Arbitraging the Basel Securitization Framework: Evidence from German ABS Investment*

Matthias Efing
Swiss Finance Institute & University of Geneva

January 28, 2015

Abstract

I use data about bond holdings of banks domiciled in Germany to identify regulatory arbitrage under the Basel Securitization Framework. Within a group of asset-backed securities (ABS) with the same Basel II risk weight, banks buy the ABS with the highest yields, the worst collateral, and the most inflated credit ratings. The effect is more pronounced for banks operating with capital adequacy ratios close to the regulatory minimum requirement and for large banks. The evidence suggests that regulatory arbitrage considerations influence investment decisions and that ratings inflation reinforces regulatory arbitrage as Basel II risk weights depend mechanically on credit ratings.

Keywords: Regulatory arbitrage, asset-backed securities, risk-taking, ratings inflation

JEL classification: G01, G21, G24, G28.

*Contact address: University of Geneva, Uni Pignon, 40 Boulevard du Pont d’Arve, CH - 1211 Geneva 4, Switzerland. Phone: (++41)22 379 82 06. E-Mail: matthias.efing@unige.ch. I thank an anonymous referee, Tony Berrada, Ines Chaieb, Harald Hau, and Philip Valta for helpful comments. I am grateful to Markus Baltzer, Peter Raupach, and Simone Schultz from the Deutsche Bundesbank for providing me with the necessary data. Discussion Papers represent the authors’ personal opinions and do not necessarily reflect the views of the Deutsche Bundesbank or its staff.