate committee and has not designated one or more board members; valuation matters are discussed at the full Board level</td>
<td>18%</td>
</tr>
<tr>
<td>Other -- <em>Most selecting the “Other” response clarified that the full Board is ultimately responsible for valuation matters, although it has delegated a committee consisting of management to be responsible for day-to-day valuation matters and to report to the Board.</em></td>
<td>8%</td>
</tr>
</tbody>
</table>
Select Fair Valuation Survey Questions

Relative to “real-time” involvement by the Board, Please indicate which of the following is accurate

<table>
<thead>
<tr>
<th>The valuation policies and procedures explicitly identify certain circumstances in which one or more noninterested Board members must be involved in the evaluation of the pricing of one or more holdings prior to the use of such valuation</th>
<th>17%</th>
</tr>
</thead>
<tbody>
<tr>
<td>The valuation policies and procedures explicitly identify certain circumstances in which one or more noninterested Board members must be notified of the valuation of one or more holdings on the same day or on the next day. (Please note that this represents notification and not active participation)</td>
<td>20%</td>
</tr>
<tr>
<td>The valuation policies and procedures do not explicitly identify certain circumstances (Please select this even if one or more noninterested Board members may be involved on a real-time basis at management’s discretion or upon an impromptu request from one or more Board members)</td>
<td>62%</td>
</tr>
</tbody>
</table>
Select Fair Valuation Survey Questions

Does a non-interested Board member participate in the IPC?

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>14 %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>86 %</td>
</tr>
</tbody>
</table>
The Heat is On ..........

Mutual Fund Directors have challenges that they can think about...

2. What is the right amount of due diligence needed?
“Management may need to consider how the pricing service developed the assumptions and models used to assure that its fair value estimate is consistent with a market participant view.”

Source: Speech made by Jason K. Plourde, SEC Professional Accounting Fellow
Select Fair Valuation Survey Questions
Describe your due diligence process for your pricing vendor

Survey participants specified a number of Questions/Inquiries. The most common general themes included the following:

---

**Deeper dives into:**
- Inputs used by the pricing vendor
- Sources used by the pricing vendor
- Assumptions made by the pricing vendor
- How judgments were reached
- SOC1 reports
- Specific securities selected by the fund group

**Internal Controls**
- How judgments are validated
- Availability of additional SOC 1 reports
- Exceptions noted within

**Transparency into the pricing process**
- Availability of tools
- How vendor will be able to accommodate increased demands for transparency

**Other**
- Due diligence questionnaire is sent to the pricing vendor, Periodic calls with vendor, Review of the SSAE 16/SOC 1 report, Perform other comparative analysis
---
Select Fair Valuation Survey Questions
Describe your due diligence process for your pricing vendor

<table>
<thead>
<tr>
<th>Description</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>We perform a site visit for all vendors</td>
<td>23%</td>
</tr>
<tr>
<td>We perform a site visit for certain vendors</td>
<td>47%</td>
</tr>
<tr>
<td>All vendors present to us</td>
<td>21%</td>
</tr>
<tr>
<td>Certain vendors present to us</td>
<td>39%</td>
</tr>
<tr>
<td>Each vendor presents or we performed a site visit - no vendors were excluded</td>
<td>15%</td>
</tr>
<tr>
<td>We did not perform a site visit or have a vendor present during the year</td>
<td>11%</td>
</tr>
<tr>
<td>Other (Please specify below)</td>
<td>10%</td>
</tr>
</tbody>
</table>
Asset Managers and Auditors may need....

- To understand:
  - Methodologies - methods or practices employed to evaluate securities
  - Inputs - observable market information obtained
  - Assumptions - spreads, average life, prepayment speeds

- Increased interaction between pricing vendor and clients/audit firms
  - Due-diligence calls
  - Methodology documents
  - Summary of Inputs document
  - Assumption data
  - Transparency regarding the observed market data
Due Diligence Considerations
Becoming an Industry Best Practice

Interactive Data Pricing and Reference Data LLC
Due Diligence FAQ

Distributed at the ICI
• Tax & Accounting 9/12
• MF & Investment Mgmt 3/13
• General Membership 5/13

Due Diligence Considerations
9/20/2012

Please refer to the Interactive Data Due Diligence FAQ for more information specific to Interactive Data.

<table>
<thead>
<tr>
<th>Complete</th>
<th>The Company</th>
<th>Resources Available</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Company Overview: number of clients, competitive advantages, etc.</td>
<td>Due Diligence Meeting</td>
</tr>
<tr>
<td></td>
<td>Corporate Organization - identify parent company</td>
<td>Due Diligence Meeting</td>
</tr>
<tr>
<td></td>
<td>Organization: Management team</td>
<td>Due Diligence Meeting</td>
</tr>
<tr>
<td></td>
<td>Audited financial statements</td>
<td>Due Diligence Meeting</td>
</tr>
<tr>
<td></td>
<td>Insurance coverage</td>
<td>Due Diligence Meeting</td>
</tr>
<tr>
<td></td>
<td>Corporate Strategy - examples of investment initiatives</td>
<td>Due Diligence Meeting</td>
</tr>
<tr>
<td></td>
<td>Culture and Tone of organization</td>
<td>Due Diligence Meeting</td>
</tr>
<tr>
<td></td>
<td>On-site visit: inspect premises</td>
<td>Request an On-Site Visit</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Complete</th>
<th>Evaluation Team</th>
<th>Resources Available</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Staff Size: has it increased or decreased since 2002?</td>
<td>Due Diligence Meeting</td>
</tr>
<tr>
<td></td>
<td>What is their experience level?</td>
<td>Due Diligence Meeting</td>
</tr>
<tr>
<td></td>
<td>What type of training do the evaluators undergo?</td>
<td>Due Diligence Meeting</td>
</tr>
<tr>
<td></td>
<td>How are the evaluation teams structured?</td>
<td>Due Diligence Meeting</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Complete</th>
<th>Evaluation Process and Verification</th>
<th>Resources Available</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Understand the methodology applied per asset class.</td>
<td>Asset class methodology</td>
</tr>
<tr>
<td></td>
<td>Does the vendor have documented evaluation procedures?</td>
<td>Due Diligence Meeting and Compliance Overview Document</td>
</tr>
<tr>
<td></td>
<td>What are the evaluation quality controls? Are there additional oversight processes?</td>
<td>Due Diligence Meeting and Methodology document</td>
</tr>
<tr>
<td></td>
<td>What is the process for adding securities to evaluation coverage?</td>
<td>Due Diligence Meeting and Summary of Input document</td>
</tr>
<tr>
<td></td>
<td>How is market data sourced (e.g. do evaluations include a buy and sell side perspective)?</td>
<td>Vantage™ Valuation Toolkit and Methodology documents</td>
</tr>
<tr>
<td></td>
<td>What additional data may have an impact on the evaluation process (e.g. assumptions data, relevant credit information, sector news, etc.)</td>
<td>Due Diligence Meeting and Summary of Inputs document</td>
</tr>
<tr>
<td></td>
<td>Cite examples of reactions/responses to shifting market situations.</td>
<td>Due Diligence Meeting and Summary of Inputs document</td>
</tr>
<tr>
<td></td>
<td>Does vendor identify valuations from third party sources?</td>
<td>Due Diligence Meeting and Summary of Inputs document</td>
</tr>
</tbody>
</table>

September 2012
Page 1 of 8
Considerations For Mutual Fund Boards

Board Interactions

‣ Does the pricing vendor present to your Board?
‣ How often does the pricing vendor present to other Boards?
‣ What are some of the typical questions other Boards are asking the pricing vendor?
‣ What changes has the pricing vendor observed in Board due diligence as a result of the Morgan Keegan headlines?
‣ Highlight recent financial market headlines and inquire as to how the pricing vendor addressed or reacted to those situations.
‣ When possible, review Business Continuity in terms of real events: e.g. Hurricane Sandy
Considerations For Mutual Fund Boards

General information relating to the pricing vendor
- The size of the organization
- The size of the evaluation team
- Locations where evaluated pricing is performed
- Breadth and depth of client base
- Is the pricing vendor well established within the Mutual Fund market segment

Compliance
- Is the pricing vendor regulated?
- Is there a compliance officer?
- Is there a compliance program?
- Is there a code of conduct?
- Are there restrictions on evaluators trading in securities they evaluate?

Business Continuity
- Discuss relevant events if possible
Questions Mutual Fund Boards Are Grappling With

**Timing and extent of board involvement**

- Should involvement be real-time or afterwards?
- How involved should those in fund governance be in reviewing the policies and procedures?
- How much detail should be reviewed?

**Understanding the funds’ basis for valuation, policies, and procedures**

- Choice of bid vs. mean, 3 p.m. vs. 4 p.m. pricing, etc. of each asset class?
- Are the benchmarks and trigger controls appropriate based on the nature of the fund and the evidence that has been obtained?
- Is there an understanding of the valuation methodology used by the third party pricing vendor?
- Understand the extent of the documentation/reports being prepared.

**Understanding the potential for bias and manipulation**

- Are controls designed appropriately and operating effectively? Oversight?
- How are price challenges handled? Oversight?
- Is there a process regarding pre/post market transparency with pricing vendor?
Increase in Number of Client Requests for Meetings

Client meetings increased by 26% from 2011 through 2012
- ASU 2011-4 implemented in Dec. 2011
- 2011 year end audit season is in full swing in early 2012

BOD meetings also increased by more than 80%
Example Mutual Fund Director Questions

- Are the prices used by the fund consistent with prices used by the adviser for its other products and/or its separate accounts? If not, why does it differ?

- Do we perform the same level of due diligence over all of our pricing sources? If not, how does the due diligence differ?

- Does the approval of pricing sources or methodology occur on ex-ante or ex-post basis? Is the level of evidence supporting the use of a pricing source or methodology sufficient?

- How many pricing sources are available for each investment? How many of them are independent of the investment and the fund group? Do we have a back-up plan if a source is unable to provide a price?

- What daily controls are performed over the valuation process? Are they effective? Who performs them and do they have sufficient expertise? For controls that are not performed daily, are they performed on a frequency that is sufficient? How are pricing deviations, challenges, etc. resolved? How are pricing bias and the potential for inappropriate overrides considered?

- Has the fund group considered the changes in the trading activity of its investments and whether transactions are orderly?

- How does the fund group ensure that available information relevant to valuation is considered daily and is not ignored?

- Does the documentation of the fair value governance process accurately, and perhaps equally important, sufficiently reflect the materials reviewed, the factors considered, and the decisions reached?
Mutual Fund Directors have challenges that they can think about…

3. What should valuation policies and procedures look like?
Some historical context: Change in valuation policies/procedures is a constant

Have you changed your fair valuation policies and procedures in the past year? If yes, how would you characterize the level of change?

- **Survey Year**
  - 2nd Annual
  - 3rd Annual
  - 4th Annual
  - 5th Annual
  - 6th Annual
  - 7th Annual
  - 8th Annual
  - 9th Annual
  - 10th Annual

- **Responses**
  - Minimal
  - More than routine
  - Moderate
  - Significant
Clients’ Valuation Practices Evolve

1. Valuation Transparency
2. Challenges
Valuation Transparency

Interactive Data’s 3pm & 4pm evaluated prices, displayed along with high-level assumptive data.

Events highlights market activity, tolerance reports and other information.

Interactive Data’s proprietary market color (quotes and trades), displayed in a box plot framework.

Combination of trades and market color provides market data context that was available at the time of evaluation.

Reference data including terms and conditions.

Market depth indicators provide a summary of recent trade and quote activity.

Publicly disseminated trade data displayed in the form of dots, color and size coded according to the size of the trade.

Trading activity is provided in traditional tabular format, with both summary and individual trade-level views.

Clients will soon be able to upload their own market data, providing an even richer market data context.
The Steps to Valuation Transparency

1 – Review Evaluations
3PM/4PM Bid/Mean
Benchmark & Spreads

2 – Review Trade & Quote Data
Structured data from Empirasign trade platform displayed as squares
Quote data displayed as Box Plot

3 – Review Market Depth Indicator Panel
Summarizes sources & quotes per source feeding Box Plot
Provides summary TRACE trade data (Not available)

4 – Review Comparable Bonds
For additional context and security details

5 – Review Events Panel
This section is under construction for structured bonds
Considerations For Mutual Fund Boards

Transparency Initiatives

› What is the fund company's policy/philosophy regarding the sharing of market data with the evaluated pricing vendor?
› Has this practice/policy been reviewed in the last 24 months?
› When will the fund company share market data with the pricing vendor?
› What process does the fund company employ to understand the evaluated prices received from a pricing vendor?
› How has the process changed in the last 24 months?
› What transparency tools is the fund company utilizing to understand evaluated prices?
While down from late 2008 peak, volume of evaluation challenges remains high as the industry maintains a careful watch over fixed income valuation procedures.

Many mutual funds have incorporated evaluation challenges into their workflow, tracking communications and recording response and completion time.

The Challenge Portal was designed to help establish industry best practice by offering:

- Client workflow management
- Central repository for challenges
- Instantaneous feedback on level of information provided by client
- Historical challenge retrieval
- Detailed reporting
Considerations For Mutual Fund Boards

Price Challenges

- This is a focus of regulators
- What is the fund company's policy/philosophy regarding evaluated price challenges?
- Does the firm share market data with pricing vendors when submitting an evaluated price challenge?
- How does the fund company oversee the challenge process – what tools are used?
- How does the fund company monitor for “undue influence” in the evaluated price challenge process?
- Have these practices/procedures been reviewed in the last 24 months?
- Does the fund company inform the Board regarding SEC questionnaires or mini-sweeps?
- Is the evaluated pricing vendor able to provide metrics to the fund company regarding the fund’s challenges?
Questions a Regulator might pose:

**Price Challenge Process**

1. Does your firm have a price challenge process with the third party vendor or broker?

2. Please describe the frequency with which prices are challenged for any particular security *you classified as level two and for which you received from a service provider*.

3. What were the results of such *valuation* challenges? Do prices or valuations change? *At what frequency do they change*?

4. What is the impact of these challenges on your assessment of the *third party* provider’s internal controls?
The Heat is On........

*Mutual Fund Directors have challenges that they can think about…*

4. **What reporting should Mutual Fund Directors look for?**
Select Fair Valuation Survey Questions

What information regarding fair value decisions does the full Board or one of its committees receive to evaluate the valuation process?

<table>
<thead>
<tr>
<th>Information Provided</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Written valuation memos discussing the basic facts, analysis, and decision reached</td>
<td>91%</td>
</tr>
<tr>
<td>Analysis of impact on NAV of individual fair value decisions</td>
<td>72%</td>
</tr>
<tr>
<td>Value of each position as a percentage of total investments</td>
<td>63%</td>
</tr>
<tr>
<td>Fair value price compared to actual sale price upon disposition (back-testing)</td>
<td>60%</td>
</tr>
<tr>
<td>Calculations supporting the valuation decisions</td>
<td>54%</td>
</tr>
<tr>
<td>NAV effect of fair value price compared to actual sale price upon disposition</td>
<td>34%</td>
</tr>
<tr>
<td>Design and operating effectiveness of internal controls in place over the daily pricing process</td>
<td>32%</td>
</tr>
<tr>
<td>Known transactions relating to such investment(s) information on the market, industry, and company trends and performance, including competitive, political, and regulatory matters that could have an effect on valuation decisions</td>
<td>31%</td>
</tr>
<tr>
<td>Copies of external evidence supporting the valuation decisions</td>
<td>30%</td>
</tr>
<tr>
<td>Analysis of impact on NAV of all fair value decisions in aggregate</td>
<td>28%</td>
</tr>
<tr>
<td>Sensitivity analysis of assumptions used in determining valuation decisions</td>
<td>9%</td>
</tr>
<tr>
<td>Other - most common response related to back-testing results related to the price used (especially for foreign equities) compared to the price used by the fund. Additional “Other” responses included Accounting Standards Codification (ASC) 820 leveling information, Changes to fair value prices, Fair valued securities as percentage of net assets, Foreign Security Fair Valuation Report (showing adjustments to foreign equities due to timing differences), List of illiquid securities including percentage of assets, Methodologies used to fair value securities, Other supporting documentation related to certain prices</td>
<td>14%</td>
</tr>
</tbody>
</table>
Select Fair Valuation Survey Questions

Does the full Board or one of its committees (if the committee is responsible for considering valuation on behalf of the Board), or one (or more) of its Board members receive information regarding pricing challenges made by fund management?
Select Fair Valuation Survey Questions

Does the full Board, or one (or more) of its committees receive the results of back-testing for the following holdings?

a) Vendor-priced securities

- Yes, in summary fashion quarterly: 35%
- Yes, in summary fashion annually: 2%
- Yes, in full detail as part of Board materials: 11%
- Only upon request: 33%
- The fund group does not perform back-testing on such securities: 19%
Select Fair Valuation Survey Questions

a) Broker-priced securities

- Yes, in summary fashion quarterly: 35%
- Yes, in full detail as part of Board materials: 12%
- Only upon request: 29%
- The fund group does not perform back-testing on such securities: 24%
The Heat is On.......... 

_Mutual Fund Directors have challenges that they can think about..._

5. **What is the control environment within which the Mutual Fund operates?**
“Management may need to design controls to appropriately weigh information received [from] multiple pricing services and/or other sources of fair value information.”

Source: Speech made by Jason K. Plourde, SEC Professional Accounting Fellow
How does your “valuation temperature” compare?

- 39% indicate that they are using new tools/controls to increase their overall transparency into pricing sources/vendor pricing
- 60% for equities and 33% for fixed income undertake the daily valuation control to compare the pricing from the primary source to a secondary source
- 77% for equities and 66% for fixed income review stale prices as part of daily valuation control processes
- 97% indicate that their valuation policies and procedures have resulted in challenges to the valuations provided by the primary pricing vendor; almost 34% issue price challenges on a daily basis
- Chief Compliance Officers continue to be involved in the valuation process; over 60% are involved in the adviser-led Internal Pricing Committee meetings, most commonly in an observer role
- 94% state that all fair value decisions are reported to the full board
- 96% employ back-testing to analyze fair value procedures; 94% use the next-day opening price as the benchmark comparison
- 29% indicate that their boards have created a separate valuation committee responsible for governance of the valuation process
- 72% of fund boards or one of their committees receive an analysis of the impact of NAV per share for each individual fair-valued investment
- 29% address management bias via the control process whereby fund accounting sends an e-mail to designated parties prior to processing an override to a vendor price, seeking either approval or providing notification
- 96% compare day-over-day price fluctuations and investigate those fluctuations that exceed a certain threshold; 96% perform for equities and 90% for fixed income
- More than 80% have procedures in place to detect situations where securities are either illiquid or thinly traded
- 71% made changes to their fair value policies and procedures
- More than 50% use an internal analysis to assess the reasonableness of a counterparty quote

Source: Deloitte Fair Value Pricing Survey
Deloitte Development LLC.
Evolution of Board Reporting - Common Practices

• Timing and extent of involvement
  – Should involvement be real-time or afterwards?
  – How much level of detail should be reviewed?

• Understanding the policies and procedures
  – How involved should those in governance be in reviewing the policies and procedures?

• Understanding the methodologies, elections and third party pricing services
  – Is there an understanding of the basis (bid vs. mean, 4 p.m. pricing, etc.) for each price?
  – Are the threshold and trigger controls appropriate based on the nature of the investment and the evidence that has been obtained?
  – Is there an understanding of the valuation methodology used by the third party pricing vendor?

• Understanding the potential for bias and manipulation
  – Are controls designed appropriately and operating effectively?
  – How are price challenges handled?
  – Understand the extent of documentation being prepared

• Understanding the disclosures
  – What process exists relative to determining the disclosure hierarchy (Levels 1-3)?
Evolution of Board Reporting – What is Next?

• Today, the boards of more than half of our survey participants have delegated certain valuation oversight responsibilities to one of their committees, and more than half receive an analysis of the per-share effect on NAV for each fair-valued investment individually.

• SEC continued focused on potential bias in the valuation process and the adequacy of pricing source due diligence.

• Inclusion of security valuation in the risk management process/program.

• SEC recent discussion on discharge of Board responsibilities and definition of Adviser-determined vs. Board-determined valuations.

• Board consideration of a valuation dashboard
  – What are key metrics to be tracked and monitored for trends?
"Some considerations I believe may be useful in assessing the risk of material misstatements relating to estimating fair value measurements include:

- Nature and complexity of securities involved (for example, the issuer, term, coupon, collateral, cash flow waterfall, priority in default, and other key drivers of value);

- Level of market activity for securities (for example, normal activity in market and changes thereto, nature of market (brokered, exchange, etc.), analysis of bid-ask spreads, and so forth); and

- Availability of market data (for example, who compiles data, timeliness, alternative markets, assessment of trades for adequate size and distressed nature)."

Industry Event for Board of Directors Exclusively

Valuation Oversight for Fund Directors

- Schedule for June 27th
- Location: Interactive Data 100 Church St NYC
- Time: 1-5 pm.
- http://go.interactivedata.com/funddirectors.html
Limitations

This presentation is not to be published, reproduced, copied, disclosed or used without the express written consent of Interactive Data Pricing and Preference Data LLC. This presentation contains confidential and proprietary information and/or trade secrets of Interactive Data Pricing and Reference Data LLC. This document is provided for informational purposes only. The information contained in this document is subject to change and does not constitute any form of warranty, representation, or undertaking. Nothing herein should in any way be deemed to alter the legal rights and obligations contained in agreements between Interactive Data Pricing and Reference Data LLC and its clients relating to any of the products or services described herein. Interactive Data Pricing and Reference Data LLC does not provide legal, tax or accounting advice. Clients should consult with an attorney or accounting professional regarding any specific legal tax, or accounting situation.

Interactive Data Pricing and Reference Data LLC makes no warranties whatsoever, either express or implied, as to merchantability, fitness for a particular purpose, or any other matter. Without limiting the foregoing, Interactive Data Pricing and Reference Data LLC makes no representation or warranty that any data or information (including, but not limited to, evaluations) supplied to or by it are complete or free from errors, omissions or defects.

Evaluated pricing is provided in the U.S. through Interactive Data Pricing and Reference Data LLC. and internationally through Interactive Data (Europe) Ltd. and Interactive Data (Australia) Pty Ltd. Interactive Data℠ and the Interactive Data logo are registered service marks or service marks of Interactive Data Corporation in the United States or other countries. Vantage℠ is a service mark of Interactive Data Pricing and Reference Data LLC. Other products, services or company names mentioned herein are the property of, and may be the service mark or trademark of, their respective owners.