DOWNTOWN THINKING ABOUT LENDING AND RISK

by Steve Brown

You get an unusual feeling when you walk around any big city downtown area early in the morning. Such areas deliver their own unique experiences, as you notice some people are heading into work, while others are just now heading home from a late night out on the town. Downtown office buildings tower around you on all sides, which causes the wind to blow constantly, as it rolls down each one. Papers swirl in the street, creating a strange morning dance for you to enjoy with each step as you go on your way. We happen to enjoy walking into work at an early hour, because along with everything else it delivers, we have found no better way to find time to think about the day ahead and clear the mind. The next time you are downtown in a major city around this country, try drinking things in and using all of your senses. If you do, perhaps you too can find the Zen that comes from such a calm, albeit somewhat eerily quiet, environment (and most often a chilly one too). As you ponder that, we once again explore some of the interesting things going on around the industry that we think you will enjoy.

Strange Situation: Every lender is taught that the first position is the place to be when it comes to controlling a loan deal and the risk around it over time. That is why we found it fascinating that data shows while 30 to 89 day delinquencies on first trust deed single family residential loans compared to 2nd trust deed home equity loans are about 1% apart (3% vs. slightly less than 2%), things shift drastically when you review loans 90 days plus or in nonaccrual. There, while home equity loans remain close to the 2% level, first mortgages soar to above 9%. Theories vary, but they run the gamut from consumers are staying current on home equity loans over first mortgages because they want to pay as many bills as they can and money just runs out when it comes to the mortgage. Others say it is because borrowers are using home equity lines for day to day expenses and to keep options open. Still others say it is because the banks moved faster and back in 2007 deeply cut lines to the weakest borrowers. No matter the reason, it makes you certainly pause to rethink what really is the best position to be in when originating any loan.

Risk Management: Regulators and bankers everywhere are trying to figure out the best way to manage risk industry-wide and it is not an easy problem to solve. Complexities surface everywhere, but some of those we like to discuss the most are due to underlying human psychology. You see, when it comes to assessing risk, it is important to know that the human mind plays tricks on us all. It will react in different ways to the exact same data, depending on how that data has been framed and presented. As humans, when presented with a best-case scenario, something shifts in our mind and we usually increase our appetite for risk. Meanwhile, there are also certain groups of people that enjoy taking risks in an attempt to control their own destiny. Still other research finds higher testosterone levels play a major role in driving risk taking during financial decision making. Finally, people like to make good decisions that are logic based. That is our goal, but because of the way we are all wired, we also enter each discussion carrying cognitive biases (rules of thumb, memory, errors in judgment) that can produce incorrect conclusions. As if that weren't enough, we also tend to overestimate our abilities and underestimate what can go wrong so care must be taken and recognition of these weaknesses should be incorporated into any good program.

Perhaps we never will figure out what makes people tick and why we do what we do, but no matter the thinking process, we still enjoy mulling it over while walking downtown streets in the early morning hours.

BANK NEWS

Earnings

BB&T earnings dropped 40% from last year, as noninterest income fell 18.1% due to lower securities gains and additional net losses/writedowns on foreclosures. Comerica profits jumped $52mm though interest income dropped 15% and total loans fell 16%. Fifth Third reported a loss of $72mm, following a $26mm loss last quarter. Delinquent loans, nonperforming and net chargeoffs declined 15%, 7% and 18%, respectively. KeyBank reported a $55mm loss, down from $488mm 1Q last year. Total loans fell 20% as lending income dropping 8.7%. Morgan Stanley raked in a $1.78B profit, as revenue grew to over $9B. Net income at PNC rose 26% YoY to $671mm as loan loss provisions fell 28%. SunTrust net losses shrank to $229mm, although net chargeoffs rose 35% YoY and nonperforming assets jumped 15%. Wells Fargo reported a 60% YoY rise in net Income as revenue grew 16%.

Insurance Calc

The FDIC released the latest version of its deposit insurance estimator, designed to be included on bank websites (it's brandable). It allows users to compute coverage for irrevocable trusts and government accounts, in addition to personal and business accounts. The estimator now allows the calculation of insurance coverage past 2014.