

Information Asymmetry in Private-Label Mortgage Securitization: Evidence from Allocations to Affiliated Funds

By: Ambrose, Diop, D'Lima, and Thibodeau

Discussion by: Rohan Ganduri
Emory University

Main Results From The Paper

- Loans in deals placed with affiliated investors have *lower* prepayment rates and *higher* default rates (both ex-ante and ex-post).
- Evidence is consistent with the “*dumping*” hypothesis as opposed to “*preferential treatment*” hypothesis.
- Results are stronger for fully integrated affiliated status (link between loan originator, deal underwriter and investor).
- Study concludes that MBS issuers and underwriters might have taken advantage of their strategic position when placing securities to investors.

Comments On The Paper

- Dumping hypothesis vs Preferential treatment hypothesis
- Observed vs Unobserved quality of loans
- Comments on empirics

Dumping vs Preferential Treatment Hypothesis

- Dumping (negative connotation) vs Preferential Treatment (positive connotation)
- Along with loan and deal performance, it is important to consider MBS pricing (issuance yields, deal subordination, overcollateralization, risk retention etc.) to distinguish between both.
- Despite riskier MBS securities placed with affiliated investors, if these securities are priced more favorably conditional on the risk, then it could be preferential treatment.

Dumping vs Preferential Treatment Hypothesis

Evidence and discussion on how “dumping” might be beneficial or optimal for the issuers will help:

- Any evidence of a quid pro quo relationship between issuers and investors?
- Any time-series variation? – bad-times vs. good times?
- Did it help MBS issuers to prop up demand during the crisis and continue placing MBS securities to non-affiliate investors? Conditional on being able to sell MBS securities to non-affiliates, can the issuers sell it at a higher price? (summ stats show 94% of deals are sold to non-affiliates).
- Did it help mask originator losses by transferring bad mortgages to affiliated investors like diversified mutual funds? (especially in the presence of claw back options and lawsuits that could be triggered by non-affiliate investors).
(Pre-2005: ~2% were affiliated deals, Post-2005: ~ 8.33% were affiliated deals)

Observed vs Unobserved Quality of Loans

Important to distinguish between observed and unobserved quality of loans (Ashcraft et al (2010); Adelino et al (2017a, 2017b))

- Observed: Can be priced, so harder to accord “preferential treatment” or “dump” without public knowledge.
- Unobserved: But privately known to loan originator, underwriter, issuer. “Preferential treatment” or “dumping” should occur on this component.
- But ex-ante loan quality and deal placement tests in paper are based on observed quality as opposed to unobserved quality. Moreover, results on observed quality in paper are expected in the presence of adverse selection (i.e It is easier to place MBSs backed by pools with observably higher quality loans to non-affiliates.)
- Ex-post defaults, controlling for observable characteristics, can help capture the effect of unobserved quality of loans. However, this is confounded by endogeneity concerns.
- Exploit loan-type heterogeneity: private information on defaults greater for low-doc loans; on prepayment greater for ARM loans.

Observed vs Unobserved Quality of Loans

Table 6. Estimation of Affiliation Status using Ex Ante Predictions of Early Termination by Deal Securitization Year

Explanatory Variable	
Pr(Prepayment)	-0.142** (0.066)
Pr(Default)	1.193* (0.658)
Deal Pct. Linked Originator-Underwriter at 75%	-0.044* (0.024)
Deal Avg. Seasoning	0.003 (0.004)
Constant	0.088*** (0.030)
R-Squared	0.032
Deals	366

The first-stage control variables used to generate the out-of-sample predicted early termination probabilities for a 12 month performance window include: Interest Rate Spread, $\ln(\text{Loan Balance at Securitization})$, Months to Maturity from Securitization, Fico, LTV Waterfall, Fixed Rate Indicator, Property type, Owner-Occupied Indicator, Refinance Indicator, Documentation Type, and 1st Lien Indicator. The second-stage controls are currently displayed with the figures in parentheses reporting robust standard errors of the coefficient estimates where, 1, 2, and 3 stars indicate statistical significance at 10%, 5%, and 1%, respectively.

Comments on Empirics

- Data: Only 6% are affiliated deals (Pre-2005: ~2%; Post-2005: ~ 8.33%). Economically small?
 - Most affiliated deals concentrated around crisis: External validity?
 - Deal sample: 500 deals between 2002—2007 ~ 10% of deals issues in this period, and 6% of this sample are affiliated. Are very few deals driving results or are they sufficiently representative?
 - Results seem strongest for fully integrated affiliated status: Summary stats on number of fully integrated affiliated deals would help.
- Can make specifications for ex-ante and ex-post default and prepayment analysis the same and distinguish between observed vs unobserved components of risk.
- Clustering also at loan vintage/origination quarter for default and prepayment analysis.
- Incidental parameter problems with non-linear probit/logit models with large FEs. Can also conduct ex-post analysis with LPM for robustness just like ex-ante.

Concluding Remarks

- Overall, I believe it will be interesting to further flesh out the “dumping” and “preferential treatment” channels:
 - This is especially important given the information asymmetries and the perverse incentives that plague the OTD market as documented in the literature.
- I really enjoyed reading the paper and it is a great read!
- Thanks for the opportunity to discuss the paper, and good luck in the publication process.