

Melville Rodrigues: AIFMR HMT ConDoc Question 15 Draft Response

Question: Should the liability for external valuers be reviewed, and would any additional safeguards be required?

HM Treasury consultation document¹ statements:

External Valuation

5.17 The AIFM regulations allow for AIFMs to appoint external valuers to carry out a valuation of an AIF. However, they also set out that the external valuer is liable to the AIFM, for any losses caused by the valuer being negligent or intentionally failing to perform its tasks.

5.18 Feedback suggests that this liability makes valuers cautious about taking on business and makes it challenging for them to obtain professional indemnity insurance. This particularly impacts funds investing in longer-term assets which may be more complex to value.

5.19 We are considering whether growth in the market for external valuation services would be facilitated by removing the legal liability of the external valuer and removing this concept from legislation. In this scenario, the external valuer would have contractual liability to the AIFM, and the AIFM would still have legal liability to the fund and its investors; the final responsibility would rest with the AIFM.

DRAFT RESPONSE: START

We have campaigned for several years requesting that the liability for external valuers be reviewed, and (in the context of regulatory reform) have proposed additional safeguards. Hence, we very much welcome ConDoc Question 15.

It is unfair that external valuers (appointed to UK alternative investment funds) face unlimited liability under legislation. Valuation professional bodies require valuers to hold approved Professional Liability Insurance for the work they undertake. Such insurance cannot be obtained with unlimited liability, so the current AIFM regulations effectively prevent firms that are members of and regulated by professional bodies from accepting appointments as external valuers.

No wonder that in its multi-firm review² of valuation processes for private market assets (published: 5th March 2025), the FCA found that it was rare for fund managers to use external valuers. The increased use of external valuers would likely assist AIFMs in addressing the risks and conflicts identified in this review.

This means that AIF investors lose out, as they are unable to benefit from valuations that are transparently external and independent from the AIFM. The reform will better allow for AIF investors to benefit from independent determinations of asset value by external valuers, with the current Regulation 24(5) [The Alternative Investment Fund Managers Regulations 2013] ("Regulation

¹ https://assets.publishing.service.gov.uk/media/67ef9c8798b3bac1ec299cf9/AIFMR_Consultation.pdf

² <https://www.fca.org.uk/publications/multi-firm-reviews/private-market-valuation-practices#If-chapter-id-detailed-findings-policies-procedures-and-documentation>

24(5)”) meaning AIF investors are placing reliance upon an AIFM’s internal valuation methodologies, which runs counter to principles of investor protection and good corporate governance.

We share the view that growth in the market for external valuation services would indeed be facilitated by removing the legal liability of the external valuer.

We agree with the feedback in ConDoc paragraph 5.18 *“that this liability makes valuers cautious about taking on business and makes it challenging for them to obtain professional indemnity insurance. This particularly impacts funds investing in longer-term assets which may be more complex to value”*. Such funds include funds that hold underlying real estate.

In the context of Regulation 24(5) being reformed (as we propose), there are also advantages for all UK alternative investment funds (holding investment property in the UK):

- being then aligned with the valuation benchmarks with the financial reporting requirements: both IFRS and UK GAAP implicitly encourage entities to use an independent valuer (by requiring entities to disclose if an independent, suitably qualified valuer were not used).
- it would also simplify the valuation process for UK AIFMs, as they could use the same valuations for compliance with both Accounting Standards and the UK AIFMR.

Context

Regulation 24(5) overrides any contractual limit on liability agreed between the AIFM and the valuer. This simply does not work in practice.

At present few, if any, professional valuers can or will accept appointment as external valuers by an AIFM because of the unlimited liability imposed by Regulation 24(5). Most reputable valuers in the UK are members of professional bodies that require them to have professional indemnity insurance. Moreover, some insurers will also have policy conditions that require all instructions to contain liability caps.

Proposal

We propose an amendment to Regulation 24(5) along the following lines (with in red font amended wording):

24. Valuation

(1) An external valuer must carry out the valuation function described in [section 3.9 of the Investment Funds sourcebook] impartially, and with all due skill, care and diligence.

(2) An external valuer may not delegate such valuation function to a third party.

(3) If the FCA considers the appointment of an external valuer does not comply with the implementing provisions, the FCA may require that another external valuer be appointed instead.

(4) Any liability of a full-scope UK AIFM to an AIF managed by it, or to an investor of such an AIF, arising out of the AIFM's responsibility for the proper valuation of AIF assets, the calculation of the net asset value of the AIF and the publication of that net asset value, is not affected by the appointment by the AIFM of an external valuer in respect of that AIF.

(5) (a) Where the AIFM of an AIF and the external valuer agree to limit liability of the external valuer for losses suffered by the AIFM as a result of the external valuer's negligence in performing its tasks (provided the limit of liability agreed is reasonable and proportionate to value of the AIF assets), the external valuer shall only be liable to that limit; and

(b) Subject to Regulation 24(5)(a) and irrespective of any other contractual arrangements³, an external valuer is liable to the AIFM of an AIF in respect of which the external valuer is appointed for any losses suffered by the AIFM as a result of the external valuer's negligence or intentional failure to perform its tasks.

We are aware of industry stakeholders conferring extensively with contacts at valuation firms, UK fund managers, pension funds and other institutional indirect investors and industry associations, and understand from stakeholders there is widespread consensus:

- 1) that the proposed amendment is a workable solution; and
- 2) in support of the proposed amendment.

This proposal is consistent with the analysis expressed in ConDoc paragraph 5.19 (which we endorse) that: *"the external valuer would have contractual liability to the AIFM, and the AIFM would still have legal liability to the fund and its investors; the final responsibility would rest with the AIFM."*

Explanation of proposal

From a drafting perspective, we are proposing amendments that:

- utilise existing The Alternative Investment Fund Managers Regulations 2013 Regulation 24 words and concepts; and
- are minimal in nature, so the overall Regulation 24(5) policy intent is preserved.

We hope that our proposed Regulation 24(5) amendment is self-explanatory. However, we also make the following comments:

- (i) The Alternative Investment Fund Managers Regulations 2013 Regulation 24 deals with the valuation process. The Alternative Investment Fund Managers Regulations 2013 Regulation 24(4) refers to *"the AIFM's responsibility for the proper valuation of AIF assets, the calculation of the net asset value of the AIF and the publication of that net asset value"*. The proposed Regulation 24(5) amendment does not affect this AIFM responsibility.
- (ii) Under the proposed amendment:
 - If the AIFM were to:
 - appoint an external valuer; and
 - agree to limit the external valuer's liability for losses suffered by the AIFM as a result of the external valuer's negligence in performing its tasksthen the external valuer would only be liable to that limit.
 - Regulation 24(5)(b) would still provide a safeguard default option to AIFMs and external valuers who wished to use it, and this default provision would be essentially unchanged. Under the proposed amendment, however, AIFMs and external valuers

³ Delete *"that provide otherwise"*

would have greater flexibility than is permitted under the current legislative approach.

- (iii) Industry stakeholders have suggested that - in relation to the proposed words “(provided that the limit of liability agreed is reasonable and proportionate to value of the AIF assets)” – it would be helpful if the Financial Conduct Authority were to consult and (in light of consultation) issue guidance on how these words may apply in practice.

[EU Dimension]

UK real estate funds managers can and do operate funds that service institutional and other investors from the UK and internationally, including those based in the EU. We are keen that - in respect of Regulation 24(5) and the equivalent EU AIFMD Article 19(10) - there will be alignment. The alignment may reduce barriers to capital flows from EU investors into the UK (and vice versa).

Unfortunately, the EU AIFMD II reforms⁴ do not extend to EU AIFMD Article 19(10). However, in its response to the preceding review of the directive, the European Securities and Markets Authority (“ESMA”) did recognise⁵ that there was a problem with external valuer liability. We hope a satisfactory resolution in UK legislation may well influence future discussion in the EU potentially leading to helpful guidance from ESMA or the European Commission.

We hope that reform of Regulation 24(5) may in time prompt an equivalent reform in the EU AIFMD Article 19(10), although we recognise this will take more time.]

DRAFT RESPONSE: END

Disclaimer: views expressed in this document are on a non-liability basis.

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⁴ https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L_202400927

⁵ <https://www.esma.europa.eu/press-news/esma-news/esma-recommends-priority-topics-in-aifmd-review>