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Háskóli Íslands

Credit risk transfer and its implications for financial stability

“In the aftermath of the subprime crisis it is interesting to look at how a small part of the U.S. mortgage market can cause a global turmoil in the financial markets. It gives reasons to question whether the credit risk transfer (CRT) markets have a positive impact on financial stability. This thesis analyzes the fundamental functions of the CRT markets and how they affect financial stability. Three important elements are studied. Firstly, how the asymmetric information problem is affected when lenders can sell off their credit risk. Secondly, how a shock in a small part of the U.S. mortgage market may be amplified within the CRT markets and result in a collapse of certain market segments, such as the structured product market. Thirdly, how a problem in these market segments can be transmitted to wholesale funding markets and impact the financial sector globally.

In conclusion, to minimize the destabilizing effect that the CRT markets may have on the financial system it is important to minimize the asymmetric information problem, minimize the vulnerability of financial institutions towards the markets and finally reduce the dependence of banks on CRT markets as a channel for wholesale funding.”

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