Enhancing Loan Quality through Transparency:
Evidence from the European Central Bank Loan Level Reporting Initiative

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In a nutshell

- Securitization can lead to lax screening incentives (Keys et al., 2010).
- Can increased transparency of securitized loans solve the problem?
- ECB initiative: loan data made publicly available.
- Result: lower default frequency, days in default, LGD.
- Interpretation: transparency improves market discipline, incentivizes banks to screen/monitor better.
Overall assessment

- Important topic: understanding market failures related to securitization.
  - Post-mortem analysis of the crisis.
  - How to restart this market, financing of SMEs.
- Results seem intuitive, confirm that transparency can help.
- A lot of controls, additional datasets, and robustness checks.
- Maybe a bit too many!
Source: SIFMA.
A loan is a multidimensional object: delinquent amount, days in delinquency, default, LGD, interest rate, collateral, maturity...

Main specification:

\[ \text{DefaultProxy} = \alpha + \beta_1 \text{Transparency} + \beta_2 \text{InterestRate} + \beta_3 \text{Secured} + \beta_4 \text{Maturity} + \beta_5 \text{SecuritizedAmount} + \beta_6 \text{LendingRelationship} + \text{LoanPurposeFE} + \text{LoanTypeFE} + \text{BorrowerTypeFE} + \text{BorrowerIndustryFE} + \text{QuarterFE} + \text{ABSDealFE} \]

Compares transparent to non-transparent loan in the same ABS deal and quarter.

\[ \beta_1 < 0: \text{for same InterestRate, transparency lowers the } \text{PD}. \]
Overcontrolling

- But surely \textit{InterestRate} also affected by transparency!
- \textbf{Overcontrolling}: all the dimensions are jointly determined by the bank, and affected by \textit{Transparency}.
- Specification does not rule out that \textit{Transparency} increases interest rates (Ahn and Breton, 2014) and defaults are in the end higher.
- Solution: all RHS variables should be \textit{unaffected by the treatment}. \textit{InterestRate} and others are interesting LHS variables.
- Goal should be to see all the dimensions of bank loans have been affected.
What is loan quality?

- Focus on the safety of loans.
- A good loan is not necessarily a safe loan!
- One could flip the story: banks lend only to super-safe SMEs ⇒ credit crunch!
- We need an aggregate measure of loan quality ⇒ valuation.
Validating the story

- If transparency solves a lemon problem, price of more transparent ABS should be higher (requires to drop deal FE).

- Then why don’t banks voluntarily disclose this type of information?

- Do ABS prices react to disclosed loan characteristics, in addition to ABS rating?

- Are ABS prices more informative? Is there more cross-sectional variation?

- How do investors react to missing variables? Is it a negative signal?
Policy implications

▶ If transparency solves a lemon problem, securitization can restart, credit to SMEs go up.

▶ Or, banks are desperate for collateral, originating risky loans is punished, credit to SMEs go down?

▶ Authors look at the decision to sell ABS vs. keep them. Other possibility: securitize good loans only, keep riskier ones on the banking book.

▶ Banks incentivized to produce more information about loans, but may not disclose everything. Does not necessarily sound very good (Hirshleifer effect? Collateral crisis as in Gorton and Ordonez (2014)?).
Alternative stories

- A lot of robustness checks already!

- Two important alternatives for which I could not find an answer:
  - **Reverse causality**: bank adopts transparency because it has good loans.
  - **Common cause**: banks with liquidity needs lend less, to better borrowers, AND adopt transparency to post ABS as collateral.
Other things to look at?

- Can we exploit variations in assets accepted as collateral at the ECB?
- Match loan quality with banks’ liquidity needs, amount they borrow from the ECB.
- Impact of policies such as LTRO.
Details

- The theory to test is too vague.
- Start with a leaner specification, making the identification assumptions clear.
- First results arrive really late p. 20!
- Too many controls and robustness checks. Can we first have a minimal analysis, and less important checks in an appendix?
- Log variables are a bit confusing. How are zeros dealt with? For info. collection, surely if avg. $\ln N = 4.43$ then avg. $N \neq 85 \approx \exp(4.43)$. 
Great topic and policy experiment.

Important results on transparency and securitization.

Story and policy implications could be clarified further.

A lot of different analyses, controls, etc. Better separate first-order results from robustness checks.
Thank you!