Inside Reference Data

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Pricing

Special Report

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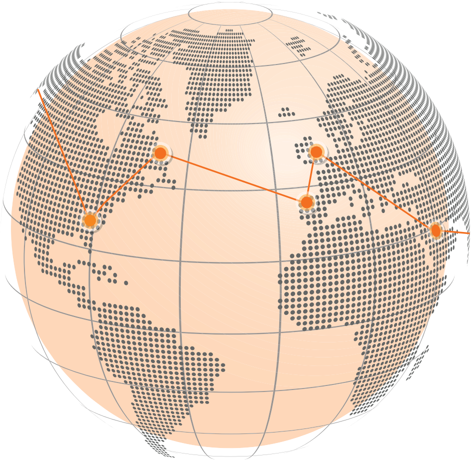


Editor's Letter

Pain Points

For the Virtual Roundtable in this special report on pricing, *Inside Reference Data* asked experts what they see as the biggest pain point for pricing and valuation, particularly when trying to be transparent about sourcing.

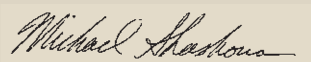
Their answers covered several aspects, including accessing information, assessing liquidity and independence of valuations. AIM Software's Michael Walford-Grant points to the spread of information across multiple business units or applications as a big reason for difficulty of access and difficulty with getting responses to requests for transparency. Ensuing aggregation of pricing and valuation data can complicate retrieval because data collected from different systems and sources has to be reconciled and made compatible.

Thomson Reuters' Jayme Fagas points to assessing liquidity as the biggest pain point. It requires a lot of moving parts, including overall reference data, pricing assumptions and derived analytics. Particularly with fixed-income securities, priced in aggregate using reference data and performance data attributes, getting transparency for assessing liquidity is a tall order.

On the end-user side, Wells Fargo's Daniel Johnson sees difficulty achieving transparency and making efficient processes for finalizing pricing at the same time. Also, in contending with the AIFMD regulatory mandate for independent valuations, getting such valuations without the influence of fund managers is difficult, Johnson says.

Transparency and independence in pricing and valuations might very well be at odds with each other. Chasing them both might be like chasing one's own tail.

Yours sincerely,



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News Review

Markit Expands European Pricing Data Service

Data services provider Markit has expanded its pricing data for European asset-backed securities (ABS) to cover more than 9,000 European residential mortgage-backed securities, commercial mortgage-backed securities, consumer ABS and collateralized loan obligation securities, according to company officials.

Markit previously offered pricing data for around 4,000 of these asset-backed securities, says Philippe Pagnotta, director, bond pricing and structured finance, Europe.

New rules and regulations governing asset-backed securities also spurred Markit to increase its coverage, he adds.

The expansion makes the provider's offerings nearly complete in terms of coverage of all European asset-backed securities, according to Mike Mahoney, vice president of bond pricing and structured finance, North America, at Markit.

The plans to further extend its pricing data to include securities issued in eastern European countries, he adds.

Michael Shashoua

Interactive Data Responds to Asia Demand

Pricing and data services provider Interactive Data rolled out the fourth version of its web-based, Vantage fixed-income price discovery and evaluated pricing application to clients in the Asia-Pacific region, after adding content during 2013 in response to feedback on client requirements.

Interactive Data officials say the firm added global data in Version 2 of the platform, responding in part to firms in Asia wanting access to assets from outside the region, ranging from sovereign and corporate bonds to single-name and sovereign credit default swaps.

Magnus Cattan, business development director for Asia at Interactive Data in Hong Kong, says the rendition of Vantage being rolled out in Asia is Version 4, which is completely different from the first one rolled out in the region at the start of 2013, a full year after its initial introduction in North America.

In September, Interactive Data upgraded the transparency and workflow functionality of Vantage, which, it says, will help firms to cut costs by making the price-review process more efficient.

Max Bowie and Nicholas Hamilton

S&P Capital IQ Expands Govt, Corp Bond Data

Pricing and data vendor S&P Capital IQ has expanded the content displayed beside evaluated prices on its valuation platform, by including government bond quotes from Tullett Prebon Information and pre-trade pricing on more than 30,000 bonds.

As part of a data-distribution agreement with Tullett, S&P Capital IQ has added 2,000 unique daily government bond quotes in 37 currencies to its Valuation and Data Portal. It has also added pre-trade pricing on more than 30,000 corporate and emerging market bonds from its own S&P Capital IQ Quote product.

S&P Capital IQ and other units of its parent company, McGraw Hill Financial, will be able to distribute Tullett data via desktops, mobile apps, application programming interfaces and data feeds.

The data sets involved include interest rate swaps, municipal swaps, cross-currency swaps, forward rate agreements, government bond data, government benchmark bills, mortgage-backed securities and spot foreign exchange.

The additional data has been added to the platform to make S&P Capital IQ's evaluated prices more transparent and to help companies comply with legislation such as the Dodd-Frank Act and Mifid II.

Nicholas Hamilton

SIX Data Supports Hessegim Bond Analytics

Fixed-income software provider Hessegim is using real-time, fixed-income and reference data from SIX Financial Information for its new bond analytics tool, Prafis.

Hessegim uses SIX's Valordata Feed (VDF) to supply the hierarchical reference data for its fixed-income analysis, and combining it with apiD, SIX's web-based application program interface, to integrate the data into Prafis.

Evaluated Pricing Head Blance Leaves SIX

Ian Blance, who headed business development for SIX's evaluated pricing service for almost four years, has resumed work as an independent consultant. In a statement, SIX says: "Blance's departure was driven by new opportunities."

Switzerland-based Blance is specializing in valuation and pricing issues, and associated com-pliance risks and reporting requirements. Before joining SIX, he worked as a consultant for two years and at Interactive Data for 12.

Mirko Silvestri, SIX's Zurich-based head of product management for market data, will lead the evaluated pricing service.

Virtual Roundtable

Pricing: Changes and Challenges

Inside Reference Data gathers together leading data management professionals to discuss the latest movements in the pricing and valuations sector

What's the greatest pain point in the pricing and valuation process when it comes to meeting demands for transparency?

Michael Walford-Grant, country manager, UK/Ireland, AIM Software: One of the most frequent pain points mentioned by our clients is the difficulty of access to readily available information, which makes every request for transparency very time consuming. The information is not in one place, and is often spread across different business units, applications or countries, depending on how the financial institution is organized.

Once the data is acquired, it then needs to be aggregated. Sometimes, the required information is not in a readable format—for example, an audit log —so this adds further overhead. The demands are increasingly more granular in terms of the level of detail, which is a further challenge, especially if the data is held on older technology systems. The situation may be exacerbated if the processing rules are spreadsheet-based, because they are particularly poor when it comes to traceability and transparency.

Jayme Fagas, global head of valuations and transparency services,

Thomson Reuters: Assessing liquidity continues to be the greatest pain point for all market participants with financial reporting obligations. Aside from reference data, pricing assumptions, and derived analytics, determining the depth of the market, especially for hard-to-value, less liquid securities, continues to be a challenge.

Equally challenging is creating the necessary transparency for fixed-income securities, which are priced in aggregate based on reference data and performance data attributes. The task of displaying transparent market information is easy for direct quotes and secondary trades. But when comparable relationships are established, the transparency for market inputs becomes more complicated.

Daniel Johnson, vice president, valuation, Wells Fargo Global Fund Services: From the perspective of an administrator, we face two main challenges. On the data management side, we want to provide our clients with enough transparency to understand their pricing, while creating an efficient process that helps them finalize their pricing in a timely manner.

On the data side, we continue to encourage clients to move towards data-rich vendor pricing and away from more opaque broker quotes.

Advanced Information Management

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Are changes to validation processes or pricing methods with an eye toward providing more transparency possible? What sort of changes can or should be made?

Walford-Grant: Yes, it is possible. Our clients have no other choice than to invest in systems that provide the required levels of transparency, as this is a requirement of the regulators, their clients, and the fundamental need to

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>
> *Michael Walford-Grant, AIM Software*

operate in a marketplace that is highly competitive.

Because of the above requirements, AIM has been selected on a number of occasions to provide our solution operating as a pricing hub. Our clients have moved the pricing activities out of the core system, such as an accounting system, and into GAIN to get the required level of transparency and flexibility. The pricing hub becomes the central point of control, processing all asset classes, and centrally sourcing the required data to underpin the pricing policies from data vendors, pricing vendors and internal valuation teams. It is the starting point for transparency for all fund types.

The requirements of the pricing hub in terms of control, versioning and audit apply not only to the valuations, but also the pricing policies. This enables firms to be quicker explaining the pricing methods applied at a given point in time.

Fagas: Yes; one of the key components of enhancing transparency lies in the dissemination of secondary market trades in the fixed-income space. As we have seen with Finra's TRACE for various asset classes and the MSRB reporting of secondary market trades for US municipals, having a robust secondary market repository serves the over-the-counter fixed-income market well. It will be interesting to see how soon other fixed-income jurisdictions can develop similar secondary market trade reporting.

Johnson: This remains a challenge, as our clients often have different expectations around validation depending on the instruments and markets involved. We provide all necessary documentation around pricing methods and sources and have arranged calls between clients and vendors to make sure we are all on the same page when dealing with more exotic or illiquid prod-

"One of the key components of enhancing transparency lies in the dissemination of secondary market trades in the fixed-income space"

Jayme Fagas, Thomson Reuters

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Daniel Johnson, Wells Fargo Global Fund Services

ucts. We also provide some investors with pricing transparency reports so they are comfortable.

Is the AIFMD directive's mandate of independent valuations consistent? What challenges does it create?

Walford-Grant: For an alternative investment fund manager, the challenges are data acquisition and consolidation, and setting up the valuation function in house. Because a "price vendor" is not considered "independent," the majority of alternative investment fund managers will need to manage the valuation function themselves, typically using fund administrators to collect prices from pricing providers, but combining this with other sources and valuation models.

An alternative investment fund manager has the option to choose to use one or more external valuers to perform the valuation function, thereby leading to data integration challenges to gather the valuations from the various sources.

From the service provider point of view, securities services firms that have both custodian and fund administration arms will need to ensure the valuation function is "functionally and hierarchically separate," which can be complex and costly.

Fagas: The challenge in applying the AIFMD directive for independent valuations lies in the determination of an "External Valuer" as defined by the directive. The implied liability assumed in the registration process of an "External Valuer" also further complicates independent valuations for alternative investment managers.

The heightened scrutiny of independent valuations for hedge funds and private equity funds is understandable given the nature of the higher risk and often levered strategies employed to maximize returns.

Johnson: The AIFMD mandate on independent valuation of securities is not

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> *Daniel Johnson, Wells Fargo Global Fund Services*

without merit. Unfortunately, obtaining valuations that are fully independent of the fund manager is not always easy. The challenge is finding an independent capable of valuing all investments from exchange-traded products to Level 3 exotics with little or no observable market data and willing to take on the unlimited liabilities associated with the role.

"For firms of all sizes, valuation techniques and assumptions used in making fair-value estimates will need to be reviewed under IFRS 13 and ASC 820"

Michael Walford-Grant, AIM Software

What types or sizes of firms will be most affected by IFRS 13 and ASC 820, and how will they be affected?

Walford-Grant: For firms of all sizes, valuation techniques and assumptions used in making fair-value estimates will need to be reviewed under IFRS 13 and ASC 820. For non-financial assets in particular, entities may find that they need to refine their valuation methods. Even entities largely unaffected by the valuation guidance are likely to be affected by IFRS 13's extensive disclosure demands.

This will create a need to be equipped with tools, and referential data systems, to centralize the execution, collection and disclosure of market-based and model-based valuations from the various sources, both internal and external. This is where purpose-built business applications for pricing, such as GAIN, are relevant for our clients, because they extend existing system infrastructure with the required flexibility and transparency, reducing compliance costs to both these regulations and ones in the future.

Fagas: Virtually all financial market participants are impacted by IFRS 13 and ASC 820. But those most obviously affected are regulated entities such as banks, insurance companies, mutual funds, etc., where the assessment of inherent portfolio risks are assessed through the fair-value determination and related disclosures.

Analysts continue to assess Level 3 activity as an indicator of portfolio liquidity and fair-value measurement of liabilities are often scrutinized in reviewing impact on quarterly earnings. Regulators, including the US Securities and Exchange Commission, continue to evaluate the adequacy of fair-value disclosures for reporting entities.

Johnson: ASC 820 and its predecessor, FAS 157, have been in place for a few

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> *Jayme Fagas, Thomson Reuters*

years, so this is nothing new for a global administrator. For the funds covered by IFRS, this will involve some additional work in preparing financial statements based on valuation methods and will require closer monitoring of investment pricing methods on a regular basis.

How are service providers meeting the changes for pricing and valuations being driven by new standards and the demand for transparency?

Walford-Grant: As discussed above, the pressure for compliant practices and more transparency has led a great deal of our clients to consider moving the pricing process out of their existing accounting systems and into the GAIN Pricing Hub. The processing requirements in terms of transparency, speed of processing, automation, audit, control, the rate of change and the move away from IT to business operations, have all contributed to this. The original design of most accounting systems did not consider these factors to the extent they are required now.

One of our clients, a fund administrator, is actually exploiting the situation to their advantage. They built their business case for investment in two ways. One element was the ability to offer their clients their own bespoke pricing policies at competitive rates, so this was a business enabler with a strong competitive advantage. In addition, because outsourcing is "in their DNA," there is a medium-term plan to leverage the core platform, and offer similar pricing services to the wider financial community.

Fagas: Non-compliance presents huge reputational, and potentially financial, risks for organizations. With the cost and complexity of regulation escalating, it is ever more important that market participants develop relationships with trusted data partners to help

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them navigate this evolving landscape. New standards have brought increased demand on data providers around the scope of pricing, transparency, customer service, responsiveness, reference data coverage and global reach.

Users want an extensive and scalable listed markets and evaluated pricing service that can accurately price the full spectrum of assets. Transparency entails meeting accounting disclosure requirements, and other regulatory mandates require a transparent process and workflow for collecting and reporting data, particularly valuations, in a consistent and auditable manner. This includes disclosure of the methodologies used, and an ability to drill down into the inputs to understand how a securities valuation was calculated.

Customer service requires easy access to market experts who can explain how an instrument has been priced, to ensure customer confidence in the prices they use. Responsiveness means providing clients with a rapid turnaround time to their pricing requests, and depends on having a combination of the right people, tools and market data.

Understanding the attributes and associated risk profile of a firm's securities holdings is a vital part of regulatory-mandated calculations. Given the fragmentation of global markets, and proliferation of instruments and identification codes, a data provider's capabilities need to include support of all reference data standards, including new identifiers (e.g. LEIs and CICIs) and classifications. Lastly, for global reach, evaluations and reference data support depend on in-depth jurisdictional knowledge of local financial markets. Partnering with a data provider that has a global on-the-ground presence and a wealth of local market expertise is crucial in ensuring user firms can meet regulators' and trading counterparties' demands.

"The pressure for compliant practices and more transparency has led a great deal of our clients to consider moving the pricing process out of their existing accounting systems and into the GAIN Pricing Hub"

Michael Walford-Grant, AIM Software

Johnson: We work closely with clients to keep them up to date on new regulations, such as AIFMD, as well as changes to market best practice, such as the 2013 AIMA guide to sound valuation practices. We also monitor actions by regulators, such as the SEC, and recently published an update on an SEC action relating to sufficient documentation to support management discretion on pricing.

Sponsored Statement

IFRS & AIFMD: Managing Fair Value Pricing & the Transparency Paradigm

IFRS, AIFMD—under these directives lie significant reshaping effects on the financial practices in accounting standards and fund management. From domestic-centric to multiple jurisdictions' operations, any financial institution will see its operating model impacted. The challenge is now to implement the transparency paradigm.

These key financial regulations increase transparency and disclosure of exposures. The AIFMD introduces an EU-wide framework for monitoring and supervising risks in the alternative funds management space. In the US, the Form PF rule calls on registered private fund advisers to furnish regulators with detailed activity reports. Enhancing transparency should help supervisors monitor better the build-up of risk, as report inaccuracies could mean significant reputational and financial damages.

Accurate, verifiable pricing data that adheres to fair-value disclosure provisions is crucial for reporting entities to achieve compliance.

The revised US and international accounting rules (Topic 820, IFRS 13) have redefined how to measure and disclose assets and liabilities value. Under IFRS 13, investment management organizations must use the standardized definition of fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date i.e. an exit price. Fund administration will be impacted with updates to systems and controls to ensure data is captured, processed and reported following the new standards.

For traditional asset managers investing in regulated markets where an exit price is readily available, meeting the fair value measurement requirement will be relatively simple. The process becomes more complex for entities such as hedge or private equity funds investing in complex, illiquid assets. Some instrument types such as interest rate swaps will benefit from well-established valuation models and numerous observable inputs. Certain structured products—OTC derivatives, unlisted papers—will depend primarily on unobservable inputs: investigation and judgment are involved in reaching a fair value measurement.

With the cost and complexity of regulation escalating, market participants must develop relationships with trusted pricing and reference data partners to help navigate this evolving landscape.

An extensive, scalable listed markets and evaluated pricing service to price the full range of securities holdings is vital for any firm to avoid relying on a medley of pricing services. Coverage must be geographically expansive to ensure prices are taken from the principal market as per IFRS 13 rules and provide frequent prices for hard-to-value assets. Knowledgeable staff and technological capacity are also key when valuing new and esoteric instruments.

Meeting accounting disclosures requires a transparent process for collecting and reporting data in a consistent, auditable manner to understand how a valuation was calculated.

Accounting standards demand more information transfer, hence more due diligence from data vendors to clients. For data providers, the onus is on delivering high-quality prices calculated in a rigorously controlled SAS 70-compliant environment, to mitigate operational risk within their infrastructure.

Understanding the attributes and risk profile of a firm's holdings is vital in regulatory-mandated calculations. Facing fragmented global markets and a proliferation of instruments and identification codes, a data provider's capabilities must include support of all reference data standards, new identifiers and classifications.

Evaluations and reference data support depend on in-depth jurisdictional knowledge of local financial markets. Partnering with a data provider with a global on-the-ground presence expertise is crucial in ensuring user firms can satisfy regulators' and trading counterparties' demands.

The cost and time implications of meeting the enhanced risk management and reporting obligations are significant. Yet by taking a strategic approach to high-quality, transparent data collection, processing, storage and reporting, industry participants will be well-positioned to comply with local and global regulations, keep up with on-going changes, at a lower total cost of ownership. With so much at stake, firms must partner with data providers that can offer the clearly defined processes, data richness and auditable price justification users need.

Jayme Fagas is global head of valuations and transparency services at Thomson Reuters (thomsonreuters.com)

Find more on fair value pricing and transparency obligations on *prdcommunity.com*.

Q&A

Trust, But Verify

Inside Reference Data asks David Weiss, senior analyst at Aite Group, about the demands for transparency in pricing


David Weiss, Aite Group

Does the push for transparency in pricing lose momentum when encountering multiple sources of prices?
Not necessarily, as there have always been multiple private sources; namely, the dealers. Multiple markets of non- and semi-continuous pricing, such as swap execution facilities, mitigate the transparency push to some degree, but this is greatly limited by the number of daily trades overall and on any single market.

Moreover, we're still in the early days of G-20 initiatives – even in the US, which has taken the lead with the Dodd Frank Act (while regulatory latency in the EU and Asia-Pacific ranges from one to three years) – so there is still a need for 'real world' valuation across trading decisions, risk management and portfolio accounting.

Is independent verification of pricing an effective means of raising transparency in pricing?
Independent verification may be the most effective means, short of mark-to-market, if independence can actually be established. However, it being effective is no guarantee of such a source being profitable or a going business.

Over the last year, there have already been casualties in this area, where pricing was valuable, but the firm just couldn't make a go of it.

What is the biggest challenge for pricing operations as a result of IFRS 13 regulation? How is that being addressed or met?
Fair valuation is currently being hampered by inadequate price reporting and aggregation of the new interest rate derivative markets. The data is there, but getting it all in a good quality source is difficult.

There are some traditional valuation vendors that are either considering or already expanding their interest rate derivative coverage to fill the gap while bolstering their incumbent offerings.

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