



ESMA Launches CSA with NCAs on Valuation Risks for UCITS and AIFs

Your Partner For What's Next

As was noted in its work programme for 2022, On 20th January 2022, the European Securities and Market Authority (ESMA), the EU's securities market regulator, issued a press release about launching a Common Supervisory Action (CSA) with National Competent Authorities (NCAs) on the valuation of UCITS and open-ended Alternative Investment Funds (AIFs) across the EU. The CSA will be conducted throughout 2022 focusing on fund managers that invest in less liquid assets, e.g. unlisted equities, unrated bonds, corporate debt, real estate, high yield bonds, emerging markets, listed equities that are not actively traded, bank loans etc. The CSA aims to assess compliance of supervised entities with the relevant valuation-related provisions in the UCITS and AIFMD framework.

The National Competent Authorities (NCAs) will share knowledge and experiences through ESMA in how they supervise valuation related issues. The main purpose of the exercise is "the consistent and effective supervision of valuation methodologies, policies and procedures of supervised entities to ensure that less liquid assets are valued fairly both during normal and stressed market conditions," ESMA said. ESMA confirmed the work will be done using a common assessment framework developed by them, which sets out the scope, methodology, supervisory expectations and timeline for how to carry out a comprehensive supervisory action in a convergent manner.

Amid sensitive market uncertainty and the current economic environment, the necessity of assessing valuation risks which may pose a potential threat to financial stability is of extreme importance.

This is the third CSA that ESMA and NCAs have launched on asset management. The first two covered UCITS liquidity risk management and supervision of costs and fees in UCITS.

Jorge Fernandez Revilla, Head of Financial Instruments in KPMG Ireland, argues that "the economic volatility that we have suffered during the previous years, confirms the importance of valuations which might cause a potential threat to the financial stability."

It is expected that the National Authority will issue the CSA shortly. As in previous CSA, we are expecting, as a next step, a questionnaire to a group of Management Companies, identified by the regulator as working in the less liquid assets framework, as outlined in the press release.

How KPMG can help you with the valuation risks?

1. Centralised specialist team

KPMG Financial Instruments (KFI) utilises a centralised team of quantitative finance specialists and technology dedicated to performing comprehensive substantive fair value testing work on financial instruments as well as hedge accounting and VaR revision. KFI is designed to determine independent fair values which are tested for their relevance and reliability and through establishing ranges of acceptable prices.

2. Periodically review methodology

KFI performs a periodic review and test of valuation methodology for exchange-traded and OTC instruments to ensure that the fair value determination methods are reasonable and appropriate, and in line with market practice.

3. Expertise in a wide range of financial instruments

KFI provides the fair value determination services on a wide range of financial instruments, including exchange-traded instruments and over the counter (OTC) instruments. For exchange-traded instruments, KFI covers the valuation for Equities, Funds, Debt instruments and Exchange-traded derivatives. For OTC instruments, both vanilla OTCs and non-vanilla are under KFI's scope.

4. KFI is continuing to assess the relevance and reliability of each pricing sources at each reporting date.

KFI also developed KPMG's hand-pricing procedures to provide support to the above methodology and help ascertain fair value for unquoted fixed income instruments.

5. Global Professional Services Firm

As a Global Professional Services Firm, KPMG provides timely and relevant support in areas such

as forensics, tax, information risk management and valuations. Our highly experienced professionals can assist in the management of diverse areas such as risk monitoring, assessment and adequacy of internal controls around pricing and fraud prevention.

6. Reports and records

KFI documents material differences in their concluding working papers including the respective appendix, providing documentation about an opinion of the nature of such differences.



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