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To:

International Valuation Standards Council

Ref:

Comments on „The Valuation of Equity Derivatives" Exposure Draft

Dear Sirs

Smart Consult SRL is a Romanian company, specialised in valuations. Our areas of expertise include companies and assets valuation, stock exchange analysis, and also corporative and investment advisory. We are familiar with the Romanian stock exchange and derivatives market; hence, we take the opportunity to respond to some of your question, considering the problem of derivatives valuation and risk assessment as one of a growing importance in today's financial environment.

1. Are all the derivatives mentioned in the exposure draft?

In our opinion, some important products are missing from the list. These are contracts for difference (CFD), certificates, and hedging and arbitrage portfolios. Each of them have some distinct characteristics (CFD usually do not expire, every certificate has a different prospectus, hedging is treated differently from individual assets), so they must be mentioned distinctly.

2. How far the description must go?

In our opinion, just the principle must be mentioned. This is because every product and every market has different characteristics, which must be clearly identified by the valuer in order to give competent arguments. For example, some markets/brokers admit simultaneously long and short on the same ticker, while others automatically close these opposite positions.

3. How far strategies description must go?

You must mention their existence, but analysing all the important strategies can be too much for a TIP. Anyway, if you want to present them, our opinion is that you must use also chart representations (this could be useful also for simple cases, like futures and options).

4.,5. Using of formulas.

Our opinion is that you can mention some basic formulas, but the valuers must acknowledge that they could have to consider also other elements, so the calculation can be more complicated. For example, you may have to take into account transaction costs, taxes, swap points and so on.
If you choose to use formulas (and/or charts), then you must use them for all the presented products, not just for some of them.

8. Detailed discussions of sensitivities.

Not just for options, but also for all derivative products you must provide a discussion about sensitivity and risk. Apart from the usually uncertainty problems, which you addressed in a previous paper, financial derivatives involve considerable more risks due to their leverage.

10. The level of presentation.

We consider the level of this draft similar to other TIPs. It is obvious that every national organisation must prepare more detailed lectures, in order to rationally standardize the financial instruments valuation.

We must mention here that IOSCO (International Organization of Securities Commissions) recently published its final report regarding the “Principles for the Valuation of Collective Investment Schemes” (May 2013). In brief, they state that products listed on regulated markets must be valued on a mark-to-market base, while hard-to-value assets must be estimated by mark-to-model, based on policies and procedures established by the management.
IOSCO’s concern is about avoiding errors and conflicts of interest and not about the precise valuation methods. Here, we must address an important question: what if the valuer and the management have different approaches, and because of this, the final values differ?

We also expect you to clarify para. *“24. The value of forwards and future contracts is not affected by the stock volatility, making the valuation process more straightforward than for other products.”*
Speculators in futures or in American type options usually do not wait the expiration date to close their positions. Sometimes, the margin needed can be too much for them. In addition, investors frequently use stop-loss and take-profit orders, while some strategies involve exiting a hedge to track a strong ongoing trend. All these situations imply that even if the value at maturity is in accordance with the initial expectation, due to market movements during the asset life time, the investor will need to close the position long before expire date.
Hence, market volatility can never be omitted.

Best regards,
Florin Turcaş,
MAA

Arad, Romania