

Bank Risk-Taking and the Real Economy: Evidence from the Housing Boom and its Aftermath

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Discussion: Daniel Greenwald (MIT Sloan)

SFS Cavalcade

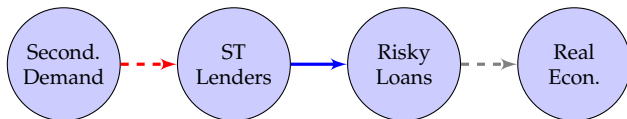
May, 2018

Overview

- ▶ **Main question:** what are the real costs of lender short-termism (ST) on the aggregate economy?
 - Focus on publicly vs. privately owned lenders in the housing boom.
 - Also zero in on public lenders with signs of high ST behavior.
- ▶ **Challenge:** equilibrium lending behavior due to demand or supply?
 - This paper's approach: compare public (ST) to private (non-ST) lenders **within the same county**.
- ▶ **Within-County Results:** Public (ST) lenders: (i) originate more; (ii) deny less; (iii) issue more risky loans; (iv) have more loans go delinquent.
- ▶ **Aggregate Results:** 2002 exposure to public (ST) lenders led to worse house prices crashes and real outcomes in the bust.

My Take

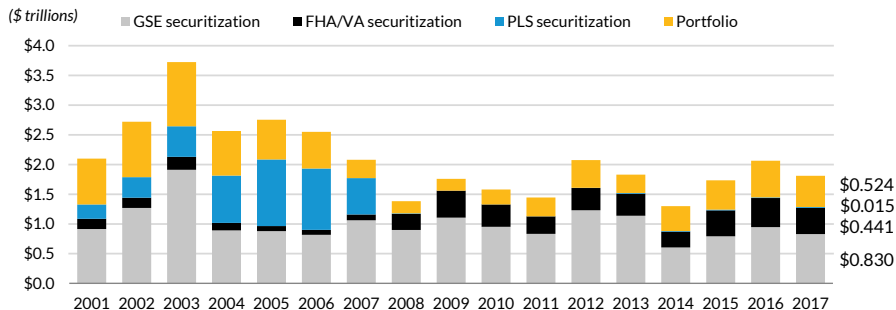
- ▶ Well-executed paper using high-powered empirics and sophisticated data construction.
- ▶ Very convincing result that public ownership and ST indicators were associated with more lending growth and riskier lending.
- ▶ Broader question of whether short-termism was responsible for real effects of bust less clear.
 1. Major changes in secondary market demand over this period.
 2. Most lending securitized, why does short-termism matter?
 3. Pre-exposure to ST lenders not as clean as within-county variation.



Background: Mortgage Finance in the Boom

Fundamental Change #1: Huge increase in “private-label” securitization.

- ▶ Large alternative source of secondary market demand.
- ▶ Tapped markets (jumbos, risky loans) that Fannie/Freddie were (initially) unwilling to enter.

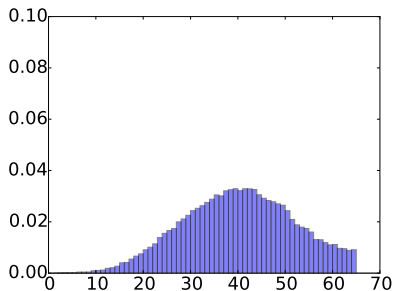


Sources: Inside Mortgage Finance and Urban Institute. Last updated March 2018.

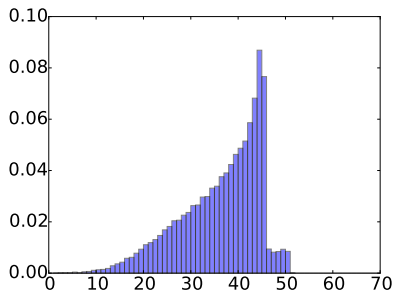
Background: Mortgage Finance in the Boom

Fundamental Change #2: Relaxation of credit standards.

- ▶ Key changes income-based (PTI limits, “low doc,” IO loans, etc.).
- ▶ Even “vanilla” Fannie/Freddie loans massively relax standards.
 - Picture: payment-to-income ratios on Fannie Mae cash-out refis.



(a) PTI Histogram: 2006 Q1



(b) PTI Histogram: 2014 Q3

Comment #1: Credit Demand

- ▶ Securitization environment is relevant for this paper's findings.
- ▶ Huge changes to secondary market **demand** for loans (esp. **risky** loans), that appear **unrelated to lender corporate structure**.
- ▶ Alternative hypothesis: publicly owned/ST lenders had **comparative advantage** in satisfying this demand.
 - But many of these loans might have been made anyway.
- ▶ Wouldn't invalidate the results, but may change the interpretation.
- ▶ Policy: reining in public firms may not be as helpful as we might think.
 - Instead, need to influence final securitizer credit standards and behavior.

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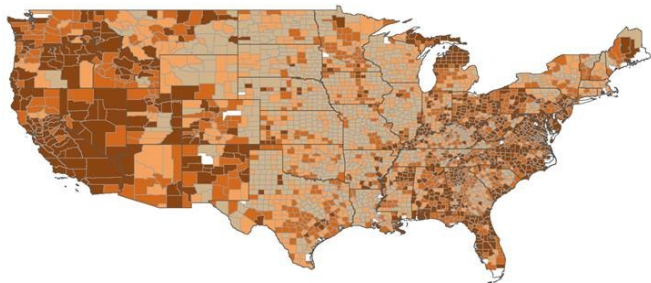
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Comment #2: Causal Mechanism

- ▶ Deeper issue: causal mechanism from short-termism to risky lending not clear under securitization.
- ▶ Originator passes on risk, not direct “gambling” channel.
- ▶ Alternative channel for short-termism?
 - Going for “quick buck” of securitization vs. longer-term investments (e.g., relationship lending)?
 - Willingness to “burn bridges” with securitizers?
- ▶ Matched sample results are nice evidence that corporate structure matters, but would be good to have a clear mechanism in mind.
- ▶ Aside: short-termism of **securitizers** may be first order!

Comment #3: Aggregate Effects

- ▶ Counties with larger initial exposure to public lenders have larger drops over the bust in: (i) house prices (26%), (ii) employment (5%), (iii) durable consumption (21%), (iv) retail sales (5%).
- ▶ Issue: public lender exposure seems pretty geographically correlated.
- ▶ Authors include good controls, but could have spurious correlation with geographically correlated house price beliefs.



Suggestions

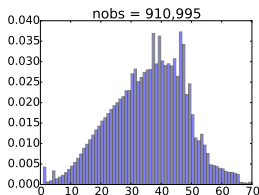
- ▶ To deal with securitization issues, focus more on portfolio loans.
 - Controlling for securitization in delinquency regression is a great start, but seems like it should be interacted with lender.
 - Unreported results: origination coefficients robust to controlling for county securitization propensity.
 - May still need to argue that this was quantitatively important.
- ▶ Strengthen causal channel.
 - Check whether short-termism actually disproportionately hurt lenders through their originations.
- ▶ For aggregates, ideal experiment would be to swap some branches from one ownership structure to another.
 - Would bank merger instrument (Williams 2018, Liebersohn 2017) work?

Conclusions

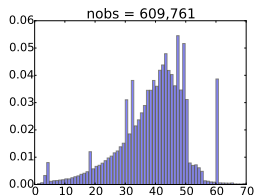
- ▶ Very nice paper.
- ▶ Argument that public lenders were disproportionately behind risky lending seems airtight.
- ▶ Keep pushing on causal channel and aggregate effects.

APPENDIX

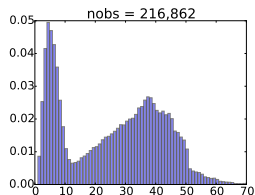
2006 Credit Standards: McDash Data



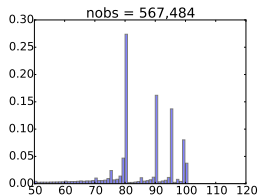
(a) PTI: GSE



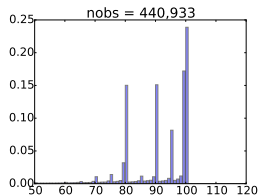
(b) PTI: PLS



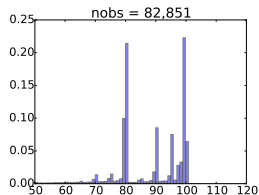
(c) PTI: Port.



(d) LTV: GSE



(e) LTV: PLS



(f) LTV: Port.