Discussion of
"Bank Risk Taking and the Real Economy: Evidence from the Housing Boom and its Aftermath"

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Big Picture I

Two Views of the Housing Boom: Supply vs Demand

- Supply view:
  - Financial intermediaries relaxed lending to (riskier) households. (Mian-Sufi 2009)
  - Increased **credit** supply **induced boom-bust** cycle. (Favara-Imbs 2015, DK 2016)

- Demand view:
  - Expectations of future house prices is at the core.
  - All kind of households like to consume from the future value of their home and therefore all kind of households increase their leverage. (Adelino-Schoar-Severino 2015)

- These views are not mutually exclusive. (to me they are complementary, remember Ben-Hur –Judah and Messala)
  - Increase in lending to riskier borrowers may trigger the process, then house prices increase, then backward looking expectations can result in higher expectation for future house prices.
  - Increase in house price expectations reduce cost of default, increase credit supply to risky borrowers,…

Big Picture II

- Within the supply view an important question is what caused the change in credit supply (other than change in expectations)

- Previous answers of the literature:
  - Securitization and **skin in the game** (Keys-Mukherjee-Seru-Vig 2010, Purnanandam 2010, Begley-Purnanandam 2015, AGK 2016)
  - Regulation (Anti-predatory laws, CRA regulation, Capital arbitrage,..)

- This paper: Ownership structure of the lenders and in particular *Short termism.*

- My discussion focuses of whether this paper helps us distinguish between Supply vs Demand view and then whether this is a new channel or not.

Main Findings of the Paper

- Mortgage origination of public banks grew 8 to 15 percent more than mortgage origination of private banks.
  - They also rejected less loans and originated more "low doc" loans.

- Mortgages originated by public banks ex-post defaulted more.

- Within public banks the ones with more emphasis on short-term profits originated more mortgages

- Regions that were more exposed to public banks experienced a larger decline during the recession.

Comment 1: Supply vs. Demand

- Is this a pure supply-side story?

- Let assume the initial boom was an increase in expectation about future house prices growth.

- This increases demand for mortgages. (*Demand shifter*)

- This also makes lending more profitable. (*Supply shifter*)

- And it becomes even more profitable for the banks who are diversified and have better access to capital market (and therefore can raise more capital more quickly). (*Differential supply curve elasticities*)

- Any estimated coefficient is a combined effect of shift in demand and supply.
  - In other words if there was no change in the demand for loans the estimated coefficients would have been different.

Comment 2: Public vs Private or OTD?

- The main innovation of this paper is to show evidence on the importance of ownership on risk taking.

- Therefore it is very important to disentangle from the securitization and skin-in-the-game story.

- Many of the top RMBS issuers were Public Financial Institutions.
  - But there were private securitizers as well.

- Ideally we would like to control for private securitization activity.
  - Of course RMBS origination itself can be driven by ownership-structure.

- A suggestion for example is to match financial institutions based on their private RMBS issuance as of 2002.

- Would be also good to match institutions based on fraction of mortgages sold to non-GSEs as of 2002.

Comment 2.5: Public vs. Private or Regulation?

- National banks were subject to different regulations than local banks. In particular the APL preemption that happened in 2004 only applies to national banks.

- Almost all public banks are national. Almost all local banks are private.

- Would be great to show that within national banks public banks lending grow more than private banks.
  - I am sure it is the case. They also show aggregate result is robust to controlling for share of national banks.

- The general comment is that I am personally more in favor of making a sample of public and private banks that in terms of size, exposure to securitization, exposure to regulation are similar to each other and do all the analysis on that base sample.

Comment 3:
Agency Problem vs. Shor-termism

- The authors are very creative in making a measure of short-termism of financial institutions based on a textual analysis.

- Why not using the cross-section result among public banks to put a number on how much of the variation between public vs private comes from short-termism?

- Here is an example of calculation I did for myself:
  - 20% of public lenders are classified as short-term public lenders.
  - If we assume the other 80% have the same horizon as private banks
  - And combine Table 2 with Table 5, then: 0.126*0.20/0.088 ~ 30%

- What about using the cross-section in concentration of ownership? Or the share of activist investors?

Comment 4: Exploit Cross-Section of Mortgages

- As of now the only measure of risky mortgages is mortgages with missing income information in HMDA.

  - It seems that this is less than 5% of the sample.
  - I am also not sure what is the main reason for missing income. b/c HMDA income can be based on absolutely no documentation (back to Ben-Hur).

- Would be better to use LPS-HMDA merge or LP-HMDA merge and show result for a broader set or risky mortgages.

- More result on the cross-section of mortgages (specially in a DD framework –i.e. whether public banks originated relatively more riskier loans) will make the paper even stronger.

Other Comments

- Put more regional controls for the aggregate result. (For example share of mortgages privately securitized, share of subprime households, …)

- Regressions are weighted by population of the county. But it also has to be weighted by the importance of lender. One possibility is loan amounts of the lender in the base year in that county as weights? Weight regressions with mortgage originations as of a base year.

- Show rejection rate result for different subsample of borrowers.
  - Borrowers with high DTI vs Low DTI
  - Areas with high vs low share of subprime borrowers.

- Do some aggregation and show how many percent of the aggregate boom in lending can be explained by short-termism.

- Compare performance of national lenders with independent mortgage companies and other lenders who are not a bank.

Policy implication

- Result of this paper + Result of papers on Skin-in-the-game: the most toxic combination is lenders without skin-in-the-game going public.
- WATCH OUT!

This is a snapshot of the top 10 lenders in 2011 and in 2016. Overall, the top three big banks (JPMorgan Chase, Bank of America and Wells Fargo) went from providing nearly 50 percent of all new loans in 2011 to about 21 percent of all new loans in 2016. Also in 2016, six of the top 10 lenders were non-banks. The share of non-bank loans among the top 10 lenders went from 10.9 percent in 2011 to 17.11 percent in 2016.

2011 market share		2016 market share	
Wells Fargo	24.20%	Wells Fargo	12.55%
Bank of America	10.58%	JPMorgan Chase	5.95%
JPMorgan Chase	9.95%	Quicken Loans	4.90%
U.S. Bank Home Mortgage	4.38%	U.S. Bank Home Mortgage	4.12%
Citigroup	4.29%	Bank of America	4.07%
Ally-GMAC	3.81%	PennyMac Financial Services	3.37%
PHH Mortgage	3.51%	Freedom Mortgage	2.90%
Quicken Loans	2.03%	PHH Mortgage	2.01%
Flagstar Bancorp	1.80%	Caliber Home Loans	2.00%
MetLife	1.60%	loanDepot	1.89%

Source: Mortgage Daily

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