

MIS manager valuation and pricing practices

This information sheet sets out our recommendations following a review of the pricing and valuation practices of Managed Investment Scheme (MIS) managers. It will be of particular interest to MIS managers and their supervisors.

In May 2017, the International Monetary Fund (IMF) published a Financial Sector Assessment Program Technical Note on Fund Management in New Zealand (the IMF Review).

The IMF acknowledged the role of supervisors in the oversight of MIS managers and noted the benefits of frequent contact. However, it recommended we “ensure that the supervisory approach to MIS managers places an emphasis on direct monitoring by the FMA (as opposed to exclusively through Financial Markets Supervisors) of aspects most relevant to financial stability”¹. These aspects include the valuation of MIS assets.

To determine whether MIS managers are valuing and pricing MIS assets consistently in line with the International Organisation of Securities Commissions (IOSCO) principles, we analysed responses to a questionnaire sent to MIS managers and outsource providers, who self-assessed their practices. The sample contained:

- six MIS managers who perform in-house valuation and unit pricing
- eight MIS managers who outsource their valuation and unit pricing
- five third-party providers of valuation and unit pricing (outsource providers).

This work is aligned with our [2017 Strategic Risk Outlook](#), and our focus on the risks and harms associated with our strategic priorities for Conflicted conduct and Investor decision-making.

The IOSCO principles

The IOSCO principles for the valuation of collective investment schemes are “intended to be a basis against which both the industry and regulators can assess the quality of regulation and industry practices concerning CIS² (MIS) valuation. Generally, the principles reflect a level of common approach and are a practical guide for regulators and industry practitioners. Implementation of the principles may vary from jurisdiction to jurisdiction, depending on local conditions and circumstances.”³

Compliance with the principles is not a legal requirement in New Zealand. However, the Financial Markets Conduct Act 2013⁴ requires that governing documents for a registered scheme provide for the rules relating to asset valuation and pricing for the scheme.

The principles are reflected in our MIS licensing criteria, where there are minimum standards for asset valuation, pricing and outsourcing.

1. IMF Financial Sector Assessment Programme, Technical note May 2017, Table 1. p6
2. Collective Investment Scheme. Known as Managed Investment Scheme (MIS) in New Zealand
3. IOSCO Principles for the Valuation of Collective Investment Schemes May 2013, page 8
4. FMC Act s135 (1) (a) and (d)

Findings and recommendations

We found MIS managers' operations and assets valuations were generally consistent with the IOSCO principles. We also saw examples of MIS managers reviewing industry and international regulatory guidance on pricing errors, which we consider to be good practice.

Principle 1: The Responsible Entity should establish comprehensive, documented policies and procedures to govern the valuation of assets held or employed by a collective investment scheme (CIS)

Finding

All respondents had valuation policies and procedures in place. However, we believe there is potential for MIS managers that have adopted their outsource provider's pricing and valuation policy to improve their own policies.

Recommendation

We expect MIS Managers who accept their outsource service provider's policy to note any exceptions to that policy, including a comprehensive process for bespoke valuations. This ensures integrity of the valuation process and consistency with the outsource provider, and ultimately that investors are treated fairly and transparently. For example, the policy could cover:

- the acceptance or tailoring of the outsource service provider's policy
- any assets that have a bespoke valuation methodology, the requirements around these and the process for determining the methodology
- any source data the MIS manager must provide to the outsource provider
- any other material matters relating to the valuation function, such as consultation or liaison with the outsource provider or supervisor.

Principle 2: The policies and procedures should identify the methodologies that will be used for valuing each type of asset held or employed by the CIS

Finding

We were not satisfied that stale pricing has been fully addressed by all MIS managers.

Recommendation

MIS Managers have confirmed their policies and procedures include the methodologies that are used for valuing each type of asset. However, some MIS managers did not have clear policies for adjusting valuations for stale prices, or for escalating a pricing decision where prices seem to be stale. Policies and procedures should incorporate these areas where there is the possibility of stale prices.

Principle 3: The valuation policies and procedures should seek to address conflicts of interest

Finding

Conflicts of interest were not fully addressed by MIS managers who outsourced the pricing and valuation function.

Recommendation

Although valuation and pricing may be outsourced, the MIS manager is ultimately responsible for the functions performed by the outsource provider. The MIS manager should have their own policies and procedures to identify and manage risks associated with conflicts of interests. Where MIS managers don't currently have these in place, they should be developed and implemented as soon as practical. Addressing conflicts of interest minimises the potential for influences that can unfairly affect the price of the asset, and helps to ensure investors are treated fairly.

Principle 4: The assets held or employed by CIS should be consistently valued according to the policies and procedures

Finding

Assets are consistently valued according to the policies and procedures.

Principle 5: A Responsible Entity should have policies and procedures in place that seek to detect, prevent, and correct pricing errors. Pricing errors that result in a material harm to CIS investors should be addressed promptly, and investors fully compensated

Finding

MIS managers have policies and procedures in place that seek to detect, prevent and correct pricing errors. In addition, some MIS managers also consider industry and international regulatory guidance on pricing errors which we consider to be good practice.

Principle 6: The Responsible Entity should provide for the periodic review of the valuation policies and procedures to seek to ensure their continued appropriateness and effective implementation. A third party should review the CIS valuation process at least annually

Finding

Not all MIS managers could show that the review of their valuation policies and procedures was sufficiently removed from day-to-day activity to be considered the equivalent of a third party. Not all reviews were conducted annually

Recommendation

MIS managers should ensure the reviews are performed by an entity or person sufficiently independent of the valuation process. This system recognises that a MIS operates "within a dynamic environment in which the trading parameters, strategies and products change over time, and its policies and procedures should be similarly dynamic"⁵. Our minimum standards for licensing state that methodologies should be reviewed periodically. In line with the principle, we expect that to be annually.

5. IOSCO Principles for the Valuation of Collective Investment Schemes May 2013, page 9

Principle 7: The Responsible Entity should conduct initial and periodic due diligence on third parties that are appointed to perform valuation services

Finding

For MIS Managers who outsource, due diligence appeared to be robust but not always fully documented.

Recommendation

MIS managers should fully document their outsource provider due diligence process to ensure consistency and robustness. As part of their due diligence and monitoring processes, MIS managers should also consider the capacity of their outsource provider. Thorough due diligence ensures the outsource provider has the appropriate systems, controls, policies, procedures, knowledge, experience and training to perform the function.

Principle 8: The Responsible Entity should seek to ensure that arrangements in place for the valuation of the assets in the CIS's portfolio are disclosed appropriately to investors in the CIS offering documents or otherwise made transparent to investors

Finding

Information about pricing and valuation policies is not well disclosed

Recommendation

MIS managers should ensure their disclosures are appropriate. We do not consider it necessary to include the policy within the SIPO, but we recommend MIS managers should make their valuation and pricing policy (or a non-technical factsheet) available on the Disclose register or their website, and provide a link in the SIPO. This will provide transparency for investors and encourage consistency from the MIS manager.

Principle 9: The purchase and redemption of CIS interests generally should not be effected at historic NAV

Finding

We did not identify any particular issue however, consider it useful to set out our expectations around the use of historic NAV (net asset value).

Recommendation

Historic pricing can only be justified when risks of abusive trades are minimised. Where historic NAV is possible, we would expect all MIS managers to have clearly defined policies, procedures and escalation provisions for its use. This ensures there is little chance of arbitrage and investors are treated equitably.

Principle 10: A CIS's portfolio should be valued on any day that CIS units are purchased or redeemed

Finding

Managed Fund portfolios are valued on the same day that units are purchased or redeemed.

Principle 11: A CIS's NAV should be available to investors at no fee

Finding

Investors are able to access NAV information at no cost.

AUCKLAND

Level 5, Ernst & Young Building
2 Takutai Square, Britomart
PO Box 106 672, Auckland 1143

Phone: +64 9 300 0400

WELLINGTON

Level 2, 1 Grey Street
PO Box 1179, Wellington 6140

Phone: +64 4 472 9830

