

For Release on Delivery:
7 p.m., Eastern Standard Time,
Wednesday, October 19, 1955

HUMAN TRUST CERTIFICATES

Remarks

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Member, Board of Governors
of the Federal Reserve System
before
8th District Group
Georgia Bankers Association

Valdosta, Georgia

October 19, 1955

Dinner Meeting, 7 p.m., E.S.T.

The ease with which the American people have changed by peaceful means the social pattern and economic policies of their country without changing the basic form of its government should be a source of great pride and confidence to all of us.

After 168 years of hard usage, the Constitution and Bill of Rights are still intact, remarkably alive and steadfast in sustaining the concepts of individual freedom which they cradled. Our Government continues to maintain an effective separation of its three primary divisions, legislative, judicial, and executive, with each properly jealous of its own prerogatives.

Within this constitutional framework, however, there have been constant adaptations in our concepts of citizenship, of the freedom of the individual, and of the entitlements of all people to share the necessities and luxuries of life. Through constitutional procedures as well as economic change, the ordinary individual today has privileges and opportunities of which he hardly dreamed in the early days of our Government. He enjoys educational and health benefits, unemployment and old age security, physical comforts, mechanical luxuries, and dietary delicacies that were not even figments of imagination to the great numbers of our people during the early years of the Republic.

These changes have been brought about by a comparatively rapid process of public opinion generating public demands which have been satisfied at the national level by successive Congresses through legislative

enactment. It seems a routine American custom to belittle the Congresses in session during one's lifetime. But those who take time to study our political history are forced to the conclusion that on the whole our Congress has been composed of patriotic, wise, and farsighted individuals. They have been and are today, typical representatives of the American people. More often than not they are a distinct credit to the people and to the Government.

Having been in and out of Washington for more than fifty years and having worked on the inside of about a dozen sessions and observed about twenty-five, I have much more faith in these Congressional bodies than many people have. Far from becoming discouraged and embittered by the weakness of a few individual members, my faith in Congress as an institution has been confirmed and strengthened.

I am going out of my way here to express this considered opinion of Congress in the hope that, when some enactments are proposed in the next decade which I feel sure will be proposed that memory of this evening may cause you to pause and think before speaking or acting. If you do, I believe you will be objective, impersonal, and wise in your conduct and analysis. Try to help the Congress instead of condemning the few individuals who propose offending measures. Remember, they are probably just as sincere as we. And undoubtedly they are much better informed than we as to what the people want.

Tonight, let's talk briefly about one area of prospective enactment which may be prompted by two changes in our credit system, changes that

have been most upsetting to our traditional notions of proper personal financial arrangements and which seem destined to affect further the relations between our Government and the individual citizen. As with most other adaptations that have brought about an extension of the role of Government, these changes have developed gradually among the people. And like other changes in the past, a point of development will be reached when their public interest aspects will have to be recognized by the Congress.

It may be interesting to note here that nearly all major changes in financial customs effected by Congress in the last forty years--especially those from which the economy has derived greatest benefit--have been opposed by bankers. A banker since 1920 and a banker's lawyer before that, I know whereof I speak.

Bankers are not always wrong even though they usually, and quite naturally, dislike any change in the status quo. When the Congress had before it such questions as the establishment of the Federal Reserve System, the Federal Housing Administration, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, opposition by bankers was widespread, loud, and long.

It is to be hoped that bankers will continue to oppose any change in the status quo that looks suspicious or unsound to them. Opposition and critical analyses usually prove helpful in the drafting of far-reaching legislation and is especially important where effects of the enactments on the people will be lasting. Therefore, I say to you, keep up your guard;

continue fighting for what you think is right. Let nothing go by unquestioned. Of one thing you may be certain--if the legislative proposals are good for the country and are really required and demanded, they will eventually be enacted into law whether we oppose or favor.

I say this because the American people who hold the ultimate destiny of this country in their own hands are today better educated, have a clearer understanding of their Government, and are in a stronger position to demand and accomplish what they want from Government than ever before. In today's environment, no political party or administration can ignore for long the well formed, definite demands of the people.

As in politics, where the people have largely superseded party bosses, so in the credit field individual buyers and borrowers have largely superseded the production man and the banker as the initiator of credit, both as to type and amount. The individual consumer has become the dominating influence in our entire credit structure. Today, his short-term, instalment and mortgage obligations account for approximately 45 per cent of all private debt.

Thirty or more years ago when the idea of consumer credit began to dawn on buyer and retailer, financing facilities for fulfilling their needs were almost nonexistent. Commercial banks either failed or refused to anticipate the rising demand. As a consequence of this failure, small loan companies, Morris Plan Banks, industrial banks, credit unions, and sales finance companies came into being. Almost before we knew it, there

developed a full-fledged industry outside the commercial banking field, rendering helpful service to borrowers who were not welcomed at most commercial banks. The service was constructive, even though often times performed at a cost excessive to the individual borrower, with a resultant excessive profit to the lender.

By the late Thirties, the consumer credit industry had become well organized and was dominated by a wise, alert, and responsible leadership. And, in 1945 on returning from four years' over-seas duty with the Amphibious Navy, I was much encouraged by the improvement in personnel and the change in their concept of the business and of their community responsibility.

So much did this impress me, that soon after becoming a member of the Federal Reserve Board in 1946 I talked with a group of Morris Plan bankers at Virginia Beach and made complimentary remarks about this type of credit and about its growing importance as a necessary element in our economy. I expressed hope that misconceived regulations, such as "W," would soon be eliminated and that instalment credit would be allowed to expand as required by people and industry. Those remarks brought down on my head a good deal of criticism--even ridicule.

Since that time a great lifting of animosity to consumer credit has taken place. My statements then were based on a feeling of confidence in and respect for the mass of American citizens, and a strong but unconfirmed feeling that the old order was changing. For four years I had been

living in close contact with hundreds of young men in the Army, Navy, Marine Corps, and Coast Guard, in Europe, in Africa, and the Far East. Most of these men were from fifteen to thirty years my junior. It was the first time that I had had direct association with groups of young Americans since World War One, and the experience forcefully revealed to me, as a matured lawyer and banker, how completely out of step and how far behind the times I was with this group of dynamic, fearless, demanding, and patriotic young men. As an executive officer partially responsible for their welfare in and out of combat, I not only came to know them well but to realize that America was safe in their hands; that neither Germans, nor Italians, nor French, nor Japanese, nor Russians could stop them; and that they would not long be led astray by domestic quacks.

What was most significant to me was the realization that this group believed America belonged to them, that they were determined to run it as they thought it should be run. They were not going to be restricted or limited socially or economically by past, strait-laced concepts of government, sociology, finance, or personal conduct. Above all, they held a conviction that Government and the economic structure should serve them as well as be served by them.

Since the war I have been in a position to watch these men in all sections of the United States. The conclusions to which I came while on active duty with them have been forcefully confirmed. Those boys, as we called them ten and fourteen years ago, and their wives, are the people

who are now running this country. They are making a good job of it, too. And even though my basically conservative leanings cause me to disagree with much that has taken place, I am satisfied, from their conduct, that if the Government and the banks and other industries do not operate so as to benefit the largest number of people in the largest number of ways, then they are going to change the Government, or banking or other business to fit their aspirations. And who are we to say they would be wrong?

My point is that, as an aftermath of three wars and the impact of the military draft on millions of our young people, we have actually become a much truer democracy, while retaining the original framework of a constitutional representative government. Our broad and highly accelerated educational program and our rapid communication systems, both contribute to the immediate and increasing influence of popular opinion on government-- on all three of its divisions with equal force. The trend is definitely toward more control by the people. In spite of what our desires and opinions may be to the contrary, our government and major industries have had to become more directly responsive to the needs, desires, and aspirations, of the people.

I stress this theme of today's role of government with particular reference to consumer lending, because this business, in the nature of things, is tinctured with a strong color of public interest. At the present time, about sixty per cent of American families use consumer credit. With

this many users, the figures on the current volume of consumer credit, on the terms of such credit, and on the characteristics of consumer debtors are naturally items of front page news. The public likes to read about and talk about consumer credit because when so doing it is really reading and talking about itself. It is a subject most of them know about from personal experience--usually in from 18 to 36 allegedly easy lessons.

Time was when a man who financed luxury expenditures on credit was considered stupid and unreliable; but now one who refuses to capitalize on his potential and confines himself to financial actuality is the unusual case. The typical instalment borrower today is not an improvident man with small income. He is chiefly an urban or suburban dweller, is generally above twenty-five and under forty-five years of age, is married and has children to support, has an average income of about \$5,000, and often has sizable financial assets. He is the man I referred to earlier--the man who will not be stopped by foreign foes or domestic fogeys. He has committed himself to a regimen of small monthly payments for the purpose of acquiring an equity. To him these payments are essentially savings. And when you stop to think about it, what more sensible use of savings is there than their purposeful application to an improved standard of living for the saver himself and his family? This is investment in life itself.

As an investment banker and broker years ago I became familiar with Equipment Trust Certificates and regarded them as amongst the soundest forms of investment. As you know, the equipment trust certificate

is predicated upon a chattel mortgage on equipment and the corporate note of the borrower; and maturity is based partially on the operating life of the equipment.

Consumer instalment credit paper, in my opinion, finds a close parallel in equipment trust paper. Consumer instalment notes might well be termed Human or Consumer Trust Certificates.

They differ from the Equipment Trust Certificate in that chattel on a physical asset is not an invariable requisite of the transaction. In consumer lending, transactions vary one from another in the importance of the security versus the credit component. In many cases the financial strength of the borrower is so buttressed by employment and residential stability, as well as proved credit worthiness, that loans can be extended on general credit standing alone. In such cases, a life insurance policy, and other reinforcements, are often part of the credit picture. The lender achieves his diversification of risk by lending many small amounts to many different people in diverse occupations and different localities. The amazingly low percentage of delinquencies and repossessions certainly attest to the wisdom and safety of these Human Trust Certificates. To my mind, when properly handled by lender and borrower, these certificates constitute one of the soundest and most constructive types of credit offered today.

With sixty per cent of American families using consumer instalment credit, even though the total of such credit is only about \$26 billion as

compared with \$84 billion for housing and \$30 billion for commercial bank business loans, I venture the thought that this \$26 billion of consumer credit has a more influential impact on the overall credit structure today than any other form, both as an indicator of its soundness and as a fore-caster of future commercial activity. Its importance to industry is apparent from the fact that about 65 per cent of all automobiles and about half of all major appliances are now sold on credit; and instalment credit alone provides about \$20 billion a year for these purchases.

Without consumer credit, it is now generally admitted that mass production would be impossible. Without mass production, mass employment would not be possible. Without steadily increasing employment opportunities, the provisions of the Employment Act of 1946 cannot be carried out.

In other words, continued high level employment is largely contingent upon the full use of a sound and steadily expanding system of consumer financing; and the liquidity of consumer credit is heavily contingent upon a sustained high level of employment. Thus, this form of credit, probably more than any other, becomes a social as well as a financial problem.

Housing credit is also a social as well as a financial problem. In recent years home construction has virtually attained a mass production and distribution phase. Today over four-fifths of all homes, both new and existing, are purchased on amortized mortgage credit. Most of you bankers felt as I did about the too liberal terms of the housing program--

no down payments and too-long maturities. However, after thinking the matter through, I am--reluctantly and to my own surprise--not nearly as unreconciled as I once was, and mainly because of its social aspects.

Of course, the combination of down payment and maturity terms in housing credit can be too liberal and risky for a prudent lender position, just as consumer instalment credit can be unsound. But the record shows that even under liberal mortgage terms, defaults have not been excessively large. Our test of the amortized mortgage is only two decades long, but it has proven economically sound, on the whole, to make homes generally available to deserving people on terms much more liberal than were known in the first 140 years of this Republic. The mere fact that people may be able to make only a small down payment is not of critical importance if the transaction is written on a basis that enables some building up of equity within a time that is reasonable in the light of the occupation, age, and earning circumstances of the borrower, and the serviceability of the housing property.

The compensating social gains of liberal mortgage terms have been enormous. By moving a man into his own home, even though his down payment has been small, the big gain has been in converting that man and his family from renters, itinerants, or boarding house lodgers into a stable unit of population and of the labor force. It has given him an opportunity to become a responsible citizen, a part of his community. He

has acquired the pride of ownership and all of its appeals to his better senses. Every monthly payment on his home has tied him to his community and to the stable values of life. In place of the monthly rental payment which he regarded as a penalty, he is now making a monthly deposit to his good living account, an increasing portion of which goes into the property as a form of savings. In other words, he is progressively made into a man of estate, a substantial permanent resident taxpayer.

But the best social and economic effect derived from this permanent residence and home ownership is the influence which it has on the individual's children. Even if the man personally fails to appreciate the potential goodness of his position, it is hardly likely to be missed by the children. Allowed to live in the same community for a series of years, to attend the same schools, to form social contacts and friendships with children of other home-owner citizens, they certainly have a greater social and moral potential than have the children of itinerants.

Consumer instalment and housing credit are the most popular goats of people who want something to kick around or who are interested in distracting attention from abuses in other credit fields. I have tried to present a picture of these two credit structures for you, not that they are what you and I may like, but simply as they exist today, and to emphasize the high degree of the economy's dependency upon them. You may want to think seriously when it is next proposed to limit too rigorously the terms of housing credit or to arbitrarily restrict consumer credit. My belief is

that from now on these credits must be given at least equal consideration and respect with the several other types of bank and commercial credit.

Of course, in a grave national emergency, all credit has to be strictly limited, but only as a temporary part of a complete blanket of controls that are discarded once the emergency is past. Normally, the traditional means of regulating the total availability of credit are sufficient for fostering stable financial growth. And the distribution of our credit resources among competing uses, including consumer and housing credit, should be left to market forces.

I hope that you will not let your reactions to some flamboyant advertisement as to terms by some overly aggressive retailer, builder, or lender blur your vision of consumer credit and real estate credit; but, rather, that you will look at these two types of credit as important solvent units in our financial structure and as great contributors to our social and moral advancement. It is seriously important that you bear in mind that all bank credit is to a considerable measure dependent upon these two categories for liquidity and ultimate soundness. Our overall credit structure is simply too irrevocably interdependent for this not to be true.

We all give lip service to the objective of economic growth and we give unctuous endorsement to private enterprise and private spending as the basic driving forces in providing such growth. But many bankers and businessmen are alarmed at the prospect of a larger amount of consumer

and housing credit. Those who have this reaction need to give a lot of thought to the question: Just how are we going to realize this desired growth for the economy if we do not have a long-term, orderly, and sound expansion of consumer and real estate credit? We must have this credit expansion if our economy is to grow on the basis of private spending. We should have no fears about it; we should welcome it and nurture it; and we must make it safe. Our only concern need be that lender risk shall continue on the prudent side. And this may mean at times that by voluntary action we must slow down a too rapid expansion of these credits. Bankers, more than any other group, can exert constructive influence in that direction and make Federal interference and dictation of terms unnecessary.

As time passes, you may expect the Government to take cognizance of consumer credit as it has of home mortgage credit. Many of you present will probably still be actively engaged in financial work when Congress is called upon to enact legislation relating to it. I do not pretend to see now the shape of such legislation, but I should not be surprised if it is patterned after the Federal Home Loan Bank System, and has a three-fold objective: first, to regulate, not with a view to limiting the amount, but rather with a view to making consumer credit extension and expansion more uniform, and to keeping it prudent and healthy; second, to make funds available to individual borrowers at less cost than is now necessary in many instances; and third, to assure a steadily expanding flow of funds from private lenders into consumer financing.

I fully understand why the thought of such Congressional enactment is distressing to some of us but, as I mentioned earlier, Government today must be responsive to what the people want.

So, in closing, I ask you not to let the walls of your banking house, or the curtains at its vaulted windows keep from you the sound and sight of the obvious requirements and demands of the people and the industries whom you are chartered primarily to serve. Try to guide their thinking and actions along sound social and economic lines. Bear in mind that this post-war population is probably more capable of thinking through on its requirements than we of the pre-war generations. Remember always that you cannot whip something with nothing, and when proposals are made with which you cannot agree, try to come up with some reasonable and constructive compromise or substitute.

As to consumer and housing credits, I am convinced that the public requires and demands them. So, as a final word, don't be shocked or surprised or too upset when they get more of the same--under the benign guidance of a paternalistic government--ever looking to the welfare of its people--and to its own bureaucratic salvation.

I leave with you the motto of one of America's most helpful citizens and undoubtedly its best salesman--Thomas J. Watson of IBM--a really great man who wisely emphasizes one big important word--THINK.