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Sources and Rates of Income

DURING the period 1929-41, consumer instalment financing agencies derived practically all of their income from loans, whereas commercial banks in the aggregate derived substantial amounts of income from other sources. Not only was the level of the effective rate of income received on loans markedly different for each type of specialized agency and for commercial banks, but effective rates differed even more significantly among individual institutions. These variations reflected primarily differences in the character of the predominant type of paper and in the size of the average loan held.

SOURCES OF INCOME

The income of sales finance companies took many forms: discounts on retail instalment paper, income from wholesale financing, commissions on insurance, and sometimes interest on small loans, income from factoring (the discounting of accounts receivable) and from rediscounting the paper of other finance companies. Income from securities was negligible.

Despite wide variations between companies, discounted retail instalment paper normally furnished the bulk of gross earnings. Although wholesale financing—the financing of dealers' purchases—accounted in general for 10 to 20 percent of receivables outstanding at any one time, it accounted for a materially smaller proportion of gross income, because rates were set low as a competitive device intended to enable the company to share in the dealer's retail instalment paper.

Insurance income tended to be the second most important source of earnings in an automobile sales finance company. Although such income was sometimes derived directly from subsidiary insurance companies it more frequently took the form of commissions on insurance business placed with independent companies. A sample of 10 local sales finance companies reporting this item separately in 1937 revealed insurance commissions ranging from 0.1 to 21.3 percent of total earnings; in 5 of the companies commissions exceeded 10 percent.[1]

If a sales finance company engaged in the extension of small loans at all, it constituted as a rule only a very small part of the business. Loan extension derived mainly from the refinancing of unfulfilled contracts, a procedure sometimes interpreted as making the contract subject to statutory interest provisions. Most sales finance companies engaging in this type of business solved the legal problem by setting up subsidiaries licensed as small loan offices, and charged the usual small loan rate on the unpaid balance (including the original finance charge). Such offices were able to extend small loans that were not connected with refinancing, but their business represented only a minor fraction of the sales finance company's activities. In a sample of 48 national, regional and local companies small loans constituted only 0.5 percent of outstandings at the end of 1937, though for the 40 local companies of this group the proportion ran as high as 6 percent.[2]

Factoring, the discounting of various types of accounts receivable, and the rediscounting of other finance company paper are specialized types of activity in which few sales finance companies engaged. Two large organizations of nationwide scope developed, however, a substantial amount of factoring, and a few companies rediscounted other finance company paper.

The income of personal finance companies consisted almost entirely of interest on loans, except in those jurisdictions where lenders were permitted to make a service charge. In this study both types of charge are regarded as income on loans, and no attempt is made to distinguish between them.

Some personal finance companies received income from interest on bank balances or on investments, but only an insignificant amount. Collections on accounts previously charged off are variously treated in published figures either as income or as a deduction from expenses; they represented about 1 to 3 percent of total income, varying from year to year and from company to company. When, to meet competition from other types of consumer instalment financing agencies, some personal finance companies undertook the

[1] See National Bureau of Economic Research (Financial Research Program), *Sales Finance Companies and Their Credit Practices*, by Wilbur C. Plummer and Ralph A. Young (New York 1940) p. 247.
[2] *Ibid.*, p. 39.

financing of retail instalment sales, commissions on insurance placement constituted a further source of income.

Among industrial banks income from loans constituted, on the average, about 85 to 90 percent of the total, as can be seen from Table 9 (see also Table 12). The importance of other sources of income varied from one institution to another, depending on the degree of diversification of activities: other sources include factoring, interest and dividends on securities, rents from real estate and from safe deposit vaults, insurance commissions, service charges on checking accounts and interest on bank deposits.[3]

In the industrial banking company which limited its lending activities to cash instalment loans, income from loans—including interest, fees and fines—amounted to practically the whole of total earnings. But some industrial banks developed a substantial amount of sales financing, both retail and wholesale,[4] and their income from loans and discounts was likely to be supplemented by insurance commissions.

A good many industrial banks have attempted to diversify their activities, engaging to an increasing extent in a general banking business. Within the last few years, for example, several insured industrial banks have acquired membership in the Federal Reserve System, or have acquired a national bank charter, with a change in name. Whether this diversification of activities has been stimulated by growing competition from commercial banks in the field of consumer instalment loans cannot be determined.

[3] A discussion in considerable detail of the income of industrial banking companies appears in National Bureau of Economic Research (Financial Research Program), *Industrial Banking Companies and Their Credit Practices*, by Raymond J. Saulnier (New York 1940) Chapter 7.

The figures in the present table differ from those in Saulnier (pp. 148-49) for the following reasons: first, they include data on several insured industrial banks that became members of the Federal Reserve System in the later years; second, amounts reported as income from loans have been revised to include investigation and penalty fees, service charges and fines on loans, which had been improperly reported by the banks under other captions; third, recoveries on assets and profits on assets sold or exchanged have been excluded from total income and considered as offsets to gross charge-offs, in order that the figures for total income may be on a basis consistent with the income tax tabulations and with the concept of gross or total earnings from current operations, as reported by insured commercial banks.

[4] In recent years about 10 percent of total loans of industrial loan companies in Indiana have consisted of retail instalment sales contracts, and about 5 percent of real estate mortgage loans. In some insured industrial banks retail instalment paper amounted to as much as 60 percent of total loans on December 31, 1940.

TABLE 9

PERCENTAGE DISTRIBUTION OF TOTAL INCOME OF ALL INSURED INDUSTRIAL BANKS, 1934–41, BY SOURCE OF INCOME[a]

Source	*1934*[b]	*1935*[b]	*1936*	*1937*	*1938*	*1939*	*1940*	*1941*
Interest, discount and fees on loans	84.0%	87.2%	89.1%	89.5%	89.7%	88.0%	90.0%	89.5%
Interest and dividends on securities	8.5	5.8	4.3	4.0	3.7	4.0	2.1	2.3
Commissions, fees, service charges	3.7	3.8	4.1	4.4	4.6	5.7	6.3	6.6
Other current operating earnings	3.8	3.2	2.5	2.1	2.0	2.3	1.6	1.6
TOTAL	100.0% $7,880,000	100.0% $9,252,000	100.0% $11,484,000	100.0% $13,776,000	100.0% $15,070,000	100.0% $16,515,000	100.0% $18,407,000	100.0% $20,226,000
Number of banks	60	62	63	66	70	73	75	80

[a] Based on data from Federal Deposit Insurance Corporation. Banks that submitted reports covering less than the full year's operations are not included.
[b] Partially estimated, on the basis of corrected figures submitted by the reporting banks for 1936-41.

Such competition has undoubtedly played a part, but it is also true that many business loans originate with successful clients who were formerly consumer-borrowers, or depositors. The expansion of service facilities represents an attempt to satisfy more completely the banking needs of customers. Income from such services—rent for safe deposit facilities, insurance commissions, service charges on checking accounts (chiefly of the no-minimum-balance types)—still accounted for a very small proportion of total earnings in the average industrial bank in 1941, though the proportion rose steadily after 1934. In some of the large urban, insured institutions service income assumed more importance, but even there it rarely exceeded 10 percent of total income.

Income from loans consisted chiefly of interest and discount, although in jurisdictions where statutes permitted, it included also a substantial amount from fees for investigation and other services as well as from penalty fees or fines for late payments. In banks for which data are available such fees represented from 15 to 40 percent of the interest on loans.[5]

In view of the earlier discussion it is not surprising that income from securities represented a small and decreasing proportion of industrial banks' total earnings for the period under review. In 1941 only one insured industrial bank received income from securities amounting to 10 percent or more of total earnings (see Table 12, below).

Among federal credit unions, as can be seen from Table 10, the second most important source of income, after interest on loans, was, in the early years, at least, the entrance fee. The Federal Credit Union Act of June 26, 1934, provides that each member shall "subscribe to at least one share of [the credit union's] stock and pay the initial installment thereon and the entrance fee. . . ." This fee amounts to 25 cents, or 5 percent of the $5 par value of the first share subscribed, and the total of such fees represented a significant proportion of the total income of all credit unions in the years when expansion was rapid and many new organizations were being formed. But as the number of new credit unions has declined, the

[5] Fees and charges of reporting members of the American Industrial Bankers Association, 1936 and 1937, and of reporting members of the Morris Plan Bankers Association, 1937, aggregated in those years almost 20 percent of interest and discount on loans; see Saulnier, *op. cit.*, p. 151.

TABLE 10

PERCENTAGE DISTRIBUTION OF TOTAL INCOME OF REPORTING FEDERAL CREDIT UNIONS, 1935–41, BY SOURCE OF INCOME[a]

Source	*1935*	*1936*	*1937*	*1938*	*1939*	*1940*	*1941*
Interest on loans	67.6%	85.8%	91.9%	93.6%	93.7%	93.1%	95.8%
Entrance fees and fines[b]	29.0	12.1	6.6	4.7	3.9	3.0	. .
Income from investments	3.4	2.1	1.5	1.7	1.6	2.7	3.4
Other income					.8	1.2	.8
TOTAL	100.0% $112,000	100.0% $555,000	100.0% $1,399,000	100.0% $2,261,000	100.0% $3,570,000	100.0% $5,422,000	100.0% $7,293,000
Number of credit unions	762	1,701	2,276	2,753	3,172	3,715	4,144

[a] Based on data from U. S. Farm Credit Administration, Division of Finance and Accounts.

[b] In 1938 and subsequent years this item—which is used to augment a reserve for bad loans—was not regarded in the source reports as a part of income. It is here so regarded, however, from 1935 to 1940; in 1941 the amount of this item was not published and it is therefore necessarily excluded; it probably did not exceed 2 percent of total income.

income from fees has also fallen off in relation to the aggregate total.[6]

The Federal Credit Union Act also specifies that a credit union may "fine members, in accordance with the by-laws, for failure to meet promptly their obligations to the Federal credit union." In accordance with the practice followed in this study with regard to industrial and commercial banks, such fines are considered as a portion of income from loans. Although in the published reports fines are not segregated from entrance fees their amount appears to have been nominal.

Investments permitted to federal credit unions are limited to those whose anticipated rate of return is materially lower than that on loans to members. Income from investments, while still only a small proportion of total income in 1941, increased considerably from 1938 to 1941, and may be expected to rise even more sharply as credit unions continue to invest all available funds in United States government securities.

With the rise in prices of government securities in recent years some federal credit unions may have received a significant proportion of total income from profits on securities sold; in the aggregate, however, this item has probably been unimportant. In Massachusetts, where credit unions operating under State charter have been permitted to invest in real estate mortgages, these investments have reached sizeable proportions in relation to total loans. The income they produce has not been segregated in reports of the State Superintendent of Banking from income on other loans.

In sources of income, as in distribution of assets, commercial banks differ markedly, in the aggregate, from the specialized agen-

[6] The entire amount of such entrance fees, as well as all fines and 20 percent of the net earnings of each year, must be segregated for the establishment of and addition to "a reserve fund against possible bad loans." This fund is directly analogous to the surplus frequently paid in at the organization of corporations, and to the surplus provided for in the organization of national banks. It is debatable, therefore, whether the entrance fees should be considered a portion of total income. Before 1938 they were so treated in reports published by the Farm Credit Administration; from 1938 through 1940 the amount of fees and fines transferred to the reserve for bad loans was reported as a memorandum to the operating statement, rather than as a part of total income; for 1941 the amount of fines and fees was not reported. For the purpose of this volume, both fees and fines have been treated as a part of total income, and the transfer to the "reserve" is regarded as an allocation of net profits, rather than as an expense.

TABLE 11

PERCENTAGE DISTRIBUTION OF TOTAL INCOME OF ALL INSURED COMMERCIAL BANKS, 1934–41, BY SOURCE OF INCOME[a] (dollar figures in millions)

Source	*1934*	*1935*	*1936*	*1937*	*1938*	*1939*	*1940*	*1941*
Interest and discount on loans	45.5%	43.3%	42.3%	43.5%	44.5%	45.3%	47.1%	49.0%
Interest and dividends on securities	36.2	36.9	36.7	35.0	33.6	32.5	30.7	29.4
Commissions, fees, service charges	5.0	6.0	6.7	6.8	7.3	7.6	7.9	8.1
Other current operating earnings	13.3	13.8	14.3	14.7	14.6	14.6	14.3	13.5
TOTAL	100.0% $1,518	100.0% $1,486	100.0% $1,567	100.0% $1,634	100.0% $1,584	100.0% $1,606	100.0% $1,631	100.0% $1,730
Number of banks	14,137	14,123	13,969	13,795	13,657	13,534	13,438	13,427

[a] Based on Federal Deposit Insurance Corporation, *Annual Report* for 1941, p. 158. Cash depositories and banks designated in this study as insured industrial banks are included.

cies.[7] Table 11 shows that income from loans, which had represented more than 60 percent of the total income of commercial banks in the late 1920's, dropped as low as 42 percent in the years after the depression, and in 1941 represented only 49 percent. Throughout most of the 1930's interest and dividends on securities constituted about 35 percent of total income, the proportion declining after 1938 as holdings of low-rate United States government securities increased.

Among other sources of commercial banks' income that gradually increased in importance during the period under review, service charges on deposit accounts have become the most significant, although a decade ago they probably represented less than 1 percent of total income. Trust department income, rent from real estate and from safe deposit facilities, collection charges, insurance commissions and fees account for practically all other forms of income from current operations.[8]

For commercial banks, however, aggregate ratios for the various sources of income are strongly influenced by the fact that in the large banks in large centers income from loans represents a particularly low proportion of total income. Actually, most banks have a higher figure for this item than is indicated in the table. If the average is taken from the ratios of individual banks, rather than from the aggregate amounts, thus eliminating the weight of the large banks, the figure for average income from loans in 1941 becomes 62 rather than 49 percent.[9]

In more than three-fourths of the insured commercial banks in the country (see Table 12) income from loans in 1941 represented 50 percent or more of total income, and in more than one-third of them such income amounted to 70 percent or more. Conversely, despite the fact that the average figure for income from interest and dividends on securities was about 30 percent, somewhat more than half of these banks derived less than 20 percent of total income in 1941 from these sources and three-fourths of them received less than the average.[10]

[7] The distribution of the sources of income of all national banks, 1917-37, in percent of gross current operating earnings, is presented in *Annual Report* for 1938 of the Comptroller of the Currency, pp. 100 ff.

[8] The proportion of total income derived from consumer instalment loans is not known.

[9] See also footnote 9, Chapter 3.

[10] About 70 banks, or 1 in 200, obtained more than 50 percent of their total income from sources other than loans and securities in 1940. These include banks with a

In the years for which data are available, small banks consistently received a higher percentage of their income in the form of interest on loans. This inverse relationship to size of bank was found to be characteristic, irrespective of the size of the banking center or the geographic location. The consistently higher proportions shown by smaller banks reflect their greater utilization of available funds

TABLE 12

PERCENTAGE DISTRIBUTION OF LOANS AND SECURITIES OF INSURED COMMERCIAL AND INDUSTRIAL BANKS, 1941, BY PERCENT OF TOTAL INCOME DERIVED FROM LOANS AND SECURITIES[a]

Income on Loans or Securities in Percent of Total Income[b]	*Commercial Banks*		*Industrial Banks*	
	Loans	Securities	Loans	Securities
Less than 10%	.1%	25.3%	..	98.8%
10–20	.9	29.7	..	1.2
20–30	3.0	20.6	..	..
30–40	7.1	12.4	..	..
40–50	12.7	6.8	..	..
50–60	18.5	3.2	1.2%	..
60–70	23.4	1.4	..	..
70–80	21.5	.5	3.7	..
80–90	10.7	.1	23.8	..
90–100	2.1	..	68.8	..
100	.0	..	2.5	..
ALL BANKS	100.0%	100.0%	100.0%	100.0%
Number of Banks	13,220		80	

[a] Based on data from Federal Deposit Insurance Corporation. Cash depositories and banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included.
[b] Each level is inclusive of the lower limit and exclusive of the upper.

(discussed in the preceding chapter), and also their higher rate of income on loans.

Commercial banks' income from loans, in relation to total income, appears to have been much less closely related to size of center than to size of bank. True, banks in the smaller centers showed higher proportions, but for banks of the same size the proportion

large proportion of trust activities, a few institutions with substantial income from title departments, and others whose activities consist chiefly of the encashment of checks. The heterogeneity of the concept "commercial bank" appears from the definition of the term as used in banking statistics; see *Annual Report* of the FDIC for 1941, pp. 89-90.

varied little, showing no consistent decrease as the size of the center increased. To this there was one noteworthy exception: among banks with deposits of $500,000 or less, those located in the very large centers showed a smaller loan income proportion than banks of the same size elsewhere. This may indicate that metropolitan banks have been better able to diversify their activities than banks of the same size in smaller centers.

The proportion of total income received from loans showed some geographic variation. In the south and west both the smaller and the larger banks showed higher proportions than did banks of the same size in the east and north.[11] Here, too, a contributory reason was a fuller utilization of lendable funds and, in particular, higher effective rates: among banks with the same percentages of loans those in the south and west showed higher average rates of income on them than did banks in other areas. Moreover, in the older, more stable eastern and northern sections more banks had developed supplementary activities, such as real estate, trust, insurance, foreign and title departments, which contribute to total income—activities less fully developed by banks of comparable size in the south and west, further removed from the money markets.

RATES OF INCOME ON LOANS

The best obtainable measure of the effective use of loan funds,[12] and of the average rate of charge borne by customers, is provided by computing income in percent of average or year-end outstanding loans. Such a measure must necessarily include, as a part of income, all fees or charges incident to the extension or collection of loans.

The rate of income from loans in percent of average or year-end outstanding loans has been used for commercial banks (average loans), insured industrial banks[13] (average loans) and federal credit unions (year-end loans), the only institutions for which it is readily available. The rate represented by total income in percent of aver-

[11] Among banks of intermediate size—those with deposits between $500,000 and $5,000,000—geographic location did not appear to make so great a difference.

[12] The best measure of an institution's use of all funds at its command is total income in percent of total assets. This measure would be most useful in comparing the various types of consumer instalment financing agencies with one another, but it would be unsatisfactory in comparing them with commercial banks, since the latter, as a result of their monetary function, are not able to invest so large a proportion of their resources in productive assets; compare Table 13 and Appendix Table B-6.

[13] For these institutions the amount of loans used as the base is net after deduction of deposits accumulated for loan repayments.

age or year-end outstanding loans has been used as the best available substitute for companies in the income tax sample (year-end loans) and for those in the National Credit Office samples (average loans).[14] Neither, however, provides a perfect measure of the rate of charge on loans, for both show the average rate *collected* rather than the average rate *charged*.[15] Moreover, they show the average rate collected on *all* paper acquired, weighted by the amount of paper at each rate, rather than the rate on any one class of loan. In the following pages no distinction will be made between these measures, and both will be referred to as loan-income rates.

Comparison of Averages

Significant differences in the rates of income on loans are shown in Table 13, which presents averages for the various types of agencies and the various samples over the period 1929-41.[16] Although the averages shown by commercial banks were materially lower than those for consumer instalment financing agencies the rates of some of the individual banks approached those characteristic of the specialized institutions.

Among the specialized agencies sales finance companies showed the most marked decline in loan-income rate during the period. Local sales finance companies reported an average rate of 20 to 24 percent in 1929 and a rate of 16 percent in 1941; rates of the larger companies fell off relatively as much or more. The decline, after 1934, should probably be attributed in part to voluntary rate reductions following the favorable loss experience of the depression, but primarily to reductions following the increase in competition as in-

[14] It is not likely that this procedure results in any significant overstatement, since income from loans constitutes the overwhelming proportion of total income in the consumer instalment financing companies. In the National Credit Office samples, however, this rate may not be so accurate, for figures of some of the companies are based on published statements, which were probably not prepared in an entirely consistent manner from year to year.

[15] The average of charges collected to charges earned varies greatly from state to state and from year to year, with depression and prosperity. The average for all reporting personal finance licensees in selected states (from 2 to 19 in various years) ranged during 1929-36 from 81 to 98 percent. For individual companies the variation would be materially greater. See M. R. Neifeld, *Personal Finance Comes of Age* (New York 1939) p. 224.

[16] In the income tax tabulations—in contrast to the probable practice in the National Credit Office samples—bad-debt recoveries were deducted from bad-debt expense; whenever the former exceeded the latter the excess was treated as a negative expense item, not as a portion of total income.

TABLE 13

LOAN-INCOME RATES OF SELECTED SAMPLES OF CONSUMER INSTALMENT FINANCING AGENCIES AND COMMERCIAL BANKS, 1929–41[a]

Sample	*1929*	*1930*	*1931*	*1932*	*1933*	*1934*	*1935*	*1936*	*1937*	*1938*	*1939*	*1940*	*1941*
Sales finance companies													
2 to 3 national[b]	17.7%	15.3%	14.6%	14.6%	16.6%	17.6%	14.9%	13.3%	12.0%	10.7%	11.0%	9.9%	10.2%
2 to 4 regional[b]	17.3	17.1	17.2	16.7	18.4	20.5	19.5	17.7	15.6	12.8	14.4	12.7	11.6
9 to 32 local[b]	24.0	20.7	21.0	18.7	20.1	21.2	20.8	18.9	18.2	15.6	17.2	16.2	16.0
202 local[c]	19.6	..	..	..	18.7	..	..	16.4	..	..	..	..	..
Personal finance companies													
2 national[d]	..	32.6	32.8	33.4	35.0	34.7	34.0	33.2	33.8	31.8	32.0	31.1	30.5
2 to 5 regional[d]	37.2	35.5	29.1	35.6	33.2	35.5	36.7	36.5	35.5	33.4	32.1	32.5	33.2
5 to 7 local[d]	..	..	..	..	..	32.1	34.0	33.7	31.7	29.4	30.7	32.5	31.5
153 local[c]	25.5	..	..	..	26.0	..	..	26.7	..	..	..	..	..
79 non-invest. type indust. bkg. cos.[c]	15.5	..	..	..	13.7	..	..	15.2	..	..	..	..	..
Invest. type indust. banks													
56 noninsured[c]	10.4	..	..	..	10.4	..	..	10.3	..	..	..	..	..
6 largest insured[e]	..	..	..	..	..	11.5	9.4	10.4	10.7	11.1	10.5	10.0	9.4
All other insured[e]	..	..	..	..	..	12.5	12.0	13.0	12.8	12.5	12.3	11.8	11.3
37 insured[c]	10.0	..	..	..	10.1	..	..	9.3	..	..	..	..	..
Credit unions													
All reporting federal credit unions[f]	..	..	..	..	..	..	4.1	6.5	8.2	8.9	8.8	9.0	10.1
Commercial banks													
All natl. banks (loans)[g]	6.1	5.6	5.2	5.3	4.8	4.7	4.6	4.5	4.4	4.4	4.5	4.4	4.2
All insured banks (loans)[e]	..	..	..	..	..	4.6	4.4	4.3	4.3	4.4	4.5	4.4	4.3
All natl. banks (securities)[h]	4.5	4.6	4.2	4.1	3.6	3.4	2.9	2.7	2.7	2.6	2.4	2.2	2.0
All insured banks (securities)[i]	..	..	..	..	..	3.2	2.9	2.7	2.7	2.6	2.4	2.2	2.0

(footnotes on opposite page)

dustrial and commercial banks expanded their activities in this field.[17]

In almost every year national and regional sales finance companies showed lower income rates than the locals, the nationals showing the lowest. These differences, reflecting differences in character of business, are indicative of the larger proportion of low-rate wholesale paper acquired by the larger companies.[18]

Highest in average loan-income rate was the personal finance group. The companies in the income tax tabulation, 1929, 1933 and

[17] A portion of the drop since 1938 may be attributed to a change in operating practices; at that time many sales finance companies lowered their discount rates and discontinued rebates to dealers subsequent to collections.

[18] The lower rates shown for the local sales finance companies in the income tax sample than for the local companies in the National Credit Office sample in 1929, 1933 and 1936 probably resulted from the use of year-end loans as the base in the income tax sample rather than average loans, as in the National Credit Office sample. In all three years year-end outstandings were higher than the average for the year.

FOOTNOTES TO TABLE 13

[a] Except where otherwise indicated the figures represent total income (which is, except in commercial banks, composed predominantly of loan income) in percent of average or year-end loans outstanding. The number of companies for each year may be found in Appendix Table B-1.

[b] Based on data from the National Credit Office, Inc. Some of these companies are included in the 202 local companies of the income tax sample. In the majority of cases recoveries are probably included in total income. Here the denominator is the average of loans outstanding at beginning and end of year.

[c] Based on tabulations prepared by the Income Tax Study. The figures represent total income in percent of year-end loans outstanding.

[d] Based on data from the National Credit Office, Inc. Some of these companies are included in the 153 local companies of the income tax sample. In the majority of cases recoveries are probably included in total income. Here the denominator is the average of loans outstanding at beginning and end of year.

[e] Based on data from Federal Deposit Insurance Corporation. The figures represent income on loans only (not total income) in percent of average of loans outstanding at beginning, middle and end of year, except for industrial banks in 1934 and 1935, when year-end loans outstanding are used; deposits accumulated for the repayment of loans have been deducted from total loans of industrial banks. Cash depositories and banks designated in this study as insured industrial banks are included with all insured commercial banks.

[f] Based on data from U. S. Farm Credit Administration, Division of Finance and Accounts. The figures represent income on loans only (not total income) in percent of year-end loans outstanding.

[g] Based on data in Annual Reports of the Comptroller of the Currency. The figures represent income on loans only (not total income) in percent of average of loans outstanding on call dates during the year.

[h] Income on securities in percent of average of securities held on call dates during the year. For source see footnote g above.

[i] Income on securities in percent of average of securities held at beginning, middle and end of year. For source see footnote e above.

1936, reported an average rate of about 26 percent,[19] and the smaller group of national, regional and local companies in the National Credit Office sample indicated considerably higher rates. In part the latter are due to a definitional difference, for among the majority of companies in the smaller samples, "total income" probably included recoveries on assets previously charged off—an item which was significant after the depression and was treated as a deduction from expenses in the income tax data.

The difference thus produced between the two sets of data is much smaller, however, than the differences between one company and another in the income tax sample, and therefore the two sets of samples may be considered fully corroborative. While fluctuations appear in the rates shown for the samples of personal finance companies, only a minor downward tendency can be discerned from data covering the last decade.[20]

For non-investment type industrial banking companies included in the income tax sample average total income in percent of year-end loans outstanding was lower than for either personal finance or sales finance companies, but higher than that for the other industrial banking companies. Its fall from 1929 to 1933 was probably due to collection delinquencies, for its former level was regained in 1936.

Over the same period noninsured investment type industrial banking companies included in the income tax sample maintained a notably stable loan-income rate, but the insured companies experienced a slight drop. Data for 1934-41 on the six largest insured industrial banks, and on all other banks in this class, reveal a downward tendency after 1938, indicative of the expansion of lending activities to include more non-consumer loans as a result of competition from commercial banks.

Federal credit unions are permitted to charge interest on loans at an effective rate not exceeding 1 percent a month. Actually, the average effective rate reported rose from 8.2 percent in 1937 to 10.1

[19] The use of a higher-than-average year-end base of outstanding loans in 1929 and 1936 results in an understatement of the loan-income rates for the personal finance companies in the income tax sample. See Appendix Table A-2.

[20] Neifeld, *op. cit.*, p. 220, presents a table showing gross earnings of personal finance companies, in percent of total assets, by states, for 1929-36; these, too, show no consistent tendency, nor do figures supplied to me by Mr. Neifeld for the years 1937-40.

percent in 1941.[21] These rates are comparable to, or lower than, those received by commercial banks and insured industrial banks on consumer instalment paper. The low credit unions' rates may be attributed chiefly to low investigation and collection expenses, resulting from their cooperative character. Since the handling of small loans generally entails high costs per dollar it is significant that the average size of all federal credit union loans since their organization has been $108[22]—an amount no larger than the average loan of personal finance companies and materially below the average consumer loan of industrial and commercial banks.

From 1929 through 1933 the loan-income rate received by commercial banks dropped rapidly, but after 1934 showed only minor fluctuations. On the other hand, income from securities (in relation to average securities holdings) continued to decline from year to year, until in 1941 it was less than half the loan-income rate as against three-quarters of it in 1929.

After 1934 the loan-income rate of all insured commercial banks was scarcely more than one-third the rate of all insured industrial banks, and approximately one-seventh the rate of personal finance companies. The lower average for commercial banks is due in large part to their high proportion of large commercial loans, commercial paper, bankers' acceptances and FHA Title II insured mortgage loans—on all of which the rate of charge is materially less than on consumer instalment paper.

Variation Among Individual Companies

Average loan-income rates, while significant for general comparisons, give no indication of the wide variation from one company to another within each type of institution. To a slight degree this variation may result from differences in geographic location, but in gen-

[21] The materially lower rates shown in Table 13 for 1935 and 1936 result from the facts that year-end loans were used as the base in computing the average; that loan volume was expanding rapidly during this period as the number of credit unions grew; and that for a great many of the reporting institutions the amount of interest included probably represented income for only part of the year. These influences were probably also operative, to some extent, in later years.

Francis E. Wilcox, in *A Statistical Study of Credit Unions in New York* (Chicago 1940) Table 20, p. 54, shows that interest rates charged borrowing members of state-chartered credit unions in New York State, 1937, ranged from ⅓ percent to 1 percent per month. Although a discount rate of 6 percent per annum in advance (equivalent to 0.97 percent per month on an actuarial basis) was the most common rate charged, 67 of 148 credit unions reported lower rates.

[22] U. S. Farm Credit Administration, *Ninth Annual Report* (Washington 1942) p. 135.

eral it indicates that the companies in any one type of agency have, despite their similarity of function, engaged to a greater or lesser degree in other specialized activities which affected their rates of income.[23]

Chart VIII indicates for 1936 (1938 for commercial banks) the percentages of companies in various types of agencies which reported five different levels of loan-income rate.[24] Though the rates of individual companies showed marked shifts from 1929 to 1933 and also, though less notably, from 1929 to 1936, there was no discernible trend in the percentage reporting different rates. The movement was toward the middle, and away from both the high and low rates, except among the investment type industrial banking companies: between 45 and 70 percent of the companies reporting high rates in 1929 reported lower rates in 1933 and 1936; and conversely, a substantial percentage of those reporting low rates in 1929 reported higher rates in 1933 and 1936.

A majority of the personal finance companies—nearly two-thirds —reported rates of 16 to 32 percent in 1936. The distribution of companies was such that two-thirds also fell in the 20 to 40 percent rate group.[25] There was a tendency for the larger companies to show a higher rate than the smaller companies but it was not pronounced.

For a personal finance company the rate represented by total income in percent of year-end loans outstanding reflects closely the rate of charge on loans, since practically the entire income of a company engaged solely in the small loan business is derived from interest on loans. Moreover, since seasonal fluctuation in personal finance company outstandings is slight (in contrast to new credits and repayments), it may be presumed that the rate base used here—outstanding loans at a single date, December 31—achieves a reasonably satisfactory approximation of the rate that would be derived by using as base the average of loans outstanding throughout the year.[26]

[23] The extent to which ability or inability to collect charges "earned" affects the rates of individual companies cannot be determined; in a small proportion of cases this may be substantial. See footnote 15, above.

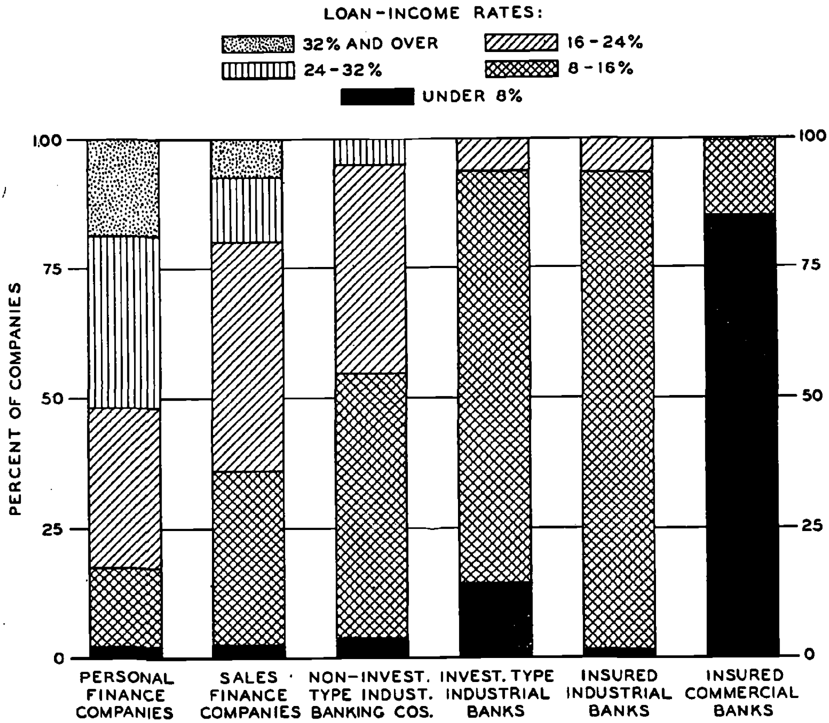
[24] No data are available on the loan-income rates of individual credit unions.

[25] Averages covering all licensees, by states, show a substantial degree of geographic variation. See Russell Sage Foundation, *Regulation of the Small Loan Business,* by Louis N. Robinson and Rolf Nugent (New York 1935) pp. 240-41.

[26] A slight distortion does result, however, from the growth trend in personal finance company outstandings during this period; at the end of 1936 outstandings were 7.6 percent higher than the average of month-end figures. See Appendix A.

CHART VIII

LOAN-INCOME RATES OF CONSUMER INSTALMENT FINANCING AGENCIES AND COMMERCIAL BANKS, 1936[a]



[a] Represents percentage distribution of companies, arranged according to loan-income rates. For personal finance, sales finance and non-investment type industrial banking companies, and for investment type industrial banks, based on tabulations prepared by the Income Tax Study; in regard to these agencies loan-income rates represent total income (composed predominantly of loan-income) in percent of total year-end loans outstanding. For insured industrial and commercial banks, based on data from Federal Deposit Insurance Corporation, pertaining to the year 1938 for commercial banks. In regard to insured banks loan-income rates represent income on loans in percent of average loans outstanding, net after deduction of hypothecated deposits for insured industrial banks. In regard to insured banks that were members of the Federal Reserve System, loans are averages of figures for call dates during the year, and in regard to non-member banks they are averages of figures for the beginning, middle and end of the year. Cash depositories, banks designated in this study as insured industrial banks, and banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included with insured commercial banks. Each rate group is inclusive of the lower limit and exclusive of the upper.

Both the 27 percent average for the entire personal finance group (income tax sample) and the rates reported by the majority of individual companies were materially less than the maximum permitted licensed small loan companies in most states. One reason is that some companies charge less than the legal maximum on all paper, and most companies charge less than the maximum on some paper.

The difference in rates on individual loans corresponds to differences in size of loan, in type of security, in liberality of loan and collection policy or in size and frequency of repayments. Furthermore, charges collected are always less than charges "earned," the proportion of charges "earned but not collected" being materially higher in a year like 1933 than in one like 1929 or 1936.[27] M. R. Neifeld's data for licensees in those states in which the permitted monthly maximum was 3.5 percent show that between 1929 and 1936 the average rate collected ranged between 2.35 and 2.99 percent.[28]

About one-sixth of the personal finance companies, those with assets of $250,000 or less, reported loan-income rates of less than 16 percent. This return—low for personal finance companies—may indicate improper classification of the companies concerned; temporary investments in retail paper; specialization in low-rate business;[29] or a competitive situation that tended to obliterate the distinction between personal finance and industrial banking companies. This last probably existed in Pennsylvania, where a large number of personal finance companies showed relatively low average rates of return.

Nearly half of the sales finance companies covered in Chart VIII reported rates ranging from 16 to 24 percent; about one-fifth reported rates higher than 24 percent, and some even higher than 32 percent. The largest companies showed a slight tendency toward a lower rate.

[27] See footnote 15, above.

[28] Neifeld, *op. cit.*, p. 225.

[29] Comaker and other endorsed loans tend to carry lower rates than loans secured by chattels; also, loans to specific classes of borrowers (teachers, for example) are often made at preferential rates. The extent to which unsecured and various types of secured loans were extended by personal finance licensees in 16 selected states, in 1937, is shown in National Bureau of Economic Research (Financial Research Program), *Personal Finance Companies and Their Credit Practices*, by Ralph A. Young and Associates (New York 1940) p. 50; the use of preferential rates to attract preferred risks, and the extent to which loss data appear to justify special rates to teachers, are there discussed on pp. 68 and 92-95, respectively.

For sales finance companies, total income in relation to year-end loans outstanding represents, on the whole, a certain overstatement of the average effective rate of charge on retail instalment paper, for practically all of these companies reported some income from insurance activities.

The variation in rates from one company to another arises from variations in insurance income, but partly also from differences in charges on comparable types of sales finance paper, in the relative amounts of wholesale (low-rate) and retail (higher-rate) paper, and in the proportion of business involving used as contrasted with new articles.

Some companies were undoubtedly affected by seasonal fluctuations in the dominant industry of the community. In such cases loans outstanding on December 31 might grossly understate or overstate the average for the year, and thus exaggerate or minimize the rate of income. Had average holdings throughout the year been available they would have provided a more accurate measure of rates.

Possibly some of the companies that reported particularly high rates were improperly classified, and were actually predominantly engaged in the extention of small cash loans. Probably, however, a good many of them had large proportions of high-rate business, such as the financing of second-hand commodities, chiefly automobiles. They may also have made a practice of rediscounting their loans with other institutions or selling them on a non-recourse basis.[30] If figures on the total amount of paper handled by sales finance companies during the year had been available, it would have been possible to determine to what extent the reported rates resulted from rediscounting.

Very few of the non-investment type industrial banking companies in Chart VIII showed loan-income rates of less than 8 or more than 24 percent. Over half reported rates of 8 to 16 percent, and about two-fifths reported rates of 16 to 24 percent—proportions fairly characteristic of all three years covered by the income tax sample. A substantial number of non-investment type industrial

[30] In regard to paper sold on a non-recourse basis the usual accounting procedure is to eliminate the loans from the balance sheet; the result is a correspondingly lower denominator for the computation of the rate. If the paper were rediscounted, and the asset removed from the books, the same result would follow. In regard to rediscounted paper, however, or paper sold on a recourse basis, it is considered more correct accounting procedure not to remove the asset from the books.

banking companies were qualified to operate under small loan laws, and it is probable that the companies showing the higher rates of return were engaged in a combination type of business, their activities overlapping to a considerable extent with those of personal finance companies.

Four-fifths of the investment type industrial banks in the income tax sample showed rates between 8 and 16 percent, with some tendency toward a lower rate among the largest companies. Even if correction were made for hypothecated deposits the proportion of banks in the intermediate rate group would not be materially affected, though there would be more banks with rates of 16 to 24 percent and fewer with rates under 8 percent.

In 1936, as shown in Chart VIII, over nine-tenths of the insured industrial banks showed loan-income rates of 8 to 16 percent (income from loans in percent of average loans, net after deduction of hypothecated deposits). Further data show that from 70 to 85 percent of these banks received rates of 10 to 14 percent during the period 1936-41, with a tendency for fewer banks to receive higher rates and more banks to receive lower rates in later years.

Banks located in centers of over 100,000 population tended to have lower-than-average loan-income rates, those in New York and Chicago showing averages slightly below the rates in other large centers. The six largest insured industrial banks, however, regardless of location, showed a lower average than all industrial banks in New York and Chicago. These and other findings are evidence of a tendency among the insured industrial banks faced with active competition from commercial banks or with a surplus of lendable funds, to increase the proportion of non-consumer loans bearing lower rates than consumer loans.[31]

Table 13 shows the average loan-income rate of all insured commercial banks to have been about 4½ percent during the years 1934-41. From Chart VIII it is evident that nearly seven-eighths of these banks had rates of less than 8 percent in 1938, practically all of the remainder having rates of less than 16 percent; supplementary data show that well over nine-tenths of the banks had rates ranging from 4 to 10 percent.

[31] Among the industrial banks whose loan-income rate was less than 10 percent in 1941 non-consumer loans averaged 35 percent of total loans at the end of that year; among the banks whose rate was more than 14 percent such loans averaged 6.1 percent of the total.

A commercial bank's effective rate of income on loans depends on the character and average size of the loans it extends, and on the amount and character of its charges. These in turn are influenced by a number of factors, the chief measurable ones on which data are available[32] being the size of the bank, the size of the center in which the bank is situated, the geographic location, and the proportion of loans in the form of consumer instalment paper.[33]

These factors operate, of course, in widely differing combinations, as is indicated by the fact that there were some banks during 1938-41 that received rates far outside the characteristic span—ranging from less than 2 to more than 20 percent. But on the whole there was a high degree of stability in commercial banks' loan-income rates. Their distribution according to this factor was almost identical in the four years 1938-41 and, significantly, there was very little variation from year to year in the average rate received by any one bank.[34] This consistency indicates that while the relative weights of factors that influence rates may differ widely from one bank to another, they change very little in a given bank.[35]

Available data indicate a strong relationship between size of bank and effective rate of income on loans: the larger the bank the lower the rate. Since there is a strong association between size of bank and size of center it is not surprising to find also, in general, that the larger the center the lower the rate.

Rates of income on loans, however, appeared to vary more with changes in size of bank than with any other measurable variable:[36] the rate tended to decline as size of bank increased, irrespective of the size of center,[37] but there was no conclusive relationship between

[32] For example, the relative volume of small loans, chiefly to consumers, which are not repaid in regular instalments has a significant effect, but no data are available on this factor.

[33] For distributions of insured commercial banks (including those designated in this study as insured industrial banks) by loan-income rate and size of bank, and by loan-income rate and size of center, 1941, see *Annual Report* of the FDIC for 1941, p. 171.

[34] Over two-thirds of the banks showed less than 1 percent change in effective rate from year to year during 1938-40.

[35] The principal variable that may cause relatively abrupt changes in any one bank's loan-income rate is the proportion of business represented by consumer loans; in some banks this proportion grew rapidly over the last few years of the period.

[36] As was shown in Chapter 3, this was true also in regard to the proportion of total assets in the form of loans.

[37] The exceptions occur principally where the number of banks is too small to provide a reliable average.

size of center and loan-income rates, once the influence of size of bank was eliminated. As size of center increased there was apparent some tendency for loan-income rates to rise in smaller banks and to decline in larger banks, but this was not so clear-cut as the decline in rates in any one center as bank size increased.

Differences among banks of different size, and among banks in centers of different size, have in recent years been due largely to differences in the average size of loans, in turn reflecting the average size of the customer concerns.[38] There is a high correlation between size of bank and the size of concerns with which the major portion of the bank's lending business is regularly transacted.

As a rule the largest concerns in an area tend to deal with the largest banks (even though these banks may lend also to a great many smaller concerns).[39] Smaller banks likewise tend to deal with smaller concerns for the major portion of their non-consumer loan business, and so on down. This procedure is dictated by statutory as well as sound business limitations on the proportion of resources an individual bank may extend in the form of a loan to a single customer.

The size of the banking center also delimits the size of a bank's loans. Large concerns, which may be big borrowers, are generally located in large towns. Thus, in so far as it reflects the size of the concerns with which a bank may deal, the size of the center may influence the average rate of income on loans.

Large loans made to large concerns are generally made at lower rates than small ones.[40] Therefore, a bank with a preponderance of large loans extended at lower rates will show a low average, even

[38] The average rate of income on loans is also dependent on the proportion of business conducted with "non-customers." Such business consists of special types of so-called low-risk paper which is included in, and reported as part of, the loan category: for example, bankers' acceptances, commercial paper and crop storage loans made in cooperation with the Commodity Credit Corporation. The rates on commercial paper are influenced to some extent by the size of the total loan to the borrower even though more than one creditor participates in that loan.

[39] A survey of commercial loans made by member banks from April 16, 1942, to May 15, 1942, reveals that the bulk of the loans of central reserve city banks, by dollar volume, was to borrowers with assets of more than $500,000; most of those of reserve city banks were to borrowers with assets of from $50,000 to 5 million dollars; while in the country banks, over three-fourths of all loans were to borrowers with assets of less than $500,000. See *Federal Reserve Bulletin* (August 1942) p. 772.

[40] These low rates are due partly to competitive forces and partly to the lower expense involved in the extension of larger loans. Also, in the analysis of risk factors there has probably been a tendency to confuse size of concern and proportion of equity. In this discussion, though emphasis is placed on other factors, it is recognized that rates are usually graduated to the anticipated risk on individual loans.

though the bank extends some small loans at higher rates. Conversely, a bank that has a majority of small loans exhibits a high average rate, even though it handles some larger loans at low rates.

There are no data for all insured commercial banks either on the number of loans held at any one time, or on their average size.[41] In lieu thereof, the average rate of income on loans may be regarded as an indication of the principal type of lending business undertaken by any one bank.

Geographic factors also bear an important relationship to rates of income. Rates follow broad geographic patterns, tending away from a low level in the older, more developed, industrial and financial centers of the north and east to a high level in the agricultural and more recently developed communities of the south and west. This distinct geographic pattern is evident whether banks are grouped according to regions or according to states. The divergence reflects differences in stage of economic development; differences in custom and accepted practices, interrelated in turn with the maximum rate of interest allowed by law; actual or generally accepted differences in risk among communities of differing economic characteristics.[42]

[41] Since this study was prepared a survey has appeared by G. L. Bach (*Federal Reserve Bulletin,* November 1942, pp. 1089-97), which is substantially in agreement with this analysis. Bach's survey covered all commercial loans (in excess of $1000, $2500 and $5000, respectively, in banks of varying size) made by member banks between April 16, 1942, and May 15, 1942, and disclosed the following pertinent facts:

A strong relationship existed between size of borrower and rate of charge—companies with assets over 5 million dollars paid, on the average, rates that were only about one-third of those paid by borrowers with assets of $50,000 or less;

Since large firms generally borrowed much larger amounts than did small ones, the relationship between size of borrower and rate of charge was probably equally indicative of a relationship between size of loan and rate of charge;

Geographic differences in rates reflected largely a varying size distribution of borrowers, or of loans, since borrowers of like size generally paid closely similar rates, regardless of industry or geographic location;

Consistent differentials in rates paid by borrowers in various industries indicated that difference in industry accounts for part of the geographic variation in reported rates;

Smaller banks, on the average, charged somewhat higher rates than did large banks to borrowers of comparable size, but this difference might have disappeared if a larger number of size groups for borrowers had been used. Bach concludes that, "using size as one possible measure of the credit standing of borrowers, it appears, therefore, that differences of this nature were perhaps the major factor accounting for the wide differentials in rates paid on different commercial loans" (p. 1090).

[42] Though any one state or geographic region may consist predominantly of agricultural, industrial, trading or mining communities, many states are composed of widely varying types of communities. No other, more satisfactory, units are readily available, however, for measuring differences in economic characteristics.

When the average rates of income on bank loans are arranged by size and by states and geographic areas, both geographic and size differences persist.[43] There is almost as much variation in rates from one state or area to another, among banks of the same size, as there is from one bank-size group to another within the same state or area. The difference in rates between states and areas tends to be less among the larger banks than among the smaller ones, and reflects the wider choice of credit sources available to larger borrowers.

The higher-than-average geographic differences among the small banks are readily understandable. Located predominantly in small centers, presumably in agricultural areas, these banks are relatively far from the easy money centers; and since a large proportion of their loans are made at the maximum rate, their averages tend to depend, in large part, upon variations in the maximum legal rates of interest in the various states.[44]

In some small communities, however, the average rate of income from loans is unduly depressed, because the banks acquire commercial paper when there is a lack of demand for loans in the immediate community; and even a relatively small amount of commercial paper sharply affects a small bank's average rate of income on loans.

One reason for the lack of a demonstrable relationship between commercial banks' loan-income rates and their relative holdings of consumer instalment paper is the anomalous character of some of their loans, particularly those of small banks. In the preceding chapter it was noted that a group of small banks attributed their higher-than-average rate of income on loans to the fact that they held a high proportion of small loans. While such loans are similar in character to consumer instalment paper, and carry comparable charges, many of them are not so reported, because they provide for repayment on

[43] There is an apparent contradiction in the tendency, found in some of the southern and western states, for banks with deposits of 10 to 50 million dollars to receive a lower rate of income from loans than banks of the same size in the eastern and northern states. This may be attributed, however, to the fact that in the south or west a bank of this size is likely to have a larger proportion of correspondent balances, and therefore to keep a larger proportion of its loans in low-rate commercial paper, than a bank of the same size in the east or north.

[44] Most states have maximum legal rates of interest prescribed by state law for state banks, and by federal statute such rates are applicable to national banks (*U. S. Code Annotated,* Title 12, Sect. 85; *U. S. Revised Statutes,* Sect. 5197). The legal rate is mainly about 6 percent in the eastern states; from 6 to 10 percent in the southern states; either 7 or 8 percent in the midwestern states; 10 percent in the western states; and from 8 to 12 percent in the Pacific states.

terms other than the usual equal instalments at regular intervals; this is for the convenience of the borrowers, mainly farmers, whose income is seasonal and erratic and not easily adjustable to instalment terms.

Another reason why such a relationship is not evident from the data is that if the commercial banks' loan-income rate is to be materially affected by the proportion of consumer instalment loans, that proportion must be fairly high and the rate on such loans must materially exceed the average on all other loans. In a great many instances these conditions are not fulfilled, and then other factors exert an influence strong enough to overshadow any definable relationship between rate of income on loans and the proportion of total loans represented by consumer instalment paper.