Finance Watch: The Long Term Financing Agenda - The Way to Sustainable Growth? (Novares Monitoring – reproduced with permission)

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Agenda

High-level conference - The long term financing agenda - the way to sustainable growth?

Key Points

- **High quality securitisation:** Securitisation featured highly on the agenda of the Finance Watch conference, with participants discussing the desirability of promoting securitisation and debating what characteristics high quality securitisation should have. Frédéric Hache (Head of Policy Analysis, Finance Watch) argued that 'tranching', the practice of splitting securities into different classes with different credit ratings from the same pool of assets, should not feature in a high quality securitisation framework. While Hache did not call for an outright ban of the practice, he argued that the practice creates model uncertainty, introduces complex risks and pro-cyclicality, as well as conflicts of interest between holders of the different tranches. Richard Hopkin (Head of Fixed Income, AFME) argued in favour of the practice of tranching, and cited that it is a widely used technique in bank financing, where banks issue equity, subordinated debt and senior debt. Hopkin also warned of the dangers of using the phrase 'high quality', as it could discourage investors from carrying out their own due diligence. He called for a value neutral term to be used instead. Bogdan Patriniche (Lakestone Capital) argued that tranching is only suitable for certain kinds of investors that hold the right kind of risk and liquidity appetite.

- **Capital neutrality for securitisation:** Hache stated that while Finance Watch supports a 'limited softening' of the prudential treatment for high quality securitisation, he argued that there should not be a move towards full neutrality for high quality securitisation. Hache justified the case for maintaining a higher capital charge for securitisations compared to their underlying assets, as securitising assets introduces "additional complexity, procyclicality and interconnectedness" compared to the simple non-transformed assets. Hopkin, on the other hand, argued that securitisation had fared much better in the European Union than the United States during the financial crisis, and pointed to low default rates for European prime residential mortgage backed securities and SME securitisations. He argued that the low defaults rates suggest that securitised products could be treated more favourably, but agreed that there is indeed a reasonable argument against complete capital neutrality.

- **Financial regulation** Dennis Kelleher (CEO, Better Markets) argued that the choice between growth and jobs over stability and financial reform is a false choice used as a weapon in order to defeat reform, and to divide countries and regulators. He argued that that there is no evidence in favour of the argument that increased regulation would prevent banks from lending or hurt liquidity. Kelleher stated that deregulation was the real job killer, and referred to the decades following the Great Depression, when banks were highly regulated, as a prosperous era in which the finance industry and the economy mutually benefited from one another. Kelleher also demanded that the industry should be more transparent with the data it uses to justify claims, and that their analyses should be subject to independent scrutiny and analysis.

- **Collateralisation:** Christophe Nijdam (Secretary General, Finance Watch) stated in his opening speech that while collateralised funds can be useful in uncertain times, he warned that "making collateralised funding the new normal" could result in a more interconnected and more procyclical financial system. Paulina Przewoska (Senior Policy Analyst, Finance Watch) argued that a revival of securitisation through the efforts promoted by the European Commission could lead to a strengthening of the role of collateral in the financial system, as well as the problems associated with it, such as asset fire sales during crises and additional pro-cyclicality. Andy Hill (ICMA) disagreed that securitisation was being promoted for the sake of fuelling the collateral market, as collateral users and takers are incredibly circumspect about what they will accept as collateral. McNulty agreed and argued that Asset Backed Securities only constitute a small fraction of the collateral market. Daniela Gabor (Associate Professor, Bristol Business School) argued that transparency alone would not resolve systemic issues in the repo market, and called for regulation such as minimum haircuts and limits on the re-use of collateral.

- **Securities Financing Transactions:** McNulty agreed that there are risks in relation to collateralisation, and welcomed the EU initiative on the Securities Financing Transactions (SFT) Regulation. Werner Bijkerk (IOSCO) and McNulty both stated that SFTs are a worldwide problem, and so encouraged other regions other than the EU to pursue similar initiatives. McNulty called for regulators to coordinate in order to ensure data consistency between the various SFT initiatives. He also argued that submitting data in an aggregated form, rather than just capturing the individual transactions that took place in a day, may be a more useful form of handing over data to regulators. Bijkerk agreed, arguing that data is not a panacea. He urged regulators to carefully consider what type of data could guide them in assessing financial stability in relation to SFTs. Andy Hill argued that the SFT Regulation could make the cost of bank financing higher, and warned that this could translate into more expensive costs for end-users.

- **Diversity of EU banking models:** Dr Lothar Blatt-von Raczeck (German Association of Savings Banks) argued in favour of traditional, regional and local banks that do not pursue significant amounts of capital market activity. Raczeck argued that the economy is best served by local banks, who hold a proximity to the clients they lend to, and who focus on maintaining lifelong business relations with their clients. He warned that this model has come under growing threats, due to the prolonged accommodative monetary stance of the European Central Bank (ECB), which has discouraged savings, as well as the threat of growing regulatory costs and higher administrative burdens that especially threaten smaller banks. Martin Wolf (Financial Times) warned of the risks of local banking, which remain highly dependent upon local economic conditions, and thereby are exposed to the threat of a lack of diversification. Wolf favoured specialised business banks that focus their lending across wider regions.

- **SME financing:** Luca Bertalot (Secretary General, European Covered Bond Council) referred to SMEs as a new potential asset class for covered bonds. He noted that SMEs have a different nature compared to mortgages, as the latter have the advantage of a guarantee. He argued that SME loans would require a different structure, and called on the European Commission to look at other ways to finance SMEs through direct funds or direct access to capital markets by proposing a harmonised way to finance SMEs.