Discussion of:
The Life Cycle of a Bank Enforcement Action and Its Impact on Minority Lending

James Vickery
Federal Reserve Bank of Philadelphia

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1. Example of a bank enforcement action

In the Matter of:	)	Docket Nos. 11-094-B-HC1 11-094-I-HC1 11-094-B-HC2 11-094-I-HC2
WELLS FARGO & COMPANY, San Francisco, California	)	
and	)	Order to Cease and Desist and Order of Assessment
WELLS FARGO FINANCIAL, INC., Des Moines, Iowa	)	of a Civil Money Penalty Issued Upon Consent

...

1. Within 90 days of the date of this Order, Wells Fargo shall submit an acceptable plan for overseeing fraud prevention and detection, and overseeing compliance with applicable federal and state laws pertaining to unfair or deceptive acts or practices and with section 129C of the

...

9. Within 90 days following this Order, and every calendar quarter thereafter, Wells Fargo shall submit a written progress report to the Reserve Bank. The progress report shall detail the actions taken to comply with each provision of this Order and the results of those actions. This may require additional progress reports if necessary. Such reports may be discontinued when the Reserve Bank, in writing, releases Wells Fargo from making further reports.

Source: `https://www.federalreserve.gov/newsevents/pressreleases/files/enf20110720a1.pdf`

2. This paper

Research question: How do enforcement actions (EDOs) change bank behavior? In particular: effects on mortgage credit to minority borrowers?

Key findings:

1. Mortgage lending to minorities rises (in *relative* terms) after EDO is lifted.
2. Evidence consistent with catering to regulators.
    - E.g., stronger effects for banks with low CRA ratings

3. General reactions

- Important research question. Significant practical policy implications.
  1. Enforcement is a key regulatory tool. Important to understand distributional effects.
  2. Nice complement to literature on effects of financial supervision
     - e.g., Agarwal et al. 2014; Granja and Leuz 2019; Hirtle et al. 2020; Eisenbach et al. 2021; Ivanov and Wang 2021; Fuster et al. 2021

- Appealing strategy to link EDOs to HMDA and trace out mortgage lending effects
  1. Could extend to other margins too (e.g., CRA data on small business lending)

4. My comments

1. Mechanisms
2. Measuring lending risk
3. Causality

5. Mechanisms

Not (yet) fully convinced about catering explanation. Main concerns:

1. Enforcement actions related to fair lending $<1\%$ of the total (12/1,350)
   - Shouldn't catering focus on actions directly related to EDO?
2. Why no response *during* the period the EDO is in effect?
   - Disconnect relative to motivating evidence in table 3
3. In denial results, credit availability for minorities goes *down* after end of EDO – just by less than other groups

5. Mechanisms (cont.)

	No Denial
	(1)
During EDO	-0.0370*
	(-1.73)
Post EDO	-0.1380***
	(-7.21)
Borrower	-0.1110***
	(-5.56)
During EDO x Borrower	-0.0054
	(-0.48)
Post EDO x Borrower	0.0640**
	(2.24)
Observations	3,102,329
Pseudo R^2	0.068
Reg Type	Multinomial Logit
Controls	Yes
Year FE	Yes
Cluster	Bank
Years	1994–2018

5. Mechanisms: suggestions

1. Alternative story – shifts in risk-taking?
   - Higher credit risk in segments where minority borrowers are over-represented (e.g., low-FICO)? Other risks? e.g., legal risk for FHA lending
   - Do banks become less risk-averse after the EDO is lifted?
   - Some analysis of loan risk in paper, but could be much sharper (next slide)

2. Suggestion: Look at subset of EDOs where regulator is more likely to pay attention to mortgages and fair lending
   a. Mortgage lending is highlighted/mentioned in the action itself
   b. CFPB is a participant in the EDO
   c. Fair lending EDOs (but not enough of them?)

6. Measuring lending risk

- Current approach: $NPA_{it} = a.EDO_t + b.postEDO_t + c.controls_{it} + \epsilon$

- Not great way to measure changes in lending standards, for a few reasons:
  1. NPLs reflect defaults on total *stock* of loans. Mortgages are long-lived.
  2. Exacerbating this issue: "seasoning" (mortgages typically don't default immediately)
  3. Most mortgages are securitized, and don't show up on Call report.

- Alternatives:
  1. Use observable characteristics in HMDA:
     - E.g., i) FHA lending; ii) high LTI $\times$ sole-borrower (predicts default; Fuster et al. 2021)
  2. Use performance data for securitized loans (Fan/Fred/Gin)

7. Causality

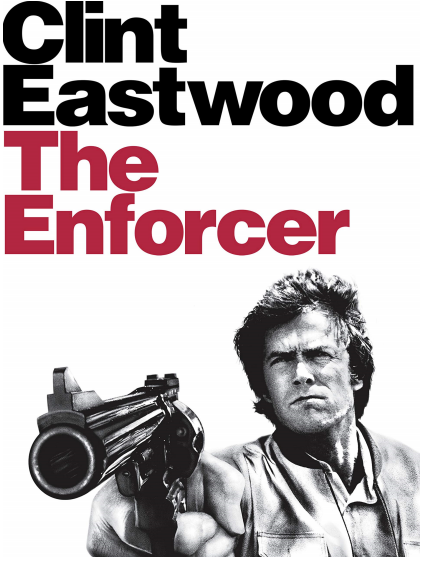
- **Key question:** How would lending, deposits etc. have evolved in absence of EDO? Were these banks heading for a fall anyway?

- Suggestion: Trace out full dynamics: include $\Sigma_t \tau_t \times (t - date_{EDO})$ in model, and show results graphically.
  - $\rightarrow$ Allows reader to assess pre-trends. Also easier to understand.

- What is comparison group? Sample only includes EDO banks?
  - $\rightarrow$ Suggestion: Consider matching, to compare to otherwise similar group of non-EDO banks

8. Other comments (for authors)

- Securitization: how does EDO affect securitized vs balance sheet lending?
  - Matters for interpretation (e.g., implications of additional lending on bank size, risk weights & bank capital)
- Related: look at wider range of mortgage outcomes
  - Jumbo vs conforming; borrower income etc.
  - Exactly which loan segments are lenders targeting?
- Econometrics:
  - Poisson regression to deal with zeros?
  - Issues with staggered TWFE DiD models (Goodman-Bacon 2019 etc.)



- Very interesting paper on an important topic – effects of financial enforcement
- My reading: EDOs do not exacerbate inequality in credit access (at least not directly)
- Further study and monitoring is important