NEWS RELEASE

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COMPETITION FOR THE CONSUMER BANKING DOLLAR

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before the

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COMPETITION FOR THE CONSUMER BANKING DOLLAR

Fifty years ago many of the instalment loans which now are handled as a matter of course would not have been considered proper for any commercial bank. Yet today we can come together to consider, not the "whys" of the operation, but the fact that there is now a tremendous competition within and without the banking industry for such loans.

That competition is growing. All the facts suggest that as we enter the 1970's and as the population continues to grow consumer credit needs will expand. Competition to fill those needs will grow perhaps at an even greater pace.

It should be helpful to pause for a moment and ask ourselves why that competitive pattern is developing, where it is coming from, what pitfalls we may have to avoid, and how we can best serve the public, our banks, and the nation in administering consumer credit operations.

The forms of competition are two-fold. There are those generated within the industry as bankers compete with each other for customers, and as banks seek to cover higher costs of money due to higher rates paid on savings funds. There are external pressures, at least in part relating to that same cost of money factor, which are leading other industries to enter, or to seek to enter, this instalment lending field.

Perhaps these pressures are leading to excesses in instalment lending totals and personal debt loads on individuals. We do not have enough data for this relatively new industry to say with assurance that this is so -- but I would urge that the over-all competitive position and the historic highs in instalment loans outstanding suggest bankers exercise care and a dedicated effort

to serve the customer in all lending operations. Now is the time for lending policies which are beneficial to the borrower, not burdensome.

Consumer credit operations, the making of instalment loans, is a relatively new device. Shortly after the turn of the century Arthur Morris began his Morris Plan banks, the first to make small loans to individuals on a character basis as a regular banking operation. At about the same time, some 3,000 miles away, A. P. Giannini began similar operations in the then-small Bank of Italy. It was not, however, until the late 1920's that any larger money center type of banks made instalment loans to average customers, and the full growth of consumer credit operations did not come until after the end of World War II. In 1939, for example, the total instalment credit outstanding was only $4.5 billion for all operations including retail store credit, and during World War II this total shrunk to only $2.5 billion. The tremendous demand for goods and services unleashed after the end of the war, combined with new banking techniques, combined to send lending figures up to record highs, which are being exceeded every year and which will, I suspect, continue to mount as long as the economy remains healthy.

Consumer credit banking has, of course, been a major factor in permitting the average American to acquire major hard goods, such as automobiles, through payment out of current income rather than through savings. It has permitted the growth of mass markets served by mass production, and in a sense, mass credit operations.

In this development banks have been leaders. Whereas in 1939 bank holdings of instalment credit comprised about 25 percent of the total volume, by 1950, banks had 39 percent of that market. Since that time, however, banks have grown in volume as the total volume grew, and bank percentages have not

risen significantly. Banking has been holding its own, in an intensely competitive atmosphere. This suggests that it will be difficult to increase the banking share, although as consumer credit borrowings rise so will bank totals. It also suggests that bankers will have to be competitive just to maintain the existing share of the total "pie."

Proof of this competitive pattern can be found by comparing recent bank gains with those registered by just one competitive force in the field -- the sales finance companies. From the end of 1960 to May, 1964, banks showed a gain from $8.1 billion to $11.9 billion in automobile paper, compared to sales finance companies gains from $7.5 billion to $8.4 billion. The bank figures look good. On the other hand, sales finance companies posted better gains in financing of "other consumer goods," to actually pass bank holdings. Banks gained from $2.7 billion to $3.1 billion, while sales finance companies went from $2.7 billion to $3.5 billion. And in the area of personal loans, while banks were and continue far ahead, the sales finance companies gains were far larger on a percentage basis: banks rose from $3.5 billion to $5.1 billion, while sales companies went up from $1 billion to $1.8 billion.

In repairs and modernization figures banks maintained a dominate position, with gains from $2.2 billion to $2.3 billion, compared to $139 million and $149 million, respectively, for the sales finance companies.

Those figures can be called a stand-off. They emphasize the fact that other lenders, such as credit unions, retailers, and consumer finance companies, are not leaving the field to banking alone. Public demands are there, and credit needs must be met.

This school is one outstanding proof that the banking industry knows that these demands must be met. The activities of the Consumer Bankers

Association show that senior bank management is aware of the tremendous importance here and now of sound instalment lending operations for the consumer. More and more wholesale banks in recent years have added substantial retail operations to their activities. Recently the New York State Bankers Association added a new division to its structure, to be known as the Instalment Credit Division. The various state and national conferences on instalment credit also emphasize the importance to banks of consumer credit.

This is as it should be. The figures I have cited, together with a few more, show the importance of this field to banking. As of now private debt is reported to be at $752.8 billion net, with consumer instalment debt at $55.1 billion net, and with commercial banks holding $22.5 billion of this latter figure.

Recent developments have heightened the drive for consumer instalment loans. In 1963, the figure rose $5.7 billion, the highest ever recorded in history. The rising trend of family formations, the entry into the buying market of the World War II and immediate post-war "baby crop," the need for replacements for the massive durable goods and automobile purchases of the early and mid-1950's all helped develop the biggest market in history.

Working from the other side, one of the biggest spurs to increased instalment loans to the commercial banking industry has been the cost pressure created by the increase in interest which could be paid on time and savings deposits. Revision in 1962 and 1963 of the Federal Reserve Board's Regulation Q and of the Federal Deposit Insurance Corporation's Regulation 329 created an earnings pressure on the industry and stimulated the desire to move more funds into such areas as mortgage lending and consumer instalment lending. As savings

and time funds have flowed into the banking industry, the amount of funds available for instalment loans has risen sharply. This, of course, has sparked an intense competition within the industry for such business, and many banks which have in past years been somewhat hesitant have been entering the business. Additionally, new banks have been chartered, some for the expressed purpose of entering the retail field, especially in the instalment lending area. As an example, we recently approved a bank for insurance in the Southwest, located in the heart of a large city, which planned a completely retail business, rather than the business-retail-correspondent approach of the existing banks.

As the greatly heightened flow of savings funds in the past three years has spurred commercial banks to greater instalment lending activities, it also has sparked strong desires from presently non-competitive organizations to enter this field. Both the savings bank and the savings and loan industry have made it abundantly clear that they would like at least limited instalment lending powers to consumers which go beyond their traditional home financing powers and, in a few instances, passbook loan authority. In one instance, the push has been extended to a desire to make signature loans not secured by durable goods collateral, although the greatest pressure is for the power to make loans on durable goods traditionally associated with home ownership, such as refrigerators, washing machines, and the like.

The thrift industry's drive to broaden their powers stems from the over-all pressure created by sustained savings gains, relatively high dividend rates, which in part may be responsible for the savings gains, and the increased activity of commercial banks in the mortgage field. As the primary lending area for thrift institutions, they feel any pressure in the home mortgage field

acutely, and many of their leaders have felt that at least limited entry into the instalment lending field would enable them to put savings gains to work, earning dividend funds.

Make no mistake, the thrift industry does intend to seek entry on at least a limited basis into the consumer instalment lending field. As long ago as 1962 this became abundantly clear. In October of that year M. L. Dye of Salt Lake City, then president of the United States Savings and Loan League, declared that the savings and loan industry would have to "do considerably more" in several areas, notably in "major improvements that are handled by a new mortgage or by the extension of an open-end mortgage, and small improvements handled by an unsecured loan."

That same year one industry regulator declared that "to the extent that a home is not just a building but a combination of a structure, furniture, appliances and other equipment, consideration might be given to permitting associations to lend to consumers for these needs as well."

One veteran legislator, long a friend of the savings and loan industry, has said, "I would like to see your lending authority broadened in several respects," one of which, he said, was to "permit your financing of the other consumer durables which are necessary to make a house a home." He added, "I would like to see your lending authority broadened to permit you to finance all kinds of consumer durables -- home appliances, home furnishings, and the family automobile."

Some of you will be familiar with the New York State drive by both the mutual savings bank industry and the savings and loan industry, launched in 1962, at hearings held in Albany before the State Legislature. This may seem

to be ancient history, but it isn't -- the drive still continues..

At that time the New York State savings bankers, through their trade association, asked for a four-point expansion of powers, the second of which was a personal loan service. At the same hearings, the savings and loan trade people urged the privilege of making personal loans. They asked for a modest beginning, with a ceiling of $500 for a period not to exceed 25 months at a maximum rate of 6 percent discount.

These drives not only are being continued in New York State, but have been pressed on a national level. There is a measure pending in Congress now, H. R. 9609, which will permit savings and loan associations to make home improvement loans. More significant is the Federal mutual chartering bill, H. R. 258, containing a clause which in effect would permit all types of instalment loans, secured or unsecured. These broad provisions are not accidental; the thrift industry faces the same problem commercial bankers do, of excess savings funds which must be invested in relatively high yield loans and mortgages and portfolio investments, such as municipal obligations.

These drives can be expected to be continued. Consumer credit bankers should be aware of these pressures, both within and without the industry, because they have been a fact of life for the past three or four years and will continue to be a fact of life for some time.

At the same time a note of caution is in order; these pressures, and some loose practices resulting from them, are developing a debt pattern which some find disturbing. Last year instalment debt rose $5.7 billion, to a figure more than double that of the 1953 period, from $23 billion to $54 billion.

Instalment credit's growth has far outstripped both population growth

and disposable personal income growth. In the ten-year period ending 1963, population went up 18 percent, disposable income 59 percent, and instalment credit a whopping 130 percent.

Springing from this fact, that instalment credit is growing faster than the income from which it must come, are a set of figures showing just how Americans are spending more of what they make solely to pay off instalment debt obligations. In 1953, consumers spent 11.1 percent of disposable personal income for instalment debt payments, while by the end of last year they were spending 13.7 percent.

The total amount spent on consumer borrowings of all kinds, from the single payment loan, instalment payment loan, retail service charges, through mortgage payments, now is 20 percent of disposable personal income, compared with only 15 percent at the end of 1953.

It is hard to say whether these figures suggest that these levels are healthy or unsound. The experience in the field has not allowed for the accumulation of enough data to pin down answers, especially as the short time span during which consumer credit has been an important factor in the economy was interrupted by a major depression and a major war.

We do know that personal bankruptcies are rising alarmingly. This may represent unsound credit practices, and in some cases does represent poor controls over credit. But it is a moot point whether this bankruptcy rise is a sign of weak credit practices and overextension of the credit system, or a loosening of the moral fiber of too many individuals. Are these bankrupts people who have been, through unwise instalment credit grants, pushed too deeply in debt? Or are they people who have built up heavy debt pictures, and rather than apply some old-fashioned restraint and self-discipline to correct the situation, take the easy way out? Just how much of a warning these increasing bankruptcies are is

difficult to say. It can be said with certainty that they do warn instalment lenders to stress the elements of character in making commitments, especially in any instances which are financially marginal.

There are, of course, good aspects to this whole picture. For one thing, while instalment debt has been rising, repayment figures have also gone up substantially, so that over-all loss figures have remained rather stable.

In a nutshell, it can be said of instalment credit that it has contributed mightily to the growth of the American economy and the ability of the average American to enjoy the production of that economy. Many pressures combined have created an intensely competitive instalment credit field, and some industries not now in the field seek to get into instalment lending, so that the competitive aspects can be expected to increase in future years. Partly because of consumer demand, and partly perhaps because of these competitive pressures, instalment debt figures are rising sharply to new highs, and are taking more and more of the disposable income of the average spender. Whether a plateau has been reached or whether these figures can go even higher is problematical, because new ground is being plowed, and historical guidelines have not been formed as yet.

All these facts taken together create a climate, I think, in which the instalment banker must exercise redoubled caution, must sharpen his bankers' tools, and avoid the abuses which can infest any industry. Gimmicks like special deals should be watched carefully. Reduced dealer reserves, free services which eat into profit margins and which cause a stretch-out for marginal paper do not seem wise, at this or any time. Pyramiding of debt for the individual is a constant danger for which to watch out.

Perhpas we can set this whole problem in another perspective. After all, for the individual banker, statistics in this area are not always the criterion.

The rate of total debt to income may be excessive, but to the banker making such loans on a day to day basis it should be the position of his own individual bank, and the individual customer, which should be the deciding factor.

Sound banking practices suggest that the industry, at least, can assure the continued health of consumer banking operations if one simple rule is followed Each consumer credit application should be looked at as an individual case, with continued emphasis on character, the capacity to pay, and the credit record of the individual. These have been rules of thumb for so many years because they are good rules.

The private debt and debt versus disposable income figures are not too high if the loans they represent are good for the person making them and he can discharge them, and if they are good loans for the bank -- which means loans which will be paid off.

The banker is derelict if he leads the borrower down the primrose path to insolvency, but if loans serve constructive purposes and do not create economic difficulties for the borrower they should not serve to add pressures to the economy and the debt picture.

Isn't it fair to say that the consumer credit banker more than any other lender should function as a budgeting aide to the borrowing customer? If the industry operates with that thought in mind, then it can be said that the banking industry will, notwithstanding apparently high bankruptcy figures and large debt ratios, be a vital aid in helping to keep the American economy viable and healthy. By lending an experienced hand to mass consumer credit facilities, which in turn, facilitate our mass production, our mass distribution, and our mass consumption, bankers can strengthen the American economic base and contribute to the bright future for which we all hope.

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