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Subject: Fwd: Securitised debt could give Europe's economy the kiss of life

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Begin forwarded message:

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Subject: Securitised debt could give Europe's economy the kiss of life

Haha - sound familiar?! (Check out highlighted paragraph.)

Securitised debt could give Europe's economy the kiss of life

By Jacques de Larosière

Investors can earn better returns from industrial companies than banks, says Jacques de Larosière

©Reuters

Tougher financial regulation has made [European banks](#) more resilient. But the drought of credit now confronting promising businesses across Europe is making the continent's economy more fragile. These facts are linked – and the second cannot be ignored.

European banks have strengthened their capital reserves, which have doubled on average since the financial crisis. And they have reduced their exposure to risk, notably by scaling back speculative trading activities. At the same time, their diminished profitability is making it difficult to find the fresh capital they need to meet the tightened rules. Investors can now earn higher returns by investing in industrial companies rather than financial institutions, a reversal of the situation before 2008.

With fresh investment capital no longer forthcoming, stringent liquidity and capital adequacy ratios can be met only through a

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reduction in assets, including loans. American banks, too, face [harsher rules](#). But – for now at least – they can offload a large portion of their mortgage loans to government-backed entities such as Fannie Mae and Freddie Mac.

Rising defaults on corporate loans in the [eurozone periphery](#) are also discouraging banks from extending credit. That hurts business profits, and deters companies from committing to investment projects that would have to be funded by debt. Consequently, many businesses are struggling to obtain the credit they need. This problem first emerged in the countries of the periphery but is now affecting several states across the EU. By the end of 2013, 29 per cent of applications for bank loans in France were facing obstacles such as rejection, partial coverage or high price.

In Italy, the figure was 48 per cent. Part of the explanation may be that the most eligible borrowers are not applying for loans. However, banks' unwillingness to lend is also part of the story. Many observers believe this rationing of credit could be the prelude to sharper restrictions down the road. And many lay the blame on the prudential regulation that is supposed to be making banks safer.

Fixing this is an urgent task. One option would be to make it easier for smaller companies to gain direct access to financial markets through equities or bond vehicles. But this would take time. Improving the profitability of EU banks is also not feasible in the short term.

“ Investors' confidence needs to be rebuilt. This means the quality of underlying bank loans must be beyond question ”

A better answer is to revitalise the market for securitised loans that has all but vanished since the financial crisis. This is supported by the European Central Bank, which has called for loans to small and medium-sized enterprises to be repackaged into standardised products that are easier for rating agencies to assess and for

investors to price. Before this can happen, investors need to be freed from the regulations that diminish their appetite even for high-quality assets.

Investors' confidence needs to be rebuilt. This means that the quality of underlying bank loans must be beyond question. Central banks have already defined rigorous quality thresholds that determine which loans they will accept as collateral, and some of them employ teams of specialists to assess these risks. Those standards could be applied more widely. European central banks should work together to create securitisation conduits in eurozone countries, which would purchase SME loans

complying with these strict criteria and bundle them into highly rated securities that could be sold on to investors.

European states, acting via national and multilateral development banks, should offer guarantees on these securities to insulate investors from losses if the loans turn sour. The ECB in conjunction with national central banks should also stand ready to purchase such asset-backed securities temporarily if needed, to provide liquidity to the market. Such government action is necessary to foster confidence in an asset class that has all but disappeared since the financial crisis. They should not prove costly to taxpayers, so long as the underlying loans are of high quality.

Until enterprises and households have access to adequate sources of financing, there will be no convincing return to growth. Reviving the market for securitised loans is the fastest way to bring Europe's credit shortage to an end.

The writer is a former governor of the Bank of France and president of Eurofi, a think-tank