

in 2002, exceeding its previous record of \$193.8 billion in 1984. The USDA expects farm debt to increase roughly 4 percent in 2003 to reach \$210 billion. At the same time, farm net worth is predicted to increase due to an increase in asset value greater than the growth of debt. Since the early 1990s, rising farm asset values have helped to offset increasing debt levels. As stated in a USDA report, because farm real estate values have risen faster than farm mortgage debt, "the degree of farmland leverage has declined slightly. This has provided farm investors with an added equity cushion to lessen the impact of any short-term declines in income or asset values."

Regarding home mortgage trends in the industry, both Freddie Mac and Fannie Mae announced increased limits for single-family mortgages for 2000. The new limit of \$252,700 per single-family mortgage represented an increase of 5.3 percent over the 1999 ceiling for single-family mortgages of \$240,000. Also, the declining home interest rates of the early 2000s, which caused a spike in new home mortgage applications, boosted both profits and sales for Freddie Mac and Fannie Mae.

INDUSTRY LEADERS

The public companies Freddie Mac and Fannie Mae are industry leaders in the sense that they do a relatively larger portion of business in the industry than other lender brokers. One of every six mortgages in the United States is indirectly financed by Freddie Mac. Private competitors in the industry have objected to the unique business hybrid existence of a company like Fannie Mae, complaining that Fannie Mae has a competitive advantage in the lending market. Fannie Mae had sales of \$50.8 billion in 2001, reflecting a one-year sales growth of 15.2 percent. Fannie Mae's net income in 2001 was \$5.9 million, an increase of 32.5 percent. Freddie Mac saw its sales grow 1.7 percent to \$36.7 billion during 2002. The company had net income in 2002 of \$5.7 million, a 39 percent increase from the previous year.

WORKFORCE

Organizations covered in this industry classification range in workforce size from 11,000 to 225,000 employees. These employees represent all of the disciplines found in the private lending sector, including secretaries, financial analysts, managers, and clerks. These organizations are affiliated with the government to some degree and thus have many employees in the Greater Washington, D.C., area. Similarly, many of the organizations serve rural constituencies, so many employees involved with those organizations live in communities of fewer than 50,000.

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SIC 6141

PERSONAL CREDIT INSTITUTIONS

This category covers establishments primarily engaged in providing loans to individuals. Also included in this industry are establishments primarily engaged in financing retail sales made on the installment plan and financing automobile loans for individuals.

NAICS CODE(S)

522210 (Credit Card Issuing)

522220 (Sales Financing)

522291 (Consumer Lending)

INDUSTRY SNAPSHOT

"Credit" is derived from the Latin word "credo," which means "I believe." It typically refers to a purchase or the power to make a purchase of goods for enjoyment in the present while deferring payment to a future date. Thus, the transaction consists of a transfer and delivery of goods in the present in exchange for a promise of future payment.

The granting of credit depends upon three factors: character, capacity, and capital. Each of these factors introduces some risk into the transaction. The risk of lending on character is called "moral risk." The risk of lending on capacity is called "business risk." The risk of lending on capital is called "property risk." An ideal borrower will meet a minimum of requirements set for evaluating each of these three risks.

Since it is impossible for most companies to determine how their credit applicants are ranked in each of these categories, they must obtain their information from centralized sources. These sources are credit-reporting agencies. Credit reporting agencies keep files of information on all consumers who have made credit transactions at some point in their lives. Credit granting institutions may purchase these files to evaluate the “credit worthiness” of individual applicants. Since misuse or abuse of these files can be financially detrimental to the consumer, the credit reporting industry is heavily regulated. Adverse information must be removed within seven years—except bankruptcy, which remains in a credit file for 10 years. Disputed information that cannot be verified must be removed, and access to the file must be granted for the individual concerned. Finally, the information may only be given to authorized users.

The personal credit industry encompasses many diverse organizations. These participants range from General Motors Acceptance Corp. (GMAC), with 2001 sales of \$25.4 billion and 29,390 employees, to tiny one-office credit firms with a handful of staff and assets under \$1 million.

The U.S. economic recession in the early 2000s helped fuel consumer debt levels, as well as personal bankruptcies, to record highs. While many personal credit institutions experienced increased business as a result of the increased debt load carried by consumers, these businesses were also faced with the increased likelihood of loan defaults.

ORGANIZATION AND STRUCTURE

Personal credit transactions are regulated by the Uniform Commercial Code (U.C.C.) and the Uniform Consumer Credit Code (U.C.C.C.). Additionally, a number of pieces of legislation are designed to protect the consumer, including the Fair Credit Reporting Act. Each of the various entities that constitute this category has varying organizations and structures.

Automobile Loans. Since automobiles are too expensive for most individuals to purchase with cash, most new car purchases are made with the assistance of automobile loans; these types of loans are typically made by banks and finance companies. This type of consumer lending typically has a maturity of 8 months, although maturities of 60 months and longer are not uncommon.

Automobile loans may be either direct or indirect. Direct automobile loans are made to the consumer to purchase an automobile and are secured by a chattel interest in the auto. Indirect automobile loans are made by the auto dealer. Under this arrangement the dealer collects the required information from the consumer and furnishes it to the bank. The bank then either accepts or

rejects the applicant. Usually the dealer packages the loans in bundles and sells them to banks; these loans tend to have higher delinquency rates than direct loans.

The automobile loan is the most common type of consumer loan, accounting for more than 40 percent of all consumer credit. Normally consumers spend about 5 percent of their income on automobiles, down from nearly 7 percent in the 1970s. Banks, however, make less than 40 percent of all automobile loans. The remainder of the loans are made by auto manufacturers' financing divisions. These financing entities offer below market rates, as well as more flexible financing options to stimulate the sales of their products.

Banks also offer “floorplan” financing to support dealers' leasing programs. “Floorplan” financing, or trust receipt financing, is a form of inventory financing under which the bank holds title to the automobile inventory. The automobile dealer is considered the borrower in these transactions and is loaned funds to buy the inventory from suppliers. The dealer holds the inventory in trust for the bank and then sells inventory to consumers. Subsequently, these proceeds are paid to the bank, but the dealer keeps the mark-up of the retail price over the payments due the bank. When the sale is made on a credit basis, the dealer often sells the obligation to the bank.

Consumer Finance Companies. Consumer finance companies are small loan companies that specialize in personal loans under the small loan laws of the various states. These establishments are often called personal finance companies.

Financing of Automobiles, Furniture, Appliances, Personal Airplanes, etc., Not Engaged in Deposit Banking. The financing of personal property is included under the general title of consumer credit. Consumer credit is the short- and medium-term debt owed by individuals to financial institutions, retailers, and other distributors for financing consumer purchases of goods and services, but not including real estate mortgages and insurance policy loans. In 1995 the total consumer installment credit outstanding was \$1.02 trillion. Of that, \$353.3 billion was for automobile loans, \$395.2 billion was for credit card loans (plus bank overdraft privileges and the like), and \$276.2 billion was for other types of loans.

Due to the disparate positions of the creditor and consumer in negotiating credit terms, the government regulates this industry very heavily. The Consumer Credit Protection Act of 1968 assures that every consumer with a need for credit is given meaningful information with respect to the cost of that credit. This means that the dollar amount of the finance charge, as well as the annual percentage rate computed on the unpaid balance, must be disclosed. Other information must also be disclosed to allow the consumer the opportunity to read-

ily compare the various credit terms offered by different sources.

The Consumer Credit Protection Act and other related regulations apply to banks, savings and loan associations, department stores, credit card issuers, credit unions, automobile dealers, consumer finance companies, hospitals, and any other organizations that extend or arrange credit to which a finance charge is added. Residential mortgage brokers, craftsmen, doctors, dentists, and other professionals are also subject to these regulations. The act does not apply to business and commercial credit (governed by the U.C.C.), credit to government entities, transactions covered by the SEC, and credit over \$25,000 except for household and agricultural uses.

Interest on consumer credit transactions is typically computed in one of two ways. For open-end credit accounts with credit cards and revolving charge accounts in retail stores, finance charges are imposed on unpaid balances each month. To determine the monthly finance charge rate, the annual rate is divided by 12. For example 1.5 percent might be applied per month for an annual rate of 18 percent. For other forms of credit, including loans and sales credit, the total amount, number of payments, and due dates are negotiated with the consumer. Examples of these transactions include an automobile loan or the purchase of a large appliance on department store credit.

Installment Sales Finance, Other Than Banks.

Installment sales are sales of goods under a definite schedule of payments, which involve a specified cash outlay as a down payment with the balance payable in agreed upon periodic installments until the item is paid for. This type of sale is a relatively recent phenomenon. Before 1922, installment sales were confined to a small number of retail outlets, typically those specializing in lower quality merchandise. In the late 1920s, this type of transaction became more popular after its success in the automotive industry and intense promotion by consumer finance companies. Automobile sales have been the most prevalent form of installment sales through the present day.

Installment sales are based on one of two legal documents. The first is a conditional sales contract under which the title, or ownership, of the item remains with the seller. The second is the chattel mortgage under which the buyer holds title subject to a lien in favor of the seller. As the various states have detailed and complex legislation on conditional sales, most creditors favor the chattel mortgage, which is governed by Article 9 of the U.C.C. Under this process, the buyer signs a promissory note, secured by the product, that constitutes a promise to repay the debt. The mortgage will typically contain an acceleration clause (causing the entire debt to come due upon certain conditions that indicate default) and a power of sale clause (allowing the seller to repossess the

item and sell it subject to certain conditions that indicate default).

Other terms may also be present in chattel mortgages. A "balloon" installment plan is one under which the initial payments are small but a later one is very large, usually requiring refinancing. Another financing plan is the "open end" type of chattel mortgage under which additional purchases may be made on an installment basis. Under this arrangement the seller retains a lien on all of the purchased goods whether they have been paid for or not. If the buyer defaults on a later purchase, the seller may repossess all of the items purchased. While many of these provisions still exist, the current trend is toward consumer-oriented legislation that renders such excessively punitive practices illegal or non-binding.

The following are some of the most important pieces of federal legislation regulating consumer credit:

The Consumer Credit Protection Act of 1968. The key provisions of this act are: Title I, the Truth-in-Lending Act, which provides for consumer credit cost disclosure; Title II, which contains penalties for extortionate credit transactions; Title III, which contains restrictions on garnishments; and Title IV, which provides for the establishment of the National Commission on Consumer Finance to report and make recommendations to Congress on consumer credit topics. Title V pertains to the issuance of credit cards, liabilities of credit card holders, and the fraudulent use of credit cards. Title VI contains provisions relating to credit information and credit reports and gives credit consumers the right to confront the preparers of credit reports and correct any misstatements of facts contained in such reports. The act also prohibits unwarranted disclosure of the information contained in these reports, requires the elimination of erroneous information, and protects against unfair credit reporting practices.

The Fair Credit Billing Act, an amendment to the Truth-in-Lending Act, states that consumers shall have fair methods available for the correction of billing errors.

The Equal Credit Opportunity Act declares that creditors cannot discriminate against consumers seeking credit on the basis of sex or marital status.

The Real Estate Settlement Procedures Act requires that a standard real estate settlement form be developed in compliance with the provisions of the Truth-in-Lending Act for use in all transactions involving federally funded or secured mortgage loans. This form includes a clear and conspicuous itemization of all settlement charges imposed upon the buyer and seller, as well as greater disclosure of the nature and costs of real estate settlement charges.

The Home Mortgage Disclosure Act requires that mortgage lending be free of discriminatory bias and requires that depository institutions with offices in metro-

politan areas and with assets of over \$10 million identify the geographic distribution of their home mortgage loan.

The Consumer Leasing Act, another amendment to the Truth-in Lending Act, requires that consumers be provided with full information regarding the terms of their leases of personal property, including open-end and closed-end vehicle and furniture leases.

The Fair Debt Collection Practices Act makes abusive and deceptive debt collection practices illegal for those the act defines as debt collectors, as opposed to the primary lender.

The Truth-in-Lending Simplification and Reform Act exempts all extensions of credit for agricultural purposes from the disclosure provisions of the Truth-in-Lending Act, eliminates disclosure requirements calling for periodic statements from lenders in connection with closed-end credit transactions, and allows an exception to the "cooling off" period for consumers who pledge their homes as collateral in open-end credit arrangements.

The Installment Sale Revision Act liberalizes the rules for postponing tax on property that is sold on the deferred payment basis.

Most of this legislation was passed between the late 1960s and mid-1970s in response to a broader concern for consumer protection. Currently, the consumer credit industry is one of the most heavily regulated segments of the economy.

As installment selling has become more established, commercial banks have also become involved in this industry. To remain liquid, finance companies and retailers often sell these obligations, or chattel paper, to banks or factors. The bank pays cash, normally at a discount, to the seller who turns the buyer's obligation over to the bank.

In the late 1970s, the Carter Administration attempted to restrain consumer credit to curb inflation. The Board of Governors of the Federal Reserve System implemented several programs in compliance with this broader policy, including a voluntary credit restraint program; a program of restraint on specified types of consumer credit, including credit cards, check overdraft plans, unsecured credit, and secured credit, where the proceeds are not used to finance the collateral; an increase in the marginal reserve requirement on managed liabilities of Federal Reserve member banks and a decrease in the base amount on which these charges applied; a 10 percent deposit requirement on managed liabilities of non-member banks and a 15 percent deposit requirement on any increase of money market funds over the March 14, 1980, base period; and a surcharge on frequent discount borrowing by large Federal Reserve member banks.

Morris Plans Not Engaged in Deposit Banking. Morris Plans are named after Arthur J. Morris who founded a

system of personal loans in 1910 at the Fidelity Savings & Trust Co. of Norfolk, Virginia. Morris Plan loans are made on a monthly repayment basis, with the first month's installment deducted from the face value of the loan and the remaining balance. This arrangement makes the effective interest rate about twice the nominal rate. Because of the permissive banking laws effective at the time, the plan evolved as a loan for the amount desired, nominally to purchase an investment certificate, to be paid for in monthly installments with the credit for the payments going to the certificate rather than the loan account. A variation on this scheme credited the monthly payments to a deposit account. Thus, under either scenario, the effective rate of interest, about twice the nominal rate, did not violate usury laws. Currently, several states have modified their banking laws to allow Morris Plans, avoiding the need to resort to legal actions.

In addition to providing loan funds, Morris Plans also provide life insurance for borrowers. Borrowers can purchase life insurance policies for the full amount of their loans; if the borrower dies while the loan is outstanding, the insurance would be applied to the full amount of the loan, and the remainder would be paid to the family or estate.

Mutual Benefit Associations. Mutual Benefit Associations, or Mutual Associations, are savings banks, savings and loan associations, insurance companies, and credit unions that are not organized under state corporation laws as stock corporations but are owned by their depositors, policyholders, or members. In the mid-1990s, these included mutual savings banks, savings and loan associations, and credit unions. Savings and loan institutions are either state or federally chartered and deposit insurance is available from state and federal insurance agencies for these institutions.

Mutual savings banks, savings and loans, and credit unions are permitted to sell federal mutual certificates, which allow these institutions to efficiently build their net worth and reserves. These certificates are obligations that are subordinated to savings accounts, savings certificates, and debt obligations of the mutual benefit association. The target net worth-to-resources ratio is 3 percent and the desired net worth-to-liability ratio is 6 percent.

Personal Finance Companies, Small Loan: Licensed. These organizations specialize in personal loans, which are cash loans to individual borrowers for such purposes as refinancing payments on medical bills, taxes, and insurance premiums. These companies also provide cash for transactions that will permit cost savings for borrowers.

The industry is very closely regulated. Personal finance companies are subject to related statutes in all 50 states, the District of Columbia, and Puerto Rico. Most of the loans made by these companies are subject to a state

version of the Uniform Small Loan Law or the Model Consumer Finance Act. These institutions are also subject to state laws that regulate sales financing and revolving credit, insurance premium financing, home repair financing, second mortgages on homes, and usury laws. Personal finance companies must also comply with the Uniform Consumer Credit Code and the Federal Consumer Credit Protection Act.

Personal loan companies operate either as chains with many locations or as independent offices. The primary customers of these institutions are wage earners in the lower income bracket. To target these customers, most personal loan companies are located in industrial centers and urban areas where they can generate sufficient volume or in jurisdictions that allow them to charge the high interest rates necessary to maintain profitability.

Most of the receivables of these companies are unsecured. They are most concerned with the ability of the borrower to repay the obligation out of monthly income as opposed to the ability to repossess and liquidate security. Because of the frequently urgent nature of such loans, the application process tends to be simplified and streamlined.

Personal finance companies, also known as consumer credit companies or small loan companies, have been instrumental in educating consumers in the management of personal finance, particularly in advising against overborrowing and improper management of personal finances.

BACKGROUND AND DEVELOPMENT

While each of the separate entities included under this industry classification has a distinct history and development, there are issues that are common to all.

As the American economy has become more consumer oriented, many options that allow consumers easier access to products have been created. Most of these fall under the personal finance industry. By the mid-1990s, personal finance was one of the largest and most aggressive sectors of the broader finance industry.

From the late 1960s to the mid-1970s, a wave of regulations were passed by Congress in response to the public's demand for greater protection from unfair practices by the government. This wave of regulation was designed to protect the consumer from unfair credit collection practices and unconscionable credit terms by requiring creditors to adhere to stricter standards and fully disclose consumer credit terms.

Many personal credit institutions sell their loans to other companies. This frees money for new loans and investments. While this practice is not new, it intensified during the early 1990s. In other cases, the loans are serviced for a fee by companies other than the lender, which allows the loan originator to free resources nor-

mally used in processing loan-related paperwork. The booming economy of the mid-1990s allowed credit companies to prosper. GMAC, for example, saw its total assets rise by \$8 billion from year-end 1995 to year-end 1996. The company operates from nearly 600 offices worldwide and services 7.2 million customer accounts. GMAC's primary business remains what it has always been, financing consumer purchases of new cars. But the widely diversified company also finances home mortgages, home equity loans, various insurance products, and other lines of business. Since its founding in 1919, GMAC extended \$870 billion in credit to help finance more than 138 million vehicle purchases.

The competition between credit card companies intensified in the late 1980s and early 1990s, as consumer confidence decreased and the public grew more reluctant to buy on credit during the prolonged recession. In 1993, MasterCard International Incorporated had the largest change in volume, with a 23 percent increase, compared with 16 percent for Visa International and 10 percent for American Express Company. Most of this difference was attributed to MasterCard's aggressive co-branding program. In co-branding, a card issuer joins with another organization, a car manufacturer for example, to offer a card jointly with benefits from both companies including rebates on purchases from the co-branding company. By the end of 1993, MasterCard had issued 25 million co-branded cards to consumers.

U.S. Banker reported that consumer debt was on the rise again by the end of 1997. The American Bankruptcy Institute of the Administrative Office of the United States Courts reported that consumer debts during the 1990s grew twice as fast as mortgage debt, which grew 60 percent faster than consumer earnings. The personal loan industry was also challenged by the trend of increasing personal bankruptcy; in 1996, for example, \$30 billion of consumer debt in the United States was discharged in bankruptcy, leaving credit agencies with nothing. Credit agencies took preventative measures to try to slow the trend, including raising interest rates and putting more effort into collections.

Personal credit agencies also looked to form new alliances with credit counseling agencies in an attempt to stave off the effects of consumer bankruptcy. Visa, for example, ran 70,000 radio information spots in 1997 to persuade debt-ridden customers to consider working with credit counseling agencies. The National Foundation for Consumer Credit reported in 1997 that it expected to counsel 1.5 million consumers, a 20 percent increase from the previous year.

CURRENT CONDITIONS

The late 1990s marked a period of unprecedented spending in the United States. When the economy began

to weaken in 2000, consumer debt began to climb to record levels. The average consumer credit card debt in American households grew from \$7,842 at the end of 2000, to \$8,234 at the end of 2001, and \$8,940 by the end of 2002. Between 2001 and 2002, credit card debt grew 8.5 percent, and since 1997, credit card debt has grown 36 percent.

Because of this mounting debt, along with higher unemployment levels, some analysts predict that personal bankruptcies will increase by 8 percent in 2003 to reach 1.65 million. During the last three months of 2002, bankruptcy filings reached a record 395,129. Between 2001 and 2002, personal bankruptcies grew 5.7 percent to reach more than 1.57 million.

Bank credit cards account for roughly 18 percent of personal consumption expenditures made by U.S. consumers. Retail credit cards and debit cards account for another 6 percent. According to CardWeb.com Inc., debit and credit cards will account for roughly 30 percent of all U.S. personal consumption expenditures.

Advertising spending by the leading credit card networks, including Visa, MasterCard, Discover, and American Express, exceeded \$800 million in 2001. Marketing dollars spent by individual card issuers, such as banks, totaled roughly \$10 billion that year. Some analysts predict that credit card advertising efforts may wane in 2002 and 2003, due to adverse market conditions. In particular, personal credit institutions that offer credit to those individuals labeled credit risks are expected to curb their marketing expenditures.

INDUSTRY LEADERS

As of December 31, 2001, the top 10 bank credit card issuers in the United States were Citigroup, MBNA America, Bank One, Chase, Capital One, Provident, Bank of America, Household Bank, Fleet, and Direct Merchants. Combined, they held a 78 percent share of the U.S. credit card market.

Visa operates as the leading consumer payment brand in the world, ahead of both MasterCard and American Express. Total Visa cards in circulation, including credit cards and other types of payments cards, exceeded 1 billion as of 2002.

In the U.S. automobile financing sector, the market leader in the early 2000s was GMAC, which held assets of roughly \$200 billion in 2002. Other leading automobile financiers include Ford Motor Credit Co. and Toyota Motor Credit Corp.

WORKFORCE

This industry classification includes many diverse employers who employ anywhere from 20 to 20,000 workers. The employees in this field represent diverse

backgrounds in the finance industry and its related support services. These workers include bankers, tellers, loan officers, secretaries, and security personnel.

RESEARCH AND TECHNOLOGY

In the late 1990s, credit companies that had been forced to downsize adopted the use of new technology to compensate for previous staff functions. According to *Business Credit*, such technology allowed personal credit agencies to maximize efficiency and increase productivity. The technology that the industry adopted generally included software that addressed accounts receivable functions or addressed task-specific applications. According to a 1999 survey by *Business Credit*, companies generally spent amounts ranging from a few hundred dollars to \$100,000 for such software. The survey noted that the personal credit industry would be expected to interface increasingly with the Internet. An example of such an interface is provided by the Internet company Creditland, which was founded in 1998 and directs consumers to good matches for personal loans, auto loans, mortgages, or credit cards.

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SIC 6153

SHORT-TERM BUSINESS CREDIT INSTITUTIONS, EXCEPT AGRICULTURAL

This industry includes establishments primarily engaged in extending credit to business enterprises for relatively short periods. Private establishments primarily engaged in extending agricultural credit are classified in **SIC 6159: Miscellaneous Business Credit Institutions**.