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Master thesis

Is securitization a useful financial innovation?

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Abstract

The goal of this thesis is to determine whether securitization was a useful financial innovation before the recent financial crisis and whether it is or has become one today, after the crisis. In the context of this analysis, the financial innovation can be classified as useful if it improves financial stability. Therefore, a literature analysis is conducted in order to determine the impact of securitization on the components of the definition of financial stability as defined by Shinasi (2004). The analysis concludes that securitization was not a useful financial innovation before the crisis as the innovation had a negative impact on most components of the definition. The analysis further comes to the conclusion that the main cause for these negative effects was the increase and inefficient allocation of (high) credit risk. Another approach is used for the period after the crisis, because papers analyzing the impact of the innovation on the components of financial stability after that turbulent period are scarce. Again based on a literature analysis, this thesis elaborates whether the changes in the regulatory environment after the crisis have mitigated the inefficiencies in the process of securitization that enabled the increase and inefficient allocation of (high) credit risk. The analysis finds that some inefficiencies are mitigated partly. Based on this finding and due to the limitations of the approach, it is not possible to determine whether securitization is a useful financial innovation today.