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Risk #6: Valuation Under Pressure: Market Stress and the Enforcement Lens

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Markets have recently been experiencing heightened volatility and credit availability has tightened, which has placed valuation practices under unusual pressure from regulators and investors. The events of the past several years, including rising interest rates, geopolitical turmoil and the impacts of artificial intelligence tools, among other issues, have amplified the inherent challenges of valuing illiquid assets and sparked greater regulatory scrutiny. This is particularly true when marks affect fees paid by investors, or the prices at which they invest in or redeem from a fund.

Valuation Volatility Meets Valuation Reality

Economic stress and uncertainty expose valuation judgment calls. When observable inputs are limited or unavailable, marks can also affect M&A disputes, LP disagreements or post-closing earnouts. The disputes and investigations we see most often turn on whether a firm followed its own policies, applied methods consistently across vehicles, considered all relevant data and contemporaneously documented rationales for material changes.

Key takeaways for asset managers:

1. **Valuation policies and procedures matter.** This is particularly true where valuations directly impact investor reporting and calculation of fees. Regulators look first to whether written policies are reasonably designed for the assets being valued and whether, in practice, those policies were actually followed.
2. **Transparent communications reduce risk.** Clear disclosures about methodologies, inputs and limits can reduce the likelihood of disputes and provide evidentiary support when valuations change. The SEC often focuses on mismatches between stated valuation rigor and actual practice.
3. **Flexibility in methodology should be documented.** Methodology consistency matters, particularly across related vehicles. When a different methodology is needed, clearly documenting why it was chosen (*e.g.*, because shifting market

conditions require a new methodology in order to ensure valuations reflect current documented realities) is essential.

Retail Access and Regulatory Shifts

As private market products reach retail investors, scrutiny of valuations has become an important means by which the SEC may exercise its investor protection mission. New products blur the line between private and public vehicles, requiring the SEC to quickly build familiarity with new or unusual structures. The Division of Examinations is reportedly running a sweep focused on interval funds, examining liquidity management, valuation practices, disclosures and board oversight. Meanwhile, the Division of Investment Management is informally engaging with market participants to understand how these new retail products function. For now, the approach appears to be primarily collaborative in nature rather than enforcement-driven, but increased retail exposure will keep valuations a regulatory priority.

Regulatory focus on valuation is not limited to the U.S. In 2025, the U.K. Financial Conduct Authority (FCA) published a review of private market valuation practices that identified meaningful areas for improvement—particularly around consistency, transparency and governance. The FCA's observations include a spectrum of challenges similar to those highlighted in the U.S. context: difficulties in valuing illiquid or rarely traded assets, the need for documented rationale when departing from observable market prices and the importance of robust oversight structures.

Valuation Frictions Across Private Funds and Registered Products

Valuation complexity can increase further where a private fund manager also manages a registered fund or business development company, both structures that have become increasingly common as managers seek permanent capital and retail access. Fund boards may reasonably arrive at valuation views that differ from those of a private fund's valuation committee, creating pressure points around consistency, disclosure and governance when marks affect NAV, fees, subscriptions or redemptions.

Asset managers should also be aware of potential attention paid to "NAV squeezing," a practice in which investment fund interests acquired on the secondary market (frequently at a discount to the valuation assigned to such interest by the third-party manager) are carried on the books of the acquiring fund at the valuation assigned by the third-party manager of such fund. This is permitted by GAAP ASC 820 and is frequently the best available option, since managers of acquiring funds generally are not in a position to question the marks assigned by a third-party manager. However, certain articles in the popular press have portrayed the practice as inappropriate, which could lead to regulatory scrutiny.

Potential for Regulatory Enforcement

Valuation risk was the focus of recent public remarks by U.S. Attorney for the Southern District of New York and former SEC Chair Jay Clayton. Clayton flagged "marks on assets with no trading" and transfers "from Fund A to Fund B" where managers can "name a price internally." In such situations, Clayton warned, the chance to "pick a price that benefits the house over investors is pretty high," and because of that potential, "financial regulators and the department are looking at those." Furthermore, while the SEC under Chair Paul Atkins has generally recalibrated toward traditional securities fraud cases, valuation and fee issues typically involve demonstrable investor harm, and as such remain squarely on the enforcement radar, especially when the interests of retail investors are implicated.

Indeed, although some expected a sharper retreat from enforcement, the SEC continues to focus on areas with tangible investor impact, including inaccurate valuations and resultant fee calculations. Recent enforcement actions confirm that the SEC will continue to focus on improperly calculated management, performance, or other fees, particularly when inaccuracies stem from valuation practices.

Conclusion

For asset managers, sponsors and advisers navigating today's landscape, the interplay between market stress, valuation transparency and regulatory expectations demands proactive attention and a thoughtful, well-documented approach. Key steps firms should consider include the following:

1. **Revisit valuation policies** to ensure they reflect current market conditions and align with stated procedures and investor disclosures.
2. **Strengthen governance and documentation** of key valuation judgments, especially for illiquid or hard-to-observe assets.
3. **Monitoring retail access developments** will help firms anticipate enhanced disclosures or requirements tied to broader investor participation.
4. **Staying attuned to SEC examination trends**, particularly as enforcement balances traditional investor protection with newer regulatory approaches.

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