

Executive Summary

In the aftermath of the global financial crisis of 2007-09, bank involvement in securitized banking gained considerable attention and is claimed to be one of the main sources of the crisis. Securitized banking is the use of securitized instruments as collateral in repo transactions, which allowed financial institutions to borrow money from each other for very short periods of time. The crisis highlighted the shortcomings of global financial regulation and the failure of banks and regulators to incorporate the risks from securitized banking in capital regulation.

The dissertation assesses the role of international capital regulation – the Basel Accords, in encouraging bank involvement in securitized banking. Emphasis is on the presence of regulatory capital arbitrage, which refers to strategies by which regulated financial institutions evade capital requirements. The dissertation conducts a legal analysis of the Basel Accords to evaluate the underlying incentives and their impact on bank involvement in securitized banking.

The introduction sets the stage for the dissertation and is followed by the first two chapters, which provide a theoretical overview of securitized banking and summarize the current literature in this regard. Chapter 1 focuses on the functioning and motivation behind bank involvement in securitized banking. Chapter 2 highlights the key literature, focusing on the negative externalities from private liquidity creation through securitized banking and elaborates on the shortcomings of the financial regulatory framework visible after the crisis.

These chapters are followed by an analysis of the preceding Basel Accords to evaluate the role of regulation in incentivising bank involvement in securitized banking. Chapter 3 is an analysis of the pre-crisis Basel Accords to identify the presence of regulatory arbitrage and Chapter 4 assesses the effectiveness of the post-crisis Basel Accords in eliminating any arbitrage opportunities. Both chapters find the presence of significant adverse incentives that encouraged banks to engage in securitized banking. The finding regarding capital arbitrage is vital, as this made securitized banking an inexpensive source of funding for banks.

Chapter 5 focuses on the implementation of the Basel Accords in Emerging Economies (EMEs) to determine whether global implementation also transposed the incentives inherent in these Accords, thereby encouraging similar bank behavior. The findings of this chapter illustrate that EMEs, both Basel Committee member and non-member states, were similarly affected by Basel implementation and transposed the adverse incentives inherent in the Basel Accords.

Chapter 6 evaluates the effectiveness of the current Basel regime in eliminating the previous adverse incentives and also assesses whether it continues to incentivise banks to engage in securitized banking. The chapter finds that although the current Basel regime has made significant improvements to overcome the previous weaknesses, the adverse incentives for bank involvement in securitized banking still persist. This chapter also provides policy

implications and recommends higher capital requirements for securitized banking and repo transactions with other innovative collateral to restrict the growth of instruments with complex risks which can lead to instability in financial markets. The dissertation concludes with a summary of the research findings and suggestions for future research.