FROM:
THE AMERICAN BANKERS ASSOCIATION
THE NEWS BUREAU
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RELEASED FOR P.M.'S
TUESDAY, MAY 14, 1963

ADDRESS OF M. MONROE KIMBREL

President of The American Bankers Association, before the 72nd Annual Convention of the Illinois Bankers Association, Pere-Marquette Hotel, Peoria, Tuesday, May 14, 1963. Mr. Kimbrel is chairman of the board, First National Bank, Thomson, Ga.

This job of being president of The American Bankers Association is very educational, especially at this time of year. For example, my knowledge of geography has been improving tremendously. Then too, after this round of spring conventions I should know enough about air line schedules and routes, and train schedules and hotel accommodations to set up my own travel agency. It does, I admit, have a few drawbacks. For instance, I find that in attending six state association conventions in one week, I end up reading a different newspaper every day. The unfortunate part of it is that no two papers carry the same comic strips and you all know how easy it is to get behind.

The papers have, however, been fairly consistent in recent weeks on two subjects. First, the White Sox and the Cubs have been receiving a lot of favorable publicity for winning more than their share of ball games.

The second subject is much more serious and I would like to spend these next few minutes discussing it with you. It is the attention being given to the reported deterioration of bank credit standards and the liberalization of bank terms.

I am sure that many of you have been, to use the words of President Kennedy, reading more but enjoying it less. There have been reports about

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increases in mortgage foreclosures, greater risks involved in automobile financing, and allegations of lower bank credit standards in general.

Bankers here in Illinois are facing the same problems as bankers all over the country. There is an abundance of loanable funds. Your time deposits are costing you more than they did two years ago. Loan demand is good but it cannot be considered heavy. Corporate borrowing has not shown any tremendous growth, partially because of the increased cash flows to corporations. Yet, banks with plenty of high-cost funds are under pressure to invest them in high-yielding assets. Two areas which have become particularly attractive have been mortgage lending and instalment credit.

Let's look further at these two types of credit. You didn't have to be in the mortgage lending business right after World War II to know that there was a tremendous backlog of demand. Many of you were probably helping to create the demand. Nor did it require any particular degree of wisdom to know that inflation would boost the price of the house. These two factors combined to help reduce some of the risk in mortgage lending.

But, as you know, the scene changed drastically in the late 'fifties. Supply was catching up with demand and many people who had conditioned themselves to take inflation for granted were sadly disillusioned. Foreclosures have been on the rise. During 1962, total foreclosures on all types of mortgages, conventional and insured, topped 86,000. That figure is almost double the number of foreclosures in 1958. Moreover, foreclosures have shown a steady rise since 1952.

In January of this year, the Federal Housing Administration made a study of foreclosures. In the foreword to the study, the Commissioner of F.H.A. said:

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"I believe the greatest significance of this study is the emphasis on the dramatic changes that have occurred in the housing market in recent years, and the added emphasis this new condition places on sound, careful mortgage underwriting and risk evaluation. Supply has caught up with demand; the housing market has become increasingly competitive; inflationary equities have been reduced. At the same time, mortgage terms, both conventional and insured, have become increasingly liberal. The unreal and virtually foolproof conditions that have, until recently, prevailed in the housing market were likely to lull even the wisest men into complacency."

The study produced some interesting findings. The rise in defaults has been persistent since 1957. A high percentage of home properties acquired by F.H.A. were insured within the preceding three years. "Homes of low value had a higher acquisition ratio than homes of higher value . . . mortgages with low down payments had a higher acquisition ratio than mortgages with a higher down payment . . . the acquisition ratio for longer term mortgages was higher than for those with shorter mortgages. . . ."

In investigating a sampling of foreclosures, the study showed borrower ratings for acquired properties were generally low, and new credit reports showed that 29 per cent of the loan applications would have been rejected if the original credit report had been accurate and complete.

The study did, however, show that banks had a lower record of acquisitions than some other lenders.

Last week at the Mortgage Bankers Association meeting, George W. Mitchell, member of the Federal Reserve Board, said, "I think we are all aware of the caution signals blinking in real estate finance. . . . For the custodians of the public's savings, our changing economic and real estates environment calls for both prudence and caution."

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He said with the increased competition there is evidence that credit standards have been giving ground.

While there is cause for concern, there is no need for alarm. Total foreclosures on all types of mortgages are still only 4.12 per 1,000. However, it is significant to note the general trend. Foreclosures showed a steady decline from the high of 252,000 in 1933 to a little over 10,000 in 1946. Since then, with the exception of 1951 and 1952, the number has been going up and in recent years has shown a more striking increase.

Now many observers find it very easy to sit back and blame monetary authorities for the loosening of credit terms, but in my opinion this oversimplifies the problem. Monetary authorities have maintained a policy of relative ease for roughly three years, and it is understandable that the abundance of loanable funds should have encouraged banks to be more aggressive in seeking profitable outlets.

Nevertheless, while the monetary authorities have ultimate control over the supply of bank credit, they do not assume primary responsibility for the allocation of this credit among private borrowers. They do not tell us how to put credit to work. They do not tell us how to appraise real estate values; they do not tell us how to select borrowers. They do not tell us what the downpayment or the terms of the mortgage should be. More importantly, I don't believe anyone in this room thinks they should.

I mention all of these trends for two reasons. First, they have been receiving a lot of publicity in the newspapers and magazines. And regardless of policies and practices in your own bank, the publicity can do nothing but hurt the reputation of all banks. My second reason is that more and more banks are entering the mortgage business. I would hope that newcomers to the mortgage field would exert the extra effort necessary to get their operations off on a sound footing. The mortgage lending business can be a very profitable



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means of increasing your net earnings. At the same time, the demand for housing in the future will be increasing. Sound banking practices, established now and maintained as you build a mortgage portfolio, will put you in a better position to take advantage of the increased demand.

Now, what of the instalment credit situation? There has been evidence in many sections of the country of easing of terms. This, of course, means a lowering of the quality of bank assets.

Last month at the Instalment Credit Conference in New York, the A.B.A.'s advisory board on instalment credit reported evidence of disquieting trends. Particularly in the Sixth, Seventh and Eighth Federal Reserve Districts, the advisory board noted a pronounced tendency to lengthen terms on automobile credit. The long-established 36-months maximum has been breached by 42-and 48-month contracts.

The report also stated that among consumer lenders, commercial banks have been most aggressive in offering the longer terms. The manufacturers and dealers are well aware that longer terms hold the buyer out of the market for a longer period, and the major finance companies are especially mindful of the added risk involved.

The big problem, of course, is that on the typical 36-month contract, the new car buyer generally doesn't have any equity in the car until after 22 months. When terms are extended to 42-months, it is often 26 months before the buyer has any equity, and on 48 month-terms, it may take 31 months before the buyer owns as much as a wheel.

One large bank made a study of repossessions during 1962. It had six repossessed units per 100 contracts. On the average, four of the six were cars financed on 36-months; one was on 24-month-terms and one a 30-month contract. The repossession losses on the cars were $25 on the 24-month contract,



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$180 on the 30-month contract, and $300 on the 36-month contract. The total repossession loss for six cars was $1,405. This amount is the equivalent to the finance income for twenty-seven 12-month contracts; eighteen 18-month contracts, fourteen 24-month contracts, eleven 30-month contracts or nine 36-month contracts.

If you assume the net profit is $250 on a new car sale, a dealer would have to sell one new car to make up for each car repossessed. If the cars financed at 36-months were financed for 42-months the loss of six cars repossessed per 100, on the average, would be $1,805. Assuming the same variable net profit of $250 on a new car sale, the dealer would now have to sell four new cars for every three repossessed to break even.

The bank concluded that 42-month terms generally appeal to buyers who are overfinanced and to weaker credit risks. If the dealer agrees to these terms, the dealer increases his risk of loss per hundred contracts by a minimum of 30 per cent or the profit from two new car sales.

The studies of one bank are not broad enough to fit the different situations existing in different parts of the country. However, the general trend would undoubtedly be the same--the difference would be due to different rates and different terms.

So far, we have been looking at the problem solely from the standpoint of the risk involved for the dealer and the bank. What about the customer? Is it good public relations for the banking industry when a car is repossessed after 26-months or 31-months and the customer, after making all those payments, does not have a dime to show for his investment? Have we performed a service for him?

Many banks have reduced their rates on auto loans. For example, some banks which charged a discount rate of $5-$6 per $100, have been dropping the rate to $4-$5 per $100. This should result in increased

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volume. But at the same time, we should recognize that this could increase the squeeze on profits. This can be remedied only by increased volume coupled with increased efficiency. If you know your costs and your markets you will be in a good position to do this. But you must know your market.

Commercial banks have done a good job of meeting the needs of consumers in recent years. Between 1956 and last month, commercial banks increased their holdings of instalment credit on automobiles from $5.7 billion to $9.8 billion--a gain of more than $4 billion. During the same period, finance companies have increased their outstandings by $276 million.
My concern is this: We have made a lot of progress in this field and we should protect our position. It would be unfortunate if troubles generated by too liberal terms and rates were to influence some banks to pull out of the instalment credit business. In the past, banks have been accused of running hot and cold when it comes to meeting the needs of the consumer. I would hate to see banking provide a base for such charges.

The outlook for consumer credit is indeed encouraging. You are all familiar with the figures. Disposable income is on the rise and population projections show a large proportionate increase in the age groups which are historically the biggest users of instalment credit. Banks which maintain sound standards and improve the efficiency of their operations will be in an excellent position to benefit from the increased use of instalment credit.

While mortgage lending and instalment credit are by far the most publicized forms of lending that allegedly have been deteriorating, credit standards in other areas are also being questioned. The papers have been reporting, with increased consistency, commercial loans that have gone sour.

Barron's recently published a story covering many types of free and easy credit. It discussed a furniture store bankruptcy case where four banks



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were among the top 10 creditors of the corporation. A vending machine company had to close its doors and two large banks were left holding the bag.

The number of large discount operations that have encountered trouble--as many bankers are sadly aware--has increased greatly in recent months. The article also reported the official autopsy of Blue Monday in the stock market, including this statement on non-purpose loans from commercial banks--"A substantial buildup of such loans can constitute a large potential for liquidation and downward pressure. . . ."

The widespread reports of credit ease prompted Federal Reserve Board Chairman Martin a month or so ago to state, "The quality of credit in my judgment . . . has been going downhill in this country."

All of this unfavorable publicity--although it may apply to only a few banks and in scattered sections of the country--can do irreparable damage to the banking industry. Some bankers have told me there is some talk of reviving Regulation W of the Federal Reserve System to control the terms of consumer credit. You will recall the concern this subject caused in 1957 when many believed that consumer credit was getting out of hand. Needless to say, we would not want that to happen. We don't think the Government should tell people how they must finance a car.

We will not be able to justify lowered credit standards on the basis of easy money. As I mentioned earlier, monetary authorities control the aggregate amount of credit available; they do not control the types of loans we make. Moreover, it is ridiculous to think we can hide behind the shield of monetary ease when we face our stockholders, our depositors or individuals who are forced to give up a home or a car which they couldn't afford in the first place.

In summing up, I want to repeat that while there is no cause for panic, there is cause for concern. The outlook for the banking business is indeed healthy and we will share in the nation's economic growth. However, I urge you to analyze the costs and consequences of your various credit programs so that you will be in a position to benefit from this growth without sacrificing solid banking standards. We must look at the long range prospects and not allow ourselves to abandon established principles because of increased competitive pressures.

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