Unlisted investment valuations in the spotlight

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Unlisted investment valuations are attracting greater media attention and regulatory scrutiny prompting asset owners to review their valuation policies.

Concerns have been building since the 2020 COVID-19 market downturn and the Australian government's early super release scheme – pressure that has continued in a rising interest rate environment, according to Paul Newfield, Director of Sector Research at Frontier Advisors.

"We, as a firm today, are getting more queries around governance of unlisted assets and valuations and having more engagement on this topic than probably any other… more than I've seen in 30 years of financial services. Funds also have more in unlisted private markets today than ever before and more managed internally than ever before" Newfield said during the annual conference.

APRA has tackled the issue by recently updating its Prudential Standard SPS 530 on Investment Governance, which places a new legal requirement on super fund trustees around valuation governance, while changes to its Prudential Practice Guide SPG 530 are expected to be finalised shortly.

"When it comes to actually valuing unlisted assets, it is quite quantitatively complex," Sarah Cornelius, Senior Consultant, Frontier Advisors, said. "And there is a lot in terms of interpretation around particular valuation drivers and different adjustment factors."

Accurate unlisted asset valuations are crucial to ensure member equity, particularly when members are entering or leaving a fund or switching investment options.

Cornelius said asset owners should review their valuation policy against the updated prudential standard, as well as external managers' valuation policies to identify any gaps and engage with them as needed.

UniSuper set to shift to quarterly unlisted asset valuations

APRA's draft Prudential Guidance SPG 530 has prompted funds such as UniSuper to shift to more frequent quarterly valuations from December 31 this year.

Unlisted assets account for more than 18% of UniSuper's circa $125 billion in funds under management. Those assets comprise approximately $13 billion in infrastructure circa $8 billion in property and about $2 billion in private equity.

Sandra Lee, Head of Private Markets, UniSuper, said the fund, notwithstanding this shift, has always had the ability to perform out-of-cycle valuation updates, when market conditions require them, such as the sharp pandemic-inspired downturn in March 2020.

"It wasn't just UniSuper, a couple of our peer funds conducted out of cycle valuations just to make sure we could accurately reflect the latest market conditions. So we don't use that ability that often, but we can do it," Lee said.

Brett Lazarides, Head of Investment Governance, Frontier Advisors, said the industry's shift to quarterly valuations didn't always require full revaluations given the onerous costs involved, noting too that costs ultimately impact members

"There are certain short form valuations that you can look at: major factors such as a roll forward, changes in interest rates, any material changes in cash flows in the operating business," he said "What is important to the regulator is that when those valuations, however derived, are received and processed in the fund, that they are reviewed at a senior level."

UniSuper has an unlisted assets valuation policy which outlines the role of independent valuers (who are rotated every five years), the frequency of valuations, methodology, and differences in approach between unlisted asset sectors.

“We are very big on ensuring that the financial models that we hand off to the independent valuers are not adjusted by my team,” Lee said. “This is to ensure that there's proper independence. What we also do to ensure the valuers can maintain their independence is provide the valuers direct access to the underlying management teams.”

Lee and UniSuper’s Head of Property are also directly accountable each year to UniSuper’s Audit, Risk and Compliance Committee.

“We will attend that meeting. We will have to present on the valuation outcomes for the year and in that particular meeting, you will have the external auditors present… they're now taking a very active role in our valuation reports.”

Not all unlisted asset classes are the same

Lazarides said asset owners needed a structured process to value assets in a consistent and accurate manner every time but the process would change depending on the asset class.

“Think about adjusting a private equity portfolio which may have 100 underlying companies invested, versus an infrastructure portfolio, which may have six big lumpy assets – the valuation methodology is different in both those asset classes. Secondly, the process for evaluating them requires different skills.”

A super fund holding unlisted assets through a third party manager generally has less control and transparency than a direct holding.

Lee said the regular use of independent valuers quarterly by private equity general partners remained “a bit patchy” but those managers in private equity were generally always tracking comparable transactions in the market.

“There's a fair bit of agency risk when you’re doing PE because you're a little bit more distant to your underlying investee companies compared to when we're running our direct infrastructure program – we know exactly what we're doing.”

Lazarides said for asset classes where valuations are driven by transactions, such as property, created more governance issues compared to those using a discounted cash flow model. Property owners for example were less likely to sell in a down market, impacting the ability of the sector, through its 3rd party valuers, to adjust valuations.

Lee said a key question the fund asked its independent valuers was whether their valuations were market-based, which included recent market transactions as well as comparable listed assets.

“We’re always challenging our valuers to consider if you were to put this asset on the market tomorrow do you think your recommended valuation would hold?”