

# CANDIDE

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## PRIVATE ASSET VALUATION - AND THE LIGHT SHINETH IN DARKNESS...?



The valuation of private equity interests is hot news at the moment, especially those for the large, technology companies known as ‘unicorns’. We were alerted to this issue a couple of years ago when the Securities and Exchange Commission (SEC) starting [questioning the pricing](#) of these holdings by investment funds. This culminated in a ‘sweep’ letter to mutual funds in November 2016, soliciting a range of information about how asset managers valued these portfolio securities.

Later last year it was also revealed that a [Platinum Partners](#) hedge fund was being investigated for, amongst other things, overvaluing

their investments in private portfolio companies to mislead investors.

More recently we had news of a Delaware judge [second guessing valuations](#) in some detail during an M&A case and an extremely pejorative story in the [New York Times](#) relating to valuations for 409A purposes.

In all, it seems like the methods of valuing private assets by investors and deal makers is coming under unprecedented scrutiny.

Voltaire Advisors addressed this problem extensively early this year in our [Alternative Asset Valuation Briefings](#) in New York and London, and our follow up Webinar on [‘Unicorn’ Pricing](#). *Continued on P2*

### SEC ON PRIVATE EQUITY AUDIT



Keynote speaker at our New York Briefing on [Alternative Assets Valuation](#) was Norm Champ – Partner at Kirkland & Ellis and former Director of the SEC Division of Investment Management.

Norm gave us a thought provoking view on how the Commission might develop under its new Chair, and focused specifically on recent cases he has been involved in relating to audit independence in private equity funds. The SEC is taking a hard view on auditors whose firms are also engaged in other business elsewhere in private equity shops.

**More of this in the upcoming special report on this event.**

### THOUGHT OF THE DAY

*“God is not on the side of the big battalions, but on the side of the best shots” Voltaire*

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## PRIVATE ASSET VALUATION - AND THE LIGHT SHINETH IN DARKNESS...?

A series of experts presented their views and opinions on the current landscape for private equity (especially 'unicorn'), private debt and real estate pricing, particularly by private funds.

A notable takeaway from these events was that, while standards for valuation of these assets do exist, they tend to be much more robust and well developed for real estate than for debt or equity.

The industry is clearly resolved to do something about this. Driven by the SEC, the [AICPA](#) is in the process of developing a much more comprehensive new guide to private equity and debt valuation which is due out later this year. The objective of this project is to synthesize much of the current guidance (including the [IPEV standards](#)) and provide much needed detail in areas where this was lacking.

In a related initiative, the AICPA, ASA and RICS have created a new credential for professionals engaged in fair valuation of business interests. This [Certificate in Entity an Intangible Valuations \(CEIV\)](#) is heavily focused on the documentation requirements of such exercises, following a theme that ran throughout our events of the need for more transparent recording of assumptions and calibration. Such substantiation is a key component of the [Mandatory Performance Framework](#) underpinning this new landscape.

**Any initiative that brings clarity and transparency to this rather murky valuation environment is to be lauded. Voltaire Advisors is fully engaged in this process and clients will receive regular updates on progress and developments.**

# BOND PRICING - ODD-LOTS AND BROKER QUOTES



We all heard in 2015 that PIMCO had received a Wells Notice from the SEC in relation to its marking of odd-lot positions in its Total Return Fund ETF in 2012. Maybe with the acrimonious departure of Bill Gross, everyone forgot about this, but we all got reminded in December 2016 when the firm was [fined nearly \\$20m](#) because of the investigation.

The fine print of this order made interesting reading on what the Commission saw as malfeasance (and, equally importantly, what they did not!). Being at the intersection of regulation, valuation and vendor use, this was right in our sweet spot, and we covered the issue in a series of client notes and a [Webinar](#) earlier this year.

Wrapping up another valuation related action - this time criminal - from a few years ago, a trader from [Visium Asset Management](#) was jailed in January for fraudulently mis-valuing his bond holdings.

The jury in the case heard about overrides of fund administrator prices nearly 300 times in 2 years, false broker quotes nearly 1000% higher than trade levels, 'painting the tape' to create false

trade prices and many other manipulations to distort fund NAV.

The influence of broker quotes on fund valuations - and the shortcomings of this method in an illiquid market - were also apparent in a recently settled case between [Saba Capital Management](#) and the Public Sector Pension Investment Board of Canada.

Coming down to **"a commercial dispute involving a good faith disagreement over the valuation of two highly illiquid corporate bonds"**, let's hope this does not set a precedent for fair value disputes in the future!

A characteristic of several recent fund valuation problems that they occurred with Mortgage Backed or other structured credit securities. The bête noire of the financial crisis is still biting, it appears, and we may have another issue on the horizon with [Premium Point Investments](#).

The resignation of a CFO does not bode well, we fear, and will be keeping a close eye on this. We will also be looking specifically at pricing sources and challenges for MBS and Structured Credit in our **upcoming Webinar on June 21st**.

## MUNICIPAL MARKET MOILS



In another sector of the bond market – municipal bonds – decades old operational certainties were being upended by a period of pricing and benchmark indices vendor consolidation.

ICE Data Services – already owners of the business formerly known as Interactive Data, the market leader in fixed income evaluated pricing – announced that they were acquiring their main competitor in the Muni market, [Standard & Poor's Securities Evaluations](#).

Earlier in the year, Bloomberg had [acquired the index business](#)

of Barclays, which consisted of the most widely deployed Municipal Bond Index.

Given that Interactive Data had historically priced the constituents of this index, and this would now be transitioned to the Bloomberg evaluations service, BVAL, it was musical chairs in this space!

We have already covered this extensively in a [Breakfast Briefing, User Survey and Special Report](#) and will be providing an update in **upcoming webinars on May 25th and July 6th.**

## CHIEF VALUATION OFFICER?



Jay Baris

The increasing level of scrutiny and oversight of valuation issues by mutual fund boards and directors have

led some prominent commentators to suggest it may be time for a Chief Valuation Officer (CVO) to work alongside CCOs in funds.

Renowned fund lawyer Jay Baris [floated this idea at a conference](#) of ours late last year and we think that it has real merit. Having a named individual responsible for all valuation related issues in a mutual fund would provide appropriate focus on such a mission critical activity.

We will be doing more work on what this might entail in coming months, so watch this space!

# THE SEC AND FUND LIQUIDITY MANAGEMENT

The changing priorities at the SEC – subject of Norm Champ's keynote at our February Briefing – have also raised a question mark over some of the recent rulemaking under former Chair Mary Jo White. Our inaugural [Fund Valuation Workshop](#) in 2016 discussed some of these issues prior to the Trump victory.

While the proposed derivatives rules look like they are dead in the water, industry experts expect that the Liquidity Management rules will go ahead pretty much as planned. The need for such oversight was illustrated by circumstances at the Third Avenue Focused Credit



Mary Jo White

fund which collapsed in 2015 and just recently settled the subsequent [lawsuit](#).

The implementation of fund processes to comply with these rules by December 2018 is no small task, and the definition and bucketing of assets into liquidity categories has major implications for asset valuation.

We will be covering these issues extensively in coming months, notably in our **2nd Fund Valuation Workshop in New York on Apr 25th** and a **Liquidity Management focused Breakfast Briefing on June 15th.**

# FIXED INCOME LIQUIDITY



With the scaling back of investment banks as sources of fixed income liquidity, a raft of new electronic trading platforms has emerged to connect buyers and sellers of bonds. This trend has wide ranging implications for the disintermediation of the sell-side and the growing price making power of the buy-side. Such trade and quote data is also important 'fuel' for the specialist valuation vendors, and we believe that these firms have a significant role to play in the price discovery and transparency of the future.

There are way too many of these platforms now – over 100 – and such numbers cannot possibly achieve sufficient trade volumes to survive. We think 10-12 is likely, and we are already seeing some consolidation in the industry with ***Trumid acquiring Electronifie***.

Expect this to continue and we will be following developments closely. We have a panel on this issue at our **June 15th Breakfast Briefing** and will be following up with a **Webinar on the topic in H2 2017**.

## UPCOMING RELEASES

**Apr 13 - Special Report**  
*ETF Pricing*

**Apr 20 - Topical Webinar**  
*Feature - Syndicated Loan Valuation & Analysis*

**Apr 25 - 2nd Fund Valuation Workshop, New York**  
*Inc. Evaluated Pricing, Liquidity Management, Alternative Asset Valuation, Benchmarks...*

**May 11 - Topical Webinar**  
*Feature - European Private Debt Valuation*

**May 25 - Topical Webinar**  
*Feature - Changing Landscape of Municipal Bond Pricing*

**May 31 - Valuation Risk Review #3**  
*Portfolio Valuation for Hedge Funds*

**Jun 15 - Breakfast Briefing, New York** *Feature - Fund Liquidity Management*

**Jun 21 - Topical Webinar**  
*Feature - MBS & Structured Credit Valuation*

**Jun 31 - Quarterly Briefing Note**  
*Topical Valuation Issues Newsletter*

**Jul 06 - Topical Webinar**  
*Feature - Fixed Income Indices & Benchmarks*



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