Summary

Regulations for securitisation have been subject to criticism before and after the Global Financial Crisis (GFC). It was widely blamed for spawning the GFC that led to strict regulations for this market. As a result, this market was frozen and banks were not able to issue Asset-Backed Securities (ABS) to access non-depository funds and they moved to alternate instruments. Covered Bond (CB) was an important instrument used by the European banks for this purpose. Preferential regulatory treatment given to CBs also played an important role in focus on this market. However, once the dust of the GFC was settled, many questions were raised on the blames placed on securitisation. It was realised that securitisation plays an important role in the economic growth and strict regulatory treatment should not be given to this market. Regulators are currently trying to restart this market but strict regulations are hindering the resumption. It is still an open question that how this market should be regulated optimally? This study attempts to contribute in finding the answer of this question.

This study makes a comparison of ABS with CBs as they are close counterparts, but blames those are places on ABS cannot be applied to CBs. Banks transfer their assets out of their balance sheet during the securitisation process and it is perceived that they do not have the so-called ‘skin in the game’ after this transfer. For this reason, securitisation is mainly blamed for creating the problems of moral hazards that allegedly led to the issuance of large scale risky loans. However, such a transfer of underlying asset does not take place in case of CB issuance and banks are supposed to have a strong ‘skin in the game’. Hence, allegations on securitisation should not stand true if CB issuing banks also face similar problems.

The initial legal analysis in this study highlight three elements. First, some questions are raised on the premises of the regulations devised for securitisation after the GFC. It seems that many of these regulations are influenced by the market criticism and political reactions towards the securitisation market. Second, the European regulations are highly influenced by the situation in the US market and not based on the European realities. Many complex forms of ABS those were omnipresent in the US market were not commonly issued in the European
securitisation market. Moreover, the Originate-to-Distribute (OTD) model of securitisation that has been subject of mass criticism was also not present in the European market. Third, CBs are given a favourable treatment as compared to ABS that also plays a role in hindering the efforts to restart this market. The investors might feel that CBs are better instruments, even they offer a lower yield as compared to ABS, because of the high capital requirements in case of exposures in ABS. An empirical analysis has been performed to deeply study these concerns about the regulations.

Chapter 4 of this study compares the impact of ABS and CBs on credit risk taking behaviour of banks by using the data of 253 banks from 7 European countries for the period 2000-2014. This analysis helps evaluate the regulations inspired by the perception that securitising banks take more risk. The study uses the Covariate Balancing Propensity Score (CBPS) with Difference-in-Differences (DID) for the analysis. Initial results suggest that European banks do not securitise for the credit risk transfer, rather main motive behind securitisation and CBs is liquidity generation. I examine effects of securitisation and CBs on credit risk-taking behaviour in the short and long run. The results suggest that securitisation may not have a positive impact on credit risk-taking behaviour of banks. The findings do not support the perception that securitising banks under-price their risk. However, results indicate that CBs may have a positive impact on credit risk-taking in the long run. These results are attributed to the recourse provided in securitisation transactions, competitive pressure and asset encumbrance in case of large scale CB issuance. The ‘skin in the game’ in form of on-balance sheet retention may not help reduce credit risk-taking.

Chapter 5 of this study goes a little deeper and empirically investigates how the relationship of securitisation and CBs with bank stability varies with the level of variations in banks involvement in any of these two instruments. The study uses here the data from 46 securitising and CB issuing listed banks in Europe for 2000-2014. The initial results show that some banks have been heavily involved in the securitisation activity, while CB issuance does not go beyond a certain limit. The results obtained using a quadratic model and a generalized additive model suggest a U-shaped relationship between securitisation and systemic risk of the banks. However, this relationship is reversed for CBs. Small issuance of these bonds fail to provide the intended benefits and increase the banks’ risk. Further investigation reveal the presence of a strong size effect. The systemic risk of smaller banks increases after the issuance of CB, while larger banks remain unaffected. The study does not support imposing uniform limits on the CB issuance; instead such limits should be linked with the bank size. However, some framework is needed to limit the banks’ involvement in securitisation.

The empirical analysis suggests that securitisation per se does not lead to high risk taking,
rather the problem starts when banks increase their level of securitisation. In the light of these findings, the study suggest that flat regulatory treatment given to all securitising banks may not be suitable. The objective of the revival of the securitisation market may not be achievable in the presence of strict treatment given to all forms and levels of securitisation. The study recommends differentiated treatment of different classes of ABS and incremental capital regulations. The capital regulations should be relaxed for banks having a reasonable presence in the securitisation market but they should increase when a banks accelerate its securitisation activity. A differentiated treatment with respect to the classes of ABS and a bank’s involvement in this market will encourage those banks who have a low presence in this market and discourage banks to extensively involve in the securitisation activity.