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The global credit crisis and securitization in East Asia

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Key points

- Securitization offers a range of benefits for Asia's financial systems and economies as a mechanism to assist funding and investment. As a form of structured finance, reliable and efficient securitization can assist development by enabling financial systems to deepen and strengthen, and thus contribute to overall economic growth and stability.
- At the same time, there are both overt and more subtle risks in certain uses of securitization. The credit and liquidity crisis that began in the United States and spread to other developed financial systems in mid-2007 exposed the dangers associated with securitization in excessive risk-taking or regulatory capital arbitrage, rather than as a tool to assist a more conventional or conservative approach to funding, risk management or investment.
- Securitization has also been criticized for helping increase the opacity of markets for credit, while contributing to a growing emphasis in the global economy of intermediation conducted in capital markets rather than through regulated banks.
- This article suggests that if East Asia begins to make fuller use of securitization, then its motive should be to meet funding or investment needs in the real economy, rather than balance sheet arbitrage of the kind that peaked in 2007.

1. Introduction

This article questions whether the effectiveness and stability of East Asian financial systems can benefit from improved access to securitization as a form of market-based financial intermediation.¹ The practical implication would be a greater reliance on public and private securities markets in capital funding and portfolio investment, to complement traditional bank lending on which both newly industrialized and developing East Asian economies now largely depend. Given the general loss of confidence and liquidity in global credit markets and structured finance that began in mid-2007, this article also examines how credit risk transfer and regulatory incentives to securitization will be re-assessed beyond the changes contemplated by the implementation of recent revisions to the Basel capital accord.

To date, the overall development of securitization in the region is modest compared with Europe or North America, despite the fact that many national authorities have encouraged its use since the 1997–1998 Asian financial crisis. This prompts the question

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¹ Unless stated, for the purpose of this article East Asia comprises China, Hong Kong, Indonesia, Japan, Malaysia, Philippines, Singapore, South Korea, Thailand and Vietnam. For more detailed discussion, see P. Lejot, D. Arner and L. Schou-Zibell, 'Securitisation in East Asia' (2008) Asian Development Bank Working Paper Series on Regional Economic Integration No. 12.

whether this aspect of financial development lags other regions as a function of time, as a matter of national institutional conditions or as the result of certain economic conditions—such as national savings and investment imbalances or relatively high banking sector liquidity. If effective securitization can support financial sector development and efficiency, which contribute to economic objectives such as growth and financial stability,² then it may be valuable both commercially and socially to promote its use.

However, it must be recognized that there are both overt and more subtle risks in certain uses of securitization. The global credit and liquidity crisis that began in the United States and spread to other developed financial systems in mid-2007 exposed the danger associated with securitization in excessive risk-taking or regulatory capital arbitrage, rather than as a tool to assist a more conventional or conservative approach to funding, risk management or investment. Securitization has also been criticized for rendering financial markets opaque, while contributing to a growing emphasis in the global economy on credit intermediation conducted in capital markets rather than through banks.

To the extent that securitized transactions or programmes exist in East Asia, have they developed to their fullest potential? Do special advantages exist to increasing structured finance resources in the region, especially if non-commercial interests such as state or transnational organizations are involved in their development? For example, could structured finance techniques provide new sources of funding for infrastructure capital as in parts of Europe, or as specialist long-term lenders that became important in prior phases of growth in Japan and South Korea? Last, have institutional changes to facilitate or stimulate securitization had any impact on post-crisis risk aversion for Asian investors?

Section 2 assesses the development of securitization in Asia, including the legal and regulatory issues peculiar to the region. Section 3 examines the relationship between transaction use and national and global standards in capital regulation, especially under the Basel capital accords. Section 4 considers the context of recent global developments, and looks to possible reforms in global markets emerging in the wake of the 2007 global credit crisis. Section 5 closes by examining the future scope for structured finance, given current levels of activity in Asia, and the implications of post-2007 global developments for the future of securitization. Is it time to reconsider the economic and systemic results of securitization, rather than its prolific use since the early 1990s in transactional regulatory arbitrage by financial intermediaries?³

² Financial stability is taken, in one sense, as the avoidance or mitigation of financial crises, and in another as the effective functioning of the financial system. See D. Arner, *Financial Stability, Economic Growth and the Role of Law* (Cambridge University Press, Cambridge 2007).

³ This article takes no direct account of the inclination of East Asian intermediaries or sources of portfolio investment to acquire or trade in non-Asian securitized risks. Such capital flows from East Asian sources have often been considerable since 2000.