

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”**

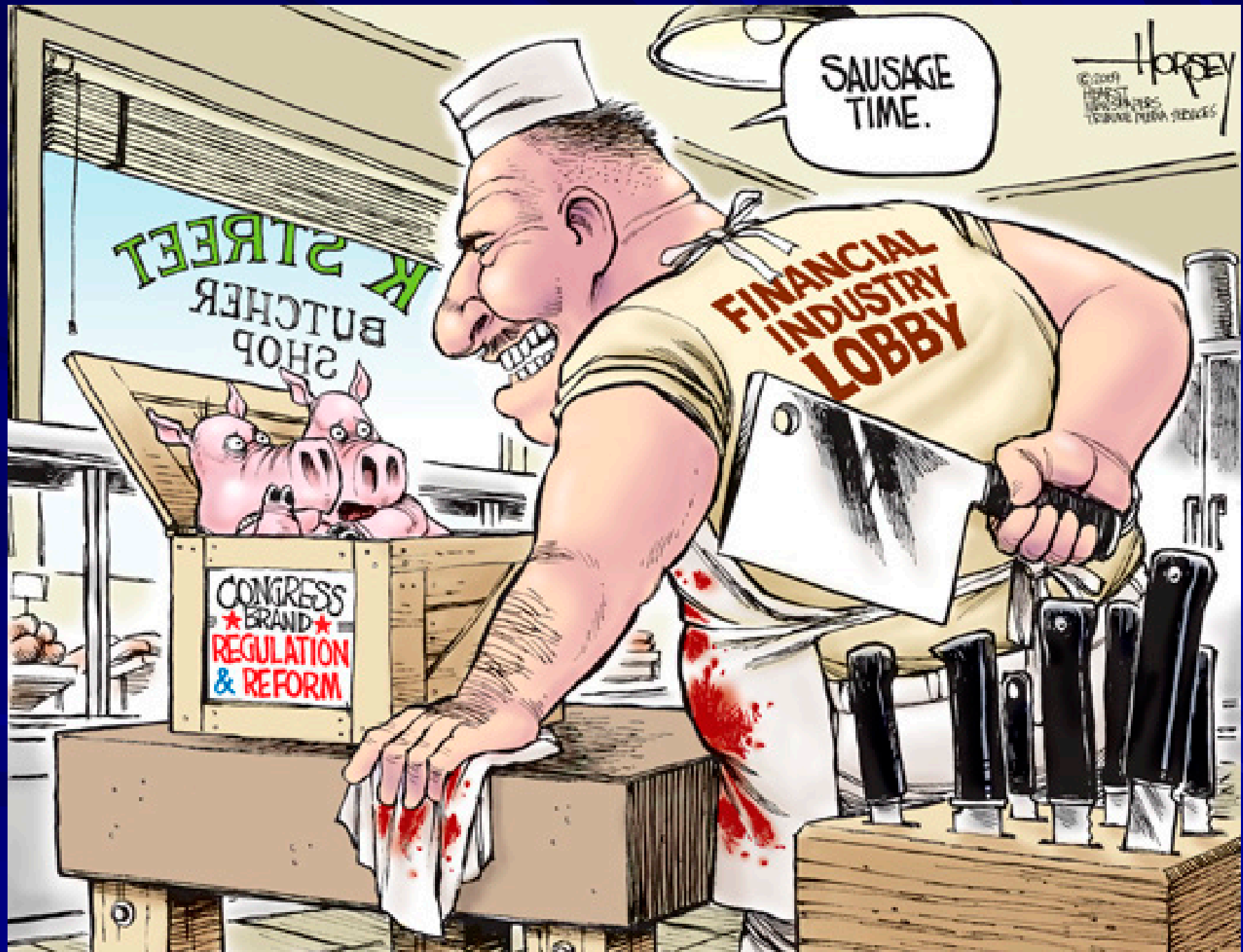
- **Threat:** A wave of restrictive new laws
- **Reaction:** Lenders lobbied to defeat legislation
- **Result:** Timely regulatory responses shut down

(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)



K STREET
BUTCHER
SHOP

CONGRESS
BRAND
REGULATION
& REFORM

FINANCIAL
INDUSTRY
LOBBY

SAUSAGE
TIME.

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FOR THE PEOPLE

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 markets
 - (1) originated loans with higher loan-to-income ratios,
 - (2) tended to securitize more,
 - (3) had faster growing loan portfolios,
 - (4) expanded faster in areas that later suffered from high delinquency rates,
 - (5) experienced negative abnormal returns during crisis.
- Results consistent with moral hazard
 - lobbying may be linked to lenders expecting special treatments from policymakers, allowing riskier lending behavior.

CONTRIBUTION

- First to examine empirically the relationship between lobbying and mortgage lending
- Unique dataset combining detailed information on lobbying and lending at the lender level
- Provide suggestive evidence that political influence of the financial sector might threaten financial stability

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

DATA

- Lending
- Lobbying
- Matching the two datasets

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 collapsed to the lender-MSA level
- Covers 2000-2007 (to overlap with lobbying database)

Variables on lending activity

- Main variable of interest:
 - Loan-to-income ratio (LIR) of loans originated by the lender – divide loan amount by income of borrower and take average of loans originated by the lender in a given MSA
 - Higher LIR as a measure of lax lending (affordability)
- Other variables of interest
 - Proportion of loans securitized
 - Credit growth

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 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: 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: => 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: => 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

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**

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
<i>Share of finance, insurance, and real estate industry FIRE in overall lobbying (in percent)</i>	14.7	14.3	15.8	15.2
Contributions from PACs	326	348	461	509
Total targeted political activity	3298	3696	4542	5256

EMPIRICAL ANALYSIS

■ EX-ANTE CHARACTERISTICS:

- Main variable of interest
- Loan-to-income ratio (LIR)

- Alternative dependent variables
- Securitization
- Credit growth

■ EX-POST PERFORMANCE:

- Delinquency rates
- Event study with 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

This finding does not change in specifications with lender fixed effects...

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

ENDOGENEITY ISSUES

- **FALSIFICATION TEST:** Omitted factors affecting lobbying in general?
 - Lobbying on other financial sector issues (consumer credit, deposit taking, etc.)
- **INSTRUMENTAL VARIABLES:**
 - *Distance to D.C. for cost of lobbying; opportunity cost of lobbying*
 - *Internal instruments (GMM)*
- **DIFFERENCE IN DIFFERENCE:** timing of introduction of anti-predatory lending laws (APL) 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 others in absence of APLs

FURTHER ROBUSTNESS CHECKS

- 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

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.

Bottom line....

- Lobbying is associated *ex-ante* with more risk-taking

LOBBYING & EX-POST PERFORMANCE

- Delinquency rates in 2008 and lobbying at the MSA level
 - Growth in lobbying lenders market share in the MSA during 2000-2006
- 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
Δ MS of lobbying lenders, 2000-06	0.220***	0.223*	1.475***
Δ MS 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* $\log(\text{distance to DC})$
 *** 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

Bottom line....

- Lobbying is associated *ex-post* with worse performance

INTERPRETATION: MORAL HAZARD

Sources of moral hazard

■ Preferential treatment

- higher likelihood of bailout during financial crisis

■ Short-termism

- lobby to create regulatory environment that allows them exploit short-term gains

Evidence

■ Stronger effect for large lenders

- large lenders which lobbied took more risks and had worst outcomes during the crisis
- “Too big to fail” argument

ALTERNATIVE INTERPRETATIONS

- Bad lenders lobby more to mimic good lenders
- Lobbying lenders specialize in catering to low-income borrowers
- Lobbying lenders are overoptimistic

Evidence suggests interpretations less likely

- Lender, MSA*time fixed effects
- Explicit controls for specialization
- Falsification tests based on lobbying on unrelated issues
- IV strategies
- Larger effect of lobbying on LIR in 2005 and 2006 – suggestive evidence against overoptimism

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