4

Credit Standards

FROM the lender's standpoint a high-quality loan is one that has a good probability of repayment without delinquency, and a possibility of some recovery in the event of unavoidable default. Although most personal loans are secured by a mortgage on household chattels, the market value of this security has usually been found insufficient to cover the unpaid balance in cases of default. Consequently the lender must choose carefully among potential borrowers in order to avoid costly collection problems. In extending personal finance credit, consideration must be given to the incomes of borrowers and to their trustworthiness as evidenced by their readiness to meet monthly charges fully and promptly. The important items, then, on which the lender must pass judgment include broadly: the size of the borrower's income, and expectations as to its stability; the relation of the amount of the instalment payment to the borrower's income and to his expenditure pattern; the borrower's credit record; the value of the chattel items that the borrower offers as collateral, or the financial responsibility of a comaker; the borrower's other assets, debts and family obligations. From cumulative experience in extending and collecting loans the personal finance lender has necessarily developed certain rule-of-thumb standards in evaluating these risk elements.

13

Any factual discussion of credit standards in this field must necessarily be based on the experience of the larger companies; their extensive operations compel careful control of credit risk, and from time to time they subject their lending records to a systematic sifting in order to modify their lending standards in the light of experience. The principal quantitative data used in the following discussion, covering various years in the period 1933-37, have been generously furnished by one of these chain lenders, the Household Finance Corporation,[1] whose offices, including a few in Canada, numbered 228 at the end of 1937. Since the data reflect the lending policies of a single company they are not necessarily representative of the experience of all lenders, and must be interpreted with this qualification. Thus, for example, the average loan made by this particular chain company is somewhat larger than that made by many other lenders. Moreover, its operations in the United States are confined to 17 states, located in the middle western and eastern sections. The data are the most comprehensive available, however, and they are utilized here to illustrate the type of credit problem with which the personal finance lender must cope and the kind of credit standards he must apply.

Each loan made by a lender can be described in terms of the characteristics of the borrower and of the contract. The credit problem thus resolves itself into this question: what is the relative importance, as indicators of credit risk, of the various characteristics of the borrower and of the loan contract? In the following pages charge-off experience on small loans is analyzed with this question in mind. It should be remembered, however, that not all pertinent factors are capable of statistical measurement; there are also intangible elements that only the expert judgment of the loan office manager can appraise.

PROCEDURE IN ANALYSIS OF CHARGE-OFF EXPERIENCE

The method of analyzing charge-offs requires brief explanation. For each of the principal characteristics of borrowers

[1] This company is hereafter referred to in the text of this chapter as the "source lender."

and loans the charge-off experience recorded for each individual subclassification is compared with the average for all. Thus when loans are classified according to the income of the borrower the charge-off experience recorded for any one income group of borrowers is compared with the average for all income groups.[2]

The average charge-off experience for all subclassifications combined is measured by the charge-off percentage, that is, the percentage relation between the total number of loans charged off and the total number of loans made; the charge-off experience of each individual subclassification is measured in the same way—by the percentage relation between its number of charge-offs and its number of loans. In the following discussion, however, we have used not these percentage relationships but an "index of charge-off experience" to show the relative performance of each subclassification and of all combined. This index is computed by dividing the percentage arrived at for each subclassification by the average percentage arrived at for all subclassifications combined, and subtracting 100. The index is thus merely a record of the deviation from average experience, a plus value indicating worse than average and a minus value indicating better than average charge-off experience in comparison with that of all subclassifications combined. Such indices were computed separately for each year in the particular period that was covered in each classification, and were averaged by taking the arithmetic means of the values for the entire period.

In some classifications we show also the percentage distribution of all loans made. The degree of concentration of loans does not directly affect the values of the index, but the extent

[2] For this analysis we have adopted the method of stating charge-off experience originally developed by the Household Finance Corporation and embodied in the tabulations it furnished to us. We are indebted to Burr Blackburn, Director of Research of the Household Finance Corporation, Wilfred Helms of the Statistical Department, and Theodore Yntema, consulting statistician, for many criticisms and suggestions concerning the interpretation of this material.

to which loans are concentrated in a particular subclassification indicates the degree of importance that should be attached to the index number for that class.

CHARGE-OFF EXPERIENCE BY STATUS OF CUSTOMER

One significant classification of personal finance company customers is according to their status as borrowers, that is, whether they are "new" customers (those borrowing from this lender for the first time), "former" customers (old customers returned), "present" customers (those who refinance an unpaid balance and receive an advance of additional funds)[3] or "renewal" customers (those who refinance an unpaid balance without advance of additional funds). A study of customer status, made by the source lender for the years 1934-37 and presented in Table 23, shows that new borrowers constituted 24 percent, former borrowers 14 percent, present borrowers 61 percent, and renewal borrowers only 1 percent of all customers during this period.

The logic of this distribution is revealed by the record of charge-off experience for these various types of borrowers, also presented in Table 23. That the risk-quality of new borrowers is relatively uncertain, even after rather careful investigation, is indicated by the fact that charge-offs of loans to new borrowers are more numerous than average. Former borrowers, on the other hand, may reasonably be supposed to include only those who in their previous loans have lived up to contract terms, and thus it is not surprising that the best relative experience with collections is associated with loans to this group. Loans to present borrowers provide additional money for customers already engaged in amortizing a previous commitment, and inasmuch as lenders would doubtless not be

[3] It should be noted that for the purposes of this chapter "present" customers are defined more narrowly than in the preceding chapter, for "renewal" customers, formerly included, are here considered as a separate classification.

TABLE 23

CHARGE-OFF EXPERIENCE OF A PERSONAL FINANCE CHAIN, 1934–37, BY STATUS OF CUSTOMER[a]

Status of Customer	*Average Size of Loan*	*% Distribution of Number of Loans Made*	*Index of Charge-off Experience*[b]
New customers	$ 137	*24.1*	+ *19*
Non-teacher		22.6	+ 19
Teacher		1.5	+ 19
Former customers	131	*13.6*	− *50*
Non-teacher		12.4	− 49
Teacher		1.2	− 67
Present customers[c]	189	*61.3*	− *6*
Non-teacher		57.0	− 4
Teacher		4.3	− 17
Renewal customers[c]	148	*1.0*	+*408*
Non-teacher		.9	+408
Teacher		.1	+384
All customers	169	*100.0*	
Non-teacher		92.9	+ 1
Teacher		7.1	− 16

[a] Based on data supplied by the Household Finance Corporation.
[b] Obtained by dividing each charge-off percentage by the average percentage for all combined, and subtracting 100; the result shows each level's deviation from the average of all levels, the plus indicating worse than average and the minus indicating better than average experience.
[c] "Renewal" customers were not segregated from "present" customers before 1936. Average loan to renewal customers and indices of charge-off experience for both types are for the period 1936–37 only.

willing to extend the new loan unless the customer's past record were satisfactory, experience with such borrowers is relatively good. The renewal of an existing balance, however, usually occurs only when the lender is already experiencing difficulty in collection, and such loans, even after adjustment, result in relatively more frequent charge-offs than any other type.

A comparison of charge-off experience according to customer status must take into account the fact that the size and various other characteristics of the loan may have a bearing upon the results.[4] According to Table 23, however, the average size of loan does not explain the differences in the indices of charge-off experience for the various types of borrowers.[5] Although the average loan to present borrowers is nearly 40 percent larger than the average loan to new borrowers, the index of charge-off experience is markedly better for the present borrower class; the average loan to former customers is only about 5 percent smaller than that to new customers, but it shows a strikingly better index of charge-off experience. These facts suggest that although for any one type of borrower differences in size of loan may determine the probability of successful collection, as among different types the size of loan is of secondary importance. The significant determinants of success are rather certain other facts pertaining to the character and condition of borrowers.

Table 23 indicates, finally, that among loans to new borrowers the indices of charge-off experience are identical for teacher and non-teacher loans, but that for all other customers (former, present and renewal) relatively fewer loans to teachers than to non-teachers are charged off. Actually the

[4] According to a special Detroit study including 7,118 loans (discussed below) when the loans are cross-classified by size of loan and customer status each of the four types of customers shows the greatest concentration of loans in the same size group ($100-150). Of loans to new borrowers 36.5 percent were in this size group, and 24.6 percent (the next largest concentration) were in the $50-100 group. Of loans to former borrowers 35.7 percent were for $100-150, but only 27 percent of the loans to present borrowers were of this size. Loans to renewal borrowers were a negligible proportion of the total, but they too showed their greatest concentration in this size group.

This tendency toward concentration in the same size group does not mean that the average size of loan is about the same for the four different types of customers. Table 23 shows a size variation similar to that in the Detroit study, and is based upon a much larger sample; loans to present borrowers are the largest, with renewal loans next, followed by loans to new and former borrowers.

[5] The relation of size of loan to charge-off experience is dealt with in detail in a subsequent section (see pp. 103 ff.). With the exception of $300 loans, the smaller the size the better the charge-off experience.

indices understate the difference between teacher and non-teacher loans for, it will be recalled, these indices are based upon the number of charge-offs in relation to the number of loans. Supplementary figures, not presented here, showing the amount charged off as a percentage of the original amount of all charged-off loans, reveal that even when loans to teachers are charged off, the balance owed on principal at the time of charge-off is a smaller proportion of the original loan than is the case in charge-offs of loans to non-teachers. These factors account for the practice, general among personal finance companies, of viewing schoolteachers as preferred risks.

CHARGE-OFF EXPERIENCE BY SECURITY FOR LOAN

In Table 24, which presents the charge-off experience of the source lender for 1936 and 1937 according to the type of se~~curity,~~ loans are classed according to five types of security, but there are only two basic classes—secured and unsecured; teacher loans, note loans and honor loans all fall in the latter category. Teacher loans are made on unsecured notes, the safety of the loan depending on the teaching contract; honor loans are note loans made by the source lender's so-called honor offices, which make only unsecured loans. Nevertheless, classification into five rather than two divisions brings out important differences in charge-off experience.

73.

For the two years covered by these data loans secured by household goods were markedly successful, a record that is particularly significant because in both years such loans amounted to more than four-fifths of all loans made. Since loans secured by automobiles constituted only ½ percent of all loans made, charge-off experience regarding them is of doubtful significance. Teacher loans had a strikingly better charge-off record than either secured loans or the other unsecured types. This favorable record is doubtless due to the relative stability of position and income enjoyed by this profession, and to the fact that usually teachers are employed only after careful examination of their character and responsibility.

The relatively more successful record on honor loans than on note loans may be ascribed to the fact that the former are made to all types of people in the community, while note loans are made to single persons and married people who do not possess furniture. The latter probably constitute a less stable group of borrowers.

TABLE 24

CHARGE-OFF EXPERIENCE OF A PERSONAL FINANCE CHAIN, 1936 AND 1937, BY SECURITY FOR LOAN[a]

	1936		1937	
Type of Security	% Distribution of Number of Loans Made	Index of Charge-off Experience[b]	% Distribution of Number of Loans Made	Index of Charge-off Experience[b]
Teaching position	6.7	− 20	5.7	− 46
Household goods	81.7	− 17	82.6	− 19
Automobile	.5	− 8	.5	+ 10
Honor	3.8	+130	4.2	+102
Note	7.3	+143	7.0	+196
TOTAL	100.0		100.0	

[a] Based on data supplied by the Household Finance Corporation.
[b] See Table 23, footnote b.

CHARGE-OFF EXPERIENCE BY INCOME OF BORROWER

13 Data on the relationship between charge-off experience and income of borrower are presented in Table 25, and are supplemented by a special study of all loans made by the source lender's Detroit offices during the first quarter of 1936, shown in Table 26. The latter table, while containing no direct data on charge-offs, presents material essential to their explana-

TABLE 25

CHARGE-OFF EXPERIENCE OF A PERSONAL FINANCE CHAIN, 1934–37, BY INCOME OF BORROWER[a]

Monthly Income[b]	*Average Size of Loan*	*% Distribution of Number of Loans Made*	*Index of Charge-off Experience*[c]
$ 50 or less	$ 92	.8	+102
50 – 100	108	16.5	+ 27
100 – 150	152	33.7	+ 3
150 – 200	191	26.7	− 14
200 – 250	211	11.4	− 30
Over 250	234	10.9	− 35
TOTAL		100.0	

[a] Based on data supplied by the Household Finance Corporation.
[b] Each level is exclusive of the lower figure and inclusive of the higher.
[c] See Table 23, footnote b.

tion, in that it shows the average proportion of the borrower's 13 monthly income which is absorbed by loan payments. Although these data are limited, both as to the period covered and as to the proportion of total personal loan business surveyed, the consistency which they display suggests that they are not the result of random forces.

The outstanding conclusions to be derived from Table 25 are that charge-off experience improves in direct relation to the income of the borrower; that the average size of loan increases in direct relation to the income of the borrower; and, finally, that it is the $100-150 monthly income band that contains the greatest concentration of customers.

Two income factors appear responsible for the better performance on loans to persons in the higher income classes. First, the proportion of income required to meet principal payments on loans declines as the income of the borrower increases; in the Detroit study the amount of income so required ranged from 13 percent for borrowers receiving monthly incomes of $50 or less to 3 percent for those with

TABLE 26

DISTRIBUTION OF 7,118 LOANS MADE BY A PERSONAL FINANCE CHAIN, AND PROPORTION OF BORROWER'S INCOME REQUIRED FOR PAYMENTS ON PRINCIPAL, FIRST QUARTER 1936, BY SIZE OF LOAN AND INCOME OF BORROWER[a]

Size of Loan[b]		*Monthly Income of Borrower*[c]							
		$50 or Less	$50–100	$100–150	$150–200	$200–250	Over $250	Unemployed and not Reporting	Total
Under $50	Number of loans	1	50	87	25	8	6	1	178
	% of income required for payments	4.44	1.92	1.33	.94	.78	.63	..	1.27
50–100	Number of loans	4	245	624	270	94	43	4	1,284
	% of income required for payments	7.06	3.63	2.56	1.89	1.46	1.03	..	2.28
100–150	Number of loans	....	319	1,079	535	176	133	5	2,247
	% of income required for payments	....	5.89	4.44	3.24	2.53	1.84	..	3.70
150–200	Number of loans	1	49	439	294	127	60	4	974
	% of income required for payments	30.00	8.62	6.28	4.77	3.63	2.60	..	4.96
200–250	Number of loans	....	35	434	348	152	163	9	1,141
	% of income required for payments	....	10.69	7.91	5.94	4.66	3.18	..	5.63
250–300	Number of loans	....	6	76	83	39	52	1	257
	% of income required for payments	....	13.86	9.84	7.53	5.90	4.14	..	6.68
300	Number of loans	1	7	168	322	246	286	7	1,037
	% of income required for payments	39.47	15.44	10.99	8.25	6.68	4.34	..	6.54
TOTAL	Number of loans	7	711	2,907	1,877	842	743	31	7,118
	% of income required for payments	13.43	5.47	5.30	4.83	4.31	3.30	..	4.62

[a] Based on data supplied by the Household Finance Corporation, covering the operations of its Detroit offices.
[b] Each size level is inclusive of the lower figure and exclusive of the higher.
[c] Each income level is exclusive of the lower figure and inclusive of the higher.

monthly incomes over $250. Second, the high-income borrower could probably use for repayments an even higher proportion of his income than the borrower in the low income bands, without equal strain, for it is likely that a smaller proportion of the former's income must be assigned to meet basic living expenses. In other words, data on the proportion of monthly income required to meet monthly principal payments do not measure precisely the differences in the financial burden imposed on individuals in different income classes by their borrowing activities: the burden carried by the low income groups is understated because for them other fixed expenses are also more burdensome than they are for the higher income groups.

CHARGE-OFF EXPERIENCE BY OCCUPATION OF BORROWER

During the five-year period 1933-37, as indicated by Table 27, the charge-off experience of the source lender was worse than average on loans to proprietors, unskilled workers and salespersons (and also those for whom no occupation was reported). It was better than average on loans to skilled and semi-skilled workers, to managers, superintendents and foremen, to schoolteachers and others in professional pursuits, persons with independent incomes, and office and clerical workers.

Supplementary data not included in Table 27, covering the source lender's Detroit offices for the first quarter of 1936, show the average size of loan for each occupation, and indicate that the better performance of certain occupational groups was in spite of the fact that their loans were larger, on the average, than loans to the occupational groups in which charge-offs were proportionately more numerous. Occupations listed in Table 27 as having a relatively poor charge-off record received loans ranging from $135 to $185, while those having

TABLE 27

CHARGE-OFF EXPERIENCE OF A PERSONAL FINANCE CHAIN, 1933–37, BY OCCUPATION OF BORROWER[a]

Occupation	*% Distribution of Number of Loans Made*	*Index of Charge-off Experience*[b]
Schoolteachers	7.6	− 21
Office, clerical and other non-manual workers	18.5	− 21
Persons with independent incomes, not employed	1.2	− 20
Professional persons (exclusive of schoolteachers)	2.6	− 13
Managers, superintendents and foremen	10.2	− 6
Skilled and semi-skilled workers	37.5	− 2
Proprietors	10.4	+ 15
Unskilled workers	5.1	+ 33
Salespersons	6.3	+ 54
Not reporting	.6	+105
TOTAL	100.0	

[a] Based on data supplied by the Household Finance Corporation.
[b] See Table 23, footnote b.

a relatively good charge-off record borrowed sums ranging from $144 to $198.

Since the indices shown in Table 27 are five-year averages, they conceal any year-to-year trends that might exist, but study of the separate yearly indices reveals that collections from unskilled workers and, with somewhat less regularity, those from professional persons exclusive of teachers, became relatively more successful over the period. Charge-off records became relatively worse for salespersons and office and clerical workers. Some occupations became relatively worse as credit risks, then better; and others vice versa. The significant contrast lies between the experience with unskilled workers and with office workers, though the trend of the indices for these groups was, in general, what one would expect. During the recovery period income status probably improved more markedly among unskilled workers than in most other groups and, as wages became higher and steadier, defaults logically became fewer. In contrast, the office, clerical and other non-manual worker groups, comparatively the best risks in the depth of the depression, showed an increasingly poorer charge-off record during the recovery period.

These year-to-year changes in charge-off indices are of doubtful significance, however, because the method of computation is such that a change in charge-off experience for any one group will be reflected in changes in the charge-off indices for all other groups. Thus the increasingly poorer record of office, clerical and other non-manual worker groups may have been due to the improving charge-off record of other occupations. Year-to-year studies of indices are nevertheless useful in showing shifts in the relative positions of various groups as compared to the average for all groups.

Table 28, which presents charge-off experience according to the industrial source of borrowers' income, indicates that postal service, telephone and telegraph, agricultural, railroad and streetcar, public and professional service, and iron and steel groups have provided the most desirable credit risks for the source lender. Mining, truck and taxicab, domestic and personal service, building and construction, food manufacture, and wholesale and retail trade groups account for the poorest credit risks. Borrowers from the groups classified under machinery and transportation equipment, automobile factories, textiles, printing and publishing, banking, insurance, real estate and brokerage, and also those classified as "miscellaneous and not reporting," show about an average charge-off experience.

An examination of the annual indices from which the averages are derived shows that the pattern of behavior for "better than average" industries, with the exception of agriculture in 1933, was consistent throughout the period, as was also that of the four industries having the poorest charge-off record, with the exception of building and construction in 1935. The in-

TABLE 28

CHARGE-OFF EXPERIENCE OF A PERSONAL FINANCE CHAIN, 1933-37, BY INDUSTRIAL AFFILIATION OF BORROWER[a]

Industry	*% Distribution of Number of Loans Made*	*Index of Charge-off Experience*[b]
Postal service	1.5	− 61.0
Telephone and telegraph	1.1	− 54.4
Agriculture	1.9	− 31.1
Railroads and streetcars	7.1	− 28.7
Public service	10.0	− 24.3
Professional service	11.5	− 14.5
Iron and steel	4.9	− 13.8
Machinery and transportation equipment	4.4	− 8.7
Automobile factories	4.8	− 5.2
Textiles	3.4	− 2.2
Printing and publishing[c]	2.5	+ .4
Banking, insurance, real estate, brokerage	4.7	+ 2.3
Miscellaneous and not reporting[d]	16.7	+ 4.1
Wholesale trade	.9	+ 14.0
Food manufacture	5.5	+ 20.2
Retail trade	9.4	+ 24.7
Building and construction	2.4	+ 31.1
Domestic and personal service	4.8	+ 32.9
Trucks and taxicabs	1.7	+ 61.2
Mining	.8	+100.4
TOTAL	100.0	

[a] Based on data supplied by the Household Finance Corporation.
[b] See Table 23, footnote b.
[c] This industry was not segregated in 1933.
[d] "Miscellaneous" includes "other manufacturing," "miscellaneous transportation and communication" and "miscellaneous trade."

dustries in the middle group display such varied patterns that no generalization is possible.

It appears that from the standpoint of successful credit administration the industrial affiliation of a borrower is an important determinant of credit standards, its significance lying in the regularity and security of employment provided by a given occupation. It is probably true, however, that in judging the relative safety of various credit risks a study of general economic conditions in particular fields of industry is second in importance to a careful investigation of the individual applicant.

CHARGE-OFF EXPERIENCE BY SIZE OF LOAN

The experience of the source lender during 1934-37 was that, in general, charge-offs vary directly with the size of loan.[6] 13.
According to Table 29 they are less than average for loans under $100, just average within the $100-150 group, and greater than average for loans of $150 and above. Loans between $250 and $300 have a considerably less successful charge-off record than those of $200-250, but the progression toward a poorer charge-off record is broken at the $300 group, which shows a record only slightly poorer than average. This group merits special attention, because $300 loans constituted about 20 percent of the total number and 36 percent of the dollar volume of all loans made by the source lender during this period, while loans between $250 and $300 were considerably less important, both in number and in volume.

This exception in charge-off experience in regard to $300 loans can perhaps be explained most satisfactorily by reference to the occupational status of those who borrowed the maximum amount permitted. Data derived from the Detroit study referred to above show that approximately 70 percent of the $300 loans were taken by office and clerical workers, managers, superintendents and foremen, owners and managers (proprietors) and schoolteachers. According to Table 27 borrowers in these occupations, with the single exception of owners and managers (proprietors), displayed a charge-off

[6] Table 25 may have given the reverse impression. Indices shown in that table refer to income groups, however, not to average loan within those groups. The higher income brackets have a better record in spite of, not because of, their larger average loan.

TABLE 29

CHARGE-OFF EXPERIENCE OF A PERSONAL FINANCE CHAIN, 1934–37, BY SIZE OF LOAN[a]

Size of Loan[b]	*Average Size of Loan*	*% Distribution of Number of Loans Made*	*% Distribution of Amount of Loans Made*	*Index of Charge-off Experience*[c]
Under $50	$ 34	3.5	.7	−38
50–100	66	16.7	6.5	−14
100–150	115	27.0	18.4	0
150–200	166	13.6	13.4	+ 7
200–250	211	14.9	18.6	+ 9
250–300	265	3.8	5.9	+26
300	300	20.5	36.5	+ 2
TOTAL		100.0	100.0	

[a] Based on data supplied by the Household Finance Corporation.
[b] Each level is inclusive of the lower figure and exclusive of the higher.
[c] See Table 23, footnote b.

record better than average (the office and clerical workers and schoolteachers much better than average). There is no such concentration of relatively better risks among the borrowers of $250-300, for whom the distribution by occupation is about the same as that for borrowers of smaller amounts. Unskilled laborers, for example, with a relatively poor charge-off record, account for about the same proportion of $250-300 loans as of those under $50.

A cross-classification of the data, showing the uses to which loans of various sizes are put, reveals that loans for any purpose other than business needs constitute roughly the same proportion of the total, regardless of their size, but that business loans form a considerably higher proportion of $300 loans than of those of any other amount. About 15 percent of the $300 loans, but only 8 percent of the $200-300 loans, are for business needs. Proprietors are the most likely to borrow for this purpose, and since they have a worse than average charge-off record (Table 27) a relatively bad charge-off experience on $300 loans would seem to be indicated—at least for those obtained to meet business purposes. It seems reasonable to suppose, however, that proprietors who obtain loans of this size are those who have relatively high incomes and are thus the better credit risks, an inference supported by the data in Table 25, which show a direct variation between size of loan and income class. Also, loans of $300 are less likely to be used for basic living expenses, such as rent, than are those of smaller size.

The better charge-off record on $300 loans than on $250-300 loans may be further explained by data presented in Table 26, which shows that approximately 50 percent of the borrowers of $300 had monthly incomes of over $200, while only about 35 percent of those persons receiving loans of $250-300 were in this income class.

There would be a still further explanation of the charge-off experience on $300 loans if these loans were secured mainly by chattel mortgages, while those in the $250-300 group were primarily note loans. The Detroit study does not bear out this hypothesis, however. There were no significant differences in the distributions of various loan sizes by type of security.

The relatively successful record on $300 loans must be explained, then, on the grounds that these loans are most frequently made to persons in occupational classes that provide the better risks, and are most likely to be made to the borrowers with the highest incomes. Differences in credit investigation and collection procedure for loans of different sizes may have a significant influence on charge-offs, but this cannot be expressed in statistical terms.

CHARGE-OFF EXPERIENCE BY CUSTOMER RATINGS

The controls instituted by the large chain lenders have been designed in part to limit bad-debt losses to those that are unpredictable and unavoidable, and there is reason to believe that such losses are even lower than they are at present estimated to be. The source lender has recently kept records, covering 1936 and 1937, that classify charged-off accounts according to whether they were or were not suspect at the time the loans were made. Terming as "A loans" all those that were considered sound when made, and as "B loans" those that were considered doubtful, the tabulation expresses the number of A loans charged off as a percent of the number of A loans made, and similarly for B loans. The computations were made separately according to the status of the borrower—new, former, present or renewal. It was found that among new borrowers the ratio of B loans charged off to B loans made was between two and three times as great as the ratio between A loans charged off and A loans made; among former borrowers it was about seven times; among present borrowers about five times; among renewal borrowers six to seven times. These proportions obtained in both years covered by the data. It may be inferred from this analysis that among all except new borrowers the likelihood that a B loan will be charged off is at least five times as great as that for an A loan.

The problem of selecting risks is not solved, of course, by this finding, for although the proportion of loans charged off is greater for B loans than for A, the proportion of each which is eventually charged off is relatively small; furthermore, B loans as a whole are a rather small proportion of total loans. Therefore a lender might find it inexpedient to stop making B loans, since the income derived from them may be greater than the additional costs that they entail.