

September 27, 2013

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 – Valuation of Equity Derivatives



The Canadian Institute of Chartered Business Valuators is pleased to provide our comments on the above noted IVSV Exposure Draft concerning a proposed Technical Information Paper on the valuation of equity derivatives (TIP).

Responses to Questions posed in the Exposure Draft

Question 1

Under the heading of “Equity Derivative Products” (para 11-22) the main types of equity derivative are listed. Do you believe there are any material omissions? If so, please indicate what they are?

CICBV Response

We do not believe that there are any significant omissions in the Exposure Draft. The IVSC may consider including other common structured products, depending on the intended target audience for the TIP.

Question 2

Do you believe the descriptions provided for each of the listed products are sufficiently detailed?

CICBV Response

The inclusion and introduction of “typical” option payoff graphs/diagrams may be useful to help describe the economics of equity options.

Question 3

Do you think more complicated derivatives and strategies should be included? For example where products are combined, such as in straddles and strangles?

CICBV Response

Given the long list of possible option strategies, it may not make sense to list every one. In addition, option strategies will not directly have an impact on valuation. Where the introduction of option strategies may make sense (in the context of valuation) is in describing how exotic payoff structures may resemble a combination of various other options. The inclusion of “typical” option payoff graphs/diagrams may be useful in illustrating these relationships and payoffs (assuming they have been described and introduced earlier in the paper, see our response to question 2 above).

Question 4

The discussion on forwards (para 23 to 27) includes a number of formulae. Do you find the inclusion of formulae to be helpful in understanding the principles or would you prefer a purely descriptive nature?

CICBV Response

The formula for the forwards was useful for that particular product. Given the increasing complexity and significant volume of formula that could be introduced for all products, it may not be practical to do so without creating what would amount to be a textbook on the subject.

Question 5

Would you prefer to see greater use being made of formulae to illustrate principles in other parts of the TIP?

CICBV Response

The only other formula that we would suggest be considered for inclusion would be basic Geometric Brownian models (i.e. Black-Scholes-Merton solution, Cox-Ross-Rubenstein binomial tree, Geometric Brownian in a Monte Carlo setting). They would help to illustrate the commonality and differences between methodologies.

Question 6

The discussion of various models types includes the key assumptions and other inputs required. The objective is not to provide detailed instruction on the use of the model, but do you think the information on these inputs is sufficiently detailed to provide an understanding of the principles involved by someone relying on the valuation?

CICBV Response

A detailed step-by-step set of instructions may not be necessary for the determination of inputs; however, it may be useful to introduce some overall principles. For example, IFRS accounting standards go into detail on the hierarchy of input selection (observable inputs before unobservable inputs etc.).

Question 7

Do you believe the model section of this paper should discuss each model's relative applications and when it is appropriate to use one rather than another, for example, by mapping each model to a list of products?

CICBV Response

In the case of closed form solutions, it would be useful to map model to product; however, it would be useful to clarify that there are also other ways to arrive at a valuation. Where there may be ambiguity is when a product is being valued that is similar but not identical to a product with a closed form valuation solution. For example, should the closed form solution be used and adjusted or should a more open ended model such as trees or simulation be used? It may be useful to address this ambiguity when mapping products to solutions (not necessarily to arrive at a valuation or how to deal with it, but to raise the issue for readers to consider).

Question 8

"The Greeks" are summarized with brief descriptions in this paper. Do you believe it would be helpful if there were a more detailed discussion of sensitivities?

CICBV Response

Although, the Greeks may be useful in understanding the sensitivity of answers, they may not be directly related to arriving at a discreet valuation.

Question 9

Please list the departments within your organization that you believe would find this document useful, e.g. Executive Management, Treasury, Risk, Financial Reporting, Product Control, etc.

CICBV Response

We are of the view that this exposure draft will be of interest to those individuals in executive management, treasury, risk management and financial reporting functions. The extent to which such individuals will find the document useful will depend on the extent of tie-in with their specific function (i.e. reference to accounting standards in case of financial reporting, or discussion of the Greeks and option strategies in the case of risk management and/or treasury).

Question 10

Do you consider that the overall level scope and level of detail in this proposed TIP is sufficient to meet its objective of reducing diversity of practice and raising awareness of the principle methods used for valuing equity instruments among the wider financial community, and in particular investors?

CICBV Response

It is our view that the scope and depth of this paper meets its objective of raising awareness of principal methods used for valuing equity instruments; however, it is not clearly defined or obvious to us for whom the paper is intended, particularly with regard to reader's level of knowledge of the subject matter. Readers knowledgeable in the subject matter will likely find the paper to be overly simplistic and obvious in many cases, while less knowledgeable readers may find that the paper gets into too much detail on methodologies and definitions. It may be useful for the IVSC to more clearly identify the knowledge level of the target audience for the TIP and direct the contents of the TIP to that reader versus trying to appeal to all readers.

Specific Comments on the Discussion Paper

1. Paragraph 7 – in the definition of deterministic we would suggest that “variability” may be a more appropriate than “variables”.
2. Paragraph 8 – should refer to billions of dollars as opposed to billion dollars.

3. Paragraph 18 – under the American option type its date of” should be added before maturity and “the” should be added before “holder” in the phrase “...the holder has more rights but holder has to determine...”.
4. Paragraph 22 – inference is made that options are unlike warrants in that settlement is not usually from newly issued shares, issues of options are often also the holder of the underlying equity as with warrants.
5. Paragraph 22 – reference is made to bonds being callable whereas it appears that redeemable is the correct context.
6. Paragraph 26 – “of” should be added after estimate.
7. Paragraph 75 – the inclusion of an explanation as to why volatility is not a constant function of strike price might be a useful addition.

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