A Fistful of Dollars: Lobbying and the Financial Crisis

by

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The views expressed in this paper are those of the authors and do not necessarily represent those of the IMF or IMF policy.
MOTIVATION

“Lender Lobbying Blitz Abetted Mortgage Mess”
- Threat: A wave of restrictive new laws
- Reaction: Lenders lobbied to defeat legislation
- Result: Timely regulatory responses shut down
  (Wall Street Journal, December 31, 2007)

“US Banks Spent $370 million to Fight Rules”
- "Their unbridled political contributions and massive lobbying created the lack of regulation and oversight that led to this crisis"
  (The Financial Times, May 6, 2009)
Sausage Time.

K Street Butcher Shop

Congress Brand Regulation & Reform

Financial Industry Lobby
QUESTIONS

Was lobbying by financial institutions associated with riskier lending strategies in the run-up to the crisis? (*ex-ante analysis*)

Did financial institutions that lobby have worse outcomes during the crisis? (*ex-post analysis*)
SUMMARY OF FINDINGS

- Lobbying is associated *ex-ante* with more risk-taking and *ex-post* with worse performance.

- Lenders lobbying more intensively on specific issues related to mortgage lending:
  1. originated loans with higher loan-to-income ratios,
  2. tended to securitize more,
  3. had faster growing loan portfolios,

- Ex-post, during the crisis:
  1. Delinquency rates were higher in areas in which these lenders expanded faster,
  2. They experienced negative abnormal returns during crisis.
Interpretation

Results consistent with moral hazard & distorted incentives:
- Lenders lobbied to take excessive risks and to enjoy rents such as:
  . special treatments from policymakers *ex-post*
  . and/or high short-term gains *ex-ante*.
CONTRIBUTION

- First to examine empirically the relationship between lobbying and mortgage lending

- Unique dataset combining detailed information on Federal lobbying and lending at the local level

- Provide suggestive evidence that political influence of the financial sector may have created conditions allowing excessive risk taking
ROAD MAP

- Related Literature
- Data
- Empirical Analysis
- Interpretations
- Conclusion
Scarce evidence on the political economy of the current financial crisis

- Mian, Sufi and Trebbi (forthcoming, AER)
  - Consequences of the financial crisis
  - Constituent and special interests theories explain voting on key bills in 2008

Growing literature on the crisis

- Mian and Sufi (2008): contribution of subprime lending and securitization to credit boom and default rates
- Mian and Sufi (2009): home equity based borrowing contributed to increase in leverage and increase in defaults
- Dell’Ariccia et al. (2008): Competition, lending standards and credit booms
- Keys et al. (2008), Rajan et al. (2008): securitization creates moral hazard
- Calomiris (2008): Agency problems in asset management
DATA

- Lobbying
- Lending
Data – lobbying expenditures

We compile a unique dataset at the firm-level from the Center for Responsive Politics (CRP) and Senate’s Office of Public Records (SOPR) websites.

1995 Lobbying and Disclosure Act

All lobbyists must file semi-annual reports
- List name of the client and the total income received from each client
- Firms with in-house lobbying department required to file total amounts they spend
- Disclosure of issue category with which lobbying is associated (76 categories)
- Focus on 5 general issues – accounting, banking, bankruptcy, financial institutions and housing
- Specific issue with which the lobbying is associated (e.g. bills)

1999-2006
Lobbying on mortgage lending was very intensive before the crisis

Lobbying by the Financial Industry (in millions of US$)

- Total lobbying by financial institutions
- Lobbying on issues related to mortgage lending & securitization
- Total lobbying expenditures by associations

Examples of specific bills
(never passed into law)

- **H.R. 4250: Predatory Lending Consumer Protection Act of 2000**
  - Introduced April 12, 2000
  - Requires additional disclosures to consumers applying for high-cost mortgages
  - Creditors to evaluate each consumer’s ability to repay the loan

- **H.R. 1163: Predatory Mortgage Lending Practices Reduction Act**
  - Introduced April 8, 2003
  - Any individual who providing mortgage lending or brokerage services be adequately trained in subprime lending
  - Sub-prime lender requirements and prohibitions and penalties for unfair and deceptive practices
  - Extends grants to community organizations offering education on subprime or illegal lending practices.
Data – Lending Activities

- Home Mortgage Disclosure Act (HMDA) Loan Application Registry
  - Extensive time-series data on applications received and loans originated by mortgage lenders

- HMDA enacted in 1975
  - Requires most lenders to make their data on housing-related lending activity publicly available
  - Covers 90 percent of mortgage loan activity

- Data aggregated at the lender-MSA-year level

- Covers 2000-2007 (to overlap with lobbying database)
Empirical Analysis

- Empirical Model
- Results
Existing theories of lobbying suggest reduced form relationship between lobbying and lending behavior.

Theories:

- **Common agency theories:**
  Firms compete for influence over a policy by strategically choosing contribution schedule (Grossman & Helpman, 1994)

- **Information-based theories:**
  Lobbying firms have better information than policymaker and other firms and partly reveal their information by endogenously choosing lobbying amount (Potters & van Winden, 1992, Lohmann, 1995)
EMPIRICAL MODEL

- **Lobbying and policies:**
  1. Lobbying firm chooses $\text{lobbying}_i$ for each policy $\text{POL}_i$, given other firms’ contributions:

    $$\text{lobbying}_i(\text{pol}) = \lambda \cdot B_i + \nu \cdot C_i + \delta \cdot \text{lobbying}_{-i}(\text{pol}) + \gamma \cdot \text{pol} + \eta_i$$

  2. Policy maker chooses policy $\text{POL}_i$.

    $$\text{pol} = \alpha \cdot \text{lobbying}_i + \beta \cdot \text{lobbying}_{-i}$$

    Where:
    - $B_i$: lender specific benefits of lobbying
    - $C_i$: lender specific costs of lobbying
    - Other lenders’ costs & benefits of lobbying

- **Lobbying and lending standards:**

    $$\text{loan}_i = \phi \cdot Z_i + \varphi \cdot X_i + \mu \cdot \text{pol} + \delta \cdot \text{lobbying}_i + \nu_i$$

    Reduced form:

    $$\text{loan}_i = \phi \cdot Z_i + \varphi \cdot X_i + (\mu \alpha + \delta) \cdot \text{lobbying}_i + \varepsilon_i$$

    Where:
    - $\text{POL}$ is vector policy (federal + state)
    - $Z_i$: lender characteristics
    - $X_i$: borrowers characteristics
LENDING CHARACTERISTICS AND LOBBYING:
- Main variable of interest
  - Loan-to-income ratio (LIR)
    - Higher LIR indicates laxer lending standards (affordability)
- Other characteristics of mortgage lending:
  - Proportion of loans sold (potential source of moral hazard)
  - Growth of mortgage lending

EX-POST PERFORMANCE:
- Delinquency rates
- Event study: abnormal stock returns
Lenders that lobby for specific issues have higher LIR after controlling for area and lender characteristics and other factors changing over time

Table 3. Effect of Lobbying on Loan-to-Income Ratio

<table>
<thead>
<tr>
<th>Lobby dummy</th>
<th>[1]</th>
<th>[7]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lobby dummy</td>
<td>0.012***</td>
<td>0.144***</td>
</tr>
<tr>
<td>MSA FE</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Year FE</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>MSA*year FE</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Lender controls</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Observations</td>
<td>648,938</td>
<td>648,938</td>
</tr>
</tbody>
</table>

**** denotes statistical significance at the 1 percent level
A rise in lobbying expenditures is associated with higher loan-to-income ratio ...

Table 4: Effect of Lobbying Expenditures on LIR

<table>
<thead>
<tr>
<th>Dependent variable: LIR at (lender, MSA, year) level</th>
</tr>
</thead>
<tbody>
<tr>
<td>[1]</td>
</tr>
<tr>
<td>Log (lobby exp)</td>
</tr>
<tr>
<td>Lender FE</td>
</tr>
<tr>
<td>MSA FE</td>
</tr>
<tr>
<td>Year FE</td>
</tr>
<tr>
<td>MSA*year FE</td>
</tr>
<tr>
<td>Lender controls</td>
</tr>
<tr>
<td>Observations</td>
</tr>
</tbody>
</table>

**** denotes statistical significance at the 1 percent level
Lenders that lobby securitize larger proportion of loans and expand credit faster...

<table>
<thead>
<tr>
<th>Tables 9, 10. Lobbying, Securitization and Credit Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dependent variables</td>
</tr>
<tr>
<td>Log (Lobby exp)</td>
</tr>
<tr>
<td>Lender controls</td>
</tr>
<tr>
<td>Lender FE</td>
</tr>
<tr>
<td>MSA FE</td>
</tr>
<tr>
<td>Year FE</td>
</tr>
<tr>
<td>MSA*year FE</td>
</tr>
<tr>
<td>Observations</td>
</tr>
</tbody>
</table>

**** denotes statistical significance at the 1 percent level.
Omitted Variables?

- Many lender & MSA controls + Fixed Effects

FALSIFICATION TEST: Omitted factors affecting lobbying in general?
- Lobbying on other financial sector issues (consumer credit, deposit taking, anti-money laundering, etc.)

DIFFERENCE IN DIFFERENCE: timing of introduction of anti-predatory lending laws (APLs) at state level
- Lobbying lenders raise their lending standards more when a law is in place
- Consistent with the fact that lobbying lenders originate riskier loans than other lenders in absence of APLs
Bottom line....

- Lobbying is associated *ex-ante* with more risk-taking,
- and higher propensity to securitize mortgage loans
Delinquency rates in 2008 and lending growth by lobbying lenders at the MSA level

(1) Growth in lobbying lenders market share in the MSA during 2000-2006

(2) Various control variables and IVs to address omitted variable concerns

Event study analysis on stock returns of lobbying lenders around key events of financial crisis
**Areas where the lobbying lenders gained more market share have higher delinquency rates**

Table 11. Lobbying and Loan Outcomes

<table>
<thead>
<tr>
<th>Dependent variable: Delinquency rate at the MSA-level in 2008</th>
<th>OLS</th>
<th>2SLS</th>
</tr>
</thead>
<tbody>
<tr>
<td>ΔMS of lobbying lenders, 2000-06</td>
<td>0.220***</td>
<td>0.223*</td>
</tr>
<tr>
<td>ΔMS of lobbying lenders, other issues</td>
<td>-0.032</td>
<td></td>
</tr>
<tr>
<td>MSA controls; state FE</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Hansen’s p value</td>
<td></td>
<td>0.29</td>
</tr>
<tr>
<td>F-stat</td>
<td></td>
<td>4.56</td>
</tr>
<tr>
<td>Observations</td>
<td>306</td>
<td>306</td>
</tr>
</tbody>
</table>

IV: Initial market share of lenders lobbying on specific/other issues*\log(distance to DC)

*** and * denote statistical significance at 1 and 10 percent respectively.
Lenders that lobbied experienced negative abnormal returns during key events of the financial crisis

Table 12. Lobbying and Abnormal Stock Returns

- Dependent variable: Market- and risk-adjusted stock return

<table>
<thead>
<tr>
<th></th>
<th>(1) &amp; (2)</th>
<th>(3) &amp; (4)</th>
<th>(4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lobbying dummy</td>
<td>-0.052***</td>
<td>-0.157**</td>
<td>-0.274**</td>
</tr>
<tr>
<td>Lender controls</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Event fixed effects</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Observations</td>
<td>459</td>
<td>137</td>
<td>67</td>
</tr>
</tbody>
</table>

(1) August 1-17, 2007: ECB injection of overnight liquidity in response to problems in French and German banks
(2) December 12, 2007: Coordinated injection of liquidity by major Central banks to address short-term funding pressures
(4) September 15-16, 2008: Lehman Brothers files for bankruptcy; AIG is bailed out
Additional Evidence

- Stronger effect on LIR for large lenders
- Positive abnormal return during bailout
- Higher likelihood of bailout for lobbying lenders
Lobbying is associated *ex-post* with worse performance ....
suggesting larger exposure of lobbying lenders to bad mortgages
INTERPRETATION: MORAL HAZARD

Sources of moral hazard (rent seeking)

- Preferential treatment
  - higher likelihood of bailout during financial crisis or regulatory forebearance:

- Short-termism
  - lobby to create regulatory environment that allows them exploit short-term gains (compensation structure, origination and underwriting fees)

Evidence

- Stronger effect for large lenders
  - “Too big to fail” argument: large lenders which lobbied took even greater risks
ALTERNATIVE INTERPRETATIONS: ASYMMETRIC INFORMATION

Financial institutions lobby to convey information to policy makers:
- Lobbying lenders are specialized in catering to low-income borrowers
- Lobbying lenders underestimated risks

Evidence against interpretations
- Various fixed effects and explicit controls for specialization
- IV strategies to address omitted variable bias in ex-post analysis
- Stronger effects for large lenders
- Larger effect of lobbying on LIR in 2005 and 2006 – suggestive evidence against over-optimism
CONCLUSION

- First paper to document how lobbying contributed to accumulation of risks leading way to current financial crisis
- Construct a unique database at lender-level combining information on loan characteristics and lobbying on laws and regulations related to mortgage lending
- Main findings
  - Lenders that lobby have higher loan-to-income ratios, securitize more, and extend credit faster
  - Delinquencies in areas where lobbying lenders are prominent are higher; and stock returns for these lenders are lower during key events of the crisis
- Results suggestive of moral hazard
Additional Slides
## Match statistics between HMDA and lobbying datasets

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of lender-MSA</th>
<th>Fraction that lobby</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Total</td>
</tr>
<tr>
<td>1999</td>
<td>74,404</td>
<td>0.14</td>
</tr>
<tr>
<td>2000</td>
<td>69,899</td>
<td>0.15</td>
</tr>
<tr>
<td>2001</td>
<td>70,788</td>
<td>0.16</td>
</tr>
<tr>
<td>2002</td>
<td>76,920</td>
<td>0.15</td>
</tr>
<tr>
<td>2003</td>
<td>92,482</td>
<td>0.14</td>
</tr>
<tr>
<td>2004</td>
<td>82,955</td>
<td>0.15</td>
</tr>
<tr>
<td>2005</td>
<td>93,685</td>
<td>0.12</td>
</tr>
<tr>
<td>2006</td>
<td>94,978</td>
<td>0.13</td>
</tr>
</tbody>
</table>
### Firm-level lobbying constitutes 90 percent of targeted political activity

Table 1a. Targeted Political Activity Campaign Contributions and Lobbying Expenditures

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall lobbying expenditure</td>
<td>2972</td>
<td>3348</td>
<td>4081</td>
<td>4747</td>
</tr>
<tr>
<td>Share of finance, insurance, and real estate industry FIRE in overall lobbying (in percent)</td>
<td>14.7</td>
<td>14.3</td>
<td>15.8</td>
<td>15.2</td>
</tr>
<tr>
<td>Contributions from PACs</td>
<td>326</td>
<td>348</td>
<td>461</td>
<td>509</td>
</tr>
<tr>
<td>Total targeted political activity</td>
<td>3298</td>
<td>3696</td>
<td>4542</td>
<td>5256</td>
</tr>
</tbody>
</table>
Calculation of lobbying expenditures for specific issues of interest

- Total number of general issues stated in report = G
- Number of general issues of interest = GI
  - Accounting
  - Banking
  - Bankruptcy
  - Financial Institutions/Investments/ Securities
  - Housing
- Total number of specific issues corresponding to general issues of interest in report = S
- Number of specific issues of interest = SI
- Estimated lobbying expenditures on specific issues by firm = 
  \[
  \left\{ \left( \frac{\text{Total lobbying expenditures by firm}}{G} \right) \times GI \right\} / S \times SI
  \]
Examples of specific issues of interest from the lobbying reports

General Issue: Housing. List of Bills that focus on tighter restrictions for lenders

- H.R. 1163: Predatory Mortgage Lending Practices Reduction Act
- H.R. 1182: Prohibit Predatory Lending Act 2005
- H.R. 1295: Responsible Lending Act
- H.R. 1865: Prevention of Predatory Lending Through Education Act
- H.R. 3607: Protecting Our Communities From Predatory Lending Practices Act
- H.R. 3807: Predatory Mortgage Lending Practices Reduction Act
- H.R. 4471: Fair and Responsible Lending Act
- H.R. 4818: Mortgage Loan Consumer Protection Act
- H.R. 833: Responsible Lending Act
- S. 2415: Predatory Lending Consumer Protection Act of 2000
- S. 2438: Predatory Lending Consumer Protection Act of 2002
Other data

- MSA level data on social and economic indicators e.g. personal income, self employment from BEA; unemployment and inflation from BLS; population from Census Bureau; house price appreciation from the OFHEO

- Indicator whether a lender is subprime (HUD classification based on a number of HMDA variables)

- Delinquency rate at the MSA-level in 2008 from LoanPerformance
FURTHER ROBUSTNESS CHECKS
(Loan to Income Ratio)

- Alternative measures of lobbying expenditures
  - split among specific issues by share of reports
  - include expenditures by associations
  - scaled by assets
  - scaled by importance of law and regulations

- Alternative clustering of standard errors

- Drop outliers
Lending standards declined in the 2000s

Figure 3. Lending Standards

Loan to Income Ratio

Securitization picked up

Figure 4. Securitization

Percent of Loans Sold


Y-axis: 50 - 80
LOBBHY REPORT
Lobbying Disclosure Act of 1995 (Section 5) - All Filers Are Required To Complete This Page

1. Registrant Name:

BEAR STEARNS & CO

2. Address:
383 MADISON AVE., NEW YORK, NY 10179

3. Principal place of business (if different from line 2):

4. Contact Name: NANCY LOPEZ
   Telephone: 9737332267
   E-mail (optional): nancy.lopez@bear.com

Senate ID #: 5701-12
House ID #: 6

7. Client Name: X Self

TYPE OF REPORT

8. Year 2007 Midyear (January 1 - June 30): ☐ OR Year End (July 1 - December 31): ☒

9. Check if this filing amends a previously filed version of this report: ☐

10. Check if this is a Termination Report: ☐ => Termination Date: 11. No Lobbying Activity: ☐

INCOME OR EXPENSES

Complete Either Line 12 OR Line 13

12. Lobbying Firms

   INCOME relating to lobbying activities for this reporting period was:
   Less than $10,000: ☐
   $10,000 or more: X => Income (nearest $20,000):

   Provide a good faith estimate, rounded to the nearest $20,000, of all lobbying related income from the client (including all payments to the registrant by any other entity for lobbying activities on behalf of the client).

13. Organizations

   EXPENSES relating to lobbying activities for this reporting period were:
   Less than $10,000: ☐
   $10,000 or more: X => Expenses (nearest $20,000):

   Check box to indicate expense accounting method. See instructions for description of options.
   ☐ Method A. Reporting amounts using LDA definitions only
   ☒ Method B. Reporting amounts under section 6033(b)(8) of the Internal Revenue Code
   X Method C. Reporting amounts under section 162(e) of the Internal Revenue Code
LOBBYING ACTIVITY.
Select as many codes as necessary to reflect the general issue areas in which the registrant engaged in lobbying on behalf of the client during the reporting period. Using a separate page for each code, provide information as requested. Attach additional page(s) as needed.

15. General issue area code: BAN (one per page)

16. Specific lobbying issues:


17. House(s) of Congress and Federal agencies contacted:
HOUSE OF REPRESENTATIVES

18. Name of each individual who acted as a lobbyist in this issue area:

Name: O’NEILL, MARY LYNN
Covered Official Position (if applicable): N/A

19. Interest of each foreign entity in the specific issues listed on line 16 above. None
### Table X. Lobbying, Loan Problems, and Bail-Out

<table>
<thead>
<tr>
<th>Institution name</th>
<th>Political contributions (in US$ million)</th>
<th>Delinquency rate in 2008 on subprime loans of 2006 vintage (in percent)</th>
<th>Funds allocated (in US$ million)</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Citigroup</td>
<td>42.74</td>
<td>36.6%</td>
<td>52,071</td>
<td>Delinquencies at Argent Mortgage, which was acquired in 2007 and took the name CitiResidential</td>
</tr>
<tr>
<td>Bank of America</td>
<td>33.37</td>
<td>5.6%</td>
<td>53,299</td>
<td></td>
</tr>
<tr>
<td>Merrill Lynch</td>
<td>25.32</td>
<td>25.5%</td>
<td>n.a.</td>
<td>Acquired by Bank of America in 2008 (effective Jan. 1, 2009)</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>13.38</td>
<td>28.3%</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>Wells Fargo</td>
<td>7.59</td>
<td>17.5%</td>
<td>27,873</td>
<td></td>
</tr>
<tr>
<td>JP Morgan Chase &amp; Co.</td>
<td>6.78</td>
<td>25.1%</td>
<td>28,552</td>
<td></td>
</tr>
<tr>
<td>GreenPoint Credit</td>
<td>6.61</td>
<td>38.3%</td>
<td>3,555</td>
<td>GreenPoint Credit's parent North Fork Bancorp was acquired by Capital One in 2006. Capital One shut down GreenPoint in August 2007.</td>
</tr>
<tr>
<td>Countrywide Financial</td>
<td>6.24</td>
<td>26.1%</td>
<td>1,864</td>
<td>Acquired by Bank of America in 2008</td>
</tr>
<tr>
<td>New Century Financial</td>
<td>0.94</td>
<td>34.5%</td>
<td>n.a.</td>
<td>Filed for bankruptcy in April 2007</td>
</tr>
</tbody>
</table>

Political contributions are amounts spent for lobbying on specific issues over 2000-06 by the institution itself or its affiliates. Funds allocated are total funds provided by the government under the Emergency Economic Stabilization Act, including TARP, and the Housing and Economic Recovery Act.