GSE Activity Report

Monday, March 07, 2022

Banks Take Blame

Summary

A new Urban Institute study suggests that banks are more likely to discriminate when it comes to minority borrowers, heightening concerns at a time with increased political risk related to racial equity and mortgage finance.

Impact

At present, mortgage appraisers and AVMs are taking the brunt of legislative and regulatory action but banks are also targets, especially if they are big, as regulators rewrite CRA rules in concert with a sharp uptick in M&A. This paper finds that, even taking different business models of banks and nonbanks into account, nonbanks (including credit unions) make a larger share of loans to communities of color at every income level (23% versus 31%) from 2018 to 2019. Within either FHA or GSE originations, bank shares remain smaller than that of nonbanks. The largest percentages of bank loans to minority households are in LMI communities, doubtless reflecting many majority-minority neighborhoods. Still, the numbers here are problematic -- 38% versus 45%.

The study blames these differences on risk aversion, an issue we have long noted. What it doesn't mention is that banks are risk averse because of rules, such as the capital assigned to put-back risk. This capital-at-risk -- inapplicable to nonbanks and credit unions -- thus leads banks and especially large banks to double-barreled underwriting, especially for FHA.

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