FEDERAL RESERVE BANK OF
KANSAS CITY

FEDERAL RESERVE BANK
OF KANSAS CITY
KANSAS CITY, MISSOURI 64198

THOMAS E. DAVIS
SENIOR VICE PRESIDENT
AND DIRECTOR OF RESEARCH

December 20, 1984

#1728
84-4839

Chairman Paul A. Volcker
Board of Governors
of the Federal Reserve System
Washington, D.C. 20551

Dear Paul:

In view of the discussion on agricultural credit conditions immediately following the recent FOMC meeting, Roger Guffey asked me to send the enclosed material to you for your information.

The material includes our recent Financial Letter containing results of our latest survey of agricultural credit conditions in the Tenth District, and a copy of a presentation on "Financial Stress in American Agriculture" made recently to our Board of Directors by Marvin Duncan, Vice President and Economist in our Economic Research Department.

Sincerely,

Tom

Copies to:

Gov. Gramley
Gov. Martin
Gov. Partee
Gov. Rice
Gov. Seger
Gov. Wallich

Financial Letter

FEDERAL RESERVE BANK OF KANSAS CITY

Survey of Agricultural Credit Conditions

Agricultural credit conditions generally worsened in the Tenth Federal Reserve District during the third quarter of 1984, according to 173 bankers responding to the Federal Reserve Bank of Kansas City's quarterly survey. Land values declined substantially during the quarter, loan repayments continued their year-long slow pace, and the interest rates charged by the bankers rose slightly. Also, the financial problems of district farmers and ranchers remain more substantial than bankers expected.

Land values fall

Farm financial stress is still seen in lower farmland values. District farmland values fell sharply in the third quarter, after declining moderately in the second quarter. For all categories of land, values averaged 7 percent lower than in the second quarter, 15 percent lower than in the year-earlier quarter, and 29 percent lower than the market highs reached in 1981. Irrigated land values in the third quarter were down almost 9 percent from the second quarter, and the per-acre value was below $1,000 for the first time since early 1978 (Table 1). The value of nonirrigated land was off 8 percent from the second quarter, but ranchland values fell only 4 percent. The largest declines in land values were in Missouri and Oklahoma. The value of land in the Mountain States (Colorado, New Mexico, and Wyoming combined) averaged slightly higher than in the second quarter.

Table 1
FARM REAL ESTATE VALUES
September 30, 1984
(Average value per acre by reporting banks)

	Non-irrigated	Irrigated	Ranch-land
Kansas	$558	$858	$282
Missouri	785	1,050	452
Nebraska	655	1,150	240
Oklahoma	634	814	427
Mountain States*	323	751	182
Tenth District	$602	$982	$297
Percent Change From:			
Last Quarter	−8.1	−8.5	−4.1
Year Ago	−15.6	−17.1	−12.1
Market High	−28.7	−31.8	−26.8

*Colorado, New Mexico, and Wyoming combined.

Table 2
YEAR-TO-YEAR CHANGES IN NONREAL ESTATE FARM LOANS
September 30, 1984
(Percentage of banks reporting)

	Greater	Same	Lower
Demand for Farm Loans	23.84	53.49	22.67
Availability of Funds	25.00	55.23	19.77
Rate of Loan Repayments	3.49	42.44	54.07
Renewals or Extensions	51.16	45.35	3.49
Amount of Collateral Required	59.88	39.53	0.58
Referrals to Correspondent Banks	11.38	72.46	16.17
Referrals to Nonbank Credit Agencies	33.33	56.36	10.30

Loan repayments continue slow

The rate of loan repayments at agricultural banks in the district continued slow. Fifty-four percent of the bankers reported loan repayment rates lower than a year before (Table 2). At about half of the reporting banks, requests for renewals and extensions were higher than the same quarter a year ago. Sixty percent of respondents reported an increase over a year earlier in the collateral required for nonreal estate farm loans. That was the second highest percentage reporting an increase in collateral requirements since the survey was started in 1976. Only the record 61 percent in the second quarter was higher.

Research Division, Federal Reserve Bank of Kansas City
Kansas City, Missouri 64198 (ISSN 0739-5299)

Vol. 10, No. 11
November 1984

Table 3
SELECTED MEASURES OF CREDIT CONDITIONS AT TENTH DISTRICT AGRICULTURAL BANKS

	Loan Demand (index)†	Fund Availability (index)†	Loan Repayment Rates (index)†	Loan Renewals or Extensions (index)†	Average Rate on Operating Loans (percent)	Average Loan-Deposit Ratio* (percent)	Banks with Loan-Deposit Ratio Above Desired Level* (percent of banks)
1981							
Jan.-Mar.	94	132	68	133	16.33	59.6	34
Apr.-June	102	120	60	142	17.43	61.2	37
July-Sept.	93	113	55	144	18.12	61.3	37
Oct.-Dec.	90	127	44	159	16.65	58.8	39
1982							
Jan.-Mar.	81	127	39	161	16.96	58.3	31
Apr.-June	86	124	47	157	16.94	60.0	31
July-Sept.	97	116	50	156	15.50	61.5	40
Oct.-Dec.	88	128	45	155	14.38	59.8	39
1983							
Jan.-Mar.	85	133	62	144	13.98	59.3	31
Apr.-June	92	129	71	137	13.88	61.0	38
July-Sept.	88	126	69	138	14.04	60.8	38
Oct.-Dec.	100	126	59	140	13.99	60.7	44
1984							
Jan.-Mar.	107	116	53	145	14.19	59.9	38
Apr.-June	108	116	51	150	14.58	60.9	38
July-Sept.	101	105	49	148	14.69	61.2	42

*At end of period.

†Bankers responded to each item by indicating whether conditions during the current quarter were higher, lower, or the same as in the year-earlier period. The index numbers are computed by subtracting the percent of bankers that responded "lower" from the percent that responded "higher" and adding 100.

SOURCE: Federal Reserve Bank of Kansas City.

Loan conditions and interest rates

Loanable funds remained generally available during the third quarter, and loan demand eased. Only 9 percent of the banks reported they had refused loans because of a shortage of loanable funds, and fewer loan requests were referred to correspondent and nonbank credit agencies than in the first half of the year. Moreover, 25 percent of the banks reported more funds available than a year earlier. However, 20 percent of the banks reported funds less available than a year earlier, the largest percentage since early 1980. Also, fewer bankers actively sought new farm loan accounts than in any quarter since mid-1981.

The average loan-deposit ratio in the district increased slightly to 61.2 percent, the highest ratio since the third quarter of 1982 (Table 3). Loan-deposit ratios were up at some banks because adverse harvest conditions delayed loan repayments. Ratios ranged from 54.7 percent in Missouri to 67.9 percent in Nebraska. Thirty percent of the respondents reported loan-deposit ratios of more than 70 percent, a slight increase from the second quarter. About 42 percent of the banks indicated their loan-deposit ratios were higher than they would have liked, the largest percentage so far this year. Overall, banks remain cautious about prospective credit conditions for farm borrowers.

Interest rates edged upward only slightly in the third quarter after a small increase in the second quarter. Rates increased an average of 13 basis points to a level 61 basis points higher than a year earlier. Interest rates were higher for all categories of loans. At the end of the third quarter, rates averaged 14.7 percent on operating loans, 14.6 percent on feeder cattle loans, 14.9 percent on intermediate loans, and 14.6 percent on real estate loans. Rates were highest in Oklahoma and lowest in Missouri, as they have been all year.

BANKING AND MONETARY AGGREGATES

(Seasonally adjusted annual growth rates)

	1982*	1983*	1984 Q2*	1984 Q3*	1984 Aug.	1984 Sept.	1984 Oct.
Banking Aggregates							
Total reserves	6.1	6.6	8.5	6.6	4.6	−9.0	−13.0
Nonborrowed reserves†	6.7	5.6	−3.7	17.8	2.9	−3.1	−19.0
Monetary base	7.6	9.3	7.1	7.3	7.6	−0.3	2.7
Bank loans and investments	7.8	10.3	10.0	7.5	8.2	7.3	7.6
Monetary Aggregates§							
M1	8.7	10.0	6.2	4.5	2.0	4.8	−7.2
M2	9.5	12.1	6.9	6.2	4.8	7.6	5.9
M3	10.6	9.7	10.3	8.2	4.9	7.6	10.7

*Based on quarterly average data.
†Nonborrowed reserves include extended credit borrowing.
§M1 is currency plus demand deposits, other checkable deposits, and travelers checks. M2 is M1 plus overnight and retail RP's, noninstitutional money market mutual funds, and savings and small time deposits. M3 is M2 plus large time deposits, institutional money market mutual funds, and term RP's.

Farm financial problems continue

The financial condition of many farm businesses in the Tenth District remains strained. Responding bankers report that producer financial stress was substantially higher than normal in the past six months.

The rate of farm business failure grew worse in the past two quarters. Bankers reported that 4.5 percent of farmers and ranchers in the district went out of business in the past six months because of financial difficulties, nearly three times as many failures as the bankers considered normal and up slightly from the first quarter. All categories of liquidations—whether due to bankruptcy, foreclosure or repossession, or other financial stress reasons—were higher than normal, according to the bankers. Full liquidations for reasons of financial stress were highest in Missouri and lowest in Oklahoma and Kansas. Farmers and ranchers leaving agriculture over the previous six months for reasons not related to financial conditions—such as retirement, health, or age—were only slightly higher than normal.

Partial liquidations due to financial stress also increased in the past six months. In the second and third quarters, 5.7 percent of farm businesses sold part of their capital assets but continued to operate. This figure, which was up slightly compared with the previous six months, was a little more than three times as many partial liquidations as the bankers considered normal. Partial liquidations were highest in Missouri and lowest in Oklahoma and the Mountain States.

In response to continuing farm financial problems, the Reagan administration has announced a four-point debt restructuring program to help farmers that have shown good management skills but cannot repay existing loans because of cash flow problems. The program, announced late in the third quarter, will be administered by the Farmers Home Administration (FmHA).

The program has two primary features. First, part of eligible loans (that is, loans whose restructuring will provide a positive anticipated cash flow for the borrower) held by the FmHA can be set aside—with no repayment of principal or interest—for up to five years and payments will be rescheduled on the remaining indebtedness. After five years, the total loan, including the set-aside portion, will be amortized over the remaining life of the loan. Second, the government will guarantee up to 90 percent of eligible loans held by other lenders, including commercial banks, in exchange for lenders writing off at least 10 percent of the initial loan value. Additional credit management guidance and FmHA contracting of loan servicing with private sector lenders make up the remaining points of the program. The program is expected to be fully implemented in Kansas, Iowa, Minnesota, Missouri, and Nebraska by January 1, 1985 and could be extended to other states as need indicates.

Success of the program remains to be seen, but agriculture will still have financial problems. Marked decline in district land values, high real interest rates, and continued high liquidation rates suggest farm financial stress will remain significant in coming months. □

—Mark Drabenstott and Marla Borowski

TENTH DISTRICT DEPOSITORY INSTITUTION STATISTICS

(In millions of dollars, not seasonally adjusted)

	Level	Change For Month		Percent Change Year Ended	
	Oct. 1984	Oct. 1984	Oct. 1983	Oct. 1984	Oct. 1983
All Depository Institutions*					
Total deposits	136,735	+3,356	+1,010	+13.6	+12.4
Total checkable	29,976	+361	+434	+3.8	+6.2
Demand	19,494	+198	+323	+0.4	−2.7
Other checkable	10,482	+163	+111	+10.9	+31.0
Small time and savings	82,422	+2,209	+547	+14.4	+21.6
Large time	24,337	+786	+29	+25.4	−5.7
Large District Commercial Banks					
Total loans, gross	17,472	+148	+403	+10.5	+6.0
Real estate	3,790	+28	+106	+13.2	+7.1
Commercial and industrial	6,757	+97	+127	+3.1	+4.5
Consumer	3,268	+36	+55	+14.1	+4.4
All other	3,657	−13	+115	+20.2	+9.8
Total investments	5,360	+1	−11	−1.3	+12.1
U.S. Treasury securities	2,987	−23	+51	+46.2	+36.4
All other securities	2,373	+24	−62	−30.0	+1.3
Total deposits	21,939	+292	+202	+3.9	+4.0
Total checkable	7,981	+58	+177	+0.0	+0.2
Demand	6,743	+45	+149	−1.2	−2.4
Other checkable	1,238	+13	+28	+6.7	+20.0
Small time and savings	7,230	+115	+81	+10.3	+47.3
Large time	6,728	+119	−56	+2.5	−16.5
Federal funds purchased, net	2,524	−52	−134	+35.3	+5.8

*Data include deposits at commercial banks, savings and loan associations, credit unions, and industrial banks with reservable liabilities above $2.2 million.

In the Tenth District

Total deposits at depository institutions in the Tenth District grew $3.4 billion in October, compared with an increase of about $1 billion a year earlier. The increase in total deposits resulted primarily from increases in small time and savings deposits and large time deposits.

For the year ended in October, total deposits grew 13.6 percent, after a 12.4 percent advance the previous year. Increases in large time deposits, small time and savings deposits, and other checkable deposits led the advance in total deposits.

Total deposits at large commercial banks in the district increased $292 million in October, compared with an increase of $202 million in October 1983. Increases in large time deposits and small time and savings deposits accounted for most of the gain. For the year ended in October, total deposits rose 3.9 percent, after a rise of 4.0 percent the previous year.

Total loans at large commercial banks in the district rose $148 million in October, well under the $403 million increase in October 1983. Commercial and industrial, real estate, and consumer loan categories all showed gains. For the year ended in October, total loans increased 10.5 percent, compared with a 6.0 percent increase the previous year. All loan categories registered increases over the past 12 months. □

FEDERAL RESERVE BANK OF KANSAS CITY
BOARD OF DIRECTORS' MEETING

FINANCIAL STRESS IN AMERICAN AGRICULTURE

by

Marvin Duncan
Vice President
and Economist

Kansas City, Missouri
December 13, 1984

American agriculture is in the midst of a traumatic adjustment to greater market competitiveness. Farmers who entered the 1980s with high amounts of leverage are reaping a bitter harvest of financial stress. Commercial banks and other lenders are now sharing in that stress as loan foreclosures and loan losses mount. The heightened stress has spawned a number of proposals for government assistance to hard pressed farmers and their lenders.

This morning I will discuss the farm leverage dilemma, examine its effect on farm finances, and indicate the implications for farmers and lenders. Finally, I will mention a range of government assistance packages currently being discussed.

It is leverage that separates those who are doing reasonably well from those who have serious troubles (Chart 1). Induced by rising income expectations and price signals distorted by rising inflation, farmers aggressively used debt in the 1970s to finance farm business expansion and paper over short-term debt service problems. As the decade began, the sector's debts were about 3.5 times its annual income. The debt-to-income ratio climbed rapidly during the decade, and by 1984 farm sector debt had risen to nearly ten times annual farm sector income.

With the arrival of relative price stability, financial market deregulation, and more realistic income expectations, debt service for heavily leveraged farmers became a crushing burden. Inflation adjusted interest rates, which had been negative on a before-tax basis during most of the past decade, turned sharply positive in late 1979 and have remained very high since then. Chart 2 plots the interest rate on three-month U.S. Treasury bills adjusted for inflation by use of the Consumer Price Index.

The effect of leverage is demonstrated in Table 1. Even with relatively unfavorable prices, farmers holding little or no debt can earn positive income

returns to equity. But with an interest rate of 11 percent, income returns to equity have turned negative for farmers with debt-to-asset ratios over 20 percent. Sharply increasing negative rates of return are earned as leverage increases. With an 80 percent debt-to-asset ratio a farmer could lose one-third of his equity in the span of one year.

Poor farm income prospects and high real interest rates have exacted a toll on farm real estate values (Chart 3). In the Tenth Federal Reserve District, land values have declined by 27 to 32 percent from the market highs reached in early 1981. Moreover, land values appear to be falling more rapidly as 1984 draws to a close. District farmland values, barring lower real interest rates or higher farm product prices, now seem destined to decline to about 50 to 60 percent of their previous market highs.

Thus, both farm operating income and equity have come under severe downward pressure, calling the creditworthiness of many farmers into question. As a result, farmers, agricultural lenders, and their elected representatives have all warned about the rising level of farm financial stress and its serious effects on rural communities.

High leverage is the common theme explaining such stress. A 40 percent debt-to-asset ratio seems to be the dividing line between modest and serious financial stress. Nationally, farmer-operators with over 40 percent leverage represent 19 percent of all farm operators (Chart 4). They account for 64 percent of all farm debt but hold only 22 percent of farm assets.

These data likely overstate the national proportion of farmers in serious financial trouble, however. That is true for the following reasons. First, farms with annual sales of $500,000 or more, despite high leverage, seem as a group to be very profitable. In the Tenth District, cattle feedlots and large confinement hog operations would fall into this group, for example. Second,

farms with sales less than $40,000 in annual sales, although often highly leveraged, usually rely on off-farm income to help service debt. Indeed, farm income for this group has typically not been sufficient either to justify extension of the debt held or to properly service it.

Thus, it seems reasonable to conclude that major farm financial stress problems are occurring on heavily leveraged farms with annual sales of from $40,000 to $499,999 (Chart 5). Nationally, among farms with debt-to-asset ratios over 40 percent are about 9 percent of the farm operators. These highly leveraged farmers, who hold 39 percent of farm operator debts and own about 14 percent of farm operator assets, are about 210,000 in number. They own assets valued at $107 billion and owe $73 billion.

Farm financial stress is forcing many farmers into liquidation (Chart 6). In the Tenth District, agricultural bankers report that during the second and third quarters of 1984, 4.5 percent of the district's farmers went out of business because of financial stress--2.8 times the proportion bankers considered normal. Partial liquidations due to financial stress affected 5.7 percent of farm businesses--3.2 times the normal proportion. Tenth District financial stress was apparently highest in Missouri and Nebraska. Current indications point toward even more financial stress this winter and next spring.

Farm financial stress has affected the performance of agricultural banks across the country. Loan loss rates at these banks at the end of 1983 were five times as great as in 1979 (Chart 7). Substantially higher loan losses are in prospect for 1984 and 1985. So far, provisions for loan losses have kept pace with the losses written off. Agricultural bank profits, measured by returns to equity, have fallen sharply, however (Chart 8). But capital ratios have been maintained, so far.

Growing financial problems in agriculture, as indicated by the growth of total net charge-offs as a proportion of total loans outstanding at agricultural banks, are of major concern to lenders (Chart 9). It is apparent that agricultural bank performance, over the past few years has changed from exhibiting fewer loan losses than nonagricultural banks to exhibiting substantially more loan losses than nonagricultural banks.

Until recently, failures among agricultural commercial banks lagged behind failures of comparable sized nonagricultural banks. This year, the rate of agricultural bank failures has climbed relative to nonagricultural banks. Out of 76 bank failures nationwide this year, 21 have been agricultural banks.

Losses have mounted for the farmer-owned cooperative farm credit system, as well. Production Credit Association (PCA) losses for 1984 are expected to total $250 million, compared with only $109 million for the entire decade of the 1970s. PCA losses in 1983-84 together exceed the combined losses of the previous 50 years. Five PCAs failed this year, and a larger number will likely fail in 1985. The losses expected for the Spokane Federal Intermediate Credit Bank (FICB) could be large enough to jeopardize the bank's financial stability. Losses could be very large at a number of other FICBs, as well.

Federal Land Banks (FLB), which have experienced relatively few loan losses thus far, are now bracing for what could be a marked increase in loan delinquencies and later in loan losses. The increase is expected because commercial banks and PCAs probably will no longer extend credit to farmers for financing land payments; for most heavily leveraged farmers, equity in land is being rapidly dissipated as land values decline. While FLBs are well capitalized and loan losses are not expected to impair their stability, the losses could be substantial. For example, the Omaha FLB, could experience one

of the higher loss ratios among the 12 district FLBs. Insurance companies report mounting delinquencies and losses in their farm real estate portfolios, as well.

This rather sober view of farm financial conditions and the fears by some that conditions could continue to deteriorate for another two to three years have prompted a number of proposals for public intervention. Among these are the following:

1. The administration's proposals for limited public assistance to financially troubled farmers and lenders through its Farmers Home Administration credit assistance programs, announced this fall.
2. A proposal that the Federal Reserve System, through its discount window, lend directly to troubled farmers, accepting a security interest in real estate and other assets as collateral.
3. A proposal to create and capitalize a new federal agency to lend to troubled farmers, accepting a security interest in real estate and other assets as collateral.
4. A proposal to require that the Governor of the Farm Credit Administration release a contingency fund (currently $125 million) to support short-term and long-term lending to troubled farmers. Congress presumably would add substantially to this fund once the program was underway.

These proposals are not without problems. Each entails government expenditures--or at least contingent liability--from a few billion dollars to several billion. Ultimately, losses to the government could be substantial. Necessary downward adjustment in farm asset values could be stalled. And perhaps most serious, essential functions of the Federal Reserve System and the Farm Credit Administration could be distorted and possibly impaired.

In summary, much of the current financial stress in agriculture is rooted in the inflationary excesses of the 1970s. The current and prospective financial problems resulting from adjustment to slower world economic growth and relatively greater price stability are placing great stress on the farm sector and its lenders. The stress will become more intense before it eases. Pressures for quick political solutions will build this winter. Some public intervention to modulate the sector's adjustment may be appropriate. Unfortunately, most of the proposals being raised are at best poorly conceived. At worst, they could jeopardize the effectiveness of important public institutions and limit the longer term competitiveness of U.S. agriculture in the world marketplace.

Table 1

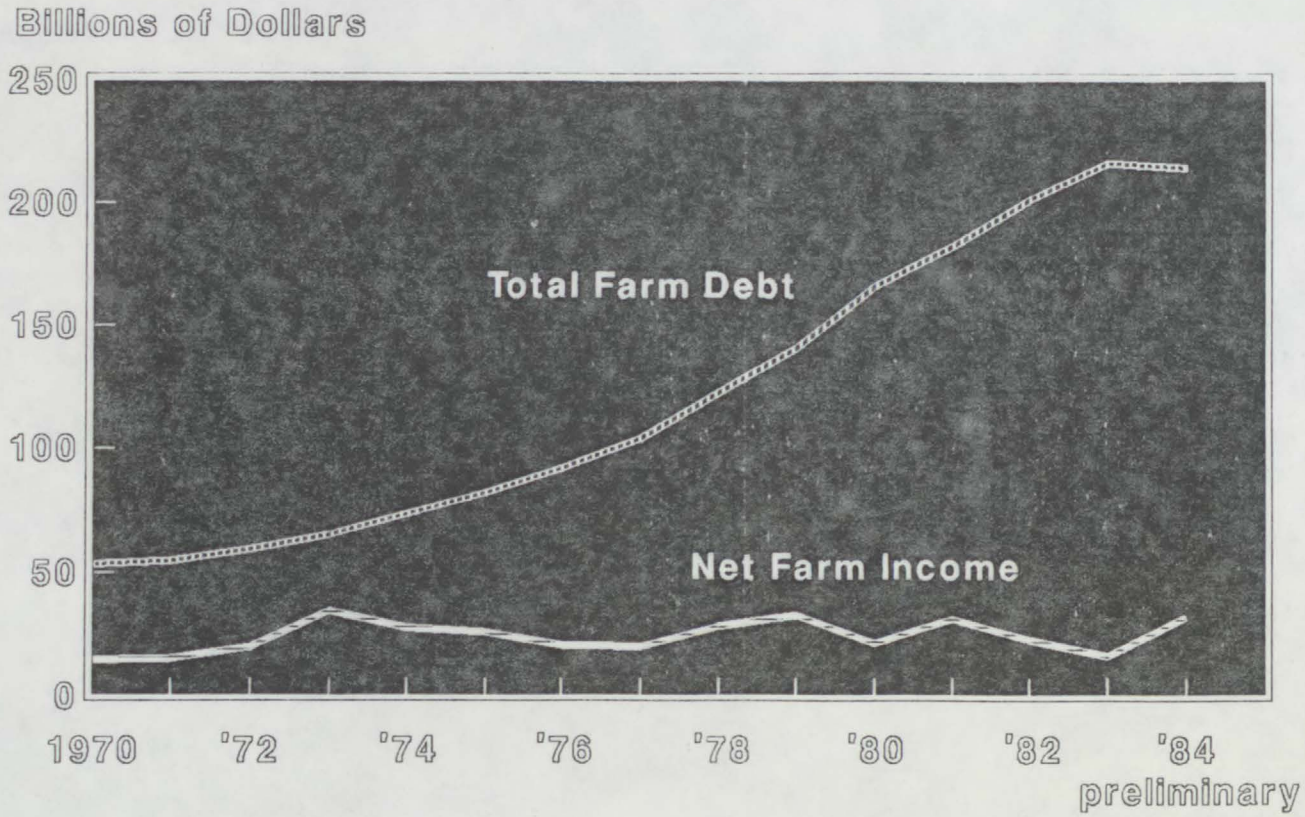
Income Return to Equity

Debts/Assets	Interest rate on debt		
	7%	11%	15%
0	2.0	2.0	2.0
20	0.8	-0.2	-1.2
40	-1.3	-4.0	-6.7
60	-5.5	-11.5	-17.5
80	-18.0	-34.0	-50.0

Source: Board of Governors of the Federal Reserve System.

Chart 1

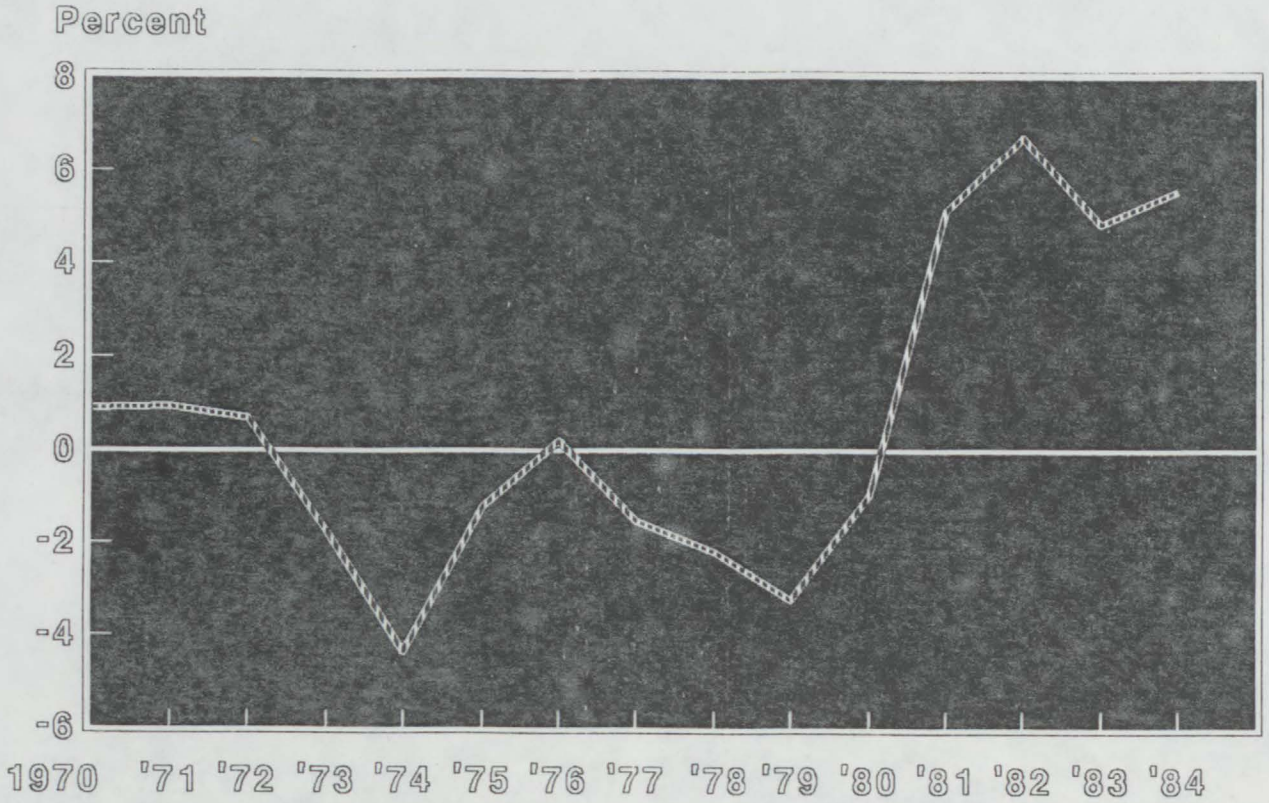
Farm Income and Farm Debt



Source: U.S. Department of Agriculture.

Chart 2

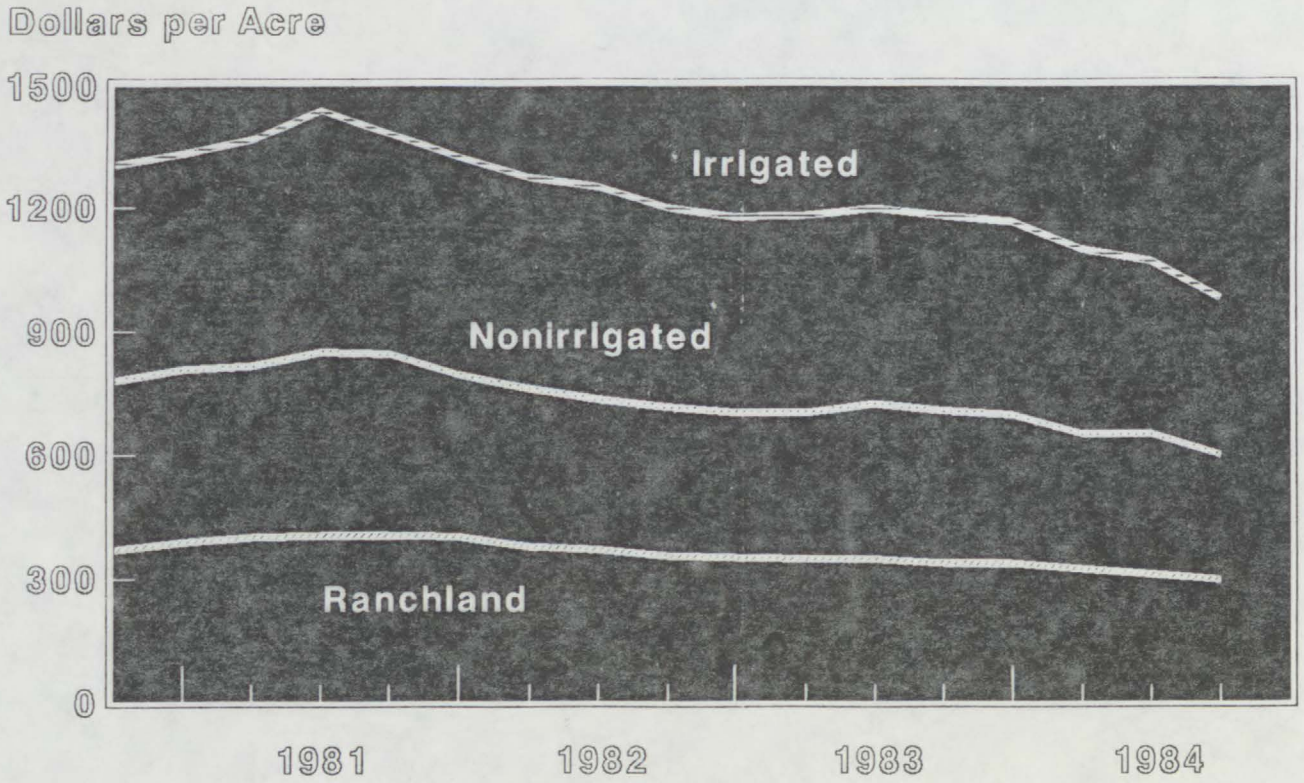
Real Interest Rates*



*Three-month Treasury-bill rates and annual inflation rates from the Bureau of Labor Statistics were used to calculate the real rate of interest, which is defined as the nominal interest rate minus the actual rate of inflation.

Chart 3

Farm Real Estate Values

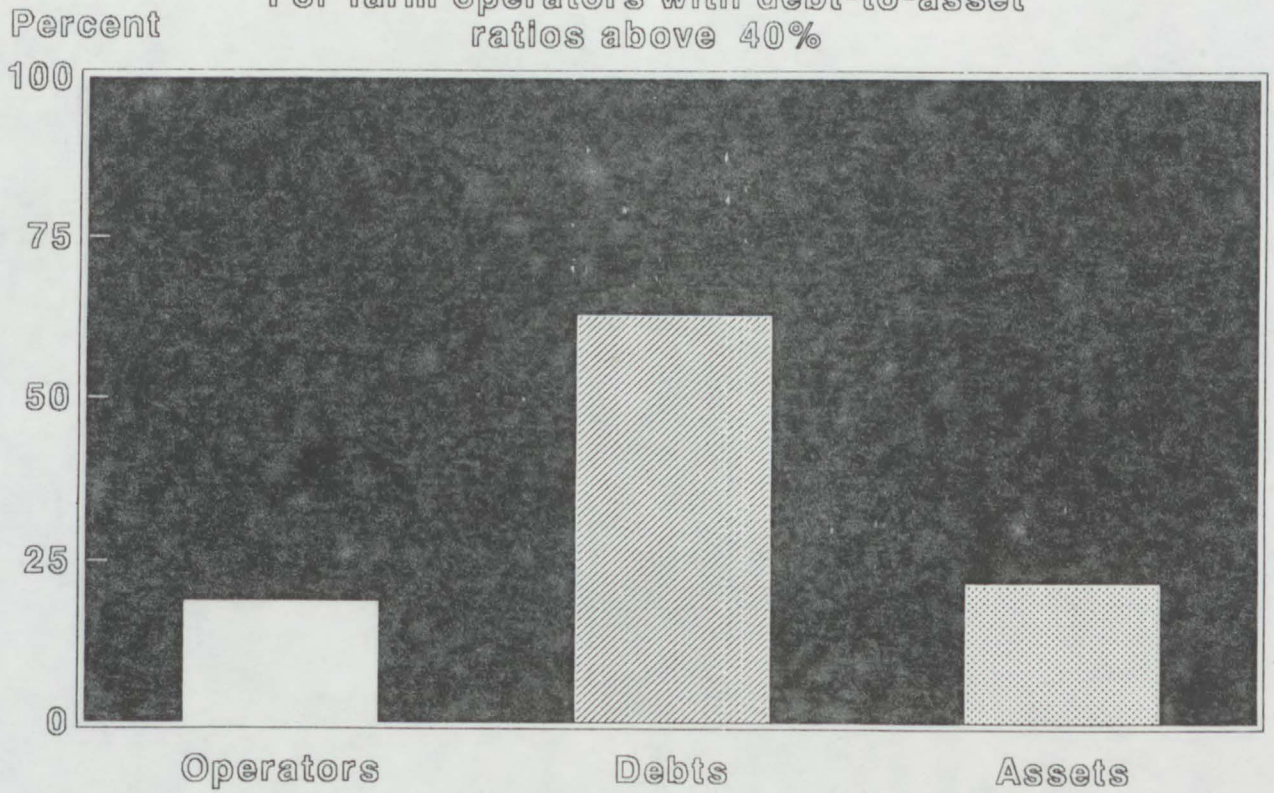


Source: Federal Reserve Bank of Kansas City.

Chart 4

Distribution of Farm Debt and Assets

For farm operators with debt-to-asset ratios above 40%

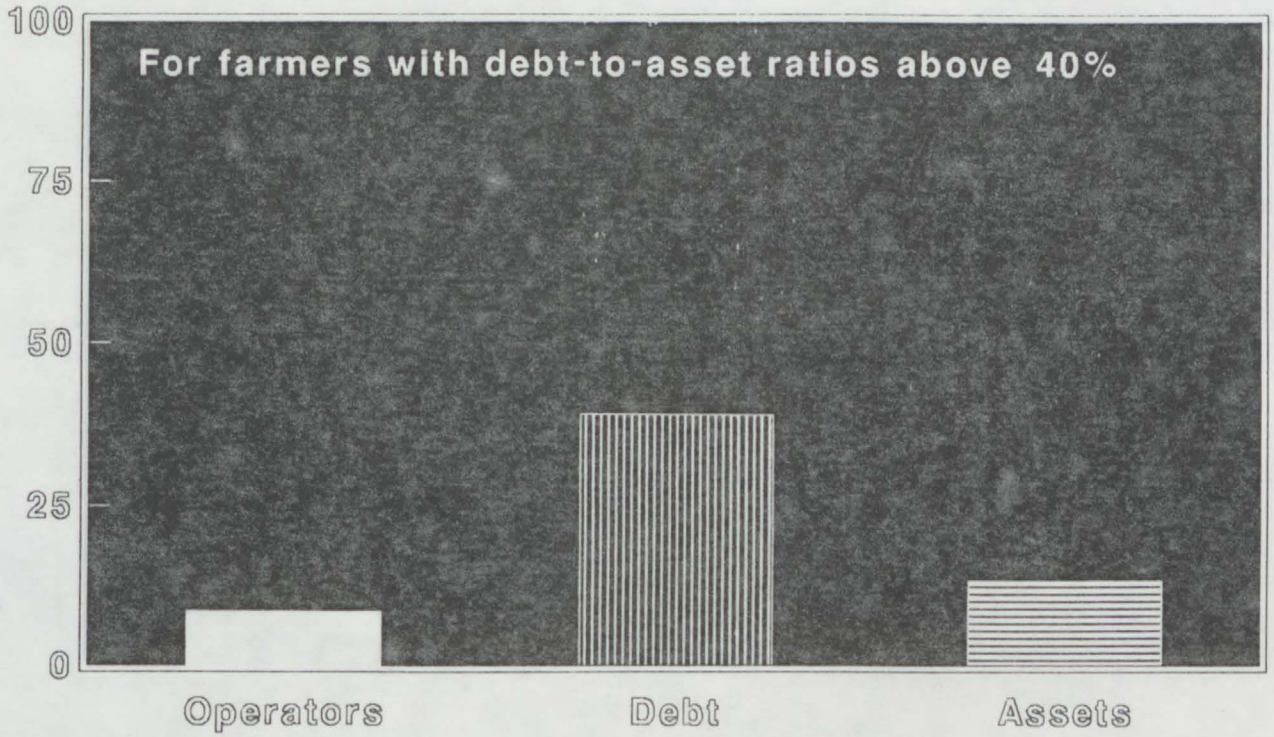


Source: U.S. Department of Agriculture.

Chart 5

Farm Debt and Assets for Selected Sales Classes

$40,000 to $499,999

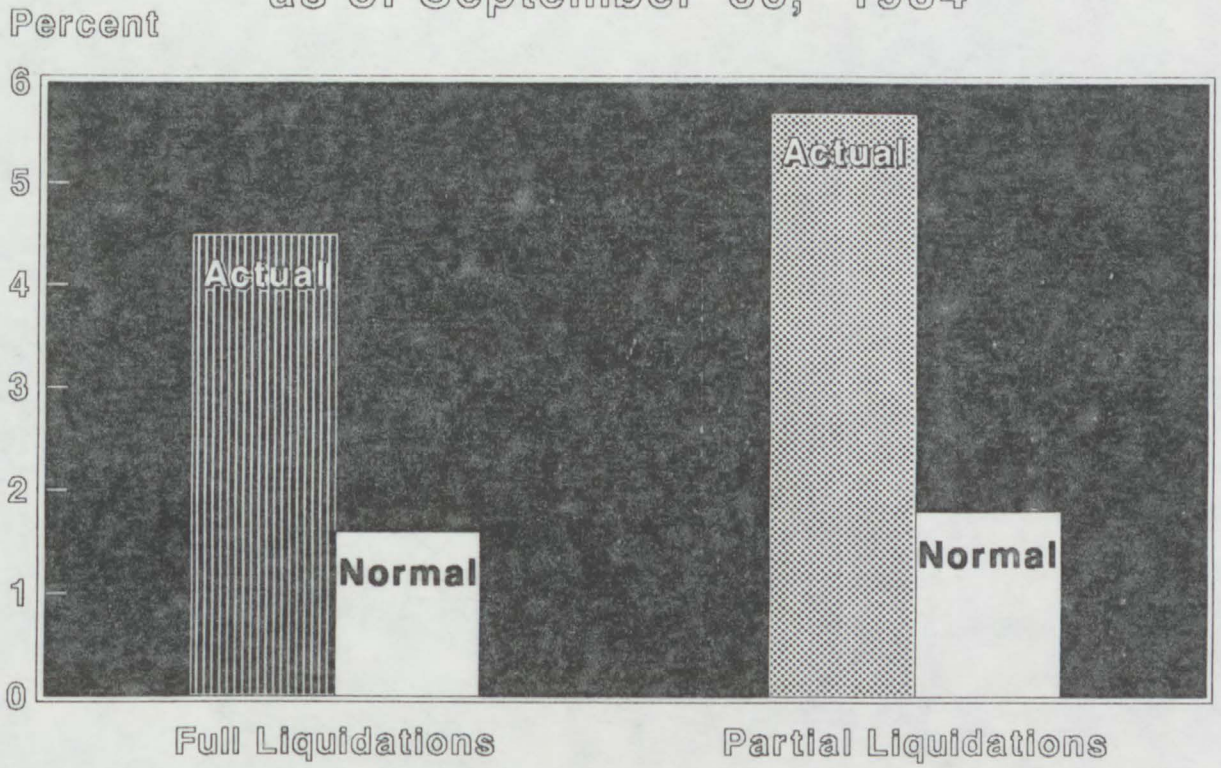


Source: U.S. Department of Agriculture.

Chart 6

Financial Stress in Tenth District Agriculture

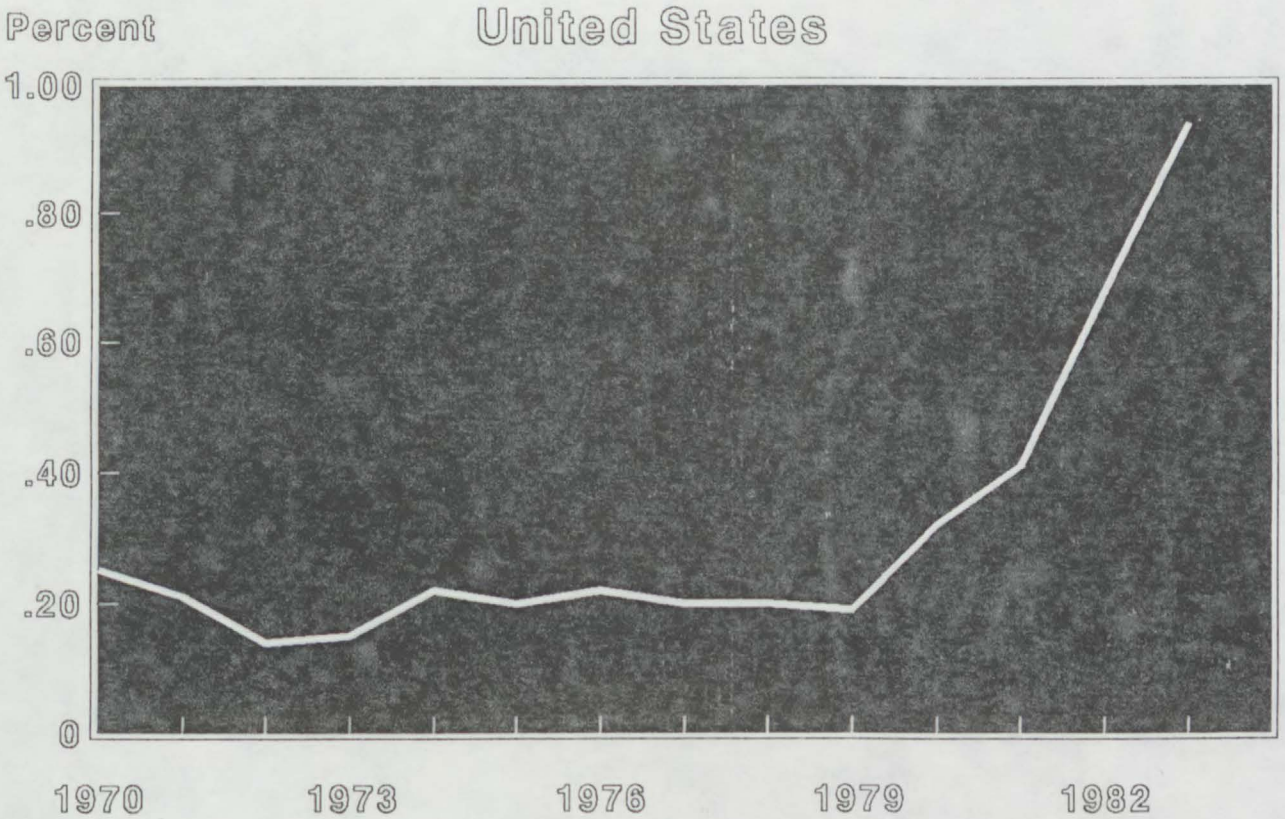
as of September 30, 1984



Source: Federal Reserve Bank of Kansas City.

Chart 7

Loan Loss Rate at Agricultural Banks

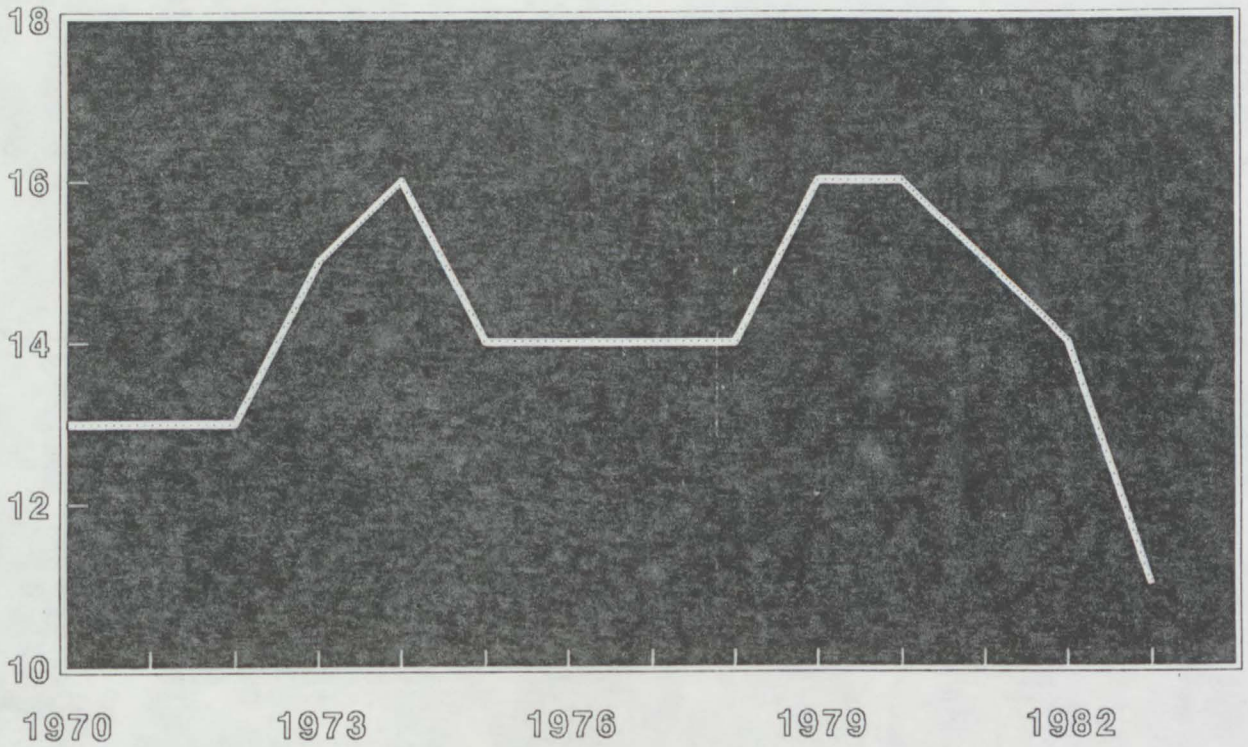


Source: Board of Governors of the Federal Reserve System.

Chart 8

Profitability at Agricultural Banks

United States

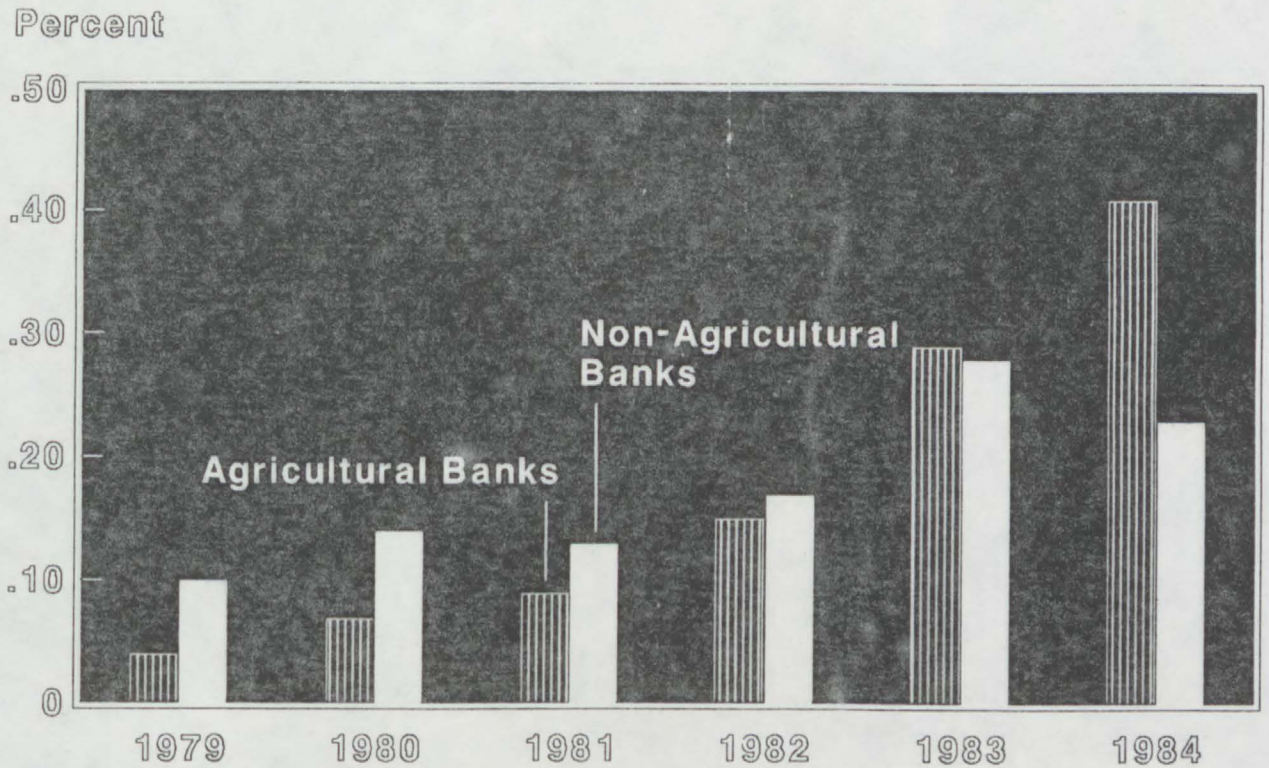


Source: Board of Governors of the Federal Reserve System.

Chart 9

Total Net Charge-Offs

First half of year



Source: Board of Governors of the Federal Reserve System.

Paul A. Volcker

July 22, 1982

Governor Martin:

Does this inspire you?

Preston Martin

July 26, 1982

Chairman Volcker

No, but it reminds me that gratitude is the most fleeting of human emotions.

P.M.

FEDERAL RESERVE BANK
OF KANSAS CITY

#2419

ROGER GUFFEY
PRESIDENT

July 19, 1982

Mr. Paul Volcker
Chairman
Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

Dear Paul:

Attached are copies of letters from Bill McLean and Jack Conn, Oklahoma City bankers, concerning the receiver certificates which will be issued by the FDIC to nondepository entities. You will note that each of them questions whether the receiver certificates will be used by a depository institution as collateral for a loan at the discount window since they are only accepted by the Federal Reserve with recourse. They would urge the Federal Reserve to liquify the certificates by purchasing them on a discount basis.

I pass this correspondence on to you without further comment.

Sincerely,

Roger

Gov Martin
Gov Partee
Does this inquire you.
PAV

copy sent to each 7/22/82

LIBERTY
THE BANK OF MID-AMERICA

July 12, 1982

13 JUL 82 14:29

- PRESIDENT -

Mr. Roger Guffey
President
Federal Reserve Bank
Federal Reserve Station
Kansas City, Missouri 64198

Dear Roger:

My associates and I have now become aware of a significant number of Penn Square Bank uninsured depositors who may well be forced out of business, if their "receiver certificates" cannot be converted to cash on some reasonable basis -- and promptly.

Clearly, your recent communication that they "will be acceptable as collateral from depository institutions" at the Discount Window is of little assistance, inasmuch as you have confirmed that such a pledge would be "with recourse"; and we know of no financial institution (local or otherwise) which would be willing to make a market for individual certificate holders or to assign them a significant collateral value.

Roger, the mismanagement of Penn Square was bad enough in terms of its general debilitating effects upon the economy of our region. Surely something can be done to prevent a chain of innocent business failures as well.

It is understandable that no one can foresee with any reliability the ultimate hard value of the certificates, but here's an approach for the Fed's consideration:

> "MAKE THE CERTIFICATES ELIGIBLE FOR REDISCOUNTING AT 60% OF VALUE 'WITHOUT RECOURSE' AT THE DISCOUNT WINDOW, PLUS A SHARING OF ANY ULTIMATE EXCESS IN FINAL LIQUIDATION, IN THE RATIO OF 3/4THS TO THE ORIGINAL HOLDER AND 1/4TH TO THE FEDERAL RESERVE BANK OF KANSAS CITY."

LIBERTY NATIONAL BANK AND TRUST COMPANY · LIBERTY TOWER · 100 BROADWAY · OKLAHOMA CITY 73125

In other words, if a $1 million certificate ultimately liquidates at 80% of face value, your bank would earn $50,000 for having advanced $600,000. Admittedly, the pecuniary return would be modest, especially if liquidation requires a lengthy legal process. But, the return to the Fed in terms of preventive maintenance of business conditions in the District could be incalcuable. I also happen to believe that Fed involvement might be the very element that would in fact shorten the liquidation process. Indeed, even if there are statutory problems, they should be set aside.

Respectfully, I cannot close without the reminder that -- if very much time is consumed in reaching a final and reasonable decision -- it shall all have been in vain.

Most sincerely,

D. W. McLean

LIBERTY TOWER 100 BROADWAY OKLAHOMA CITY 73125

13 JUL 82 12: 20

PRESIDENT

FIDELITY BANK N.A.

JACK T. CONN
VICE CHAIRMAN

FIDELITY OF OKLAHOMA, INC.
CHAIRMAN OF THE BOARD

July 12, 1982

Mr. Roger Guffey
President
Federal Reserve Bank of Kansas City
Federal Reserve Station
10th and Grand Streets
Kansas City, Missouri 64198

Dear Roger:

We are appalled and dismayed by the failure of Penn Square Bank, N.A. In our seventy five years of Statehood, we have never experienced the insolvency of a financial institution approaching its magnitude.

The repercussions are heart rending. The FDIC estimates $190 million of deposits exceed the maximum coverage of $100,000. Thus far that Agency has refused to extend insurance coverage in whole or in part to those deposits, one of the few exceptions to its past policy. If relief be not granted expeditiously and with dispatch, many businesses in Oklahoma will be severely strained and it is probable, some will fail.

The issuance to these depositors of so called "receivers certificates" is of no benefit and harmful in that the appellation is misleading. Such certificates, contrasted to the top quality accorded in bankruptcy, have no priority save over the bank's shareholders. At this juncture, no sound, well managed commercial bank would accord value to them for any purpose.

The tender of the Federal Reserve Bank has been made to accept the certificates as collateral <u>with recourse</u> at the discount window is of little benefit. In essence, there is no difference in liability in buying the certificates or endorsing them to the Fed with recourse. We find no moral or banking justification for taking that risk. Fidelity does not possess knowledge of the losses in Penn Square's note and investment portfolios, and we are powerless to enforce collection of its notes or to dispose of its investments.

ROBINSON AT ROBERT S. KERR AVENUE · P. O. BOX 24128 · OKLAHOMA CITY 73124 · (405) 272-2000

The FDIC and the Comptroller of the Currency have information upon which reasonable and expeditious appraisal of banking assets could be made. Should that appraisal indicate possible losses would not exceed insured deposits, and 60% of uninsured deposits, the FDIC and, perhaps, the Federal Reserve Bank would then be in position to accept receivers certificates up to 60% of their face amount without recourse, with fair and equitable treatment to depositors upon liquidation of the certificates. That solution would do much to relieve many businesses from their present jeopardy.

There may be other and more viable solutions. We ask only that something be done immediately to aid these depositors who face economic peril.

Sincerely,

Jack

Jack T. Conn

JTC/hr

cc: Mr. J. W. McLean
Liberty National Bank
P. O. Box 25848
Oklahoma City, OK 73125

Copy

DAV
Guffey

FEDERAL RESERVE BANK OF KANSAS CITY
KANSAS CITY, MISSOURI 64198

March 14, 1980

Mr. Edward C. Ettin
Deputy Staff Director
Office of Staff Director
for Monetary and Financial Policy
Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

Dear Mr. Ettin:

As requested in Ted Allison's letter of February 12, we have obtained views from senior officers of selected member banks on the issue of daylight overdrafts. Meetings were held with representatives of 19 banks in eight cities in our district; a summary of their responses follows.

The bankers unanimously reacted very negatively to the Federal Reserve taking a uniform approach to dealing with daylight overdrafts rather than judging the need to apply such measures on an individual bank basis. They believe the System could justify applying such measures only to banks that are either approaching insolvency or have frequent operating problems that result in overnight overdrafts under present procedures.

Understandably, the bankers do not agree that a penalty should ever be charged for daylight overdrafting in the course of carrying on normal business activity. They point out that the American business system is based almost entirely on good faith relationships. The only time there is deviation from this style of operation is when there is reason to believe that payment might not be made as scheduled. There is some real concern that the Fed would be shirking its responsibilities for promoting a smoothly functioning and effective payments mechanism if strong measures were implemented to curtail daylight overdrafts. They believe it is unreasonable for the Fed to take a position of dealing in a no-risk fashion with banking functions which entail taking normal business risks.

All banks we contacted assured us they would find it necessary to develop automated systems which would permit them to enter transfers and hold them for transmission until some few minutes prior to our closing the wire system. Of course, they recognize that banks throughout the nation would be doing the same thing, causing problems for the entire banking system. In this regard, they think the System would have to establish uniform operating hours for the Fed wire to keep banks from being either advantaged or disadvantaged by being located in a particular time zone.

There is some question about what effects would be caused by the holding of high volumes of transfer traffic until late in the day. The bankers judge that the banking system could be faced with a very large excess or shortage of funds available on a given day. This factor could make reserve management more difficult for member banks. It may be that the Open Market Desk would find it more difficult to monitor and interpret intra-day movements in the Fed funds market. Whether these impacts would be fully realized or not, it appears that the bunching up of transactions within a short time frame late in the day would make the financial markets very sensitive to the level of activity awaiting processing.

From an operating standpoint, the bankers do not believe the Federal Reserve is capable of processing the heavy volumes that would be involved in the afternoon hours. They are especially concerned about that every-day situation where some component of the Federal Reserve wire network is down. Though we assured them there would be some provision for permitting daylight overdrafts in these situations, they see this as too common a problem to make blanket restraint of daylight overdrafts a workable concept. They note that, to do the job right, the Reserve Banks would need to develop very sophisticated real-time operating systems. Further, they see problems in dealing in a so-called real-time environment when many of the types of transactions we process require considerable processing time before the banks' accounts can be posted.

The staff report on daylight overdrafts suggested that the dollar flow of funds transfers could be reduced by placing some Fed funds transactions under continuing or multi-day contracts, and that this would reduce the occurrence of daylight overdrafts. Most of our banks indicate they would not be willing to do this. They believe their risk would be greater and the interest rates earned would be lower than if the transactions were reestablished each day.

We were somewhat surprised at the strength of the reaction against collateralizing daylight overdrafts, and it was noted in all of our meetings. They indicate they have very little additional collateral of the types currently acceptable for loans at the Fed that could be used for this purpose. They are unanimous in stating they would not be willing to purchase additional similar securities since many of them are taking substantial losses on their portfolio. We thought they might react more positively to the Fed permitting other types of collateral, such as customer notes, to be pledged against daylight overdrafts, but they

did not. Their view is that the Fed would find it necessary to review the collateral, which would either require that it be transferred to the Fed or be physically segregated within the bank for examination purposes. If the approach taken did not provide for the Fed actually inspecting the collateral, they feel we would be no better off than we would be without such collateral and would question our motives.

It appears that System restraints on daylight overdrafts could cause a problem for some banks which hold a state treasurer's account. In our district, those banks which hold such an account indicate that the treasurer's securities are sometimes held by a bank in another part of the country. When the securities mature, some state statutes require that the local bank purchase replacement securities prior to receiving payment for the maturing securities. The amounts involved are usually significant and could create daylight overdrafts for certain of our banks. The point of this example is that settlement procedures currently being followed for certain kinds of transactions may, by their very nature, cause daylight overdrafts.

In my view, the bankers we contacted did an excellent job of independently reviewing the issue, of recognizing that the Fed may have cause to be concerned about any extreme cases of daylight overdrafts, and of judging the impacts on their operations and on their customers. If they were to have to deal in a no-daylight-overdraft environment, they uniformly believe they would be confronted with situations where they would not always be able to respond to all legitimate customer requests on a timely basis. Further, they would find it costly to develop and operate new systems to control their daylight reserve balances.

Any questions you may have about our contacts with member banks should be directed to Jerry Shreeves, vice president in charge of our Accounting department.

Sincerely,

Roger Guffey
President

cc: Chairman Volcker
Presidents of the
Reserve Banks

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Citations: Letter to Paul Volcker from Joseph H. Williams, January 4, 1980.

April 30, 1979

Dear Roger:

Many thanks for sending me the correspondence from Farmers Savings Bank. In light of your comment about the bank's management and the list of reasons given for its withdrawal from the System, it's obvious the move was carefully considered and is, of course, disconcerting from our point of view. We can't do much at this juncture about the first, and undoubtedly the most important, reason--nonearning reserves--but the other reasons suggest to me that the Board and the Presidents should take a careful look at our services at an early date.

Sincerely,

Mr. Roger Guffey, President
Federal Reserve Bank of Kansas City
Kansas City, Missouri 64198

NB:aw
#1066
cc: Mr. Bernard

cc Mr. Apilrodt (ack.)
Mr. Guenther

FEDERAL RESERVE BANK OF KANSAS CITY
FEDERAL RESERVE STATION
KANSAS CITY, MISSOURI 64198

April 24, 1979

#1066

4/30 Acknowledge w thanks
Have we always replied?

Mr. G. William Miller
Chairman
Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

Dear Bill:

In accordance with your request for information concerning banks that are withdrawing from System membership, I am enclosing a copy of a notice to withdraw which was received from the Farmers Savings Bank, Marshall, Missouri.

The bank is a well operated $38 M bank located in a rural community in mid-Missouri. The reasons for this action are setforth in the letter notice. I would note that the bank has been an active borrower at the discount window for adjustment credit over the past year.

This is the tenth bank, representing banking assets of approximately $170 M, in this district that has either withdrawn or is in the process of withdrawing since January 1, 1979.

If you have any questions or need additional information, please let me know.

Sincerely,

Roger Guffey
President

Farmers Savings Bank

Marshall, Missouri 65340

816-886-7477

Member, FDIC

April 20, 1979

Board of Governors of the Federal Reserve System
c/o Federal Reserve Bank of Kansas City
Federal Reserve Station
Kansas City, Missouri 64198

Gentlemen:

Under terms of Regulation H of the Board of Governors of the Federal Reserve System, Section 208.11, entitled "VOLUNTARY WITHDRAWAL FROM FEDERAL RESERVE SYSTEM," we hereby submit our request for permission for the FARMERS SAVINGS BANK, to withdraw from membership in the Federal Reserve Bank of Kansas City. We further request that permission to make such withdrawal be granted prior to the expiration of six months from the above date.

Our reasons for requesting this withdrawal are numerous.

1. We find that the inability to earn an investment return on our reserve balances tends to impair the profitability of our bank.

2. We also find we can get faster collection of deposited items through our primary correspondent than through the Federal Reserve Bank.

3. We find the Federal Reserve Bank will not permit us to put securities in safe-keeping for our customers in their own names. This involves added expense for us in terms of record-keeping. On the other hand, our correspondent will do this and issue duplicate safekeeping receipts for our customers.

4. We anticipate that the Federal Reserve Bank may begin charging for certain services with no offsetting credits or allowances. By carrying our legal reserves with our correspondent we believe we would experience expense savings on an account analysis basis.

5. We have also found it more convenient to use our correspondent in overline loan situations than to use the Federal Reserve discount window.

6. In summary, then, for these and other reasons, we believe we can provide better service to our customers and increase our overall profitability by our withdrawal.

Enclosed please find a certified copy of our Board's resolution authorizing this action. If further information is required for your consideration of this request, please contact us. And, your consideration of this matter at the earliest possible time will be appreciated. Thank you.

Very truly yours,

Alfred R. Hupp
President

ARH:sel
Encl.

4-23-79

CERTIFIED COPY OF RESOLUTION OF BOARD OF DIRECTORS

William G. Buckner, the undersigned, Secretary of the Board of Directors of the Farmers Savings Bank, Marshall, Missouri, hereinafter called "Bank" does hereby certify:

1. That he is the duly elected and acting Secretary of the Bank and has the custody of the Bank records, minutes, bank seal, and is present at and transcribes the minutes of all meetings of the Board of Directors of the Bank.

2. That at a meeting of the Board of Directors of the Bank duly called, convened and held in accordance with its by-laws and with law on the 20th day of April, 1979, at which a duly authorized quorum of the members of the Board of Directors of the Bank were present in person, the following resolution was duly adopted:

"RESOLVED, that the Board of Directors of this Bank does hereby authorize the withdrawal of this Bank's membership in the Federal Reserve System, specifically its membership in the Federal Reserve Bank of Kansas City, Kansas City, Missouri."

"RESOLVED FURTHER, that Alfred R. Hupp, President is hereby authorized to file an appropriate withdrawal application to the Board of Governors of the Federal Reserve System, to surrender for cancellation the stock of Federal Reserve Bank of Kansas City held by this Bank, to receive and receipt for any moneys or other property due to this Bank from the Federal Reserve Bank of Kansas City, and to take such other action as may be necessary to effect the withdrawal of this Bank from membership in the Federal Reserve System."

"RESOLVED FURTHER, that the Secretary be and he is hereby authorized and directed to certify to the Board of Governors of the Federal Reserve System this resolution and that the provisions thereof are in conformity with the Charter and By-Laws of this Bank."

3. That the foregoing resolution was adopted in accordance with the Charter and By-Laws of the Bank and that such resolution is now in full force and effect.

IN WITNESS WHEREOF, the undersigned has caused this certificate to be executed and the seal of the Bank to be hereunto appended this 20th day of April, 1979.

Secretary

W. C. Fletcher, Jr., a Director of the Bank above named, does hereby certify that he knows of his own knowledge that the foregoing is a correct copy of the resolution as therein stated, adopted by the Board of Directors at said Bank as above set forth.

Dated this 20th day of April, 1979.

Director