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Vendor Flub

Pricing Vendor to Pay $8M Over Flawed Data

By David Isenberg   December 10, 2020

ICE Data Pricing and Reference Data has agreed to pay $8 million for delivering clients prices based on unreliable data, the Securities and Exchange Commission said Wednesday.

Between at least 2015 through September 2020, the pricing service provided clients with securities data that did not reasonably reflect their actual value, the SEC said.

The firm typically analyzes multiple sources before sending clients pricing estimates on securities, the SEC's order notes. But for more than 46,000 fixed-income securities, the company delivered data based on quotes received from just one market participant.

ICE Data PRD, a subsidiary of the firm formerly known as Interactive Data **Corp.**, failed to adopt and implement policies and procedures that would have addressed the risk of using such unreliable single-broker quotes, the order found. In addition, its existing quality controls were also ineffectively or inconsistently implemented.

"They're going out and in certain instances getting a broker quote and using that as a gospel and sending that out to clients," says Karen Aspinall, a partner at Practus. "What the settled actions says … [is] you need to have policies and procedures around using these single-broker quotes."

ICE Data's applications and models failed to evaluate the securities, the SEC found. Instead, they spat out single-broker-quoted prices when sufficient information was not available, including cash flows or other security structure or market information. Many of the securities were opaque structures such as synthetic convertible notes, structured notes, index-linked notes, church bonds, asset-backed securities, collateralized mortgage obligations and commercial mortgage–backed securities, the order says.

The systems were designed to create alerts when valuations were based on only one quote, the order says. But there was nothing in place to ensure that any actions were taken.

"Information provided by pricing services can play an important role in the valuation of complex fixed-income securities by many types of market participants," stated Daniel Michael, chief of the SEC Enforcement Division's Complex Financial Instruments Unit, in a press release. "ICE Data Pricing & Reference Data's compliance failures created a risk of, and in some cases resulted in, its delivery to clients of inaccurate prices."

In 2015, Intercontinental Exchange acquired Interactive Data for $5.2 billion. The Intercontinental subsidiary provides pricing information for 2.8 million securities, according to the order. For most of them, it also provides independent evaluations, reference data, analytics data and corporate actions data.

Its customers include clearing and custody firms, registered investment companies, pooled investment vehicles, broker-dealers and other institutional clients, the SEC's order notes.

"Pricing services are really everything, particularly in the mutual fund industry," says Todd Cipperman, managing principal of Cipperman Compliance Services.

Mutual fund boards rely on pricing services' independence, he says. There are only a few large ones, making accurate pricing from them that much more important. "It's kind of an oligopoly," he adds.

ICE Data is also a registered investment advisor, the SEC's order notes.

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But many pricing services are not, Cipperman says. Those other vendors are not required to follow the policy and procedure requirements that ICE Data violated, he added.

ICE Data agreed to the penalty without admitting or denying the findings, the order says.

Last week, the SEC finalized a rule that will require fund boards to appoint and oversee somebody who will conduct valuation for each fund. The board can hand the task off to an advisor, an officer of the fund if it is internally managed, or someone else, the rule notes. However, valuation cannot be assigned to a portfolio manager.

"As part of your valuation oversight, you need to understand the methodologies and the various ways that the services are pricing your instruments," Aspinall says.

The enforcement action also sets the stage for how the SEC expects advisors to create valuation processes, Cipperman says.

“It’s a good road map for building valuation procedures for what the SEC expects,” he says.

In 2012, the SEC charged Morgan Keegan directors over fund valuation failures. They overstated the value of certain securities during the 2007–2009 financial crisis, the SEC found.

In the Morgan Keegan case, the SEC found that at least one broker-dealer was incentivized to provide price confirmations that were lower than how the funds valued certain bonds, but higher than the initial confirmations that the broker-dealer had intended to provide.

“[R]elying on one broker quote prices could be problematic due to conflicts. They may have incentives to provide prices that may not be accurate,” Aspinall says. “This is part of why the valuation rule requires the board or the valuation designee to perform more diligence and testing around pricing vendor methodologies and the prices themselves.”

Such due diligence is especially important when the price is not from a typically subjective source like a pricing vendor, she adds.

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