Bryan Stevens

Why Can't My Bank Help Me?

When people need a loan, the first thought many have is, "Let's call our bank to see what it can do for us." People automatically believe that banks make money from lending and therefore should be willing to help.

Seems logical.

If my clients don't have the money to pay for our funeral services, why can't I just go to my bank and set up a program to help these clients get a small loan? The answer is quite simple: Banks are not interested in this type of lending.

Since 2008 when the financial markets collapsed, banks have become more regulated and their profits have slowed because of the increased cost of regulation. Despite arguments over whether bank regulation is good or bad, the reality is that regulation isn't going to go away.

Why are banks more heavily regulated? The answer is simple: Banks carry your deposits and take those deposits to lend money to people. If a bank makes a number of bad loans, it puts at risk your deposits at that bank. The FDIC will insure up to $250,000 of a consumer's deposits, but getting those funds from a failed bank takes time. What bank regulators do is ensure that your funds are safe from bad decisions by bankers. Thus, more regulation and more conservative bankers better protect your deposits.

Banking regulations limit the types of consumer loans made. For example, collateralized loans are more acceptable than uncollateralized loans. Within collateralized loans, housing loans are more favorable than auto loans. Within housing loans, banks favor consumers with larger down payments. Lending is far more complicated than most think, and the rules and regulations are ever changing.

Banks are required to reserve part of their profits to cover bad loans or bad debt. If collateral is attached to a loan – for example, a car is used to secure an auto loan – the car can always be sold off to pay off as much of the loan as possible. A plan is then set up with the borrower to cover the difference. If the borrower cannot pay the difference, the bank writes off the loan balance, which impacts its profits. This is an oversimplification of the banking industry, but it's obvious that a loan backed by collateral is less risky than a loan backed by nothing.

The least liked loan in banking is an uncollateralized consumer loan.

The absence of banks to finance these consumers opens the door to consumer finance companies. For years, people who used consumer finance companies to buy appliances, furniture, vacation packages, carpeting and other products were thought of as higher risk consumers. Nothing could be further from the truth. Consumer finance companies finance those products that banks have no interest in financing.

Consumer finance companies are not banks. Their interest rates and fees will be higher, but they can finance consumers with less-than-perfect credit, which banks will not.

Consumer finance companies are not as regulated as banks are and have greater flexibility on the types of loans compared to banks. They are less regulated because consumer finance companies do not take deposits – they raise money from private investors and lend to consumers. If a consumer loan company makes a number of bad loans, the private investors lose their investment, not a depositor.

The higher interest rates and fees are attributed to the private investors' return on investment. A private investor may require a return of 7 percent on his or her investment, which means that a loan made by this finance company will carry an interest rate of 15 percent to 25 percent based on the risk. Compare that to a bank, which pays a customer a deposit rate between 0 percent and 2 percent, and you can see why bank interest rates are lower.

In my opinion, banks will never be in the at-need funeral financing business. Because of the risk, amount of the loan and interest rates, banks will continue to lend in areas in which they are most familiar, which makes consumer finance companies the only viable, safe option for funeral homes going forward.

Bryan Stevens is president of Red Apple Capital LLC. Prior to Red Apple Capital, Stevens was president of a small community bank in Illinois. He has a strong background in consumer lending and compliance, both as a chief compliance officer and chief financial officer of a consumer finance company. Stevens has also held positions with the FDIC as an asset review specialist, chief credit officer with KeyBank's SBA Division and national SBA sales manager for business lenders, a Merrill Lynch investment. He holds a bachelor's degree in economics from Cleveland State University and an MBA from the University of Notre Dame.

This article was written in collaboration with Tony Colson of E. Harper & Son Funeral Home in New Haven, Indiana.