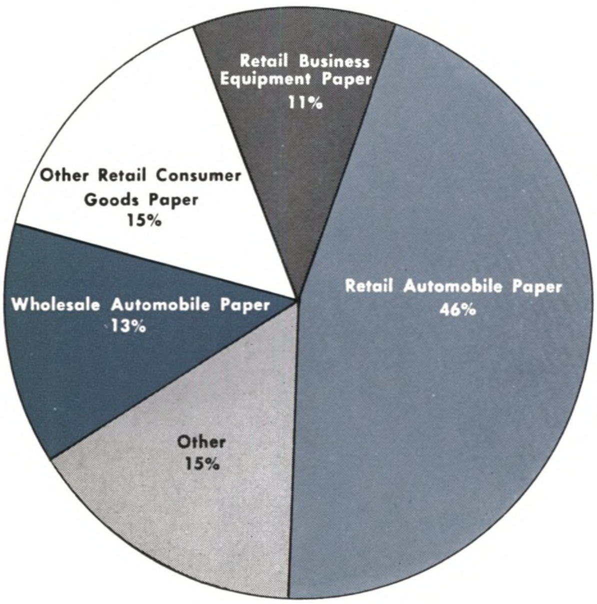
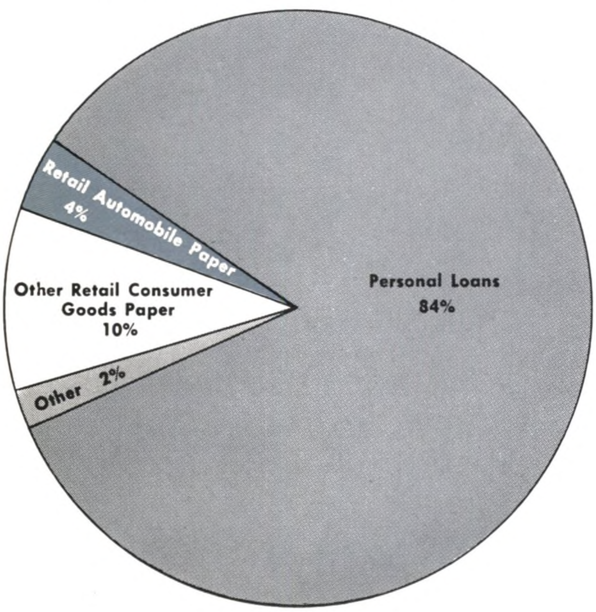
SALES AND CONSUMER

DISTRIBUTION OF LOANS
June 30, 1960

SALES FINANCE COMPANIES



CONSUMER FINANCE COMPANIES



Boats, industrial equipment, television sets, dealers' new car inventories, vacations, college tuition, wheel chairs, home repairs, and hospital bills all have something in common. Either sales finance or consumer finance companies are anxious to finance them.

SALES VS. CONSUMER FINANCE COMPANIES It's difficult to draw a hard and fast line between sales and consumer finance companies since individual companies frequently have characteristics of both. There's one key distinction, however. Sales finance companies extend credit primarily by *purchasing* instalment loans dealers make to their customers to finance consumer goods and services. In contrast, consumer finance companies—or small loan companies, as they are often called—make most of their loans *directly* to consumers.

BUSINESS PRACTICES Typically, sales finance companies have very close relationships with the firms from which they buy retail paper. Often there's no direct connection between the two even though the finance company may handle all the dealer's paper. Frequently, however, the finance companies are "captive companies" controlled in some manner by a dealer or the manufacturer from which the dealer buys his merchandise. An example of this type is General Motors Acceptance Corporation, which is a wholly-owned subsidiary of General Motors. In such cases, of course, dealers generally place the bulk of their paper with the captive finance company.

Since they purchase most of their paper, sales finance companies have virtually no initial contacts with borrowers. They do, however, supply dealers with the necessary forms and specify the maturities, down payments, charges, and other terms of the contracts they are willing to purchase. The dealers draw up the actual contracts. Then they sell the "deals" to the finance company. Most contracts are conditional sales instruments that permit dealers or purchasers of the contracts to retain title to the merchandise until all payments have been made.

Contracts are sold on either a "full-recourse," "nonrecourse," or "repurchase" basis. On a full-recourse basis, the dealer must repay the contract in the event of default and handle any subsequent

FINANCE COMPANIES

collections or repossessions himself. Under a nonrecourse arrangement, the finance company assumes all risk and must make any repossessions. Under the more common repurchase arrangement, the finance company repossesses the merchandise but resells it to the dealer for the remaining unpaid balance.

"Wholesale financing" is handled quite differently. The "floor-plan" financing of automobile dealers, for example, works as follows. The manufacturer ships automobiles directly to the dealer, drawing a sight draft for the value of the cars on the sales finance company, which receives the bill of lading. The finance company then swaps the bill of lading for the dealer's note secured by a trust receipt on the cars. As cars are sold, the dealer repays the note either with cash or by assigning customers' sales contracts.

Unlike sales finance companies, consumer finance companies usually deal directly with their borrowers. Loans—which may be for almost any purpose ranging from medical expenses to the purchase of household items—are fairly small and, as in the case of sales finance companies, are almost always installment loans. Many are signature loans with no cosigners or collateral, but quite a few are secured by wage assignments or chattel mortgages on household furniture.

DISTRIBUTION OF ASSETS Both sales and consumer finance companies are active lenders and hold few investments or cash assets. The most recent survey of finance companies conducted by the Federal Reserve Board showed that at mid-1960 loans made up 90% of sales finance company assets as compared with only 5% in cash and bank balances and just 3% in investments. At the same time, loans of consumer finance companies totaled 82% of assets, investments made up 8%, and cash and bank balances accounted for 6%.

The charts on page 8 illustrate the basic distinctions between the lending patterns of the two institutions. Loans of consumer finance companies are overwhelmingly personal loans, whereas sales finance companies have several important types. At the time of the mid-1960 survey, retail and wholesale automobile paper accounted for 59% of sales finance com-

SOURCES OF FUNDS
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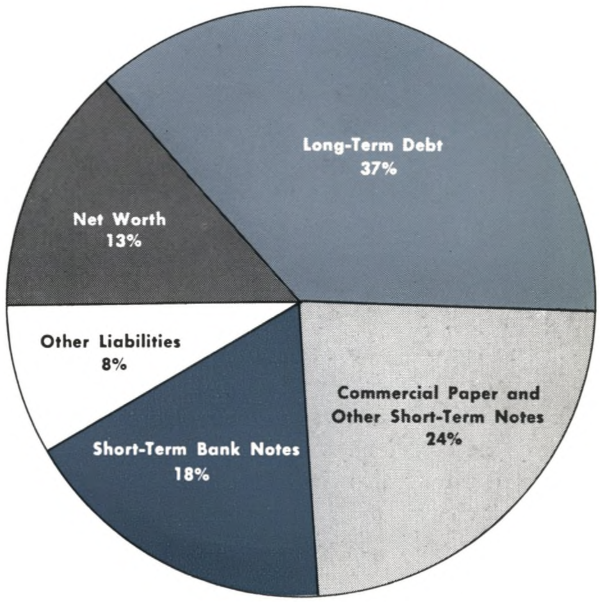
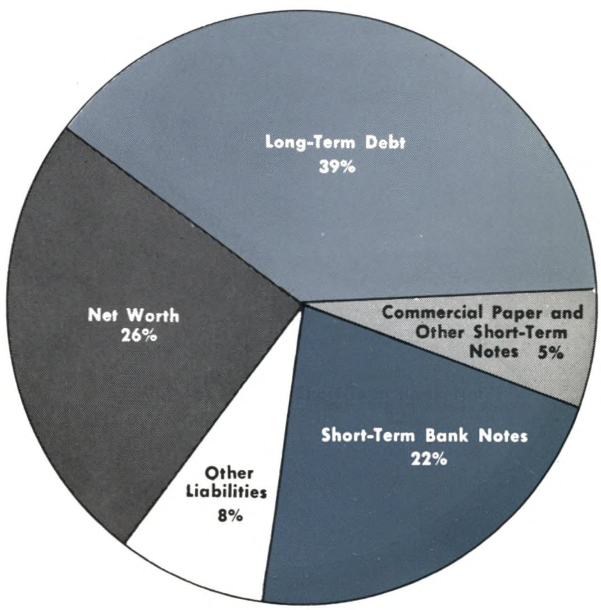


CONSUMER FINANCE COMPANIES



pany loans, other retail consumer goods paper made up another 15%, and retail business equipment paper constituted 11%. Other types of loans such as personal, repair and modernization, and miscellaneous business loans were also fairly important.

SOURCES OF FUNDS As indicated by the charts on page 9, both types of companies draw their funds from a variety of sources. Long-term debt—bank notes, subordinated debentures, and the like—is the chief source, accounting in both cases for nearly 40% of liabilities at mid-1960. Both also borrow considerable short-term money from banks. The main differences are that sales finance companies lean relatively more heavily upon open market commercial paper for their funds and much less upon net worth than do consumer finance companies.

CHARGES AND PROFITS Sales finance companies generally express interest on retail loans as a percentage of the original unpaid balance of the note. Interest on a 5½% two-year monthly instalment $1,200 note, for example, would be $1,200 x 5½% x 2, or $132. Because of the monthly reductions in the principal, this is equivalent to borrowing only $625 on the average over the life of the note. Hence, the actual rate of interest is $66 divided by $625 x 100, or 10.56%. Interest on floor-plan loans is paid on only the *actual* unpaid balance, however, so that the stated rate is also the true rate.

Interest charges of consumer finance companies are typically stated in terms of a rate of interest per month. Rates are much higher than those of sales finance companies because of the risk and heavy expenses connected with small personal loans. Interest is stated as a percentage of the *actual* unpaid balance, however, rather than the *original* unpaid balance and, hence, the stated monthly rate multiplied by 12 is the annual rate. Unlike sales finance companies, which sometimes permit a dealer to add a "pack" for himself to the usual interest charges, consumer finance companies are not permitted to charge additional fees.

A study by Ray H. Matson of the First National Bank of Chicago suggests that consumer finance companies are slightly more profitable on the average than sales finance companies. The typical consumer finance company he studied earned net profits of 11.04% on average net worth during 1960 as compared with 8.19% for the average sales finance company. The same year consumer finance companies averaged 2.63% on total assets versus 1.16% for sales finance companies.

LEGAL RESTRICTIONS In a number of states, sales finance companies are regulated by means of state laws governing instalment selling. In other states, there is no direct regulation. State laws vary, of course, but usually regulate insurance coverages, terms of rebate, finance charges, and the like and provide that the written contract must set forth the terms of the agreement.

Consumer finance companies operate under state small loan laws modeled after the Uniform Small Loan Act drawn up by the Russell Sage Foundation or the more recent Model Consumer Finance Act prepared by the National Consumer Finance Association. These laws set minimum capitalization for companies and specify the necessary records, essential forms, permissible rates, loan limits, and so on. Such companies are not subject to regular usury laws.

IMPORTANCE Sales finance companies are relatively more important than consumer finance companies. At mid-1960, for example, the nation's 2,021 sales finance companies held $16.2 billion in assets and $16.0 billion in loans as compared with $3.9 billion in assets and $3.5 billion in loans at the 2,165 consumer finance companies.

In terms of total assets, both sales finance and consumer finance companies rank way down the line among other nonbank financial institutions. At mid-1960 their $20.1 billion in assets placed them far behind mutual savings banks, savings and loan associations, and life insurance companies, which had assets of $39.7 billion, $67.2 billion, and $116.4 billion, respectively. They were several billion dollars ahead of investment companies (mutual funds and closed-end investment companies), however, and were about four times as large as credit unions, which held just $5.2 billion in assets.

Finance companies are a potent force in the consumer instalment credit field. At the end of 1961, sales finance companies held 25.6% of the total instalment credit, second only to the 39.0% held by commercial banks. Consumer finance companies held 8.8%, ranking fifth behind retail outlets and credit unions.

GROWTH Both sales and consumer finance companies have grown tremendously fast recently, assets probably tripling since 1950. This is somewhat less spectacular than the three- to five-fold gains chalked up by savings and loan associations, credit unions, and investment companies but significantly better than the experience of life insurance companies and mutual savings banks. The gains appear even larger when compared with the corresponding 60% growth in Gross National Product—the best over-all measure of the nation's level of economic activity.