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Operating Methods and Collection Experience

THE procedures worked out by commercial banks for granting cash loans to individuals and for financing instalment sales of consumer goods are in general similar to those which have been developed and tested by other instalment credit agencies.[1] There are, nevertheless, certain divergences which can be traced to differences in the kinds of service offered. Thus commercial banks differ from sales finance companies in that they frequently deal directly with the purchaser of the commodity instead of with a dealer; commonly also their personal loan departments exclude a type of business characteristic of most personal finance companies—the extension of credit on the security of household chattels.

Although the basic operating problems of the consumer credit division of a commercial bank are similar to those of comparable consumer credit agencies, they are quite different from the problems encountered in the other departments of the bank. From the outset a personal loan department is confronted with a new type of loan business; it must deal with customers not previously served, except perhaps as depositors, and must devise a technique for handling credit risks which are characteristically unlike those involved in the extension of commercial loans.

[1] References in this chapter to the number of banks reporting on various matters of policy and experience are based on responses to questionnaires sent by the National Bureau to a large number of banks throughout the country. See Appendix A for a statement of the nature and extent of the survey and for facsimiles of the questionnaires distributed.

METHODS OF OBTAINING BUSINESS

Personal Loans

In order to augment the volume of their personal loans, banks employ the advertising media which other consumer credit agencies have found to be fruitful: they write directly to preferred groups of borrowers, and advertise through newspapers, posters, window cards, street-car cards, moving picture screens, billboards and radio. On the whole, however, they find that advertising is less productive than the recommendations of present and previous borrowers; in one large metropolitan bank such recommendations brought in 45 percent of the new business. In addition, banks use a number of special plans for attracting borrowers. One such plan involves the establishment of relations between the bank and industrial or commercial firms whose employees are likely to be desirable customers. In a typical arrangement of this sort the bank is allowed to notify the firm's employees that it will be glad to consider their applications for loans at stated rates. In some cases the bank is permitted to insert a notice to this effect in the house organ of the firm. The bank thus acquires a preferred competitive position; officers of the firm may further enhance the bank's advantage by recommending it to the employees. Where such an accord between bank and employer exists, employees are sometimes granted loans on a single-name basis.

From the viewpoint of the lender, the plan is advantageous because the bank can usually obtain from a designated officer of the firm more complete information on employees' income and tenure than would otherwise be available. It may arrange also to have repayments deducted by the firm from the borrower's paycheck, and thus further reduce the likelihood of collection difficulty. Although many of the larger personal loan departments have developed schemes of this sort, the practice is by no means common; reports from

132 banks show that only 26 of them obtained loan volume in this way.

Then there is the so-called "executive plan" used by banks to build up, from a preferred group of salaried people in relatively secure positions, a volume of loans of greater-than-average size. Business of this type is usually obtained through direct mail solicitation. Loans of $2500 or more may be extended to such specially selected customers, often on a single-name basis, and at a lower discount rate than is applied to personal instalment loans of lesser amounts.

Some commercial banks, like the personal finance and industrial banking companies, develop loan volume by arranging with doctors and dentists to have their accounts receivable paid off by means of personal loans to clients. In certain cases the doctor is required to guarantee the patient's note, but these plans vary so widely that it is hardly possible to describe them in general terms. Department stores may participate in a similar plan whereby the customer contracts for a personal loan to refinance an open-book account or to finance planned purchases; in most of these transactions the retailer is not required to offer any guarantee of payment.

Sales Finance Paper

Banks obtain business for their time-sales departments either from dealers or directly from individual purchasers. When the bank negotiates with the dealer, it purchases instalment paper originated and sometimes guaranteed by him. In this respect the bank's procedure is no different from that of the sales finance company. Nor have the banks devised any important new schemes for securing the cooperation of dealers. One method, typical of the business in general and of automobile financing in particular, is known as "floor-planning," and involves the extension of credit on a dealer's wholesale stock. Of 141 banks reporting the acquisition of retail automobile time-sales paper from dealers, 74 were extending

wholesale credit to dealers on stocks of new cars and 36 of these were floor-planning used cars. A few banks extend this type of credit even if they acquire retail automobile paper exclusively from non-dealer sources. Thus of 45 banks which reported that they bought no new-car retail paper from dealers, 6 stated that they made wholesale loans on new cars, and of 47 reporting no dealer used-car paper, 2 indicated that they floor-planned used cars.

Data on the dollar volume of retail and wholesale automobile financing were reported by 53 banks; these banks had purchased during 1938 retail instalment paper amounting to $34,700,000, and had made wholesale loans of $27,700,000 on new and used cars combined. Still more interesting is a comparison of the amounts of retail and wholesale automobile paper purchased by 43 banks which obtained some or all of their paper from dealers. They reported approximately $31,800,000 of retail automobile paper purchased and $22,300,000 of wholesale loans on automobile inventories, of which $21,500,000 was applied to new-car and $800,000 to used-car financing. In addition they acquired $34,100,000 of retail automobile paper from sources other than dealers.

These figures for wholesale and retail financing must be compared cautiously, however. The duration of wholesale loans is generally shorter than that of retail loans, and if these loans were renewed at fairly brief intervals, being considered as new loans with each renewal, the average outstandings on wholesale financing in 1938 would be considerably smaller than the foregoing data indicate. Nonetheless it seems clear that banks obtaining retail sales finance paper from dealers do carry in addition a substantial amount of wholesale loans, incurring the special risks incident to this type of operation.

The method of obtaining time-sales paper described with reference to automobile dealers has been developed also for department stores and public utilities. The department store arrangement is simple: the bank purchases contracts that have

originated in the department store, sometimes on a recourse or insurance basis modeled after the FHA insurance plan, with the store giving the bank a percentage guarantee computed on all the contracts purchased.[2] This guarantee provides that all uncollectible notes up to the amount of the reserve must be repurchased by the store for the amount of the unpaid balance, or else replaced by non-delinquent notes. Some large banks similarly purchase instalment accounts receivable from mail order houses. The bank buys a block of such accounts and holds this paper until it is paid, the mail order company attending to all credit investigations and collections. A percentage guarantee may provide that if the bank has purchased $1,000,000 worth of paper it is protected up to $100,000 of this amount; or the mail order company may agree to substitute new contracts for any that create a collection problem.

Under a related plan banks purchase instalment sales contracts through public utilities and through dealers who sell appliances to the customers of utilities. If a dealer sells the appliances, the interest of the utility company is confined largely to increasing the consumption of power through the sale and use of appliances. The dealer therefore originates the contracts, the utility accepts or rejects them after an investigation of credit risks, and the bank purchases them in groups. The customer usually receives a combined bill for the instalment payment due and for the utility's services. The bank may obtain a guarantee from either the dealer or the utility, or from both; it may also participate in some arrangement for the disposition of repossessed appliances. If, however, the appliances are sold through the utility's own outlets, the utility will sell the instalment contracts thus originated directly to the bank and take all responsibility for collections.

When a bank cannot make arrangements to acquire con-

[2] The setting up and the administration of loss reserves on retail instalment paper acquired from dealers and other sources are discussed also in Chapter 6.

tracts directly from dealers, or prefers not to do so, it may use other methods of obtaining sales finance business. It may, for example, secure the cooperation of automobile salesmen who will urge customers to finance their car purchases through the bank's time-sales division, or it may even pay a commission to customers who send in new clients.

Banks frequently augment their time-sales business through advertising programs which invite buyers of automobiles or other goods to finance such purchases by means of a direct cash instalment loan. As a variation of this method a small number of banks issue a letter of credit for the convenience of the purchaser. The letter of credit is then presented by the customer to the dealer, who signs a statement to the effect that the deal is made in good faith and correctly described on the appropriate documents. When the dealer has received payment for the merchandise he has no further concern with the transaction, for the buyer now makes his payments directly to the bank. The charge to the borrower includes interest and the cost of whatever credit investigation fee and insurance the bank requires. When a bank employs this method of time-sales financing, it has no recourse on the dealer and must itself dispose of any articles repossessed.[3]

The relative importance of the several sources from which banks obtain sales finance paper is indicated in Tables 19 and 20. Table 19, based on reports from 164 banks, shows that automobiles accounted for almost 55 percent of the sales finance business done by these banks in 1938, and that 52 percent of their automobile paper was obtained from purchasers and 46 percent from dealers. Of these 164 banks a group of 114, which in 1938 had a combined business amount-

[3] All the plans described above are based, of course, on a regular monthly, semi-monthly or weekly payment by the borrower or purchaser. In a predominantly agricultural area, therefore, such schemes are of limited applicability. Some banks in farming communities have worked out arrangements with dealers in agricultural equipment whereby farmers can purchase durable goods under a repayment schedule specially adapted to the irregular flow of farm income.

TABLE 19

Percentage Distribution of Sales Finance Paper Obtained from Various Sources by Reporting Banks, 1938, by Type of Commodity Financed[a]

TYPE OF COMMODITY	SOURCE OF PAPER				TOTAL	TOTAL AMOUNT (in thousands)	NUMBER OF BANKS REPORTING
	Purchasers	Dealers	Manufacturers	Others			
Automobiles	52.4	46.4	....	1.2	100.0	$ 79,732	149
Household appliances	65.1	28.2	.7	5.0	100.0	57,531	86
House-heating equipment	3.2	84.0	11.8	1.0	100.0	6,764	52
Furniture	31.0	60.0	5.0	4.0	100.0	420	29
Soft goods	27.7	38.4	33.9	...	100.0	112	6
Miscellaneous	37.1	60.7	2.2	...	100.0	502	14
ALL COMMODITIES	54.9	41.5	.9	2.7	100.0	$145,061	164

[a] Based on questionnaire returns from 164 banks.

ing to $32,000,000 in automobile financing alone, reported that this amount was almost equally divided between new- and used-car contracts. Table 19 reveals also that dealers were the largest source of paper attributable to instalment sales of all other commodities except appliances; and that for appliances the retail purchaser was the most important source. Manufacturers supplied about one-third of the paper arising from the sale of soft goods.[4]

Table 20, based on reports from 263 banks, shows how many of these institutions received paper from the sources enumerated. There is, of course, a good deal of overlapping, since some banks employ several sources. It is significant, however, that 90 percent of the banks that handled automobile

[4] About half of the sales finance volume of these 164 banks came from institutions in the Pacific states, which reported that 51.8 percent of their business was obtained from dealers, 47.1 percent directly from purchasers, and 1.1 percent from other sources.

paper acquired at least part of their supply from car purchasers themselves; only 77 percent drew some of their automobile paper from dealers. For all other commodities dealers were the most frequent source of financing business.

TABLE 20

Number of Reporting Banks Obtaining Sales Finance Paper From Various Sources, 1938, by Type of Commodity Financed[a]

TYPE OF COMMODITY	SOURCE OF PAPER					NUMBER OF BANKS	
	Purchasers	Dealers	Manufacturers	Finance Companies	Others	Obtaining Paper	Not Obtaining Paper
Automobiles	209	178	12	10	2	232	31
Household appliances	62	152	20	5	3	169	94
House-heating equipment	52	81	7	3	2	103	160
Furniture	26	59	3	2	1	77	186
Soft goods	8	12	4	..	1	20	243
Miscellaneous	18	27	3	1	1	35	228

[a] Based on questionnaire returns from 263 banks.

Reports from 145 banks indicate the extent to which sales finance paper is obtained on a recourse or repurchase basis. The great majority of these banks have full recourse on the dealer in case of default. Of 114 banks reporting on their automobile sales finance paper, 88 stated that full recourse was required for all of it; a similar situation prevails with respect to paper obtained from dealers for household appliances, house-heating equipment and other types of merchandise. Paper acquired from manufacturers, on the other hand, is generally bought without recourse, regardless of the type of commodity financed.[5]

[5] Full recourse, non-recourse and general repurchase agreements are discussed in National Bureau of Economic Research (Financial Research Program), *Sales Finance Companies and Their Credit Practices,* by W. C. Plummer and R. A.

ORGANIZATION OF CONSUMER LOAN DEPARTMENTS

Because the granting of personal loans and the financing of instalment sales require highly specialized operating techniques, many banks have set up separate departments for the conduct of this business. In some cases the departments were not established until a reasonably large volume of business had been developed; in others a personal loan department and a time-sales department were formally organized before any considerable volume of loans was obtained. As we have already noted, many banks make consumer loans but have not set up a special department to handle them.

Departmentalization is designed to facilitate the handling of loan applications and to reduce the costs of collection. Consumer instalment loans are granted only after interviews with prospective borrowers, and if the accounts become delinquent they necessitate numerous follow-up procedures as well. These tasks cannot readily be assumed by other departments of the bank. Furthermore, the amount of detail per dollar of personal loans outstanding is much greater than for regular commercial loans.

Although most banks have acknowledged the advantages of a strictly departmentalized system, many have considered it unnecessary to employ a specially trained person to organize the consumer credit department. Thus 121 out of 138 reporting banks stated that they had not engaged a specially trained man to set up their consumer loan department or departments but had merely transferred an employee from some

Young (1940) Chapter 11. See also Federal Trade Commission, *Report on Motor Vehicle Industry,* 76th Congress, 1st Session, House Document No. 468, pp. 927-28 for definitions of these three plans. As distinct from the full recourse arrangement, the general repurchase agreement calls for no specific dealer liability on individual contracts but does require that the dealer repurchase a repossessed commodity from the financing agency for the amount of the customer's unpaid balance if the article is returned to the dealer in good condition within 90 days after the customer's default.

other department. The banks which did appoint trained men drew them from personal finance, industrial banking or sales finance companies.

Personal loan departments in all commercial banks have the same basic functions: they take loan applications from would-be borrowers, secure and analyze the necessary credit information, decide whether or not to grant the loans, keep records and make collections. Departmental structure varies, however, according to the amount of business transacted. If the volume is small, the bank employees may handle loan operations along with their other duties. If it is large, a full-time employee will probably be assigned to do part of the work, such as interviewing applicants, while the bank tellers will receive payments. Most departments are located in the regular bank offices, so that it is feasible for certain bank employees to do part-time work, but a large, highly specialized department, which may be located in a separate building, cannot operate on this basis.

Because workers in other departments are so frequently employed on a part-time basis in the personal loan department, it is difficult to determine the number of accounts handled per worker, a measure of efficiency often cited by other consumer credit agencies. In the present study, banks were asked to report on the number of full- and part-time employees in their personal loan departments, and usable returns were received from 133 institutions. The average number of workers was then studied in relation to the total personal loan outstandings of such departments.[6] According to this analysis departments with outstandings up to $100,000 employed, on the average, one full-time and one half-time worker; those with $100,000 to $250,000 about three full-time workers; those with $250,000 to $500,000 four full-time

[6] All part-time workers were counted as half-time workers; this probably resulted in an overstatement of time employed in some departments.

workers and those with $500,000 to $1,000,000 about seven full-time workers.[7]

The extent to which time-sales financing is handled in personal loan departments is indicated by reports from 164 banks; in 97 the personal loan department took charge of all sales financing transactions, in 45 cases it handled some of the latter, and in only 22 were the two types of business allocated to separate departments.[8]

PERSONAL LOAN PROCEDURE

The main outlines of lending procedure do not vary substantially from one bank to another. The process of passing on the applicant's credit standing begins with the first interview. If at that time the prospective borrower provides satisfactory information concerning his income and occupation and the purpose of the loan, he is commonly asked to fill out a formal loan application blank. Banks operating branches divide the work of interviewing customers and distributing forms among the various offices. Application forms are usually returned to the head office, where credit investigation is centralized, unless a bank has a large number of branches; in such cases loan applications may be investigated at several different offices.

In banks with a small amount of personal loan business the work of credit investigation is not likely to be highly systematized, but in institutions with a large volume it follows a definite routine. Let us describe the process most commonly

[7] No attempt was made to study the organization of banks with outstandings in excess of $1,000,000; this group includes a number of banks that have departments employing several hundred people.

[8] Departments that handle both types are known by a great variety of names. A partial list follows: Personal Credit Department, Personal Loan Department, Personal Savings Department, Personal Loan-Savings Department, Personal Credit Division, Personal Loan Center, Instalment Loan Department, Loan Service Department, Insured Budget Loan Department, Premium Fund Plan, Year-to-Pay Loan Department, Time Plan Way, Employees Credit Plan, Consumer Credit Department.

used in a department with a substantial volume of loans, where the borrower is likely to be unknown to the bank and where speed in granting credit is an important competitive factor. The application received by the credit department bears a number for general identification, as well as a branch number if the bank has more than one office. It may be time-stamped to provide a check on the speed of investigation. Applications are sorted as received, by type of loan security and perhaps by broad classifications as to size of loan, in order that the credit investigation may be specialized along these lines.

The primary purpose of the credit investigation is to verify the information given on the loan application. The name and address of the borrower may be checked first; a bank with a large loan business may maintain an address file so that it can determine whether any credit difficulties have been experienced with loan applicants or comakers from a given address. If the amount requested is large, say $1000 or more, a card may be mailed to the applicant, asking for his signature for comparison with that on the loan application. The bank checks the applicant's record in its own credit files; these generally contain names and brief records of all previous makers and comakers.

All banks depend rather heavily on local credit information and credit exchange agencies. Some cities have a number of these organizations, others have very few; even where only one exists its membership may be limited, so that not all lenders in the community can have access to its central files. There are two types of credit agency, and they operate either separately or in combination: the credit information service, which prepares data on the paying record of borrowers; and the "clearing house," which maintains a central file of borrowers and can determine whether the applicant has ever had a loan from any other member of the credit exchange bureau.

The bank using the latter service must find out from the lending agency to which it is referred what the borrower's credit record has been. If the loan is a large one the bank may obtain also a special commercial report and a litigation report covering any suits and judgments in which the applicant has been involved. Banks differ considerably in their evaluation of the several kinds of credit report; some claim, for example, that the borrower's department store credit record is not particularly significant, while others take an opposite view.

According to reports from 141 banks the most important source of credit information concerning applicants for personal loans is the bank's own commercial credit department; the outside sources were ranked by these banks in the following order of importance: retail credit exchange agencies, the applicant's employer, his bank, his creditors, mercantile credit agencies, and bank and other personal loan credit exchange bureaus.

The bank staff checks independently the employment record and income statement of the applicant—if possible with a responsible officer of the employing firm—his bank references, and the telephone number cited by him. It may verify the business position of the applicant who describes himself as owner, partner or officer in a corporation, and check on the statements he has made concerning comakers or the value of his collateral.

When the credit investigation is completed the application is referred to the loan committee or to the officer responsible for granting loans, along with the applications submitted in connection with any previous loans to the same borrower. An applicant who has already been refused a loan may or may not be rejected when this fact becomes known. The record of an earlier loan, of course, provides detailed information concerning collection experience with the prospective borrower.

Although a recommendation to reject may have been made at some point during the investigation, the responsibility of making the final decision rests with the loan officer.

The percentage of loan applications that are ultimately rejected is conditioned by a bank's policies and standards. Reports from 118 banks show that most of them reject between 1 and 25 percent of their applications; 85 reports were distributed evenly within this range. Some banks rejected much more than 25 percent, but these were in the minority.

If a prospective borrower has instalment debts outstanding, the bank usually requires that they be consolidated and paid off from the proceeds of the new loan. Of 135 banks reporting on this topic, 81 made such a demand, 36 did not, and the remainder adapted their policy to the borrower's credit record.

When all documents pertaining to an accepted loan, including the note with appropriate signatures, are filled out satisfactorily, the borrower is notified and a cashier's check is sent to him for the amount of the advance, together with directions for payment. Some banks use a coupon book for this purpose, with a separate page showing the amount and date for every due payment. Accounting cards are set up for accepted loans; the most important of these is the ledger card containing a description of the loan, the schedule of repayments and similar information.

Repayments on loans are either accepted as a direct reduction of the principal of the loan or are treated as hypothecated deposits. Where the latter practice prevails the special deposit built up out of the instalment payments is used at the maturity of the loan to repay the face amount of the note. A total of 128 banks, perhaps not an entirely representative group, replied to a question regarding this practice: 71 reported that payments were applied directly to a reduction of the loan and 57 that they were hypothecated. Most of the

banks paid no interest on these deposits, although a few reported paying as much as 2 percent.

As payments or deposits are received they are posted on the ledger cards. These cards are checked daily for payments due and from them is prepared a list of delinquencies to be handled by the collection department.

Under the usual collection system, the bank notifies the borrower of a delinquency after the waiting period, if one is allowed, has expired, and assesses the delinquency fee at the same time. In general comakers are not notified until the borrower has been given an opportunity to make the payment, and the first notice to comakers is often in the form of a request that they use their influence to have the maker fulfil his obligation. If the delinquency continues, a more urgent notice is sent to both maker and comaker. When the bank gives up all hope of collecting from the maker it may exercise its right to accelerate the note—that is, to require that the entire unpaid balance be paid at once—and concentrate entirely on the comakers. Where the loan is secured by stocks, bonds or a savings passbook the obligation will probably be settled at this point; but in the case of one- and two-name paper the bank may have to threaten court action if payment is not made.

In many cases a delinquent note is adjusted so that the borrower will resume payments. The adjustment may consist of a refinancing of the loan, an extension of its maturity without a new contract, a shifting of payment dates or some other arrangement designed to assist the borrower to meet his commitments.

The procedure outlined above will necessarily vary with the type of loan. Notes secured by automobile collateral, for example, require different collection methods because of the special nature of the security; loans made by special arrangement with outside firms may involve a simpler credit investigation or another collection technique.

SALES FINANCE PROCEDURE

The basic factors in all sales financing operations are the dealer or seller, the purchaser, and the value of the collateral. The relations of the bank with the dealer are conditioned by the terms on which the contract is obtained. If the bank acquires the paper directly from the retail purchaser, the dealer merely receives the advance payment for the merchandise and certifies that the contract is made in good faith. When the paper is bought from the dealer on a recourse or general repurchase agreement a more complete examination of the dealer's credit standing is necessary. Indeed a bank which does a large volume of time-sales financing regards verification of the dealer's credit as an important function of its credit department, and especially when the bank, besides financing a dealer's retail instalment sales, is also making a commercial loan to finance his inventory on the so-called "floor-plan" basis. When such a floor-plan is in effect the bank must maintain an outside force to check the dealer's inventory at frequent intervals and see that the merchandise security is not disposed of in contravention of contractual agreements.

There are other arrangements with dealers besides the dealer recourse or general repurchase plan. For example, a bank may finance time sales of such merchandise as radios or other electric goods under a limited guarantee from the dealer and a full guarantee from the manufacturer, or may enter into agreements with utility companies for the discounting of all paper arising out of instalment sales of appliances to the utility's customers. If under such an arrangement the dealer, manufacturer, utility, or a combination of these, is subject to recourse, the retail purchaser's credit record need not be investigated as carefully by the bank.

When a bank deals directly with the retail purchaser, it requires him to fill out an application blank similar to that used in the personal loan department, covering his employ-

ment, income, address, assets and liabilities, the merchandise to be purchased, the amount of the contract, the down payment and other pertinent items. The credit department verifies these statements by the same methods it employs in making personal loans; sometimes it supplements the information by calling for a credit report from an outside agency. Although the investigation may be less exhaustive when the contract is purchased with recourse on the dealer than when the only security is the buyer's note plus the merchandise sold, the bank never purchases a contract without making some examination of the risk involved.

Regardless of the source of the contract, the customer is always asked to sign a note for the unpaid balance of the purchase price plus an amount representing the credit investigation charge and the interest or financing charge. The cost to the borrower of the insurance required by the bank to protect the collateral may or may not be included in the note. Payments are then arranged according to a plan essentially similar to that employed for cash loans.

In some respects the most significant element in the time-sales financing transaction is the merchandise which serves as security for the loan. Although the bank may act on the assumption that its interests are protected primarily by the purchaser's income, the contract nearly always provides for repossession of the merchandise if the buyer should fail to fulfil his agreement. Whether or not the instalment sales contracts acquired by the bank are purchased under a dealer recourse or repurchase agreement, the bank protects its interest by means of a conditional sales agreement under which title to the merchandise rests with the bank, or a bailment lease whereby the purchaser merely leases the goods from the bank on certain terms and takes title only after the contract has been paid out.

The appraisal of merchandise security is a difficult and complicated task. A bank that finances instalment purchases

of refrigerators, for example, must be familiar with a wide assortment of makes, models and price lines, and must be able to predict the probable decline in their value with the passage of time. Similar difficulties are encountered in the financing of used cars and, to a lesser degree, of new cars as well. In general, however, down payment and maturity requirements offer some protection against depreciation of the value of the commodity which serves as security.

LOAN TERMS

Personal Loans

Commercial banks ordinarily restrict consumer instalment loans to certain amounts and lengths of contract. From questionnaire returns of 563 banks, summarized in Table 21, it appears that nearly all banks have set maximum and minimum limits to the amount they will advance on a personal instalment contract. Slightly more than 25 percent reported $1000 as a maximum and another 25 percent a maximum of less than $1000; the remainder were willing to make loans in excess of that amount.[9] Over 80 percent of these banks also had a minimum limit of $50 or less,[10] and approximately 16 percent a minimum of over $50. The most frequent combination was a $1000 maximum and a $50 minimum.

Table 22, presenting data on lengths of contract from 594 banks, shows that the most common limitation on maturity, reported by 77 banks, was a maximum of 12 months and no minimum. There is rather wide variation, however, in the limits cited by reporting banks, and this particular combination cannot be regarded as typical of commercial bank policy. General practice can be stated more accurately in terms of

[9] Those reporting "no maximum limit" are classed with the group willing to lend over $1000.

[10] Banks reporting "no minimum limit" are classed with this group.

TABLE 21

Number of Banks Reporting Various Minimum and Maximum Sizes for Personal Loans[a]

MINIMUM SIZE OF LOAN	MAXIMUM SIZE OF LOAN							NO LIMIT	TOTAL	PERCENTAGE DISTRIBUTION
	$200 and Under	$200 to $500	$500	$500 to $1000	$1000	$1000 to $3500	Over $3500			
No limit	4	10	11	1	21	10	7	73	137	24.3
Under $25	2	6	6	1	7	9	17	3	51	9.1
25	3	7	19	3	20	4	3	15	74	13.1
25–50	..	..	2	..	1	1	..	1	5	.9
50	2	13	34	5	76	29	6	33	198	35.2
50–100	..	..	2	..	4	7	2	4	19	3.4
100	..	4	4	1	26	13	1	17	66	11.7
Over $100	..	1	..	..	1	..	1	1	4	.7
No information	1	..	1	..	..	..	2	5	9	1.6
TOTAL	12	41	79	11	156	73	39	152	563	
Percentage distribution	2.1	7.3	14.0	2.0	27.7	13.0	6.9	27.0		100.0

[a] Based on questionnaire returns from 563 banks.

TABLE 22

Number of Banks Reporting Various Minimum and Maximum Contract Lengths for Personal Loans[a]

MINIMUM LENGTH OF CONTRACT (in months)	MAXIMUM LENGTH OF CONTRACT (in months)											NO LIMIT	TOTAL	PERCENTAGE DISTRIBUTION
	3	6	9–10	12	14–15	18	20	24	26–30	36	60			
No limit	1	8	1	77	8	36	1	22	..	6	3	11	174	29.4
Under 1	..	..	1	1	..	1	..	..	..	..	..	..	3	.5
1	1	20	1	36	2	17	2	9	2	2	1	..	93	15.6
2– 2½	..	1	1	4	..	2	..	3	1	..	..	..	12	2.0
3	1	1	1	37	5	31	1	13	1	4	1	..	96	16.2
4– 5	..	..	1	11	3	8	..	8	..	2	1	..	34	5.7
6	..	..	..	41	10	43	..	31	..	6	2	..	133	22.4
8–10	..	..	..	2	1	3	2	..	..	..	..	..	8	1.3
12	..	..	..	21	3	8	..	4	..	3	1	..	40	6.7
24	..	..	..	..	..	..	..	..	..	1	..	..	1	.2
TOTAL	3	30	6	230	32	149	4	92	4	24	9	11	594	
Percentage distribution	.5	5.1	1.0	38.6	5.4	25.1	.7	15.5	.7	4.0	1.5	1.9		100.0

[a] Based on questionnaire returns from 594 banks.

the most common range of limits; thus 545 of the 594 reporting banks set a lower limit of 6 months or less, and 411 set the upper limit between 12 and 18 months.[11]

Sales Finance Contracts

In time-sales financing the length of the contract is usually limited, and in addition the purchaser is commonly required to make a minimum down payment which is expressed as a percentage of the cash price of the merchandise. These stipulations vary for different commodities, and may fluctuate also over a period of time with changes in credit conditions. They constitute the lender's protection against excessive depreciation of the merchandise which secures the loan. Of 193 banks reporting on automobile paper, 113 stated that the maximum contract length was 18 months, 34 had a maximum of 24 months and 25 a limit of 12 months.[12] For household appliance paper the 95 reporting banks were divided into four almost equal groups, specifying maximum periods of 12, 18, 24 and 30 months each. Lengths of contract for furniture and soft goods seem to be considerably shorter than for the other types of commodity discussed; the most frequently reported maxima were 12 and 18 months for furniture, and 12 months or less for soft goods. The number of reports on these two items was small (41 and 9 respectively) and for this reason the findings cannot be considered conclusive.

More than 90 percent of the 196 banks reporting on the down payments stipulated for automobile contracts stated that their minimum requirement was between 25 and 40 percent; the most common down payment, however, was 33.3 percent.[13] Terms for household goods were reported by 83

[11] Maximum loan sizes are fixed by law in 8 states, and maximum contract lengths in 4 states. See Chapter 2.

[12] Maximum contract lengths tend to be shorter for used-car paper than for new-car paper.

[13] The minimum down payment for time sales of new cars is generally lower than for used cars.

banks, for furniture by 33 and for soft goods by 4; for these commodities a minimum down payment of 10 percent was favored most widely. Terms for house-heating equipment appear to be somewhat more liberal than those for other commodities; of 57 banks, 20 reported 10 percent, 12 reported 10 to 25 percent, and 11 reported 33.3 percent as the minimum down payment required.

COLLECTION EXPERIENCE

Personal Loan Collections

Like customers of other consumer credit agencies, borrowers from the personal loan departments of commercial banks sometimes terminate their indebtedness before the set date of maturity, either by paying off the debt in cash or by refinancing the loan. Of 55 banks reporting on cash prepayments for the year 1938, 28 stated that from 1 to 5 percent, and 11 that from 6 to 10 percent of their personal loans were so terminated. Prepayment by refinancing may be accomplished in two ways: under one scheme the borrower merely extends the payment period by signing a new note for the unpaid balance; under the other he refinances the old balance and obtains additional funds at the same time. Borrowers who receive additional funds are probably better-than-average credit risks, while those who merely refinance an unpaid balance are more likely to be among the relatively poor risks. In the present study 61 banks reported cases of loans made merely to refinance outstanding balances; about one-half of these indicated that 5 percent or less of their loans were terminated in this way during 1938. Of another group of banks of equal size, one-half reported that 10 percent or less of their loans were paid off by new contracts providing additional cash. If both types of refinancing are combined, it is found that for 44 of the 61 banks the proportion of all loans paid off in 1938 by means of refinancing ranged from 1 to 35

percent, and that for 27 of these banks it varied from 6 to 20.

On the subject of delinquency, the data made available to us are much more conclusive, since they represent reports from 478 personal loan departments. In Table 23 delinquent loans outstanding at the end of 1938 are classified by the extent of delinquency. Because banks define delinquency in different ways, they were asked to measure it uniformly by the

TABLE 23

Number of Banks Reporting Various Percentages of Delinquency on Personal Loans Outstanding December 31, 1938, by Extent of Delinquency[a]

EXTENT OF DELINQUENCY[b]	PERCENT OF OUTSTANDING LOANS DELINQUENT						
	0–.9	1–1.9	2–2.9	3–4.9	5–6.9	7–9.9	10 and Over
30 days	177	82	61	43	54	11	50
31–59 days	299	73	43	27	23	3	10
60 days and over	360	51	36	12	11	1	7

[a] Based on questionnaire returns from 478 banks.
[b] Measured by number of days elapsed from date on which payment was due.

number of days which had elapsed since the date when payment was due, and to state what percentage of their loans outstanding at the end of 1938 were delinquent by 30 days, by 31-59 days, and by 60 days or more. As shown in Table 23, the range most frequently reported on 30-day delinquency was from 0 to 0.9 percent; a number of banks stated that 10 percent or more of their outstanding loans were delinquent to this extent. For the two other delinquency periods the reports were concentrated in the low percent classes.

According to reports from 104 personal loan departments, few comaker loans are paid by the comaker; 46 of these banks stated that less than 0.25 percent of their comaker loans were paid off in this manner, and 89 that less than 1 percent were

so terminated. Of 96 banks reporting on loans paid off by disposal of collateral, 59 had no loans at all in this class and 28 had less than 1 percent.

Before we turn to the final stage of customer default, that is, the point at which loans are charged off as losses, another collection device sometimes used by personal loan departments should be mentioned. The note signed by a cash borrower usually contains an "acceleration clause" giving the holder of the note, in the event of default on a payment, the option of demanding immediate settlement of the entire balance due.[14] Since this demand is not made until all normal collection procedures have failed, the extent of acceleration on notes may be regarded as an indication of serious collection difficulty. The need for such drastic action seems to arise, if at all, before delinquency has passed the 90-day stage. Of 529 reporting banks, 433 indicated that notes were accelerated before they had become 90 days delinquent, and of these 383 set 60 days as the maximum delinquency permitted before acceleration. Only a very small proportion of bank personal loans are accelerated, however. Of 436 banks reporting on this topic, 204 stated that no notes had been accelerated, 93 reported acceleration on less than 1 percent of their notes, 50 banks on 1 to 2 percent, and 33 banks on 2 to 3 percent.[15]

It would seem reasonable to assume that almost all accounts for which full payment had been demanded before maturity would be turned over to an attorney for collection if the demand were not met. Questionnaire returns from 101 banks indicate, however, that this step is rarely taken; 72 percent reported either that no accelerated account had been

[14] A note is sometimes said to have been "matured" when this option is exercised, but the more common term is "accelerated."

[15] From a supplementary breakdown of these figures according to the region in which the bank is located, it appears that these statements are an accurate indication of the experience of various sections of the country.

placed in the hands of an attorney, or that less than 1 percent had been thus treated.[16]

Questionnaire returns from 83 banks show what percentage of unsecured and comaker notes turned over to attorneys were taken into court, and what percentage were finally paid; 45 of these banks stated that none of their accounts eventuated in court action, and 19 reported less than 1 percent. Some of the others indicated that nearly all attorney accounts ended up in court. Returns from 52 banks showed that the number of single-name and comaker loans which were turned over to attorneys for collection and finally paid ranged from "none" to "all"; this result is not very illuminating, especially since banks vary widely in their determination of the point at which collection difficulty is considered serious enough to warrant an attorney's attention.

When all attempts to collect a loan are unavailing, the account is charged off as a bad debt. Data on charge-offs of personal loans are available from two sources—responses to our questionnaire and reports made to the New York state banking superintendent by state banks with personal loan departments.

The questionnaire data are presented in a regional breakdown in Table 24.[17] For 171 banks giving both the number and the amount of charge-offs, the average unpaid balance on loans charged off during 1938 was $108, but ranged from $83 in the West South Central region to $140 in the East North Central. A larger number of banks—209—supplied figures on their total personal loan outstandings as of the end of 1938, as well as on the volume of charge-offs during the year,

[16] The low percentage may possibly reflect a misunderstanding of the term "acceleration" in this part of the questionnaire. Although an attempt was made to define the term clearly, some banks may have interpreted the question to mean the percentage of total loans *collected* through an attorney.

[17] The data in Table 24 refer to all charge-offs during 1938 regardless of the date when the original loans were made; they do not include recoveries because questionnaire information regarding the latter was too fragmentary for use.

TABLE 24

Number, Total Amount and Average Amount of Charge-Offs of Personal Loans of 171 Banks, 1938, and Charge-Offs of 209 Banks, 1938, in Percent of Total Personal Loans Outstanding December 31, 1938, by Region[a]

REGION	171 BANKS				209 BANKS			
	Charge-Offs			NUMBER OF BANKS REPORTING	TOTAL CHARGE-OFFS[b]	TOTAL OUTSTANDINGS[b]	CHARGE-OFF PERCENTAGE	NUMBER OF BANKS REPORTING
	Total Number	Total Amount[b]	Average Amount					
New England	201	$ 23.8	$118	12	$ 31.4	$ 3,540.0	.89	13
Middle Atlantic	803	88.4	110	43	66.3	20,291.6	.33	51
East North Central	192	26.8	140	32	30.3	9,429.9	.32	37
West North Central	322	30.5	95	27	48.0	9,184.9	.52	35
South Atlantic	153	13.6	89	25	19.9	7,406.8	.27	32
East South Central	49	5.7	116	6	7.7	2,113.7	.36	7
West South Central	58	4.8	83	12	8.7	3,966.4	.22	16
Mountain	33	3.0	91	5	3.2	1,491.3	.21	8
Pacific	156	16.6	106	9	16.4	4,753.2	.35	10
ALL REGIONS	1,967	$213.2	$108	171	$231.9	$62,177.8	.37	209

[a] Based on questionnaire returns. The two groups of banks are not mutually exclusive.
[b] In thousands.

thus making possible a computation of the percentage relation of charge-offs to outstandings. These data show that relatively few personal loans were written off as losses. For the country as a whole the average charge-off percentage was 0.37, varying from 0.21 in the Mountain states to 0.89 in New England. If charge-offs were related to the total volume of loans made during 1938 rather than to loans outstanding at the year end, these percentages would be still lower. A common method of estimating volume from outstandings is to multiply the latter by 1.54; applying this method to the figures in Table 24, and relating charge-offs to the resulting estimated volume, we find that the ratio of charge-offs to the total volume of loans made in all regions combined was 0.24 percent.

Data from the New York state banking department, which requires that charge-offs be reported according to the year in which the loan was made, and that they be net of all recoveries on loans granted during that year, provide a charge-off percentage which, though constantly subject to correction, is nevertheless representative of the final experience on loans made during a given year. These data, presented in Table 25, show that at the end of 1938 net charge-offs for the period 1936-38 amounted to 0.12 percent of total personal loans. The percentages for 1936, 1937 and 1938 were 0.27, 0.20 and 0.04 respectively. This downward trend in the charge-off ratio is not unexpected, for at the time the state report was compiled, the loans made in 1938—and to a lesser degree those made in 1937—had not been on the books long enough to give rise to all the charge-offs that would eventually occur. For loans granted during 1937 the charge-off percentage was only 0.05 at the end of that year, a figure which is close to the 0.04 percent reported for loans made in 1938. The low charge-off percentage for the three-year period naturally reflects the small proportion reported at the end of 1938.

For the entire period 1936-38 the charge-off percentage on

TABLE 25

Total Net Charge-Offs of Personal Loans, and Net Charge-Offs and Loss Reserves in Percent of Total Personal Loans Made, for 65 New York State Banks, 1936–38[a]

YEAR	TOTAL NET AMOUNT CHARGED OFF[b]	TOTAL LOANS MADE	PERCENT OF TOTAL LOANS	
			Net Charge-offs	Reserve for Losses
1936	$10,766	$ 3,995,864	.27	.29
1937	48,111	23,815,062	.20	.35
1938	10,630	27,869,378	.04	.52
1936–38	69,507	55,680,304	.12	.43

[a] Based on reports made to the New York state banking department.
[b] Total charge-offs less recoveries. Charge-offs and recoveries are classified according to the year in which the loans were made.

personal loans made by New York state banks was much smaller than the reserve generally set up for losses. According to our questionnaire returns there was considerable variation in bank policy with regard to both loss reserves and the handling of losses on defaulted notes. Most frequently the reserve represented from 0.5 to 2 percent of the face amount of the notes written, or from 1 to 25 percent of the interest earned on loans. A smaller number of banks reported that their reserves covered 0.5 to 2 percent of their outstandings.

Sales Finance Collections

Questionnaire data covering charge-off experience on loans made to finance the instalment purchase of automobiles and other goods likewise show a low ratio of net losses to outstanding loans. A group of 155 banks reported their 1938 charge-offs and recoveries; 119 of them, with automobile finance paper of $15,500,000 outstanding, reported no losses at all, and 36 others, with outstanding automobile paper of $69,200,000, had an average net charge-off percentage of 0.12.

On finance paper secured by goods other than automobiles the net percentage was 0.24. The favorable charge-off record for sales finance paper reflects the fact that through recourse and general repurchase agreements a substantial share of the loss risk is transferred to the dealer from whom the bank purchases the paper.

Reserves against sales finance losses are set up in several different ways. In response to our questionnaire 56 banks indicated their methods of computing such reserves; these institutions may be divided about equally into 4 groups: (1) those which set up the reserve as a percentage of average outstanding balances (1 to 4 percent); (2) those treating it as a percentage of the volume of loans made (0.5 to 5 percent); (3) those fixing it as a proportion of gross income (10 to 25 percent); and (4) those measuring it in terms of earnings (1 to 30 percent). Not much significance can be attached to these percentages, however, since a bank's policy may depend primarily upon the length of time the reserve system has been in operation.