

## The SEC's Division of Examinations Discusses Valuation in October 2021 Risk Alert

The SEC's Division of Examinations (the "Division" - formerly known as OCIE) has issued a new Risk Alert (the "Alert")<sup>1</sup> regarding Observations from Examinations in the Registered Investment Company Initiatives ("RIC Initiatives" or "Initiatives")<sup>2</sup>. In November 2018, the Division announced the Initiatives which would assess industry practices and regulatory compliance in certain areas that may have an impact on retail investors.

The Initiatives focused on funds and/or their investment advisers ("advisers").

This Alert posted by the Division on October 26, 2021, provides observations after conducting examinations for over 50 fund complexes, which covered more than 200 funds and/or series of funds, and almost 100 advisers.

The Division issued deficiency letters to non-compliant firms and believes the observations in this Risk Alert can assist all funds in assessing compliance risk. The fund exams focused on policies and procedures, disclosures to investors, and fund governance issues. Valuation was an area of focus for these examinations.

### Valuation was discussed in the following sections:

#### **Compliance Program:**

The staff observed funds and their advisers that did not establish, maintain, update, follow and/or appropriately tailor their compliance programs to address various business practices, including portfolio management, valuation, trading, conflicts of interest, fees and expenses, and advertising.

#### **Compliance Oversight of Valuation:**

- Maintaining an adequate compliance program for valuation of portfolio securities, including processes, controls, or both, that provide for due diligence and oversight of pricing vendors that provide evaluated prices for portfolio holdings for purposes of calculating the funds' daily net asset values.<sup>3</sup>
- Maintaining appropriate policies, procedures and/or controls for valuation of portfolio securities, including provisions that address potential conflicts and issues, such as where portfolio managers are permitted to provide input – as voting members of the valuation committee – on prices of securities in funds they managed.

<sup>1</sup> <https://www.sec.gov/files/exams-registered-investment-company-risk-alert.pdf>

<sup>2</sup> [https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20RIC%20Initiatives\\_0.pdf](https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20RIC%20Initiatives_0.pdf)

<sup>3</sup> Examples of due diligence and oversight processes concerning pricing vendors include, but are not limited to, processes for reviewing variance reports on stale or outlier prices and formal price challenges. See Division of Investment Management, Valuation Guidance Frequently Asked Questions ("FAQs") (Feb. 11, 2016) and Final Rule: Money Market Fund Reform; Amendments to Form PF ("money market reforms release"), Rel. No. IC-31166 (July 23, 2014) regarding oversight of mutual fund pricing service providers (FAQs provide responses to questions related to valuation guidance for all mutual funds provided in the money market reforms release). See also IC Act Rule 2a-5 and Final Rule: Good Faith Determinations of Fair Value, Rel. No. IC-34128 (Dec. 3, 2020) (adopting Rule 2a-5). New Rule 2a-5, which has a compliance date of Sept. 8, 2022, updates the regulatory framework on valuation practices and a board of director's role in valuating securities of a registered investment company or business development company. Under this new regulatory framework, funds may choose to comply with Rule 2a-5 voluntarily prior to the compliance date, provided they no longer consider Commission and staff guidance and no-action letters that will be withdrawn on the compliance date.

## Boards' Oversight of the Funds' Compliance Programs

The staff observed issues with funds' policies and procedures for their boards' oversight of the funds' compliance programs. For example, the staff observed funds that did not:

- Have appropriate policies, procedures and processes for monitoring and reporting to their boards with accurate information, such as information regarding: (1) fees paid by the funds to financial intermediaries and other service providers for providing shareholder services; (2) the type of services provided by service providers; and (3) pricing exceptions under the funds' valuation policies and procedures;
- Complete required annual reviews of the Funds' compliance programs that address the adequacy of policies and procedures and effectiveness of their implementation.

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## How Houlihan Capital Can Help

Houlihan Capital can help with the valuation process, including reviewing your valuation policy and with the process of determining fair value of your illiquid investments. The firm has extensive experience in providing objective, independent and defensible opinions of value that meet accounting and regulatory requirements. Houlihan Capital is SOC-compliant, a Financial Industry Regulatory Authority (FINRA) and SIPC member and committed to the highest levels of professional ethics and standards.

**For more information and valuation assistance, please contact:**

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## Related Risk Alerts regarding Valuation:

- [Valuation Raised as an Issue by the OCIE \(July 2020\)](#)