International Valuation Standards Council
1 King Street
LONDON EC2V 8AU
United Kingdom

October 20, 2014

Re: IVSC Standards Board Agenda Consultation

Dear Technical Director,

Duff & Phelps appreciates the opportunity to provide comments on the above referenced Exposure Draft.

Our valuation advice, particularly with regards to financial reporting, is sought by hundreds of global clients annually as we work with them in developing pragmatic solutions for applying fair value techniques.

We would be pleased to further discuss our comments with the IVSC. Please direct any questions to us via the contact information set forth below.

Sincerely,

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Managing Director
Global Financial Services Leader

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General Criteria for Content

Question 1a

Should the IVSC supplement its current standards with additional standards for subsets of assets that fall within the high level categories currently covered in IVS 200 – IVS 250?

If yes, please indicate the nature of the subsets that you would like to see included and any criteria that you believe that the Board should take into account in determining the priority to be given to these.

> **D&P Response:** We do not see a need to create additional *standards* for sub-asset classes (also see our response on the *Structure and Scope of IVS Consultation Paper*). We believe that the five main asset classes – Businesses and Business Interests; Intangible Assets; Plant & Equipment; Real property Interests; and Financial Instruments – constitute the appropriate level for standards. However, in general, *non-mandatory* implementation/application guidance would be useful on the sub-asset class level and industry level, as well as for different purposes.
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> Care should be taken when identifying specific subsets of assets that may require different perspectives depending on the defined basis of value or the purpose of the valuation. For example, IP value is viewed differently in the context of financial reporting and transfer pricing. Industry best practices on specific assets such as IPR&D (issued by the AICPA) and Customer-Related Assets (under development by The Appraisal Foundation) are developed specifically for use in financial reporting. Therefore, the basis of value addressed and the purpose of the valuation should be a consideration for any IVSC agenda item, particularly in the area of best practices.

Question 1b

Should the IVSC create additional standards to deal with the application of the principles in the existing IVSs to valuations for different purposes?

If yes, please indicate any purposes other than those already covered in IVSs 300 and 310 (Financial Reporting and Real Property for Secured Lending) that you would like to see included and any criteria that you believe that the Board should take into account in determining the priority to be given to these.

> **D&P Response:** In general, yes. However, these would be considered low priority in our opinion, compared to application guidance on sub-asset classes, especially for financial instruments (for various purposes), which we think is a high priority item. We believe that the high-priority focus on the latter is due to the general lack of unified guidance in the marketplace regarding financial instruments valuation, the fact that this affects multiple jurisdictions, and its pervasive effect on economic stability.
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> Furthermore, we would envision application guidance that is far more detailed than what is currently incorporated in IVS 300 and 310. For example, the guidance contained in IVS 300 seems to present a high-level summary of the requirements of different IFRSs, but no real hands-on guidance.
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> As noted in 1a above, developing standards for different *purposes* may entail a different treatment of the same asset depending on the purpose of the valuation. This creates a challenge when considering the timing and interaction of sequentially developed standards addressing asset/sub-asset classes vs. valuation purposes. For IVSC's consideration, the approach taken by the AICPA, TAF and IPEV (to name a few) is different, as they have chosen to limit their guidance to specific assets for specific purposes (at the same time). This is an entirely different perspective from IVSC's approach which seems to address assets broadly, and then separately address valuation purposes. We think that the IVSC should evaluate its approach more carefully.

Extractive Industries

Question 2a

Do you or your organisation encounter valuations of assets in the Extractive Industries? If no, please proceed to Question 3a.

If yes, please indicate the nature of the assets involved and the purposes for which the valuations are required.

D&P Response: Yes, we perform such valuations.

Question 2b

Do you have experience of problems or inconsistency in the way in which assets in the Extractive Industries are valued? If so please also indicate whether, in your experience, these are:

1. **specific to a particular country or jurisdiction or are common across borders,**

2. **arise across all the extractive industries or are specific to a particular sector (eg mining) or subsector (eg metal ores).**

D&P Response: While we recognize that mining and oil & gas are characterized by different geological structures, mapping technologies and extraction methods, to say the least, even within the mining and oil & gas industries there are differences in application depending on the specific resource being extracted which reflect different risks, capital investment, different inputs used in the valuations. Well thought-out high level guidance would provide the common principles for performing valuations in the extractive industries, while allowing flexibility in the actual execution to reflect the unique characteristics of the resources and reserves being valued.

We think that the majority if not all of the guidance should be in the form of best practices (non-mandatory) guidance. We believe that in general, high-level guidance would be suitable for Extractive Industries to accommodate variations in applications to different types of resources and reserves. The alternative of providing specific guidance by type of resource is not practical in our opinion.

Also please see our comment letter (dated October 20, 2012) on IVSC's discussion paper on Extractive Industries.

Question 2c

Please indicate whether you believe that this should be a high, medium or low priority for inclusion on the Board's agenda.

D&P Response: See response to 2b.

Trade Related/Going Concern Property

Question 4a

Do you or your organisation produce or rely on valuations of real property that is normally bought and sold at a price which reflects the potential earnings that can be made from operating a particular type of business from the property? If no, please proceed to Question 5a.

If yes, please indicate the type or types of real property that you are aware are generally valued using this approach.

D&P Response: Yes, but note that the use of earnings may result in a value that comprises more than the "bricks and mortar" of the real estate. The value of the "real estate" in such an example would indicate the value of a business including some intangible assets (for example, trade name, customers). Also see comments in 4d below.

Question 4b

Do you consider that it would be beneficial for the Board to produce guidance on the method of valuation of a real property interest that uses the income that can be generated by a business in occupation as an input?

D&P Response: No. Also see comments in 4d below.

Question 4c

If you have answered yes to question 4b, please indicate the issues that commonly cause difficulty or inconsistency in applying this approach.

D&P Response: It all depends on what assets are included in the term "real property". For personal property, an analogous issue arises when valuing satellites. One could value the "business" attributable to the satellite in space by capitalizing earnings in some manner. However, that value would include intangibles such as 1) the orbital slot, and 2) customer contracts/backlog/relationships.

Also see comments in 4d below.

Question 4d

Please indicate whether you believe that this should be a high, medium or low priority for inclusion on the Board's agenda.

D&P Response: We believe that it is neither practical nor necessary to issue guidance about specialized real property, such as trade related property. The specialized nature of these assets does not require an application of the Cost, Market or Income approaches that is in any way different from their application to other assets, and neither is the related thought process. One is essentially valuing a business and it components: the analysis starts with the valuation of a business and the real property interest is an allocation thereof.

Also, please see our comment letter (dated October 31, 2012) on IVSC's discussion paper on Trade Related Property.

However, **if** the Board decides to pursue a project, we believe its priority should be low/very low, as this issue is a matter of asset definition rather than methodology.

Specialized Public Sector Assets

Question 5a

Do you of your organization value or rely on valuations for real property, plant and equipment held in the public sector? If no please proceed to question 6a.

If yes, please indicate the purposes for which the valuations are required

> **D&P Response:** Yes, we perform such valuations for the public sector/government. The purpose of the valuations include: 1) equity transfers from one agency to another; 2) monetization potential of excess assets; 3) negotiation of leases with or direct sales/purchases to/from the private sector.

Question 5 b

Do you have experience of problems or inconsistencies in the way in which these assets are valued? If yes, please indicate whether these:

1. **Arise from the nature of the asset**

   D&P Response: For the most part, we would try to consider three approaches to value in special purpose asset situations, even if it entails looking at a pro forma income approach, or at nongovernment building sale transactions as a benchmark, as a reasonableness check to the cost approach. In practice, most special purpose property appraisals are centered on a cost approach only. This issue arises mostly due to the nature of the asset and lack of similar sale and/or lease transactions.

2. **Arise or a likely to arise across borders,**

   D&P Response: Real estate is local and ideally we try to focus on neighborhood or submarket specific data. However, in many situations our focus, based on availability of data, can become at a minimum country-specific, down to city-specific.

3. **Arise because of need to comply with specific legislation or regulation**

   D&P Response: Public entities have specific requirements for their valuations which are addressed, for the most part, by the methodology referenced earlier. Additional requirements usually relate to market value definitions, local/state/national law and regulatory consideration, etc. which generally do not add a significant amount of additional analysis.

Question 5c

Please indicate whether you believe that this should be a high, medium or low priority for inclusion on the Board's agenda.

> **D&P Response:** We do not believe there are any pressing issues in this area outside of the appraiser being familiar with the local laws and regulation as it relates to fair value definitions, licensing requirements, and qualified expertise. Therefore, we consider this to be a medium priority agenda item.
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> Also please see our comment letter (dated March 1, 2013) on IVSC's exposure draft on Specialized Public Service Assets.

Derivatives

Question 6a

Do you or your organisation value or rely on valuations of derivatives? If no, please proceed to question 7a.

> **D&P Response:** Yes.

Question 6b

Please indicate which of the listed underlying asset classes you believe should be given priority in the next phase of the Derivatives project

> **D&P Response:** Foreign exchange derivatives - its priority is based on the size being the largest within the derivatives market, as well as that most public and private companies, firms, institutions, entities and organizations have some exposure with this type of derivative.

Funding Valuation Adjustments

Question 7a

Please indicate whether you have encountered problems or inconsistencies in the way in which funding valuation adjustments are applied. If not please proceed to question 8a.

> **D&P Response:** We are aware that there is a debate on the inclusion of, and if so, the methods for deriving the Funding Valuation Adjustments (FVA) in financial reporting. We understand that recently certain banks have observed an "industry migration" to incorporating FVAs as part of valuations for financial reporting and that the adjustments can be significant. Clearly there is diversity in practice in this area and best practices guidance is by its nature intended to reduce such diversity without being mandatory. Perhaps the IVSC can make an effort to build consensus on this topic when it is most needed.
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> Also please see our comment letter (dated February 28, 2014) on IVSC's exposure draft on Credit and debit Valuation Adjustments which included a question on Funding Valuation Adjustments.

Question 7b

Please indicate whether you believe that this should be a high, medium or low priority for inclusion on the Board's agenda

> **D&P Response:** The level of priority would be driven by the materiality of these adjustments and the prevalence of various practices that would yield significantly different results.

Valuations for Resolution and Recovery

Question 8a

Please indicate whether you or your organisation has to value or rely on valuations to support restructuring or corporate recovery. If no please proceed to question 9.

D&P Response: We have prepared valuations of assets, liabilities and enterprises during periods of time that are considered financially difficult, in connection with restructurings, or required through new regulations. These periods of time are unusual and may require additional analyses and probabilistic scenarios to consider the impact of market conditions on going concern, the potential pool of market participants, as well as the available information that would be considered in a contemplated transaction, all of which has a direct impact on the value of the underlying assets, liabilities and enterprises.

Question 8b

If yes, please indicate any valuation issues that you currently experience or anticipate arising under emerging regulations.

D&P Response: Turbulent periods of time such as the financial crisis tend to impact all assets, liabilities and enterprises. During such periods, liquidity as well as "willing buyer" considerations were top issues affecting valuations. The accounting profession addressed many of these issues with fair value accounting.

In today's environment, and in situations where liquidity is in fact available, these issues have given way to other phenomena affecting the fair value of assets, liabilities and enterprises. The mere knowledge that assets or enterprises are required to be divested (pursuant to a regulatory requirement or strategic reasons, such as non-core business considerations), often results in buyers paying less for those assets, even in an auction process. This is a reflection of higher rates or return or lower acceptable risk tolerances by potential buyers who are well aware that a transaction is required, which might otherwise not be observed, had the requirement to sell or divestiture announcement had not been made known.

As one specific example, in the global banking industry, where certain assets and businesses are required to be divested pursuant to current regulations, observed pricing has been lower than what would be anticipated based on "market participant assumptions". In addition, specific structures are often negotiated to appease the potential buyer or management and to arrive at acceptable terms to transact, which would normally not come into place. Note that since the seller is given ample time to dispose of the assets or enterprises, these circumstances would not fall under "duress".

Further, in some cases, market participants that would have normally been included under consideration are now excluded given regulatory requirements and their resulting impact on the underlying business operations and financial results. For example, now PE firms are the primary buyers of underperforming loan portfolios, and, while other financial institutions are not excluded from bidding, the risk associated with these types of assets, as specified by regulatory capital requirements, would indicate the need to allocate a significant amount of capital to put up against these portfolios, which would not provide adequate or comparable returns relative to the private equity firms that do not have similar capital requirements. Additionally, most of these financial institutions have these types of portfolios in the process of liquidation.

In summary, to avoid significant volatility in the fair value of these assets, liabilities and enterprises (which are typically marked-to-market), we think that guidance should be provided on the consideration of current market conditions, and in particular, the effect of the requirement to sell on fair value. This would take into account how the buyers might view the assets, perceived risk, and potential transaction structures that are feasible, which might differ from a market participant perspective, absent a requirement to sell. This would likely require consideration of various probabilistic scenarios and an understanding of how other transactions were recently evaluated, structured and priced.

Question 8c

Please indicate whether you believe that this should be a high, medium or low priority for inclusion on the Board's agenda.

D&P Response: We think that the issue outlined above would be a medium- to high priority on the agenda. Even though many of these assets and enterprises are considered non-core in nature and often not material to the overall entity, these transactions still have a high profile in the marketplace. They also result in significant volatility in the financial statements, when considering the fair value at which the assets are carried vs. the price achieved in an actual transaction pursuant to a requirement to sell.

Invitation to Suggest Projects

Question 10

Do you wish to suggest any additional projects for inclusion in the Board's agenda?

If yes, please identify the nature of the suggested project as precisely as possible and provide the information requested in para 42 above.

D&P Response: With respect to **derivatives**, the IVSC discussion earlier seems to be covering the core However, there are a couple of possible omissions in the derivatives territory:

- Hybrid securities (such as convertible debt, cocos, preference shares, structured products) though these may well be covered to a certain extent in other projects. The nature of this area is such that a coherent study would be very difficult to write due to the highly varied nature of the instruments that fall under the heading.
- Inflation products – though this may be a sub-area of the interest rate (fixed income) derivatives paper.

Neither of the two areas identified above are a higher priority compared to the other subject areas in derivatives, and financial instruments more broadly. However, considering the size of the market for hybrids, and the significance of inflation-linked products in the insurance markets, both areas are possibly of medium importance.

With respect to **other financial instruments**, possible areas to address include credit impairments, as well as the development of probabilistic scenarios (the latter having applications extending beyond financial instruments). Due to the pervasiveness of financial instruments and the fact that multiple jurisdictions are affected, we believe that this is a medium-to-high priority item.

With respect to **real property** valuations, there are a number of other organizations (The Appraisal Foundation, RICS) focusing on this asset class, which the IVSC should collaborate with and leverage their expertise in the area. Apart from the universally accepted principles, in many cases approaches and methodologies should defer to the respective jurisdictions and/or local law, so in this regard any guidance in this area would be best positioned as "best practices" guidance. We view this as a medium priority item.

With respect to **assets** broadly, we think that it would be useful to address economic obsolescence in greater depth, best practices for its estimation, and how to incorporate it into the valuation of the tangible and/or the intangible assets of an enterprise, where applicable.

In general, with respect to **asset and liability valuations** (e.g. intangible assets), and **various valuation issues**, both The Appraisal Foundation in the U.S. and the AICPA have been facilitating working groups and task forces to address a number of practice issues. We strongly recommend coordination of the development any IVSC guidance with those groups, to the extent common subject areas are concerned.