SPORTS AND BANKING

by Steve Brown

People love to watch and participate in many different kinds of sports and over the years that has resulted in some interesting information to surface. For instance, did you know the average life span of a major league baseball is about 7 pitches; that it takes 3,000 cows to supply the NFL with enough leather for a year's supply of footballs; that 300mm golf balls are lost or discarded in the U.S. every year; or that on average 42,000 tennis balls are used at Wimbledon? Another thing that you may find interesting comes from research on payment defaults of single family housing loans. The research has surfaced some interesting facts about borrower behavior that could influence not only residential lending, but also perhaps business lending as well. The simple fact is that social media, smartphones and multi-tasking are so much a part of one's life that business creeps into personal and personal bleeds over into business. Simply put, the lines between business and personal lives have been blurred and that can inject behaviors that can influence the bank and risk. This research on payment defaults during the credit crisis found borrowers with strong credit ratings tended to act more in their self interests, the more assets they held. Since lending teams often position borrowers favorably that have more assets (as a way to ascertain guarantor strength), this new research certainly turns part of that thought process on its ear. While borrowers with stronger credit ratings as a group were more likely to remain current on their loan during the crisis than those with lower ratings, it did not hold true for all. In fact, a small subset of the higher credit rating group had worse payment performance the greater the number of properties they owned. Essentially, the research found that payment performance was worse for a given credit score, when borrowers with that score had higher than average levels of other assets. While borrowers with two properties or less performed about at the average default rate, borrowers who owned three or more properties performed as much as 253% worse. Since so many lending teams look to guarantor strength and assets in their underwriting, the research points out more may be more at work here than simple analysis to truly protect the bank against future risk. Also of interest, perhaps, the research found that the risk needle moved to "red" (more likely to have one or more payment defaults) despite a high credit score if the borrower had a mortgage balance of more than $1mm; was in a geographic area of the country where prices had fallen sharply; and the borrower had multiple property ownership. It should be pointed out however, that those with higher credit scores overall still defaulted at a lower rate than borrowers with lower scores; but the data shows a subset of these higher credit score borrowers (with the characteristics above) were more likely to have one or more payment defaults as they acted in their own self interest. In an effort to improve, perhaps it is time to modify or expand the way your bank handles the underwriting process and the components considered before you extend credit to a borrower. Adding loan covenants based on financial triggers, making sure the borrower understands how these work and consistently monitoring and managing issues in the earliest stages of difficulty will help ensure you are in a good position to ultimately collect on the principal. As we close the discussion today and you think about which sport(s) you might participate in / watch this weekend, consider that 3 consecutive strikes in bowling is called a turkey; that Babe Ruth wore #3 on his jersey because he batted 3rd in the lineup; and that a turkey, stuffed with a duck, stuffed with a chicken is known as a turducken.

Related Links:

PCBB 2012 Executive Management Conference

BANK NEWS

M&A

Commerce Bancshares ($1.6B, MA) will purchase Mercantile B&T ($193mm, MA) for $26.5 million in cash, or about 1.3x tangible book.

M&A

PSB Holdings ($622mm, WI) will buy Marathon State Bank ($108mm, WI) for $5.6mm in cash or 1x book. In a twist that used to be popular, Marathon will pay $14.3mm to shareholders before the sale in the form of a special dividend. Since PSB doesn't need the capital, the move is a way to return shareholder value under the lower capital gains tax.

Hunger Games

While the movie opens at midnight, we will have a recap of the increase in bank M&A transactions next week and will show how multiples have seen their largest increase in at least 4Ys.

Apple Bank

Rumors are circulating that Apple will attempt to start a bank to support its forthcoming "digital branch." We doubt it, as Apple is smarter than to enter such a highly regulated sector as banking right now.

StressTesting

The FDIC extended the comment period from this week to the end of April on a proposal that would require savings and non-FDIC banks with more than $10B to conduct annual stress testing to ensure capital-adequacy.

Holiday Account

In a throwback move, Webster Bank has introduced a Holiday Club Savings account that pays 3bp on balances locked in until the end of the year. The Christmas account has the distinction in banking of being the first mass marketed account dating back to 1912 and the distinction of being one of the more profitable a bank can have.

Clarifying Clarification

The average (mean) duration of unemployment from 1948 until early 2009 was 13.6 weeks and is now 40.8 weeks (not months). Sorry for the confusion.