



EBA/CP/2014/38

7 November 2014

Consultation Paper

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

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1. Responding to this Consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 6.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 06.02.2015. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) N° 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

The Bank Recovery and Resolution Directive (BRRD) provides a comprehensive framework of powers for resolution authorities to intervene in failing banks to protect the public interest. To ensure that authorities exercise these powers in ways which reduce the risk of costs falling on the taxpayer, preserve value where possible, and respect the property rights of affected shareholders and creditors, the BRRD requires independent valuations to be carried out to inform decisions of the authorities.

These valuations are required for several distinct purposes. Prior to resolution valuations are required to:

- a) inform the determination whether the conditions for resolution or the write-down or conversion of capital instruments are met (**Valuation 1**);
- b) inform the choice resolution action to be adopted, the extent of any eventual write-down or conversion of capital instruments, and other decisions on the implementation of resolution tools (**Valuation 2**);

After the resolution, a valuation is required to determine whether an entity's shareholders and/or creditors would have received better treatment if the entity had entered into normal insolvency proceedings (**Valuation 3**).

These draft technical standards are intended to promote the consistent application of methodologies for these valuations throughout the Union. They do not seek to provide detailed valuation rules for particular types of asset or liability, but to further specify the principles on the basis of which the independent valuer must apply their own information and expertise in particular cases.

The different purposes these valuations serve require different approaches to valuation, as recognised in the recitals and text of the BRRD. For **Valuation 1** the draft technical standards emphasise the importance of producing a valuation which is consistent with the framework of accounting and prudential rules on the basis of which the determination of whether the conditions for resolution are met must be made. But the valuer is required to apply their independent, sceptical, judgement as to how this framework has been applied. For **Valuation 2**, the standards emphasise the need to assess economic value in order to ensure losses are fully recognised, even if this requires departures from accounting and prudential rules. This is necessary to ensure that resolved institutions are recapitalised to a prudent extent and because certain resolution actions (e.g. the sale of business tool) will in fact crystallise economic values. For **Valuation 3** the valuation should be conducted on a gone-concern basis.

3. Background and rationale

The BRRD relies on independent valuations for a number of purposes. These include, under Article 36(4) of the BRRD:

- c) informing the determination whether the conditions for resolution or the write-down or conversion of capital instruments are met;
- d) where the resolution authority determines that an entity meets those conditions, informing the resolution action to be adopted, the extent of any eventual write-down or conversion of capital instruments, and other decisions on the implementation of resolution tools;

and under Article 74:

- e) determining whether an entity's shareholders and/or creditors would have received better treatment if the entity had entered into normal insolvency proceedings.

The Directive permits the EBA to develop regulatory technical standards which set out the criteria on which valuations for the purposes of points a) and b) should be based, and to define the methodology for the valuation under c). Two separate RTS have been drafted covering the deliverables related to points a) and b), and point c), respectively.

Although valuation for the purpose of article 36 (points a) and b) above) is a single process, the purposes described above require a three-step exercise designed to inform the decisions to be adopted by the authorities.

A valuation ("Valuation 1") for the purpose of informing a decision whether or not to trigger resolution requires considering the value of the relevant entity prior to the impact of any actions taken by the resolution authority. It must also be closely aligned with the standards relevant for determining whether an entity meets the conditions for continuing authorisation and, more generally, assessing the conditions for resolution in article 32 of the BRRD.

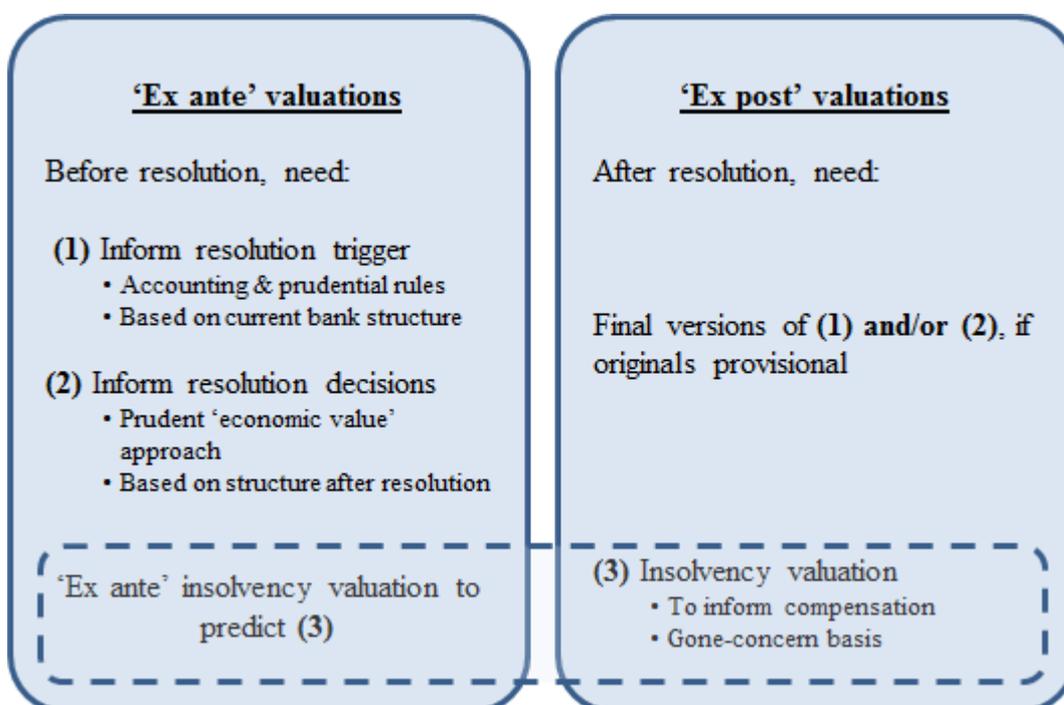
Valuation to inform the resolution decisions described in point b) above ("Valuation 2") must on the other hand consider the (as yet hypothetical) impact of actions that would be taken by the resolution authority in implementing their resolution strategy.

These valuations take place before resolution actions are implemented, and therefore will be referred to as "ex ante" valuations in this consultation paper. It is important to note though that these valuations may be conducted on a provisional basis where it is not possible to fulfil all of the requirements of Article 36 of the BRRD in the time available. In this case a final, definitive,

valuation must be carried out after resolution. The provisions of the RTS apply both to the final definitive valuation and, insofar as is feasible, to any provisional valuation.

Lastly, the third step (“Valuation 3”, or “ex-post valuation”, as opposed to the “ex-ante” valuations 1 and 2) takes place after resolution, and informs the application of the Directive’s legal safeguards to protect the rights of shareholders and creditors against decisions adopted on the basis of Valuation 2. Note as well that Article 36 (8) requires the *ex ante* valuation to include an estimate of insolvency treatment, which should be carried out consistently with the principles of this RTS, insofar as they can be applied prior to resolution.

Figure 1: Valuations required by the BRRD



2. Approach to measurement assumptions

As described in recital (51) of the BRRD, informing the determination whether the conditions are met for an entity’s resolution, or for the write-down or conversion of its capital instruments, requires a fair and realistic valuation of the entity’s assets and liabilities. In this connection, valuation 1 must be closely linked to the accounting principles relevant to the preparation of the entity’s financial statements and the prudential regulations relevant for the calculation of the entity’s capital requirements.

This should not prevent the valuer from deviating from assumptions made by the entity’s existing management which affect valuation. The valuation should be adequately supported by evidence, and be consistent with existing supervisory guidance or other generally accepted sources of

interpretation of accounting standards or regulatory requirements that result in a fair and realistic depiction of the entity's financial position.

Valuation 2 on the other hand contemplates a situation where the resolution authority had determined that an entity meets the conditions for resolution, or the write-down or conversion of capital instruments. This may result in changes to the assumptions made in applying accounting principles and regulatory requirements, and more broadly the basis of valuation, which must be appropriate for informing any resolution strategy, its extent and characteristics. For instance, application of the sale of business tool requires a valuation of the business on commercial terms. Consistent criteria for valuation methodologies should be applied for all resolution tools, to avoid introducing any systemic bias for or against any particular tool which is not justified by the underlying economics.

Further, as described by recital (52) of the Directive, only by requiring the use of prudent assumptions can resolution authorities ensure that losses are fully recognized upon application of resolution measures or the power to write down or convert capital instruments.

Finally, the ex-post valuation seeks to ensure that shareholders and creditors do not receive worse treatment under resolution than what would be expected in a counterfactual liquidation under normal insolvency proceedings. Accordingly, in this case the assumptions governing the estimation of the treatment shareholders or creditors would have received in insolvency are driven by the sole purpose of determining the appropriate discounted amount of cash flows that can reasonably be expected under the relevant national insolvency procedures.

3. Criteria for Valuations 1 and 2

The criteria aimed at guiding ex-ante valuations are directed towards the estimation of the amount and timing of expected cash flows from the entity's assets and liabilities, and the applicable discount rates, in order to fairly represent the entity's financial position in the context of the opportunities and risks it confronts. To that end, the valuer may use any relevant information pertinent to the valuation date.

The first step in the valuation process seeks to inform the determination whether the conditions for resolution or the write-down or conversion of capital instruments are met. In guiding the methodologies pursuant to that goal, the criteria in the RTS refer only to the determination of whether the entity is "failing or likely to fail". The determination of whether the other conditions are met for the write-down or conversion of capital instruments, or for resolution, requires assessing whether the resolution action is in the public interest, or the prospects that an alternative private sector measure or supervisory action can prevent the entity's failure. This requires a forward-looking impact assessment of the measure or action which falls beyond the scope of the valuation exercise.

The valuer shall focus on areas subject to significant valuation uncertainty (e.g. loans or loan portfolios, or repossessed assets), and consider general factors affecting key assumptions, such as

the entity's business model, or asset selection criteria. It will be for the valuer to determine the most appropriate valuation methodologies consistent with the criteria described in the RTS, which may or may not rely on the entity's internal models, depending on the nature of the entity's risk management framework, and the quality of data and information available.

If the resolution authority concludes that the entity meets the conditions for resolution, Valuation 2 informs the decision on the appropriate resolution action to be taken and, depending on such action, decisions on the extent of the cancellation or dilution of shares, the extent of the write-down or conversion of eligible liabilities, the assets, rights, liabilities or shares to be transferred, and the value of any consideration to be paid. For those purposes, the criteria in the RTS aim to guiding separate valuations capturing the impact on expected cash flows resulting from a sufficiently diverse range of actions that may be adopted by the resolution authority, including but not limited to any resolution strategy described in the entity's resolution plan.

Any such valuations are to be based on the present value of cash flows that the entity can reasonably expect, and the valuers shall apply their independent expert judgment in determining key characteristics of the assets or liabilities being measured. However the estimation of the amount and timing of cash flows will be significantly affected by the specific choice of resolution tools and characteristics of the resolution actions. In this sense, the intentions of the resolution authority are one key input in valuing the entity's assets and liabilities.

For strategies that involve continuing to hold some or all of the entity's assets, either with an aim to continuing or running off business, any factor (favorable or unfavorable) potentially affecting future cash flows must be considered, especially when resulting from the resolution actions. On the other hand, exit values expected in a defined disposal period are to be regarded as the main determinants of expected cash flows if the entity lacks the ability to hold the assets or their sale is necessary or appropriate to implement the resolution actions being considered.

Where resolution envisages conversion of capital instruments or other liabilities, Valuation 2 shall also provide an estimate of the post-conversion equity value of new shares transferred or issued as consideration. This is necessary to enable the resolution authority to determine a rate of conversion into equity which ensures that holders of converted instruments receive equity of sufficient value to be consistent with their fundamental property rights and the 'no creditor worse off' safeguard provided by Article 73 of the BRRD. This equity value shall be an estimate of the market price for those shares that would result from generally accepted valuation methodologies, and the estimate shall inform the determination of the conversion rate or rates.

Either step of the ex-ante valuation may be carried out on a provisional basis in accordance with Article 36 (9) of the BRRD when it is not possible to comply with the general requirements of Article 36. Any provisional valuation shall include a buffer aimed at approximating the amount of losses that would otherwise be determined by the valuer after conducting valuations pursuant to the general criteria contained in the RTS. For a provisional Valuation 1, the valuers shall seek to determine whether evidence supports the existence of additional losses of uncertain amount or

timing. For a provisional Valuation 2, they shall apply judgment in identifying factors that may affect expected cash flows as a result of resolution actions likely to be adopted.

4. Valuation 3 methodology

The BRRD provides explicit safeguards to protect the fundamental property rights of shareholders and creditors. Article 73 of the BRRD requires that Member States ensure that shareholders and creditors affected by resolution tools receive at least as much in resolution as they would have received had the entity been wound up under normal insolvency proceedings, whether their claims are written down or modified as a result of resolution actions.

In order to make those safeguards effective, the methodology described by the RTS seeks to determine:

- a) the treatment shareholders and creditors would have received had the entity under resolution entered insolvency proceedings at the time when the authority decided to apply the resolution strategy;
- b) the actual treatment shareholders and creditors have received in resolution; and
- c) the difference between actual treatment and counterfactual treatment.

In other words, the exercise attempts to determine the treatment actually received by each class of shareholders and creditors existing as of the date of resolution, but immediately preceding any resolution action, and to compare this with an estimate of the outcome for those classes resulting from a hypothetical insolvency of the entity under normal insolvency proceedings.

4. Draft regulatory TS on valuation for the purposes of resolution

COMMISSION DELEGATED REGULATION (EU) No .../..

supplementing Directive xx/XX/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria relating to the methodology for assessing the value of assets and liabilities of institutions or entities referred to in points (b), (c) or (d) of Article 1(1)

of xx.x.2014

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms¹, and in particular articles 36(15) thereof.

Whereas:

- (1) The resolution framework laid down in Directive 2014/59/EU entrusts the resolution authority with a set of tools and powers to intervene swiftly and at a sufficiently early stage in a non viable entity or an entity which is failing or likely to fail, with the view to ensuring the continuity of the entity's critical functions while minimizing the impact of its eventual failure on the economy and the financial system.
- (2) The framework is devised with a view to minimising the cost of an entity's resolution to taxpayers and to ensuring that shareholders bear losses prior to creditors, with no shareholder or creditor incurring greater losses than it would have incurred if the entity had been wound up under normal insolvency proceedings in its jurisdiction.
- (3) Following recital (51) of Directive 2014/59/EU, determining whether the conditions for resolution or for the write-down or conversion of capital instruments are met requires a fair and realistic valuation of the entity's assets and liabilities. Such valuation is not meant to replace accounting principles or to introduce greater prescription into the accounting standards relevant to the preparation of the entity's financial statements or the prudential regulatory framework. Additionally, where the resolution authority determines that an entity meets the referred conditions, prudent assumptions are required, as indicated in recital (52) of Directive 2014/59/EU, in determining the value

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that informs any resolution action, as well as the extent of an eventual write-down or conversion of capital instruments.

- (4) The valuation involves estimating both the impact of decisions by the entity's management and shareholders existing prior to any resolution action or the exercise of the power to write down or convert capital instruments, and the impact of different actions that might be pursued by the resolution authority. In both cases, the valuation has the potential to affect the rights of shareholders and creditors, and therefore legal safeguards have been introduced, as described in Article 74 of the Directive, to ensure the treatment of shareholders and creditors under resolution is no worse than the treatment they would be expected to receive if the entity were wound up under normal insolvency proceedings.
- (5) Article 36(15) of Directive 2014/59/EU allows the EBA to develop regulatory technical standards specifying the criteria for the valuation methodologies to be applied by independent valuation experts for different purposes specified in the Directive. According to this provision, the regulatory technical standards should also specify the criteria to be applied in defining the methodology for calculating and including a buffer for additional losses in cases where a provisional valuation is conducted.
- (6) In guiding the methodologies pursuant to the determination of whether the conditions for the write down or conversion of capital instruments, or the conditions for resolution, are met, the criteria in Part II of this Regulation refer exclusively to the determination of whether the entity is 'failing or likely to fail' according to point (a) of Article 32(1) in Directive 2014/59/EU. The determination whether the other conditions are met for the write-down or conversion of capital instruments, or the entity's resolution, normally requires additional assessments not necessarily driven by the valuation of the entity's assets and liabilities.
- (7) In addition to the entity being 'failing or likely to fail', the determination that an entity has reached the point of non-viability, that may trigger the write-down or conversion of capital instruments, requires that there be no reasonable prospect that any alternative private sector measures, or supervisory action other than the write-down or conversion of capital instruments, would prevent the entity's failure. Assessing the likelihood of such prospect would necessarily start from a fair and realistic depiction of the entity's existing financial position, but would normally require a forward-looking assessment of the impact of any such measure or action, possibly based on the results of supervisory examinations and quantitative and qualitative analyses of the systemic impact of the entity's insolvency. Similar forward-looking assessments would normally be required to determine whether the additional conditions for resolution are met (that a resolution action is necessary in the public interest, and that there is no reasonable prospect that any alternative private sector measures, or supervisory action, including early intervention measures or the write-down or conversion of capital instruments, would prevent the entity's failure).
- (8) Informing the determination whether an entity is failing or likely to fail requires a valuation consistent with the applicable accounting and prudential regulatory framework. At the same time, the valuation may differ from management assumptions under which financial statements are prepared. Such deviations should be supported by the best available information, and be based on existing supervisory guidance or other generally recognized sources of interpretation of accounting standards or the prudential

regulatory framework, resulting in a fair and realistic representation of the entity's financial position.

- (9) If the resolution authority determines that the conditions for write-down or conversion of capital instruments are met, the valuation based on the criteria in Part III of this Regulation should: (i) form the basis of the calculation of such write-down or the level of conversion, according to Article 59(10) of Directive 2014/59/EU; (ii) require the valuer to provide an estimate of the post-conversion equity value of shares to be transferred to holders of capital instruments that are converted; and (iii) inform the determination of the conversion rate accordingly.
- (10) Where the resolution authority determines that the conditions for resolution are met, certain criteria in Part III of this Regulation should provide guidance for conducting separate valuations that capture the impact of different resolution actions that may be adopted by the resolution authority.
- (11) For the purposes referred to in recitals (9) and (10), the valuations should be fair, prudent and realistic, in order to ensure that all losses are fully recognised at the moment the resolution tools are applied or the power to write down or convert relevant capital instruments is exercised. The most appropriate measurement base or bases should be determined by the particular resolution tools, and by the characteristics of different resolution actions under assessment.
- (12) Any valuation conducted after the decision is adopted by the resolution authority to resolve, or to convert or write down capital instruments, should assess economic value be based on the present value of cash flows that the entity can reasonably expect, even if this requires departures from accounting or prudential valuation frameworks. For purposes of estimating such cash flows, consideration should be given to the range of potential options available to the resolution authority, notably the maintenance or the sale of assets.
- (13) When the resolution action envisages holding the assets, factors that potentially affect future cash flows should be considered in the valuation. Reasonable expectations for franchise value stemming from the resolution actions may be taken into account in the estimate of the post-conversion equity value of shares. In turn, cash flows should be referenced to exit values expected in a defined disposal period if the entity lacks the ability to hold the assets or their sale is considered necessary by the resolution authority.
- (14) As regards liabilities that are measured at fair value, the previously existing credit risk spreads may no longer be valid in resolution. To the extent the valuation requires updated credit spread assumptions related to the entity or its liabilities, those spreads may need to be adjusted to isolate the valuation from stress levels observed on the verge of resolution.
- (15) Any provisional valuation pursuant to Article 36(9) of Directive 2014/59/EU should include a buffer aimed at approximating the amount of losses that would otherwise be determined by the independent valuer when conducting valuations pursuant to the criteria contained in this Regulation.
- (16) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.

(17) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with article 37 of Regulation (EU) No 1093/2010.

HAS ADOPTED THIS REGULATION:

PART I

GENERAL PROVISIONS

Article 1

Subject matter and scope

1. This Regulation lays down the criteria for methodologies to assess the value of assets and liabilities for purposes of paragraphs (1), (3) and (9) of Article 36 of Directive 2014/59/EU. These criteria shall be applied when conducting a valuation, in accordance with Article 36(4) of the referred Directive, aiming at:

- (a) informing the determination whether the conditions for the write down or conversion of capital instruments, or the conditions for resolution, are met;
- (b) if the conditions for the write-down or conversion of relevant capital instruments are met, informing the decision on the extent of such write-down or conversion; and
- (c) if the conditions for resolution are met, informing the decision on the appropriate resolution actions by the resolution authority and, depending on the type of resolution action that is adopted, the decisions on respectively: (i) the extent of the cancellation or dilution of shares; (ii) the extent of the write-down or conversion of eligible liabilities; (iii) the assets, rights, liabilities or shares to be transferred, and (iv) the value of any consideration to be paid.

2. Part II of this Regulation lays down the criteria to be applied by valuers and resolution authorities for purposes of the valuation informing the determination in point (a), while Part III lays down the criteria to be applied when conducting a valuation informing the decisions referred to in points (b) and (c). Both Parts II and III also contain criteria for calculating and including a buffer for additional losses in cases where a provisional valuation is conducted.

3. Where the criteria refer to measurement of individual assets and liabilities of an entity, they shall be deemed also to apply to portfolios or groups of assets or combined assets and liabilities, businesses, or the entity considered as a whole, as the circumstances require.

4. The criteria laid down in Parts II and III of this Regulation refer to valuations to be conducted for the purposes set out in Directive 2014/59/EU, and are not meant to replace or amend accounting principles and standards or the prudential regulatory framework that apply to entities in contexts other than resolution.

5. Notwithstanding paragraph (4), the valuer may use information resulting from the valuation in order to identify possible misapplication of accounting standards or the prudential regulatory framework, or to inform changes in the entity's accounting policies or in the assumptions or judgments driving the measurement of assets and liabilities. Such circumstances shall be taken into account when preparing the updated balance sheet required by Article 36(6) of Directive 2014/59/EU, and for this purpose the valuer shall

provide an adequate explanation of differences between the existing and the updated balance sheets.

Article 2

Definitions

For the purpose of this Regulation the following definitions shall apply:

- (a) ‘valuation’ means the assessment of an entity’s assets and liabilities conducted by a valuer pursuant to Article 36(1) of Directive 2014/59/EU, or the provisional valuation conducted by the resolution authority or the valuer, as the case may be, pursuant respectively to paragraphs (2) and (9) of Article 36 of the referred Directive.
- (b) ‘valuer’ means any of: (a) the independent expert in compliance with the requirements and the criteria set out in Commission Regulation (EU) No. xx/xxxx (EBA RTS 2015/xx/EU) specifying circumstances in which a valuer is to be considered independent, which is appointed to carry out the valuation; or (b) the resolution authority when conducting the valuation pursuant to paragraphs (2) and (9) of Article 36 of Directive 2014/59/EU.
- (c) ‘entity’ means an institution or an entity as referred to in points (b), (c) or (d) of article 1(1) of Directive 2014/59/EU.
- (d) ‘valuation date’ means either: (a) the reference date to which the valuation refers, as determined by the valuer on the basis of the expected date of an eventual decision by the resolution authority to put the entity in resolution or to exercise the power to write down or convert capital instruments; or (b) except as provided in Article 11.6 of this Regulation, the resolution date, when an ex-post definitive valuation required by article 36(10) of the Directive is conducted.
- (e) ‘fair value’ means the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the valuation date, as defined in the relevant accounting standards.
- (f) ‘hold value’ means the present value, discounted at an appropriate rate, of cash flows that the entity can reasonably expect under fair, prudent and realistic assumptions from retaining particular assets and liabilities in the ordinary course of business, considering factors affecting customer behavior in the context of resolution, but excluding business opportunities that may stem from resolution actions.
- (g) ‘exit value’ means the cash flows that the entity can reasonably expect through sale or transfer of assets or liabilities within a given disposal period.
- (h) ‘franchise value’ means the present value of cash flows that can reasonably be expected to result from business opportunities, including those stemming from the different resolution actions that are assessed.

- (i) ‘equity value’, for the purposes set out in Part III of this Regulation, means an estimate of the assessed market price, for transferred or issued shares, that would result from the application of generally accepted valuation methodologies.

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?

- (j) ‘measurement base’ means the process for determining monetary amounts at which assets or liabilities are presented for the purposes established in Article 36(4) of Directive 2014/59/EU.

*Article 3**General criteria*

1. The valuation shall consider circumstances affecting the expected cash flows of, and discount rates applicable to an entity’s assets and liabilities, and it shall aim to fairly represent the entity’s financial position in the context of the opportunities and risks it confronts.
2. The valuer shall disclose and justify the key assumptions used in the valuation. Any significant deviation from the assumptions used by the incumbent management in the preparation of financial statements and in the calculation of the entity’s regulatory capital and capital requirements shall be supported by the best available information.
3. The valuer shall provide the best point estimate of a given asset’s or liability’s value. Where deemed appropriate, and in any case for purposes set out in Article 8(1) of this Regulation, the results of the valuation shall additionally be provided in the form of value ranges. For the purpose of determining the limits for each range, the valuer may refer to the methodology set out in the EBA RTS/2014/06 on Prudent Valuation.
4. The valuer shall provide a classification of creditors including:
 - (a) an estimate of the value of claims of each class according to the applicable insolvency law and to the contractual rights conferred on claimants;
 - (b) an estimate of the proceeds each class would receive if the entity were wound up under normal insolvency proceedings;

*Article 4**Sources of information*

The valuation shall be based on any information pertinent to the valuation date which is deemed relevant by the valuer. In addition to the entity’s financial statements and

regulatory reporting as of a period end as close as possible to the valuation date, such information may include:

- (a) data contained in the records of the entity;
- (b) relevant market data;
- (c) conclusions drawn from discussion with management and auditors;
- (d) where available, supervisory assessments of the entity's financial condition, including information acquired pursuant to point (h) of Article 27(1) of Directive 2014/59/EU;
- (e) industry-wide assessments of asset quality, where relevant to the entity's assets;
- (f) valuations of peers, adequately adjusted to capture the entity's specific circumstances;
- (g) historical information, adequately adjusted to eliminate factors that are no longer relevant, and incorporate others that did not affect the historical information; or
- (h) trend analyses, adequately adjusted to capture the entity's specific circumstances.

Article 5

Impact of group arrangements

1. Where the entity forms part of a group, the potential impact of existing contractual intra-group support arrangements on the value of its assets and liabilities shall be considered by the valuer if it is foreseen that those arrangements will be triggered.
2. The impact of other formal or informal arrangements within the group, such as use of brand or infrastructure, shall be considered only if they are foreseen to remain in place in the context of a group's stressed financial condition or in resolution.
3. In any case, the valuer shall determine whether the resources of an entity within the group are available to meet losses of other group entities.

PART II

CRITERIA PURSUANT TO INFORMING THE DETERMINATION WHETHER THE CONDITIONS FOR THE WRITE-DOWN OR CONVERSION OF CAPITAL INSTRUMENTS, OR THE CONDITIONS FOR RESOLUTION, ARE MET

Article 6

Purpose of the criteria

The criteria laid down in this Part II of the Regulation aim at guiding valuations that inform the determination whether an entity is failing or likely to fail, for the purpose of assessing whether the conditions for resolution or the write-down or conversion of capital instruments are met.

Article 7

Overarching principles

1. Valuations conducted in accordance with the criteria laid down in this Part II shall be based on fair and realistic assumptions. For this purpose the valuer may challenge the assumptions, data, methodologies and judgments underpinning the entity's valuations used for financial reporting obligations or for the calculation of regulatory capital and capital requirements, on the basis of existing supervisory guidance or other generally recognised sources setting out criteria conducive to the fair and realistic measurement of different types of assets and liabilities.
2. The valuer shall determine the most appropriate valuation methodologies. Depending on the nature of the entity's risk management framework and the quality of data and information available, such methodologies may rely on the entity's internal models.
3. In any case, the resulting valuations shall be consistent with the applicable accounting and prudential regulatory framework. Any significant deviation from management assumptions used in the preparation of financial statements or in the calculation of regulatory capital and capital requirements shall be identified and explained.

Question 2:

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?

4. For the purposes of informing the determination whether the entity meets the conditions for continuing authorisation, the valuer shall provide information on how the assumptions driving valuations affect the numerator and denominator of regulatory capital ratios.

Article 8

Factors affecting the valuation

1. The valuer shall particularly focus on areas subject to significant valuation uncertainty. For those areas 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. Areas which are likely to be subject to significant valuation uncertainty include, but are not limited to:

- (a) loans or loan portfolios, the expected cash flows of which depend on a counterparty's ability, willingness or incentive to perform on its obligation, in turn driven by assumptions relating to delinquency rates, probabilities of default, loss given default, or instrument characteristics, especially where evidenced by loss patterns for a portfolio of loans;
- (b) repossessed assets, the cash flows of which are affected both by the asset's fair value at the time the entity forecloses on the related security or lien, and the expected evolution of such value after foreclosure;
- (c) instruments measured at fair value where, due to misapplication, the determination of such value is not in accordance with accounting or prudential requirements regarding their marking to market or marking to model, as applicable to the degree of uncertainty of measurement inputs;
- (d) goodwill and intangibles, where the impairment test may depend on subjective judgment, including as regards the reasonably attainable cash flow stream, discount rates, and the perimeter of cash generating units; and
- (e) legal disputes and regulatory actions, the expected cash flows of which may be subject to varying degrees of uncertainty relating to their amount and/or timing.

Question 3:

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

2. General factors that may affect key assumptions on which the values of assets and liabilities in those areas are based include:

- (a) the economic and industry circumstances affecting the entity, including relevant market developments;
- (b) the entity's business model and changes in its strategy;
- (c) the entity's asset selection criteria, including loan underwriting policies;
- (d) circumstances and practices likely leading to payment shocks;
- (e) circumstances affecting the parameters used to determine risk weighted assets for the calculation of minimum capital requirements;
- (f) the impact of the entity's financial structure on its capacity to retain assets for the expected holding period and its ability to generate predictable cash flows; and
- (g) general or entity-specific liquidity or funding concerns.

3. The valuer shall clearly separate any material latent gains identified while conducting the valuation, and inform of the exceptional circumstances leading to those gains.

Article 9

Buffer for additional losses

1. For purposes of addressing the uncertainty attached to provisional valuations conducted in accordance with point (a) of Article 36(4) of Directive 2014/59/EU, the valuer shall include a buffer whenever facts and circumstances support the existence of additional losses of uncertain amount or timing.
2. In determining whether such facts and circumstances exist, the valuer shall consult with the relevant supervisory authority, focusing on the entity's key risk areas, in particular as identified through an assessment of any deficiencies in its accounting policies, procedures and systems.
3. In order to determine the magnitude of the buffer, the valuer shall take into account existing supervisory guidance or generally recognised sources setting out criteria for the fair and realistic measurement of assets and liabilities. In the absence of facts and circumstances supporting the existence of additional losses, the buffer shall have a value of zero.

Question 4:

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

PART III

CRITERIA PURSUANT TO INFORMING THE DECISIONS ON THE EXTENT OF THE WRITE-DOWN OR CONVERSION OF CAPITAL INSTRUMENTS, THE APPROPRIATE RESOLUTION ACTIONS BY THE RESOLUTION AUTHORITY, AND THE CHARACTERISTICS OF THOSE ACTIONS

Article 10

Purpose of the criteria

1. Where it is determined that the entity is failing or likely to fail and meets the conditions for the write-down or conversion of capital instruments, the criteria set out in this Part III guide valuations that form the basis for the calculation of such write-down or conversion.
2. When the entity meets the conditions for resolution, the valuer shall follow the criteria laid down in this Part III for the purpose of conducting valuations that inform:
 - (a) the decision on the appropriate resolution action to be taken;
 - (b) depending on the resolution action which is finally adopted, the decisions on: (i) the extent of the cancellation, transfer or dilution of shares; (ii) the extent of the write-down or conversion of eligible liabilities; (iii) the assets, rights, liabilities or shares to be transferred; and (iv) the value of any consideration to be paid to the entity or, as the case may be, to the owners of the shares; and
 - (c) the resolution authority's understanding of what constitutes commercial terms for the purposes of Article 38 of Directive 2014/59/EU.

Article 11

Overarching principles

1. The valuer shall consult with the resolution authority on the actions contained in the resolution plan or, if different, any proposed resolution scheme.
2. In order to inform the decisions referred to in Article 10 of this Regulation, the valuer shall present separate valuations that capture the impact on expected cash flows resulting from a sufficiently diverse range of resolution actions that may be adopted by the resolution authority, including but not necessarily limited to actions contained in resolution plans or proposed resolution schemes.
3. The valuer shall ensure that any losses on the assets of the entity are fully recognised at the moment when the resolution tools are applied or the power to write down or convert relevant capital instruments is exercised. For this purpose, valuations shall be based on fair, prudent and realistic assumptions.
4. When resulting in values that significantly diverge from those presented in the financial statements, such assumptions, where consistent with accounting rules, shall inform

eventual adjustments to assumptions and accounting policies that are necessary to prepare the updated balance sheet required under Article 36(6) of Directive 2014/59/EU.

5. Where capital instruments or other liabilities are converted, a separate valuation shall provide an estimate of the post-conversion equity value of new shares transferred or issued as consideration to holders of converted capital instruments or other creditors. This estimate shall inform the determination of the conversion rate or rates pursuant to Article 50 of Directive 2014/59/EU.

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?

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 ?

6. Where liabilities arising from derivatives are bailed-in, the valuation shall be considered provisional until the close-out of the derivatives takes place. As a result, the reference date for the ex-post definitive valuation shall be the close-out date.

Article 12

Selection of measurement base

1. In selecting the most appropriate measurement base or bases, the valuer shall take into account the range of resolution actions to be examined according to paragraphs (1) and (2) of Article 11 in this Regulation, and shall follow the criteria set out in paragraphs (2) to (6) of this Article.

2. The valuer shall determine the cash flows that the entity can reasonably expect from existing assets and liabilities following adoption of the examined resolution action or actions, discounted at an appropriate rate as described in paragraph (6).

3. Cash flows shall be determined at the appropriate level of aggregation, ranging from individual assets and liabilities to portfolios or businesses, with due consideration to differences in the risk profiles.

4. Where the resolution actions referred to in paragraphs (1) and (2) of Article 11 in this Regulation envisage that assets are to be retained by the entity, the valuer shall use hold value as the appropriate measurement base. For assets that are retained to be run off, the expected cash flows may be anticipating a normalisation of market conditions, and assumptions may be required regarding the refinancing of such assets.

5. Where the resolution actions referred to in paragraphs (1) and (2) of Article 11 in this Regulation envisage the sale of assets, the expected cash flows shall generally correspond to the exit values foreseen for the defined disposal period.

6. Discount rates shall be determined having regard to the timing of cash flows and financing costs as appropriate to the asset or liability being measured, the entity's post-resolution financial position, and the market context.

Article 13

Specific factors relating to the estimation and discounting of expected cash flows

1. For purposes of estimating cash flows, the valuer shall apply expert judgment in determining key characteristics of the assets or liabilities being measured, and how their continuation, run-off or disposal, as envisaged in the examined resolution action, affect those cash flows.

2. Where the resolution action envisages the entity holding an asset, maintaining a liability, or continuing a business, the valuer may take into account factors potentially affecting future cash flows, including:

- (a) changes in assumptions or expectations, as compared to those prevailing as of the valuation date, consistent with long-term historical trends and a reasonable horizon for the recovery of the entity; or
- (b) for the purpose of estimating the post-conversion equity value of shares, reasonable expectations for franchise value resulting from renewal of assets or from the refinancing of an open portfolio in the context of the resolution actions.

3. As regards groups of assets and liabilities or businesses envisaged to be run off, the valuer shall take into account workout costs and benefits.

4. Where the entity's situation prevents it from holding an asset or continuing a business, or the sale is otherwise deemed necessary by the resolution authority in order to achieve the resolution objectives, the expected cash flows shall be referenced to exit values expected within a given disposal period. The valuer shall have regard to factors that might affect those values and periods, which include, but are not limited to:

- (a) the values and periods observed in similar transactions, adequately adjusted to take into account differences in the business model and in the financial structure of the parties to such transactions;
- (b) advantages or disadvantages of a particular transaction that are specific to parties involved, or to a subset of market participants;
- (c) particular attributes of an asset or business that may only be relevant to the potential purchaser, or to a subset of market participants; and
- (d) the likely impact of foreseen sales on the entity's franchise value.

5. Where an exit value is determined for a group of assets, or a business, a part of which is expected to be separated in resolution, the valuer may consider excluding an amount of such value.

6. As regards parts of a group of assets, or of a business, that are likely to be liquidated under ordinary insolvency procedures, the valuer may consider the exit values and disposal periods observed in auctions involving assets of a similar nature and condition. In any case, the determination of expected cash flows shall take into account illiquidity, the

absence of reliable inputs for the determination of exit values, and the resulting need to rely on valuation methodologies based on unobservable inputs.

7. Where the valuer assesses that no realistic prospect for the disposal of an asset or business can reasonably be expected, the valuer shall not be required to determine the exit value, but shall estimate the related cash flows on the basis of the relevant prospects for continuation or run-off.

Article 14

Buffer for additional losses

1. For purposes of addressing the uncertainty attached to provisional valuations conducted in accordance with points (b) to (g) of Article 36(4) of Directive 2014/59/EU, the valuer shall include a buffer for additional losses.
2. In order to determine the magnitude of the buffer, the valuer shall apply expert judgment in identifying factors that may affect expected cash flows as a result of resolution actions likely to be adopted.
3. For purposes of paragraph (2), the valuer may extrapolate losses estimated for a part of the entity's assets to the remainder of the entity's balance sheet. Where available, average losses estimated for assets of peer competitors may also be extrapolated, subject to the necessary adjustments for differences in the business model and financial structure.

5. Draft regulatory technical standards on valuation to determine difference in treatment following resolution

COMMISSION DELEGATED REGULATION (EU) No .../..

supplementing Directive xx/XX/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria guiding methodologies for assessing the value of assets and liabilities of institutions or entities referred to in points (b), (c) or (d) of Article 1

of xx.x.2014

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms², and in particular Article 36(15) thereof.

Whereas:

- (1) The resolution framework laid down in Directive 2014/59/EU entrusts the resolution authority with a set of tools and powers to intervene swiftly and at a sufficiently early stage in a non viable entity or an entity which is failing or likely to fail, with the view to ensuring the continuity of the entity's critical functions while minimizing the impact of its eventual failure on the economy and the financial system.
- (2) The framework is devised with a view to minimising the cost of an entity's resolution to taxpayers and to ensuring that shareholders bear losses prior to creditors, with no shareholder or creditor incurring greater losses than it would have incurred if the entity had been wound up under normal insolvency proceedings in its jurisdiction.
- (3) The Directive introduces safeguards aimed at ensuring the 'no creditor worse-off' principle referred to in recital (2). The overall objective of such safeguards is to ensure that, where one or more resolution tools have been applied, a methodology is established for carrying out a valuation after the resolution action or actions have been effected. Such ex-post valuation is aimed at determining whether there is any difference between the actual treatment of shareholders and creditors in respect of which the resolution action or actions have been effected, and the amount that they would have received had the entity been subject to ordinary insolvency proceedings at

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OJ.....

the date on which the decision to resolve an entity is adopted according to Article 82 of Directive 2014/59/EU.

- (4) Any adverse difference in treatment should entitle shareholders and creditors, in respect of which resolution actions have been effected, to compensation from the resolution financing arrangements, pursuant to point (e) of Article 101(1) in Directive 2014/59/EU.
- (5) The ex-post valuation should be carried out as soon as possible after the resolution action or actions have been effected, even though its completion could take some time. While the valuation should be based on available information pertinent to the resolution date, the valuer should have the ability to adjust or ignore certain pieces of information obtained with hindsight, in order to adequately reflect specific circumstances as of that date, such as distressed market conditions.
- (6) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.
- (7) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010.

HAS ADOPTED THIS REGULATION:

PART I

GENERAL PROVISIONS

Article 1

Subject matter and scope

1. This Regulation establishes the methodology to be used for the valuation to be carried out under Article 74(1) of Directive 2014/59/EU.
2. The reference date of the valuation shall be the resolution date, which may differ from the actual treatment date at which shareholders and creditors receive compensation following resolution actions. The undiscounted proceeds as of the actual-treatment date may be directly compared with the discounted amount of hypothetical proceeds that shareholders and creditors would have received had the entity entered normal insolvency proceedings at the resolution date, insofar as the impact of any discounting of those proceeds is deemed negligible by the valuer.
3. The valuation shall be conducted as soon as possible after the resolution action or actions have been effected. For purposes of determining the treatment of shareholders and creditors under normal insolvency proceedings, the valuation shall only be based on information about facts and circumstances existing as of the resolution date which, had they been known, would have affected the measurement of the entity's assets and liabilities at that date. For purposes of determining the actual treatment of shareholders and creditors in resolution, the valuer, or the resolution authority, shall rely on available information concerning facts and circumstances existing as of the actual-treatment date or dates.

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?

Article 2

Definitions

For the purpose of this Regulation the following definitions shall apply:

- (a) 'valuation' means the process conducted by an independent valuer aimed at assessing whether shareholders and creditors would have received better treatment

- had the entity under resolution entered normal insolvency proceedings, pursuant to Article 74 of Directive 2014/59/EU.
- (b) ‘difference in treatment’ means the difference between the actual treatment shareholders and creditors have received in resolution and the hypothetical treatment they would have received had the institution entered into normal insolvency proceedings.
 - (c) ‘liquidation’ means disposal of an institution’s assets, collection of the resulting proceeds and settlement of obligations with creditors, in accordance with normal insolvency proceedings, and distribution of the proceeds to the institution’s creditors and equity holders.
 - (d) ‘entity’ means an institution or an entity as referred to in points (b), (c) or (d) of Article 1 of Directive 2014/59/EU.
 - (e) ‘resolution date’ means the date on which the decision to resolve an entity is adopted, pursuant to Article 82 of Directive 2014/59/EU, following the determination that the entity meets the conditions for resolution.
 - (f) ‘actual-treatment date’ means the date on which a resolution action is effected.
 - (g) ‘relevant discount rate’ means the rate or rates reflecting, as appropriate, the timing associated with expected cash flows, prevailing circumstances as of the resolution date, risk-free interest rates, risk premia for similar financial instruments issued by similar entities, and characteristics of the element or elements being valued.
 - (h) ‘valuer’ means the expert in charge of conducting the valuation, independent from the entity and from any public authority, and complying with the criteria set out in Commission Regulation (EU) No. xx/xxxx (EBA RTS 2015/xx/EU) specifying circumstances in which a valuer is to be considered independent.
 - (i) ‘commutation’ means the negotiated early termination of a contract ahead of its contractual term.

Article 3

Inventory of assets and claims

1. The valuer shall establish an inventory of all identifiable and contingent assets owned by the entity. Such inventory shall include assets whose for which the existence of associated cash flows is demonstrated or can reasonably be expected.
2. The valuer shall list all claims and contingent claims against the entity, and classify those claims according to their rights and priority under normal insolvency proceedings.
3. The valuer shall separately identify encumbered assets and claims secured on those assets.

PART II

CRITERIA GUIDING THE VALUATION EXERCISE

Article 4

Purpose and mechanics of the valuation

For purposes of determining whether difference in treatment exists the valuer shall determine:

- (a) the treatment that shareholders and creditors in respect of which resolution actions have been effected, or the relevant deposit guarantee scheme, would have received had the entity entered normal insolvency proceedings at the resolution date, disregarding any provision of extraordinary public financial support;
- (b) the value of the restructured claims or other proceeds received by shareholders and creditors as of the actual-treatment date or dates, discounted back to the resolution date if deemed necessary to enable a fair comparison with the determination under point (a); and
- (c) whether the outcome of the determination under point (a) exceeds the outcome of the determination under point (b) for each creditor class as determined according to Article 3 of this Regulation.

Article 5

Determination of the treatment of shareholders and creditors under normal insolvency proceedings

1. The methodology for conducting the valuation pursuant to point (a) of Article 4 of this Regulation shall be limited to determining the discounted amount of expected cash flows under normal insolvency proceedings.
2. Except in cases where particular rates, if relevant for the purposes of the valuation, are specified in local insolvency law or practice, expected cash flows shall be discounted at the relevant discount rate or rates.

Question 9:

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

3. In estimating the expected cash flows, the valuer shall take into account:
 - (a) applicable laws and usual insolvency practice in the relevant jurisdiction, which may influence factors such as the expected disposal period or recovery rates; and
 - (b) reasonably foreseeable administration, transaction, maintenance, disposal and other costs which would have been incurred by an administrator or insolvency practitioner, as well as financing costs.

4. For assets traded in an active market, the valuer shall use the observed price, except where specific circumstances hamper the marketability of the entity's assets.
5. For assets not traded in an active market, the valuer shall consider a number of factors when determining the amount and timing of expected cash flows, including:
 - (a) prices observed in active markets where similar assets are traded;
 - (b) prices observed in insolvency proceedings or otherwise distressed transactions involving assets of a similar nature and condition;
 - (c) prices observed in transactions involving the sale of business or the transfer to a bridge institution or an asset management vehicle in a resolution context relating to similar entities;
 - (d) the likelihood of an asset generating net cash inflows under normal insolvency proceedings;
 - (e) expected market conditions within a given disposal period, including market depth and the ability of the market to exchange the relevant volume of assets within that period; and
 - (f) the length of such disposal period, which shall be bound by the expected length of the liquidation process and reflect the implications of insolvency law and proceedings in the entity's Member State and/or the characteristics of the relevant assets.
6. The valuer shall consider whether the entity's financial condition would have affected the expected cash flows, including through restrictions on the administrator's ability to negotiate terms with potential purchasers.
7. Where possible, and subject to any applicable provision of the relevant insolvency regime, the cash flows shall reflect the contractual, statutory, or other legal rights of creditors or normal insolvency practices.
8. The hypothetical proceeds resulting from the valuation shall be allocated to different classes of claims based on their priority under the applicable insolvency law, as determined pursuant to Article 3 of this Regulation.
9. For the purpose of determining any unsecured amount of derivatives claims in insolvency, the valuer should apply methodologies consistent with the methodologies and principles contained in the Regulatory Technical Standards developed pursuant to Article 49 of Directive 2014/59/EU, unless to do so would produce results which are inconsistent with normal insolvency law and practice.

Comment: this paragraph will be reviewed in light of the content of those draft technical standards, once finalised.
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Article 6

Determination of the actual treatment of shareholders and creditors in resolution

1. The valuer shall identify all claims outstanding after exercise of the power to write-down or convert capital instruments and application of any resolution actions, and shall assign those claims to shareholders and creditors existing immediately prior to resolution.
2. In order to assess the actual treatment of shareholders and creditors existing immediately prior to resolution in cases where they receive equity compensation in resolution, the valuer shall provide an estimate of the overall value of shares transferred or issued as consideration to holders of converted capital instruments or to bailed-in creditors.
3. The estimate required in paragraph 2 may be based on the assessed market price, for shares referred to in such paragraph, resulting from generally accepted valuation methodologies.
4. In order to assess the actual treatment of shareholders and creditors existing immediately prior to resolution in cases where they receive debt compensation as a result of resolution, the valuer shall consider factors including changes in contractual cash flows resulting from the write-down or conversion, or the application of other resolution actions, as well as the relevant discount rate.

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)?

5. For any claim outstanding, the valuer may take into account, where available and together with the factors described in paragraphs (2) and (3), prices observed in active markets for the same or similar instruments issued by the entity under resolution or other similar entities.

Article 7

Difference in treatment

For each claim, the valuer shall compare the amounts determined under Articles 5 and 6 of this Regulation.

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)?

FINAL PROVISION

Article 8

Entry into force

This Regulation shall enter into force on the day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President

[For the Commission
On behalf of the President

[Position]

6. Accompanying documents

6.1 Draft Cost- Benefit Analysis / Impact Assessment for RTS on ex ante valuation

Introduction

Article 36(15) of CRR mandates the EBA to develop draft RTS to specify the valuation methodologies applied by valuation experts 1) when determining whether the conditions for write-down or conversion of capital are met and 2) when informing the resolution authority on the most appropriate resolution action to be taken and its impact on the treatment of shareholders and creditors. The valuation methodology should also specify the calculation of a potential buffer for additional losses in case a provisional valuation is carried out.

As per Article 10(1) of the EBA regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council), any draft RTS developed by the EBA shall be accompanied by a cost and benefit analysis. Such annex shall provide the reader with an overview of the findings as regards the problem identification, the options identified to remove the problem and their potential impacts.

This annex presents the impact assessment of the policy options considered in these RTS. However, given the nature of the policy options considered in these RTS, the impact assessment is qualitative.

Policy background

BRRD provides the resolution authority with a set of tools and powers to deal effectively with unsound or failing credit institutions and investment firms. However, before applying these tools the resolution authority should be informed on whether the conditions for resolution or the write-down or conversion of capital instruments are met. It should also identify the most appropriate resolution strategy as well as the impact on the treatment of shareholders and creditors.

Determining these pre-conditions requires ensuring a fair, prudent and realistic valuation of the institution's balance sheet items. In that context art 36 (15) of the BRRD requires the EBA to develop RTS to specify the valuation methodology to be used by independent valuers when determining the elements mentioned above.

Problem identification

A fair, accurate and realistic valuation of the assets and liabilities of an institution is key to ensure an effective and efficient implementation of the resolution powers and tools. It is also crucial in ensuring an adequate treatment of shareholders and creditors in case they have to absorb losses. The absence of a common EU framework to specify the methodology on valuation would thus:

- Create an uneven regulatory playing field across EU banks and stakeholders when applying the resolution tools;
- Make the resolution of cross border institutions more complex; and
- Increase legal risks when applying the resolution tools due to uncertainties surrounding the valuations rules.

However, if a common EU framework on valuation is needed to ensure an efficient implementation of the BRRD, such a framework should also be defined in a context where there are already accounting rules both at the national and international level which purpose is properly to specify the methodology to be followed when assessing the value of an institution's balance sheet. Therefore, when defining an EU framework on the valuation methodology for the purpose of resolution these RTS should also remain consistent with the existing accounting rules and should duly justify any potential deviations. This makes the drafting of these RTS quite challenging.

Objectives

Given the identified problems, the general objectives of the RTS are to:

- Set out an EU harmonized methodology for assessing the assets and liabilities in a context of resolution while remaining consistent with current accounting and prudential frameworks;
- Ensure a consistent implementation of the BRRD across EU countries by ensuring a fair, effective and efficient implementation of the resolution power and tools.

More specifically, the RTS also aims at:

- Helping the resolution authority to adopt the most appropriate resolution strategy when deciding to apply its resolution power;
- Accelerating the valuation process by defining a clear tool kit to be applied easily by independent valuers and thus allowing resolution authority to take quicker actions; and
- Increasing transparency and reducing uncertainties regarding the treatment of shareholders thus minimizing legal disputes that may arise during the resolution process.

Policy options

While drafting the RTS, the EBA identified five areas under which two alternative policy options have been considered:

1. Overreaching principles

2. *Option 1:* The RTS aim for consistency with with existing accounting and prudential rules.

Option 2: The RTS aim for an economic valuation approach, rather than focusing on accounting and prudential values.

3. Date of valuation 2

Option 1: The valuation takes into account the last available financial statement (last known value by market).

Option 2: The valuation is performed at the expected date of resolution.

4. Information to be used

Option 1: The valuation relies only on financial statement and (where available) supervisory information

Option 2: The valuation relies on all available pertinent information.

5. Measurement base

Option 1: The measurement base is standardized (same valuation methodology applied to all type of assets and liabilities).

Option 2: The measurement base is tailored (different valuation methodology applied to different type of assets)

6. Buffer for additional losses

Option 1: The same valuation methodology is applied for the calculation of the buffer for valuation 1 (aimed at determining whether the conditions for resolution are met) and valuation 2 (aimed at identifying the most appropriate resolution action as well as its impact on shareholders and creditors).

Option 2: Different methodologies are applied for the calculation of the buffer for valuation 1 and valuation 2).

Baseline

There is no common EU framework specifying the valuation methodology to be followed for resolution purposes. Most the countries rely on a combination of valuation based on rules defined in the accounting and prudential frameworks, or on valuations prepared by external experts in line with market valuation practices.

Comparison of the policy options

Given the nature of the policy options considered in these RTS, the present cost and benefit analysis is qualitative.

Area	Policy options	Costs	Benefits
<p>1) Overreaching principles</p>	<p>Option 1: The RTS aim for consistency with existing accounting and prudential rules</p>	<ul style="list-style-type: none"> • Risk of incompatibility with the specific objectives of valuation 2 for resolution purposes. (While valuation as per the accounting standards aim at providing market participants with information relevant for making economic decisions, valuation 2 for resolution purposes aim at ensuring that the best resolution strategy is implemented). • Risk of inconsistent • Leaving valuers with room for judgement when valuing assets and liabilities while achieving consistent implementation of BRDD requires specific harmonised methodologies and rules for assessing assets and liabilities in a context of resolution. 	<ul style="list-style-type: none"> • Accounting rules provide for valuation methodologies that are understood by entities as well as by supervisors, auditors and markets. Relying on accounting rules thus offers transparency, predictability and allows for not disconnecting valuation for accounting purposes and valuation for resolution purposes. • Low cost of design and implementation as the RTS relies on existing frameworks.
	<p>Option 2: The RTS aim for an economic valuation approach, rather than focusing on accounting and prudential values</p>	<ul style="list-style-type: none"> • Risk of creating a parallel valuation framework for the purpose of resolution, possibly disconnected from accounting and prudential rules. • For valuation 1, risk of inconsistency with the supervisory assessment required to trigger resolution, and thereby not being fit for purpose • May make the legal framework on valuation more complex and potentially confusing. 	<ul style="list-style-type: none"> • Allow a tailored approach of valuation methodology which could better meet the objective of providing prudent valuation than the one defined already defined by accounting rules. • Economic value necessary to estimate likely sale proceeds if sale of business tool used, or the resolution scheme otherwise envisages asset sales. • Prudent valuation is especially important for valuation 2 given that resolution cannot be repeated if valuation is insufficiently conservative

2) Valuation date	Option 1: Date when the last available public financial statement	<ul style="list-style-type: none"> Risk of missing pertinent information as data maybe outdated. 	<ul style="list-style-type: none"> Ensure higher transparency and objectivity as the valuation will be based on historical data. No additional cost as the valuation date is directly given in the RTS and does not rely on a specific model to be identified.
	Option 2: Expected resolution date	<ul style="list-style-type: none"> Add complexity and opacity to the framework as the determination of the valuation date will be based on estimates (model based approach) and will not be predictable. More costly and time consuming as before assessing the value of an institution's assets and liabilities, the independent valuer will have to perform an additional specific exercise to determine the resolution date. 	<ul style="list-style-type: none"> Most effective way to ensure that the valuation is prudent and realistic as it takes into account the most accurate value of an institution about to be resolved.
3) Information to be used	Option 1: Only financial statement and (where available) supervisory information	<ul style="list-style-type: none"> Risk of missing pertinent information. Resolution authorities would be prevented from the benefit of the most up to date information when valuing (the situations or circumstances leading to the valuation of assets are likely to have changed since the last supervisory reporting has become available to authorities) and might miss some valuable market information that are not collected by supervisors. 	<ul style="list-style-type: none"> Easy to implement as resolution authorities have access to them directly or via supervisory authorities. Allow gaining time when analysing the data as it focuses on a limited range on information. Supervisory information contained in supervisory reporting are confidential which allow resolution authorities to make decision while benefiting for a more insightful view of the entity than if they were relying on public information, which may serve different purposes than resolution.
	Option 2: All available public information	<ul style="list-style-type: none"> More costly than considering only supervisory information, as resolution authorities will incur information gathering costs (compared to a situation where supervisory information is already available to them at no or little cost). 	<ul style="list-style-type: none"> Most effective way to ensure the efficiency of valuation, i.e. this valuation reflects all the available information as of the valuation date.
4) Measurement base	Option 1: Standardised base	<ul style="list-style-type: none"> Risk of undermining the outcome of the valuation as the methodology will not reflect to specific risk profile of each assets and liabilities. 	<ul style="list-style-type: none"> Simple to implement and easy to monitor as all assets and liabilities will be subjected to a same general methodology.
	Option 2: Tailored base	<ul style="list-style-type: none"> Assets and liabilities to be valued have their particularities, due to their risk peculiar profile and economics underlying of transactions they are related to. Different valuation 	<ul style="list-style-type: none"> Risk of gap in the valuation provisions might arise over time due to especially financial innovation leading to the apparition of new types of assets and liabilities, which could then require frequent

	<p>methodologies according to their specificities would ensure the valuation is truly reflective of them.</p> <ul style="list-style-type: none"> • Ensuring the harmonised implementation of BRDD would require detailed provisions regarding the implementation of valuation rules to specific types of assets and liabilities. 	updates of the RTS.
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Preferred policy options

Based on the comparison of the policy options, the EBA decided for these draft RTS:

1. To rely on accounting and regulatory rules for valuation 1, where alignment with the supervisory determination of whether an institution is failing or likely to fail is necessary, and to aim for an economic value approach for valuation 2. (mix of options 1.1 and 1.2)
2. To rely on the expected resolution date (option 2.2).
3. To adopt a holistic approach for valuation and consider any information pertinent to the valuation (option 3.2)
4. To apply the same valuation methodologies to every type of assets and liabilities, but to take due account of the specificities of these latter in determining cash flows. For instance, cash flows should be determined at the appropriate level of aggregation (which can be anything from individual asset or liability to portfolios and businesses), with consideration of the different risk profiles of assets and liabilities (mix of option 4.1 and 4.2).

6.2 Draft Cost- Benefit Analysis / Impact Assessment for RTS on ex post valuation

Introduction

Article 74(2) of CRR mandates the EBA to specify the valuation methodology to be followed by independent valuers when comparing the treatment shareholders and creditors actually received in resolution with the treatment they would have received had the institution entered into insolvency process.

As per Article 10(1) of the EBA regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council), any draft RTS developed by the EBA shall be accompanied by a cost and benefit analysis. Such annex shall provide the reader with an overview of the findings as regards the problem identification, the options identified to remove the problem and their potential impacts.

This annex presents the impact assessment (IA) of the policy options considered in these RTS. However, given the absence of relevant data, the IA is only qualitative.

Policy background

In a view of minimizing the cost of a failing institutions to taxpayers as well as negative externalities to financial stability, the BRRD provides the resolution authorities with the ability to identify and impose losses to shareholders and creditors first. However when using its power, the resolution authority should also ensure that the shareholders and creditors do not incur greater losses than they would have if the institutions had been wound up under normal insolvency proceedings in its jurisdiction (“no creditor worse off” principle).

In that context, article 74.4 requires the EBA to develop RTS specifying the methodology for carrying out a valuation to determine:

- (a) The treatment that shareholders and creditors would have received if the institutions under resolution has entered into normal insolvency proceedings at the time when the authority decided to apply the resolution strategy;
- (b) The actual treatment that shareholders and creditors have received in the resolution of the institution under resolution; and
- (c) If there is any difference between the treatment referred to in point (a) and the treatment received in point (b).

Problem identification

A fair, accurate and realistic valuation of the assets and liabilities of an institution is key to ensure an effective and efficient implementation of the resolution powers and tools. It is also crucial in

ensuring a fair and adequate treatment of shareholders and creditors in case they have to absorb losses. The absence of a common EU framework to specify the methodology on valuation would thus:

- Create an uneven regulatory playing field across EU banks and stakeholders when applying the resolution tools;
- Increase legal risks when applying the resolution tools due to uncertainties surrounding valuations rules and the assessment of the treatment of shareholders; and
- Make the resolution of cross border institutions more complex.

However, if a common EU framework on valuation is needed to ensure an efficient implementation of the BRDD, such a framework should also be defined in a context where there are already accounting and solvency rules which purpose is properly to specify the methodology to be followed when assessing the value of an institution's balance sheet. Therefore, when defining an EU framework on the valuation methodology these RTS should also remain consistent with the existing accounting and solvency rules and should duly justified any potential deviations.

Objectives

Given the identified problems, the general objectives of the RTS are to:

- Set out an EU harmonized methodology for assessing whether shareholders and creditors are incurring greater losses under the resolution process than what they would have incurred under insolvency proceedings;
- Ensure a consistent implementation of the BRRD across EU countries by ensuring a fair, and transparent assessment of the impact of the implementation of the resolution power and tools.
- Accelerate the valuation process by defining a clear tool kit to be applied easily by independent valuers and thus allowing resolution authority to take quicker actions; and
- Increase transparency and reducing uncertainties regarding the treatment of shareholders thus minimizing legal disputes that may arise during the resolution process;

Policy options

While drafting the RTS, the EBA identified three areas under which two alternative policy options have been considered:

1) *Reference date*

Option 1: Information available at the resolution date

Option 2: Information available at the date when the actions are effective

Baseline

There is no common EU framework specifying the valuation methodology to be followed for resolution purposes. Most the countries rely on a combination of valuation based on rules defined in the accounting and prudential frameworks, or on valuations prepared by external experts in line with market valuation practices.

Comparison of the policy options

Given the nature of the policy options considered in these RTS, the present cost and benefit analysis is qualitative.

Area	Policy options	Costs	Benefits
1) Valuation date	Option 1: Date when the last available public financial statement	<ul style="list-style-type: none"> Risk of missing pertinent information as data maybe outdated. 	<ul style="list-style-type: none"> Ensure higher transparency and objectivity as the valuation will be based on historical data. No additional cost as the valuation date is directly given in the RTS and does not rely on a specific model to be identified.
	Option 2: Expected resolution date	<ul style="list-style-type: none"> Add complexity and opacity to the framework as the determination of the valuation date will be based on estimates (model based approach) and will not be predictable. More costly and time consuming as before assessing the value of an institution's assets and liabilities, the independent valuer will have to perform an additional specific exercise to determine the resolution date. 	<ul style="list-style-type: none"> Most effective way to ensure that the valuation is prudent and realistic as it takes into account the most accurate value of an institution about to be resolved.

Preferred policy options

Based on the comparison of the policy options, the EBA decided for these draft RTS to require valuation to take the resolution date as the reference date (option 1.2).

6.3 Overview of questions for Consultation

Product	Questions
RTS on valuation for the purposes of resolution	<p>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?</p> <hr/> <p>Question 2: 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?</p> <hr/> <p>Question 3: Would you add, amend, or remove any areas which are likely to be subject to significant valuation uncertainty?</p> <hr/> <p>Question 4: Should the buffer instead always be greater than zero? If yes, how should the buffer be determined?</p> <hr/> <p>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?</p> <hr/> <p>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 ?</p>
RTS on valuation to determine difference in treatment	<p>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?</p> <hr/> <p>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?</p> <hr/> <p>Question 9: Should these technical standards provide further detail on the characteristics of appropriate discount rates?</p> <hr/> <p>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)?</p> <hr/> <p>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)?</p>