CREDIT UNION VIEW OF CONSUMER CREDIT PROBLEMS

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Many of the problems we associate with consumer credit actually existed before most of the development in this fiels took place. Perhaps the very growth of consumer credit put the spotlight on some of these problems by increasing intelligent public awareness.

The use of credit is logical and perhaps necessary in such an economy as ours. And it has solved problems as well as created them. It might be pointed out that the rise of home ownership, for example, has marched right along with the rise of consumer credit, and that home finance and installment buying have now reached a point where they overlap. The Federal Housing Administration encourages not only low down payments and long mortgage terms, but also the inclusion of such items as stoves, refrigerators and other equipment in the mortgage.[1]

The logic of the matter is that with our present standard of living consumer finance is essential. The new family can enjoy the benefits only by going into debt, and the benefits are generally worth the cost.

From 1939 to 1955 installment payments annually rose from 6.1 billion or 9% of disposable income to 33.7 billion or 12.7% of income, a 452% increase. Consumer income rose 293%, mortgage payments 344% and rents only 159%.[2] While we were getting the material benefits of things like cars, refrigerators, etc., rather faster than our income rise would indicate, we were also increasing home ownership at a high rate. Not an entirely improvident situation.

Nevertheless we who work in consumer credit and close to the social, legal and legislative problems resulting from its unwise use would be the last to argue that there are not very grievous problems.

The problems are as broad as the country, as varied as our climate, and as complex as our people. They cover so much territory that it is impossible to do more than suggest them here. They are affected by trade practices and conventions, state laws, public education and awareness. They range from the practices of the crooked high-pressure seller to the case of the compulsive buyer, to the problem of general public unawareness about interest rates and finance charges.

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[1] Down payments as low as 3%, amortization as long as 40 years. The inclusion of equipment in the mortgage is an idea that I personally heard Norman Mason, then FHA administrator, espouse.

[2] Stanley J. Sigel, economist, Federal Reserve Board.

In some states the laws favor the lender and the debtor is often defenseless by reason of ignorance, unfamiliarity with our customs, laws and language, and lack of resources. Here the racketeer high-pressure salesman flourishes. A few years ago a study in a Chicago packing plant showed that there were wage assignments against two of every three workers,[3] the wage assignment being a favorite gimmick in that city. In my state of Minnesota we have been able to do better partly because we don't get anywhere near the migration problem of most of the big cities, and partly because we have been favored by enlightened legislation and public administration. But those of you who work with credit unions know that even in the best legal and social climate, and even among people who know enough to join credit unions, you occasionally find the fellow who "signed a receipt" to try out a used car, and found himself stuck with an outrageous purchase contract, or the family who kept "adding on" to an installment contract, ran into a period of financial stress, and faced the loss of all their furniture because of a delinquent payment on a $50 rug.

Laws and sound administration of them are needed -- and we are far behind the need in even the best of our states. But in the long run there is no substitute for consumer education. And this education must be conceived for and aimed at the centers where it is most needed, that is, the people who are most exploited because they don't know. This means that it has to be aggressive and hard-hitting, that it has to be courageous, backed up by people who can take hard bumps from those who are hurt, that it has to be persistent and far-reaching.

One of the most baffling aspects of our problem is the confusion that is almost inherent in the credit transaction, about the true cost of the credit. Not only are interest rates stated and misstated in countless ways, but often they are not stated at all. The unwary buyer is twice unwary when he is dealing with both purchase price and finance cost; often, indeed, he looks only at the monthly payments, and only at the amount, not the number.

A 1936 Massachusetts Commission on consumer credit made a study of 106 installment sales where a 6% rate was quoted. Only one of these was actually at 6% and only six at 10% or less. Eighty sales were at 11% to 30%, and eight were at rates ranging from 100% to 679%![4]

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[3]LeBaron Foster, "Credit for Consumers", Public Affairs Pamphlets.

[4]Reavis Cox, "Economics of Installment Buying" page 194

More recently, a 1958 Minnesota commission listed nine different ways of stating installment charges then in use, including eight regulated by law. These costs ranged from 8% simple interest to $13 per $100 (translated by the commission into 23.2% simple interest) and were topped by an unregulated "carrying charge" described as "whatever traffic will allow".[5]

When, in 1959, we tried to get a disclosure law requiring Minnesota vendors to state their charges in terms of simple interest they argued that this could put them out of business. We did get a law requiring disclosure, in some transactions, of all of the charges in the contract, and this has developed some interesting information. We found bankers requiring credit life insurance at a premium 10 times the cost of credit union life insurance, and auto insurance at 150 to 200% of standard rates. The credit life insurance is quite a gimmick. The Minnesota commission found that competition in this field works in reverse, and the company charging the highest rates gets the business because it can pay the biggest commissions -- as much as 70% of premium collected. The buyer, who pays the bill, is never told what hit him.

Stanley J. Sigal, Federal Reserve Board economist, points out that "the consequences of unwise borrowing usually are heaviest among borrowers in the lower income groups". In my home town there is a kind of advertising that goes on year after year that suggests: (1) that these consequences fall lightly if at all upon the lenders, and (2) some, at least, of the unwise borrowers never learn a lesson from the consequences. The advertising (for used cars) often includes -- "Bankrupts and bad credit risks invited".

A problem that may have existed long before we in the consumer field suspected it has now become quite serious. It is the problem of the compulsive buyer, the man or woman who contracts away that last margin of income in order to acquire things equal to or better than those of the people next door. William H. Whyte ("The Organization Man") has noted in his studies how one air-conditioner in a row of houses plants air-conditioners straight down the block. When this kind of compulsion is added to a certain lack of sales resistance, there is trouble ahead.

Perhaps the trouble is as much psychological as economic, but we who have to deal with it are acutely aware of its economic aspects. If we get the case instead of one of those debt-paying agencies that exist to extract that last bit of tribute before the bankruptcy court takes over, we are immediately confronted with grievous economic, emotional, and psychological problems. And the cost of working them out, in time, effort and mental strain is such that we simply cannot afford many of them.

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[5]"Report to Governor Orville L. Freeman by the Governor's Study Committee on Consumer Credit."

Once the credit union has taken over the pay check, pacified the creditors, worked out the treatment and brought the case to a successful conclusion, the cure is usually sufficient and permanent. But there are cases that fall off the wagon, so to speak, and have to take the cure again and again. Sometimes I think we ought to organize a Debtors Anonymous for such folk! But in the absence of such a gimmick, we at least ought to try to establish the principle that sound management of one's finances is a more satisfactory status symbol than a TV antenna or a new car.

In the space available, it has been impossible to do much more than touch upon the main points of our problem. They can be summed up in two statements: (1) What we don't know about consumer credit <u>can</u> hurt us. (2) Easy credit can be tough.

The major problems in this field are:

1. Misrepresentation or ambiguity of the statement of cost or rate.
2. Exorbitant charges for consumer credit.
3. Add-ons, continuing old contracts with new purchases.
4. Dealer "packs", yielding the vendor a profit on the financing as well as the merchandise.
5. Extras, such as insurance, yielding the lender exorbitant profits.
6. Ballon contracts, calling for one large payment at the end of a series of monthly payments.
7. Contracts signed in blank, and misrepresented contracts.
8. Excessive collateral
9. Wage assignments
10. Lack of disclosure of selling price, finance costs, and extra charges.

Minimum immediate need in legislation:

1. Lack of a full disclosure law, requiring vendor to itemize selling price, finance charges in dollars and in simple interest, and extras.
2. Stronger protections for the consumer in garnishment and wage-assignment cases.
3. Outlawing of blank and misrepresented contracts and provision for strict enforcement against abuses, by such methods as revoking the offender's license.
4. Outlawing of dealer "packs" in financing arrangements.