LEVERAGING CHARACTER TO MAKE MONEY IN LENDING

by Steve Brown

A recent CNNMoney story reported how a group of millionaires that were surveyed came into their money. Since people always want to know how to make more money, we thought you would find the results interesting. The study found 95% of millionaires said they were successful as a result of hard work; 89% said education helped; 81% attributed some portion to smart investing; 79% said they were frugal and 42% admitted some of their success was due to just good old fashioned luck. Clearly a combination of factors is required if you want to hit or exceed that million dollar threshold, but this should at least get you moving in the right direction. Today we choose not to have a discussion about millionaires, but rather about moving in the right direction. We were intrigued by some recent Fed research on consumer debt. It found that since 2008, consumer deleveraging has been occurring at a decent clip, as total household liabilities have declined by about 7% or roughly $1T. That is a significant decline in dollar terms, as well as overall percentage, but it does not tell the whole story. To gain greater insight, we turned to Fed research that took a random sample of data from credit rating agency Equifax. It looked at consumer credit histories from across the country. That analysis found that as of the 4Q of 2011, of the approximately $12T in consumer debt outstanding in this country, roughly 70% was mortgages, 10% was home equity lines or installment loans, 7% was auto loans and 6% was credit cards (note that the rest was not indicated in the report). After boiling things down even further, the analysis found that deleveraging had been occurring differently by household and the most important differences were not based on geography, but rather on the type of borrower. Those who defaulted on their mortgage loan debt tended to also see a bigger decline in their non-mortgage loan debt than those who stayed current on their mortgage loan debt. The good news from this analysis for bankers is that it seems to indicate the character of the borrower still matters. Lending has certainly evolved over the years and capturing an arcane concept like character is trickier than ever, but the basic components are there nonetheless. Taking a look at borrower behavior and comparing that to a credit score still tells you a decent story when it comes to loan repayment. You have all seen it and you know who these people are in your own town. They are the borrowers who work diligently to make sure their loan is paid back, because their word is still important to them. They borrowed money with the full intent to repay it. Despite the crushing blow the economy has delivered; this group is scrimping, saving and working like crazy to make sure that happens. These borrowers not only know how to manage their money and are proactively doing so, but they also believe in the financial fabric of our system and have character. Don't get us wrong, as we still believe cashflow of a project should be at the top of your list when analyzing loan risk, but it is nice to see data that seems to support the fact that some people will bust their tails to make sure you get paid back and that character has a place in lending. These are the sorts of borrowers every bank wants to have, so we remind our readers this morning to be sure and take the time to thank borrowers who have paid continually during this period of crisis. They not only deserve a hearty thank you for doing so, but also because they truly respect the loan terms they agreed to follow. Character still matters, so if you get a chance, be sure to remind any newly-minted millionaires you come across of that fact. Then, be sure to triple check payment histories when they, or any other customers, approach your community bank seeking a loan. Good borrower character and good quality loans nearly always go hand in hand.

BANK NEWS

Moody's Negative

Credit rating agency Moody's released a report forecasting a negative outlook for the U.S. banking system over the next 12 to 18 months. The agency cited economic challenges, a challenging operating environment, prolonged low interest rates, high unemployment, fiscal policy uncertainties and the threat of contagion from the European sovereign-debt crisis as the primary reasons. Moody's pointed out that banks are in recovery mode, but at risk of reversal if the economy takes a turn for the worse.

For Sale

ING Group will sell its 9% stake in Capital One acquired when it sold its online bank earlier this year. The deal is expected to be worth about $3B.

Small Biz

After steadily declining since late 2006, the latest Wells Fargo-Gallup Small Business Index finds small business owner satisfaction has jumped to 39 in the 3Q vs. 26 in the same quarter of 2010. Overall, 55% of small business owners say they are satisfied with being an owner, 29% are somewhat satisfied and 16% say they are not satisfied.

Retail Risk

In a trend banks should be monitoring, Moody's has modified the way it rates retail loans, as concerns increase retail outlets will face increased competition from online.

National Debt

The Treasury reports our national debt has now surpassed $16T.

Euro Zone

The European Commission has submitted a proposal that would allow it to supervise the 6,000 banks operating in the Eurozone, as it struggles to contain the financial crisis. The proposal would allow the ECB to pull banking licenses and take other actions to stabilize the system.

Spanish Stress

As concerns increase around the financial system, Spaniards have withdrawn a record $94B from their banks, an amount equal to about 7% of GDP.