

Discussion of:  
**“Did Securitization Lead to Lax  
Screening? Evidence from Subprime  
Loans”**

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IMF / World Bank Risk Management  
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# Summary

- Main thesis: Securitization reduces lenders' incentives to screen mortgage applicants.
  - One of “seven deadly frictions” involving brokers, lenders, underwriters, ratings agencies, trustees, servicers, investors etc. (e.g. Ashcraft and Schuermann, 2008)

## General comments:

- Very interesting, carefully-done paper on an important economic and policy question.
- Takes identification seriously.

# Thought experiment

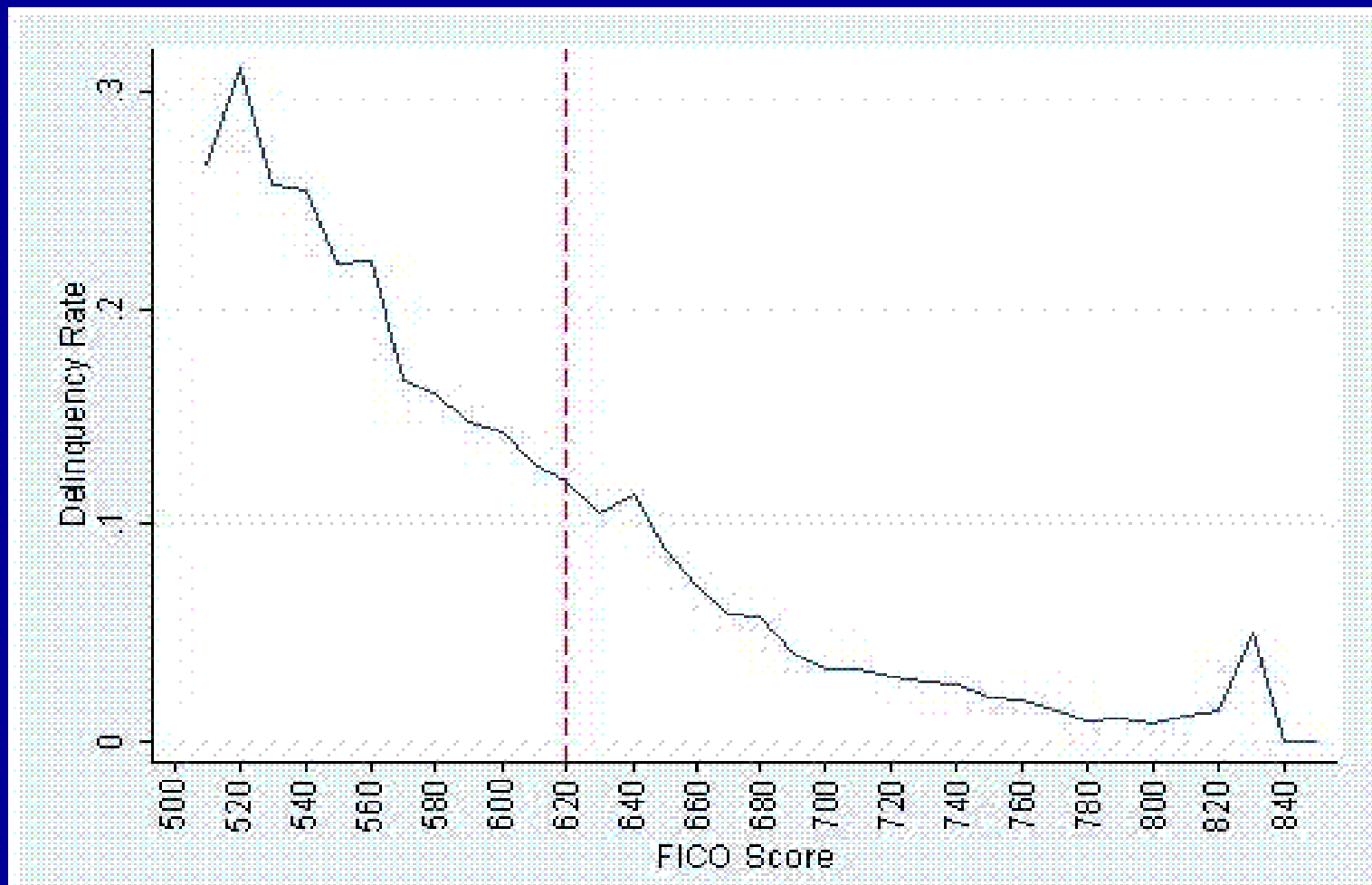
- Two potential borrowers approach a lender or broker. FICO scores close on either side of 620.
- Then, examine how outcomes differ. For applicant with FICO just below 620:
  - More likely application will be denied?
  - Borrower may get a smaller loan, or higher rate?
  - Less likely loan securitized via non-agency market?
  - Less default ex-post, either because bad borrowers are screened out ex-ante (less adverse selection) or because lender holds loan and services it more effectively (less moral hazard)?

# Thought experiment vs data

- Ideal: data to compare performance of large random samples of *all* borrowers with FICO just above and below 620.
- Limitation of LP data: Only observe loans that have been securitized into non-agency market.
  - Amongst loans with FICO < 620 (source: McDash):
    - 55% sold into non-agency secondary market
    - 8% retained on balance sheet by originator
    - 37% financed by GSEs, FHLB system, local housing agencies
  - Choice of loans to securitize, method of securitization not random (e.g. Ambrose et al., 2005). Selection bias?

# FICO and delinquency: McDash data

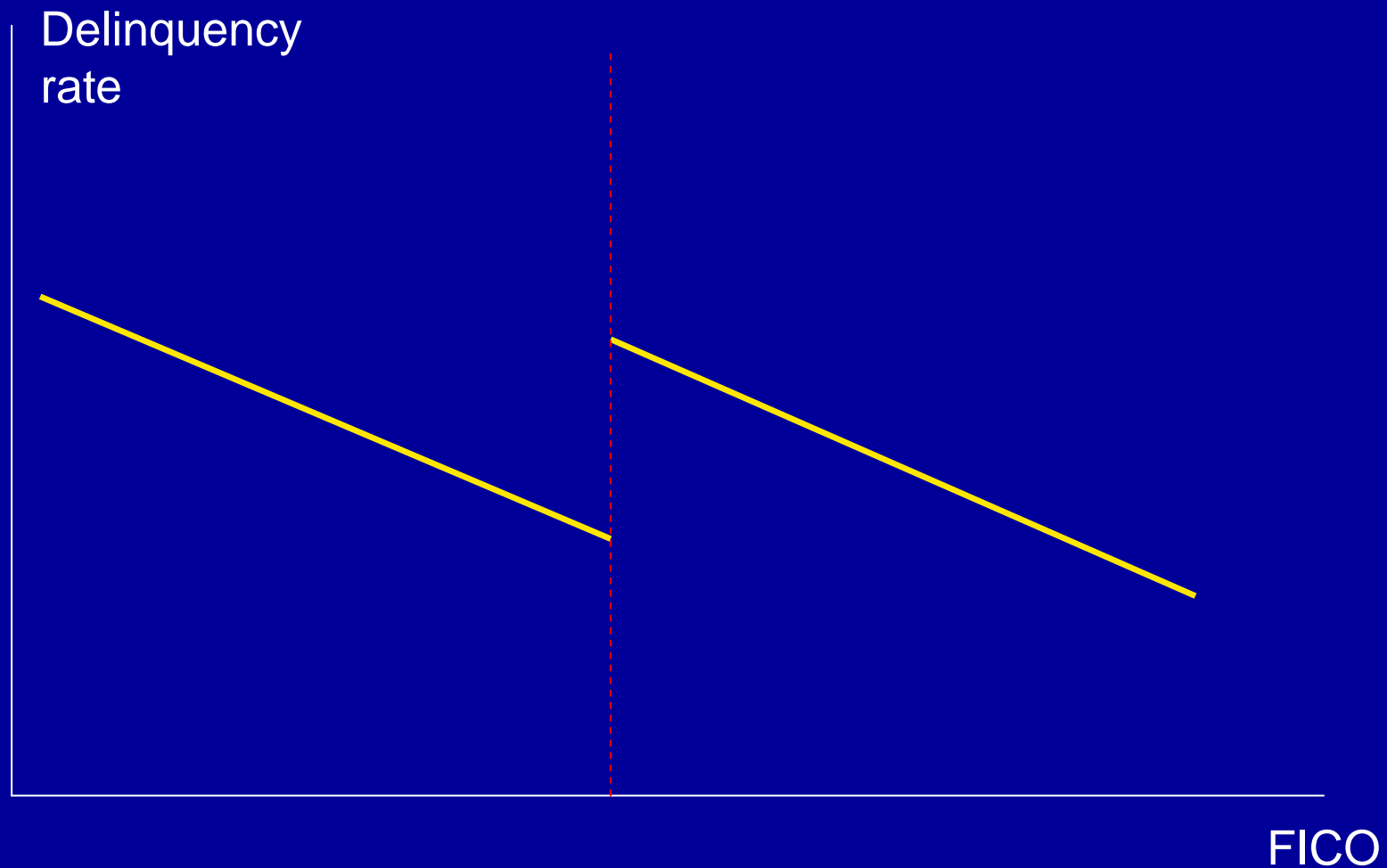
Replicate analysis using dataset that also includes loans in these other categories.



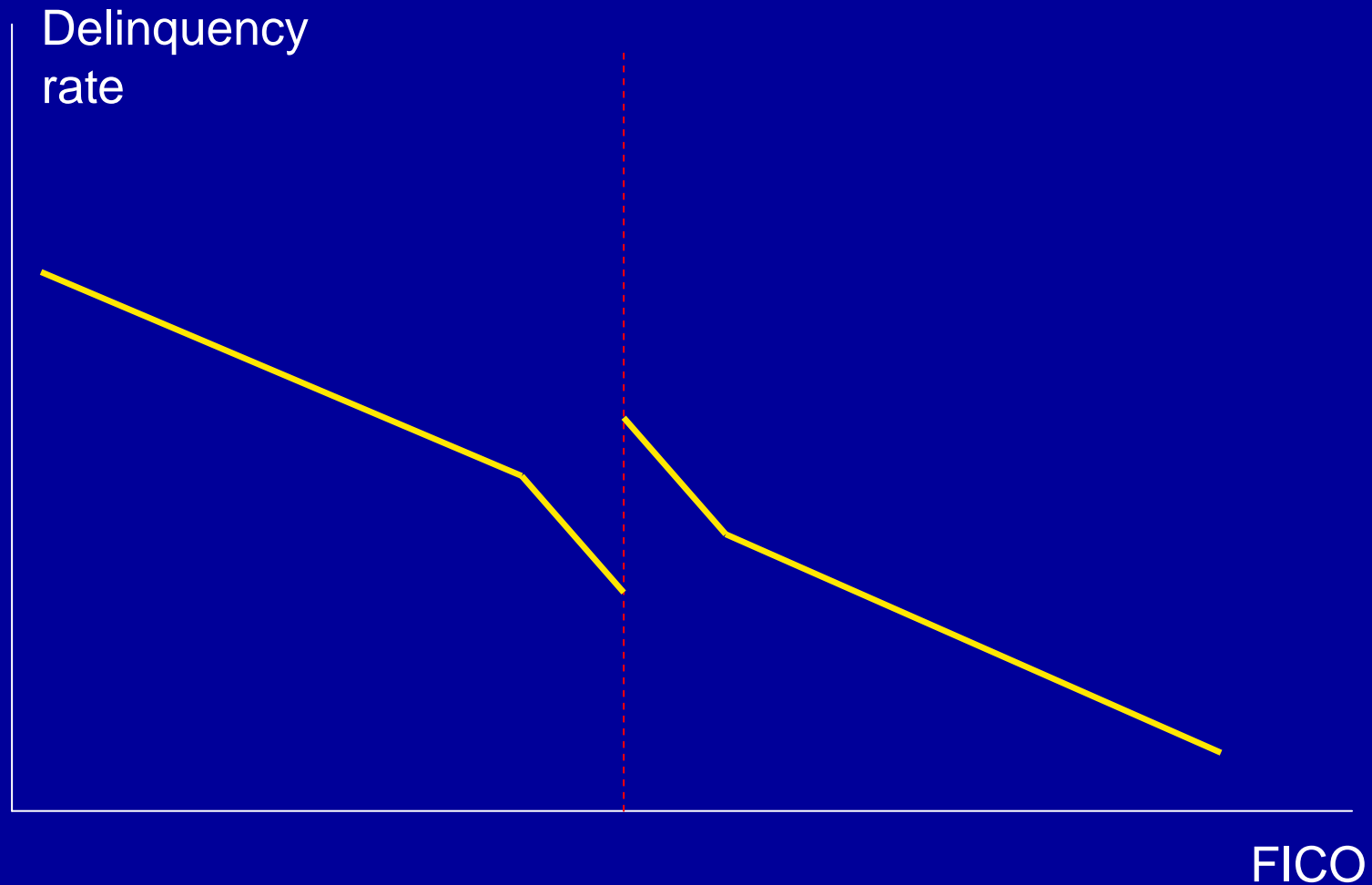
# Is FICO exogenous?

- Paper treats FICO scores as fixed.
  - Cites claims from Fair Isaac that scores cannot be easily manipulated within a 3-6 month timeframe.
- However, other evidence suggests FICO scores can be manipulated over short periods.
  - “Credit renting” industry: impaired borrower pays fee to list as user on credit card of person with high FICO.
  - Some reports: Borrowers can increase FICO score by 100+ points in a month (e.g. Washington Post, 2007).
  - 2008: Fair Isaac changed methodology to combat credit renting, other manipulations.

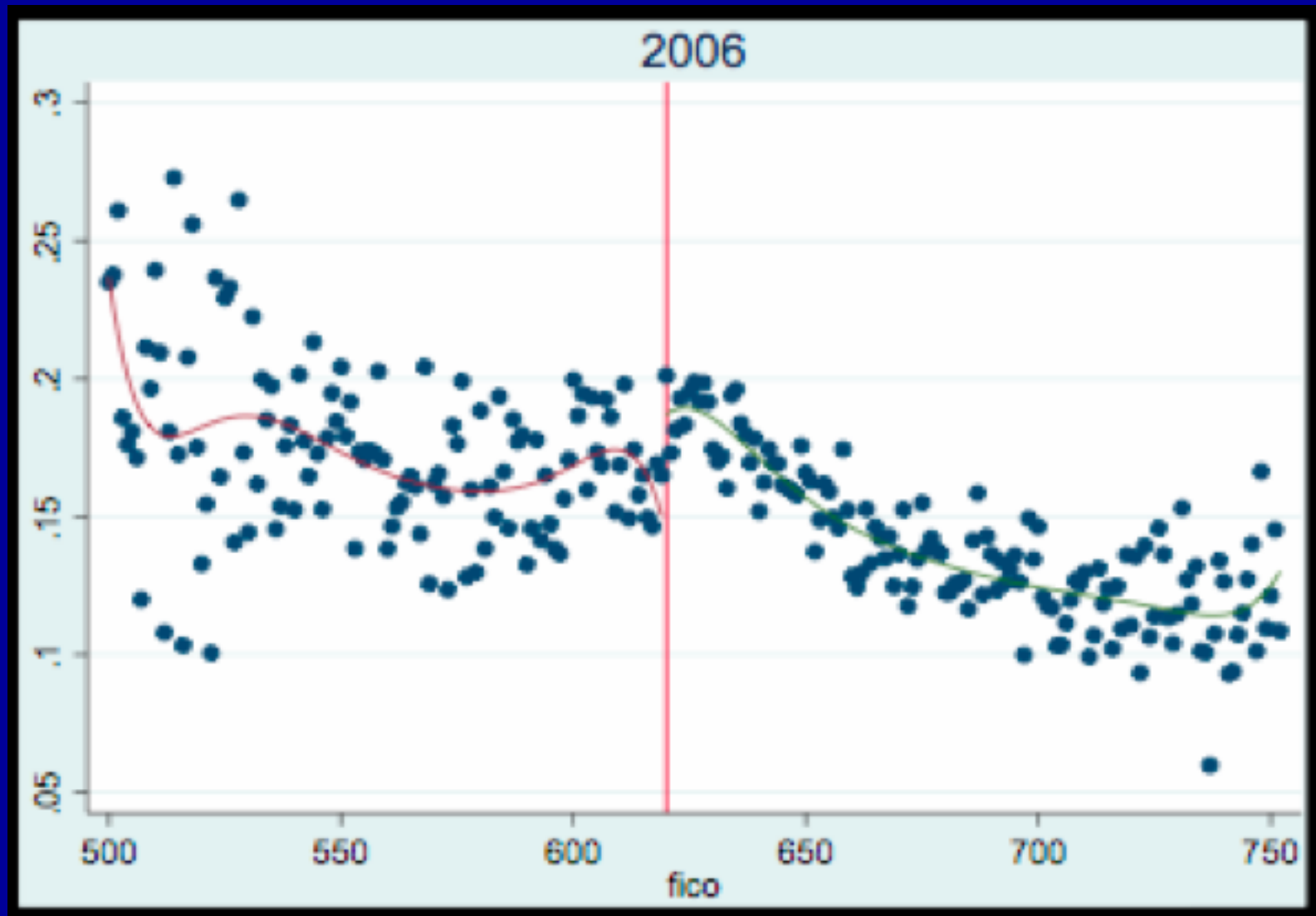
# Expected effect if securitization reduces screening



# Expected effect if borrowers manipulate FICO



# Observed effect in the LP data



# Final comments

- Even if securitization weakens screening, doesn't necessarily follow that it is suboptimal.
  - Tradeoff between informational frictions vs risk-sharing, access to capital markets. This tradeoff exists in many contexts (e.g. bank vs market finance).
  - Not criticism of paper, but more research needed!
- Summing up:
  - Very interesting paper, made me think a lot!!!
  - Looking forward to more research in this area.