

August 31, 2016

International Valuation Standards Council
1 King Street
London, EC2V 8AU, United Kingdom
commentletters@ivsc.org

Re. IVSC Exposure Document IVS 500: “Financial Instruments”

Dear Members of the Council,

Thank you for the opportunity to comment on the IVSC Exposure Document IVS 500 “Financial Instruments.” As an independent securities valuation specialist with over twenty years’ experience in financial reporting, securities valuation, and the use and application of fair value measurement in the United States, Harvest Investments, Ltd. welcomes the Council’s attention to improving transparency in financial reporting worldwide and strongly supports its Financial Instruments Initiative.

At the outset, we note that the IVSC attributes a placeholder status to IVS 500: its content reflects the work undertaken to date, but does not necessarily circumscribe what the Council will do. In what follows, we would like to call the Council’s attention to the distance that can separate the fair-value guidance provided in IFRS 13 and ASC 820 from what we have observed in practice. We are encouraged by the fact that, even in its current provisional form, IVS 500 attends to several of the most important sources of the problems we have encountered. Its general focus on pricing, its counsel against over-reliance on a single price quote (and, by extension, on quotes from a single pricing service), as well as the idea that transparency in valuation is fundamentally pegged to user understanding of inputs are all integral to fashioning effective guidance.

In addition, we recommend that the Council consider making a clear distinction within IVS 500 between pricing and valuation, with the term valuation reserved for independent analysis that provides transparency with respect to inputs. We agree with the Council that reliance on a single pricing source can obscure bad values, and that, conversely, the use of more than one source for pricing information can highlight bad values. While we realize that pricing services play an important role in the financial system because of the sheer volume of securities and the need for timely information, we would also caution that they do not (and indeed cannot) offer the degree of transparency with respect to inputs that a valuation specialist can because they operate in a proprietary manner.

Transparency deficits are a major source for the variances that we routinely detect each year within many types of securities, particularly among types that are more complex (e.g., levels 2 and 3 in the fair-value hierarchy). We often see mispricings of the agency mortgage pools we review, for example, which are core investments for banks. The vast majority of the meaningful variances we discover are due to

inappropriate market comparisons and/or inputs and overreliance on a single source of data. We routinely find problems with fair value leveling, particularly with the overuse of level 2 in order to avoid the implication of uncertainty or “subjectivity” in valuation that accompanies level 3.

Our examples indicate that current practice can and does fall short of conformity to existing guidance. Fair value is a powerful indicator of both present and future risks and exposures, but only when it is done right. These problems are also consonant with broader contemporary concerns about confirmatory bias with respect to valuations and/or the “rubberstamping” of management data. Independence in valuation, the availability and intelligent use of multiple pricing sources, and transparency with respect to inputs are all key to ensuring that bad prices don’t hide bad securities. They are also essential for mitigating the systemic risks that can be concealed in the uncritical repetition of data.

We agree with the statements in IVS 500 that both pricing sources and inputs must be clearly understood in order to be used in an informed manner, and we would welcome the opportunity to work with the Council to achieve this. We thank the Council for the opportunity to comment on this exposure document, and for its time in reviewing our concerns. If the Council is interested in discussing any of our views in more detail, we are at its disposal: please contact Susan DuRoss at 312-823-7051.

With best regards,

Harvest Investments, Ltd.