CORE
Metadata, citation and similar papers at core.ac.uk
Provided by Research Papers in Economics

This PDF is a selection from an out-of-print volume from the National Bureau of Economic Research

Volume Title: Industrial Banking Companies and Their Credit Practices

Volume Author/Editor: Raymond J. Saulnier

Volume Publisher: NBER

Volume ISBN: 0-870-14463-4

Volume URL: http://www.nber.org/books/saul40-1

Publication Date: 1940

Chapter Title: Services and Charges

Chapter Author: Raymond J. Saulnier

Chapter URL: http://www.nber.org/chapters/c5007

Chapter pages in book: (p. 72 - 97)

4

Services and Charges

As INDUSTRIAL banking companies have grown in number, size and resources, they have steadily diversified their activities. They now offer a variety of services which they seek to make as flexible as possible, for it is their stated aim to adapt themselves to the "needs of the individual." Since one of their basic functions is to lend money to consumers, they have sought to adjust their lending terms—especially those relating to payments, security and maturity—to the capacity and inclination of the borrower, and to avoid stereotyped forms and procedures.

LENDING SERVICES

It is principally by offering to the public a wider assortment of loans that industrial banking companies have accomplished their purpose of meeting the needs of a great variety of borrowers. It may be observed, however, that in increasing the types of their lending services they have been motivated as much by the twin necessities of meeting competition from other consumer lending agencies and of augmenting their volume of business as they have by a desire to simplify the problem of the man or woman who needs to borrow money.

Types of Loans

It was through its comaker loan that the industrial banking company first established itself as a consumer credit agency, and though in recent years many firms have emphasized

other types of lending services, the comaker loan is still widely regarded as the mainstay of the business. The risk involved in the extension of a loan of this type is dependent on the character and earning power not only of the maker but also of the one or more others—usually friends or relatives—who sign the note. Originally industrial banking firms intended to diversify the risk by stipulating that a comaker be employed in a different industry from that in which the maker was engaged, but there has never been any rigid requirement to this effect. Invariably, however, the credit status of the comakers as well as of the maker is investigated thoroughly; and the standing of the former is studied with particular care when the maker's credit is not altogether satisfactory. These loans are commonly signed by two comakers, and generally run for 12 months. They are paid off, for the most part, in monthly instalments, but for loans of relatively small size and short maturity semi-monthly or weekly payments are sometimes arranged.

Although comaker loans still account for an important part of the volume of industrial banking business, they have tended to decline in relative importance in recent years. Many reasons have been advanced for this change in lending practice. One important cause is the fact that many would-be borrowers find it difficult to find qualified and willing comakers, or are reluctant to seek signers because they prefer not to disclose their need of a loan to friends or relatives. Persons who have previously resorted to comaker loans will often hesitate to call upon the same individuals for additional favors, or fear that by requesting such signatures they have incurred an obligation to sign notes in return. More general reasons are to be found in the force of competitive conditions affecting the companies themselves, and in the constant quest for additional volume which has impelled them to expand into new fields.

Of comparatively recent origin is the single-name loan.

Granted solely on the basis of the maker's income and ability to pay, it requires no other signature than that of the borrower, though it is sometimes signed also by the borrower's wife. Single-name loans are extended to such relatively superior risks as well-known customers of the lending institution, executives with an established and assured income, schoolteachers and other professional persons, and individuals in equally responsible positions. In the granting of such loans group life insurance protection, for the amount of the unpaid balance, is always required.

The requirement of collateral security for the maker's note is another procedure employed by industrial banking companies to minimize risk and at the same time obviate the need for comakers. Such collateral may consist of stocks, bonds, insurance policies, fully paid investment certificates, savings passbooks or household furniture. The desirability of making furniture loans is still the subject of vigorous debate among industrial bankers.[1] Some contend that the collateral does not afford as sound security as does a comaker's signature; others, however, point to the obvious advantage of this type of loan—that it relieves the customer of the embarrassment involved in acquiring a comaker.

Aside from introducing these new types of loans, industrial banking companies have branched out in other directions in order to increase their volume of business. For example, they have entered into agreements with retail establishments, usually department stores, for the financing of time sales. Under an arrangement of this sort the company passes the credits and advances the cash directly to the store; thereafter it makes all collections on the contract. One large Morris Plan company has made such arrangements with a number of stores. On a similar basis some companies advance funds

[1] See Clifton Bourdelais, "Co-maker Loans vs. Furniture Loans" in *American Industrial Banker*, vol. 3, no. 4 (October 1937) p. 9.

to persons desiring to pay over a period of time for travel expenditures.

Another scheme which has gained considerable favor is the "creditor plan," whereby an industrial banking company extends a loan to consolidate all the obligations of the maker. Each of the borrower's creditors signs the note and is liable as comaker for an amount or proportion of the unpaid balance equal to the borrower's debt to him. Then, too, there are special terms for certain classes of customers. Thus industrial banking companies, like some personal finance companies, may offer to schoolteachers loans which do not require payments during summer months. One large institution has featured loans that call for much smaller payments during the first six months than during the last six months. Industrial banking companies, especially the larger ones, sometimes make loans on real estate, and also some commercial loans.

In recent years industrial banking companies have tended to do an increasing amount of business in the financing of instalment purchases, particularly of automobiles. There are several ways in which this financing may be arranged. An individual may apply to a lending company for a cash loan and use the proceeds for the purchase of the car, in which case the loan is the same as an ordinary comaker or single-name transaction. Or he may take advantage of the special automobile loan, which requires no signers or guarantors, since the car itself serves as security. The borrower simply makes a down payment and repays the loan within 12 to 24 months. The proportion of the purchase price financed in this way varies among firms and differs also for new and used cars, although in general it represents a conservative portion of the value of the automobile. This type of financing also requires that insurance be purchased on the car, at least against fire and theft. A third method of financing automobile purchases closely resembles the procedure followed

by sales finance companies: a company advances funds to the dealer to enable him to carry wholesale stocks of cars, and the dealer's retail instalment paper is then discounted on some sort of recourse or repurchase basis.

Sales financing by industrial banking companies extends into a very broad range of commodities, including electric equipment for home and farm, agricultural machinery, trailers, heating units and equipment for restaurants, beauty parlors and barber shops. It has been stimulated to a considerable extent by the insurance on real estate modernization loans granted to approved lending institutions under Title I of the National Housing Act. In the years 1934-37 industrial banking companies were responsible for 5.7 percent of the approximately $560,000,000 total of insured loans extended to homeowners for alterations, improvements and repairs. Each of 77 industrial banking companies, representing 1.2 percent of the total number of participating institutions, had an average volume of about $422,000 in insured loans during the four-year period.[2]

Table 8 indicates the comparative importance, as a source of business for insured industrial banking companies and for insured commercial banks, of paper arising out of retail instalment sales. At the end of 1939 only about $29,000,000 of the $541,000,000 of retail instalment paper held by these two types of institutions was held by the insured industrial banking companies. In relation to total customer loans, however, the paper held by the industrial banking companies represented a much greater proportion than did the larger volume held by commercial banks—nearly 23 as compared with only 7 percent for non-member commercial banks and 4 percent for member banks. It is significant to note, too, that for each of these types of institutions by far the greatest

[2] See National Bureau of Economic Research (Financial Research Program), *Government Agencies of Consumer Instalment Credit*, by Joseph D. Coppock (1940) Chapter 2, Table 3.

TABLE 8

RETAIL INSTALMENT PAPER HELD BY INSURED COMMERCIAL BANKS AND INSURED INDUSTRIAL BANKING COMPANIES, DECEMBER 31, 1939, BY TYPE OF INSTITUTION[a]

Type of Institution	Number of Institutions: Reporting Some Ret. Inst. Paper	Number of Institutions: Reporting No Ret. Inst. Paper	Retail Instalment Paper[b]: Automobile	Retail Instalment Paper[b]: Non-Automobile	Retail Instalment Paper[b]: Total	Total Ret. Inst. Paper in Percent of Customer Loans[c]	Automobile Paper in Percent of Total Ret. Inst. Paper
All insured commercial banks and industrial banking companies	*10,382*	*3,116*	*$387,647*	*$153,720*	*$541,367*	*5.1*	*71.6*
Member banks	5,021	1,330	274,758	125,937	400,695	4.4	68.6
Non-member banks and companies							
Commercial banks[d]	5,298	1,779	92,075	20,078	112,153	7.2	82.1
Industrial banking companies[e]	63	7	20,814	7,705	28,519	22.7	73.0

[a] For commercial banks based on data contained in *Federal Reserve Bulletin* (June 1940) p. 526; for industrial banking companies based on data supplied by the Federal Deposit Insurance Corporation.
[b] In thousands of dollars.
[c] Customer loans as used here consist of total loans minus open-market paper, real estate loans and loans for purchasing or carrying securities.
[d] Data obtained by subtracting figures for insured industrial banking companies from figures for all insured non-member banks and companies.
[e] Excluding 4 insured industrial banking companies which are members of the Federal Reserve System, a Morris Plan institution which reports directly to the Comptroller of the Currency, and a Morris Plan institution which recently changed its type of business.

part of the retail instalment paper arose from the sale of automobiles.

Some indication of the diversity of industrial banking companies' lending activities is to be found in Table 9, which

TABLE 9

PERCENTAGE DISTRIBUTION OF OUTSTANDING LOANS AND DISCOUNTS OF INSURED INDUSTRIAL BANKING COMPANIES, 1934–38, BY TYPE OF LOAN[a]

Type of Loan[b]	*1934*	*1935*	*1936*	*1937*	*1938*
Commercial and industrial loans	[c]	[c]	7.0	6.7	11.7
Real estate loans	6.5	4.7	4.2	4.7	5.6
Commercial paper bought in open market	.2	.2	.2	.4	.6
Loans to banks	.4	.1	[d]	[d]	.1
All other loans	92.9	95.0	88.6	88.2	82.1
TOTAL[e]	100.0	100.0	100.0	100.0	100.0
	$55,898	$78,122	$92,989	$108,247	$101,015
Number of companies	60	62	63	69	71

[a] Based on year-end data supplied by the Federal Deposit Insurance Corporation. Figures are net of repayments on instalment loans.

[b] The loan classification is that used in Schedule A, Form 64, of the Federal Deposit Insurance Corporation call report; commercial and industrial loans include "all business loans to individuals, partnerships, and corporations . . ." and specifically exclude "personal or instalment loans to individuals other than for business purposes . . ." (*Instructions for the Preparation of Reports of Condition on Form 64 By Insured State Banks Not Members of The Federal Reserve System,* FDIC, Washington, December 1939, p. 10).

[c] Not reported separately.

[d] Less than 0.1 percent.

[e] Dollar figures in thousands.

is based on call reports made to the Federal Deposit Insurance Corporation by the insured companies, these firms accounting for about half the total assets of all industrial banking companies. In spite of the fact that a large proportion of the paper has to be aggregated under the heading "all other loans"—a classification necessitated by the form of the

call report—the table shows interesting relationships between broad types of loans. The lack of data on commercial and industrial loans in the years 1934 and 1935 is undoubtedly due to the practice of the reporting companies in classifying loans, rather than to an absence of loans of this type in their portfolios.

Several other sets of data provide a more adequate statistical description of the directions in which industrial lending has branched out. Table 10, based on information supplied by the Morris Plan Bankers Association, shows that

TABLE 10

PERCENTAGE DISTRIBUTION OF OUTSTANDING LOAN BALANCES OF REPORTING MEMBERS OF THE MORRIS PLAN BANKERS ASSOCIATION, 1936 AND 1938, BY TYPE OF LOAN[a]

Type of Loan	*1936*	*1938*
Comaker and single-name	49.60	50.27
Collateral	8.45	7.46
Sales finance	21.49	22.52
Automobile	*15.39*	*15.92*
Non-automobile	*6.70*	*6.60*
Real estate	1.75	1.50
FHA Title I	12.74	9.06
Other	5.97	9.19
TOTAL	100.00	100.00

[a] Based on data supplied by the Morris Plan Bankers Association. Data for 1936 are as of June 30; number of companies represented is not reported. Data for 1938 are as of December 31, covering 80 companies. Total dollar volume not reported for either year.

in both 1936 and 1938 the total of comaker and single-name loans advanced by member companies accounted for only half of outstanding loan balances, and that sales financing accounted for more than a fifth. A distribution of loans substantially similar to that shown in Table 10 is to be noted in Table 11, which has been prepared from data for the year

TABLE 11

PERCENTAGE DISTRIBUTION OF VOLUME OF LOANS MADE BY 3 LARGE INDUSTRIAL BANKING COMPANIES, 1937, BY TYPE OF LOAN[a]

<table>
<tr><th>Type of Loan</th><th>Company A</th><th>Company B</th><th>Company C</th></tr>
<tr><td>Comaker</td><td>23.3</td><td>64.2</td><td rowspan="2">53.2</td></tr>
<tr><td>Single-name</td><td>17.7</td><td>.0</td></tr>
<tr><td>Collateral</td><td>17.1[b]</td><td>9.4</td><td>7.3</td></tr>
<tr><td>Sales finance</td><td>29.7[c]</td><td>19.7</td><td>18.5</td></tr>
<tr><td>Real estate</td><td>.0</td><td>.0</td><td>2.0</td></tr>
<tr><td>FHA Title I</td><td>.9</td><td>2.2</td><td>11.5</td></tr>
<tr><td>FHA Title II</td><td>9.9</td><td>2.0</td><td>7.5</td></tr>
<tr><td>Automobile wholesale</td><td>.0</td><td>2.5</td><td>.0</td></tr>
<tr><td>Other</td><td>1.4</td><td>.0</td><td>.0</td></tr>
<tr><td>TOTAL</td><td>100.0</td><td>100.0</td><td>100.0</td></tr>
</table>

[a] Based on data supplied by the companies. Data on Company B cover a volume of $12,282,000; for other companies volume figures are not reported. Data on Company A cover a sample of 2,352 loans, in amounts up to $1000, made during 1937 and 1938; for other companies figures on number of loans are not reported.

[b] Including 14.2 percent of automobile collateral loans.

[c] Including 25.3 percent of automobile finance paper.

1937, supplied by three large industrial banking companies, one in the Middle West and two in eastern states. For Company A additional data not included in this table, covering the years 1936 and 1938, show that over the three-year period 1936-38 there was an increase in both the number and the volume of comaker and single-name loans. The same company reports a rise in automobile and other sales financing from 14.6 percent in 1936 to 18.0 percent in 1938.

Slightly more detailed information is provided by Table 12, which is based on reports for 1936, 1937 and 1938 made by 8 Indiana companies permitted to sell investment certificates. Of especial interest are the data on loans secured by household goods, a classification which comprised 11 percent of all loans made by these companies in 1938.

TABLE 12

PERCENTAGE DISTRIBUTION OF NUMBER AND VOLUME OF LOANS MADE BY 8 INDIANA INDUSTRIAL BANKING COMPANIES, 1936–38, BY TYPE OF LOAN[a]

<table>
<tr><th rowspan="2">Type of Loan</th><th colspan="2">1936</th><th colspan="2">1937</th><th colspan="2">1938</th></tr>
<tr><th>Number</th><th>Volume</th><th>Number</th><th>Volume</th><th>Number</th><th>Volume</th></tr>
<tr><td>Comaker and endorser[b]</td><td rowspan="2">49.5</td><td rowspan="2">40.5</td><td>40.6</td><td>32.0</td><td>40.8</td><td>34.6</td></tr>
<tr><td>Unsecured (single-name)</td><td>3.3</td><td>3.8</td><td>8.3</td><td>9.4</td></tr>
<tr><td>Collateral[c]</td><td>6.3</td><td>11.2</td><td>..</td><td>..</td><td>..</td><td>..</td></tr>
<tr><td>Chattel mortgage</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Household goods</td><td>8.6</td><td>7.6</td><td>10.2</td><td>8.2</td><td>11.2</td><td>9.5</td></tr>
<tr><td>Automobiles</td><td>15.0</td><td>20.5</td><td>17.4</td><td>23.2</td><td>18.7</td><td>23.0</td></tr>
<tr><td>Other</td><td>.4</td><td>.9</td><td>2.3</td><td>4.8</td><td>2.8</td><td>3.9</td></tr>
<tr><td>Retail instalment sales contract</td><td>16.0</td><td>10.6</td><td>19.2</td><td>11.9</td><td>13.1</td><td>7.6</td></tr>
<tr><td>Real estate mortgage[d]</td><td>1.5</td><td>4.1</td><td>.8</td><td>5.8</td><td>.6</td><td>4.1</td></tr>
<tr><td>Other</td><td>2.7</td><td>4.6</td><td>6.2</td><td>10.3</td><td>4.5</td><td>7.9</td></tr>
<tr><td>TOTAL[e]</td><td>100.0%
28,891</td><td>100.0%
$5,995</td><td>100.0%
34,248</td><td>100.0%
$7,488</td><td>100.0%
34,977</td><td>100.0%
$6,964</td></tr>
</table>

[a] Based on *Annual Report* of the Department of Financial Institutions of the State of Indiana, for the years ended June 30, 1937 (p. 9), June 30, 1938 (p. 91) and June 30, 1939 (p. 69); data are for the calendar years indicated.
[b] Excluding "husband and wife" loans.
[c] Marketable securities, etc. This classification was not used in the reports for 1937 and 1938.
[d] Excluding mortgages taken as additional security.
[e] Dollar figures in thousands.

Data supplied by a large Morris Plan company, presented in Table 13, indicate the comparative importance of the various types of loans extended by this company during the fifteen-year period 1925-39. Comparable data are not available for other companies, but the figures on this one institution, while they are not to be taken as entirely representative, do illustrate a trend in lending activities which is probably

TABLE 13

PERCENTAGE DISTRIBUTION OF VOLUME OF LOANS MADE BY A LARGE MORRIS PLAN BANKING COMPANY, 1925–39, BY TYPE OF LOAN[a]

Year	*Co-maker*	*Single-Name*[b]	*Col-lateral*	*Auto-mobile*[c]	*Other*[d]	*Total*[e]	
1925[f]	89.0	.0	8.0	.2	2.8	100.0%	$ 815
1926	85.8	.0	10.4	.4	3.4	100.0	1,673
1927	82.5	.0	13.1	1.8	2.6	100.0	2,120
1928	77.9	.0	11.9	7.1	3.1	100.0	2,437
1929	89.2	.0	8.5	2.3	.0	100.0	2,355
1930	94.9	.0	5.1	.0	.0	100.0	2,394
1931	96.6	.0	3.4	.0	.0	100.0	2,362
1932	97.2	.0	2.6	.0	.2	100.0	2,419
1933	96.8	.0	3.2	.0	.0	100.0	2,030
1934	96.8	.0	3.2	.0	.0	100.0	1,841
1935	94.5	.0	2.8	.0	2.7	100.0	2,042
1936	76.0	9.1	2.6	9.3	3.0	100.0	2,861
1937	60.3	29.1	2.3	7.5	.8	100.0	3,279
1938	58.6	30.3	2.4	7.5	1.2	100.0	3,769
1939[g]	56.7	30.6	2.3	9.3	1.1	100.0	2,899

[a] Based on data supplied by the company.
[b] Including "husband and wife" loans.
[c] Including cash loans made on automobile collateral as well as loans made to finance automobile purchases.
[d] Including equipment, FHA Title I and Title II loans, and trade acceptances other than automobile.
[e] Dollar figures in thousands.
[f] April 1 to December 31.
[g] January 1 to August 31.

characteristic of many of the larger firms. Of particular interest is the indication that this company did not markedly diversify its services until 1936. Up to that year (except for 1927 and 1928) more than 85 percent of its loans, as measured by volume, were of the comaker type, and except in the first five years of the period the percentage of such loans was 95 or higher. In most of the years before 1936 the only other significant type of lending carried on by this company

was the extension of collateral loans, though after 1927 these showed an almost uninterrupted decline in relative importance. In 1936 a change in management occurred and there began a rapid expansion of new types of lending. Comaker loans declined conspicuously in relative importance, accounting for less than 57 percent of the company's total loan volume during the first eight months of 1939. Single-name loans, which were not granted at all before 1936, represented nearly 31 percent of the total loan volume at the end of this period, and loans made on automobile collateral, or for the financing of automobile purchases, amounted to nearly 10 percent.

The data that have been presented indicate a general decline in the relative importance of comaker loans extended by industrial banking companies. They also give evidence of a relative increase in the volume of single-name loans, and of automobile and other sales financing transactions.

Duration and Size of Loans

No detailed data are available on the maturity of loans made by industrial banking companies. It is known, however, that cash loans extended by these firms generally have a 12-month duration unless they are granted for very small amounts, in which case the note may be for only 3 to 6 months. Industrial banking companies which finance automobile and other purchases usually prescribe contract lengths similar to those favored by other consumer financing institutions. Thus automobile loans generally run from 18 to 24 months,[3] but a shorter or a longer contract may be offered if the type of car being financed and the practice of competing agencies make a modification in terms desirable. The financing of purchases of less expensive items generally involves shorter

[3] Myron R. Bone, "Current Trends Are Revealed by Survey" in *American Industrial Banker*, vol. 4, no. 5 (October 1938) p. 5.

contracts. Real estate and modernization loans, on the other hand, may run for two years or more.

On the size of loans somewhat more detailed information is available, though it is not altogether satisfactory either in form or in coverage. A recent survey of the lending practices of members of the American Industrial Bankers Association indicates that these companies make loans ranging in size from $10 to $10,000, and that on rare occasions they extend even larger sums. It is not likely that loans made in sizes near the upper limit of this range are strictly consumer loans. They may be made to merchants on the security of a group of accounts receivable, to be collected by the lender, or they may be straight commercial loans repayable in regular instalments. It appears also that it is the practice among some companies not to advance a loan of less than $50 or $75.[4] As was pointed out in Chapter 2, the maximum limit of loans is set in some instances by the law under which the companies operate. Where the governing legislation is a small loan law, as in Maryland, cash loans are limited to $300. In the District of Columbia companies are not allowed to lend more than $200 to a single borrower. Neither in Maryland nor in the District of Columbia, however, do these limitations affect companies that operate under the general banking code. Nor do legal provisions of this sort affect transactions which do not involve an advance of cash; thus the amount of sales finance credit extended by industrial banking companies is determined by their own judgment.

The survey just mentioned includes not only industrial banking companies as defined in this study, but also institutions which neither take deposits nor sell investment certificates. The average size of loans extended by companies in this mixed group ranges from $90 to $260, with the ma-

[4] *Ibid.*, p. 5.

jority reporting an average of $175 to $210.[5] Other data supplied by the American Industrial Bankers Association, based on reports by its members, show that the average size of loan accounts opened was $159 in 1936, $167 in 1937 and $187 in 1939. These averages, too, are for a mixed group, comprising a limited number of relatively small firms—38 companies in 1936, 26 in 1937 and 44 in 1939. Data on the average size of loans made by 10 comparatively large Morris Plan industrial banking companies during the period 1929-38 are given in Table 14, which shows that the average loan

TABLE 14
NUMBER, VOLUME AND AVERAGE SIZE OF LOANS MADE BY 10 MORRIS PLAN BANKING COMPANIES, 1929–38[a]

Year	*Number of Loans*	*Volume of Loans*	*Average Size of Loans*
1929	351,941	$ 95,396,846	$271
1930	351,080	90,444,349	258
1931	332,578	85,866,829	258
1932	277,472	66,696,643	240
1933	256,730	58,496,361	228
1934	290,049	70,835,507	244
1935	354,379	93,154,454	263
1936	388,955	106,049,074	273
1937	370,027	117,345,757	317
1938	404,226	116,289,561	288

[a] Based on data supplied by The Morris Plan Corporation of America.

made by these companies fell from $271 in 1929 to a low of $228 in 1933, rose to $317 in 1937, and declined to $288 in 1938.

Differences from one company to another in the average size of loans doubtless reflect in large degree variations in the types of loans extended. Again, however, only limited data are available. As can be seen from Table 15, loans

[5] *Ibid.*, p. 5.

TABLE 15

AVERAGE SIZE OF LOANS MADE BY 8 INDIANA INDUSTRIAL BANKING COMPANIES, 1936–38, BY TYPE OF LOAN[a]

Type of Loan	*1936*	*1937*	*1938*
Comaker and endorser[b]	$170 (comaker and unsecured combined)	$ 172	$ 169
Unsecured (single-name)		249	227
Collateral[c]	370	..	..
Chattel mortgage			
Household goods	183	175	169
Automobiles	285	292	245
Other	419	464	277
Retail instalment sales contract	137	135	116
Real estate mortgage[d]	560	1,670	1,478
Other	350	366	345
TOTAL	208	219	199

[a] Based on *Annual Report* of the Department of Financial Institutions of the State of Indiana, for the years ended June 30, 1937 (p. 9), June 30, 1938 (p. 91) and June 30, 1939 (p. 69); data are for the calendar years indicated.
[b] Excluding "husband and wife" loans.
[c] Marketable securities, etc. This classification was not used in the reports for 1937 and 1938.
[d] Excluding mortgages taken as additional security.

made by 8 Indiana companies authorized to issue investment certificates averaged $208, $219 and $199 in 1936, 1937 and 1938 respectively (the average was $195 in 1935). In the different types of loans, however, there was considerable deviation from these averages. Comaker loans, and those secured by household chattels, were well under average, as was also the typical amount of credit extended on retail instalment sales contracts. Unsecured single-name loans were somewhat larger than average, and loans secured by automobiles, or by marketable securities, were still larger. The handful of loans secured by real estate mortgages was, of course, far larger than the other types.

A fifteen-year record covering the average size of loans

made on different types of security by a large Morris Plan industrial banking company is presented in Table 16. The relatively large size of loans extended on automobile collateral during the years 1925-29 doubtless reflects the inclusion in the data of some wholesale loans; such loans are not represented in the figures for 1936-39. In 1937-39 loans secured by automobiles were roughly the size of comaker loans, and were considerably smaller than single-name loans, probably because this particular bank does no automobile

TABLE 16

AVERAGE SIZE OF LOANS MADE BY A LARGE MORRIS PLAN BANKING COMPANY, 1925–39, BY TYPE OF LOAN[a]

Year	*Co-maker*	*Single-Name*[b]	*Col-lateral*	*Auto-mobile*[c]	*Other*[d]	*All Loans*
1925[e]	$183	$ 0	$212	$ 622	$226	$186
1926	193	0	248	310	192	198
1927	217	0	374	610	233	233
1928	234	0	556	1,706	222	268
1929	248	0	389	5,012	163	262
1930	260	0	284	0	0	261
1931	266	0	201	0	0	263
1932	251	0	179	0	639	249
1933	232	0	170	0	0	230
1934	228	0	173	0	0	225
1935	246	0	175	0	260	243
1936	270	290	222	349	440	279
1937	262	306	212	253	386	272
1938	259	320	194	253	429	274
1939[f]	271	301	192	275	425	278

[a] Based on data supplied by the company.
[b] Including "husband and wife" loans.
[c] Including cash loans made on automobile collateral as well as loans made to finance automobile purchases.
[d] Including equipment, FHA Title I and Title II loans, and trade acceptances other than automobile.
[e] April 1 to December 31.
[f] January 1 to August 31.

sales financing through dealers. Single-name loans, which were not extended before 1936, averaged considerably larger than collateral loans, and somewhat larger than comaker notes. It was only after 1930, however, that comaker loans were larger than those secured by collateral.

The relative importance of loans of different sizes is indicated in Table 17, which is based on data for the same 8 Indiana companies represented in Tables 12 and 15. In 1937 over 80 percent of the loans, and in 1938 nearly 85 percent, were for amounts of $300 or less. For each of the two years, roughly a third of the total number of loans were for $25 to $100, though in volume loans of this size accounted for only about one-eighth. These data, however, are for fairly

TABLE 17

PERCENTAGE DISTRIBUTION OF NUMBER AND VOLUME OF LOANS MADE BY 8 INDIANA INDUSTRIAL BANKING COMPANIES, 1937–38, BY SIZE OF LOAN[a]

Size of Loan[b]	*1937*		*1938*	
	Number	Volume	Number	Volume
$ 25–100	32.5	11.0	33.9	12.4
100–150	18.7	10.6	20.3	12.8
150–200	13.2	10.8	14.0	12.2
200–300	16.5	19.1	16.5	19.1
300–500	12.4	21.9	10.7	24.6
500–1000	5.6	17.9	3.8	12.1
Over 1000	1.1	8.7	.8	6.8
TOTAL[c]	100.0%	100.0%	100.0%	100.0%
	27,424	$6,168	30,207	$6,147

[a] Based on *Annual Report* of the Department of Financial Institutions of the State of Indiana, for the years ended June 30, 1938 (p. 91) and June 30, 1939 (p. 69); data are for the calendar years indicated.
[b] Each level (except the first, which includes $25 loans) is exclusive of the lower figure and inclusive of the higher.
[c] Excluding real estate loans and purchases of retail instalment sales contracts. Dollar figures in thousands.

average-size companies. That they are not necessarily representative for very large industrial banking companies is indicated by a study of 2,948 loans made by such a company in 1937. In this sample only 32 percent of the total number of loans were for amounts under $300, while 20 percent of all the loans were for $1000 or more.

The lending policies of the 8 Indiana industrial banking companies already referred to are compared in Table 18 with those of small loan companies operating in the same state. The distributions include all loans made by the small loan companies but for industrial banking companies they include only those loans which are for $300 or less, $300 being

TABLE 18

PERCENTAGE DISTRIBUTION OF VOLUME OF LOANS OF $300 OR LESS MADE BY INDIANA INDUSTRIAL BANKING COMPANIES AND SMALL LOAN COMPANIES, 1937–38, BY SIZE OF LOAN[a]

Size of Loan[b]	*1937*		*1938*	
	Ind. Bkg. Cos.[c]	Small Loan Cos.	Ind. Bkg. Cos.[c]	Small Loan Cos.
$ 25 or less	.0	1.5	.0	1.6
25– 50	21.4 (25–100)	7.0	21.9 (25–100)	7.1
50–100		18.0		18.2
100–150	20.6	15.4	22.6	16.1
150–200	21.0	18.5	21.6	17.9
200–300	37.0	39.6	33.9	39.1
TOTAL[d]	100.0%	100.0%	100.0%	100.0%
	$3,177	$32,842	$ 3,467	$30,939
Number of companies	8	274	8	279

[a] Based on *Annual Report* of the Department of Financial Institutions of the State of Indiana, for the years ended June 30, 1938 (pp. 91 and 144) and June 30, 1939 (pp. 69 and 112); data are for the calendar years indicated.
[b] Each level is exclusive of the lower figure and inclusive of the higher.
[c] Authorized to sell investment certificates.
[d] Dollar figures in thousands.

the maximum loan permitted by law for small loan companies in Indiana. These figures reveal a notable similarity in the practices of the two types of companies. Both in 1937 and in 1938, however, the industrial banking companies granted a somewhat smaller proportion of their loan volume in loans of $100 or less, and a somewhat larger proportion in $100-200 loans. The $200-300 loans accounted for slightly higher percentages in the small loan companies' distribution than in that of industrial banking companies.

Methods of Loan Repayment

Payments on loans made by industrial banking companies may be applied directly to the face amount of the loan, or set up in an hypothecated deposit account, or applied to the instalment purchase of a pledged investment certificate. The first of these methods is commonly used for repayments on trade acceptance loans, FHA loans and other transactions which do not involve an extension of cash to the borrower. Cash loans, on the other hand, are usually repaid either by the accumulation of an hypothecated deposit account or by the purchase of a pledged certificate. The practice a given company will follow depends upon the legal conditions under which it operates.

Where a cash loan is involved, the accumulated instalment payments made by the borrower are not applied to the loan until its maturity. Although there is no requirement that the hypothecated deposit or the sum accumulated by the instalment purchase of the certificate be used to pay off the loan, this procedure is followed almost without exception. Where industrial banking companies have a deposit-taking privilege these accumulated payments may be reported as "repayments on loans not directly applied to loans." Most companies report separately gross loans outstanding and hypothecated certificates, but a few exclude the latter from

their reported liabilities and report a single figure for net outstandings.

The significance of the procedure followed in accepting loan repayments lies in the way in which it affects the computation of the effective interest rate paid by the borrower. In Chapter 2 it was pointed out that the sale of a certificate of indebtedness or investment at the time a loan is granted is held in some states to be a separate and distinct transaction, thus creating a legal fiction to the effect that the loan is not paid off in instalments. It is possible to argue, on the basis of this legal distinction, that the effective rate of interest is the rate at which the loan is discounted, whereas it is approximately double that rate if the loan is regarded as an instalment transaction, with a regularly declining principal balance.

CUSTOMER CHARGES

Many of the state laws regulating industrial banking companies not only set maximum rates of interest or discount but also indicate what additional charges may be levied. Often, however, companies lower their rates and charges below the legal maximum in order to meet competition. It should be noted that in almost all industrial loan laws the rate provisions apply only to cash loans; credit extended to finance the time sale of merchandise is not affected by such provisions, except in Indiana and Wisconsin.

The industrial banking company characteristically quotes loan costs as a certain rate of discount plus a charge for credit investigation. In this respect it differs from the personal finance company, which usually levies its charge as a specified rate per month on unpaid principal balance. Sometimes, however, industrial banking company rates are stated in more complicated terms, and in any case a number of considerations must be taken into account in computing

the actual cost to the borrower. This cost may include a fine for delinquent payments and a fee for insurance, as well as the discount charge and credit investigation or service fee. From this sum must be deducted any rebate granted for prepayment of the loan or for prompt payment, and any interest credited to the borrower on the deposit accumulated or the instalment certificate employed as a device for payment of the loan. While few companies actually impose all these charges and grant all these rebates and interest payments, each loan must be examined from every one of these angles before the actual cost to the borrower can be ascertained. His cost varies also, of course, with the size and duration of his loan, and perhaps with the kind of security he provides.

Computation of the effective rate of interest must take into account the fact that industrial loans are paid off in regular instalments. As has already been stressed, the effective rate on such a loan is higher than the stated rate of discount. On a $100 loan, for example, carrying a 6 percent discount deducted from the face amount of the note, and repayable in 12 equal monthly instalments, the effective rate of interest is 11.8 percent.[6]

On rates charged by Morris Plan banking companies no data are available which are sufficiently extensive to be used in any other way than as scattered examples of forms of quotation and general levels of charge. As for rates charged by other industrial banking companies, some facts are brought out in a recent study by the American Industrial Bankers Association. Almost half of the companies which submitted data for this survey employed a base rate of 6 percent discount plus an investigation fee of $1 per $50 on loans up to $250 or $500, and a smaller fee or none at all on

[6] See the discussion in National Bureau of Economic Research (Financial Research Program), *Commercial Banks and Consumer Instalment Credit,* by John M. Chapman and Associates (1940) p. 153.

loans above these amounts.[7] Of the reporting companies, 35 percent varied their rates according to the type of security. The lowest rate reported, 5 percent discount, was that charged for FHA Title I insured loans.

There is little uniformity among industrial banking companies as to the scale of rates for different types of loans. Generally, however, where a variation prevails, comaker loans are discounted at a higher rate than loans secured by savings passbooks, stocks or bonds. Frequently single-name loans carry a higher discount rate than comaker loans, or involve a higher investigation charge; on the other hand, they may be made at a lower rate than that charged on comaker loans, especially if they are of relatively large amounts. Loans secured by automobiles and household furniture likewise tend to carry a rate higher than that applied to comaker loans.

The size of a loan is an important criterion in the setting of rates. One company advertises that it makes no service charge and discounts at 8 percent on loans up to $500 in size, at 7 percent on loans from $500 to $1000, and at 6 percent on loans above $1000. Another company, which charges 6 percent on all loans, varies its investigation fees so that the percentage charge on a large loan is less than that on a smaller loan. This company levies a credit investigation fee of $2 on each $100 and sets a maximum fee of $6. No fee is imposed for collateral loans, even those below $300, and for $300-500 loans no fee is set regardless of the type of security. Borrowers of $500 and over are not only charged no credit investigation fee but they receive interest, at the rate of 2½ percent per annum computed on a quarterly basis, on the monthly deposits which they accumulate to liquidate their loans.

The rates recently put into effect by another large industrial banking company provide a further illustration of the adaptation of charges to the size and type of the loan. For

[7] Myron R. Bone, "Industrial Banks Loan Many Millions Yearly" in *American Industrial Banker,* vol. 4, no. 6 (December 1938) pp. 7-8.

comaker loans the rate is 6 percent, plus a service fee ranging as low as 1¼ percent and never in excess of 2 percent, depending on the size of the loan. No service fee is charged on loans of $700 or over. Loans secured by stock exchange collateral carry a rate of 5 percent if the amount is less than $1000, and of 4½ percent if the loan exceeds $1000. Loans secured by the bank's own certificates of deposit or by savings passbook accounts are charged the lowest rates. Those of less than $300 are discounted at 4½ percent, those of $300 to $500 at 4 percent, and those of $500 or more at 3½ percent.

The amount that a loan costs the borrower generally includes an insurance fee. On cash loans this insurance covers the life of the borrower, and provides for payment of the unpaid balance if he should die before the loan is paid off. Insurance is not always required, but when it is the borrower generally pays $1 per $100 for this coverage. For large loans, those of $500 or more, the company may carry the insurance without levying a special charge on the borrower.

The effective rates of interest on different sizes of loans are sometimes influenced considerably by the imposition of minimum charges. A company may impose a minimum charge of $1 on loans of $10 which are payable in 2 months, or it may state its credit investigation fees as a flat dollar charge, regardless of the size of the loan.

The problem of calculating the amount that a loan costs the borrower is further complicated by the practice of levying special delinquency charges. Thus for persons who fail to make payments promptly the cost may be increased substantially by the amount of the delinquency fine. In imposing this penalty not all companies define delinquency in the same way. Some maintain that a loan is delinquent if payment is not made on the due date; others grant a period of grace ranging from 2 to 10 days; still others do not consider a loan delinquent until a payment is 60 days overdue. Some companies, however, are not allowed by the law under which they

operate to charge any delinquency fee at all, and even the companies that are not subject to such a legal prohibition may not find it advantageous to exact a fee of this sort. Many have found that the amount of money thus collected does not compensate them for the ill-will engendered in the customer by the imposition of the fine. Delinquency fees are far from uniform; most companies charge 5 percent of the past-due payment, but some have a fixed minimum charge.

On the other hand, the allowance of rebates for prompt payment or prepayment reduces the cost of the loan to the borrower. In a few states industrial loan laws provide for a standard system of rebates for prepaid loans. In Indiana, for example, the Industrial Loan and Investment Act sets a minimum rebate on Class I loans of 1 percent per month on the amount prepaid, except that no rebate need amount to more than the original discount minus 3 percent of the original sum lent. Where rebates are not governed by law or administrative rulings, companies follow various methods; they may rebate unearned discount minus a minimum charge, or refund the full amount or some fraction of unearned interest.

The borrower's cost may be cut down somewhat if the company pays interest on hypothecated deposits. Few companies, however, follow this practice at the present time, and those which do so may pay interest only on deposits accumulated on loans above a set amount. For example, on deposits accumulated on loans of $500 and over, the Morris Plan Bank of Virginia pays interest at the same rate that it pays on unhypothecated deposits.

NON-LENDING SERVICES

From their inception industrial banking companies have sought to be more than consumer lending agencies. Many firms originally planned to serve also as thrift or savings in-

stitutions, for example, even though the legal arrangements under which they operated did not permit them to present themselves as savings institutions. From the point of view of the small company, thrift services are a desirable practice, for small companies can obtain funds in this way at lower rates of interest than they would have to pay to other potential sources of working funds.

State prohibitions against the acceptance of deposits have made it necessary for industrial banking companies to resort to the sale of various kinds of investment certificates in order to fulfil the savings or thrift function. These unhypothecated certificates vary considerably in form, but they have a strong basic similarity. They run for varying periods of time and carry different rates of interest; usually they are issued in relatively small, fixed denominations, and they may be paid for outright or in instalments. Where companies have been given deposit-taking privileges it is possible for the usual savings passbook to be used, and in such cases the instalment investment certificate may be dispensed with.

The rate paid on unhypothecated investment certificates varies with the size and maturity of the certificate, but funds obtained in this way generally prove more costly to the industrial banking company than do savings deposit funds. A recent survey conducted by the American Industrial Bankers Association shows that interest on certificates ranges from 3½ to 5 percent, and that some companies pay as much as 6 percent. On the other hand, interest on savings accounts varies between 1½ and 4 percent.[8] The latter, for the 4 companies which are now members of the Federal Reserve System and the 75 companies now insured by the Federal Deposit Insurance Corporation, is subject to legal regulation. These two government agencies set the same maximum rates on time deposits: 2½ percent on savings deposits and on time deposits

[8] Myron R. Bone, "Current Trends Are Revealed by Survey" in *American Industrial Banker*, vol. 4, no. 5 (October 1938) p. 5.

payable in 6 months or more; 2 percent on time deposits payable in 90 days to 6 months; and 1 percent on time deposits payable in less than 90 days.[9]

Where the law permits, industrial banking companies also offer their customers checking or demand account facilities. They usually arrange this service by selling the customer a book of 20 checks for $1.50, and require no minimum balance. Other services which are becoming increasingly common are such special plans as those designed to facilitate Christmas and vacation savings; in most instances no interest is paid on deposits of this nature. Finally, a few companies offer safe deposit accommodations to their customers.

Although it is impossible to depict statistically the pattern of lending and non-lending functions of industrial banking companies, all indications support the contention that the prevailing tendency, over the past thirty years, has been toward a diversification of services. At the present time the exigencies of the competitive situation are providing further stimuli in this direction.

[9] Federal Reserve System, *Twenty-fifth Annual Report of the Board of Governors,* covering operations for the year 1938, p. 59, and Federal Deposit Insurance Corporation, *Annual Report,* for the year ended December 31, 1936, p. 91.