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# CONSUMER CREDIT FINANCE CHARGES

### Rate Information and Quotation

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### Contents

	ACKNOWLEDGMENTS	xiii
	FOREWORD, by Robert P. Shay	xv
1.	SUMMARY OF FINDINGS	3
2.	METHODS OF COMPUTING AND QUOTING FINANCE CHARGES	8
	Methods of Computing Finance Charges	9
	The Three General Methods	9
	Historical Development: Instalment Cash	
	Lending	. 9
	Historical Development: Retail Instalment	
	Financing	19
	Present Status	24
	Recent Legislative Trends	27
	Methods of Quoting Finance Charges	33
	Instalment Cash Lending	33
	Retail Instalment Financing	<b>35</b>
	Legislative Proposals for Uniformity in Method	
	of Finance Charge Quotation	36
3.	CONSUMER USES OF FINANCE CHARGE INFORMATION	39
	Measures of Credit Cost	39
	Finance Charges in Dollars	39
	Size and Number of Monthly Payments	40
	Computational Rates of Charge and Computational	
	Equivalents	41
	Finance Rates	43
	Multiple Effective Rates	44

viii		•		Contents

Influence of Finance Charge Information on	
Consumer Behavior	45
Finance Rate vs. Size of Monthly Payment	45
Use of Debt vs. Liquid Assets	52
4. PROCEDURES AND PROBLEMS IN CONVERTING EXISTING	
FINANCE CHARGE INFORMATION TO COMPARABLE FOR	мs 61
Converting Computational Rates (Equivalents) to	
Dollar Charges and to Monthly Payments	61
Converting One Form of Computational Rate	
(Equivalent) to Another	61
Converting Computational Rates (Equivalents) or	
Dollar Charges to Monthly and Annual Finance	ce '
Rates	62
Choice and Use of Formulas	62
Relevance of Ex Ante Computations	66
Graduated Rate Contracts	67
Treatment of Recording and Filing Fees	68
Treatment of Minimum Charges	69
Special Financing Plans	69
Meaningfulness of Retail Instalment Finance Ra	tes 73
Converting Finance Charges to Rates Comparab	ole
with Usury Ceilings	75
5. CONSUMER KNOWLEDGE OF FINANCE CHARGES	. 80
Illinois Survey	80
San Francisco Area Survey	81
Survey Research Center Survey	82
National Bureau-Consumers Union Survey	8 <del>4</del>
Concluding Remarks	. 89
APPENDIXES	
A. Effects of Different Methods of Computing Fina	
Charges on Maturity Patterns of Finance Charg	
B. Equivalent Effective Monthly and Annual Finan	
Rates Converted from Annual Add-On and Dis	count
Rates for Selected Even Monthly Payment Contra	act
Maturities	102

Conten	ix	
C.	State Supervisors' Opinions on the Ability of Financing Agencies to Convert Finance Charges	
	to Effective Annual Rates	106
D.	Prepayment, Refinancing, Extension, and	
	Delinquency	109
GLOSSARY		126
INDEX		129

,

.

## Tables

l.	Frequency Distribution of State Contract Usury	
	Ceilings and Method of Expressing These	
	Ceilings, 1964	10
2.	Allocation of Finance Charge Earned (Gross Revenue)	
	on a Hypothetical Loan Under Per Cent Per Month	
	and Precomputation	30
3.	Added Gross Revenue from Precomputation as a Percent-	
	age of Gross Revenue from Per Cent Per Month for	
	Selected Loan Sizes, Maturities, and Graduated Rates	31
4.	Disclosure Requirements of Consumer Financing Laws	
	and Disclosure Practices of Consumer Financing	
	Agencies and Sellers	34
5.	Fraction Accepting One or More Alternative Finance	
	Plans for Specified Variant Groups, Credit Users	
	Only	49
6.	Estimated Finance Rate and Monthly Payment Elasticity	
	of Demand for Households Classified as Rationed or	
	Unrationed on Three Bases	50
7.	Consumer Attitudes Toward Credit Users with Liquid	
	Assets	54
8.	Relation Between Personal Debt and Liquid Assets, by	
	Income Group, Early 1959	55
9.	Distribution of Personal Debt and Liquid Assets, by	
	Income Group, Early 1959	57
0.	Cumulative Percentage Distribution of Consumer Esti-	
	mates of Finance Rates on Auto Financing, 1959, by	•
	Selected Income Groups, and New-Car Instalment	
	Financing Rates, 1954-55 and 1959	<b>5</b> 9

Tab		X1	
11.	Relation of Average Operating Profit and Average	<b>5</b> .4	
10	Finance Reserve Per New Car Unit, 1950-59	74	
12.	Distribution of Effective Annual Interest Rates Paid,		
	According to Interest Rates Stated by Respondents, 1956-57	82	
13.	Distribution of Effective Annual Interest Rates	02,	
10.	Paid by Respondents on New and Used Cars, 1956-57	83	
14.	Distribution of Consumer Estimates and Actual Finance	00	
	Rates on Auto Financing, 1954-55 and 1959	84	
15.	Question 25A, Reinterview Questionnaire, May 1960,		
	Consumers Union Members' Panel	85	
16.	Distribution of Reported Annual Rates and Derived		
	Finance Rates by Amount Borrowed	87	
17.	Estimated Distribution and Mean Effective Rates of		
	Sample of Households, Classified by Rate Information		
	and Loan Size	87	
18.	Respondents Reporting 6 Per Cent, by Class Intervals		
	of Actual Rates Paid	89	
A-1.	Selected Computational Rates and Equivalent Effective		
	Monthly Finance Rates for Varying Maturities	93	
A-2.	Selected Computational Rates and Equivalent Effective	0.	
	Annual Finance Rates for Varying Maturities	97	
A-3.	•		
	Add-On Plus and Annual Discount-Plus Computational	00	
<b>B-</b> 1.	Rates for Varying Maturities  Equivalent Effective Annual Finance Rates for Selected	99	
1)-1.	Annual Add-On Rates with Varying Contract Maturities		
	and Even Monthly Payments	102	
<b>B</b> -2.	Equivalent Effective Annual Finance Rates for Selected		
	Annual Discount Rates with Varying Contract Maturities		
	and Even Monthly Payments.	104	
<b>C</b> -1.	· · ·		
		107	
D-l.	State Supervisor Survey Replies to Questions on		
	Prepayment Refunds	117	

# Charts

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	and the second of the second of the second	
ı.	Comparable Effective Annual Finance Rates for	
	Monthly Payment Contracts with 6, 7, and 8 Per	
	Cent Annual Add-On and Discount Rates, by	
	Maturity	64
A-1.	Effective Monthly Finance Rates Equivalent to	
	Selected Annual Add-On, Annual Discount, and	
	Per Cent Per Month Rates on Monthly Payment	
	Contracts, by Maturity	94

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#### Foreword

EARLY IN THE TWENTIETH CENTURY the form in which finance charges were to be disclosed became an important part of the discussions which led to the formulation of the Uniform Small-Loan Law, first drafted in 1916 by the Russell Sage Foundation. This period witnessed the development of the modern techniques of instalment selling of durable consumer goods and the growth of the institutions which today provide a wide variety of credit services to consumers under quite different systems of computing and quoting finance charges. This study by Wallace P. Mors traces the origins of the procedures currently in use, in order to show why the consumer is faced with varying forms of information. The author goes on to analyze and evaluate the usefulness of this information to consumer borrowers.

In drawing up plans for the National Bureau's current study of consumer credit, of which this report forms a part, the subject of consumer credit finance charges was given central importance for several reasons. First, there were no statistical series measuring changes in the cost of credit, although estimates of the amount of credit extended, repaid, and outstanding had been developed in earlier National Bureau studies and later extended by Federal Reserve System estimates. Second, there had been recurrent questions about the amount of consumer credit charges in relation to the costs of providing credit. It was known that consumer credit charges were higher than those in other sectors where the amounts involved were larger and the costs consequently lower. But without empirical measurement of the relation between consumer credit charges and their component costs, there was little basis for judging whether charges were excessive or not. Third, little was known about how

xvi Foreword

borrowers reacted to finance charges, and it was believed by many that lack of knowledge contributed to excessive charges and misuse of credit. Finally, there was the question of how different methods of quoting finance charges affected the ways in which borrowers used consumer credit.

The results of some studies designed to remedy these gaps in knowledge about finance charges have already appeared as National Bureau studies, and the remainder are nearing completion. The preliminary results of my work on automobile finance charges appeared as New-Automobile Finance Rates, 1924-62. Paul F. Smith's book, Consumer Credit Costs, 1949-59, revealed the relation of finance charges to component costs for four major types of credit institutions. Consumer Sensitivity to Finance Rates, by F. Thomas Juster and myself, showed that some borrowers are sensitive to changes in the rate of charge for credit, although relatively few estimate finance rates reasonably well. Finally, Mors's study provides a thorough analysis of the kinds of finance charge information given borrowers and its usefulness in helping to make rational credit decisions.

A major finding about the usefulness of finance charge information is that no one method of quoting charges conveys enough information about credit cost to satisfy all questions involved in credit decisions. Dollar charges, monthly or annual effective rates, and monthly payments convey valuable information, but the usefulness of each of these methods varies with different borrowing situations. As a further complication, Mors finds that state legislation contributes to a still greater diversity in information provided. He concludes that consumers do not receive easily comparable information from alternative suppliers of credit.

Mors' unraveling of the complexities in finance charge information—based on alternative mathematical formulas, legal and legislative factors, and a wide variety of credit transactions—should prove invaluable to those who seek to improve their ability to compare credit costs as well as to others who wish to evaluate the varied legislative proposals designed to expand or simplify the information given consumer borrowers.

Foreword xvii

The Consumer Credit Study was made possible by research grants to the National Bureau from four finance companies: Associates Investment Company, C.I.T. Financial Corporation, General Motors Acceptance Corporation, and Pacific Finance Corporation. These institutions are, of course, not to be held responsible for any of the statments made or views expressed in this study.

ROBERT P. SHAY
Director, Consumer Credit Study

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