

Ethnic minorities in the UK have less access to loans and credit cards than the general population, a study has found. What lies behind this alleged racial discrimination in the credit market? PHIL MOLYNEUX reports.

Why credit isn't **colour-blind**

Now more than ever, there is much interest in how banking and finance can aid economic development and help alleviate poverty.

One strand of the studies currently being carried out focuses on financial exclusion – individuals barred from access to banking services for a variety of reasons.

The inability of individuals and households to access financial services is seen as a setback for society, since it leads to social exclusion. Moreover, those who lack access to financial services are often excluded in other areas of society too.

Recently, the World Bank has sought to identify the extent to which financial exclusion is globally prevalent. It set out to gauge how people in 148 countries – including the poor, women, and rural residents – save, borrow, make payments and manage risk (Demirguc-Kunt and Klapper, 2012).

Although the data reported covers only one year (2011), the results are revealing. They highlight the limited access of underprivileged people to financial institutions in many of the world's poorer nations.

Academic studies on access to finance have mainly focused on advanced economies and household access to financial services. They generally discover that it is determined by factors such as levels of income, net worth,

education, employment status, age and ethnicity.

In the US, before the 1990s, financial exclusion existed primarily in forms of “redlining” – refusing to provide financial services, typically loans, because people live in a certain geographical area – and discrimination. In terms of ethnicity, the World Bank study generally confirms that financially excluded households include a

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disproportionate number of ethnic minorities.

Early empirical analysis of racial discrimination in mortgage lending was prompted by analysis of data compiled by the Federal Reserve Bank of Boston. Typically, black and Hispanic people have higher mortgage

application rejection rates and are offered less attractive terms than white people with similar credit and other features. Other evidence points to people from these communities paying more for their mortgages – around 0.5 per cent – even when factors such as income levels, property dates and the age of buyer are taken into account.

Smaller, yet adverse, price differences for minority mortgages are found in other studies, although these higher rates may be counteracted with more favourable terms (longer low rate lock-ins) elsewhere. Mortgage default rates may also be higher or no different. Other evidence suggests that racial disparity in mortgage approval rates falls substantially for black people the longer their credit history.

Features of US racial residential segregation have been widely documented. Academic interest in racial redlining increased after the passing of the 1974 Equal Credit Opportunity Act (which outlawed redlining), and the Community Reinvestment Act of 1977 (which made it illegal for lenders to have a smaller amount of mortgage funds available in minority neighbourhoods compared to similar white neighbourhoods).

Literature on discrimination in the consumer credit market is again typically US

focused, and less developed than that on mortgage financing. Early findings are mixed. Some studies find no evidence that minorities are discriminated against in access to consumer credit; others find loan approval rates are lower for minorities.

A number of studies look at car loan pricing and find no evidence of discrimination. However, this could be because non-price terms differ for minorities compared to whites, leaving those discriminated against to drop out of the market.

In a recent paper we use data obtained from the Living Costs and Food Survey, gathered by the Office of National Statistics in the UK, to investigate whether discrimination is prevalent in the UK consumer credit market. In particular, we focus on information provided by over 59,000 households' access to loans and credit cards between 2001 and 2009.

Overall, we find that non-white households are more likely to be excluded from consumer credit, even if they have comparable credentials. Compared to white households, Asians are more likely to have less access to bank loans, whereas black households are


more likely to be excluded from the credit card market.

What is also interesting is our finding that the presence of racial discrimination holds over the business cycle. Surprisingly, we observe a rise in discrimination during the boom period between 2004 and 2007, a time when banks are reported to have relaxed lending standards. It may be that relaxation of credit standards only applied to white households; this is likely to have further increased the gap of credit accessibility for non-white households.

The possible reasons behind racial discrimination in access to consumer credit in the UK are unclear. One can surmise that it is due to long-established prejudices of bankers enshrined in credit granting decision-making (and possibly built in to credit scoring models too!).

Another difficulty in the study of discrimination is that banks and regulators rarely provide information on bank lending or other services according to ethnic groups or in specific regions. Also, dealing with demand issues can be problematic. Typically studies rely heavily on consumer/household survey information, which is useful but not ideal for

empirical investigation. A strong case should be for banks and regulators to provide more information on their intermediation activity with consumers and households, so discriminatory practices can be ruled out.

Being aware of the link between access to credit and social exclusion, policymakers should seek to develop policies aimed at reducing such inequalities. There is a strong case to consider legislation that encourages intermediaries to reveal information on lending and other financial services activity, to ensure that such discrimination does not take place – whether in developing or developed countries. 

Professor Phil Molyneux, the Dean of the College of Business, Law, Education and Social Sciences ('BLESS') at Bangor University is also a Module Director for the Chartered Banker MBA programme. More information can be found www.charteredbankermba.com

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