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iPhone Financing? Regionals Get Creative with Consumer Lending

By Brian Patrick Eha
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Last September, when Citizens Financial Group launched its iPhone upgrade lending program—a new partnership with Apple in which it offered 0% interest-rate financing to consumers buying the latest smartphones—it set a record for loan originations.

On the program's first day, the Providence, R.I., company booked about 60,000 loans. It was, as far as its executives could tell, the greatest number of loans that any bank in the history of the United States had opened in a single day.

"It was a near-flawless launch," said Brendan Coughlin, president of consumer lending at Citizens, still marveling months later. Just like that, the $146 billion-asset bank had tens of thousands of new customers.

In retrospect, given the demand for the iPhone 6s, which launched that same day, the result shouldn't have been a surprise. By Sept. 28, three days after launch, Apple had sold more than 13 million units of the iPhone 6s and 6s Plus, "blowing past any previous first weekend sales results in Apple's history," according to the tech giant's chief executive, Tim Cook.

But the wild initial success of Citizens' new, point-of-sale loan offering was no fluke. In fact, it looks like a sign of the times.

Consumer lending, the death of which was perhaps always exaggerated, is back in a big way. Since 2011, banks' total loans to individuals, including credit card debt, have increased about 15%, from $1.28 trillion to $1.47 trillion, according to the Federal Deposit Insurance Corp. Since 2009, at the height of the recession, consumer loans on banks' books have increased by more than 40%.

Automobile lending -- the one type of consumer lending that had experienced strong growth throughout the recession

– has driven much of that growth, but with the air going out of auto, banks are finding innovative ways to pump up their consumer loan books.

At a time when yields on commercial and real estate loans are at historic lows, they are creating new business lines, teaming with established retailers, even partnering with alternative lenders in an effort to diversify loan portfolios and generate new revenue streams.

When Citizens launched its iPhone lending program, its stated goal was for loan balances from iPhone purchases to total between $400 million and $500 million within 12 months. With these loans having already added $310 million to the bank's balance sheet, the program looks to be on schedule.

"It's not a big [revenue] driver yet," said Brian Klock, an analyst at Keefe, Bruyette & Woods, "but it's a great product to have when you think about the interest-rate environment they're in, to be able to remix the portfolio."

Citizens is about equally weighted between consumer and commercial lending. It is expecting 6% to 8% overall loan growth this year, and around 2% quarter over quarter, according to Brad Conner, vice chairman of the consumer banking division.

Another bank profiting by its recent foray into point-of-sale lending is Regions Financial. For more than a year now, the $126 billion-asset bank has been partnering with alternative lender GreenSky to provide loans to Home Depot customers undertaking large, expensive projects for which they can't or don't want to use a credit card.

Those loans did more than any others to boost volume in the overall category of indirect consumer lending, according to Grayson Hall, Regions' chairman and chief executive. That portfolio totaled $599 million as of March 31, up 153% since the same time last year. Largely as a result of this success, the bank's total consumer loans increased 5% from a year earlier, to $30.5 billion.

During the bank's first-quarter earnings call, Hall said he was surprised by just how well the point-of-sale loan product was performing. But he has now adjusted his expectations. "We do expect continued growth in this product category in 2016," he said.

Even with recent gains, Regions is still relatively light on consumer loans. Commercial loans made up 70% of the bank's total loan portfolio in the first quarter of this year.

Consumer lending stalled in years after the financial crisis as consumers, facing an uncertain future, began to spend less and save more, paying down existing debts and living within their means.

It’s not that banks didn’t want to lend to consumers, but they saw more opportunity in commercial lending and focused on growing that business. On the consumer side, bankers "were just as focused on creating growth, there just wasn't any to be had," said Marty Mosby, an analyst at Vining Sparks.

But there are positive signs. As consumer confidence recovers and households begin to increase their spending, credit card debt is growing again. Total credit card debit was $712 billion in the first quarter of 2016, up $28 billion from the year before. Big banks, including Wells Fargo and JPMorgan Chase, have made strides in their effort to position the credit card not as a tool reserved for big purchases but as "a cornerstone" of consumers' daily lives, Mosby said.

Another growth area is student lending. Since March 2015, the total load of student debt borne by Americans has increased by $72 billion, hitting the extraordinary sum total of $1.26 trillion. While the government is now the country’s largest student lender, banks are finding new opportunities in student lending.

Citizens, for example, is a student-loan refinancing product for which the target borrower, is a 33-year-old with an established job, a FICO score in the high 700s and a history of repayment, according to CEO Bruce Van Saun. Over the past 15 months, Citizens has managed to grow its student-lending business "from a standing start" to about $1.5 billion, Van Saun said at an investor conference in New York last month.

Changing consumer behavior—the increasing tendency to bank digitally—is also driving renewed interest in consumer lending. The low overhead of online lending allows banks to offer lower interest rates on unsecured personal loans, often by partnering with alternative lenders.

SunTrust Banks is investing heavily in LightStream, an online platform it owns that makes direct unsecured loans to individuals for a wide variety of purposes. The interest rate of each loan depends on what the borrower is using the money for. "The application process is easy to understand and the vast majority of our clients apply, fund, service and repay their loans completely online," Aleem Gillani, the bank's chief financial officer, said last month at a conference hosted by Barclays.

SunTrust acquired LightStream in 2012 and, since introducing it to its retail branches in 2015, has seen "good early results," Gillani said. Thirty percent of the loans originated through LightStream came from SunTrust in the first quarter of 2016. The bank's total loan portfolio in the category of direct consumer lending, not counting student loans and credit cards, has shot up in the past few years, from $2.8 billion in 2013 to $6.1 billion in 2015.

Like Regions, SunTrust also has a partnership with GreenSky to provide streamlined financing to consumers looking to make home improvements. "Over time there may be additional opportunities for SunTrust to partner with other high-quality companies and jointly deliver our capabilities to consumer and small-business clients," Gillani said on the call.

Indeed, the shift toward treating alternative lenders as allies rather than enemies looks set to continue. In April, Regions announced that it was partnering with the online lender Avant to use Avant's digital platform to originate consumer loans. The bank will also refer to Avant less creditworthy borrowers, those with scores below 700, who don't meet Regions' more stringent standards.

That same month, however, Citigroup broke off its relationship with Prosper, a large peer-to-peer lender, after Moody's dinged Prosper for a higher than expected rate of loan chargeoffs. When second-quarter earnings are reported, analysts will be listening closely to hear whether partnerships between banks and online lenders, such as that between JPMorgan Chase and OnDeck Capital, which also launched this spring, are paying off.

Indeed, bankers are taking pains to reassure investors that creditworthiness is still of paramount concern when it comes to consumer lending. "We don't play in subprime, which may be a concern for some investors," Van Saun said last month. "We're not in auto subprime. Never have been."

Jason Ware, the chief investment officer at Albion Financial, an asset- and wealth-management firm that invests in banks, agreed that banks are being more cautious.

"Bankers lost their way 10 or 15 years ago, and we've gone so far the other way that unless you have a pristine balance sheet or a good credit score, a good credit history statement, a good job, it's very difficult to receive new lending, and that's good," he said. "But where they can provide incremental growth through those channels, they're certainly starting to pursue those."

Ware said it will almost certainly be years before consumer lending returns to pre-crisis levels -- and that's fine for investors like him. In his view, the mid-2000s was "an artificial period. Not only do we not want to go back there, but that was not a normalized rate for this economy. The quick growth we saw in [2006] was never sustainable."

"You don't want to compare your last mile run to the mile you ran five years ago when you were doing performance-enhancing drugs," Ware added.
