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SuperDerivatives: Transparency Is About Accurate Pricing

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Though it was not a new product, SuperDerivatives noticed a decidedly heightened interest in its SD-Revaluation service during last summer's credit crunch. "This is really where we saw clients come to us for a very real-time solution--same day or as close to trade as possible," says Dani Weigert, manager of the SuperDerivatives revaluation center.

"Every single institutional investor on the buy side and sell side is looking for an independent revaluation service, either out of fears regarding risk management and ... losses caused by mismanagement of derivative positions or pressure from regulators," says Weigert. Over the second half of 2007, the London- and New York-based options pricing, benchmarking and analytics provider saw interest peak in valuations of plain vanilla credit default swaps (CDS), credit default indexes (CDX) and collateralized debt obligations.

SD-Revaluation, introduced in 2004, also performs valuations on derivatives and underlying assets for interest rate swaps, equity options and foreign exchange options. Prices are generated through a combination of in-house modeling and market data contributed from a variety of sources. The company believes it has a better handle on valuing less-liquid, infrequently traded products due to its benchmark pricing models, which--although they don't publish them--are "freely accessible via our pricing applications," explains Weigert. "This is as transparent as it can get."

Markit Group, a data and valuation services provider that specializes in over-the-counter derivatives and last month announced that it would later this year launch Markit Valuations Manager, a multidealer, cross-asset-class platform, would disagree. Jeff Gooch, Markit's global head of trade processing and valuations, calls SuperDerivatives' model "a black box. You can send trades and they send back values, but it won't give you any transparency as to how their mathematics works or where they source their data from."

Gooch asserts that Markit uses "standard math models to value trades and consensus or public sources of data along consensus credit curves. We do calibration for all banks [Markit's clients] at month's end; and we believe we use the best data sources in the best way."

Weigert counters: "Transparency is about providing an accurate price--not to publish a series of models. Our aim is to simulate the price that is actually traded in the market." As to Markit's characterization of the product, Weigert claims "that's a sign the competitor is worried."

Bermuda-based fund administrator **Fulcrum Group**, which has $10 billion in assets under administration, distributed among 50 funds, started using SD-Revaluation in August. Fulcrum services the complex strategies of investment funds, hedge funds and funds of funds, offering a range of functions from simple month-end net asset valuations to daily middle- or back-office needs.

Clients depend on Fulcrum to supply independent portfolio valuations, for which the group uses different vendors. It relies on the SuperDerivatives service primarily for valuations of CDS, CDX and a variety of OTC option types--plain vanilla, equity and FX.

"SuperDerivatives provides a much wider snapshot for what's actually happening in the market on which to base evaluations," says Tim Thornton, director of risk at Fulcrum. "The service provides genuine trading values, rather than theoretical market prices."

During times of volatility, when it is difficult to mark to market, Thorton says that SD-Revaluation's historic market data--in addition to its validated data--and models help to give a fuller picture. Because SuperDerivatives offers these details and the risk variables used to arrive at the valuations, the process is "fully transparent for our clients and the investors," notes Thornton.

Despite last year's market surges, Fulcrum didn't experience any bottlenecks in submitting files and getting prices back, a process that involves collecting data across portfolios and submitting Excel files via e-mail to SuperDerivatives. The positions from SD-Revaluation are returned to Fulcrum in spreadsheets populated with customized fields. That information is then uploaded to Advent Software's Geneva, which Fulcrum uses for portfolio management and fund accounting.

Valuation transparency became particularly important when market concerns during the volatile period prompted extra scrutiny of the process by clients, says Thornton. Fulcrum had to field more inquiries from clients doing "due diligence on how we administer or would price the portfolio," he says.

Thornton says that he's found the SuperDerivatives valuations to be as accurate as any found in the market. "Ultimately you're looking for the price that represents the reality and can be supported on independent sources," he adds. A number of auditing groups also use the SD-Revaluation service.

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