The Role of Intermediaries During Boom and Bust

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Incentives in Lending
Limiting High-Power Incentives

• **Loan officers:** Bonus-based compensation $\rightarrow$ poor mortgage quality

• **Appraisers:** Inflate valuations when under pressure
  • Agarwal and Ben-David (WP); Agarwal, Ben-David, and Yao (MS 2015)
Anti-Predatory Laws Help, At a Cost

- Can deter predatory lending
- At the expense of lower market activity

- Reduced 18-months default rate: 27% → 21%
- Agarwal, Amromin, Ben-David, Chomsisengphet, and Evanoff (2014 JFE)
Financial Literacy Has Little Value

• Borrowers not interested in mortgage counselling

• Mortgage counselling mandatory:
  • Did not change behavior

• Mortgage counselling conditional on product risk:
  • Changed behavior

• “Mortgage Risk Tax” would have worked just as well

• Agarwal, Amromin, Ben-David, Chomsisengphet, and Evanoff (WP)
Incentives During Crisis
Gov Intervention During Crisis Helps; Intermediaries Important

• HAMP: Government intervention is needed and can be effective
  • Renegotiations ↑
  • Foreclosures ↓
  • Consumption demand ↑
  • House prices ↑

• Strong servicer fixed effects

• Agarwal, Amromin, Ben-David, Chomsisengphet, Piskorski, and Seru (2016 JPE)
# Hold Up in Second Liens

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<thead>
<tr>
<th>Ownership</th>
<th>Decision Making</th>
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<td>First Lien</td>
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<td>Servicer A</td>
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<td>Second Lien</td>
<td>Investor</td>
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<td>Servicer B</td>
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- Hold up incentives: **X**
- Action: Rapid
- Resolution: Liquidate
- Liquidation: Foreclosures

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- Delayed
- Modify
- Soft Liq

*Agarwal, Amromin, Ben-David, Chomsisengphet, and Zhang (2014)*
Conclusion

• Intermediaries have a crucial role in origination of mortgages and in loss mitigation

• During boom
  • Financial literacy and predatory lending
  • Aligning incentives of intermediaries

• During bust
  • Servicer incentives
  • Variation in servicer quality