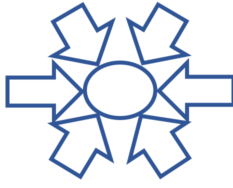

GSE Activity Report

Friday, January 12, 2024

Bad, Bad Banks?

Summary

A new staff paper from the Federal Reserve Bank of New York assesses the tender topic of bank mortgage lending to minority borrowers. Going beyond the usual statistics showing significant racial disparities, the paper dives into a bank-by-bank analysis of why this might be, finding significantly different and persistent fair-lending records at different banks. Controversially, it comes up with what might be called a structural racism rationale for bank-by-bank differences when it comes to mortgage lending for African Americans. This might not sit at all well with bankers, but it could well have political traction with progressive advocacy groups despite our methodological quibbles.

Analysis

Based on a dataset of 114 million mortgage applications sent to 838 banks from 1995 to 2019, the paper assesses the racial home-ownership gap, which has not materially budged in fifty years, and loan-denial disparities (notably wider since CRA's enactment in 1977). These data derive from three public sources and may have methodological challenges not clearly addressed in this study. Notably, mortgages originated for FHA, VA, and other "government programs" are eliminated. Given the disproportionate amount of minority loans in these programs, it is possible that study results would look considerably different if they captured government loans, especially if the "government loans" left out of the study include those sold to Fannie and Freddie. The paper does not explain why these loans were omitted.

Based on its methodology, the paper finds that bank-by-bank approval rates are differentiated in ways that do not comport with different geographic markets that might account for different borrower demographics or other objective differential factors such as credit score. Instead, differences are due to the extent to which a bank is "inequality averse." This subjective criterion is measured by census-tract voting records in counties where a bank has branches. Banks in "left-leaning" counties are thus judged more inequality-averse than those in areas that go to the right based on the authors' view of literature on political attitudes to redistribution. The mechanism by which inequality-averse stakeholders affect bank lending in their areas is said to be a bank's responsiveness to depositors, borrowers, and employees based on dominant political ideology, with the paper citing the stakeholder reaction to George Floyd's murder as evidence of this "channel."

The paper not only finds that goodness is its own reward when it comes to attracting deposits in inequality-averse areas; it also concludes that banks willing to cotton inequality have small, but observably higher charge-offs and non-performing real estate loans, and lower net-interest/asset ratios. The paper posits that the difference here between inequality-averse and -tolerant banks results from the motivation inequality-averse banks have to ensure that they reach creditworthy Black borrowers to avoid stakeholder punishment.

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Outlook

Regardless of its methodological challenges, this paper could have a political impact because it either names bank names or could be used to do so if advocates press analysts surely sympathetic to their concerns. The one list in the paper considers the nation's largest banks, finding that Citi has the smallest racial disparity of mortgage approval ratios and Regions the largest.

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