MID-CONTINENT BANKER

(ISSN 0026-296X) *The Financial Magazine of the Mississippi Valley & Southwest* **NOVEMBER, 1980**

IN THIS ISSUE: INSURANCE/INVESTMENTS

"INFLATION is the single most important economic and social challenge facing America today.

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C. C. Hope, Jr.
President
American Bankers Association

ABA Takes Up Inflation Challenge

Page 19

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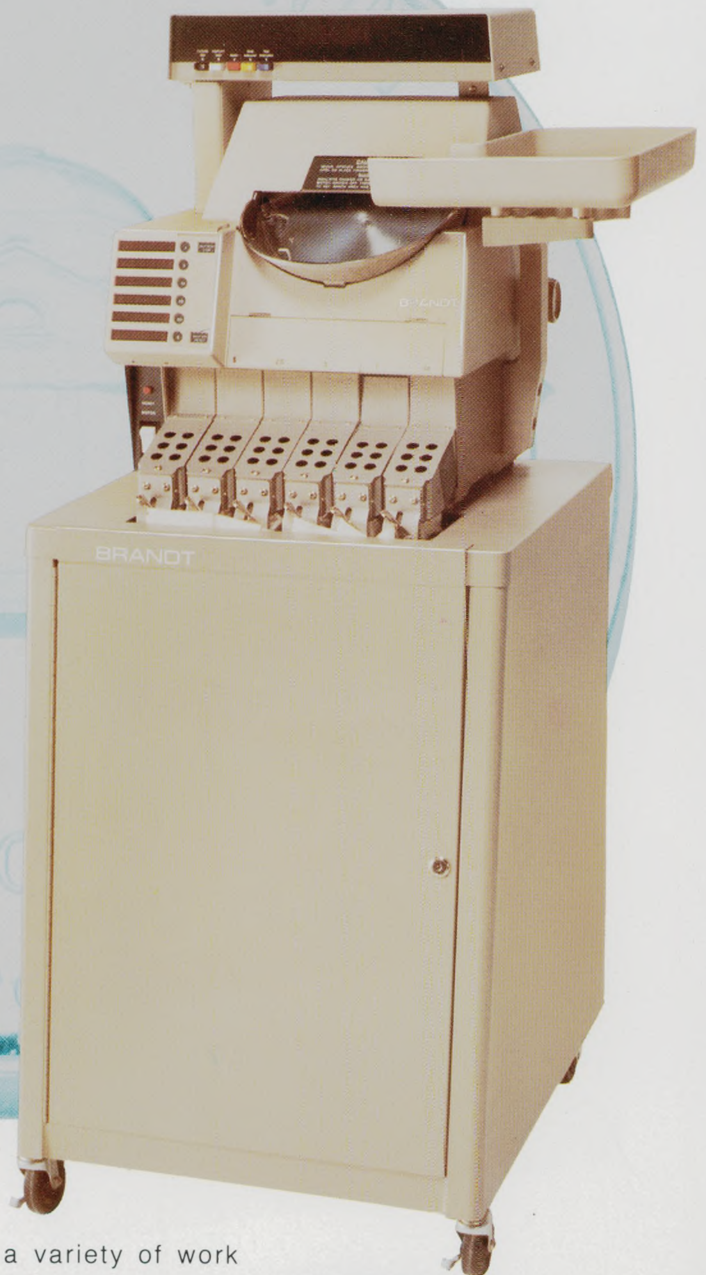

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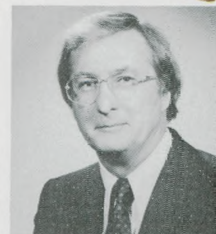

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Convention Calendar

Nov. 16-18: ABA National Correspondent Banking Conference, Atlanta, Hyatt Regency.
Nov. 16-19: Bank Administration Institute ATM Conference, New Orleans, New Orleans Hilton.
Nov. 16-19: Bank Marketing Association Officer Call Sales Workshop, Chicago, Chicago Marriott.
Nov. 18-22: Bank Marketing Association Essentials of Bank Marketing Course/Southwest Extension, Houston, University of Houston.
Nov. 30-Dec. 2: Bank Marketing Association Product Development/Product Management Conference, New Orleans, Fairmont Hotel.
Nov. 30-Dec. 3: Bank Administration Institute Money Transfer Conference, New York City.
Dec. 4-7: Independent Bankers Association of America Seminar/Workshop on Bank Ownership, Point Clear, Ala., Grand Hotel.
Dec. 7-12: ABA National Commercial Lending Graduate School, Norman, Okla., University of Oklahoma.
Jan. 18-20: ABA International Banking Conference, New York City, Grand Hyatt.
Jan. 19-22: Bank Administration Institute Productivity Through Automation/Technology/Human Resources Conference, Dallas, Fairmont Hotel.
Feb. 1-4: ABA Bank Telecommunications Workshop, New Orleans, Fairmont Hotel.
Feb. 1-6: ABA Conference for Community Bank CEOs, St. Petersburg, Fla., Don Cesar Beach Hotel.
Feb. 2-3: Robert Morris Associates BHC/Branch Bank Loan Administration Workshop, Dallas.
Feb. 5-8: 44th Assembly for Bank Directors, Hawaii, Kuilima.
Feb. 8-10: ABA Bank Investments Conference, Washington, D. C., Sheraton Washington.
Feb. 8-20: ABA National Installment Credit School, Norman, Okla., University of Oklahoma.
Feb. 9-11: Bank Administration Institute Bank Security Conference, Miami Beach, Fla., Fontainebleau Hilton.
Feb. 11-14: Bank Marketing Association EFTS Marketing Conference, New Orleans, New Orleans Marriott.
Feb. 12-15: 44th Assembly for Bank Directors, Boca Raton, Fla., Boca Raton Hotel/Club.
Feb. 14-20: ABA National Trust Conference, Honolulu, Sheraton Waikiki.
Feb. 15-18: ABA Community Banks Executive Conference, Phoenix, Hyatt Regency Phoenix.
Feb. 18-20: ABA Corporate/Commercial Marketing Seminar, Dallas, Fairmont Hotel.
Feb. 19-20: Robert Morris Associates Managing International Lending Risks Workshop, Houston.
March 15-18: Bank Marketing Association Community Bank CEO Seminar, San Diego, Calif., Hotel Del Coronado.
March 22-24: ABA National Credit Conference, Chicago, Chicago Marriott.
March 22-25: ABA National Installment Credit Conference, Los Angeles, LA Bonaventure.
Feb. 22-25: ABA Conference for Branch Administrators, Phoenix, Hyatt Regency Phoenix.
Feb. 22-25: Bank Marketing Association Consumer Business Development Training Workshop, Dallas, Regent Hotel.
March 2-5: ABA Risk & Insurance Management in Banking Seminar, San Diego, Calif., Sheraton.
March 15-18: Bank Marketing Association Marketing Research Conference, Dearborn, Mich., Hyatt Regency Dearborn.
March 15-18: 45th Assembly for Bank Directors, Honolulu, Sheraton Waikiki.
March 15-18: ABA National Compliance Conference, Dallas, Fairmont Hotel.
March 22-26: Independent Bankers Association of America Annual Convention, Las Vegas, Las Vegas Hilton.
March 22-28: ABA National Compliance School, Norman, Okla., University of Oklahoma.
March 25-27: ABA Basic Secondary/Mortgage Market Workshop, Atlanta, Omni International Hotel.
March 29-31: ABA International Systems Symposium, Washington, D. C., Capital Hilton.
March 29-April 1: ABA Southern Regional Bank Card Conference, Miami, Omni International Hotel.
March 29-April 2: Bank Administration Institute Bank Auditors Conference, Dallas, Loew's Anatole.

MID-CONTINENT BANKER

The Financial Magazine of the Mississippi Valley & Southwest

Volume 76, No. 12 November, 1980

FEATURES

19 **INFLATION-FIGHTING PROGRAM UNVEILED**
At ABA convention in Chicago

28 **MUNICIPAL REVENUE BONDS**
Should banks be allowed to underwrite them?

38 **NEW INTEREST-RATE BEHAVIOR FOR BONDS**
Due to shattered traditional analytical mold

42 **MONEY-MARKET MUTUAL FUNDS**
Small banks 'getting into act'

46 **ERRORS AND OMISSIONS**
Changing exposures under the law

62 **CAN THE FED COMPETE WITH CORRESPONDENTS?**
Yes, says panelist at ABA convention

63 **FED'S ROLE AS CORRESPONDENT BANK COMPETITOR**
Panelist predicts rough sailing for Fed

67 **FED'S COMPETITIVE EFFECT WILL BE MINOR**
Survey reveals correspondent bankers' opinions

DEPARTMENTS

8 THE BANKING SCENE
13 SELLING/MARKETING
14 BANKING WORLD
16 WASHINGTON WIRE

STATE NEWS

90 ALABAMA
90 ARKANSAS
91 ILLINOIS
92 INDIANA
92 KANSAS
93 KENTUCKY
93 LOUISIANA
94 MISSISSIPPI
94 MISSOURI
94 NEW MEXICO
94 OKLAHOMA
96 TENNESSEE
96 TEXAS

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The Banking Scene

By Dr. LEWIS E. DAVIDS
Illinois Bankers Professor of Bank Management
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Side Results of the Fed's Fee Schedule

CORRESPONDENT and respondent bankers are analyzing the figures that the Federal Reserve Board released on its proposed schedule for services to financial institutions.

These fees involve transportation of currency and coin, coin wrapping, check clearing and collection via transfer of funds, use of Fed automated clearinghouse facilities, net settlement of debits and credits affecting accounts held at the Fed, book-entry safekeeping and other services connected with purchases or sales of government securities. Also involved are noncash collection (receipt collection and crediting of accounts of depository institutions in connection with municipal and corporate securities) and cost of Fed float (interest on items, generally the dollar value of checks credited by the Fed's depository institution before being collected from another institution).

The Depository Institutions Deregulation and Monetary Control Act has forced the Fed to adopt certain principles. One is that all services covered by the Fed's fee schedule be priced explicitly; that services covered by the fee schedule are to be available to nonmember depositories at the same price charged to member banks, except that nonmembers may be subject to any other terms, such as clearing balances, that may apply to member banks. These fees are to be based on all direct and indirect costs actually incurred by Fed banks. The concept of float will be an interest rate charged at the current market rate for Fed funds.

This is a rather historic time in that access to service pricing will start in January, 1981, for wire transfer and net settlements. By April, 1981, check clearing and collection as well as automated clearinghouse items will be covered, with currency in coin being priced as of July, 1981. Purchases and sales of transfer securities will be effective in October, 1981, as well as noncash items. By mid-1982, float will be entirely phased in as being charged.

A review of the proposed prices suggested by the Fed makes for fascinating reading.

With more than a decade of experience with functional cost analysis (FCA) for its member banks, the Fed certainly is well experienced with FCA application. Thus, it's interesting to review the various tables and Fed has provided on the proposed fee schedule. Respondent banks will study these tables carefully and probably on that basis will examine fees they are paying to their commercial correspondent banks.

"A correspondent bank should be able to price its services well below prices charged by the (Fed's) high-fee schedules in many areas."

The definitive study on this area was made by Robert Knight when he was an executive of the Kansas City Fed. It concluded that there was a substantial variation in the pricing structure of services of correspondents to respondents. A similar comment can be made for the various costs of specific Fed offices. Table 1 of the Fed's proposed fee schedule for commercial-check services shows a rather amazing spread between various Fed offices for their services.

It may be generalized that the New York Fed has (with some exceptions) a much higher cost structure than the other Feds. To illustrate: For cash letters deposited directly at processing Fed offices, for city items the New York Fed charges 2.5¢ per item while the Cleveland district charges only 0.9¢ per item. Moving on to country RCPC and mixed items, again the New York Fed at 2.9¢ per item is on the high side, while in Indianapolis the item cost is only 1.2¢. For other Fed cash-letter items, the New York Fed charges 5.1¢ per item, while in the Denver and Atlanta districts the cost is 3.3¢. For non-machinable items, the New York Fed charges at its head office 7¢ per item, but only 3.9¢ at its Buffalo Branch; however, in the Charlotte Branch of the Richmond Fed, the price is only 3.2¢.

For package-sort items, the New York Fed price varies considerably from most Fed districts. Item cost for the New York Fed package sort is 0.2¢, which is the same price charged by the San Francisco Fed. However, Richmond and some other districts charge 0.6¢ for package sort. For group sorts, the Philadelphia Fed is high at 1.8¢, while the Kansas City Fed is low with 1¢. For cash letters consolidated with shipments sent from nonprocessing Fed offices to processing Fed offices, the New York Fed again is on the high side with 3¢ per item, while the Cincinnati Branch of the Cleveland Fed is low at 1.3¢. For cash letters consolidated for country NRCPCs, the New York Fed charge is 3.4¢, while the Indianapolis Office of the Chicago Fed charge is 1.6¢.

For automated clearinghouse services, the New York Fed charges only 0.3¢ per item, while all other intra-ACH items are charged 1¢ by the other Fed districts. In view of the volume of activity in Chicago, one must wonder why the Chicago Fed charges 1¢ while the New York Fed is able to charge only 0.3¢.

On the Fed's proposed fee schedule for currency/coin-shipping services, it would look as though there was a little cost analysis hanky-panky and collaboration by Fed offices in computing schedules of fees. For example, on the high side, Buffalo, Cincinnati, Richmond, Charlotte, Birmingham, Jacksonville, New Orleans, Chicago, Detroit, San Antonio-El Paso, San Francisco, Los Angeles, Salt Lake City and Seattle have the same fee schedule of

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$2.74 for mail-shipment delivery to or from the post office. On the low side, Boston, New York, Cleveland, Pittsburgh, Louisville, Memphis, Helena, Kansas City, Denver, Dallas and Portland charge $1.82, with the remaining offices charging in between.

For city end points for currency/coin-shipping services per bundle of currency, the price for Detroit is a whopping 40¢, while San Francisco charges only 5¢. Most of the other Fed offices charge either 10¢ or 20¢. Thus, Detroit's cost is eight times the cost of San Francisco's.

The same thing holds per bag of coins shipped, with Detroit charging a whopping 62¢, while Little Rock and Dallas charge only 12¢. But when one looks at the per-stop pickup and/or delivery of coin and currency at city end points, the high is for Buffalo at $20.96, while the low is for Cincinnati at $1. For suburban end points per bundle of currency, the high is for Seattle at 70¢, while the low is for Little Rock, Oklahoma City and San Antonio at 10¢. For suburban end points per bag of coin, Little Rock is low on the totem pole with 12¢, while the high is for Seattle and Salt Lake City at 78¢. For stop pickup and/or delivery for suburban end points, Little Rock shows a remarkable low of $2.10 and Seattle is high with $22 per pickup stop.

These fees are noted simply to point out the wide spread of these items, in some cases over 800%. The numbers were necessary to make the point that cost-related fees vary significantly.

A correspondent bank should be able to price its services well below prices charged by the high-fee schedules in many areas. On the other hand, the low-fee schedules of the Fed district offices probably will be hard to meet. However, if we look at the generalization of the proposed fee schedule by Fed district, it appears that New York correspondent banks are in the most favorable position because of the generally higher costs of the New York Fed and the offices in its district. To that extent, the higher costs seem to favor the competitive stance of major New York City correspondent banks over correspondent banks in some of the other regional districts.

But more than that, we note that most of the calculations used by the Fed in determining its adjustment factor costs were predicated on 1979 data. It plugged into the formula use of the average cost of capital before taxes of 13.1%. Obviously, using the past as the prologue for future pricing presumes that those rates are in the ball park. One argument could be made that because of the rather ponderous procedure the Fed uses, it will have difficulty pricing its services competitively — especially as interest rates increase. However, as labor and operating overhead increase, correspondent bankers will find the fixed rates of the Fed pose a competitive disadvantage. How frequently the Fed changes its fee structure will be important to both correspondent and respondent bankers.

Undoubtedly, a commercial bank should be able to compete with the Fed in most all service areas. The Fed typically has a higher salary structure than the normal bank, especially in operating areas. Since personnel costs are a significant factor in these areas, we can anticipate that in a number of areas the Fed will find that commercial banks providing correspondent services should be able to compete satisfactorily. That is, if the fees are based on true functional costs.

Maybe the General Accounting Office should look at how the Fed computed its fees! ● ●

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Left to Right: Abigail Woods, Assistant Cashier, Contract Services Group; John Fowler, Senior Vice President, Correspondent Division; Gary A. Thompson, Assistant Cashier, Data Processing Department; James Hopkins, Assistant Vice President, Data Processing Department.

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Premium Suppliers Pleased with Ban Defeat

ALTHOUGH some changes in operations were mandated by the new premium policy laid down by the Depository Institutions Deregulation Committee (DIDC) for financial institutions in September, premium suppliers are relieved that the indecision created by the proposed ban of premiums is over.

And they expect to see a renewal of orders for premiums as financial institution managements gear up for new marketing thrusts.

"I'm confident that we'll see a further uptrend in the use of premiums by financial institutions," said Jay Keller of Salem China Co., Salem, Ohio. He said his firm didn't experience a drop-off in orders during the period of indecision occasioned by the proposed ban; in fact, Salem had three record months of sales during the summer. "However," he said, "the question is: Would we have had even better sales during that period if the ban business was not in the news?"

"In effect, we've gone through a premium ban," said Dick Martin of Possum Trot, McKee, Ky. "Even though the ban was never imposed, the indecision it caused had its effect." A new problem facing suppliers is the fact that bankers are busy thinking about the offering of NOW accounts and the high costs involved with such accounts. This is taking their minds off premiums, he said.

A good outlook for the premium business is predicted by Marsha Mosely of J. Edward Connelly & Associates, Pittsburgh. The firm experienced an immediate pickup in orders once the ban threat was eliminated. Continuity programs are big now as banks try to encourage people to save, she said.

"We've had an influx of orders during the past three weeks," said Richard Crouse of Fabcraft, Frenchtown, N. J. Apparently a number of financial institutions had held back on premiums, not knowing what to do during the period of indecision, he said. Now they've decided to go ahead with their premium programs. He said his firm normally doesn't have such a surge of business at this time of year, since most customers order for Christmas and therefore place their orders earlier in the year.

Thom Welch in Brookhaven, Miss., is optimistic for the premium business in the near future. After a period of slow business, things are picking up. "There's a lot of interest out there," he said, and added that his firm expects to send out more proposals in the next 60 days than in any comparable period in the last several years.

Everything looks very bright now that the ban business had been dispensed with, said Carol Schultz of Animal Fair in Minneapolis. She said suppliers are still trying to determine the exact meaning of the DIDC's new restrictions on premiums, but she sees ample opportunity for her firm to capture a large share of the market.

"I'm unequivocably happy with the results of the premium ban proposal," said Neil Kanney of Kanney Marketing Services, Hauppauge, N. Y. He said that every premium supplier experienced sales declines during the period of uncertainty while the DIDC was considering the premium ban.

The battle against the premium ban involved a lot of work by a lot of people, said Al Partenheimer of W. M. Dalton & Associates, Newtown, Pa. A lot of firms were involved and many lawyers were put to work to present the case for premiums. He said that the fact that the Justice Department came down on the side of premiums by declaring that there was no legal basis for

(Continued on page 97)

DIDC Finalizes Premium/Rate Rulings

THE DIDC (Depository Institutions Deregulation Committee) has issued final rules for premiums, finders fees and prepayment of interest. The rules will become effective December 13.

The DIDC said premiums in the form of cash, merchandise or credit won't be regarded as payment of interest if:

- The premium is given to a depositor only on opening a new account or renewing or adding to an existing account.
- No more than two premiums are given per account in any 12-month period.
- Premium value or total cost of merchandise is no more than $10 for deposits of less than $5,000 or $20 for larger deposits.

Averaging of premium prices won't be permitted and an officer of the institution must certify merchandise cost, including expenses of shipping, packaging and handling. Costs of development, advertising, promotion or other expenses aren't included.

Self-liquidating sales aren't considered premiums, but continuity programs are.

Finders fees are payment of interest to the depositor and may be paid only in cash, except for certain employee incentive plans. A two-year phase-out of finders fees is proposed for institutions that have a history of obtaining, on average, 25% or more of their domestic small time and savings deposits through finders fees. (Comment on this aspect of the program can be made through November 17.)

Under payment of interest, the DIDC will consider raising the passbook savings rate no later than September 30, 1981, as the first phase in eliminating Regulation Q rate ceilings. The committee adopted a uniform ceiling of 5¼% on NOW accounts as of December 31 and retained a 5% ceiling up to that date for institutions authorized to issue NOWs in eight eastern states.

A ceiling rate of 5¼% applies to 14-90-day time accounts under $100,000 at member banks as of October 30. The ceiling will apply to nonmember banks if federal regulators permit them to issue such accounts. But S&Ls and mutual savings banks can pay 5½% on the accounts.

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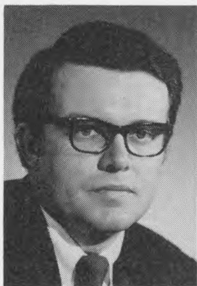
NEWS OF THE
BANKING WORLD

• **Harris Bank,** Chicago, has named Craig H. White, vice president, head of the government bond division and opened an international money-market representative office in Los Angeles. Mr. White, who serves in the bank's New York office, is responsible for the government bond division's operations in Chicago and New York. Harris Bank is one of the 12 banks in the U. S. designated as primary treasury dealers by the Fed. The new Los Angeles office will serve bank customers in the western U. S. and Canada. It's headed by Robert A. White, assistant vice president.


C. WHITE

BOYKIN

Robert H. Boykin will become president of the Dallas Fed January 1. He will succeed Ernest T. Baughman, who will reach retirement age at that time after serving nearly 35 years with the Federal Reserve System, the last six as president of the Dallas Fed. Mr. Boykin has been first vice president of that bank since 1976 and has held several posts since 1953. William H. Wallace will succeed Mr. Boykin as first vice president. He is staff director/Federal Reserve Bank activities, Board of Governors, in Washington, D. C. He joined the Richmond, Va., Fed in 1967 after having been assistant economics professor, Duke University. In 1973-74, he was professor of economics and head of program in business administration, North Carolina University. In 1974, he joined the Fed's Board of Governors.

• **Rita Garrett,** school coordinator, Farmers & Merchants Bank, Centre, Ala., is the winner of a $1,000 cash award from National Learning Products, Inc., St. Albans, Va., in a contest in which bank school coordinators throughout the nation told how they

used teaching materials from the firm in their work. Mrs. Garrett has taught classes on banking to approximately 2,100 students, each of whom has been included in tours of the bank. Mrs. Garrett is shown receiving her award from J. R. Thacker of National Learning Productions.

• **S. A. Constance** has been elected senior vice president and deputy general manager, Manufacturers Hanover Trust, New York. He is officer-in-charge of a newly established merchant banking group, which has responsibility for investment banking activities worldwide. The new group includes Manufacturers Hanover Ltd., London, and Manufacturers Hanover Asia, Hong Kong; in New York, investment banking functions of the corporate finance department, MH Ltd. activities, international asset management and a consolidation of the bank's project finance activities. John L. McCarthy, senior vice president, supervises the group in New York. Mr. Constance is based in London.

• **Clifford W. Stone,** chairman/CEO, Walnut Valley Bank, El Dorado, Kan., has been elected board president of Schools of Banking, Inc., a nonprofit organization that sponsors schools for bank employees. The organization is affiliated with the bankers associations of Nebraska, Missouri and Kansas. Mr. Stone also is president-elect of the Kansas Bankers Association.

• **Patricia W. Shaw,** senior vice president, Universal Life Insurance Co., Memphis, has been appointed to the board of the Memphis Branch of the St. Louis Fed. She fills the unexpired term of Walter Walker, president, LeMoyne-Owen College, Memphis, who resigned recently. The term expires at the end of 1982.

• **The Kansas City Fed** has promoted James R. Bell to senior vice president and named David J. France and Kent M. Scott assistant vice presidents. Mr. Bell joined the bank in 1966; Mr. France joined the bank in 1967, but left in 1972 and returned in 1978; and Mr. Scott started at the Fed in 1972.

• **Paul C. Clendening,** senior vice president, Johnson County National, Prairie Village, Kan., has been elected chairman of the Kansas City Group of Robert Morris Associates. Thomas Papa, vice president, First National, Kansas City, was elected vice chairman and Michael Brosnahan, senior vice president, Columbia-Union National, Kansas City, was elected secretary/treasurer.

• **First National,** Louisville, is the first bank in Kentucky to receive the President's "E" award for excellence in exporting. The award recognizes the bank's marketing and promotional services made available to, and used by, exporters in the development and ex-

pansion of export markets. Shown exhibiting the "E" flag are (from l.) A. Stevens Miles, bank president; Senator Wendell Ford; Gordon B. Thomas, U. S. Department of Commerce; and Charles M. Williams, vice president of the bank's international division.

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THIS BANK OPENED IN 1913. WE OPENED IT UP IN 1980.

This is the main banking room of Helena National Bank in their headquarters building, built in 1913. While maintaining the traditional exterior that the citizens of Helena, Arkansas, have come to know and respect, the bank asked us, Arrow Business Services, to completely redesign the interior in keeping with the needs of banking today. We specified one of several modular systems we offer to achieve a bright, open atmosphere while still providing privacy where it's needed, functional efficiency and flexibility to change as the bank does. Our design opened up a closed environment to provide a better reception for customers and better working conditions for employees. We back up a wealth of bank experience with 16,000 square feet of ideas in our showroom and 25,000 square feet of active inventory in our warehouse. Let Arrow Business Services open up your bank for you. Give us a call.

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Comptroller Raises Capital, Mortgage Issues

RECENT proposals by the Comptroller of the Currency have raised new questions about two unrelated areas of bank operations. The proposals deserve the attention of the entire banking community. Although the Comptroller's regulations apply only to national banks, they still are relevant to state-chartered banks. "Wild card" statutes in many states give state-chartered banks the authority to engage in all activities that national banks engage in, and regulations in many states, therefore, are directly affected by regulations issued by the Comptroller.

One proposal is intended to open discussion of how bank capital should be defined and what its role in banking regulation should be. The other proposal raises the subject of adjustable-rate mortgages (ARMs) and could lead to a much wider use of these instruments in the future.

The first proposal is to change the definition of "surplus unimpaired funds" that a bank may count as its capital. The definition would be changed to exclude subordinated notes and debentures and 50% of the loan-loss reserve funds that now are included in capital. Obviously, the effect of such a change would be to reduce the capital of most national banks. (The Comptroller estimates that for the average bank, capital would be reduced 12.8% by the deletion of subordinated notes and debentures and 4.5% by the deletion of the loan-loss reserve.) A reduction in the amount of capital would be a serious change, for that figure is used to determine the bank's legal lending limits and other matters, such as whether a bank may establish a branch.

This proposal comes at a difficult time for banks. The only sources of capital that would be permitted to a bank if the proposed definitions were to become final would be equity and retained earnings. Bank stocks are, and long have been, generally undervalued and inflation has lowered earnings. At the same time, inflation has caused the stated value of assets to rise dramatically. Therefore, banks are faced with the possibility of having artificially high asset levels and a reduced capital base against which those asset levels will be measured.

The ABA long has been aware of the complexity of the issue of capital adequacy. In June, one month before the Comptroller published his proposals, the ABA commissioned a study of this matter by one of the "big eight" accounting firms. This study, due in February, 1981, will consider all facets of the capital-adequacy question. The ABA has asked the Comptroller to delay further action on his proposal until the ABA's study is complete.

> What is bank capital in the first place, and what is the proper level of adequate capital?

Comments that accompany the proposed regulation suggest that the Comptroller is less interested in changing the definition of capital as a matter of regulatory fiat than in stimulating a dialog with the banking community. The amendments are described by the Comptroller as "part of a larger project to develop an improved regulatory and supervisory policy for this office, . . . enabling national banks to improve their capital evaluation techniques and maintaining the pivotal role of the banking system in meeting the credit demands of a diversified economy. Another element in this comprehensive policy study is an evaluation of the appropriateness of the present 10% lending limitation and the possible need for legislative amendments to the governing statute."

The Comptroller's interest in stimulating a dialog with bankers is encouraging, because the dual questions of capital ratios and lending limits long have frustrated bankers. The question of capital adequacy is complex, involving a careful balance of the desire to protect depositors from loss and the need to provide enough leverage to banks to allow them to operate profitably. The questions implicitly raised by the Comptroller are good ones: What is bank capital in the first place, and what is the proper level of adequate capital?

At present, there is no unanimity among regulators, economists or even among bankers about the proper definition of bank capital or the proper ratio of capital (however defined) to a bank's assets. The Comptroller's latest proposal suggests he is interested in a permanent solution to the question of capital and its proper role in banking regulation. The ABA believes its study will provide valuable help to regulators in this matter.

On another front, the Comptroller is suggesting that the use of alternative mortgage instruments — in particular, the adjustable-rate mortgage (ARM) — should be formalized and expanded.

The proposed guidelines provide that interest rates could be increased at stated intervals during the term of a mortgage. The increase could not exceed one half of 1% for every six months between adjustments, and in no event could it exceed 5% for any one adjustment period. The guidelines also provide for a federal override of state laws where an ARM would be in conflict with a state statute. The purpose of the guidelines is not to prescribe minimum increases but, rather, to provide some standard for banks to use in setting up innovative mortgage lending programs. At the same time, the Comptroller is providing a reasonable measure of protection for the consumer.

National banks currently are authorized to offer any type of loan not forbidden by statute, and ARMs are not forbidden. What the Comptroller is proposing will formalize the right of a national bank to exercise a power it already has. The most important legal feature of the proposal, therefore, is the override of state laws that prohibit ARMs. State usury limits on fixed-rate residential mortgages were overridden by the Omnibus Banking Law in March, but many states still have laws forbidding or restricting ARMs. With-

(Continued on page 82)

Editor's Note: This column was prepared by the ABA's public relations division.

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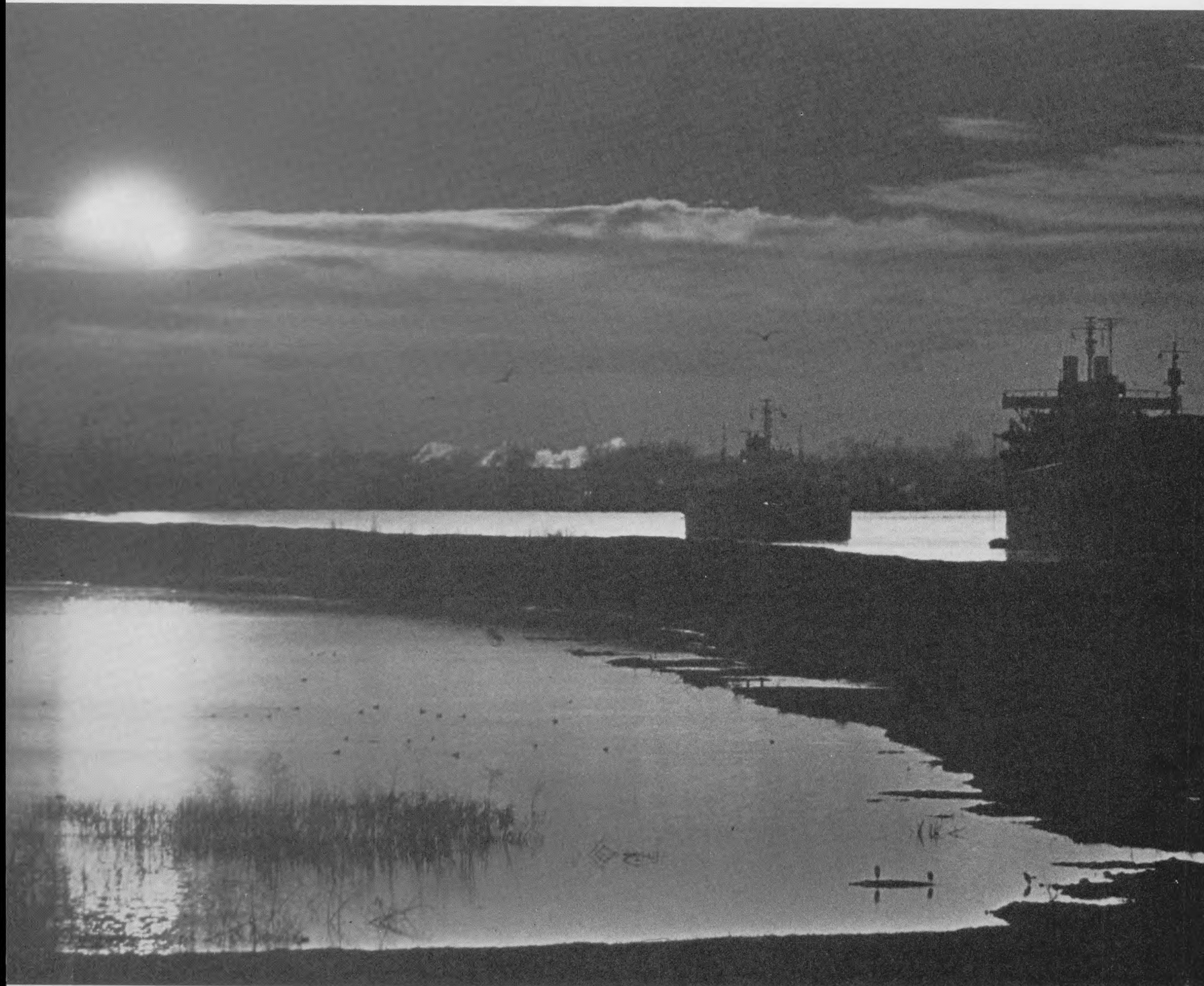
Nobody knows New Orleans like the Whitney



When you have an important customer who asks about banking in New Orleans and Louisiana, tell him about the Whitney.

The Whitney, now in its 97th year, can offer your customer the same high quality, efficiency and excellence in banking that your bank has so capably provided.

Whitney

NATIONAL BANK OF NEW ORLEANS
Established 1883

A great bank for a great city

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There comes a time when you have to step outside and fight.

"Inflation is the single most important economic and social challenge facing America today. I call on all bankers to lead the battle to eliminate this destructive force from our nation. You can make a difference."

C. C. Hope, Jr.

C. C. Hope, Jr., President, 1980
American Bankers Association

And we'll do a lot more than just hold your coat. In fact, the ABA has sent an Inflation Fighting Kit to all member-bank CEO's free! This kit will provide you with a great combination of punches to fight inflation in your local market. It contains the following professionally prepared items:

- a list of selected messages stressing the importance of fighting inflation
- a speech which you can use before local groups on the subject of inflation
- a sample news release to accompany your speech
- a radio script which can be used in your local market
- a print advertisement which you can place in your local newspapers with your own bank's logo
- a question-and-answer sheet to assist you in preparing for interviews

While your ABA is doing battle on a national level, we hope you'll take advantage of this material and use it to slug it out with inflation on the local level. We're all in this fight together. And with your help, we *can* win!

For further information, phone or write Mr. Dan Buser, Director of Public Relations, ABA, 1120 Connecticut Avenue, N.W., Washington, D.C. 20036. Phone (202) 467-4273.

AMERICAN BANKERS ASSOCIATION

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Registration area for ABA convention fronted exhibit area, said to be "largest ever" for an ABA convention.

Program to Help Bankers Fight Inflation Unveiled at ABA Convention in Chicago

Root of Inflation is 'Soaring Price of Government'—Rockefeller

INFLATION — its real cause and a program to help bankers fight it — was a focal point of the ABA's annual convention in Chicago last month.

Speaking bluntly in his keynote speech, David Rockefeller, chairman, Chase Manhattan, New York City, charged that the root of inflation is "the soaring price of government."

The ABA's outgoing president, C. C. Hope Jr., vice chairman, First Union National, Charlotte, N. C., pointed out that one of the first actions of the association the past year was appointment of a select task force on inflation. This group, he continued, had worked diligently during the year to study the causes of inflation in order to suggest ways the entire American banking community could help reverse the inflationary trend in this country.

Then, he asked his fellow bankers to carry on the battle begun by the task force by taking home — and using — a comprehensive "inflation kit," which was to be distributed to them. (See story, page 20.)

Frank talk also came from other convention speakers, including Comptroller John G. Heimann, who called for consolidation of regulation into fewer government agencies; and Fed Chairman Paul Volcker, who admitted there are far too many regulations, many of them duplicative, coming from his agency, the FDIC and the Comptroller.

Along the same lines, FDIC Chairman Irvine H. Sprague described a divided examination program in which the FDIC and qualified participating states alternate and exchange results on annual examinations of non-problem institutions. This reduces dual federal and state examinations.

COVER: This is reproduction of cover of "Inflation Kit," which was distributed to bankers during ABA convention in Chicago last month. Quote on inflation is by C. C. Hope Jr., ABA president, 1979-80, and vice chairman, First Union National, Charlotte, N. C.

Keynoter David Rockefeller urged ABA members to join fight against inflation. He's ch., Chase Manhattan, New York City.

The Fed's recently proposed schedule of fees was discussed at the convention, and related articles on this subject appear on pages 62, 63 and 67.

One of the many and varied special-interest sessions was devoted to "Implications of the Farm Credit Act Amendments" (HR 7548). See page 22.

Rockefeller on Inflation. David Rockefeller cited deterioration of productivity and personal savings as contributors to but not the cause of "an inflation crisis of worldwide reach and profound ramifications in the United States. Inflation is a mundane and pervasive reality that should be considered carefully in view of its effects and causes, its nature and its remedy."

He pointed out that the popular misconception that rising prices are both the cause and effect of inflation has resulted in the view that "inflation is something done by the private sector: businesses lifting prices and pulling in higher profits; workers demanding raises; bankers asking higher interest rates . . . government is left out altogether, which is something like giving a performance of 'Hamlet' without the moody Danish prince — in this

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'Inflation Kit' Distributed at Convention Reflects Views of ABA Task Force

A COMPREHENSIVE "Inflation Kit" was distributed to bankers at the ABA convention in Chicago last month. It is an outgrowth of work done during the past year by the association's select task force on inflation, created in the fall of 1979. According to C. C. Hope Jr., outgoing ABA president (vice chairman, First Union National, Charlotte, N. C.), this group worked diligently during the year to study causes of inflation in order to suggest ways that the entire American banking community could help reverse the inflationary trend in this country.

In preparing the kit, the ABA drew heavily on the advice and guidance of the inflation task force, and Mr. Hope said their sage counsel was invaluable in helping determine what messages and approaches should be emphasized. However, the ABA had final responsibility for the kit's contents.

The ABA hopes bankers will use the kit to discuss publicly the problem of inflation and to generate interest in solving it among residents and leaders of their communities.

The kit contains the following items:

- A list of *selected messages* designed to tell bankers at a glance those issues the ABA believes should be stressed in any discussion of inflation.
- A *sample speech* that spells out in detail just where the ABA thinks the problems are with public policy and what kind of solutions should be adopted by the nation's leaders. The speech, about 30 minutes in length, may be used as is or modified or as a source document.
- A *sample news release* to go with the speech. It highlights the important points made in the speech.
- A *sample question-and-answer list*. The ABA has tried to anticipate questions that might be put to bankers by the media based on remarks made in the speech.
- Two *sample radio statements*, one of approximately 30 seconds' duration and one of 60 seconds. These are meant to be used as public-service announcements on local radio stations.
- A *sample advertisement* designed to be used on or opposite the editorial page of local newspapers. Each bank is to add its name and logo.

America Faces A Grave National Crisis:

INFLATION

America's Bankers Are Ready To Help.

You Can Make A Difference.

ABA suggests that this ad, part of its "Inflation Kit," be used by banks in their local newspapers, with banks' logos inserted under "You Can Make a Difference."

Basic messages contained in information in the kit are that bankers are calling for: a sound monetary policy that refuses to allow the money supply to grow faster than the real economy; a sound fiscal policy and an end to deficit spending except in exceptional circumstances; an end to excessive government regulation that overburdens industry; a tax system that provides incentives for savings and investment rather than consumption and fosters productivity and growth, and a vocal and active electorate that tells our leaders to follow these sound policies.

case, the moody American Administration, Congress and Federal Reserve Board. Inflation is a decline in the value of money — and only government has the power to debase the currency by creating too much of it."

Mr. Rockefeller called on the new Congress, which will convene in January, to recognize as a top priority a more effective control over expenditures.

"Overspending by government," he continued, "has created nightmarish deficits for 19 of the past 20 years, with a total deficit exceeding $400 billion — the result of the sociopolitical process."

He explained this by pointing out that during the past decade, social programs that fell under the name of the Great Society meant federal outlays for education, health, social security and other benefits that increased by $270 billion, with these outlays now accounting for more than 60% of the total budget.

Mr. Rockefeller emphasized that he doesn't want to have these programs repealed, but the headlong expansion of government benefits must be curtailed.

The New York banker urged that further changes in the budget-making process be established so Congress will be forced to control expenditures more effectively than in the past. Among changes he recommended for consideration are:

- A requirement that any deficit has to be approved by more than a simple majority of Congress — perhaps by two-thirds or more.
- Presidential authorization to withhold expenditures that Congress has authorized unless the President's decision is overridden by 60% of Congress.
- Tighter standards for social-entitlement programs, without creating hardship for genuinely needy recipients.
- A thorough scrutinization of the practice and method of indexing many

Edwin S. Jones (l.) was honored with reception during ABA convention on his retirement as ch., exec. com., First Nat'l, St. Louis. In c. is Mrs. Jones; at r. is T. Barton French, s.v.p./corres. head, First of St. Louis.

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of these benefits to inflation.

- Reforms in depreciation taxes to provide more working capital for businesses and income-tax cuts to encourage personal savings.

Mr. Rockefeller also cited the expense of regulations and suggested that "too many regulations, issued too rapidly and thoughtlessly, defeat their very purpose. A crucial mandate is to prune the forest of rules and let the economy grow."

He asked bankers to convince their constituents that inflation, once and for all, must be brought under control.

Treasury Secretary's Viewpoint. A different opinion on the current inflation situation was presented by Treasury Secretary William Miller, who preceded Mr. Rockefeller on the speakers' stand. According to Mr. Miller, ". . . responsible fiscal, monetary and credit policies were able to help break the extreme inflationary fever of last spring, and . . . there is every reason to believe that a continuation of such policies can lead to genuine, if gradual, progress in our efforts to reduce the underlying inflation rate."

However, he admitted that inflation is the foremost problem on the nation's domestic front. The economy, he continued, is completing the first year of the 1980s with an underlying inflation rate disturbingly close to the double-digit range.

Secretary Miller then pointed to some encouraging signs. Over the past three months, the Consumer Price Index has risen at a 7% annual rate. The Producer Price Index for finished goods rose at a 13% annual rate during the same period, but moderated significantly in September. Although these are welcome figures, he said, it would be a mistake to use them as an excuse for complacency. Accordingly, he went on, inflation remains a matter of utmost urgency.

NEW ABA OFFICERS installed at Chicago convention pose with Willis Alexander (l.), e.v.p. They are (from l. of Mr. Alexander) C. C. Hope Jr., v. ch., First Union Nat'l, Charlotte, N. C. — council ch.; Lee Gunderson, pres., Bank of Osceola, Wis. — pres.; Virgil E. Solso, v. ch., Oregon Bank, Portland — treas. (for second term); and Llewellyn Jenkins, v. ch., Manufacturers Hanover, New York — pres.-elect.

A related domestic problem, said Secretary Miller, is the gradual decline in productivity growth, a decline that results from a number of factors, including an aging capital stock, presence in the work force of an unusually high number of inexperienced workers and insufficient technological innovation.

Rockefeller Talk Available

The keynote address on inflation given by David Rockefeller, ch., Chase Manhattan, New York City, at the ABA's 1980 convention is available in booklet form.

For a copy of "Facing up to the Hard Facts of Inflation," write: Public Relations Division, Chase Manhattan Bank, 1 Chase Manhattan Plaza, New York, NY 10081.

Mr. Miller then discussed some challenges on the international front, including huge balance-of-payments deficits and slow growth rates that beset the global economy. Intertwined in both the domestic and international areas, he pointed out, is the energy situation, which contributes to the current account deficits of less-developed and developed countries alike, siphons resources from our own economy and causes enormous inflationary pressure.

What is needed, he said, is a decade of unprecedented investment — in modern plants and equipment, in energy-saving technologies, in energy-producing technologies, in transportation infrastructure and in development overseas.

He told ABA members they are most intimately involved in one aspect

Attention-getters among convention exhibits were (left photo) Brother Dominic, known for his TV commercials for Xerox Corp., signing autographs for Robert K. Reese, ch./pres., Livestock Nat'l, Kansas City, and Mrs. Reese at Xerox exhibit; and (right photo) gasoline pump that operates similar to ATM at Petro Vend exhibit, which interested Mr. and Mrs. Mel Schroeder, v.p., Mercantile Bank, Kansas City.

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Three generations of Hope family attended ABA convention. They are (from l.) C. C. Hope Sr., C. C. Hope Jr. (ABA pres.) and C. C. Hope III.

of this task — the financial aspect.

"On you and your colleagues in the financial community," he said, "will fall a major responsibility for continuing to devise more efficient ways of using and channeling capital resources."

The Comptroller's Message. In his appearance before the ABA, Comptroller John G. Heimann — in looking at the '80's — said financial services cannot be provided successfully by relying on the old ways, nor can the old ways of regulating financial institutions be continued. In this context, he continued, laws and regulations that define the framework within which banks operate must be systematically reexamined and revised to make them responsive to a dramatically different set of circumstances, and, he added, this process already has begun.

Mr. Heimann called for modernizing the regulatory structure, saying that numerous options have been suggested, beginning as early as 1937. Two basic options are to create a single agency or separate agencies for federally and state-chartered depository institutions.

He also focused on effective, efficient and equitable supervision of smaller banks, pointing out that larger institutions can spread the fixed costs of regulatory compliance over a greater volume of assets or transactions than can smaller banks. Morever, he said, the rapidity of statutory and regulatory change has exacerbated this problem.

"To the extent possible," Mr. Heimann told his audience, "we must revise statutes, regulations and supervisory procedures to differentiate them according to the capacities of smaller and larger banks. This requires our urgent attention. . . ."

He spoke of his office's senior task force whose purpose is to review and propose revision of examination and enforcement efforts with respect to the Community Reinvestment Act, civil-rights laws and consumer-protection laws.

"Beyond this," he continued, "we might consider relaxing certain prudential standards, such as permitting sound and well-managed smaller banks to reduce modestly their traditionally high capital ratios and accept

(Continued on page 80)

Farm Credit Act Amendments Berated by ABA Panelists

SPIRITED CRITICISM of amendments to the Farm Credit Act were voiced during a special-interest session at the ABA convention last month.

Willis G. Candland, vice chairman, ABA agricultural bankers division, and president, Tri-State Bank, Montpelier, Idaho, said, "With the exception of the Omnibus Banking Bill of 1980, no other legislation will have as far-reaching implications to banking in general, and — more specifically — to agricultural banking, than the proposed Farm Credit Amendments of 1980 (HR 7548).

He said the proposed legislation had passed the Senate in the basic form in which it was submitted by the Farm Credit System and that the House agricultural committee had passed the measure by a 41-0 vote.

The ABA's position has been attacked by other trade associations and by the Farm Credit System, he said. Since the bill didn't come up before Congress adjourned on October 3, it's likely that it will come up during the lame-duck session after the elections.

"This bill is an entree into areas not perceived by those who passed the Farm Credit Act in the 1920s," said Walter W. Minger, senior vice president/agribusiness, Bank of America, San Francisco, and a past chairman of the ABA's agricultural bankers division. Mr. Minger and Harlin D. Jackson, current chairman of the ag division, and chairman/president, Security Bank, Paragould, Ark., spoke on the issue during the session.

Mr. Minger charged that the bill opens the door to cooperative and commercial financing, international financing and to various kinds of financially related services. It will aid and abet other businesses, basically credit, and will change some of the fundamental membership regulations that permit farm-controlled co-ops to do an increasing amount of business in suburban and rural areas of the U. S.

Under the act's export provisions, he said, banks for co-ops will be permitted to do everything an international bank can do. They will be able to finance trade credit, enter into transactions converting one kind of currency into another, create bankers acceptances without bank regulatory controls and create finance bills without the burden of eligibility requirements that banks are under, Mr. Minger said.

"These amendments would permit an ever-increasing volume of exports," he continued, but also would permit Banks for Cooperative (BCs) to finance purchases made by proprietary companies in the U. S. from co-op members. They would permit BCs to finance purchases when U. S.-sourced commodities were to be exported. The rationale for being able to do this is that the purchase by a U. S. grain merchant would aid and abet the farmer-members who belong to a U. S. co-op who have put their grains into the co-op for merchandising." This could have a direct impact on the kind of business bankers are doing today with proprietary grain merchants, he added.

The amendments also would authorize BCs to make deposits, take deposits, engage in the buying and selling of acceptances, notes and all kinds of debentures, which, to some extent, the system does now. "But, any way you slice it, it becomes a full-blown international bank," he said.

These things all can be done without the kind of monetary constraints banks have to work under, he said. "We keep reserves, we have insurance on deposits and banks are constrained from

(Continued on page 80)

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Get to know your Commerce banker.

David Scott joins Commerce's Correspondent Bank Division with eight years experience in bank operations. You can rely on him for sound advice on operational questions. David has a total of 16 years service with Commerce, having worked his way up from mail clerk to his current position of assistant vice president. During this time he also spent three years in the military and earned a B.A. from Rockhurst College. He is a Kansas City native who enjoys tennis and snow skiing.

Frampton Rowland joined Commerce in 1963 after studying at Indiana University, Oklahoma and K-State, and stints with the U.S. Army Medical Corps and a large finance company. Now he's an experienced Calling Officer for our Correspondent Department. Whatever your needs, Frampton Rowland can help.

H.C. Bauman went to William Jewell College. Before joining Commerce in 1975, he was chief executive officer of a Kansas City area bank. Today, he heads up our Correspondent Department. This former Air Force captain enjoys racquetball and tennis, as well as helping you with all your correspondent requirements. Look for him soon.

We're the leading correspondent bank in the Midwest.
What can we do for you?

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Financial Models Can Play Important Role In Selecting Proper Investment Strategy

By Joe Meals
Assistant Vice President
National Bank of Commerce
Memphis

IN RECENT YEARS, the task of the investment portfolio manager has increased in complexity. Volatile interest rates and bond prices have complicated purchases of securities for earnings, while at the same time, added emphasis on asset-liability management has increased the requirement for higher portfolio yields. Changing liability-management concepts have reduced dependency on the investment portfolio for liquidity. Many times, however, this trend has increased the need for collateral to support the desired liability strategy. Such changes raise many searching questions about portfolio management in general and various management techniques in particular. One such technique is use of financial models as an aid in determining appropriate investment strategies.

While portfolio management is still an art and not an exact science, financial models can play an important role in selecting proper investment strategy. Certain basic factors should be considered by the management of any financial institution when evaluating proposed investment strategies. These are:

- Does this strategy meet requirements for collateral?
- Does it provide the desired secondary source of liquidity?
- Does it adhere to the institution's tax plan?
- Does it generate a positive spread over cost of funds?

Also, these strategies must be evaluated in the context of the institution's total needs and requirements, not in isolation. Therefore, information from the liability manager, the manager of the loan portfolio and the financial officer must be incorporated into the decision-making process. Each of these factors can be included in a financial model, thereby ensuring that they are applied consistently and objectively for each proposed investment strategy. National Bank of Commerce has a model (which it markets under the name ALMS™) that applies these concepts to asset liability management. ALMS is a total asset-liability-management system, but this article will concentrate only on the portion that pertains to investment management.

The first step in constructing a model is to establish and/or recognize the objective(s) for the portfolio and the constraints under which it must operate. These constraints should include a statement(s) defining collateral requirements, need for secondary liquidity and amount of tax-exempt income acceptable. Also, a constraint on maturity distribution and/or security mix may be desired. Once these conditions are defined, security classifications to be included in the portfolio strategy must be identified. At a minimum, this classification should separate taxable from tax-exempt securities. In many instances, it is desirable to break these classifications into further categories, identifying various issuing agents, different maturities and/or risk as shown in the box. The model then is able to provide a more complete analysis of the various portfolio strategies available and identify the one that provides the greatest return.

The approach taken by ALMS in analyzing various portfolio strategies is described below. First, the model determines the need for collateral based on the liability manager's estimate of availability of fund sources that require pledging. Collateral needed is compared to the amount of pledgeable securities currently in the portfolio to determine whether additional collateral must be obtained. If more collateral is needed, the strategy suggested by ALMS will include the purchase of the highest-yielding securities that meet the standards set for collateral. In many instances, a "safety margin" may be desired.

Next, the model will identify the requirement for secondary liquidity as set by management policy. Generally a trade-off exists between yield and liquidity; therefore, the system will seek to maintain only the minimum level of liquid securities. Again, input from the liability manager will be necessary to determine the amount of liquid securities required.

The model also must assess the institution's overall tax position as this will affect the mix of taxable versus tax-exempt securities to be included in

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HIGH RISK	HIGH RISK
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LOW RISK	LOW RISK
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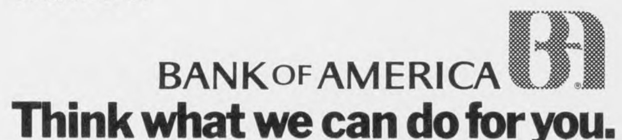

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the investment strategy. Another use of ALMS in this area is identifying the effect on the investment portfolio of legislative changes pertaining to tax laws. For example, an institution may wish to subdivide tax-exempt securities into in-state municipal issues and out-of-state issues. ALMS then can test the effect of legislative changes pertaining to inclusion or exclusion of in-state municipals in calculation of local income taxes. Differences in tax laws can then be considered in the development of investment strategy. Use of a model in this area is important since failure to assess tax requirements adequately may result in having to sell or swap large amounts of bonds in a depressed market.

Once the above constraints have been satisfied, the model can complete the investment strategy based on the potential for earnings. ALMS will seek those investment opportunities that provide a positive spread over the incremental cost of funds. Also, the model will indicate the spread (either positive or negative) for each additional security purchase. This statistic allows the portfolio manager to evaluate the impact of future interest-rate environments on the portfolio strategy being developed. The smaller the spread, the more sensitive the strategy is to changes in the interest-rate environment.

While investment management still is very much an art, rapidly changing environments have increased the need for using sophisticated tools in managing the portfolio. Computer modeling provides a vehicle for quickly and objectively evaluating various strategies and their impact on management policies and earnings. A model should never make an investment decision, but proper use of a model can ensure that correct investment decisions occur as a result of studied judgment rather than pure luck. ● ●

Investment Policy Changes Result From Wild Rate Environment

WHAT HAVE BEEN termed the most dramatic investment policy changes in modern history are being implemented by commercial banks in response to the mercurial rate environment of the past three quarters. This conclusion comes from Gerald S. Roberts, vice president, John Nuveen & Co., who released results of the firm's ninth semi-annual survey of regional commercial banks recently.

"Banks have entered a new era in spread management," Mr. Roberts said. "Banks have realized the need for more flexible portfolio strategies that complement spread."

Portfolio managers have been directed to create a closer maturity balance between purchased liabilities and investment assets, he said. This results in the purchase of shorter maturities of fixed-rate assets and more active trading in municipal securities prior to maturity, based on anticipated rate cycles.

As of June 30, the average tax-exempt return on the municipal bond accounts of reporting banks was 5.65%, or the equivalent of 10.46% at the fully taxable 46% rate. Operating earnings generated by municipal assets increased a substantial 39 basis points in 12 months. This reflected a large rise in tax-exempt yields in the maturity ranges preferred by banks. At the same time, increasing yields meant an 84 basis-point decline in market value of municipal securities held by the survey group.

Bank portfolio managers participating in the survey are in the process of changing po tfolio policies in these directions:

- Tax-exempt maturities beyond 10 years have been declared off limits. The average maturity of the $16-billion of municipal securities held by the reporting banks was 8.2 years. The 1-5 year and 5-10 year maturities accounted for 58.5% of the holdings in almost equal amounts.
- Approximately half the banks plan a more aggressive municipal posture with new additions being made. The other half will be reducing or not changing the size of their municipal portfolios, particularly those banks whose profit outlook is affected by their no-growth locales.
- Holdings of general-obligation bonds experienced a decline from 57.7% of the municipal-bond account to 51.1%. The shift to revenue bonds and escrow-secured obligations, as noted in Nuveen's year-end banks survey, has continued.
- Managers are emphasizing purchases of and switches to quality municipal bonds that are more marketable and less affected by interest-rate fluctuations.
- Escrow-secured bonds continue to be a preferred category. Eighty-six percent of the respondents will add or maintain these items to their historically large positions.
- Interest-rate futures still are in their infancy but are being examined more closely by leverage-sensitive managers.

Mr. Roberts noted that several factors other than interest rate swings have impacted bank management policies, including: phasing out of Regulation Q, and payment of interest on NOW accounts beginning January 1.

Unquestionably, there is a new emphasis on funds management and especially on investment management of the bank's portfolio to generate as much earnings as possible from each segment of a bank's assets," Mr. Roberts said.

Survey respondents included 103 banks, located in all Fed districts. ● ●

Bankers Teach Economics In Summer Youth Program

A special project for branch managers at Central Trust, Cincinnati, during the summer was a youth employment program for economically — and sometimes physically — handicapped youth in the various local school districts.

The program was government-funded through the Comprehensive Employment Training Act and was organized and conducted under the auspices of the Hamilton County Board of Education. At the board's invitation, about 20 Central Trust managers taught a basic financial course to about 450 students, ages 14-21, who participated in the program.

The major goal of the eight-week program was to prepare students for the world of work, increasing their employability potential in future unsubsidized employment. The format to meet this goal was a combination of classroom instruction, work experience and guidance and counseling. Central Trust managers appeared as guest speakers at about 40 classroom locations, instructing students on the wise use of banking and credit services.

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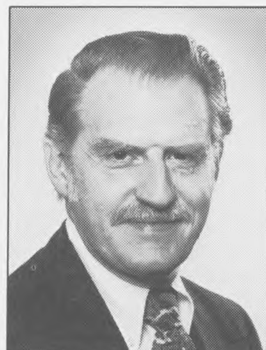
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Municipal Revenue Bonds

Should Commercial Banks Be Allowed To Underwrite and Deal in Them?

By Rosemary McKelvey, Editor

SHOULD banks be allowed to underwrite and deal in municipal revenue bonds (MRBs)? As one would surmise, opinions follow "party lines." That is, a majority of banks believe they should have this power, while investment firms are against it.

The latest proposed legislation to allow banks to enter the MRB field is HR 1539, introduced in January, 1979, by Representative Gladys Spellman (D.,Md.). The bill would allow banks to underwrite all municipal bonds except special-assessment obligations, industrial-development bonds secured by lease payments and lower-quality MRBs deemed not suitable for bank purchase.

According to Peter B. Harkins, executive director, Dealer Bank Association (DBA), Washington, D. C., there's little likelihood that anything could happen on HR 1539 in the lame-duck Congress, which will convene November 12 and which will be focusing on a limited number of bills. HR 1539, he adds, probably won't be among them.

However, Mr. Harkins says his association is gearing up right now for 1981 and the 97th Congress, and Representative Spellman again will be much involved, as she has been since 1975. Moreover, he continues, there are a number of other members of Congress who have expressed a strong interest in the proposed legislation and will be equally as involved as Representative Spellman. Thus, he foresees an expanded set of sponsors for the new bill, with Representative Spellman at the heart of it.

The Banking Act of 1933, usually called the Glass-Steagall Act, authorized banks to underwrite certain securities of the federal government, as well as those backed by the full faith and credit of state or local ("municipal") governments. Excluded from the latter category of general-obligation (GO) bonds were municipal securities secured solely by revenues from such municipal projects as highways, housing projects and the like.

In 1968, legislation was passed permitting banks to underwrite and deal in investment-quality revenue bonds issued to finance housing, universities and dormitories.

GO bonds, according to the DBA, are those based on the full faith and credit of a government. Revenue bonds are those payable out of specified sources of revenues, such as highway tolls and sewerage fees. The DBA points out that because of legislative language adopted in 1933, for descriptive rather than restrictive purposes, banks are allowed to underwrite GO bonds, the prevalent form of state and local borrowing in 1933, but not revenue bonds, which virtually were unknown at that time. The modern trend, continues the DBA, is to revenue bonds, which now exceed 60% of all state and local bond issues. The association believes the trend to revenue-bond financing is likely to continue and perhaps accelerate.

In 1979, the Securities and Exchange Commission (SEC) made and released a study on "Bank Participation in Municipal Revenue Bond Underwriting: Impact on Securities-Industry Revenues." This study found that, under the assumption that banks would attain the same underwriting share of the overall MRB market as they held in 1978 of MRBs currently eligible for bank underwriting or, alternatively, of GOs, the securities industry could lose between $65 million and $116 million in underwriting revenue. This would amount to between 6.9% and 12.4% of total industry underwriting and selling group revenues. This estimate, the study continues, does not include any potential loss of revenue from secondary-market trading of municipal securities, nor does it assume that bank entry into MRB underwriting will result in an increased bank-market share of GO underwriting, since there's no factual basis for estimating either factor. The SEC says a decrease in trading revenues or GO underwriting revenues would increase the impact on broker-dealers.

According to the SEC study, the estimated revenue loss may not be deemed a major fraction of all securities-industry revenues, but it may represent a substantial loss to firms specializing in municipal-bond underwriting, primarily the smaller, regional firms. Of the 977 firms that reported revenues from underwriting securities

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The Dealer Bank Association (DBA), referred to in the accompanying article, was founded in 1972. It is a nonprofit organization whose purpose is to represent and promote the common interest and objectives of dealer banks and to help develop its members' skills and activities as participants in the public-securities industry.

Currently, it is comprised of 165 commercial banks in 37 states, Puerto Rico and the District of Columbia.

A dealer bank is defined as a commercial bank that, through a "dealer" division or department in the bank, underwrites, trades or deals in a variety of public securities, including federal, state and local government securities, money-market instruments and foreign exchange. However, according to a brochure put out by the DBA, because the dealer function relates to a broader range of bank activities, the DBA recognizes the importance of these interrelationships by involvement in two other essential functions of its members — investment management and funds (or liquidity) management.

Peter B. Harkins is executive director of the DBA, located in Suite 1014, 1800 K St., N.W., Washington, DC 20006.

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— corporate or government — in 1978, says the SEC, 132 firms earned more than 50% of their total revenues from underwriting. Of these 132, only one had more than $10 million in total revenues, and only 41 had more than $1 million. Of those broker-dealers reporting underwriting revenue, the study goes on to say, firms with less than $1 million in total revenue derived 18.4% of their revenue from underwriting, while firms with between $1 million and $10 million in total revenues and firms over $10 million in total revenues derived 14.9% and 9.5%, respectively, of their total revenues from that source.

"This progression indicates," says the SEC study, "that, in general, the smaller broker-dealers are considerably more dependent on underwriting as a source of revenue than are the larger firms.

"While it cannot be predicted how many, if any, firms would not remain in the securities industry due to expanded bank-MRB underwriting, the potential exit of securities firms could lessen any competitive gains from bank entry. Moreover, because of the importance of the smaller firms in underwriting smaller issues, loss of these firms could have an impact on the ability of smaller municipalities to meet their financing needs. Finally, any adverse impact on smaller, regional broker-dealers may have serious implications for the corporate capital-formation process, particularly for small businesses."

On the opposite side of the fence, the DBA — in "The Revenue-Bond Underwriting Kit" published in June, 1979 — maintains that state and local governments want banks to participate in underwriting revenue bonds because of the lower borrowing costs they anticipate. The DBA goes on to say that banks want to underwrite revenue bonds because (1) as active and involved financial institutions in their state and communities, banks want to participate fully in all reasonably safe government-financing activities; (2) they are distressed to see their local governments paying much larger underwriting fees than would be necessary if there existed the greater competition they could bring; (3) they dislike being restricted by legislative language written for a different time and not yet modernized, and (4) it is safe and profitable financing.

The DBA also says state and local governments through their various associations have strongly supported this legislation in the past. The U. S. Treasury Department, the Comptroller of the Currency, the Fed Board of Governors and the FDIC all strongly supported this legislation in previous years.

The ABA also is solidly behind passage of this legislation. The association points out that, with growth of cash-management-account services and money-market mutual funds, investment banking firms increasingly are offering financial services directly competitive with the commercial-banking business. This legislation, according to the ABA, would provide banks with an opportunity to begin to redress this competitive circumstance by allowing them to enter the field of underwriting and dealing in municipal revenue bonds, a business now exclusively in the province of investment banking firms.

Richard F. Ford, president, First National, St. Louis, and a member of the ABA's governing council, testified on behalf of HR 1539 last June 26 before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs. He was accompanied by Raymond A. Meany Jr., treasurer, Connecticut Bank, Hartford, and

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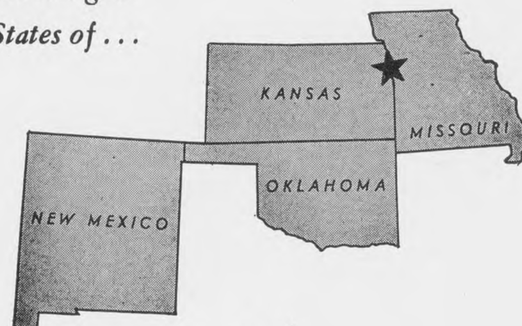

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Proposed legislation would allow banks to underwrite all municipal bonds except special-assessment obligations, industrial-revenue bonds secured to lease payments and lower-quality MRBs deemed not suitable for bank purchase.

chairman of the ABA's bank investment division.

"Granting this authority," said Mr. Ford, "would increase competition to the benefit of state and local governments and the people they serve. Little seems to be said as institutions other than banks begin to provide traditional bank services in the name of competition, but a great reluctance seems to exist on the part of some to allow banks to provide the advantages of competition to state and local governments in the revenue-bond-underwriting area."

Mr. Ford pointed out that the investment-banking community now has a virtual monopoly on underwriting and dealing in MRBs, and it's understandable that the securities industry does not want to lose this monopoly.

The St. Louis banker referred to a comment of Professor Samuel Hayes in the January-February, 1979, *Harvard Business Review* that "[m]ost of the profitability apparently does not spring from the competitive-bid general-obligation bonds of states and municipalities. . . . The profitable business is the predominantly negotiated revenue-bond area." Mr. Ford added that investment bankers do not need, nor should they have, a protected area of the market.

Mr. Ford then referred to another study, this completed in 1978 by Professor Phillip Cagan of Columbia University on the savings to states and municipalities if banks were eligible to underwrite revenue bonds. The study, said Mr. Ford, concluded that state and local governments would have realized in 1977 a total savings with a present value of $412 million if banks had been eligible to underwrite revenue bonds. These figures, he continued, have been disputed by the securities industry, but the fact remains that bank participation in this market would increase competition with the expected result being lower costs to the issuers — state and local governments that will be the primary beneficiaries if banks are permitted to underwrite revenue bonds. He went on to say that expanding the distribution network of dealer participants to include banks would broaden the realm of potential purchasers and would broaden the secondary market in these securities.

Mr. Ford cited several organizations representing state and municipal officials from around the country who have announced their support of HR 1539.

"The overriding 'theme' of the securities industry's arguments is the frightening consequence of authorizing bank underwriting," Mr. Ford said. "We hear that this is but the first step in our taking over the securities industry. We want to make it clear that the banking industry has expressed interest in and called for congressional action for obtaining only two new securities services: underwriting revenue bonds and collective investment of agency accounts. Both of these services are essentially the same as services historically offered by banks. Banks underwrite and deal in general obligations of state and local governments and have been authorized to underwrite and deal in select categories of revenue bonds over the years. No bank, to our knowledge, has indicated any desire to seek more than these two services, which are services truly indistinguishable from ones currently being offered."

Another argument advanced by opponents to the legislation, said Mr. Ford, is that big banks will dominate underwriting revenue bonds if allowed to offer this service. He countered this argument by saying that there has been healthy competition in underwriting GO bonds over the years. He cited Professor Almarin Phillips of the University of Pennsylvania, who prepared an economic analysis of bank entry and compared bank and nonbank leading underwriters in 1967 and 1977. According to Mr. Ford, Professor Phillips concluded that his data showed a pattern of decreasing concentration; the decrease occurring with the overall commercial-bank share falling and overall share of investment bankers constant or rising, even in those underwriting activities where the two are in the same markets. Professor Phillips found, said Mr. Ford, that there is no sign that commercial banks use their alleged advantages over investment bankers to the latter's detriment.

Mr. Ford cited and then countered other arguments the securities industry was using to keep the legislation from being passed, including the one that banks should not be allowed to underwrite revenue bonds because of risks that would weaken the safety and soundness of the banking system.

"HR 1539 itself provides certain safeguards," said Mr. Ford. "It would limit a bank's aggregate holdings of revenue bonds of any one maker or obligor to no more than 10% of the bank's capital and surplus, and banks could underwrite only those revenue-bond issues approved by the Comptroller of the Currency for purchase by national banks. Moreover, it must be remembered that the business of banking is evaluation of credit and market risks. Banks currently may and do invest for their own accounts in revenue bonds, and, in underwriting municipal securities, the bank typically would hold the issue only for a very short time. As to market risk, banks today underwrite general-obligation bonds and certain categories of revenue bonds so they have had long experience in handling this type of risk."

Arguments against passage of the legislation were advanced by investment firms in answer to a survey MID-CONTINENT BANKER conducted among these firms and among banks. Surprisingly, a few of the latter don't believe banks should get into MRB underwriting.

One of the most vocal opponents in the survey was Floyd H. Beatty, corporate vice president and manager/fixed income department, A. G. Edwards & Sons, Inc., St. Louis. Mr. Beatty wrote:

"We strongly oppose the termination of Glass-Steagall to allow commercial banks to underwrite and distribute municipal revenue bonds. Such issues have many of the characteristics of corporate securities as opposed to the general obligations, which are based on taxes, assessed valuations, etc.

"The proposal that we revert to the days before Glass-Steagall could well bring back the excesses which promoted passage of that act. Banks dealt generally in commercial-type securities with results that were detrimental to the depositors, their customers, trust accounts and shareholders. The potential conflict of interest arising from a bank acting in both a fiduciary and merchandising/underwriting

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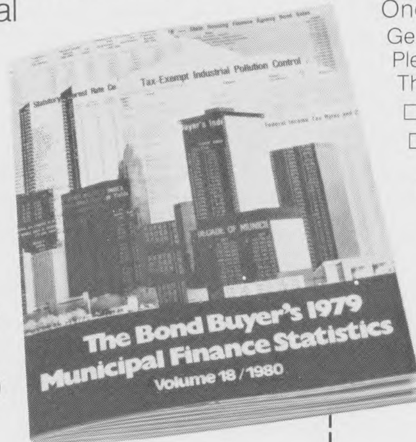

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capacity was violated in those days, and there is no reason to expect that the same would not occur again. Should the banks' bond departments discover themselves underwriting an issue with which they are not familiar and, faced with the necessity of disposing of that block, the temptation to distribute those securities in controlled accounts would be tempered only by the understanding that it is not right. Economic necessity could well influence that view.

"The investment-banking fraternity has functioned admirably to provide funds for our industry and for municipalities' revenue needs. Commercial banks' insistent search for new revenue sources in which to invest their massive capital would seriously weaken that investment-banking industry. It may lead to the potential demise of a large group of municipal bond houses that could well be forced out of business because of the decreased revenue available to them. Many smaller regional municipal bond houses specialize in serving investment needs of smaller communities. If that occurred and if the large commercial banks that logically would be expected to operate in the revenue-bond business decided that it was uneconomic to handle the small bond issues, those smaller communities and their taxpayers could suffer. Those smaller communities would be forced to deal to an increasing degree with the federal government with its resultant onerous controls.

"Commercial banks' argument that increased competition will result in lower interest costs to municipalities was disproved in a well-researched University of Chicago report. The minimal potential improvement in interest cost to municipalities is much more than offset by the potentially serious violations of the conflict of interest, requirements of the banks, unfair imposition of the immense capital that would draw the investment-banking industry and the probable demise of a large number of municipal bond houses.

"We strongly oppose banks entering into the revenue-bond business."

John E. McTavish, vice president/ general counsel, John Nuveen & Co., Inc., Chicago, sent a brochure published by the Securities Industry Association (SIA), which has offices in Washington and New York City. The brochure, "Is Bank Underwriting of Revenue Bonds a Trojan Horse?," disputed several claims made by banks in support of their efforts to get into MRBs. For instance, the brochure says banks claim that their participation in the revenue-bond business would broaden the market as a result of banks selling to their "preferred customers," who are inaccessible and unknown to nonbank dealers. The brochure answers by pointing to data collected by the Senate Judiciary Committee in 1972 that indicated that primary customers of bank underwriters were the banks themselves. In addition, it said, substantial amounts were sold to bank trust accounts and correspondent banks. The brochure added that two-thirds of tax-exempt bonds are bought by the institutional market, with which dealers are in daily contact.

The owner of Norfleet & Co., Shreveport, La., believes passage of HR 1539 or similar legislation would be the first step toward allowing banks to underwrite corporate issues, "and those with long memories will recall the horrible results of this policy prior to 1933."

An officer of Stifel, Nicolaus & Co., Wichita, maintains banks have plenty of domain as it is.

A Nashville investment firm representative says that aside from the possibility of repeating the excesses of the '20s, such legislation would place a further concentration of power in banks.

Two officers of Parham & Co., Inc., Little Rock — R. G. Parham Jr., president, and Richard E. Cross, vice president — point to banks' unfair advantage of having unusually large capital bases and of being able to purchase bonds for themselves or place them with their downstream banks.

W. W. Satterfield, president, Powell & Satterfield, Inc., Little Rock, believes it would be a further encroachment by banks into nonbanking businesses. He points out that banks can deal in bonds, but securities dealers can't engage in banking, and the legislation would be detrimental to local and regional dealers, who are necessary for providing an orderly market for small, limited-marketability issues.

James D. Rutter, who is in the securities business in Tulsa, says one reason banks desire entry into the revenue-bond business is that after having overthrown one provision of the Glass-Steagall Act, it will be easier to get into the *corporate*-bond business later. He adds that, having been in the bond business *before* passage of Glass-Steagall, he sees the latter as a surely needed piece of legislation.

Even some bankers surveyed voiced objections to the proposed legislation. E. G. Potter Sr., vice chairman, Commercial National, Anniston, Ala., says being able to underwrite such bonds was one of the reasons banks were in the condition they were in during the early '30s. Other bankers cited the risks involved and lack of personnel trained in that area.

A Texas banker believes there is a place for brokerage firms that are independent of banks; this is an area in which they are allowed to participate free of the influence of large banks and that competition would be stifled by allowing large banks to enter the revenue-credit field.

For the Legislation. Bankers in the survey who support the legislation give a variety of reasons, including that of needing new revenue sources to generate profits. James G. Boyer, president, Gulf National, Lake Charles, La., points out that brokers are in the banking business, and there's no reason for the rule prohibiting banks from dealing in securities. He believes Glass-Steagall has outlived its usefulness.

A Mississippi banker believes banks should be able to ascertain the creditworthiness and repayment ability of the underlying credit as well as mortgage bankers and bond dealers. He adds that this should add to the competitive situation and could help government agencies obtain better rates. A Texas banker says banks that are underwriting GOs and governments successfully also should be successful in underwriting revenue bonds. Banks tend to be some of the largest purchasers of these bonds, says a Houston banker, and they are becoming a larger part of the tax-exempt market. In addition, he says, banks have become sophisticated underwriters.

Pete M. Drexler, vice president/ cashier, American Bank, Houma, La., says banks participating should broaden the market, making it more orderly than it is now. He adds that many revenue bonds are excellent investments for banks.

A Wichita banker gives four reasons for his "yes" vote: 1. Banks are close to the credit and, therefore, should be familiar with local problems and needs. 2. It would provide more competition in bidding and pricing bonds. 3. Many dealers, such as Merrill Lynch, are competing directly with banks for deposits and providing other traditional banking services. If they are allowed to provide these, banks should be allowed to compete on services they provide. 4. If banks are allowed to trade in MRBs, it would make another investment alternative available to small, less sophisticated investors. ● ●

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Banks Financing Tender Offers Must Watch Legal, Financial Rules

BANKS making loans that finance tender offers must pay scrupulous attention to legal and financial strategies. Chicago attorneys Leo Herzel and Richard Rosenberg claim such transactions pose legal problems that can endanger repayment of such loans and cause a bank to become a defendant in troublesome litigation. Messrs. Herzel and Rosenberg are partners in Mayer, Brown & Platt, Chicago.

Banks are most vulnerable when the target company is an old customer and the would-be borrower isn't. Such a situation could look sufficiently like a violation of confidential information to bring about lawsuits, the attorneys say.

Although a bank's legal counsel should be able to disprove claims of breach of confidentiality, it's better to base loan consideration on publicly available information about a target firm rather than on research already on file, Messrs. Herzel and Rosenberg claim. At the same time, the bank should build a type of internal "Chinese wall" to separate officers involved in tender-offer financing from officers with knowledge of the target firm.

While Messrs. Herzel and Rosenberg emphasize the protection of all confidential relationships, they set out three other potential problems:

- The bank must take great care in cases where it relies on the use the borrower expects to make of the target firm's assets and earnings to repay a loan. For example, any use of the target firm's assets to pay all or part of a loan may be subject to attack by the public minority in a stockholder suit as a breach of fiduciary obligation. Clearly, banks must protect themselves against such a suit, the attorneys state.
- Legal suits can arise out of aiding and abetting situations; that is, a bank's involvement in a loan where there are violations of securities laws.
- The bank must carefully avoid violating Regulation U which provides that "a bank loan to finance a tender offer for 'margin stock,' if secured directly or indirectly by any stock, may not exceed the maximum loan value of the collateral as determined in good faith by the bank." Consequently, a violation of Regulation U could affect the enforceability of the loan. Messrs. Herzel and Rosenberg point out that if the loan is not secured by stock, suspicion of involvement with an investment banker would be a violation of Regulation T — a further complication.

Despite these four serious exposures, the attorneys assert that banks can protect themselves against substantial legal expense and unfavorable publicity. • •

Phone Network Can Save Banks $22 Million Annually

An ABA/AT&T study estimates that a $22 million savings is possible in telephone bills if 60% of the nation's banks participate in a telephone network. Banks with assets of $1 billion or more can expect to save about $100,000 a year in long-distance phone tolls. Substantial savings can be achieved by smaller banks, depending on the physical location of bank offices in relation to network trunking lines, according to the study.

The study, begun in 1978, is available to the public, and followed a preliminary investigation into the feasibility of a nationwide telephone system for bank-to-bank calling made by the ABA.

The ABA has mailed requests for information to vendors and suppliers of telecommunications products and services inviting information on their ability to provide a cost-efficient bank-to-bank telephone service. Responses are due this month and will be reviewed by the ABA telecommunications subcommittee.

The question of the legality of such a network has yet to be addressed. Communications systems are regulated by the Federal Communications Commission and the network can't be implemented until it's determined that the proposed system is within FCC policy.

Copies of the study are available to ABA member banks for $25. Orders should be sent to the ABA Order Processing Department, 1120 Connecticut Ave., N. W., Washington, DC 20036. Requests should indicate publication number 06400.

Bank 'Takes off Gloves,' Fights Money-Mkt. Funds With Ads, Commercials

For many months, commercial banks have seen potential deposits go to money-market funds in such firms as Merrill Lynch, but these banks have been reluctant to come out and fight the investment firms for such business.

More recently, however, there have been signs that banks are "taking off their velvet gloves" and are actively seeking the money that's going into money-market funds.

A case in point is City Savings Bank, Meriden, Conn., which has started an ad program designed to counter the appeal of these funds. Its theme is "The Good Guys vs. the Money-Market Funds."

One recent such ad — described by President Robert K. Montgomery as "a public-service message" — began by asking the pointed question, "What have money-market funds ever done for Meriden?" The ad went on, "How much do they loan out locally in mortgages? How much in installment loans? How many jobs have the money-market funds created in Meriden? How much have they invested in local buildings? What local charities and community organizations do they support? The answer in every cases is: nothing.

"What's more, money-market funds are not insured, not regulated, and their interest rates are not guaranteed — they can change overnight."

The ad then compared the record of money-market funds with that of money deposited with City Savings. It pointed out that money deposited in the bank is safe because the bank is regulated by state and federal agencies and insured by the FDIC, and its rates are guaranteed. In addition, dollars deposited with City Savings, said the ad, will be reinvested to help Meriden and its residents. Then, the ad gave several examples of such reinvestment in the areas of mortgages and installment loans and told how this money has helped create jobs. The ad also told how the bank has invested in buildings and equipment and has contributed to local charities.

Besides newspaper ads, the bank uses this theme in direct mailings, radio commercials and a large lobby sign.

Have the ads paid off? According to Mr. Montgomery, they have, attributing one $40,000 and one $20,000 CD directly to them. He has received many favorable comments on them.

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National Detroit Corporation Statement of Condition

CONSOLIDATED BALANCE SHEET—September 30, 1980
(dollars in thousands)

ASSETS

Cash and Due From Banks (including Foreign Time Deposits of $1,296,914)	$ 2,449,468
Investment Securities—At Amortized Cost (Market value $1,641,449)	1,781,579
Trading Account Securities—At Lower of Cost or Market (Market value $1,554)	1,554
Money Market Investments	1,296,041
Loans:	
Commercial	2,602,344
Real Estate—Construction	67,599
Real Estate—Mortgage	1,145,458
Consumer	645,286
Foreign	621,772
	5,082,459
Allowance For Loan Losses	(63,456)
Unearned Income	(81,693)
	4,937,310
Lease Financing	24,538
Bank Premises and Equipment (at cost less accumulated depreciation of $78,405)	105,098
Customers' Liability on Acceptances	368,984
Other Assets	168,859
Total Assets	$11,133,431

LIABILITIES AND SHAREHOLDERS' EQUITY

Deposits:		
Demand		$ 2,150,166
Certified and Other Official Checks		326,716
Savings		1,439,986
Time		628,088
Certificates of Deposit		810,709
Money Market Certificates		985,394
Foreign Office		1,441,817
Total Deposits		7,782,876
Short-Term Borrowings		2,028,483
Liability on Acceptances		368,984
Accrued Expenses and Sundry Liabilities		197,387
Long-Term Debt		111,699
Total Liabilities		10,489,429
Shareholders' Equity:		
Preferred Stock—No Par Value		—
No. of Shares		
Authorized	1,000,000	
Issued	—	
Common Stock—Par Value $6.25		76,640
No. of Shares		
Authorized	20,000,000	
Issued	12,262,475	
Capital Surplus		183,156
Retained Earnings		384,206
Total Shareholders' Equity		644,002
Total Liabilities and Shareholders' Equity		$11,133,431

Assets carried at approximately $966,000,000 (including U.S. Treasury Securities carried at $23,000,000) were pledged at September 30, 1980, to secure public deposits (including deposits of $62,572,000 of the Treasurer, State of Michigan) and for other purposes required by law.
Outstanding standby letters of credit at September 30, 1980, approximated $46,000,000.

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National Detroit Corporation is listed on the New York Stock Exchange (Ticker Symbol NBD).

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Bond Markets See New Interest-Rate Behavior Due to Shattered Traditional Analytical Mold

A NEW interest-rate behavior has emerged in the markets that will require fixed-income portfolio managers to struggle to gain new footings, according to Henry Kaufman, general partner and member of the executive committee of Salomon Brothers, New York City.

"The traditional analytical framework for the credit markets and interest rates is being shattered by the financial and economic excesses in the real world," he said.

"In less than two decades, traditional conventions have vanished. Outstanding debt exploded; innumerable credit instruments were introduced; distinctions among financial institutions blurred; individual investors became more sophisticated; and only short-time horizons were allotted for measuring the performance of institutional portfolios."

In the past 15 years, Mr. Kaufman said, the U. S. experienced credit crunches and financial crises when interest rates flared, institutions and debtors failed and uncertainty became the dominant factor dictating business and financial decisions.

As a consequence, nine new developments in interest-rate behavior have been perceived by Mr. Kaufman:

• *Highs and lows of interest rates don't remain constant*. Even though there have been only two brief periods of double-digit interest rates in the postwar period, yields of 10½% to 11½% on high-grade long-term taxable bonds now are considered low, an unthinkable perception a decade ago. Cyclical climbs in interest rates have lasted longer than their declines, in a sweeping secular upswing spanning about 35 years. This was a direct result of each cyclical high and low in inflation moving successively upward. In fact, Mr. Kaufman pointed out, on examination of the fundamentals, it would not be rash to conclude that double-digit interest rates will prevail for the foreseeable future. In addition, on the basis of certain statistical benchmarks, the current cyclical low in yields for high-grade utility bonds of 10½% to 11% is already behind us.

Among the underlying fundamentals that point to a continuation of double-digit interest rates, he stated, are double-digit inflation for the second consecutive business cycle; conduct of only a limited war against inflation, with virtually all the burden placed on the Fed in the absence of fiscal constraints; government projections for 1981 of a 10% increase for the GNP deflator; continuing annual wage gains of 9% to 11%; expectations of higher domestic oil prices; less than cyclical improvement in productivity; and an aggravation of inflation from possible tax cuts and increased military outlays that are not offset by expenditure cuts.

• *Sizable interest-rate volatility needs to be incorporated into portfolio and financing decisions*. Interest-rate volatility has increased substantially, Mr. Kaufman pointed out. He attributed the wide fluctuations to increasing sensitivity to inflation; enhanced ability of borrowers and investors to respond to rising prices; and the Fed's new monetary approach which has abandoned a money-market condition target and adopted a banking reserves' provision objective.

Analyzing credit-market price fluctuations since 1974, Mr. Kaufman pointed out that the weekly average price swings in long Treasury bonds in the past year were 3½ times greater than in 1974 and, for Treasury bills, twice as great as in the preceding four years.

• *Bonds are now bought for price appreciation potential and not for income protection*. The attractiveness of income protection offered by bonds has been whittled away by the corrosive effects of inflation, Mr. Kaufman stated. The recent poor performance of bonds, measured by total rate of return, has not gone unnoticed by portfolio managers nor has the negative gap between the costs and market values of institutional long-bond holdings. The consequence of high and volatile interest rates has been the rush to risk aversion and to minimize price risks in bonds. Another consequence may be regulatory and accounting requirements that fixed-income investments be shown at current market value rather than purchase price. Both strengthen trends to buy bonds for price appreciation potential when occasional upswings in bond prices are anticipated.

Heightened bond-price volatility has improved the relative merits of common stocks over bonds, he added. During the past year, the mean weekly price change of long bonds was 2% compared with 1.9% for common stocks as measured by Standard & Poor's 500. By contrast, Mr. Kaufman noted, from early 1977 to September, 1979, stock volatility was 1.5% and bond volatility was 0.5%.

• *Positive yield curve essential to long bond market viability*. In the past, Mr. Kaufman noted, bond markets functioned well when the yield curve shifted gradually away from its most positive slope. When the yield curve flattened, the change was concentrated in short-term rates; the change in long-bond yields was substantially less. Now, quickly rising short rates are perceived as a threat to the stability of long-term rates. A contracting positive yield-curve differential now can do nothing but destabilize bond prices, cause a sharp falloff in long-bond financing as investors back away and create crowded borrowings in the short-term market.

• *The U. S. government market is the pricing pacesetter of the bond market*. Because of the federal government's continuously large cash needs, the publicly held Treasury debt has risen from $237 billion in 1960 to $707 billion in September, 1980. This has given an increasing pricing leadership to the Treasury securities market, Mr.

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Kaufman said, so that the homogeneity of this market contrasts sharply with the heterogeneity of the corporate bond market. "In other words," he said, "governments are improving as a trading vehicle, while corporates are becoming less liquid."

• *Mortgage securities are alternatives to bonds, especially corporate bonds*. With the advent of packaging mortgages in securities form, the mortgage market has been transformed from a regional market into a national market, Mr. Kaufman stated. The mortgage market has become a more uniform credit instrument than it was a few decades ago, while the corporate bond market has lost some of its homogeneity. Mortgage securities, compared with bonds, have larger and quicker cash-flow schedules and offer viable interest rates to lenders. Both are great benefits in an inflationary-biased economy. But, perhaps the greatest challenge to the traditional bond instrument is the birth this year of the mortgate-appreciation sharing obligation. This gives the lender the opportunity to share in the appreciation of the home over the life of the mortgage and provides the borrower with an interest cost well below a straight mortgage. Lenders and borrowers have every incentive to resort to this credit instrument. Treasury securities will withstand this challenge, but corporate bonds can only suffer.

• *Bond portfolios will emphasize interest-rate-anticipation swaps and minimize most other types of swaps*. The inflationary bias in most portfolio strategies suggests a preference to shorten maturities by passive and active portfolio decisions, Mr. Kaufman noted. However, this strategy will be reversed from time to time when the expectation looms great for a price appreciation in bonds. Then, shorter-term securities will be swapped for longer-term. However, some other types of swaps, based on traditional yield relationships among different bonds, are likely to diminish because heightened bond-price volatility exacerbates the risk.

• *Financial futures are an integrated part of an interest-rate strategy*. Although financial futures are controversial, they will be an important part of interest-rate strategy, Mr. Kaufman stated. Through intricate hedging operations, they reduce the underwriting risks inherent in extremely volatile markets and, unquestionably, it would have been difficult without financial futures to underwrite the record volume of new bond offerings so far this year. They have enhanced the dominance of U. S. government securities because they are most applicable to huge homogeneous markets.

• *Interest rates in the U. S. are internationally linked*. The sensitivity of U. S. to foreign interest rates has soared, Mr. Kaufman said. Now, two world forces are bearing down on domestic interest rates. The first is the performance of the dollar in foreign-exchange markets. A weak dollar, for example, would limit an easing in monetary policy for domestic reasons.

Second is the performance of the international bond markets. The performances of some of these markets have been superior to the American bond market. From 1972 to 1979, the least attractive of foreign opportunities would have resulted in an improvement in performance of 3.6 percentage points per year in the money market and 3.5 percentage points in bonds. A diversified investment in six foreign markets annually would have increased portfolio performance over U. S. dollar investments by six percentage points in the money market and 8.6 percentage points in bonds. • •

Community Youth Corps Financed by Detroit HC

A special "Community Youth Corps Project" to provide summer jobs for inner-city youths aged 15 to 19 has been financed by DETROITBANK Corp. The project was initiated by a $250,000 contribution to New Detroit from the HC, whose lead bank is Detroit Bank.

New Detroit is a coalition of business, labor, government and the community dedicated to improving social and economic conditions in Detroit, particularly for minorities.

The community Youth Corps Project is administered through the Comprehensive Youth Training and Community Involvement Program which is a part of New Detroit's activities. Developed by the HC, the project is designed to help ease the economic crunch for inner-city youths — the people hit first and hardest by the city's rising unemployment rate.

Young people have been hired to work five days a week through August 15 at a wage of $3.10 per hour. Jobs range from assisting city clean-up crews at inner-city parks to paint-up, fix-up, clean-up chores in 21 Detroit communities.

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On Money-Market Mutual Funds:

Door Is Opened For Small Banks To 'Get Into Act'

On August 15, a Pittsburgh money-market fund started investing in $100,000 CDs of small banks in a recycling-of-cash program developed with the assistance of the Independent Bankers Association. The program is said to have been extremely successful in its early phase, and it is hoped that the initial efforts in Minnesota will have a meaningful impact in recycling back to smaller banks cash with which to make agricultural loans, etc.

MONEY-MARKET mutual funds (MMFs) have enjoyed immense success across the country, with about $77.1 billion now invested in them (after reaching a high of $81.5 billion last August). As bankers are well aware, much of this is money that has been withdrawn from small and regional banks. Thus, it is money that has left the communities in which these banks are located because MMFs invest their assets in CDs of large money-center banks.

At least, that's the way it was until last summer, when the way was opened for small banks to get into the "MMF act." On August 15, a Pittsburgh money-market fund called Federated Cash Management Systems started investing in $100,000 CDs of small banks in a recycling-of-cash program developed with the assistance of the Independent Bankers Association of America.

The first two purchases were of one six-month $100,000 CD each from two Minnesota banks — the $23-million-deposit Citizens State, Clara City, and the $8-million-deposit First State, Lake Lillian.

Since then, 56 additional such CDs have been purchased.

Federated expects to buy $5-million lots each week until it reaches the maximum allowable. Its president, Glen R. Johnson, says that as more money funds and banks get into the business, a secondary market will develop, as it usually does. He pointed to Government National Mortgage Association (Ginnie Mae) pass-through securities as a recent example.

Federated expects to go into a relationship, continues Mr. Johnson, with the intention of holding the CDs to maturity, which will be six months in most cases. Rates on CDs bought by Federated are secondary-market rates for 180-day CDs of major New York City banks.

At maturity, says Mr. Johnson, his firm will make it easy for banks to roll the CDs over simply by phoning the banks three days before maturities. In this way, according to Mr. Johnson, logistics will be kept simple and paperwork to a minimum.

The $100,000 figure is significant because it is the maximum FDIC coverage, and it's the minimum size for a CD to avoid Regulation Q limits.

Federated Cash Management Systems was created in mid-1973 by Federated Investors, Inc., also of Pittsburgh, which foresaw a need by institutional investors, specifically bank trust departments, for an administratively convenient, conservatively managed cash-equivalent fund that could be used to move surplus cash into and out of in response to their perception of equity and bond markets. Federated Investors is a financial services holding company, whose subsidiaries create, manage, administer and market open-end investment companies (mutual funds). As of this writing, mutual funds within the Federated complex have aggregate assets of about $11 billion.

The new CD program for small banks is being operated under Federated's six-year-old Money Market Management, Inc., a short-term money-market fund whose investment objectives and policies limit it to purchases of bank CDs.

The money-market-fund industry — almost exclusively on the retail side — has enjoyed enormous investor acceptance throughout the U. S. Although the amount of money that has been withdrawn from bank savings or checking accounts to be invested in MMFs is virtually unquantifiable; nevertheless, the mutual-fund industry and the banking community are aware that substantial shifts of assets have taken place from smaller banking institutions to

(Continued on page 44)

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MMFs, which thereupon invest their assets in large money-center banks' CDs.

Dislocations caused by this redistribution have not been lost on either the Fed Board of Governors or Congress, points out Eugene F. Maloney, corporate counsel for the Federated complex. Mr. Maloney illustrates this point by referring to the August 5th testimony of Fed Chairman Paul Volcker, reporting to Congress on results of the initial meeting of the Depository Institutions Deregulation Committee, wherein he advised Senator Robert B. Morgan (D., N.C.) that in his (Chairman Volcker's) opinion, banks and S&Ls — rather than fighting among themselves — perhaps should join forces and recognize that the single biggest threat facing them was MMFs. In addition, says Mr. Maloney, various hearings have been held by appropriate House and Senate committees for the purpose of probing the effect of MMFs on the thrift and banking industries.

"Perhaps our organization," continues Mr. Maloney, "with its tremendous exposure in the bank-trust community, is uniquely situated to understand the sensitivity of this issue. Many months ago, Glen R. Johnson (as president of our various MMFs) testified before Congress as to his awareness of and sensitivity to this problem. Shortly thereafter, Mr. Johnson sent a letter to Senator William Proxmire (D., Wis.), advising him of our willingness to initiate a program whereby our money-market funds would purchase CDs of smaller banks. Mr. Johnson pointed out in his letter that it appeared to him that certain problems existed as a result of the rules and regulations of the Securities and Exchange Commission (SEC), primarily in the area of credit-worthiness of small banking institutions and liquidity of their debt instruments.

"Senator Proxmire took the initiative in contacting SEC Chairman Harold M. Williams for the purpose of resolving our concerns. Simultaneously, through the good offices of the Investment Company Institute, Washington, D. C. (the mutual-fund-industry association), a meeting was held last May between various members of the mutual-fund industry and representatives of the Independent Bankers Association of America for the twofold purpose of discussing differences that existed between the two organizations, as well as the possibility of initiating a program such as that proposed by Mr. Johnson.

"Present at the meeting was Noel H. Busch, executive vice president, Independent State Bank of Minnesota (Minneapolis). This bank can be defined roughly as a banker's bank for smaller banking institutions in Minnesota. Mr. Busch's bank previously had undertaken programs to place small bank CDs issued by Minnesota banks with the Minnesota State Board of Investments. Accordingly, we engaged in a dialogue with Mr. Busch for the purpose of having him canvass his member banks to seek indications of interest as to whether they would be willing to sell to Money Market Management $100,000 principle-amount CDs, insured by the FDIC.

"The program has been extremely successful in its early phase, and we are optimistic that our efforts in the state of Minnesota will have a meaningful impact in recycling back to smaller banks cash with which to make agricultural loans, etc."

Mr. Maloney reports that his firm is negotiating with other banking institutions to serve in similar roles in other states. Also, banks are being solicited on a direct basis through various publications and Federated's own monthly newsletter. This solicitation program has been successful, and Federated is moving aggressively to expand it.

Mr. Maloney says Federated cannot single-handedly make a sizable impact on the disintermediation caused by all MMFs. Accordingly, both Federated and the Investment Company Institute have urged other member MMFs to initiate similar programs.

Mr. Maloney explains that money-market funds are open-end investment companies registered with the SEC under the Investment Company Act of 1940 and Securities Act of 1933. In their registration statements and prospectuses, each fund must set forth an investment policy that typically describes the types of securities they intend to acquire. Most MMFs, including several within Mr. Maloney's own organization, have placed size requirements on CDs they can acquire. An example would be a Federated MMF that purchases only CDs of banks having capital and surplus in excess of $100 million. To modify these policies, continues Mr. Maloney, it's necessary to secure shareholder approval, which he describes as a somewhat cumbersome and time-consuming process. His organization is moving swiftly to secure such approval, and he understands other MMF groups are considering similar action.

However, there doesn't seem to be a stampede of other MMFs to this new program. IDS Cash Management Fund, Minneapolis, is looking at the possibility of starting one, and Government Investors Trust, Arlington, Va., would consider buying $100,000 CDs from small banks. Gradison Cash Reserves, Inc., Cincinnati, is not able at this time to handle the large number of individual transactions such purchases would require. However, Paul J. Weston, the firm's vice president, says it is looking into it because it would like to buy the CDs.

Several firms that are not going into this program gave such reasons as being prohibited by their prospectuses or having $1-billion minimums on size of CD purchases. The prospectus of Capital Preservation Fund, Palo Alto, Calif., limits its portfolio positions to U. S. Treasury bills and Treasury securities under repurchase agreements. A partner in a Chicago firm says its guidelines do not permit such investments and if these guidelines were amended by a shareholder vote, such investments would be considered only if a premium rate was available.

Perhaps as the Federated program out of Minneapolis grows, other MMFs will follow suit and initiate similar programs. As Federated's Glen Johnson says, ". . . we are convinced of the nationwide importance of recycling cash back into small banks of America. We at Federated will do our best to help in maintaining the economic vitality in the different regions of the country. We hope that other money funds will follow our lead in this matter so that the program will make a difference." ● ●

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Errors and Omissions:

Changing Exposures Under the Law

By Edward D. Norris
Executive Vice President
MGIC Indemnity Corp.
Milwaukee

EACH service your bank offers its customers and employees — from trust departments and Individual Retirement/Keogh accounts to employee-benefit and pension programs — increases your bank's vulnerability and legal exposure at the same time that it increases your customer base. It is fairly clear why this occurs.

The more complex the regulations and the greater number of decisions and administrative duties each officer and employee is involved in, the more possible it becomes that either someone in the bank will commit an error or that a customer will see cause for bringing suit in a particular situation for a variety of reasons. As an example, trust departments and other areas with fiduciary responsibility operate in a complex legal and regulatory environment with immense responsibilities and staggering potential liabilities. Decisions your officers make today may prove years later to have been imprudent.

Second, while the economy is showing some small signs of spotty recovery, the general population continues to be hard pressed. In such an atmosphere, you can expect litigation to increase. People who run into financial trouble trying to live on sums paid out of a trust closely scrutinize the bank's investment procedures and general handling of the funds in their trusts.

Although bank trust departments have not been viewed traditionally as profit centers, increased competition and earnings squeezes will increasingly cause those departments to become more aggressive and profitable. At the same time, you are working under close adherence to the terms of the Employee Retirement Income Security Act (ERISA), which specifically states that " . . . a fiduciary shall discharge his duties with respect to a plan . . . with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. . . . "

Many suits result in staggering costs of litigation and sometimes loss of public confidence when a trust beneficiary takes legal action. This is especially true for small- to medium-sized banks that not only provide a new mix of services to remain competitive, but that also manage their own in-house pension plans.

Litigation Continues to Increase. Just what does this scenario mean in terms of the specific suits that can be brought? What are some of the exposures your bank, its directors, officers and employees face in terms of breach of duty, neglect, error, misstatement, misleading statement or omission? The following examples of recent cases will help demonstrate some of the areas of potential concern:

1. In one case currently being settled, a bank faces potential suit from the beneficiary of a simple trust that held 4,500 shares of stock in a single corporation. When that corporation experienced financial problems, the bank attempted to contact the beneficiary either for permission to diversify the investment or to be relieved of the financial responsibility over the trust. However, the beneficiary never replied to the bank's requests, and over a five-year period, the trust lost more than $130,000 in principal and interest.

2. Another bank incurred a loss from the overpayment of distributions to 13 beneficiaries of an estate. The bank, acting as executor of the estate, distributed more than $88,000 in assets, which were to have been used to establish a scholarship program at a local college. When the error was discovered, the bank asked the beneficiaries to return the excess payments, but at present it has not been able to collect from any of the 13 beneficiaries.

3. A shareholder of a mortgage trust filed suit against the trust company charging that defendants overstated their assets in financial statements to those shareholders for the purpose of generating excessive advisory fees. The plaintiffs further alleged that the trust made irresponsible loans the holding company would *not* make. Specifically, the suit charged the trustees and officers with violation of federal securities law, mismanagement, misrepresentation and breach of fiduciary duties.

4. Another suit charged that a bank, by its actions, violated provisions of ERISA, Section 405 (A) (3). A beneficiary and participant in a retirement plan sponsored by a bank customer alleged that the bank failed to discharge its fiduciary duty with regard to the re-

MGIC Indemnity Corp. is said to be the nation's largest writer of directors' and officers' (D&O) liability insurance for financial institutions. Edward D. Norris has spent the past 14 years specializing in various coverages designed exclusively for financial institutions, with particular emphasis in D&O and bonding areas.

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tirement plan. The bank had failed to determine whether sufficient assets were retained in the plan in case any participants chose to call for distribution of their vested benefits on plan termination.

5. Action was brought against a bank acting as trustee of a radio station. The charges were restraint of trade, damages to business reputation and interference with contractual obligations by not allowing commercials produced by the plaintiff to be played on the air. The plaintiff claimed damages exceeding $285,000.

6. Another bank was found liable to the Internal Revenue Service for failure to file a federal estate tax extension. This failure resulted in a penalty against the estate for $98,241. The bank settled with the IRS for $43,241.

7. A class-action suit was brought against a bank for improperly charging a "termination fee" after the bank resigned as trustee for four testamentary trusts. Since the suit was filed on behalf of the estimated thousands of beneficiaries of trusts that have been charged a "termination fee," the loss potential for the bank could be enormous.

Assess Your Bank's Needs. What can be seen clearly from these cases is that trust departments exist in an extremely sensitive environment. The "prudent-man rule" is not new; but your exposures under ERISA increase and change as you offer new services to your customers and as the courts set new guidelines via their interpretations and legal decisions.

Since 1974 banks have been handling IRA and Keogh plans. In administering these types of retirement accounts, you make decisions about and safeguard the funds held. IRAs benefit you and your customers, but they also provide yet another area in which actions could be questioned at some future date.

Since passage of ERISA, the potential for suit also has increased with regard to a bank's in-house employee-benefit plans. Beneficiaries of these plans have brought and will continue to bring suits on grounds of alleged breach of fiduciary duty.

In light of the potential for costly litigation, you know that you need to set up safeguards to protect your bank, its officers and employees. What does this mean in specific terms?

More than ever, you need to exercise great care in recruiting and hiring competent, professional people. This means selecting your staff for their abilities, ethical standards and astuteness in keeping up with the latest developments in the banking industry.

Second, review educational programs and formal procedures within the bank for training new employees and for circulating new ideas and regulations through your current staff. Since procedures and requirements change so quickly today, and investment markets move just as quickly, well-informed staff members and good internal controls are essential to the security and integrity of your bank.

Third, maintain frequent communication with the bank's legal counsel, keeping abreast of current issues and reviewing trends of the banking industry.

Fourth, consider the specialized insurance coverages that have been designed to protect banks and directors and officers from loss exposures associated with the banking industry.

Examine the forms of errors and omissions insurance that protect trust departments, IRA/Keogh accounts and in-house pension plans and mortgagee interest. In each of these services, the bank, its directors, officers and employees face increased accountability for mistakes, misjudgment, a less-than-spectacular investment strategy or whatever else a beneficiary or customer may perceive as not being prudent, discreet or honest.

You owe it to yourself and your institution to evaluate the way exposures change as laws and regulations are interpreted and new bank services become more popular. Attorneys and doctors protect their professional standings with malpractice insurance. Today's bankers need to exercise the same precautions in an ever-more-complex world of managing assets. ● ●

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Doll Houses Given Away At Bank's Open House

Doll houses were given away last year by Peoples Savings Bank, Evansville, Ind. The occasion was the grand opening of the new Westside Branch.

A "Washington" doll-house kit was awarded every business hour, on the hour, during the grand-opening week last December. A fully assembled "Van Buren" doll house was given away during Santa's visit on a Friday during opening week. Three "Harrison" doll-house kits were given to winners from among persons who took demonstrations on the bank's "Ready Teller" ATM anytime during the week. These presentations were made after the celebration was over.

Little girl examines "Harrison" doll house, which, along with "Washington" model (l.) and "Van Buren" (top), were given away in forms of kits for week before Christmas last year by Peoples Savings Bank, Evansville, Ind. One fully assembled "Van Buren" model was presented by Santa to its winner. Bank was celebrating grand opening of its new Westside Branch.

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How to Reduce Kidnap/Hostage Risks For Bankers and Their Families

A BANKER faces a dilemma. On the one hand, because of his position, he usually is a community leader or at least is called on to be an extremely visible participant in charitable and civic activities. On the other hand, he is advised to keep a low profile to reduce the possibility of becoming involved in a kidnap/hostage situation.

How can he solve this problem?

For one thing, says H. E. Williams, director, Williams & Associates, Aurora, Colo., a banker should be constantly alert to the possibility of kidnapping and extortion and to organize a lifestyle that affords the most protection, around the clock. Mr. Williams' company is a security consulting firm.

There are six hours of high-risk vulnerability for a banker, according to Mr. Williams, if his bank is secure for eight hours, and his home is secure for 10 hours.

"The kidnapper/extortionist selects a victim who offers him the most opportunity with the strongest likelihood of success," he adds. "In all planned abductions, criminals and terrorists spend a great deal of time keeping their victim under surveillance to acquaint themselves with his/her routine. A potential victim must learn to recognize a surveillance, then alter his routine to reduce or eliminate kidnap risks."

Bankers are advised by Mr. Williams to give careful thought to requests for photos of themselves and/or their families because pictures in newspapers may be used by kidnappers to identify the bankers and their families. In interviews, bankers are cautioned not to give their addresses, tentative travel plans, itineraries, children's school(s) or similar information.

Mr. Williams lists the following rules for bank staffs to consider:

1. Know callers. In some cases, you may not know them personally, but you should know them by name or by the name of the firm they represent.

2. Put away papers. When you are away from your desk or out of the office, any material you are working on should be out of sight. Do not allow anyone to look over your shoulder or walk behind your desk when you are working on confidential or proprietary material.

3. Follow the "need-to-know" rule. Do not discuss your plans with anyone not directly involved.

4. Conduct your personal conversations carefully. Avoid all discussions of travel plans in public restaurants, elevators or any place you may be overheard.

5. Security "leaks" usually come from well-meaning, loyal employees who inadvertently disclose information. It's only natural to discuss with friends and co-workers items that are interesting and newsworthy.

Bank-Executive Guidelines. Here are guidelines Mr. Williams suggests that bank executives should follow:

1. Vary your daily routines. Avoid habitual patterns kidnappers look for; alternate travel as to time and route to and from the bank. Use different doors, different parking places. Do not work late the same days and same hours.

2. Be alert to strangers on business property for no apparent reason. Maintain control of strangers and visitors.

3. Instruct your family and business associates not to provide information to strangers about you or your family.

4. Avoid giving unnecessary personal details in response to inquiries from such publications as business directories, social registers or community directories.

5. If your bank has security officers, know them by sight. A man in uniform could be your abductor. Personal recognition is the surest method of establishing positive identification.

6. Require your guards to be trained.

7. If a definite threat exists and your building or bank has uniformed security officers, ask one of them to meet you and walk you to your car.

8. Avoid working alone in your office at night. If you must, keep drapes closed late at night. Don't stand in front of windows.

9. Always tell a business associate or family member your destination and anticipated return when leaving the bank or home. Refuse to meet with strangers away from the bank at unknown locations or secluded places.

10. Establish simple, effective signal systems, which, when activated, will alert your business associates or family members that you are in danger.

11. Review your bank's security plans at least monthly to evaluate their effectiveness. Make certain all employees are aware of these plans. This will ensure security consciousness.

Access Control. Offices of bank officers likely to be targets should not be directly accessible to the public, advises Mr. Williams. Whenever possible, executive offices should not be located on the ground floor.

The primary purpose of access-control systems is to ensure that only authorized personnel are allowed to enter sensitive areas inside a bank. Any access system should be simple in its operation and should not adversely

(Continued on page 54)

There were 25 Hobbs Act violations in the Mid-Continent area during the first six months of this year, according to FBI statistics. This act prohibits any attempt to obtain money from financial institutions, mainly through kidnap/extortion plots. Here's how the 13 states in the Mid-Continent area fared in number of violations:

State	Violations
Alabama	4
Arkansas	2
Illinois	3
Indiana	2
Kansas	0
Kentucky	0
Louisiana	0
Mississippi	3
Missouri	4
New Mexico	0
Oklahoma	2
Tennessee	0
Texas	5

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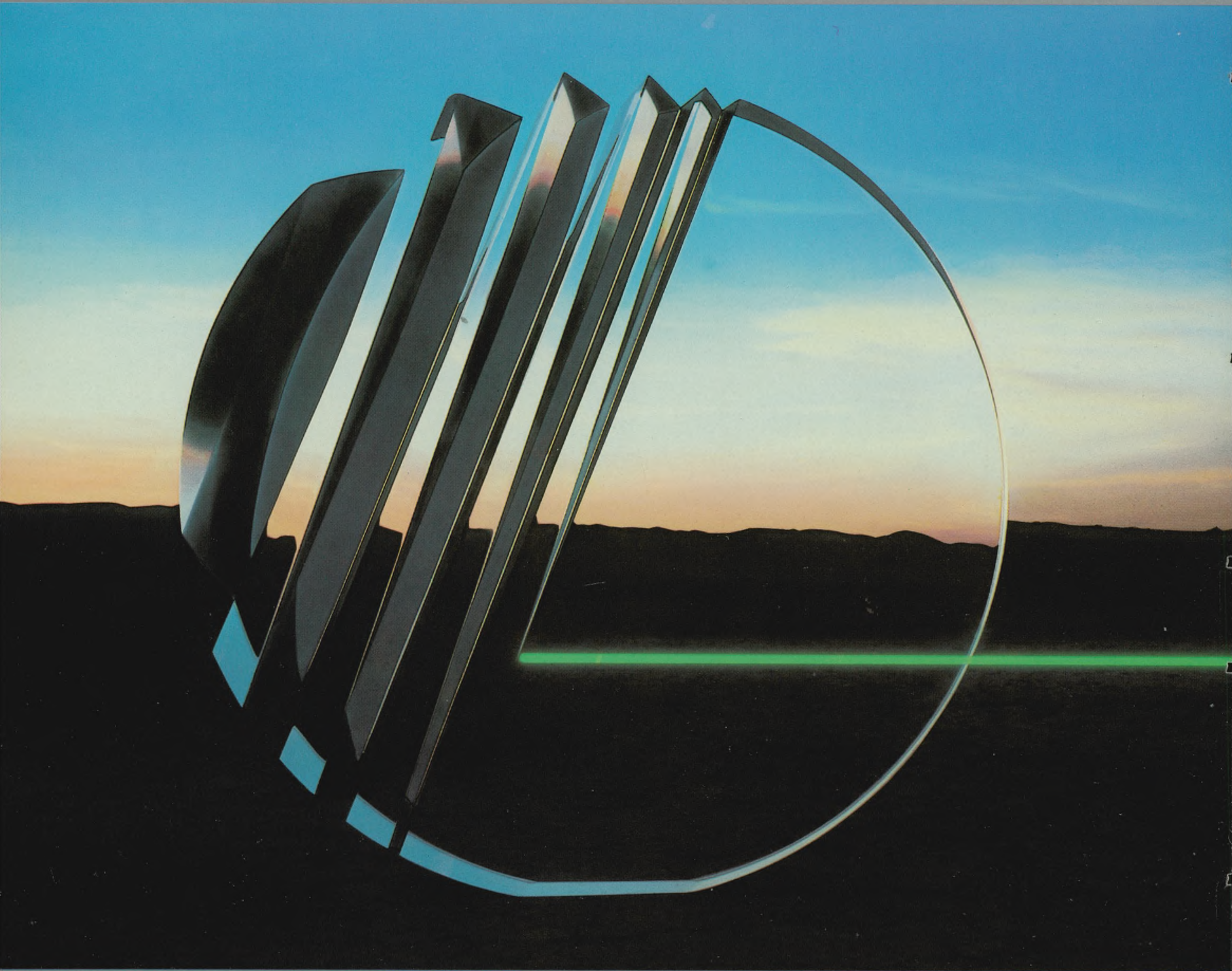

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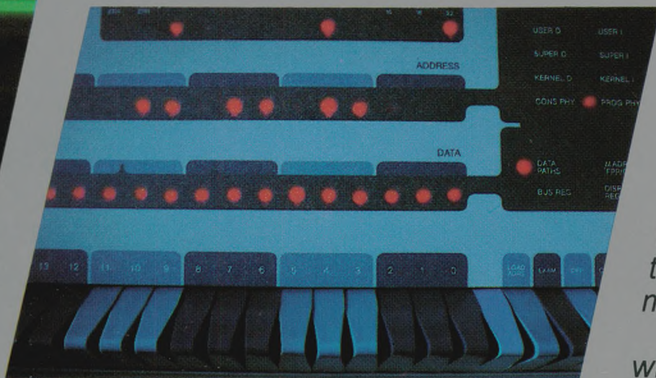

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affect day-to-day operations, says Mr. Williams.

Some of the most commonly used systems, he points out, are pass-control, photo and escort systems.

Precautions for Family. Because wives and children of bank executives can be targets of extortionists, Mr. Williams suggests they should be:

1. Constantly alert for surveillance.
2. Continually alert to anything unusual or out of the ordinary in the neighborhood.
3. Aware of strangers loitering in the neighborhood. (Both men and women qualify as potential threats to safety.)
4. Alert for cars, trucks, motorcycles or bicycles that spend more than normal time in the neighborhood.
5. Aware of any vehicle parked in the neighborhood that doesn't belong there. Such vehicles should be noted and licenses recorded and reported to the police.
6. Alert for persons who may be posing as public-utility employees, street repairmen or servicemen in order to observe actions of a banker or of a family member.

Like the bank executive, continues Mr. Williams, his spouse should avoid establishing routines that are repetitious — shopping at the same stores at the same time each week, going to the beauty shop at the same time. In addition, the whereabouts of family members should be known at *all* times.

It's a good idea, says Mr. Williams, for family members to devise signals to indicate the presence of intruders, and these signals could be oral or visual.

All these guidelines and advice sound like a lot of work. However, any banker who has been through a kidnap/hostage situation will be the first to say he would have done anything to avoid it. ● ●

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Kidnap/Extortion Plots Perpetrated Most on Commercial Banks

COMMERCIAL BANKS were the victims in 94 of the 107 violations of the Hobbs Act between last January 1 and June 30, according to a report issued recently by the FBI. The Hobbs Act prohibits any attempt to obtain money from financial institutions, mainly through kidnap/extortion.

Mutual savings banks and S&Ls were victimized six times each, and one credit union was a victim.

In the area covered by MID-CONTINENT BANKER, there were 25 Hobbs Act violations during the first six months of this year. Texas suffered the greatest number of violations — five, followed by Alabama and Missouri with four each. Next came Illinois and Mississippi with three each, then Arkansas, Indiana and Oklahoma with two each. Kansas, Kentucky, Louisiana, New Mexico and Tennessee had none.

Nationwide, California led with 16 violations. Next came Minnesota, New York and Pennsylvania with eight each.

Money was *not* obtained in 98 of the 107 violations. In the other nine, $392,007 was obtained, and $54,373 was recovered. The telephone was the most popular method of extortion, having been used 83 times. Threats also were made in demand notes and with bomb devices and firearms. Sometimes, various combinations of these methods were used.

Eight of the violations involved violence, with one resulting in injury to a financial-institution employee and one in the death of a member of a financial-institution employee's family. Twenty hostages were taken during these eight violations. Four hostages were employees, and 16 were family members. The latter were taken hostage in their homes. Three of the employees were taken hostage in their homes, and one was taken hostage elsewhere, but not at his job.

Figures compiled by the ABA show that from July 1, 1979, to June 30, 1980, there were 235 Hobbs Act violations, a 29.1% increase over the same period the year before. Just about every category showed increases, too: 19.6% of the violations this past year involved hostages, compared with 17% the previous year; 9.4% resulted in

Bankers worried about the possibility of becoming involved in kidnap/hostage situations are offered help by the ABA in the form of a booklet, "Kidnap/Hostage — Confidential," and a folder-type brochure, "Kidnap/Hostage Guidelines." Both are described in the accompanying article.

The booklet, No. 211601, is offered to ABA members as follows: 1-10 copies, $3 apiece; 11-30 copies, $2.50 apiece; 31-50 copies, $2.25 apiece; 51-100 copies, $2 apiece, and over 100 copies, $1.75 apiece. For nonmembers: 1-10 copies, $3.75 each; 11-30 copies, $3.50 each; 31-50 copies, $3.25 each; 51-100 copies, $3 each, and over 100 copies, $2.75 each.

The brochure, No. 211200, costs: one, $2 each; 2-5, $1.90 each; 6-10, $1.80 each; 11-50, $1.70 each; 51-100, $1.60 each, and 101 and over, $1.50 each. (Each brochure includes five wallet-size cards.)

Contact: Order Processing Dept., American Bankers Assn., 1120 Connecticut Ave., N.W., Washington, DC 20036. Telephone: 202/467-4118.

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violence this year, compared with 7.1% last year; money obtained increased from $700,000 last year to $1.7 million this year, and, in situations where hostages were taken, net ransoms went up from $13,500 to $37,000.

To help banks reduce their chances of becoming kidnap/hostage victims, the ABA offers some aids. A chapter from the Bank Protection Manual has been reprinted in booklet form. Called "Kidnap/Hostage — Confidential," it provides a clear, objective review of the controversial kidnap/hostage problems with suggested methods of handling them. It contains precautions and protection plans to help concerned bankers combat extortionists.

A brochure, "Kidnap/Hostage Guidelines," contains suggestions for maximum security and effectiveness. It also includes plastic wallet-size cards listing these guidelines. The ABA suggests that bankers carry these cards at all times and refer to them when faced with possible kidnap/hostage situations. Of course, these cards and booklets are never to be left out where outsiders could read them. ● ●

Bank Takes Self-Insurance Route To Hold Down Health-Care Costs

CONCERN ABOUT soaring health-care costs has prompted many banks to evaluate the benefits of self-insuring their health-care plans.

National Bank of Commerce (NBC), Memphis, elected to self-insure its employee health/dental-care plan, and, on July 1, became financially liable for health/dental-care claims incurred by its employees as well as those of the bank's two subsidiaries — James E. McGehee & Co. and Commerce General Corp.

The bank elected to self-insure for a variety of reasons after spending almost a year on research and analysis of plan designs with the assistance of an outside benefits consultant (actuarial firm), said Brenda Haughney, manager of compensation and benefits.

"Basically, we wanted to provide a more cost-efficient delivery of health benefits to employees while trying to offset rising health-care costs," she said. "Many times people begin to take third-party payments for granted when a company is insured for health/dental-care benefits."

Another reason for the change was elimination of the need for reserves being held at an insurance firm. Deposits are required by insurance carriers in order to handle health-care insurance for a company. Claim payments are made from the reserves.

"Self-funding or self-insurance, contrary to popular belief, won't lower the cost of a firm's claims, but should lower administrative costs and improve cash flow," said John LeCave, vice president/director of personnel. "Claims costs are a function of plan design, utilization patterns, employee demographics and local trends in health-care delivery.

"We felt our administrative costs were on the high side and probably could be reduced under alternative approaches. As a bank, we're interested in improving cash flow," he added.

According to Mr. LeCave, self-insurance allows the bank to maximize its cash flow. Under an insured contract, the insurance company collects monthly premiums to cover incurred claims. Under the provision of an administrative-services-only contract, the insurance company, acting in a claims-processing capacity, draws a draft against an account established in the bank. The money to cover the draft is held in this special account until the draft clears the bank.

"Another advantage of self-insurance is elimination of the necessity to pay state premium taxes, which run from 2% to 3% of premiums paid in most states," he said.

"By self-insuring, NBC is able to contain the major liability within the company and to gain better control over claims through upgraded reporting capabilities, so management knows where the money is being spent," said Mr. LeCave. "Self-insurance has simplified administrative procedures for enrollment and eligibility."

Before self-insurance, NBC was dealing with several insurance firms. Now the bank has one carrier and receives a consolidated coverage and claims report, which has simplified record-keeping procedures, according to Mrs. Haughney.

The bank wanted to remain highly competitive in the area of employee benefits, so the investigation into self-

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insuring was thorough. Ten regional firms were surveyed to compare NBC's level of benefits to other banks and companies in the area. That data was instrumental in the plan design, Mrs. Haughney said.

"We worked with the benefits consultant to tailor the plan to our needs," she said. "I think it's helpful to use a consultant in such an undertaking to ensure objectivity from a source outside the insurance industry."

The bank looked for certain criteria when deciding which insurance company to select. A recording system that would yield specific claims data as well as record the information was a high-priority item. Also taken into consideration was the care given by the carrier when scrutinizing claims. Nine insurance firms submitted bids.

Regarding the conditions a firm must meet in order to self-insure, Mrs. Haughney said, "We have been told by several carriers that $500,000 in claims per year is the cut-off figure, and a minimum number of employees must participate."

Mrs. Haughney was asked if self-insurance is an approach that smaller banks might elect. "I would doubt that anyone would recommend self-insurance to a small company," she said. "However, another approach, such as a minimum premium, could be considered by a smaller company."

After the carrier was chosen, NBC set the maximum amount for claims payments (based on previous claims experience). Beyond that maximum, the insurance carrier pays the claims. NBC pays the carrier an annual premium for this coverage.

Mrs. Haughney emphasized that self-insurance doesn't affect the payment stability of employee claims. "There's no hidden cost involved," she said. "We have seen other companies that have implemented similar plans successfully. Their motivation also was cost-effectiveness.

"Since we changed carriers and a portion of the plan design at the same time we self-insured, we experienced a greater impact than if we had changed only to self-insurance. The only problems we have experienced are in the claims-procedures area. Medical claims are processed locally, while dental claims are handled out of town. It will take time to smooth out the procedures.

"Since we are spreading the liability over three companies (NBC and two subsidiaries), there also are some things to be overcome involving account procedures," she said.

NBC's management feels the program is too new to be evaluated accurately. A tentative review will be made six months into the plan. After a full year of operation, a comparison is expected to be made of estimated experience to actual experience and an appraisal made.

"We are dedicated to making it work and anticipate the self-insurance program will be successful," Mr. LeCave said. ● ●

Nebraska BA Sues Reg Agencies Over TIL Guideline Enforcement

THE FDIC and the Fed are being sued by the Nebraska Bankers Association (NBA) and six Nebraska banks over enforcement of a guideline that could discourage commercial banks from providing credit life and disability insurance to their customers.

At issue is an enforcement guideline adopted earlier this year by the two regulatory agencies that requires banks to make extensive file searches to determine if past credit life and disability insurance coverage provided to customers meets current federal truth-in-lending requirements.

The enforcement guideline that requires additional insurance notice compliance prior to the time the guideline was adopted is placing an undue, expensive and unfair burden on banks that had originally been following approved procedures, said an NBA spokesman. The result could be that some banks will be forced to quit offering this insurance as a service to customers, many of whom aren't otherwise insurable.

The suit seeks a declaratory judgment by the court, restraining the FDIC and the Fed from enforcing the guidelines.

Banks joining the NBA in the suit include First Bank, Cozad; Brunswick State; Minden Exchange Bank; City State, Sutton; Lexington State; and Culbertson Bank.

The spokesman said the compliance problem on credit life had been partially "put on a back burner" a year ago following the filing of a suit by the ABA against the FDIC, the Fed and the Comptroller of the Currency on retroactive reimbursement.

The suit was dismissed by a federal judge who ruled the guideline lacked enforcement power and "merely constitutes a warning" to banks.

The ABA then held that the ruling achieved one of the ABA's purposes in filing its suit, namely, that TIL guidelines "can no longer be used to enforce any demands for searches of records or reimbursements to borrowers because of alleged violations of the truth-in-lending act."

But the issue came up again when the FDIC renewed strict enforcement of the guidelines, permitting no exceptions. ● ●

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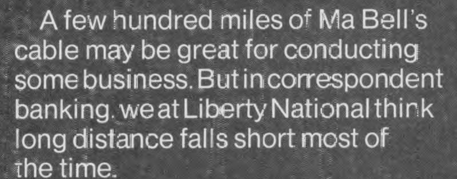

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Improved Bank Productivity to Be Researched

A SERIES of research projects and educational activities directed toward increasing productivity within the banking industry has been initiated by the Bank Administration Institute's operations and technology commission. BAI's "Productivity Through Automation, Technology and Human Resources" (PATH) series was announced recently by David Van L. Taylor, senior vice president and director, banking services division.

The division's operations and technology group will administer the series, including several surveys and studies, publications, seminars and a major conference, all addressing the complexities involved in measuring and increasing productivity in a service industry.

PATH incorporates current and ongoing BAI productivity efforts, as well as new projects designed to define and disseminate information on the most promising means of productivity improvement, Mr. Taylor said.

"Productivity has become a critical bank management issue in today's inflationary and highly competitive environment," he said. "Improved productivity is essential for the attainment of bank profit goals and maintenance of high levels of customer service."

Specific PATH projects include an industry-wide survey to acquire comparative bank productivity data, a communications and automation study to be conducted jointly with Sears Bank, Chicago, and a major conference early next year. In addition, several joint projects are being discussed with the consulting firm of Booz Allen & Hamilton and other service organizations.

A three-day PATH conference is set for January 19-21 at the Fairmont Hotel in Dallas. In addition to preliminary results available on the new BAI studies, the conference program will examine current productivity theories and practices and strategies to combat soaring space, facilities and energy costs. The results of a comprehensive survey of office automation technologies will be presented.

The comparative productivity research project will provide information needed to define standards by which an organization's effectiveness can be compared to other institutions of similar size and with similar operating environments. The first phase of the study will focus on determination of labor productivity norms and will encompass marketing and administration systems as well as bank operational areas.

The BAI has developed a communications matrix analysis technique to help determine what productivity improvement benefits a bank might expect from a selectively applied office automation plan. In a long-term, joint research project, BAI methodology will be applied to Sears Bank's trust department; when published, case study findings will serve as a documented guide for bankers considering the applicability of office automation in their institutions.

In cooperation with Booz Allen & Hamilton, the BAI has identified significant possibilities for developing tools and techniques to pursue productivity improvement in banks' managerial and professional ranks. Booz Allen recently completed a study focusing on productivity improvement to be derived from automation technology that serves the decision-maker. According to Booz Allen Vice President Harvey Poppel, "Major banking institutions could increase noninterest operational income by 35% by 1985 if they install automated office systems in a way that improves productivity of managerial and professional employees."

"Practical information is the main objective of all PATH series projects, emphasizing identification and development of opportunities for banks to improve significantly their operations and bottom-line numbers," Mr. Taylor said. He added that a steering committee of bank officers, whose responsibilities within their banks include productivity improvement, has been appointed to oversee PATH activities.

Among steering committee members are: Mike Bickley, vice president/deputy comptoller, First National, Fort Worth; Jeffrey Bond, vice president, First City National, Houston; M. L. Bond, vice president, First National, St. Louis; and William Swift, vice president, First National, Chicago. ● ●

Emergency Guide for Kids Offered to Banks, Thrifts

A booklet entitled "In Case of Emergency . . ." is being offered to financial institutions to be used to train children to dial for help in emergency situations. The booklet is designed to be offered to parents to help teach small children how to save lives through proper use of the telephone.

The booklet was researched and tested by two University of Washington experts in the psychology of early learning. Its eight pages outline proper training methods for children of various age levels and includes a picture-book page for small children.

The booklet can be used as part of an advertising campaign, in special promotions, in consumer information centers or as giveaways in a public relations or publicity promotion.

A free copy is available from Bank Graphic Systems, P. O. Box 24287, Seattle, WA 98124.

● **American Municipal Bond Assurance Corp.** This firm has published a booklet that outlines how institutional investors such as commercial banks, their trust departments and insurance companies can boost their net average returns by 50-100 basis points by turning to medium-grade municipal bonds and insuring them. An insert gives specific yield samples. The booklet lists "special implications" for trust departments. Other topics covered include reinsurance, credit research, cost and the process involved in starting an AMBAC municipal-bond-portfolio insurance program. Write: American Municipal Bond Assurance Corp., MGIC Plaza, Milwaukee, WI 53201.

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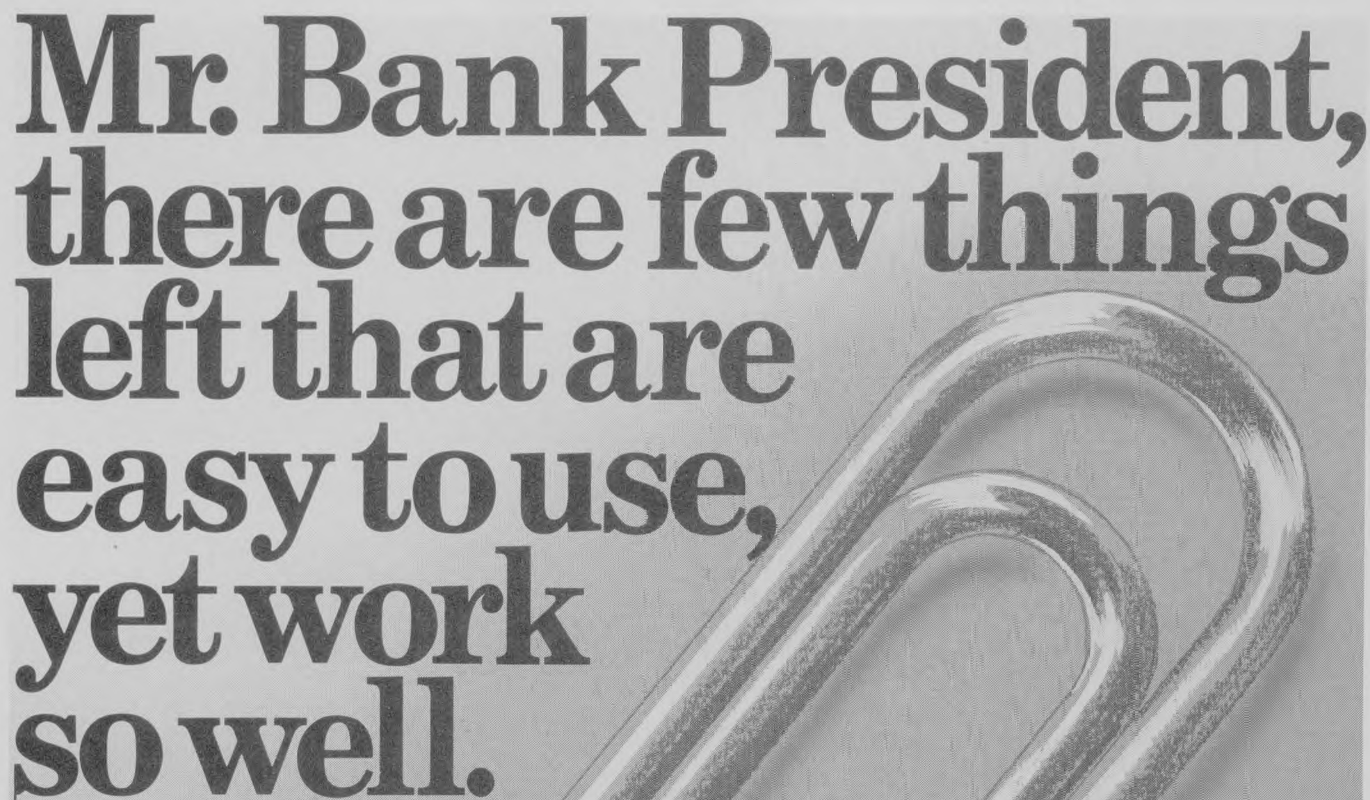

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Can the Federal Reserve System Compete With Correspondent Banks?

By Gerald Corrigan
President
Federal Reserve Bank
Minneapolis

THE FEDERAL Reserve has been accused, by some, of being unresponsive in its service policies to the banks that it serves. In fact, I will admit that there is an element of validity to that observation. The Fed has, in many cases, been satisfied to provide its own version of a "no frills" service. One banker — paraphrasing Henry Ford — described the Fed's attitude as follows: "You can have any color you want, as long as it's black." In defense of the Fed, though, I'd like to note that our basic black was a pretty reliable product and that basic black was able to blend into a number of different color schemes.

But, the Fed is changing — indeed, it has to change. It is in the midst of a major reassessment of its service policies and attitudes. That reassessment is a natural outgrowth of the legislatively imposed mandate that we price our services. But, from my personal vantage point, that fundamental reassessment must go beyond — considerably beyond — the narrow questions of how we determine our prices, how we respond to shifts in patterns of demand for our services, and how we adapt our operations to this new environment. In that light, I would like to share some of my tentative impressions about some of these broader implications of Fed pricing.

The new program of Fed pricing is quite different from past practices. Under the present program, the Fed's services are, for the most part, available only to members, and at no explicit charge — but the services, of course, are not free. The implicit price of these services is the amount of income member banks have foregone by virtue of the maintenance of nonearning Fed reserves. And, many bankers had concluded that the implicit price of the services was greater than the value of the services — hence, one critical element of the so-called Fed membership problem.

Under the new program of pricing, the Fed's services will be available to all depository institutions on the same basis and will be explicitly priced. The Fed will set a fee for each of the services it offers, so that it recovers its costs — including the so-called private sector markup — as if it were a private firm. At the same time, essentially all institutions will be subject to reserve requirements. Thus, there still will be a cost associated with reserves, but that cost will no longer give one depository institution a comparative advantage over another. Members and nonmembers alike will have to play the game by the same rules.

However, the underlying rationale for Fed pricing and, indeed, the congressional intent regarding Fed pricing, goes beyond the creation of the so-called "level playing field." At its root, the move toward Fed pricing reflects a desire — one shared by the Fed — to ensure that payments services are provided in the most efficient manner.

As I see it, the market for payments services that is unfolding is fully compatible with that objective, in that it will produce a more efficient payments mechanism, if by *efficient* we mean that it produces the desired amounts of goods or services at the least cost. Compare the Fed's present approach to the new approach. Currently, the Fed really doesn't have a good way to make decisions about the quantity and quality of the services it provides. How fast should checks be cleared? How often should coin and currency be delivered? It can't answer such questions clearly, because it can't readily determine if the benefits of improved service are worth the additional costs. So the Fed generally makes its production decisions — educated guesses — and then proceeds to minimize its costs.

Under the new competitive approach, in contrast, the Fed will have an unambiguous way of knowing if its production decisions are yielding benefits commensurate with their costs: the bottom line.

The change is that it will know for sure which services are really wanted at what price. If the Fed's price is too high, the demand for its services will shift to those with lower prices — those that are presumably more efficient — and the objective of overall efficiency will be served. In those circumstances the Fed will be faced with the need to match those efficiencies or get out of the particular line of service in question. The reverse is also true if the business shifts to the Fed. But in either case, the market — not the ambiguities associated with a particular regulatory

(Continued on page 70)

This article is based on remarks by Mr. Corrigan given at the ABA convention in Chicago last month.

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Exploring the Role of the Fed As a Correspondent Bank Competitor

By Thomas P. Rideout
President/CEO
Savannah (Ga.) Bank

LET'S EXPLORE the role of the Federal Reserve as a correspondent bank competitor.

On the surface, it would appear that the Fed means business in that the prices for its basic payments system services seem to be quite competitive. In addition, pricing principle number seven, which would grant the Fed the ability to administer prices flexibly, certainly should serve as a warning to correspondent bankers that the Fed might lower prices to achieve or maintain adequate service volumes despite specific cost considerations in various product lines. This would seem possible due to the Fed's apparent initial approach of cross-subsidizing specific services with revenues from those that are priced at a good profit margin.

It should be pointed out that sailing for the Fed is not guaranteed to be smooth, especially in the servicing area.

For instance, by pricing package-sort checks, the clearing house mechanism could migrate from the Fed into private-sector local and regional clearing houses. In addition, the plan to lengthen availability schedules to actual clearing times as part of the Fed's float reduction effort should provide opportunities for private-sector correspondents who concentrate on direct-send programs.

I think the Fed's move from artificial to actual availability is constructive in the sense that it will create competitive opportunities that should result in improved availabilities for the payments system overall. If the private sector should increase its share of this market in the process, it should be of little concern to the Fed if payment-system efficiencies are improved.

In addition, it should be remembered that the Fed has not had much practice in the business of competing. Historically, it has tended to off-load work on the private sector. In addition, it has not had a consistent system of incentives to build volume, though some of that may change — as a result of the Monetary Control Act.

By contrast, the private sector has a number of things going for it. First is the apparent distrust that many bankers have for dealing with governmental entities of any kind. Second is that pricing should stimulate a much more competitive attitude on the part of the private sector for operational business, with a stressing of the historic private sector quality differential being the main emphasis. Finally, the traditional broader range of correspondent services — in loan assistance, for instance — will provide the private sector with a packaging advantage over the Fed, which traditionally hasn't offered such services.

I'd like to touch on three items that I think are important in the private sector's adjustment to the Fed's proposed regulations. They are the pass-through concept, implications for financial reporting and examination and the clearing-balance concept.

The law states that reserves should be maintained by all depository institutions offering either transaction accounts and/or non-personal time accounts. Reserves may be maintained in the form of vault cash, and, that being insufficient, through either direct deposit of reserves at the Fed or by passing them through an institution that maintains its reserves directly at the Fed. The Fed will permit those banks passing through reserves to establish separate accounts in which they might commingle reserves for all depository institutions they represent. But it also has created complications by requiring that separate reserve accounts be maintained in other Fed districts for respondents whose head offices might be in those districts. Many correspondent bankers feel this is a needlessly complicated, unnecessary and potentially discouraging regulation.

The law provides that all depository institutions subject to reserves shall have access to the Fed's priced services. The question of how those services might be purchased directly and settled for raises some additional questions. Important among these is whether the correspondent would agree to its respondent purchasing services directly and yet allowing settlement for that transaction in either its pass-through reserve account or its regular reserve account. Using the example of a correspondent utilizing the Fed Wire directly, a question is raised of contingent liability. I feel that many correspondent banks are going to be nervous with such an arrangement due to loss of both the control feature of the pass-through service and the income incentive as well.

Another question is whether correspondents will permit their pass-through respondent banks to move their reserves around as member banks now do. There are some signs that a number of correspondents will not permit this because of their liability for insufficient reserves as well as for the bookkeeping nightmare that would be required by such activity.

The pass-through concept raises other questions. One has to do with whether pass-through banks will need to report as both an asset and a liability the reserves that are passed through. Were this to be required, the unfortunate effect of ballooning the balance sheet of pass-through correspondents

This article is based on remarks by Mr. Rideout given at the ABA convention in Chicago last month. Mr. Rideout is chairman, ABA correspondent banking division's executive committee, and a member of the ABA's Federal Reserve task force.

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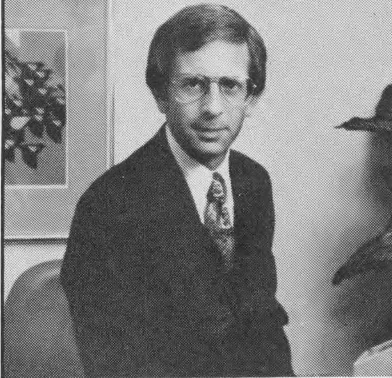

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could occur, opening correspondents to criticism by both examiners and the investment public. The Fed, along with the appropriate accounting standard boards, should address itself to this question at an early date.

In addition, there is a question of concentration of assets. As is well known, it is a common practice for the various banking agency examiners to criticise banks that have concentrated more than 25% of their capital with upstream correspondents in the form of either due-from-bank balances and/or Fed funds sold. The passing through of required reserves as a part of the definition of such concentrations could severely discourage the development of the pass-through mechanism, given the preference of correspondent banks for both demand balances and sources of Fed funds. Bank regulators should address this question soon.

The final point I want to cover is the Fed's clearing balance proposal. As part of the Monetary Control Act, Congress authorized the Fed to require clearing balances, if necessary, for those depository institutions wishing to purchase services directly but who were not otherwise required to maintain reserve balances with the Fed.

The Fed would require that an individual clearing-balance level be established, on some basis, by the district bank for each such institution. Since that balance would not be required for reserve purposes, the Fed is proposing to pay a soft-dollar earnings credit using the 91-day Treasury-bill rate. Two observations might be made about this procedure.

First, the bill did require that Fed services be priced explicitly and presumably that implies that payment would be made on an explicit basis. Since Congress didn't give the Fed the power to pay interest on reserves, it is seeking to use a soft-dollar alternative as a way of providing compensation for the required clearing balances. While not having any disagreement with the equity of the proposed approach, it could be argued that utilization of the soft-dollar credit doesn't satisfy the intent of the law in this regard. Presumably, the Fed has reviewed this approach with the staffs of the various banking committees and found no objection.

Second, there could be some confusion in that no standards have been set forth with regard to the manner in which clearing balances will be determined. Given the relative disparity among Fed districts concerning the aggressiveness with which payments-system business is sought, there could be an inconsistent approach around the country. Thus, some districts might tend to set clearing-balance levels artifically high with the hopes that an accumulation of unused soft-dollar credits would induce the transfer of even more service volume to the Fed system.

There is no assurance this would happen, given the risk that too high a clearing balance level could have the reverse effect of discouraging service flows. However, it presents a potential problem to the system overall.

As a result, it would seem appropriate that the Fed set forth some realistic nationwide standards for the establishment of clearing balances, so as to avoid both the potential for internal abuses and for confusion among the commercial banking public as well. ••

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A spokesman said the bank is believed to be the first in the nation to offer the service using the ACH network.

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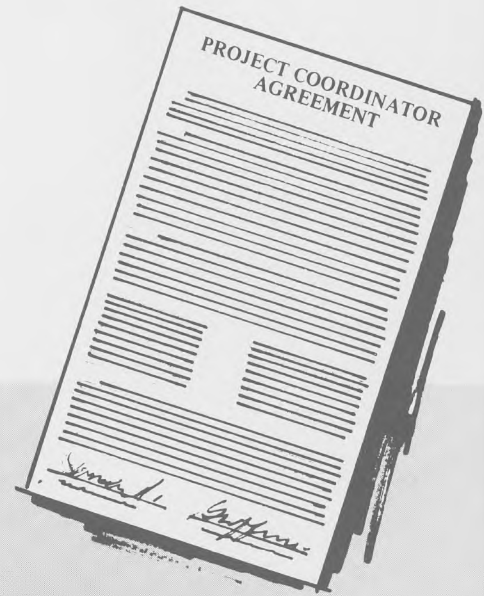

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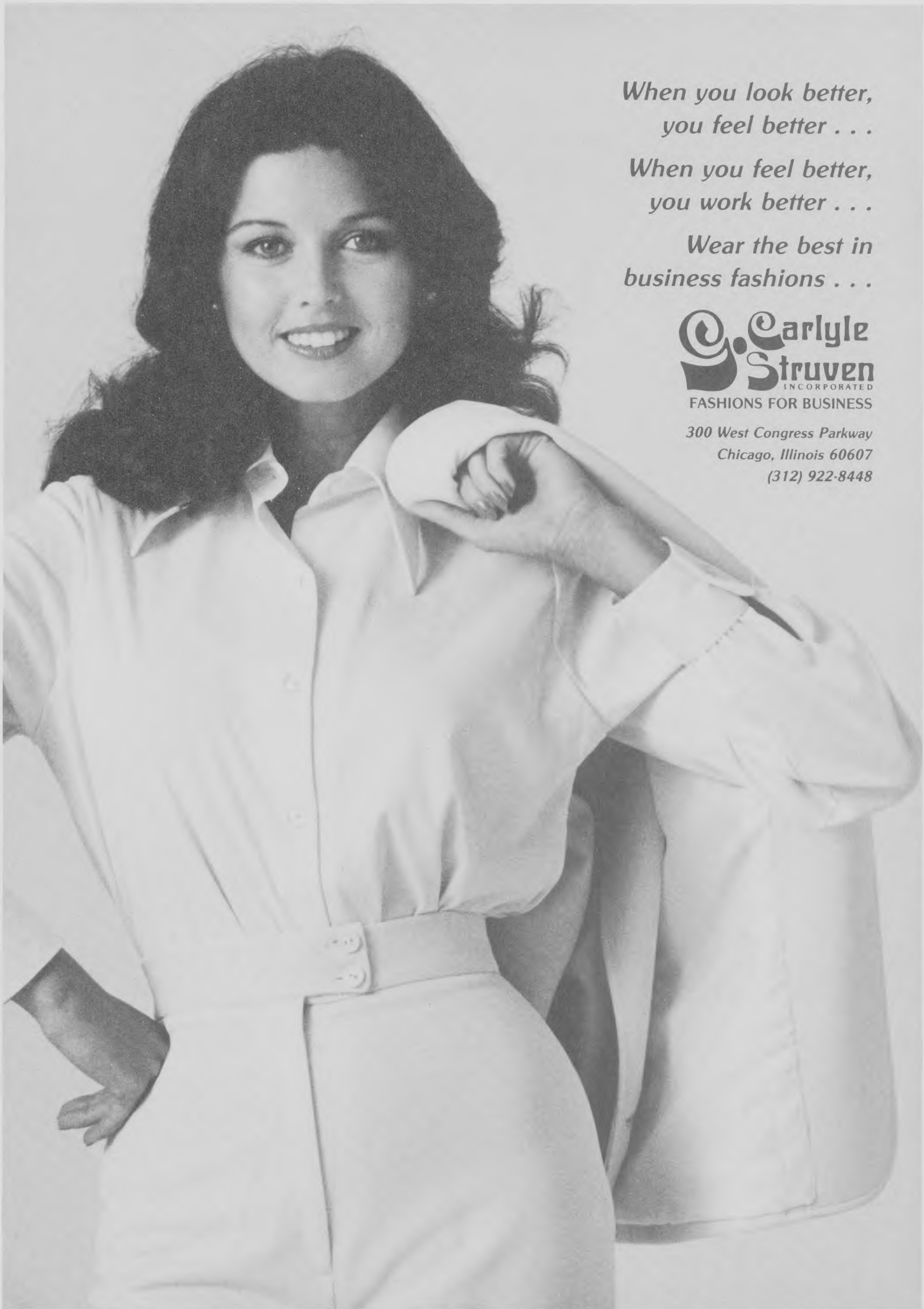

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Fed's Competitive Effect Will Be Minor; Correspondent Relationships Will Thrive

MCB Survey Reveals Correspondent-Bank Confidence

By Jim Fabian
Associate Editor

CORRESPONDENT BANKERS, for the most part, feel the stepped-up competition of the Fed, as evidenced in the issuance of a fee-pricing schedule, will have little effect on correspondent-respondent relationships.

Correspondents feel they can negate any competitive effect from the Fed by continuing to offer "personal-touch" services that respondents need and that can't be obtained from the Fed. The majority of respondent banks, especially smaller institutions, are expected to opt for the convenience of one-stop service offered by correspondents.

This is the general consensus obtained from tabulation of a survey of correspondent banks conducted by MID-CONTINENT BANKER. Other survey results included the following:

- Few correspondent bankers feel the Fed's prices are higher than theirs.
- Opinion is split on whether the Fed has bitten off more than it can chew with its pricing schedule.
- The Fed will not be completely successful in eliminating float.
- A majority of banks expected to comment on the Fed pricing schedule prior to the October 31 deadline.

Bankers were asked what they were telling their respondents in regard to the advantages of continuing their correspondent relationships. Responses included: offering better service and more timely responses to problems presented by respondents, offering a wider variety of services, making it more profitable for a respondent to continue banking with its correspondent, emphasizing the pass-through capability that correspondents have and more personal service.

Some banks report that, since they are located closer to their respondents than the respondents are to the Fed, it's geographically more feasible for respondents to receive the majority of their services from the correspondent.

Other comments:

- Many of our respondents look to us to provide accommodation financing and to participate in overloans and lines of credit to their customers.
- We will market our bank as we have in the past, offering above-average quality of service and response. The best way to discourage respondent banks from dealing with the Fed will be to let them try it — the few who wish to!
- We haven't had to sell our respondents on the advantages of the correspondent relationship. We can offer the pass-through capability which makes it possible for respondents to avoid opening another account with the Fed that must be maintained. Convenience of handling investments, reserves, etc., at one correspondent bank remains the best advantage for respondents not using the Fed's services. Most correspondent banks haven't increased their account-analysis service charges, so their prices are below those of the Fed.
- We will sell against the Fed just as we do against other competitors.
- We don't feel there is any motivation for our respondents to migrate to the Fed.
- We will continue to supply faster availability with no sorting requirements. In addition, we will offer later deadlines and provide low-cost transportation programs.
- We are stressing the customer-service aspect of our relationships as well as the increasing role we are playing in the continuing education of our respondents.
- We are stressing additional features we offer in our services that the Fed doesn't offer. And we are stressing credit-related services that are valuable and complementary to some of the priced services.

Correspondents were asked what reaction their banks were getting from respondents concerning whether or not respondents will remain with their correspondents or go directly to the Fed.

- All indications point to our respondents continuing with us. Some will be compelled to utilize Fed services to take advantage of price differentiations.
- None of our respondents has given any indication about severing or altering relationships with our bank. Respondents are reticent about replacing an arrangement with which they are pleased with one with the Fed, especially when the quality of Fed services provided to member banks leaves much to be desired.
- Few banks have expressed their views. Those that have are awaiting our counter programs. Our largest respondents have indicated they will review the Fed alternative and make decisions based on bottom-line benefits.
- Reaction has been positive with the exception of some who will continue to use the Fed for RCPC items.
- Community respondents appear

A candid assessment of the Fed's pricing policy by a midwestern correspondent banker:

"We think the Fed will have problems in billing for priced services, in handling all the new reserve accounts and in curbing internal float. It will muddle through on the first point; phase-in of Regulation D will allow it to survive the second problem; it has artfully refused to set public objectives for solving the third and intends to stick banks with the problems in any event!"

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to be willing to stay with us for the time being. Larger respondents indicate more awareness of selecting various services, influenced by availability and price sensitivity.

- It's too early to tell on large accounts; small ones seem to want to stay with us without question.

The overall effect Fed pricing is expected to have on correspondent relationships was commented on by bankers responding to the survey:

- If we can't compete through providing higher-quality services, competitively priced, or develop new services that can be marketed profitably, we'll be out of business. However, it will take a period of years for the effect to be fully realized.
- The effect will be negligible. While the Fed will be in a position to respond with more mechanical services, many respondent relationships go much deeper. Respondents look to us for lending assistance, advice, information and the personal touch. It's doubtful that respondents will look to the Fed for such services in lieu of remaining with their correspondents. Some will look to the Fed to provide mechanical services simply because the Fed may be more competitive in price. However, most respondents will ignore the pricing differential and will maintain their present all-purpose relationships.
- Increased movement to fee-pricing for correspondent services may actually help us price services closer to actual costs.
- The overall effect I see is a better future for correspondent banking!
- We see our primary market changing from the small bank that does everything with us to the larger bank that can't meet the Fed's sorting requirements and the large bank that might deposit with us to get a lower price.
- In the long run, the effect will be positive as we don't feel the Fed can provide the level of service that correspondent banks offer.
- Fed pricing will have a negative impact on the Fed's earnings as well as on the earnings of respondent banks.
- The effect will be more cash management by large correspondents, fewer free balances, spirited pricing in the private sector and no more free services.
- The effect will be a better, more efficient job by correspondents on a competitive basis.

When asked what long-range changes are in store for the typical correspondent relationship due to the Fed's competitive stance, correspondent bankers replied as follows:

- We will be managing our businesses better!
- Banks will have to offer their services in a most professional manner, getting away from the "Hi, Howdy" way of doing business. Respondents will be depending on their correspondents more than ever for services and advice in the 1980s. If commercial correspondents don't provide satisfactory service and price their services competitively, respondents will take their business elsewhere.
- More local clearinghouses will be organized to clear direct to respondents.
- I believe the Fed getting into the act will help the correspondent bank system.
- The Fed will soon find that it can't provide the degree of service demanded by customers at the price quoted.
- Emphasis will be placed on quality of service and pricing more than it has been in the past.
- One probable change will be a movement to fee compensation in lieu of balances. Another change will be a much more selective use of a bank's services by respondents. And correspondents probably will drop some services due to Fed competition.
- It's possible that service charges

Reuss Calls for Fed Re-Examination

A CALL for re-examination of the entire Federal Reserve System has been made to the U. S. Comptroller General by Henry S. Reuss (D.,Wis.), chairman of the House Committee on Banking, Finance and Urban Affairs.

Purpose of the study, to be made by the General Accounting Office, would be to determine the estimated market value of all Fed real estate and all other property and to determine all operating expenses and categorize them by functions, such as check-clearing, currency storage, bank supervision, fiscal agency operations and research.

Mr. Reuss said the Fed was established in 1913 to serve the banking needs of that era. In this era important questions should be asked, including: "Is the vast Federal Reserve bureaucracy that has developed still needed to serve the essential functions of a central bank? Should its bank regulatory functions be transferred to the Comptroller of the Currency and the FDIC? Could its vast clerical and check-clearing services be carried out better by the private sector, where competition would produce cost-saving efficiencies?

"The Fed currently costs the taxpayers more than $1 billion annually to operate, even without considering its enormous investment in capital facilities," Mr. Reuss said. "The system has 12 regional reserve banks, 25 branches, 48 check-clearing facilities and 22,000 employees. Its banks and branches occupy some of the choicest and most valuable real estate in our urban centers. In recent years, the New York Federal Reserve Bank has purchased additional prime land next to Wall Street and the San Francisco Bank has assembled a large land package."

As part of the study, Mr. Reuss asks that a detailed analysis of all operating expenses be made concerning any one reserve bank. The report, he said, should include the nature of expenses that would commonly be classified as administrative. Mr. Reuss also called on the study compilers to give recommendations on the abolishment of Fed services and/or the transference of some services to other agencies.

Mr. Reuss' request includes a reporting date of February 1, 1981.

He cited the nation's continuing huge budgetary deficits as reason for requesting the study. These deficits, he said, are forcing cutbacks in many highly desirable programs and "require that we re-examine every aspect of federal operations to determine where economies can be made without loss of essential government functions."

Mr. Reuss' estimate of the Fed's cost to taxpayers, while technically accurate, has been termed as being somewhat misleading. The Fed receives almost all its income from the Treasury as interest on Treasury securities that it owns. Of $10.3 billion in interest earned on Treasury securities in 1979, the Fed turned almost $9.3 billion back to the Treasury.

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will be based on hard-dollar rather than analysis charges.

- There's a possibility of correspondent banks establishing downstream direct-send service.
- Changes will include explicit pricing on every service, price shopping by large banks and more frequent relationship changes.
- The Fed always was in the act. It is merely rewriting its part in the play. At most, correspondent banks may lose some volume and concomitant demand balances. No structural changes are likely.

Correspondents were asked if they expected the Fed to eliminate float. Among the responses were the following:

- If the Fed adheres to its schedule and actions as outlined, it could well eliminate float — especially if the Fed charges banks for float.
- There always will be ways to escape float charges.
- Float is a part of the commercial banking system that will remain until we have ultimate EFTS. The Fed now will no longer subsidize the banking system by passing float along to commercial banks rather than absorbing it.
- It's possible that the Fed will be able to reduce float, but it won't be able to eliminate it.
- Float is a fact of any processing condition. The Fed may be able to reduce float below current levels, but there always will be transportation delays, equipment failures, etc., that will prevent the complete elimination of float.
- In the long term, float will be substantially reduced. This will benefit those correspondent banks with high levels of direct-send cash-letter activity.
- It will be too costly to eliminate float. There's no way to place the burden of float on the party causing it. ● ●

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Can Fed Compete?

(Continued from page 62)

structure — will make the decision.

What I have just described is a rather straightforward textbook description of how things should work in a competitive environment. In fact, markets and institutions seldom conform to the simplicities of the textbook model. The case in point is no exception. There are characteristics associated with the market for payment services and characteristics associated with the players in that market that are not readily captured in my synopsis as to how things *should* work. Those characteristics will, however, have an important bearing on how things *will* work.

For example, one of the textbook prerequisites for a market is that there be perfect knowledge about prices on the part of all market participants. This will hardly be the case in the market for payments services. Fed prices and our costs must be laid out in detail for scrutiny — if not nit-picking — by competitors and customers and the Congress itself. Our competitors — the large correspondent banks — do not have that constraint. Similarly, they do not have to publish their prices and possibly even some price changes for public comment. The resulting advantage is not inconsequential, since I am not so naive to believe that practices such as "loss leader" pricing do not or will not exist in the market for payments services.

When I look at the Federal Reserve banks relative to their potential competitors under this regime, I am also inclined to believe that certain "nonprice" considerations will weigh heavily in the manner in which the demand for payments services ultimately is met. For example, the full array of services offered by large correspondent banks to their prospective customers — computer services, loan sharing agreements, investment advice — is far wider than the services provided by the Fed. In short, large correspondent banks are, in fact, supermarkets for banking services, while the Fed is something more akin to the corner delicatessen. Given our society's preference for convenience shopping, here too, I suspect that the Fed banks are at a real disadvantage, even if its charges for — say — processing a check are close to or even below charges available in the private sector.

I don't want to leave you with the impression that the Fed is without some comparative advantages of its own in these areas. We have considerable expertise; we have considerable capital, both human and physical; and we have a solid, if not spectacular, reputation for the delivery of services. There also may be areas in which the Fed has an inherent advantage in providing services, if for no other reason than the fact that customer relationships are not divulged to prospective competitors for loans and deposits. And, as with the Fed wire or net settlement services, there may be some areas in which the Fed has its own nonprice competitive advantage. But, even if I make some generous allowances as to the significance of those factors in a competitive environment, I am inclined to the view that we in the Fed will not be able to fully match the scope and types of competition we will face in the new environment.

All of this raises the question as to how the Fed should go about the business of being a market competitor — stated differently, just how vigorously should the Fed compete? Should the Fed advertise? And if so, how and how much? Should it draw the line at informative mailings, at a billboard campaign, or at hiring Bob Hope to be its national spokesman? Should it hire a public relations firm to change its image? Should it sponsor a television show like "Dialing for Dollars"?

Or consider the gifts or premiums that private firms give away to customers. Should the Fed imitate these firms? Should it give football tickets to institutions that buy a lot of services? Should it give toasters or teddy bears to institutions that open clearing accounts at the Fed?

Although these examples may be a little farfetched, offering demand-deposit accounting services to depository institutions — if priced to cover our costs — may not be so farfetched. And, in such less exotic areas, it doesn't seem to me that offering a fuller range of services, if priced appropriately, would be incompatible with the intent of the Congress that the Fed compete. I am not predicting any such result, but I do think we in the Fed must consider the question of how we will compete within a framework in which we realistically appraise the nature of the competition we face.

In fact, we in the Fed cannot answer the question of our competitive posture in the same ways that a private-sector firm would. We have underlying public and statutory responsibilities relating to the payments and banking systems that transcend our role as a competitor in the market for payments

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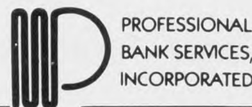

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services. These public responsibilities may, at some point, come into conflict with the mandate to compete or, at least, the mandate to compete in the more traditional ways that private institutions might compete. In a word, we could encounter situations that from the perception of the public interest might pose serious dilemmas. Let me give an example or two:

Is it possible — looking down the road a few years — that economies of scale are, or will be, such that the clearing and correspondent business for the nation as a whole will end up concentrated in a handful of electronically interdependent large banks, and if so, is that result in the public interest?

Is it possible that the current Fed share of the market for check clearing will be "cherry picked" to the point where the Fed is serving only the most remote of locations with the result that prices of such services in those locations will be many times in excess of prices available in other locations — that is, the post office problem — and, if so, will that result be acceptable?

Finally, is there any real risk — however remote — that, in the name of competition, operational practices or credit risk insensitivities which are contrary to the public interest could crop into the payments mechanism? We in this country are fortunate indeed to have a highly efficient, reliable and flexible payments mechanism — a payments mechanism that ultimately rests on the confidence we all have in the payments we make and receive. That confidence is central to the functioning of our banking system and our economy at large. Whatever we in the Fed and you in the banking system do in response to this new environment, we must preserve that confidence.

I don't know the answers to these questions, and I don't know if events will unfold in a manner that will require that we answer these questions. But, I do know that from my personal vantage point as a central banker it would be as inappropriate to ignore them as it is devilishly intricate to answer them.

If I've raised more questions than I've answered, it's because I have more questions than answers. That's an indication of where I stand. To get at the answers — indeed, to be sure we know all the questions — will take time and some careful thinking. But, in spite of all the unanswered questions, I believe that the move to Fed pricing is the right move. Pricing is more efficient — it should provide services in the desired amounts at the lowest cost. Pricing is more equitable — it makes the institutions that use the Fed's services pay for them in proportion to use. And pricing is perhaps what the Fed needs to further improve its services. In a few years — who knows? — the Fed may offer not just the standard black, but a whole rainbow of choices.

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Employees and customers are chosen by the bank's advertising agency following auditions for a given part in a commercial. The following criteria are used: ability to be directed, good personality projection on tape and ability to appear relaxed on camera.

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Central Bank Pres. Donald D. Hoffman (standing) participated in TV commercial with John Pung, bank's marketing research analyst, one of more than 40 "extras" used to make commercial.

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"Why can't every computer processor do that?"

"Because most haven't tailored their operations to do the meat-and-potato jobs most subscribers need most. Their systems are over-designed, over-engineered, too complex."

"And yours . . .?"

"Ours is highly sophisticated, but simple and flexible."

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Pricing the NOW Account

A Return-on-Capital Approach for Pricing Bank Services

By Donald R. Perdue
Vice President
Central Trust Bank
Jefferson City, Mo.

THE ADDITION OF NOW accounts constitutes a major change in a bank's product line. Bankers are asking one another, "How is your bank going to price NOWs?"

The New England experience provides a variety of existing pricing strategies and ATS accounts presently offered by many banks give further indication of how NOW accounts may be priced. In addition, prior to pricing their NOWs, bankers are being advised to pick a specific strategy based on their goals with respect to this new product. They should determine whether their philosophy will be passive (offer the service on a low-key basis), defensive (with a goal of retaining present deposits and current profitability) or aggressive (NOWs seen as a tool to increase deposits and deepen customer base).

After a bank's strategy has been determined, the product must be priced and the strategy's effect on the bottom line evaluated, using the best estimates available.

In making a NOW-account evaluation, a myriad of factors must be considered. In order to determine the possible extent of conversion, the bank's customer base must be examined. In stratifying its accounts with respect to balances and activity, the competition also must be examined.

After this broad analysis is complete, management still finds itself asking the same question, "How do you price the NOW account?" The questions about whether or not a bank should meet competition, price high or low or combine NOWs with other services can't be answered effectively without apprehension unless the banker can evaluate the results quantitatively.

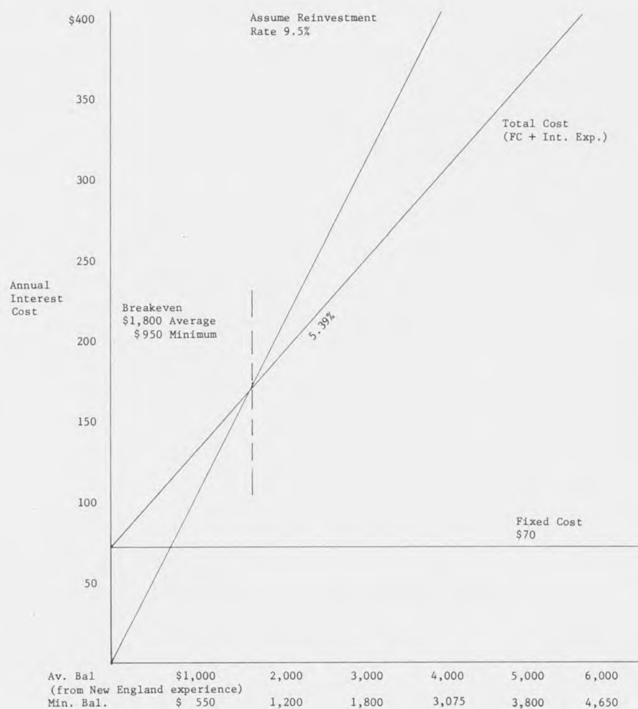
When viewed by a quantitative approach, an amazing number of similarities appear in much existing written material about NOW-account pricing. Most of this material is based on the same data — the Fed's functional cost analysis (FCA) and the composite data of the New England experience with NOWs. The FCA data is used to determine the cost of account maintenance and check processing, whereas the New England experience data provides information such as the relationship between minimum and average balances and the percent of conversion from checking to NOW accounts. A break-even analysis can be constructed using the data from these two sources.

Prior to constructing a break-even analysis, however, the banker should list his evaluation criteria (see Exhibit 1). Evaluation of data used in this exhibit requires the banker to relate the NOW account to future earnings, interest and operational costs and interest rates. In evaluating this criteria, most bankers will discover something else — they don't know their operational costs. If this is the case, FCA data can provide the cost of account maintenance. The transaction cost for a prospective NOW-account customer ideally should be developed from stratifying or examining the bank's existing accounts. An examination of those accounts that fall within a possible NOW-account range (say, checking accounts with a $500-or-higher average) can provide the banker with a composite of the number of checks,

Exhibit 1

Bank Evaluation Criteria —NOW Accounts

- **Pay 5.25% compounded daily, which equates to effective annual rate of 5.39%.**
- **Interest will not be paid on uncollected funds.**
- **Maintain capital/assets ratio of 8%.**
- **Average cost of NOW account (account maintenance and transactions) is $70.**
- **Reinvestment rate on bank funds is 9.5% (net) of operational expenses on asset side of bank.**



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```
   Interest Income  -  Interest Expense     =  B/T Return on Capital
or Assets X Yield - Liabilities X Yield     =  B/T Income
                                               Capital

or (A) (R)   -     (.92A) (.0539)           =  (.26) (.08A)

   where R = the required reinvestment rate on total assets that
             will meet the bank's profit goals assuming no
             operating expenses
```

deposits and transit items written on these target accounts. If the bank doesn't know its own costs, FCA data can be used to provide them for the size of bank in question. These costs then can be compiled to provide an annual operational cost per account. If account stratification isn't possible for the bank, the New England experience suggests that NOW-account customers write from 15-20 checks per month and that transaction costs are about $35 per year per account. With small variances, most banks will find their fixed costs (account maintenance and transaction costs) to average about $70 per year per account.

Using the criteria in Exhibit 1, a break-even analysis can be calculated for a range of balances (averages and their related minimums based on the New England experience). The $70 fixed-account cost, the 5.39% interest expense and the 9.5% reinvestment rate show a break-even point at approximately an $1,800 average balance or a $950 minimum balance. (See Exhibit 2 on page 74.)

Generally speaking, quantitative analysis stops at the NOW account break-even point. Certainly banks aren't in business to break even but to return a profit for shareholders. The final chapter in quantitatively evaluating the NOW account must be written to systemize the pricing of the service for the desired profit.

To do this, bankers should begin with the basic relationship formula for all accounting: Assets = Liabilities + Capital (A = L + C). Referring to the evaluation criteria in Exhibit 1, it was determined that a capital/assets ratio of 8% is needed by the bank. Therefore, "C" in the equation can be replaced with ".08A." At this point, "L" easily can be solved in terms of "A."

Where C = .08A
A = L + .08A
L = A .08A
L = .92A

It's now been determined that the bank's liabilities equal 92% of its total assets. It also can be stated that a bank (or bank product) derives its gross profit before operating expenses (or gross return on capital) by the spread it maintains between its return on assets (interest income) less its cost on liabilities (interest expense). If it is assumed that operating expenses were zero, this spread relationship would provide a bank's return on capital as follows:

Interest Income-Interest Expense = B/T Return on Capital

In relating the two equations to NOW accounts, the evaluation criteria again are referred to. These criteria state that the bank is going to pay 5.39% on NOW-account balances and that a 26% before-tax return on equity is required. A formula now can be constructed to arrive at the required reinvestment rate a bank should attain in order to meet its profit objectives (not break-even), assuming operating expenses are zero.

When the above formula is used, "A × R" can be substituted for interest income where "R" is the required reinvestment rate on total assets. We then can substitute ".92A times .0539" for interest expense and ".26 times .08A" for the required return on capital. The NOW-account formula appears at the top of this page.

The pricing formula still isn't complete because the evaluation criteria further state that interest will not be paid on uncollected funds. In addition, it must be recognized that a bank can't invest reserves, float or that portion of capital allocated to non-earning assets (land, fixtures, buildings, etc.). The following then can be assumed:

- Float on NOW accounts = 5% or (.05) (.92A)
- Reserve requirements* on NOWs are 3% or (.03) (.92A)
- 60% of the bank's capital is allocated to non-earning assets or (.6) (.08A)

The formula can be completed by

Exhibit 3

Pricing the NOW Account — Revenue vs. Cost

(A) Min. Bal.	(B) Av. Bal.	(C) Acct. Fixed Cost ($70) Converted to %	+	(D) Required Reinvest. Rate for Return on Cap.	=	(E) Total Required Reinvest. Rate as as % of Bal.	−	(F) Less Assumed Reinvest. Rate	=	(G) Remaining % Needed for Profit Goals	(H) % Loss or Gain Converted to $ per Year	(I) Monthly Charge (H) Divided by 12
$ 125	$ 250	28	+	8	=	36	−	9.5	=	26.5	$66.25	$5.52
250	500	14	+	8	=	22	−	9.5	=	12.5	62.50	5.21
550	1,000	7	+	8	=	15	−	9.5	=	5.5	55.00	4.58
875	1,500	4.7	+	8	=	12.7	−	9.5	=	3.2	48.00	4.00
1,200	2,000	3.5	+	8	=	11.5	−	9.5	=	2.0	40.00	3.33
1,500	2,500	2.8	+	8	=	10.8	−	9.5	=	1.3	32.50	2.70
1,800	3,000	2.3	+	8	=	10.3	−	9.5	=	.8	24.00	2.00
2,437	3,500	2.0	+	8	=	10.0	−	9.5	=	.5	15.00	1.25
3,075	4,000	1.7	+	8	=	9.7	−	9.5	=	.2	7.00	.58
3,347	4,500	1.5	+	8	=	9.5	−	9.5	=	0	0	0

At a $4,500 average collected balance, the bank's profit objectives are met; from this point forward, excess profit per account can be calculated. Stratification of accounts also can be used in calculating profitability of the NOW-account portfolio mix if proper data can be obtained.

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```
Total Assets -  Non-Earning Capital    +      Float     +     Reserves
[A       -     [(.6) (.08A)        + (.05) (.92A)  +  (.03) (.92A)]]  (R)  -

     Collected Funds          Interest Rate       B/T Return on Capital
     (.95) (.92A)               (.0539)      =     (.26) (.08A)

                                R = .077
```

inputting the additional information. It's noteworthy that the level of funds available to invest from the NOW-account product have been reduced appreciably. The level of earning assets on the NOW-account product available to invest is only 88% of the asset total. A cross-check on this approach would be to take the bank's statement of condition and calculate its overall level of earning assets as a percentage of total assets. The completed formula appears above.

This formula further assumes that earning assets are without risk or the loan portfolio has no losses. Therefore, it can be assumed that a loan loss would equate to ¼ of 1% on all earning assets or

R	=	.077
Loan Loss**	=	.0025
Total R	=	.0795 or 8.0%

We have finally arrived at the required reinvestment rate in order that a bank can meet its profit goals on a NOW account, assuming no operating expenses. The next step is to factor the operational cost of the NOW account back into the analysis.

The evaluation criteria provide an operational cost of $70 per NOW account. This fixed cost can be converted into an interest rate on any given balance. This interest rate, combined with the calculated reinvestment rate, can provide the total interest rate necessary to be earned on a particular balance to enable the bank to meet its goals.

Exhibit 3 illustrates this point by showing the combined effect of the reinvestment rate and the operational cost converted into an interest rate (Column E). As shown in Column E, the cost of low-balance NOW accounts becomes quite clear.

Regardless of a bank's pricing strategy, it can't exist with all low-balance NOW accounts without assessing monthly fees. Exhibit 3 also demonstrates the interrelationship between interest cost and interest income. Many banks still attempt to price their services without this interrelationship of earning assets, spread and leverage.

The next step in the analysis is to subtract the assumed reinvestment rate (9.5%) listed in the evaluation criteria from the total required reinvestment rate (E − F) in order to determine the shortfall or gain in terms of interest rate on a particular NOW-account balance (G). When this interest rate is converted into a dollar loss or gain, the fee mechanism for balances is quantified. For example, a $500 average balance technically would require a $5.21 monthly fee in order for a bank to maintain its profit objective. By the same token, a minimum balance of approximately $3,000 requires little in the way of fees to meet the bank's objective.

This pricing analysis quantifies any particular NOW-account balance according to a particular bank's criteria. This analysis should be used in conjunction with account stratification, analysis of competition and the bank's philosophy or strategy toward NOW accounts. In pricing the NOW account, the consensus of marketing opinion centers around simplicity in pricing. Charging various fees can confuse the customer and reduce strategy effectiveness.

Therefore, a pricing method using a $1,000 minimum balance with a $7 fee for those accounts that drop below the minimum balance may be a reasonable pricing structure. A $1,000 minimum pricing structure may attract a high percentage of accounts whose balances average $5,000.

The thrust of this analysis is to provide the banker with a method to quantify proposed pricing strategies and further enable bank management to analyze the NOW-account portfolio on a periodic basis. If, over time, NOW-account balances don't average a profitable mix or if other evaluation criteria are changed, adjustments must be made. ● ●

** The reserve requirement will depend on whether the institution is a state bank with an eight-year phase-in or a national bank with a phase-down situation. The first $25,000,000 of transaction accounts can be allocated to NOW accounts at 3% reserve. Each bank should perform its own calculation in order to use the correct reserve requirement for its NOW accounts.*

*** Each bank should divide its loan loss by total earning assets in order to calculate its own percentage.*

NOW Training Tapes Available From ABA

A series of three video-tape programs for in-house training about NOW accounts is available from the ABA. They are titled "Profitable Banking in a NOW-Account Environment," "Planning Considerations for NOW Accounts" and "Check Safekeeping and NOW Accounts."

The first tape covers such basics as the historical/legislative background, market share, pricing and selectivity, value marketing, pitfalls and how to avoid them and how to make NOWs a profitable venture.

The second tape takes an in-depth case-study approach to planning and marketing. It covers bank objectives, market research, assumptions, strategies, account expectations, lessons learned from the New England experience and recommendations for bank implementation. Printed materials also are available.

The third program is an introduction to check safekeeping, or truncation, and covers costs savings and a cost analysis, marketing, legal issues, benefits, technological and operational issues and specific considerations for implementation with NOWs.

The tapes were produced for a series of NOW-account workshops held by the ABA during the summer. They are designed for use in planning, implementing, modifying and managing NOW accounts, and for training bank personnel.

For a brochure and order form, write: State Association Division, ABA, 1120 Connecticut Avenue, N. W., Washington, DC 20036.

● **Bank Marketing Association.** A videotape featuring highlights of the BMA's 1980 NOW account seminar is available. The seminar is one of a series of meetings that the BMA has been conducting to help bank marketing professionals get ready for nationwide negotiable order of withdrawal (NOW) accounts authorized by Congress to be implemented December 31, 1980. The tape has been edited down to less than two hours and is available in both half-inch and three-quarter-inch formats. Write: Bank Marketing Association Order Department, 309 W. Washington St., Chicago, IL 60606.

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Farm Credit Act

(Continued from page 22)

doing a number of things that BCs can do. Yet none of these constraints is imposed on the Farm Credit System," he said. "It's our contention that, if this is a move into banking, let's all play essentially by the same kind of game plan."

Mr. Minger said the Farm Credit System wants to broaden its power to get into corporate financing — a concept that was not foreseen by those writing the original act in 1933. He added that policing this type of financing would be difficult. The Farm Credit System is seeking opportunities to take farm operations that aren't large and go off the farm to finance major commercial operations, with the Production Credit and Federal Land Bank associations participating in the financing, he said.

He also commented on a proposal to reduce farm-voting membership from 80% to 60% in the cooperative farm-supply operation. "Since there is a requirement that, to be eligible for financing from a BC, a co-op must do at least 51% of its business with farm members, the change would result in a farm supply co-op doing 70% of its business with non-farm members while the co-op is controlled by the voting membership made up of farmers. Our feeling is that there's no reasonable need for lowering the eligibility requirements."

"The one thing that comes through loud and clear is that bankers operate under certain kinds of restraints," Mr. Minger said. "This bill really isn't a farm-related bill; it's the kind of bill that's related to what bankers do in the commercial sector. It's our belief that if we're going to permit the entree of another bank — actually a nationwide matrix of banks — banking rules should apply equally."

Mr. Jackson termed the bill an "unwarranted intrusion and a serious burden on the private sector of the American business community."

He said that state bank regulators are stymied by a batch of bank-like entities that are beyond their authority to regulate. The national chartering of the Farm Credit System looks a lot like one of these entities, he said. He compared them to money-market mutual funds and said the FCA will have an awesome ability to gather deposits with no fear of regulation. He termed the bill the "most insidious, innocuous piece of legislation since the highly espoused differential between thrifts and banks."

He called attention to the fact that, for all practical purposes, the Farm Credit System is untaxed. Half of the system is exempt outright from state and federal income taxes, he said, and the other half has some imposition to pay state and federal income taxes. However, its prescribed accounting procedures are such that its effective tax rate is less than half that of commercial banks.

"If you want to compete in the future with both hands tied behind you, then I suggest you ignore the Farm Credit Act of 1980," Mr. Jackson said. "If you're concerned about an organization that has federal backing, that enjoys unheard of benefits as a child of Congress, that's seen as having the full credit of the government without government constraints — if you want that kind of competition on Main Street USA, financing agricultural business, supplies, marketing, exporting and leveraged leasing and equity ownership — I suggest that, in a great sense of urgency, you contact Congress."

Mr. Jackson added that two portions of the bill meet with the ABA's approval. They are the parts that would provide convenience participations of banks with PCAs whereby banks and not customers buy stock in the Farm Credit System and the provision for participation of banks with the Federal Land Bank System in an easy-participation form. "These are good and proper improvements," he said.

"But the unwarranted intrusion of this system, enjoying exemption from almost everything we have to deal with, not the least of which are regulation and taxation, enjoying being identified as a quasi-arm of the government — that intrusion into the private sector is not appropriate at this time." ● ●

ABA Convention

(Continued from page 22)

the increased risk this would entail. This would give smaller institutions a greater competitive opportunity to seek new markets as they saw fit. The resulting benefits of more aggressive, competitive smaller banking organizations might more than compensate for the increased risks." This suggestion was greeted with applause.

Mr. Heimann then turned to a subject he has discussed on previous occasions — geographical restraints on banking, saying that his office believes such restraints on bank expansion are anti-competitive and impede the effectiveness and efficiency of the banking system.

He also called for concentrating initially on phasing out Douglas Amendment restrictions on interstate bank-holding-company expansion, including establishment of new banks and acquisitions of existing ones.

Letter to the President. Branching and the Douglas Amendment also were subjects of a letter written September 30 to President Jimmy Carter by Senator William Proxmire (D.,Wis.), chairman, Senate Banking Committee. Copies of the letter were distributed at a press conference with the senator during the ABA convention.

Senator Proxmire referred to a requirement of the International Banking Act of 1978 that a study of branch banking be submitted to Congress by September 17, 1979. Although more than a year has passed without such a study, he continued, rumors in the financial press say that a draft report now is on the President's desk and soon may be transmitted to Congress. These rumors indicate that the report will recommend that geographic restraints on banking be relaxed and that the first priority be a modification of the Douglas Amendment to the Bank Holding Company Act. This amendment restricts interstate-bank acquisitions by bank HCs.

In the letter, Senator Proxmire said it would be extremely unlikely that Congress would show much enthusiasm for any substantial weakening of the McFadden Act, which requires national banks to operate under state-branching laws. He bases this opinion on the fact that many congressional members and bankers share the same views that there are many benefits in preserving independent and locally controlled banks.

The senator said that, perhaps because of these perceived difficulties, drafters of the proposed report apparently have focused much of their attention on liberalizing the Douglas Amendment to the Bank Holding Company Act. He indicated concern about this, saying that unrestricted de novo branching at least has the advantage of injecting new competition into markets that may, in some instances, be overly protected. On the other hand, he continued, acquisition of existing banks across state lines provides no new banking facilities to meet community needs. Thus, many of the pro-competitive merits claimed for branch-

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ing do not necessarily extend to HC acquisitions.

Also, said the letter, it should be emphasized that the Douglas Amendment already allows interstate acquisitions whenever specifically permitted under laws of the state where a bank to be acquired is located. Thus, if a case can be made for interstate acquisitions, federal law already provides states with authority to act. Presumably, said Senator Proxmire, the proposed modifications to the Douglas Amendment would reverse this long-standing policy by preempting the rights of states to determine their own policies. He said he understands the Conference of State Bank Supervisors adamantly opposes this incursion into states' rights.

"Because of these factors," the letter concluded, "I urge that you approach the draft-branching report with extreme caution and review carefully its reported focus on interstate acquisitions. There may be a case for interstate deployment of electronic teller machines or other de novo facilities within a single market area such as an SMSA, and the next Congress might be prepared to move in this regard. However, if the branching issue is encumbered with more far-reaching approaches such as the reported modifications to the Douglas Amendment, I am fearful that the ensuing controversy might prejudice any legislative endeavors in this area."

From Chairman Volcker. Regulatory reform also was called for by Fed Chairman Paul Volcker, who admitted he is uncomfortable when he realizes that regulations, often running thousands of pages, frequently are incomprehensible to the bankers who must follow them. Too often, he said, these regulations concern insignificant issues and often are duplicative, coming from the Fed, Comptroller and FDIC.

Chairman Volcker said that the spewing out of complex regulations, applicable to all institutions, big and small, may be a larger threat to the economic viability of the smallest banks than any branching statute because only the larger institutions can possibly have both the expertise and specialization to know the regulations. It doesn't make sense either, he went on, to burden banks to the point that their competitors can grow more rapidly.

However, he added, this does not mean that small banks in general should be wholly exempt, but there are opportunities to simplify regulation and enforcement procedures. As an example: less frequent reporting and reserve calculations for the smallest financial institutions under the Monetary Control Act.

Mr. Volcker also believes basic objectives of "social" regulations could be achieved with much less cost if the basic legislation did not demand precisely the same disclosures and treatment for all transactions.

FDIC Project. More than 30% of the 9,300 insured state nonmember banks supervised by the FDIC will be covered by the end of 1980 by alternate instead of dual federal and state examinations, FDIC Chairman Irvine H. Sprague told ABA conventioneers.

The goal of this broad new initiative in FDIC and state cooperation, he said, is to improve supervision, lessen the regulatory burden on banks and improve service to the public.

Mr. Sprague also detailed cooperative efforts involving establishment of regional typing centers to speed typing of examination reports, legal drafting assistance where state law must be changed to permit cooperative programs, state access to the FDIC's computerized data base, common enforcement actions and development of common bank application and examination forms.

The FDIC chairman emphasized that participation in these programs is voluntary, that each state determines the extent of its own involvement.

A highlight of the final day was an appearance by George Bush, Republican candidate for U. S. Vice President. Vice President Walter F. Mondale also was scheduled to speak — on October 13 — but was unable to make it. ● ●

Loan Documentation Text

Banks' commercial loan officers should approach documentation as a logical process that is an integral part of the loan transaction, states "An Introduction to Commercial Loan Documentation," a new publication from the ABA's commercial lending division.

The text contends that although the complexity, volume and variety of commercial lending law and practices make it "impractical, if not impossible" for lending personnel to know all the rules, regulations and laws, a loan officer properly trained in the loan documentation process can develop techniques for effectively handling secured and unsecured commercial loans.

The publication is designed to introduce new lenders to the process of loan documentation and to provide banks that don't have a loan documentation manual with guidance in developing one.

The publication is available at $7.50 a copy for ABA members and $9.50 a copy for nonmembers. Requests for the publication, #168600, should be sent to Order Processing, ABA, 1120 Connecticut Avenue, N.W., Washington, DC 20036.

Washington Wire

(Continued from page 16)

out the override provision, banks in many states simply would be unable to write ARMs at all.

By proposing a set of standards for banks to follow, the Comptroller is hoping to encourage banks to enter the mortgage market with a new and flexible instrument that should help make money available to the home-buying public. Banks retain the primary responsibility to develop and promote the ARM. The Comptroller has proposed a way to open up a new field of investment for banks, but he has stopped short of dictating specifically how banks are to take advantage of it. As part of the new era of deregulation, bankers would be on their own in using the opportunity this proposed regulation presents.

It's clear that the ARM will be one of the most important new types of residential mortgage instruments in the near future. The decline in the availability of mortgage money lendable by banks at fixed rates has caused many observers to conclude that the fixed-rate mortgage is a thing of the past. The Federal Home Loan Bank Board already has issued its regulations governing the writing of a new instrument similar to the ARM, which the board has called "renegotiable-rate mortgages."

The ABA has established a task force on adjustable rate mortgages which is formulating the association's response to the Comptroller's proposal and is working with the banking community to encourage the development of these new instruments. ● ●

● **Pitney Bowes.** A new six-page booklet written specifically to help the banking community speed its paperwork processing at lower cost is available. Titled "Banking and the Copying Challenge," the booklet demonstrates six common techniques that banks could be using every day in handling their growing volume of paperwork.

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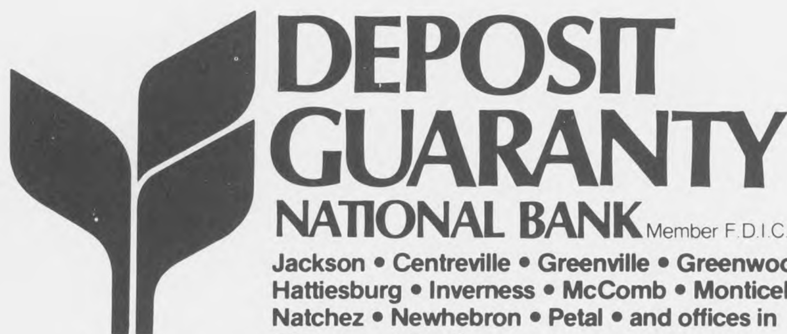

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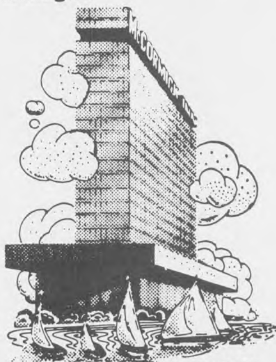

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U. S. Not in Typical Recession, Darryl Francis Tells Bankers

By Jim Fabian
Associate Editor

Featured speaker Darryl Francis (l.) former pres., St. Louis Fed, chats with Ed Lee, partner, Peat, Marwick, Mitchell & Co., at seminar for Illinois and Missouri bankers sponsored last month by CPA firm in St. Louis. Mr. Francis now is ch./pres., Merchants Nat'l, Fort Smith, Ark.

A GROUP of bankers from Illinois and Missouri were somewhat surprised to learn last month that the U. S. is not in a recession and hasn't been in one since 1973. Furthermore, they learned that no real recession is expected until 1982.

Irresponsible talk? Not when the speaker is Darryl R. Francis, former president of the St. Louis Fed and currently chairman/president, Merchants National, Fort Smith, Ark. Mr. Francis was a featured speaker at the annual bank seminar held in St. Louis by Peat, Marwick, Mitchell & Co.'s St. Louis office.

Mr. Francis explained his statement: "By not moving the federal government toward balance, by not slowing up the rate of monetary expansion, we didn't this time condition this economy for the classical type of recession. It just wasn't built in."

Earlier in his talk, Mr. Francis explained that things were different preceding the current economic slowdown, and this difference fooled many people into predicting a recession.

For the first time, he said, we have seen a major cycle in the peaking-out process without the federal government making any attempt to balance out its accounts. Also, federal spending has continued at increasing rates with no attempt to cover all the increases through taxation. This policy has resulted in massive deficits.

He added that the Fed traditionally turns down the spigot to slow the flow of reserves when "inflation raises its ugly head to the point where it becomes disturbing." This was not done in the past year, even though the Fed announced a year ago that it was turning its attention to the control of monetary aggregates, particularly the money supply. "The Fed has not been firm or tight in terms of its monetary policy," Mr. Francis said.

The result, he added, is that "what we're seeing isn't recession; we're seeing a kind of a wedge drop that's coming right back and we're going to see the economy work back to about where it was before the fall."

Since the economic decline wasn't severe enough to curb inflation, he said, the economy will continue its seesaw motion and there's no quick turnaround possible.

Bankers attending the seminar were polled on their plans to offer NOW accounts. Responses included the following:

- 96% of the banks represented at the conference plan to offer NOW accounts.
- 90% said their banks will offer NOWs to retain current customers; only 6% said their intent was to attract new customers from competitors.
- When considering NOW-account pricing, 77% said they priced their accounts according to the internal costs of the bank, while 14% said they priced their accounts to meet the price structure of their competitors.
- 53% plan to price NOWs according to a minimum balance, while 22% said their pricing was according to average collected balance and 20% according to average ledger balance.
- 52% anticipate offering free NOW-account service at a minimum balance level from $1,000 to $1,500; 30% at a minimum balance level over $1,500; and 11% at a level of from $500 to $1,000.
- The majority expect to levy a service charge of either $5 or $10 per month on accounts that don't maintain the minimum balance.
- A surprising 40% said their banks would truncate NOW-account checks.
- More than half said they expect to adjust their bank's total service-charge structure with the advent of NOWs.
- 65% said they expect their bank's profits will decrease as an impact of NOW accounts. ● ●

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Anti-Redlining Regs Have Adverse Impact

FEDERAL regulations designed to prevent redlining have substantially increased home mortgage costs, placed an undue financial burden on lending institutions and, paradoxically, actually have harmed the disadvantaged borrowers they were supposed to protect.

The result also has been a reduction in the overall supply of mortgage credit in inner-city neighborhoods. Moreover, the regulations may have contributed to the further deterioration of these areas.

These are the major findings of a research study entitled "Redlining and Public Policy," by professors Jack Guttentag and Susan Wachter of the Wharton School, University of Pennsylvania, and published by the Salomon Brothers Center for the Study of Financial Institutions at New York University's Graduate School of Business Administration.

Original research for the study was sponsored by the Federal Home Loan Bank Board.

The research study systematically examines the necessary steps in defining and detecting mortgage redlining and provides realistic policy proposals to help deregulate the financial marketplace while providing positive incentives for lenders to invest in local communities, says Arnold Sametz, director of the Salomon Brothers Center.

Professors Guttentag and Wachter contend that redlining is a problem mainly because the private risk and cost of lending in these areas has become excessive and regulation has only aggravated those costs.

Among the costs imposed on lenders, according to the study, is the burden of making loans they might otherwise reject, of incurring additional information costs to assess questionable loans and of demonstrating that they are meeting community needs.

This has reduced the profitability of inner-city office locations and even forced some lenders to evade regulations by moving out of the troublesome locations.

The federal regulations are incorporated in the Home Mortgage Disclosure Act (1975), the Equal Credit Opportunity Act (1974-76), the Fair Housing Act (1968-74) and the Community Reinvestment Act (1977). These acts are interpreted and administered by the Federal Home Loan Bank Board, the FDIC, the Comptroller and the Fed.

Although the study specifically didn't seek to obtain cost estimates, the authors have used available data to establish possible costs of $250-$350 million annually. This represents monitoring costs by the federal agency (which the study says are eventually passed along) and record keeping, procedural and information-gathering costs, as well as reduced operating efficiency for the lender. Ultimately, these costs are borne by the consumer.

Professors Guttentag and Wachter recommend that a more appropriate public policy response to the redlining problem is to lower lender cost by coordination of investment and information gathering or by the payment by government of premiums to lenders for making loans in specified areas,

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while leaving them responsible for losses.

Such proposals include the revamping of the FHA program to reform lending standards and terms and eliminate the financial incentive to foreclose FHA loans as soon as possible.

The incentive to foreclose, the authors say, would be eliminated if maximum interest rates were set so that discounts averaged only two or three points on a national basis instead of five or more points, as in the past.

The study provides a definition of redlining behavior by mortgage lenders that is consistent with the concerns of community groups and Congress over inequities to individuals and the decline of inner-city neighborhoods. It considers whether redlining behavior is detectable using various data sources and statistical techniques and summarizes the current academic literature on redlining issues. ● ●

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Redlining Is Found To Be 'Red Herring' In Rochester, N. Y.

George J. Benston and Dan Horsky, "Redlining and the Demand for Mortgages in the Central City and Suburbs," *Journal of Bank Research* (Summer, 1979), pp. 72-87. (Single copies available at $5 each from the Bank Administration Institute, 303 South Northwest Highway, Park Ridge, IL 60068.)

Messrs. Benston and Horsky attempt to shed some light on the much-debated, highly emotional and politically sensitive question of "redlining" by commercial banks and S&Ls. Their means is an open-ended questionnaire of central-city and suburban home owners in the Rochester, N. Y., metropolitan area.

This paper reports results of interviews with 1,198 home owners and recent home buyers. The interviews elicited information about actual and perceived demand for mortgage loans by these two groups of interested parties and extent to which this demand is unmet by traditional suppliers of mortgage credit.

The interviews were aimed at examining four basic sets of questions: 1. Is unmet demand greater in the (redlined) central city than in the suburbs? 2. Do home buyers in the central city experience significantly more difficulty in obtaining mortgages than suburban home buyers? 3. Do home buyers in the central city obtain FHA mortgages because they have no other alternative? 4. Are home-improvement loans more difficult to obtain in the central city than in the suburbs? A series of questions was designed to provide information about each of these four broad categories. Results provided by Messrs. Benston and Horsky are too numerous to report in detail here. However, some highlights deserve mention.

In the survey of recent home sellers, the authors find that 5.5% of the central-city home owners had tried unsuccessfully to sell their homes in the past five years versus 3.3% of the suburban home owners. Of these, a greater percentage of the prospective buyers of central-city homes experienced "mortgage-related" problems than did prospective buyers of suburban homes, 27.6% compared to 21.4%. However, in no case was location of the property cited as the root cause of the difficulty in obtaining the loan. The authors conclude that this evidence is not consistent with the hypothesis that demand for mortgages was unmet because lenders "redlined" the central-city area.

In the survey of actual home buyers, the authors find that 91.9% of central-city home buyers financed their purchases with mortgage loans, while 98.5% of suburban home buyers financed with mortgage loans. Of those home buyers from both groups that did use mortgage loans, the proportion obtaining loans from financial institutions is the same for both groups, 78%. Further analysis of home buyers who attempted but failed to obtain loans indicated that . . . "possible redlining activities affected only 0.2% of the central-city houses offered for sale."

Finally, the authors report the higher incidence of FHA loans in the central city is more likely to be the result of the lower down-payment requirements of these loans than of redlining by banks and S&Ls.

Based on their surveys of home owners and recent home buyers, Mr. Benston and Mr. Horsky conclude that redlining is not practiced by lending institutions in Rochester, N. Y. They further note that examination of supply-side phenomena in the absence of a consideration of demand variables may lead to an incorrect conclusion that redlining exists. They strongly suggest that future studies of this politically sensitive issue consider both demand and supply effects.

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S&L Student Essay Contest Hits Voting Importance

A competition aimed at encouraging young people to think about the voting process at an early age, so as to better prepare them for the time they can vote, was held recently by St. Paul Federal S&L, Chicago. The essay contest was titled "The Importance of Voting" and was open to students in grades seven through 12.

Judging was based on original composition and knowledge of the political system. Junior high school essays were 250 words or less with the winner receiving a $75 savings account. High school entries were limited to 500 words or less and the winner received a $100 savings account.

S&L officials expressed the hope that contestants would remind their parents that voting is their right and duty as American citizens.

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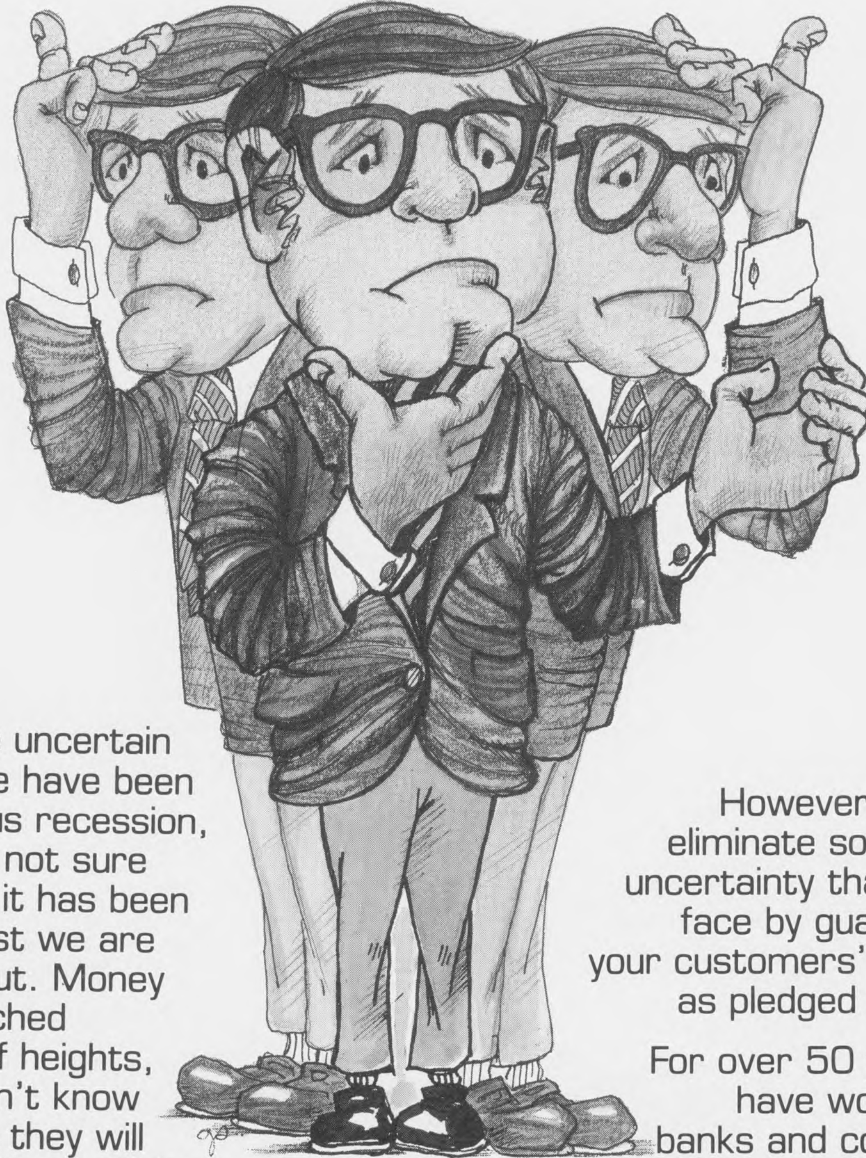
Uncertainty.



These are uncertain times. We have been in a serious recession, but we're not sure how deep it has been or how fast we are climbing out. Money rates reached unheard of heights, but we don't know how much they will drop or if they will drop back to normal. Some of our large, basic industries are in trouble. Our economic stability is dependent on a steady flow of petroleum imports which may or may not prove dependable.

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New Visual Auto Teller Machines Save Space, Building Costs for Bank

IN 1972, Northwest Bank, Houston, had assets of $25 million and eight lanes of drive-up banking. In 1980, the bank had grown to $100 million in assets — but still had eight lanes of drive-up banking.

That meant that any Friday night and on paydays, lines of traffic backed up behind the machines. A solution definitely was needed.

It came in the form of a new product called VAT 7 from Diebold. VAT stands for "visual auto teller," and VAT 7 seemed custom-made for the bank's operations, according to Raybon A. Ross, senior vice president.

"We had an eight-lane, line-of-sight drive-up operation using Diebold VAT units since 1972," he said. "We had a good experience with Diebold as a company; so we considered the firm again when we needed to enlarge our system. At about the time we were ready to order, Diebold introduced the VAT 7 and it seemed the specifications for that product came right off our 'wish list.' "

The wish list Mr. Ross referred to reflects the bank's land-use situation. The site selected for the new 12-lane drive-up facility was 1,350 feet away from the main office and the land would have to be leased. Because the VAT 7 is a narrower streamlined version of the visual auto teller, Northwest Bank would have been able to lease less land. Instead, the bank has opted to use the land for future expansion.

Slim VAT 7 visual auto teller from Diebold features roll-out presentation door, overload detector, narrow island, automatic dispatch and molded high-impact skin.

"In effect, VAT 7 is giving us three more lanes of drive-up for the same land cost," Mr. Ross noted. "And the cost for the canopy will be reduced, too."

Another important consideration for the bank was customer ease of operation. Mr. Ross noted the VAT 7's carrier presentation was like that of the bank's existing VATs with which his customers were familiar.

"The presentation makes the VAT 7 easy to use from every vehicle and we tend to put our customer's comfort high on our priority list here," Mr. Ross said.

Cost savings in the new installation will also be possible because of the overhead tube installation. The high water table in the Houston area usually means extra expense in ramping and providing a trough for underground tubes. And, since the bank is building on leased land, an installation with a permanent look but future movability was important.

With the expansion of the main office drive-up to nine lanes and the addition of 12 new lanes plus expansion plans, Northwest Bank will be the largest motor bank in an area where the customer really uses drive-up banking.

Reliability is especially important in such a heavy-use area and Mr. Ross liked the microprocessor technology of the VAT 7 as well as features like overload prevention. "A commercial customer sometimes would put bags of quarters in the unit, causing a problem. This can't happen with VAT 7," Mr. Ross said.

"I think the VAT 7 represents not only cost savings but also the latest in technology," Mr. Ross said. "And that appeals to us, since we are a progressive, growing organization."

Northwest Bank has jumped to 25th out of the 168 banks in the Houston area, according to latest figures. Planning for the future, as evidenced by the just-announced VAT 7 contract, is undoubtedly part of the reason for the success of this independent bank. ● ●

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Advertising Law Guide Published by BMA

Publication of a manual that explains government advertising regulations for financial institutions has been announced by the Bank Marketing Association.

"The Federal Advertising Law Guide" is said to be the only book of its kind in the field of bank advertising. It presents excerpts from laws issued by bank regulatory agencies, including the Comptroller of the Currency, the FDIC, the Fed and the Federal Trade Commission.

The book was compiled by industry attorneys for both experts and novices at banks of all sizes as well as ad agency executives. Because government regulations are constantly changing, the publication is published in a loose-leaf format to accommodate periodic updates that will be made available by the BMA.

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"When manual wire transfers were wasting too much time, we helped save the day."

John Ballantine, Vice President and Group Head, Correspondent Banking

"Having the right product at the right time for our correspondent customers is no accident. It's First Chicago's philosophy.

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"Cost? Little more than the phone bills they were paying before. And when the time is right, we can plug in modules that will automate activities like cash letter and target balance reporting.

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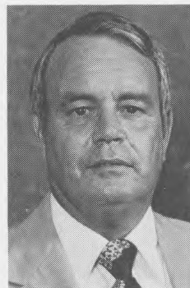
News

About Banks and Bankers

Alabama

Farmers & Merchants, Centre, recently honored the community's civic worker of the year after selection had been made from candidates submitted by various civic organizations. Each organization was asked to submit the name of one member who had made outstanding contributions to the community and the club. Winner was B. E. Yarbrough, member of the Civitan Club. He is shown receiving a plaque from Mary George Jordan Waite, the bank's chairman/president. Mr. Yarbrough's club also received a $100 check from the bank.

Robert E. Letson Jr. has been appointed sales engineer by LeFebure. He will serve various parts of Alabama, operating out of the Atlanta office. Mr. Letson had been active in the computer field in Columbiana prior to his appointment.



LETSON

Joseph L. Lomax has been promoted to vice president at First National, Mobile, heading a list of other promotions that included Michael F. Johnson and Charles E. Reid to assistant vice presidents and Rodger D. Overton and David Jones to data processing officers. They joined the bank in 1969, 1974, 1977, 1974 and 1977, respectively. In other action, the bank recently honored branch advisory board member C. G. Bitzer on his 90th birthday for his "continuous leadership on the branch advisory board."

Arkansas

Bank of Malvern has promoted Margaret Saunders and Peggy Allen to assistant cashiers. Mrs. Saunders joined the bank in 1961 and Miss Allen has been with the bank since 1978.

Farmers Bank, Clarksville, has promoted Truman S. Jacobs to vice president/trust officer and Nina G. Mason to cashier. Mr. Jacobs has been with the bank 12 years and Mrs. Mason joined the bank in 1973.

First National, Siloam Springs, has been acquired by Springtown Bancshares, a newly Fed-approved one-bank HC.

Worthen Bank, Little Rock, has promoted Stephen Plunkett and Paul

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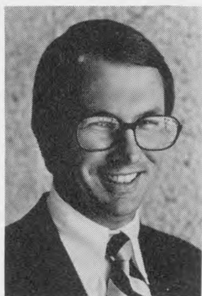
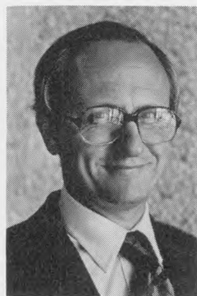


PLUNKETT



WATSON

Watson to vice presidents; David Peglow, Robert Thompson, Margie Jones and Peter Coffield to assistant vice presidents; Delores Yates to assistant cashier; Nancy Priest to assistant trust operations officer; and Marilyn Berry to assistant trust officer. Mr. Plunkett joined the bank last August and was formerly with First American National, North Little Rock. Mr. Watson has been with Worthen for more than two years and was formerly with banks in Richmond, Va.

Illinois

Farmers State, Dahlgren, has been acquired by Hamilton Bancgroup, St. Louis, a bank HC whose application was recently approved by the Fed.

DuBank Holding, Inc., Carbondale, has become a bank HC through acquisition of DuQuoin State, following approval of its application by the Fed.

Ernest A. "Drew" Karandjeff Jr., executive vice president, Granite City

IBA Receives 4-H Award

For the third consecutive year, the Illinois Bankers Association (IBA) has received a green clover award from the Illinois 4-H Foundation for the association's assistance with direct mail, publicity and contributions from member banks. Shown at presentation are (from l.) Thomas Dammrich, IBA vice president of education; Keleen Richardson, Southeast Chicago 4-H; Jack Lemmerman, IBA president and president, National Bank, Monmouth; Scott Anderson, Palos Heights 4-H; William Hocter, IBA executive vice president; and Norman Peterson, IBA vice president of administration.

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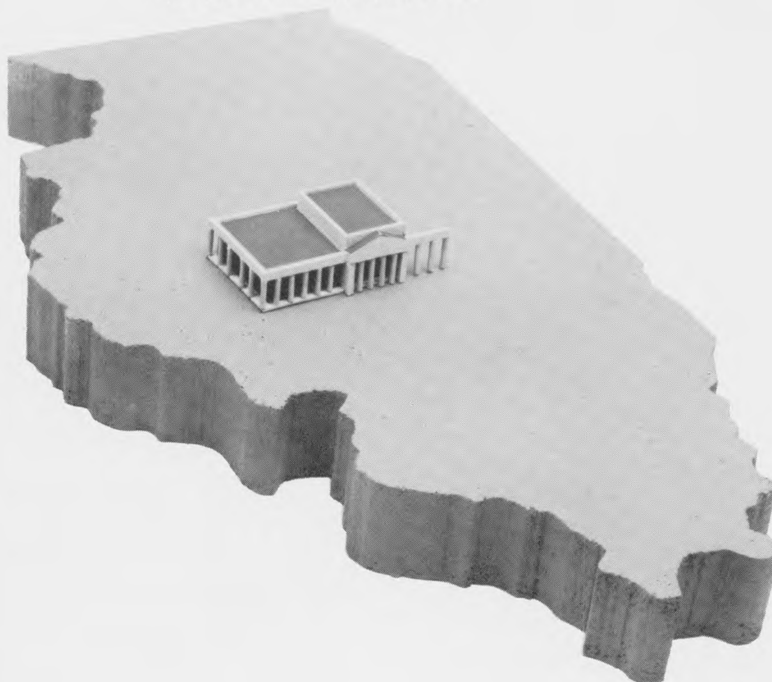

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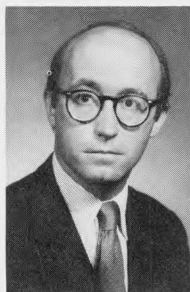
Trust, has been elected 1980-81 president, Tri-Cities Chamber of Commerce. His father, Ernest A. Karandjeff, chairman/president of the bank, and grandfather, Henry D. Karandjeff, honorary chairman, are past C. of C. presidents.

Willard Bunn III has advanced from executive vice president, a post he had held since 1978, to president, Springfield Marine Bank. He succeeds J. D. Fagan, who died of a heart attack August 4 at the age of 54. Mr. Fagan had been president since 1977. Mr. Bunn, immediate past treasurer, Association for Modern Banking in Illinois, joined New York City's Chemical Bank in 1969, was assigned to the corporate banking division, where he became a vice president in 1974, and supervised the opening and operation of Chemical's Toronto office from 1975-77. In 1977, Mr. Bunn was promoted to group head/domestic depository institutions, with responsibility for New York and the New England states. In other action, Springfield Marine has received approval from the Illinois commissioner of banks and trust companies to form a one-bank HC, Marine Bancorp., Inc.



BUNN

GILLAM

Constance B. Gillam, vice president, has been named head of the convenience banking division at Harris Bank, Chicago. Nancy J. Miller has joined the bank as vice president in the training and development division. Miss Gillam is responsible for the bank's first-floor "Harris bankers" who deliver personal banking services to retail customers. Miss Miller is responsible for career, management and organization development and continuing affirmative-action training.

Northern Trust, Chicago, has promoted Don W. Hummel and John W. Taylor III to senior vice presidents in the banking and international departments, respectively. New vice presidents include Mary Ann Banach and William C. Walker, operating department; Steven E. Cutler, Gary J. Kampmann, Roger W. Kushla and Robert E. Ross, trust department; and William J. Pisarra, banking department. Named second vice presidents were Harry T. McMahon and John B. Schnure, banking department, and Theodore D. Tice, trust department.

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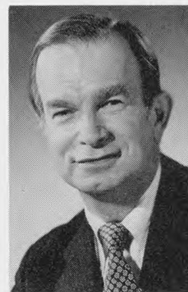

HUMMEL

First National, Winnetka, has realigned its management by electing Byron A. Warnes executive committee chairman/chairman emeritus, Paul M. Mikelson chairman and Thomas H. Werner president. Mr. Werner and Robert Field, executive vice president, were elected to the bank's board. Mr. Werner was formerly with Glencoe National and joined First of Winnetka last September.

Elmhurst National has given new positions to Harry F. Milkert, senior vice president-consumer banking; Thomas F. Franklin, vice president-marketing and planning; and Janice E. Kinzel, vice president-installment loans. Each is now a department head. Mr. Milkert joined the bank in 1946 and Mr. Franklin has been with Elmhurst National since 1977.

Indiana

John R. Schnurlein has been promoted to vice president and director of marketing at Northern Indiana Bank, Valparaiso. He joined the bank in 1968.

Citizens Bank, Jeffersonville, has promoted Barry Cahill to vice president in charge of data processing and appointed Ray Beaufait vice president in charge of installment loans. Mr. Cahill first joined the bank in 1975 and rejoined it this year. Mr. Beaufait was formerly a supervisor in the lending field.

Mary Lou Mitchell has been promoted to assistant vice president at First Bank, South Bend. She joined the bank in 1968.

Kansas

Robert Stainbrook has been promoted to president/CEO, Olathe State. He had been executive vice president since the bank's opening in 1973 and was with Metcalf State, Overland Park, prior to that time.

Kansans Visit Washington

Emery E. Fager, KBA president, visited with Senator Nancy Kassebaum (R.,Kan.) member, Senate Banking Committee, during recent trip to Washington, D. C., as part of delegation of bankers visiting congressional representatives. Mr. Fager is chairman, Commerce Bank, Topeka.

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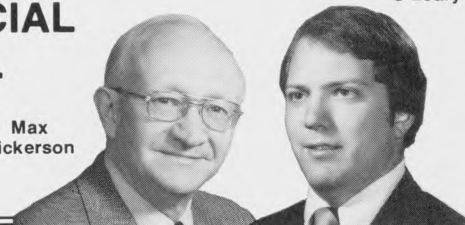

Max Dickerson

Mike O'Leary

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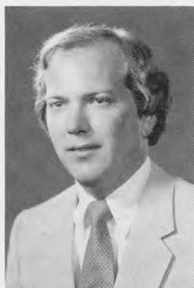
Kansas BA Officers Report During Regional Meetings

LEFT — Kansas BA President Emery Fager (r.), chairman, Commerce Bank, Topeka, speaking at CEO session at KBA's regional meetings last month, reported that the KBA Mortgage Co. would be operational by Jan. 1. Details of the new corporation operation were not finalized, but the KBA is expected to own all stock in the corporation and the firm would purchase mortgages from originating banks. Customer retention was the primary motivating factor in forming the corporation. Mr. Fager said Kansas banks can't afford to send customers to a thrift to get a mortgage because the customer might end up doing all his banking business with the thrift, due to thrifts' expanded powers. At left is KBA President-Elect Clifford Stone, chairman/CEO, Walnut Valley State, El Dorado, who explained KBA's new compliance, legal and litigation center that will provide members with reference data on banking laws and regulations, model written policy manuals and copies of pleadings, briefs, depositions, transcripts, decisions and settlements relating to situations involving banks. CENTER — Portion of group attending CEO session at Wichita regional. RIGHT — Harold Stones, KBA senior vice president, discusses federal and state governmental changes affecting future of banks at customer-contact staff session in Wichita.

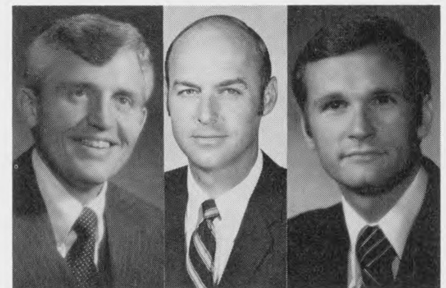


O'LEARY

Michael J. O'Leary has been named vice president at Commercial National, Kansas City. He joined the bank in 1975 and was formerly second vice president. He has been in the bank's correspondent banking division for the past four years.

Jack A. Gerhard has been elected to the board at Overland Park State. He is general manager of Kansas City retail operations for Sears, Roebuck & Co.

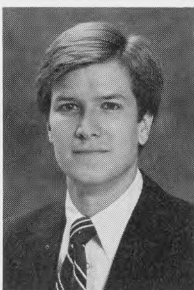
Hutchinson National has elected Scott A. Woods to a newly created post as executive vice president. Richard A. Snowbarger has succeeded Mr. Woods as senior vice president, commercial loans. Gary L. Rohrer has been elected senior vice president and trust officer and Harland Priddle has been named vice president, marketing. Bob B. Elder, auditor, has been given additional duties as compliance officer. Mr. Woods also is president, Polaris Leasing Corp. He joined the bank in 1969. Mr. Snowbarger joined the bank in 1976 and Messrs. Rohrer, Priddle and Elder have been with the bank since 1970, 1978 and 1977, respectively.



WOODS ROHRER SNOWBARGER

Kentucky

First National, Louisville, has elected five new vice presidents: John E. Darnell, formerly senior correspondent banking officer; Michael E. Fowler, Robert L. Jones and Charles E. Moosier Jr., all formerly senior national banking officers, and Marcus H. Davis, who also remains auditor. At First National's affiliate, First Kentucky Trust, Louisville, Stanley A. Rourke moved up from senior trust investment officer to vice president.



DARNELL

William W. Gaunt III has been elected vice president, facilities management and security department/administration group, United Kentucky Bank, Louisville. He joined the bank in 1965 and is responsible for construction and maintenance of banking centers and facilities. In other action, D. Michael Boyd was made assistant treasurer, mortgage division/commercial banking group.

Liberty National, Louisville, has elected Stanley S. Dickson to its board. He is an officer of South Central Bell and vice president/Kentucky.

Louisiana

Bank of New Orleans has promoted the following to vice presidents: Michael R. McGrail Jr., manager/Lakeview Banking Center, and Raymond M. Asprion Jr., regional manager/Uptown region and manager/Medical Plaza Banking Center. Larry Dorris has been promoted from assistant cashier/branch administration to assistant vice president/operations.

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Mississippi

Hancock Bank, Gulfport, has promoted Robert Guy Chatham to assistant auditor and Charles E. Hargrove Jr. to compliance officer. Mr. Chatham went to the bank in 1979, and Mr. Hargrove joined it in 1978.

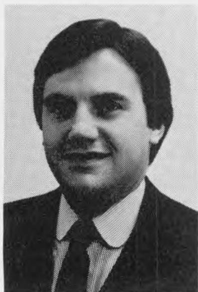
MBA Visits Washington

The Mississippi Bankers Association visited Senator John C. Stennis, dean of Mississippi's congressional delegation, during its recent trip to Washington, D. C. Pictured, l. to r., are: Don Calfee, MBA pres. and s.v.p./governmental relations officer, First Mississippi Nat'l, Jackson; Senator Stennis and Cecil Robbins, pres., Bank of Edwards. In addition to visiting their congressional representatives, the 37 Mississippians in the group were briefed by the ABA and federal officials on the status of legislative and regulatory issues.

Missouri

James G. Graham has been named correspondent bank officer at Boatmen's National, St. Louis. He has been in the correspondent-banking area during most of his banking career.

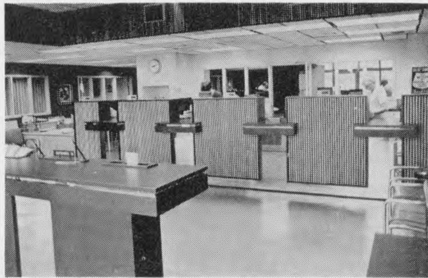
Robert N. McDowell has been elected executive vice president, Franklin County Mercantile Bank, Washington. He formerly was vice president, Mercantile Trust, St. Louis, where he was in the central group, working with correspondent banks. He also was responsible for coordinating loan participations with Mercantile community



GRAHAM

McDOWELL

Cabool State Remodeled



Cabool State was host to 300 persons at an open house celebrating completion of its remodeling program, which was carried out by Richard L. Bacon, Architect, Ste. Genevieve. The entrance, lobby and officers' quarters have been modernized and now have contemporary design. There are new tellers stations (pictured here) and a note payment department. During the open house, guests viewed paintings done by Myra Mohler and Janene Thompson, bank employees, and Mrs. Richard Stringer, wife of a director.

banks. Mr. McDowell joined Mercantile Trust in 1978, going from Security National, Kansas City, Kan., where he was an assistant vice president.

Boatmen's Bancshares, St. Louis, has reached an agreement in principle with Plaza National Bancshares, St. Louis County, providing for acquisition of that HC by Boatmen's. Plaza Bank of West Port is Plaza National Bancshares' principal subsidiary.

Mercantile Trust, St. Louis, has promoted the following: to vice president, John T. Lamping, and to assistant vice presidents, Vincent S. Boyer, Robert J. Anthony and W. Bruce Phelps. Mr. Lamping joined the bank in 1976, Mr. Boyer in 1970, Mr. Anthony in 1973 and Mr. Phelps just recently.

Charles N. Van Zante has been promoted to vice president/manager, State Line Facility, United Missouri Bank, Kansas City. Terry Dierks has been elected vice president in charge of lending at the facility. Mr. Van Zante went to the bank about four years ago and Mr. Dierks, formerly an assistant vice president, in 1977.

Robert P. DeRodes and Michael E. Jennings have been elected vice presidents/data processing, First National, St. Louis. Elected assistant vice presidents were Mary Ann Denny and John M. Mitchell, both in operations. Paul F. Glarner has been named assistant auditor.

Douglas A. Doll has been named executive vice president/CEO, Commerce Bank, Grandview. He joined Commerce Bancshares, Kansas City, in 1977, and, most recently, was vice president/commercial loans, Commerce Bank, Columbia.

Fred N. Coulson Jr., president/CEO, Old Western Life Insurance Co., Kansas City, has been elected to the board of Laurel Bank, Raytown. Mr. Coulson headed the correspondent banking division at Kansas City's Commerce Bank from 1970 until last May. Before 1970, he spent 23 years with ISC Financial Corp., Kansas City, where he was vice president/sales director of the firm's affiliated insurance companies.

New Mexico

Arthur Sossong, who joined Albuquerque's Fidelity National last June as executive vice president, has been elected to the bank's board. He has almost 30 years' banking experience. Also at Fidelity National, Tina Stoneking has been promoted from personnel officer/assistant cashier to assistant vice president, with responsibility for personnel supervision/public relations. Gerda Gulde has been named assistant vice president in charge of branch administration. She formerly was assistant cashier/North Carlisle Branch manager.

James W. Steward became president/CEO, Security Bank, Alamogordo, October 15. He has been chairman/CEO, Republic Bank, Albuquerque. At Security Bank, Mr. Steward succeeds Maurice Hobson, who becomes chairman of the bank's executive committee.

Oklahoma

GRANT

Carl E. Grant has been promoted from senior vice president to executive vice president at Liberty National, Oklahoma City. He heads the personal banking department, which includes the installment loan and credit card divisions. Mr. Grant joined Liberty National in 1969 after 22 years with another Oklahoma City bank.

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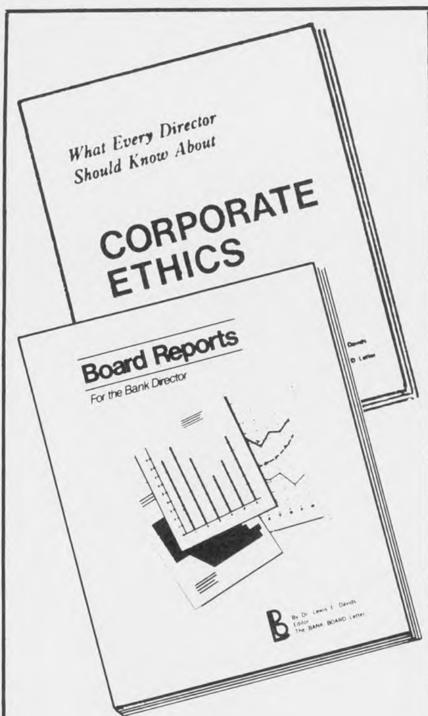

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First National, Oklahoma City, has promoted Louis Fournet and Ann Taliaferro to vice presidents/trust officers. Mr. Fournet joined the bank as an assistant vice president in March, going from Republic National, Dallas, where he was a trust officer. Miss Taliaferro went to First National in October, 1979, also as an assistant vice president. In other action, the bank elected Kathy M. Jones and Bruce C. Williams assistant vice presidents/trust officers; Patrick D. Meziere assistant vice president/methods research and management systems; Darole B. Mott assistant vice president/cash management marketing and Gary L. Call and David H. Dietz assistant auditors/outside auditing.

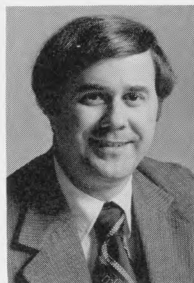
Central National, Enid, has elected Danny Wingate vice president/data processing manager and Jan Martin assistant vice president/operations. Mr. Wingate formerly was a systems analyst with NCR Corp. in Fayetteville, Ark. Mr. Martin joined the bank in 1977 and, most recently, was float control coordinator/transportation coordinator.

Tennessee

Esther H. Smith has joined Union Peoples Bank of Anderson County, Clinton, as senior vice president and manager/Oak Ridge branches. Mrs. Smith, a past president, National Association of Bank Women, was vice president, Commerce Union, Lebanon, which she joined in 1978. Before that, she was with Commerce Union, Nashville, where — from 1975-78 — she was in the correspondent banking department.

David B. Ramsay, formerly vice president/correspondent division, American National, Chattanooga, has joined Hamilton Bank, Johnson City, as executive vice president/chief operating officer. Also at the latter bank, J. Lloyd Langdon, chairman/CEO, also was elected president, succeeding Chauncey W. Lever. Mr. Lever resigned to organize his own management consulting firm. He had been president of the bank since October, 1979. He also resigned as a bank director.

SMITH

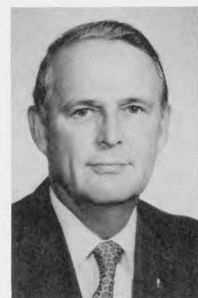

RAMSAY

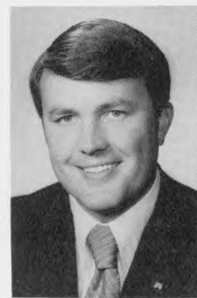
Mike V. Kennedy has joined First National of Franklin County, Decherd, as farm representative. He had been working in farm-related areas since his graduation from the University of Tennessee in 1956 with a B.S. degree in agriculture. He was chairman of the Tennessee Agricultural Stabilization and Conservation Committee from 1977 until resigning last June. He received the "Outstanding Young Farmer" award in Franklin County for two years.

John Howard Hamilton has been elected vice president/regional manager, branch division, First Tennessee Bank, Memphis. He joined the bank in 1972 and was manager/Main Office Branch. In his new post, Mr. Hamilton shares responsibility for managing Memphis bank branches with Ken Youngblood.

Third National, Nashville, has elected three new assistant vice presidents: Lloyd Smith, bank systems; Trudy Balph, retail services, and William T. Startup, consumer credit. Mr. Smith joined the bank in 1964, Miss Balph in 1967 and Mr. Startup in 1970.

Texas


MITCHELL


WILSON

Republic National, Dallas, has named Jim P. Wilson, senior vice president, to head the new financial institutions division, which includes correspondent relationships. Mason E. Mitchell, executive vice president, has been named senior liaison officer to coordinate activities between the bank and its subsidiaries in Republic of Texas Corp. Mr. Mitchell had directed the correspondent banking department since 1972. H. Edward Anderson has been named head of the securities management division as senior vice president and trust officer. He serves

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as trust investment committee chairman. He formerly was with Lincoln First Bank, Rochester, N. Y. Linnet F. Trow has been promoted to senior vice president and head of the management division of the international department. New vice presidents include Roy R. Grenwelge, Marjorie E. Bernbaum, John A. Bricker Jr., Marvin G. Schiebout and Harry K. Kaelber. Benno J. Fischer and Charles P. Lamb were promoted to vice presidents and trust officers. New assistant vice presidents include Royce D. James, Patricia M. Ingram, Kay Holleman, Donald W. Petton, Ted H. Bayless and Donald M. Phillips. Stephen Myres was promoted to assistant vice president and trust officer and Marilyn G. Stanfield was named trust officer. Virgil Barnard has been elected assistant vice president at Republic of Texas Corp.

Bank's Hot Air Balloon Benefits Local Charities

A hot air balloon owned and operated by Amarillo National is helping to promote local charities.

The custom-designed balloon stands nearly seven stories tall and has been used to help local charities attract attention at fund-raisers and special events. In addition, the bank has donated "champagne rides" to be sold at benefit auctions.

The balloon has flown tethered flights over events sponsored by the Muscular Dystrophy Association, the American Heart Association, Multiple Sclerosis summer camp, the Amarillo Industrial Exposition and the Amarillo Art Alliance. A "champagne ride" was auctioned off to benefit the U. S. Symphony in Washington, D. C., and the balloon has been featured at the grand openings of several area stores.

The green, blue and red striped design of the balloon features the bank's logo. The balloon is flown by a professional, but the co-pilot is Bill Ware, senior vice president at the bank.

The craft is featured in bank TV commercials and on billboards. Employees wear lapel pins styled in the shape of the balloon.

Amarillo Nat'l's gas balloon attracts attention for the bank and is used to promote local charitable events.

RISSMAN YOUNG VICK VAN METER

Frost National, San Antonio, has promoted Stephen E. Larson to vice president and Phillip D. Green and T. Kenneth Vick Jr. to assistant vice presidents. Mr. Vick is in the correspondent department. Newly elected officers include John A. Bustos, computer operations; Larry E. Dunn, Houston Data Center; Skip Fitzpatrick, proof; Douglas W. Frederick, Corpus Christi Data Center; L. Robin Gorskie and Sandra H. McIntyre, credit; Renee B. Rissman, Joe R. Van Meter and Richard D. Young, correspondent banking; and Tom L. Stringfellow, trust.

Citizens National, Greenville, has elected James R. Huffines to its board. He is vice president and director, Bank of Dallas, and president, Dallas Bancshares.

First National, Fort Worth, has promoted Jerry Lee Mechell to vice president/auditor, Gary L. Moore to vice president and Sue Caldwell, Susan Drew, Paulette Haddock and DuBois Nicar to assistant vice presidents. Newly elected assistant vice presidents include Blaine Calloway and Ed Cuellar.

Premium Suppliers

(Continued from page 13)

banning them influenced the DIDC to change its mind about the ban proposal.

He said his firm experienced no decline in orders during the period of uncertainty. In fact, during that period three billion-dollar financial institutions began premium programs using Dalton products. He added that the bulk of premiums were not under fire by the DIDC; it was the unorthodox practices and exotic premiums used by some New York institutions that brought on the ban proposal.

He added that it's impossible to fault continuity premium promotions because they don't encourage bank customers to jump from one institution to another to get premiums.

The outlook for premiums is "very positive," said John H. Guinan, president, Christmas Club a Corporation, Easton, Pa. Although sales dwindled somewhat during the period of uncertainty, Christmas Club expects to have a "good strong year," he said.

September was a "super" month, Mr. Guinan said, and he expects financial institutions to give premiums to up to five million customers signing up for new Christmas club accounts. ● ●

Index to Advertisers

Agri Careers, Inc. 98
American Banker 95
American Bank Directory 88
American Bankers Association 18
American National Bank & Trust Co., Chattanooga 30
Animal Fair, Inc. 39
Aristocrat Inns 84
Arrow Business Services 15
Assemblies for Bank Directors 72
Bank Board Letter 96
Bank of America 25
Boatmen's National Bank, St. Louis 99
Bond Buyer 33
Brandt, Inc. 3-4
Bryant Bureau 64
Cawthon Building Systems, Inc. 85
Citicorp 52-53
Commerce Bank, Kansas City 23
Commercial National Bank, Kansas City, Kan. 92
Connelly Associates, J. Edward 40
De Luxe Check Printers, Inc. 51
De Luxe Check Printers, Inc. Forms Division .. 79
Deposit Guaranty National Bank, Jackson 83
Diebold, Inc. 55
Don Howard Personnel, Inc. 86
Durham Life Insurance Co. 47
Ecom Systems, Inc. 61
Financial Placements 90
First Alabama Bank, Montgomery 64
First National Bank, Chicago 89
First National Bank, Kansas City 11
First National Bank, Mobile 41
First National Bank, St. Louis 100
First National Bank of Commerce, New Orleans 49
First Total Systems, Inc. 58
Fourth National Bank, Tulsa 43
Fourth National Bank & Trust Co., Wichita ... 81

(Continued on page 98)

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Fed Answers Reg Questions

John W. Rosbrugh, examiner in the St. Louis Fed's consumer and community affairs department, answers common questions about federal regulations affecting most banks. Information given here reflects Mr. Rosbrugh's opinions, not necessarily those of the St. Louis Fed or the Board of Governors.

Q. What is the change in the grace period for payment of certificates of deposit at maturity without suffering an interest penalty?

A. There has been no change in the 10-day penalty-free grace period. Regulation Q prohibits the payment of interest on any deposit payable on demand, and if a deposit is withdrawn during the 10-day period after maturity, no interest may be paid thereon for any part of the period subsequent to maturity. However, when the certificate is renewed within 10 days after maturity, payment of interest for such period is not believed to be prohibited.

Q. This being the case, what is the new seven-day rule?

A. Effective May 6, 1980, the Depository Institutions Deregulation Committee adopted a final rule concerning the payment of interest on time certificates of deposit. The rule generally applies to all commercial banks, mutual savings banks and S&Ls, and states that if a depository institution includes provisions in the time-deposit contract, the institution may pay interest on the funds withdrawn during the first seven days after maturity, at the deposit-contract rate or a lower rate, if such lower rate is specified in the provisions. The rate may not be less than that established for regular passbook accounts.

The provisions of the two questions are independent of each other and must be treated as separate occurrences.

Q. Does the full early withdrawal penalty apply to the withdrawal of funds that have a maturity of less than three months?

A. No. A technical amendment to the Depository Institutions Deregulation Committee's final rule adopted on May 28, 1980, that became effective June 2, 1980, states that when funds are withdrawn prior to maturity from a time deposit with an original maturity of less than three months, the minimum required penalty is the amount of interest that could have been earned at the nominal contract rate if the time-deposit funds had remained on deposit to maturity. For example, when funds are withdrawn prior to maturity from a time deposit with an original maturity of 45 days, the minimum required penalty is the forfeiture of an amount equal to the amount of interest at the nominal contract rate that could have been earned on such funds for 45 days.

Q. Is there any time deposit that may be written for initial terms of less than 30 days?

A. Yes, effective October 30, 1980, a new type of time deposit with a maturity of 14 to 29 days was permitted. The rate has been established with a ceiling of 5¼%.

Index to Advertising

(Continued from page 97)

General Electric Credit Corp. 10
Hagan & Associates, Tom 30, 70
Harland Co., John H. 29
Harris Trust & Savings Bank, Chicago 27
Hibernia National Bank, New Orleans 45
IAC Group 34
Indiana National Bank 30
Industrial Life Insurance Co. 56
Insurance Enterprises, Inc. 48
Insured Credit Services, Inc. 12
Liberty National Bank & Trust Co., Louisville 59
Liberty National Bank & Trust Co., Oklahoma City 2
MGIC-Indemnity Corp. 57
Memphis Bank & Trust Co. 5
Mercantile Bancorp. 6
Missouri Encom, Inc. 44
Mosler Safe Co. 77
National Bank of Detroit 37
National Boulevard Bank, Chicago 69
Planned Projects 65
Professional Bank Services 71
Republic National Bank, Dallas 75
SLT Warehouse Co. 87
Springfield Marine Bank 91
Struven, Inc., Carlyle G. 66
Travelers Express 9
Union National Bank, Little Rock 30
United Missouri Bank, Kansas City 73
van Wagenen Co., G. D. 54
Whitney National Bank, New Orleans 17
Zahner & Co. 31

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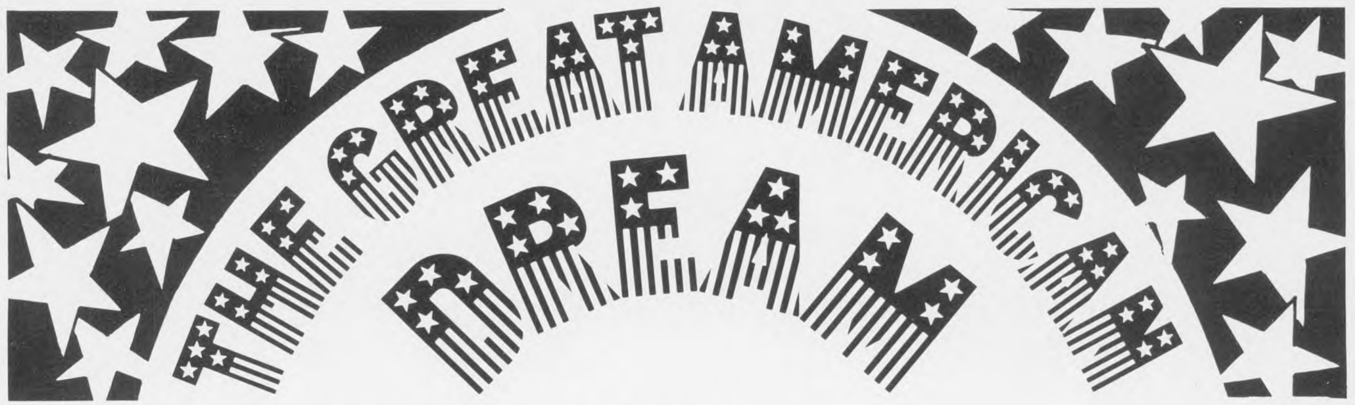

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FOR MORE INFORMATION: Contact your correspondent officer at First National Bank in St. Louis or:

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