

U.S. FUND MANAGER TO ADVISE EUROPEAN BANK

The manager of the world's largest fund was the hired gun brought in by the Federal Reserve in 2008 to help manage the U.S. financial crisis and specifically to advise on the management of Fannie Mae and Freddie Mac assets after the U.S. government took control of the two federal housing finance agencies. Now the European Central Bank (ECB) has contracted with the same firm to address its own asset-backed securities (ABS) aspirations as it seeks to pump up the still sluggish European economy. But being one of the largest investors in European ABS, the firm will need to tread carefully along the precarious conflict-of-interest line.

Reviving the Euro Zone

As part of its efforts to revive the Euro-based economy, the ECB is preparing to purchase ABS. The once \$1.2 trillion strong ABS market has shrunk 34% in the past five years. Now it is believed that acquiring ABS should be a viable part of the overall Quantitative Easing (QE) program deemed necessary to stimulate the European economy. The importance of revitalizing the ABS market has been recognized by both the ECB and the Bank of England in a joint statement issued earlier this year:

A market for prudently designed ABS has the potential to improve the efficiency of resource allocation in the economy and to allow for better risk sharing. It does so by transforming relatively illiquid assets into more liquid securities. These can then be sold to investors thereby allowing originators to obtain funding and, potentially, transfer part of the underlying risk, while investors in such securities can diversify their portfolios in terms of risk and return. This can lead to lower costs of capital, higher economic growth and a broader distribution of risk. (https://www.ecb.europa.eu/pub/pdf/other/ecb-boe_impaired_eu_securitisation_market_en.pdf)

Expertise: Before, During and After

In a statement acknowledging the U.S. firm's extensive experience in the ABS market, Dipesh Mehta, a research director at Barclays in London noted, "Hiring an adviser who knows the ABS market and has experience investing in it before, during, and after the crisis is clearly positive." The firm was one of four co-managers hired to analyze mortgage-backed assets of Fannie Mae and Freddie Mac and to report back to the Federal Reserve. Accordingly, they are particularly well suited for advising the ECB on their intended ABS purchase plan.

Separating Consulting from Management

A critical element of the terms of hire between the firm and the ECB is that an effective separation exists at all times between its ECB advisory staff and its own ABS investments. External auditing will be employed to ensure that no conflict of interest or insider advantage can cross between the two functions. The firm invests in European ABS backed by debt ranging from commercial mortgages to everyday consumer loans.

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