

DETERMINING CREDIT

A SUGGESTIVE METHOD FOR CREDIT
COMMITTEES OF CREDIT UNIONS

DEvised BY

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**SOME PUBLICATIONS ON COOPERATIVE CREDIT
ISSUED BY
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- No. 5. Cooperative Credit.** A Selected Bibliography. Bulletin of Russell Sage Foundation Library, June, 1914. (5 cents.)
- RL 15. A Credit Union Primer.** By Arthur H. Ham and Leonard G. Robinson.
Contains a brief history of cooperative credit, a definition of its field in the United States, an outline of the elementary principles of credit unionism, together with model by-laws, necessary books and forms, instructions for organizing, and the New York credit union law.
Division of Remedial Loans. 79 p. 1914. (25 cents.)
- RL 16. The Cooperative People's Bank.** By Alphonse Desjardins.
The evolution of the cooperative bank, the Canadian system, its growth and accomplishments.
Division of Remedial Loans. 42 p. 1914. (15 cents.)
- RL 19. Credit Unions and their Relation to Savings and Loan Associations.** By Arthur H. Ham.
An address delivered before the State League of Savings and Loan Associations, Port Jervis, N. Y., June 10, 1915.
Division of Remedial Loans. 12 p. 1915. (Single copies free.)

DETERMINING CREDIT

Treasurers and credit committees of credit unions have always before them the necessity of deciding whether a loan can safely and properly be made, and whenever applications for loans exceed the funds on hand, they must decide which of the loans are to be made at once and which are to be laid aside.

The statutes provide two rules: first, that all loans must be for a provident purpose, and second, that preference shall be given to the smaller loans. These rules, however, do not answer all questions that arise, and are, besides, somewhat difficult to apply. Every application for a loan must be considered from the following points of view:

1. Purpose of the loan
2. Record of the applicant
3. Security offered

PURPOSE OF THE LOAN

The statutes provide, and it is laid down in the by-laws of most credit unions, that the purpose of each loan must be ascertained and the loan shall not be granted unless it promises to benefit the borrower. A loan may be considered of benefit to the borrower when made to enable him

- a. To buy for cash instead of upon credit
- b. To buy in large instead of in small quantities
- c. To pay bills incurred on account of illness
- d. To expand his business
- e. To keep up premiums on a life insurance policy
- f. To pay taxes or assessments on his house
- g. To meet any legitimate expense occasioned by emergencies or to effect a saving.

A loan may not wisely be made to enable a member to increase his expenditures beyond his expected income, but it is desirable to loan to a member to enable him to get out of the clutches of the loan shark, even though his original borrowing from the loan shark was due to improvidence or unwise expendi-

ture. In most cases the credit committee should seek to ascertain not only the purpose of the loan, but the use which the borrower intends to make of his present and expected income from whatever source. Borrowers need not always be required to give the intimate details of their financial and domestic situation, but when full information is given loans can be made with more safety.

RECORD OF THE APPLICANT

Before granting a loan the credit committee should obtain as full answers as possible to the following questions:

- a. How long has the applicant been in his present employment?
- b. How long in former position?
- c. How long has he lived at his present address?
- d. How long at former address?
- e. How long has he been a member of the credit union?
- f. How regularly has he saved money in the union or in other ways?
- g. How promptly has he paid his debts in the past, including former loans from the credit union and outside obligations?
- h. Is he married and how many are dependent upon him?
- i. What are his personal habits?
- j. Of what clubs and societies is he a member?

SECURITY

The character of the applicant as shown by his record and the purpose of the loan is largely the security upon which the loan is made. Many loans, however, are additionally secured by the endorsements of fellow-members or non-members and by collateral security.

a. Collateral

The best collateral security that a credit union can obtain is the applicant's share holdings in the union. It may also accept as collateral security for a loan a savings bank book, a mortgage of real estate, a chattel mortgage, an assignment of wages, a life insurance policy having a certain cash value, or marketable securities.

b. Endorsements

The value of endorsements upon a borrower's note is determined by an examination of the record of the endorser in the

same manner as the applicant's record is appraised. The best endorsers are members of the union who own a fair number of shares. Though their share holdings may not equal the amount of the loan they increase the security, for endorsers will use every effort to have the loan paid in full rather than lose their own money. Endorsers should be independent of each other and of the borrower. A wife, brother or partner of a borrower is not as valuable an endorser as a person not related to or connected with him, for the same accident or illness that makes it difficult for the borrower to pay may handicap an endorser who is related to him.

In a credit union having a small homogeneous membership in which the credit committee is acquainted with every member it is not necessary for each application to be appraised in great detail, but in many credit unions there will be members who are not personally known to the credit committee and the committee should have a working plan to enable it to determine with fair accuracy the credit to which each applicant is entitled and the relative merits of the several applications filed with the committee. The decision must in the last analysis be based upon the judgment of the treasurer and the credit committee—it is a matter that can never be handled by rule-of-thumb. But in order to systematize the operation of passing upon applications and minimize the labors of the treasurer and credit committee the following plan has been worked out by the Industrial Credit Union of Boston. The total points required and the point allowance for each item have been changed several times since the system was adopted, and further changes will doubtless come as more experience is acquired. The scale is not to be considered as complete, but it indicates the essential factors that must be considered in making a loan and suggests what seems to be a practical method of determining the amount of credit that may safely be extended to each member. The value of the system is not that it determines credit accurately, but that it helps the treasurer and credit committee to form their judgments. It is to be hoped that credit committees which make use of this method will suggest such changes as seem to them to be necessary in order that a satisfactory working plan of general applicability may be evolved.

POINT SYSTEM OF DETERMINING CREDIT

Minimum number of points required	100
A. Loans on collateral security	Max. points allowed
1. Purpose	10
(If it is certain that the loan will effect a saving or benefit for the borrower, allow maximum points; if not, allow fewer points. If the borrower is spending or planning to spend an undue amount for luxuries, negative points should be charged against him.)	
2. Collateral	90
a. Member's paid-up shares equivalent to loan	90
b. Savings bank books or life insurance policies with surrender value	80
c. Stock market collateral with good margin	75
d. Real estate, first mortgage	75
e. Chattel mortgage	20
3. Past record	20
<i>Either one of the following:</i>	
a. Record (outside credit union):	
1. Payment of debts (Evidenced by receipted bills)	10
2. Savings or investments	10
b. Record (in credit union):	
1. Payment of loans	10
2. Savings, last year	5
3. Savings, year before last	5
Total	120
B. Loans without collateral security	
1. Purpose (see above, A 1)	10
2. Proportion of loan to income (If no larger than weekly income, give maximum points.)	10
3. How long in present position or with present employers (1 point a year, maximum 10)	10
4. How long with last employer (1 point a year, maximum 10)	10
5. Housekeeping or boarding (A man keeping house is a better risk than one who is boarding. If the former, give maximum points.)	5
6. How long living at present address (1 point a year, maximum 10)	10

7. How long at last address	10
(1 point a year, maximum 10)	
8. How many legal dependents	5
(A man without dependents should ordinarily be able to pay his debts, but a married man with children is usually a better risk. For five dependents, give maximum of 5 points and 1 point less for each less or greater number.)	
9. Life insurance:	10
a. What company	
b. Kind of policy	
c. Amount	
d. How long in force	
e. Any outstanding loans against it; if so, what amount	
10. Present financial condition:	10
a. Assets	
b. Liabilities	
11. Personal habits and reputation:	10
a. Good health	5
(Frequent illness is bad from a credit point of view even though not the fault of the applicant.)	
b. Membership in organizations:	5
Fraternal, church, militia, clubs, etc.	
(Most fraternal bodies investigate before electing members and if a man has been favorably passed upon in this manner he is a better risk for a credit union. Allow maximum points if habits and reputation are very good and from that down to zero and even negative points in case unfavorable reports are obtained.)	
12. Past record:	20
<i>Either one of the following:</i>	
a. Record (outside credit union):	
1. Payment of debts and loans	10
(Allow maximum points if record of payment of debts is very good. If record is not good allow fewer points or even charge negative points.)	
2. Savings or investments	10
b. Record (in credit union):	
1. Payment of loans	10
2. Savings, last year	5
3. Savings, year before	5
Total	120

ENDORSERS

Having given the applicant a point rating endorsers offered should be rated in the same manner, an allowance being made, as in the case of borrowers, for any share capital which becomes collateral for the loan. An effort should be made to see that there is no collusion between the borrower and the endorser—that the borrower does not give any part of the loan to the endorser and that the endorser is actually risking his own money. If the endorser is a close connection of the borrower, such as wife, son or partner, credit the endorser with only one-quarter of the points that would be allowed if such relation did not exist.

Illustration: John Jones applies for a loan of \$50 having no collateral to offer as security. He would be rated as follows:

	Points allowed
1. To pay doctor's bill (The allowance is not as great as if he were to buy coal in the spring or summer, but more than if the money were to be spent for luxuries.)	5
2. Income \$25 per week	5
3. Ten years with present employer	10
4. Four years with last employer	4
5. Keeps house	5
6. Has lived in the same house for four years	4
7. Four years at former address	4
8. Four legal dependents	4
9. Has no life insurance	0
10. Has no outstanding debts and current bills are paid to date except that for which this loan is desired. No assets except household furniture	5
11. a. His own health and that of his family is generally good. This bill is for an operation	5
b. Mason and church member	5 10
12. Has been in the credit union 1 year and saved \$20 out of an annual income of \$1,300. No record as to previous saving in other ways. No judgments filed against him. Apparently pays bills promptly though information not full on this point	12
Total	68

As these points do not count up to 100—the minimum points required—a loan of this amount should not be made without an endorser. One good endorser, even if related to the applicant, would bring the point allowance up to the minimum required.