

AISE 2007: Synthetic Pricing for Alternative Products



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Hierarchy of Security Price Types (2007)



Compelling Response by AIMs: 14% of Assets Declared Hard to Value



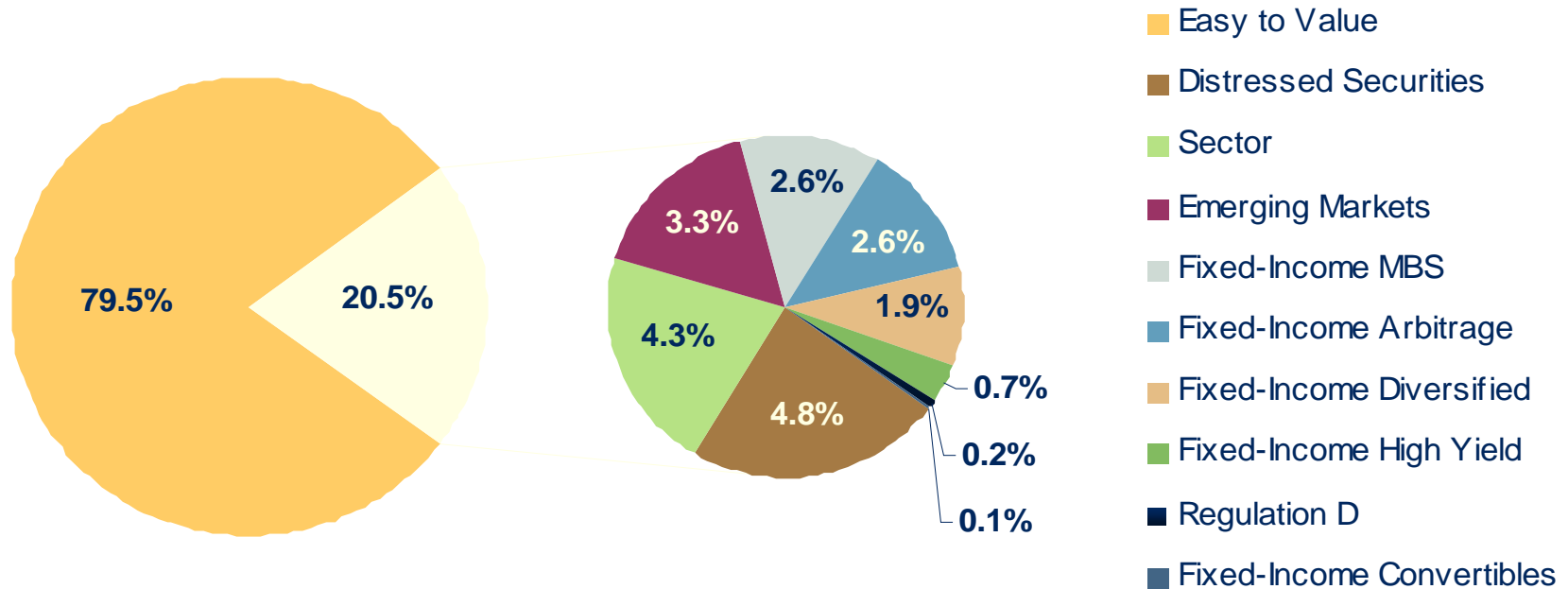
Recent survey conducted by Alternative Investment Management Association (AIMA) revealed:

- 32% of respondents (alternative investment managers or AIMs) report that the pricing of illiquid instruments represents the most significant challenge with regard to portfolio valuation
 - Hard-to-value instruments represented *on (average) 14% of the aggregate value of the funds* managed by respondents

The Role of Synthetic Pricing in Hedge Funds (2005)



Hard-to-Value Assets Make Up 20.5% of Global Hedge Fund Assets



Note: Regulation D refers to hedge fund strategies involving private investments in micro or small cap companies.

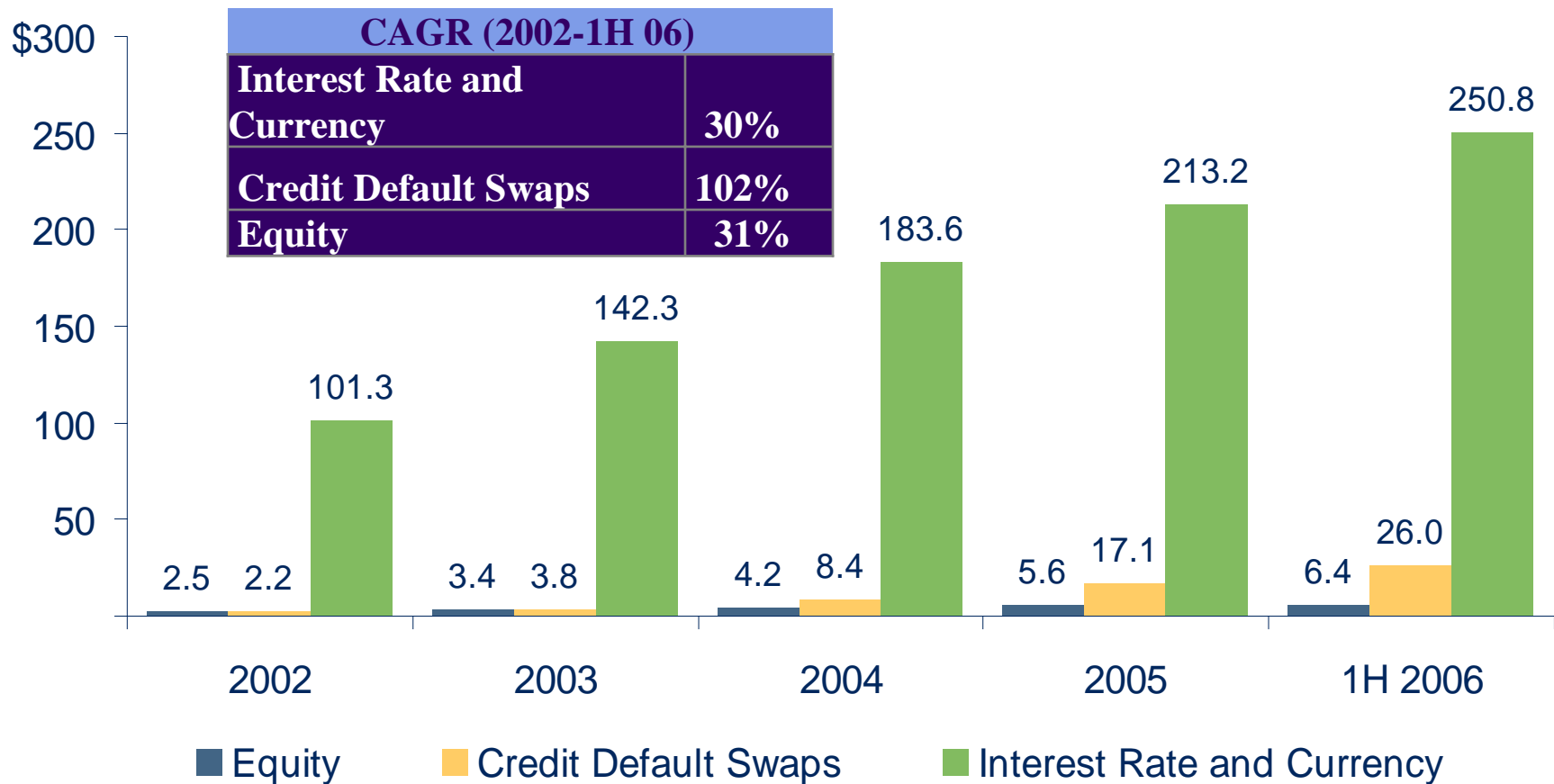
Exhibit #:50:02M-E2
Source: Alternative Investment Management Association (AIMA)

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Total Notional Value Outstanding of Major Derivative Security Types (2002–1H 2006)



(USD in Trillions)





FASB 157 Fair Value

- ‘... Therefore, the definition focuses on the price that would be received to sell the asset or paid to transfer the liability (an exit price), *not* the price that would be paid to acquire the asset or received to assume the liability (an entry price).’
 - *Mid Price indication or mid price synthetic value becomes the reference point – not the bid side*

Other Problem/Solution Sets Found in Synthetic Pricing Algorithms



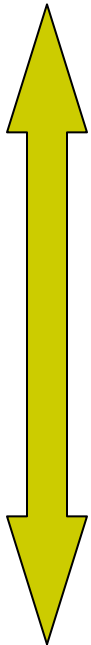
- IMPROVED MONTH END Net Asset Values (NAV) or Statements: Broker only bid /offer indications are often asymmetrical to investor size held – (\$5M indication / \$50M actually held by AIM).
- Absence of INDICATIVE MID PRICE: One side only indications ignore ‘value at risk’ held (e.g. 101-103 mkt. rather than 99-104 mkt. for \$50MM not \$5MM).
- IMPROVED MANAGEMENT of Liquidity Sources to permit review of ‘no-name’ bid reports in alternative products from cooperating AIMS at month end.

Market Value or Hierarchy By Price Types & Source Vendor



Hierarchy of Price Types By Value & Source

Increasing
Value



Higher
Risk

Actual traded or historical prices	Reuters or Bloomberg	1
Active Dealer Quote, (ready to be traded on for size)	Market Axess or TradeWeb	2
Traded price on like Bond or Asset	FT Interactive	3
<u>Evaluated or Synthetic Price</u>		4
Avg. of Multiple Dealer Quotes – may or may not trade for any size related to position held by Fund Mgr.	Mark It™	5
Single dealer quote indications at month end which never trade & apply to minimum 'round lot' only	Single Broker /Dealer Trader	

Why Synthetic Price Data Subscriber Growth is Happening



FAS Rule 157(Financial Accounting Standards Board) introduced 9-06:

- *iFVS*' tracks like or similar assets' mkt. value and applies appropriate models & algorithms.
- This meets obligation for a Level 2 comparable price. Level 1 is the traded px. of actual asset.
- Level 3 is the 'red flag' of non-independent or in-house derived price or valuation & must be disclosed in notes of actng. statements.

Regulatory Agenda Driving Synthetic Pricing Services

IAS 39: 01-06 calls for fair value accounting in active markets.

UCITS III: Allows complex asset & Struc. Prod. use by traditional mgrs.

FASB: FAS 157, 09-06 forces disclosure of in-house Level 3 valuations, non-independent.

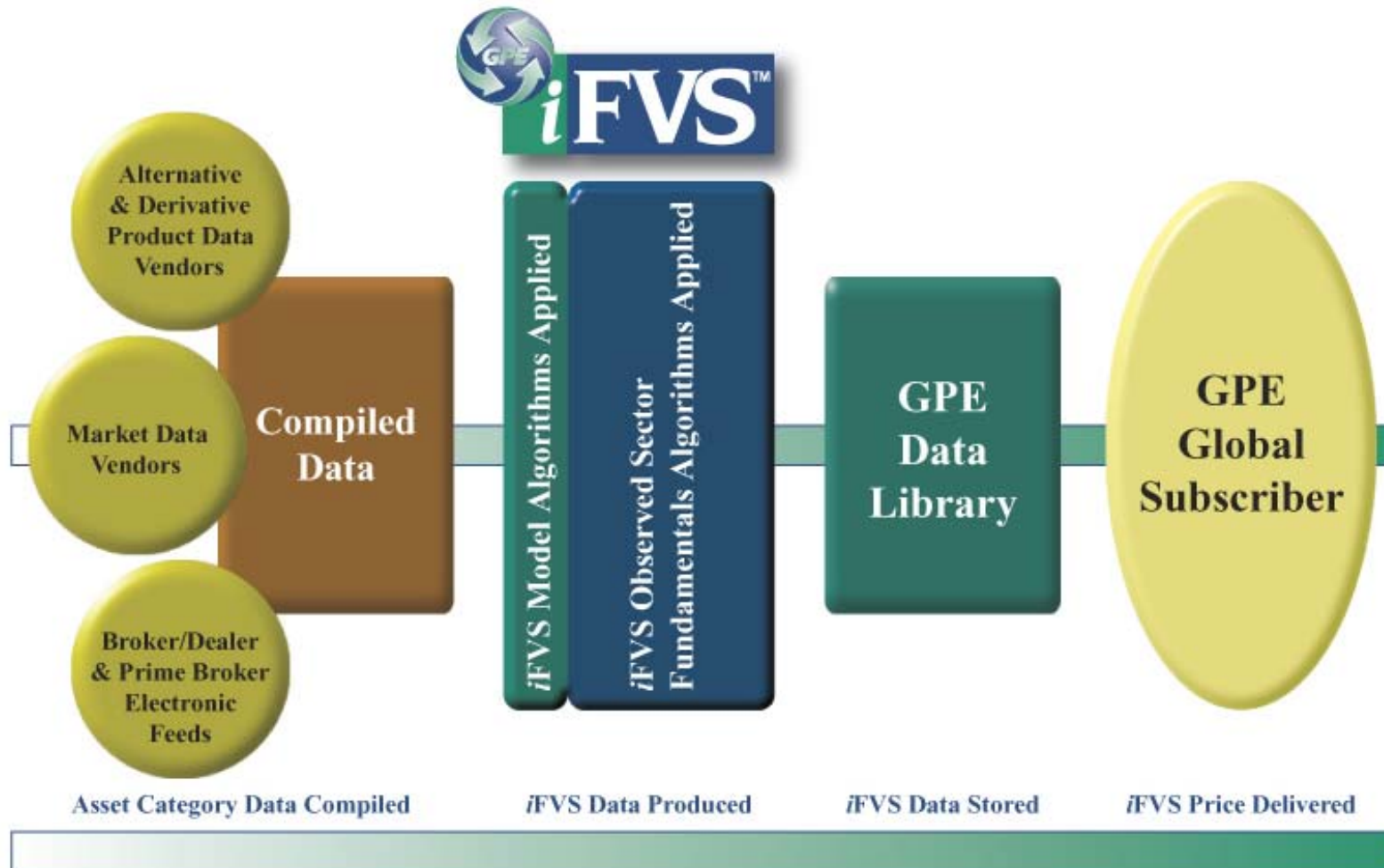
MiFID: In Europe 11-07, requires B/D support or documentation of fair value of all executed trades in all markets.

KYC: Know Your Customer – transparency & disclosure.

AML: Anti-Money laundering statutes – real assets w/ fair values + disclosure.



Independent Fair Value Service Web-based, Data Automation Mid 2007





Independent Fair Value Services or *iFVS*
(for alternative assets, derivatives, & structured products)