CARLTON FIELDS

SEC Curious About Mutual Fund Unicorns

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The Securities and Exchange Commission (SEC) staff has reportedly been asking mutual funds how they value their investments in “unicorns” – i.e., dynamic pre-IPO companies with market capitalization exceeding $1 billion, and shares that are not publicly traded. (Once market cap goes above $10 billion, the term “decacorns” is also used.) Liquidity and other considerations can limit the amount of a unicorn’s shares in which any one mutual fund can invest. Nevertheless, unicorn share prices can be volatile and can have a significant impact on a fund’s performance, particularly relative to its “benchmark” index (which generally would not include unicorn shares). Recently, the performance of unicorn shares, and their popularity among mutual funds, has varied with circumstances. Some analysts, however, have observed that the share prices of unicorns in which mutual funds invest have at times seemed to increase significantly faster than shares of unicorns that receive financing from other sources. This might reflect, among other things, superior investment acumen on the part of the mutual funds, or the increased “demand” that mutual funds create for the shares of those unicorns they find attractive. Also, for several reasons, a mutual fund’s valuation of its investment in unicorn shares generally requires the exercise of considerable judgment, particularly to the extent that such shares do not have active secondary markets. Accordingly, the SEC staff may be seeking to satisfy themselves that mutual funds are ascribing appropriate values to their unicorn investments and are not seeking to make such investments’ performance appear more favorable by inflating those values. Given the SEC staff’s apparent interest, now is an opportune time for mutual fund advisers, boards, and valuation committees to carefully review the pricing methodology and practices for the funds’ unicorn-type investments, if they have not recently done so.

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