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RBS Group plc response to EBA consultation paper (EBA/CP/2014/38) on Draft Regulatory Technical Standards ('RTS') on valuation under Directive 2014/59/EU

We welcome the opportunity to provide our views. We set out below our general comments and observations on the consultation paper (CP) and respond to the specific questions in the RTS.

RBS supports the intentions of the RTS and the direction it provides. Whilst we believe the RTS is directionally sound, the practical implementation is more challenging and we have outlined some specific concerns in our general comments below.

General Comments

We suggest more clarity and guidance be provided on:

- Roles: It is not clear from the RTS what the role of the banks is. This is required in order that banks can determine resource requirements, both for systems development and at the point of resolution.
- Tooling: It is not clear whether banks are to provide the models to support the valuer or whether the valuer's independent models would be utilised. (As an aside, have valuers' been asked to contribute feedback on this CP?)
- Timing: The timeframe in which banks are required to provide information is not clear. This is required in order that banks can clearly determine capability gaps. Clearly a shorter timeframe for producing information will require a more automated solution to enable delivery. Data production may be challenging.
- Sequencing: Further clarification is sought on the timing sequence for Valuations 1 and 2. Accepting confidentiality protocols, we would raise concerns as to timing of these and potential for impact on market confidence.

Valuation 1 (RTS Part II, Articles 6 – 9)

The CP contemplates an up-to-date balance sheet prepared on a going concern basis under existing accounting standards. Banks can typically generate a daily balance sheet for the financial instruments in their trading businesses as they are generally carried at fair value. Currently banks would have much longer timescales for the completion of a balance sheet relating to their retail and commercial businesses. It is impractical to aim to prepare a materially 'correct' balance sheet on any given day on a consolidated basis for both retail and commercial and investment banking activities. Alternatively our recommendation would be to roll forward the balance sheet from the previous month end adjusted for material movements.

Valuation 2 Asset and liability valuation (RTS Part III, Articles 10 – 14)

It is our expectation that to enable the valuer to complete these valuations, banks would be required to have comprehensive data readily available on an instrument-by-instrument basis.

Our interpretation is that the type of data that would be required would be similar to that required for securitisations but covering all assets. . Whilst our valuation methodologies and processes are documented we, or to our knowledge any other major bank, do not currently have the infrastructure, capability or processes to generate such volumes of reliably accurate asset-by asset data at a reporting date or on any given day.

It is envisaged that banks would need a significant amount of time, measured in years, to build, test and refine the level of data capability required. We consider a pragmatic approach needs to be taken for retail and commercial banking assets and liabilities.

Questions

The following are our responses to the specific questions asked in the RTS. We have also responded to these using the proforma provided.

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?**

   With regards to definition of **(f) 'hold value'**, an element of subjective judgment should be included as regards the reasonably attainable cash flow stream, discount rates, etc. The use of judgement by an appropriately experienced expert is necessary, and the basis for determining the inputs to such valuation would need to be documented so that the judgement calls are evident.

   With regards to definition of **(i) 'equity value'**, no changes suggested although clarity that this is intended to refer to each individual share immediately following the resolution actions would be useful
   We agree that, in terms of the equity valuation, "generally accepted valuation methodology" is likely to be most appropriate as being too specific could result in having to use a valuation approach that is appropriate now but may not be in the future

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?**

   We agree that, where fundamental assumptions have changed, it is reasonable to expect these to be explicitly identified in communication with the market and other stakeholders. However, we would suggest that these are not made overly specific otherwise banks may be forced to disclose information that is irrelevant.

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

   We agree that by wording in the form "likely to include, but not limited to", means that this does not have to be a comprehensive list. “Deferred Tax” and “Pensions” are other areas that could be added further examples

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

   We consider that, in the absence of facts and circumstances supporting the existence of additional losses, the buffer shall have a value of zero. If the valuations impose sufficient additional discount, especially with regard to the exit valuation, then no additional buffer would be appropriate. The provisional valuation should provide clarity where subjective judgement has been used, and the basis for approximating any discount.

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

   Yes, the equity value, being an estimate of the market price for those shares that would result from generally accepted valuation methodologies informing the determination of the conversion rate or rates, is necessary to assure all holders of converted instruments of fair and equitable treatment.

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 ?**

   See response to Q1(i).

   We expect that in the event of resolution, there will be considerable uncertainty and the “assessed market price” could be influenced heavily by illiquidity in the market. As a result of this we believe that market value would be very challenging to estimate and the reliability of valuations could be called into 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?**

   We agree that only contemporaneous evidence which might reasonably be expected to be available to the valuer should be considered. Information should only be permitted if it refers to facts and circumstances existing at the resolution date which could reasonably have been known at that date

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?**

   We agree but there needs to be a definition of what constitutes ‘significant change’.

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

   We believe the technical standards should provide further guidance to ensure that valuers and users of the information have clarity as to how the discount rates have been derived but that this should avoid prescribing an approach that might diminish in relevance overtime. It is important that rates are derived consistently within a jurisdiction and the RTS should consider including reference to where this mandate currently exists within a competent authority as it does in the UK through HMT.

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)?**

    No comments to make.

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)?**

    Yes, each creditor bailed in requires evidence of fair process and valuation. The valuer needs to have a prescribed set of valuations and accompanying disclosures to be provided, so that the expectations of creditors are met without favour.

We would be happy to elaborate further on any of the points made in this response and look forward to engaging with the Authority as it further considers its proposals.

Yours sincerely

John Needham
Head of Regulatory Design

Copies to:
Bank of England
British Bankers Association (BBA)
Association for Financial Markets in Europe (AFME)