Color and Credit
Race, Regulation, and the Quality of Financial Services

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\textsuperscript{2}University of Michigan

October 2017
5\textsuperscript{th} Annual Community Banking Research and Policy Conference
Federal Reserve Bank of St. Louis
Motivation

Consumer protection is important and is a focus of regulators across many areas in the economy.

- e.g., FTC, FDA, DoJ.

Banking and financial services have drawn a great deal of attention.

- debates on the fiduciary rule for financial advisors.
- recent Wells Fargo scandal.

Little is known about who bears the brunt of this misbehavior.
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Our setting: mortgage lending.

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In a world with frictions, distortions will be present.

- products may have restricted quantities, higher prices.
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We provide a first step to focus on product quality in banking.
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Plan of attack

Examining mortgage quality dilution (complaints):

1. Data & Research Design
   - “protect consumers from unfair, deceptive, or abusive practices and take action against companies that break the law.”
   - We study mortgage complaints from 2012-2016:
     - about 175k complaints
     - 16k zip codes (covers ~ 282m people as of 2010 census)

2. Income, Education, & Race

3. The Role of Regulation
## Example Complaint Narrative

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Lower quality (i.e., more complaints) in areas with
- lower income
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- higher minority population

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- true quality is unobserved.
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- Are minority areas simply “complainers,” regardless of the quality provided to them?
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The CRA regulations establish the framework and criteria by which the Agencies assess an institution’s record of helping to meet the credit needs of its community, including low- and moderate-income neighborhoods.

- Goals include
  - “promote the availability of credit and other banking services in low- and moderate-income communities.”

- Low-to-moderate-income (LMI) tract (CRA focus areas):
  - median family income (MFI) ≤ 80% of MSA-level MFI.

- Observably identical areas, including on income, can have different regulation-induced pressures to lend.
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⇒ $50,000 tract is LMI for Dallas, but not LMI for San Antonio.
Matching: Regulation-targeted Tracts

Match CRA-focus areas to non-focus areas using

- number of mortgages, population (size of the market)
- education, income (information and sophistication)
- house price changes (wealth and home equity change)
- state (regulation)

Assumption:

- After the matching on observables, the LMI regulatory designation is not systematically related to other unobserved factors that drive complaints.
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Is the CRA effect different for high-minority areas?
- *Low-Minority:* 0-5% higher.
- *High-Minority:* 40-50% higher.
Summary and Main Findings

Consumer protection and equality is a paramount concern for policy-makers and regulators.

1. What are the key characteristics of areas that receive poor-quality financial products and services?

   ▶ Low income.
   ▶ Low education.
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Color and Credit
Race, Regulation, and the Quality of Financial Services

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October 2017
5\textsuperscript{th} Annual Community Banking Research and Policy Conference
Federal Reserve Bank of St. Louis