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BlackRock, Kalotay Announce Licensing Agreement

By Kyle Glazier

Fixed income software provider Kalotay Analytics has licensed its patent-pending tax-neutral municipal bond valuation and risk analysis methodology to BlackRock.

The new methodology is calibrated to markets on a daily basis and incorporates after-tax effects, BlackRock said in a notice to its customers. The two companies explained the importance of the licensing agreement in a joint release Tuesday.

"When interest rates rise, the prices of lower coupon bonds may drop much more precipitously than predicted by traditional risk calculations," Kalotay and BlackRock said. "The traditional approach fails to account for the tax payable at maturity on the discount when prices fall below par, which pushes prices further down.

"We believe the new enhanced methodology better reflects how municipal securities trade in the financial markets and, as such, can provide portfolio managers with greater insight when employing strategies such as hedging of municipal securities," BlackRock continued. "Other enhancements, such as robust yield curve construction and estimation techniques, further strengthen the new methodology."

Leadership at both firms also extolled the benefits of the arrangement.

"Incorporating tax effects is vital for the proper risk analysis and tax management of municipal bonds," said Andy Kalotay, president of Kalotay,which has been providing fixed income valuation and risk measurement tools to major market participants since 1990. "We're thrilled that BlackRock recognizes the benefits of our innovative methodology, and is implementing it across its existing platforms."

Antonio Silva, the head of the Financial Modeling Group at BlackRock said, "We continually look for improvements to our analytics platform and are pleased to integrate the tax effects model into the new valuation methodology used for municipal bonds."

The new methodology took effect Sept. 26, BlackRock told its customers. The new approach is timely as the Federal Reserve contemplates raising interest rates, the firm said.

"The implementation of the new effective duration calculation methodology comes after many months of analysis, model construction and testing, consistent with BlackRock's rigorous process for reviewing and updating its analytics," the company said in the customer notice. "We believe the timing is advantageous as the Federal Reserve seeks to `normalize' interest rates after a long period of accommodative monetary policy."

There is no change to the investment strategy or policies of BlackRock's funds. The company manages more than $5 trillion. The Kalotay software enhances an underlying analytical model, known as the Black-Karasinski model, that is consistent with many of the options-based municipal duration models used in the industry, BlackRock said.