

Consumer credit beckons

Six points to consider before you jump back in Management tips presented in online companion to November 2009 magazine's cover story, "Is consumer lending the new model?"

By Steve Cocheo, executive editor, scocheo@sbspub.com

In the November 2009 cover story, experts suggested that with mainstream credit cards evolving, and commercial real estate still smarting, that community banks might benefit from a shift back towards personal lending. The cover story explored broad trends as well as potential opportunities in specific niches.

In reporting that story we also asked the experts, "If you were a bank executive considering a renewed push into consumer lending, how would you go about it?" Here is what they said:

1. Know before you jump in what credit strata you wish to serve, stick to that strata, but think twice about "B" and "C" credits.

"Normally banks are going to make consumer loans to A-credit borrowers," says Catherine Ghiglieri, president of Ghiglieri & Co., Austin, Texas, and former Texas Banking Commissioner. "B" and "C" credits are not for banks, she maintains, adding that "I think regulators would be leery of banks getting into B and C loans."

No matter what strata the bank determines to serve, it's essential to stick to the policy set up at the outset. More than ever, says Ghiglieri, how borrowers have paid their bills in the past will be the key factor.

2. Acknowledge that rates are going to rise, sooner or later, in planning your program and in pricing your credits.

Many bankers appear to be in denial that interest rates are eventually going to climb, and as a result they are not building this certainty into their asset-liability management planning, says Michelle Gula, president at m.rae resources, inc. Bethlehem, Pa. If a renewed consumer lending effort is going to succeed, it has to be based on realistic pricing and projections, she adds, and management has to address any faults embedded in the bank's balance sheet.

3. Recognize that there are going to be losses.

The advantage that community banks bring to consumer credit is that they know their prospects, their community, and their local economy far better than most large banks, says Randy Marshall, managing director at consulting firm Protiviti, Inc.

That said, the nature of consumer credit is that "the real cost is the degree of credit loss that is borne by these types of products," says Marshall. This must be acknowledged as the bank formulates its strategy.

4. Consider adding automated credit scoring to your evaluation methods.

While his colleague Randy Marshall's point is well taken, Protiviti's Michael Brauneis, director of regulatory risk consulting, says credit scoring is necessary for programs of any significant scope to make economic sense. Similarly, while some believe that community banks' future lies in enabling A-level, "dented credit" customers to borrow from a bank, Marshall believes that consumer credit programs need homogeneity in design and underwriting to work well.

5. Don't get stuck in credit-only thinking.

Many of the experts interviewed spoke of the importance of building larger relationships with consumers, beginning from a credit base.

For instance, m.rael's Michelle Gula believes that consumer borrowers can, in time, prove a good source of deposits, frequently low-interest or no-interest transaction account deposits. Her firm often recommends that client banks set up a "CDO" position. ("CDO" stands for "cash deposit officer.")

6. Sweat the details of funding up front, not on the fly.

More than ever, funding is a key detail for consumer lending. Experts say it is most likely that community banks will be putting consumer loans into their portfolios, not selling them to a secondary market, in the immediate years ahead. Given that terms for some types of instalment loans can run for six years or more, Catherine Ghiglieri warns, community banks won't want to fund them solely with short-term deposits. This will mean paying additional attention to deposit and funding strategy, and in a time when traditional and nontraditional liquidity practices have both been running into tougher regulatory scrutiny.

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