

Introduction to IPV and Valuation Controls

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Independent Price Verification (IPV) is an increasingly important process within the valuation control framework supporting the finance and risk management functions across a wide range of financial institutions. The core IPV process requires that internal prices are verified against independent third-party sources. Significant discrepancies between the internal and independent prices above a certain threshold trigger an investigation and possible adjustments.

In order to help prevent regulatory action, industry leaders are investing substantial time and resources in what they consider the core components of the valuation control framework to help ensure a more efficient and compliant process moving forward. A robust valuation control framework and IPV process allows more efficient management of risk during times of market turbulence and ensures that financial reporting is accurate and timely.

Per regulatory guidance, internal and external audit teams are required to devote considerable resources to review the control environment, including the price verification and fair value leveling processes, especially in those institutions where fair value is a critical component of reported results.

What are the benefits of an effective control framework?

An effective IPV framework provides efficient controls for multiple risks within financial institutions. Some examples are:

Price Risk – Ensuring that Front Office prices are consistent within each region that the firm operates.

Earnings Manipulation – IPV controls for P&L smoothing when proper processes and thresholds are in place which holds the business to accurate pricing standards.

RWA (Capital requirements) - Effective valuation controls across the entire fair value inventory (incl. off balance sheet) provides more accurate RWA calculations and capital reserves.

Accurate OBS Valuations – Off Balance Sheet items such as collateral are often neglected during the IPV process which allows for margin disputes and potential miscalculated metrics within the RWA formula.

Accurate leveling (enhanced) – Implementation of enhanced fair value hierarchy controls provides more accurate disclosures and capital reserves.

What are some major challenges faced by banks when implementing controls?

Finance controls including IPV and Fair Value Leveling requires high-volume, complex data analytics. For example, multiple price vendors or third-party holders of collateral providing data in different formats requires an institution to clean and standardize the data before it can be consumed by internal systems. Additionally, current Fair Value Leveling procedures requires sensitivity and / or volume analysis in order to determine the proper classifications on the balance sheet.

Manually attempting to merge disparate data sources for standardization and analysis of price differences is inefficient, labor-intensive, and can create operational risk that can leave the institution unprepared and vulnerable to negative regulatory and/or audit findings. Compliance teams need the right tools to keep up with the flow of new data and technologies, address new and changing regulations, and respond to rapidly shifting economic conditions and crises without becoming overwhelmed.

This vigilance requires control teams to process an increasingly complex set of data, consisting of many different and dynamic variables. Simply put, Excel sheets and Pivot Tables are no longer enough.

Automating critical components of the control framework increases efficiency of the control and review processes while creating a line of defense for enhanced reporting of exceptions and overrides.

Feedback from regulatory and audit examinations has highlighted that there is a need for financial institutions to revisit their current Independent Price Verification (IPV) framework to ensure processes and procedures are both effective and compliant in the current regulatory and economic environment. As a result, this has encouraged financial institutions to invest in the core components of IPV to increase efficiencies, establish robust controls, and review current policies and procedures.

How innovative technology and automation can help address the challenges

Modern Financial institutions need technological sophistication to identify, manage and prevent Valuation Control risks. This is true in light of regulators increasing the technological requirements on firms leading to growth in the Regulatory Technology (RegTech) space. More specifically, majority of finance functions, such as IPV, within banks are relying heavily on spreadsheet based process' which creates roadblocks and delays results as they work through their monthly or daily process'. These manual process' also open the firm up to operational risk.

Technology intervention can address regulatory concerns and assist firms in staying compliant by automating process' such as IPV and Daily P&L.. This will increase efficiencies while also allows more time for team to analyze the results. It is also important to note that large institutions which require multiple spreadsheet to perform the daily and monthly process' are at higher risk due to each excel working file requiring a set of controls

Data management and Automation are the two clear ways forward for finance functions such as IPV. Cloud based technology can help perform the following IPV processes at scale:

- 1) Data synchronization and cleaning – Price data sourcing and merging
- 2) Data Storage – efficient storage for faster and secure processing
- 3) Data processing using custom algorithms – An In-house developed proprietary pricing engine performs verification and leveling process'
- 4) KPI and trend reporting – Overrides and exception monitoring driven by easy consumable formats
- 5) Workflow automation and Security – Faster monthly and intra-monthly reporting in a secure environment

BDO advantage

BDO has specialized and experienced professionals who understand the process', regulations and technology in order to package it as a RegTech offering for clients who are concerned about high costs associated with overhauling existing server-based infrastructure, as well as firms concerned about the risks associated with gaps in

existing technology. In addition, ambiguous regulatory requirements layered on top of legacy systems is more reason why many firms can benefit from RegTech partners such as BDO. We deliver exceptional value because we operate in the cloud, are more agile, and can scale to meet the shifting regulatory landscape.