Does Credit Securitization Reduce Bank Risk? Evidence from the European CDO Market

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Dennis Haensel (https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=413489)
Goethe University Frankfurt - Department of Finance

Jan Pieter Krahnen (https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=120211)
Goethe University Frankfurt

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Abstract

In this paper we analyze whether the use of credit risk transfer instruments affects the risk taking by large, international banks. Relying on a unique data set of European collateralized debt obligations (CDOs), we find that the issue of CDOs tends to raise the systematic risk (equity beta) of the issuing bank. We also perform a cross-sectional analysis to identify determinants of the change in systematic risk, and find that equity beta rises significantly more if the issuing bank is financially weak (low profitability and high leverage), and if it is domiciled in a bank-based financial system. Overall, our findings suggest that credit securitization goes hand in hand with an increase in the risk appetite of the issuing bank. Our findings are also relevant for understanding the financial stability implications of credit securitizations.

Keywords: risk transfer, systemic risk, event study, bank risk, securitization

JEL Classification: G28, G21

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