

IX OIV Business Valuation International Conference:
Valuation Challenges and Solutions

Update on International Standards and the Impact on the Valuation of Financial Instruments

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Update on IVS - **Impact on Financial Instrument Valuations**



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Agenda - IVS and Impact on FI Valuations

Background on the
IVSC

Overview of the IVSC
General Standards
Improvement Project

Potential Impact on
the Current IVSC
Standards

Examples of Applying
IVSC Standards to
Financial Instruments



IVSC Background - Mission

- International Valuation Standards (IVS) serve as the key guide for valuation professionals globally to underpin consistency, transparency and confidence in valuations.
- IVS's are central to the IVSC's mission to raise standards of international valuation practice as a core part of the financial system for the benefit of capital markets and the public interest.
- IVSC and IOSCO Collaboration
 - IOSCO and IVSC agree to explore best ways to promote high quality valuation practices in the public interest.
 - Cooperation agreement follows feedback from securities regulators highlighting inconsistency in valuation quality and approach worldwide

IVSC Background - Technical Boards

Three independent technical boards of international experts are appointed to lead the development of the IVS Asset Standards.

Tangible Assets
Business Valuation
Financial Instruments



Standards Review Board

The Standards Review Board (SRB) comprises senior leaders from all fields of valuation and is responsible for overseeing the work of the technical boards and leads the development of the General Standards.

IVSC Background - Overview of Standards

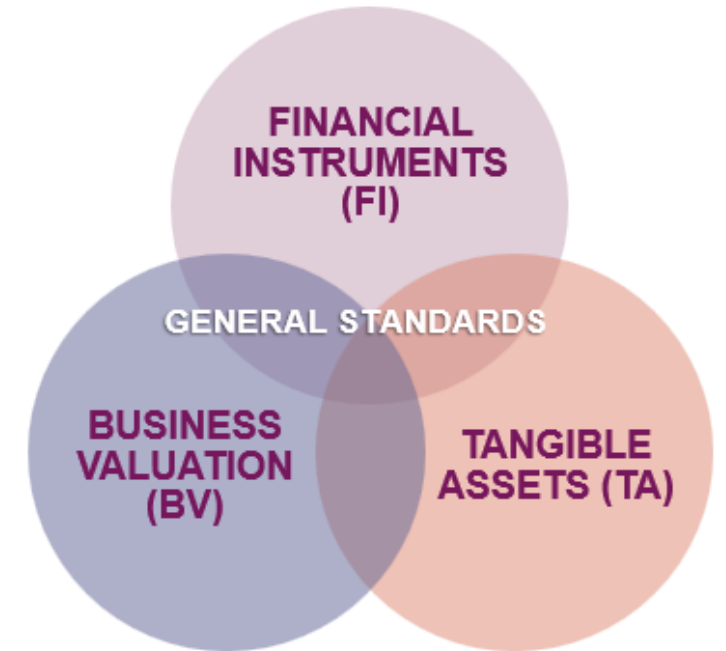
IVS are comprised of General Standards and Asset-Specific Standards

General Standards - requirements for conduct of all valuation assignments

- Key pillars of valuation
- Terms of a valuation engagement, basis of value and scope of work
- Valuation methods, models, data and inputs
- Documentation and reporting

Asset Standards - requirements related to specific types of asset valuation

- Background information on the characteristics of each asset type that influence value
- Additional asset-specific requirements regarding common valuation approaches and methods used



IVSC Improvement Project - Goals

Based on feedback from the Agenda Consultation, the IVSC SRB has launched this initiative to:

1. Modernize to include key valuation components
 - Data and Inputs
 - Models
2. Increase understandability and relevance of the IVSC Standards
 - Valuers
 - Financial institutions
 - Investors
 - Regulators
3. Future-proof the IVSC Standards
 - New markets
 - New and different assets and liabilities
4. Address and limit valuation risk
 - Principles of valuation
 - Quality control
5. Protect public and stakeholders

IVSC Improvement Project - Potential Impact

Requirements	Location	Format	Features
Standards will have certain additional requirements, for data, models, documentation, and controls	Certain requirements will move between the IVS General Standards and Asset Standards	Some requirements will shift to appendices	Appendices will allow for addressing additional valuation features such as ESG

*Technical boards will be reviewing current Asset Standards for consistency with the updated General Standards

IVSC Improvement Project - Valuation Process

General Standards (IVS 100-106)

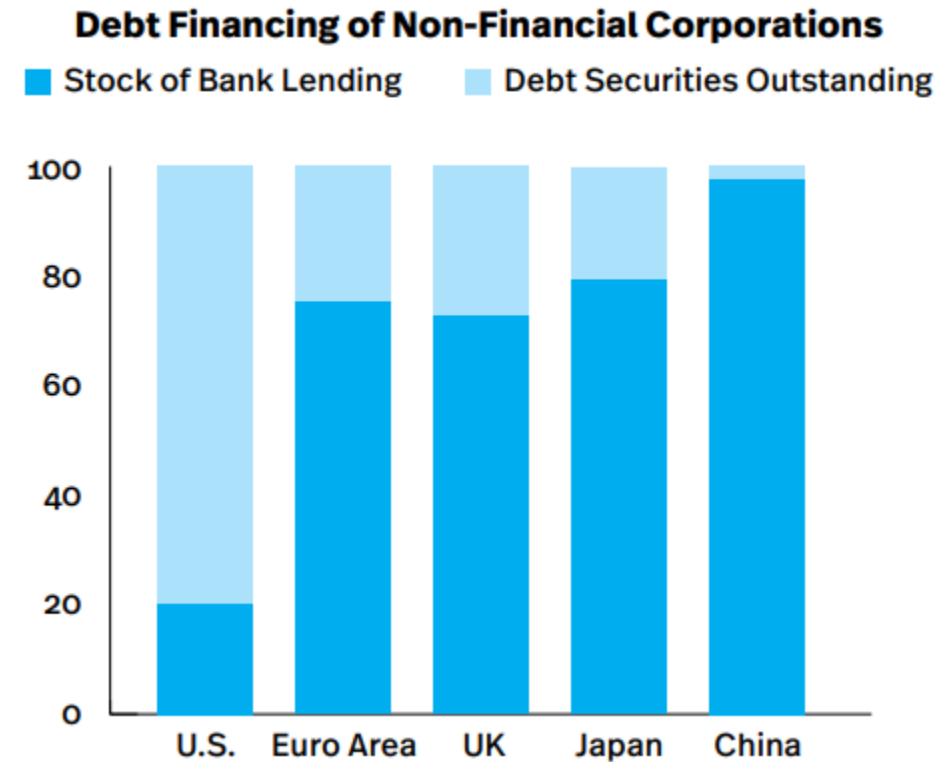
- Describes key processes in a valuation required to be IVSC compliant
- Designed to be applicable for any asset or liability to be valued
- Clarifies the connection between the IVS General Standards and Asset Standards
- Provides flexibility for inclusion of additional specifics in Asset Standards



IVSC Standards - Financial Instrument Markets

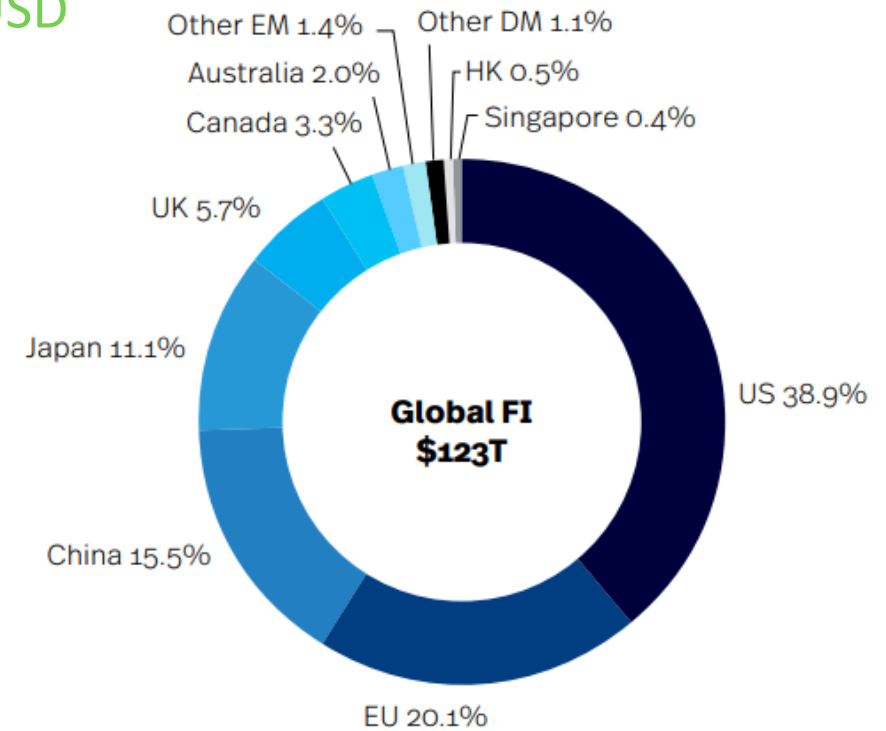
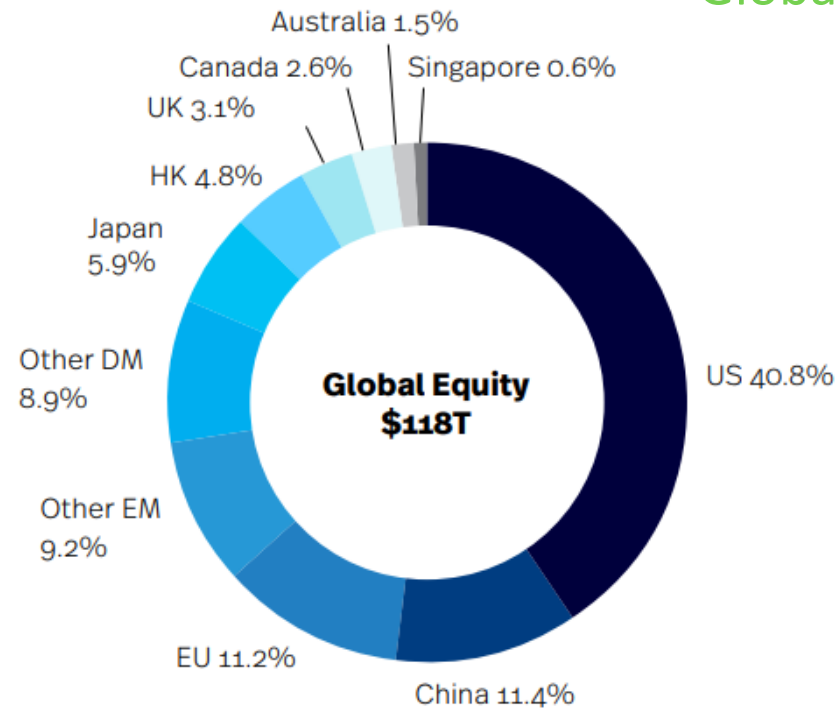
Global Capital Markets

- Critical to economic financing
- Support economic growth
- Offer less restrictive borrowing
- Fund companies, governments, and consumers
- Provide returns for investors
 - Banks and financial institutions
 - Funds
 - Corporate investors
 - Retail Investors
 - Household liquid savings
 - Retirement savings



IVSC Standards - Financial Instrument Markets

Capital Markets \$240T USD
Global GDP \$94T USD



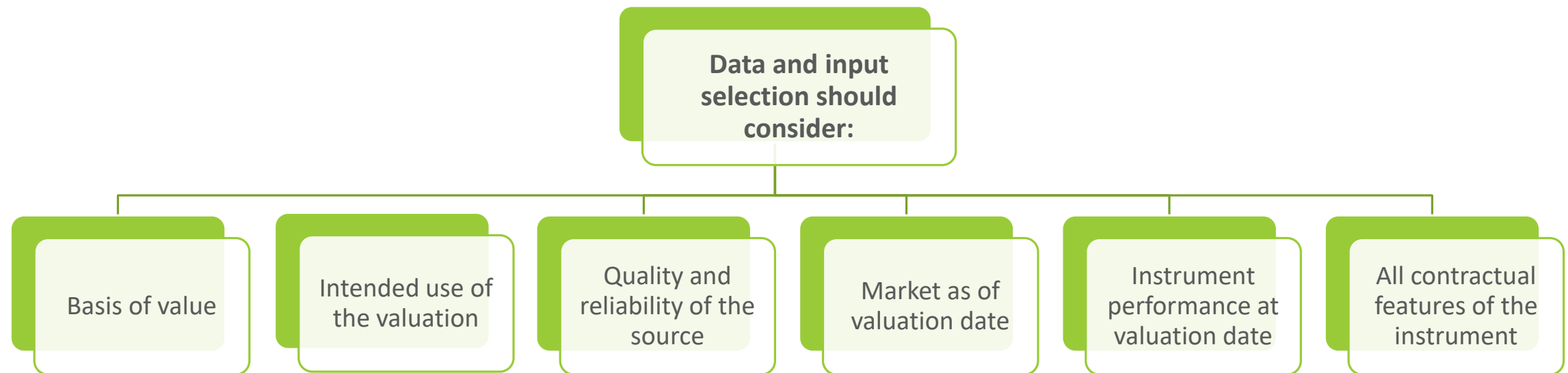
IVSC Standards - Financial Instrument Valuation

Financial instruments vary greatly and require different competencies



IVSC Standards - Financial Instrument Data Selection

IVSC Standards address the selection of data and inputs



****Note: Most valuations are estimates. Data and input selection is often imperfect.***

IVSC Standards - Financial Instrument Data Selection

IVSC Standards address the selection of data and inputs

IVS outlines the following features that should be maximized in data selection

- **Accuracy** - free from error and reflective of characteristics they are designed to measure
- **Appropriateness** - relevant for the asset being valued
- **Completeness** - set of inputs sufficient to address all attributes of the asset
- **Observability** - obtainable and visible to multiple users or market participants
- **Timeliness** - reflective of market conditions as of valuation date
- **Transparency** - source of the inputs can be traced from their origin



IVSC Standards - Financial Instrument Data

Lessons from the financial crisis – Current credit assessments

EXAMPLE: Sub-Prime Mortgage-Backed Securities (MBS)

Sub-prime mortgage originations supported by mortgage-backed security issuance

- Valuations based on credit ratings from agencies
- Valuations did not independently assess future cash flows



Housing bubble and financial crisis

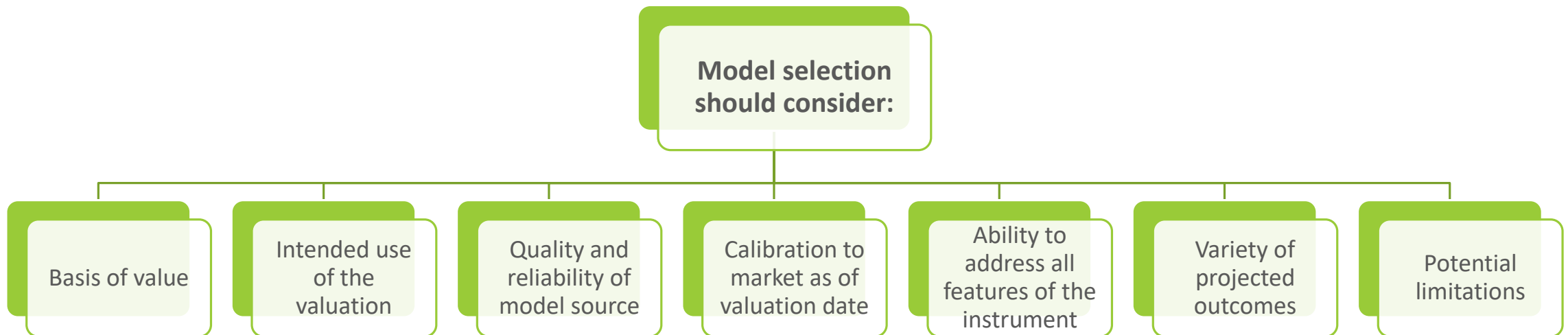
- Rating agencies did not conduct timely review of cash flows
- MBS ratings shifted from AAA to CCC overnight, plummeting values

Valuation lesson

- Ensure credit ratings have been recently visited
- Check multiple rating agencies
- Independently assess credit and cash flows

IVSC Standards - Financial Instrument Model Selection

IVSC Standards address the selection of models

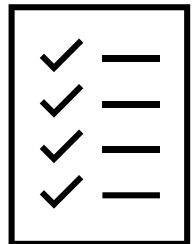


IVSC Standards - Financial Instrument Model Selection

IVSC Standards address the selection of models

IVS outlines the following features that should be maximized in model selection

- **Accuracy** - free from error and functions correctly based on valuation objective
- **Appropriateness** - suitable for the instrument being valued given market on valuation date
- **Completeness** - addresses all contractual and performance features of the instrument
- **Transparency** - ability to understand how the model works and any inherent limitations



IVSC Standards - Financial Instrument Models

Lessons from the financial crisis – Model all features and potential outcomes

EXAMPLE: Auction Rate Securities (ARS)

Long term, variable rate bonds tied to short term interest rates

- Money market-equivalent interest rates set at auction
- Frequent auctions but 30-year maturities
- Modeled as very short-term instruments despite long-dated contractual maturities



2007- auctions began to fail

- Too few bidders
- Lead underwriters stopped supporting the auctions
- Investors left with long term, illiquid investments worth a fraction of the value

Valuation lesson

- Understand and model all contractual features
- Consider and model all possible cash flow outcomes

IVSC Improvement Project - Proposed Schedule



Update on IVS - Impact on Financial Instrument Valuations

Questions?

