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FCA Review of Private Market Valuation Practices

On 5 March 2025, the FCA published its long awaited review on private market valuations, providing insights into what it perceives to be the key issues for funds, managers and investment advisers operating in private markets.

The FCA's review is set against the backdrop of increasing regulatory interest in valuation practices in private markets, and follows reports from IOSCO and the Bank of England's Financial Stability Board highlighting concerns with a lack of transparency in such practices.

Following an announcement in March 2024 that it would conduct a multi-firm review of private market valuation practices, the FCA surveyed 36 firms in two phases. During the first phase, the FCA asked firms for information on their private market activity and their approach to valuing private assets. In the second phase, the FCA selected a subset of firms for an in-depth review, which included document reviews and on-site thematic visits.

Scope

The FCA's review is relevant for UK AIFMs, portfolio managers and investment advisers. While only AIFM firms are subject to specific / prescriptive requirements on valuation under the AIFMD (and the FCA have reviewed how surveyed AIFMs complied with these rules), the FCA have also assessed the valuation practices of all surveyed firms, including MIFID investment managers and advisers, against the Principles for Businesses (notably, 1 (*Integrity*), 2 (*Skill, care and diligence*), 3 (*Management and control*), 7 (*Communications with clients*) and 8 (*Conflicts of interest*)).

Summary of findings and next steps

The FCA summarised their findings into eight themes: (i) governance; (ii) conflicts of interest; (iii) functional independence; (iv) policies / procedures; (v) frequency of valuations; (vi) transparency; (vii) valuation methodologies; and (viii) use of third-party advisers.

The FCA was encouraged to find instances of good practices in several areas, especially around the quality of investor reporting, the use of third party advisers and the consistent application of valuation methodologies. Equally, the FCA found firms had room for improvements in certain other areas, particularly around accurate and detailed record keeping of valuation-related conflicts, the functional independence of valuation functions, and the absence of processes for ad-hoc valuations.

The FCA expects all firms to consider its review, identify any gaps in their internal controls and take action where appropriate. More generally, the FCA will use its findings to inform its upcoming multi-firm review on conflicts of interest, and its review of the UK AIFMD.

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Detailed key findings

Governance

The FCA found that while most firms had specific governance arrangements in place for valuations, there was an absence of proper record-keeping of valuation decisions and how they were reached. The FCA asks firms to assess their record-keeping arrangements, to ensure clear accountability for valuation and oversight of the valuation process.

Conflicts of interest

The FCA's expectation is that all valuation-related conflicts are to be considered, and where relevant to the firm, documented together with the actions taken to mitigate or manage them. The FCA found that only a few firms demonstrated awareness and control over all possible conflicts that could exist between their interests (in valuing private assets) and those of investors. The FCA noted the following with respect to certain valuation-related conflicts:

- Investor fees: the FCA found that firms did not always document how fee-related valuation conflicts varied across different product types – for instance, funds charging management fees based solely on committed capital were less likely to create valuation-related conflicts than those that charged management fees based on NAV.

- Asset transfers: where the firm's valuation determines the transfer price of fund assets (including in the context of continuation funds), the FCA observed the use of various controls on conflicts, including obtaining consent from the fund's limited partner advisory committee and an independent "fairness opinion" on the transfer price. Where firms enabled incoming investors to take their own view on price and bid to existing investors, the FCA highlighted the importance of such investors having sufficient access to information to enable them to make an informed decision.

- Redemptions / subscriptions: the FCA noted that conflicts could arise for open-ended funds where redemptions and subscriptions are priced using the fund's NAV, and may not always reflect the value of the fund's investments. The FCA noted that not all firms had documented these elevated risks.

- Marketing: the FCA cautioned firms using unrealised performance information of existing funds to raise capital for new funds. The FCA expects firms to document the conflict and clearly separate the realised and unrealised investments in marketing materials, making it clear that unrealised performance was based on the firm's valuation approach.

- Secured borrowing: several firms did not proactively identify or document conflicts relevant to NAV financings, where a manager might be incentivised to inflate the fund's NAV to maximise LTV ratios and / or avoid breaching covenants to lenders.

- Uplifts in volatility: the FCA noted perceptions that investors prefer valuations with a certain return profile, e.g. a consistent return over time combined with an "uplift" on exit. The FCA warned firms to take account of the risks of overly conservative / stable valuations to reflect these investor preferences, including that the impact might be to create a misleading perception of a less volatile investment.

- Remuneration: the FCA noted that in most cases, employee remuneration was not linked to valuations. Firms should determine if there is any link between staff remuneration and unrealised fund performance, and if so, put in place appropriate measures.

Functional independence

The FCA noted that its expectations for the functional independence of the valuation function were met by firms that: (i) created a dedicated valuation function; (ii) staffed the function with individuals with the relevant expertise; and (iii) clearly segregated and documented any input from investment professionals.

The FCA's expectations were not met where valuation functions had insufficient expertise, or where their voting membership comprised entirely or mostly of senior investment professionals. On the latter point, the FCA is following-up with certain firms whose valuation functions include investment professionals as voting members to discuss how those firms ensure appropriate independence and manage conflicts.

Policies, procedures and documentation

- Valuation policies: the FCA noted commonly occurring gaps in valuation policies, including the absence of detail on: (i) the rationale for selecting valuation methodologies (and related data); (ii) safeguards to ensure functional independence and avoiding potential conflicts of interest in the valuation process; and (iii) escalation measures.

- Valuation models: the FCA identified good practices including (i) the use of valuation templates (that facilitate a clear/consistent approach); (ii) the highlighting of changes in inputs, assumptions and value; (iii) the provision of qualitative information on the context and performance of an asset; and (iv) the introduction of automated third-party valuation software to reduce the risk of human error.

- Auditors: the FCA indicated that where auditors participated in the valuation process (e.g. by reviewing valuations, or conducting sample tests), firms could demonstrate good practice by inviting auditors to valuation committee meetings and raising/discussing any challenges posed by them. The FCA also recommended alternating between multiple providers to strengthen confidence in the valuation process.

- Backtesting: the FCA commented that backtesting could be a helpful tool for firms to reassess their valuation process in light of changing market circumstances and identify limitations in their models, assumptions and risks.

Frequency and ad hoc valuations

In reviewing the frequency of valuations of the surveyed firms, the FCA expressed concerns over stale valuations – in particular, the lack of quantitative and / or qualitative thresholds for triggering out of cycle (or ad hoc) valuations. The FCA stated that firms should incorporate a process for ad hoc valuations by setting quantitative or qualitative triggers to account for significant market events or disruptions to the global economy (e.g. COVID-19 pandemic, Russia-Ukraine conflict or certain sector specific changes).

Application of valuation methodologies

The FCA observed that the "market approach" (which uses prices generated by transactions involving comparable assets) and the "income approach" (which uses a multiple of cash flows / income to arrive at fair value) were the most commonly adopted methodologies, with firms using one or both of the methodologies depending on the underlying asset class (private equity, venture capital, infrastructure equity / debt and private debt).

The FCA found that firms encountered certain challenges, including identifying comparable assets (particularly for portfolio companies with unique attributes) and reflecting public market volatility. The FCA also reported differences in firms' approaches, including in weighting comparable companies, calculating components of a discount rate and discounted cash flow models.

The FCA expects firms to review their methodologies and assumptions and ensure any adjustments are applied consistently based on fair value. Firms should consider using industry guidelines to ensure their approach is in line with market practice, and also consider using a secondary methodology as a sense check.

Use of third-party valuation advisers

The FCA noted the benefits of using of third-party valuation advisers to provide additional independence and expertise, but cautioned that firms should consider any conflicts of interest associated with their appointment, together with any limitations of the services they provide and a disclosure of their appointment to investors.

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