

Chapter 21

The Role of Securitization Market in the Post-Crisis European Economic Recovery

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ABSTRACT

European national economies begin to recover, and securitization can play an important role in supporting both monetary and financial stability. In particular, securitization may allow banks to lend without over-committing of the capital and other sources of funding, and thereby to provide indirect market access to borrowers. Otherwise, such borrowers as SME's are not able to tap markets directly. At the same time securitization suffers from stigma, reflecting both its adverse reputation among investors and conservatism among regulators and standard-setters. This is the consequence of misaligned incentives in years prior to the financial crisis, when industry participants became entwined in a self-reinforcing dynamic between demand and supply of securitizations. Using data accessible within the period of 2009-2014, the chapter will input by the analysis of transformation in the securitization market within the post-crisis economic recovery of the EU.

INTRODUCTION

Concerns over the future economy of the European Union (EU) have been persistently growing since 2010 after the notorious 2008 global financial crisis. Instability of national economies and a contagious debt crisis makes European existence insecure. In the last five years, fears of a possible Eurozone collapse have been transformed into the

real emergent political and economic steps of EU institutions. Therefore, securitization could be an answer to the old and new trends and can play an important role in supporting both monetary and financial stability. In other words, securitization matters as soon it creates value by minimizing the costs associated with market misbalance. In particular, securitization may allow banks to lend without over-committing capital and other sources

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of funding, thereby providing indirect market access to borrowers. Otherwise, such borrowers as Small- and Medium-sized Enterprises (SMEs) are not able to tap markets directly.

From an essentialist position, we use the following the definition of securitization by Roever and Fabozzi (2003): a form of financing in which monetary assets with predictable cash flows are pooled and sold to a specially created third party that has borrowed money to finance the purchase. These borrowed funds are raised through the sale of asset-backed securities (ABS), which can take the form of either commercial paper or bonds. The same position is articulated by academics since the beginning of the 2000s (Kothari, 2014; Davidson, 2003).

The interest in considering economic securitization and the role of securitization market is justified by its increase in the last 10 years and recent events in the Eurozone. We can see that today securitization suffers from stigma, reflecting both its adverse reputation among investors and conservatism among regulators and standard-setters. This is the consequence of misaligned incentives in years prior to the global financial crisis when industry participants became entwined in a self-reinforcing dynamic between demand and supply of securitizations.

The outstanding amount of ABS in the EU is currently about 1,500 billion Euros, or around one quarter of the US ABS market. Since its peak in 2009, the outstanding amount has decreased by a one third, or 750 billion Euros. Residential Mortgage Backed Securities (RMBS) form by far the largest securitization segment, accounting for 58%; SME ABS is second, but the account is only for 8% of the market. The largest jurisdictions in terms of outstanding ABS are the UK, Netherlands, Spain, and Italy (Barclays, 2013).

Some asset classes such as consumer finance ABS, SME Collateralized Loan Obligations (CLO), and RMBS have experienced default rates far below this average and the performance of European structured finance products has also

been substantially better than US peers. The corresponding default rates for European consumer finance ABS, RMBS, and SME CLO are 0.04, 0.1, and 0.4% respectively. However, the ABS on US loans experienced default rates of 18.4% over the same period, including subprime loans (Barclays, 2013).

Using data obtained from the database of the Securities Industry and Financial Markets Association (SIFMA), the European Central Bank and the Association for Financial Markets in Europe (AFME) within the period of 2009-2014, we will try to analyze transformation in the securitization market within the post-crisis economic recovery of the EU. The econometric approach to assessing the role of securitization in mortgage lending will be implemented. It will assist with the following:

- Analysis of the impact new regulatory environment (CRD II, CRD 4, Basel III) on the European securitization market (Allen, 2011; Joint Association Reports, 2014).
- Analysis of changes in the structure of the European securitization market (Dulake, 2011).
- Influence poor credit performance analyses of some U.S. structured finance asset classes on the European securitization market.

ECONOMIC RECOVERY, SECURITIZATION, AND DEFLATION

The development of the securitization market is an important factor in the post-crisis recovery of the European economy. Smart ECB policy in relation to the securitization market as a source of liquidity for European banks will reduce deflation, which is a major obstacle to post-crisis recovery of Europe. Low inflation and deflation is dangerous for the economy of any country. Deflation eventually reduces wages at a fixed level of debt and makes it complicated to repay. Deflationary expectations cause people to delay

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