

## AIFMD Factsheet: Valuation

### What is the AIFMD?

The Alternative Investment Fund Managers Directive (“**AIFMD**”) introduced a new passport system for the marketing of alternative investment funds (“**AIFs**”) in the European Union (“**EU**”) and created a legal framework operating at European level to monitor and supervise alternative investment fund managers (“**AIFMs**”) within a harmonised system for the first time.

### Requirements under the AIFMD in relation to Valuation

This note provides an overview of the valuation provisions under the AIFMD. The AIFMD requires that an AIFM establishes and maintains appropriate and consistent procedures concerning the valuation of an AIF. Under the AIFMD, the AIFM is responsible for ensuring that written valuation policies and procedures are established which clarify the valuation methodologies and the roles of the various parties involved in the valuation process of the AIF. The Irish implementing legislation specifies that these methodologies must be set out in the AIF’s constitutional documents eg, trust deed, memorandum and articles of association, deed of constitution or instrument of incorporation depending on the fund structure.

Prior to the introduction of the AIFMD, the responsibility for the valuation procedures of an AIF rested with the board of directors for Irish funds. If the board of directors of an AIF elects to act as AIFM under the AIFMD, the board continues to retain this responsibility. However, if the investment manager or another entity undertakes the role of the AIFM, the investment manager or that other entity assumes responsibility for this function which represents a change from the pre-AIFMD practice. The key issues to consider in relation to valuation provisions under the AIFMD are:

- which entities are permitted to carry out the valuation function;
- the classification of an external valuation agent;
- the valuation procedures under the AIFMD; and
- the liability provisions in relation to the valuation function.

### Who can perform the valuation function?

The valuation function may be carried out by the AIFM itself, or it may appoint an external valuation agent. Where the AIFM decides to carry out the valuation function itself, it must ensure that the process is functionally independent from the portfolio management and remuneration functions of the AIFM and that measures are put in place to mitigate conflicts of interest. Regulators have the power to require the AIFM to subject its valuation procedures and / or valuations to verification by an external valuation agent or auditor.

Where an external valuation agent is appointed by the AIFM, the AIFMD provides that the external valuation agent is not permitted to sub-delegate the valuation function to a third party. In relation to the appointment, the AIFM must be able to demonstrate that the delegation is to an external valuation agent that is professionally recognised, can furnish professional guarantees, and is appointed pursuant to the delegation provisions of AIFMD. It is worth noting that what constitutes a “professional guarantee” is not defined under the AIFMD. Implementing measures adopted under the AIFMD (the “**Level 2 Regulation**”) provide that professional guarantees ought to be in written form and should contain evidence of the external valuer’s qualification and capability to perform proper and independent valuation. The Level 2 Regulation also clarifies that the valuation of the AIF’s assets can be performed by one or several external valuation agents.

### Who is an external valuation agent?

The AIFMD clearly distinguishes between the valuation of assets and the calculation of the net asset value. The European Securities and Markets Authority’s (“**ESMA’s**”) advice to the European Commission on implementing measures under the AIFMD clarified that an administrator which carries out the calculation of the net asset value is not considered to be an external valuation agent as long as the entity does not provide valuations for individual assets but incorporates values which are obtained from other sources. This means that the fund administrator does not automatically assume the role of an external valuation agent and the AIFM may retain the valuation function, determine the fund’s pricing policy and delegate calculation of the net asset value in accordance with the pricing policy to the fund administrator.

## **Valuation Procedures**

The AIFMD requires an AIFM to ensure appropriate and consistent procedures are in place for the proper and independent valuation of assets of each AIF under management. Each AIF's net asset value must be calculated at least on an annual basis. Open-ended funds will be required to carry out more frequent valuations and net asset value calculations at a frequency appropriate to the assets they hold, whereas closed-ended funds must carry them out each time the capital of the fund increases or decreases. The Level 2 Regulation sets out general requirements in relation to the calculation of the net asset value per share of an AIF and provides some useful clarification in relation to the valuation measures to be implemented:

- where a pricing model is used, information on the main features of the pricing model should be included in the valuation section of the AIF's prospectus including the reason for the choice of the model;
- the AIF's valuation policies and procedures should be reviewed at least annually;
- the valuation policies and procedures should set out a review process for the individual value of assets where a material risk of inappropriate valuation exists, including where valuation is based on prices only available from a single counterparty or broker source;
- the AIFM should ensure that, for each AIF that it manages, the valuation policies and procedures and designated valuation models are applied consistently; and
- the AIFM will be required to determine the valuation methodologies that will be used for each of the types of asset in which the AIF may invest.

## **Liability of the AIFM**

The AIFM's liability towards the AIF and its investors shall not be affected by the fact that the AIFM has appointed an external valuation agent. The AIFMD provides that the AIFM is responsible for the proper valuation of AIF assets, the calculation of the net asset value and the publication of that net asset value and that, in no case, shall the AIFM's liability towards the AIF and its investors be affected by the fact that the AIFM has appointed an external valuation agent. The external valuation agent is, however, liable to the AIFM for any losses suffered by the AIFM as a result of the external valuation agent's negligence or intentional failure to perform its tasks. This liability is irrespective of any contractual arrangements providing otherwise.

## **Summary**

The AIFMD allows for a flexible valuation framework adaptable to the diverse types of assets in which an AIF can invest. As outlined above, it is necessary for the board of directors of the AIF to consider whether the AIF wishes to act as AIFM or, alternatively, whether it will appoint the investment manager or another entity as AIFM who will assume responsibility for the valuation function.

Full details of the Asset Management and Investment Funds Group, together with further updates, articles and briefing notes written by members of the Asset Management and Investment Funds team can be accessed at [www.matheson.com](http://www.matheson.com).

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