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Dear Sirs

European Banking Authority ("EBA") Consultation Paper EBA/CP/2014/18– Draft regulatory technical standards ("RTS") on independent valuers

We are responding to the request for comments on the proposals set out in the EBA's Consultation Paper EBA/CP/2014/18. As well as responding to the specific questions that are set out in section 5.2 of the RTS, we have also provided other comments on the content of the draft text. If you would like to discuss any of the comments set out below, please contact Jeroen Weimer, KPMG in the Netherlands (+31 206 567469 / Weimer.Jeroen@kpmg.nl) or Viral Desai, KPMG in the UK (020 7311 8394 / viral.desai@kpmg.co.uk).

Responses to questions raised in Consultation Paper

1. Do you agree that the approach followed in the draft RTS to determine and identify conflicts of interest is the appropriate one?

   We broadly agree with the approach but highlight a number of observations and reservations in our detailed comments below. In particular, we would suggest that any EBA guidelines on valuer independence leverage existing procedures which other global regulators will already have confirmed meet their requirements. In addition, we would suggest that the issue of a valuer's competence is dealt with as a necessary pre-condition of appointment, but separate from the concept of independence.

2. Do you agree that three years is the appropriate period of time for the purposes of Article 4(5)?

   Any time limits should be linked to a discussion on the materiality of any previous involvement with the institution subject to valuation and threats to the objectivity of the valuer. Hence, there should be consideration of the specific valuation services offered and other relationships with the institution. It is not clear why the timeframe for the provision of

valuation services is inconsistent with the one year period for the provision of audit services.

3. Do you agree with the possibility to task the temporary administrator as an independent valuer, subject to the condition set forth in the above provision?

   In our opinion and experience, the administrator (temporary or otherwise) will need different skills from a valuer and both roles would unlikely to be capable of being fulfilled by the same person. Whilst this will differ within the various member states, we would typically expect the administrator to be a natural person or named individual. If they are supported by a large organisation, then valuation specialists from within that organisation could fulfil the independent valuer role, although industry practice would also suggest separation of these two roles to ensure independence.

4. Do you reckon there are other cases of where independence should be ruled out in any case?

   As noted in our response to Question 2, there should be consideration of any historic provision of valuation series and, in particular, if the valuer has acted in an advocacy role for the institution which might affect their objectivity and hence ability to perform an independent valuation role under the European Union Bank Recovery and Resolution Directive ("BRRD").

5. Do you agree with the approach outlined in the impact assessment and more specifically, with the elements included in the assessment of costs and benefits?

   We are in broad agreement. However, as noted in our response to Question 1, we would suggest that the issues of technical competence, expertise and resources are dealt with separately from considering the independence of the valuer. In addition, and from a practical perspective, an outright ban on the use of 3rd parties to assist in the valuation, especially in respect of a unique asset class, may frustrate the ability of the appointed valuer to complete their duties in full.

Key comments in relation to EBA Consultation Paper

- In setting out a framework for the performance of the various valuations that would be required under the BRRD, the determination of whether a valuer is considered to be independent should take into account the existing requirements that professional bodies (e.g. ICAEW, RICS, IVSC) stipulate their members to satisfy. For example, many professional bodies require their members to be independent and to act in the public interest.
- Similarly, professional services firms will have established internal procedures for identifying and resolving conflicts of interest and confirming independence prior to accepting any appointment. Therefore, we would suggest that any EBA guidelines on valuer independence leverage existing procedures which other global regulators will already have confirmed meet their requirements.

- A possible solution may be to require such professional services firms to pre-qualify for the ability to accept appointment as an independent valuer for the purposes of the BRRD, based on their expertise and capabilities and a demonstration that their existing engagement acceptance procedures operate effectively and continue to meet the requirements of regulators (e.g. by way of annual confirmation). In this way, public authorities can have a significant level of confidence that the valuation related aspects of a future resolution can be conducted in an efficient and prompt manner and without undue delay on the selection of the independent valuer

- We would suggest that the RTS specifically allows the use of judgement and ability for Regulatory Authorities to have sufficient flexibility in appointing an independent valuer rather than follow strict adherence to the guidelines as currently drafted. By way of example, the RTS requires that if any firm has provided valuation services to an institution in the 3 years preceding resolution, then that firm cannot be considered independent for the purposes of the BRRD. As such, if a 3rd party valuer is appointed by a Regulatory Authority to assist them at an ex ante phase (e.g. to assess existing valuation procedures of a potentially failing bank, but not as the independent valuer for the purposes of determining if an institution is failing or likely to fail), the draft RTS would preclude that firm from acting in an independent valuer role due to their prior involvement with that bank. This means that a firm with the most recent and up-to-date knowledge of a bank's valuation systems and processes would be precluded from undertaking any of the independent valuation roles for resolution purposes at a time when such knowledge and expertise would be beneficial to the prompt and efficient resolution of that bank. Any previous valuation services provided to an institution should consider the specific role undertaken, materiality of such involvement and whether this would impinge on the objectivity of the valuer in the context of the independent valuation roles required under the BRRD.

- The skills and attributes that a firm will need to demonstrate and the resources required in order to perform the role of an independent valuer means that in all likelihood there will be a small selection of possible firms that Resolution Authorities could appoint to such a role. Unless the resolution involves a very small or isolated bank failure, the independent valuation role will require the significant resource and capabilities that one would normally associate with a Big 4 firm (or a limited number of valuation boutiques, although they may not have the necessary experience in other areas such as accounting or insolvency). The variety of skills that a valuer will need to draw upon (e.g. valuation, accounting, tax, regulatory, insolvency, banking etc.) and significant resources required to perform the role should be highlighted more predominantly as a pre-requisite for an independent valuation role and this is something that Regulatory Authorities can attest on an annual basis.

- The draft text states that "*a person shall be deemed to be independent from both the public, including the resolution, authorities …*". It is not clear how far the definition of "*public authorities*" extends or if this is meant to refer to governmental agencies. If it is the latter, then the text should state this explicitly. Furthermore, it is not clear if this is a requirement for the valuer to be a separate entity from the Regulatory Authorities and other public bodies or to be independent from certain relationships with these bodies. We would recommend that Regulatory Authorities and other relevant public bodies being given the flexibility to

consider whether a valuer is deemed independent rather than stipulate such a wide ranging exclusion.

- "*Independent valuer*" is not a defined term in the draft text. It is important to distinguish between an Independent Valuer as a firm and Independent Valuer as an individual. There may be persons within the firm that are conflicted (e.g. due to family ties with the institution subject to valuation) whereas the firm will not be. As noted above, professional services firms will have established internal procedures for identifying and resolving conflicts of interest, both for the firm as a whole and for individuals who will work on any valuation engagement.

Specific comments on draft text

- Page 4 Paragraph 4 – The draft text states that the valuer has to have qualifications and expertise "*so as to ensure that (s)he is able to perform the valuation without depending on support from third parties*". Such a stipulation could prevent the valuer from completing his role since there may be a unique asset class which requires the valuer to engage a specialist third party to assist in the valuation of. The use of other third parties by the valuer in such cases should be permitted so long as the valuer accepts ultimate responsibility for the final valuation opinion. Such arrangements are already common in the conduct of other independent valuation roles.
- Page 6 – There is reference in Para 4 to "*the legal requirement of independence*". What is the specific legal requirement that is referred to here and where is this stated?
- Page 6 – Para 5 states that "*the valuer should not have performed auditing services for the institution one year before the valuation is carried out*". Why is there no mention of other services that the valuation firm may have provided (e.g. tax, valuation, risk consulting etc.) and is there a need to draw a distinction between audit and other services? In addition, Article 4(5) prescribes a three year limit in respect of valuation services. Why is there not consistency with the one year timeframe for audit services?
- Page 9 Para (1) – How wide reaching is "*other public authorities*"? Is it not better to allow the relevant authorities (Resolution or other) to use their judgement and the established procedures that are already in place to help in the determination of whether a valuer is considered independent for a specific valuation?
- Page 9 Para (3) – Other relevant subjects that the valuer must have expertise in should include valuation, regulation and insolvency. In fact, valuation expertise should be highlighted as a primary requirement.
- Page 9 Para (5) – This requires the assessment of independence to be extended to "*shareholders or significant creditors of that institution*". How far does the requirement to consider relationships with other stakeholders extend? What if such relationships exist under normal commercial arrangements? Professional services firms will have commercial relationships and also provide services to many stakeholders who may be connected to the affected institution. An unintended consequence of an overly draconian requirement to be

"independent" of all of these stakeholders is that the pool of possible providers of valuation services in the event of a resolution will be significantly reduced. It would be better to ensure that valuation firms adhered to their established procedures in confirming their independence as described above.

- Page 9 Para (6) – What timeframe is envisaged and should this be consistent with the audit requirement of 1 year? Are there specific services that are captured in this requirement or is it just valuation?
- Article 1 (a) – It is not clear what this has to do with independence and why competency is presented as an attribute of independence. This appears to be a technical requirement which presumably can be assessed in advance of a resolution (i.e. firms can pre-qualify) and reviewed on an on-going basis. To include it as part of the assessment of independence confuses the issue and therefore we would suggest that technical competence is presented as a necessary pre-condition but separate from independence.
- Article 1 (c) – Does this include normal commercial arrangements? (e.g. if the affected bank provides loans or banking services to the valuation firm).
- Article 2 (1) – There should be mention of valuation, regulatory and insolvency expertise as well.
- Article 3 (3) – This will not work in practice if the valuer is appointed by the authorities and is reliant upon them (or other relevant parties) to provide certain information or working assumptions in order to complete their duties (e.g. macroeconomic assumptions, future capital requirements of the resolved institution). Is Article 3 (4) meant to cover this eventuality or the provision of information about the institution subject to valuation?
- Article 4 (4) – How realistic is this in the case of a bank and the provision of normal banking relationships? Again, it would be more appropriate to require valuation firms to confirm that they have a formal independence and ethics procedure which they (and their employees) will adhere to in the event that they are asked to act as an independent valuer. In that way, firms can provide confirmation and ensure that resources to be used for the valuation are independent of the affected institution. The relevant Resolution Authority can review and approve firms' independence confirmation processes in advance and on an on-going basis.
- Article 4 (5) – Why is a 3 year timeframe suggested? This is inconsistent with the auditor timeframe of 1 year set out in Para 5 on page 6 of the text. In addition, we would recommend that any specific time limit is considered in conjunction with a broader discussion on materiality and potential threats to objectivity. For example, if the proposed valuation firm has had a material involvement with the bank that is the subject of the valuation 35 months ago and this is identified as a potential conflict of interest, this does not cease to be a material involvement or potential conflict 1 or 2 months later.
- Article 4 (6) – How will this work if the temporary administrator is the Resolution Authority? Also, there is a risk of a conflict of interest if the temporary administrator wishes to pursue a particular course of action and is simultaneously asked to provide an independent valuation (which may confirm or contradict this preferred view). As noted above, there are a

number of different roles and separate valuations to be conducted in the event of a resolution and it would be more appropriate to have separate (and different) parties fulfil these roles to ensure there is no conflict of interest (actual or perceived) and to ensure that the firm with the most relevant expertise performs these separate roles. Industry practice is also to have an independent valuer separate from the administrator to ensure independence and transparency over key decisions.

Other general comments

- Reference is made a number of times in the draft text to the "*valuation of assets and liabilities*". However, aside from valuing assets and liabilities, the BRRD requires an independent valuation for a variety of reasons including determining if a firm is failing or likely to fail; to determine the scope and size of resolution measures (including the size of any bail-in); and for No Creditor Worse Off purposes. Therefore, valuation of other property is needed and not just of the firm's balance sheet assets and liabilities. Examples of this include an equity valuation of the firm and valuation of the compensation to be given to bailed-in creditors. As such, this RTS should also cover the requirement for independent valuers for these other purposes as well (and not just restrict it to the valuation of assets and liabilities) and make it clear that there will need to be a different independent valuer appointed for these separate and distinct purposes. One valuer should not perform all of the valuations identified in the BRRD and in certain cases it is imperative that the same valuer does not opine on all or a combination of the required valuations (e.g. determination of the securities to be bailed-in and the subsequent NCWO determination).
- The requirement to not have had an audit relation with the affected institution in the year preceding resolution makes sense and is desirable. However, the strict interpretation of this could in certain instances lead to a restriction in the choice of firms available to provide an independent valuation. For example, what if audit rotation is taking place or has occurred in the months preceding a resolution or if a new auditor is appointed at the time of resolution? In such cases, you effectively will exclude 2 potential parties (or more if there is a joint audit appointment) as the valuer which could restrict the choice of firms available to provide an independent valuation. Is an alternative solution to stipulate that the audit firm that opined on the last set of financial statements for the affected institution should not be considered as independent for the purposes of valuation under the BRRD?

Yours faithfully

KPMG LLP

For KPMG LLP