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“Securitization, Signalling, and Interbank Competition”

Abstract

We study the effects of securitization on interbank lending competition when banks see private signals of local borrowers' repayment chances. If banks cannot securitize, the outcome is efficient: they lend to their most creditworthy local applicants. With securitization, lending grows and banks lend also to remote applicants with strong observables in order to lessen the lemons problem they face in selling their securities. This reliance on observables is inefficient, raises the mean default risk, and may lead to a deceptive rise in credit scores.

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