NatEquity Knowledge Base

SEC Enforcement of Fair Value Measurement for Level 3 Audit Standards

Guiding rule for financial products - IF you can't bundle it and sell it at a profit, you can't ramp to scale.

The SEC is bringing a new paradigm to fintech and financial product markets because of long-standing non-compliant GAAP valuation audits. For the last 40-years the value of a bundle of assets or liabilities has been the "predictable" net present value of future portfolio cash flows. For Level-3 assets, where the value is dependent upon an "unknowable" future event (collateralized debt, derivatives, real estate), for too long clients have argued this doesn't matter. They have persuaded auditors to allow them to use mark-to-market or the value of comparable asset previous sold. After 50-years of not intervening, on December 3, 2020, the SEC issued Rule 2a-5, compelling companies and their auditors to comply with fair value GAAP accounting rules. The Financial Accounting Standards Board (FASB) is clarifying this in a rewrite of audit standards. All of this is set to take effect September 8, 2022.

Our company, NatEquity wrote and controls the GAAP compliant predictive IP and valuation method described in Rule 2a-5. Since 2009, when we first present this IP to the SEC, we have followed the SEC's progress closely. In 1992, as the founders of Transamerica HomeFirst (THF), we were forced to value our substantial private jumbo reverse mortgage portfolio under similar rules. While others suffered crippling devaluations, THF sold our $6 billion portfolio in 1999. We have come back with better products to serve the 6.5 million house rich cash poor senior household in coastal California with $28 trillion of trapper equity.

Yesterday the SEC announced part of its strategy to force auditors to enforce these rules by observing proper audit standards or pay the price.

WSJ 3/15/22: WASHINGTON—"Regulators are carrying out a sweeping investigation of conflicts of interest at the nation's largest accounting firms, asking whether consulting and other nonaudit services they sell undermine their ability to conduct independent reviews of public companies' financials, according to people familiar with the matter.

The Securities and Exchange Commission probe highlights the agency's new focus on financial-market gatekeepers such as accountants, bankers and lawyers. These firms help companies raise capital and communicate with shareholders, but also have duties under federal investor-protection laws. Auditors are a shareholder's first line of defense against sloppy or dodgy accounting.

Speaking at a national conference of auditors in December, SEC Enforcement Director Gurbir Grewal said: "You will see that we will have a firm commitment moving forward to continue to target deficient auditing by auditors, auditor independence cases, cases around earnings management."

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