

Do Residential Mortgage-Backed Securities Exhibit Higher Default Risk? An Analysis of Key Risk Drivers in UK Residential Mortgage Securitisation

Abstract

To the best of our knowledge, this is the first study to compare the default risk of securitised versus non-securitised residential mortgages in the UK. Using a large dataset covering the UK residential mortgage market from 2005 to 2023, we find that securitised residential mortgages exhibit a higher default risk than non-securitised loans. We obtain a statistically significant positive relationship between credit defaults and securitisation in a bivariate model, suggesting that banks are securitising higher-risk mortgage loans. Our model is robust while controlling for regional and temporal heterogeneity. Moreover, we conducted experiments to compare this relationship before and after regulatory changes. We analyse the Mortgage Credit Directive adopted on 6 April 2015 in the UK and the criteria 'simplicity, transparency, and standardisation' effective from 3 January 2019. We find a lower dependence between credit defaults and securitisation, which implies improvement in the credit quality of mortgage-backed residential securities. Finally, in this research, we also present additional findings on bank behaviour in residential mortgage securitisation during periods of financial turbulence, such as the mini-budget event (September 2022). Therefore, policy-makers can use our model to assess the impact of changes in the regulatory framework on default risk for securitised and non-securitised residential mortgages.

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