International Valuation Standards Board
1 King Street
London
EC2V 8AU, United Kingdom

28 February 2014

Re: Credit and Debit Valuation Adjustments Exposure Draft

Dear Sir / Madam:

We are responding to your invitation to comment on the above exposure draft on behalf of PricewaterhouseCoopers. Following consultation with several members of the PricewaterhouseCoopers network of firms, this response summarizes their views. "PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

PricewaterhouseCoopers appreciates the International Valuation Standards Committee (IVSC) Standards Board (Board) efforts and welcomes the opportunity to provide comments on the exposure draft (ED) that sets out the Board's proposals aimed at providing information on credit and debit valuation adjustments. We have in this letter outlined our general comments and then, as requested in the ED, responded to certain specific questions for comment in Appendix A.

We agree that the valuation of derivatives is a complex area and that information aimed at improving the general understanding of complex valuation concepts is beneficial. However, we have three fundamental concerns with the document that we believe the Board should address before proceeding with its issuance. First, it is not clear what valuation standard this document is interpreting. Without that clarity, it is difficult for a reader to understand the conceptual framework that underpins this document, and may interfere with the stated goal of reducing diversity. We believe that the Board should be more disciplined in its use of TIPs, and be sure to provide clear linkage to a related valuation conceptual standard. Second, the TIP states that the issue applies not only to financial institutions, but to corporate entities as well. It is not clear to us that the views of those corporate entities have been fully considered in the document, and we suggest that the Board specifically solicit and incorporate those views prior to release. Finally, we do not believe a TIP should dictate or prescribe what model or technique is appropriate for a given user. Rather, it is more appropriate to provide information about the valuation standard that enables users to make an informed decision based on their specific facts and circumstances.

As a related matter to our third point above, we believe the IVSC should proactively caution any users not familiar with TIPs that the document is not meant to specifically prescribe any one methodology or approach. As currently stated in the paper, the IVSC defines the audience as individuals with "valuation or risk management functions". Even if it is not intended, this paper will reach a much broader audience. We believe that users who are unfamiliar with the IVSC's process may rely on the models without proper consideration of whether it is appropriate for their intended use.

As further illustration of our previous point, we note that the financial theories surrounding the issues explored in the paper are evolving and complex. In many cases, the appropriate approach is influenced by a number of factors including the size of the portfolio / credit exposure, as well as general data availability of market participants that transact in derivative products. In order to address these observations, we think the Board should consider whether it would be better to introduce the different approaches as “tools” that companies have at their disposal, albeit not an all-inclusive list, and describe the benefits, limitations and degree of precision each provides. This would provide an entity with more context with which to determine the model that is appropriate given its specific facts and circumstances, nature of its portfolio and required level of precision. Notwithstanding this point, as noted above we believe the Board should ensure that the conceptual valuation model underpinning this guidance is clearly articulated in a Standard prior to providing any information in a TIP.

We believe the discussion related to governance and controls related matters are beyond the scope of the Board’s mandate as we understand it, and detract from the overall purpose of the paper.

As a related, and secondary consideration, we believe it is reasonable for the paper to state that IFRS 13 *Fair Value Measurement* requires an entity to consider non-performance risk when determining the fair value of an asset or liability. However, we believe the paper should clarify the inherent limitations that users should not use the paper for specific application guidance for IFRS 13, or any other accounting framework including US GAAP.

In summary, we encourage the IVSC to be more structured in its approach to addressing valuation issues. We are concerned that the current hierarchy of valuation standards and TIPs is not being adhered to, and in fact may not be the most appropriate structure for the Board to follow. We would be pleased to share our views regarding the broader issues at the Board’s convenience

If you have any questions on the content of this letter, please do not hesitate to contact John Glynn, PwC Global Valuations Leader (+1 646 471 8420), Romil Radia, UK Valuations partner (+44 20 7804 7899) or John Hitchins, PwC Global Chief Accountant (+44 20 7804 2497).

Yours faithfully,

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Appendix

Questions
Paras 4 - 7 set out the proposed scope of the paper.
1. Do you agree that the proposed scope is appropriate? If you disagree, please indicate changes that you would recommend.
As noted in our cover letter, we believe that it is unclear what valuation standard is being interpreted and that the scope of the paper should be adjusted both to address who the audience is intended to be as well as the purpose of the paper and calibrate the messaging accordingly.

Para 8 sets out a series of proposed definitions for terms used in this TIP.
2. Do you agree with these definitions? If you consider an alternative or additional definition is appropriate then please provide this in your response.
We noted two examples of internal inconsistencies. One is between the terms "debt valuation adjustment" and "debit valuation adjustment". The document should be updated to use the term consistently. We also note that there is a difference between the term "contingent credit default swaps (CCDs)" and the corresponding definition that only refers to credit default swaps. This should be updated as these two terms describe different types of derivatives.

The "Principles, Methodology, and Practical Application" sections all reference the Monte Carlo process as the most accepted method of exposure simulation.
3. Do you believe that other methods should be considered in addition to the Monte Carlo, such as binomial and trinomial trees?
Consistent with our cover letter, we do not believe that this paper should state which method is most appropriate. Rather, it would be helpful for the reader if the paper focused on the merits, limitations, and degree of precision of each model.

The "Principles, Methodology, and Practical Application" sections all reference netting sets.
4. Do you believe that netting sets have been discussed to an appropriate level of detail?
We recognize that it is reasonable that the paper refer to an entity's legal right to offset in the event of default as we understand such provisions are well established tools utilized to manage credit exposures. As such, we believe they would have an impact on the calculations of CVA and DVA. We believe the paper should discuss the theoretical impact netting has, but should emphasize the importance of legal analysis supporting enforceability of such netting.

Paras 79 - 83 discuss the importance of appropriate governance and controls around the process of calculating credit and debit valuation adjustments. They highlight this as a particular issue for financial entities which create and trade instruments but also for non-financial entities where there is also a need for systems to ensure that the data used is objective and reliable. Although the IVS Framework indicates that it is a fundamental expectation that adequate controls and procedures are in place to ensure objectivity in the valuation process, the standards do not otherwise expand on this. The IVSC publishes a Code of Ethical Principles for Professional Valuers that can be applied to a wide range of valuation activity.
5. Do you consider that there is a need for the IVSC to augment this with more specific guidance on governance and controls in the financial sector?
As described in more detail in our cover letter, we do not believe this document is the appropriate forum to address questions around governance or controls. We believe that this document should not try reach beyond its target audience and primary topic and not attempt to address issues related to governance and controls.

6. Do you consider that there is a particular issue or issues that arise when considering a suitable governance and control protocol for calculating CVA or DVA that does not otherwise give rise to concern?
Please see our response to question 5.

Paras 84 - 94 of the paper dealing with the Practical Application of the principles discussed previously proposes that entities adopt more complex methodology as the size or materiality of their derivative transactions increases.

7. Do you agree that it is appropriate to suggest that entities with less complex or smaller derivative holdings in relation to their overall business should adopt less complex methodology, or instead should all entities be expected to implement equally rigorous methodology?
We feel that it is a flawed premise to suggest that an approach can be selected based on the size or level of sophistication and to suggest otherwise could unintentionally give entities a false impression of what model can or should be used.

The “Cost of Funding” section discusses Funding Valuation Adjustments (FVAs) and their relationship to CVA and DVA.

8. Does the discussion about the cost of funding contribute to the objectives of the TIP outlined in the “Scope and Purpose” section on p3?
No, we do not believe the cost of funding valuation adjustment discussion contributes to the objective of this paper. FVA is a complex issue. If the IVSC were inclined to explore this topic, we believe that it would require a much more detailed analysis of the issue in a separate TIP.

The “Cost of Funding” section indicates that there is still an on-going discussion about how best to apply FVA, or whether it is even relevant to the calculation of market value, or fair value as defined in IFRS 13.

9. Given the current debate in this area, do you believe it is appropriate for this TIP to outline the main issues, or should this be removed altogether until there is greater consensus?
As noted in question 8, we believe it would be more appropriate to remove it from the document.

The TIP is not intended to be used as an educational resource; however one objective is to aid professionals who are not specialists in understanding the principles that underline credit and debit valuation adjustments.

10. With this in mind, are there any key principles that have been omitted or not fully explained?
See discussion of scope in our cover letter.