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Editor's Letter



The Next Big Thing

Last summer, news alerts were filled with stories about data vendors expanding their evaluated pricing services, claiming an increase in customer demand is driving rapid growth. At one point it seemed like too many firms were jumping into the same space, but the reality is the need for independent valuations is expected to continue to boom in coming years. For many vendors, independent valuation is the big thing in 2008.

And this is no coincidence. The demand for third-party services has increased due to regulatory focus on transparency, more investments across borders and more complex investments. In addition, the turbulent market conditions have given it an extra boost.

Recent credit events have highlighted that there is a significant need to track the valuation of an illiquid instrument in a similar fashion to exchange-traded securities. Investors are seeking to take more evaluated prices to reduce risk and the trend towards taking valuations from several parties is growing. Evaluated pricing has now emerged as an area everyone wants to grasp.

With this special report, which includes comments from industry experts and a news review, we hope to provide readers with an insight into the latest development in the independent valuation space.

Yours sincerely,

A handwritten signature in black ink that reads "Tine Thoresen". The signature is fluid and cursive.

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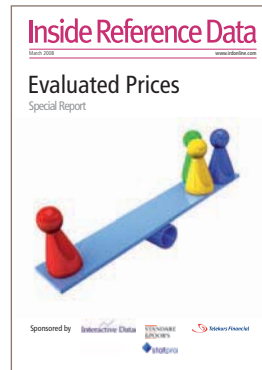
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IRD speaks to Denise Valentine, senior analyst, Aite Group about how the focus on evaluated pricing services has increased in recent years



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News Review

Puerto Rican First for Interactive Data

NEW YORK—Interactive Data's Pricing and Reference Data business has introduced daily evaluations for Puerto Rican Government National Mortgage Association serial notes, making it the first vendor to provide this service.

New York-based Elizabeth Duggan, vice-president at Interactive Data Pricing and Reference Data, says the decision was made due to increasing client demand.

"It allows clients to use a third-party unbiased evaluation provider, instead of relying on their own internal processes," says Duggan.

The new offering, available through the

existing evaluation services, allows clients looking for an independent valuation to receive this information automatically in existing pricing feeds without the need for new programming or interfacing. It removes manual intervention, enabling firms to free resources.

Duggan foresees a growing demand for this offering. "I believe more firms will seek out our service to help them evaluate these securities—especially in the light of the new accounting developments, such as the financial accounting standard, FAS 157."

The full version of this story appeared in *Inside Reference Data*, February 2008.

Moody's Buys BQuotes Amid Valuation Push

NEW YORK—In response to growing demand from user firms for transparent pricing information, ratings agencies are expanding their securities pricing services and dedicating more resources to those services.

Roger Stein, head of research and analysis for the new products group at Moody's Investors Service, says the need for better valuation data became evident last summer when the values of instruments such as collateralized debt obligations were distorted by the market's lack of liquidity.

Moody's acquisition of pricing vendor BQuotes is the latest move by the rating agency to strengthen its valuation

services. As a result, the agency has created a new division, Moody's Credit Values, comprising three units—Discounted Cashflow Valuation (DCV), CreditEvaluations and CreditQuotes—respectively offering modeled values, evaluated prices and observed quotes.

BQuotes, which extracts quotes from unstructured emails to create a price data feed, will form the basis of CreditQuotes, which will provide end-of-day credit and derivatives prices from 50 primary dealers, and real-time quote extraction for over-the-counter financial instruments.

The full version of this story appeared in *Inside Market Data*, February 4, 2008.

Bear Expands Derivatives Pricing Services Range

NEW YORK—Bear Stearns is expanding the range of derivatives products for which its PricingDirect division provides valuations, and is also expanding the currencies in which the firm provides valuations, officials tell *Inside Reference Data's* sibling publication, *Inside Market Data*.

The firm recently added pricing capabilities for Swiss franc and Swedish krona-denominated interest rate derivatives to the valuation services it provides to clients, joining the five other currencies, US dollars, sterling, euros, yen and Canadian dollars, in which it already provides prices.

"Demand is very high for pricing on rates," says Rajan Gadkari, managing director of PricingDirect. "Based on market data, we believe our current offerings provide coverage for 94 percent of the available swaps. Adding these new currencies increases our coverage even further."

The prices are generated by PricingDirect based on prices from Bear Stearns' own trading desk, and Gadkari says the firm needs to consider various factors—specifically around the data that its trading operations have available—when expanding coverage to new currencies. "We need to be comfortable that there is an availability of rates for money markets, swaps and futures expressed in that currency," Gadkari says.

The full version of this story appeared in *Inside Market Data*, December 17, 2007.

Reuters Introduces Bespoke Valuations for Derivatives and Complex Securities

Reuters has launched a new pricing service aimed at providing clients with bespoke valuations for derivatives and complex securities. Reuters DataScope Derivatives Pricing Service, which complements Reuters DataScope Select, offers users transparent pricing and methodology for each valuation and helps speed up the valuation process.

Credit Crunch to Shape Reference Data Market in 2008

Recent turmoil in financial markets will push performance measurement, valuation and counterparty data initiatives up the agenda in 2008, say industry professionals. After several firms reported losses in third-quarter 2007, mainly due to investments tied to subprime assets, senior executives are expected to focus increasingly on risk management this year. This trend is also likely to hit the reference data market.

"A kneejerk reaction to the credit market meltdown could be that firms pull back their focus and spending on enterprise reference data management initiatives," says Bill Butterfield, senior research associate at TowerGroup.

Evaluated prices: getting them right

Inside Reference Data gathers leading professionals to discuss the problems associated with evaluated prices and how to solve them

How can independent valuations help firms identify questionable investments before it is too late?

Christopher Richmond, vice-president, global products, derivatives, Bank of New York Mellon: Independent valuations offer additional or alternative sources allowing firms to compare interested sources, such as the investment manager or broker marks to an independent vendor source. By utilizing one or multiple vendors, firms can compare data from multiple places to help identify potential issues. While independent values offer additional information or an alternate source for looking at the value of the instrument, this is only a component in understanding the risks of an investment to a firm.

Shant Harootunian, managing director, evaluated services, Interactive Data Pricing and Reference Data:

Interactive Data Pricing and Reference Data defines our evaluations as a good faith opinion as to what a buyer in the market-place would pay for a security (typically in an institutional round lot position) in a current sale. We believe that independent evaluations are an important component for financial institutions to consider as part of their portfolio valuation process.

If a financial institution decides against using independent evaluations in their portfolio valuation process, it could choose other options such as a broker quote. A broker quote, however, may reflect the view of only that individual broker, while evaluated pricing services attempt to obtain market color from a number of sources.

By considering independent evaluations that reflect information from a range of market participants, financial institutions are better positioned to see if a fixed-income security is moving in the opposite direction

of the market, or in a more extreme manner than the market, and make their investment decisions accordingly.

**Michele Kelsey, senior vice-president/
Americas business owner, pricing
and reference data, Reuters America:**

Investment firms must conduct their own analysis, both at an individual asset and a portfolio level. They must provide the 'critical eyes' overlay, the point of view that shapes their own investment strategy and portfolio holdings. In other words, they are the engine that makes the investment decisions. That said, valuation firms and reference data providers provide the fuel to power those engines. It is the role of valuation firms to provide credible, market-driven data to value the holdings, to enable buy-side investors to look at the portfolio, empowered with concrete data to make decisions.

For example, there is tremendous value in historical data. An investor can look at how a particular security (or a sector) has performed under stressful market conditions in the past. Though this credit cycle is slightly different (as is each one) there is still value in having the rear-view mirror view into what happened in past cycles.

Another application of independent valuations is to look at the yield of the security you are buying relative to the yield of other securities in the same sector to see if the market thinks it could be riskier. Though the role of valuations has traditionally been post-trade, we are increasingly seeing this data used in



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applications to facilitate trade decisions, as another window into the market.

**Christopher Johnson, head of data
management, institutional fund
services, Europe, HSBC Securities**

Services: I would not expect bond evaluations to be used to identify questionable investments; such checks should be performed as part of pre-trade and post-trade compliance rather than as an asset pricing function. Evaluations are however very useful, as part of the subsequent valuation process, for pricing bonds that only trade infrequently.

Ian Swain, head of data services,

StatPro: I think independent valuations can help management firms to keep a closer eye on their investments by giving them the necessary tools to monitor the situation on an ongoing basis. By this, I mean flexible, convenient tools that help them perform consistent and timely checks against the

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*Christopher
Richmond, Bank of
New York Mellon*

firm's internal valuations. This is ultimately about reassuring investors that their investment fund company is doing everything possible to safeguard shareholder interest for them.

Problems often tend to arise when firms rely solely on out-of-date models or dealer-biased values. StatPro, like other independent service providers, addresses this by ensuring a high level of due diligence and proven procedural insight. This includes the cross-checking of data from numerous sources, in several instances from primary sources, through to intra-day and end-of-day checks. Similarly, having a support team of data specialists working closely with the client is also a great help in ensuring that any potential issues are spotted early on and dealt with in a timely manner.

By dealing with any changes in valuations on a regular basis, and identifying and addressing any irregularities early on, we can help the client avoid being surprised at a later date, and in doing so minimize the risk for both them and their clients.

Lydia Galasean, Quantitative Analyst, Business Development, Telekurs

Financial: The lack of any bias in an independently calculated price service can help

firms to identify mis-priced (usually over-valued) financial securities. In particular, fully transparent valuations—where all the calculation inputs, model assumptions and calculation methodology are disclosed—can be very useful. This type of valuation service supplies analysis data that can help firms identify questionable prices and steer clear of such investments. If an investment appears to be too good to be true and an independent valuation clearly shows significant price differences, then an investment manager is well advised not to enter the transaction.

What is the value of a mark-to-model evaluation compared with a mark-to-market evaluation?

Richmond: From what we have seen, our clients are looking for an exit price of an instrument to determine the value of their portfolios based on this. We look for a mark-to-market evaluation based on market or exchange data from vendors. Where this is not available, vendors may use a mark-to-model approach to calculate a value, using as much market data as is available and the attributes of the investment. The value of this may be that it offers a better price than a stale or unchanged price.

Harootunian: Interactive Data's evaluation methodologies incorporate aspects of both mark-to-market and mark-to-model approaches. As such, we seek to utilize market data and observations in our evaluation services. For our evaluations, we utilize

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evaluated pricing applications that vary by asset class and incorporate available market information and, because many fixed-income securities do not trade on a daily basis, apply available information through processes such as benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing. In addition, we use model processes, such as an option adjusted spread model, to assess interest rate impact and develop prepayment scenarios.

Kelsey: Most market participants have struggled with the realization that valuations in many fixed-income instrument classes are not perfectly liquid, and in many cases rather illiquid. In other words, not every cell in the grid can be filled in based on actual trades. In a perfectly liquid market, there would be actual trades to point to in every sector and for every name, at every point in the day, or dealer quotes to support the name.

But there are sectors of the market where

actual trades are simply not available; the instrument hasn't changed hands. In many asset classes, participants will maintain that trade data and dealer quotes from dealers, who can credibly make a market for that instrument, are the best source. But most will also agree that some level of modeling is often necessary and appropriate. For example, in derivatives, it is not enough to look at the spot along the credit curve, but one must also overlay the specific terms of that transaction and arrive at a NPV [net present value]. When looking at structured products, there is a place for modeling; it is often not enough to look at a single quote, but also look at the underlying cashflow waterfalls.

There are places for both mark-to-market and mark-to-model evaluations. What is important is gaining an understanding into exactly what the provider is offering, that is, what part of the value chain, their access to dealer quotes and actual trade data, and how much visibility they are providing into their methodology.

Johnson: Evaluations are an effective way of obtaining a model price, via a third party, in order to obtain independent prices for hard-to-price securities, where a market-sourced price is not readily available.

Greg Carlin, vice-president, securities evaluations products, Standard & Poor's Securities Evaluations: Many of the approaches to modeling hard-to-price securities are mathematically inten-

sive. Where there is little (or no) observable market data, these models can serve a valuable purpose as long as there exists significant transparency. Clients should be able to see and understand the processes that are being utilized. All inputs into the model must be readily available (such as Libor curves, forward curves, volatilities). The actual formulas used for the calculation of certain data elements should be transparent as well. The evaluation source must be available to explain model inputs that are attributable to positive or negative price movements. The importance of complete transparency is essential given the recent turbulence in the market.

Swain: For all securities, the value of mark-to-market evaluations is clear; being able to place an accurate market value, the probable level for an actual trade, is the primary focus for us at StatPro. Undergoing a rigorous pricing methodology is key—carefully chosen multiple data sources, continuous collection of data throughout the day and evening alongside well-sourced data selection, all help to increase the reliability and accuracy of data for clients, thus saving them time and money.

For mark-to-model, the value to clients is not as evident—the value of an asset is what the market is willing to pay, which can

be significantly different from the intrinsic valuation. Mark-to-model is less reliable than mark-to-market for the simple reason that the assumptions in the model may be inaccurate... for example, the liquidity for some of the securities may be overestimated. StatPro has recently developed a credit risk model that provides generic model valuations used by our internal processes, helping us to identify anomalies in our evaluations and contributed broker/dealer values. Exceptions based on record

counts, potential record type mismatches and suspect values are therefore identified and the pricing is confirmed.

Galasean: The mark-to-market evaluation is based on current market prices. Financial

markets are supposed to be efficient and iron out price inconsistencies quickly. However, this does not work well in illiquid market segments. In such segments (quite common in the fixed-income world) prices can be several months or even years old.

This is where the mark-to-model evaluation comes into place. A calculated price service can deliver estimated values based on the latest observable market information several times per day.

The other benefit of the mark-to-model evaluation is that it enables investors to perform price analysis. Market prices

“Most market participants have struggled with the realization that valuations in many fixed-income instrument classes are not perfectly liquid”

Michele Kelsey, Reuters

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invariably contain profit margins set by the participants in the financial markets. A calculated price is a fair-value price that shows how much the instrument is worth without any profit margin applied to it or "distress discount" subtracted from the price.

Why has the interest in evaluated pricing services increased in recent years?

Richmond: We work to provide independent prices from vendors for as much of clients' portfolio as possible. As more investments are purchased that are not traded on an exchange, evaluated prices using market data and modeling techniques provides an independent evaluation of the value. As the volume of these

"Regulatory pressure coupled with changing accounting standards is driving firms toward independent evaluation"

Greg Carlin, Standard & Poor's

investments continues to grow, the use of vendors who can provide meaningful values for these instruments will be needed as an additional source of data.

Harootunian: A number of factors, including regulatory scrutiny, portfolio diversification, market volatility, an increase in the complexity of securities and the introduction of new funds, have contributed to a heightened interest in evaluated pricing services.

Regulation has helped spur the need

for services that help mutual funds meet their fair-value pricing requirements. This includes offerings that estimate the price of an international, exchange-traded equity when the local market

for that equity is closed, which can help safeguard their investors' interest against market timers. Our Fair Value Information Service, introduced just a few years ago, is now being used by nearly 150 clients.

As investment companies continue to diversify their portfolios, they will be seeking independent evaluations for a broader range of securities that have traditionally been challenging to evaluate. For example, Interactive Data recently began to evaluate GNMA Serial Notes backed by 100% Puerto Rico collateral (see page 6). We are the first company to provide an



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evaluation service for these securities, which has drawn a significant amount of interest from clients.

We are also seeing increased client interest in new, innovative services that we have developed based on our fixed-income evaluations. Interactive Data recently introduced the Basket Calculation ServiceSM, an offering that delivers indicative valuations for equity and fixed-income ETFs every 15 seconds throughout the trading day.

Kelsey: In short—the markets have changed. Regulation has certainly been a factor in fueling the requirement for evaluated pricing services in recent years, as mutual funds and other investors have required this in order to put an asset into their portfolios.

There is also an increased need to measure the risk return in a portfolio, and measure actual portfolio holdings. While the market is in significant turbulence, portfolio managers are still seeking alpha, and looking for diversification across industry and geography. The market has globalized significantly so valuations across geographies become increasingly critical.

Perhaps the most driving reason is that buy-side players, wanting to diversify their portfolios, have shifted from cash instruments to derivatives. Portfolio managers, in seeking diversification and increased risk/return in their portfolios, and finding a shortage of opportunity in the cash markets,

have shifted to more challenging-to-value, lucrative, and available derivatives. The perceived elusive nature of these instruments, and valuation challenge, coupled with the volumes—far in excess of the cash markets—has brought valuations into the spotlight.

“Mark-to-model is less reliable than mark-to-market for the simple reason that the assumptions in the model may be inaccurate”

Ian Swain, StatPro

Johnson: There is a strong regulatory obligation on fund managers to provide up-to-date prices for all held investments; evaluations often provide a means of obtaining prices for hard-to-price securities.

Carlin: Investors are demanding greater transparency regarding asset values, regulatory bodies are strongly encouraging the

use of independent evaluations, accounting standards such as FAS 157 are changing the ways in which firms must make fair-value determinations. The challenges presented by complex securities valuations have industry participants looking for alternative valuation sources.

Swain: On the surface, regulatory changes have played a large part in the interest we see. In recent years, this has been predominantly driven by corporate and market forces, such as the high-profile fraud cases and spectacular fund collapses. Even more recent events, such as the subprime mortgage crisis in the US and ABCP credit crunch in Canada, stress the need for independence and transparency in security evaluations.

The increased use of illiquid and complex derivatives securities has also shown the need for third-party evaluations, as often there is no clear-cut market-place to obtain even benchmark trades. I think investment managers view spending increasing amounts of time and resources on evaluating securities as a loss of focus and believe outsourcing the process to a firm like StatPro that specializes in providing the service is a prudent business move.

We also see increasing demand for the timely delivery of data as another key driving force behind the increased interest in evaluated pricing. (As evaluated services are generally in the business of providing a service, they can be relied upon by clients to deliver accurate data,

on time.) Broker feeds usually play only a secondary or supporting role to their main business focus of investing and trading, and as such are not always as client-focused as evaluated feeds can be.

Galasean: Investors are increasingly more interested in evaluated price services as they offer price transparency, sound price estimation for illiquid instruments and help with regulatory issues. Price transparency is crucial when making investment decisions, and insight into the data inputs and quantitative methods used creates clarity about the fair value of an instrument.

The lack of daily quoted prices also makes risk management and regulatory compliance cumbersome. In particular, a common theme of many global accounting standards (IAS 39, FAS 157, US GAAP and Basel II) is the requirement for a consistent and up-to-date valuation of financial instruments.

To what extent is regulation pushing firms to more independent value assessments?

Richmond: Regulatory and audit concerns continue to be a driving factor in our clients looking for pricing coverage supplied by vendors. In some cases this is a need to have a non-interested price source and in other cases it is an additional source for comparison purposes.

Harootunian: We believe that regulation is playing a significant role in driving

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interest in independent evaluations. One example is the recently introduced FAS 157. This has resulted in firms reviewing their existing valuation policies and procedures and having to develop procedures for fair value disclosures in their financial statements.

In response to FAS 157, Interactive Data has been helping clients to understand the inputs that we utilize in our evaluated services.

This enhanced transparency is designed to provide clients with sufficient information to make their own fair-value hierarchy determinations as required under FAS 157.

“A calculated price is a fair-value price that shows how much the instrument is worth without any profit margin applied to it or “distress discount” subtracted from the price”

Lydia Galasean, Telekurs Financial

Kelsey: Certainly, regulation has come into play more and more over the last few years, first in the wake of corporate scandals, for example, KYC, Patriot Act. More recently, we have seen MiFID and FAS 157, and in light of the credit events of the past few months, it is unlikely that this trend toward regulation will slow.

Regulation has certainly fueled the need for transparency into holdings and for investors to work with an unbiased, independent valuation source. This has been most markedly pronounced for US mutual funds that need to report daily NAV [net asset value] to [US regulator] the SEC. That said, even investors who don't strike a NAV

are continuing to self-regulate, and are looking to measure the holdings of their portfolio, and their risk/return composition, with greater accuracy.

Johnson: Regulation is a strong driver for independence of asset prices.

Regulators are very aware of the risk in pricing and very clear on standards required of fund managers and their administrators, in obtaining and applying independent prices.

Carlin: Regulatory pressure coupled with changing accounting standards is driving



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*Chris Johnson,
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Swain: We are seeing regulation as a strong force in driving firms to independent evaluations, but it is by no means the only factor. Experience and common sense have firms voluntarily moving towards including evaluated prices as they see the benefits in fund transparency and value to the investor. Of course there are some who still believe—erroneously in our view—an evaluated feed is an unnecessary bureaucratic layer being pushed on to their portfolios, bringing higher costs and a greater pull on already limited resources. It is partially views such as these that drive the regulators to work on behalf of the investor in forcing these firms to adhere.

Galasean: The need for consistent valuation is made explicit in the IAS 39 accounting standard, Financial Instruments: Recognition and Measurement, which has

firms toward independent evaluation. In addition to FAS 157, other accounting standards that impact the need for independent marks include FAS 133, Accounting For Derivative Instruments & Hedges, FAS 155, Accounting for Hybrid Instruments, and in early 2007, FAS 159,

been adopted for use in the EU. The IAS 39 standard requires fair value for most financial instruments, and offers detailed guidelines to the methods that should be used to calculate fair value. The best evidence of fair value is the quoted price in an active market, but in cases where active markets do not exist, valuation should be performed using accepted valuation methods, making maximum use of relevant market inputs and relying as little as possible on internal estimates and more on independent value assessments.

What type of investors should take several sources for third party valuations?

Richmond: We have seen a broad range of clients asking for independent or third-party values. We would not prescribe what is necessary or not necessary for an investor, but see the requests from our clients for more data and more data sources.

Harootunian: All financial institutions with holdings that include fixed-income securities, derivatives, and a range of other financial instruments may want to consider using independent evaluations. Reviewing multiple sources of third-party valuations can assist a firm in carrying out its fiduciary responsibilities by adding an additional level of scrutiny to the valuation process. Since different valuations vendors have different sources of gathering market information and unique proprietary methodologies, there

may sometimes be variations in the valuations for a particular security.

While a client may choose not to use an evaluation from Interactive Data or any other vendor on any given day, reviewing the information that a third party provides can be an essential part of their portfolio valuation process.

Kelsey: In the US markets, regulated mutual funds that need to strike a NAV necessarily require multiple sources to satisfy regulatory requirements. Most funds, whether or not they need to provide a NAV, require a minimum of two providers of independent pricing to satisfy board requirements. They have to receive an independent view of the market value of the investment in order to put it into their portfolio. So there is a regulatory/board requirement and element that comes into play.

But we also find that many firms seek to use more than one source to ensure that they can cover the broadest range of instruments in the portfolio on a daily basis. They want a breadth of data, and several sources so that they can scrub and develop their own security master file. They also may choose providers for different instrument classes based on expertise and coverage.

In some cases, for example, fund administrators who are servicing multiple clients, they often want several providers in their repertoire, so that they can serve the needs of their downstream clients.

Johnson: It is not uncommon to source

market prices from two recognized vendors, with checks against a third if required. There is a regulatory distinction between regulated collective funds and segregated funds/hedge funds. However, my view is that consistent standards of pricing validation should be applied for pricing all assets held by clients regardless of type.

Swain: I think investors who believe in providing the highest level of service and quality of product for their clients would be at the top of the list. Obtaining multiple sources, specifically for illiquid or OTC securities, will allow any prudent investor to provide more accurate daily levels and watch for any anomalies that might arise.

Galasean: Generally speaking, all investors should take several sources for third-party valuations, especially if one of those sources is not fully transparent. There are black box type valuation services where only the evaluated price is provided, without disclosure of model inputs or methodology used. In these cases, the investor relies entirely on the service provider's reputation.

There are also fully transparent services that provide full insight into key data and market factors on which the calculations are based and that provide clients with fully documented calculation methodology. The Telekurs Fair Value fixed-income evaluation service is just this sort of fully documented, fully transparent solution.

Sponsor's Statement

What's Fueling Demand for

Independent evaluations of fixed-income securities have long been a critical input to the portfolio valuation processes of major financial institutions, but they have historically not been well known beyond a small number of groups within an organization. Now, independent evaluations have been thrust into the spotlight as a result of a unique mix of new regulations, market volatility, and the credit crunch.

In recent years, a deluge of new acronyms have taken on almost mythical status in the financial services industry. From MiFID to Reg NMS, IAS 39 and

UCITS III, new regulations, standards and directives have impacted the industry with new compliance processes and procedures to implement and follow.

One recent accounting change stands apart in terms of its impact on the demand for independent evaluations. The Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 157, or FAS 157, has resulted in firms reviewing their existing valuation policies and procedures and developing procedures for fair value disclosures in their financial statements.

To help clients prepare for FAS 157,

Interactive Data, through its Pricing and Reference Data business, is a leading independent provider of daily evaluations for fixed-income securities. With over 30 years of experience, Interactive Data's teams of experienced evaluators operating in three major time zones evaluate approximately 2.5 million fixed-income issues every day. Over 5,000 financial institutions worldwide, ranging from central banks to large investment banks, subscribe to Interactive Data's bond evaluations.

- Evaluations of global fixed-income instruments include corporates, high yields, governments and agencies, securitized debt issues, U.S. municipal securities, hybrid securities and money market securities
- Fair Value Information Service
- CDS valuations
- Interest rate swap valuations
- Bank loan valuations
- Intra-day indicative valuations for equity and fixed income ETFs
- Risk analytics data

Independent Evaluations?

Interactive Data has developed a set of informational resources that disclose the types of inputs by asset class that we utilize to prepare evaluations.

We believe that this “bucketed approach” can provide clients with enough information to establish their own fair value hierarchy determinations as required under FAS 157.

New regulations are not alone in driving demand for independent evaluations of fixed-income securities. With the volatility in the global financial markets in mid-to-late 2007, financial institutions have been keenly focused on making sure that they have a firm grasp on the value of their holdings – especially thinly traded fixed-income securities.

Providers of independent evaluations can deliver significant value to financial institutions during these turbulent times. Interactive Data has teams of experienced evaluators who incorporate available transaction data, credit-quality information and perceived market movements into the evaluated pricing applications and models for fixed-income securities.

Global institutions have also been impacted by a lack of liquidity as the credit markets have tightened, and they have had to take a step back to determine their risk exposure. Once again, these

institutions have looked to organizations such as Interactive Data to provide independent evaluations for their portfolio valuation processes.

Independent providers of evaluations put an emphasis on building relationships with a broad range of market sources who can offer insight into market activity. By leveraging relationships with the buy side, electronic trading platforms, and other major market makers, Interactive Data has access to a wide-range of market color. This can help to ensure that Interactive Data’s evaluations reflect information that market participants would consider in pricing the asset.

With the constant market fluctuations and new regulatory mandates, providers of independent evaluations have seen a greater demand for their mission-critical services.

We believe that this increased demand is a sign of things to come, particularly as financial institutions continue to seek to invest in new, more complex financial instruments in an effort to diversify their portfolios and grow their business in these challenging times.

Shant Harootunian is managing director, evaluated services, Interactive Data Pricing and Reference Data

Sponsor's Statement

Navigating the Storm: Toward More

It is natural for the evolution of an asset class to fuel the need for deeper and more precise information around financial investments, in terms of reference data, terms and conditions, and in particular of late, evaluated pricing. Though this becomes increasingly pronounced as liquidity within an asset class increases, data and methodology inevitably come squarely into focus during periods of turbulence.

In every credit cycle there is a period of 'easy money' and liquidity, followed by a tightening up of issuance. What invariably follows is a period of scrutiny, which in turn drives a need for timely, accurate information and valuations. Currently the information demand is driven by investors needing to value their portfolios to fuel investments, along with an increased need to understand exposures and returns, that is, risk/return. That said, increased regulation that has already occurred in the wake of corporate scandals, and is sure to follow as a result of the pains of the last few months, coupled with FAS 157, make it unlikely that this trend will slow.

What is unique about this cycle is that while primary issuance has dried up

While primary issuance has dried up considerably, new derivatives instruments continue to flourish, and derivatives volumes continue to eclipse the cash markets

considerably, new derivatives instruments continue to flourish, and derivatives volumes continue to eclipse the cash markets. Similarly, while structured product issuance has virtually dried up, there is still considerable exposure held by investors. This brings with it a need to value the underlying instruments, and measure their exposure on an issuer basis. As a result, the need for information on these instruments has multiplied, and with it the focus on valuation and transparency.

In the derivatives markets, the sheer number of types of instruments has multiplied geometrically. Portfolio managers continue to seek higher returns, globalization, and diversification in their portfolios. The realities of the current market leave them faced with fewer options and cash investments, so they increasingly turn to the derivatives market. Mainstream CDS, LCDS, and IRS have been joined by CDS on ABS, equity warrants, TRS and other permutations. Providers of valuations must follow suit, to become a virtual mirror of their clients' new portfolios.

In the structured products markets, there

Liquid Seas Through Transparency

is much debate about what the future holds for primary issuance of CDOs, and whether investors really understand the risk exposure and value of their underlying investments. How many times do I own exposure to a particular issuer? And how many times do I hold it across multiple vehicles? It is likely that the mix of underliers will shift over time, and give way to new instruments. What is certain is that off-balance-sheet investment structures are necessary, and there are a great deal of holdings out there that need to be measured and valued. It is critical that providers are able to power their clients with reliable reference and counterparty data to be able to link the portfolio holdings to the underlying issuers, as well as value the underliers.

Some key themes and considerations for valuation services, in light of recent market turbulence, are:

- Transparency. As risk has increased, and structures have become more complex, investors and their boards are less willing to deal with a 'black box' construct, and valuation services methodology must be documented and transparent. Whether it is a model or contributed price, use of dealer quotes and how timely they are, and audit tests should all be readily available, and frequently stress tested.

- Delivery capability. Are they set up for NAV time frames? How will they support

price challenges? Do they have quality metrics, and a disciplined way of measuring output? Whether or not they have a global capability is also a key consideration in this environment.

- Tie-ins to the point of origination, that is, trading systems and actual transaction data. Harnessing information, and automating data flow throughout the organization has never been more vital. It is not enough to create a security master file—investors, and those who service their portfolios, are increasingly looking to funnel front-office data to power valuations, as this data, particularly in illiquid asset classes, is often vital to valuing the asset.

While a lack of transparency in pricing complex and structured instruments might have been tolerated in a more robust market, current market conditions make this simply too much risk for investors to tolerate. Providers must be swift to adjust, transparent in their methodology, and be able to handle the rapidly changing makeup of their clients' portfolios. The attention to complex instruments and structured products has intensified, as has the need to independently value and price these instruments.

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Q&A

On Everyone's Mind

IRD speaks to Denise Valentine, senior analyst, Aite Group about how the focus on evaluated pricing services has increased in recent years



Denise Valentine

Who's driving the evaluated pricing agenda?

There are a couple of drivers. Primarily, clients. Institutional investors will not invest with firms using hard to price derivatives if they do not feel there are legitimate processes around valuation, use of side pockets, and transactional processing. But market events, such as what happened to the sub-prime market, are also a driver.

Regulatory-wise, in the US, firms need to classify instruments under GAAP 157 [accounting principle] which necessitates review and control of all instruments in a portfolio and procedures for valuation that even factor in risk modelling. Further, there is reputation risk. A well-respected firm may find it hard to recover from negative press that suggests operational incompetence or client negligence.

How do you see firms rating the importance of independent valuations?

It's on everyone's mind. But it is not new a new topic. Everybody has been very well aware

that some valuations have been suspect. It's been going on for a couple of years and the mortgage crisis brought it to the forefront.

Has the focus on independent valuations developed as rapidly as you expected?

No. Countries around the world have been talking about the issues in valuation for years. Now, we see vendors and service providers bringing out new products and analytic and valuation tools. We are seeing interest from our own clients too.

What impact do regulatory initiatives have on this development?

Regulation always drives change, but at this moment there is nothing outrageous about the regulation. I think people are more concerned with what might be forced from regulatory initiatives in the future. The hedge fund industry is pushing for best practices and so forth to avoid a stringent "stick" reaction from regulators. Hiring an independent valuation provider may be less onerous than any potential regulatory regime.



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