The voice of banking

European Banking Authority
One Canada Square (Floor 46)
Canary Wharf
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6th February 2015

Dear Sirs,

Draft Regulatory Technical Standards on valuation under Directive 2014/59/EU

This is the British Bankers' Association's response to the above consultation paper; we welcome the opportunity to provide our views.

The draft RTS cover an important topic. We note that the introduction states that the purpose of the RTS is to promote consistent application of the methodologies for the valuations and not to set out detailed valuation rules. Nevertheless we believe the RTS should provide further guidance and clarity in a number of areas to assist those appointed as valuers in conducting their task and to maximise market certainty. For example, it is self-evident that the choice of basis on which discount rates are calculated could result in material differences in outcomes.

Article 36 envisages that the valuation for the purposes of resolution will be conducted in a manner which is independent of the institution but is not clear whether the valuer should place reliance on the systems or models of the firm in question. If this is to be expected then we highlight that firms can currently generate up-to-date going-concern balance sheets on a daily basis for the financial instruments in their trading books, as these are carried at fair value. This is not currently the case, however, for banking books where the timescales are much greater. Consideration should therefore be given to the timescales banks will require to materially enhance their infrastructure if reliance is to be placed on their systems.

We set out our answers to the questions below. In addition, we wish to note the points which follow on the proposals.

Draft RTS on valuation for the purposes of resolution

- Article 4: We recommend that the issue of hindsight is clarified by replacing 'pertinent to' with 'considered to be publicly available at'

Draft RTS on valuation to determine difference in treatment

- Article 3: We suggest that rather than just identifying assets encumbered by security this Article should list liabilities subject to set-off rights or netting agreements.
- Article 3: delete 'whose' from second line

<u>RTS on valuation for the purposes of resolution</u>

Question 1: 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?

We propose the following amendments:

- 2(f): Consider inserting ‘back to the valuation date’ after ‘discounted’
- 2(f): We note that “prudent” and “realistic” are conflicting assumptions
- 2(g): Consider inserting ‘the present value of’ after ‘means’
- 2(i): We question whether this definition should refer to <u>each individual share</u> that is in existence <u>immediately following</u> the resolution action?
- 2(i): Means an estimate of the assessed market price for each individual share in existence post-conversion regardless of whether it is transferred or newly issued, that would result from the application of generally accepted valuation methodologies

Question 2: Should specific types of information be required on derivatives from management assumptions, for example on differences in expected cash flows and/or the discount rate?

We agree that additional information would be appropriate, particularly in the case of derivatives, such as the reasons for using expected cash flows/discount rates and the underlying assumptions the valuer has used to arrive at the expected cash flows/discount rate. Furthermore, it should be explained if ranges have been used to provide this information and what the background calculations were to arrive at the output i.e. cash flows/discount rate.

Question 3: Would you add, amend, or remove any areas which are likely to be subject to significant valuation uncertainty?

We recommend that the list of factors affecting the valuation should be extended to include tangible assets and that consideration should also be given to deferred tax assets and pensions.

We note also that the meaning of Article 8(c) is unclear. Specifically what is the meaning of “misapplication” in this context?

Question 4: Should the buffer instead always be greater than zero? If yes, how should the buffer be determined?

We question whether it is necessary to provide for a buffer when the draft RTS under Article 3(3) makes provision for valuation to be provided in the form of ‘value ranges’ with the limits set in conjunction with the EBA RTS on Prudent Valuation.

Question 5: Do you agree that a valuation of post-conversion equity is necessary to inform decision on the terms of write-down or conversion?

We agree that it is necessary to estimate the value of a firm’s post-resolution equity to inform the terms of the write-down or conversion.

Question 6: 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?

Yes, this is similar to the accounting definition.

<u>RTS on valuation to determine difference in treatment</u>

Question 7: 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?

Question 8: 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?

Whilst we agree that the valuation should disregard factors such as value created in the failed entity as a result of intervention by the resolution authority, for example via liquidity assistance, it is inappropriate to limit the valuation to an artificial point in time state of knowledge to determine the actual factual circumstances as known at the time that the NCWO claim is to be assessed. It would also appear to be inappropriate to apply a materiality test to the circumstances in which such additional information should be utilised.

Question 9: Should these technical standards provide further detail on the characteristics of appropriate discount rates?

We believe the technical standards should provide further guidance to ensure that valuers and users of the information have clarity as to how the discount rates have been derived but that this should avoid prescribing an approach that might diminish in relevance overtime. We note that there could be a material difference between the use of a risk free Libor or government rate or a corporate or bank funding curve.

Question 10: 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 believe it would be appropriate to provide further detail as to the methodology for valuing equity. Not least as the equity is to be provided as compensation to creditors with a value approximating cash.

Question 11: 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)?

It will be important for creditors affected by resolution to be provided with sufficient disclosure to ensure satisfaction of fair process and valuation.

Yours faithfully,

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