Principles for the Valuation of Collective Investment Schemes

Consultation Report

TECHNICAL COMMITTEE
OF THE
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

CR01/12 **FEBRUARY 2012**

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Foreword

The International Organization of Securities Commissions' (IOSCO) Technical Committee has published this Consultation Report with the aim of this consultation paper is to outline principles against which both the industry and regulators can assess the quality of regulation and industry practices concerning CIS valuation. Generally, these draft 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.

How to Submit Comments

Comments may be submitted by one of the three following methods **on or before Friday, 18 May 2012**. To help us process and review your comments more efficiently, please use only one method.

Important: All comments will be made available publicly, unless anonymity is specifically requested. Comments will be converted to PDF format and posted on the IOSCO website. Personal identifying information will not be edited from submissions.

1. Email

- Send comments to CIS-Valuations@iosco.org.
- The subject line of your message must indicate ***Principles for the Valuation of Collective Investment Schemes***.'
- If you attach a document, indicate the software used (e.g., WordPerfect, Microsoft WORD, ASCII text, etc) to create the attachment.
- Do not submit attachments as HTML, PDF, GIFG, TIFF, PIF, ZIP or EXE files.

2. Facsimile Transmission

Send by facsimile transmission using the following fax number: + 34 (91) 555 93 68.

3. Paper

Send 3 copies of your paper comment letter to:

Mohamed Ben Salem
General Secretariat
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

Your comment letter should indicate prominently that it is a "*Public Comment on Principles for the Valuation of Collective Investment Scheme*."

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Chapter 1 - Executive Summary

It is critical that a collective investment scheme (CIS) properly value all assets in its portfolio, including those instruments for which market quotations are not readily available (e.g., restricted securities and many derivatives). Valuation is extremely important because a CIS must redeem and sell its shares at their net asset value (the value of its portfolio securities and other assets, less liabilities)[1]. If CIS portfolio securities and assets are incorrectly valued, CIS investors may unfairly pay more for their shares (or unfairly receive less upon redemption), and investors remaining in the CIS also may be adversely affected.

The Technical Committee Standing Committee on Investment Management (TCSC5) previously examined CIS valuation in the 1999 report, *Regulatory Approaches to the Valuation and Pricing of Collective Investment Schemes*,[2] (Valuation Paper). The Valuation Paper listed several guiding principles for pricing of CIS interests and valuation of CIS portfolios.[3] In 2007, the Technical Committee also published *Principles for the Valuation of Hedge Fund Portfolios*.[4] That paper identified nine principles designed to ensure that a hedge fund's financial instruments are appropriately valued and, in particular, that these values are not distorted to the disadvantage of fund investors.[5] In addition, TCSC5 is also examining related topics.[6]

There have been a number of developments that have impacted valuation since TCSC5 last reviewed CIS valuation. Many complex and hard-to-value securities are now available to CIS, including some that did not exist a decade ago (such as certain structured financial instruments). The value of such assets cannot be determined by using quoted prices (so-called mark-to-market) but instead CIS may rely on internal techniques which imply management's judgment (so-called mark-to-model). The difficulty and subjectivity of valuation increases regulatory risks and requires general principles to be supplemented by the identification of policies and procedures designed to address the appropriate valuation of CIS assets[7]. This paper seeks to update and modernise principles for CIS valuation, taking into

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1 Principle 27 of the IOSCO objectives and principles of securities regulation states that: "Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme."

See *IOSCO Objectives and Principles of Securities Regulation*, IOSCO Report, 10 June 2010, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf.

2 See *Regulatory Approaches to the Valuation and Pricing of Collective Investment Schemes*, Report of the Technical Committee, May 1999, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD91.pdf..

3 Ibid. The guiding principles are attached at appendix A.

4 See *Principles for the Valuation of Hedge Fund Portfolios*, Final Report, Report of the Technical Committee of IOSCO, November 2007, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD253.pdf..

5 Ibid. These principles are attached at appendix B.

6 See *FR02/12 Principles on Suspensions of Redemptions in Collective Investment Schemes*, Final Report, Report of the Technical Committee of IOSCO, 19 January 2012, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD367.pdf. and *Principles of Liquidity Risk Management in Collective Investment Schemes (*work in progress)

7 The term "assets" as used in this paper refers to all of the assets in a CIS's portfolio. For example, "assets" include, but are not limited to, equity and fixed income securities, positions in derivatives, and

account the prior work and recent market developments that impact valuation.

In preparing this consultation paper, IOSCO worked with a group of industry experts to gain practical insight. The aim of this consultation paper is to outline principles against which both the industry and regulators can assess the quality of regulation and industry practices concerning CIS valuation. Generally, these draft 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.

IOSCO requests comments generally on the proposed principles discussed below, as well as comments on the following specific concerns:

- **Do these principles adequately address the regulatory issues raised by the valuation of CIS?**

- **Are potential conflicts of interest appropriately addressed? Do you see a need for more stringent principles in this area?**

- **In particular, does the principle on the NAV at which the purchase and redemption of CIS interests should be effected adequately cover the issues?**

- **Are there other areas that TCSC5 should address?**

- **Please, when answering these questions, elaborate.**

short positions.

Chapter 2 – Introduction

The Technical Committee Standing Committee on Investment Management (TCSC5) drafted this paper following a mandate from the IOSCO Technical Committee (TC). This mandate requested that it update collective investment scheme (CIS) valuation principles with a major focus on policies and procedures related to the valuation process in order to ensure that CIS asset valuations are not distorted to the disadvantage of CIS investors. In the context of such work, the term CIS refers to those collective investment schemes that are open-ended and provide regular redemptions to shareholders at net asset value (the then-current value of their portfolio securities and other assets, less liabilities) (NAV).[8]

This paper identifies the implementation of comprehensive policies and procedures for valuation of CIS assets as a central principle. It recommends general principles that should apply to the development and implementation of such policies and procedures. The paper also emphasizes that these policies and procedures should be consistently applied. In addition, it stresses the goals of independent oversight in the establishment and application of the policies and procedures in order to mitigate the conflicts of interests that CIS operators face. The key objective underlying the CIS valuation principles outlined below is that investors should be treated fairly.

8 In the context of this paper, CIS does not include a CIS that is not subject to direct regulation. The principles outlined in this paper may serve as best practices for these unregulated CIS.

Chapter 3 – Background

The valuation of the assets employed or held by a CIS is critical to investors because it affects, among other things, the CIS's NAV, financial reporting, performance reporting and presentation, and fees paid to CIS service providers (such as the CIS operator). Therefore, it is crucial to understand all the valuation drivers in order to reach a correct valuation of the assets in the portfolio or, before purchasing/selling an asset, in order to assess the correct value of such an asset.

The valuation of CIS assets potentially presents conflicts between the interests of those who value the assets and the CIS investors. There are many different ways in which this could occur. For example, a CIS operator or other conflicted entity could overvalue the CIS assets in an attempt to attract more investors by showing an inflated performance record, therefore earning more management fees. In addition, a CIS operator could rid itself of unattractive assets that it owns by dumping them into the CIS at an overvalued price. The CIS operator could also undervalue the CIS's assets and cause the CIS to sell them to affiliates at an artificially low price. Therefore, the management of a CIS's conflicts of interests is critical to ensuring that the CIS's assets are valued properly, and that CIS investors are protected.

The CIS governance framework in the jurisdictions of TCSC5 members, including how the framework addresses conflicts of interests, will reflect the legal structure of CIS in the jurisdictions. For more information, please refer to TCSC5's previous examination of CIS governance framework and attendant conflicts of interest in the paper, *Examination of Governance for Collective Investment Schemes*[9] published in February 2005. Throughout this paper, the entity or entities responsible for the overall operation of the CIS and, in particular, its compliance with the legal and regulatory framework in the respective jurisdiction are referred to as the *Responsible Entity*.

[9] See *Examination of Governance for Collective Investment Schemes*, Consultation Report, Report of the Technical Committee of IOSCO, February 2005 available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD183.pdf.

Chapter 4 – Principles for the valuation of collective investment schemes

Principle 1: ***The Responsible Entity should establish comprehensive, documented policies and procedures to govern the valuation of assets held or employed by a CIS.***

While the CIS portfolio manager may be heavily involved in formulating the policies and procedures, the Responsible Entity should ensure that written policies, and procedures which implement the policies, are established to seek to ensure integrity in the valuation process.

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.***

The CIS policies and procedures should set out the methodology to be used for valuing each type of asset, which could include inputs, models and the selection criteria for pricing and market data sources, having regard to sound and reliable data. The types of assets that a CIS holds may vary according to the CIS's investment objectives and applicable regulations. Therefore, a CIS's policies and procedures should be appropriate to the types and complexity of assets that it holds and employs. For example, one CIS may invest in assets that are traded frequently and for which prices are readily available and reliable (such as on an exchange). In this case, the CIS's methodologies for valuing these assets may be relatively generalized.

Another CIS may invest in more complex assets that are more difficult to value (such as OTC derivatives), and thereby may utilize particular methodologies relevant to those assets to address those valuation issues. In these cases, it may be appropriate to consider whether the valuations of the more complex assets requires specific skills and systems; in particular, whether the personnel in charge of the valuation should have an appropriate level of knowledge, experience and training.

While each jurisdiction may have different rules and guidance for valuing particular types of assets, TCSC5 has identified certain general practices that may be useful in considering the appropriate methodologies for valuing CIS assets. First and most importantly, valuations should be determined in good faith.[10] Where possible, assets should be valued according to current market prices, providing that those prices are available, reliable, and frequently updated.

However, there may be circumstances where it may be more appropriate to fair value the asset because the use of the most recent market price is not appropriate, such as in the case of a security that has not traded frequently, or is otherwise illiquid and hard-to-value. As stated above, the CIS also should consider whether specific skills and systems are necessary in considering valuation issues regarding hard-to-value assets.

Frequently, hard-to-value assets tend to be illiquid (with a very limited or no secondary market). In this respect, a CIS portfolio manager should monitor the liquidity in markets in which the CIS is invested as part of a liquidity management policy. The more illiquid such markets are, the more robust the valuation process may need to be.

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[10] See Principle 1 in *Regulatory Approaches to the Valuation and Pricing of Collective Investment Schemes*, IOSCO, May 1999, fn 2.

For example, in some jurisdictions, certain securitized and structured finance instruments (SFIs) are considered as hard-to-value assets. In these jurisdictions, in valuing such assets (such as collateralized debt obligations, residential mortgage-backed securities and other types of asset backed securities), marking SFI to model implies the understanding of its underlying assets and structure, including collateral. The methodologies used to value SFIs should be based on qualitative and quantitative analyses which have to be conducted both in *normal* and *stress* scenario[11].

When taking into account the opinion of a third party (e.g., a valuation agent or credit rating agencies), the Responsible Entity should assess and understand the methodology and parameters on which such opinion was produced.

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

Potential conflicts of interest regarding valuation of a CIS's portfolio assets can arise in a number of ways. For example, while the Responsible Entity remains ultimately responsible for overseeing the implementation of the CIS's valuation policies and procedures, in some cases the CIS operator can have input into the appropriateness of a particular valuation. For example, in cases involving complex or illiquid assets that are hard to value, the CIS operator may in practice be the most reliable or only source of information about pricing for a particular asset. However, the CIS operator has a conflict of interest with regard to the CIS's valuations, particularly as its fees are calculated based on the CIS's assets under management. As a result, the CIS operator has an incentive to overvalue CIS assets to increase its fees.

A CIS can address conflicts of interest in a number of ways. For example, reviews of valuations that are independent of the CIS operator can help to ensure that the valuations of assets have been determined fairly and in good faith, and protect investors as CIS must redeem and sell their shares at NAV. In order to meet this objective, the following approaches would be possible:

- The risk management function of the CIS could review the valuation provided by the CIS operator. Under this model, the risk management function would be hierarchically and functionally independent of the CIS portfolio management function. Similarly, an internal auditor or committee that is separate from the CIS portfolio management function could review the valuations.

- The portfolio management function could be separated from the valuation and/or pricing function, and thus not permit the CIS operator or portfolio manager to determine the valuations, although the CIS operator may be able to provide input, as appropriate. In addition, automating the valuation process, where possible, can help

[11] The analysis in *normal* scenario should include, for instance, the understanding of how cash flow will be allocated to the different tranches of the SFI and the roles of the parties involved in the SFI. IOSCO previously examined good practices for investment managers when investing in SFI see *Good Practices in Relation to Investment Managers' Due Diligence When Investing in Structured Financial Instruments*, Final Report, Report of the Technical Committee of IOSCO, 29 July 2009, available at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD300.pdf.

to reduce the possibility of improper influence on valuations.

- The CIS depositary, as applicable, could seek to ensure that the CIS operator carries out the valuation of the CIS appropriately, therefore providing an independent check on the valuation policy and the way it is implemented.

- The Responsible Entity could define and maintain a conflict of interests policy designed to manage conflicts associated with the valuation process, among other things.

- The CIS could retain independent pricing services or other experts to assist them in obtaining independent valuations, as appropriate.

- If the valuation is obtained from a third party that itself has a conflict of interest (i.e., the counterparty of an OTC derivative, the structurer or the originator), the verification of an appropriate degree of objectivity in the valuation could be carried out by one of the following:

    - An appropriate party which is independent from the third party, at an adequate frequency and in such a way that the Responsible Entity is able to check it;

    - The depositary of the CIS; or

    - A unit within the CIS which is independent from the department in charge of managing the assets and which is adequately equipped for such purpose.

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

A CIS's policies and procedures should make clear that the CIS's assets are to be valued consistently in accordance with the designated methodologies. In addition, the policies should also generally be consistent across similar types of assets (e.g., securities that share similar economic characteristics) and across all CIS that have the same CIS operator.

In certain circumstances, the value of an asset determined in accordance with the CIS's policies and procedures may not be appropriate. Therefore, it may be appropriate to deviate from the methodology set forth in the policies and procedures and to determine the value of the asset by using a different methodology, when, for example, the original methodology does not result in the fair treatment of investors.[12]

A price override (or deviation) is the rejection of a value for an asset that was determined according to the previously established policies and procedures of the CIS. For example, price overrides may occur where a pricing service or other third party is responsible for valuing an asset, yet this valuation has been determined to be inappropriate.

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[12] In general, the valuation policies and procedures should specify a framework applicable to both current and, where practicable, future assets in which the CIS anticipates investing. To this end, the valuation policies and procedures should address how the valuation of assets will be undertaken in case an asset falls outside of the scope of the existing valuation policy.

The policies and procedures should describe the process for handling and documenting such exceptional events, including:

(i) documenting the reason for the price override; and

(ii) the review of price overrides by a party that is independent of the CIS's portfolio manager.

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

A pricing error occurs when a CIS's price per unit is incorrect (i.e. the price is not an accurate result of the CIS's valuation process). A pricing error can result in an investor purchasing or redeeming shares at the incorrect price. As stated above, an incorrect price could also potentially affect the CIS's payments to its service providers and to the CIS operator, among other things.

Pricing errors can occur for a number of reasons. For example, incorrect accrual of CIS fees, late reporting of trades in assets, or simple human error in inputting data can all produce pricing errors. Accordingly, a CIS should have policies and procedures in place that seek to detect and prevent pricing errors. The CIS policies and procedures should also identify those pricing errors that materially harm investors, as determined by the appropriate jurisdiction's guidance, determination, or rules as appropriate.

For material pricing errors, the CIS should compensate fully investors for the amount of the pricing error in a manner that would correct the error, or otherwise in accordance with the applicable jurisdiction's guidance or rules. Frequent pricing errors, or an escalation in the number of pricing errors whether or not material, should prompt a review and amendment of the CIS's policies and procedures, as appropriate, to reduce or eliminate the number of pricing errors.

Principle 6: ***The Responsible Entity should provide for the periodic review of the valuation policies and procedures to seek to ensure their continued appropriateness.***

The desirability of consistent application over time of the policies and procedures should be balanced with a periodic review of, and appropriate changes to, the policies and procedures. The policies should allow the Responsible Entity to review and change the methodologies periodically and after any event that calls into question the validity or utility of the policies and procedures (e.g. when market events call into question whether a particular pricing methodology continues to be appropriate). This recognizes that CIS operate within a dynamic environment in which the trading parameters, strategies and products change over time, and its policies and procedures should be similarly dynamic.

Principle 7: ***The Responsible Entity should provide for the periodic review of the valuation policies and procedures to seek to ensure that they are being implemented effectively.***

As stated above, a CIS's policies and procedures should make clear that the CIS's assets are to be valued consistently in accordance with the designated methodologies, among other things. To this end, the CIS's policies and procedures should be reviewed periodically to seek to ensure that the policies and procedures continue to work as designed. For example, the review could evaluate whether the valuations are consistent with designated methodologies and whether any pricing overrides and errors are handled in accordance with the policies and procedures. This review should be performed by an entity or person that is sufficiently independent of the valuation process such that an objective review can be performed.

Principle 8: **A third-party should review the CIS's valuation process at least annually.**

A CIS should arrange for a third-party (e.g., an independent or external auditor as part of its periodic review of a CIS's financial statements,[13] depositary, custodian or accountant) to perform an annual review of its valuation process. This review could be more frequent. A third-party can provide an independent review of the CIS valuation process, as relevant to the particular jurisdictions' regulations. In particular, a third party can verify the consistency of the CIS's NAV calculations and test the valuation procedures by which the CIS values its portfolio securities.

Principle 9: ***The Responsible Entity should conduct initial and periodic due diligence on third parties that are appointed to perform valuation services.***

The Responsible Entity typically appoints third parties to perform valuation services for the CIS. Such third parties could include, among others, a valuation agent. When the Responsible Entity decides to appoint a third party, suitable due diligence should be conducted by the Responsible Entity, or its delegate, to determine that the service provider has and maintains appropriate systems, controls, and valuation policies and procedures, as well as a sufficient complement of personnel with an appropriate level of knowledge, experience and training commensurate with the CIS's valuation needs. In addition, when the Responsible Entity delegates valuation functions to a third party, the Responsible Entity is responsible for overseeing the third party's activities in connection with the services provided to the CIS. Similarly, the Responsible Entity retains responsibility and liability for the valuations of the CIS's assets.

[13] In some jurisdictions, the audit must be conducted in accordance with high-quality standards (e.g. GAAP or IFRS).

Principle 10: ***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.***

Disclosure to investors about the CIS's valuation policies and procedures could include general information about how certain assets are valued and how frequently they are valued. This information should be updated and made available to investors when these valuation policies and procedures materially change. For example, in the U.S., a CIS prospectus must disclose that the price of CIS shares is based on the CIS's NAV and the methods used to value the CIS's assets (e.g. market price, or amortized cost). For non-money market CIS, this disclosure must include a brief explanation of the circumstances under which it will use a price other than market price and the effects of using this price. The prospectus is updated annually or more frequently, depending on whether its information has changed materially. Other jurisdictions may require the CIS's policy to include a specific section illustrating the criteria used to value the CIS assets. This information is then made available to investors upon request. In addition, certain valuation criteria are reported in the notes to the CIS/sub-CIS annual report.

Principle 11: ***The purchase and redemption of CIS interests should not be effected at historic NAV***

Forward pricing is generally understood to be the practice of effecting purchasing and redemption of CIS interests at the next computed NAV after receipt of the order. Generally, cut-off times (i.e., the time at which the NAV is calculated, and before the orders have to be received) are established to provide that investors receive the correct NAV for their redemption and purchase orders.[14] As a result, investors will not know the NAV per share at the time of placing the order, and all investor orders will be treated the same (i.e., given the same NAV) if the orders are received by the cut-off time in good order.[15] Forward pricing ensures that incoming, continuing and outgoing investors are treated equitably such that purchases and redemptions of CIS interests are effected in a non-discriminatory manner.[16] Historical pricing is the pricing method whereby investors purchase or redeem units/shares based on the last calculated NAV of the CIS. In general, historical pricing would most likely have to be justified only if the risks of abusive trades by insiders and resulting dilution of CIS

[14] In some jurisdictions, a CIS may offer and sell shares only on specific days (dealing day). The CIS will announce the deadline for such dealing days. In these circumstances, an investor will receive the NAV for the applicable dealing day if the order is received in good order by the dealing day's deadline.

[15] When an order is considered *received* by the CIS may vary according to operational requirements in various jurisdictions. For example, in some jurisdictions, an order paid for by personal check will not be considered received in good order until the check has cleared.

[16] See *Best Practice Standards on Anti Market Timing and Associated Issues for CIS*, Final Report, Report of the Technical Committee of IOSCO, October 2005, available at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD207.pdf), recommends the use of forward pricing: "Forward pricing could be used to reduce the attractiveness of CIS to market timing funds. CIS operators should consider selling and redeeming on the basis of an unknown/forward price only and combining the cut off time and NAV calculation time in a manner so as to minimize any arbitrage possibility arising from the timing differences, as the price of the unit would be unknown to the investor at the time of placing the request."

interests are minimized.[17]

Principle 12: ***A CIS's portfolio should be valued on any day that CIS units are purchased or redeemed.[18]***

CIS investors should purchase or redeem units at prices that fairly reflect the value of the CIS's assets. If a CIS's assets are not valued on any day that CIS units are purchased or redeemed, it is possible that investors could purchase or redeem units at too low or too high a price, thus harming CIS investors, and potentially affecting the CIS's payments to its service providers and to the CIS operator, among other things.

Principle 13: ***A CIS's NAV should be available to investors at no cost.***

As previously stated, a CIS provides regular redemptions and sales to investors at the next computed NAV after receipt of the orders. Therefore, it is important that a CIS's NAV is available to investors at no cost. In some jurisdictions, the CIS is not required to disclose or publish its NAV on a regular basis to investors, but the price of a CIS is generally available on a daily basis in financial publications and websites and may also be available on the CIS's or CIS operator's website.

[17] See *Regulatory Approaches to the Valuation and Pricing of Collective Investment Schemes,* IOSCO, May 1999, fn 2..

[18] In general, a CIS's portfolio may not be valued on days when the applicable jurisdiction's stock exchange is closed, such as a holiday.

Appendix A – Guiding Principles for CIS Valuation[19]

The following fundamental guiding principles for valuation of CIS and pricing of CIS interests were published in 1999 based on a study of regulatory approaches. These principles were found to transcend jurisdictional boundaries.

- Valuation to be determined in good faith;
- CIS to be valued on a per unit/share basis based on the CIS's asset value, net of allowable fees and expenses previously disclosed to investors, divided by the number of outstanding units/shares;
- Incoming, continuing and outgoing investors to be treated equitably such that purchases and redemptions of CIS interests are effected in a non-discriminatory manner;
- CIS to be valued at regular intervals3 appropriate to the nature of scheme property;
- CIS to be valued in accordance with its constitutive and offering documents;
- Valuation methods to be consistently applied (unless change is desirable in the interests of investors);
- Valuation and pricing basis adopted to be disclosed to investors in the CIS offering documents.

[19] See *Regulatory Approaches to the Valuation and Pricing of Collective Investment Schemes*, IOSCO, May 1999, fn 2.

Appendix B – Principles for the Valuation of Hedge Fund Portfolios

The following nine principles were identified in IOSCO's final report on valuation of hedge funds in 2007[20]:

1. Comprehensive, documented policies and procedures should be established for the valuation of financial instruments held or employed by a hedge fund.

2. The policies should identify the methodologies that will be used for valuing each type of financial instrument held or employed by the hedge fund.

3. The financial instruments held or employed by hedge funds should be consistently valued according to the policies and procedures.

4. The policies and procedures should be reviewed periodically to seek to ensure their continued appropriateness.

5. The Governing Body should seek to ensure that an appropriately high level of independence is brought to bear in the application of the policies and procedures and whenever they are reviewed.

6. The policies and procedures should seek to ensure that an appropriate level of independent review is undertaken of each individual valuation and in particular of any valuation that is influenced by the Manager.

7. The policies and procedures should describe the process for handling and documenting price overrides, including the review of price overrides by an Independent Party.

8. The Governing Body should conduct initial and periodic due diligence on third parties that are appointed to perform valuation services.

9. The arrangements in place for the valuation of the hedge fund's investment portfolio should be transparent to investors.

[20] See *Principles for the Valuation of Hedge Fund Portfolios*, Final Report, IOSCO, November 2007, fn 4.