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Evaluated Prices

Special Report

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Editor's Letter

Evaluated Prices Evolve

What do evaluated price data consumers want? That's effectively what *Inside Reference Data* asked data operations executives in this issue's Virtual Roundtable. Participants said they tend to go to multiple sources for data. In fact, one news story in this report, about a poll *Inside Reference Data* conducted in the fall, notes that 87% of respondents use two or more vendors for evaluated price data (see page 7).

Education, risk and regulation are considerations for those data consumers in determining what they want from vendors. By education, Roundtable participants mean getting explanations of pricing methodologies, as Laurent Thuillier, head of asset servicing at Société Générale Securities Services, relates. "They want more from the process than just receiving a CSV file filled with figures," he says.

Standard & Poor's Capital IQ aims to offer more by giving users a look into the pricing process, says Greg Carlin, vice president, business development, S&P. "This involves showing the client components of the model and the ultimate build-out of a price," he says, adding that this includes showing what securities are being included in sophisticated sectoring plans for those pricing models.

Could reducing risk require moving away from evaluated prices entirely? Gary Pringle, vice president of global pricing operations in the worldwide securities services unit at JPMorgan, says demand for intra-day valuations is increasing. A regulatory push for greater transparency in pricing, noted by our Roundtable participants, could also change the way evaluated prices are used.

Changes in the production and use of evaluated prices are clearly afoot. These won't happen overnight, but the trends and themes spotted here should point the way to how evaluated prices will operate and what they will mean in the future.

Yours sincerely,

Michael Shashoua

Michael Shashoua
Editor, *Inside Reference Data*
Email: michael.shashoua@incisivemedia.com
Tel: +1 646 490 3969

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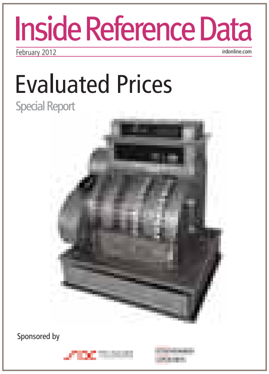

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News Review

Evaluated Prices Confront Information Scarcity in Emerging Markets

Information scarcity is the biggest hurdle for evaluated prices in emerging markets, says a major service provider executive. "Some emerging markets have effective trading and information-sharing infrastructures to develop the availability and accessibility to data within these markets, but generally where a market is new, information will be scarce," says Malcolm Oldham, head of evaluated pricing for EMEA and Asia at Thomson Reuters.

Brokers used to trading in developed markets get greater automation that delivers information very rapidly to their fingertips, often in nanoseconds. In the emerging arena, however, there rarely is infrastructure to support that. Participants have to account for differing regulations, local conventions and other issues. "In the past, where markets are emerging or had very limited availability, vendors may have walked away due to a lack of available information to work with," says Oldham.

The front, back and middle offices all need to provide evaluated price data, says Phil Lynch, chief executive at data management services provider Asset Control. "Once you execute, you need all the details, and there hasn't been nearly as much focus in the middle and back office on timeliness around the details," he says.

James Rundle

Partnerships Proving Key to Managing Pricing Data

Partnerships between firms and providers can help navigate pricing data at times when prices become like "a philosophical question," says Perry Beaumont, head of evaluated pricing research and development at SIX Telekurs.

"It's easy to think of a situation where there might be one security with three prices, all correct," he says. "For example, there may be a security in which a trader needs to aggressively cover a short. They will have a higher price to have positions where they can cover that trade and be risk-neutral. Or maybe a trader needs to quickly sell a large amount because a risk manager instructs them to reduce their holding. In that case, they may have a very low price to make it attractive. The third price could reflect an orderly market and transaction. All three aggregately reflect the perspective of the person offering that price to the market and in that sense, all are correct."

Michael Shashoua

News Download

Firms Seek Multiple Sources For Evaluated Prices

More firms are turning to multiple sources of evaluated prices for the same securities, according to a poll conducted during a recent *Inside Reference Data* webcast. 50% of respondents said they now take multiple sources for multiple asset classes and less than 13% rely on only one vendor for multiple asset classes.

In the past couple of years, many firms have increased the number of vendors they take evaluated prices from, according to New York-based Stephen Engdahl, senior vice president of product strategy, GoldenSource. "Different vendors excel in different specialty areas, whether it's regions of the globe or types of assets, but at the same time there is a need just to show you're doing due diligence to have multiple vendors rather than relying on and trusting the model they apply," he says.

The amount of transparency and customer service to expect from the vendor plays a part in the procurement decision, according to Engdahl. "What is the response, the extent of the information you're getting back, and is it valid what you're getting back?" he said were questions to review.

All this is seen as even more important than the price of the data, which is another selection factor to consider.

Tine Thoresen

Interactive Data's Vantage Adds Munis, Structured Products

Interactive Data plans to expand its fixed-income pricing interface Vantage into municipal securities and structured products in the first quarter of 2012, says John Locksley, Vantage product manager at Interactive Data in New York. The data services provider also plans to develop the Vantage benchmarking capability and comparability of its data.

Vantage, launched October 18, is built around a fixed-income markets heat map, and is designed to provide transparency, says Locksley. It also offers a single system for transparent valuations, and consolidates relevant transparency data on one screen.

EDI Launches Commodity Pricing Service

Corporate actions and reference data provider Exchange Data International (EDI) has launched a commodity pricing service in collaboration with the Commodities Research Bureau. The service covers more than 1,000 markets globally, with daily global futures, futures options and cash pricing data.

Evaluated Prices: Sourcing, Selecting and Accelerating

Inside Reference Data gathers leading industry professionals to discuss the crucial issues around obtaining reliable pricing data

What is the best way for a firm to ensure credible pricing? Is the key to calculate the average price based on different sources, or to find that one source with the right price?

Gary Pringle, vice president, global pricing operations, worldwide securities services, JPMorgan: Price sourcing should match with the sub-asset type/category across the fixed-income and debt instruments. With the varied sources and methodologies available, consistency of source for that particular sub-asset type, such as mortgage pass-throughs (evaluated) are important to the clients.

The aspiration is to have at least dual-sourcing wherever possible—that is two evaluated providers for the same instruments and to avoid one type of source comparing to another source, such as evaluated versus contributor. Average pricing is risky and subject to heavy scrutiny due to the lack of consistency of inputs to that average, the arbitrary nature of outlier removal and lack of suppliers providing average prices.

To ensure credibility, a pricing agent must provide a robust price capture framework with reputable vendors and sources, sound due diligence over price quality, evaluation techniques and transparency from evaluators. Back-testing to client trades is an additional key step to ensure evaluators are keeping to the market activity and can be used to challenge processes between pricing agent and evaluator.

SIX TELEKURS

Ian Blance,
Head of Evaluated Pricing Business Development, SIX Telekurs
Tel: +44 (0) 207 550 5430
www.six-group.com

Paul Sharkey, vice president, Northern Trust Investor Services: Our current process involves using two primary evaluated pricing sources. However, we don't receive full coverage from these vendors. The gaps in coverage are filled by composite providers or individual broker quotes.

We apply both vendor-to-vendor checks and day-on-day movement checks, in addition to stale price checks. We generate many 'false exceptions' as we are not always comparing 'apples with apples,' such as an IDC evaluated-to-a-broker quote. Combined with day-on-day tolerances to reflect the new normal of increased volatility, this leads to a large number of exceptions to manage daily. As a result, every day involves handling high volumes of exceptions and attempting to add value by focusing on outliers or material exceptions.

Proposals including a straight waterfall approach are in place for fixed-income. The primary provider should be used across markets and for both intra-day and close-of-business. A daily check should be performed on the evaluated prices received. Tolerance levels should be set at country and asset levels to reflect market realities. For example, Greek bonds should have a higher tolerance than US Treasuries. A secondary provider should be used to fill gaps in coverage from the primary provider.

At a set period, either weekly or monthly depending on market or asset type, a full file is received from the secondary vendor and a vendor-to-vendor scrub is performed. The vendor can be challenged or even changed.

Ian Blance, head of evaluated pricing business development, SIX Telekurs: The question here is how one defines a

"User firms tend to look at a number of factors when choosing an evaluations vendor, with many highly subjective constraints coming into play"

Ian Blance, SIX Telekurs

Greg Carlin,
Vice President, Business Development, Standard & Poor's
Tel: +1-212 438 4500
www.globalcreditportal.com/valuations

credible price? To my mind, a credible price is one that can be justified based on current conditions in the underlying market and is fully defensible taking into account the reference, market and assumptive data and the methodology used to derive the price.

Averaging different evaluation sources might not be very helpful in this respect, where they may use different data and methods. There is a case to compare sources against each other to identify outliers that might require challenge or investigation, but a systematic averaging process would mean the result produced would be a hybrid and would not be backed by any coherent market evidence or consistent and justifiable methodological approach.

We should also be very careful with the term 'right price.' Depending on the asset in question and the use for which the price is required, there may not be a 'right price'—or, to be more specific, there may be many 'right' prices. A price used for fair value accounting purposes, for instance, may not accord with one for the same instrument in a transaction or with that placed on a dealer's inventory. All three prices, however, can be argued to be 'right' in their own context.

Laurent Thuillier, head of asset servicing at Société Générale Securities Services (SGSS): It really depends on asset classes. For OTCs or bespoke structures like structured products, it will be challenging to find out another valuation than the one provided by the counterparty/issuer.

In that case, the only alternative is to compute a valuation with an accurate mathematical model fed by market data and calibrated to the market.

Greg Carlin, vice president, business development, Standard & Poor's: Firms may take a number of different approaches in assessing price quality. All firms should have established policies and procedures that guide the price verification process, and some aspects of the process may be unique to each firm. Firm type, securities type, market conditions, data usage and time deadlines will influence the complexity of, and the time allocated to, the price verification process.

Firms may elect to take pricing information from independent pricing services, and the firms remain responsible for final determinations as to whether or not to use the prices provided. The availability of underlying price data may influence a user's selection process.

A detailed offering that includes price, market data supporting that price, and underlying assumptions based on that data should increase an end-user's confidence in a price.

What should firms look for when choosing a vendor?

Sharkey: Some key criteria in no particular order are quality of prices, transparency around methodology, breadth of coverage in markets, products and times, timeliness of file delivery, cost, responsiveness to queries, BCP plans, training and literature available, and performance in stressed market conditions.

Blance: User firms tend to look at a number of factors when choosing an evaluations vendor, with many highly subjective constraints such as cost, commercial arrangements, usage rights, historical relationship and internal programming issues coming into play.

Taking a purely objective view, however, it would seem to me the primary factor should be the defensibility of a vendor's prices based on the methodology deployed to produce them, and the transparency of the data inputs and assumptions which calibrate the model. This should produce a result that can be fully justified to auditors and regulators (and ideally has been independently validated, so one is not just taking the vendor's word for it). This renders the evaluation much more credible and useful to the recipient, since they can rely on the data with more confidence.

Thuillier: Transparency of the process, the expertise of the vendor team and their capability to source exotic parameters, such as implied volatilities or correlations, are key. At SGSS, we have developed exclusive partnerships with OTC brokers to get this data.

"All firms should have established policies and procedures that guide the price verification process"

Greg Carlin, Standard & Poor's

Gary Pringle, JPMorgan

Carlin: Firms may assess a number of attributes when choosing providers. With the ongoing refinement of regulatory and financial reporting requirements, transparency is likely a primary driver of vendor selection.

Firms should have access to clearly written methodology documents, the opportunity to understand the vendor's processes, and a view into the underlying market data that is driving a valuation as well as the assumptions made based on interpretation of the market data. Therefore, clients should look for a pricing provider with an unwavering commitment to building out a comprehensive transparency offering.

"With the varied sources and methodologies available, consistency of source is paramount"

Gary Pringle, JPMorgan

Additionally, operational policies and procedures may be considered. What is the firm's customer service model? Is direct access to a pricing analyst available? How does the price challenge process work? How will they interact with the client's auditors? Does the provider have a compliance program?

How can you best increase efficiency in the evaluated pricing process? Is there a need for further education in the market?

Pringle: Price sourcing should match with the sub-asset type or category across the fixed-income and debt instruments. With the varied sources and methodologies available, consistency of source is paramount. The supply of evaluated pricing needs to increase in frequency to intra-day as clients become more time-sensitive.

There is definitely a need to educate more but also for evaluators to be more transparent in pricing for customers and clients.

Sharkey: Education is key for both market data professionals and the end-users of the data, concerning the inputs into an evaluated price and how this may lead to different prices from a composite price source such as Bloomberg or a broker-run quote.

Internally, the end-users are trustees, and externally, they are auditors and investment managers.

Blance: As far as efficiency in the evaluated pricing process is concerned, from a price production perspective, the best way to achieve this is to automate as much as possible. This would encompass the encoding of terms and conditions data, the gathering and reporting of corporate actions, the building of yield curves and the derivation of spreads and other key input data.

Systematic automation allows for a highly efficient process that can be leveraged to produce sophisticated quality assurance tools such as comparative exception reports and internal logic reviews.

There is always a need for further education as markets evolve and new asset classes and instrument types develop. For evaluated pricing, however, I believe there is a particular need for additional education, since the approach is so different from other pricing types.

Specifically, there needs to be a greater appreciation of the problems that attend to some popular price sources for illiquid and OTC instruments (trades, counterparty prices and dealer averages) and how a properly deployed evaluation service can resolve many of these.

Paul Sharkey, Northern Trust Investor Services

Thuillier: On complex or illiquid products, we find our clients are not just looking for a valuation but also for full support from us to explain methodologies. Basically, they want to get more from the process than just receiving a CSV file filled with figures.

Carlin: Yes, there is a need for further education in the market. Providers need to provide more information to their end-users. Where should the provider start? S&P Capital IQ has found that providing the user with a look into the pricing process provides valuable insight to its clients. These sessions

> "Providers need to provide more information to their end-users. Where should the provider start?"
>
> *Greg Carlin, Standard & Poor's*

Laurent Thuillier, SGSS

involve showing the client components of the model and the ultimate build-out of a price.

Further, vendors often employ sophisticated sectoring schemes within their pricing systems. Providing an indication of what securities reside within a sector would likely help users. Sectors can be based on a number of factors, including bond type, issuer, and collateral. Such data offers insight into how a provider is interpreting relative value within and between sectors. When sectors experience significant volatility, an understanding of the related securities within a sector may result in a user submitting fewer price challenges, providing the end-user with increased efficiencies.

"On complex or illiquid products, we find our clients are not just looking for a valuation but also for full support from us to explain methodologies"

Laurent Thuillier, SGSS

With growing focus on risk, fund services teams are under pressure to deliver evaluated prices to clients earlier than before, as clients want time to validate the prices. How is this affecting the rest of the market? What does this mean for vendors?

Pringle: Evaluation supply needs to drive toward intra-day provision as clients become more time-sensitive. Evaluated prices often lag the market for the underlying assets and the fund net asset value (NAV) points. Demand for introducing intra-day evaluations is growing for UK and European NAV clients. This can be based on a credit market or benchmark move, or a full market evaluation. We have seen both being introduced, a key factor is cost of this provision.

Blance: The timescales for delivering evaluations are constantly under pressure. With increased audit and regulatory oversight, rising volumes, and particularly during periods of market volatility, user firms need longer and longer to validate their prices as they would like, while being given less time to do it.

This places an onus on vendors to be more efficient during the production process to deliver prices to their users as soon after market close as possible.

There is also a focus on providing more efficient tools to assist the user validation process, such as transparency visuals and a more streamlined challenge process.

One other useful way to mitigate these issues is to price intra-day. This has the benefit of identifying some of the potential issues earlier in the process and possibly getting them resolved before the final production run of the day.

Thuillier: Definitely, there is a market pressure to reduce delivery timelines. At the same time, quality expectations are increasing. This is a challenge for vendors to manage these two constraints. In fact, the only way is to increase automated controls to identify valuation issues at the earliest stage of the process.

Carlin: Vendors will continue to make improvements and create efficiencies in their intra-day communications with clients. Such communications will include delivery of market analysis in the form of commentary, large price movements, and benchmark trade details.

Interest in multiple pricing snaps seems to be growing among industry participants, yet this may prove challenging in terms of processing and reviews. One solution is for vendors to deliver information that expedites users' end-of-day price validation process. Saving the end-user time by providing information that reduces price challenges and general market movement inquiries should be the aim of a provider.

> "Flexibility and capability of pricing agents to switch providers easily is a developing trend among pricing agents"
>
> *Gary Pringle, JPMorgan*

How do you see future regulatory requirements impacting the evaluated pricing market?

Pringle: Greater scrutiny on the evaluators, more transparency for all recipients and better linkage to FAS/IFRS/Solvency III requirements are all key areas. Expertise needs to grow along with general awareness and evaluators or providers of evaluations need to ensure marks are related to genuine market activity or provide advice where that is not the case.

Quality is worth paying for. Poor quality and transparency will not be tolerated. Flexibility and capability of pricing agents to switch providers easily is a developing trend among pricing agents, as regulatory focus on fund administrators and pricing agents to manage their vendors increases.

Sharkey: Growing pressure on vendors to increase the transparency around their in-house models and to take greater responsibility for the accuracy of the prices. The vendors will probably be more helpful on the former than the latter.

Blance: Ironically, regulation is the friend of evaluated pricing—a statement that few other areas could make. With a regulatory focus on independence, objectivity, consumer protection and defensibility of valuations, few other pricing types can provide the confidence that properly produced and supported evaluations can. With trades, dealer quotes and aggregates posing questions of coverage, reliability and potential conflict of interest, I believe evaluated pricing has an important role to play in helping to ensure compliance with valuation requirements.

Thuillier: Regulators are pushing for more transparency. The trend is to have an audit trail for each valuation and to be able to justify any methodology used. It is important for our clients that we stay ahead of regulatory changes and develop our services so we can advise and accompany them throughout the process. For instance, we have developed transparency reports that can be delivered on demand for any given product valuation; in these reports, we describe the characteristics of the trade, the model and assumptions used, as well as all underlying market data.

> "Ironically, regulation is the friend of evaluated pricing—a statement that few other areas could make"
>
> *Ian Blance, SIX Telekurs*

Carlin: The convergence of regulatory rules and accounting standards globally will make it essential that firms have a consistent flow of price data throughout the entity.

All disciplines spanning front to back office will require the same price data at the same time. Pre- and post-trade transparency initiatives may compel firms to utilize more providers than they employ today.

The pressure to be more transparent on level 3 assets may provide opportunities for providers interested in developing analytical models that offer risk-adjusted valuations. S&P Capital IQ has recently announced the launch of such a service.

Q&A

Raising Pricing's Profile

Legacy positions still on the books are likely to drive increased interest in third-party evaluated prices. IRD speaks to John Jay, senior analyst at Aite Group, about the ways market developments are pushing users to data services vendors

John Jay, Aite Group

Is there any give and take between issuers and users of evaluated prices, and how is that playing out?

Historically, issuers and users of evaluated prices should operate at arm's length because of the inherent conflicts of interest involved. To the extent an issuer can provide certain aspects they feel are not properly reflected in the evaluations, then they might be able to raise them with an evaluator. However, the final evaluated price or fair value should be left entirely in the hands of the evaluator.

Is interest in evaluated prices still on the rise?

For holders of risky assets, evaluated prices "live" in level 2 and 3 securities. That said, interest will increase if the issuance of level 2 and 3 securities increases. Even if issuance does not increase, all else being equal and given an industry and regulatory environment pushing for increased overall transparency, the interest level for evaluated prices from third-parties is much greater today than just a few years ago due to substantial legacy positions that are still on the books.

Are market developments affecting the interest in evaluated prices?

Greece's impending default, the European Union's progress toward a debt agreement, and voluntary write-down of credit default swaps of Greek debt are affecting security values. As global securities become more intertwined with cross-border interests, the need for, and interest in, evaluated prices will play a continuing important role in the capital markets.

What is the current state of third-party offerings for evaluated prices?

Within the context of a conservative regulatory trend of pushing for more transparency, not less, vendors offering evaluated pricing services are in a sweet spot. Moreover, the arm's-length role vendors provide also effectively removes an inherent conflict of interest of marking one's own book.

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