GSE Activity Report

Monday, January 24, 2022

The Processing Problem

Summary

A new Federal Reserve Bank of Atlanta study adds another element to those prior research argues are evidence of widespread racial discrimination in U.S. mortgage finance. It adds processing speed to the list of discriminatory practices that now is said to include denial disparities, pricing, and refi rates. The paper's findings cast particular aspersions on loans originated for the GSEs, but it does so at a time when PLS distorted the market in terms of both underwriting and processing speed. Its conclusions that GSE practices exacerbated discrimination and that processing times added to the problem are not, in our view, clearly validated by the data, which suggest to us that processing speed is an artifact of other market factors (e.g., discriminatory steering by some lenders, GSE AU and put-back power).

Impact

This study tackles processing speed on grounds that racial and ethnic equity require not just fair access, pricing, and terms, but also timely loan availability. As the authors observe, lengthy approval times adversely affect minority borrowers, especially in competitive mortgage markets (i.e., now).

The study relies on HMDA and CoreLogic data on purchase and refi mortgages from 2001 to 2006, a time of rampant PLS and thus one in which securitization incentives can also be assessed. White borrowers are found to be over-represented in GSE securitizations, while Blacks and Hispanics are over-represented in PLS – minority borrowers were 25% of the market, but 50% of PLS borrowers and less than 20% of loans purchased by Fannie and Freddie.

Controlling for borrower, lender, county, and other characteristics, loans originated for the GSEs took one week longer for minorities seeking GSE loans but about the same for PLS. Importantly, controlling for lenders sharply widens the processing-time disparity, suggesting that some lenders may have been steering minority borrower to more profitable subprime loans heading for PLS even when the borrower qualified for a prime mortgage. As the paper notes, Countrywide's fair-lending settlement – the largest at the time – was in part based on the lender's practice of pushing minority borrowers into the subprime channel; the study doesn't say so, but Countrywide and some of the other lenders also accused of steering then may well have been large enough to skew the data.

Like other studies, this one finds that minority borrowers have a disproportionate share of higher-risk loans for which processing times are shorter. However, this may be spurious correlation – i.e., finding that processing times exacerbate discrimination may confuse causality in that the actual discrimination is in steering, not processing. And, despite its topline finding, the study also notes that racial/ethnic disparities between GSE and PLS loans may be due to GSE AU processing which required more due diligence than the get-happy PLS sector did at the end. Put-back risk doubtless also contributed to greater lender care.

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Outlook

As noted, this is a study of times happily gone by, making its applicability to current market practice at best uncertain. It also excludes FHA originations, thus omitting a key sector germane not only to mortgage finance before the great financial crisis, but also to current markets in which this channel is of particular importance to minority borrowers. Still, the paper's findings could well lead to regulatory and/or plaintiff inquiries given HUD's and FHFA's overall, high-priority focus on equitable finance, and the imprimatur often accorded Federal Reserve Bank studies.

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