Going for Broke:
Underwriter Reputation and the Performance of Mortgage-Backed Securities
By de Jong, Kooijmans, and Koudijs

Sasha Indarte
Wharton, UPenn
MFA
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• **Question:** can intermediaries reputational concerns dampen booms and busts?

• **Approach:**
  ▶ Assemble novel historical dataset with detailed info on MBS, intermediary, and investor characteristics
  ▶ Compare origination characteristics and performance of high vs. low reputation banks

• **Main Findings:**
  ▶ Low reputation banks origination **worse loans**
  ▶ High reputation banks **retreated** during boom, but with limited aggregate impact

• **Comments:** framing and interpretation
• Investors, borrowers, and financial intermediaries appear to value intermediary reputation. 
  Beatty and Ritter (1986); Nanda and Yun (1997); Dunbar (2000); Fang (2005); Lewellen (2006); Ivashina (2009); Drucker and Puri (2009); Becker and Milbourn (2011); Murfin (2012); Baghai and Becker (2020)

• Does financial intermediary **reputational capital** matter as much as **financial capital**?
  ▶ Underwriter reputation ⇒ substantial contagion in early sovereign bond markets (Indarte, 2021)

• **This paper:** can a lack of reputation concerns exacerbate credit booms and busts?
Framing: What is the Null Hypothesis?
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• Intro framing: did banks not value their reputation or were they overly-optimistic?

• Why not both? Not mutually exclusive

• Alternative possible framing:
  ▶ Does reputation incentivize good behavior? And does this mitigate credit booms/busts?
  ▶ Was the boom driven by optimism or opportunism?
    ⇒ Were low rep. banks worse at evaluating securities and deserving a weak rep?
Does a Good Reputation Incentivize Good Behavior?

- Another reason paper is interesting: answer isn’t obvious!

- Economics here are similar to setting where firms make unobserved investments in product quality (Board and Meyer-ter-Vehn, 2013)
  - Incentives to maintain reputation depend on how buyers learn
  - With imperfect signals: can have either work-shirk equilibrium or shirk-work-shirk (i.e., slacking when reputation is very high)

Recent examples suggest competition can weaken desire to maintain reputation
- Entry of Fitch in 1990s into corp. bond ratings ⇒ Moody’s and S&P issued higher ratings and became less predictive of bond yields (Becker and Milbourn, 2011)
- Re-entry of S&P into set of ratings markets after procedural error ⇒ overly-optimistic ratings in attempts to regain market share (Baghai and Becker, 2017)
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Interpretation
How Did Reputation Discipline Banks?

• Paper argues that investors ignored underwriter reputation by continuing to buy MBS from low reputation banks

• Q: if investors aren’t attentive to reputation, why do banks exert effort to maintain it?

• Are there long-run costs from repeated interactions?
  ▶ Test: possible to examine post-boom activity/prices? In other markets/activities?
  ▶ Test: lower long-run wealth of bankers whose MBS performed worse?
Establishing the Counterfactual

- Paper has a clever proxy for reputation
  - Evidence on how the loans differed between high/low rep. helps corroborate explanations for boom and bust

- Would the crisis have been more severe if high reputation banks didn’t retreat?
  - **Test:** possible to partition bonds into groups that experienced differential exposure to retreating by high reputation banks? Perhaps sugar/coffee sample split is informative?

- How would high rep. banks have behaved without competition from low rep. banks?
  - Would high reputation banks have filled the gap? Creating the same loans?
Conclusion
In conclusion...

- Insightful and interesting paper tackling an important question!

- Sheds light on how fin. intermediary reputation matters for credit booms and busts

- Assemble valuable and unique datasets
Thanks!