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# Europe tries to jump-start slumped securitization market

Geoff Nairn August 7, 2014

The asset-backed securities market is on a roll in the US but will the revival be enough to overturn Europe's traditional skepticism towards this asset class?

In 2013, just €181bn of ABS was issued in Europe compared to €1,553bn in the US, according to the Association for Financial Markets in Europe.

Unlike the residential mortgage-backed securities market, where painful memories still linger, sales of most types of ABS are booming in the US.

Another sign that confidence has returned is that issuance of securities linked to offbeat collateral is rising. Take, for example, the $300m bond issuance (http://www.bloomberg.com/news/2014-07-14/hooters-said-to-plan-300-million-of-asset-backed-bonds.html) planned by Hooters, the restaurant chain known for its scantily clad waitresses.

The list of assets that can be securitized gets longer each day and includes car-rental loans (http://www.ft.com/cms/s/0/db39d6fc-d561-11e3-9bca-00144feabdc0.html), aircraft, sports stadiums, student loans, cellular masts, consumer loans, intellectual property and even celebrities – remember Bowie Bonds (http://online.wsj.com/news/articles/SB112476043457720240)?

In stark contrast to the US, where ABS issuance has bounced back to its pre-crisis levels, in
In the first three months of 2014, just €18.5bn of securitized product was issued in Europe, a decrease of 43 percent from the year-earlier first quarter.

The ABS market remains stigmatized in Europe because of the role that complicated securitization structures and poorly underwritten loans played in exacerbating the financial crisis.

But many investors feel that this prejudice is unwarranted and they have found powerful allies in the European Central Bank and the Bank of England.

In a recent discussion paper (http://www.bankofengland.co.uk/publications/Pages/news/2014/082.aspx), the two institutions make the point that European securitizations actually performed well during the financial crisis, with default rates an order of magnitude lower than those in the US.

Simon Hills, Executive Director of the British Bankers' Association, which supports the recommendations of the ECB/BoE discussion paper, says:

"European securitizations were tarred with the same brush as US sub-prime loan backed securitizations that had been originated and structured with insufficient understanding of how the underlying assets would perform in a period of stress."

Since the crisis, international rules and regulations have been significantly tightened and the US ABS market has bounced back. But in Europe, the opposite has happened and ABS issuance has slumped.

The ECB and BoE want to reverse this trend as they argue more securitization would benefit Europe's financial markets by encouraging funding diversification, freeing up capital to allow banks to extend new credit to the real economy, and providing non-bank investors, such as insurance companies and pension funds, with access to a broader pool of assets.

As credit demand starts to pick up in Europe, the ECB is particularly concerned that the health of the broader economy depends too heavily on the ability of banks to lend. So, it wants to encourage non-bank financial institutions to participate in real- economy lending, so providing an alternative to bank lending for smaller companies that cannot raise investment directly from the capital markets.

ABS could help fulfill these functions and so the ECB and BoE identify recommend a series of measures to fix Europe's broken securitization market.

One of the big issues is the discriminatory treatment that ABS receive compared to similar investments, Some investors are reluctant to hold ABS due to uncertainty over the regulatory capital treatment of ABS under the new Capital Requirements Directive IV and the Solvency II Directive. A lack of standardization across the EU, as well as a lack of data to assess the performance of some ABS are also holding back the market.

But perhaps the biggest issue – and one that won't be solved overnight – is the widespread perception in Europe that ABS are illiquid and generally more risky than other forms of long-term wholesale funding, such as covered bonds.

Although with activity in the covered bond market now at its lowest level (http://www.ft.com/cms/s/0/7e58e182-1277-11e4-a581-00144feabdc0.html) in more than a decade and with the ECB and BoE now throwing their support behind securitization, the conditions for a an ABS resurgence in Europe are looking a lot better than they have in the past.



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