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Opening remarks at the European Parliament Public Hearing on Securitisation (June 13, 2016)

Session 'Can STS securitisation revive the European market?'

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The European Parliament has invited us to answer the question: can STS securitisation revive the European market? It is important to consider two points.

First, if we are to use public interventions to breath life into this market, what are the benefits of doing so?

On the supply side, it is often argued that STS securitisation would ease SME access to financing, and therefore stimulate growth. Yet we know from ECB surveys that SMEs in Europe are more concerned about finding demand for their products, and less about financing. We also have some evidence that SMEs perform better in countries with a large number of small banks, such as cooperative banks. So for SMEs, old boring banking rather than capital markets will continue to be, in the medium to long term, the main answer to financing needs. If the past experience of the EU securitisation markets offers any guidance, then other types of borrowers – for example, those borrowing to buy homes or durable goods – may benefit more. Yet such borrowing may not always be macroeconomically desirable, if, for instance, it feeds real estate bubbles.

We also know that, on the supply side, it will take a long time to establish a truly European securitisation market. Since there are many barriers to pooling loans across borders, the moment when a German SME loan and a Greek SME loan can share the same securitisation vehicle is rather far away.

This takes me to the second issue.

It may not matter that a well-designed STS will only revive national securitisation markets as long as institutional investors, the demand side in the CMU equation, can purchase securitised instruments issued across borders.

It is here that we will see the most significant impact of the CMU securitisation plans. The CMU Green Paper, along with the Bank of England and the ECB paper on securitisation, tell us that there is growing institutional demand for investment assets that the STS process can meet. The involvement of pension funds and insurance companies, investors with low leverage and little dependency on short-term funding, and with 'buy to hold' strategies, would improve the robustness of securitisation markets.

Here, economic theory and the experience of the crisis teach us to be cautious. For institutional investors, it will be increasingly important that the STS process generates securities that trade in liquid markets. This has, for example, been the position of the Association for Financial Markets in Europe since the Commission published the Green Paper. Price volatility is higher in illiquid markets, and it will show up on the balance sheets of institutional investors because their accounting rules require assets to be valued at market prices. To illustrate the importance of accounting rules, the losses on European securitisation during 2007-2008 were mostly due to mark-to-market requirements. This is why research from the Bank of England concluded that accounting rules create incentives for insurance companies and pension funds to buy during good times and sell during bad times. Such behaviour amplifies fragility – liquidity disappears when it is most needed. Market liquidity is an elusive concept, as every central bank in the world will testify. If not even the US government bond market, the most liquid in the world, is immune to liquidity illusion, can we safely assume that the 55 criteria to qualify for the STS label would provide the answer? Liquidity stops are dangerous when they affect holders of securitisation assets.

The European Parliament faces a momentous decision on a highly technical issue. But the politics is simple. When you vote on the criteria to define STS, you are voting on the public safety net that we want to place under the STS market in Europe. States simply cannot afford the social costs of letting private pensions or insurance companies fail, and since they cannot, they will either have to use the balance sheet of the sovereign, or use the central bank as 'purchaser of last resort' in the event of a crisis. The broader the interpretation of what we mean by STS, the larger the safety net becomes. Higher skin in the game to better overcome endemic conflicts of interest, less complexity, and a thorough impact assessment that takes into account the position of all stakeholders, remain imperative.

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