



Securitization and lending standards: Evidence from the European wholesale loan market[☆]



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ABSTRACT

We assess the relative effect of securitization activity on banks' lending rates employing a uniquely detailed dataset from the euro-denominated syndicated loan market. We find that in the run-up to the 2007–2009 crisis banks more active at originating asset-backed securities did not price their loans more aggressively (i.e. with narrower lending spreads) than non-active banks. We show that also within the set of loans that were previously securitized, the relative level of securitization activity by the originating bank is not related to narrower lending spreads. Our findings, which are limited to the cross-sectional impact of securitization, suggest that the effect of securitization on the cost of corporate funding appears to be quite limited.

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1. Introduction

The 2007–2009 Financial crisis has shown that securitization could be a major danger to financial stability (Financial Crisis Inquiry Commission, 2011). Specifically, securitization has been suspected to endanger financial stability by weakening banks credit

standards and thereby fuelling excessive risk-taking (Keys et al., 2011). Prior to the crisis, however, the usual view emphasized the positive role played by securitization in supporting financial stability. This was also the prevalent view in policy circles empowered with maintaining financial stability (see for instance Greenspan, 2005). Securitization activity was expected to make the financial system more stable as risk was more easily diversified, managed and allocated economy-wide. From the perspective of individual institutions, securitization was believed to be employed by banks to manage and diversify more effectively their credit risk portfolio (Cebenoyan and Strahan, 2004; Jiangli et al., 2007; Duffie, 2008).

At the same time, there were growing concerns about the possible effects of financial innovation on financial stability. In particular, securitization could compound adverse selection and moral hazard problems in banking leading to poorer screening standards as well as weaker monitoring of borrowers. Mostly building on this argument, there was a more skeptical view on the final impact of securitization on the stability of the financial system (Rajan, 2006). It was also argued that securitization could undermine lending standards (Greenbaum and Thakor, 1987; Gorton and Pennacchi,

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1995)¹ and enhance banks' risk appetite (Calem and LaCour-Little, 2004; Ambrose et al., 2005; Brunnermeier and Sannikov, 2014). If securitization activity leads to excessively lax lending standards by banks', it could have an impact on the overall financial stability by building up imbalances on credit markets that can make the overall system more fragile.

Following the 2007–2009 financial crisis, evidence on the link between securitization and bank risk-taking is growing. Part of the literature argues that banks resorting to securitization activity relaxed their lending standards in the years prior to the crisis more aggressively, making the overall financial system less stable (Dell'Ariccia et al., 2012; Nadauld and Sherlund, 2013; Wang and Xia, 2014). Other studies do not find any evidence suggesting that securitization led to riskier lending [see for instance Benmelech et al., 2012]. Overall and partly due to data availability the findings on the effects of securitization remain ambiguous and centered in the United States.

In this paper we assess the impact of banks' securitization activity on their lending function. In particular on their lending rates for euro-denominated loans. We test whether banks that were active in the securitization market priced loans more aggressively, via tighter spreads, as they were able to sell these loans to other investors via securitization. If securitization activity increases banks' risk appetite when extending loans, we would observe lower spreads for these loans compared to loans extended by banks not active in this market. It is important to note that our analysis is relative as it is limited to the cross-sectional dimension of the relationship between securitization and the cost of corporate credit. We focus on pricing differences of syndicated loans associated with banks' securitization activity and, as a result, our paper does not provide evidence on a so-called "level effect". For instance, an increase in securitization activity by banks might induce a decrease in the overall cost of funding for all syndicated loans, or other types of credit.

We investigate this at two levels. We start by examining the pricing behavior of banks in the syndicated loan market by comparing banks active in the securitization market to those who are non-active in this market. This approach has the advantage of examining banks' lending standards by including first-hand information on bank, borrower and loan conditions. This should, in turn, give an indication of banks' changes in risk-taking appetite. In our second step we consider only those banks that are already active as originators in the securitization market and include only those loans that were securitized. This step aims to reduce possible concerns about self-selection across bank or instruments connected to securitization by considering only the variability within those banks that are already active in the securitization market, and within those loans which have been securitized. We select a group of 406 broadly similar European banks – 94 of which were active in the securitization market –, and 10,911 syndicated loan deals for the period ranging from 2000 to 2009.

We contribute to the literature in several dimensions. The coverage and quality of our dataset constitutes significant addition to the literature. Our sample has been obtained directly from the largest trustees operating in the European Union and covers the overwhelming majority of the syndicated loans issued in euro. This is an important advantage as data from previous studies was mostly limited to public deals as reported by publicly available sources. In contrast, we are able to form a more complete picture of the market, which also includes private deals. In addition, the dataset allows us to identify, among all syndicate loan transactions, those that were eventually securitized. Utilizing this dataset gives us the advan-

tage of examining banks' pricing behavior of loans with first-hand information on their lending practices.

The focus on the European Union, the second largest securitization market in the world, is another contribution of our paper as most of the existing evidence is based on the United States. The European Union is a good laboratory to assess the impact of securitization on financial stability. First, the growth of the securitization market in the European Union has been relatively recent and brusque. This allows us to assess more clearly the impact of this recent phenomenon (i.e. securitization) on lending standards. Second, unlike in the United States, where institutions such as Fannie Mae and Freddie Mac have supported the securitization market, government-sponsored institutions have not driven the development of the securitization market in the European Union. Hence our results cannot be ascribed to any individual institutional or regulatory features idiosyncratic to any single country.

Another contribution is our focus on securitization in the corporate loan market, which stands in contrast with the bulk of the previous securitization literature that usually analyzes the mortgage market. Corporate lending decisions are more dependent on idiosyncratic, and often proprietary, information on the credit quality of borrowers. Looking at corporate loans gives more insights to the extent of how securitization might undermine screening and monitoring incentives of lenders, and thereby weaken financial stability, when information asymmetries are larger.

We find that in the run up to the 2007–2009 crisis, banks that were more active at originating asset-backed securities did not price their loans more aggressively (i.e. with narrower loan spreads) than non-active banks. Our results also show that larger banks with relatively smaller securitization-origination programs seem to be somewhat more aggressive in their loan pricing. In addition, we show that, within the set of loans that were securitized, the amount of securitization activity by the originating bank is not related to lower loan spreads. Our results consistently suggest that broad credit cycle conditions seem to be far more correlated with looser credit standards (measured via price aggressiveness) than banks' securitization activity.

We test the robustness of our findings extensively. In particular we try to account for the possible effects of the syndicate structure, lead banks' influence, and borrower opacity on our findings (see Sufi, 2007). We run our models with restricted samples where information asymmetries are mitigated by the use of incidences of *repeated lending*, i.e. limiting our sample to those occasions in which the lender already knows the borrower. We also control for syndicate and lead bank fixed effects. Finally we also conduct our analysis at the syndicate level. Our results remain unchanged.

The remainder of this paper is organized as follows: Section 2 reviews the related literature on the effects of securitization on lending standards and risk-taking behavior. Section 3 describes the data sources, reports the descriptive statistics of our sample and explains the empirical methodology used in the analysis. The results of estimations and robustness checks are presented in Sections 4 and 5, respectively. Section 6 concludes.

2. Background and literature review

2.1. European securitization market developments

Public euro-denominated securitization markets started timidly in the late 1990s and gained momentum upon the introduction of the Euro in 1999 and the integration of the European financial system. The market accelerated strongly and increased in size: From US\$230 billion in 2003 to US\$2 trillion in 2008. Total amounts outstanding peaked at US\$3.1 trillion at the end of 2009 and by 2014 it felt by 39%. During the pre-crisis period, the majority of securiti-

¹ See also DeMarzo (2005), Instefjord (2005), Morrison (2005), Chiesa (2008), Parlour and Plantin (2008) and Shin (2009).

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