

Rehabilitation of Equity Borrowers
through Service Packaging
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by
Sherman Whipple

Introduction: 05:00

As one who has spent the last twenty years involved in confidential research and marketing to help clients, including financial institutions, gain a strategic advantages over competitors, it is something of a twist to be standing here talking to a room full of bankers and, in a sense, giving away the store to everyone. But the issues I will address today, cannot be resolved by one bank competing with another and will require a fundamental change in the role of consumer banking.

Since 1979, I have conducted periodic benchmark research into the attitudes and needs of the financial services market. We have tracked the rise and fall of disintermediation and developed marketing strategies and packaged financial instruments to help banks, thrifts and credit unions turn adversity into market dominance.

Every two years we conduct overlay studies of our financial market model to reveal new trends, pitfalls and opportunities for our clients to increase share. In 1985 and 87 we tracked the emerging consumerism of the New England region and the market instability caused by inflated real estate appraisals and equity lending. While the market shifts were in the range of 3 or 4% per year, they were still quite significant in a market which, historically, moves very conservatively. In years past, a 2% shift was considered significant.

Nothing, however, prepared me for the changes in 1989 and 91. Market shifts began accelerating at a rate of 10 to 20%, consumer attitudes and confidence went through a total reversal. When we completed the analysis of our 1991 findings, we found that the profile of customers for bank and financial services had changed more in the period between 1985 and 1989, a period of just five years, than it had evolved in the period of 1937 to 1985, a period of nearly fifty years.

More important, our findings showed that the greatest shift was concentrated in one demographic segment: The 35 to 54 year old, professional/managerial, upper income homeowner - the anchor of the consumer economy of the 70's and 80's.

Frankly, I doubted my own research...but after contacting economists, other researchers throughout the country, and banking organizations. we learned that our findings were almost totally consistent.

In essence, we found that upper income baby boomers, a generation educated from birth with the lessons their parents had learned from the great depression, had for some reason and in great numbers, changed their investment, savings and spending habits. Starting in 1984 they began to cash out their equity and investments to adopt a more expensive lifestyle. Now many of these baby boomers are paying the price, they have spent or invested themselves into a negative equity position.

Because this formed a significantly large and defined market segment, we coined the term NEBBie to describe Negative Equity Baby Boomers.

Let's look at the numbers...

In Massachusetts and the industrialized markets of New England, we found that 53% of the upper income, professional/managerial baby boomers were approaching or in a negative equity position. In New Jersey, a researcher came up with findings showing 49% of baby boomer households were NEBBies. In Atlanta this figure of debt concentration was reported at 63% and one California bank analyst estimated the NEBBie incidence to be 30 to 40% on the West Coast.

The magnitude of this debt concentration becomes even more significant when we consider that professional/managerial baby boomers represent 19.1% of total US households. That's about 17,359,448 families. If we are conservative, this means that 30%, or more than 5 million American families are unlendable and, without help, will be unable to put their children through college or even retire with any security at all. In the worst case, we may be talking about 9 million households.

In terms of spending, between 1984 and 1987, this group alone may be credited with contributing more than 275 billion dollars per year to the US economy, over 90 billion per year of which was not disposable income, but home equity secured or generated spending from this group alone, not including other demographic segments. It can be reasonably argued that this massive infusion of dollars into the consumer economy may have delayed the onset of the national recession by nearly two years.

Today, their equity is gone and so is their contribution to the regional and national economies. In fact, without their buying power, the economy may take several generations to fully recover. The long-term impacts are quite ominous. Can we afford to support the largest generation in this nation's history through their retirement on social security alone? Let's face it, the

laborforce is not growing fast enough to carry a whole generation of grandparents who have already cashed out of the American Dream!

NEBBies may be the single biggest problem facing both the economy as well as the banking industry. But for the banking industry, in particular, NEBBies may also be your greatest opportunity for future revenues and profitability and well as your chance to show the world how progressive banking practices can be applied to put the economy back on track.

Development of Specific Points: 12:00

First, let's put the statistics aside for a moment and look at the NEBBies as people. We all know NEBBies, they are our customers, our doctors, lawyers, neighbors...if fact, statistically it represents about of third of the people in this room. Do we need a show of hands.....mabye not.

Back in the mid-80's after the baby boomers had established themselves into top management and in their professions, we all saw a new generation enter and begin to move up within the workforce. They were called Young Urban Professionals or YUPpies. Kids just out of college with tremendous preparation and upward mobility who didn't own their own homes and had high disposable incomes. While Yuppies, as a group, represented only a 3.7% share of US households, their spending habits and lifestyles were both attractive and conspicuous.

Imagine what a threat they must have seemed to the baby boomers who held senior positions to the Yuppies, it seemed that every Yuppie had a BMW, better clothes, ate a finer restaurants, knew more, was more ruthless, and was a definite threat to the baby boomers job and personal criteria for success. The fact that consumer advertising targeted the Yuppie lifestyle appeal into the

boomer demographic only reinforced the baby boomer's insecurities. Imagine the motivational forces at work to make these children of the '60's compete with the "me now" generation of the '80's.

At the same time, in the east and west, it appeared that the escalation of home values would never stop. To the baby boomer, who had most likely purchased his first home in the inflationary seventies, and already invested fifteen or more years in building equity, this must have seemed like a windfall opportunity to cash in years of hard work to build equity and just skim enough to make themselves more competitive with the young newcomers in the workplace.

To defend themselves, the baby boomers established new alliances. Once they refinanced their home or began equity borrowing, their bankers became their closest friends. They learned all the catch phrases and reveled in their ability to leverage a lifestyle of the rich and famous. From our industry interviews, the friendship went both ways. Many bankers sponsored their free wheeling baby boomer customers for seats on their boards, and they increased their social and leisure interaction.

But then, in 1989, the friendship began to sour, particularly in the Northeast corridor, when the real estate market softened. The pressure from regulators and the drying up of the equity well turned relationships into resentments and the constant reminders in the news about the banking crisis left both the bankers and the boomers with feelings of suspicion and guilt.

So, ladies and gentlemen, the honeymoon is over and we are into the seven year itch. You may never again have the warm supporting relationship with the NEBBies, but we still must consider the children.

No act of congress or presidential candidate is going to turn this economy around or help the NEBBies recover their buying power and security.

There is no magical program to allow their children to be able to pay for college when the parents are unlendable and have no equity to pledge. Now, it is up to you...the banks.

Someone in my office suggested, the other day, that we hold a NEBBie Aid Concert with Neil Diamond, Barry Manilo and the Beach Boys and ask all the farmers and blue collar workers to contribute Lean Cuisine Dinners and Visa Gold Cards.

Actually, by understanding the motivations of the market and their present state-of-mind, we will realize that the NEBBies already have the potential to rehabilitate themselves and return to a strong financial position. They just do not have the mechanism...and this is where you come in. You can help the NEBBies to help themselves.

More important, by rehabilitating the NEBBies, you will be repositioning your entire industry to profitably serve future generations.

The key is cash management services

To determine how to address the need and market such services, we went beyond the statistical research and conducted in-depth, focused analysis of more than 50 NEBBie families in the northeast. Our research indicates that the equity borrower market will respond favorably to the availability of banking services which will help manage debt, reduce debt-service costs, budget family expenses, re-establish equity and provide for greater security and retirement benefits.

Remember, we are not talking about people on the unemployment lines. These people still have their jobs, usually two incomes, 2.12 children and homeownership. Many have second homes and investment properties. The minimum household income is \$55,000.00 per year and the median is over \$75,000.00, adjusted nationally.

One of the most significant factors preventing the NEBBies from re-emerging as a strong component in the consumer economy is that they are currently paying out 30 to 40% of their household income to debt service, alone. This doesn't include principal, only interest.

Many are paying very high interest rates on unsecured credit card debt. Of the 51 households where we conducted in-depth interviews, 29 indicated that they had exhausted the credit lines on their cards to make their mortgage payments. Considering that the cost of the mortgage debt is no more than 12% and the cost of the unsecured card debt may be twice as high, this is a clear indication of desperation and lack of financial planning.

One comment related by many NEBBie heads of households is that they were too embarrassed to let their bankers know they were in trouble. Many are forced to borrow from Peter to pay Paul and it is costing them dearly. They know they are paying too much interest, but they don't know any other way, short of bankruptcy protection, to get themselves out of trouble.

At the same time, 90% of the study group stated that they would definitely consider paying up to \$100.00 per month for the services of a professional financial manager if they could realize additional disposable income without risk or further increasing their debt.

60% of this group stated they would place all of their deposits in a non-interest bearing checking account if their bank offered financial management services, in lieu of interest.

100% of this group stated that they would place all of their deposits in interest bearing accounts with a bank offering professional cash management services, if the services were discretionary and the charges for the specific services they elected to use, could be offset by their interest.

We followed up with focused discussions on specific services, existing instruments, new programs, costs and exactly how the market would utilize these services and what forms of marketing and offerings would be perceived as most attractive.

Relating to specific services,

Your junior and senior professional/managerial customers would be willing to pay a premium or give up interest for no hassle checking. They are willing to pay for transactions services and you can turn your checking business from a loss leader into a profit center.

They would prepay in advance for the availability of Pre-approved loans, lines of credit, O-D protection.

The NEBBies would agree to premium service charges, administration fees or transaction fees for customized systematic savings/loan plans for equity reconstruction, balloon payments, tax bills, home purchases, travel, investment, autolease buyouts, education. Understand these are not simply savings clubs, but bank managed savings plans, geared to a customer's individual needs.

The affluent baby boomers would pay for banks acting as investment managers to maximize their return on certificates.

Your market would consider accounting and tax preparation services to be a natural offering of a bank.

They would even consider compensating their bank for participating in the role of estate planning.

Our study group mentioned many other features and services which they felt the banking industry should address which would enable them to appreciate your value and esteem. They

mentioned:

- Bank by phone to pay bills
- Buyer protection plans
- Direct deposit
- Earlier hours
- Later hours
- Life insurance
- Safe deposit box
- Self directed IRA accounts
- Trust account

With the statistics on the market and a laundry list of their needs in hand, we have followed up with bankers, regulators and legislators to determine how feasible it would be to reposition the role of the consumer banking industry into the role of financial services management. We have analyzed the profitability issue as well as the operational and regulatory.

Nearly every banker I have spoken with has told me that this is what he or she would like to do, but the rest of the industry would never go for it. It would be too much of a risk for one bank to take the initiative. There would be too much risk.

Maybe you've been beat up too much lately, or you just don't give yourselves enough credit.

This is not a question of risk.

My research and the research of others clearly shows that a sufficiently large market already exists to justify the restructuring costs and operational issues involved in turning the transaction side of bank operations into a profit center. Why should you continue to devote up to 90% of your operational costs to underwriting a loss leader?

Financial and transaction services packaging will enable you to become profitable since you will be offering a true value and become less dependent on the performance of your loan portfolio. You will

have a more balanced operation. This was recognized in the February 1991 Department of the Treasury Report on Bank Modernization and Regulation.

Banks do not have to make the change overnight. You can build step by step, just as Fleet in Rhode Island has been doing. One of the first steps for you NEBBie customers could be restructuring loan repayments to bi-weekly paydown. As a marketing convenience, offer this with automatic withdrawal from your customers transaction account. For the professional, get their business account and include direct deposit into their personal accounts.

Once your customers have established a track record, offer them debt consolidation or low interest cards to further reduce their debt service, increase disposable income and pull additional loan revenues based upon a complete credit history and total financial control. Services such as this, do not even increase your overhead if you take advantage of packaged or private label computer software.

Appropriate technology exists to allow banks to automate and cost-effectively implement profit generating services packages without requiring modification of their present computer or accounting systems. For many services packages, your cost per branch could actually be less than \$1,000.00 using PCs and pre-packaged financial management software.

Given today's advancements in VAP applications, the emerging technology which is rapidly replacing networks, a totally automated consumer based cash management system could be developed in a matter of a year which could cut your service expense in half from present levels while allowing you to increase the amount of service available to customers tenfold.

That's right, you increase profits, reduce costs

and save the economy.

Conclusion and Benefits: 03:00

By creating market driven and responsive transaction services packages, the banking industry will develop new profit centers, sources of revenue and become more competitive against non-bank financial services organizations.

By participating in transaction services packages and cash/debt management programs, every one of your customers, including the NEBBie demographic will reduce debt service, build equity and enjoy increased disposable income.

The resulting increase disposable income on the customer side combined with the more profitable and balanced operating structure of the banking industry will contribute to a more stable economy and economic growth.

Finally, I know the banking industry has taken a bad rap for giving the market what it wanted. Now it is time you reasserted yourselves by giving the market what it needs.

Q&A: 10:00