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Shops Move to Automate Valuation, but Risks Abound: Survey

By Beagan Wilcox Volz October 11, 2018

Automation is playing a growing role in shops' daily valuation of fund securities.

Twenty-eight percent of asset managers that participated in a recent Deloitte survey said they had incorporated robotics into valuation functions.

"[T]hey're adopting new technologies across the entire complex," says Paul Kraft, head of Deloitte's U.S. mutual fund and investment advisor practice. "The fact that it would ultimately work its way into the valuation process makes sense."

More broadly, 26% of the asset managers said that they had conducted a study in the past 12 months to identify ways to make their valuation processes more efficient, according to Deloitte's 16th annual fair valuation pricing survey.

Deloitte surveyed personnel involved in the valuation process at 93 asset managers of all sizes in July and August. It was the first year the firm asked participants whether they use robotics in valuation.

What Is "Striking the NAV?'

One area of valuation where automation is taking hold is with identifying price exceptions, says Rajan Chari, a partner at Deloitte. This refers to fluctuations in a security's price that may require the advisor to examine whether the price is accurate.

Fund firms have typically used static benchmarks to review the variation over time in a security's price. With automation, firms can use more variables that are "smarter or more flexible" for identifying price movements, Chari says.

However, firms are not automating the evaluation of price exceptions, Deloitte notes.

Indeed, automation allows firms to free up personnel for more complex tasks such as evaluating price exceptions, says Rob Haddad, head of product strategy and innovation at **ICE Data Services**.

Firms are also using automation in the backtesting of securities for which they have assessed fair values, Deloitte found.

But some see a potential downside to greater automation, the survey suggests.

Nearly a quarter of those surveyed said that the technology was not tested frequently enough. Meanwhile, 28% identified the loss of valuation expertise as a concern. And 64% said they believe dependence on third parties was a risk.

Another potential risk with fund shops' increased automation more generally stems from the disconnect between information technology personnel and compliance staff, says Todd Cipperman, founding principal of Cipperman Compliance Services.

Compliance professionals should test whatever automated processes are put in place, he says.

"It's a big problem," he adds. "There are no two groups that are more disjointed than the compliance group and the IT group."

The survey also found that chief compliance officers are becoming more involved in changes to valuation programs. Fifty-five percent of the surveyed firms now give CCOs some responsibility for revising valuation policies and procedures, up from 38% last year.

About 60% of firms changed or revised their valuation policies over the previous year, the survey found. Common changes were adding vendors that supply pricing information and changing the composition of the pricing committee and its responsibilities.

Personnel involved in valuation also are giving greater consideration to the liquidity of fund holdings, the survey indicates. The issue has gained prominence in recent years, with the Securities and Exchange Commission's 2016 liquidity rule. Larger fund groups face a Dec. 1 deadline for complying with the rule's requirement that they establish liquidity risk management programs.

Thirty-four percent of those surveyed said they consider liquidity in the fair valuation determination of all portfolio holdings. Last year, 22% did so.

In addition, 39% reported that their traders evaluate the appropriateness of the valuation of illiquid investments — a significant increase over 17% in 2017.

However, firms typically have found it challenging to figure out how to share and use the newly generated liquidity data from different parts of the business for other purposes, says Deloitte's Chari. In fact, 69% of survey participants said liquidity data used by front-office personnel is not directly used in the valuation process.

Deloitte also highlighted that the SEC may issue new valuation guidance for fund directors, which the firm said would be a "big deal."

Boards spend a lot of time on valuation because it's a very broad area of oversight, says Chari. If the SEC narrows the scope of their oversight, he says, directors would be able to focus on the more important aspects of valuation.

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