Setting the standard for securitisation

Press Release

PCS calls for Europe's capital markets to fill estimated €4 trillion funding gap in Europe

Prime Collateralised Securities (PCS) today publishes a White Paper, *'Europe in Transition',* which outlines ways to bridge a funding gap for the European economy, which it estimates to be at least €4 trillion over the next five years. This figure represents the sum of what PCS estimates the new regulatory capital and liquidity rules will take out of the system and what a conservative economic estimate believes needs to go in to the system to generate growth.

Unless this funding gap can be bridged, European governments and businesses face the potential of an economic wasted decade: a long-term period of stagnation, similar to that experienced in Japan.

According to the paper, there are two courses of action to avoid such stagnation: either banks must increase the amount of capital they hold or non-bank sources must replace the lost funding.

The paper sets out how four key factors combine to constrain banks' ability to raise capital:

- **Dilution:** repeated dilutive impacts of equity issues lead to strong resistance from existing shareholders to yet more
- **Uncertainty:** the chicken and egg conundrum that banks' problems will not be over until the European economy exits recession and the banks recapitalise and the economy will not improve until banks' problems are overcome
- **Business model:** Going forward banks' return on equity is expected to be substantially below the present cost of capital for banking institutions
- **No more 'too big to fail':** greater willingness by politicians to see banks fail reduces the implicit governmental support that provided equity holders with certain levels of comfort.

If bank capital raising cannot fill the gap, this means either the public sector or the capital markets must, if we are to avoid stagnation. However, given current demands on European public expenditures, the primary gap will have to be addressed through Europe's capital markets.

But capital market funding for the key mid-cap/SME and the consumer segments of the economy (so important for growth) is not straightforward. The *'Europe in Transition'* paper examines the hurdles that lie in the way of such capital market funding in Europe and sets out why the most likely, tested and scalable channel available for such funding in Europe is **securitisation**, thus making it a key component of any successful attempt at bridging the funding gap for borrowers - such as SME's - without direct access to the capital markets.

In addition, though, it reviews the issues raised by the challenging past of securitisation in light of the role played by certain securitisations in the crisis. Based on thorough analysis of five years of crisis, it identifies clearly the aspects that divide strong and resilient securitisations which will be needed to bridge the funding gap from those that failed so dramatically in 2007/2008 and should not form part of Europe's future.

Ian Bell, the Head of the PCS Secretariat commented:

"We believe that, as the acute bank and sovereign crisis of the last few years appears to be receding, the task of providing for the long term funding of the European real economy is posing a critical challenge for policy makers across the continent.

"With this paper, we hope to contribute to one of the most important debates taking place today; one that is central to Europe's transition to a stable and prosperous future.

"Europe's future prosperity is conditional on bridging this funding gap and the paper identifies ways to do that – pivotal is having a healthy high-quality securitisation market."

Francesco Papadia, Chair of PCS commented:

"Securitisation is a brilliant financial innovation, which was nearly destroyed by diffuse cases of very poor implementation, shedding a negative light on the entire product. There is an urgent need, as shown in the PCS paper, to distinguish good securitisation from the types of securitisations that failed. This is the objective of the PCS initiative. Its fulfillment will contribute to fill the gap that the PCS paper identifies."

-ENDS-

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Notes:

1. The Prime Collateralised Securities initiative (PCS) is an independent, not-for-profit initiative set up to re-inforce the asset-backed securities market in Europe as a key to generating robust and sustainable economic growth for the region. At the heart of the PCS initiative is the PCS Label designed to enhance and promote quality, transparency, simplicity and standardisation throughout the asset-backed market. You can find more information on our website: www.pcsmarket.org .

2. Having started to operate in November 2012, PCS has already granted eight labels to high quality securitisations. PCS also is an active participant in policy and regulatory discussions around securitisation, its proper regulation and its place in funding the European economy.

3. The governing body of the PCS initiative is the Board of the PCS Association, a Belgian not-for-profit association with its seat in Brussels. The PCS Association Board, chaired by Francesco Papadia, groups individuals with background in the public sector, the banking sector, investment and the law.

4. There are 40 members and 10 permanent observers making up the PCS Association. The membership represents all segments of the financial markets (for our membership, see http://pcsmarket.org/our-membership/members/ and for our observers, see http://pcsmarket.org/our-membership/observers/)

5. The conservative €4 trillion finance gap, is derived from the addition of data from a variety of sources including the IMF and European banks' own estimates for the deleveraging (€2 trillion), the European Banking Association for the impact of the liquidity rules (at least €0.6 trillion), and economic estimates from Standard & Poor's research for the additional financing that would be required for growth (between €1.6 and €1.9 trillion).

6. The paper contains additional figures for the estimated new bank capital the new regulations would require (mainly from the EBA), past and current bank ROE figures, corporate bond issuance and the limited amount of deleveraging that has already occurred (from BIS figures and estimates).