How a Subprime Banking Workaround Could Crush Your Retirement

December 10, 2018 4 min read

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The devastating housing crash of 2008 is now 10 years in the rearview mirror, but the danger of another financial crisis looms despite assurances to the contrary.

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We've been told that the housing bubble and collapse was about predatory lending and high-risk borrowers who were duped into loans they couldn't afford. So, we can assume that the massive regulatory response to the subprime crisis meant that banks are no longer allowed to behave badly, right?

If only it were that simple . . .

I've previously written about the various warnings out there that say the current booming economy is on shaky ground and about some potential causes of the next crash. Looming large among the latter is the increasing economic clout of pseudo-banks and their ability to play outside the rules put in place to help prevent another housing collapse.

In fact, the largest source of mortgage lending in the United States is these same non-banks — financial entities that offer unsecured personal lending, business loans, leveraged lending and mortgage services. Because these companies are not

required to hold banking licenses, they're not subject to standard banking oversight and can freely engage in risky lending.

What are these "shadow banks," and how do they get the money to make these loans?

Shadow banks include all risky investment products and activities that flourish outside the reach of regulation. Think about those hedge funds, credit default swaps, collateralized debt obligations, and mortgage-backed securities (a/k/a derivatives) that triggered the subprime mortgage crisis.

The list of Wall Street and banking villains is long, and their shady dealings have not gone away. Instead, they have morphed into new ways to skate around the rules which themselves were intended to prevent greed run amok from causing another collapse.

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Today, the list of players involved in shadow banking encompasses everything from pawn shops and loan sharks to elite art dealers. They include so-called peer-to-peer lending outfits and online lenders such as Quicken Loans, Loan Depot, PennyMac, Freedom Mortgage and Caliber Home Loans. They aren't allowed to get money from direct deposits, the way traditional banks do, but that has not stopped big banks from dumping money into them, in the form of loans.

In fact, loans to non-bank financial firms increased six-fold from 2010 to 2017, hitting a record $345 billion, *The Wall Street Journal* reported. Wells Fargo coughed up $81 billion, Citigroup and Bank of America ponied up $30 billion each, and

JPMorgan Chase threw in another $28 billion.

By funding these “shadow” banks, the big financial players are still in the risky loan business. It was precisely this type of under the radar, back-door lending that led to the soaring foreclosures, cratering home values, failing banks and dwindling retirement accounts of a decade ago.

And it gets worse …

An astonishing 6 out of 10 mortgage lenders in the U.S. are now shadow banks, according to the *L.A. Times*. And they operate online and peddle subprime loans. Shadow lending is now “larger than the world economy and poses a risk to financial stability,” *Bloomberg News* wrote.

And early next year, Fair Isaac and Company, the creator of the FICO score, will launch a new opt-in program that will enable consumers to enhance their credit scores by using checking and savings account data. Astonishingly, a decade after subprime lending crashed the housing and financial markets, the new ultraFICO score will boost loan approvals to those who were previously considered subpar borrowers.

Could these conditions again drive our economy into a ditch? Economists say no. But the fact that major financial players are dumping billions into subprime loans through shadow banking is only one of the factors at work. Stock market volatility, cooling home sales and corporate debt that has tripled in the past eight years all add to the case for caution.

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By using non-banks and secret back channels between their money and risky borrowers, big banks and fat cat investors jeopardize the whole economy. It’s another reason why smart entrepreneurs and business owners need to make sure they have

a “Plan B” for their retirement. Because you never know when the greed and hubris of a few will create economic hardship and heartache for everyone – all over again.

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