



The Rolls-Royce Story

("Collateral")



A man walked into a New York City bank and asked a loan officer for \$6,000.

"Are you a customer of the bank?" the loan officer asked.

"No."

"Well, if you're not a customer of the bank, the rate is 15% for an unsecured loan."

"But I'm only willing to pay 5%," the man insisted.

The man asked the loan officer to follow him outside.

The two walked out to the street where the man pointed to his Rolls-Royce, parked right in front of the bank.

The loan officer examined the car carefully, understanding that the car was to be the collateral for the loan.

"That is certainly worth more than \$6,000," the loan officer stated. "If the bank loans you \$6,000, and you don't pay it back, are you comfortable losing the car?"

They agreed to a 5% interest rate, and the man left the bank with a check for \$6,000 in hand, and the loan officer took the keys to the car.

One month later, the man returned to the bank and told the teller, "I have a loan for \$6,000 at a 5% interest rate. For one year, that would be \$300 of interest. It's only been one month, so 1/12th of \$300 is \$25."

He then proceeded to write out a check for \$6,025.

As he was writing out the check, the loan officer saw him and walked over to say hello.

"How've you been? Travelling?"

The man said, "No, actually I was staying with a friend right around the corner. You're probably curious why I needed the loan, right?"

"Well, yes," the loan officer said.

"Well, I honestly couldn't think of a better way to park my car in NYC for an entire month for only \$25!"

What's the point of this story? Collateral reduces risk to the bank or lender and allows the borrower to receive loans at a low interest rate.