When Does Mortgage Broker Regulation Matter? *

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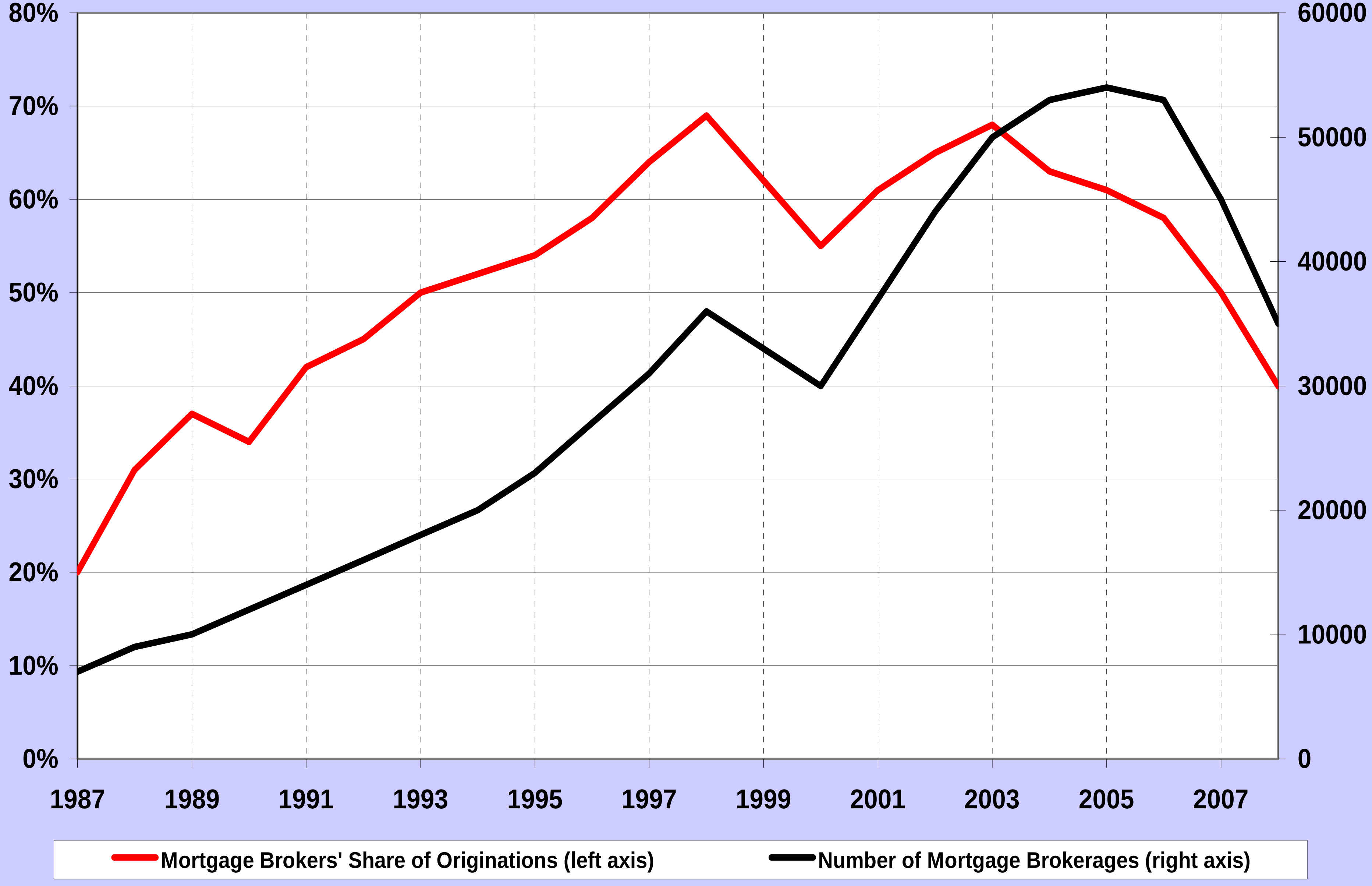
The Rise and Decline of Mortgage Brokers

(source: Wholesale Access to 2006)



Main Points

- Most forms of mortgage broker regulation are not related to market outcomes
- Bonding/net worth requirements have fairly robust 1996-2006 associations with
  - fewer brokers
  - fewer subprime loans
  - higher foreclosure rates
  - more high-priced loans
- Not inconsistent with licensing as an anti-consumer entry barrier; not supportive of a human-capital theory of broker licensing

Additional Points

- Only a few other empirical studies
- No fully developed theory, only elements with unclear or ambiguous implications
  - Search theories of (honest) brokers
  - Asymmetric information theories of quality/reputation/fraud
  - Asymmetric information theories of credit markets
  - Theories of limited rationality
  - Occupational licensing theories
- Our regulatory data are available
- Surety bonds are interesting and little studied

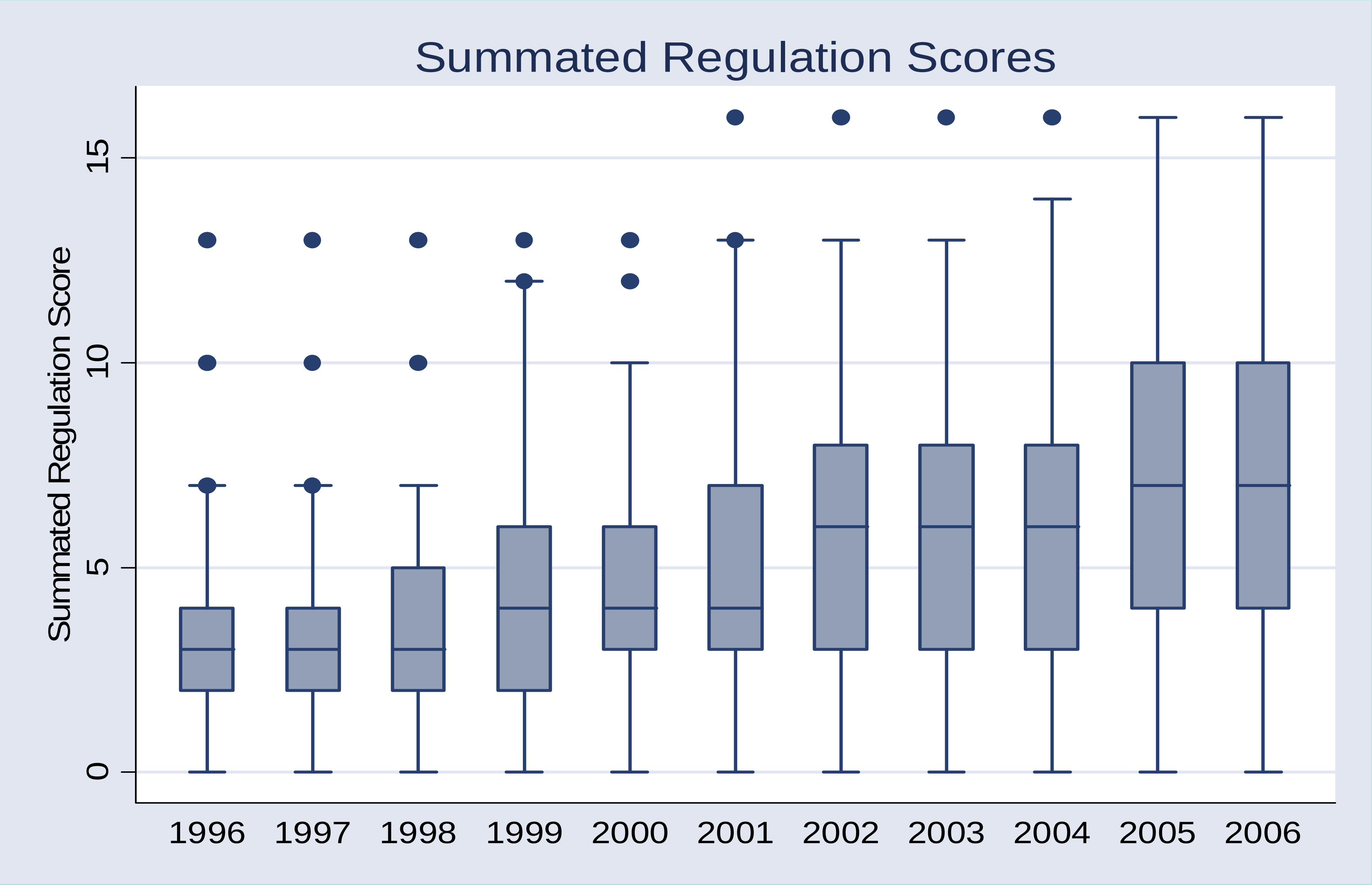
Mortgage Brokerage Profile

- Like lenders' loan officers, but independent
- Typically work with about 8 lenders, helping them penetrate new markets quickly, cheaply
- Typical fees 1% to 3% of loan, which may include lender-paid yield spread premium
- Typical brokerage has about 10 employees (5-6 brokers, 1-2 managers) & one office
- Industry grew extensively, by adding firms, with little change in average firm size

REGULATION VARIABLE DEFINITIONS: 1996-2006

- Education, exam, or experience needed to enter
- Continuing education requirements
- License fees (upon entry and annual renewal)
- Background check, “good character”
- Physical presence (“bricks and mortar”)
- Legal form
- Audited financial statements
- Minimum net worth and/or surety bond
- Can apply to firm, its management, its branch offices or managers, and/or its employees
- Some exemptions may apply

Rise of Mortgage Broker Regulation



Panel Data Results

- Variation over 51 “states” and years 2001 to 2006
- Bond/NW ($real) at minimum amount to enter
- ACS (OES) for labor data; HUD/HMDA for subprime mortgages, MBA for foreclosure rates
- Bond/Net Worth coefficient is
  - significant & negative for brokers per capita
  - imprecise positive for broker earnings
  - Significant & negative for volume of new subprime loans
  - Significant & positive for % mortgages in foreclosure
- Other broker regulations have no significant relationships

Cross-Sectional Results

- “High priced” loan dummy from 2005 HMDA
  - All CRA lenders, in & out of assessment area
  - 10 “broker dependent” non-CRA lenders
- Regress on other loan variables, census tract controls, and state regulatory controls
- Bond/Net Worth coefficient is consistently
  - Significant & positive for high-priced refinance in both samples
  - Marginally positive for high-priced home purchase mortgages in broker-dependent sample
- Other broker regulations have no consistent effects

Conclusions

- Dramatic growth in mortgage brokers and regulations
- Theory incomplete and ambiguous
- Thus our results lack a clear causal story
- They are consistent with a simple story that licensing is mainly an entry barrier that raises prices and cuts quantity and quality
- Pro-consumer interpretations not as simple
- Results downplay human capital influence
- More analysis needed, but broker licensing does not look like a silver bullet for curing abuses (though some role is possible)

Sources

- Kleiner, Morris M. and Richard M. Todd. 2007. "Mortgage Broker Regulations That Matter: Analyzing Earnings, Employment, and Outcomes for Consumers", NBER Working Paper No. 13684, (December), http://www.nber.org/papers/w13684

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