Mutual fund boards are becoming more demanding of information about advisers' fair value pricing policies and procedures and more involved in the process generally, according to Interactive Data. Innovations such as new benchmarking tools and an increase in the practice of validating prices and using multiple sources for prices are boosting the ability of advisers and fund directors to fairly value their portfolios, the firm found during a day-long workshop that included audience polling.

"Fund boards know the importance of valuation oversight and are becoming increasingly active," Interactive Data said in its survey summary. The majority of the participants at the workshop said the board has become "increasingly active during the past year in asking our department for information about the processes and practices." The biggest challenge the clients face in helping the board understand the valuation processes is "producing reports that validate our processes and demonstrate appropriate controls are in place."

Directors themselves said the most useful reports they receive from advisers and third-party pricing vendors showed:

-- The percentage of fund assets derived from a single source;

-- Comparisons between reported prices and realized sale prices for securities sold by a fund;

-- The number of price challenges;

-- The number of unchanged prices.

In discussing fair value-adjusted benchmarks, participants said the tools can help advisers explain artificial tracking errors that can consume a portion of a fund's risk budget. Artificial tracking error occurs when a fund uses fair value-adjusted prices to calculate its daily net asset value but benchmarks against an index calculated using local market closing prices. "The participants welcomed the advent of fair value-adjusted benchmarks but cautioned that such indexes will not eliminate artificial tracking error for funds that employ triggers and confidence levels," Interactive Data said. "It's moving in the right direction, [and] it will help firms with board reporting."

Participants also discussed due diligence visits, price challenges and other issues related to the use of third-party pricing vendors. Funds are reexamining their valuation practices and sharing proprietary market information-including their own trades and market color they get from dealers with their pricing vendors, Interactive Data found. "Funds' due diligence activities with price vendors have increased in frequency and depth, and responsibility for initiating price challenges has shifted from fund administrators to end users over the past two to three years." As a result, the number of price challenges submitted through administrators has fallen by more than half.