# Financial intermediation and the post-crisis financial system

## Discussant comments by José Viñals[1]

## Taxonomy of Views on Securitization

Let me begin by laying out a taxonomy of views on securitization, because I think it helps to place Professor Shin's paper in context. The first view of securitization, which I would characterize as the "benign" view, was predominant among policymakers prior to the current crisis. Many policymakers were praising the "originate-to-distribute" lending model as a financial system stabilizer. In theory, through securitization markets, it was supposed to smooth credit allocation and disperse credit risk to a broader and more diverse group of investors, rather than concentrating it on bank balance sheets. It was supposed to make the banking and overall financial system more resilient. Mass bank failures would be a thing of the past, and credit cycles would be smoother.

However, the crisis has shown that banks themselves became among the biggest holders of these risks. In some cases, they retained what they thought were the least risky slices – the senior instruments based on the performance of highly-diversified loan pools. These were supposed to be vulnerable only to most improbable economic catastrophes. In other cases, they bought economic "catastrophe" instruments originated by other banks. These purchases were largely based on what has turned out to be a number of faulty assumptions, which I will get to in a minute.

At the same time, this new model facilitated the funding of long-term claims with short-term liabilities, such as ABCP through SIVs. Tranquil market conditions and low interest rates made it seem easy and safe for financial institutions to lever up using short-term funding. Of course, there is nothing new about banks funding long-term assets with short-term liabilities – banks have been doing it for centuries. The difference this time around was the dependence on wholesale lending, which is far less dependable than traditional retail deposits.

As a result of all this, instead of dispersing risk, the originate-to-distribute model concentrated risk in the financial sector, and increased the potential for disruptions to spread swiftly across markets and borders. As Andy Haldane from the Bank of England pointed out in a recent paper, these connected networks "exhibit a knife-edge, or tipping point, property." Up to a point they serve as a "shock absorber" but beyond that point they can become "shock amplifiers", as we now know all too well! This is the second view of securitization, and what Shin characterizes as the "hot potato" view of securitization.

Professor Shin's paper provides a third characterization of the process of securitization. It characterizes the originate-to-distribute model as a lengthening of intermediation chains that has increased complexity across the financial system. As a result of this chain lengthening, financial market disruptions were able to spread swiftly across markets and national borders, and in a highly procyclical way. Also, bank balance sheets became more vulnerable to market shutdowns. Indeed, we are witnessing the first "post-securitization" crisis. Professor

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