Informing Mortgage Market Reform

Discussion of
"The Time-Varying Price of Financial Intermediation in the Mortgage Market"
"Eyes Wide Shut? Mortgage Insurance During the Housing Boom"
"Economics of Underwriting, Pricing and Managing (Mitigating) Credit Risk: Implications for (Re)Organizing the Mortgage Market"

Karen Dynan
Harvard University and Peterson Institute for International Economics
MIT Golub Center for Finance and Policy Annual Conference
September 28, 2017

Credit to conference organizers

3 really excellent papers!

Important in different ways

Context

9 years, 22 days since Fannie and Freddie went into conservatorship

"It is clear to all that conservatorship is a temporary form …"

-- Treasury Secretary Paulson 1/7/2009

Housing finance reform called out many times as a "priority" by key policymakers

Senate bipartisan reform bill made it through committee in 2014 but did not get a vote on the Senate floor

So conservatorship continues …

Why no reform yet?

NOT BECAUSE of a lack of proposals!

Political obstacles—plans have winners and losers

Problems and solutions hard to understand

Try to explain it to smart non-experts, let alone your parents

Substantive disagreements

Lack of evidence re what actually would happen to cost, access, systemic risk under different proposals

Different goals and how to weight them

$\boxed{\text{All of the above make for a messy policy process!}}$

Contributions

Fuster, Lo, and Willen (FLW)

Thoughtful intensive exploration of new data on the cost of financial intermediation (originating, underwriting, servicing, maybe profits)

Find degree of pass-through from secondary market to primary market large *and timely*

But varies with demand likely reflecting capacity constraints

Implications for affordability and monetary policy

Uptrend in intermediation costs over time

Implications for affordability

CAVEAT: Importantly, we are not making any welfare statements.

Bhutta and Keys (BK)

Looks at important mortgage sub-industry that has received almost no attention in the academic literature --- HUGE!

Striking finding:

> PMI companies had the tools and incentives to impose constraints on GSE lending when risks increased
>
> But PMI *surged* as troubles in housing market started to ramp up

Key factor seems to have been relationship with GSEs

The institutional details of the system really matter

Dokko and Golding (DG)

One way to distinguish different proposals is that they are associated with different secondary market structures

Create matrix showing how different market structures perform with regard to different possible goals of reform

Inherently stylized exercise:

- Proposals don't actually fit neatly into the columns
- Many of the rankings are informed guesses based on limited evidence

Dokko and Golding (II)

But anyone who has sat at the policymaking table can tell you such exercises are IMMENSELY USEFUL

Policymaking often involves operating in a 2nd (or nth) best world!

In addition to compiling *and distilling* a lot of information (both from research and authors' own institutional expertise), the paper:

- Moves the debate to thinking about trade-offs
- Points out that the weights you assign to different goals make a big difference
- Heightens focus on features (like system's ability to mitigate shocks) that probably haven't gotten enough attention

All told, this set of papers helps reduce the obstacles to reform

FLW and BK fill in some missing evidence relevant to cost, access, systemic risk

DG help to organize what we do know, simplify the conversation, provide a concrete framework for comparing options => should generally make the policy process less messy

Where to go next?

Obvious scope for FLW and BK to help inform the DG boxes

	(1) Insurance	(2) Purchase	(3) PLS	(4) Portfolio
1. Cost of Funding	2- TBA market but some heterogeneity	1-liquid TBA market	3 – no guarantee or TBA	4 - Core deposits are expensive; no separation of credit & interest rate risks
2. Scale Economies (G&A)	4 - Competition for volume drives up costs	1 - Standardization and scale	3 – Inability to achieve MES in underwriting	2 – Vertically integrated
3. Market Power (P=MC)	3 - Some barriers to entry and limited number of firms	4 – Monopoly power from few firms and barriers to entry	2 –Relatively competitive industry	1 – Competitive industry
4. Information Costs	3 – Standardization reduces agency costs	2 - control over asset reduces agency costs	4 - very little vertical integration	1 – vertical integration addresses many issues
5. Innovation*	1	2	4	3
6. Macroeconomic Stability	2 – guarantee & TBA	1 – guarantee & TBA, likely TBTF firms	4 - market procyclical	3 - deposit insurance limits procyclicality

More to say with FLW data?

Lessons from BK?

But BK raises a further question about the DG framework

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How do you deal with goal of not causing another global financial crisis?

Answer unclear

Maybe you simply assume structures will have best possible design

Realistic? (costs of being wrong big)

Could incorporate concerns into “macro stability” row

But hard and don’t want to distract from important point that some structures are better once you are in a crisis

Add more rows?

Scope for regulatory capture? Transparency? Safeguards against incentives to take excessive risk?