



# Draft Technical Standards on valuation for resolution

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# 1. Context: relationship to other EBA products

This consultation paper is part of a series of EBA regulatory mandates which aim to ensure that the BRRD resolution powers are effective and that stakeholders have a clear understanding of how valuation information should be used:

- Guidelines on terms of bail-in for shareholders and creditors (EBA/CP/2014/40 & EBA/CP/2014/39)
- Guidelines on treatment of liabilities in bail-in (EBA/CP/2014/29)
- Technical standards on contractual recognition of bail-in (EBA/CP/2014/33)

## 2. Bank Recovery and Resolution Directive (BRRD)

- Multiple valuations are required to support a bail-in, including;
  - Ex ante: to inform decision on use of resolution powers and plan the resolution
  - During resolution: to set the terms of resolution
  - Ex post: to assess if additional compensation is required
- These valuations will require significant input from firms, authorities and independent third party advisors

## 2. Bank Recovery and Resolution Directive (BRRD)

### *Different valuations / stages of valuation*

| <b>BRRD</b> | <b>Article 36</b>                        | <b>Article 74</b>                    | <b>Article 49</b> |
|-------------|--|--------------------------------------|-------------------|
|             | Valuation for the purposes of resolution | Valuation of difference in treatment | Derivatives       |

Three articles of the BRRD discuss valuations for the purposes of bail-in transactions.

- EBA is mandated to develop Regulatory Technical Standards (RTS) for each valuation
- The valuations must be conducted by an independent valuer. However the Article 36 valuation may be done on a provisional basis by the resolution authority.
- Today’s hearing covers RTS on articles 36 and 74. A consultation paper on Article 49 is forthcoming

## 2. Bank Recovery and Resolution Directive (BRRD)

Article 36:

The purposes of the independent valuation include:

- To inform the determination of whether the conditions for resolution are met

and if the conditions are met:

- to inform the appropriate resolution action to be taken
- to ensure that any losses on the assets are fully recognised at resolution
- for bail-in; to inform the extent of the cancellation or dilution of equity and capital instruments and of the write down or conversion of liabilities

Article 74:

The purpose of the valuation is to assess whether shareholders and creditors would have received better treatment had the entity entered into normal insolvency proceedings than in resolution (NCWO protection).

## Stage 1 - Failing or likely to fail

- Article 36 – an independent valuation “to inform the determination of whether the conditions for resolution are met”
- Key condition is breach or likely breach of conditions for authorisation
- So measurement basis must be consistent with that used for ongoing supervision - an updated accounting valuation with regulatory adjustments
- Assumptions and judgement applied by the independent valuer may differ from management assumptions
- May be provisional with a buffer for additional losses

## Stage 2 - Asset and liability valuation

- Essential that this valuation is prudent – cannot use resolution again if valuation is overly optimistic. This is recognised in the BRRD recitals.
- Measurement basis therefore an estimate of the “economic value” which may differ from accounting valuation
- Also needs to take account of how the resolution strategy may affect values – in practice this will mean valuation is needed on both a hold and an exit basis
- This will inform the extent of losses on the assets of the institution at the moment the resolution tools are applied and the amount of recapitalisation needed
- Firms are likely to be required to support this detailed, credible and rapid revaluation using their own staff, systems and processes – ability to do this assessed in the resolution planning process



## Stage 2 - Equity valuation

- In a bail-in, creditors receive equity in the bank instead of claims in insolvency process. The value of this equity should be at least as high as the value of insolvency claims foregone (NCWO)
- An estimate of the post resolution equity value is therefore required to assess the value of equity the RA has available to distribute to affected creditors
- In a sale of business, equity valuation required to set reserve price for the sale process

## Stage 2 - Criteria

- Information used should be pertinent to the valuation date
- Valuer should focus on areas of significant valuation uncertainty. Several are flagged in the text
- Choice of precise valuation methodologies is for the valuer to make

## Stage 3 - Estimated insolvency outcome

- First part of the Article 74 valuation of difference in treatment
- Performed post-resolution by an independent valuer – underpins the “no creditor worse off” safeguard
- A hypothetical exercise to determine the value creditors would have received had the firm entered insolvency rather than resolution.
- Draft RTS prohibit the use of hindsight
- Draft RTS include a discount rate

## Stage 3 - Actual treatment

- Second part of the Article 74 valuation of difference in treatment
- The value of compensation (shares) actually received by bailed-in creditors
- Not necessarily equal to the observed price of the shares post-resolution
- Compensation would be due to affected creditors if the actual compensation received from resolution was lower than the estimated insolvency outcome.
- NB that resolution authorities will need an estimate of this stage 3 valuation *before* carrying out resolution

## 3 Summary of valuations

### 'Ex ante' valuations

Before resolution, need:

- (1) Inform resolution trigger
  - Accounting & prudential rules
  - Based on current bank structure
- (2) Inform resolution decisions
  - Prudent 'economic value' approach
  - Based on structure after resolution

'Ex ante' insolvency valuation to predict (3)

### 'Ex post' valuations

After resolution, need:

Final versions of (1) and/or (2), if originals provisional

- (3) Insolvency valuation
  - To inform compensation
  - Gone-concern basis

## 4. Challenges for firms, authorities and advisors

- It is challenging to produce reliable valuations in a short time frame.
- Consequently, firms' existing MI, valuation systems and processes may need to be adapted to facilitate the resolution valuations.
- For large firms with operations in multiple jurisdictions, co-ordination between the authorities will be paramount to enable a rapid and credible valuation process.
- Valuation advisors will need to be familiar with the types of valuations, the level of detail required and the inputs for each valuation.

## 5. Process and next steps

### Status of EBA Technical Standards

- Addressed to authorities and independent valuers
- Directly applicable

### Consultation process

- Consultation period closes on 6 February 2015
- Draft RTS will be reviewed in light of consultation responses
- Final draft RTS approved by the EBA (Resolution Committee/Board of Supervisors) then submitted to Commission for adoption
- No deadline in BRRD for submission of final version - expected in 2015
- Consultation on Article 49 also expected in 2015

## 6. Questions?

Article 36 valuations ('ex ante')

1. Would you suggest any changes to the definitions of valuation approaches?
2. Should specific types of disclosure be required from the valuer on deviations from management assumptions?
3. Would you make any changes to the areas subject to significant valuation uncertainty?
4. Should the buffer required for a provisional valuation always be greater than zero?
5. Do you agree that a valuation of post-conversion equity is necessary (at stage 2)?
6. Do you agree with the definition of equity value?
7. Should the use of potential 'hindsight' information be further restricted, e.g. to information which could have reasonably been known at the resolution date?
8. Valuation advisors will need to be familiar with the types of valuations, the level of detail required and the inputs for each valuation.



## 6. Questions?

Article 74 valuation ('ex post')

7. Should the use of information available after the resolution date be further restricted to information which could have reasonably been known at the resolution date?
8. Should the use of information available after the resolution date be further restricted to information which would result in a significant change?
9. Should the RTS provide further detail on appropriate discount rates?
10. Would you suggest any changes to the methodology for determining actual treatment?
11. Should the valuer be required to make any additional disclosures?



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