
Consumer Lending

Seventh Edition

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Preface

This seventh edition of *Consumer Lending* is a revision of the textbook originally written by Paul R. Beares, who guided it through the third edition. Richard E. Beck, Jr. and Susan M. Siegel wrote the fourth edition. For the fifth edition, Mr. Beck served as subject matter expert, and for the sixth and seventh editions, he and Kathlyn L. Farrell are co-authors.

Like its predecessors, the seventh edition introduces students to the process of lending, to its importance to the bank and consumers, and to the environment in which it functions. The textbook takes a practical approach to the fundamentals of lending. It addresses contemporary issues and developments that are important to understanding consumer lending today.

It is not the intent of this textbook to make the readers seasoned lenders. That will come in due time. Rather, the American Bankers Association hopes to spark an interest in consumer lending and to encourage students and other readers to pursue further studies and embark on careers in this challenging field.

OBJECTIVES OF THIS BOOK

- Define consumer lending and discuss its evolution to meet the financial needs of consumers.
- Identify loan product life cycles and discuss the benefits of consumer lending for banks.
- List characteristics, benefits, and disadvantages of direct lending and discuss the categories of collateral value.
- Explain the advantages and disadvantages of indirect lending from the perspectives of the bank, the dealer, and the consumer.
- Explain leasing as an alternative to a consumer loan.
- Describe the characteristics, benefits, and challenges of open-end credit products.
- Explain the objectives and components of a bank loan policy.
- State the objectives of the loan application process and discuss how banks generate applications through marketing and different delivery channels.
- Describe the sources of consumer loan information and the steps in the credit investigation process.
- Explain how the five variables of credit are used in credit evaluation and decision making in both the judgmental and credit-scoring approaches.
- Describe the factors that affect loan pricing and the methods used to calculate profitability.

- Identify structuring options for different loan products and describe how these options achieve sales objectives.
- Describe the documentation needed for different loan types, the loan closing process, and the loan review function.
- Discuss causes of consumer loan delinquencies and identify the objectives and processes of the collection and recovery functions.
- Describe the laws and regulations that affect consumer lending and identify the regulatory agencies that supervise the banking industry.

CHANGES IN THIS EDITION

In addressing these objectives, this text updates the material in the previous edition of *Consumer Lending*. Throughout, the book incorporates lessons learned from the financial crisis of 2008 and new laws and regulations that relate to chapter topics. New information presented in this edition includes

- an explanation of the legal and regulatory results of the financial crisis of 2008, including the Dodd-Frank Act and creation of the Consumer Financial Protection Bureau
- updated information about the federal response to subprime lending products, including the qualified mortgage rules and changes to the Truth in Lending Act
- an explanation of the purposes and requirements of the CARD Act and its impact on credit card lending
- an explanation of the changes to UDAAP laws made by the Dodd-Frank Act and the CFPB and the importance of these changes to consumer lending
- updated information on the changing economic landscape of consumer lending channels, including Internet lending and social media sites as well as direct lending and indirect lending
- updated information on Regulation Z and Regulation M as revised by the Dodd-Frank Act
- revised content on the use of prepaid cards

Numerous exhibits have been updated and a new exhibit that lists the regulations transferred to the Consumer Financial Protection Bureau has been added. There have also been numerous additions and revisions in glossary terms, information in sidebars, additional resources, review questions, and appendixes.

TEXT ORGANIZATION

The text is organized as it was in the sixth edition. Chapter 1 describes the general legal and regulatory environment for lending, though all chapters have a section on laws and regulations that apply to the chapter topic. The text is typeset in a single column, with sidebars that highlight especially relevant information. Graphics visually enhance the reading and learning experience. The appendixes have been moved from the back of the book to follow related chapters. Instructional design features are

- learning objectives at the beginning of the chapter
- an introduction that sets the stage for topics covered in the chapter
- sidebars, charts, exhibits, and “by the numbers” and “did you know?” callouts that supplement chapter content
- definitions in sidebars for terms bolded in the text
- situations with questions that test the reader’s understanding of concepts and principles
- a summary that reviews the chapter’s main points
- self-check and review questions for testing comprehension of chapter content
- a list of additional resources, such as publications and websites, that contain material related to chapter content
- sections at the back of the book with answers to chapter self-check and review questions and the situations
- appendixes that include a compliance policy statement, a consumer loan policy statement, and a case study with questions and answers
- a glossary that defines terms used in the text
- an index that can be used to locate content

The first two chapters present an overview of consumer lending: The Introduction sets the scene for what follows. Chapter 1 presents a historical perspective on consumer lending, establishes foundational issues, and explains the regulatory environment in which consumer lenders operate. Chapter 2 deals with the dynamics of the consumer loan market and its evolution. The next three chapters introduce today’s consumer lending products and services: Chapter 3 looks at how the direct lending function has changed over the years and how technology affects the delivery of loan products. Chapter 4 addresses the traditional function of indirect lending, changes in the market, and the effects of technology. Chapter 5 discusses open-end credit, the ever-changing consumer lending product line.

Chapter 6 looks at the process of drafting a consumer loan policy, its importance to all involved in the lending process, how it is created, its features and benefits, and how compliance with it can be ensured.

The next five chapters deal with the actual process of making a loan. Chapter 7 looks at how the loan application process and interviews are conducted. It also discusses the challenge of generating quality loan applications, an issue for all lending institutions. Chapter 8, which discusses the credit investigation function, highlights the importance of conducting rapid yet thorough investigations. Chapter 9 covers the evaluation and decision-making phases of the process, suggesting methods for efficient and effective evaluations and quick decisions. Chapter 10 delves into the joint issues of loan pricing and loan profitability and the importance of balancing both while making consumer loans. Finally, Chapter 11 tackles selling and how lenders use loan structuring to find the most appropriate loan for the borrower while at the same time building consumer relationships.

Consumer Lending concludes with a discussion of other areas of consumer loan administration. Chapter 12 discusses the importance of loan documentation and proper loan closings. This chapter presents lists of typical documents required for different types of loans, the process for establishing a security interest, and related legal essentials. Chapter 13, the final chapter, addresses the world of collections and recovery. It discusses how banks approach collection and the importance of monitoring and following up on delinquent loans; it also deals with bankruptcy. The appendixes at the end of the chapters are additional readings intended to enhance the learning experience. They are examples of a compliance policy, a loan policy, a sample credit report, and a case study. Appendix 4, The Galaxy Bank Financial Case Study, is an example of a bank's experience with many of the content points covered in this textbook, supplemented by questions and answers for the student.

About the Authors

The American Bankers Association extends its gratitude to Richard E. Beck, Jr., and Kathlyn L. Farrell, who co-authored this textbook.

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