# Issues in Securitization

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# Common Theme

- Securitization
  - Originate and distribute
- Around in different forms for a long time
  - Credit Cards, Auto, Freddie/Fannie in mortgages
  - Stable structures
- 2000s different: Growth and underperformance
  - Residential Mortgages
  - This session
    - Commercial Real Estate
    - Corporate Loans

# Common Theme

- Is there is an effect on performance?
  – Yes
  – Bord and Santos

- What changed?
  – “Incentives”
  – Bord and Santos, Black et al., Furfine

- Why was there a change?
  – Furfine

# Bord and Santos

- Compare performance of securitized and non-securitized loans
  - Securitized loans underperform
  - Similar to residential mortgages: Agarwal et al. (2010), Keys et al. (2010)…
- Heterogeneity
  - Skin in the game seems to matter
  - Concentrated in boom period: Keys et al. (2011)
- Pricing
  - Priced “differently” (perhaps mispricing by investors)

# Bord and Santos: Questions

- Heterogeneity across participants?
  - Monitoring incentives vary (e.g., hedge funds)

- Decision to securitize exogenous?
  - Hard to interpret
    - Selection on unobservables:  Adverse selection/cherry picking etc.
    - Time to securitize affects which loans end up on books: Keys et al.

- Is this really mispricing?
  - Risk aversion heterogeneity/ LGD/Mapping (model)?

- Why did this change over time?
  - Different clienteles?, Cost of capital went down?...

# Black, Chu, Cohen and Nichols

- Performance of securitized loans varies depending on "organizational form" of issuer
  - Conduits (worst), Commercial banks (best)
- Heterogeneity
  - Skin in the game matters
    - Internal funds
    - Warehousing risk
    - Do both "originate and hold" and "originate and sell"
  - Similar to several papers in residential mortgage literature (e.g., Agarwal et al. (2011))

# Black, Chu, Cohen and Nichols: Questions

- What is the ex-ante prediction?
  - Fragility of capital structure could discipline: Diamond and Rajan, Calomiris and Kahn
  - Diversified/large business could make one more lax
    - In a narrow range of very comparable loans banks underperformed independent sellers: Keys et al.

- What could be the differences?
  - Screening technology?
  - Cost of capital?
  - Time to securitize?
  - Investors?

# Furfine

- “Complex” deals consist of worse loans
  - Large pools, Fusion pools, # of tranches and Rating disagreements
- Skin in the game matters
  - Aligned interests matter
- Complexity effect accentuates over time
- Some evidence of mispricing

# Furfine: Questions

- What causes what?
  - More complexity => risky collateral Or Risky collateral =>“complexity”? (Amromin et al, Barlevy and Fisher)
  - More tranches in complex deals: Demarzo
    - Assuming complex deals have more asymmetric information
    - Lower cost of capital over time => riskier loans
- Is this really mispricing?
  - Risk aversion heterogeneity/LGD/Mapping (model)?
  - Actual versus model generated investor yields?
- Why did this change over time?
  - Different clienteles?, Cost of capital went down?...

# Going Forward

- What can be generalized? Can we learn from other securitization markets/history?
  - If it works in one market doesn't mean always works
  - Incentive provision varies dramatically across markets
    - GSE (exclusion threat) vs. Credit Cards (reps and warranties)
  - Direct incentives/Reputation/Disclosure/Market structure/Internal governance/Capital structure fragility?

- What should and should not be securitized?
  - Is this innovation efficient for all assets? (hard vs. soft)

# Going Forward

- What are "benefits" and "costs" of securitization?
  - Value added by banks in screening and monitoring?
    - For what sorts of assets?
    - How much "ease of securitization" leads to change in behavior of agents?
  - What is the right security design?
    - What are investors after?

- Beyond mispricing…a bigger question: why did regulators/rating agencies not pick this?
  - What information do they see? When do they see it? What do they do with it? Lucas critique?
  - Regulatory distortions have real outcomes