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SECTION B

Projects Amplifying Specific Research Recommendations of the Committee

FINANCING THE CONSUMER AND ITS RELATION TO COMMERCIAL BANKING

General Background

In the decade following 1920 instalment finance companies, personal finance companies, credit unions, etc., emerged in increasing number to meet the ever widening demands for consumer and personal credit accommodation. Commercial banks at first viewed with indifference the rise of special institutions to finance the consumer. Gradually, however, they became more and more involved themselves in financing individuals as a result of: (1) receding local demands of business enterprise for working capital accommodation; (2) the phenomenal growth of instalment and other consumer finance institutions necessitating their recourse to bank borrowing; (3) expanding demands on the part of bank customers to finance personal consumption needs, including home financing, as well as to provide funds for supplementing personal investment activities. Here and there banks recognized the necessity of developing special routines to deal with consumer lending, especially for customers of small means. In isolated instances, this recognition found

expression in the establishment of personal loan departments.

The depression and accompanying repercussions upon business and investment market credit requirements heightened interest in consumer financing. From 1929 to 1931 personal loan departments of banks increased from 65 to 277; during the ensuing two years of distress a number of them were discontinued. More recently, commercial banking interest in the consumer credit field has again revived, owing chiefly to: (1) the notable recovery of cash resources in the hands of banks, variously caused; (2) the failure of expanding demands for business and investment credit accommodation to keep pace with capacity for meeting demands; (3) the unprecedented levels to which yields of available assets for bank portfolios have fallen in consequence, creating an acute problem of subsistence earnings for banking institutions generally; (4) the excellent record of consumer loans during depression. An additional influence, doubtless of considerable importance, has been the encouragement to consumer financing given by various Federal agencies, notably the Federal Housing Administration in its efforts to promote and popularize insured modernization credits as a boon to construction activity.

Specific Problem

This study would deal with the extent to which commercial banking activity today is concerned with consumer and personal finance, whether primarily the consequence of cumulative banking tendencies of the last twenty years or of the force of present and imminent circumstances. The significance of more adequate factual knowledge on this matter for basic theories of banking

and credit, national credit policies, and practical problems and philosophies of bank administration is self-evident.

To facilitate quantitative treatment and analysis of trends a more satisfactory concept and effective definition of the area of consumer finance would have to be developed. The next step would be an anatomical description of the institutional organization of consumer finance facilities with the particular objective of indicating more accurately the interrelationships of commercial banks with specialized consumer finance agencies and the extent to which commercial banks themselves finance consumers. This would require an intensive study of the financial statements of the more important consumer credit agencies, and a cooperative appraisal of loan portfolios of a selected sample of banks in different areas with a view to ascertaining their consumer credit commitments. Current studies of the loan portfolios of closed and active banks in western states would afford supplementary evidence.¹ Should Federal Reserve authorities decide to require the classification of loans in economic as well as purely financial categories in future call reports of banks, reference data of immense value to this study would be made available.

In this general setting, the investigation would be directed to the lending experience of consumer credit agencies over the last ten years or more, and particularly during the depression. It is believed that a wealth of data might be assembled from the following sources: (1) the larger instalment companies; (2) personal and industrial finance companies and the Morris Plan banks; (3) banks with established personal loan departments; (4) other banks that have recently made special studies of their

¹ For example, the studies of F. L. Garlock of the Bureau of Agricultural Economics, covering Arkansas, Utah and Wisconsin.

personal loan experience; (5) the internal records of the Federal Housing Administration, which contain a complete description of each insured modernization loan made under the Federal Housing Act. On the basis of these data the relationship of consumer and personal debt to individual income, occupation, and other relevant factors of economic status would be intensively studied for repaid loans and loss loans. Such an analysis should not only yield results of immense practical value for those engaged in consumer finance, but also provide a more adequate basis for appraising the penetration of commercial banks into this field of activity and for evaluating the role of consumer credit as a factor accentuating economic instability.

A final phase of this investigation would involve an examination of state and national legislation bearing on consumer financing as in one way or another affecting the personal lending activities of consumer finance agencies and commercial banks. This would necessitate special consideration of usury and other laws limiting charges on this type of lending and the various practices of consumer finance institutions and banks under those laws. It would also require attention to administrative and other costs entailed in such lending. Data bearing on costs would have to be obtained from consumer credit agencies directly and from banks that have made extensive studies of lending costs.

Procedure

This investigation would necessitate not only effective cooperative relations with consumer finance agencies and commercial banks in order to obtain access to pertinent raw data, but also the collaboration of individuals and research agencies possessing materials pertaining to this