

## STAFF PAPER

27 January 2015

## IFRS Interpretations Committee Meeting

Project	Finalisation of agenda decision
Paper topic	IFRS 13 <i>Fair Value Measurement</i> –The fair value hierarchy when third-party consensus prices are used
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

## Introduction

1. In September 2014, the IFRS Interpretations Committee (the ‘Interpretations Committee’) published a tentative agenda decision not to add to its agenda a request to clarify the circumstances in which prices provided by third parties (especially consensus prices) qualify as a Level 1 input in the fair value hierarchy in IFRS 13 *Fair Value Measurement*.
2. More specifically, the Interpretations Committee was asked to consider what the correct fair value hierarchy level is for debt securities such as government bonds that are traded in active markets but that are priced using third-party consensus prices.
3. The Interpretations Committee considered the results of the outreach request performed by the staff. The outreach indicated that there was no significant diversity observed in practice on this issue.
4. The Interpretations Committee observed that this issue is not widespread and that the guidance in IFRS 13 is sufficient to draw an appropriate conclusion on the issue submitted. The Interpretations Committee therefore determined that neither an Interpretation nor an amendment to the Standard was necessary.

5. Consequently, the Interpretations Committee decided to issue a tentative agenda decision that can be found in the [IFRIC Update](#) of September 2014.

### **Purpose of the paper**

6. The purpose of this paper is to:
- (a) provide an analysis of the comments received on the tentative agenda decision; and
  - (b) set out the wording for the final agenda decision (see **Appendix A**).

### **Comment letter summary**

7. The comment period for the tentative agenda decision ended on 25 November 2014.
8. We received **five** comment letters on the tentative agenda decision. The comment letters from these respondents are attached to this paper (see **Appendix B**).
9. Two respondents support the Interpretations Committee’s tentative decision not to add these issues to its agenda for the reasons provided in the tentative agenda decision.<sup>1</sup>
10. One respondent, the Interactive Data Pricing and Reference Data (‘Interactive Data’), outlined an overview of its approach to providing evaluated prices including the types of inputs used and how third party pricing as inputs may be classified under the fair value hierarchy.
11. It supports a wide view of the market with an appropriate assessment of all available inputs instead of an overreliance on a single dealer source.
12. Another respondent, the German Insurance Association (GIA), did not agree with the conclusion that the issue does not have a widespread or material effect. The GIA is of the view that inconsistent application of IFRS 13 in terms of third-party

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<sup>1</sup> Deloitte and EY

consensus pricing indicates that clarification of the principles of IFRS 13 is required.

13. To support its assertion of the inconsistent application of IFRS 13 in terms of third-party consensus pricing, the GIA has cited the results of a recent KPMG study relating to the reclassification of instruments by German insurers from Level 1 to Level 2 within the fair value hierarchy.<sup>2</sup>
14. The GIA also asserts that:
  - (a) the fair value measurement of assets and liabilities within Level 1 of the fair value hierarchy does not need to consist of a single quoted price but may consist of several Level 1 inputs flowing into a valuation technique and still result in a Level 1 output; and
  - (b) Level 1 inputs are not restricted to prices that reflect the results of a transaction (ie executed prices) but may also include binding offers (executable prices) and indicative prices.
15. The GIA recommends that the Interpretations Committee should clarify in its tentative agenda decision that :

Assets and liabilities, especially debt securities priced by third party vendors, can be classified as Level 1 inputs of the fair value hierarchy if all inputs of the price are of Level 1 quality and the valuation technique is a pricing convention used by market participants as a practical expedient for fair value measurement within a bid-ask spread.
16. Another respondent, the Accounting Standards Committee of Germany (ASCG), expressed the view that the Interpretations Committee's tentative decision raised follow-up questions. More specifically, the ASCG raised the following questions:
  - (a) If a third-party pricing service used a model to measure fair value and if all of the input parameters used in that model constitute a Level 1 input, would a

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<sup>2</sup> KPMG Insurance Reporting Round-Up, p27 <http://www.kpmg.com/DE/de/Documents/anlage-16-insurance-reporting-roundup-kpmg-2014.pdf>.

fair value measurement based on that model be categorised within Level 1 of the fair value hierarchy or would the mere use of a pricing algorithm, resulting in a composite price, in itself lead to a fair value measurement that cannot be considered ‘unadjusted’, thus, would not be categorised within Level 1 of the fair value hierarchy?

- (b) Can certain input parameters that lack an actual transaction—such as executable prices (binding offer)—be considered ‘quoted’ prices, thus satisfying the Level 1 definition?

### **Staff analysis**

17. The Interpretations Committee noted that when instruments are priced on the basis of third-party consensus prices, the final classification of those measurements within the fair value hierarchy will depend on the inputs used to derive the consensus prices. Consensus prices are derived using a variety of inputs that may range from Level 1 to Level 3. The Interpretations Committee noted that if the fair value measurements are based on quoted prices that have been adjusted for market information that is not observable, the fair value measurements would not be classified within Level 1 of the fair value hierarchy.
18. The questions subsequently received add a new dimension. We are now being asked to consider the classification within the fair value hierarchy in which the fair value measurement is based on a model or valuation technique that only uses unadjusted quoted prices or Level 1 inputs. The additional question then goes on to ask whether certain types of quotes or executable prices (for example, third party quotes that represent binding offers) can be considered to meet the definition of Level 1 inputs.
19. The above questions were raised subsequent to the publication of the agenda decision and were not *part of* what the Interpretations Committee was asked to assess in the original submission.
20. We note that IFRS 13 provides guidance that would be relevant to answering such questions, notably, Appendix A (Defined terms) of IFRS 13 defines Level 1 inputs as (emphasis added):

Quoted **prices** (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

21. IFRS 13 also provides guidance in respect of whether prices lack an actual transaction, such as executable prices (for example, third party quotes that represent binding offers). In particular, paragraph B46 of IFRS 13 states that:
 

... In weighting a quoted price as an input to a fair value measurement, an entity places less weight (when compared with other indications of fair value that reflect the results of transactions) on quotes that do not reflect the result of transactions.
22. However, given that these questions were not part of the original submission, the staff is of the view that further analysis and outreach is needed. Before embarking on such additional analysis, we wanted to seek the Interpretations Committee's views on this matter.

### **Staff recommendation**

23. We think that answering the additional questions raised by constituents would be helpful to stakeholders and therefore we recommend that we undertake the additional work to do so. If the Interpretations Committee agrees, we will bring our additional analysis to a future meeting.
24. However, if the Interpretations Committee disagrees with addressing these additional questions, then we recommend that the Interpretations Committee finalises the agenda decision without any further changes based on the original submission received. We have set out the wording for the final agenda decision in **Appendix A** of this paper.

## Questions for the Interpretations Committee

### Question for the Interpretations Committee

1. Does the Interpretations Committee agree with our recommendation to address the additional questions raised as set out in paragraph 18 of this paper?

## Appendix A—Final agenda decision

- A1. If the Interpretations Committee decides to finalise the agenda decisions at this meeting, we propose the following wording.

**IFRS 13 *Fair Value Measurement*—The fair value hierarchy when third-party consensus prices are used**

The IFRS Interpretations Committee (the 'Interpretations Committee') received a request to clarify what the correct fair value hierarchy level is for debt securities such as government bonds that are traded in active markets but are priced using third-party consensus prices.

The submitter states that the difficulties in applying IFRS 13 lead to the following two views:

- (a) View A: a fair value measurement based only on unadjusted prices from an active market for an identical instrument would be a Level 1 measurement. Prices from pricing services based on in-house models (consensus or evaluated prices) are to be qualified as Level 2 or Level 3 inputs; or
- (b) View B: the fair value hierarchy in IFRS 13 focuses on the relative certainty of the fair value measurement as an exit price and also on the liquidity of an instrument. If the fair value measurement of a security with a verifiable high market activity has been determined following appropriate due diligence, it should be categorised in Level 1 of the fair value hierarchy.

The Interpretations Committee noted that when instruments are priced on the basis of third-party consensus prices, the final classification of those measurements within the fair value hierarchy will depend on the inputs used to derive the consensus prices. Consensus prices are derived using a variety of inputs that may range from Level 1 to Level 3. The Interpretations Committee noted that if the fair value measurements are based on quoted prices which have been adjusted for market information that is not observable, the fair value measurements would not be classified within Level 1 of the fair value hierarchy.

The Interpretations Committee observed that the issue analysed is not widespread. It also observed that the guidance in IFRS 13 is sufficient to draw an appropriate conclusion on the issue submitted. Consequently, the Interpretations Committee [decided] not to add this issue to its agenda.

## **Appendix B—comment letters submitted**



International Financial Reporting Standards Interpretations  
Committee  
30 Cannon Street  
London  
EC4M 6XH

24 November 2014

Dear IFRS Interpretations Committee members

**Tentative agenda decision - IFRS 13 *Fair Value Measurement* - the fair value hierarchy when third-party consensus prices are used**

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on the above tentative agenda decision of the IFRS Interpretations Committee ('Committee') published in the September 2014 *IFRIC Update*.

The Committee received "a request to clarify under what circumstances prices that are provided by third parties would qualify as Level 1 in the fair value hierarchy in accordance with IFRS 13 *Fair Value Measurement*. The submitter noted that there are divergent views on the level within the hierarchy in which fair value measurements based on prices received from third parties should be classified."

We support the Committee's decision not to take this issue onto its agenda and agree with the tentative agenda decision, as worded in the September 2014 *IFRIC Update*.

Should you wish to discuss the contents of the letter with us, please contact Leo van der Tas at the above address or on +44 [0]20 7951 3152

Yours faithfully

*Ernst + Young Global Limited*



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Berlin, 21 November 2014

Dear Wayne,

**IFRS IC tentative agenda decisions in its September 2014 meeting**

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on three IFRS IC tentative agenda decisions, published in the September 2014 *IFRIC Update*. Further, we comment on one issue of IFRS IC's work in progress. Please find our detailed comments in appendices A and B to this letter.

If you would like to discuss our views further, please do not hesitate to contact me.

Yours sincerely,

*Liesel Knorr*

President



## Appendix A – Comments on recent tentative agenda decisions

### ***IAS 28 – Fund manager's significant influence over a fund***

We do not agree with the IFRS IC's abstract view that "IAS 28 does not address the issue of whether the fund manager should include, in the assessment of whether it has significant influence, its participation in financial and operating policy decisions that it undertakes on behalf of, and for the benefit of, others". Whereas it is appropriate to state that this issue is not explicitly addressed by IAS 28, we think that the fund manager's participation in policy decisions, combined with its holding, should implicitly be considered when estimating whether the fund manager has significant influence.

This derives from the definition of significant influence in IAS 28.3, which is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies. Since – as to the submitted issue – the fund manager is participating in the financial and operating policy decisions of the investee, as a first step, an assessment has to be made whether the fund manager has control (IFRS 10.7) or joint control (IFRS 10.9) of the investee. This assessment by the fund manager shall include all facts and circumstances (IFRS 10.8) including whether it is a principal or an agent (IFRS 10.18). An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (IFRS 10.B58). Therefore, the assessment of control, joint control or, if neither, significant influence by the fund manager shall include the participation in financial and operating policy decisions that it undertakes on behalf of, and for the benefit of, others. As to our knowledge, this understanding is common in practice, with no diversity.

Beyond that, we deem the tentative agenda decision on this issue being detrimental, as it would create room for judgment and, thus, risk that diversity in practice arises.



### ***IFRS 12 – Disclosure for a subsidiary with a material NCI***

We appreciate and support the IFRS IC's tentative agenda decision and the clarification it comprises. However, we have concerns about not developing any formal clarification of the standard, but declaring that sufficient guidance would exist and neither a clarification nor an interpretation is needed.

Moreover, the wording of the tentative decision actually represents that clarification which IFRS 12 is lacking, stating that the entity would apply judgement in determining whether:

- (a) the entity presents this information about the subgroup of the subsidiary that has a material non-controlling interest (i.e. present the required information on the basis of the subsidiary together with its investees), or
- (b) it is necessary in achieving the disclosure objective in IFRS 12.10 to disaggregate the information further to present information about individual subsidiaries that have material non-controlling interests within that subgroup.

Thus, we urge the IFRS IC to hold onto its view, but to revise the decision by proposing a narrow scope amendment which would add guidance to IFRS 12, relying on the wording of the current tentative agenda decision.



### ***IFRS 13 – FV hierarchy when third-party consensus prices are used***

We appreciate the IFRS IC helping to clarify the issue that has been submitted by our organisation. We understand the rationale that the determination of fair value level shall be based on evaluating the input parameters. We are aware of this principle, and we are also aware that if any of the input parameters would not satisfy level 1, the fair value cannot be a level 1 price.

However, we think that the IFRS IC's tentative decision does not answer our main question submitted, being "*under which circumstances do third party prices ... qualify as level 1 ... of the fair value hierarchy*". Moreover, the IFRS IC's main finding that "*the classification ... within the fair value hierarchy will depend on the evaluation of the inputs ... instead of the pricing methodology used*" raises follow-up questions. Actually, all our constituents supporting View A as well as those supporting View B understand the IFRS IC's tentative decision as supporting their respective views.

The most obvious question that arises and, so far, remains unanswered is the following: If a third-party pricing service used a model to determine the fair value and if all of the input parameters used in that model constitute a level 1 input, would then a fair value based on that model be a level 1 fair value? Or would the mere use of a pricing algorithm, resulting in a composite price, in itself lead to a fair value that cannot be considered "unadjusted", thus, would not be a level 1 fair value?

We further like to note that, to our knowledge, there are indeed circumstances where any of the input parameters for such composite prices are considered level 1 inputs. However, this might be subject to approval by additional outreach. Regardless of this, we would raise the question of whether, and how, the nature of a quote drives the fair value hierarchy level. In other words: can certain input parameters that lack an actual transaction – such as executable prices (binding offer) – be considered "quoted" prices, thus satisfying the level 1 definition? We deem IFRS 13 not being sufficiently clear, since it only states that the nature of a quote drives the weight that shall be placed on them (B46-47), which does not indicate whether and how the nature of a quote drives the level.

We urge the IFRS IC to discuss these two additional questions raised by us before finalising its decision on the issue.



## **Appendix B – Comments on work in progress**

### ***IFRS 5 – Write-down and reversal of impairment losses relating to goodwill***

We deem it essential that certain issues on IFRS 5 are further considered and clarified. Thus, we support the IFRS IC's intention to reiterate discussing those issues that have been on hold for some time. This said, we would appreciate if the several issues relating to IFRS 5 were considered further.

We deem the issue of determining the unit of account (non-current assets, or net assets, or total assets) being the central and most important question to be answered. In addition, other issues that are fundamental or even derive from this question are:

- impairment loss for a disposal group;
- reversal of an impairment loss for a disposal group;
- definition of a segment and a major line of business – which has been proposed as an amendment in 2008, but those proposals have never been finalised.

Whilst the IFRS IC tentatively suggested addressing any potential IFRS 5 issue within a broader-scope project, which we fully support, we are not aware of any such project being initiated. Although it might be useful to first discuss those further IFRS 5 issues that have recently been submitted to the IFRS IC until finally deciding upon the way forward, this should not prevent the IFRS IC from asking the IASB as soon as possible for setting up a project to amend IFRS 5.

Wayne Upton  
Chairman  
IFRS Interpretations Committee  
30 Cannon Street  
London  
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25 November 2014

Dear Mr Upton

**Tentative agenda decision - IFRS 13 *Fair Value Measurement*: The fair value hierarchy when third-party consensus prices are used**

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the September IFRIC Update of the tentative decision not to take onto the Committee's agenda a request for guidance on the circumstances in which prices that are provided by third parties would qualify as Level 1 in the fair value hierarchy.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely



Veronica Poole  
Global IFRS Leader

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21.11.2014

### **IFRS Interpretations Committee's tentative agenda decision on IFRS 13 Fair Value Measurement**

Dear Mr. Upton,

The German Insurance Association (GDV) welcomes the opportunity to respond to the IFRS Interpretations Committee's publication in the September 2014 IFRIC Update of the tentative decision related to application of IFRS 13 Fair Value Measurement - the fair value hierarchy when third-party consensus prices are used.

We regret the tentative decision to not add this issue on the Committee's agenda. We continue to believe that the inconsistent application of IFRS 13 in terms of third-party consensus prices strongly indicates a clarification need of the official interpretations. In particular, we do not agree with the Staff's conclusion that this issue does not have widespread or material effect. In contrast, studies reveal a massive reclassification from Level 1 to Level 2-instruments by German insurers at the end of 2013 not experienced in other major European jurisdictions. This derives from the fact that German auditors adopted an interpretation of IFRS 13 which does not seem to be shared by their colleagues.

Please find attached an analysis of the Committee's decision for your consideration (**Annex**). We fully agree that the quality of inputs to valuation techniques is paramount rather than the valuation technique itself. As a result, we strongly recommend clarifying that third-party consensus prices may qualify for Level 1-classification if the corresponding inputs meet Level 1-requirements. Such an amendment would greatly enhance legal certainty both for auditors and insurers and improve the consistent application and enforceability of IFRS 13.

**Gesamtverband der Deutschen  
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We would appreciate to discuss this issue further with you. Please contact us if you have further queries.

With kind regards



Dr. Axel Wehling



Hans-Juergen Saeglitz

Annex

## Annex

### IFRIC Update – Interpretations Committee tentative agenda decisions

The Interpretations Committee received a request to clarify under what circumstances prices that are provided by third parties would qualify as Level 1 in the fair value hierarchy in accordance with IFRS 13 Fair Value Measurement. The Interpretations Committee (IC) tentatively decided not to add this issue to its agenda as the guidance in IFRS 13 was seen as already sufficient to draw appropriate conclusion on the issue submitted. For explanatory purposes, however, the IC noted that the inputs to valuation techniques are more important than the valuation technique itself when finding the correct fair value hierarchy level. “The Interpretations Committee noted that when assets or liabilities are measured on the basis of prices provided by third parties, the classification of those measurements within the fair value hierarchy will depend on the evaluation of the inputs used by the third party to derive those prices instead of on the pricing methodology used. In other words, the fair value hierarchy prioritizes the inputs to valuation techniques, not the valuation techniques used to measure fair value. In accordance with IFRS 13, only unadjusted quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date qualify as Level 1 inputs. Consequently, the Interpretations Committee noted that a fair value measurement that is based on prices provided by third parties may only be categorised within Level 1 of the fair value hierarchy if the measurement relies solely on unadjusted quoted prices in an active market for an identical instrument that the entity can access at the measurement date.”<sup>1</sup>

### Analysis

This interpretation reveals several things:

- The fair value measurement of assets and liabilities in Level 1 of the fair value hierarchy of IFRS 13 does not need to consist of a single quoted price. It seems acceptable to have several Level 1 inputs flowing into a valuation technique and still be able to end up with a Level 1 output. The interpretation of the Institute of Public Auditors in Germany, IDW, to allow only a single quoted price of a third party provider in Level 1 seems, therefore, too narrow.

If all inputs used by a third party in developing a Level 1-price need to be themselves Level 1-inputs, two more things might need clarification. What counts as Level 1 input parameters and what valuation techniques are allowed to still have a third party price classified as Level 1 input?

- All input parameters that constitute a third party price need to be “unadjusted quoted prices of an active market for an identical instrument that the entity can access at the measurement date” (i.e. Level 1 input, IFRS 13.76). Level 1 inputs are, therefore, not restricted to prices that reflect the result of a transaction. The nature of a quote (e.g. whether the quote is an indicative price or a binding offer) shall of course be taken into account when weighting the

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<sup>1</sup> Source IASB: „IFRIC Update September“ page 6.

available evidence, with more weight given to quotes provided by third parties that represent binding offers (IFRS 13.B47). Thus, results of transactions (“executed prices”), binding offers (“executable prices”) as well as indicative prices seem suitable Level 1 inputs. The details of what weighting should be given to these different quotes should be an issue of discussion between auditors and preparers of IFRS.

- The objective of using a valuation technique is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions (IFRS 13.62). A “consensus price” as an average of unadjusted quoted prices of Level 1 quality is a theoretical value. It is a price a trader would not use. But it is a very good estimate for an orderly transaction. There is even great consensus between auditors and preparers of IFRS that such a price is the most representative of fair value in the circumstances. An outcome of such an algorithm seems, therefore, well deserved in the Level 1 category.

### **Recommendation**

In its final agenda decision the Interpretations Committee should clarify that assets and liabilities, especially debt securities priced by third party vendors, can be classified as Level 1 inputs of the Fair Value Hierarchy if all inputs of the price are of Level 1 quality and the valuation technique is a pricing convention used by market participants as a practical expedient for fair value measurement within a bid-ask spread. On basis of such guidance auditors and preparers of IFRS-based financial reporting could agree on a thorough due diligence process for third party providers to ensure these requirements are met.

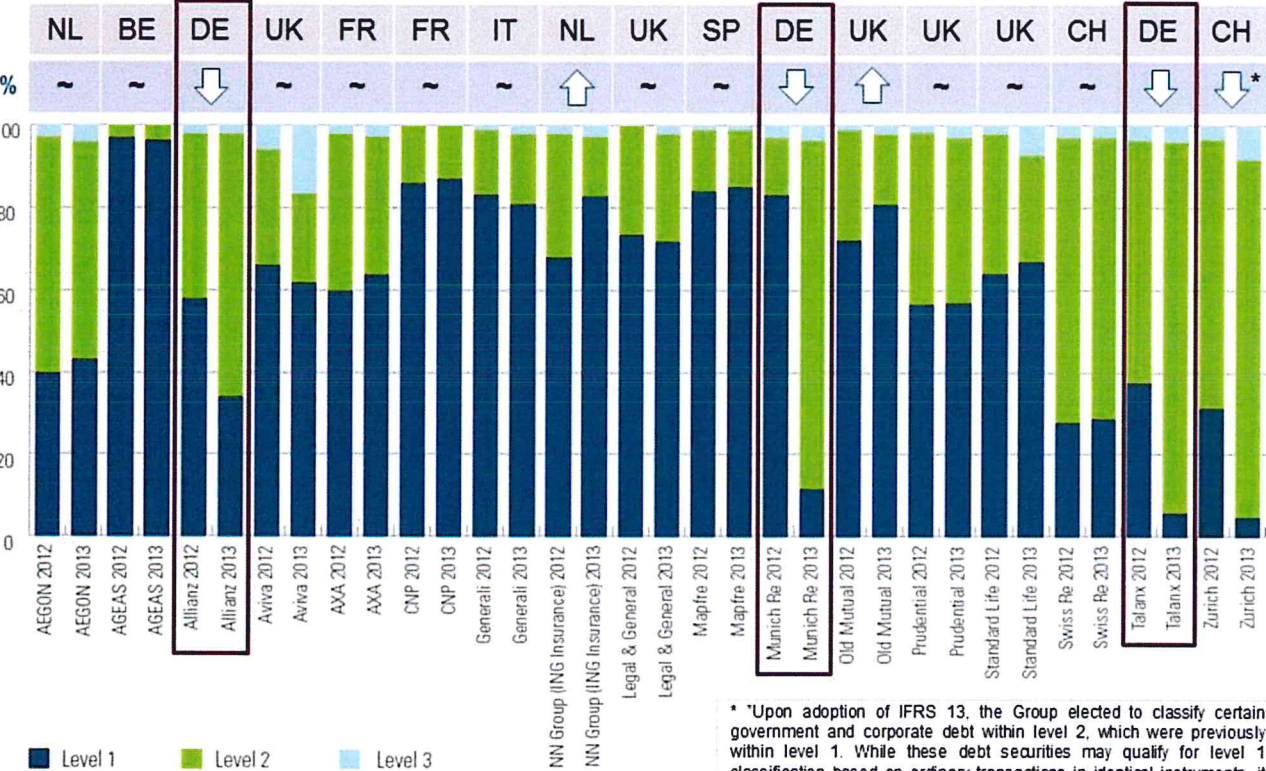


**Appendix Diversity in practice - the need for clarification**

Despite the staff’s assessment that the issue has neither widespread nor material effect, it seems worthwhile to look at the European insurance and banking industry. A recent study by KPMG on the insurance business revealed that in the Netherlands (NL), Belgium (BE), United Kingdom (UK), France (FR), Italy (IT), Spain (SP) and Switzerland (CH) the amount of instruments in Level 1 did not change or did not rise between year end 2012 and year end 2013. Only in Germany, where the Institute of Public Auditors in Germany, IDW, forced preparers of IFRS to classify consensus prices in Level 2, the amount of Level 1 instruments fell significantly.

**Diversity in practice**

Recurring fair value measurements 2012 vs 2013



\* Upon adoption of IFRS 13, the Group elected to classify certain government and corporate debt within level 2, which were previously within level 1. While these debt securities may qualify for level 1 classification based on ordinary transactions in identical instruments, it has been assumed, as a practical expedient, that such instruments would predominantly be valued based on a mix of observable inputs.

Source: KPMG 2014: Insurance Reporting Round-Up 2013, p. 27.

24 November, 2014

By email: [ifric@ifrs.org](mailto:ifric@ifrs.org)

IFRS Interpretations Committee  
30 Cannon Street  
London  
EC4M 6XH  
United Kingdom

Re: IFRS 13 *Fair Value Measurement* - The fair value hierarchy when third-party consensus prices are used

To the Members of the IFRS Interpretations Committee:

Interactive Data appreciates the opportunity to comment on the Tentative Agenda Decision by the IFRS Interpretations Committee regarding 'IFRS 13 Fair Value Measurement: the fair value hierarchy when third-party consensus prices are used'.

Interactive Data provides independent evaluations to clients including auditors as an input in their valuation process for assets and liabilities. We believe our extensive experience as a third party evaluations provider serving more than 5,000 global organisations can give rise to useful insights concerning the practices and processes that result in high quality evaluations. We believe that this experience closely aligns us with the auditing objective of assessing the reasonableness of valuations in financial statements. Because Interactive Data is not an accounting firm or auditor, we are not well-positioned to comment in depth on specific accounting standards or frameworks.

As different third party sources can apply different approaches to determine valuations, we would like to highlight the process of how our evaluations are determined. We believe this will help to inform the debate into how valuations determined using inputs from third party sources may be classified under the fair value hierarchy.

We note in particular the importance laid out in IFRS 13 on the type of inputs used when determining hierarchy levels. We highlight below how observable market data is used in our evaluation process. We also provide details of the transparency and tools we provide to our clients to assist them in determining fair value measurement classifications.

#### Background on Interactive Data

An independent source of evaluated prices, Interactive Data Pricing and Reference Data ("Interactive Data") has been in the evaluations business for more than 40 years. The company provides global security evaluations designed to support financial institutions' and investment funds' pricing activities, research, and portfolio management. Our evaluations operations are conducted from offices located globally, including the United States, the United Kingdom, Germany, Hong Kong and Australia. We offer evaluations for approximately 2.7 million fixed income securities, including loan products,



representing approximately 135 countries and over 50 currencies, as well as OTC derivatives, structured products and our Fair Value Information Services for international equities, options and futures.

Interactive Data Pricing and Reference Data LLC is a Registered Investment Adviser with the United States Securities and Exchange Commission under the Investment Advisers Act of 1940 (the “Advisers Act”). We have adopted policies and procedures for our evaluations process which we consider to be best practice in the industry and applied these standards to our business globally.

Interactive Data Pricing and Reference Data has built a strong presence globally and currently counts 49 of the top 50 global asset managers as customers as well as 41 of the top 50 banks, 16 of the top 16 custodian banks and 32 of the top 50 hedge funds.

Interactive Data maintains active collaboration with auditors and the asset management industry to discuss valuation and price validation matters. In the United States, the Public Company Accounting Oversight Board (PCAOB) has set up a Pricing Sources Task Force under its Standing Advisory Group on which members of our staff are participants. The Pricing Sources Task Force focuses on the auditing of fair value of financial instruments that are not actively traded and on the use of third-party pricing sources.

### Our Evaluation Approach

Interactive Data provides evaluated prices to assist our clients in estimating fair values for assets and liabilities. Interactive Data uses valuation techniques that maximise the use of relevant observable inputs including quoted prices for identical or similar instruments. If sufficient observable market information is not available for the instrument or comparable instrument, Interactive Data will not provide an evaluation.

An extensive range of observable market information sources is incorporated into the evaluation process including trades, quote information from platform feeds, exchanges and dealer runs, as well as other relevant observable market information. Interactive Data seeks to take into account as much observable market information as possible. Interactive Data advises against the implementation of practices which lead to a narrow view of the market and which promote reliance on a single broker quote as an input rather a wider view of the market.

The diversity of market data available creates an important role for the selection of the data used as inputs and for oversight of the valuation process. Interactive Data believes that evaluation best practice includes assessing each incoming market data point as a distinct input *and* in context with the set of other available data for the same or similar securities. As such, Interactive Data’s process includes expert oversight and validation by a team of professional evaluators. We do not provide evaluations based purely on algorithms. The evaluation reflects the observable market information we consider most reflective of current market activity for a security. Interactive Data recommends that auditors are sensitive to these differences when assessing fair value measurement.

Checks and controls are inherent throughout the process. For example, tolerance parameters are set for each security and any change in the observable market data which breaches parameters generates a notification which must be reviewed by an evaluator.

Picture 1 provides a visual representation of our Continuous Fixed Income Evaluated Pricing service and demonstrates how evaluations for a sample security are updated throughout the day, driven by observable market data, in this case both trades and market quote information for the security. This

insight into intra-day activity in the markets allows for the analysis of market trends and can fortify the assessment processes used in the determination of fair value. The chart also demonstrates the importance of selection in the application of market information, even for reported trades, when determining valuations. One inter-dealer trade is shown at 1 point above other trades, as well as the evaluated price; this trade was ultimately cancelled.

Picture 1:



The blue line charts the progression of the evaluated mid price for an investment grade corporate bond during a sample day, with the shaded area representing the bid – offer spread.

The dots represent individual trades. Dealer buys represented in green, dealer sells in red and inter-dealer trades in yellow.

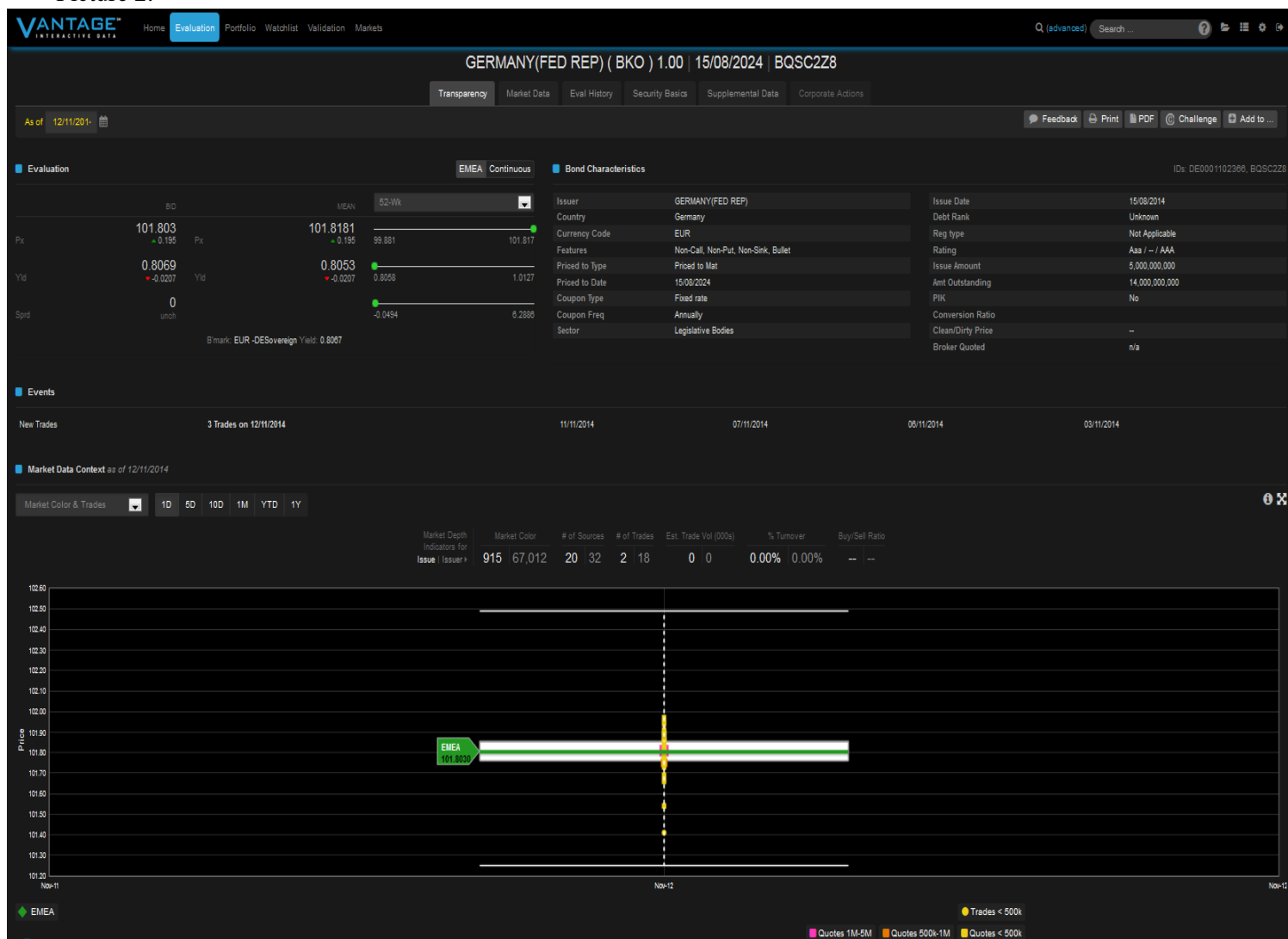
## Analysis of Inputs to Determine an Evaluation

Interactive Data recognises the importance of providing clients with the transparency, information and tools to determine fair value hierarchy classifications. In recent years, we have invested considerable resources to expand our coverage and provide our clients with greater insight and transparency into the inputs used to derive our evaluated prices, as well as help automate and streamline key valuation processes. This service was developed in close collaboration with our global clients and auditors.

Our products include the ability to analyse individual securities and review inputs used in the evaluation. This is best represented by demonstration of examples of securities with different levels of available market information.

Picture 2 provides an example of the display for an evaluated price together with associated market input data. Summary statistics are also available detailing trade and quote information (in this example over 20 sources of market information for the security and at least 2 reported trades on the day).

Picture 2:

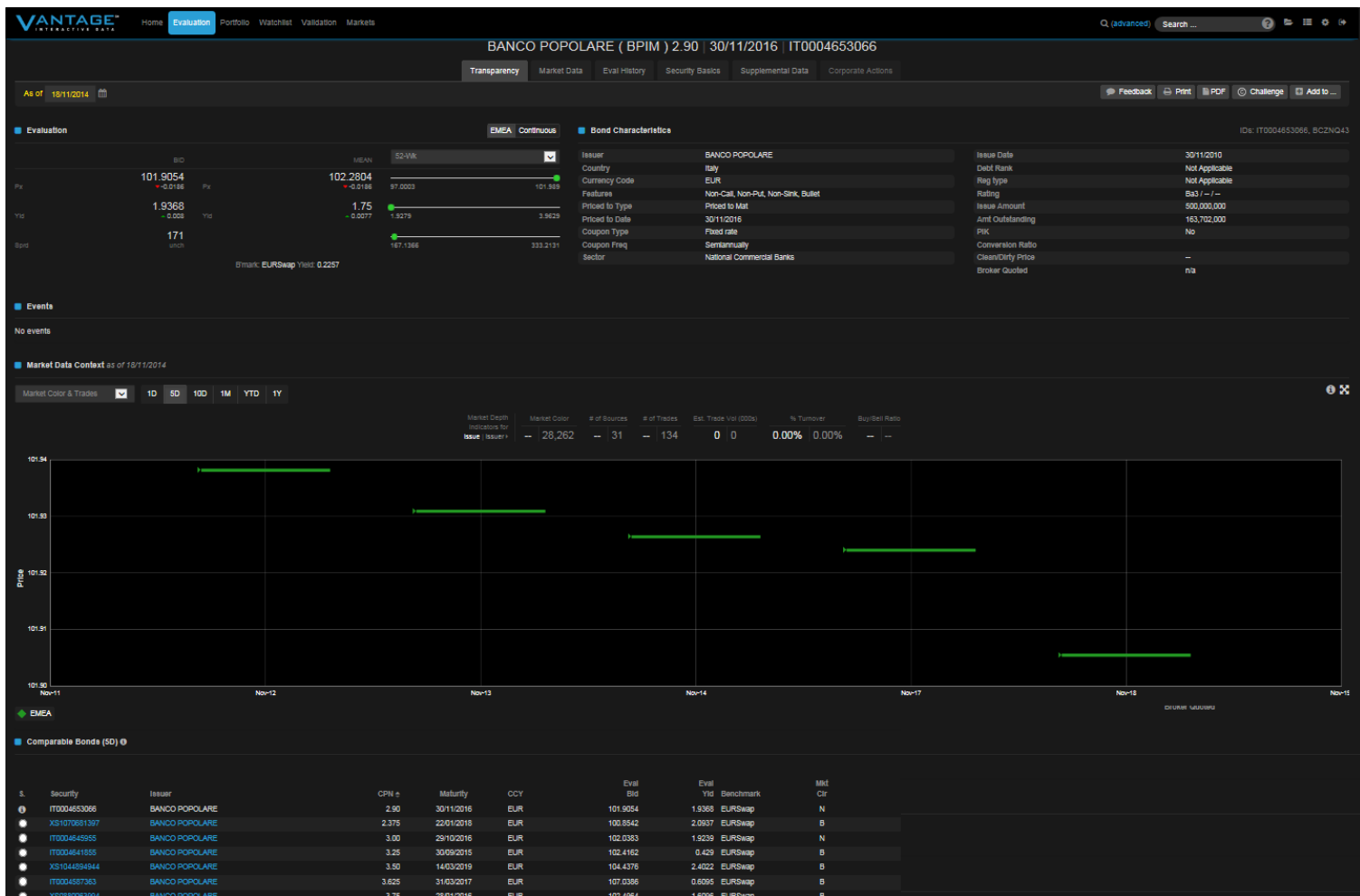


The box plot displays the observable market information for a sample security, in this case a German bund, on one day. The white box represents the 25<sup>th</sup>-75<sup>th</sup> percentile range of all market information received. Certain specific quotes and trades are displayed as pink and yellow dots. The green line represents Interactive Data's end of day evaluation.

Picture 3 displays a security with no current market information available; however, a list of comparable securities is identified. The other securities can be selected for comparison and further analysis.



Picture 3:



No market data is available for the security. A list of comparable securities is provided, including a market data column to identify those with market data.

## Conclusion

We hope this document provides a clearer understanding of our evaluation process, including the types of inputs used and the transparency provided to our clients, and informs the discussion on how valuations determined using third party pricing as inputs may be classified under the fair value hierarchy. As a leading provider for over 40 years of independent valuations which are widely used as inputs to determine NAVs and with a large, global client base, we believe our experience adds unique insight into discussions on appropriate valuation approaches. We encourage the incorporation of a wide view of the market, with an appropriate assessment of all available inputs, and advise against the implementation of practices which create a narrow view of the market or encourage an overreliance on a single dealer source.

We would be happy to provide further information on our processes, and to discuss any of the points raised in this letter in further detail.



Sincerely,

A handwritten signature in black ink that reads "Mark Hepsworth".

Mark Hepsworth  
President, Interactive Data Europe, Middle East & Africa