US CONSUMER CREDIT RISK
Trends and Expectations
FOURTH QUARTER 2011

A Survey by the Professional Risk Managers' International Association

January 2012

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ACKNOWLEDGEMENTS

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PRMIA would like to extend special appreciation to The Center for Decision Sciences at Columbia Business School for their assistance in analyzing the survey responses. The Center for Decision Sciences brings together scholars from a range of fields who share an interest in human decision making. The center facilitates research and understanding on consumer behavior, the implications of decision making on public policy, and the neurological underpinnings of judgment and decision making. The center is housed within Columbia Business School, widely acknowledged as being among the world's top business schools. To learn more, visit ***http://decisionsciences.columbia.edu***.

EXECUTIVE SUMMARY

Since the fourth quarter of 2009, PRMIA has conducted a quarterly survey of bank risk professionals regarding their predictions for the next six months and the impact of current events on their field. The survey asks risk managers about consumer credit supply and demand, credit standards, delinquencies and other issues related to consumer credit. During the fourth quarter of 2011, risk management professionals polled reported similar responses to previous surveys; however, there is growing concern about instability in the student loan market, and the respondents offered interesting observations about the Eurozone crisis and the growing influence of Chinese consumers.

As mentioned, many findings from the fourth quarter echo those seen in the third quarter report. The notable exceptions come from consumer revolving credit and small business credit and loan behavior. Notably, many, if not most, respondents feel that consumer credit interest rates and the approval criteria for credit and loan products will not increase or become more stringent over the next six months. And while respondents were not as optimistic regarding small business borrowing as they were a year ago, they are slowly becoming more positive in terms of business borrowing ability and the amount of money extended to small businesses.

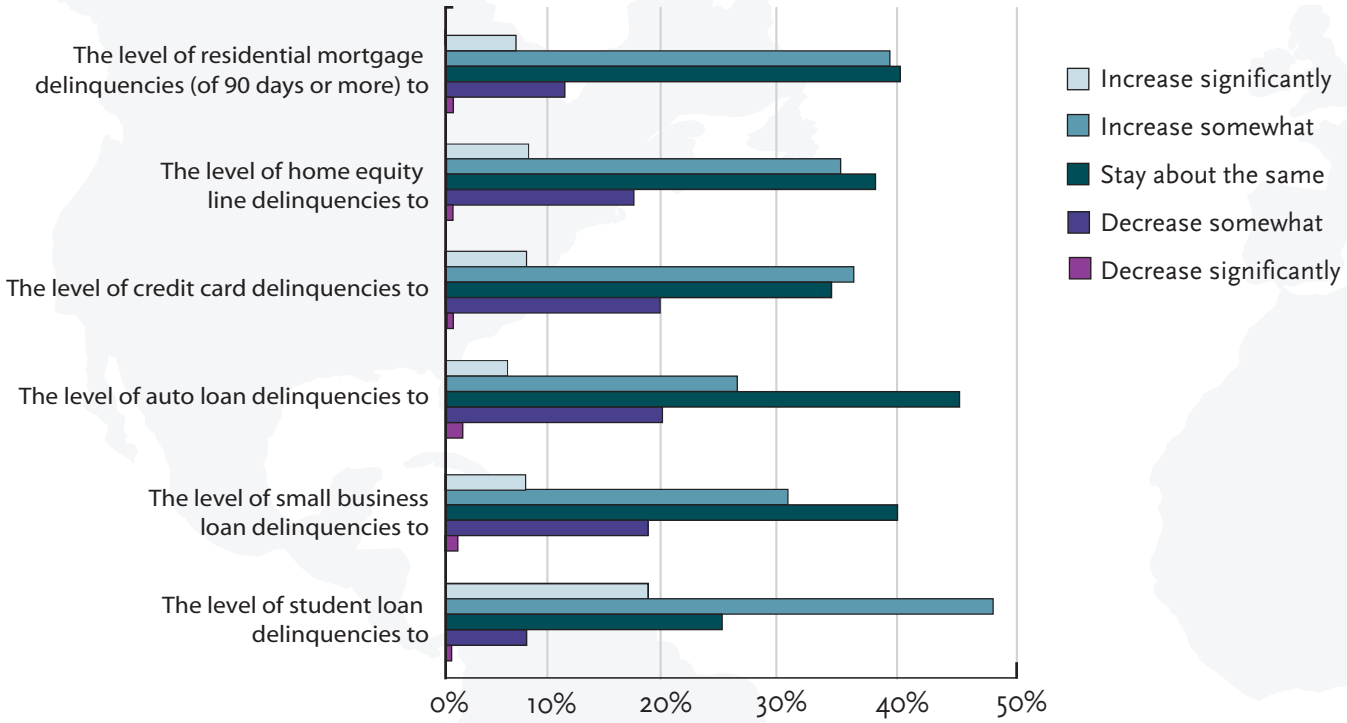
Key findings and predictions about the next six months:

- Many (47%) feel that the level of mortgage delinquencies will increase.
- While 64% of respondents expect small businesses to request more credit, only 35% of respondents expect banks to extend more credit to small businesses. This indicates that a significant 'credit gap' remains.
- Most (67.4%) feel that the level of student loan delinquencies will rise.
- Over half (54.3%) expect that the average credit card balance will increase.
- Only a quarter (25.1%) feel that the amount of consumer credit extended by lenders will increase.
- If the U.S. were to fall into a double dip recession, one third (38.8%) feel that the European debt crisis would be primarily to blame, while another third (38.4%) blame U.S. government policy.
- Nearly three quarters (72.4%) feel that the influence of Chinese consumers will surpass the influence of U.S. consumers within the next 10 years.
- Half (51%) expect that the U.S. banking sector is more prepared for a financial shock now than it was in 2008.

KEY FINDINGS AND ANALYSIS

Delinquency Predictions Remain Consistent

Looking at the industry as a whole, over the next six months, do you expect: (check all that apply)



For a third straight quarter, risk managers remain unconvinced that the delinquency rates involving the six types of loans discussed would improve anytime soon. In reviewing the data from previous quarters, there are no dramatic differences – however, several smaller shifts have been observed.

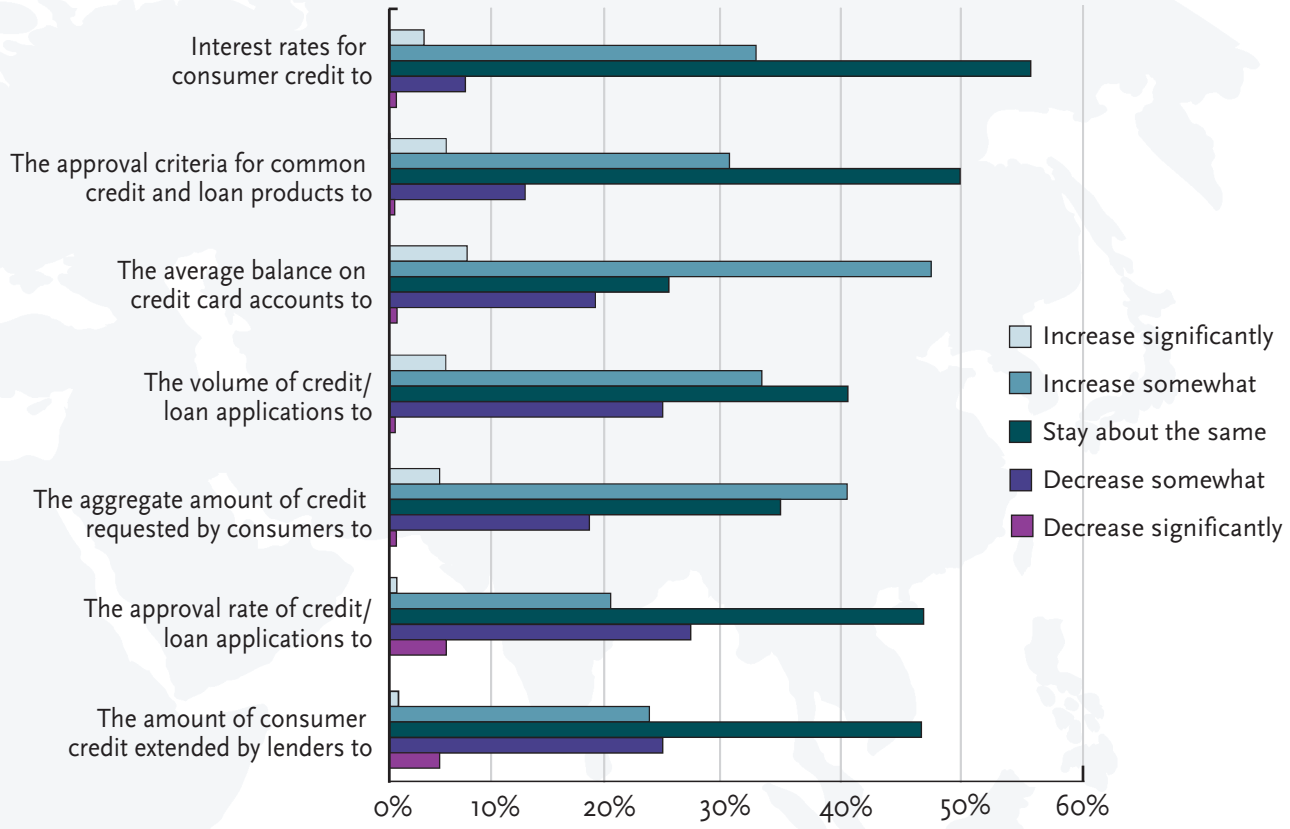
Beginning with mortgage delinquencies, 47.1% expect an increase, slightly more than was predicted during last quarter's survey. Slightly higher predictions of increases in home equity line delinquencies are also noted (44.3% compared to 40% last quarter). Credit card delinquency predictions also show slightly more (44.6%) predicting an increase compared to Q3 (39.7%). Of these slight bumps, the credit card delinquency prediction is most concerning, as over the past two quarters the number of respondents predicting an increase has risen 14.3%.

Slightly less than half (45.4%) predict no change to the level of auto loan delinquencies, and similarly, 40.1% predict no change to the level of small business loan delinquencies. Both of these numbers, however, are 3-4% lower than previous levels in Q3. Finally, only a quarter (25.5%) of respondents predict the levels of student loan delinquencies to stay the same, nearly identical to Q3's predictions.

Overall, delinquency predictions paint a somewhat pessimistic picture. Risk managers continue to express concern that delinquency rates are high and likely to grow higher.

In Consumer Credit, Many See Things Leveling Out

Looking at the industry as a whole, over the next six months, do you expect: (check all that apply)



In consumer underwriting, a slightly more positive story emerges compared to previous surveys. For example, when asked about both consumer credit interest rates and the approval criteria for credit and loan products, a majority of respondents (55.7% and 49.7%, respectively) predicted no change over the next six months. This reverses a trend of risk managers to predict increases in rates and more stringent criteria that was observed in Q3. Additionally, Q2 saw a large number predicting an increase in interest rates (62.3%), a number now down to 36.6%. Not surprisingly, half of respondents (54.3%) predict an increase in the average credit card balance over the next 6 months, perhaps in a small way suggesting that consumers would feel confident buying more over the holiday season. Similar, 1 in 5 (20.4%) predict a decrease in loan applications, and while many (40.7%) predict consumers will request more credit over the next six months, a sizeable group (54.9%) predict no change or decrease in credit requests.

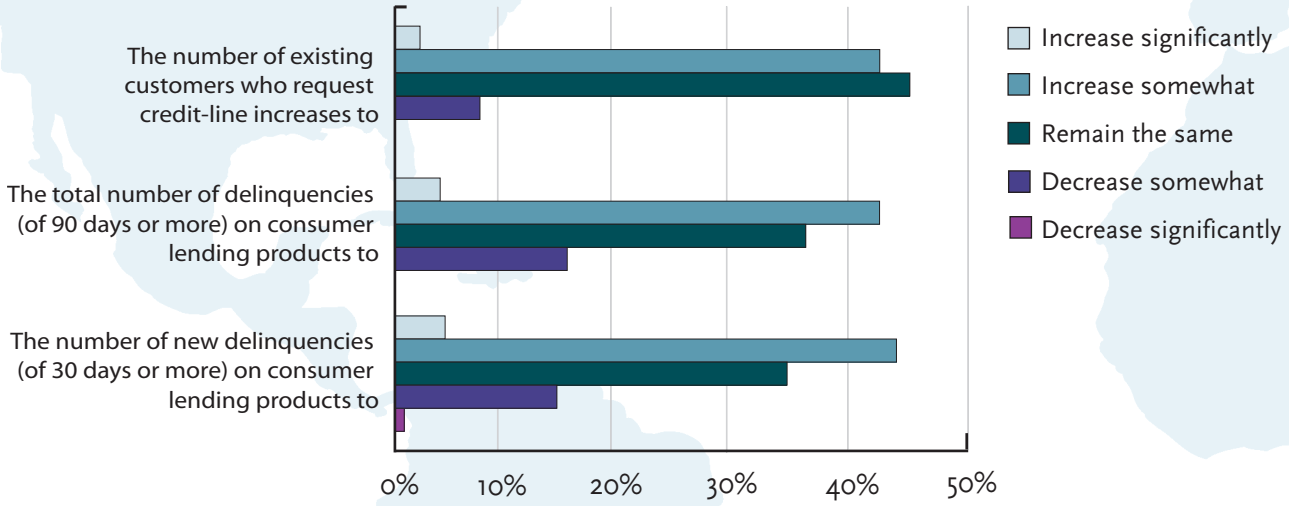
Finally, slightly less than half of respondents felt that the approval rate for credit or loan applications, as well as the amount of credit extended by lenders, would remain about the same (46.3% and 46.2%, respectively). Of those who do see an increase or decrease in these areas, respondents appear to be split, with approximately 7% on average tilting toward decreased approvals and decreased amounts of credit extended.

Overall the underwriting predictions of this quarter speak to a state of consistency, and perhaps a small amount of optimism in an otherwise negative view of respondents.

Overall, the underwriting predictions of this quarter speak to a state of consistency, with a prediction of change only clear in one category (credit card balances, predicted to increase). As with delinquency predictions, this suggests that volatility in the economy over the past quarter has done little to sway underwriting predictions as a whole.

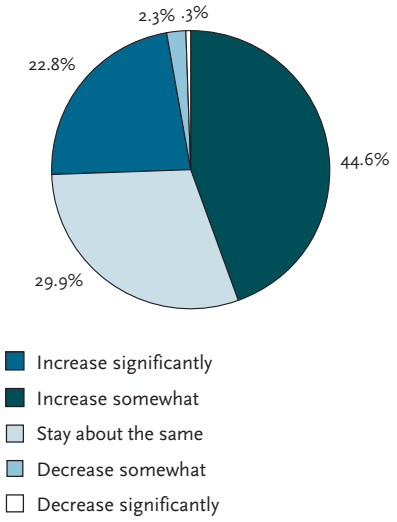
Consumers Seek More Credit, Delinquencies May Increase

Looking at the industry as a whole, over the next six months, do you expect: (check all that apply)



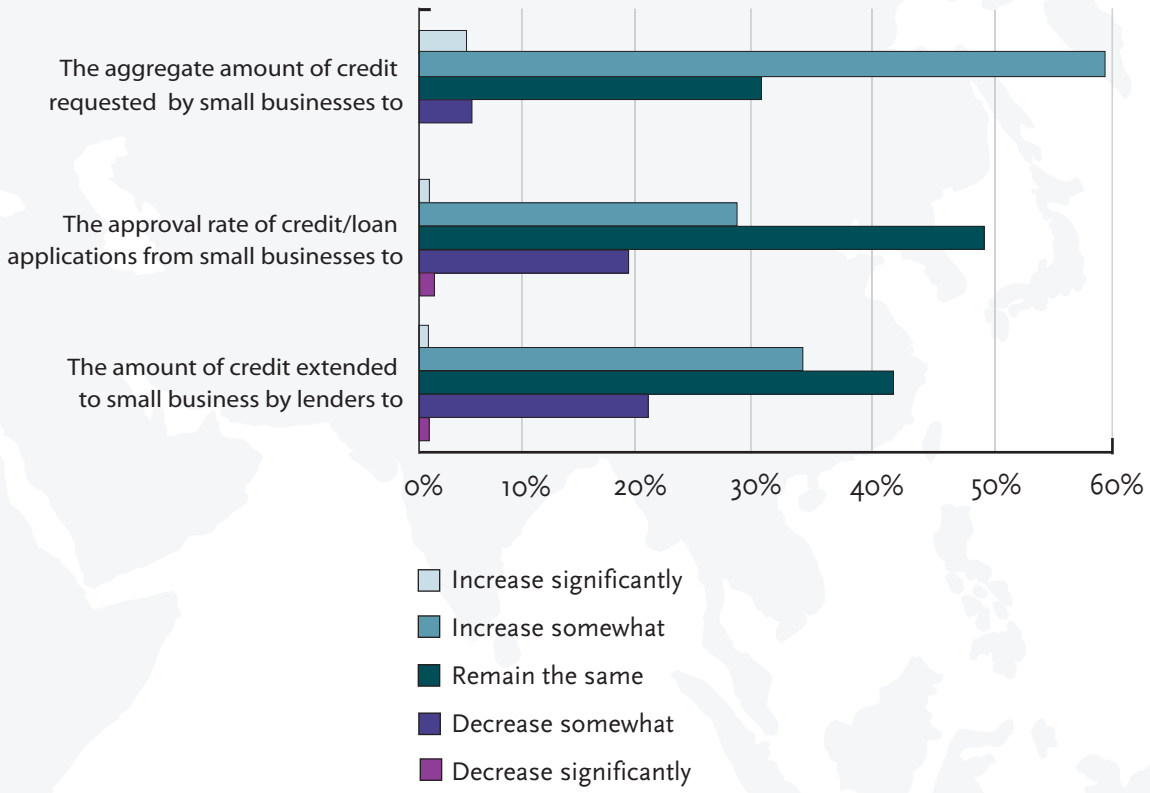
Predictions of the industry in general show an equal number of respondents predicting an increase in credit-line increase requests and those predicting the level will stay the same (45.6%). This is extremely similar to the predictions of Q3. In Q4, 47.2% predict an increase in the total number of delinquencies over the next six months, again consistent with Q3 and still higher than Q2 (36.2%). Similarly, respondents were mixed regarding new delinquencies, with 49% predicting an increase and 34.7% predicting levels would stay the same. Overall, many respondents predict a similar industry outlook over the next six months as was given in Q3, one where consumers seek out credit increases at a similar or accelerated rate, and new and existing delinquencies increase. Not surprisingly, a large number of respondents (67.4%) felt that the priority placed on risk management at their institution would increase over the next six months.

During the next budgeting cycle, do you expect the priority placed on risk management at your institution to:



The Outlook on Small Businesses Remains Skeptical; Shows Signs of Possible Improvement

Looking at the industry as a whole, over the next six months, do you expect:



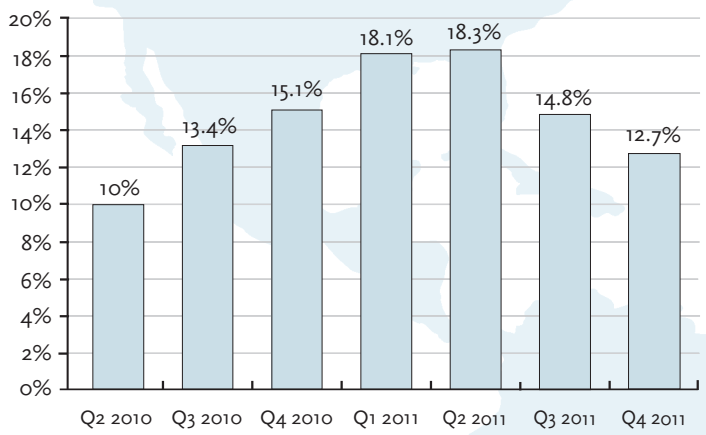
The Q2 PRMIA survey found that respondents' attitudes toward small business growth had cooled substantially since Q1, and Q3 and Q4 results tend to continue this trend of skepticism regarding small businesses. In Q4, most respondents (63.6%) felt that small businesses would request more credit over the next six months, and perhaps on a positive note, the approval rate is predicted by nearly half (49%) to stay the same. 29.9% predict an increase in the approval rate. Finally, 77% of respondents predict that the amount of credit extended to small businesses by lenders will increase or stay the same. While these numbers are optimistic, they are still smaller than the 84.2% of Q1 respondents who felt that small businesses would increase their credit requests. At that time, nearly half (49.3%) predicted an increase in approval rates, and 88.7% predicted the amount of credit extended to small businesses would increase or stay the same. Obviously the excitement seen in Q1 has cooled substantially throughout 2011, but may be poised to rebound in Q1 of 2012.

Historical Analysis

Over 7 quarters, a variety of trends have been noted by the PRMIA survey. These include:

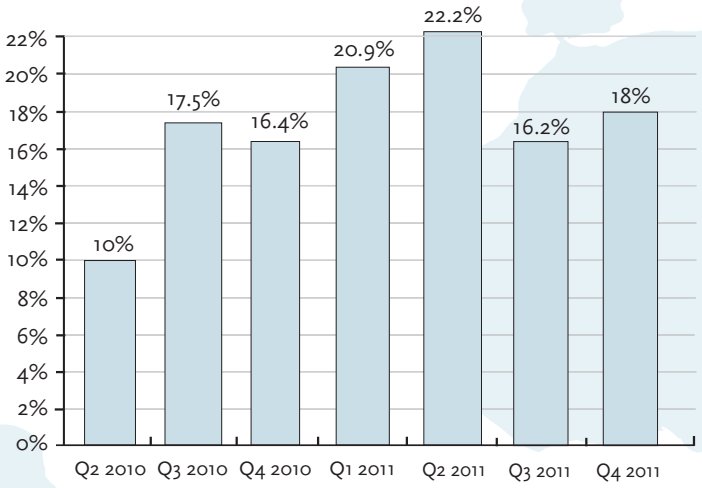
- An optimistic "peak" in Q1 2011, when delinquency prediction estimates saw between 18% and 35% of respondents (depending on loan type) predicting decreases in delinquencies. These peaks have gradually lessened into near-all-time lows in predictions of delinquency decreases.
- Q4 2011 respondents feel stronger than in previous quarters that the approval criteria for credit and loans will not become less stringent over the next 6 months. Only 13.5% feel that we will see less stringent criteria, compared to nearly 18% last quarter and a high of 22.6% in Q2 2010.

Mortgage Delinquencies



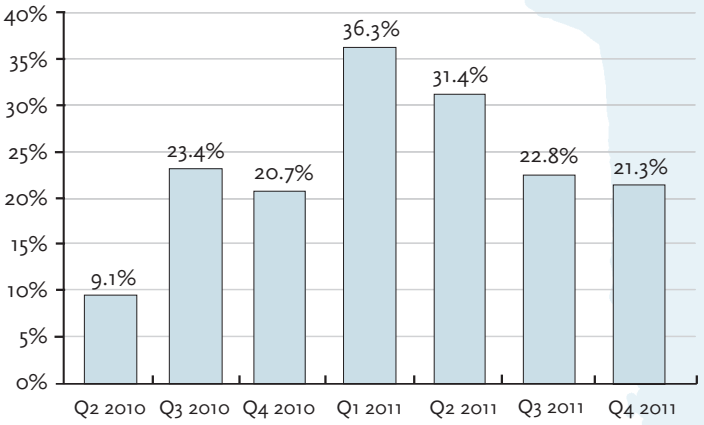
Mortgage delinquencies – percent of respondents expecting a decline

Home Equity Delinquencies



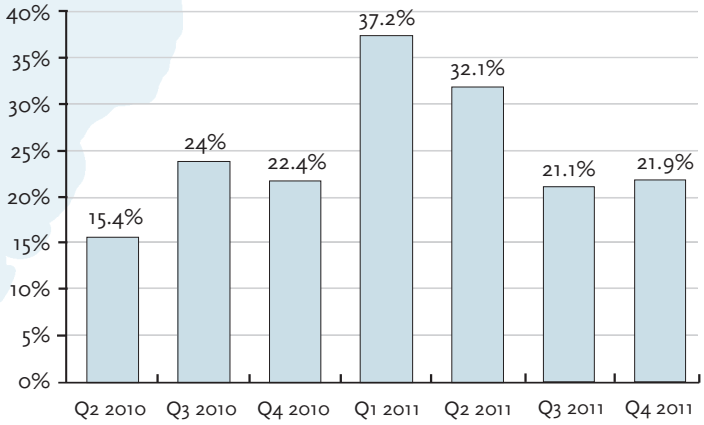
Mortgage equity deliquencies – percent of respondents expecting a decline

Credit Card Delinquencies



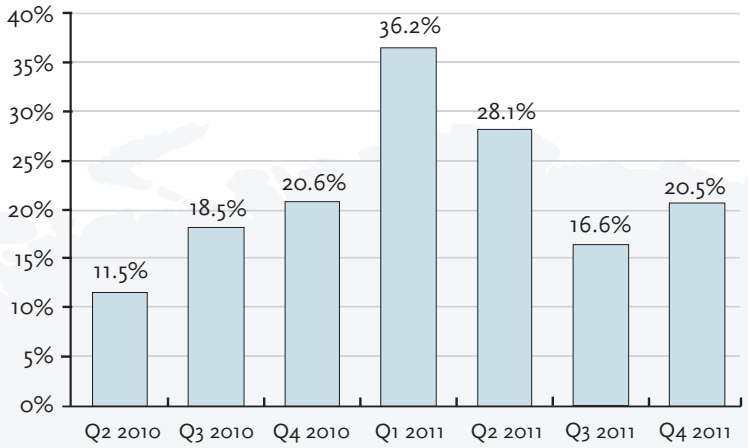
Credit card delinquencies – percent of respondents expecting a decline

Auto Loan Delinquencies



Auto loan delinquencies – percent of respondents expecting a decline

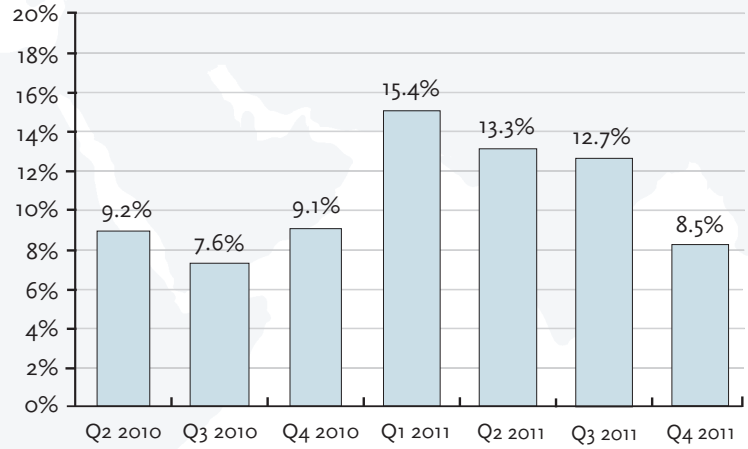
Small Business Loan Delinquencies



Small business loan delinquencies – percent of respondents expecting a decline

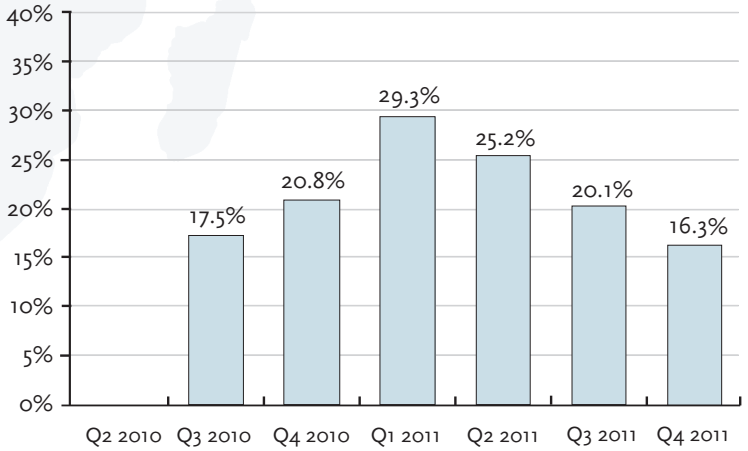
- The optimistic bubble regarding small business loan behavior, which was observed in Q1 2011, may be poised to return in Q1 2012 given the small ramp-up in favorable predictions (see the Outlook on Small Businesses section). Given the previous quarters' data, this suggests that predictions regarding small business credit and loans may be affected annually by a variety of factors, in a uniform manner.

Student Loans Delinquencies



Student loan delinquencies – percent of respondents expecting a decline

Total Loan Delinquencies



Total number of delinquencies – percent of respondents expecting a decline

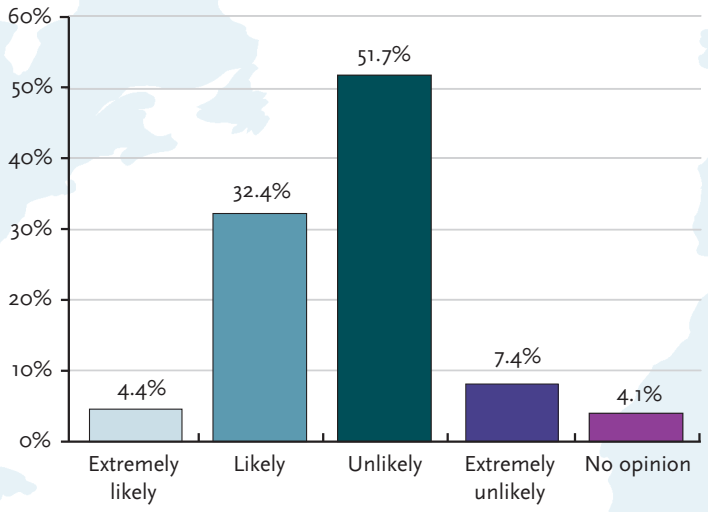
Looking Ahead

The PRMIA survey asks a number of topical interest questions each quarter, gauging risk managers' beliefs regarding the impact of financial news and developments.

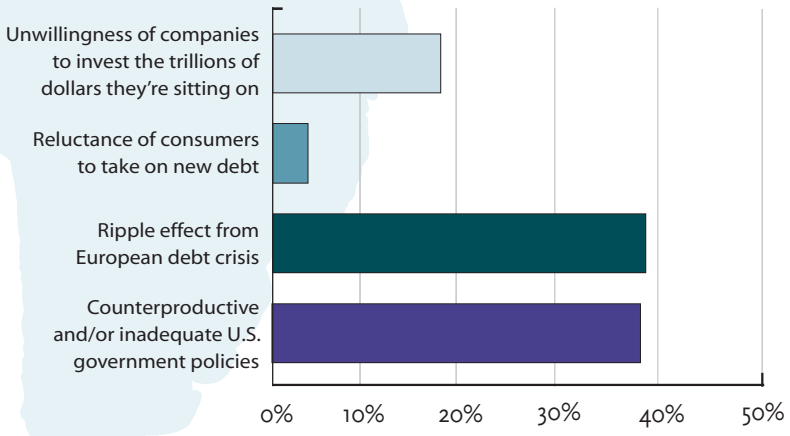
Respondents in Q4 were asked specifically about the following:

- U.S. GDP Growth in 2012: Most respondents (59.1%) feel it is unlikely that the United States will experience negative GDP growth in 2012.
- When asked about contributing factors to a potential double dip recession in the U.S., respondents were divided between those believing the European debt crisis would have a ripple effect and thus be the major contributor to a recession (38.8%) and those who felt that U.S. government policy would be to blame (38.4%). Around 1 in 5 (18.7%) felt companies who were sitting on large amounts of capital would be to blame, for not investing these monies.

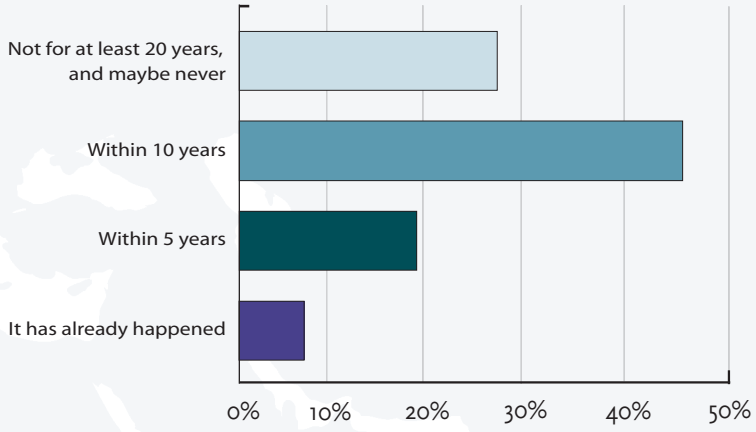
When considering potential economic scenarios for your business, how likely do you believe it is that the U.S. will have negative GDP growth in 2012?



Among the following, which do you believe poses the biggest risk to the U.S. economy and would be the most likely cause of a double dip recession?

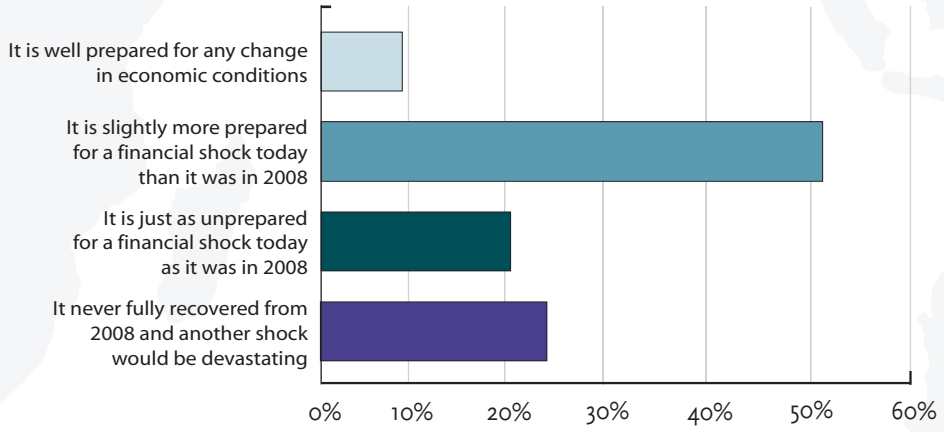


When do you believe the global influence of Chinese consumers is likely to surpass the influence of U.S. consumers (select one)?



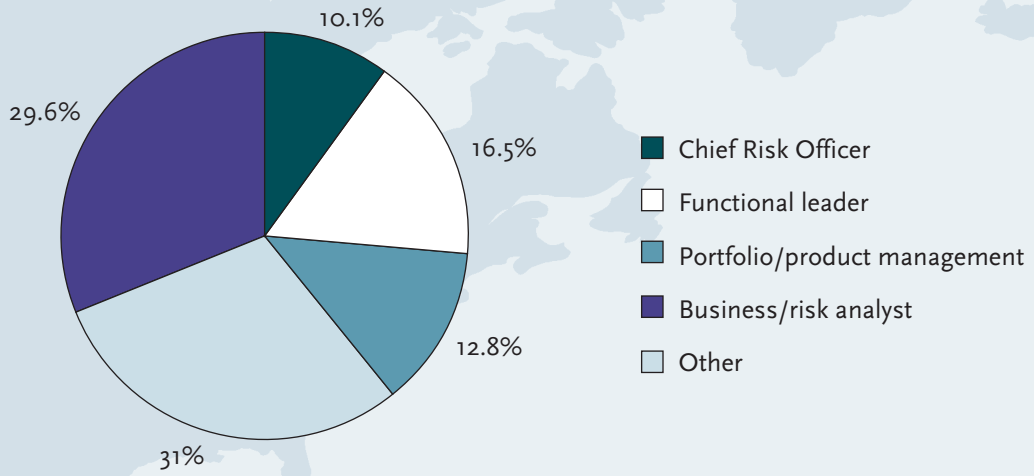
- Nearly half (45.7%) believe that the influence of Chinese consumers will surpass the influence of U.S. consumers within the next 10 years. Small groups of respondents believe this will happen within 5 years, or has already happened (19.5% and 7.2%, respectively).
- Half (51%) feel that the U.S. banking sector is more prepared for a financial shock today than it was in 2008; however a sizeable amount (20.3% and 24.3%) feel it is not prepared or has yet to fully recover from the shock felt in 2008.

Which best describes your belief about the U.S. banking sector (select one)?



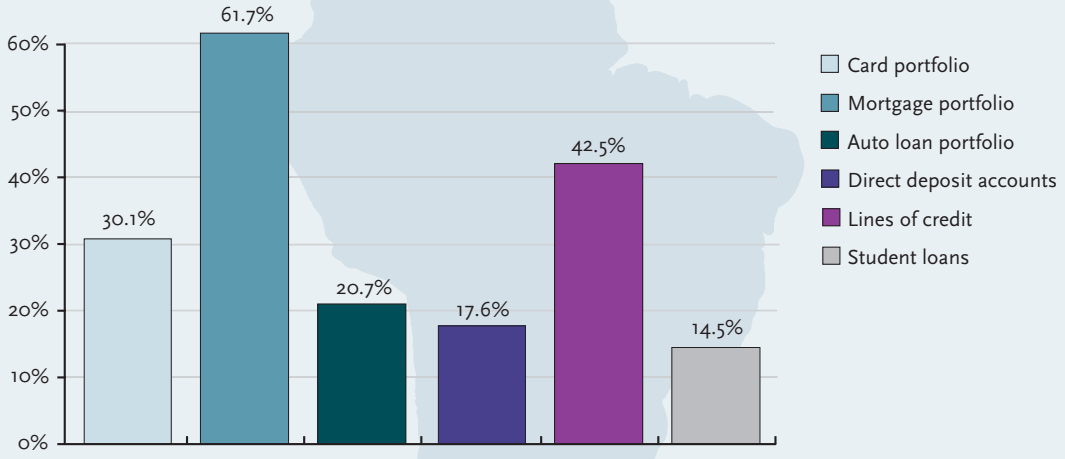
RESPONDENT PROFILE

Your job (select most appropriate)



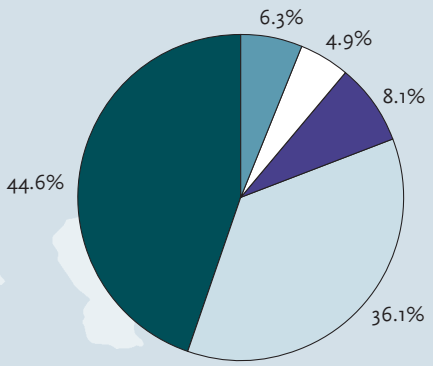
29.6% of respondents identified as a Business or Risk analyst, and 10.1% identified as the Chief Risk Officer of their company. 12.8% work in portfolio or product management. A large percentage, 31%, indicated their job as "other," which suggests that they may be tasked with multiple responsibilities involving risk management.

What is your area of responsibility (check all that apply)?



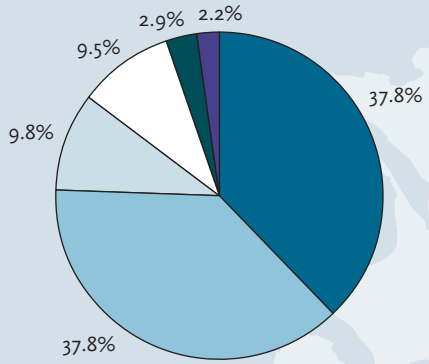
The majority of respondents (61.7%) were trusted with managing a mortgage portfolio. Slightly less were responsible for lines of credit (42.5%) or a card portfolio (30.1%).

What is the size of your institution (by total assets)?



- Up to $5 billion
- $5 – $10 billion
- $10 – $20 billion
- $20 – $40 billion
- $40 + billion

What is the business orientation of your institution (select the most appropriate)?

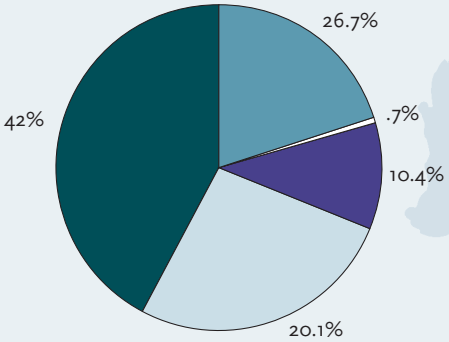


- Full Service Bank
- Credit Union
- Mortgage lender
- Wealth management, investments, retirement services
- Discount and/or self-serve financial services
- Credit Card Monoline

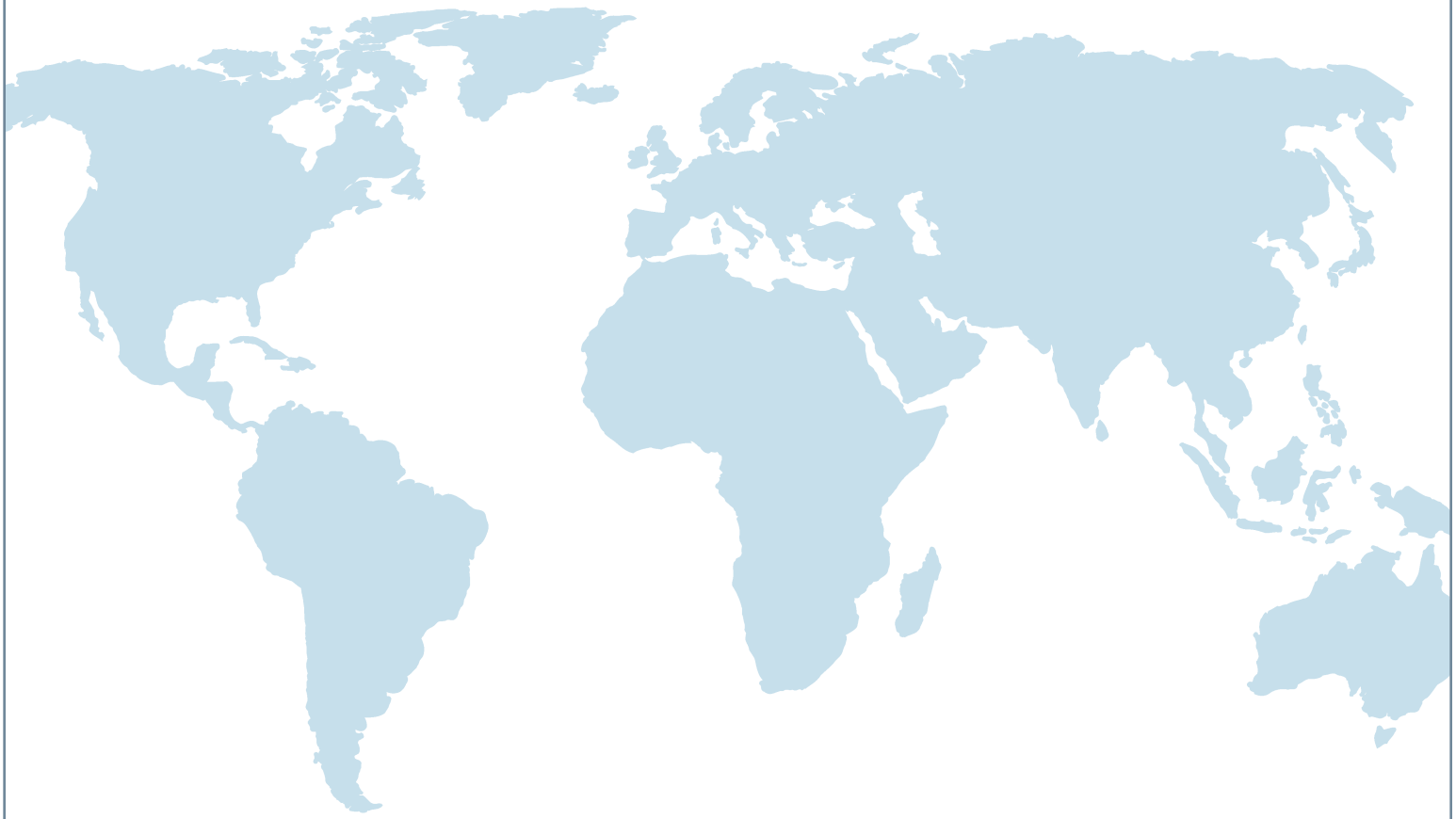
36.1% work at companies with more than $40 billion dollars in assets, with slightly less than half (44.6%) working at a smaller firm (up to $5 billion in assets). Three quarters (75.6%) work in either a full service bank or wealth management/retirement/investment services group (evenly split), 1 in 10 works in a discount or self-service firm (9.5%) or in a mortgage lender (9.9%). Finally, a small number work in a credit union (2.9%) or credit card monoline (2.2%).

What is the geographic reach of your institution?

Slightly less than half (42%) worked with a firm that operated on a global level, and a quarter of the respondents (26.7%) worked at a firm with national reach.



- Global
- National
- Regional
- Local
- Internet-based



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