Paper Session 7: Borrower Characteristics, Soft Information, and Credit Allocation

Discussion by

Rebecca Zarutskie*

Federal Reserve Board

September 29, 2023, FDIC Bank Research Conference

* The content reflects the discussant's views and not necessarily those of the Board of Governors of the Federal Reserve System or other members of its staff.

Two related papers

The Effect of Minority Bank Ownership on Minority Credit (Hurtado and Sakong)

- Finds that racial minority borrowers are more likely to be approved for mortgages by same-race owned banks and same-race loan officers.
- Finds that default rates are also lower on minority mortgages originated by minority-owned banks of same race.
- Examine outcomes for Asian borrowers following collapse of Asian-owned bank and find evidence consistent with minority-owned banks expanding credit for minority borrowers.

Social Capital and Mortgages (An, El Ghoul, Guedhami, Levine, and Roman)

- Finds that borrowers in high social capital counties are more likely to be approved for mortgage credit
- This is especially true for traditional banks
- Finds that borrowers in high social capital areas get better loan terms and are less likely to default.
- Use an instrumental variables strategy which predicts social capital as a function of based on ancestry of population.

What connects these papers?

- Both papers consider the role of soft information in lending decisions.
- In both papers soft information arises from social interactions or better understanding of community incentives and behaviors that might not be readily discernable from observable borrower data.
- Both papers examine the same lending market – home mortgages – using similar data sources (HMDA, McDash).
- Both papers find convincing evidence that social behaviors may produce soft information and create incentives that improve loan credit evaluation, loan monitoring, and loan performance.

What do we learn from considering both together?

- In the first paper, it is the match between bank and borrower that is important for soft information.

- In the second paper it is the geography more generally that is important for value of soft information, but the authors find evidence that the effect is stronger for certain lenders.

- Both papers face identification challenges and the approaches used by each paper may be helpful for the respective author teams.

- The papers highlight that the perennial importance of relationships and soft information in credit decisions and performance.

Suggestions: Hurtado and Sakong

- Is it possible to look at borrowers who apply to more than one bank?
- Can you match minority-owned banks to other similar banks? Right now only control for bank size in regressions. How do minority owned banks compare to small community banks vs large banks in their lending behavior?
- Can you find more "plausibly exogenous" bank exits or entries?
  - Perhaps look for an instrument for whether new banks are formed and new minority banks are formed.
  - Use banking deregulations as an instrument?

Suggestions: An et al

- Would like to see more analysis of whether certain types of borrowers benefit more or less from being in areas with high social capital.
  - Do minorities fare better? Young borrowers? First-time borrowers? More established borrowers?
  - Same question for borrowers in lower social capital areas – who is most affected?
- Some more intuition on why IV estimates are an order of magnitude larger would be helpful. Why do we thing LATE effects should be larger?

Some Open Questions

For areas without a lot of traditional measures of "social capital" are there lenders that may be able to discern relevant soft information?

- What might be incentives for entry or the barriers to entry for such lenders?

Or are there better and more efficient ways to process hard information in these areas that may lower in social capital?

- What might be incentives for entry or the barriers to entry for such lenders?

Are lenders who specialize in lending based on soft information in a community less or more stable over the longer run compared to lenders that do not?

Are there other types of lending or financial products that would not be as dependent on soft information?

Conclusion

- Great pair of papers and useful data collection efforts!
- Already some interesting findings and questions for future work.
- Look forward to the discussion.