Comments on:

“Mortgage Default, Foreclosures and Bankruptcy in the Context of the Financial Crisis”

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US personal bankruptcies rose to their highest level since 2005, when changes in bankruptcy law prompted a rush of filings to comply with the (more lenient) earlier rules. Rising unemployment and falling home prices are taking their toll, and individual filings were 25% higher last month than a year earlier.

News reports, November 3, 2009
Praise and Structure of Comments

- Comprehensive, well-researched, sophisticated investigation of the relationships between default, bankruptcy, foreclosure in the context of a financial crisis
- Important lessons for policy makers
- My Comments
  - Main comment: Could do more on policy lessons
  - Hypotheses and Questions on story: explain clearly what the relationships are to be expected?
  - Data: some scope for improvements
  - Empirical Methodology: some suggestions
Main Results

1. Leads/lags exist among Default, Bankruptcy, Foreclosure (DBF)
   i. Default on mortgage “leads/predicts” bankruptcy
   ii. But bankruptcy also “leads/predicts” default
   iii. Foreclosure “leads/predicts” bankruptcy

2. Decisions largely financial & economic rational

3. Effects are economically large (up to “16 fold”)

4. There are externalities, regional and otherwise
   i. Lagged DBF rate “causes” more DBF
   ii. Lower house price (growth) “causes” more DBF

Policy implications: Optimal bankruptcy law more pro-creditor and other policies more pro-debtor
Questions that paper addresses

1. What drives DBF?
   i. Why do homeowners (+ lenders) default?
   ii. Why do homeowners file for bankruptcy?
   iii. Why do lenders foreclose?

2. Are all individual decisions economically rational? Are there efficiency/welfare losses?
   i. Is there “too little”/”too much” DBF?
   ii. Do inefficient DBF lead to too much DBF?
   iii. Are there (regional) spillovers from individual DBFs? Other externalities?

3. Implications for DFB design (bankruptcy)
Analysis done on DBF decisions

1. What drives D or B or F?
   i. Does default trigger bankruptcy or
   ii. The other way around? or
   iii. Are both jointly determined? Inefficiently?

2. Priors
   i. Default need not trigger bankruptcy if default is resolved properly, could be + or -
   ii. Bankruptcy could reduce other debts and be used to save you home, -, or to facilitate D, +
   iii. Foreclosure is most likely to mean bankruptcy

3. But all simultaneity, omitted factors, etc.
Main Policy Question: Optimal DBF?

1. In policy discussion, paper mainly concerned with bankruptcy rules.

2. But many other aspects drive DBF, e.g.:
   1. Macroeconomic: unemployment, interest rates
   2. Incentives of lenders: e.g., due to securitization hard to restructuring, worse underwriting
   3. Consequences of government interventions: e.g., bankruptcy changes, housing programs
   4. These impacts can vary by D, B, and F

3. Like to see lessons/implications for these other DFB design aspects as well.
Analysis on optimal B design

1. Get less insights from analysis
   i. We do get policy conclusions, but they do not follow directly from the analysis

2. Analyze if the design is suboptimal
   i. Chapter 13 versus 7 (?); what is best?
   ii. Differences across states, due to varying homestead exemptions/features, imply.. (?)
   iii. Differences over time, due to bankruptcy law of 2005 (some findings, but more): better?
   iv. Effects of crisis, changed incentives, lower capital/liquidity, etc. Adapt bankruptcy now (?)
Securitization especially interesting

- **Findings**: if securitized, more likely DBF:
  - B↑ after D, and D↑ after B, B↑ after F (n.s.), F↑ after B
  - Effects stronger for prime than sub-prime
  - Suggests securitization worsens restructuring

- **Additional tests to perform**
  - Follow individual over whole DBF (joint Cox)
  - Some more formal causation tests
  - Run matched sample tests; yes/no securitization, prime-sub-prime. Cleaner comparisons
  - Do FICO 620 test (ease of securitization increased)
Role of lenders and crisis

- Explore more the identity/type of lender/services (not just private-public)
  - Are there fixed effects among servicers? Some more inclined to allow D, to do F? Newer servicers?
  - Can you look at lender’s capital adequacy, loan-loss provisioning, liquidity positions?

- Use the financial crisis as “experiment”
  - What was impact of crisis? For example, mergers (Countrywide/BoA, Wachovia/Wells Fargo)
  - Effects of Fannie and Freddie restructuring
Data and Robustness

- Sample is huge, need to randomize: yet tempting to ask for some “more draws”.
- Also use all data to create lagged DBFs
- Observations are dropped when transferred to a different servicer: why?
- Robustness on the default definition (not just two months delay)
- Refinancing seems hard to create
Empirical Approach

- Good to a hazard/duration (Cox) model for the (conditional) probability of DBF
- Combine prime/sub-prime in one regression
- Do clustering, probably at state/servicer level
- Year dummies, not clear. Replace with introduction of specific government programs
- Benchmark with earlier periods of recessions
- Show number of observations, pseudo $R^2$
Conclusion

➢ Well-researched paper. Good data. Sensible econometric methodology

➢ Very useful insights and findings on DBF links, “causes”, with economic significance

➢ Can expand on methodology to address specific policy questions