A Fistful of Dollars: Lobbying and the Financial Crisis

by

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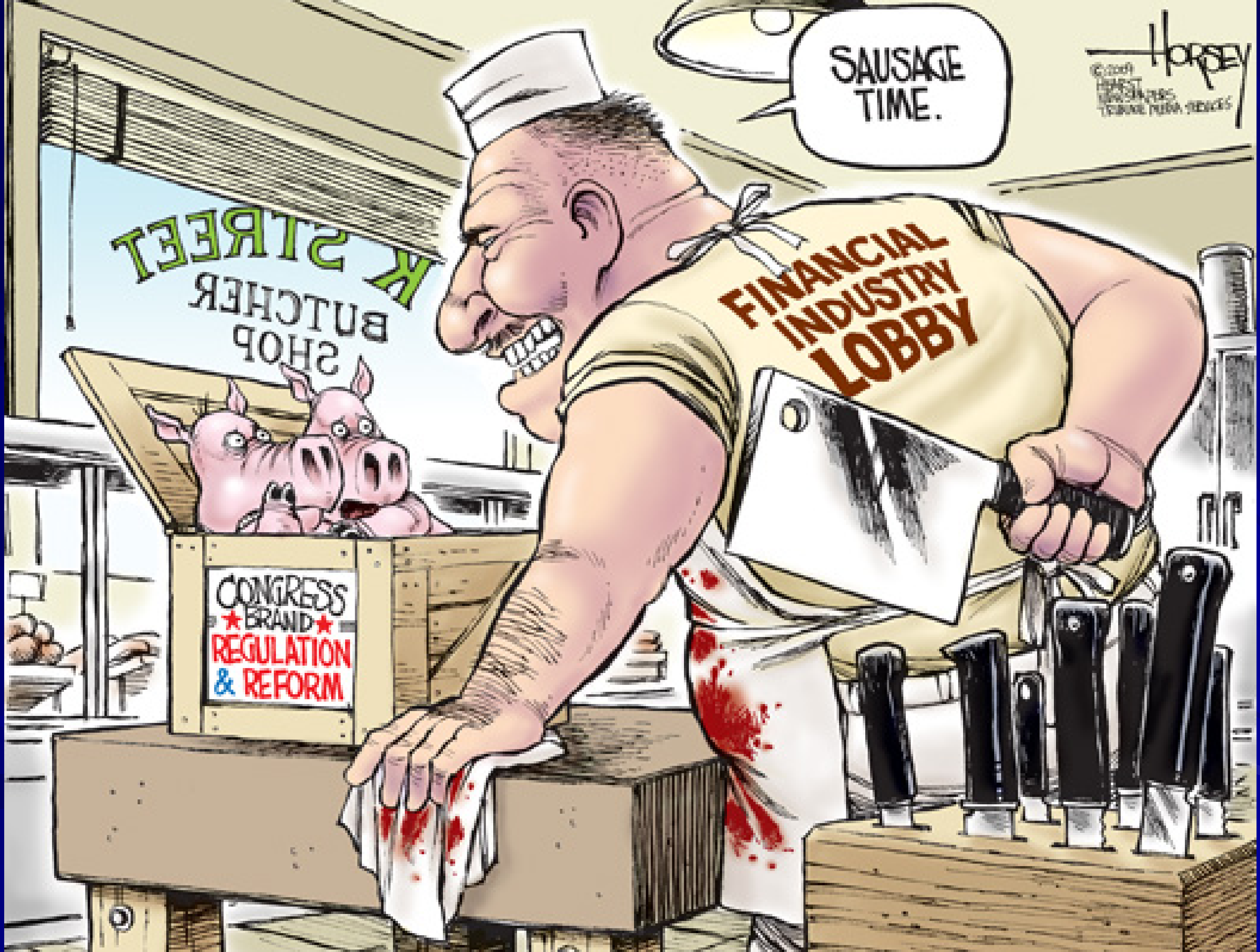
MOTIVATION

- **“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)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BUTCHER SHOP
FINANCIAL INDUSTRY LOBBY
CONGRESS
BRAND
REGULATION & REFORM
HORSEY

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

RELATED LITERATURE

- 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

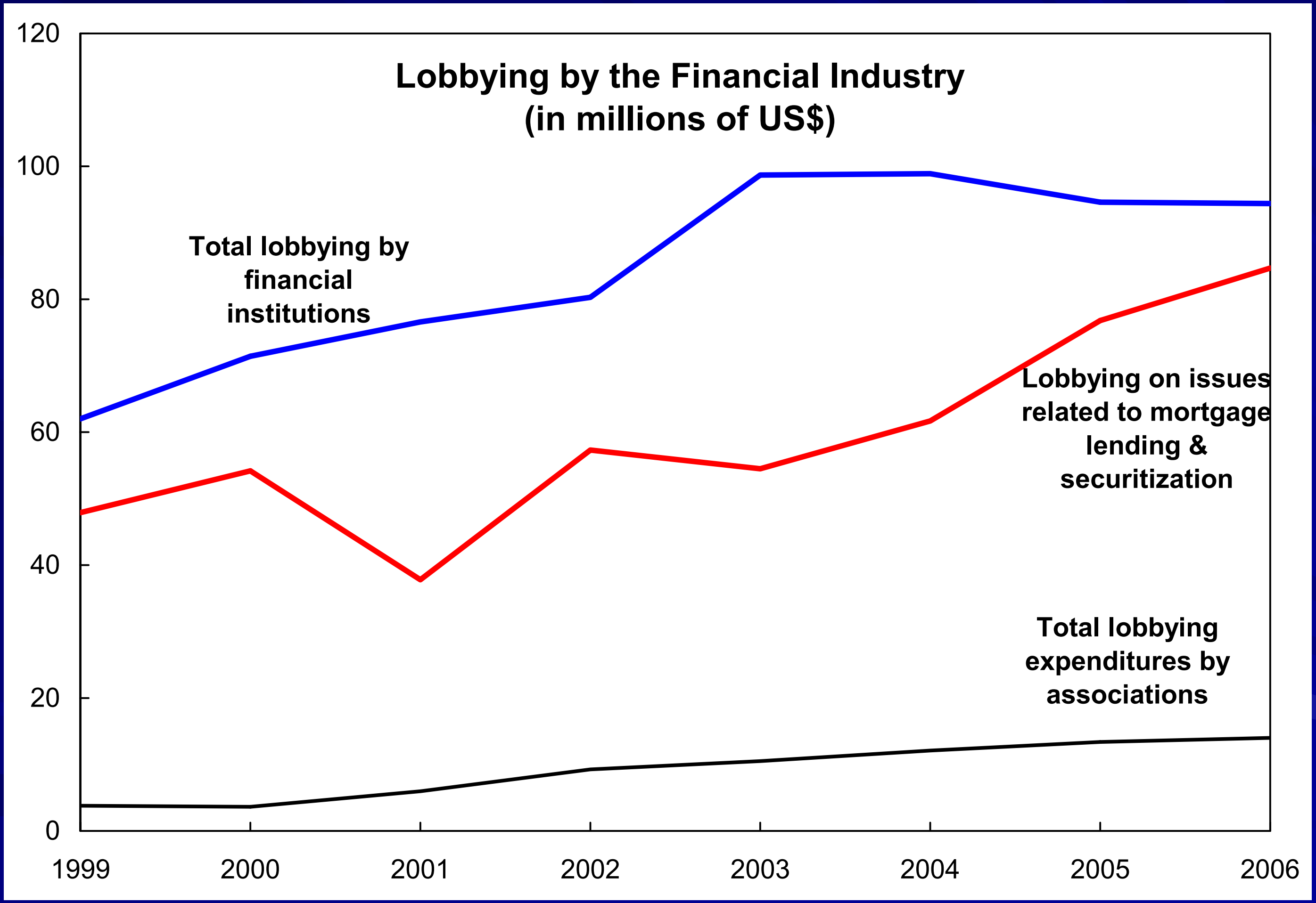
- We compile a unique dataset at the firm-level from the Center fo Responsive Politics (CRP) and Senate's Office of Public Record (SOPR) websites

- 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 the spend
  - Disclosure of issue category with which lobbying is associated (7 categories)
  - Focus on 5 general issues – accounting, banking, bankruptcy, financi 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



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

THEORY

- 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 *Lobbying*$_i$ for each policy *POL*, given other firms' contributions:

$$lobbying_i(pol) = \lambda \cdot B_i + \nu \cdot C_i + \vartheta \cdot lobbying_{-i}(pol) + \gamma \cdot pol + \eta_i$$

  (2) Policy maker chooses policy *POL*.

$$pol = \alpha \cdot lobbying_i + \beta \cdot lobbying_{-i}$$

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:**

$$loan_i = \phi \cdot Z_i + \varphi \cdot X_i + \mu \cdot pol + \delta \cdot lobbying_i + \nu_i$$

Reduced form:

$$loan_i = \phi \cdot Z_i + \varphi \cdot X_i + (\mu\alpha + \delta) \cdot lobbying_i + \varepsilon_i$$

Where:

- POL is vector policy (federal + state)
- *Zi*: lender characteristics
- *Xi*: borrowers characteristics

EMPIRICAL ANALYSIS

- 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		
Dependent variable: LIR at (lender, MSA, year) level		
	[1]	[7]
Lobby dummy	**0.012*** **	**0.144*** **
MSA FE	No	Yes
Year FE	No	Yes
MSA*year FE	No	Yes
Lender controls	No	Yes
Observations	648,938	648,938

**** 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		
Dependent variable: LIR at (lender, MSA, year) level		
	[1]	[5]
Log (lobby exp)	**0.003*** **	**0.004*** **
Lender FE	No	Yes
MSA FE	No	Yes
Year FE	No	Yes
MSA*year FE	No	Yes
Lender controls	No	Yes
Observations	648,938	648,938

**** denotes statistical significance at the 1 percent level

Lenders that lobby securitize larger proportion of loans and expand credit faster…

Tables 9, 10. Lobbying, Securitization and Credit Growth		
Dependent variables →	Proportion of loans sold	Credit growth
Log (Lobby exp)	**0.007*****	**0.322*****
Lender controls	Yes	Yes
Lender FE	Yes	Yes
MSA FE	Yes	Yes
Year FE	Yes	Yes
MSA*year FE	Yes	Yes
Observations	406,035	406,996

**** denotes statistical significance at the 1percent 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

LOBBYING & EX-POST PERFORMANCE

- 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			
Dependent variable: Delinquency rate at the MSA-level in 2008			
	OLS		2SLS
ΔMS of lobbying lenders, 2000-06	0.220***	0.223*	1.475***
ΔMS of lobbying lenders, other issues		-0.032	
MSA controls; state FE	Yes	Yes	Yes
Hansen's p value			0.29
F-stat			4.56
Observations	306	306	306

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

	(1) & (2)	(3) & (4)	(4)
Lobbying dummy	-0.052***	-0.157**	-0.274**
Lender controls	Yes	Yes	Yes
Event fixed effects	Yes	Yes	No
Observations	459	137	67

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

3) **March 11-16, 2008**: JP Morgan acquires Bear Stearns after Fed provides $30 billion in non-recourse funding; Fed expands liquidity provision

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

Bottom line....

- 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 analysi
- – Stronger effects for large lenders
- – Larger effect of lobbying on LIR in 2005 and 2006 – suggestiv 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

	Number of lender-MSA	Fraction that lobby	
Year		Total	Specific issues
1999	74,404	0.14	0.07
2000	69,899	0.15	0.07
2001	70,788	0.16	0.04
2002	76,920	0.15	0.08
2003	92,482	0.14	0.09
2004	82,955	0.15	0.08
2005	93,685	0.12	0.08
2006	94,978	0.13	0.09

Firm-level lobbying constitutes 90 percent of targeted political activity

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

(millions of dollars)

Election cycle	1999-2000	2001-02	2003-04	2005-06
Overall lobbying expenditure	2972	3348	4081	4747
Share of finance, insurance, and real estate industry *FIRE in overall lobbying (in percent)*	14.7	14.3	15.8	15.2
Contributions from PACs	326	348	461	509
Total targeted political activity	3298	3696	4542	5256

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 = **[{(Total lobbying expenditures by firm /G)*GI}/S]*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. 1051: Predatory Lending Consumer Protection Act of 2001**
- **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. 3901: Anti-Predatory Lending Act of 2000**
- **H.R. 4213: Consumer Mortgage Protection Act of 2000**
- **H.R. 4250: Predatory Lending Consumer Protection Act of 2000**
- **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**

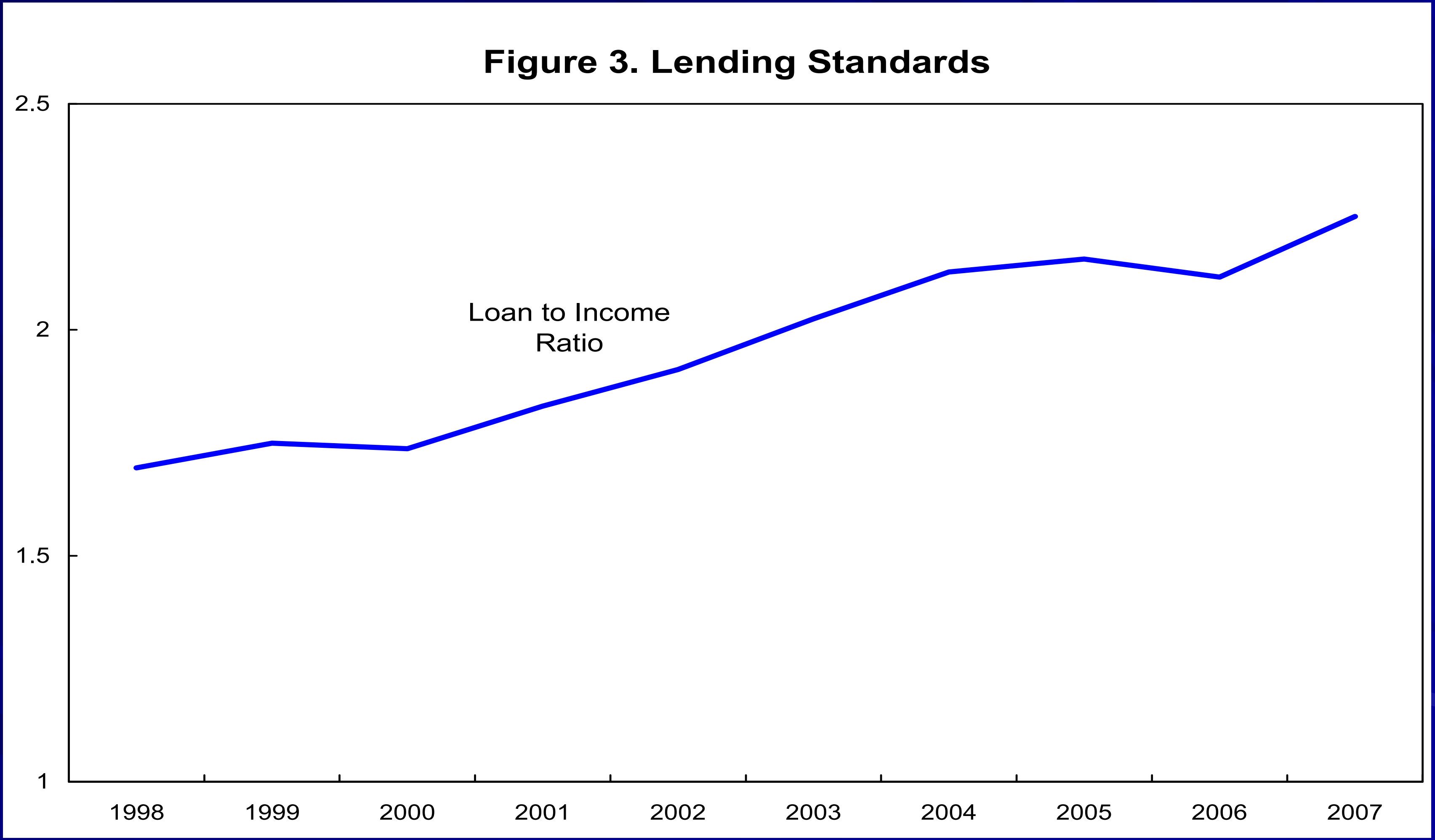
Other data

- 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

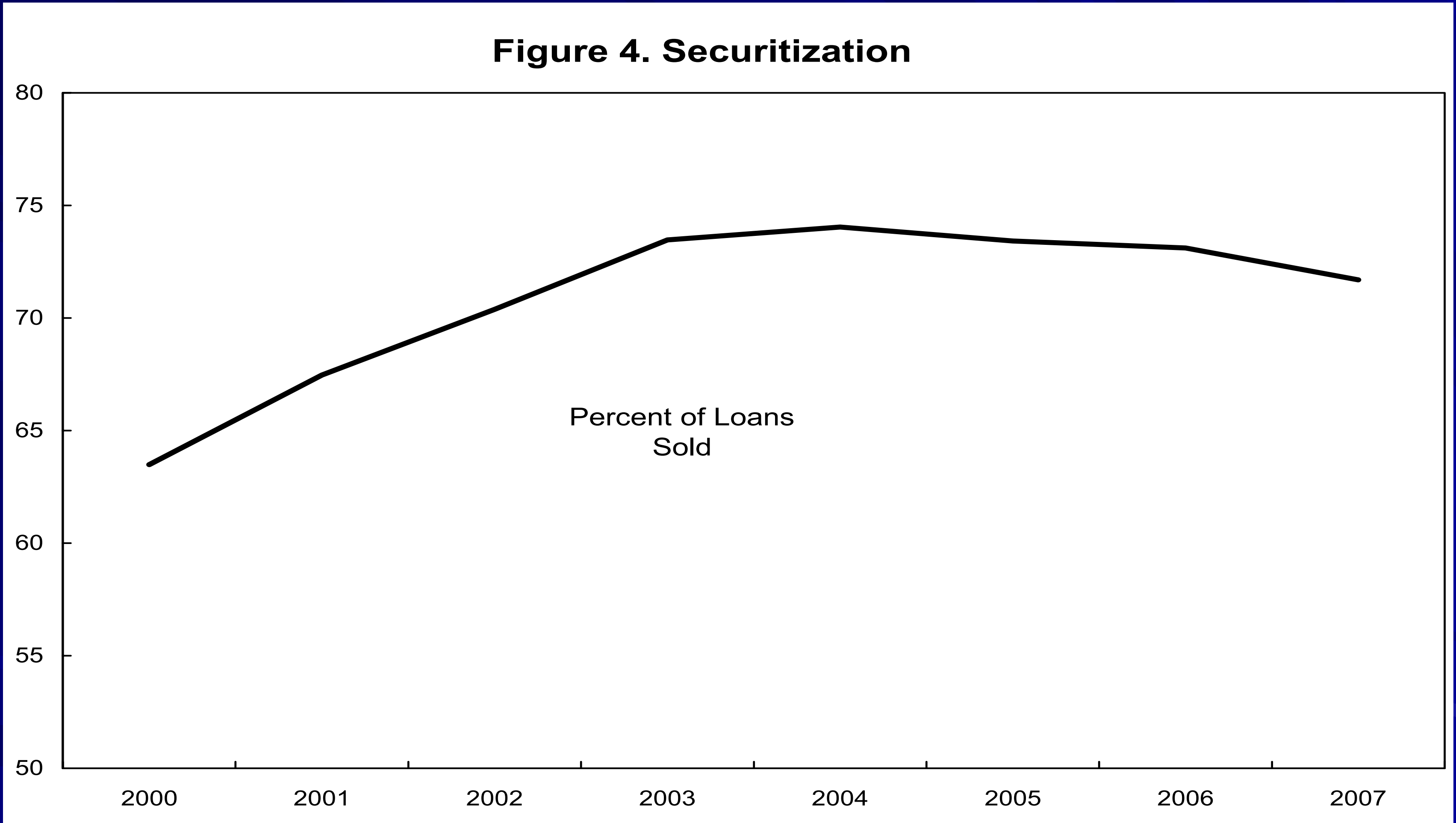
FURTHER ROBUSTNESS CHECKS (Loan to Income Ratio)

- 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



Securitization picked up



Clerk of the House of Representatives
Legislative Resource Center
B-106 Cannon Building
Washington, DC 20515

Secretary of the Senate
Office of Public Records
232 Hart Building
Washington, DC 20510

Secretary of the Senate
Received: Feb 04, 2008

LOBBYING 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: 9737932267
E-mail (optional): nancy.lopez@bear.com

Senate ID #: 5701-12
House ID #:

7. Client Name: [X] Self

TYPE OF REPORT

8. Year 2007 Midyear (January 1 - June 30): [ ] **OR** Year End (July 1 - December 31): [X]

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: [ ] => 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): 500,000.00

14. Reporting Method.
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

Registrant Name: BEAR STEARNS & CO Client Name: Self

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:

H.R. 3915 The Mortgage Reform and Anti-Predatory Lending Act of 2007. Worked to change provision of the legislation related to lending and securitization standards. H.R. 4178 Emergency Mortgage Loan Modification Act of 2007. Advocated the concepts in the proposal but not the proposal.

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**

Show me the money…

Table X. Lobbying, Loan Problems, and Bail-Out

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

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.