

Gete Pavlov Tsouderou Wachter (2025): Forbearance and the Cost of Credit

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MIT Sloan

NFA 2025

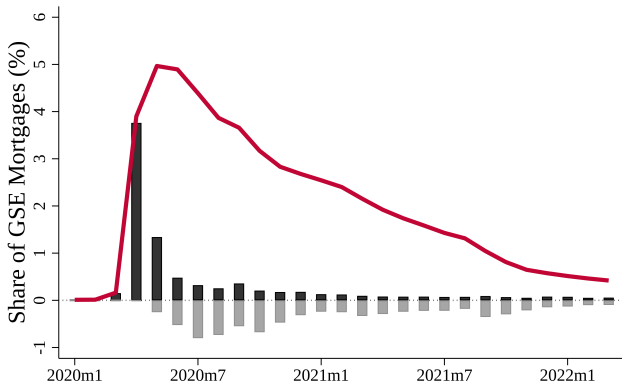
September 21, 2025

Mortgage Forbearance under the US CARES Act

- COVID-19 crisis: time of “unconventional” fiscal policy of unprecedented scope
- Under CARES Act, all federally-backed mortgages eligible to request **forbearance**
 - No late fees or penalties up to 12 months (later extended to 18 months)
 - No documentation required; must simply attest to Covid-related financial hardship
 - Option to defer missed payments until the end of maturity (as interest-free 2nd lien)

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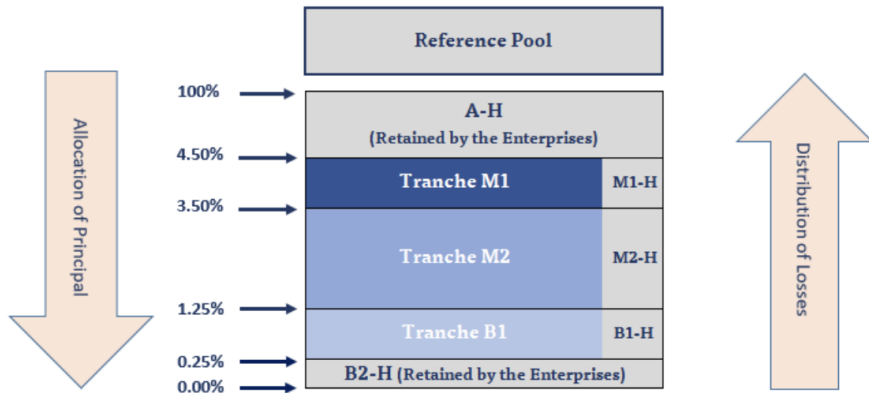
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- By June 2020, 5% of all conforming mortgages were in forbearance
 - Suspended monthly payments of \$900 on average

Credit Risk Transfer (CRT) Structure

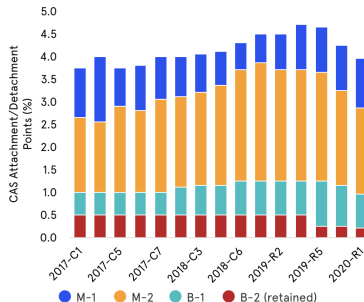
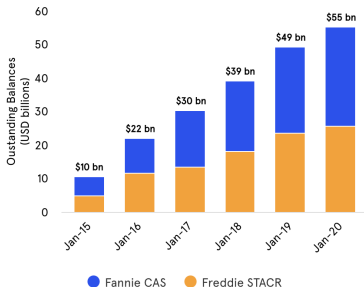


- Nice to assess “default risk” distinct from other forms of macro risk

CRTs had become riskier

- ↓ attachment points (absorbed losses by GSEs) ⇒ more loss exposure to investors

CRT bond balances and low-LTV CAS attachment and detachment points over time

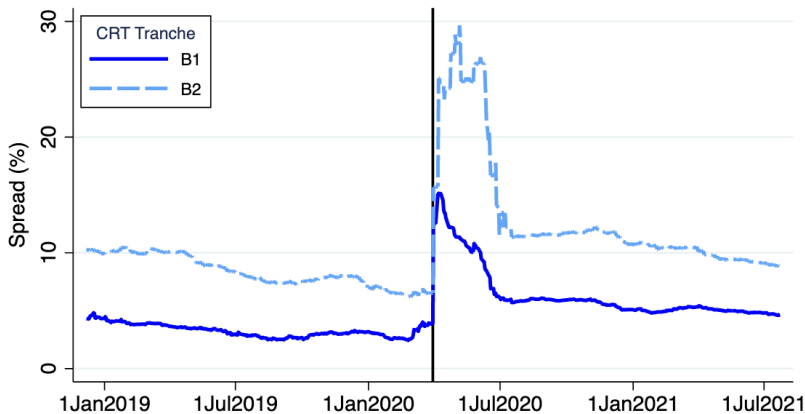


Sources: Barclays Research; the D. E. Shaw group.

Note: M-1, M-2, and B-1 securities are sold to private investors, while the remaining portions of the capital structure are retained by Fannie Mae.

Main takeaways

1. Investors were worried about COVID-era default from CRT movements!



GPTW (2025), Figure 2

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 - Reflects ex-ante pricing (vs ex-post realization)
2. Significant aggregate impact: 11–13.4% implied expected default rates (3% baseline)
3. Forbearance value can be partially undone by expectations-based Δ to cost of credit



Mortgage Credit Tightens, Creating Drag on Any Economic Recovery

Lenders stiffen conditions on refinancing, even though interest rates are low, spooked by the downturn and regulations

The Cypress Village community at Irvine, Calif. BING GUAN/BLOOMBERG NEWS

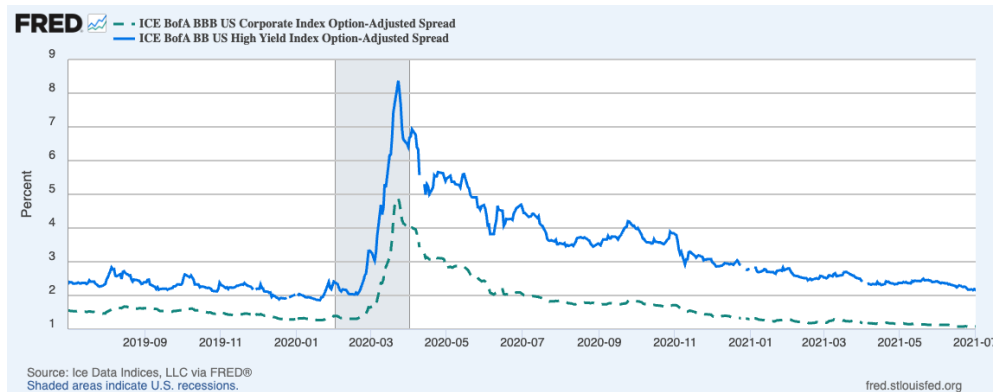
By [Andrew Ackerman](#) [Follow](#) and [Nick Timiraos](#) [Follow](#)

May 25, 2020 2:31 pm ET

"I don't think that's what the federal government intended. We are worried someone is going to ask for forbearance before we can sell the loan to investors," Mr. Kelman said.

1. Forbearance is not the only shock to default risk priced by CRTs

- Real channels priced in by CRT: elevated default risk in general



- Strong prior that stabilizing provisions in CARES Act would ↓ expected default
 - Informational channel from size of stimulus?

2. Variation in default risk from judicial foreclosure requirements

- *“Any alternative explanation would need to coincide precisely with the timing of the CARES Act and produce different effects across judicial and non-judicial states, making it unlikely that such factors drive our results.” (p.12)*
- Higher incentive to default in judicial states as liquidation by lender more costly

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- But what drives exposure across CRT securities?
 - CRT pitch decks: emphasize geographic diversification
 - Mortgage pools depend on origination date $\implies$ state-level variation can be endogenous to economic forces $\uparrow$ default risk

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- But what drives exposure across CRT securities?
 - CRT pitch decks: emphasize geographic diversification
 - Mortgage pools depend on origination date $\implies$ state-level variation can be endogenous to economic forces $\uparrow$ default risk
- **Suggestion:** highlight forbearance policy itself as source of expected default risk, not just tag for $\downarrow$ income shock
 - Local projections based on state-level forbearance take-up
 - Control for state-level predicted exposure from industry composition
 - Ex-ante measure of exposure consistent with paper

3. Poor communication rather than forbearance policy itself?

- CARES Act mandate lacking in implementation details, leading to confusion
 - Can lead investors to have poorly formed expectations of default risk
- *“What aspect of forbearance policies raised investor concerns? One possibility is that borrowers who did not need pandemic assistance might still take advantage of the no-questions-asked provision. Another is that forbearance could amplify distress by leading to larger balances or higher payments once repayment resumed.” (p. 3)*

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- Clarification by CFPB on these concerns in the following months
 - Example: Borrowers did not need to pay back forbore payments in lump sum
- If expected default risk was **allayed** by better communication of policy in early months, different policy implications
 - *Transparent* design of forbearance would ↓ uncertainty, borrower moral hazard less important

4. Investors and the secondary market

- Would like more details on the buy side:

Fannie Mae Benchmark CAS Investor Types - B1

	2016	2017	2018	2019	2020	2021	2022	2023
Hedge Fund	19.7%	49.9%	51.6%	70.3%	61.3%	17.8%	37.1%	61.4%
Insurance	1.0%	1.0%		0.1%	0.2%	7.0%	7.0%	0.6%
Money Manager	74.8%	44.2%	43.4%	20.3%	29.5%	70.8%	48.8%	35.9%
Pension/State or Local Government				0.0%		1.1%	1.2%	0.7%
REIT	4.6%	4.2%	5.1%	9.3%	8.9%	3.2%	4.7%	1.4%
Sovereign Wealth Fund (SWF)		0.8%					1.2%	

- Compositional shift in investors from deleveraging/margin calls?
- Trading volume of CRTs over this period?
- Forbearance disconnects delinquency from default, ↑ delinquency almost mechanical
 - Alternative proxy to validate expectations?

Minor points

- What is the market for B2 CRTs if they are just held by GSEs?
- Different payout/loss structure of pre-2017 CRTs could help reinforce default risk mechanism?
- Clarify role of CARES Act forbearance vs foreclosure moratorium?
- Tables 3–6 better suited as a figure, only report security-clustered SE
- Would like COVID-era placebo test to rule out other shocks to default risk expectations
 - Table 8: $R^2 > 0.99$, not much variation to explain in the pre-period
 - Balance tests of judicial vs non-judicial states and other characteristics relevant to mortgage performance or investor risk

Overall – enjoyed the paper and learned a lot!