EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Template for comments

Public consultation on the draft addendum to the ECB guidance to banks on non-performing lo

Institution/Company
Baillie Gifford & Co

Contact person

Mr/Ms
[redacted]

First name
[redacted]

Surname
[redacted]

Email address
[redacted]

Telephone number
[redacted]

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General comments

From:	[redacted]
To:	SSM Public Consultation
Subject:	Public consultation on the draft addendum to the ECB Guidance to banks on non-performing loans
Date:	06 December 2017 18:36:39
Attachments:	ECB_comment_NPLs.xlsx

To the Secretariat to the Supervisory Board:

The proposal regarding non performing exposures (NPE) is intended to accelerate the speed with which banks provision for NPEs. The scale of non-performing loans on bank balance sheets within Europe is a material problem. We note the comments of the European Central Bank (ECB) regarding the timing of trying to address the problem, and the benefits of doing so while there is a degree of increase in economic activity including bank lending, in those areas most sensitive to the subject matter. The ECB, as banking supervisor, already has the power to review NPEs at any point and to request specific banks to take action. The proposed addendum is unnecessary in terms of the effectiveness of bank supervision. Therefore the cost of the proposed guidance may exceed any potential benefit and we encourage the ECB to reconsider the proposal.

As we understand the proposal, once a bank recognises that a loan is non-performing, it would then have two years to fully provision an unsecured exposure and seven years to fully provision a secured exposure. This would be a meaningful acceleration of provisioning relative to what we have experienced in recent years.

The proposed guidance may make banks less willing to disclose NPEs in the future. There will always be a degree of subjectivity in determining when a loan is non-performing. Our interest as investors is in encouraging the early identification of non-performing loans, and ideally modifications to enable such positions to become performing. As the ECB has commented, the early identification of problems facilitates better solutions than late identification. With that in mind, measures that may discourage a member of staff of a bank from highlighting a problem, are to be avoided. We are concerned that this measure, with its specificity, would have that effect.

A potential problem related to secured lending is that a guideline is being proposed for the entire geographic area of responsibility of the ECB when within that area there exists a great degree of variation in judicial processes and time required to enforce collateral. We appreciate the point made by the ECB, emphasised during the hearing on the 30th November 2017, that the proposed guidance does not require banks to sell their non-performing loans. However, the speed of judicial processes and the impact on valuation of non performing loans is relevant to all banks in a region. If an environment is created where there is greater pressure to reduce non performing loans at a pace which the judicial system cannot match or exceed, then there will be downward pressure on valuations, affecting all similar pools of loans and all pending transactions. This will occur regardless of whether a specific bank decides to sell a pool of loans. We would highlight other research on this subject, by the Bank for International Settlements, “Resolution of non-performing loans – policy options” October 2017, that stresses the need to have a solution to match the working environment. We appreciate that the ECB does not have the authority to address judicial processes within its role as banking supervisor. That should not absolve the ECB of considering that it may be inappropriate to advocate NPL resolution on a faster timeline than certain member states’ court systems can manage. The result may be a transfer of value from banks to specialist recovery funds, with risk of unnecessary loss of confidence by the broader market and ultimately depositors.

We think the proposed guidance is unnecessary as the ECB can conduct itself with sufficient rigour regarding NPEs in its current role, with existing tools, as banking supervisor. There are potential costs to this unnecessary guidance that make us think this would be a net cost in excess of any benefit and represents an avoidable risk.

Sincerely,

[redacted]

[redacted]

Fixed Income Department – Credit
Baillie Gifford & Co

[redacted]

www.bailliegifford.com