Discussion of: Securitization and Distressed Debt Renegotiation

Evidence from the Subprime Mortgage Crisis

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I am speaking today as a researcher and a concerned citizen and not as a representative of the FRB Boston or the Federal Reserve System. But I think on this particular topic most staff would agree with me.

Overview

- Authors claim to find evidence that securitization inhibits loan renegotiation.
- We argued in Adelino, Gerardi and Willen (2009) that securitization was not a major factor preventing renegotiation.
- Three problems I have with their paper:
  1. Identification.
  2. Identification.
  3. Identification.

Different measures of renegotiation

- Headline results of the paper rest on two assumptions:
- 1. assignment to a "private label" deal is random and
- 2. [No Foreclosure] $\Leftrightarrow$ [Renegotiation]
- From *American Banker*, August 25, 2009:

Darrell Duffie, a finance professor at Stanford University's Graduate School of Business, said accounting rules give banks plenty of leeway to determine when to take losses.

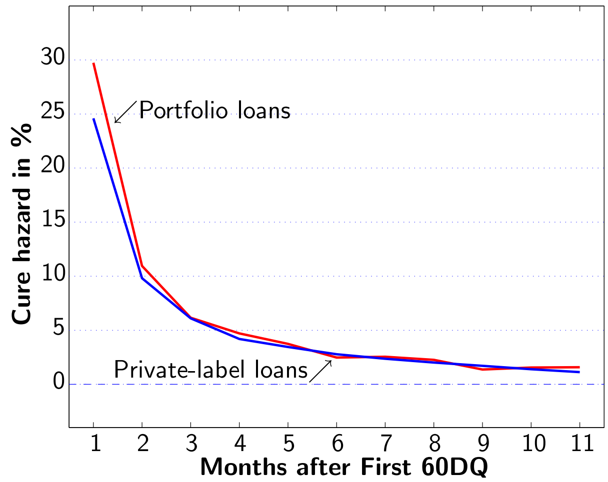
"Banks are believed to be carrying a lot of loans at accounting levels well above their true market value," he said. "But once a property goes into foreclosure, their options have disappeared."

Different results

- AGW propose: Identification: [Renegotiation] $\Rightarrow$ [Cure]
  - Direct evidence that the lender is helping the borrower.
  - Accounting issues may lead lender to delay foreclosure.
  - But not to help the borrower.
- Duffie issue is irrelevant to the cure definition.

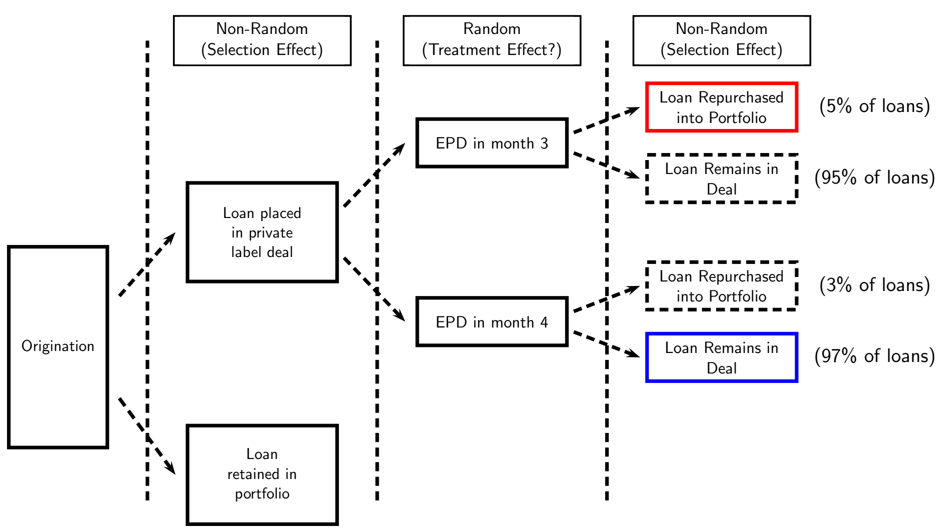
	All Loans	>680 FICO
Foreclosure Method (PSV)	18% to 32%%	14% to 50%
Cure Method (AGW sample)	10%	17%
Cure Method (PSV sample)	2.4%	7.6%

Understanding the cures



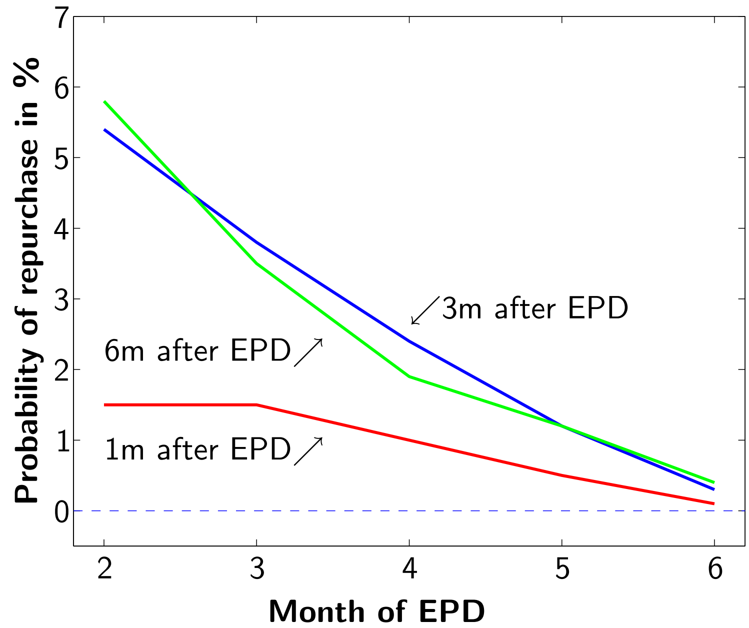
- Most of the cures are "self-cures"
  1. 85% of cures occur in first two months.
  2. Almost certainly self-cures
  3. Unobserved heterogeneity.

Using EPDs as an "experiment"



- Initial selection into private label or portfolio is non-random
- Timing of EPD *is* plausibly random
- Key: rules differ depending on when EPD occurs

Where's the "regression discontinuity"?



Subsamples

- Effect of securitization is larger for high FICO borrowers.
- Authors say it reflects greater willingness to renegotiate with higher FICO borrowers.
- We think it reflects higher unobserved heterogeneity for higher FICO scores

	All Loans	FICO>680			Fully	Subprime
		All	Conforming	Jumbo	Documented	
Hazard Ratio	0.90	0.83	0.81	0.88	0.97	1.06
z-stat	-7.08	-6.04	-5.68	-2.31	-1.36	2.14

- Question: Why are high FICO borrowers in "private-label" pools? Why didn't they get GSE loans?
  - Below the conforming loan limit: Problems borrowers.
  - Above the conforming loan limit: all borrowers.

The slide you've all been waiting for...

- The end.