

DISCUSSION

Consumer choice in mortgage markets

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London, October 5, 2016

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Price dispersion in UK mortgage market

Zanna Iscenko

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- 1 **Administrative data** for 80% of UK mortgage market
- 2 Does law of one price hold? Does the market fail?
 - ▶ Calculate best available (*benchmark*) rate
- 3 Interpretation of residual variation
 - ▶ Unobserved credit risk
 - ▶ Data limitations (e.g. unobserved mortgage duration)
 - ▶ Product complexity

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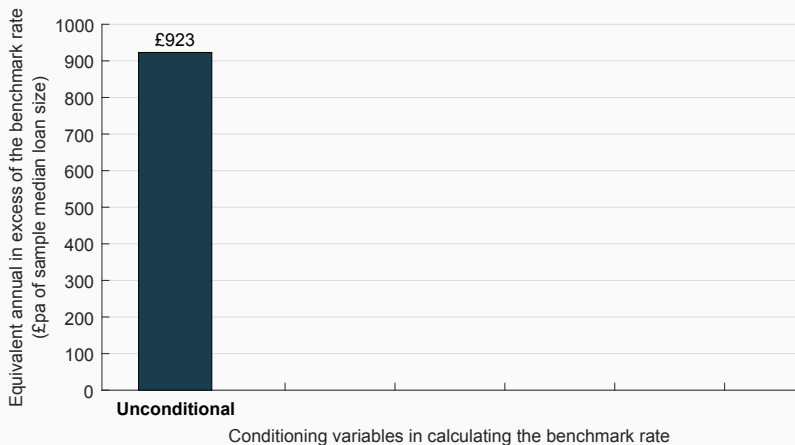
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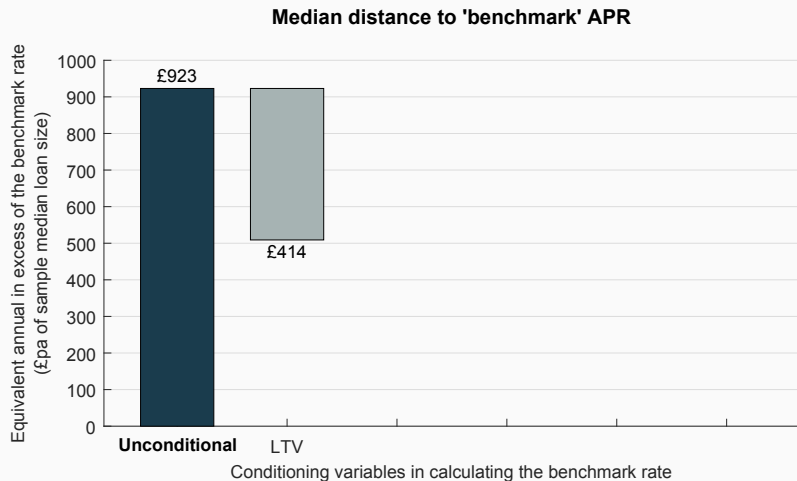
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MAIN RESULT

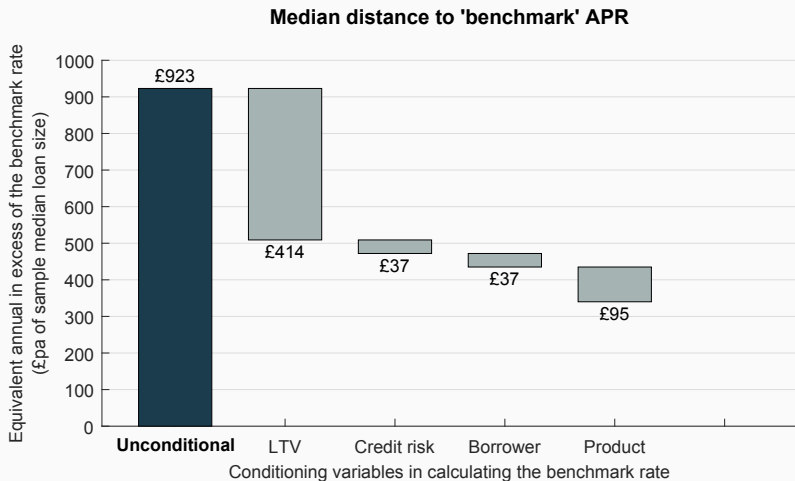
Median distance to 'benchmark' APR



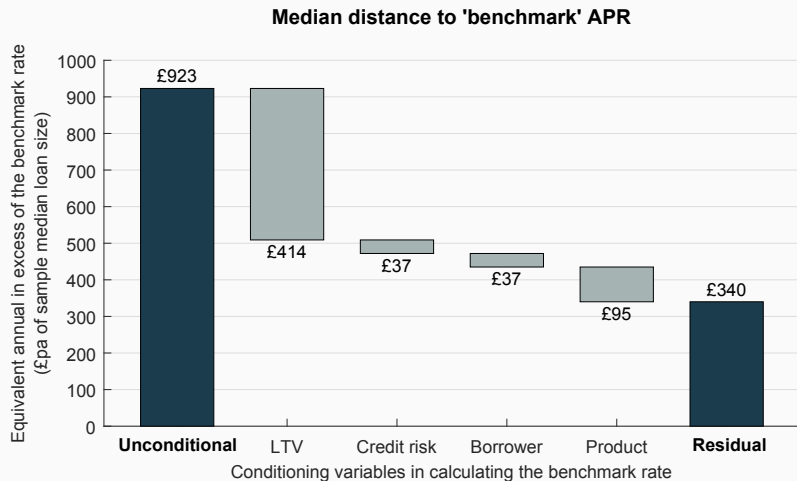
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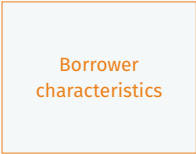


MAIN RESULT



ALTERNATIVE DECOMPOSITION

What determines mortgage product choice?



Borrower
characteristics

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Household
risk profile

- ▶ Age
- ▶ Labour income
- ▶ Net wealth
- ▶ Household composition

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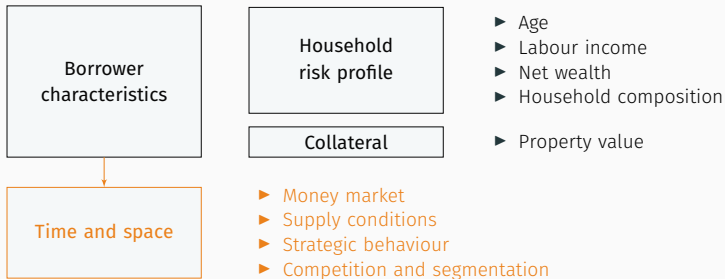
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Collateral

- ▶ Age
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- ▶ Property value

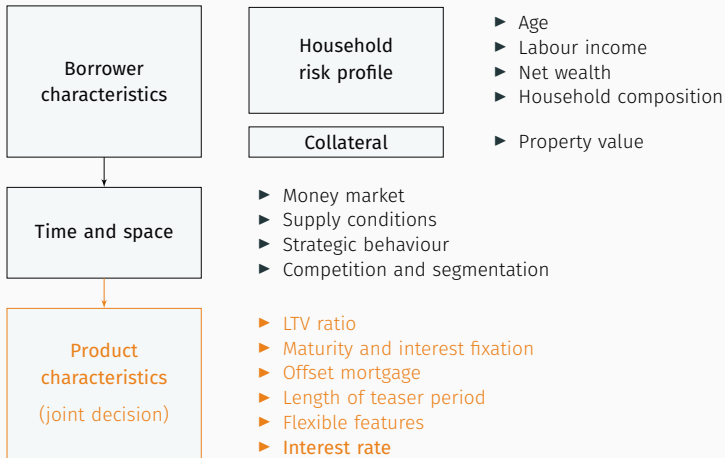
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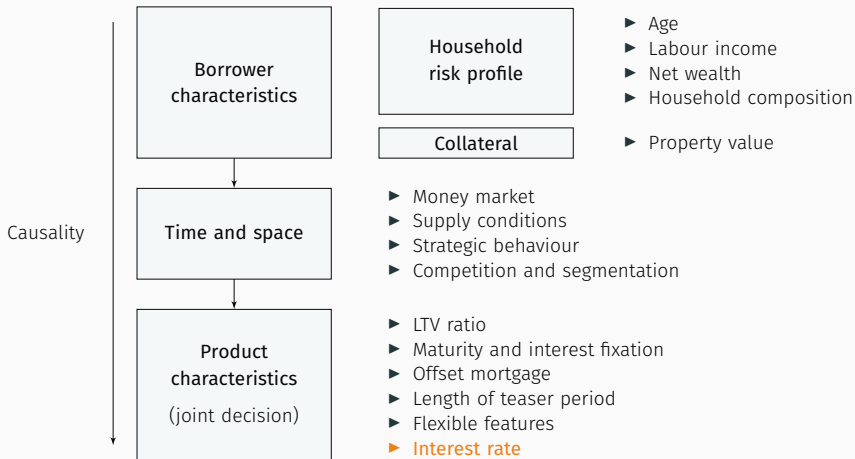
ALTERNATIVE DECOMPOSITION

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QUESTIONS

- 1 LTV driven by characteristics and supply conditions?
 - ▶ Simple solution: Change ordering of step-wise regression
 - ▶ Isolation of product features (see below)
- 2 Can we improve the credit risk model?

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Prob(credit problem)	0.0978***	0.0866***

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Loan-to-income ratio	0.0308***	0.0286***
= 1 if joint-income loan	0.0416***	0.0340***
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= 1 if offset mortgage	0.2479***
= 1 if loan has flexible features	-0.2696***

- ▶ Offset mortgages: *de facto* lower LTV (**lower risk?**)
- ▶ Flexible features (lower risk?)
 - ▶ Over- and underpayment
 - ▶ Borrow back
 - ▶ Payment holidays
- ▶ What explains difference in risk sharing?

4 Exploit bank fixed effects?

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- 5 Policy relevance: *Market failures* and the role of the FCA

Existence

5 Policy relevance: *Market failures* and the role of the FCA

Demand

- ▶ Mistakes
RATIONAL BENCHMARK
(Haliassos 1995,
Campbell 2006)
- ▶ Behavioural biases
(Andersen et al. 2016)

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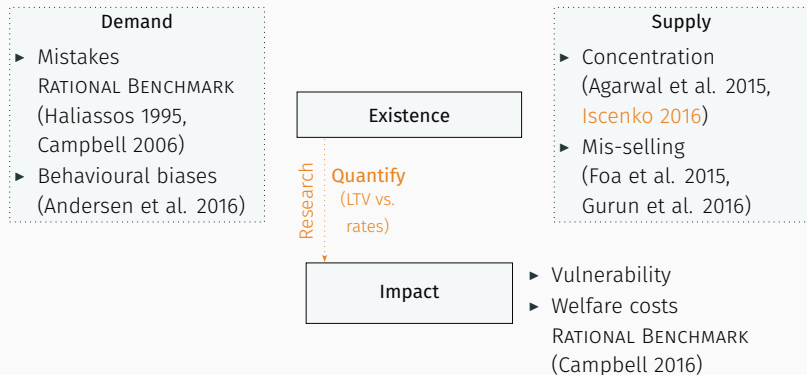
Supply

- ▶ Concentration
(Agarwal et al. 2015,
Ischenko 2016)
- ▶ Mis-selling
(Foa et al. 2015,
Gurun et al. 2016)

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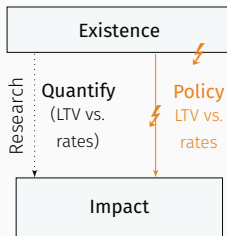
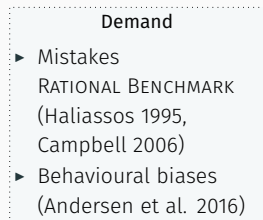


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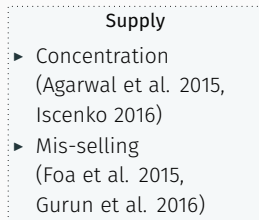
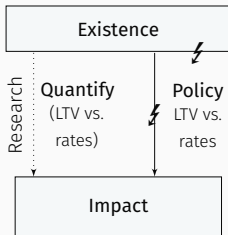
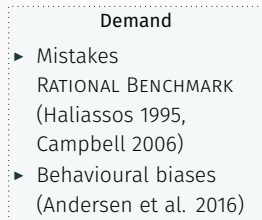
MORE POTENTIAL II

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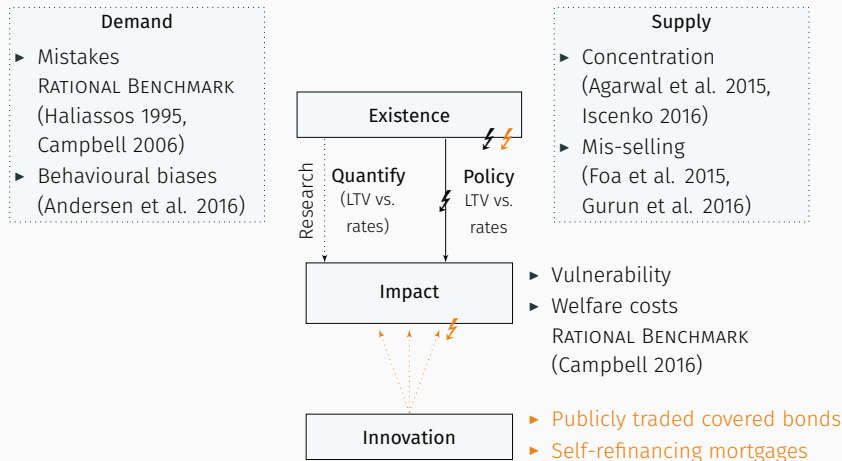


- ▶ Vulnerability
- ▶ Welfare costs
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(Campbell 2016)

Innovation

MORE POTENTIAL II

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MORE POTENTIAL II

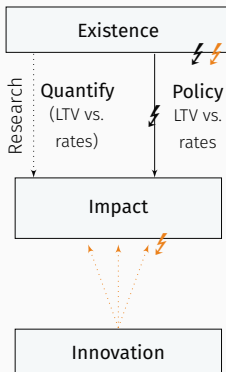
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- ▶ Complexity - how necessary?
- ▶ Why is the financial sector so prone to abuse?

- ▶ Vulnerability
- ▶ Welfare costs
RATIONAL BENCHMARK
(Campbell 2016)
- ▶ Publicly traded covered bonds
- ▶ Self-refinancing mortgages

CONCLUSIONS

- 1 Important research question: understanding mortgage pricing in the UK
 - ▶ Alternative decomposition - grounded in theory
- 2 Improve credit risk model
- 3 Risk sharing implications for flexible/complex mortgages
- 4 Policy relevance: comprehensive framework
 - ▶ Focus on LTV, loan maturity, fixation period
 - ▶ Understand sources of vulnerability
 - ▶ Decrease barriers to innovation/entry/product development