

## **EBA/CP/2014/38 – Consultation on Draft Regulatory Technical Standards on valuation under Directive 2014/59/EU**

### **INTRODUCTION**

This paper is submitted by the Financial Law Committee and the Insolvency Law Committee of the City of London Law Society and the Banking Reform Working Group of the Law Society of England and Wales (the "Committees"), in response to the Consultation Paper published in July 2014.

The City of London Law Society (CLLS) represents approximately 14,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government Departments, often in relation to complex, multijurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees.

The Law Society of England and Wales is the representative body of over 159,000 solicitors in England and Wales. The Society negotiates on behalf of the profession and makes representation to regulators and Government in both the domestic and European arena.

The Committees submitting this paper are made up of solicitors specialising in UK and international financial and insolvency law in a number of law firms based in the City of London, who advise and act for UK and international financial institutions and businesses and for regulatory and governmental bodies on financial and insolvency law matters.

We do not comment specifically on most of the questions raised which relate to the details of valuation methodology, but confine ourselves to points of legal importance related to the valuation exercise.

**Questions 7 and 8** – While the terms of the draft Delegated Regulation grapple with a difficult question in relation to claims that are not easy to value, we consider it important, in order to adhere to the principles of the BRRD that later information must be taken into account in relation to the definitive valuation. This should be clarified in the text and we consider that any extension of the restrictions on the use of information available after the resolution date (as postulated in these questions) should be rejected. Otherwise, there seems to be the potential that the legislation would create significant injustice, deviating from normal expectations with regard to the treatment of property rights, particularly as regards any rights which are contingent, in dispute or depend on other information (eg an expert assessment or report or ascertainment of information held on public or private registers).

This would also not reflect the approach taken to the valuation of such claims in an insolvency, which would be at odds with the intentions of the BRRD. The outcome, in so far as it affects creditors whose rights are the subject of a relevant valuation, could result in the effective appropriation of property rights relating to claims which are less easily valued, resulting in a disparity of treatment of creditors ranking equally according to the ease of valuation., so that they would be left without compensation on the same basis as is afforded to holders of rights which are more easily valued.

**General** There are 3 questions on which the consultation and draft Delegated Regulation are silent, which are of considerable legal and practical importance:

- 1) It is not clear what happens if the ex post valuation shows that the resolution was either not well founded because it transpires the resolution threshold were not in fact satisfied or on terms which were inappropriate because they were more extensive than required? Is there any remedy available and if so what is it?
- 2) It is unclear what happens if because of poor record keeping, processing error or misunderstanding by the valuer, any particular liability or asset (or class of liability or assets) is omitted from the valuation process altogether, is wholly or partially omitted in the assignment of equity to a creditor, or class of creditor, or is under or overvalued. This sort of error could significantly affect the amount of equity issued to a creditor or class of creditor, so treating them unfairly in relation to other creditors whose rights have been correctly valued. This is not a process in which NCWO will assist in giving a correct result (e.g. because it may have been determined that the creditor would have received nothing or less in an insolvency than the value of the equity that was actually issued to him, although this is less than the equity that should have been issued to him if his claim had been correctly assessed and valued for the bail-in conversion process). It seems to us that there needs to be a process to enable affected bailed-in creditors to make good their entitlement to a higher amount of the new equity (and for over-entitlements to be clawed back). At present there is no such process and one needs to be provided to prevent the legislation failing to meet basic standards in the protection of property rights. It may be that arbitration processes would be cheaper and speedier for resolving such disputes than leaving all issues to be determined by the courts and we consider that thought could usefully be given to setting up such a process.
- 3) NCWO applies without a de minimis and it will often be the case that ordinary creditors would always have received something on an insolvency. Therefore in any case where the new equity proves to be of little or no value, there could be a very large number of claims if ordinary creditors have been bailed-in (in addition to those holding bailable instruments). The methodologies in the draft Delegated Regulation for determining the NCWO claims are much too brief to give any degree of predictability to the determination. It seems to us that the draft Delegated Regulation underestimates the difficulty of valuing the new equity (which is unlikely immediately to be quoted, as all the previous equity will have been written off and the financial outlook for the continuing or bridge bank/parent company in which the equity is issued is likely to be uncertain for some time). It also underestimates the complexity of the valuation process for the rights that would have been available to those creditors in an insolvency. We believe that further work is needed to ensure that the valuation details in all respects will be clear, robust and public. It may be that the resolution authority itself should be able to set appropriate guidance including discount rates, valuations principles from derivatives and other assets and liabilities but that guidance should be public and itself should be capable of challenge. Again the importance of efficient processes for the handling of disputes is essential.

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