A response to the questions posed by the European Banking Authority concerning valuation in recovery and resolution

(Draft Regulatory Technical Standards on valuation under Directive 2014/59/EC)

A response by RICS
6 February 2015

ID number of the EU transparency register:
12309911354-39

Contact:
Zsolt Toth
RICS External Affairs and EU Liaison Manager, Europe
ztoth@rics.org
Tel: +32 2 739 4226

Sander Scheurwater
RICS Head of External Affairs and EU Liaison, Europe
sscheurwater@rics.org

Background

RICS is the world's leading professional body on all aspects of property, construction and land use. An independent, public interest organisation, we regulate, represent and promote over 118,000 individually qualified professionals in 140 countries worldwide. RICS promotes and enforces the highest professional qualifications and standards in the valuation, development and management of land, real estate (including construction and infrastructure), business and machinery assets. Our name promises the consistent delivery of standards – bringing confidence to the markets we serve.

We believe that standards underpin effective markets. With up to seventy percent of the world's wealth bound up in land and real estate, our sector is vital to economic development, helping to underpin stable, sustainable investment and growth around the globe. We have a strong interest in promoting more transparent, consistent and high quality valuations that span all asset classes and both strengthen market discipline and contribute to financial stability.

RICS welcomes the opportunity to contribute to the public consultation initiated by the European Banking Authority (EBA) on draft Regulatory Technical Standards (RTS) on valuation for the purposes of resolution.

We support the view set forth in the draft RTS to promote the consistent application of valuation methodologies across all asset classes throughout Europe. All RICS valuers are required to comply with the RICS Valuation Professional Standards (the 'Red Book') which guarantees consistent valuation approaches and reporting worldwide in line with the International Valuation Standards (IVS). Moreover, RICS valuers meet the same professional, ethical and business standards irrespective of their nationality or place of residence based on the principle of adequate consistency.

For clients and users of RICS valuations, these professional standards mean:

- Consistency in approach and reported value;
- Credible and consistent valuation opinions by suitably trained valuers with appropriate qualifications and adequate experience for the task;
- Independence, objectivity and transparency in the valuer's approach;
- Clarity in the reporting and disclosures to be made.

Whilst our response is largely confined to real estate, both the RICS Red Book and IVS also apply to other (including financial) assets, therefore we encourage the EBA to look at the wider usability of our comments.

We trust that the EBA will take our opinions into consideration. We stay at your disposal for more information and are happy to provide further support if required.

Q1 Would you suggest any changes to the definitions of valuation approaches (letters e-i)? In particular, are there specific valuation methodologies which the definition of equity value should refer to?

As background, we would draw attention to our earlier response dated 10 October 2014 to the Authority's consultation paper on draft regulatory technical standards (RTS) relating to independent valuers (supplementing Directive 2014/59/EC).

Regarding the present consultation, we are encouraged by the proposed definition of 'fair value', which we note generally accords with the definition adopted by the International Accounting Standards Board (IASB) in IFRS 13 (International Financial Reporting Standards). More particularly, the references in the draft RTS to market participants and to a sale make clear that for most practical purposes the concept of 'fair value' is consistent with that of 'market value', and so both bases of value will normally lead to the same valuation figure being reported. Such an outcome would be consistent with that envisaged in the International Valuation Standards (IVS) - see IVS 300 paragraph G3 – and in the RICS Red Book, which incorporates the IVS. In our view, the IVS and the RICS Red Book provide a Europe-wide, consistent valuation standard spanning land, real estate, machinery and business assets which is fully in accord with, and can positively assist in realising, the European Banking Authority's objectives here.

We note the proposed definition of 'exit value' in the draft RTS and would take the opportunity to caution that 'fair value' and 'exit value' are not necessarily to be seen as mutually exclusive terms. Thus IFRS 13 expressly refers to 'fair value' as being a market-based "exit price".

In relation to the proposed definition of 'equity value', we would highlight the risk of possible confusion with the IVS 200 definition which is 'the value of a business to all of its shareholders'. Whilst the draft RTS definition refers only in general terms to "market price", we assume that the appropriate basis of value would normally be fair value – see above.

We are unable to comment on the definitions of 'hold value' and 'franchise value'. A general comment, however, is that too many alternative valuation bases can result in confusion and we recommend that only bases which serve a clear and necessary purpose be used, and that those bases should be consistent, wherever possible, with established market practices.

Q2 Should specific types of information be required on deviations from management assumptions, for example on differences in expected cash flows and/or the discount rates?

We note Article 7 in the draft RTS states that "the valuer shall determine the most appropriate valuation methodologies" and that "valuations........shall be based on fair and realistic assumptions. For this purpose the valuer may challenge the assumptions, data, methodologies and judgements underpinning the entity's valuations used for financial reporting obligations or for the calculation of regulatory capital and capital requirements......" Our view, embodied in the RICS Red Book, is that when an opinion of value is provided a) all valuation assumptions should be made explicit and b) a rationale for their adoption should be given as appropriate. This promotes consistency, ensures transparency, and also reinforces independence and objectivity.

In general, we do not favour specifying requirements for explanatory material in finer detail, given the diversity of facts and circumstances in individual situations where valuation opinions are provided,

Q3 Would you add, amend, or remove any areas which are likely to be subject to significant valuation uncertainty?

Article 8 in the draft RTS states that "For... areas [subject to significant valuation uncertainty] the valuer shall provide the results of the valuation in the form of best point estimates and value ranges, as indicated in Article 3(3) of this Regulation" and then lists various heads of uncertainty, making clear however that this is not an exhaustive list.

Again we would not advocate attempting to make the list more comprehensive or seeking to add finer detail. In individual cases and circumstances it will always be a matter of judgement, based on facts so far as possible, as to where and how valuation uncertainty arises and how it may best be addressed and reported. The more unusual or specialised the asset being valued, and/or the more limited, illiquid or volatile the market in which it might be traded, the more important the careful exercise of professional knowledge, experience and judgement becomes in arriving at a valuation opinion. In the RICS Red Book this is addressed at VPGA 9, with a sensitivity analysis, expressly illustrating the effect of differing assumptions, generally preferred to a valuation range.

Q4 Should the buffer instead always be greater than zero? If yes, how should the buffer be determined?

Consistent with our response to Question 3 above, by following the RICS Red Book the valuer's opinion(s) as at the valuation date will have regard to all relevant factors that may impact on value including those that may give rise to uncertainty. Whether further adjustments (a "buffer") are appropriate, by whom they should be made, by what means and in what amount (if any) are matters to be considered on the facts and in the circumstances of each individual case. We do not see any immediate justification for the proposition in the question itself.

Q5 Do you agree that a valuation of post-conversion equity is necessary to inform decision on the terms of write-down or conversion?

We are not in a position to comment on this question.

Q6 Do you agree with the definition of equity value for this purpose in Article 2 (i)? If not, what changes should be made to the definition? Should the definition be more closely linked to the net asset value determined on the basis of the remainder of Valuation 2 adjusted for goodwill/'badwill', and if so how should that adjustment be estimated?

See our response to Question 1.

We would also observe that "badwill" is not an internationally defined or universally recognised term, and we would not encourage its use.

Q7 As an alternative, should the use of information that becomes available after the resolution date be more restricted, and in particular permitted only if it refers to facts and circumstances existing at the resolution date which could reasonably have been known at that date?

We would here make the observation that a general and well established principle of valuation, as embodied in the RICS Red Book, is that it should be by reference to a specific date having full and proper regard to all the facts and circumstances that could reasonably have been known at that date and without the application of hindsight.

Q8 Should the use of information available after the resolution date be further limited, for example by requiring that such information is only used if it results in a significant change in the values of the entity's assets or liabilities?

See answer to Question 7 above.

Q9 Should these technical standards provide further detail on the characteristics of appropriate discount rates?

We would again make a general observation here that facts and circumstances vary widely and attempting to specify requirements in fine detail runs the risk of over-prescription.

Q10 Are there any changes you would suggest to the methodology for determining actual treatment of shareholders and creditors in resolution? In particular, should the methodology for valuing equity be further specified and, if so, what should be included in that specification (whether additional detail on the current approach, or a different approach, linked for example to net asset values adjusted for goodwill/badwill)?

We are not in a position to comment on this question.

Q11 Should the valuer be required to accompany the comparison envisaged in Article 7 of this Regulation with additional relevant disclosures? If yes, what should those be (for example, documentation of any differences between the valuation of actual treatment and the market price that would be observed for those same claims were they traded in an active market)?

We are not in a position to comment on this question.