When Does Mortgage Broker Regulation Matter? *
Morris M. Kleiner
Richard M. Todd


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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
• 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

Summated Regulation Scores

Summated Regulation Score

Year

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
