March 5, 2014

Sent via email to commentletters@ivsc.org

IVSC Standards Board
International Valuation Standards Council
41 Moorgate
London EC2R 6PP
United Kingdom

Dear Sirs:

Re: Comments on IVSC Exposure Draft – Debit and Credit Valuation Adjustments

The Canadian Institute of Chartered Business Valuators is pleased to provide our comments on the above noted IVSC Exposure Draft concerning a proposed Technical Information Paper on Debit and Credit Valuation Adjustments (TIP).

Responses to Questions posed in the Exposure Draft

Question 1
Do you agree that the proposed scope is appropriate? If you disagree, please indicate changes that you would recommend.

CICBV Response
We agree with the proposed scope of the TIP.

Question 2
Do you agree with these definitions? If you consider an alternative or additional definition is appropriate the please provide this in your response.

CICBV Response
We generally agree with the definitions. We point out that in the definition of DVA the word debit is written as debt.
Question 3
Do you believe that other methods should be considered in addition to the Monte Carlo, such as binomial and trinomial trees?

CICBV Response
Although the Monte Carlo method is extremely robust and effective as an approach for calculating CVA and DVA, we believe that other methods such as tree based approaches can also be effectively used to estimate CVA and DVA under certain circumstances. There is the risk that a reader may assume there is a presumed bias or mandate to use one particular method over another.

Question 4
Do you believe that netting sets have been discussed to an appropriate level of detail?

CICBV Response
We believe there should be some level of discussion around netting sets as it relates to whether all trades with a particular counterparty be considered or whether it be by relevant asset classes. For example, IFRS 13 does not allow a counterparty to net loans with derivative assets and liabilities if it isn’t already measured at fair value.

Question 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?

CICBV Response
We believe the paper should focus on the valuation and determination aspects of CVA and DVA given the current objectives of the IVSC rather than on governance and controls.

Question 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?

CICBV Response
Please see our response to question 5 on this matter.
Question 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?

CICBV Response
We believe there are pros and cons of suggesting and describing a less complex methodology. While introducing a simpler methodology could represent a practical alternative to an unnecessarily complicated calculation, it does not address the issue of by whom and when should it be used.

Unlike how a discrete line can be drawn between two different methodologies described in a theoretical paper, it may cause confusion amongst readers as to where that line should be drawn in practice. Without specifically identifying what entities should be applying which approach, the concept of best practice becomes blurred. The danger of providing a simplified alternative to a more rigorous methodology is the adoption of that alternative simply for the basis of cost minimization.

We believe the adoption of a simplified approach makes most sense when the conclusion of such calculation does not result in a materially different answer then had a best practice method been used. To clarify, the materiality should be considered in reference to what the calculation is intended for (i.e. managing risk, financial reporting, capital calculation, etc.).

Question 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?

CICBV Response
We believe that the cost of funding as mentioned in the TIP is an important and significant consideration in the calculation of CVA and DVA. Given the current discussions and debates around the cost of funding currently taking place amongst both academics and practitioners, we believe it is beneficial to highlight this particular issue as it will obviously have a significant impact to the methodology as it currently exists.

Since there is no general consensus on the treatment of funding cost, we believe although it is important to have an unbiased discussion around the issues at hand (as has been done), it may also be beneficial to provide a potential view on them. Describing the challenges around cost of funding is important; however, rationale for taking one position over another is what will add value to a practitioner’s understanding and implementation process.
When the issue of funding cost is eventually resolved or a generally accepted best practice is established, the IVSC may consider updating or reissuing this TIP given the significance of its impact.

Question 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?

CICBV Response
Please see our response to question 5 on this matter.

Question 10
With this in mind, are there any key principles that have been omitted or not fully explained?

CICBV Response
As this TIP has been issued by the IVSC, it may be beneficial to have a discussion around the symmetry of CVA and DVA between two counterparties in the context of fair value. As active CVA desks are become more common amongst major financial institutions, this will no doubt impact the way CVA is managed and derivatives priced. This could complicate the way bank counterparties perceive fair value from their perspective (given the lack of transparency of the bank portfolio) when trying to determine fair value (inclusive of CVA/DVA considerations) at a future mark date.

We hope that this submission is helpful to you. If you have any questions regarding our comments, please do not hesitate to contact Robert H. Boulton, CA, CBV, CICBV Director, Education and Standards.

Yours truly,

Richard Ginsberg, CPA, CA, CBV
Chair, Professional Practice and Standards Committee