

IVSC Standards Board  
1 King Street  
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**By email to: [commentletters@ivsc.org](mailto:commentletters@ivsc.org)**

12 July 2016

Dear Sirs

**Response to Exposure Draft**

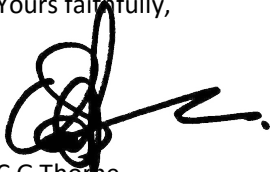
**IVS 2017: IVS 500 Financial Instruments**

Please find attached our comments on the above exposure draft.

The directors of Valuology have considerable experience of valuation standard setting generally and knowledge of the existing IVSs and their evolution.

If you would like any additional information in relation to our responses or comments, please do not hesitate to contact us

Yours faithfully,



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## Comments on Exposure Draft of IVS 2017

### IVS 500 Financial Instruments

#### Answers to Questions in ED

- (a) In IVS 2013, all substantive portions of IVS 500 (sic)<sup>1</sup> *Financial Instruments* were labelled as “commentary” (except for scope and effective date). This label seems to have created some confusion amongst stakeholders as to whether the standard was mandatory. The Board’s position is that all aspects of IVS 2017 should be mandatory and this Exposure Draft has removed the “commentary” label for clarity. Do you agree with the removal of the commentary label?

We agree with changing the “Commentary” title. This was proposed in the 2015 ED<sup>2</sup> in response to earlier consultations. We do NOT agree that all aspects of the standards should be, or are capable of being, mandatory. We do not therefore agree with a format that makes no distinction between the mandatory Requirements and the supporting guidance. For further detail see our general comments below.

- (b) The Board believes that the standard presented in this Exposure Draft can be applied in the valuation of financial instruments regardless of the purpose of the valuation (acquisitions, mergers and sales of businesses or parts of businesses, financial reporting, regulatory requirements, internal risk and compliance procedures and regulatory requirements). Do you agree? If not, for what purpose(s) do you believe this standard cannot be applied? Why?

We agree. However there some specific requirements when valuing for certain purposes that valuers need to be aware of. Valuations for compliance with regulatory capital requirements are a particularly important activity given that financial instruments are the major component of the assets of major financial institutions. However, these requirements can differ quite significantly from those for, say, financial reporting.

- (c) Are there any further topics that you feel the Board should add or remove from IVS 500 *Financial Instruments*? If so, what are they and what is your rationale?

Yes. A major omission is any reference to the Application Guidance on CVA and DVA which was the subject of an extensive project between 2012 and 2014. The Board approved this paper at its meeting in October 2014 and it was duly published on the website in January 2015.<sup>3</sup> In the 2015 ED it was indicated that this guidance would be annexed to the new IVS 250.

This guidance was developed with input from many of senior valuation experts in the City of London and New York working for major financial institutions, auditing firms and specialist consultancies. It reflects the consensus reached on the matters that need to be considered when making these adjustments and how they can be made. While most major banks are required to have specialist CVA operations by their regulators, the matter is still problematic for any corporate entity that holds derivative instruments for currency or interest rate hedging, as under IFRS 13 adjustments to fair value need to be made to reflect changes in the entity’s own credit status.

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<sup>1</sup> The current Financial Instruments standard is IVS 250.

<sup>2</sup> Proposed Amendments to the International Valuation Standards issued 19 March 2015

<sup>3</sup> <https://www.ivsc.org/standards/international-valuation-standards/consultation/Credit+Debit+Valuation+Adjustments>



The IVSC's guidance is cited in the European Banking Authority's Technical Advice on the Treatment of Own Credit Risk Related to Derivative Liabilities.<sup>4</sup> It has also been favourably received by corporate treasurers and others outside of the banking sector who do not have the dedicated resources of the large financial institutions to make the necessary adjustments.

It is in the IVSC's interests to promote this guidance and recognise the input from major entities into this project. We strongly recommend that it be included in the new IVSs as proposed in the 2015 ED.

## General Comments

In 2014 the Board agreed to review the current IVS 250 and recommend improvements in the light of market developments since the first standard on this topic had been developed, and to better reflect some issues that had emerged during projects to develop guidance on specific issues. The proposed amendments were included as Appendix 2 of the 2015 ED.

We are pleased to note that these proposed amendments have largely been carried forward into the current draft. However, the way in which the current draft has reorganised the previously proposed standard detracts significantly from its clarity.

The current IVS 250 consists of two sections, Requirements and Commentary. As indicated above, while we support a change in the title of the Commentary, to "Application Guidance" or something similar, we do not support the position that everything in the standards can be deemed mandatory. Mandatory Requirements need to be clearly identified and distinguished from material that provides useful background information, explanatory narrative and discussion on how the Requirements may be met, not have to be met. The very nature of this supporting narrative means it is incapable of being made mandatory as there is no compulsion to take a specific action and there is no definitive way in which compliance can be measured. The existing commentaries in this and the other "Asset Standards" consist almost entirely of this type of material.

We note that in this draft, matters that do require specified actions to be taken under identified circumstances and which are accordingly identified as Requirements in the current standard have been interspersed with paragraphs that provide guidance. Examples include Requirement 2 in IVS 250 now appears as 20.4 and Requirement 6 appearing as 20.7.

If the distinction between the requirements and supporting guidance is not clearly made it will mean that the Board is ignoring not only the findings of the independent Critical Review Group that reported on the composition of the standards in 2008, which provided the basis for the comprehensive rewrite that culminated in the 2011 Standards, but also the vast majority of representations received on exposure drafts since that time. Making this distinction is also an essential pre-requisite to implementation of the 2014 Adopt or Comply MoU<sup>5</sup>.

Making the words in the 2015 ED fit a predetermined common template with fixed headings compromises the logical flow of the discussion and also introduces some meaningless distractions. The whole standard concerns "special considerations for financial instruments", so this is a particularly meaningless heading and categorisation. We other specific examples below. One change we highlight here concerns the guidance on the control environment. In the current

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<sup>4</sup> EBA/Op/2014/05

<sup>5</sup> Memorandum between IVSC and over twenty Valuation Professional Organisations – first signings 23 October 2014.



published standard in IVS 2013 it is the last topic discussed. Given the importance of this and the prominence it is given by financial regulators, the 2015 ED moved this towards the beginning of the standard as it is a matter that should be considered at the outset. Removing it to the end again risks portraying this as an afterthought.

### **Specific Comments**

- 10.1 This lacks the clarity of the standard in the 2015 ED, which refers to the Requirements in the General Standards. We also note that the second sentence confirms that it includes examples of how the General Standards apply, which further indicates that the supposed mandatory status is a chimera.
- 30 Bases of Value: This is obviously included simply to fit a predetermined template. It includes no necessary or helpful information and should be deleted.
- 40 Valuation Approaches: Although there is a discussion of valuation approaches in the 2015 ED version this follows discussion of liquidity and inputs, both of which need to be considered before decided on the most appropriate approach. Once again, following a predetermined list of headings has resulted in a less than logical presentation.
- 40.2 This is strangely worded. If compliance with IVS 105 is required, it is not necessary to say that this includes 10.3. Making this statement raises the question of whether the remainder of IVS 105 is of a lesser status. This is notwithstanding our submission on IVS 105 in which we pointed out that the whole standard was not only superfluous as the key requirements are already covered in the current IVS 101, 102 and 103, but that it was wholly inappropriate to make its contents mandatory.
- 40.3 This paragraph is saying the same as 40.1 using more words. We do not believe either is necessary but one or the other should certainly be removed.
- 50 Market Approach: We are pleased to see that this uses the wording from the 2015 ED. We point out that the first paragraph contains what is now the first reference in the standard to consensus pricing. This is explained in the section on inputs, underlining the point made above about the need for the standard to flow logically in the order at which matters need to be considered, rather than follow a list of arbitrary headings. Form should follow substance, not vice versa.