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CONSUMER CREDIT ACTIVITIES OF COMMERCIAL BANKS

A Thesis

Submitted to the Faculty of

The Graduate School of the University of Richmond

as Pa l Fulfillment of the

Requi nts for the Degree of

Master of Arts

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VIRGINIA

Department of Economics

By

Adelaide Thom Johnston

1944

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CHAPTER I

INTRODUCTION

The purpose of this study is twofold: first, to analyze the consumer credit activities of commercial banks and, second, to indicate the outlook for the expansion of such activities after the war ends. The subject is of particular importance at this time because of the many changes which have recently taken place in the consumer credit field and because of the uncertainty regarding the future of commercial banks' consumer credit operations.

When the commercial banks embarked on a program of consumer credit expansion in the 1930's they did so mainly because they were seeking to invest idle funds. Since that time the banks, on the whole, have found their consumer credit activities a satisfactory source of income and they are looking forward to exploring the possibilities of consumer credit to an even greater degree when the war ends.

Should the present governmental program of regulation and control of consumer credit be continued after the war, or another program of control be established, the consumer credit operations of the banks would be affected, as would those of other consumer credit agencies. The public in turn would feel the ultimate effects. The

extent to which such a program might assist in attaining a greater degree of stability in our economic system is an interesting subject for speculation.

In order to avoid confusion, instalment loans are referred to as consumer instalment loans throughout this study. These loans are so designated in publications of the Board of Governors of the Federal Reserve System. The banks, however, usually refer to them as "personal loans." Instalment loans are also referred to as "cash loans" or "consumer cash loans," usually in works published before 1943. Consumer instalment loans are referred to occasionally in this study simply as instalment loans in order to avoid too frequent repetition of the complete name for such loans.

The term "consumer credit" is itself somewhat misleading, as goods purchased through the use of consumer credit are not always for consumption purposes. They may remain unconsumed for years and possess a resale value equal to or greater than that paid by the purchaser, as, for example, diamonds.

Loan companies are sometimes referred to as small loan companies, personal loan companies, personal finance corporations, domestic finance corporations, or personal finance companies. These companies are referred to as personal finance companies throughout this study as this seems to be the name most commonly used in connection with licensed companies.

First, the growth of consumer credit is described and attention is called to its rapid expansion and recent decline. The relation-

ship between consumer credit and economic instability is discussed briefly, and a description of the consumer financing operations of commercial banks is presented. This is followed by a discussion of bank loan policies and the various steps involved in the granting of consumer instalment loans. One chapter is devoted to the legal status and regulation of the instalment lending activities of commercial banks, and then an analysis is made of bank credit charges, costs, income, and losses. A discussion of the need for consumer credit after the war is followed by a brief summary, conclusions, and recommendations.

Two previous related studies were found: "The Consumer in Commercial Banking" by Henrietta Cooper Jennings, published in 1939, and "Commercial Banks and Consumer Instalment Credit" by John M. Chapman and Associates, published in 1940. The first study consists of a brief but interesting discussion of the credit relationships between the banks and consumers. No discussion of competitive conditions is included in the study or of events affecting bank consumer credit operations which have transpired within the past six or seven years. The Chapman book is an intensive study based largely on replies to questionnaires sent to banks in the United States. Data obtained by the sampling method are tabulated and discussed. Tabulations of loans are made according to size of banks, size of loans, age of borrowers, sex of borrowers, period of borrowers' employment, and so forth. No historical background is provided in this publication. The work is based on information pertaining to the period before 1939. The downward trend in consumer credit, the Soldiers' and Sailors' Act, Regulation W and the postwar period are

not discussed in either of these works. Several books published prior to 1941 deal with consumer credit in general, credit risks, and consumer credit agencies; and brief discussion of personal loan departments is usually included in textbooks on banking. An excellent discussion of rate regulation by Wallace P. Mors was published early in 1943 (see bibliography).

All publications available at Richmond and Washington public, university, and bank libraries, the Library of Congress, and the Federal Reserve libraries at Washington and Richmond pertaining to consumer credit and related subjects were read before any attempt was made to write the thesis. Also many pamphlets, reports, and copies of speeches, obtained from research institutions, credit bureaus, banks and government agencies were carefully studied. In addition, a thorough examination was made of existing usury and banking laws; and much valuable information was obtained from bank officials, lawyers, and research analysts.

CHAPTER II

THE GROWTH AND RECENT DECLINE OF CONSUMER CREDIT

Consumer credit is not a new kind of credit. The Argentarii (dealers in silver), who in Roman times were bankers as well as money changers, made loans for consumption purposes. Pawnbrokers have been engaged in supplying pledge credit to consumers for centuries. The present forms and high development of consumer credit, however, have come about in recent years.

Prior to the Civil War there was little need for specialized consumer credit agencies. Family groups, churches, or members of the community came to the assistance of those temporarily in need of funds to carry them through a period of emergency. Merchants and tradesmen frequently sold goods on credit, and the services of physicians were often on a credit basis. Early in the nineteenth century a few merchants began to sell furniture and other durable goods on the instalment basis.

After the Civil War, as industry expanded, there was a shift of population from the farms to the cities, individuals became more dependent upon wages and salaries, and there was an increasing need for outside financial assistance. Banks, as a whole, appear to have gradually expanded their volume of consumer loans during this period

of industrial expansion. The loans generally known as "accommodation loans" were made more frequently by banks located in small communities and agricultural regions than by city banks. They were usually on a 30, 60, or 90-day basis and it was generally understood that they would be repaid in full or renewed for a lesser amount at maturity date. During this period, however, commercial bank credit reached the consumer primarily through loans to merchants, who in turn extended credit to consumers.

The manufacture of new types of durable goods and the growth of professional and other classes of consumers who were, in general, considered good risks by the banks, led to the extension of consumer credit by an increasing number of banks. In the smaller communities where the character, earning capacity, and background of the applicant for a loan was known, a more liberal policy was maintained than in the larger cities where such knowledge of the applicant was not often possessed by the banks. The ownership of readily negotiable collateral was usually required by the city banks as the basis for consumer loans.

Principal Consumer Credit Agencies

Community aversion to the borrowing of money for personal needs was to a great extent responsible for the borrowing by individuals from illegal lenders and pawnbrokers. The illegal lenders, or "loan sharks" as they are termed, came into prominence during the latter part of the nineteenth century and dominated the cash-lending field until about 1920. Illegal lenders violate the letter of the law, as well as

its social purpose, and operate without license or supervision. Pawnbrokers have been a source of loans for centuries. They often make loans to individuals who cannot borrow elsewhere. Pawnbrokers still fill an economic need but they are now playing a lesser role in consumer credit than they have in the past.

The reform movement just after the turn of the twentieth century resulted in an increase in the number of remedial loan societies. These societies date back to the Civil War but increased greatly in number between 1906 and 1915. Some of these societies were semi-philanthropic pawnshops, lending money on pledges, others loaned on chattel mortgages, mainly household goods. Today, however, only a few remedial loan societies are in existence.

In 1909 the first credit union was formed in the United States. Credit unions are cooperative associations which lend to members the deposit funds of members, supplemented with funds borrowed from commercial banks. They are organized among people who know each other or have easy contact with one another, as for example, people who are employed in the same office or plant or are members of the same church or society. The Bureau of the Census estimates that there were over 8,500 credit unions in 1940.

In March 1910 Arthur J. Morris, a young lawyer, launched a new type of bank in Norfolk, Virginia. Loans were made in amounts as low as fifty dollars and were repayable in weekly, semi-monthly, or monthly instalments. This bank was the forerunner of what are now known as industrial banks. These banks make the majority of their loans on a

co-maker basis, but there is an increasing tendency to grant single-name loans. Industrial banks operate under specific enabling acts in some States, under bank charters in others, and in a few States under business corporation charters. They make loans up to $5,000 or more.

The exact date when the first instalment finance company was formed is not known but the sales finance company, as we know it today, probably did not function before 1910. The sales finance company buys retail instalment paper from merchants and others. Retail instalment paper arises from sales of merchandise on deferred payments, in millions of individual transactions between retailers and their customers. The sales finance company buys the paper from the retailer at a flat price or agreed rate of discount. When the paper is purchased the customer is notified that payments should be made to the finance company. A large portion of the working capital of sales finance companies is obtained by borrowing from commercial banks and a small portion from the sale of short-term notes to commercial paper brokers. Retailers also finance their own instalment paper by borrowing from finance companies or banks on their own notes.

Small loan companies or personal finance companies date from about 1911. These companies operate in 36 states under laws which resemble the Uniform Small Loan Law drafted by the Russell Sage Foundation. Laws of this type are devised to eliminate illegal money lenders. The majority of the small loan laws limit the size of loans to $300 or less. Loans are made by personal finance companies with or without co-signers. Additional security is usually required on single-name loans in the

form of wage assignments or chattel mortgages on household furniture and automobiles. These companies are prohibited from accepting savings deposits and must depend largely on their own capital for making loans. They borrow a small percentage of their working capital from commercial banks.

About 1917 several urban banks in Connecticut, North Carolina, and Virginia began to make instalment loans to salaried people on terms similar to those offered by the industrial banks. Loans were made on endorsed notes payable over a period of one year. The charges, including interest and investigation fee, were deducted in advance from the face amount of the note and the balance paid to the borrower. The number of banks making instalment loans gradually increased. Several banks in the Middle West began to finance piano and automobile instalment sales for dealers.

Consumer credit expanded rapidly during the 1920's. New types of consumer durable goods, including the mechanical refrigerator, oil-burning furnace, and radio were purchased largely on the instalment plan. These, together with the rapid increase in the number of automobile sales on an instalment basis, resulted in the establishment of an increasing number of finance companies. Commercial banks, indirectly, furnished much of the credit for the selling of automobiles on a deferred-payment basis as the finance companies borrowed a large percentage of their working capital from the commercial banks.

Establishment of Personal Loan Departments by Commercial Banks

In 1929 the National City Bank of New York announced the

establishment of a personal-loan department for the granting of small loans to individuals for non-business purposes, the loans to be repaid in easy monthly instalments. Although the National City Bank was not the first bank in the United States to establish a personal loan department as there were probably fifty such departments in existence at that time, the establishment of such a department by the largest bank in the world encouraged other banks to do so.

The expansion of consumer credit came to an end soon after the stock market collapse in 1929 and there was a substantial decline in consumer loans. In the spring of 1933 instalment credit, particularly automobile financing, began to expand again and consumer instalment loans gradually increased in volume. The number of commercial banks having personal loan departments also increased.

Factors Weighed by the Banks Before Expanding Loan Volume

Reluctance on the part of commercial banks before 1935 to engage extensively in consumer instalment lending may be attributed to a number of factors. For years commercial banks had been making commercial loans. The size of the average commercial loan is much larger than that of the average consumer instalment loan, and many bankers were of the opinion that consumer instalment loans would be unprofitable as the cost per loan is high. There was uncertainty as to the risk involved, and a different type of technique would be necessary in handling instalment loans. There was also the social stigma attached to the borrowing for personal needs and many bankers felt that they did not want to be responsible for getting people into debt, especially

after encouraging thrift on the part of the public for years. The banks were uncertain of the legal status of consumer instalment loans, as the State laws did not specifically give them authority to make such loans at rates in excess of statutory interest rates.

Earnings from loans and investments, however, had been declining steadily and the banks were accumulating large holdings of excess reserves. It became increasingly necessary for the banks to find an outlet for their idle funds. Commercial bankers were favorably impressed by the success of the personal finance companies and industrial banks in weathering the depression and the low percentage of losses sustained by these agencies on consumer loans. The granting of consumer instalment loans would put idle bank funds to work and might also bring new customers to other departments of the bank. The success of the banks in handling the Federal Housing loans helped to convince them of the desirability of expanding the volume of their consumer loans. A ruling of the Board of Governors of the Federal Reserve System in 1937 to the effect that consumer paper would be eligible for discount at Federal Reserve banks also encouraged the banks to expand their consumer credit activities.

Rapid Expansion of Consumer Credit

Beginning in 1935 commercial banks became a predominant factor in the expansion of consumer instalment loans. Between 1929 and 1935 consumer instalment loans of commercial banks made up less than 10

percent of total consumer instalment loans.[1] By August 1941, however, the total amount of commercial bank instalment loans outstanding exceeded that of any other consumer lending agency. Commercial banks provided one-third of the greatly enlarged total amount outstanding. Since 1934 thousands of banks have added consumer instalment financing to their other activities. By the end of 1938 approximately 1,500 commercial banks were operating personal loans departments and, in addition, about 500 branch banks were making consumer loans. There are also many banks engaged in consumer instalment lending which do not operate separate personal loan departments.

On June 30, 1941, 11,785 or 90 percent of the 13,414 insured commercial banks in the United States reported some consumer loan and retail instalment paper transactions. Consumer instalment loans reported by these banks amounted to 455 million dollars and F.H.A. Title I loans amounted to 277 million dollars.[2] By August 1941 the total amount of consumer instalment loans of commercial banks outstanding reached a peak of 750 million dollars.[3] This constituted an increase of 721 million dollars over the December 1933 figure. Total consumer

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[1]All figures pertaining to loan volume are based on statistical data appearing in the Federal Reserve Bulletin for August and November 1943 and on data obtained from the Division of Research and Statistics, Board of Governors of the Federal Reserve System.

[2]Statistical data obtained from the Federal Deposit Insurance Corporation in person.

[3]Loc. cit.

instalment loans of all consumer lending agencies amounted to 2.2 billion dollars in August 1941. Commercial banks contributed a larger portion of this total than did each of the other consumer lending agencies.

Total consumer credit reached its peak a month later, in September 1941, with 9.7 billion dollars outstanding. About two-thirds of this total was based directly or indirectly upon consumer goods. A substantial liberalization of credit terms had taken place between 1939 and 1941 and this helped to increase credit outstanding. For example, automobile instalment paper was often for periods in excess of 18 months. As a result, the volume of automobile paper increased tremendously, as did the volume of sale credit in general.

Recent Trends

Since September 1941 the amount of consumer credit outstanding has declined steadily. Total consumer credit outstanding September 30, 1943 amounted to 4.8 billion dollars. This constitutes a decline of 4.9 billion dollars, or slightly more than 50 percent between September 30, 1941 and September 30, 1943 (see Table 1 on the following page). This decline is due chiefly to the decreasing supply of consumer durable goods, to increased cash buying and reduction of indebtedness resulting from increased consumer incomes, and to government restrictions of consumer credit through the operation of Regulation W and Amendments. Although the decline in the supply of consumer goods has been the most important factor in the reduction of the amount of

TABLE 1

VOLUME OF CONSUMER CREDIT

(Estimated amounts outstanding, in millions of dollars)

	Sept. 30, 1943[a]	Increase or decrease from: Sept. 30, 1941[b]
Total consumer credit	[p]4,822	-4,903
Instalment sale credit	[p]784	-3,225
Automotive	[p]186	-2,030
Other	[p]598	-1,195
Total instalment loans	[p]1,086	-1,147
Commercial banks	276	- 451
Small loan companies	358	- 172
Industrial banks	170	- 135
Credit unions	113	- 114
Miscellaneous lenders	[p]85	- 17
Repair and modernization	84	- 258
Single-payment loans[c]	998	- 175
Charge accounts	1,275	- 437
Service credit	[p]679	+ 81

[a]Federal Reserve Bulletin, November 1943, p. 1108.

[b]Basic data on which these computations were made were obtained from the Board of Governors of the Federal Reserve System, Division of Research and Statistics.

[c]Single-payment loans of commercial banks and loans of pawnbrokers.

[p]Preliminary.

consumer credit outstanding, credit restrictions imposed in accordance with Regulation W, as amended May 6, 1942, have been largely responsible for the liquidation of instalment accounts other than automobile.[4]

Total consumer instalment loans outstanding have declined 50 percent since August 1941.[5] Commercial bank instalment loans show the greatest decrease. Between August 1941 and August 1943 the amount of bank instalment loans outstanding decreased 63 percent. Commercial banks advanced a sizable volume of funds for the purchase of automobiles and their loans outstanding could therefore be expected to decline more sharply than those of other consumer lending agencies which engage to a lesser extent in automobile financing. The decline in instalment loans outstanding has also been due, to some extent, to the shortening of maturities, which has been reported by all consumer lending agencies. The average retail instalment contract is now completed in five months, whereas in 1942 it was completed in about nine months.

Single-payment loans outstanding amounted to 1.5 billion dollars in 1929.[6] These include the regular 30, 60, and 90-day renewable loans to individuals by commercial banks and cash loans by pawnbrokers. Single-payment loans have never equaled this total again, even in 1941. This is largely due to the establishment of personal

---

[4]For a discussion of Regulation W and its possible effect upon consumer credit outstanding see Chapter V pp. 49-53.

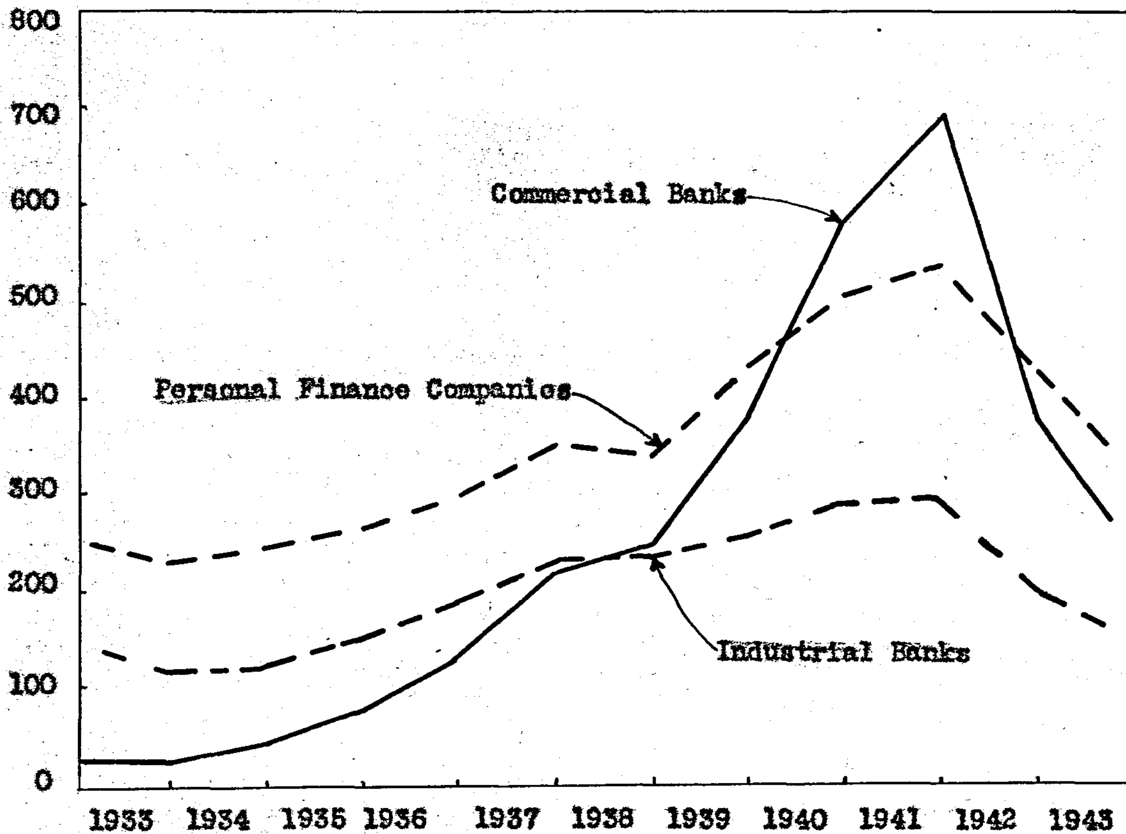
[5]Loc. cit.

[6]Loc. cit.

CHART 1

OUTSTANDING CONSUMER INSTALMENT LOANS
OF PRINCIPAL CONSUMER LENDING AGENCIES

Millions of Dollars



Source: Board of Governors of the Federal Reserve System

loan departments by many commercial banks and the shift to instalment loans. On May 7, 1942, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Comptroller of the Currency issued a joint statement urging private banks and other lending institutions to amortize all single-payment loans as far as possible. Since 1941 the contraction of consumer credit in general has also had some effect. It is interesting to note, however, that single-payment loans decreased only 15 percent in volume between September 1941 and September 1943 whereas commercial bank instalment loans decreased 62 percent during this period.

Bank Holdings of Retail Instalment Paper

The favorable experience of the banks with sales finance companies during the depression years of the early 1930's led many banks to enter the sales finance field. In the fall of 1934 commercial banks experimentally increased their holdings of retail instalment paper and by the end of 1937 approximately 10 percent of all retail instalment paper was held by commercial banks.

In 1937 deflation set in and lasted through most of 1938. Another period of expansion followed and by the end of 1939 the number of insured commercial banks reporting purchases of instalment paper increased from a few hundred to slightly over ten thousand. Bank holdings of retail instalment paper jumped to 541 million dollars or 28.6 percent of the combined holdings of banks and sales finance companies. Of the 13,493 insured commercial banks, 10,381 reported purchases of

retail instalment paper in 1939. Automobile paper constituted 71.6 percent of the retail instalment paper holdings of commercial banks, and other retail paper, which included household appliance, house heating, furniture, and miscellaneous paper, amounted to 28.4 percent.[7]

On June 30, 1941, 11,785 of the 13,414 insured commercial banks in the United States reported holdings of slightly over a billion dollars of retail instalment paper. Total consumer credit holdings of these banks amounted to 1.7 billion dollars. Retail instalment paper amounted to 58 percent, F.H.A. Title I loans 16 percent, and consumer instalment loans 26 percent of total consumer credit holdings of insured commercial banks.[8]

By December 1942 retail instalment paper holdings of insured commercial banks had dropped to 609.7 million dollars.

Consumer Credit and Economic Instability

Until the latter part of the nineteenth century, it would seem that consumer credit, in the form of retail receivables, fluctuated inversely with business activity. When crops were poor, the country storekeeper's receivables rose and when crops were good, receivables declined. As industry developed and expanded, and standards of

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[7] Sales Finance Companies and Bank Holdings of Retail Instalment Paper, Sixteenth Census of the United States: 1940, United States Department of Commerce, Bureau of the Census, 56 pp.

[8] These percentages are based upon information included in the semi-annual reports of the Federal Deposit Insurance Corporation.

living rose, consumers purchased an increasing number of goods on the instalment basis, and consumers and consumer credit agencies were compelled to anticipate business conditions a year or more in advance. The development of large-scale merchandising made it difficult for merchants to know individual customers and it therefore became hazardous to extend credit to consumers during periods of unemployment or reduced income. Producers' investments were large when consumer demand was high and increasing, and when consumer demand declined, productive investment also declined.

The cyclical movements of consumer credit have had some effect upon business activity but there has been no conclusive evidence to prove that consumer credit, in itself, creates the business cycle. In peace-time the volume of consumer credit expands during a rising market and contracts during the down-swing. Consumers liquidate their instalment debts and reduce their buying during the down-swing. The expansion of consumer credit tends to stimulate the acceleration of the boom and its contraction tends to deepen and prolong the depression.

Banks adopt a more liberal credit policy as bank deposits increase during a boom period and they become more selective in their choice of risk during a business recession. This expansion and contraction of bank credit is considered by some economists to be a major cause of the business cycle. When banks grant loans on the basis of future employment and income of borrowers, they anticipate future economic conditions. A few writers maintain that such anticipation of future economic conditions adds greatly to the cyclical movements of

consumer credit.

During the present war period as during previous wars, large government outlays and increased employment and private incomes on the one hand, and reduced supplies of goods and services on the other, give rise to inflationary tendencies which force prices up. In an attempt to combat these inflationary tendencies, a program of price and wage controls, rationing, subsidies, and consumer credit restriction has been put into effect. It is the hope of the Board of Governors of the Federal Reserve System that consumer debt liquidation will absorb income that might otherwise be used to bid up prices on consumer goods, and will place funds in the hands of commercial banks which will be invested in Government bonds by the banks.

Total consumer credit at its highest volume in September 1941 amounted to 9.7 billion dollars. Total net public and private debt amounted to approximately 185 billion dollars at the end of 1941.[9] Consumer credit, therefore, accounted for slightly over 5 percent of this figure.

About 5 billion dollars of consumer credit has been liquidated since September 1941. However, total net public and private debt is increasing daily. Many bankers seem to be of the opinion that because consumer credit forms such a small part of total net public and private debt, its liquidation, even though it were liquidated completely, would not alter the upward spiral to any appreciable degree.

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[9] Indebtedness in the United States, 1929-1941, U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, Economic Series No. 21.

CHAPTER III

TYPES OF LOANS AND SALES FINANCE OPERATIONS

Commercial banks have expanded their operations to include the extension of consumer credit through many mediums. This has placed them in direct competition with other agencies whose consumer credit activities are similar to those of the banks. The consumer credit activities of commercial banks may be classed as direct and indirect. Direct activities include the granting of consumer loans, the making of single-payment loans, and the purchase of retail instalment paper from individuals. Indirect activities include the purchase of retail instalment paper from dealers, loans to sales finance companies, loans to personal finance companies, loans to industrial banks and, to a very limited extent, loans to credit unions.

Loans to Consumers

Consumer instalment loans are repayable in instalments, usually over a period of one year. There are three main types of instalment loans, co-maker, secured, and single-name loans. Co-maker loans are made more frequently by banks than either of the other two types. Co-maker loans are made to the average employed person who does not

qualify for a single-name loan. One to three co-makers may be required, the number depending upon the credit standing of the borrower and that of the co-makers. A co-maker must be a person of good character and have a satisfactory credit rating. He must have an income sufficient to enable him to make the required monthly payments if the borrower fails to do so. Co-makers who have notes of their own or who are co-makers on other notes are acceptable if their total obligations are not excessively large.

A co-maker loan may be insured at the option of the borrower as a protection to the co-maker against the possibility of being required to pay the loan in the event of the death of the borrower. Such protection to the co-maker makes a borrower less hesitant to ask a friend or relative to act as co-maker and the friend or relative more willing to become a co-maker. On co-maker loans, the amount of the loan, less charges, is usually available to the borrower within 24 hours after the loan application is filed, provided the credit committee approves the loan.

Secured loans include notes secured by conditional sales contracts, surety bonds, bailment leases, chattel mortgages or similar security, and also those secured by savings passbooks, stocks and bonds, or life insurance policies.

Single-name loans, as the name implies, are one-signature loans, requiring no co-makers. They may be granted when circumstances justify the making of such loans by the banks. Anyone who has a steady and adequate income and a good credit rating may qualify. Single-name

loans are relatively common among small banks, and the larger banks have shown a tendency to grant more of them in recent years. Some banks prefer to have the signature of the borrower's wife on the note, as well as that of the borrower, as property is often held jointly by man and wife and because these banks have found that the wife will encourage the borrower to make loan payments promptly.

Commercial banks also make F.H.A. Title I loans. These loans are usually made by the personal loan departments and are on an installment basis. They are insured by the federal government for not more than 10 percent of the total amount of such loans.[1] These loans have been profitable to the banks and their favorable experience with these loans encouraged the banks to expand the volume of their consumer installment loans after 1934. Title I loans are now being granted by the banks for the conversion of heating plants to the use of fuel other than oil and for the installation of storm windows and other fuel-saving devices. Many banks now grant loans for such purposes in addition to the Title I loans. These banks establish their own reserve funds to cover losses resulting from such loans.

Single-payment loans are made on a 30, 60, or 90 day basis. These loans are not always strictly consumer loans. Single-payment loans are usually made with the understanding that they will be reduced periodically on renewal dates. At the present time bankers are urging

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[1] The original Act (National Housing Act of 1934) provided for insurance at the rate of 20 percent.

applicants for single-payment loans to apply for instalment loans instead.

Retail Instalment Paper Purchased

The retail instalment paper purchased by commercial banks consists of automotive, household appliance and other commodity paper. A large percentage of the paper is automotive paper.

Commercial banks negotiate automobile financing direct with the purchaser by granting a cash instalment loan on a co-maker or single-name basis and the borrower uses the proceeds to buy an automobile; or the bank finances the purchase of the automobile on a conditional sales contract or bailment lease. Reserves are set up out of finance charges to cover losses.

Commercial banks also purchase instalment paper from dealers under what is known as "Dealer Plan." The quality of such paper is in direct ratio to the character and business acumen of the dealer. Automobile instalment paper is purchased by the banks from dealers on a recourse or non-recourse basis. When the paper is purchased on a recourse basis the dealer is responsible for all repossessed automobiles. This would appear to be a point in favor of Dealer Plan financing as the bank assumes the burden of disposing of repossessed automobiles when the paper is purchased direct from the consumer. However, under the Dealer Plan of financing, the bank finds it necessary, because of finance company competition, to allow the dealer to participate in the finance charge or reserve set up to cover losses, in connection with

every retail contract; to accept all credit risks offered except those on which losses are positive; and to make other concessions.

Banks sometimes engage in what is known as floor-plan financing, that is, the extension of credit to a retailer for the purpose of financing a display stock, reserve, or warehouse stock, pending its sale.

Instalment sales contracts are purchased by the banks from department stores, often on an insurance or recourse basis. The bank is guaranteed a percentage by the store on all the contracts purchased. The guarantee also provides that all uncollectible notes up to the amount of the reserve set up to cover losses, must be repurchased by the store for the amount of the unpaid balance or else replaced with non-delinquent notes. Banks also buy instalment sales contracts from public utility companies who sell appliances to customers. They also purchase instalment accounts receivable from mail order houses. The public utility companies and mail order houses attend to the credit investigation and collection of these accounts.

Some commercial banks purchase retail instalment paper direct from individuals and also in accordance with a Dealer Plan; others purchase retail paper only from individuals; and still other banks engage in Dealer Plan financing exclusively. Banks that do not engage in Dealer Plan financing give as the main reason their desire to select their own risks. Bankers who prefer Dealer Plan financing to direct financing maintain that a direct loan to the purchaser of an automobile is more exposed to loss than when the paper is purchased from a good dealer. A longer period of time is needed to build up a bank's holdings

of retail instalment paper through direct financing than is necessary in dealer financing but credit risks are better, the cost of service less, the volume more stable, and the bank need not give part of the profits to the dealer.

Bank credit requirements for automobile financing contracts are similar to those for the usual consumer instalment loans. When it is possible to secure them, a title-retaining contract and note are preferred over a chattel mortgage. Before the curtailment of production of many consumer goods, the largest percentage of sales finance operations of commercial banks was the financing of automobiles. Household equipment ranked second.

At the peak of consumer financing in August 1941 the consumer credit activities of one large bank were as follows: Automobile loans - 35 percent, trade loans - 3 percent, collateral loans - 28 percent, co-maker and single-name loans - 33 percent, and conditional sales contracts - 1 percent.

Loans to Other Consumer Credit Agencies

Commercial banks not only supply a large share of the working capital of sales finance companies by making direct loans to them but they also purchase their notes in the open market and occasionally take over their debentures. In recent years many of the bank loans to sales finance companies have been unsecured, particularly those to the larger companies. The volume of bank loans to personal finance companies is not as large as the volume of such loans to sales finance companies.

The personal finance companies use their own capital to a large extent for making loans. Industrial banks obtain most of their funds from depositors and from the sale of instalment investment certificates. They borrow only a small percentage of their working capital from commercial banks. Credit unions lend the funds of their members chiefly and do not often borrow from the commercial banks.

Competitive Situation

Competition between the principal consumer credit agencies has become more pronounced in recent years. Instalment lending by commercial banks expanded tremendously between 1934 and 1941, as did their holdings of retail instalment paper. Such activities brought them into active competition with other agencies extending such credit. However, there appeared to be enough business to enable the personal finance companies, sales finance companies, industrial banking companies, and credit unions to also increase their volume.

Although the commercial banks make loans to persons with somewhat higher incomes, than do personal finance companies, they do compete to some extent for loan business. The instalment loans made by commercial banks are normally larger than those made by personal finance companies, the loans of the latter usually being limited by law to a maximum of $300. Personal finance companies specialize in single-name loans secured by a chattel mortgage on household furniture or an automobile. In their advertisements they stress the confidential nature of their lending services. No doubt many borrowers are willing to pay the

higher rates of personal finance companies in order to avoid disclosure of their financial position by asking a friend or relative to act as co-maker. The commercial banks have shown a tendency to grant more loans on a single-name basis in recent years but the majority of their instalment loans are still on a co-maker basis.

The rates charged by the commercial banks are lower than those charged by any other lending agency except possibly those of credit unions.[2] As the rates of the various types of agencies are stated in a different manner, comparison of rates by the borrower is difficult, and it seems unlikely that many borrowers base their choice of a lending agency solely on the rate of charge. Many form the habit of borrowing from one agency where they are known, and other factors such as the length of time the loan may run, the type of loan, and the extent of the credit investigation, influence the borrower's choice of a lending agency.

Industrial banking companies are perhaps the banks' greatest competitors in the consumer credit field. The industrial banks compete with the commercial banks in making instalment loans and in sales-financing, and their rates are usually quoted on a discount basis as are those of the commercial banks. They serve persons in somewhat the same occupational and income groups. Their rates are slightly higher than those of commercial banks. The credit unions do not compete with

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[2] For comparison of rates charged by the various lending agencies see Table 3 p. 66.

the commercial banks to any great extent as their activities are limited to relatively small groups of persons who are members of the unions. The sales finance companies are the banks' greatest competitors in the sales finance field. Their holdings of retail instalment paper in 1939 amounted to 1.3 billion dollars as compared with one-half billion dollars of such paper held by the commercial banks in that year. The bank charges, exclusive of insurance, are lower on an average than those of the smaller sales finance companies and are about the same or slightly less than those of the larger companies.

Automobile and household appliance salesmen sometimes urge customers to finance their purchases through a particular bank. By urging automobile salesmen to recommend his bank the officer in charge of the personal loan department of one Richmond bank has increased the bank's holdings of retail instalment paper in recent months.

Since 1941 competition has become keener as the volume of instalment loans and holdings of retail instalment paper have decreased. Competition between the commercial banks themselves has also increased. The advisability of limiting the number of personal finance companies by the States is now being considered, as the volume of business is not sufficient to permit all the companies to operate at a profit.[3] A number

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[3] A necessity-and-convenience clause was included in the revision of the Uniform Small Loan Law made by the Russell Sage Foundation in 1932. This clause, if adopted by the various States, would give the State supervisory body the privilege of rejecting new applications for licenses if it feels that there are already sufficient loan facilities in the area. Writers disagree regarding such a procedure; some are in favor of such action and others are of the opinion that free entry into the lending business is the best safeguard against monopolistic exploitation and the return of illegal lenders.

of personal finance companies have already been forced to liquidate. The banks have also suffered a decline in volume of consumer credit business, some banks to a greater degree than others. Several recent Federal Government releases point out that since the commercial banks have only recently entered the consumer credit field and their holdings of consumer instalment paper are a relatively small portion of their total assets, their over-all operation will not be drastically affected.

CHAPTER IV

LOAN POLICIES AND PROCEDURE

There are certain general requirements which must be met by the person who desires to obtain a bank loan, and the individual banks usually have particular requirements in addition to these general requirements. Legislation and wartime conditions have had an important effect upon the granting of consumer loans. Individuals request loans for various purposes and at certain times of the year; during different periods of the business cycle loans for some purposes are more prevalent than they are at other times. Limitation on the amount of a loan varies among banks and in accordance with legislation or regulation. The procedure followed by the various banks in handling instalment loans differs but there are certain fundamental steps connected with consumer lending which include interviewing, credit investigation, making records of loan transactions, collections, and checking on delinquencies.

Requirements for a Bank Loan

Persons of good character having regular incomes, who are free from burdensome debt and who have good credit records, may qualify for bank loans. Persons who have been employed for at least two years

by responsible companies prior to date of loan application are preferred. Banks accept only the comparatively good or higher grade risks. Some banks are more conservative than others, choosing only what they consider "safe" risks. Many banks set a maximum percentage of a borrower's income that he may borrow from the bank. A number of banks do not grant loans to persons in the very low income bracket.

The majority of bank consumer loan customers are executives, professional men and salaried or clerical workers. A relatively small proportion of their loan customers are wage-earners, whereas possibly 50 percent of all personal finance company loans are to wage-earners. Diversification of risk is desirable and lending officers keep this in mind when granting loans. The majority of bank consumer-loan customers carry life insurance, many have bank accounts, and a great many own or are buying real estate.

Many bankers have been hesitant about granting loans to men of draft age because of the provisions of the Soldiers' and Sailors' Relief Act.[1] The prospect of having large portions of their loan assets frozen for the duration of the war has made them exceedingly cautious in extending credit to men of military age. Some banks require an endorsement and also a waiver of the Act when granting loans

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[1] The purpose of Congress in enacting the Soldiers' and Sailors' Relief Act of 1940 was to assure men (and women) in military service that they and their dependents will be protected against enforcement of civil obligations that they are unable to meet by reason of their military service. The relief provision as to instalment purchase contracts and secured obligations are limited to obligations originating prior to commencement of the period of military service.

to such persons. The legality of the waiver requirement has not as yet been tested in the courts.

Purposes for Which Loans Are Made

Commercial banks usually grant consumer loans only for what they consider worthwhile purposes. The reason given by the applicant for requesting the loan may or may not be the true reason. The borrower may be perfectly honest in his intentions regarding the use to which the funds are to be put but may later change his mind, or circumstances beyond his control may necessitate the use of the borrowed funds for a purpose other than that stated in the loan application.

The purposes most often given in loan applications are:

Consolidation and payment of debts

Medical and dental services

Business opportunities

House furnishings

Purchase of automobile

Purchase of clothing

Education

Mortgage payments

Taxes and assessments

Insurance premiums

Home repairs and improvements

Vacation

Unexpected obligations

Consolidation and payment of debts has been the purpose most often stated in loan applications in the past, and medical and dental services rank second. There is more risk connected with loans made for the consolidation and payment of debts as the borrowers are often individuals who are never entirely out of debt. Loans for dental services are usually obtained through the cooperation of dental societies or individual dentists. Applications are submitted through the dentist who generally endorses the paper.

Loans for the purchase of automobiles have declined more than loans for any of the other purposes. Loans to cover income tax payments have increased in recent years. Such loans are usually made at the time when quarterly tax payments are due. Individuals often borrow to pay life insurance or other insurance premiums which are payable on an annual or semi-annual basis. The bank grants a loan payable in monthly instalments, and life insurance in an amount sufficient to cover the unpaid balance assures payment in event of the death of the borrower. Loans to pay insurance premiums increased greatly in volume during the depression of the early 1930's.

Home repair and improvement loans include F.H.A. Title I instalment loans authorized by the National Housing Act of 1934 and amendments, and also loans to cover repairs and improvements which are made by the banks in addition to Title I loans. Wartime restrictions apply to such loans but they are now being granted for heating plant conversions, weatherstripping, and other improvements designed for the conservation of fuel.

Methods for Increasing Loan Volume

In order to increase their consumer loan volume, commercial banks have resorted to many of the same channels used by other consumer lending agencies. However, the recommendations of present and former loan customers appear to be the best source of loan business. A large New York bank estimates that 45 percent of its new loan business has resulted from recommendations of previous and present loan customers.

Banks advertise in newspapers, on the radio, and on the motion picture screen. They use display cards, posters, billboards, "transit ads", and they enclose pamphlets describing their consumer loan facilities with the regular monthly statement to checking account customers. Letters are also sent to prospective customers. Many banks have found radio spot advertising very effective at little cost. One bank held meetings at which the various consumer loans offered by the bank were explained in detail to the employees. A campaign was then launched in which each employee was to tell his friends and relatives about the loans. The campaign was highly successful. Consumer loan volume increased 25 percent during the campaign which lasted six months.

Talks by representatives of one bank to employees of several manufacturing plants, emphasizing that the bank was the place to borrow if the workers found it necessary to borrow, brought an increase in loan volume. Employers sometimes recommend a particular bank to employees. One bank was given permission to distribute pamphlets, explaining their consumer loan service, to employees of several firms

at the door on pay day. Many firms also cooperate with the banks by giving them information pertaining to an employee's income, stability, and length of service. A few firms have agreed to make deduction from an employee's salary to cover repayments on a bank loan.

Special letters advertising their loan service are mailed by some banks to school teachers before the summer vacation period begins, and to Federal and State employees. Letters explaining modernization and repair loans are sent to home owners. Direct mail solicitation is also used to reach professional and high salaried people in order to build up the volume of large consumer loans. These are usually made at a lower rate of discount and are often single-name loans. Some banks arrange with doctors and dentists to have their fees paid by bank loans to clients. Department stores make arrangements with commercial banks for loans to store customers for the purpose of financing purchases or to refinance an open-book account.

Loan Amounts and Maturities

Consumer instalment loans of commercial banks are usually made in amounts of $100 or less, to $5,000. The greater portion of these loans run from $100 to $1,000 in amount. The majority of banks prefer not to grant loans of less than $100 as they have usually found such loans unprofitable. However, many banks do grant loans of $50 or even less on occasion. Some banks set both minimum and maximum limitations on the size of instalment loans while others set no definite limitations, preferring to limit the amount at the time each loan is

granted. The average size of loans made by large banks is larger than those made by small banks.

Consumer loans granted by commercial banks are larger, on an average, than those made by personal finance companies. The banks do not make many loans which are less than $100 in amount. According to statistical data furnished by the American Association of Personal Finance Companies, a personal finance company must make 16 loans to equal the amount of an average loan by a small bank and 63 loans to equal the amount of an average loan made by a large bank. Personal finance company loans usually range from $10 to $300 in amount.

Only a few States have enacted legislation limiting the amount of an instalment loan to a single person.[2] Regulation W issued by the Board of Governors of the Federal Reserve System limits the amount of a consumer instalment loan if it is for the purchase of articles listed in the supplement to the Regulation. Before Regulation W became effective, a minimum down-payment was required by the banks on sales financing contracts, usually a percentage of the cash price of the automobile or other goods purchased. Now, in accordance with the Regulation, the loan is limited to the cash price of the article less the trade-in and cash-down payment, plus the insurance and finance charges.

Maturities on consumer instalment loans were from 6 months or

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[2]See Chapter V p. 47.

less to 18 months and on sales finance contracts maturities were sometimes 24 months. Maximum maturities are now limited to 12 and 15 months under Regulation W.

Consumer Lending Procedure

Interviewing

Manuals have been prepared by the American Bankers Association and a few individual banks which deal with the technique of interviewing applicants for consumer loans. The procedure varies among banks, however. Some banks prefer to have the application for a loan filled in by the applicant when he first inquires about a loan, or the interviewer asks the applicant questions and makes the necessary entries on the application blank. Other banks prefer to ask only the name, address, employment, and amount of loan desired and allow the applicant to take the form and return it later, at which time the real interview takes place. It seems probable that the first method would result in more loans than the second, as many persons might fail to return the application, deciding to go elsewhere for their loans. Allowing the applicant to take out the application and note for the signature of co-signers sometimes results in the forgery of such signatures. However, it is not always convenient for co-signers to go to the banks to sign a note, and losses resulting from such loans are not large. Collateral loan applications are usually completed during the first interview.

Many personal loan officers take pride in saying that they give 24-hour service, that is, a loan is either granted or rejected within 24 hours after the application is received by them. Competition

between commercial banks, and between commercial banks and other consumer credit agencies, has resulted in the granting or rejecting of loans with a minimum of delay. The interviewer is sometimes unable to obtain a frank or true statement of the applicant's credit status and the bank refuses the loan. Some banks make a practice of rejecting applications of habitual borrowers, the individuals who never get out of debt. When loans are refused, suggestions are sometimes made by the interviewer which, when followed by the applicant, result in reconsideration of the loan.

Credit Investigation

The statements made by the applicant in the loan application are verified. These include his home address, length of residence at such address, place of employment, length of such employment, and whether it is of a seasonal nature, amount of income, number of dependents, indebtedness, ownership of home and other real estate, amount of mortgage, if any, and address of nearest relative. The credit investigation does not usually include the verification of every item on the loan application, but it often includes the checking of factors not included in the application form, such as the instalment buying and charge accounts of the applicant.

The bank's credit files are checked for previous information on the applicant and co-maker, if any, and then as outside check is made. In the larger cities, credit bureaus supply most of the necessary credit information. These bureaus often specialize in some particular phase of credit and it may be necessary for a bank to consult

several of these agencies. In some of the smaller communities there are no credit bureaus and a bank must depend upon its own credit investigator.

When the necessary credit information has been obtained by the bank, it is written up, the application and credit information is reviewed, and the loan is approved or rejected. In order to make sure that the person receiving the loan is the person who was investigated, the lending officer asks to see his automobile license or other paper carrying his signature.

Record of Loan Transactions

Commercial banks usually assign a number to each loan application and keep a record of the number of applications approved and rejected. If the application for a loan is approved, the note is filled in and the discount and other charges as well as the monthly payment amounts are checked for accuracy. The note is then signed by the applicant and co-makers, if required. Insurance coverage is arranged if the loan is to be insured. The necessary records of the transaction are made, including the loan card or individual ledger account, tickler card, recording of note in the register of loans made, general ledger sheet, posting of loan to the journal, making a coupon book or payment book, writing and entering cashier's check. The check is then mailed or given to the borrower and the coupon book mailed with letter of transmittal. The note is then captioned and filed. Instead of making payment by officer's check, the bank may credit the net amount of the loan to the borrower's checking account.

Repayments

Repayments are handled in one of two ways by the commercial banks:[3] (1) The repayments may be credited to a hypothecated savings account, or (2) the declining balance method is used. When the hypothecated savings account method is used, the note remains at its face value until final maturity and the repayments are considered as deposits in the savings account until they equal the amount of the note. The usual savings deposit interest is paid on the account and the bank must also pay a Federal Deposit assessment on the funds and maintain the usual reserves. The laws of some States require the use of this method.

The declining balance method is used widely by the banks at the present time. The unpaid balance can be ascertained at all times by referring to the individual ledger card. All pertinent loan information is recorded on this card. The coupon book is used by some banks for recording loan payments. Other banks use "instalvelopes" serially numbered which permit borrowers to make repayments by mail. A great many banks still use the payment book in which each payment is entered by the teller.

When payments are received by the bank, either at the teller's window or by mail, they are proved and sent to the bookkeeping department, usually in batches. The coupons are sorted and balanced, the journal entries are made, and the payments are posted to the individual ledger cards. After the loan has been paid in full the note is marked "paid" and returned to the borrower and the ledger card marked "paid." The central file is then posted to show payment of the obligation.

Collections

Collection procedure varies among banks but some type of collection control is necessary in order to curb delinquencies and to keep losses at a minimum. Various methods are used by the banks for distinguishing delinquent accounts from those not delinquent. Colored flags or signals are attached to past-due account cards, or ledger cards are filed so that all cards having the same due date are together in the file. When the latter method is used, current payments are entered on the ledger cards which are then proved and filed in the rear of the file. The cards remaining in the front of the file are delinquent accounts.

The first delinquency notice is sent to the borrower three to five days after the due date. The final notice is sent by the tenth day. A copy of the final notice is sent to the co-maker. This is a reminder of the co-maker's obligation in case of default by the borrower and the co-maker usually makes an attempt to persuade the borrower to make the over-due payment. If the delinquency notices are ignored by the borrower, the credit folder is then reviewed and a telephone call is made or a letter written to the borrower. If this does not bring results, an outside collector is then asked to call on the borrower, usually within two weeks of the date payment was due. If all efforts to collect fail, legal action may be taken and if the balance still remains, it is written off the books. Items overdue over four months are rarely collected and are usually charged off.

Delinquency may be due to a borrower's carelessness or lack

of foresight or it may be due to circumstances beyond his control. If due to the latter a bank may allow the borrower time to bring payments up to date or reduce the size of monthly instalments and extend the period of the loan, provided that such arrangements do not conflict with Regulation W. Banks do not, as a rule, call upon the co-maker to pay a delinquent account until all efforts to collect from the borrower have failed.

Reserves to cover losses are set up by transferring a portion of the discount, as it is earned, to a reserve account. There is a tendency among banks, however, to make deduction for operating costs, dividends, and so forth from earned discount before transferring earnings to a reserve account.

CHAPTER V

LEGISLATION AND REGULATION

Bills which apply to the consumer lending activities of banks have been presented to many of the State legislatures within the past few years. Some of these bills have become laws while others were discussed but not voted upon or failed to receive a majority vote. State regulation of the instalment lending operations of banks has tended to be one of "remote control" except in a few instances. In 1941 the President of the United States authorized the Board of Governors of the Federal Reserve System to investigate, regulate, and prohibit the extension of certain types of consumer credit under conditions to be prescribed by the Board, after consultation with a committee composed of certain Government officials.

Legislation

Federal and State statutes have long applied to the ordinary operations of commercial banks but legislation which applies to their consumer credit activities has been passed chiefly within the past decade. Before 1935 the banks, in most instances, made consumer loans under general banking statutes which authorized them to make loans and

discount paper, subject to the supervision of proper authority. However, few of these laws refer directly to instalment paper. The statutes known as "small loan laws" which resemble the model law drawn by the Russell Sage Foundation and which govern the lending of small sums, usually $300 or less, do not generally apply to national and State banks. The maximum charges by banks are controlled in many States by the general usury laws. Some of these laws, however, do not restrict consumer loan operations.

In 1934 there were ten States in which bank practices did not conflict with the usury laws;[1] Colorado, Maine, New Hampshire, Massachusetts, Rhode Island, California, Connecticut, Washington, Nevada, and Alabama. The first four have no general usury limitation. Rhode Island permits 30 percent per annum on loans over $50 and on loans under $50 a rate of 5 percent per month for the first six months and 2½ percent per month thereafter. California and Connecticut specifically exempt banks from the usury laws. In Nevada and Washington the usury rate is 12 percent; therefore a discount rate up to 6 percent on consumer loans is not illegal. Alabama was the first State to pass an enabling act permitting the discount method for consumer loans.

At the beginning of 1942, 15 States had enabling acts allowing commercial banks to make small instalment loans.[2] All of them, with the exception of Alabama, had passed these acts between 1935 and

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[1]See usury laws of the various States.

[2]See banking laws of the various States.

1942. Many of these laws are loosely drawn and their legality has not been tested in the courts. The States which had permissive laws prior to 1942 are Alabama, Arizona, Delaware, Florida, Georgia, Michigan, Mississippi, Nebraska, New Jersey, New York, North Carolina, Ohio, South Carolina, Virginia, and Wyoming.

New York has enacted fairly comprehensive legislation regulating personal loan departments. In accordance with Section 108 of the banking laws, the superintendent of banks has the right to charter personal loan departments and these departments are privileged to charge at a rate not exceeding 12 percent per annum, on unpaid balances. They are subject to periodic examination by the division of banks.

By the end of the 1943 legislative session consumer lending, as practiced by banks, was permissible in 27 States. The 3 additions were Texas, West Virginia, and Wisconsin. As Nebraska has recently passed a truly regulative simple-interest law, there are now 26 States in which there is either no usury limitation or where the banks have authorization to exceed the limit by the use of the discount method.

The following States and the District of Columbia have definite usury ceilings but have not passed enabling legislation or regulatory laws regarding bank consumer loans: Arkansas, Kansas, Montana, New Mexico, Oklahoma, Oregon, and Utah - 10 percent maximum rate; District of Columbia, Idaho, Indiana, Louisiana, Minnesota, Missouri, and South Dakota - 8 percent maximum rate; Illinois, Iowa, and North Dakota - 7 percent maximum rate; Kentucky, Maryland, Pennsylvania, Tennessee, and Vermont - 6 percent maximum rate.

A few States have enacted legislation which limits the amount of an instalment loan to a single borrower. In Arizona, New Jersey, Maine, and South Carolina, the maximum amount of a loan to a single customer is $1,000; South Carolina also sets a minimum of $10. In Delaware the maximum size of a loan depends upon the amount of the lenders' capital and surplus; a firm with paid-in capital of over $10,000 may lend up to 10 percent of its capital and surplus to a single borrower. In New York the maximum amount that may be loaned is related to the population. In cities with a population of 1,000,000 or more, the amount that may be loaned is limited to $3,500; in cities with a population of 300,000 to 1,000,000, the limit is $2,500; in cities of 25,000 to 300,000, the maximum amount that may be loaned is $1,500; in cities of 5,000 to 25,000, the maximum is $1,000; and in places with a population of 5,000 or less, the maximum is $500.

Several States set maximum maturities for consumer instalment loans prior to the adoption of Regulation W by the Board of Governors of the Federal Reserve System.[3] New Jersey prescribed a maximum maturity of 12 months; New York 15 months; Michigan 18 months; and Ohio 12 months.

Federal Regulation

For years several of the larger finance companies have been

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[3]For loan maturity limitations under Regulation W see p. 51.

in favor of more effective regulation of consumer credit. Personal finance companies have, in general, been in favor of a uniform statement by all consumer credit agencies of the total carrying charges on consumer loans, such as a certain percent per month on the unpaid balance. The personal finance companies which operate under the state small loan laws are required to use this method. It is also used by credit unions, which have also favored regulation.

The need for control of consumer credit during a period of rising incomes and accelerated business activity was emphasized by Kenton R. Cravens early in 1941.[4] During the summer of 1941 a number of government officials also spoke in favor of such control and in August of that year Regulation W was adopted by the Board of Governors of the Federal Reserve System.

The volume of consumer credit outstanding had increased approximately three billion dollars in three years, a billion dollars a year during 1939, 1940, and 1941. Although a rapid expansion in consumer credit usually does take place during periods of rising national income, the reverse has been true since 1941. As incomes have grown, the number of persons incurring debt have declined and those who have borrowed or made purchases on an instalment basis have paid off these debts more quickly than they did before 1941. However, a period of high income is considered a good time for people to reduce

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[4]Statement made by Mr. Cravens, president of the Cleveland Trust Company, while attending the Consumer Credit Conference at St. Louis, Missouri in April 1941.

their debts. Such a policy in wartime retards excessive buying and adds to the amount available for the purchase of war bonds. It also helps to lay a foundation for business recovery during the postwar period by creating a backlog of demand for consumer goods.

Regulation W

Regulation W became effective September 1, 1941.[5] It was intended to act as a restraint on the extension of consumer credit and to aid in the diversion of resources from civilian to military use. It was also supposed to assist in restraining general inflationary tendencies by curbing excessive buying by consumers.

The regulation, as amended, applies to banks, personal finance companies, sales finance companies, credit unions, dealers, and all others engaged in extending instalment credit, extending credit in charge accounts, and making single-payment loans (not for business or agricultural purposes) in amounts of $1,500 or less; or discounting or purchasing obligations arising out of such extensions of credit.[6]

Persons engaged in the business of extending credit, as stated above, must be licensed in accordance with the regulation.

The maximum maturity on charge accounts is stated as the 10th day of the second calendar month following the calendar month during

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[5]Regulation W was issued by the Board of Governors of the Federal Reserve System under Section 5(b) of the Act of October 6, 1917, as amended, and Executive Order No. 8843 dated August 9, 1941.

[6]The original regulation, as adopted August 21, 1941, reads "a loan which is in principal amount of $1,000, or less." This was later amended and at the present time no loan originally extended in principal amount exceeding $1,500, is subject to the regulation.

which the articles were sold. Persons having seasonal incomes are allowed 10 days after the end of the next calendar month during which most of their annual or semi-annual incomes are customarily received.

The supplement to the regulation contains a list of consumer durable goods for which maximum maturities and maximum credit values are prescribed. If an extension of instalment loan credit is wholly or partially secured, or is to be secured by any article listed in the supplement, the principal amount loaned the obligor (exclusive of interest, financing charges, and insurance) must not exceed the maximum credit value specified in the supplement and the maturity must also conform to that prescribed in the supplement. Instalments must be substantially equal in amount and are payable at approximately equal intervals, not exceeding one month.

Amendments to the regulation have been issued from time to time. These provide for numerous changes in the regulation and in the supplement. Additional articles have been included in the supplement and the maximum maturities and maximum credit values have been changed on some of the listed articles.

Regulation W, as revised May 6, 1942, contains numerous provisions which apply to consumer loans of $1,500 or less. Down payments of at least one-third the purchase price are required on articles listed in the supplement when purchased on an instalment basis. There are a few exceptions, however; on material and services in connection with home improvements no down-payment is required. A down-payment of 20 percent is required on furniture and pianos. No down-payment is

required on a consumer instalment loan or a single-payment loan which is not for the purchase of any listed article.

Maximum maturities of 15 months apply to automobile and motorcycle loans and 12 months to all other consumer loans except single-payment loans in which case the maximum maturity is 90 days.

There is no limitation on the amount of the instalment loan if it is not for the purchase of a listed article, or if it is for home improvements. On listed articles, the amount of the loan is limited to the cash price, less the trade-in and cash down-payment, plus the insurance and finance charges. There is no limitations on the amount of a single-payment loan when it is not for the purchase of listed articles. At least one payment per month must be made on all consumer instalment loans, except seasonal loans. Payments must not be less than $5.00 per month or $1.25 per week.

The renewal of a loan is permitted if the maturity, including the renewal, does not exceed the maximum maturity prescribed in the regulation. When an addition is made to an instalment loan, the payments must not be less than the borrower had been making on the original loan. Additions to single-payment loans must be handled as separate loans.

The applicant for a consumer loan of $1,500 or less is required to fill in a form prescribed by the Board of Governors of the Federal Reserve System. The purpose of the loan and other pertinent facts must be stated by the applicant.

The following loans are not subject to Regulation W as amended

October 26, 1942; a loan originally extended in a principal amount exceeding $1,500; real estate loans secured by first mortgages or improved real estate duly recorded; loans for the purchase or carrying of stocks, bonds, or other investment securities; instalment loans for educational, hospital, medical, dental or funeral expenses; and loans to dealers for the purchase of listed or unlisted articles. Also loans to religious, education, and charitable organizations; loans to finance the conversion of heating equipment to the use of other fuel, for insulation, installation of stormwindows, storm doors, weatherstripping, and loans to finance the purchase of materials for any of these purposes; disaster loans, agriculture and insurance loans; and loans to government agencies.

A fine of not more than $10,000, or imprisonment for not more than 10 years, or both, may be imposed for violation of Regulation W or any order pertaining to the regulation.

It would be difficult to determine just what effect Regulation W has had on the liquidation of consumer credit because of the many factors involved; especially the decline in the supply of consumer goods available for purchase and increased cash buying on the part of the public.

Instalment loans of commercial banks, personal finance companies, industrial banks, and credit unions began to decline in September 1941, the month in which Regulation W became effective.[7] The

[7] The restrictions placed on the production and sale of many types of durable goods to the consumer and the increased cash buying and consumer debt liquidation also played an important part in this decline.

instalment loans of personal finance companies rallied during December but the trend then became downward. Repair and modernization loans did not show a decline until November. Single-payment loans began to decline in January 1942.

Charge account credit declined in October and November 1941, rallied in December and then continued its downward movement. During 1943 it has remained at a fairly constant level through August but will no doubt increase during the holiday season. Regulation W has helped to expedite collections rather than discourage charge sales. Instalment sale credit of department stores, mail-order houses, and jewelry stores did not decline until after the 1941 Christmas peak. Furniture and household appliance stores experienced the beginning of the downward trend in instalment sale credit as early as September 1941. Automotive instalment sale credit also began to decline in September but this was due chiefly to curtailment of production. This also applies to household appliance credit to some extent.[8]

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[8]These comments are based on statistical data furnished by the Board of Governors of the Federal Reserve System, Division of Research and Statistics.

CHAPTER VI

BANK CREDIT CHARGES

A very important factor in consumer lending is the rate charged the borrower. Charges vary among banks and for different types of loans. A few banks quote a flat rate of discount on instalment loans with no additional charges but the majority of the banks make one or more charges in addition to the discount or interest rate.

Discount Rates and Other Charges on Instalment Loans

The maximum rate of interest that may be charged by banks is governed in most States by the general usury laws.[1] The way in which rates on consumer instalment loans are usually expressed and computed by commercial banks differs from the method used by personal finance companies. Commercial banks usually quote a rate of so much per hundred dollars or a certain percent discount which is deducted from the face amount of the note at the time the loan is made, whereas the personal finance companies quote a monthly rate on the unpaid balance. When the discount method is used the borrower does not receive the

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[1]See Chapter V and also the usury laws of the various States.

full amount of the note and if he wishes to have the use of $100, he must arrange for a loan which will cover the $100 plus the discount and other charges.

Some banks quote a graduated rate as do some personal finance companies. For example, on a loan of $750, the portion of the loan up to and including $500 carries a rate of 6 percent, and 5 percent is charged on the portion above $500.

Rates on consumer instalment loans may vary according to the amount of the loan and according to the type of loan. Rates also vary among banks in the same community and among banks in different parts of the country. The discount rate most frequently used by commercial banks is 6 percent, especially in the case of small loans. In addition a charge for insurance is often made and some banks also include an investigation fee.

Considerable variations in the discount rates charged in different sections of the country may be noted in the following table. Discount rates appear to be highest in the West North Central and West South Central regions. They seem to be lowest in the New England and Middle Atlantic regions where the average rate is 5.9 percent. In all regions the average rate on collateral loans was lower than the average rate for co-maker or single-name loans. This was also found to be true of loans made by Richmond, District of Columbia, and banks in other cities recently contacted in connection with this study. It was also found that co-maker loans are often made at lower rates than single-name loans and that discount rates of small banks are higher on an average than

TABLE 2

NUMBER OF REPORTING BANKS CHARGING VARIOUS DISCOUNT RATES ON CONSUMER INSTALMENT LOANS, BY REGION AND BY TYPE OF LOAN[a]

Region	Rate per annum						Number of banks reporting	Rate	
	9% and over	8%	7%	6%	5%	4% and under		Average[b]	Standard[c]
New England									
Single-name			1	33	3		37	5.9	5.9
Co-maker			1	41	3		45	6.0	5.9
Collateral			1	30	11	1	43	5.7	5.7
Middle Atlantic									
Single-name		1		109	12	1	123	5.9	5.9
Co-maker		1		122	13		136	5.9	5.9
Collateral				96	21	8	125	5.7	5.8
East North Central									
Single-name	1	6	36	66	8		117	6.4	6.3
Co-maker	1	6	33	71	9		120	6.3	6.3
Collateral	1	4	17	69	25	1	117	6.0	6.0
West North Central									
Single-name	6	30	23	18	2	2	81	7.2	7.0
Co-maker	5	33	18	24	3	1	84	7.1	7.0
Collateral	3	21	11	35	8	3	81	6.6	6.2
South Atlantic									
Single-name	2	7	3	52	4		68	6.3	6.3
Co-maker	2	7	4	59	3		75	6.3	6.3
Collateral		4	3	55	10	1	73	6.0	6.0
East South Central									
Single-name	1	5		13			19	6.7	6.4
Co-maker	1	6		16			23	6.7	6.4
Collateral	1	4	1	17	1		24	6.5	6.3
West South Central									
Single-name	14	10	1	5	3		33	8.0	8.1
Co-maker	13	12	1	6	4		36	7.9	8.1
Collateral	13	7	2	12	3		37	7.6	7.7

NUMBER OF REPORTING BANKS CHARGING VARIOUS DISCOUNT RATES ON CONSUMER INSTALMENT LOANS, BY REGION AND BY TYPE OF LOAN[a] continued

Region	Rate per annum						Number of banks reporting	Rate	
	9% and over	8%	7%	6%	5%	4% and under		Average[b]	Standard[c]
Mountain									
Single-name	3	8	2	2	7		22	7.0	6.9
Co-maker	3	8	2	2	8		23	6.9	6.8
Collateral	3	4	3	3	8	1	22	6.5	6.3
Pacific									
Single-name	3	7		10	2		22	7.0	7.2
Co-maker	4	6		12	2		24	7.0	7.1
Collateral	1	5	1	11	4		22	6.5	6.5
All Regions									
Single-name	30	74	66	308	41	3	522	6.5	
Co-maker	29	79	59	353	45	1	566	6.5	
Collateral	22	49	39	328	91	15	544	6.2	

[a] The Table is based on data furnished by 500 banks located in various parts of the country.

[b] In the computation of the average, rates of 9 percent and over were counted as $9\frac{1}{2}$ percent, and rates of 4 percent and under as $3\frac{1}{2}$ percent.

[c] These standard rates were obtained as follows: The average rates charged by banks in any size class in any region were weighted, not by the number of banks in that size class in that region, but by the number of banks in that size class in the entire country.

Source: John M. Chapman and Associates, Commercial Banks and Consumer Instalment Credit, Table 42, (New York: National Bureau of Economics Research, Inc., 1940), p. 143.

those of large banks.

The Southern Bank and Trust Company of Richmond, Virginia, makes what are termed R.R.I.A. loans to individuals.[2] No co-makers, endorsers or collateral are required. The loans are made in amounts up to $750, and are payable in monthly instalments for a period of one year or more.[3] The interest charge on R.R.I.A. loans is 5 percent per annum. The borrower also pays a sum amounting to 3 percent per annum on his loan to cover his prorata share of losses that may result from R.R.I.A. plan loans. After the loan is paid in full, a refund is made to the borrower. The amount of reserve refunded depends upon the losses suffered by the bank in making these loans.[4]

If an individual wishes to borrow		$100.00
He signs a note for $103.00 (the amount of the loan plus $3.00 reserve)		
The bank deducts the interest for one year	$5.00	
Deduction for insurance	1.00	
		6.00
Borrower received in cash		$ 94.00

[2]Reserve Refund Income Advances.

[3]Regulation W as amended limits the period of consumer instalment loans to a maximum of 15 months when such loans are for the purchase of automobiles or motorcycles and all other consumer instalment loans are limited to a maximum of 12 months. (The regulation applies to loans of $1,500 or under).

[4]During the period May 6, 1941 to July 31, 1943 the average refund of reserve for every $3.00 set up was $2.26; a net cost to the borrower of $0.74 per $100 borrowed.

The loan is then repaid in 11 monthly deposits of $8.60 each and a final payment of $8.40. If the losses to the bank on all R.R.I.A. loans amount to less than 3 percent, the bank then sends the borrower a check for his proportionate part of the reserve. The average cost to the borrower on these loans up to and including July 31, 1943 was $6.74 for each $100 borrowed. R.R.I.A. loans are available to anyone who has a steady and adequate income and who has a good credit record.

To consumer loans of $1,500 or more several Richmond banks apply a discount rate of 4 percent. On loans of less than $1,500 the rate is 4½ percent.

One of the larger Richmond banks makes co-maker loans of $100 to $500 at a rate of $6 per $100 loaned per annum. On loans of $500 or more the rate charged by this bank is $5 per $100 loaned. Collateral loans are made at $5 per $100 loaned on loans of $100 to $500 and on loans of $500 or more the rate is $4 per $100 loaned.

Another large Richmond bank makes unsecured loans on the following basis:

$299 or under	$6 per $100 loaned per annum
$300-$499	$5 per $100 loaned per annum
$500 or over	$4.50 per $100 loaned per annum

A reduction of one-half of one percent is made in the above rates if the loan is secured by collateral.

A minimum charge of $4 is made by a number of banks on consumer loans.

Individuals have frequently found it necessary to borrow on

their life insurance policies. In the past most of these loans were made by the insurance companies which issued the policies, and the rate charged was usually 6 percent per annum. In recent years many of the commercial banks have entered the field and a number of these banks now grant insurance loans at 4 percent per annum.

Investigation Fee

In States where such fees are not prohibited, many banks make a charge for credit investigation. Some banks call it an investigation fee, others call it a service fee or service charge. The charge for investigation may be a flat fee of 50 cents to $5 or it may be a certain percentage of the loan. Several of the banks contacted in connection with this study made no charge for investigation in addition to the regular discount rate, others charged $1 or $2. One large Washington bank charges an investigation fee of 2 percent on co-maker loans up to and including $150, when such investigation is necessary.

Charge for Insurance

Some banks make a charge for insurance when granting instalment loans. In the case of single-name loans, the insurance protects the borrower's estate if the borrower's death occurs before he completes the payments on the loan; the insurance company will pay the loan in full and the borrower's estate is relieved of payment. The insurance protects the co-maker when the loan is a co-maker loan.

The charge for insurance most commonly used by banks is 1 percent of the amount of the loan per month. However, some banks charge as little as 50 cents per $100. Advanced coverage is obtained by the

banks from life insurance companies through group insurance policies. Some banks make single-name loans under plans similar to the R.R.I.A. plan described earlier in this chapter, where a reserve fee is charged in addition to a charge of $1 for insurance. The majority of banks supplying data for this study require the borrower to pay an insurance fee when granting unsecured loans. Insurance on co-maker loans is optional in most of these banks. The cost of insurance to the bank is sometimes less than the rate charged the borrower.

The right of commercial banks to make such charges as investigation fees and insurance charges has been questioned by other consumer credit agencies. The Mississippi Supreme Court recently expressed the opinion that

> "Whatever may be its euphony, a service charge is something which the bank requires the borrower to pay in order to have the loan or accommodation, and therefore it is interest under another name; and when more than 8 percent per annum is thereby taken or stipulated, it is usurious."

A formal opinion rendered by the Attorney General of the State of Pennsylvania in April 1940 regarding the legality of charges made by banks in small or personal loan transactions of a fee for "insurance" of such loans may also be cited. It was stated that when a party is compelled to pay for a surety contract in order to obtain a loan, the transaction is usurious and the banking institutions should not be permitted to make such charges.[5]

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[5]Commonwealth of Pennsylvania, Department of Justice, Formal Opinion, No. 339, April 29, 1940.

Penalty for Delinquency

In some States a delinquent borrower is granted a grace period before any fines for delinquency may be levied. This grace period has been written into certain laws to protect the borrower who has mailed his check or who was unable to reach the bank in order to make payment on the loan on time. The grace period is usually from three to six days.

Delinquency penalties are imposed by the majority of banks in order to help cover the cost to the bank of such delinquency and also to discourage delinquent payments. The penalty for delinquency is sometimes expressed as a percentage of the delinquent payment; as a flat money charge; a charge in proportion to the number of days that payments are delinquent; or it may be a charge based on the number of delinquency notices sent to the borrower. Delinquency charges are not usually over five cents per dollar on late payments.

Refunds or Rebates

When a loan is paid off before maturity a refund of all or part of the unearned discount is made by the majority of banks. Refunds of one-half, one-third or three-fourths of the unearned discount are made by some banks; others refund at a lower rate than the discount rate; and still other banks refund that portion of the unearned discount in excess of the minimum charge.

A large Richmond bank refunds one-half the unearned interest on a loan having a maturity of one year which is paid up in six months but makes no refunds of less than two dollars in amount. In calculating refunds it is necessary for the banks to take into consideration

the acquisition, collection, and general overhead costs; therefore refunds of only a portion of the unearned discount are made.

Methods for Determining Rate of Charge on Unpaid Balance

When a commercial bank employs the discount method in making consumer instalment loans, the borrower pays interest on the full amount of the loan for the entire period of the loan. For example, an instalment loan of $100 is made at a rate of $6 per hundred, per annum. The bank deducts $6 and the borrower receives $94. The borrower is paying interest on $100 at 6 percent per annum but only has the use of the unpaid monthly balances as he is making monthly payments on the loan.

The rate of charge on the unpaid balance, or true interest rate, as it is often expressed, may be determined by the use of various formulas. The banking commissioner of New York State suggests that banks operating personal loan departments use the following formula:

$$D = \frac{R(N+1)}{2M + R(N+1)}$$

D = the rate of discount for the period of the loan

R = the rate percent per annum on the unpaid balance

N = the number of payments required

M = the number of payments periods in one year

Applying the formula to the above example, D = 6 percent and the equation would read: $0.06 = \frac{R(12 + 1)}{24 + R(12+1)}$. R would equal 0.1178 and the rate of charge on the unpaid balance, or true interest rate, would be 11.78 percent.

Another method which may be used to determine the rate of

charge on the unpaid balance is the constant ratio method:

$$\text{Rate} = \frac{24}{n + 1} \cdot \frac{I}{P}$$

I = the amount of money deducted from the face of the loan as interest

n = the number of equal monthly instalments

p = the amount actually received by the borrower.

In the case of a $100 loan at 6 percent per annum, to be repaid in 12 equal monthly instalments, the bank deducts $6 from the face of the loan and the borrower receives $94. Using the constant ratio method to determine the rate of charge on the unpaid balance, the equation would read: $\text{Rate} = \frac{24}{12 + 1} \cdot \frac{6}{94}$. The rate of charge on the unpaid balance would be 11.78 percent.

If a charge for insurance is made, the total cost to the borrower would be increased by that amount. An insurance fee of $1 would increase the rate of charge to 13.9 percent on the above loan. If an investigation fee of $1 is also added, the rate of charge would be 16 percent.

Comparison of Rates Charged by Principal Lending Agencies

The rates charged by commercial banks on instalment loans are lower than those charged by personal finance companies or industrial banks. Discount rates of large city banks are often as low as 3½ or 4 percent per annum. These lower rates are possible chiefly because the commercial banks have the use of depositors' funds at low cost; overhead costs of commercial banks may be shared by the various depart-

ments of the bank; and the banks serve higher income groups and their instalment loans are larger on an average than those of personal finance companies and, in some instances, industrial banks. They are also more selective in their choice of risk, taking only the better risks, and their losses are therefore low. Credit unions make consumer loans at rates equal to or lower than those of commercial banks but they do not have the facilities to operate on a large scale. They are formed by people who know each other, work together or are members of the same organization. Their loans are smaller on an average than those of commercial banks. Volunteer services by the members of the credit unions help to keep costs per loan relatively low.

In Table 3, which appears on the following page, an estimate of the common charge and range of charge for each of the principal consumer credit agencies is given.

Bank Rates on Single-Payment Loans

Single-payment loans or accommodation loans, as they are often designated by the banks, are made at the prevailing rate for small commercial loans. The common rate is 6 percent.

Rates for Sales Financing

The rate of charge for financing the purchase of new automobiles or household appliances directly with the bank by the purchaser varies but is usually around 5 percent. The rate of charge for financing used cars may be the same as that charged on new cars or it may be

TABLE 3

CONSUMER CREDIT CHARGES

(When Computed on Declining Balances)

	Common charge (Percent per year)	Range of charge (Percent per year)
Credit Unions	12	6-18
Personal Loan Departments of Commercial Banks	11.78	7-23
Remedial Loan Associations[a]		
Pledges		9-36
Chattel Mortgages and co-maker notes		15-30
Industrial Banking Companies	17	12-34
Pawnbrokers	36	24-120
Personal Finance Companies	36	12-42
Illegal Lenders[b]	240	72-720 (or more)
Finance Companies and Merchants selling on instalment plan		0-500

[a]A single association in New York, which makes loans at a rate of three-fourths of one percent per month, made two-thirds of the total loans of all remedial loan companies in the United States in 1938.

[b]The range of charges for illegal lenders was estimated at 80-1200 by one writer. No such estimate was found elsewhere, however, and it was therefore not included.

Source: This table is based on estimates made by other writers and on information obtained from various banks and finance company officials.

slightly higher, depending upon the age of the car.

When commercial banks finance automobiles in accordance with a Dealer Plan, the purchaser of the automobile usually pays a higher rate than he would pay if he financed the purchase directly with the bank. The charge to the purchaser is usually 6 percent as compared with a rate of 5 percent on direct financing.

Insurance

It is customary for the bank to require the purchase of fire, theft, and collision insurance on the automobile by the borrower. The choice of insurance agent is optional with the buyer but the bank or the dealer often acts as agent. The insurance fee is usually added to the face amount of the note and included in the regular monthly payments. When instalment paper is secured from a dealer, the insurance coverage is similar to that in direct financing. The insurance fee is usually quoted separately, and the borrower may select the agent or the dealer acts as insurance agent if permitted by State law. Banks often place all of their insurance with one or two companies, as this enables them to reduce accounting costs and expedite settlements.

Loan Rates to Other Consumer Credit Agencies

Interest rates on bank loans to sales finance companies vary, but many of these loans are made at 1½ percent. Rates to small companies are generally higher than those to large companies.

The rate on loans to personal finance companies are usually higher, as a rule, than those to sales finance companies. The rates

run from 1½ to 5 percent but the average rate is slightly less than 3 percent.

Interest rates on loans to industrial banks vary from 1½ to 5 percent or over.

Discount Method v. Simple Interest Method

Objections to the discount method have been voiced by various individuals and groups. Personal finance companies would like to see the commercial banks adopt the simple interest method in place of the discount-plus method now used by the majority of banks.[6]

The simple-interest method was prescribed in 1916 in the first draft of the Uniform Small Loan Law after having been tried out for several years in a few of the larger States. When this method is used, interest is not taken in advance or compounded but is computed on unpaid balances of the principal amount received by the borrower. No other charges may be contracted for or received, except fees actually and necessarily paid out to a public officer. Thirty-six States have adopted statutes which embody the essentials of the Uniform Small Loan Law under which personal finance companies operate.

Those who attack the discount method say that banks, when they entered the consumer instalment loan business, tried to adapt it to the discount plan which had worked well in the commercial loan

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[6] The discount-plus method is the practice of deducting the rate of discount plus other charges such as investigation fees, insurance, and so forth, in advance, from the face of the note.

business but that these two credit fields are essentially different; that consumer loans are repaid in instalments and the amount of money of which the borrower has the use, decreases from month to month and therefore the only accurate method of stating the charge is in terms of an all inclusive rate, a percentage of declining unpaid balances. The chief objection to the discount-plus method is that (in their opinion) it conceals the true rate, and that concealment enables banks to avoid the admission of usury.[7] The banks, however, uphold the discount method, maintaining that it is readily understood and that they have found it satisfactory.

The 1942-1943 legislative sessions were the first in which the discount method was really challenged by exponents of the simple interest method. Such a challenge was made in 8 States, Connecticut, Indiana, Iowa, Kentucky, Missouri, Nebraska, New Jersey, and Wisconsin. The simple interest method won approval in Nebraska but failed to do so in Wisconsin. Discount was retained in New Jersey and Connecticut; and in Indiana, Iowa, Kentucky, and Missouri, discount and simple interest were both rejected, leaving the banks without definite legal authority regarding instalment loans.

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[7] B. E. Henderson, Charges on Small Instalment Loans to Consumers, An Open Letter from the President of the Household Finance Corporation to American Bankers, April 2, 1942, 21 pp.; Robert K. Henry, Personal Loan Legislation for Banks, Reprinted from Mid-Western Banker, December 1942, 4 pp.; Phelps, Clyde William, The Four Rights, Reprinted from Banking, October 1942, p. 32.

CHAPTER VII

CONSUMER CREDIT FROM THE BANKS' VIEWPOINT

Although banks are to some extent institutions of public trust, they are also business enterprises which, in order to be successful, must operate at a profit. The cost of consumer credit financing has an important bearing upon bank income from such activities. Other consumer lending agencies have stated that the commercial banks do not always allocate to consumer instalment loans, all costs connected with the granting of such loans.

Consumer Credit Costs

The cost of extending consumer credit is greater as a rule than the cost of granting business loans. Consumer loans are usually much smaller than business loans and the cost of granting one large loan is less than the costs incident to the granting of a considerable number of small loans.

A large proportion of the commercial banks engaged in consumer lending activities do not operate separate personal loan departments. The banks which do have separate personal loan departments can allocate costs more easily than those which handle all or part of their consumer

loans in conjunction with other bank operations. It is important, however, for banks to determine the cost of making consumer loans in order that they may know whether such loans are profitable and also that they may provide such credit at a price the public is willing and able to pay.

Costs vary among banks and within the same bank at different levels of loan volume. Costs also vary for different types of loans. The average cost per consumer loan ranges from $3.50 to $7.00 and occasionally higher. Salary is the largest item of expense. Salaries constitute one-third to one-half of total costs. Investigation, disbursement, collection, and overhead costs are about the same for a $50 loan as they are for a $1,000 loan. However, the cost for credit investigation may not be as great on the larger loan as the borrower of $1,000 usually has adequate security whereas the small loan applicant may have no security to offer, in which case his credit record must be checked more carefully. The cost per dollar of loan made is lower on large loans than on small loans. Profitability increases with size and length of note. The cost of making loans tends to be inversely proportionate to a lender's loan volume.

In small banks or banks where the volume of consumer loans is small, such costs as light, heat, telephone, and even salary and equipment may not be increased as a result of consumer lending operations.

Banks operating personal loan departments generally charge all direct costs to the department. Indirect costs, or general over-

head expenses, are usually prorated among the various departments.

In making a cost analysis of the consumer instalment lending activities of commercial banks it is advisable to determine the acquisition cost per loan and the collection cost per instalment, and to allocate a proportion of general overhead expenses to such loans. The cost of the money loaned, that is, the interest paid to depositors for the use of such funds, should also be taken into consideration.[1]

Acquisition costs include such items as advertising, the printing of application forms, note forms, contracts, co-maker statements, rate charts, coupon books, ledger cards, and checks. Acquisition costs also include a portion of the salaries of loan officers and clerks handling the loans, additional telephones, cost of credit reports, desks, filing cabinets, office machinery, and the necessary space. A large proportion of the borrowers are people who are not regular customers of the bank and credit investigation and expansion of credit files are therefore necessary. Acquisition cost per loan varies from one to five dollars or more.

Collection costs include tellers' and bookkeepers' salaries,

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[1]Commercial banks by having access to the deposit funds of their depositors obtain a large share of their working capital at low cost. Sales finance companies borrow a large share of their working capital from commercial banks and personal finance companies supplement their own funds with commercial bank loans. Industrial banks and credit unions also borrow occasionally from commercial banks. The cost of borrowing from the commercial banks must be included in the cost of making consumer loans by these agencies. This is one of the reasons why the banks can make consumer loans at lower rates than these agencies.

auditing expenses, collection expenses, telephone, postage, stationery, and legal and travel expenses. Collection cost per instalment ranges from ten to fifty cents, or more.

General overhead expenses include heat, light, power, salaries, and fees of executives and directors, depreciation and amortization of buildings and fixtures, association dues, contributions, convention expenses.

The Break-Even Point on Consumer Loans

In order to determine whether a loan is profitable or unprofitable to a bank it is important to know the break-even point, that is, the point at which the gross charge to the customer for the loan is just sufficient to cover the acquisition and collection costs plus a proportionate share of general overhead or other expenses which cannot be classified as a per loan or per instalment expense. A loss results to the bank when the gross charge for the loan is insufficient to cover the cost of making the loan. The break-even point varies from month to month but it can be estimated roughly. If, for example, the acquisition cost per loan amounts to $2.20 and the collection cost per instalment is 20 cents or $2.40 per 12 months loan, and to these two costs is added $1.20 to cover a proportionate share of general overhead expenses, the break-even point is $5.80. A loan with a face value of $116 bearing a discount rate of 5 percent would produce a gross income equivalent to this break-even point.[2]

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[2]The rate of charge on the unpaid balance is not taken into consideration here. See Chapter VI p. 63.

Bankers often say that they make consumer loans of less than $100 in amount but they would prefer not to; that the granting of such loans is a part of a bank's good-will policy. Some bankers say they dislike to make a minimum charge of $4 to $4.50 on loans under $100 but they must do so in order to help defray expenses in connection with such loans. If a bank grants many loans below the break-even point it may find it necessary to increase the interest rate on unprofitable small loans or on all loans; or it may find it necessary to lower operating expenses; or discontinue making small loans.

Automobile instalment paper probably carries not only a lower per dollar but also a lower per unit cost than the usual consumer instalment loan as the average size of an automobile-finance contract is larger than the average consumer instalment loan granted by commercial banks.

Income

Gross income, per $100 of loan made, runs higher on consumer loans than on other bank loans and investments. However, acquisition and collection costs are higher on consumer loans. The greater part of the income on consumer loans is derived from discount or interest charges and the balance comes from such charges as credit investigation fees, delinquency fines, and the difference between the actual cost of the insurance and the insurance fee charged by the bank. Service charges are not permissible in some States.

All banks do not follow the same procedure when they credit

loan charges to an earned income account. Some banks credit the entire loan charge when the loan is made; other banks credit equal portions of the amount of loan charge on a daily, weekly, or monthly basis; and still others use what is known as the 78ths method. When this method is used, the bank credits 12/78's of the loan charge at the end of the first month if the loan is to be repaid in 12 equal monthly instalments; 11/78's is credited at the end of the second month, . . . and at the end of the twelfth month, 1/78th of the loan charge is credited to the earned income account.

If the entire loan charge is credited to the earned income account at the time the loan is made and the loan is to run for a period of 12 months, earnings on the loan during the remaining months are anticipated in advance. This is not a good practice, as earned income may not actually equal the charge made for the loan at the time it was granted; the loan may be paid before maturity and a part of the charge refunded. Also earned income on all consumer loans during succeeding months may decrease because of a decline in total consumer loans outstanding. The second method underestimates earned income during the first several months of the loan and overestimates it during the remaining months. The third method would appear to be the best of the three methods, as under it earned income is proportioned to the outstanding amount of the loan.

As commercial banks to not employ uniform cost accounting methods and many banks do not operate separate personal loan departments or keep consumer credit entirely separate from other bank operations, estimates by individual banks of profits derived from consumer

credit operations lack an accurate basis for comparison.

In 1942 net profits of the 13,347 insured commercial banks from all sources, after taxes and before dividends, represented a return of 6.3 percent on total capital funds. This is slightly less than the return for 1941.[3]

Effects of the War and Wartime Restrictions upon Income

Curtailed manufacture and sale of durable goods, increased government control, and the induction of young men and women into the armed forces, have resulted in changes in the consumer credit picture which have been reflected in operating costs and income.

In many of the personal loan departments which had a sizable loan volume before wartime restrictions were imposed, specialists were in charge of the various credit activities of these departments. Despite the reduction in loan volume these specialists were retained by many banks and their salaries are out of line with the type of work now being performed. It is usually not possible to reduce the cost of personnel and space as rapidly as loan volume decreases. Furthermore, many of the banks had spent much time and effort in training such personnel to become experts in the consumer credit field and were hesitant about dispensing with their services.

Advertising costs cannot be reduced quickly because contracts are usually made for a definite period of time. Especially is this true

[3]Release of the Federal Deposit Insurance Corporation, June 22, 1943.

in the case of radio programs where a specific time may have been engaged by the bank for a period of years.

The general shortening of terms and tightening up of restrictions on the rewriting of consumer obligations tend to increase costs because of the added acquisition cost in relation to total earning on a given obligation.

The average age of borrowers has increased and this, added to the stress and strain of war and deaths resulting from the war, has brought about a sharp increase in the number of deaths among borrowers. The increased deaths have had a tendency to increase insurance premium costs on consumer loans.

Losses resulting from conscription and enlistment of men in the armed forces have added materially to normal credit losses but these have been offset to some extent by the ability of the banks to make recoveries on old charge-offs.

Salary increases and the loss of efficient employees have tended to increase costs.

Automobiles are now sold mainly to defense workers and other individuals who have a large portion of the purchase price in cash and this tends to shorten maturities and reduce the amount needed for financing, even with increased sale prices.

The prepayment of obligations which would normally be on the books for a much longer period of time also tends to reduce the income of personal loan departments.

Losses

Losses resulting from consumer credit transactions depend to a great degree upon local economic conditions and upon economic conditions in general. The ability of lending officers and bank committees to judge risks and the efficient operation of the collection department are instrumental in keeping losses at a minimum. Losses for all banks average from one-quarter to one-half of one percent of annual volume. One bank with a consumer loan volume of two million dollars in 1942, estimated its losses at approximately $300.

Many banks dispose of repossessed automobiles immediately to wholesale buyers and write off the loss at once. The "skip" has been a big problem in automobile financing as it is often difficult and expensive to retrieve the automobile.

Reserves

Reserves are set aside by the banks to take care of losses resulting from consumer credit transactions. In the case of consumer loans a portion of the discount as it is earned is usually transferred to a reserve account. A reserve of one-half of one percent or more is usually considered necessary. A reserve is set up out of finance charges when the bank engages in automobile financing.

CHAPTER VIII

CONSUMER CREDIT AFTER THE WAR

At this time when plans are being formulated by various groups in an effort to mitigate the difficulties of postwar readjustments, consideration should be given to the place of consumer credit in our economy after the war. Commercial banks, in general, are looking forward to expanding their consumer loan volume and holdings of retail instalment paper. The extent to which such expansion may take place, however, will depend upon future economic conditions, the length of time necessary for the reconversion of industry, the postwar plans now being formulated, and the restrictions or limitations on consumer credit that may be in effect at the time.

Some writers express the opinion that consumer credit will be needed for rehabilitation during the demobilization period; that persons now employed in war plants will need funds to enable them to seek employment in other parts of the country. One writer states that banks can help to create more postwar jobs, and that the government can aid the banks to do so by making it possible for them to establish a special

reserve to cover losses on loans.[1] The establishment of such a reserve would encourage the banks to assume more risks and make more loans.

Consumer Credit and International Curenncy Stabilization

The need for consumer credit in connection with the operation of any International Currency Stabilization program is stressed in the May 1943 issue of Consumer Credit.[2] It is stated that neither the plan proposed for the British by John Maynard Keynes nor the plan proposed for the United States by Harry D. White takes proper recognition of the exchange problems arising in countries having chronic debit or credit balances of trade.

> "While both plans would facilitate orderly clearance of short-term excesses or deficits, neither can maintain continued clearances at par of accounts which do not in themselves balance over a reasonable period. . . . It is out of this difficulty that the need for consumer credit as an international financial tool arises. Chronic unbalance of international payments for a single country results from habitually excessive imports or exports.
>
> Skillful use of consumer credit can enable consumers in countries with excessive exports to buy more goods and services. To the extent that this new demand becomes effective, the gap between imports and exports would be closed.
>
> Whether consumer credit under such circumstances closes the gap by increasing imports or by decreasing exports is of little significance at this point. In either case, it would increase the real wealth within the country. In addition

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[1] Ebersole, J. Franklin, "Banks Can Make More Postwar Jobs," Harvard Business Review, Autumn Number 1943, and "Government Can Help Banks Make More Jobs," Harvard Business Review, Winter Number 1944.

[2] "Costly Error Would Result if Consumer Credit is not Given an Important Place in any International Stabilization," Consumer Credit, Consumer Banking Institute, May 1943. 1-4.

it would tend to stabilize foreign exchange and thus serve the objective of the international clearing fund."

The United States is cited as an example of a country which habitually exports more than it imports, as our exports of merchandise have exceeded our imports each year for the past 55 years.

Plans for Postwar Purchase

A number of plans have been suggested for payment, during the war for goods to be delivered after the war. The Nugent Plan[3] was perhaps the first such plan to be formulated in the United States. It provides for individual instalment payments now on goods to be delivered after the war. Certificates would be issued to purchasers in various denominations and could be applied toward the purchase of specific articles. Schedule of payments would range from 12 to 25 months depending upon the amount of the certificate. Priority numbers would be assigned according to the month in which the contract was made, and the number would be increased when payments became delinquent.

In order to encourage the purchase of certificates, they would be given a merchandise value 10 percent greater than the amount paid by the purchaser. The certificates would be sold by automobile and other dealers, and purchasers would sign postwar delivery contracts. Instalment payments would be made to local agencies or the post office.

The plan is intended as an anti-inflationary measure but it

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[3]Plan presented by Rolf Nugent, Director of Consumer Studies, Russell Sage Foundation, and Special Adviser, Office of Price Administration.

would also aid in averting a postwar slump, provided that reconversion of industry takes place within a relatively short period of time. It is questionable, however, whether a large number of consumers would be willing to pay for goods far in advance of actual delivery. There would be fewer requests for consumer credit if such a plan were adopted.

When the war ends, the demand for airplanes for private use will greatly increase and airplane manufacturers are now making plans to supply these demands. One company is offering a priority delivery plan for a "Family Car of the Air." When a total of $500 in war bonds has been listed with the company by potential purchasers, priority numbers are confirmed. The total value of the war bonds accumulated by potential buyers, when redeemed, will in many instances not be sufficient to cover the purchase price of such planes, and the commercial banks, or other consumer lending agencies, will be called upon to finance the remaining balances.

Preferred delivery, after the war, on new automobiles is being offered by a number of dealers. An allowance of $100 in addition to the regular cash trade-in allowance is made, provided that the amount of money granted on the trade-in is allowed to remain in the bank until after the war. It seems probable that many of these individuals will borrow some, or all, of the balance needed to complete payments on new automobiles, and some of them will borrow the necessary funds from the bank where the trade-in allowance is on deposit.

Postwar Expenditures for Consumer Goods

Several surveys have been made during the past 15 months in an

effort to determine postwar needs. The Chamber of Commerce of the United States has undertaken a series of surveys. According to the Chamber's second progress report (through 1942) the major items of demand after the war will be automobiles, household appliances, home furnishings, new homes, and home and farm improvements. The immediate demand for family automobiles is estimated at 2.3 billion dollars; household appliances, 860 million dollars; home furnishings, 710 million dollars; new homes, 5 billion dollars; and home and farm improvements, 6 billion dollars. Fortune Magazine has recently conducted a survey and found that the pent-up demand for goods after victory represents some 28 billion dollars.[4]

In terms of postwar buying, according to the Chamber of Commerce report, 56 percent of the people are accumulating spendable cash. However, only 19 percent of the families are saving for a specific postwar purchase, and the majority of people are not planning to make major purchases on a cash basis. This leads to the conclusion that much consumer buying, after the war, will be on a credit basis, thereby expanding consumer credit.

In the table reproduced on the following pages, an indication is given of the magnitude of the increase in consumer goods after the war, provided that a high level of total output is achieved in 1946. The given level of gross national product in 1946 is based on the assumption that the war and the immediate postwar reconversion period will be

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[4] Fortune Survey, Fortune, December 1943. pp. 10-32.

TABLE 4

A HYPOTHETICAL PROJECTION OF EXPENDITURES BY COMMODITY GROUPS BASED ON PAST RELATIONSHIPS TO THE GROSS NATIONAL PRODUCT

(Unit: 1 million dollars)

Item	1940	1946 assuming full utilization of available manpower and the 1942 general price level.	
		Amount	Percent increase over 1940
CONSUMER GOODS AND SERVICES			
Services:			
1. Housing (rent, depreciation on homes, etc.)	8,232	11,823	44
2. Home maintenance (domestic service, storage, insurance, repairs, etc.)	1,512	2,884	91
3. Household utilities	2,324	2,897	25
4. Personal care	1,559	2,638	69
5. Transportation	2,352	4,159	77
6. Medical care and death expenses	2,766	4,169	51
7. Recreation	1,773	2,526	42
8. Other	3,024	4,353	44
Total	23,542	35,449	51
Perishable goods:			
1. Food	20,929	33,917	62
2. Cigars, cigarettes, tobacco, and smoking supplies	1,993	2,965	49
3. Drug preparations and household medical supplies	804	1,156	44
4. Toilet preparations	508	690	36
5. Cleaning and polishing preparations	355	526	48
6. Magazines, newspapers, and other printed matter	617	786	27
7. Stationery and writing supplies	280	468	67
8. Miscellaneous household paper products	274	449	64
9. Toys, games, sport supplies	191	317	66
10. Manufactured household illuminating and heating products	669	1,249	87
11. Nonmanufactured household fuels	792	1,016	28
12. Fuels for passenger cars	1,211	1,780	47
Total	28,623	45,319	58

A HYPOTHETICAL PROJECTION OF EXPENDITURES BY COMMODITY GROUPS BASED ON PAST RELATIONSHIPS TO THE GROSS NATIONAL PRODUCT—continued

(Unit: 1 million dollars)

Item	1940	1946 assuming full utilization of available manpower and the 1942 general price level.	
		Amount	Percent increase over 1940
Semidurable goods:			
1. Clothing and accessories	5,698	9,777	72
2. Shoes and other footwear	1,223	2,021	65
3. Personal furnishings	211	414	96
4. Dry goods and notions	552	984	78
5. Semidurable house furnishings	878	1,562	78
6. Replacement tires and tubes	269	455	69
7. Passenger car replacement parts and accessories	462	841	82
Total	9,293	16,054	73
Durable goods:			
1. Household furniture	871	1,784	105
2. Floor coverings	385	882	29
3. Miscellaneous durable house furnishings	886	1,526	72
4. Heating and cooking apparatus	434	814	88
5. Refrigerators, washing machines, and sewing machines	460	799	74
6. Electrical household appliances	217	389	79
7. Other household appliances	26	44	69
8. China, glassware, tableware, and household utensils	564	865	53
9. Radio apparatus and phonographs	415	1,100	165
10. Pianos and organs	47	118	151
11. Other musical instruments	29	60	107
12. Clocks and watches	205	393	92
13. Jewelry and sterling silverware	336	620	85
14. Books and other durable printed matter	328	562	71
15. Writing equipment	53	108	104
16. Ophthalmic products, surgical and orthopedic appliances	181	283	56
17. Monuments and tombstones	62	114	84
18. Luggage	53	141	166
19. Wheel goods, durable toys, and sport equipment	338	538	59
20. Passenger cars	2,382	5,718	140
21. Pleasure craft	6	20	233
Total	8,278	16,878	104
Total Consumer Goods and Services	69,736	113,700	63

Source: Department of Commerce.

ended before 1946; that 96.5 percent of those seeking employment will have productive jobs; and that prices will be the same as they were in 1942. The gross national product for 1946 is estimated at 165 billion dollars, an increase of 70 percent over 1940. The large increase is the result of an allowance for considerably heavier interest payments on the government debt, substantially increased military expenditures, and the trend toward larger general expenditures by all units of the government.

The projection is based on the experience of this country between 1929 and 1940 and does not allow for the acceleration of past trends or for new developments resulting from the war. The airplane, chemical, drug, and many other industries will produce consumer goods far in excess of prewar output if they are to utilize present plant capacities. They will also develop new uses for materials and place new types of products on the market. The price of many individual commodities or groups of commodities may also be much higher or lower than the average stated in the table.

In order to maintain or regain their prewar standards of living, consumers will spend large sums for replacement of worn-out or obsolete durable goods, and many of these purchases will be on a credit basis. There is no reason for assuming that many consumers who acquired the habit of saving during the war, will continue to save after the war. The desire to purchase articles after the war which are not available at the present time has in many instances been the incentive to save. Present plant capacities for production and the backlog of demand for goods which is being built up, will result in greater production of consumer goods after the war, and consumer credit will be necessary to aid in the distribution of these goods.

CHAPTER IX

SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS

Just as individuals, influenced by their environment, follow definite courses of action, so banks, reacting to certain economic stimuli, evolve policies which determine the broad outlines of their credit operations.

Prior to the Civil War there was little need for consumer credit agencies, but as industry expanded, the population shifted from the farms to the cities, new types of consumer durable goods were manufactured, and the need for such agencies increased. The commercial banks gradually increased their consumer loans during this period of industrial expansion but they did not engage in instalment lending until about 1917, and then only to a very limited extent. Although banks increased their consumer loan volume during the 1920's, they engaged primarily in making commercial loans and investments. By 1934 they had accumulated large holdings of excess reserves; their earnings from commercial loans and investments had been declining steadily during the early 1930's, and they needed an outlet for their idle funds. After much hesitation, they embarked on a program of consumer credit expansion, and their outstanding consumer instalment loans increased from

29 million dollars in December 1933 to 760 million dollars in August 1941. They also greatly increased their holdings of retail instalment paper during this period. Since 1941 total consumer credit outstanding has declined steadily. However, the decline in commercial bank instalment loan volume and in holdings of retail instalment paper has been proportionately greater.

In addition to the granting of consumer instalment loans and single-payment loans, the commercial banks make loans to other consumer credit agencies; they purchase retail instalment paper from individuals and dealers; and they purchase instalment sales contracts from department stores, public utility companies, and mail order houses. The procedure for handling consumer instalment loans varies in different banks, but there are certain fundamental operations which include interviewing, credit investigation, recording of loan transactions, collections, and checking on delinquencies.

Consumer instalment loans are limited as to amount, maturity, and purpose. Legislation which applies to the consumer credit activities of commercial banks has been passed within the last ten years. Before 1935 the banks, in most instances, made loans under general banking statutes. Downpayments, and the number and amount of payments on articles purchased on credit, are limited in many instances by Regulation W. Consumer loans for the purchase of certain articles are limited in accordance with the provisions of the Regulation.

The maximum rate of interest that may be charged on consumer loans is governed in most States by the general usury laws. The majority

of banks make one or more charges on instalment loans, in addition to the discount or interest rate. Commercial bank rates on consumer instalment loans are lower than those charged by other consumer lending agencies, except possibly those of credit unions. Banks serve higher income groups and their instalment loans are larger on an average than those of personal finance companies.

The cost of granting consumer instalment loans is greater than the cost of granting business loans. Consumer loans are usually smaller, and the cost of granting one large loan is less than the cost of granting several small loans. Profitability increases with the size and length of note in the case of consumer instalment loans. Losses are relatively low on consumer loan transactions. The greater part of the income from such loans is derived from discount or interest charges. Wartime restrictions have resulted in changes which have increased operating costs and tended to reduce income.

Consumer credit will aid in the distribution of consumer goods after the war, and by expanding the volume of their loans to both business firms and consumers, the commercial banks can help to solve the employment problem during the transition period. Consumer credit may also be used in conjunction with any International Currency Stabilization program.

Without consumer credit, mass production, great improvement of products, and lower prices would have been impossible for such durable goods as automobiles, mechanical refrigerators, and radios. Through the use of consumer credit, individuals have enjoyed a higher standard of

living and paid for goods as they enjoyed them. A great portion of the consumer durable goods now in use were purchased before the war on an instalment basis and in this way consumer credit has aided the war effort.

Consumer credit is a powerful stimulant to our economic system and it should be expanded and contracted with proper timing in order to help prevent economic instability. A tightening of terms on the upswing and liberalizing them on the downswing should contribute to economic stability, and the coordination of consumer credit with other elements in the economic system should also help to attain economic stability. Persons instrumental in formulating the fiscal and monetary policies of the federal government now seem to look upon consumer credit as a device through which the transference of consumer purchasing power can be facilitated and manipulated by centralized control.

If banks are to provide suitable and adequate credit facilities for consumers after the war, they must anticipate the changes in demand for consumer credit and be prepared to meet the new demands. They should now be engaged in research on all phases of consumer credit, and should formulate policies for expansion of their consumer credit activities after the war. A thorough study of bank procedure for handling instalment loans should be undertaken, and an attempt made to simplify such procedure, and to reduce the cost of handling such loans. New devices and new methods might be used, and there should be less adherence to old customs that are inadequate.

An attempt should be made to obtain a greater degree of

uniformity in the methods for expressing loan rates, and there should be accurate disclosure of credit charges. In the case of loans paid up before maturity, all unearned discount, over and above bank expenses in connection with such loans, should be refunded.

There is need for a local credit bureau which would be in a position to furnish all information pertaining to a credit applicant's past which is vital to the commercial banks and other consumer credit agencies in evaluating risk. Counsel and advice should be given the borrower regarding his finances when he applies for a loan in order that he may not become involved with obligations beyond his ability to meet.

The commercial banks should expand their loan operations to include a wider range of risks and they should be permitted to charge appropriate rates for assuming such risks. More banks should consider the financing of accounts receivable, as the banks now extending such credit are receiving a satisfactory return from such operations.

The legal status of the bank's consumer credit activities should be clarified by State legislation, and authorization to engage in consumer lending should be in the hands of State banking commissioners.

During the 1930's the commercial banks demonstrated their ability to expand their consumer credit volume beyond even their own expectations, and this study indicates that there will be an opportunity for them to expand their consumer credit activities again after the war. The extent to which such expansion may take place will depend to a large extent upon economic conditions in general and upon skillful preparatory planning on the part of commercial bankers.

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