Discussion: “Government and Private Household Debt Relief during COVID-19” by Cherry, Jiang, Matvos, Piskorski, and Seru

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Key message: Forbearance successfully prevented massive spike in defaults
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Broader results from the paper

- Prior figure just mortgages...
  - but paper also documents forbearance in student loans, auto loans, credit cards

- Prior figure just correlation...
  - but paper presents clear *causal link* from forbearance $\rightarrow$ avoided defaults

- Prior figure aggregates all households...
  - but paper shows forbearance *targeted* to most distressed households

- Prior figure aggregates lenders...
  - but paper shows shadow banks provide less forbearance than traditional banks

Despite some limitations, CARES forbearance seems like a remarkably successful policy

- This discussion: How did we get here? How costly is it? What lessons do we learn?
- Note: will focus primarily on mortgages
Comparison to Great Recession intervention: HAMP

- Main source of debt relief: Home Affordable Modification Program (HAMP)

- Characteristics
  - Heavily subsidized by taxpayers
  - Run by servicers
  - Required new mortgage contract which varied on case-by-case basis
HAMP twisted payment schedule via complex modification

Change in annual payment after HAMP for typical mortgage

- Original term length of 23 years
- Step 1: Temporary low interest rate
- Step 2: Market interest rate
- Step 3: Term extension
- Step 4: Principal forbearance
Lessons learned since the Great Recession: three big limitations

1. Type 1 vs Type 2 error
   - Worry about false positives → HAMP required strict documentation
   - Led instead to false negatives → too hard to get a modification!

2. Reliance on voluntary costly actions by intermediaries
   - Problem: many large intermediaries were sluggish
   - Agarwal, Amromin, Ben-David, Chomsisengphet, Piskorski, and Seru (2017); Piskorski, Seru, and Vig (2010)

3. HAMP provides *drawn-out* payment relief, but what matters most is *immediate* liquidity
   - Large literature now on link between liquidity and default

Design of CARES forbearance helps address all 3 issues
CARES forbearance: Maximal immediate liquidity + simple design

Change in annual payment after intervention for typical mortgage

- Year 1 payment reduction: $15,600 (CARES) vs $5,500 (HAMP)
- NPV total payment reduction: $7,300 (CARES) vs $44,800 (HAMP)

Original term length of 23 years
How CARES addresses each lesson since Great Recession

1. Type 1 vs Type 2 error?
   1. Essentially zero documentation required $\rightarrow$ easy take-up and likely few false negatives
   2. Low NPV cost rationalizes this loose screening

2. Reliance on voluntary costly actions by intermediaries?
   1. CARES is simple and cheap
   2. *Nevertheless*, paper shows provision not perfect (especially by shadow banks)
      1. *Automatic* provision as in student loan forbearance goes furthest

3. HAMP provides *drawn-out* payment relief, but what matters most is *immediate* liquidity?
   1. CARES provides 3x immediate liquidity (at $< 0.15\times$ the cost!)
Going forward

For this crisis:

1. Paper provides convincing evidence that CARES-type forbearance helped prevent delinquency spiral *so far*

2. Raises alarm for 20% of households still in forbearance → crucial to design exits that continue liquidity-provision where needed

For next crisis:

1. Simple intervention is better, this paper shows it is attainable

2. Immediate liquidity provision is better, this paper shows it can be done cheaply

3. Consider building more forbearance-like features into *ex-ante* loan design

   - Active theoretical literature, e.g. Piskorski and Tchistyi 2010, 2011, 2017; Eberly and Krishnamurthy 2014; Guren, Krishnamurthy and McQuade 2021; Campbell, Clara, and Cocco 2020; Greenwald, Landvoigt, and Van Nieuwerburgh 2019