MID-CONTINENT BANKER

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JANUARY, 1985

Banking In 1985 And Beyond


MB82

CONVENTION CALENDAR

Jan. 27-30: ABA National Trust Conference, New York City, New York Hilton.

Jan. 29-Feb. 1: ABA National Insurance/Protection Conference, Bal Harbour, Fla., Sheraton Bal Harbour.

Feb. 3-6: ABA Telecommunications/Financial Networks Workshop, New Orleans, Hyatt Regency New Orleans.

Feb. 10-13: ABA National Assembly for Community Bankers, Orlando, Fla., Hyatt Regency Grand Cypress.

Feb. 10-22: ABA National School of Retail Banking, Norman, Okla., University of Oklahoma.

Feb. 12-15: ABA National Bank Investments Conference, Los Angeles, Westin Bonaventure.

Feb. 14-17: Assemblies for Bank Directors Assembly 60, Honolulu, Hawaii, Hyatt Regency Waikiki.

Feb. 24-27: Bank Administration Institute Security Conference/Exposition, Houston, Adams Mark Hotel.

Feb. 27-March 1: Dealer Bank Association Annual Conference, Scottsdale, Ariz., Camelback Inn.

March 3-6: ABA Trust Operations/Automation Workshop, New Orleans, Hyatt Regency New Orleans.

March 6-9: Independent Bankers Association of America National Convention, San Antonio, Tex.

March 10-14: ABA Executive Development Program, Minneapolis, Amfac Hotel.

March 10-15: ABA National Compliance School, Norman, Okla., University of Oklahoma.

March 17-19: ABA National Corporate Banking Conference, Dallas, Hyatt Regency Dallas.

March 20-21: First Lease Equipment Corp. Seminar, Chicago, Hyatt Regency.

March 26-29: Bank Administration Institute Check Processing Conference, Dearborn, Mich.

March 26-30: Louisiana Bankers Association Annual Convention, New Orleans, New Orleans Hilton.

March 28-31: Assembly for Bank Directors Assembly 61, White Sulphur Springs, W. Va., The Greenbrier.

MID-CONTINENT BANKER

(Incorporating MID-WESTERN BANKER)

IN THIS ISSUE

Volume 81, No. 1 **January, 1985**

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CHASE

In 1985 Banks Will Be More Sales Oriented

78% will offer at least one new product or service; 40% will establish or expand sales-training programs

ARE BANKERS to become salesmen? Results from a year-end survey by this publication would indicate a trend — a small but growing trend in that direction.

Perhaps bankers are responding to mounting competition or threat of competition from such giants as Sears, J. C. Penney, Citicorp and others. Perhaps it is their own determination that, as they introduce new products and services (and 78% said they would introduce new products or services in 1985), they must be prepared to SELL those products.

In any event, bankers *are* preparing to upgrade their sales tactics and programs in 1985. Some — we expect from the tone of their response — will be starting from scratch, but the signals are clear: Bankers in the Mid-Continent area are gearing up to become better salesmen. As one banker noted: "Now, we're just order takers. We must learn how to sell if we are to stay in this business."

While such positive answers to our questions about salesmanship were somewhat surprising, answers to other major areas of our questionnaire could have been anticipated. For example:

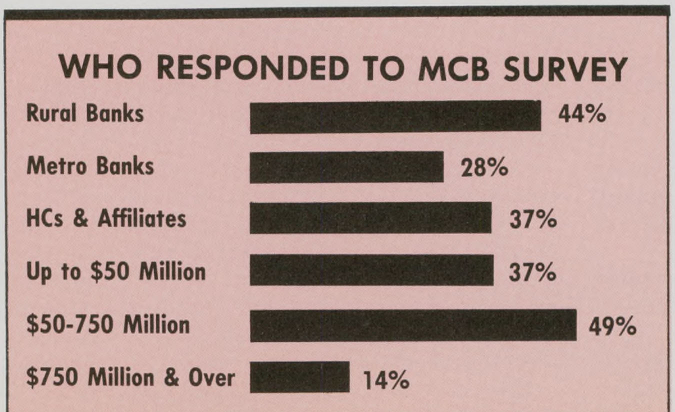
- Seventy-eight percent of the 252 bankers responding to our survey said they would introduce new products or services in 1985.
- One hundred percent (well, almost) said they would do their utmost to control non-interest expenses and also to review or implement new or better loan-monitoring systems.

Here, too, the signals were clear: Bankers recognize the need for new products and services in order to retain or increase share of market. Furthermore, they recognize the need to become "lean and mean" as industry has done in the past several years. And further, they desperately see the need to halt the massive loan losses (if possible) that have plagued the industry during the past 12-36 months.

Those answers could have been anticipated. But salesmanship? It is true that a good many bank conventions this past year have initiated the subject through expert speakers, round-table discussions and question-and-answer sessions; but salesmanship, catching on?

Here's what bankers had to say:

- Forty percent said they would establish or expand present bank-training programs. Some 38% indicated they already had such programs underway.
- Thirty-two percent said they would establish *sales training* for point-of-contact people. Programs already in effect: some 40%.
- Thirty percent said they would hold sales contests. This wasn't new since 40% had sponsored sales contests in the past.
- Twenty-two percent said they would establish incentive compensation (commissions) for opening new accounts. A small percentage indicated they would be apprehensive about offering compensation for loans. Their reasoning: Judgment might be swayed (by compensation) to open a questionable loan. By way of comparison, 16% stated they already had new-account incentives.
- Twenty-four percent said they would launch officer-call programs for the first time! Another 53% said this was commonplace with their banks.
- Sixteen percent said they were changing their "hiring policies" in order to hire sales-oriented people in the future. We found that 15% of those responding now are doing this.
- Thirteen percent will create direct-sales programs. Some 11% have been doing this.
- Nine percent will start premium campaigns for new accounts, up from the 7% who have been holding such campaigns.
- Seven percent will create the new position of sales manager! That bears repeating: *Seven percent will create the new position of sales manager*. We were equally



astounded to learn that 9% of those responding *already* had the *titled position of sales manager* in their banks. Not so clear, even after several telephone follow-ups to this survey, was whether the bank sales manager would have the same type of authority and responsibility industry generally associates with that position.

New Services — 78%

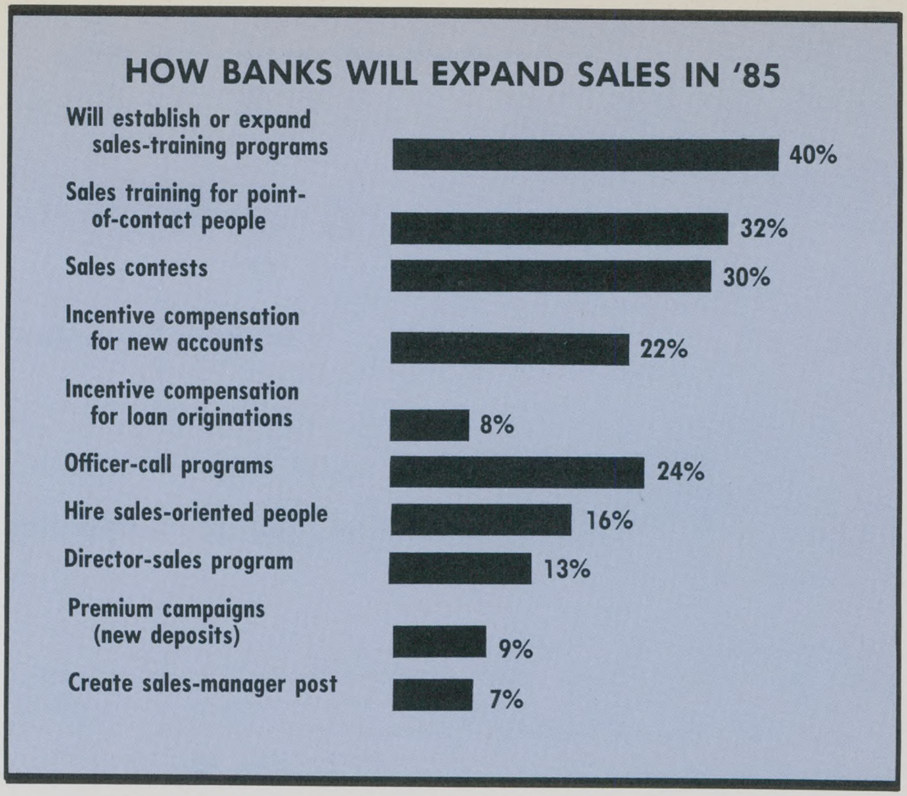
As already mentioned in preceding paragraphs, 78% of the 252 bankers responding to our survey indicated their banks would be launching *at least one* product or service in 1985. Here's how those new services ranked:

- Twenty-three percent will launch an up-scale-customer service, and this percentage is exactly the same as those who will initiate financial counseling. The same percentage (27%) already offer *both* services.
- Twenty-two percent will join ATM networks . . . 34% already have.
- Fifteen percent are looking for places to put ATMs in shopping malls, department stores, etc. Some 17% already have staked out such locations. And while a whopping 58% have at least one ATM in service, approximately 11% will offer customers ATM service for the first time in 1985.
- Fifteen percent will offer mortgage servicing for the first time. Some 32% already are involved.
- Fourteen percent expect to offer property/casualty insurance through owned or leased services. This would increase from 12% already offering the service.
- Thirteen percent will offer discount brokerage . . . 51% already do.
- Eleven percent will offer life insurance . . . 23% already do.
- Eleven percent will have manned (or should we say staffed) facilities in shopping centers or other desirable locations. Surprisingly, 14% already do.
- Ten percent will offer POS terminals (point of sale). This is more than a 300% increase over the 3% now offering such service.

Lower-Ranked Services

Other services to be introduced, but not highly ranked, in the survey are senior-citizen programs, 7%; full-investment counseling, 5%; home banking, 4%; service for handicapped, 3%; and commodity-futures brokerage sales, 3%.

While only 7% of those responding will initiate senior-citizen programs, it should be noted that 61% already have comprehensive programs for seniors. One banker even admitted he was curtailing part of his program. His comments: When these senior citizens started asking for money-market rates, we questioned how many free services we should give away! (But as most bankers know, that's where some of the big bucks are — in the senior-citizen checking accounts! Anyone for joining that banker?)



New Services: How, What and Where

Bankers look longingly at up-scale-customer and financial-counseling services, but clearly have not fully sorted out their thoughts on these services. One banker states: "We do a lot of informal counseling now, but do not offer a formal service." His bank, he says, has an advisory director who is an agent for life, property and casualty insurance companies and, through him (they hope), they might offer some financial counseling.

The trust department appears to be the logical avenue for counseling of all types. Further, there appears to be a dilemma on *how* to charge: Several would charge for financial counseling. Others would *not* charge for full *investment* counseling.

One banker who appears to have concrete plans would offer up-scale service with preferential rates on check-credit loans, discounts on safe deposit boxes, "distinction" checks and free travel insurance. Another banker writes: We will offer a credit-driven package of "prestige" items.

Still another writes: "Revolving lines of credit up to $100,000 for affluent customers. Home equity revolving lines of credit for *healthy* middle-market customers. Asset-management account for up-scale customers."

And for agricultural customers, one banker states: We'll offer tax planning and seminars (with expert speakers) on all topics we feel our customers need.

Also for farm accounts, one banker writes: We'll offer a micro-computer-based program that will analyze profit/loss, cash flow, budget (with weekly update), cost projection and break-even on crop production. Charge? An initial fee, plus monthly service charge.

Another bank will offer programs to attract younger, professional people. Included will be a self-directed IRA plan.

Among other types of services bankers hope to offer in 1985 are the following: simplified profit sharing and HR-10 plans; tax preparation; real estate brokerage; travel services; remittance processing for utilities; home-improvement loans; a national debit-card program; agricultural-type leasing; IRA-completion insurance; and a point-of-sale bank card.

Mortgage servicing and insurance products were mentioned repeatedly by bankers. Most bankers looked longingly for legislative approval for insurance products (both life and property/casualty), but many are looking for agencies to buy and operate "on the side." Leasing of desk space to insurance agents was not a popular choice.

Mortgage servicing, on the other hand, appears to be "off and running" with Mid-Continent-area bankers. All sizes: $2 million and up, with those already servicing mortgages indicating a willingness to expand through mortgage companies they own or through normal acquisitions and sales in the secondary market. (Editor's note — Readers might have noticed that the nation's No. 2 mortgage-servicing bank is in the Mid-Continent area — Union National, Little Rock — with $1.2 billion of loans! No. 1 servicing bank is Bank of America, San Francisco, with $2.2 billion of loans.)

Expansion of ATM systems — through networks and local placements — also appears high on bankers' plans. Repeatedly, bankers told us they were looking for "ideal" locations in shopping centers and grocery stores. One bank was looking at a college campus.

Controlling Expenses

Budgeting, tight controls, increased productivity were the terms bankers used as they expressed desires to control non-interest expenses in 1985.

One banker would "appoint a cost czar." Another would watch postage — mail fewer statements to local residents and instead hand them out on request. Another would buy supplies in larger quantities. Still another would look closely at advertising "giveaways."

But the major cost-cutting approach expressed repeatedly by bankers was their determined effort to reduce the number of employees and curtail employee benefits, but, at the same time, increase employee productivity. Use of part-time employees (presumably clerical) was listed frequently as a means of achieving this goal. Bankers also would allow "attrition" to solve some of their presumed over-staffing.

One bank already has reduced its level of employees from 77 to 72 during 1984 and expects to receive the full impact of savings in 1985. But there's more coming at that bank: a reduction in size of the board. (Look out, directors!)

Another bank also will "hand out" statements rather than mailing them in 1985. "Postage is going up again this year," the banker writes. Also, this bank will limit magazine subscriptions "only to those essential publications!" (Question: Is MID-CONTINENT BANKER essential?)

Target for this bank in '85: "Reduce non-interest expense by 29%."

A holding company officer reports: "Our banks work in clusters. Each CEO has specific guidelines for 1985 on non-interest expenses."

One bank will be open fewer hours, close branches on Saturday.

Product profitability was mentioned frequently. Conclusion: Bankers will eliminate the unprofitable ones. The problem will be similar to the one faced by Wrigley (the chewing gum king), who was asked: "Mr. Wrigley, don't you waste a lot of money on your advertising?" His reported reply: "I suspect I waste 50%. If I just knew which 50%, I'd cut it out!").

Health-insurance coverage is a major concern, and bankers are looking for ways to control these costs.

One banker hopes to solve his "productivity" problem with an employee-incentive plan. The plan was not divulged.

Numerous bankers are looking for HELP from financial-consulting firms. One banker currently has an "outside consultant" performing a procedures audit on various departments of the bank, and he hopes to receive recommendations on cost savings as well as revenue increases.

In each his own way, the Mid-Continent-area banker has indicated his basic philosophy: Trim; cut; slash away at non-interest expenses in 1985!

Lending Controls

Two words were found in almost every response from bankers on the subject of lending practices: "Tighter controls!"

There were few refinements of those two words, except that bankers would say: "We will stress quality . . . we'll be less aggressive . . . we'll price more realistically . . . we'll review more often . . . we're going back to basics . . . we'll get better financial information . . . we'll look for better security." And so it went.

Since a good many responses came from agri-based banks, we found repetition in statements such as: "We're cutting back on ag loans . . . we're hiring a new ag man . . . we're looking more at cash flow than at assets." Plus a new factor that has surfaced recently in agricultural lending: "We'll ask borrowers to hedge more often" (hopefully, plugging in a profit).

But the message is clear: The banker is going to put back his "glass eye" in 1985.

Mergers/Acquisitions

No one admitted his bank would merge with another in 1985. (Even with a promise of anonymity, we really didn't expect a positive answer to that question.)

But with 37% of responses coming from a number of bank HCs and affiliates of HCs, 24% of those responding stated: We plan to acquire one or more banks in 1985.

Plans are afoot by 8% to start multi-bank HCs. Another 8% plan to purchase an insurance agency, and 2%

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NEW SERVICES OFFERED BY BANKS IN '85

	Will Offer in '85	Already Offer
Upscale customer service	23%	27%
Financial counseling	23%	27%
ATM networks	22%	34%
ATM placements in shopping centers	15%	17%
Property/casualty insurance	14%	12%
Discount brokerage	13%	51%
ATMs	11%	58%
Mortgage servicing	15%	32%
Life insurance	11%	23%
Facilities (manned) shopping malls	11%	14%
POS (point of sale)	10%	3%
Senior-citizen programs	7%	61%
Leasing of all types	6%	23%
Full investment counseling	5%	12%
Service for handicapped	3%	17%
Commodity-futures-brokerage sales	3%	2%
Home banking	4%	6%

What These Bankers Are Saying . . .

"I . . . feel New York City banks should not lobby for national branch banking in states here in the Middle West until they clean up their own acts." — *R. Crosby Kemper*

"We will have to depend more on our skills as managers than ever before. We must improve productivity, identify new opportunities in the marketplace." — *Carl R. Pohlad*

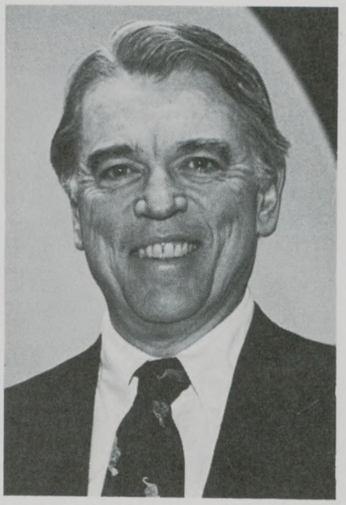
"We tend to be generally optimistic about the economy in 1985 despite the slowdown, recognizing, however, that there will continue to be pockets of distress during 1985. . . ." — *Donald N. Brandin*

"While rate of growth in employment should slow in 1985 as the recovery matures, we still expect employment growth in Texas to exceed U. S. averages." — *Robert H. Stewart III*

". . . Advances in technology are reshaping the economics of the banking industry and creating greater size economies; i.e., certain kinds of banking functions are performed most efficiently by large banks rather than by numerous small banks." — *George R. Slater*

"Much has been made of having a 'level playing field.' . . . However, it's even more important to be able to put on a uniform and be allowed to play on the field at all." — *John W. Woods*

Forecast For 1985



R. CROSBY KEMPER

GEORGE R. SLATER

By R. Crosby Kemper

THE 1985 economy will be a mixed bag — good for some and serious problems for others. Good or bad, there will be a lot of changes for us in the banking business. Deregulation will sponsor all the thrust we bankers in the Middle West will have to contend with and that will take all of our time in the coming year.

I think New York City bankers, principally Citicorp, have had a great influence with the Reagan Administration and have convinced that administration that deregulated, free-for-all, national branch banking will be good for the country. I feel nothing could be further from the truth. Most of the regulations we used to have were initiated by problems we had in the banking business in the 1920s and '30s. These regulations were accomplished to protect the public from an over-accelerating financial environment.

The current conventional wisdom among money-center bankers is that the cause of the debacle at Continental Bank, Chicago, was reliance on short-

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R. Crosby Kemper is chairman/CEO, United Missouri Bank, Kansas City.

By George R. Slater

BANKERS today are facing difficult changes in their environment due to 1) deregulation, 2) international competition and 3) technological changes. This article deals with one of these pressing issues, *geographic* deregulation.

Many experts believe Congress will authorize nationwide geographic deregulation in the banking industry by 1990 based on three factors.

First, advances in technology are reshaping the economics of the banking industry and creating greater size economies; i.e., certain kinds of banking functions are performed most efficiently by large banks rather than by numerous small banks.

Second, new and greater competitive forces, both domestic and international, require development of big U. S. banks if we are to compete worldwide for multinational business.

Third, geographic deregulation potentially can provide enormous benefits to consumers and businesses.

Congress recently took the first step

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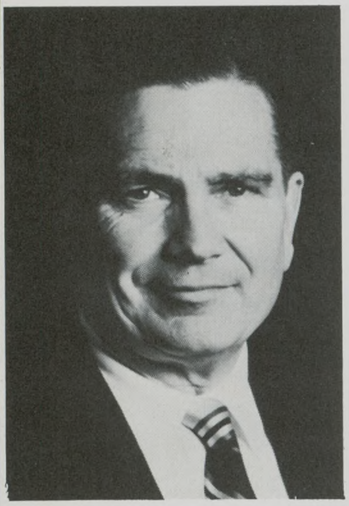
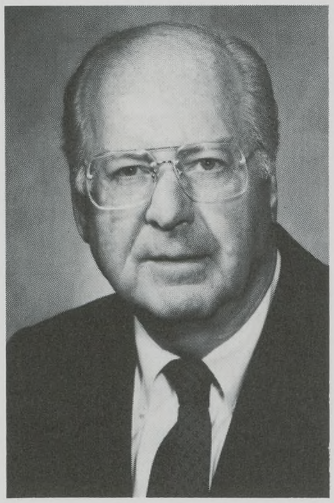
George R. Slater is chairman/CEO/president, The Marine Corp., Milwaukee.

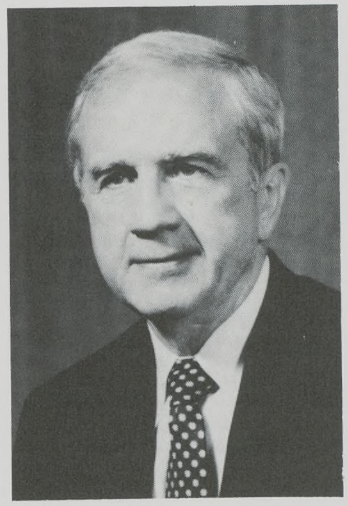
CEOs of Mid-Continent-Area Banks, HCs Tell What They Foresee in Coming Year



ROBERT H. STEWART III

DONALD N. BRANDIN





CARL R. POHLAD

JOHN W. WOODS

By Robert H. Stewart III

IN 1985, the U. S. and Texas economies will enter the third year of the recovery that began in November, 1982.

Based on total employment statistics, growth in the Texas economy is outpacing growth in the national economy; over the last year, total employment has grown in Texas by 7% and by 3.3% in the U. S., excluding Texas. While rate of growth in employment should slow in 1985 as the recovery matures, we still expect employment growth in Texas to exceed U. S. averages. This growth will lead to expansion of markets in which InterFirst's 68 affiliate banks operate.

Growth in employment has been in 1984, and will continue to be in 1985, well diversified by economic region and by industry. There are six major economic regions in Texas: the plains, metroplex, east Texas, border, central corridor and Gulf Coast. Employment growth in the large metropolitan areas of these economic regions over the last

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Robert H. Stewart III is chairman/CEO, InterFirst Corp., and InterFirst Bank, both in Dallas.

By Donald N. Brandin

FORECASTING the economy at any time is a hazardous enterprise. It is doubly hazardous this year because of questions about the strength of the recovery and uncertainty about the ability of the Administration and Congress to jointly cope with the major economic issues that must be addressed in the wake of the November elections. The timing and manner in which we resolve such issues as deficit spending, trade imbalance and tax reform will have a major impact on the economy going forward.

The present recovery is moving into a mature phase, and statistics in the last half of the year have indicated a significant slowing in rate of growth. We tend to be generally optimistic about the economy in 1985 despite the slowdown, recognizing, however, that there will continue to be pockets of distress during 1985, particularly in the agricultural areas of our trade territory. For those banks that have significant exposure in those areas, further problem situations can be expected to

(Continued on page 16)

Donald N. Brandin is chairman/CEO, Boatmen's Bancshares, Inc., St. Louis.

By Carl R. Pohlad

DEREGULATION has spawned a competitive environment that demands a level of management expertise never needed in the past. Regulatory reform and technological innovation have fostered dramatic changes in just a few short years.

For 50 years, commercial banking was a consistently stable and profitable enterprise. Banking's reliable bottom line created a complacency and resistance to change that still persist. Coping with our new environment has left some bankers disoriented; there have been closures and liquidations in our industry, and more casualties will follow. The phenomenon that finds losers acquired by winners is likely to continue for an indefinite period.

We will have to depend more on our skills as managers than ever before. We must improve productivity, identify new opportunities in the marketplace and create profitable new products. We cannot accomplish these objectives without capable, well-trained people.

In the highly competitive environ-

Carl R. Pohlad is president/CEO, F&M Marquette National, Minneapolis.

ment of the future, the successful bank will pay more attention to management functions. Those who manage well will be survivors. Those who don't manage their human resources effectively will be losers in the eyes of stockholders and could cease to exist as commercial-banking institutions. • •

Let's Join to Remove Inequities Curbing Banking's Potential

By John W. Woods

IT IS DIFFICULT today to pick up a newspaper or magazine without seeing at least one article on interest rates or some financial product. In fact, most magazines directed to the working-woman audience seem to be full of advice or suggestions about which financial products to select and from whom they should be purchased.

There are more financial services available to the consumer today than many of us who have spent some time in the banking industry would have dreamed possible 20 years ago.

The recent era of extremely high interest rates attracted the attention of a vast new audience. Realistic pricing of services and introduction of new investment opportunities have given consumers more reason than ever before to shop carefully. Consequently, we are dealing with a customer base that is far more sophisticated about financial-product selection than in the past.

Growth of this large market has attracted nonbanking companies, most of them well known, whose activities have served to expand the market even further. Many of these companies have spent decades sharpening their skills in attracting customer allegiance and in packaging their products to fulfill consumer needs. Because of their size, nationwide operations and lack of regulatory restraint, they have enormous potential for offering a wide variety of financial products tailored to the specific desires of a consumer at a particular point in his or her life and adopting these products to future needs as customer requirements change. All these developments have been healthy for the American economy.

Unfortunately, however, the consumer still remains shortchanged because of regulatory and artificial restraints established by laws that have outlived their usefulness. Banks are not allowed to offer the full range of services our customers desire. The magnitude of that restraint can be seen in the change in market share of financial assets held by commercial banks over the past 30 years. In 1950, commercial banks held more than 50% of those assets. Today, that percentage has decreased to about 35%.

There also is no question that competition is more severe today for commercial banks, but we should not overlook the many achievements of the banking industry. We offer, despite the heavy hand of government regulation and an archaic legal framework, many innovative products and services to our customers. Banks have been quick to change over the years and respond to new challenges. Indeed, profitability for banks has been remarkably consistent, and they have been able to serve many of the economy's needs in an important fashion.

That is the past, however, and we need to redefine the debate about nonbank competition in terms that present the issues in their proper light. First of all, it simply is unfair to American consumers to deny them the benefits of bank competition in appropriate financial-service markets. Additionally, it is harmful to the American economy to impose inefficiencies in delivery of service based on laws designed for problems that no longer exist. Let us not be bashful about pointing out it is the consumer who ultimately bears the cost of inefficiencies in our economy.

While we as bankers have done much to overcome these challenges, there are limits on what we can do. We need product and geographic deregulation. We have superb retail-delivery systems already in place. There is minimal incremental cost to adding appropriate services to that delivery system. We should be able to follow our customers and service their demands in our highly mobile society. The nationwide nonbank giants should not have a monopoly on providing certain financial services to the American consumer.

What can we do? Divisions within our industry are a major problem for us.

First, a concerted effort should be made to persuade our trade associations to bury parochial differences and present a unified front to Congress and state legislatures.

Second, we should focus on keeping the issue clearly defined for what it is — serving the American consumer better.

Third, we should not abrogate to our competition fulfillment of certain consumer-financial needs in this new era.

Much has been made of having a "level playing field." I, too, wish we could have a level playing field. However, it's even more important to be able to put on a uniform and be allowed to play on the field at all. The challenge to the banking industry affects all of us, no matter what our size. Now is the time for small and large banks to join in a united effort to remove the inequities that keep us from achieving our full potential. • •

John W. Woods is chairman/CEO, AmSouth Bank and AmSouth Bancorp, Birmingham, Ala.

Slater

(Continued from page 10)

toward geographic deregulation when the Senate approved a bill last fall that clarified the states' right to form interstate-banking regions. The House declined to act on the bill, but it still represented an important step in clarifying the authority of states to form regional-banking compacts.

Many experts also agree that between now and 1990, regional compacts will and should serve as a transition, and *only a transition,* to full-scale nationwide geographic deregulation. Were full nationwide interstate banking permitted *immediately,* it's probable that few Midwest bank holding companies would survive the onslaught of the large multinational institutions on the East and West coasts. Midwest bank holding companies of any consequential size would be early

targets of these giant banks. One consequence would be ownership of most large banks by holding companies outside of the Midwest region; i.e., by institutions which might or might not continue a midwestern business orientation.

Immediate nationwide deregulation, therefore, would thwart growth of major regional-banking institutions, creating an undesirable concentration of banking assets among huge financial institutions located in a few of America's largest cities. Regional geographic deregulation provides the opportunity for existing Midwest holding companies to combine into perhaps 10 to 20 powerful Midwest holding companies big enough to survive and compete in 1990. Regional-banking institutions headquartered in the Midwest have as their primary focus the economic health of this region.

Many community banks also will survive and prosper in this environment as regional banks will develop broader capabilities for serving these independent banks.

Regional deregulation may or may not be economically sound for the Midwest, depending on how the legislation is designed. Three pitfalls should be avoided as regional deregulation legislation is shaped:

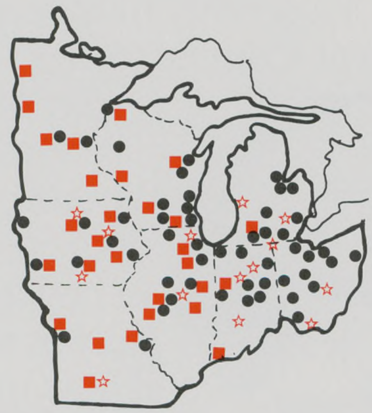
1. *Inaction*, because doing nothing is no longer an option and it would greatly penalize this area when nationwide geographic deregulation evolves.

2. *State-by-state geographic deregulation* because that approach only accentuates the economic advantages of large banks and powerful states over smaller banking institutions and less powerful states;

3. *Selecting the wrong states*, which would result in a grouping of states with dissimilar economic characteristics and dissimilar banking needs.

There are numerous benefits of well-conceived regional deregulation, including 1. Greater economic development and growth of Midwest business; 2. A banking system headquartered here and responsive to the Midwest; 3. Banks large enough to serve Midwest business; 4. Banks large enough to prosper and compete with large multinational banks; 5. A stronger, more viable Midwest economy.

Selecting the region for deregulation must be based on economic criteria: 1. The region must be large enough to be recognized as important relative to the national and world economies of which it is a part. 2. The region should be homogeneous in order to capture maximum economic benefit, and it should enhance existing economic strengths. 3. The region should not create needless barriers to natural growth.



Dots indicate manufacturing centers; squares indicate agricultural production; stars indicate consumer durables.

Using these criteria, the Midwest region should include the eight states of Illinois, Indiana, Iowa, Michigan, Minnesota, Missouri, Ohio and Wisconsin.

This eight-state area represents only 12.7% of the total land area in the United States.[1] However, its population represents 22.8% of the U. S. population, which is the highest percentage of all regions in the country.[2] Personal income is 23.5% of the total U. S. figure and, again, the highest of any region.[3]

The Midwest's manufacturing value added is 32.7% of the U. S. total and also the highest of all regions.[4] Agricultural production represents 30.8% of the U. S. total, highest in the nation.[5] Both manufacturing and agricultural exports[6, 7] in the Midwest are the highest of all regions, representing 34.7% of the U. S. total, respectively.

Comparing the various natural regions in the U. S. with other countries of the world, the Midwest ranks fifth in the world in terms of gross domestic product and is surpassed only by the U.S.S.R., Japan, West Germany and France.[8]

Not only is the Midwest important for its size, but the area is set apart from the rest of the United States by the homogeneity of its industrial base across all eight states. Dominant industries include food processing, manufacturing of automotive, construction and farm equipment and production of consumer durable goods such as appliances and electronics.[9]

The heart of the region is dominated by the Milwaukee-Chicago megalopolis. The 12-county area comprised of southeastern Wisconsin and northeastern Illinois, while representing only 1.3% of the Midwest land area, accounts for 16.4% of its population, 17.8% of manufacturing output and 19.1% of the region's personal income.[10]

Wisconsin public policymakers should attempt to strengthen existing economic ties between Milwaukee and Chicago. Commerce should not be inhibited by an artificial, political boundary separating Wisconsin and Illinois. Wisconsin should avoid laws that would pull Milwaukee and Chicago apart or put them in different interstate-banking regions.

Based on economic criteria and Midwest regional characteristics, the broad outline for Wisconsin legislation is set forth below.

Wisconsin should enact a law that permits, on a regional, reciprocal basis, acquisition and merger of Wisconsin banks and bank HCs by banks and bank HCs headquartered in the other seven states of the Midwest region; namely, Illinois, Indiana, Iowa, Michigan, Minnesota, Missouri and Ohio.

The law should stipulate that only banks and bank HCs headquartered within this eight-state region be permitted to acquire and merge with banks and bank HCs headquartered within the region.

Because of the economic dominance and interdependence of the Milwaukee-Chicago megalopolis, Wisconsin's law must preserve and enhance the free movement of banking resources within the vital 12-county area of southeastern Wisconsin and northeastern Illinois. That is, any bank HC in this entire 12-county area must have free and equal access to acquire and merge with banks and bank HCs throughout this 12-county megalopolis.

Accordingly, Wisconsin's law should become effective when any three of the other seven states, *including Illinois*, enact substantially compatible laws.

Clearly, regional deregulation must be designed prudently if it is to enhance the economic growth and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prosperity of the states involved. The Midwest region, as defined, provides a prudent region and with enactment of regional-banking deregulation, as described, will enhance the economies of all participating states. ● ●

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8. World Rankings By National Income 1981. "Gross Domestic Product in U. S. Dollars — 1981," *1984 Reader's Digest Almanac*, pages 476-479. Compiled from United Nation's publication, *Statistical Yearbook*, and other U. N. sources. U. S. regional income based on each region's percent of total personal income × national GDP.
9. Industry Mix. Compiled from *Places Rated Almanac*, Richard Boyer & David Savageau, Rand McNally & Co.: Chicago, 1981, pages 338-360.
10. Megalopolis Relative to Region: Land area (square miles); 1981 total personal income; 1977 manufacturing value added. All from: *County and City Data Book, 1983*, U. S. Department of Commerce: Bureau of the Census, U. S. Government Printing Office, Washington, D. C., November, 1983. 1983 population: *1984 Survey of Buying Power*, pages C62-C68, C209-C212.

Brandin

(Continued from page 11)

develop in addition to those already identified.

Fortunately, Boatmen's does not have any significant loan problems in those areas or in any other segment of its portfolio. For that reason, we do not anticipate any change in loan policy although we are emphasizing throughout the organization the necessity of following proved disciplines in extension as well as servicing of loans of all types.

Establishment of nonbank banks is just one more assault on banks' traditional business, highlighting once again the inequity of current banking law and regulation. How many of these units actually will be established and how effective they will be against established banks is questionable.

Pressure will continue to be put on federal and state legislators to permit expanded authority in such related lines as securities, insurance and real estate. Interest in this type of expanded authority varies widely in the industry. For regional bank holding companies like Boatmen's, the primary interest and thrust will be for interstate expansion. While it is unlikely that any federal legislation will be passed in 1985, it is likely that many states will pass legislation to permit regional compacts or contiguous state expansion with reciprocity.

For Boatmen's, following acquisition of CharterCorp of Kansas City, we will become the largest banking organization in Missouri and the Missouri trade territory, with assets of over $6 billion. As such, we will be well positioned to take advantage of any opportunities as they develop. ● ●

Kemper

(Continued from page 10)

term foreign deposits, which were controlled by fickle Asians and Arabs, and that if Continental had had a more stable deposit base from Mid-America, its problems wouldn't have occurred — thus the need for branch banking. That line of reasoning or wisdom is pure bunk. The reason Continental failed was extremely poor loan judgment! If the bank had the opportunity to reach out for more domestic deposits, it probably would have made even more bad loans.

To do something well, you have to be trained and experienced, and many people getting into the traditional banking business today have neither the training nor the experience. Consequently, many have failed and many will fail. Many entrepreneurs and speculators who have gotten into the banking business, because they felt that was where the honey was, already have failed or are having many problems keeping their banking interests alive and well. Other big companies have gotten into the business in our areas on a shoestring and are not playing cricket with the public. One big New York company has a subsidiary in Kansas that is taking deposits, and of the $1 million in initial capital, has lost half of it in one year. Its deposits are not insured by the FDIC, but by an insurance company I have never heard of before. On the face of it, it is one of the weakest institutions in the state.

I, for one, feel New York City banks should not lobby for national branch banking in states here in the Middle West until they clean up their own acts. The very ones that are lobbying the hardest have enormous problems in their own backyards. The ones that have far more foreign loans that are in trouble than they have capital and more domestic loans in trouble should be taking half their before-tax profit and putting it into a reserve until they get such loans down to 50% of face value. Instead, they are taking some of this money that should be going into reserves and pushing across the country, spending millions of dollars in lobbying to try to get into the deposit and loan business in the Middle West. These companies continue to pay dividends that take a potential buildup of capital out of the bank; i.e., Continental Bank paid a dividend in April and was, in essence, closed a short time later.

These banks don't care what it costs or what they lose. All they care about is market share. Unfortunately, most money-center banks are being run by men who are principally marketing men and not loan men. In the old days, men who ran the banks were principally loan men, but today, market-share, regardless of the consequences, seems to be the only criterion for leadership.

In my own opinion, lending still is the guts of banking. It doesn't do any good to quadruple your market share if you go broke doing it. My father always said, "It doesn't do a bit of good to say, 'The other banks were doing it, too' if your bank is just as broke as theirs are."

Unfortunately, these money-center banks will do things in our areas in the coming year that will tempt us to want

to compete, but if we do, it will cause us to lose money and weaken ourselves just as they will lose money and further weaken themselves. We must not be tempted that way, and we must use our influence with Congress and state legislatures to keep their false banking practices and shallow thinking out of our area for the good of the public and the economy. If they eventually absorb the good regional banks, there will be few good, well-run banks left, and the whole business could much more easily be nationalized. Right now, the trend is for many corporate treasurers, who are thinking soundly, to place their banking business with the solid, well-run regional banks in a move to better protect their companies. I have read several articles about this trend recently.

So, in summation, I think our greatest challenge in the year to come is to get the money-center banks to clean up their own acts before they attempt to come across the country and pervert the good banking practices of many of the fine regional banks. ● ●

Stewart

(Continued from page 11)

six months and over the last year are displayed below:

Region	Annualized Growth Rate Last Six Months	Annualized Growth Rate Last Year
The Plains	8.8%	9.1%
Metroplex	8.7	10.6
East Texas	5.2	6.8
Border	10.9	7.7
Central Corridor	12.8	14.7
Gulf Coast	6.8	4.2

Not only has growth in the metroplex and central corridor been at a double-digit pace over the last year, the border and central corridor regions remain at double-digit-growth rates in the latest six-month period. While growth in most areas has slowed some, growth in the border and Gulf Coast areas has accelerated.

The border region was hit particularly hard by peso devaluations in 1982, but the economic health of Mexico has improved dramatically in 1984. Increased certainty about the value of the peso has contributed to a return to more normal trade patterns; as a result, employment growth in the border area should be a positive for Texas in 1985.

The energy industry affects primarily three areas that have rebounded in 1984: The plains, east Texas and Gulf Coast regions. While the current softness in oil prices has dampened the typical year-end surge in drilling activity, it's likely that December, 1983's, level of rig activity will be equaled in 1984. The oil industry is cyclical, but because the U. S. economy still is in expansion and several foreign nations' energy use should be up in 1985, we expect the energy industry to be a modest plus for Texas in 1985.

Among other factors affecting our growth in 1985, relocation of businesses to the state has and will continue to provide a dynamic synergism to economic life in Texas. The metroplex and central corridor regions particularly have benefited from corporate relocations. Infrastructure needs, both public and private, generated by our population growth, will continue to stimulate real-estate activity in 1985. And, finally, economic activity among defense contractors should provide a boost to Texas in 1985. Defense contractors in Texas obtain the third-highest percentage of defense contracts in the U. S., and defense backlogs today are about double their level in 1980.

In conclusion, the Texas market is very strong and should remain so in 1985. While growth in our major metropolitan areas often is in the double-digit area, total employment outside those areas is 5% above last year's level. Manufacturing employment outside of Texas has stalled over the last three months, while manufacturing employment in Texas continues to grow at nearly a 4% annual rate over the same period. Indeed, the Texas economy is fortunate to begin 1985 with considerable potential. ● ●

Roberts Leaves St. Louis Fed To Take Over Chicago Thrift

Theodore H. Roberts resigned as president, St. Louis Fed, last month to become president/CEO, Talman Home Federal Savings & Loan, Chicago.

ROBERTS

Talman is said to be the largest savings institution in Illinois with $7 billion in assets and 60 branches.

Mr. Roberts' appointment is part of an attempt to revitalize the ailing thrift with new top management. The S&L is under the control of the Federal Savings and Loan Insurance Corp.

Mr. Roberts was chief financial officer at Harris Bank, Chicago, prior to assuming the St. Louis Fed presidency in January, 1983. He had been with Harris since 1953.

Banks Gain in IRA-Keogh Money

BANKS and credit unions increased their shares of IRA and Keogh assets during the first half of 1984, according to the Employee Benefit Research Institute (EBRI). Banks showed the largest percentage increase.

Banks posted a 3.6 percentage-point increase during the period, giving them a 33.4% share of the $120.2-billion market. Market share for S&Ls dropped 1.7%, to 26.4%. Also losing ground are mutual savings banks (down .8%, to 7.8%), mutual funds (down .5%, to 16%), and life-insurance firms (down 1.9%, to 10.1%).

Total assets in IRA and Keogh accounts increased 19% during the six-month period, according to EBRI. Asset growth during 1983 was 60%. In terms of absolute dollar amounts, assets have grown fairly steadily since 1981 — with an average increase of $30 billion each year — but the increase in total asset amounts causes the annual percentage increase to get smaller. This suggests a leveling off of participation rates among those eligible to open each of the accounts.

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TECHNOLOGIES

Financing Service-Oriented Sector To Be Focus of Late '80s Lenders

By Patrick L. Flinn

THE FIRST HALF of the 1980s was spent trying to deal with inflation, recession and unemployment. We hope most of this is behind us for the second half of the '80s. The prospect for 1985 appears to be one of growth and prosperity. Financial institutions should benefit from new loan growth and proper management risk in their current portfolios.

Commercial lending in the latter part of the 1980s also will require additional skills to finance an economy that is increasingly service-oriented. The five Cs of credit will still predominate, but makeup of cash flows, income statements and balance sheets will be different. We've already seen some increased lending activity in this sector. What we have seen is only a small fragment of what we can expect to see in 1985 and future years. How we deal with this opportunity will influence our organizations.

Patrick L. Flinn is pres., Robert Morris Associates, and e.v.p., Citizens & Southern Nat'l, Atlanta.

We will continue to finance our manufacturing and production sectors, but they will become a relatively smaller segment of our commercial and industrial loans in 1985 and the future. Distribution and service sectors will challenge our industry's ability to adjust to change. Increased technology will require better-educated, more sophisticated lending staffs.

In addition to a changing economic environment, our organizations will need to continue to emphasize quality control. This is best illustrated by the large number of bank failures during 1984. A back-to-the-basics approach will be necessary for our organizations to participate in real growth.

Continued emphasis by regulatory authorities on reserves for loan-loss adequacy will cause most institutions to increase their analyses in establishment of their provisions and reserves. This, in some cases, will require additional provisions. Our industry must take a proactive position in establishing adequate tools for properly establishing our reserves. If we do not, the regulatory authorities will have no alternative but to establish methodologies we must use. While we continue to experience an expanding economy, it is appropriate to reserve for tomorrow's losses. No one plans on having charge-offs, but some loans always will turn bad. Rather than wait, we need to be reserving for those loans now when the economy is strong and loans being negotiated are of a higher quality. When we undergo a downturn, we already will have reserved for them. The year 1985 is one of the years we should take definite steps to increase reserves.

Increased geographic expansion also will take place during 1985. This will come from many sources, including, but not limited to, regional interstate pacts and nonbank banks. All these expansions will tax the capacities of our current staffs. An increased number of lending and credit personnel will be necessary. Back-office support staffs also may need to be expanded.

The strength to access and train these additional personnel will be in the hands of the best performing financial institutions. They're the ones that have recognized the need for hiring and training quality people. They are committed to continued training at all levels. They have the flexibility to move staff geographically in order to transfer their corporate philosophies. The movement of staff is not creating a void, but provides an opportunity for someone's growth.

In summary, 1985 will be a year that requires us to lend an ever-increasing amount of dollars to the distribution and service industries. Our reserve for loan losses will be the result of a more sophisticated analysis and generally will increase in an expanding economy. Finally, financial institutions committed to continued education and training will hire and train an increasing number of personnel. This increased number will be used to staff opportunities created by geographic expansion. ● ●

A/L Mgt., Acquisitions, Nonbanks Are Concerns of Big-Bank CEOs

MORE THAN HALF the chief executive officers of the nation's largest banks expect their institutions to acquire nonbanking businesses in the next five years. Their favorite targets: insurance companies (72%) and real-estate/mortgage-related firms (35%).

The CEOs' five most critical concerns are led by asset/liability management, followed in order by loan losses/risk exposure, competitive environment, business development and deregulation/reregulation/strategic planning.

Sears, Roebuck will pose the major competitive threat in CEOs' markets in 1990.

These are some of the key findings from a November survey of the 2,235 CEOs of all U. S. commercial banks with assets of more than $100 million. This third annual survey was conducted by the U. S. offices of Egon Zehnder International, a worldwide management-consulting firm specializing in executive search. CEOs surveyed control 83% of all U. S. commercial-bank assets. Over 33% responded to the survey, termed by Egon Zehnder as an unprecedented response rate among so large and so senior a group.

The survey found that despite CEOs' acquisition plans, acquisition efforts will not slow within their own industry. Almost 70% of them expect to buy other banks, according to the survey, and another 25% think their institutions will be *acquired* within five years.

Critical Concerns. Egon Zehnder points out that with poorly managed banks continuing to falter at 1983's high levels, it's not surprising that the most frequently cited critical concerns mirror CEO choices of last year. Significantly, *loan losses/risk exposure* jumped to second place from eighth in 1983, and *deregulation* dropped from second to fifth.

In other noteworthy shifts, *interstate banking* (which tied with employee relations as No. 14 in a list of 23 critical concerns) was cited by twice as many CEOs as in 1983, and the citations increased dramatically as bank

(Continued on page 44)

Economy to Grow Through 1980s, But at Relatively Modest Pace

The significance of this prediction for banks and their customers, from a business standpoint, is that, from year to year, changes in business conditions are not likely to be great. This means that conditions are much more within the control of bank managements than outside their control.

By Roy E. Moor

IF I were to give a title to this presentation, it essentially would be "More of the Same"; that is, we will see more of the same experiences we have had over the last six to nine to 12 months, more of the same in almost every market in which we are involved through 1985.

If you want to make a forecast for your own operations, a general one applicable to most markets in which you individually deal for 1985, it's likely to be similar to the last three to five months of experience (as of the date of the First Chicago conference).

Last year, I discussed three general characteristics of the overall business environment as I foresaw it, not only for 1984, but for the rest of the decade. I want to repeat those three characteristics before going into 1985 specifics.

One, I saw relatively little fluctuation in any financial markets during the rest of the decade. My view was that, some time in the second half of 1982, we entered into a long-term horizontal trading range for every fixed-income market that will prevail throughout at least the rest of the decade and will provide relative stability in every financial market. I think that is what we saw in 1983; I think it is what we have seen in 1984, with rates going up in the early part of 1984, then coming back down to about the same levels they started at when last year began.

My specific forecast for 1985 is that rates will be rising, but modestly. Between now and December, 1985, short-term rates will increase (in about every short market) 100 basis points — about 1% above today's levels. That is an extraordinarily modest change in the third year of a business-cycle recovery.

Within the bank, my department has been asked what the up-side risk in those markets is because the faster those rates increase in those markets, the worse it is for our earnings. The maximum up-side risk I think has any likelihood of occurring in 1985 is 150 basis points — 1½% in any short-term, fixed-income market. One characteristic, therefore, of the overall environment is the relatively modest changes either upward or downward, essentially relative stability, in all fixed-income markets.

A second condition I mentioned last year essentially was the same characteristic with respect to the U. S. economy. I see the economy generally growing throughout the balance of the decade. However, rate of growth is likely to be, now that the recession and recession recoupment in the early stages of recovery are behind us, relatively slow — slow by comparison to the hyper-inflationary period of the 1970s and, indeed, to some of the rapid growth rates we have experienced in prior decades.

But the key nature of the forecast is that the swing in business conditions from peak to trough to peak is relatively small. The amplitude of the swing is blunted, or held down. The significance of that from a business standpoint, for you and your bank customers as well as for us, is that from year to year, changes in business conditions are not likely to be great. What we have seen is what we are likely to see in an ensuing year with only minor changes. What that, in turn, means for managements of banks is that conditions are much more within our control than outside our control.

The business environment remains relatively similar from year to year. In

Pictured at First Nat'l of Chicago's 38th annual conference of bank correspondents last November are (l. to r.): Nicholas J. De Leonardis, v.p./ch., money committee, municipal finance division; Walter C. Bean, v.p., domestic equity division, First Chicago Investment Advisors; Edward M. Roob, s.v.p./v. ch., asset/liability management committee; Roy E. Moor, s.v.p., chief economist, economics department; and James K. Suhr, s.v.p./head, U. S. financial institutions group. All appeared on program.

Roy E. Moor is s.v.p./chief economist, economics dept., First Nat'l, Chicago. This article is an edited transcript of a report presented in November by Dr. Moor at the bank's 38th annual conference of bank correspondents.

1985, I see the economy growing throughout the entire year, but relatively modestly, just as it has in the last three to five months.

The third condition I mentioned a year ago was a continued low inflation rate. This has a lot of significance, both in the way we manage our own affairs and the way in which businesses generally manage their affairs. Price increases are not likely to be occurring in any dramatic form in any market we know of in 1985. The inflation environment for all of 1985 is similar to what we have experienced in 1984, and the differences are so modest that an economist should not worry about trying to forecast them. What this means, therefore, is a much heavier emphasis on cost control/cost management than any of us experienced in the 1970s or in prior periods.

These three conditions are expected to continue not only in 1985, but for the rest of this decade, as I see it.

Specifics of 1985. I expect business-loan demands to be rising about 15% in terms of external credit requirements in 1985 compared to 1984. That is a strong number. It was driven much more in the past not so much by a need for working capital as by a need for expansion, for modernization, for upgrading of capital equipment in particular.

There are some qualifications to this forecast, and I would like to stress them.

First, the growth is largely in small- and medium-sized companies — the so-called middle-market area — rather than in large companies. This is similar again to conditions in 1984, when the greatest growth occurred in that particular market area.

Second, while I am comfortable with the forecast — and the ones I have given in the past generally have materialized with respect to overall business-borrowing requirements — I am not as comfortable in terms of forecasting distribution or mix of those borrowing requirements between types of markets. As we know, those markets have become vastly more competitive than in the past; therefore, there might be an increased shift again in 1985, as in 1984, relatively toward the commercial-paper market. There might be — and I cannot assess this — some shift relatively toward financing in longer-term markets as contrasted with the heavy orientation in 1984 to the shorter end, even though I continue to see a positive yield curve prevailing between short and long markets, not only in 1985, but throughout the rest of the decade.

Third, foreign sources of funds have become vastly more significant potential competitors for essentially all types of businesses. Not only the largest corporations in the U. S., but all types of businesses in this country are likely to be drawing increasingly on such sources.

I already have mentioned the need for cost containment among our business clients. Some of the same factors I stressed last year, such as continued high level of interest rates, competition from other banks and other financial intermediaries, are all there. There's one additional factor that probably is becoming more dominant in many business markets than ever before, and that is the toughness of foreign competitors, not just in the banking area, but in every aspect of business. The reason for stressing this for 1985 is that the competition is determined largely by the value of the dollar in the preceding year. Regrettably, I see increased foreign competition in every financial and real market I know of in 1985 compared to 1984. Even if

How Will Bond Markets Fare in Coming Year?

THE BOND-MARKET OUTLOOK was discussed in November at First National of Chicago's annual conference of bank correspondents by Nicholas J. De Leonardis, vice president/chairman, money management committee. Here is how he sees it:

First, it should be recognized that the Fed has a great deal invested in its fight against inflation, and while it's desirous of seeing the current recovery continue, it will not abandon its anti-inflation posture.

Second, until the post-election government, President and Congress are prepared to come to grips with the deficit, the federal government will continue to exert pressure on the marketplace through its huge deficits, which are projected to exceed $200 billion.

Third, credit needs of our states and political subdivisions are projected to remain moderate. This has been a result of increased taxes and improved fiscal positions resulting from the current recovery.

Fourth, credit demands of the private sector are expected to remain strong during the forthcoming year, and their requirements will be felt particularly in the banking system and commercial-paper market. Balance sheets of nonfinancial corporations could come under pressure as liquidity diminishes and short-term- to long-term-debt ratios reflect greater reliance on short-term debt.

Fifth, long-term interest rates during the current recovery have not responded as in previous upturns in that they have trended higher in the early stages of the economic advance, as opposed to the downward bias demonstrated in past recoveries.

Sixth, despite the higher level of long-term yields, current spread relationships between short- and long-term rates seem to be tracking, as in the past, and suggest that, as we enter the third year of the recovery, we can expect a further flattening in the yield curve. As corporations increase their dependency on short-term debt, there's also a remote possibility we could see an inversion in the yield curve.

Seventh, interest rates during the next year will remain under pressure, and the trend should be for higher levels; although, in Mr. De Leonardis' judgment, highs in interest rates for this cycle already occurred last June. Further, the higher than trough levels of interest rates during the first two years of this recovery already have slowed down certain interest-rate-sensitive sectors of the economy; whereas, in previous cycles, this phenomenon did not occur until the third year of a recovery. This overall slowing in mid-cycle will have the effect of tempering the extent of further increases in bond rates. Finally, if the post-election government does demonstrate a willingness to come to terms with the deficit, we possibly could see long-term rates peaking from current levels between mid-year and the third quarter of 1985. Therefore, Mr. De Leonardis expects five-year treasuries to peak at 12⅜%-12⅝%; long-term governments, 12¼%-12½%; "A" Moody's, 14¼%-14½%; and the Bond Buyer's Index of tax-exempts, 10¼%-10½%, all of which are well below June, 1984, levels.

the dollar declined somewhat in value — further in value relative to its peak a few months ago — and I do expect some modest decline as we go further into 1985, it will be little relief or benefit to any businesses as we go through this year.

Agricultural Picture. As I look at the agricultural picture, it is almost unremittingly bleak. Production is up for most crops, suggesting continued price weakness. I don't foresee any government programs that will benefit agriculture this year. Foreign demand for agricultural products generally is increasing, but not for agricultural products from the U. S. We consistently are losing market share in world agricultural markets and in world agribusiness markets as a result of the strength of the dollar in 1984. We will continue to lose market share throughout all of 1985.

A year ago, I talked about the transition from fixed- to variable-rate mortgages. As I see it today, that transition is complete. Basically, the mortgage market for residences now is essentially 100% variable-rate market and will not change in the foreseeable future. In 1985, I expect there will be somewhat less new-home construction in virtually every locality than there was in the early months of 1984. We no longer have as much of a backlog of new-home demand, and the speculative fervor that existed in early 1984 as a potential for rising home values has largely dissipated.

Moreover, with cost cutting so universal among companies, there are likely to be fewer employee transfers and, therefore, less turnover of existing homes this year. I expect that in 1985 there will be no particular changes in home values relative to 1984. There will be about a million and a half new-home starts nationwide and somewhat reduced demands for new mortgages compared particularly to the early months of 1984.

Aside from mortgages, consumer-related loan demand should grow throughout 1985. This growth, however, will not be as vigorous as we saw in the first six months of 1984. A year ago, I had forecast that installment-credit consumer-loan demand generally would be rising about 9% year over year; that turned out to be fairly accurate. For 1985, by comparison, I expect an increase of about 5%. There are some positive aspects to this.

First, the consumer is becoming more liquid, is increasing his financial assets, a major source of new deposits for most of us in banking. Moreover, household balance sheets are becoming stronger, and credit-worthiness in the consumer sector is increasing from already reasonably healthy levels. A year ago, I said general stability finally had arrived in deposit markets after the substantial adjustments brought about by deregulation. Through 1984, as I said a year ago, depositors were likely to change their holdings in a more balanced way under a better-understood set of conditions. Repeat the same thing for 1985. What you have seen by way of deposit changes in all the various forms of deposits is likely to be repeated, at least in 1985.

The consumer remains extremely interest sensitive, and so we are getting increasing competition from alternative types of short-term liquid instruments. I expect that competition to intensify in 1985, but the consumer, at the same time, is more liquid, and there's a greater pool of funds from which to draw deposits from the household sector as we go through this year.

These deposit forecasts by themselves point to a further pinching of interest-rate spreads within the banking industry in 1985, and that, therefore, re-emphasizes the need for cost containment and cost controls in every area in our own operations as we go through the year.

One major cost continues to be labor. I had forecast a year ago that average hourly earnings for bank employees would rise only about 4½% in 1984. Lo and behold, that turns out to have been a more accurate forecast than I really believed when I made it a year ago, and it continues to be my forecast for 1985 over 1984.

Essentially, our interest-rate forecasts, however, are not based on Fed policy. I think the Fed will remain a neutral factor in most financial markets during 1985.

Our major expectation for rising interest rates is based on business-credit demands reasserting themselves as we go through 1985. One negative factor pushing up interest rates is a significant slowdown in business cash flow and in business financial conditions, forcing them increasingly to external markets.

By now, we can reasonably trace the economic consequences to our industry of this challenging new world in which we now operate.

- One of those consequences is that at least some portion of the industry must continue to tighten its belt.
- A second is that we must scrutinize credit quality of our customers and their potential for survivability as never before.
- The third is that we must all look to new products, new services and new markets to complement our operations.
- Finally, to strengthen our market positions, all of us must expand our own interrelationships and the ways in which we do business together. • •

Policy Frameworks Outlined For Capital-Ratio Policy

COMPONENTS for an effective capital-ratio policy were outlined at First National of Chicago's conference of bank correspondents in November by William J. McDonough, executive vice president/chief financial officer, asset/liability management committee. According to Mr. McDonough, they essentially amount to a checklist for creation of proper balancing of risk and return throughout a bank's operations. These components are:

- A policy framework for interest-rate risk management that explicitly measures risk inherent in mismatching and relates it to both the profit potential of mismatching and risk capacity of the organization.
- A policy framework for liquidity management that accurately measures a bank's funding capacity and identifies ways to improve that capacity.
- A policy framework for credit risk management that seeks to constrain aggregate credit risk through careful analysis, proper pricing, diversification and aggressive credit risk management.
- A policy framework for strategic planning of growth that properly identifies risk and return trade-offs in both new and existing business opportunities and explicitly incorporates appropriate aggregate risk constraints.
- A policy framework for capital management that continually encourages access to new sources of capital.

NEWS
About Banks & Bankers

ILLINOIS

Service Aids Corporations Selling Autos to Employees

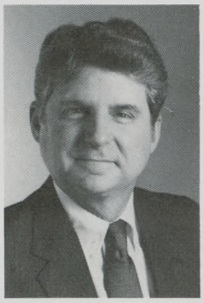
Cole-Taylor Financial Group, Northbrook, has a new program to aid corporations in transferring ownership of company-owned autos to employees.

The program is believed to be the first of its kind and provides an alternative to firms affected by recent changes in federal tax law that limit their ability to take full advantage of investment-tax credits/depreciation on company-owned vehicles used by employees.

The program enables firms to sell autos to employees in a single transaction. All employee buyers receive 100% uniform Cole-Taylor purchase financing at preferred corporate simple-interest rates.

New federal tax regulations force firms to maintain extensive records on auto usage. They can take tax credits and depreciation only to the extent an employee drives a car for actual business-related purposes. Transferring ownership enables firms to deduct reimbursements to employees for driving costs as a business expense.

Nine of the current 14 non-employee directors of Continental Bank, Chicago, will not stand for re-election at the annual stockholders' meeting in April. The action is part of a board restructuring announced last July by the FDIC as a requirement in connection with FDIC assistance to the bank. In addition to the nine, two other directors left the bank prior to the end of 1984. They are Vernon R. Loucks Jr., president/CEO, Baxter Travenol Laboratories, and Weston R. Christopherson, former chairman/CEO, Jewel Companies. Mr. Christopherson has been named chairman/CEO, Northern Trust Corp. The nine directors not standing for re-election include Raymond C. Baumhart, president, Loyola University; James F. Beré, chairman/CEO, Borg-Warner Corp.; William B. Johnson, chairman/CEO, IC Industries; Jewel S. LaFontant, senior partner, Vedder, Price, Kaufman & Kammholz; Robert H. Malott, chairman/CEO, FMC Corp.; Marvin G. Mitchell, retired chairman/CEO, CBI Industries; Paul J. Rizzo, vice chairman, IBM Corp.; Thomas H. Roberts Jr., chairman/CEO/president, DEKALB AgResearch; and Blaine J. Yarrington, retired executive vice president, Standard Oil of Indiana. The nine are expected to remain on the board until the shareholders' meeting.



CLINCH

Cole-Taylor Financial Group, Inc., Northbrook, has named J. Houstoun (Howie) M. Clinch Jr. senior vice president/administration and consulting and Paula L. Barnett training/development manager. Mr. Clinch moved from Peat, Marwick, Mitchell & Co., Chicago, and Ms. Barnett went to Cole-Taylor from Bankers Life & Casualty Co., Chicago.

James E. Welch has been elected president/CEO, Corn Belt Bank, Bloomington. He formerly was president, First National, Champaign. Mr. Welch succeeded Harry M. Petrie, who retired after serving as president for 13 years.

Weston R. Christopherson has been named chairman/CEO/director, Northern Trust Corp. and Northern Trust Bank, Chicago. He succeeds Philip W. K. Sweet Jr., who will serve as a consultant for an 18-month period. Mr. Christopherson is a retired chairman/CEO, Jewel Companies, and formerly was a director of Continental Illinois National. No other top-management changes were announced. Mr. Sweet announced his intention to retire last April, subject to selection of his replacement. In other action, the HC has agreed to acquire a minority interest in Stotler & Co., Chicago-based futures-commission merchant. The agreement is subject to regulator approval and provides for Stotler & Co. to clear all futures transactions for Northern Futures Corp., futures-commission-merchant subsidiary of the HC.

Accreditation Bestowed

The Office of the Commissioner of Banks and Trust Companies of the State of Illinois has become the first state banking department in the U. S. to receive full accreditation in the Conference of State Bank Supervisors (CSBS) accreditation program.

The program was designed by CSBS to provide state banking departments with an independent external evaluation of their operations and personnel. A similar program was recently recommended by the Task Group on Financial Services chaired by Vice President George Bush.

The evaluation leading up to accreditation was conducted during the past year and included on-site reviews of the department's operations and personnel.

William C. Harris, Illinois commissioner of banks and trust companies, said the accreditation "paves the way for a decreased federal regulator presence in the state-chartered banks in Illinois."

Elmhurst National has named Robert G. Girolamo Sr. and Walter R. Johnston vice presidents/corporate banking. Both will be expanding the bank's overall commercial-loan portfolio through loan origination and new-business development. Mr. Girolamo formerly was with Bank of Elmhurst; Mr. Johnston formerly was with First Chicago Credit Corp. In other action,

the bank has promoted Craig W. Tower to assistant vice president/consumer loans. He joined the bank in 1979.

Robert T. Stevenson Jr., has been elected president, Commercial National, Peoria, succeeding David E. Connor, who has been named chairman/CEO. Mr. Stevenson formerly was executive vice president and has been succeeded in that post by Bruce F. (Skip) Snyder, formerly senior vice president and trust division head.

The Illinois Department of Commerce & Community Affairs will sponsor a workshop to assist bankers and economic-development officials determine which firms present good credit risks. It will be held January 21-25 at the Springfield Hilton. The National Development Council will conduct the workshop that is geared to bankers, loan officers, city-planning officials, mayors and economic-development/community-action-program officers. Registration is $250 and can be made through Tony Scillia at 217/785-6355.

Larry L. Essenpreis has been promoted to senior vice president/trust officer at Eagle Bank, Highland. He joined the bank in 1969.

Richard A. Kwiecien has been named assistant vice president, Skokie Trust. He formerly was a commercial loan officer, Bank of Lincolnwood.

Cheryl L. Giacobbe has been promoted from loan interviewer to personal loan officer, Elmhurst National, which she joined in 1978.

Acquisition of Wheeling Trust has been completed by Cole-Taylor Financial Group, Inc., Chicago. Wheeling Trust has been merged into Main Bank and now is doing business as Main Bank — Wheeling Office. Cole-Taylor also announced that the headquarters of Main Bank is being moved from 1965 Milwaukee Avenue, Chicago, to 350 East Dundee Road, site of the former Wheeling Trust. The bank also operates a drive-up facility at 314 West Dundee. The Chicago office will continue to operate as a full-service-banking facility.

INDIANA

Kevin J. Himmelhaver has been promoted to controller at Lincoln National, Fort Wayne. He joined the bank in 1979.

1st Source Bank, South Bend, has moved the regional headquarters of its bank-card-services business to the downtown Mishawaka Main Office. The move permits expansion of the business and involved 26 employees.

Old National Bancorp, Evansville, and Merchants Republic Corp., Terre Haute, have announced plans to merge when Indiana law permits multi-bank HCs. At that time, Old National Bancorp will become the state's fourth largest bank HC, with assets approaching $1 billion. Following the merger, Old National Bank, Evansville, and Merchants National, Terre Haute, will become subsidiaries of the expanded Old National Bancorp.

CommerceAmerica Banking Co., Jeffersonville, is the new name of the former Citizens Bank and Clark County State, both of Jeffersonville. The two banks merged recently, consummating plans announced a year ago. The new bank has assets of $275 million. CB Bancshares, Inc., is the parent organization. It's headed by George N. Lane, chairman; B. David Boone, vice chairman; Ronald R. Carroll, president; and Gilmer G. Hensley, executive vice president. The bank is headed by Mr. Carroll as chairman, Mr. Hensley as president and David C. Esarey as executive vice president.

IOWA

Merger of Two Iowa HCs Canceled by Participants

The proposed merger of Hawkeye Bancorp., Inc., and United Central Bancshares, Inc., — the state's first- and third-largest HCs — has been canceled by mutual agreement of the two HCs. Both firms are headquartered in Des Moines and have experienced increased loan losses and earnings difficulties in the past year.

At the time the deal was announced, total value of the transaction was about $78 million in cash and stock.

Managements of both firms decided it was in the best interest of each to remain independent and devote full attention to the problems in their markets.

Steve Jones in Hawkeye's marketing department confirmed to Mid-Continent Banker that the $1.9-billion-asset Hawkeye had a loss of $1.9 million in the 1984 third quarter, compared with net income of $3.7 million during third quarter 1983. Hawkeye's earnings for the first nine months of 1984 were down 66% from year-earlier figures.

The loss was attributed to the "seriousness of the plight of the Iowa farmer," by Hawkeye's President Paul Dunlop.

United Central posted a 79% decline in net income for the third quarter, 1984, to $277,000 from $1.3 million in the same period of 1983, according to Kenneth M. Myers, president/CEO. The $1-billion-asset HC attributed the decrease to higher loan losses resulting from bad weather, depressed farm margins and falling farmland values.

United Central is negotiating an agreement with First Interstate Bancorp, Inc., Los Angeles, to join that firm's franchise program. Mr. Myers told Mid-Continent Banker the cancellation with Hawkeye will not affect the franchise plans, except to delay implementation from the first of this year to mid-year.

The merger plan was announced in July, 1984. Agreement terms called for Hawkeye to exchange $10 million in cash and four million shares of common stock for the outstanding shares of United Central.

Merchants National, Cedar Rapids, has elected two vice presidents — William M. O'Hara and Pierre J. Herszdorfer. Mr. O'Hara also was named manager, corporate banking department. Mr. Herszdorfer, who is in the bank's international banking department, formerly operated his own international-trade-consulting firm and has managed the international banking department of a Des Moines bank. Merchants National's international banking department is headed by Gretchen Sealls. In other action, Merchants National has appointed Douglas Keiper assistant vice president/commercial loan officer and Steve Boes corporate banking officer. Mr. Boes formerly was business development representative, Banks of Iowa Computer Services, Cedar Rapids.

A commercial-lending school will be held February 24-March 2 at Iowa

FOR YOUR DIRECTORS — TO HELP THEM HELP YOU

No. 51 BUDGETING, FORECASTING and PLANNING

Every bank must know WHERE it is going and HOW to get there! Management should "map the course," but directors should play a role in establishing goals.

This manual supplies directors with tools they need to steer bank policy in the best direction. Chapters help directors establish "missions" statements, trace stages of a planning process. Details HOW to perform financial planning, how to plan for new services . . . how to "forecast."

Techniques used by successful banks are included, along with sources of information and a bibliography of references.

Price — $31.00

2-5 copies $27.50 ea. 6-10 copies $26.00 ea.

No. 101 DIRECTORS . . . Selection Qualifications, Evaluation and Retirement.

This 42- page manual answers key questions concerning director selection, retention and retirement. Special section: the prospective director and how he should be expected to contribute to the bank's success. Includes a rating chart.

Manual also contains a section posing questions that a prospective director should ask himself before he accepts a bank board post.

Another section deals with the sensitive nature of director retirement. Age can be a guide but not an overriding factor in this decision.

Price — $10.00

2-5 copies $8.00 ea. 6-10 copies $7.50 ea.

No. 210 MAXIMIZING CORRESPONDENT BANK RELATIONSHIPS

Directors aren't "born correspondent experts, but you can help them catch up in a hurry, and it's profitable for you to do so. This 100-page manual covers all facets of correspondent banking. Clearings and float analysis . . . loan participations . . . lines of credit . . . foreign exchange, etc. This manual also helps directors APPRAISE correspondent services — to make certain you receive maximum service at a competitive price.

The manual also discusses several federal regulations, including the constraints imposed on "insider" bank lending by FIRA. A MUST for every bank director.

Price — $16.00

2-5 copies $13.00 ea. 6-10 copies $10.00 ea.

No. 220 — AN INVESTMENT GUIDE For the Bank Director

This 192-page manual discusses the merits of directors paying closer attention to investment policies.

Poorly thought-out-and-executed investment policies can place a bank's capital in jeopardy, particularly during a period of rising interest rates.

Should the board "intrude" upon management prerogatives of the CEO in the administration of the investment portfolio? No, says the author, However, a written policy, structured around the bank's deposit and loan "mix," can be comforting during rising or falling interest rates.

As an aid to management and the board, the author presents numerous investment policy statements presently in use by recognized well-run banks.

Price — $26.00

2-5 copies $23.00 ea. 6-10 copies $20.00 ea.

No. 230 — CONTRACTS WITH BANK EXECUTIVES

In many banks, salaries, bonuses and fringe benefits of top management are covered by contracts. Since many contracts extend for periods of five years they call for careful consideration.

This 48-page manual discusses the role of the board's Compensation Committee in determining the nature of such contracts. The author suggests that "performance" can and should be the key in rewarding the executive. Charts and worksheets are included to help the committee arrive at "fair and equitable" prerequisites as motivating factors for the bank executive.

An aid to writing a NEW contract or in REVIEWING existing contracts.

Price — $12.00

2-5 copies $9.00 ea. 6-10 copies $8.50 ea.

No. 240 — CONSUMER LENDING POLICY

Bank directors don't get involved in lending, but they do help formulate consumer-lending policy. Therefore, they must be familiar with the dramatic increases in personal bankruptcies and new policies called for.

This 208-page manual includes an array of consumer loan policies in force at various-sized banks; provides checklists of topics on installment-credit policy, procedures and policy components; model application forms; Federal Reserve regulations; cost analysis of consumer operations, plus a bibliography of reference materials.

Price $26.00

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State University, Ames, by the Iowa Bankers Association. Information is available from Judi Carber at the IBA, 430 Liberty Building, Des Moines, IA 50308.

Diane Kupferschmidt, personnel director, Waterloo Savings, has been elected chairman of the North Central Iowa Group, National Association of Bank Women. New vice chairman is Ruth Ann Uetz, assistant vice president, First Security Bank, Charles City; secretary is JoAnn Merfeld, agricultural loan officer, Citizens National, Charles City; and treasurer is Delores McLaughlin, vice president, United Central Bank, Mason City.

Eloise Pearson, vice president/secretary, City State Bank, Madison, retired recently following 44 years' service. She continues as a director.

Marie Wilson, director of education/human resources, Iowa Bankers Association, has been named executive director, Ms. Foundation for Women, New York City. She had been with the IBA for three years.

MICHIGAN

Comerica Bank-Detroit has appointed Neil F. Endres vice president/consumer loans; David C. Muzzall vice president/trust new business; Vincent F. Panzera III vice president/corporate financial services; and Gregory W. Quick assistant vice president. Raymond R. Melani was named vice president, Comerica Mortgage Corp.

Manufacturers National, Detroit, has named Robert R. Schoonbeck senior vice president/senior trust officer. Also promoted in the trust department were Stephen G. Hawkins to vice president/senior trust officer; Clinton P. Schloop to vice president/senior investment officer; and Charles W. Brown to vice president/investment officer. Donald K. Tyler Jr. was named vice president/trust officer; Carol A. Marola, Thomas E. McGahey and Harriet S. Stephens were named second vice presidents/trust officers; Stephen J. Seymour second vice president/investment officer; and Lois C. Billings and Michael J. Madison investment officers. Thomas H. Cobb was promoted to second vice president/trust officer in the personal trust division. Shari S. Cohen was named vice president/marketing and Sharon R. McMurray was named marketing officer. Brenda L. Schneider was promoted to vice president/government and community relations.

First of America Bank-Detroit has named Harold A. Cunningham and Larry J. Zahra vice presidents and Lee E. Freeland, Connie A. Richardson and Janet L. Robinette assistant vice presidents

Died: Mark B. Putney, retired chairman, First National of Michigan, Kalamazoo, at age 79. He joined the bank — now First of America Bank-Michigan — in 1922 and served as president from 1953 to 1969.

MINNESOTA

Norwest Franchises Eight Wyoming Banks In Alliance Program

Eight Wyoming banks have joined the bank-franchising program of Norwest Corp., Minneapolis. The banks are the first participants in Norwest's Alliance Banking program.

The eight banks are subsidiaries of Affiliated Bank Corp., of Wyoming, Casper. They include Wyoming National banks in Kemmerer, Gillette, West Casper, East Casper and Casper; First National of Wyoming, Cheyenne; Wyoming State, Cheyenne, and First National, Wheatland.

Banks participating in Norwest's program may adopt the Norwest identity and have access to many of the programs and resources used by Norwest affiliate banks. However, franchisees retain their ownership and management.

Norwest entered the franchising business to distribute certain of its products and services to an expanded customer base.

"Bank franchising enables us to establish a mutually beneficial relationship with independent banks and to generate income through fees," said Darin Narayana, senior vice president and head of the financial institutions group at Norwest. "It also gives us the opportunity to share the cost of research and development with major regional financial institutions and HCs."

Alliance banks have access to certain Norwest products, services and expertise available to Norwest affiliate banks. They join with Norwest in advertising and promoting consumer products and have the opportunity to participate in Norwest's ATM and debit-card network and be part of its check-cashing program. Input into research and development efforts also is available.

Alliance banks display Norwest signs and use Norwest product brochures, but statements at bank entrances and on stationery notify customers that Norwest Corp. is not the banks' owner.

Mr. Narayana said Norwest is "in various stages of negotiations with several other institutions" about franchising.

New Investment Program Introduced by F&M Marquette

A program designed to offer clients investment advice in mutual funds has been introduced by F&M Marquette National, Minneapolis.

The bank has rights to market and manage the Mutual Funds Investment Program (MFIP) in the Twin Cities and eastern Minnesota from MFIP creator/coordinator Michael Hirsch. Mr. Hirsch introduced and explained the program at an F&M Marquette MFIP seminar recently.

Through MFIP, more than 700 mutual funds are evaluated on an ongoing basis to select the 75 or 80 best performers. Marquette Capital Management Corp., the bank's investment advisory subsidiary, then selects 30 to 40 of the mutual funds best suited for its MFIP clients.

The program is available through the trust department to individual investors, corporate pension and profit-sharing plans, endowments and foundations.

Norwest Bank Minneapolis has appointed nine vice presidents, including A. William Charleton, Luis Ernesto Fernandez Moreno, Michael Sadak, Judith A. Owen, Robert A. Amundson, David J. Peterson, Thomas D. Wright, John Matyi and Jeannine McCormick. Norwest Corp. has named Stephen L. Byrnes vice president/marketing-services-division head.

James H. Hearon III has been named chairman/CEO, National City Bank, Minneapolis. Walter E. Meadley Jr. was named president/chief operating officer, succeeding Mr. Hearon.

OHIO

AmeriTrust, Cleveland, has named John P. Ringenbach executive vice president in charge of retail banking, David M. Zarnoch senior vice president and head of the new corporate finance division and J. Gerard Sheehan head of the new area develop-

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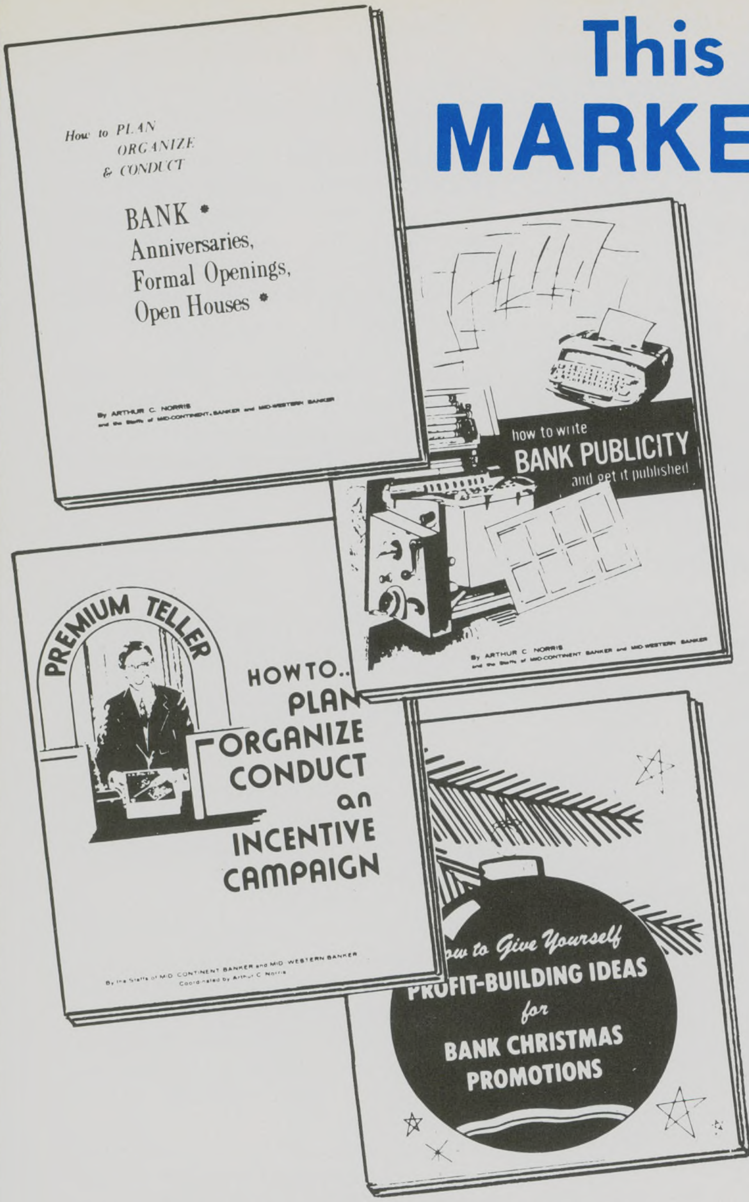

How to Plan, Organize and Conduct an Incentive Campaign . . . Mid-Continent Banker's newest how-to-do-it manual; a complete guide to procedure in evolving an effective incentive campaign to sell bank services and/or increase bank deposits; 96 pages, 16 illustrations; starts by telling you premium terms and the history of incentives, roams through such topics as trade area studies, tying in with current events, getting new business from old customers, motivating staff members and concluding with a series of six case histories of actual bank promotions that obtained exceptional results.

Regular Price: $15.00

Profit-Building Ideas for Bank Christmas Promotions. This is NOT a Christmas Club book, although ONE chapter is devoted to Christmas savings promotion plans. Other chapters: selling various bank services during the Holidays: using lobby decorations most effectively; helping children at Christmas; remembering employees in Christmas planning; using the "good will season" to build bank good will; getting the most benefits from Holiday publicity; planning for the Holidays from mid-summer to New Year's. In 80 pages are packed tested Holiday ideas used by banks, big and small, from coast to coast.

Regular Price: $11.00

How to Plan, Organize & Conduct Bank Anniversaries. . . The complete guide to procedure when holding a formal opening, an open house, any kind of bank celebration; 166 pages, many illustrations; 12 chapters starting with "First Things First," ranging through "Add a Little Pizazz and Oom-pah," concluding with " Expect the Unexpected"; eight appendices containing actual plans, budgets, programs used by banks in actual celebrations; a completely factual, step-by-step how-to-do-it book now in its second printing.

Regular Price: $24.00

How to Write Bank Publicity and Get It Published. . . The complete guide to procedure in writing publicity releases and how to prepare them so that newspaper and magazine editors will use them; 61 pages; 12 chapters with titles such as " Constructing the News Story," "Placing the News Story," "Handling 'Sticky' Situations," "Dealing with News Media"; another completely factual, step-by-step how-to-do-it manual.

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ment department. Messrs. Ringenbach and Zarnock both joined the bank in 1973. Mr. Sheehan formerly was with the Cleveland Area Development Corp.

AmeriTrust, Cleveland, Acquires Colorado HC

AmeriTrust Corp., Cleveland, has completed the acquisition of 87.9% economic interest in Central Bancorp., Inc., Colorado-based bank HC. Through its subsidiary, AT Western Corp., AmeriTrust has invested in a 92.4% nonvoting limited-partnership interest in New Central Colorado Co., a limited partnership that owns 95% of Central Bancorp. Cost of the interest was approximately $157 million.

The investment represents a major step in the HC's long-term plans, according to Jerry V. Jarrett, HC CEO.

Zuheir Sofia has been named president, Huntington Bancshares, Inc., Columbus, but remains vice chairman/director, Huntington National, Columbus. T. Carl Alderman and J. Virgil Early Jr. were made vice chairmen, Huntington National, and executive vice presidents of the HC. Both also are directors of the bank's Columbus board. Lloyd D. Peele has been named president, Central Ohio Region, and a Columbus board member of the bank. Robert W. Van Auken has been named president of Huntington's Northeast Region and a member of the Cleveland board of Huntington National. Frank Wobst continues as chairman/CEO, Huntington Bancshares, and president/CEO of the bank. In other action at Huntington National, Columbus, W. Grant Alvord and Bruce L. Barefoot were named senior vice presidents. Mr. Alvord has charge of the credit policy group/credit administration division. Mr. Barefoot is in charge of the financial institutions/international divisions.

WISCONSIN

Roger L. Fitzsimonds, executive vice president, First Wisconsin National, Milwaukee, has been named head of a newly formed commercial financial group, with responsibility for the commercial banking division, First Wisconsin Financial Corp., First Wisconsin Leasing and real estate finance and corporate finance divisions. Senior Vice President Michael J. Schmitz heads a new consumer financial group, which includes Mr. Fitzsimonds' former retail responsibilities. This group consists of the branch office and consumer credit divisions, First Wisconsin Investment Services and First Insurance Management. In his new post, Mr. Schmitz continues to be responsible for the marketing/personnel divisions. Executive Vice President Richard S. Bibler, who formerly headed the commercial banking division, now reports to Chairman Hal C. Kuehl and works on special assignments for that office.

Export-Mgt. Services To Be Performed By Bank HC Subsidiary

MILWAUKEE — Marine Corp. says it is the first bank HC in Wisconsin to announce establishment of a management firm, Marine Financial Services Corp., which will offer services to businesses taking advantage of a new federal-tax incentive to stimulate exports.

The Tax Reform Act, passed by Congress last year, allows companies to form foreign sales corporations (FSCs) in the U. S. Virgin Islands and several other offshore locations beginning January 1, 1985. When firms use FSCs, their exports are provided partial exemption from U. S. income tax. Marine Financial Services Corp. will have an office and personnel in the U. S. Virgin Islands to carry out functions and requirements of the law for companies that want to avoid the expense of establishing their own offshore offices.

Marine Financial Services Corp. also will provide services for companies with more than $5 million in export sales that must meet additional FSC managerial/economic-process requirements.

Marine Financial Services Corp. also will help companies in meeting economic requirements, which include participating in one of three sales activities: solicitation, negotiation or contracting for sales.

Marine Corp. has made filings required by the Fed to permit it to operate Marine Financial Services Corp. William B. Woodward has been named executive vice president in charge of the firm. He has had 38 years' experience in all phases of export marketing, having been vice president, export operations, Eaton/Cutler Hammer, and export manager, Trane Co.

Catherine Drager has been named assistant controller/operations officer, Capital One Corp./Brown Deer Bank. She joined the bank as a secretary in 1976 and previously held several posts in the accounting department.

Linda K. Evenson has been promoted to assistant vice president/personal banking manager, Firstar Bank Appleton, which she joined in October, 1983. She formerly was with First Wisconsin National, Madison, and Kellogg Bank, Green Bay.

Ronald L. Buzzell has joined Community Bank, Middleton, as vice president/loan-review officer. He formerly was with the office of the commissioner of banking, Madison.

Motor Club Prexy Gets Tour Of City Joked About in Ads

The president of the AAA Chicago Motor Club knows it's not nice to fool with Mishawaka, Ind.

The president, his wife and five AAA Chicago Motor Club officials were taken to the northern Indiana city by 1st Source Bank and the city administration in response to a Motor Club ad that facetiously asked, "Why settle for Mishawaka?"

Using the theme "Why settle for anything less than Mishawaka?," bank officials and the city's mayor invited the motor club people to Mishawaka, where the president was made an honorary citizen.

The group took a tour that included stops at Mishawaka landmarks as well as several "off-the-beaten-path" attractions. During the tour, the group was met by Indiana Governor Robert Orr and other civic officials. A tour of 1st Source Bank's new headquarters in South Bend was included.

Joel Roth (r.), 1st Source Bank, Mishawaka, Ind., presents packet of gifts from local merchants to AAA Chicago Motor Club Pres. Nels Pierson during Mr. Pierson's tour of Mishawaka.

The 99th Congress: What Does It Plan for Banking?

Emphasis probably will be on interstate banking and definition of bank, both emotionally charged issues. However, myriad of other bills likely to be addressed, including deregulation of insurance activities for banks, deposit-insurance changes, brokered deposits, lifeline banking, branch closings and payment of interest on demand deposits.

WITH the opening of the 99th Congress this month, bankers will be kept busy trying to keep up with the many banking issues that may be introduced, either individually or as part of larger — omnibus — bills. Emphasis probably will be placed on two emotionally charged issues — interstate banking and definition of a bank (the so-called nonbank loophole).

The new Congress also is likely to address deregulation of insurance activities for the banking industry, bank competition in securities/real estate, simplified HC-formation procedures, deposit-insurance changes, brokered deposits, payment of interest on demand deposits, basic, or lifeline, banking, failing-institutions provisions and branch closings.

Interstate Banking. While many federal laws and regulations have indirectly addressed this issue, only three have done so directly: the McFadden Act of 1927, the Banking Act of 1933 and the Douglas Amendment to the Bank Holding Company Act of 1956.

In the 98th Congress, the validity of interstate statutes was directly addressed by Title X of the Garn Bill (S. 2851), which passed the Senate by a vote of 89-5. Title X explicitly authorized states to enact laws to allow interstate-banking limitations based on geography, reciprocity or other qualifications. Title X contained "sunset" language so that the provision would expire in 1989. No merger or acquisition entered into during this five-year period would have been affected by the sunset language.

As the ABA points out, absent further specific federal legislation, the issue of where a bank can do business continues to be shaped by a hodgepodge of court cases, regulatory decisions and, indirectly, by some federal legislation. The Garn/St Germain Act of 1982, for example gives the FDIC and Federal Savings & Loan Insurance Corp. (FSLIC) greater flexibility in dealing with troubled thrift institutions and closed commercial banks, including the authority to permit interstate purchases.

From a regulatory standpoint, there's the Comptroller's recent decision to resume processing applications for nonbank charters (see page 50)

The ABA believes this issue likely will be included, at least in part, in banking legislation to be re-introduced in the new Congress.

Nonbank Loophole. The Bank Holding Company Act (BHCA) defines a bank as any institution that accepts demand deposits and makes commercial loans. If either of the functional tests in the BHCA does not apply, the institution is not a "bank" under the BHCA, and, therefore, is not subject to its limitations. However, these limited-purpose banks or "nonbanks" have bank charters and are subject to the regulation of the appropriate bank-regulatory agency. As pointed out by the ABA, because of this anomaly in the definition of a bank under the BHCA, many companies engaged in a wide variety of activities have been able to acquire or apply for charters of state or national banks with the intent of eliminating one of the functions and thus operating a "nonbank." Because the BHCA doesn't apply, interstate restrictions of the Douglas Amendment are not applicable.

In the last Congress, four bills were introduced that addressed many issues facing banking, including redefinition of a bank (H.R. 5916, S. 1609, S. 2134 and S. 2181). However, legislation that would have addressed this issue expired in the House when the 98th Congress adjourned.

As indicated by end-of-session statements, according to the ABA, both Senator Jake Garn and Representative Fernand St Germain will introduce legislation early in the 99th Congress that will redefine a bank as well as address other issues facing the banking industry. A hearing schedule has not been set, but the ABA believes one to be available by the middle of January.

Insurance Activities. Legislation (S. 1609 and S. 2181) was introduced during the 98th Congress to allow bank HCs to sell or underwrite insurance. This legislation would have repealed Title VI of the 1982 Garn/St Germain Act, which significantly limited bank-insurance activities.

Legislation that would have sharply curtailed the ability of some state-chartered banks to offer certain insurance products/services died as the 98th Congress adjourned. Similar legislation to Section 104(d) of the Senate-passed Financial Services Competitive Equity Act (S. 2851) was approved by the House Banking Committee, but was not considered by the full House.

The Fed published a proposed rule making in the March 12, 1984, *Federal Register* to define permissible insurance activities under the Garn/St Germain Depository Institutions Act of 1982. These would be amendments to Regulation Y. In addition, the Fed has a proposed rule making published in the November 25, 1983, *Federal Register* to eliminate the rate-reduction requirement from credit-life/credit-accident/health-insurance underwriting. Final rule makings were anticipated by the new year, says the ABA.

The FDIC issued an advance notice of proposed rule making in the September 12, 1983, *Federal Register* requesting comment on whether there's any need to regulate involvement of insured banks in insurance. In November, 1984, the FDIC proposed placing certain insurance activities in separate subsidiaries.

In a December 2, 1983, letter ruling, the Comptroller said national banks have authority to rent lobby space to insurance agents.

The ABA believes a proposal for deregulation of income-producing insurance activities should be re-introduced in the 99th Congress. House and Senate Banking committees will review the proposals. The Fed, according to the ABA, most likely will expand Reg Y insurance activities in its final rule making.

HC Formations. The Treasury Department submitted a legislative proposal (S. 1609, H.R. 3537), which would have permitted bank HCs to engage in certain insurance/real-estate/securities activities beyond those currently permitted. The ABA points out that to alleviate concerns that these new activities would increase risk to a bank, the Treasury proposal required that the activities be conducted through a separate subsidiary of the bank HC. For those banks not already organized as an HC, this requirement would have posed a problem. Recognizing this, the Treasury proposed an expedited procedure to allow banks to reorganize into HCs.

The ABA says the proposal could streamline and simplify bank-HC procedures and make it easier for BHCs to engage in other activities closely related to banking or of a financial nature as permitted by regulation or order under section 4(c)(8) of the BHCA.

Simplified HC procedures likely will be included in any re-introduction of S. 2181 in the 99th Congress. The Senate/House Banking committees have jurisdiction over the matter.

Deposit-Insurance Changes. In April, 1983, the FDIC and FSLIC both submitted reports to Congress, as required by the Garn/St Germain Depository Institutions Act of 1982, detailing changes they would like to see enacted into law in the deposit-insurance system. The FDIC, early in 1984, submitted proposed legislation designed to accomplish the major amendments to its statutory authority the FDIC sought in the 1983 report.

Major changes proposed by the FDIC are: 1. Enactment of a risk-related deposit-insurance-premium system that would allow the FDIC to vary the amount of deposit-insurance-premium rebate an insured commercial bank received, based on amount of risk in the bank's asset/liability portfolios. 2. Increased enforcement authority that would authorize the FDIC to take enforcement actions against all insured banks when they are placed on the FDIC's problem list. 3. Limitation on deposit insurance that would provide that deposits of government agencies and financial institutions not be insured. 4. Allowing the FDIC to assess additional fees for examinations it must do of problem institutions.

A Treasury Department task force is studying various alternatives for deposit-insurance reform. Two alternatives are being examined closely. On the one hand, they would provide for 100% deposit insurance for all banks, with 10% of the insurance being provided by private insurance companies, and, on the other hand, for a system of variable-rate-deposit-insurance premiums that would attempt to impose market-related deposit-insurance premiums on all depository institutions.

During 1984, Senator William Proxmire proposed a legislative amendment, which would impose, for the first time, the ABA says, deposit-insurance premiums on those deposits of U. S. commercial banks held in their overseas offices. The Proxmire proposal would reduce deposit-insurance premiums for all banks by an amount comparable to the additional revenues that would be raised from assessing deposit-insurance premiums on foreign deposits.

The ABA believes the House Banking Committee will make deposit-insurance reform one of its major early items of business in the 99th Congress. Also, the Senate Banking Committee has agreed to hold hearings on the Continental Illinois of Chicago rescue effort, and the ABA foresees these hearings involving the subject of deposit-insurance reform.

Brokered Deposits. Both the FDIC and Federal Home Loan Bank Board (FHLBB), says the ABA, announced a proposal to restrict deposit insurance to $100,000 per broker per institution on brokered funds placed after October 1, 1984. Final rules were issued last March 26. Although these rules are in litigation, neither agency has withdrawn its rule, although the FHLBB moved the effective date of its rule to February 1, 1985.

Both the Senate (S. 2851) and House (H.R. 5913) had bills in the last Congress to limit the amount of short-term insured brokered funds any one institution can hold to 15% of deposits or 200% of unimpaired capital and surplus, whichever is less. The House bill also required brokers to report to the insuring agencies, denies deposit insurance to any U. S. agency or depository institution and limits benefits payable to any one person through any one broker to $100,000 in any four-year period. The Senate passed S. 2851 containing the brokered-deposit provision; the House did not act.

The ABA believes the issue probably will be included as a part of a larger consideration of deposit-insurance reform in the first session of the 99th Congress.

Interest on Demand Deposits. There were several proposals during the 98th Congress that would have allowed payment of interest on demand deposits, and the issue likely will come up again in the new session.

The ABA has suggested that the following statutory changes are needed before payment of interest on demand deposits can be considered: 1. Broadening products/services that can be offered by commercial banks. 2. Elimination of unrealistically low state-usury ceilings. 3. Payment of interest on reserve balances held by the Fed. 4. Reform of the Bankruptcy Act (accomplished last July).

Lifeline Banking. As bankers know, deregulation increased substantially the cost of serving bank customers so that they had to raise service fees to meet these costs. As the ABA points out, in many cases, banks are charging customers for services previously provided free of charge.

That has caused some consumer groups, legislators and regulators to charge that rising fees and minimum-balance requirements threaten to exclude a growing number of low- and moderate-income Americans from access to the banking system. As a result, says the ABA, several states have developed, or are considering, various forms of legislation to require financial institutions to provide basic- or "lifeline"-banking accounts. For instance, Massachusetts adopted legislation that prohibits banks from charging fees on savings/checking accounts of customers under 18 and over 65.

During the 98th Congress, Representative Cardiss Collins of Illinois introduced a bill to require banks, S&Ls and credit unions to disclose fee policies and require federal regulators to study the feasibility and costs associated with establishing a lifeline-bank account for financial institutions. The ABA believes this bill will be reintroduced in the 99th Congress and that other legislation can be expected to be introduced in that Congress and in some state legislatures, notably New York and California.

Failing Institutions. The Garn/St Germain Act of 1982 granted the FDIC and FSLIC greater flexibility in dealing with troubled thrift institutions and closed commercial banks. The "emergency" provisions that were granted will expire next October 15, and the ABA says the issue will be addressed in Congress this year. — **Rosemary McKelvey, editor.**

Interstate Banking and Bank Structure To Be Aired by State Legislatures in '85

CONTIGUOUS-STATE interstate banking and bank structure are the most prevalent topics expected to be aired in state legislative chambers during 1985, according to a poll of Mid-Continent-area state bankers associations.

A few states already permit contiguous-state interstate banking, provided the privilege is reciprocal in nature. When and if the majority of states have such agreements in place, banking will spill over state lines in a limited way — limited to adjacent states, that is. This situation is expected to constitute the initial phase of interstate banking — one that will give bankers time to adjust to the practice before more ambitious regional-banking authority is enacted into law.

Some states, such as Illinois, will be dealing with intrastate-banking privileges this year. Other states will be playing "catch up" by considering structure items such as multi-bank HCs, a topic most states dealt with long ago.

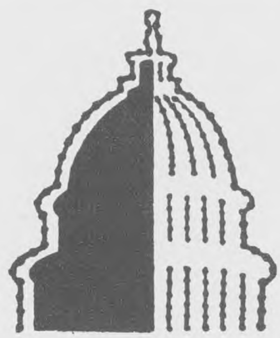
A trend that is noticeable this year is the increasing practice of state bankers associations to discard their neutral attitudes regarding legislative matters affecting their members. This is seen by some as a reversal for independent banks, whose influence in state associations seems to be declining. Regional and money-center banks appear to be gaining influence in once-independent-banker-dominated state associations.

Following is a rundown of expected legislative activities affecting banking in most of the Mid-Continent-area states.

Alabama. The Alabama Bankers Association has no plans at present to introduce legislation affecting banking. However, bills dealing with ATMs, interstate banking and oil-and-gas lease money may be introduced.

Illinois. Statewide-banking authority will be the major thrust of the Illinois Bankers Association's legislative program this year (see adjoining article).

An attempt may be made to close the "nonbank" loophole by amending the definition of "bank" under the Illinois Bank Holding Company Act. The present definition parallels the one in the Federal Bank Holding Company Act, which defines a bank as an institution that accepts demand deposits and makes commercial loans. Illinois bankers want to see the term "bank" defined simply as an institution holding a



national or state bank charter, a definition that would make any national or state bank subject to restrictions of the Illinois Bank Holding Company Act.

Other items expected to be sought by Illinois bankers include the following:

- Authority to sell insurance with or without a subsidiary.
- Exemption of GNMA and FNMA interest for income-tax purposes, reversing a recent court decision.
- A call for a constitutional convention to mandate a balanced budget.
- Legislation to deregulate or increase fees relating to consumer credit.
- Authority to permit lenders to offer true variable-rate loans.
- Legislation to include debit-card fraud within the parameters of the Credit Card Crime Act and to increase penalties for counterfeiting debit and credit cards.
- Legislation to amend the Revolving Credit Act to provide for a delinquency charge and a charge when payment is made by an NSF check.

Indiana. The cornerstone of the 1985 legislative program for the Indiana Bankers Association will be a comprehensive banking-structure-reform bill. Other proposals will be technical amendments to the Troubled Bank Act of 1983 and some reforms to the current schedule of exemptions currently allowed in the state's bankruptcy statute.

The structure-reform bill is expected to deal with the following topics:

- Statewide multi-bank HCs would be authorized, limited to controlling no more than 10% of the state's total deposits from September 1 (the enactment date) through December 31, 1985. A bank must be in existence for five years before it is eligible to be acquired or merged into an HC.
- Branching. Banks $200 million and under in assets would be permitted to add one branch de novo or by merger/acquisition annually for five years. Banks with $200-$400 million in assets would be permitted a total of three branches de novo or by merger/acquisition — one allowed each two-year period for the first four years and one in the fifth year. Banks over $400 million in assets would be able to establish two total branches de novo or by merger/acquisition — one each 2½-year period. Branching would be governed by natural market boundaries — contiguous counties with a minimum of five counties. After five years, branching would be unlimited in contiguous counties.
- Reciprocity. Banks desiring to operate in Indiana under the proposal would be governed by the same restrictions that apply to Indiana banks with regard to HC/branching activities. Banks must be home-based or domiciled in a state contiguous to Indiana.

Issues expected to be introduced that will not be favored by bankers include limits on service charges and delayed-funds availability and a rollback of the state's usury ceiling from 21% to 19%.

Iowa. The Iowa Bankers Association plans to take the following positions regarding state legislative issues in 1985:

- No increases or changes should be made to the present franchise-tax structure in view of the refunds denied to the banking industry when the present tax structure was established in lieu of the deduction concept prior to 1979.

- Endorsement of the pledging concept regarding pledging vs. sinking funds. Efforts will be sought to make pledging less cumbersome and costly for banks, which could make legislative action a moot issue.
- The IBA proposes to maintain the present language in the ag-lien bill through the first production year and oppose any changes to the existing bill.
- The IBA opposes any action at the state or federal level to change the present UCC provisions protecting banks in securing proceeds of the sale of farm produce and opposes any lien-waiver-bill provisions.
- The association favors authorization for an emergency bank acquisition not applying to the deposit limitation of a bank HC or office provisions. This authorization applies only if there are no other in-state bidders and the failed bank is a forced sale by a bank regulator.
- The IBA supports a proposal recommending the reorganization of a bank affiliate by amending the Iowa Banking Act to allow a bank to merge with a bank that has been an affiliate for five years or more. The affiliate bank that is merged into the resulting bank would not be allowed any additional bank offices in the merged bank's local area.
- The association will take no position on regional banking with reciprocity until a consensus is reached among members.
- The IBA supports an increase in the maximum time a bank can hold real estate from one to three years.
- An increase in overdraft protection to 19.8% will be supported for open-end credit transactions to bring the rate into conformity with that for credit-card and retail sales.

Other legislative issues expected to be supported by the IBA concern changing credit-card-fraud regulations to bring them into conformity with federal regulations; authority for banks to invest in interest-rate futures; allowing banks to charge customers for the cost of title insurance purchased out of state; real estate and insurance activities for banks; permission for banks to make name changes without obtaining signatures of debtors and bringing state banks into parity with banks governed by the Fed and FDIC with respect to transactions between bank affiliates.

(Continued on page 38)

Illinois Bankers Association Seeks Statewide and Interstate Banking

ILLINOIS bankers plan to scuttle the elaborate system established by statute three years ago to keep Chicago's big banks from saturating the state with facilities.

At its annual meeting in St. Louis late in November, the board of directors of the Illinois Bankers Association voted almost unanimously (24-4) to recommend legislation that would let HCs own banks throughout the state and authorize HCs in reciprocating contiguous states to own Illinois banks. In addition, the association will seek legislation authorizing five, rather than three, facilities for banks.

Outgoing IBA Pres. Charles C. Wilson (l.), ch./CEO, First Nat'l of Quad Cities, Rock Island, prepares to pin president's pin on incoming IBA Pres. James Forster, ch., De Kalb Bank, during IBA annual meeting.

Present law, effective January 1, 1982, permits Illinois HCs to acquire banks only in two of five regions in the state — the region of domicile and an adjacent region. The statute effectively limited Chicago HCs to regions 1 and 2, which occupy the northeastern portion of the state.

The IBA would like to see these regions eliminated by January 1, 1986, and it hopes to have authority for reciprocal contiguous interstate banking in place by the same date. Illinois is contiguous to six states: Missouri, Iowa, Wisconsin, Indiana, Kentucky and Michigan. Although none of these states currently sanctions reciprocal banking privileges, several are expected to consider such authorization this year.

The two-additional-facilities authority desired by the IBA would permit banks to establish facilities anywhere in their county of domicile or within 10 miles of the bank in an adjoining county. Facilities could be full-service. Currently, banks are limited to three facilities, with geographic restrictions.

Home-office protection for the additional facilities would provide that, if a facility is established within 3,500 yards of the main office of the establishing bank, it should not be closer than 600 feet to an existing main office of a competing bank.

If a new facility is established more than 3,500 yards from the main office of the establishing bank, it should not be closer than one mile from any existing main office of another bank.

The new legislative recommendations were formulated by a special IBA task force appointed by last year's IBA President, Charles C. Wilson, chairman/CEO, First National of the Quad Cities, Rock Island. The recommendations were presented to the IBA board after expiration of a two-year moratorium on bank-structure-change recommendations, which was established when the Association for Modern Banking in Illinois and the IBA merged early in 1983 to form what is called the "new" IBA. Donald R. Lovett, past IBA president, and president/CEO, Dixon National, chaired the task force.

At a press conference following announcement of the board's approval of the task-force recommendations, Mr. Wilson said the IBA was not concerned about an apparent lack of interest on the part of most IBA member banks concerning the recommendations. He explained that many of the association's banks are quite small and are too busy with the business of banking to take time out for state-wide issues. They depend on the IBA to advise them, Mr. Wilson said.

During the IBA annual meeting, which was held in conjunction with the association's bank management conference, IBA officers for 1985 were introduced. They are: President — James Forster, chairman, De Kalb Bank; vice president — Thomas Andes, president, First National, Belleville; secretary — Harlan Yates, president, Cisne State; and treasurer — John Luttrell, president, First National, Decatur. — **Jim Fabian, senior editor.**

Kansas. The Kansas Bankers Association is on record supporting authority for establishing multi-bank HCs in the state. The topic has received support from Governor John Carlin and the Kansas Chamber of Commerce and Industry.

The KBA is considering support for a bill to increase the number of detached facilities for Kansas banks from three to four and to permit one of the additional facilities to be placed in an area outside the city or township of domicile.

A two-year extension of the current rate ceiling of 21% on consumer loans is expected to be supported by creditor groups, including the KBA.

The association will take a neutral stand on legislation expected to be introduced concerning deposit of local public funds in S&Ls.

Legislation is expected to be introduced concerning a possible change in the UCC concerning farm products, bankruptcy-code changes, attorneys' fees in litigation involving commercial loans and several technical amendments to the state banking code.

Kentucky. The state legislature does not meet in 1985.

Minnesota. The Minnesota Bankers Association is on record as favoring expected legislation calling for a regional interstate-banking bill. The bill is expected to permit Minnesota banks to acquire or establish banks in any contiguous state that has a reciprocal provision and would let banks in those states acquire or establish banks in Minnesota. The Independent Bankers Association opposes the issue. However, such legislation is expected to be successful whether or not it receives support from the banking industry.

Missouri. The Missouri Bankers Association plans to initiate legislation to permit new services for state banks, additional facilities and permit regional interstate banking in contiguous states with reciprocal privileges. New services will include insurance, real-estate development and management, financial advice and tax services, security-sales authority, travel-agency services, accounting/bookkeeping services and broader leasing powers.

The proposal calls for banks located anywhere in the St. Louis and Kansas City metropolitan areas to be allowed to locate facilities anywhere in those areas. Banks outside the two metropolitan areas would be free to locate facilities anywhere within their home city or county except in another community already being served by a bank or anywhere within five miles of a main bank. Banks could cross county lines, provided the community they want to enter doesn't already have a bank.

Other issues likely to be taken up this year include liens on farm products, a moratorium on farm foreclosures, lifeline-banking services and authority to deposit public funds in all types of financial institutions.

New Mexico. The New Mexico Bankers Association will introduce legislation dealing with electronic funds transfer and the definition of "banking day" this year.

The association is recommending revision of portions of the state's Remote Financial Service Unit Act that pertain to POS terminals, POS networks and ATMs because current statutes don't meet the needs of banks and citizens. The NMBA wants all ownership restrictions for POS devices removed, recovery permitted of a reasonable return on invested capital and a reasonable profit in a POS network, nonexclusivity in identifying POS systems and mandatory sharing of POS networks.

The NMBA wants the term "day," when found on the face of a bank draft, to be clarified by changing it to "banking day" as defined in the UCC.

Legislative issues expected to be introduced this year will deal with S&L collateral, credit union public-deposit authority, public-deposit collateral, state/city/county funds policy, taxes, banking-department restructuring/budget increase, establishment of a bank HC act, funds availability, fiscal-agent deposit facility, lifeline services and geographic expansion of banking facilities. The NMBA has voted to remain neutral on the banking-facility-expansion issue.

Oklahoma. Legislation is expected to be introduced to expand the number of potential bidders for a failing bank by waiving restrictions governing acquisitions. Present law prohibits conversion of failing banks to branches and the acquisition of failing banks by multi-bank HCs unless the bank being acquired has been in existence for five years.

The Oklahoma Bankers Association is in favor of waiving acquisition restrictions for HCs willing to acquire failed banks. It will not support waiving the prohibition covering conversion of failing banks to branches because its membership has not had an opportunity to express its views on that topic.

Other issues expected to surface this year include legislation to address nonbank problems, several bank/taxation issues, additional enforcement powers for the state banking department (which the OBA is expected to support) and a number of issues of lesser importance.

Tennessee. The major issue this year is interstate banking. Both the Tennessee Bankers Association and Governor Lamar Alexander will attempt to convince the legislature to pass enabling legislation.

The proposal is expected to permit banks to establish facilities in the eight states that are contiguous to Tennessee, plus West Virginia, South Carolina, Louisiana, Indiana and Florida. Each state would need an agreement of reciprocity to participate.

Governor Alexander favors intrastate branching, but the TBA doesn't.

Concern has been expressed by legislators about the merits of interstate contiguous banking for Tennessee and the speaker of the house has urged lawmakers to move slowly on any banking legislation.

Other legislation expected this year involving banking will deal with credit insurance and minor housekeeping matters.

Wisconsin. The Wisconsin Bankers Association's task force on interstate banking has voted in favor of a neutral stance to be taken by the association when the issue is introduced in the legislature this year.

Similar legislation was opposed by the WBA in 1983 and the attempt resulted in formation of the task force.

It's expected that, should legislation be introduced, the WBA will take action to make any resulting bill favorable to the banking industry.

Other topics expected to come up in this year's legislature include authority for venture capital, closing the nonbank loophole and broader powers for banks, including real-estate brokerage, travel-agency operations and actuarial services for trust departments. — **Jim Fabian, senior editor.**

• **Allen R. Jensen** and Alicia Williams have been promoted to assistant vice presidents at the Chicago Fed. Ms. Williams continues in the consumer affairs division of the bank's supervision/regulation department and as community affairs officer. Mr. Jensen has been given responsibility for the bank's regional check-processing office in Indianapolis. He formerly was in the bank's Des Moines Office.

Fair, Orderly, Safe Transition Needed

Interstate Banking Should Be Approached On National Basis

By Martha R. Seger

WHILE pressures for change seem to be increasing, most of us probably would agree that the next Congress is not likely to authorize unlimited interstate banking. Even congressional approval of regional interstate banking is in doubt. Its fate will depend on the outcome of court challenges to state regional-banking laws and on achievement of a compromise on other provisions of a broader banking bill.

While we may not have full interstate banking in the near future, we certainly do have an abundance of banking services provided on an interstate basis. Only full retail deposit-taking powers and the ability to provide all services through one subsidiary are needed to make interstate banking a reality. A 1983 study by the Federal Reserve Bank of Atlanta found more than 7,800 out-of-state offices of banking organizations.

In addition to those provided through these 7,800 offices, many other services can be provided on an interstate basis without a physical presence in the market. Correspondent banking and many business services are in this category. Even some consumer products, such as credit cards, are now provided interstate without a banking office being required. For some services, the toll-free telephone line and the ATM have become acceptable service-delivery systems. A lesson was learned here from success of the money-market-mutual funds.

Now we have the nonbank bank as the newest method of interstate expansion. As Fed Chairman Paul Volcker's letter to Congress makes clear, our decision to approve nonbank-bank applications was made reluctantly. While all board members probably would favor some form of interstate banking, we are all opposed to allowing change to come about through this loophole in existing law.

Although the board is approving nonbank-bank applications subject to prohibitions or tandem operations, we would continue to warn the industry of the risk of having to divest these subsidiaries. Congress has made its intentions known, and those who assume the cutoff date for grandfathering will be changed are taking a major risk. Since everyone has been warned prior to establishing their new subsidiaries, the case for grandfathering is not as convincing as it was in 1956 and 1970.

Martha Romayne Seger became a member of the Fed Board of Governors last July, and her term is to run until 1998. From 1983-84, she was professor of finance, Central Michigan University, Mt. Pleasant. Before that, she was commissioner of financial institutions in Michigan, 1981-82. Her career has included being vice president in charge of economics/investments, Bank of the Commonwealth, Detroit; chief economist, Detroit Bank; and financial economist, Federal Reserve Board, Washington, D. C. She has been on the staff of the New Mexico School of Banking, University of New Mexico, Albuquerque, and lecturer, Prochnow School of Banking, Madison, Wis., and Northern School of Banking, Marquette, Mich. She holds three degrees from the University of Michigan, including an MBA in finance and a Ph.D. in finance/business economics.

While interstate banking should be considered in the process of closing the nonbank-bank loophole, that approach does not seem likely. Therefore, in the short run, changes in bank geographic-expansion powers will be the result of state initiatives. The 1985 state-legislative sessions probably will result in several additional states permitting some form of interstate expansion. I, myself, would prefer a national approach, but it seems clear that the federal government needed — and still needs — pressure from the states to remedy this constraint on banking. Like NOW accounts, state action on branching will induce changes that otherwise would have taken too long to attain.

As an economist, I welcome removal of restrictions on entry into new markets. Entry restrictions often serve only to perpetuate the existing division of market shares, regardless of how well or how poorly the market is being served. While we all may prefer to operate without competition or threat of competition, no better force has yet been devised to assure good performance.

Having endorsed freedom of entry and removal of entry barriers, I want to mention some problems I see developing in the regional-interstate-banking movement.

First, most of the actual and planned new entry involves mergers between large banking organizations. The trend is toward regional consolidation. Relatively large banks, capable of being lead banks of regional organizations, have instead become subsidiaries of even larger banks. Indeed, the merger of large regional banks appears to be the goal of the regional-banking movement.

These mergers are defended in a

number of ways I do not find completely convincing. Will the merging banks, in fact, achieve economies of scale and scope? There is no empirical evidence to suggest such economies exist. What evidence there is suggests economies of scale are quickly exhausted. Those who believe there are economies of scale provide no evidence to support their claims. Each new or prospective change in the banking industry brings new visions of efficiencies that will benefit the large banks and doom the small banks to failure. After decades of hearing these claims, we still have thousands of profitable small banks. Thus, I do not see the economic foundation for many of the large-bank mergers.

The other justification I frequently hear is that the regional banks must merge to compete with money-center banks when full interstate banking eventually is permitted. Again, there is no evidence that size is necessary for survival or that a bank must be all things to all people in all markets to be profitable. The argument that size is necessary to survival would result in a system composed of only a few large nationwide banks.

Too often, the argument for regional-interstate banking sounds like, "Let me absorb banks throughout my region so that I can be an attractive acquisition candidate when nationwide banking is allowed." Regional-interstate banking may reduce the number of bidders and hence lower the premium paid to acquired firms by acquiring firms. Therefore, it may become a boon to large regional acquirors that are motivated to set themselves up to be future acquisition candidates or to become "large enough" to remain independent. That is to say, regional banking may be desired, or turn out to be, a subsidy to the larger regional banks.

The experience of Maine, the first state to adopt an out-of-state bank-entry law, is illustrative of the value of maximizing the number of potential entrants. Rather than limiting entry to New England banks, many of which already were competing for business loans in Maine, the state was opened on a nationwide basis. Two of the first entrants were medium-sized bank holding companies from Albany, rather than the expected major Boston and New York City banks.

While the Supreme Court eventually will decide the fate of regional reciprocal-interstate banking, I hope we will quickly pass through that stage of evolution and move to full interstate banking. Maximizing the number of potential bidders for exiting banks and maximizing the diversity of new entrants into markets should result in a better long-run banking structure.

In this period of transition, we need to be concerned about the long-run structure of the banking industry. While re-examining the old rules, we must attempt to look well into the future and assess the long-run impact of proposed changes. In this regard, I would raise two questions.

"I do not foresee any forces that would suggest problems for smaller banks. They can exploit their knowledge of local market conditions, and while they may not have the resources to develop new products or operating systems, there are plenty of vendors to assist them in delivery of high-quality banking services."

First, do we need to be concerned about small banks?

Second, do we need to be concerned about nationwide concentration of banking resources?

The small-bank question does not appear to be a serious problem, although small banks have the same fears about regional banking that regional banks have about nationwide banking. Empirical work on small-bank survival does not suggest major problems resulting from continued deregulation of the banking industry. The board's study of 1983 bank profitability, published in the November, 1984, issue of the *Federal Reserve Bulletin*, suggests that small banks appear to have suffered somewhat from deposit deregulation. Money-market-deposit accounts increased their cost of funds, but large banks substituted MMDAs for purchased money and lowered their cost of funds. In addition, small banks have been less aggressive in pricing their services. In spite of these expected problems, small banks continued to earn a higher rate of return on assets than large banks. Comparative rates of return on capital were slightly in favor of large banks, but the difference will narrow in coming years as large banks increase their capital to levels closer to those of small banks.

I do not foresee any forces that would suggest problems for smaller banks. They can exploit their knowledge of local market conditions, and while they may not have the resources to develop new products or operating systems, there are plenty of vendors to assist them in delivery of high-quality banking services. Competition will be tougher than in the past, however. Merely holding a banking charter will not be a guarantee of profits. But those willing to adapt to market conditions and meet the needs of the marketplace will continue to do well, even in competition with large nationwide firms.

Even though many small banks will be acquired, most acquisitions will be by choice and not by necessity. I doubt that the total number of banking organizations will decline to the extent predicted by some forecasters. Major declines in the bank population will occur in those states that do not yet have full intrastate branching. Illinois and Texas, for example, each still have more than 1,000 banking organizations. Nearly 30% of all banking organizations are in Texas, Illinois, Kansas or Missouri. One half of all banking organizations are in only nine states. Greater intrastate branching will decrease the number of banks; whereas, interstate banking will increase national deposit concentration.

In estimating the number of banks likely to exist at some future date, we should not overlook the fact that new-bank formations still continue at relatively high rates. Banking is viewed as a profitable industry, and as long as there are markets where entrepreneurs perceive the prospect of profits, new banks will be formed.

While small-bank survival probably is not a problem, I am more concerned about the second issue I raised, the question of aggregate concentration. Aggregate concentration, or percentage of total nationwide deposits held by the few largest firms, is an issue that transcends pure economics and goes to more deeply held traditional American concerns. Prevention of financial concentration is one of the bases of American banking policy. In formulating an interstate-banking policy, we must decide whether we want to reaffirm this objective or permit a greater degree of nationwide concentration of banking resources.

Some would argue there is no need to worry about aggregate concentration. They reason that the number of firms in the banking industry is so large there is no reason even to discuss the issue. Yet I do not think that that attitude is correct. The top 100 banking organizations controlled 53.9% of domestic banking assets at the end of 1983, an increase of over five percentage points since 1978. If we do not control interstate mergers between large banking organizations, deposit concentration on the national level will increase ever more rapidly. The overwhelming proportion of the banking industry's assets would be held by a few extremely large nationwide firms. There still would be thousands of other banks, but they collectively would hold only a small fraction of total deposits.

Some observers also argue that banking concentration would not increase because there are no substantial economies of scale in banking. This argument also misses the point. Lack of sizable economies of scale has not prevented increased state-deposit concentration in those states that permit statewide branch banking. Clearly, there are factors other than economies of scale associated with mergers and acquisitions that occur after a state liberalizes its branching laws.

Would the antitrust laws prevent growth of nationwide banking concentration under a regime of interstate banking? This seems unlikely because, at least initially, banks headquartered in different states would not be considered competitors in the same local banking markets. Antitrust laws are more effective in dealing with mergers within markets than with mergers between firms operating in different geographic markets.

Therefore, if Congress wants to maintain the historically low degree of nationwide banking concentration, interstate-banking legislation should be accompanied by some restrictions on large interstate-bank mergers and acquisitions. There are many ways interstate-banking legislation could incorporate concentration limitations. We have studied many possible formulas, such as prohibiting mergers among the 100 largest firms. A simple system based on size of the acquiring firm would seem best. Nearly all banks not competing in the same markets would be free to merge interstate without limitations. The largest banks, however, would face increasingly severe size restrictions on their acquisitions as their nationwide share of banking assets increased. It seems clear that due regard will have to be taken of increasing competition banks face from other depository and nondepository financial institutions. Regardless of the specifics of the plan, I would hope that some fair and workable system for maintaining a deconcentrated financial system would be developed by Congress.

As a final topic, I would stress the need to maintain the safety and soundness of the banking system in the process of moving into the interstate-banking era. Interstate banking has the potential to decrease banking risk, but it also can lead to an increased risk. Clearly, ability to expand geographically should allow risk-reduction opportunities. To the extent that different regions of the country are subject to different economic forces, diversification of consumer- and business-loan portfolios is desirable. On the other hand, consequences of the rush to enter the energy-lending business should have taught us something about careful diversification.

The other risk frequently cited in discussing interstate banking is the danger that the acquiring firm will, in its eagerness to acquire an attractive entry vehicle, pay too high a premium for the target firm and dilute its equity position. I think the market is able to impose its discipline on firms that overbid for acquisitions. Costs of equity and debt funds will increase as the market perceives the added risk and dilution of stockholders' equity.

Still another risk that policymakers must consider involves deposit insurance and related issues. If there is in fact a cutoff over which banks are too large to let fail, growth of bank size through interstate mergers may increase the number of institutions for which market discipline is blunted by public-policy concerns. I am reasonably optimistic that policy-makers have options that can bring the same types of penalties to the large banks as to the small banks. But there are problems and trade-offs, and recent events have made clear, I think, that this dimension of banking structure is ignored at our own risk.

The final risk factor I will mention also is applicable to the current rush to establish nonbank banks. There is a danger that everyone will try to enter the same attractive banking markets. For example, 11 banking organizations have applied to establish nonbank banks in Phoenix. While Phoenix is indeed a growing and attractive market, how many new banks can the market support all at one time? I am not suggesting that any of the new entrants will fail, or that the losses incurred by their parent organizations will cause their failures. However, I would feel fairly safe in predicting that not all these new entrants are going to earn their target rates of return on their Phoenix subsidiaries. For that reason, I would suggest that investments in new subsidiaries be limited, at least initially. I also would suggest that there are plenty of profitable markets that could use some new competitors; everyone doesn't have to go to all the same places.

To conclude, I would stress my desire for a fair, orderly and safe transition to nationwide interstate banking. We must be concerned with both short-run equity for the public and private interests involved and with the long-run health and efficiency of the financial system. What we build in the next few years will be with us for many years; so we must design well. ● ●

Banks, Thrifts Favored By 8% of Households As Insurance Providers

More than 8% of all U. S. households would purchase personal lines of property/liability insurance from a bank or thrift, according to a study conducted by Mathematica, a Princeton, N. J., information-services organization.

Findings indicate that this demand — which represents 6.5 million households — is primarily from mass-market segments, rather than from more upscale market segments.

The study also projects that the banking industry could earn $121 million annually in commission revenue from sale of home-owners' insurance and $344 million in commission revenue from sale of auto insurance.

Findings are based on Mathematica's analysis of the recently released Survey of Consumer Finances sponsored by the Fed and the Comptroller of the Currency. The study consisted of in-person interviews of a national sample of nearly 5,000 households and analyzed responses to survey questions about interest in purchasing personal lines of property/liability insurance from financial institutions.

"The findings show that there is already a basic consumer interest in buying insurance from banks and thrifts," said a Mathematica spokesman. "These market projections should be viewed as the floor on which additional demand could be generated with effective marketing/pricing strategies."

Joseph Jester Named President of AIB

Joseph M. Jester, vice president, BancOhio National, Columbus, has been elected AIB president, succeeding Roy E. Huddle, executive vice president, Sunwest Bank, Espanola, N. M.

Named AIB president-elect was Herbert W. Cummings, executive vice president, Citizens Bank, Providence, R. I. The new AIB chairman is Joseph H. Riley, former chairman/president, NS&T Bank, Washington, D. C.

Long-Range Agri Solution?

DURING the recent ABA agricultural conference in Kansas City, bankers went through the "consensus process," which has become a part of the ABA's national leadership meetings. The Kansas City consensus addressed the problems of agriculture and potential long-range solutions to those problems.

A morning-long session found bankers analyzing and debating a range of proposals the group then would "send up" to the national leadership conference for "further massaging" and, eventually, creation of a policy the ABA would bring to Congress as proposals for a 1985 farm bill.

Following is a digest of several of the major items discussed and debated at Kansas City. (The reader may wish to add his comments and suggestions by writing to the ABA agricultural bankers division.)

Direct lending by Farmers Home Administration. Bankers advanced the premise that the relationships between direct and guaranteed loans (to farmers) need to be changed. For example:

• Make it possible for the private sector to handle a larger share of credits temporarily not bankable on their own merits.

• Direct loans are more dependent on government funding than guaranteed loans, which are provided by private lenders. There is some evidence that guarantees are fully funded (by Congress) as if they were direct loans. This assumes 100% loss. There is support for accounting for losses in a similar way to banks' loan-loss reserves. Bankers therefore suggested that guarantees be funded only in that fashion. They support additional authorizations for guaranteed loans as long as direct government lending is reduced by a similar amount.

• A phased-in approach for guarantees was recommended: During the first year, 60% direct and 40% guaranteed; second year, 50/50; by the fifth year, 20% direct and 80% guaranteed. This goal appears achievable, bankers stated.

Commodity reserves. These reserves should be reduced substantially, say agri-bankers. Reason: High reserve levels *and their causes* have created roadblocks to marketing efforts of agriculture. Their position was amplified with these remarks:

• Reductions should be made over a period of time so as not to create a dramatic effect on commodity prices.

AGRI-BANKERS QUIZZED by press following "consensus" session in Kansas City: (from l.) Timothy R. Taylor, pres., First of America, Holland, Mich.; Oliver Hansen, pres., Liberty Trust, Durant, Ia.; Mike Fitch, v.p., Wells Fargo, San Francisco; and Alan R. Tubbs, pres., First Central, DeWitt, Ia. Mr. Tubbs was conference chairman.

• Establish procedures that would result in a gradual decrease in reserves; e.g., production controls, PIK-type programs and reduction in support prices to make U. S. agriculture more competitive in world markets.

• Establish long-range goals for reserves at substantially lower levels for all commodities. Present buildups prevent proper development of export markets. Present high support prices add to these buildups.

• Encourage other countries to house some of their own reserves. Present U. S. policies have caused 60% of the world's grain reserves to be housed in this country.

Interest-rate subsidies on storage-facility loans. End these subsidies. There is no reason, said bankers, for the private sector not to be involved in making these loans. These subsidies further encourage unnecessary build-up of grain reserves.

Move toward a free market. Bankers believe that agriculture must begin to move toward a free market and that restructuring target-price supports and loan levels is one way to achieve this. They proposed a target-price program based on a five-year moving average, gradually phasing out supports, achieving a free market at the end of the fifth year. Supporting this recommendation were these thoughts:

• Price-support policies do help farmers deal with financial stress, but only in a small and temporary way.

• Price supports do not help those farmers most in need. Benefits cannot be targeted effectively on those farms with serious financial problems.

• The target-price concept should be more flexible and, if possible, benefits should be channeled more to "family farms."

• Price supports send improper signals to producers, increase production beyond the capacity to sell in world markets. There needs to be a balance between production and ability to market.

• Support programs have not raised prices in world markets. The opposite has resulted, and increased stocks have imposed record costs on U. S. taxpayers.

Bankers seated around some 50 round tables considered the proposals outlined in the foregoing paragraphs. Their "table reports" were monitored, and results will be considered by the ABA leadership conference.

A message will be sent to Congress. Will it hear? Will it listen? Will your voice be added to those who already have spoken? — **Ralph B. Cox, publisher.**

CEO Concerns

(Continued from page 20)

size increased. *Employee relations, management development, capital adequacy, national economy* and *CEO succession* also had higher response rates than they did last year.

On the other hand, the biggest decrease in concern was *spread management*.

The New Competition. Sears lengthened its lead over Merrill Lynch as the most respected nonbank competitor for the future. Fully 93% of the CEOs said Sears would be a major competitive threat in their markets in 1990, compared with 83% for Merrill Lynch and 77% for American Express. These percentages, says Egon Zehnder, reflect significant gains from the 1983 survey for Sears and American Express and slippage for Merrill Lynch. K mart, the giant retailer, wasn't even mentioned by any CEO in 1983, but jumped to sixth place (24%) behind Prudential-Bache (38%) and E. F. Hutton (27%) in 1984.

Corporate Leadership. "Given the 'acquire or be acquired' environment in banking, as well as the general competitive turmoil, we wanted to find out where these CEOs were turning for advice," says Samuel H. Pettway, Zehnder's survey coordinator. "Results indicate coming upheaval in bank boardrooms and executive suites."

For example, when asked to rate contributions of their boards to their banks' strategic success, 28% of the CEOs described their boards as "passive" or "largely ceremonial." Only 27% saw their boards as "critical" or "very active" contributors. In fact, *only one CEO* from the nation's 55 largest banks — all with assets of more than $5 billion — viewed the board as a critical contributor.

"The average bank board of directors," warns Mr. Pettway, "may not be fulfilling the role it's expected to. In fact, a majority of the CEOs said they are altering the makeup of their boards in response to changes in the industry or in the markets they serve."

Copies of the survey described in the accompanying article may be obtained by writing the Egon Zehnder International offices: 645 Fifth Ave., New York, NY 10022; One First National Plaza, Chicago, IL 60603; Eight Piedmont Center, Atlanta, GA 30305.

The survey also revealed that CEO succession won't be a routine matter at these banks either. Barely four CEOs in 10 are completely confident their successors are now on their staffs. Conversely, more than one in four expressed certainty that a successor will *not* come from their present management teams.

"Clearly," continues Mr. Pettway, "changes in the banking industry are having a 'trickle-down' effect, which is changing requirements for future senior executives."

CEOs cited "another officer in the bank" when asked in the survey to name their most valued business advisers.

"Ironically," Mr. Pettway points out, "the cadres of professional advice-givers — lawyers, accountants and consultants — fared quite poorly on this scale. Not one received more than 4% of the responses. In fact, spouses got as many votes as either accounting partners or management consultants."

CEOs also predicted cities in each region that will have the most potential for economic growth in the next decade. In order of preference, their leading choices for "Cinderella cities" are: *East* — 1. Boston. 2. Harrisburg, Pa. 3. Allentown, Pa. *Midwest* — 1. Indianapolis. 2. Columbus, O. 3. Minneapolis. *Southwest* — 1. Dallas. 2. Austin, Tex. 3. Houston. *Southeast* — 1. Atlanta. 2. Tampa/St. Petersburg, Fla. 3. Orlando, Fla. *West* — 1. Denver. 2. San Diego. 3. Seattle. • •

Bank Survey

(Continued from page 9)

plan to buy an investment firm.

And here is where banking's "house" is divided: *Four percent admitted they were ready to charter a nonbank*. These are commercial banks, now, in the Mid-Continent area (not from New York City or the West Coast) saying they will charter nonbanks! (The bromide must be right: If you can't beat 'em, join 'em.)

Perhaps one banker summed it up best as to what bankers should be doing or planning for 1985 and the years ahead. "We need to do what we do best. The new services will contribute only in proper markets. They won't work for everyone. Tinker Bell (a magical character in "Peter Pan") comes out only in fantasy land."

Enough said. — **Ralph B. Cox, publisher.**

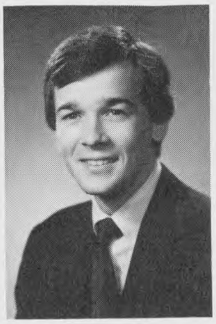
A Portfolio Approach To Asset/Liability Management

THE first thing many bankers think of when they hear the words "asset/liability management" is a half-inch stack of reports. These reports, through their maze of maturity gaps, periodic gaps and rate-sensitive-asset/rate-sensitive-liability (RSA/RSL) ratios somehow hold the key to managing the bank's interest-rate risk.

Gut feeling tells us the bank is liability sensitive, but we find it difficult to confirm or disprove that feeling through our analysis of the reports. Their complexity often leaves us uncertain or confused. Furthermore, our uncertainty is heightened by the time when, based on the negative 90-day gap, we are sure that a drop in interest rates will help us. Interest rates do, in fact, fall the following month, but net yield mysteriously declines. This type of experience brings about a renewed and intensified feeling that we are incapable of understanding the bank's interest-rate risk. The real problem is that despite a bank's actual exposure to interest rates, bank management often is so uncertain of its ability to assess that risk objectively that it never takes any action to correct it.

Well, contrary to this picture of paralyzing confusion, asset/liability management actually can be rather simple. For example, think about a situation where a bank has one asset and one liability each in the amount of $1 million (ignore stockholders' equity for the moment). Assume the asset earns a rate of 12% and matures in 180 days; the liability costs 10% and matures in 90 days. During the first 90 days, the bank earns net-interest income of 2%, or $5,000. During the first 90 days, interest rates rise. The liability matures and rolls over for another 90 days at a new rate of 14%. The asset does not re-price and continues to earn 12%. During the final 90 days, the bank earns net-interest income of −2%, or −$5,000. On day 180, the loan pays off, and the deposit is closed out, but because of interest-rate risk, the bank makes no money.

By Robert P. Prince



Robert P. Prince, v.p., First Nat'l, Tulsa, manages the bank's Treasury group. His responsibilities include asset/liability management, funds management and investment-portfolio management. He is a certified public accountant and an adjunct professor of finance, University of Tulsa, where he received a B.S. degree in business administration, with majors in finance/accounting.

In this situation, the bank clearly was more sensitive to changes in interest rates within its liability structure than its asset structure.

Graph A (page 46) illustrates this risk in the form of a maturity mismatch between the asset and liability. Graph B (page 46) shows the result of this mismatch when interest rates rise, and shorter-term liability costs increase while the longer-term asset yields hold constant.

Managing this problem is what asset/liability management is all about. The main difference between this simple example and real life is that banks have many assets and liabilities rather than just one; these assets and liabilities often pay interest before maturity; the assets may have amortizing principal balances, and the bank uses equity and non-interest-bearing deposits as a source of funds. The trick to asset/liability management is to reduce the balance sheet to a level of direct simplicity that we see in the previous example. At this level of simplicity, anyone can understand interest-rate risk and, more importantly, do something about it.

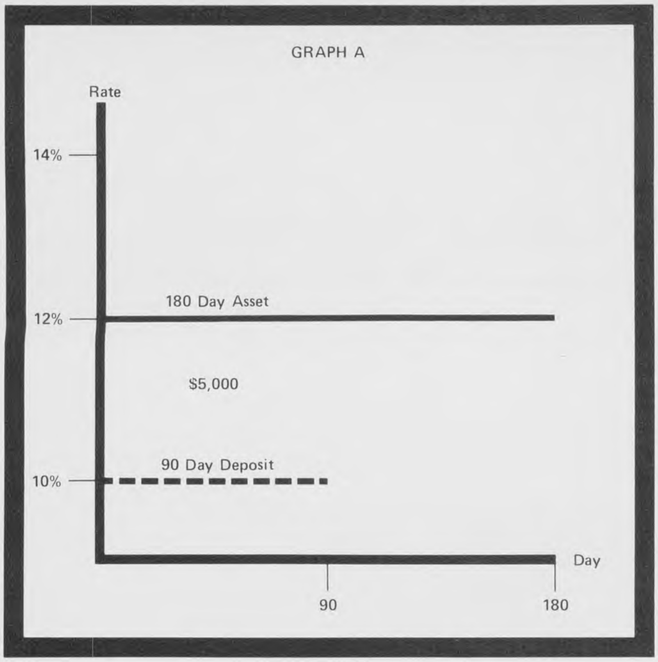
A Portfolio Approach. Two things make the previous example easy to understand. 1. We clearly can identify that a specific liability funded a specific asset. 2. Interest-rate sensitivities of both the asset and liability are expressed as a single number, their term to maturity. To analyze an entire balance sheet in such simple terms, we need to accomplish these same things.

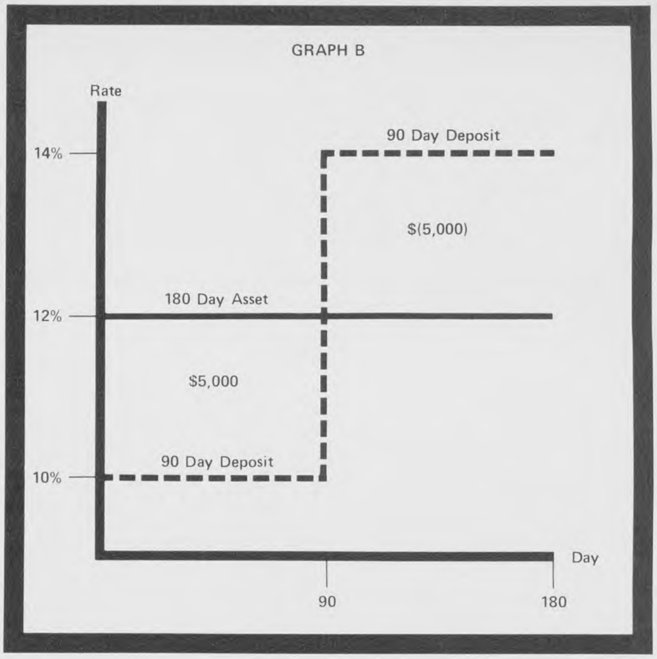
The fact that banks have a large number of individual assets and liabilities, all with different maturities and cash-flow patterns, keeps bankers from directly associating individual assets with corresponding liabilities. Without an advanced funds-transfer-pricing system and a central control point, this type of pairing off would be impossible even in the most simple balance sheet.

But when you take in a wider perspective of the balance sheet, you see that it really does contain distinctly different *types* of assets and liabilities. You see asset groupings called prime-rate-based loans, money-market investments, fixed-rate commercial loans, consumer-installment loans and investment securities. There are liability groupings called money-market deposits, CDs over $100,000, retail CDs, NOW and savings and demand deposits. And then there is a funding source called stockholders' equity. Each of these groupings represents a distinct portfolio with its own maturity and cash-flow profile.

By pairing off asset portfolios against similar maturity-liability portfolios, we can show that specific liability portfolios fund specific asset portfolios. This process of asset and liability association is the first requirement of a simplified approach to asset/liability management.

The best way to accomplish portfolio matching is to organize asset and liability portfolios into general categories according to their initial maturities. Initial maturity can be estimated by doubling the average life of the portfolio. Those assets and liabilities that generally have an initial maturity greater than one year, or an average life of more than six months, fall into the long-term category, while those





with an initial maturity of less than one year fall into the short-term category. In essence, you split the balance sheet into two separate balance sheets — a long-term balance sheet and a short-term balance sheet.

Types of assets that go on the short-term balance sheet are prime-rate assets, fed funds sold and bankers acceptances. These are funded on the short-term balance sheet by money-market deposits, CDs over $100,000 and six-month money-market CDs. Types of assets that go on the long-term balance sheet are fixed-rate loans and investment securities. These are funded by long-term CDs, NOW and savings, demand deposits and equity. Any excess liabilities on the short-term balance sheet are transferred as a group to the fixed-rate balance sheet. On the other hand, any shortage of short-term funds is covered by transferring excess fixed-rate liabilities from the long-term balance sheet to the short-term balance sheet.

Strategic Gap: A Source of Long-Term Risk. Failure of these balance sheets to fund themselves represents a major source of interest-rate risk we will call the strategic gap. For example, if the long-term balance sheet has $10 million more assets than liabilities, then these fixed-rate assets are funded by $10 million of short-term liabilities. This represents a $10-million strategic gap. Under this condition, the bank has a $10-million exposure to rising interest rates.

The first objective in a good asset/liability management system should be to minimize the strategic gap. Short-term assets should be funded by short-term liabilities and long-term assets by long-term liabilities and stockholders' equity. Doing so will eliminate a great deal of exposure to sustained interest-rate movements.

This analysis of long-term interest-rate risk is a significant departure from traditional gap analysis. Traditional gap analysis categorizes assets and liabilities by their maturities or repricing dates, but pays little or no attention to individual portfolios in the balance sheet. The portfolio approach separates assets and liabilities by type and then categorizes these portfolios into separate balance sheets according to their initial maturities. Even if you have a few CDs over $100,000 that mature in 1½ years, they should be grouped with all other CDs over $100,000 and included in the short-term balance sheet. We are concerned with portfolios, not individual CDs. The advantage of this system is that it more clearly isolates interest-rate risk and allows us to readily devise strategies to deal with that risk.

Balance-Sheet Mismatch. Once a bank minimizes its strategic gap, there is no guarantee that interest-rate risk is eliminated. A second source of interest-rate risk still lies within the separate balance sheets. This exposure is called a mismatch and is measured through a technique called duration.

Duration is a single number that represents the interest-rate sensitivity of an asset or a portfolio of assets. Duration analysis has revolutionized management of fixed-income securities and is gaining wider use in banking.

An asset's duration can be defined as the weighted average time until the asset's cash flows occur, where the relative present values of each payment are used as the weights. Duration of a portfolio of assets or liabilities is defined as the weighted average of durations of its individual assets or liabilities. For a portfolio of CDs that pay interest at maturity, the portfolio duration will equal the weighted average life of that CD portfolio. For now, suffice it to say that duration is a good index of a portfolio's interest-rate sensitivity. (For a more detailed discussion of duration, see articles by Sanford Rose in *American Banker* or publications by Alden L. Toevs of Morgan Stanley & Co.)

Similar to our first elementary example of one 180-day asset and one 90-day liability, we analyze interest-rate risk within short-term and long-term balance sheets by comparing durations of assets and liabilities. If duration of assets is longer than duration of liabilities, the bank is liability sensitive. If duration of assets is shorter than duration of liabilities, the bank is asset sensitive. In either case, there is an interest-rate mismatch.

To minimize long-term interest rate risk, a bank should strive to match durations in its long-term balance sheet. Once this is accomplished and there exists no strategic gap, the banker essentially can set aside the long-term balance sheet and then review it only periodically.

With the strategic gap minimized and no duration mismatch in the long-

CURRENT BALANCE SHEET

Assets	Balance (000's)	Liabilities	Balance (000's)
Cash & Due From	$ 2,500	Demand Deposits	$ 7,600
Fed Funds Sold	2,250	NOW & Savings Accts	4,250
		Money Market Deposit Accts.	4,675
Investment Securities:			
Bankers Acceptances	5,125	Money Market CD's	17,400
U.S. Governments	5,050	CD's $100,000	4,600
Municipals	8,500	CD's $100,000	5,300
SUBTOTAL	$18,675	TOTAL DEPOSITS	43,825
Loans:			
Commercial	$13,500		
Installment	10,450	Other Liabilities	$ 1,050
	$23,950	Equity	$ 4,000
Other Assets	1,500		
TOTAL ASSETS	$48,875	TOTAL LIABILITY & STOCKHOLDERS EQUITY	$48,875

I. Short-Term Balance Sheet

	Current Balance	Average Rate	(days) Duration
Assets			
Prime Based Loans	$10,000	13.00%	30 (a)
Fed Funds Sold	2,250	8.75	1
Bankers Acceptances	5,125	10.30	100
	$17,375	11.65%	47
Liabilities			
Money Market Deposits	$ 4,675	8.00%	1
CD's over $100,000	5,300	9.30	94
Money Market CD's	17,400	9.80	106
	$27,375	9.40%	86
Gap/Spread/Mismatch	$(10,000)	2.25%	(39)

(a) The portfolio of liabilities that best matches prime-based assets and minimizes earnings volatility is 65% 90-day average of 90-day CDs and 35% overnight fed funds. This portfolio has a duration of 30 days. We allocate this duration to prime-based assets.

II. Fixed Rate Balance Sheet

	Current Balance	Average Rate	(days) Duration
Assets			
Commercial Loans	$ 5,500	12.00%	249
Installment Loans	8,450	15.00	370
U.S. Government Securities	5,050	10.30	1,095 (3 years)
Municipal Securities	8,500	13.00	1,570 (4.3 years)
	$27,500	12.92%	850 (2.3 years)
Liabilities			
CD's under $100,000	$ 4,600	9.50%	363
NOW and Savings	4,250	5.22	1,095 (3 years)[d]
Net DDA[b]	5,100	--	1,095 (3 years)
Net Equity[c]	3,550	--	1,095 (3 years)
	$17,500	3.76%	903 (2.5 years)
Gap/Spread/Mismatch	$10,000	9.16%	(53) (.2 years)

(b) Net DDA = DDA - Cash and due from

(c) Net Equity = Equity - Non earning assets

(d) Planning period of the bank

III. Strategic Gap

	Current Balance	Average Rate	(days) Duration
Long-term Assets	$10,000	12.92%	850 (2.3 years)
Short-term Liabilities	10,000	9.40	86
Gap/Spread/Mismatch	-0-	3.52%	764 (2.1 years)

term balance sheet, the bank is pretty well insulated against long-term interest-rate risk. We now can focus attention on the short-term balance sheet, which can be managed daily or weekly depending on a bank's information capabilities.

The safest place to take interest-rate risk is in the short-term balance sheet. Taking risk in the short term allows the possibility of incrementally higher returns without risking a great deal of capital on an interest-rate forecast. If your forecast is incorrect and spreads narrow due to a wrong asset/liability mismatch, the worst that can happen is one quarter of lower earnings. Whereas a strategic gap or mismatch in the long-term balance sheet can ruin one or more years of earnings and significantly damage capital formation.

You can measure interest-rate risk in the short-term balance sheet by comparing duration of assets to duration of liabilities. One can manage these durations through the futures market or by selective funding or short-term investment strategies. Once again, risk is minimized by matching duration of assets and liabilities.

Consider the current-balance-sheet example on this page to see more clearly how portfolio-based asset/liability management works. In the example, we start with a representative balance sheet of a $50-million bank. We break it into a short-term balance sheet and a long-term balance sheet. We look at the long-term interest-rate risk presented by the strategic gap and the long-term balance-sheet duration mismatch. Short-term interest-rate risk is shown by the duration mismatch in the short-term balance sheet.

In this example, we can quickly isolate the bank's interest-rate risk.

1. Short-term Mismatch: A 39-day mismatch in the short-term balance sheet that exposes the bank to a near-term decline in interest rates. The bank should manage this mismatch according to its interest-rate forecast.
2. Long-term Mismatch: There exists no significant duration mismatch in the long-term balance sheet.
3. Strategic Gap: $10,000 of long-term assets (850 days) funded by short-term liabilities. This presents severe long-term interest-rate risk. The bank should implement strategies to eliminate the strategic gap.

Summary. Portfolio-based asset/liability management requires that we group portfolios of assets and liabilities into a short-term balance sheet and a long-term balance sheet. To minimize long-term interest-rate risk, we first seek to fund short-term assets with short-term liabilities and long-term assets with long-term liabilities and stockholders' equity, thereby minimizing the strategic gap. We then match durations of assets and liabilities in the long-term balance sheet and set that balance sheet aside for periodic review.

We focus our active management of interest-rate risk on the short-term balance sheet. There, we can match durations of assets and liabilities to minimize short-term interest-rate risk or strategically mismatch durations to capture incremental profit from correctly anticipating changes in interest rates.

Portfolio-based asset/liability management is intuitively appealing and generally easy to understand. Furthermore, since many analysts feel duration analysis is a more accurate measure of interest-rate sensitivity than traditional gap analysis, this process may be more accurate. But the key advantage to portfolio-based asset/liability management is that its concise presentation leads to decisions that control interest-rate risk. ● ●

A/L Portfolio-Management Support Offered by Chase Subsidiary

A MICRO-BASED system to assist domestic or international financial institutions manage asset/liability portfolios has been developed by Interactive Data Corp., a wholly owned information-services subsidiary of Chase Manhattan Bank, New York City.

To introduce the product, Interactive Data is making demonstration disks available to prospective users, who include chief financial officers, asset/liability-management committee members and their staffs.

The system is named "microBRMS." It's described as a what-if simulator that projects earnings for any volume, pricing or funding scenario a user wishes to test, according to Melvin J. Strauss, vice president. The system also permits users to evaluate their institutions with respect to varying economic conditions, changing Fed and fiscal policies and anticipated deregulation.

"With microBRMS results, users can easily understand the interest rate and liquidity risks inherent in their portfolios," Mr. Strauss says. "They also will be able to see the impact of different risk-management strategies before any one strategy is acted on."

Benefits of microBRMS, according to Mr. Strauss, include:

- Integration with Lotus 1-2-3™ and Symphony™. Reports can be customized for use on either spreadsheet package.
- Function range includes runoff/rollover capabilities, the ability to use target balances, consideration of the tax-exempt nature of certain instruments, balance adjustments to reflect foreign-exchange futures, access to Chase Econometrics interest-rate forecasts, etc.
- In addition to helping the user with the software itself, the microBRMS team can provide support in the subject of asset/liability management. Personnel are available to discuss broad asset/liability issues, to help

structure asset/liability committee agendas, etc.

• Balance sheets and funding/pricing strategies in the system are those the user defines. No structure is imposed on users.

• The system has been field tested for seven years at Chase Manhattan and has been used by other banks and finance companies that range in size from $40 million to $80 billion.

Mr. Strauss says microBRMS is a user-friendly system with menus and extensive help screens. Completely resident on a micro computer, the system is priced at $10,000. A mainframe-resident version also is available that is delivered via conventional timesharing.

The microBRMS demonstration disk is available at no charge from the Banking Products Group, 22 Cortlandt St., New York, NY 10007. • •

• **Patricia A. Tarbutton** has joined the St. Louis Fed as vice president/division administrator, human resources, Eighth Federal Reserve District. Most recently, she was assistant vice president, personnel, San Francisco Fed.

Nonbank Situation Plot Thickens As Comptroller OKs Applications

THE PLOT continues to thicken regarding the nonbank situation. Regulatory agencies are at odds over the issue that has positioned bankers against their peers and caused officials of bankers associations to wring their hands.

But there is one point of agreement: Congress is the villain for not coming to grips with the situation during the moratorium decreed by the Comptroller of the Currency last spring. As the congressional session drew to a close prior to the national elections, the Senate and House Banking committees were at odds — not over the need to close the nonbank loophole, but over which new services banks should be permitted to offer.

Bank HCs that had applied for nonbank charters were overjoyed when the Comptroller began processing and approving their applications about November 1. But the Fed, which has the last word in the mechanics of the establishment of HC subsidiaries such as nonbanks, followed up on its threat to make the road to the establishment of nonbanks as rocky as possible.

It ruled that nonbanks must maintain operations independent of the parent firm. That means there can be no shared check clearing, loan payments, loan-balance inquiries, receipt of deposits, trust-administration services, advice to trust customers, courier services or check-cashing unless such check cashing or other customer services are provided on the same basis to customers of unaffiliated depository institutions. Separate operations must be arranged for each affiliate.

The net effect of this ruling is a substantial increase in costs associated with establishing nonbanks. Some HC executives said these costs would inhibit establishment of many nonbanks.

At presstime, the Fed was reconsidering its restrictions, at least, as far as they concern banking firms wishing to establish nonbanks.

The threat by key congressmen that legislation to close the nonbank loophole would be the first priority of the new Congress and that nonbanks would be legislated out of existence also gave many bankers pause about establishing new subsidiaries.

But the Comptroller made light of this threat, implying that it would be possible to convince Congress to grandfather nonbanks that had already been established; hence, the importance of establishing them quickly so that Congress would be impressed enough to realize it would be stepping on a lot of important toes if it failed to include a grandfather clause in forthcoming legislation.

Not to be left out of the picture, the FDIC made some waves of its own by announcing that the Glass-Steagall Act doesn't prohibit state-chartered non-Fed-member banks from acquiring firms that sell and distribute securities, providing state statutes are friendly to the move. Most banks receiving this new go-ahead authority are not giant institutions and thus are thought to be less than eager to take advantage of the new powers.

Another development is being considered by nonbank parents of nonbanks, namely Sears, Roebuck and other firms that started the nonbank trend by opening financial centers in their stores. These firms are considering banding together to form some sort

(Continued on page 53)

1984 Tax-Reform Act Provisions Affect Wide Range of Taxpayers

By J. Alan Harkness and James W. Koeger*
Peat, Marwick, Mitchell & Co., St. Louis

THE TAX REFORM ACT of 1984 significantly revised many code sections. In the first part of this two-part article (see October, 1984, issue, page 40) we discussed revisions primarily affecting banks. In this final part we will review a number of other revisions that will affect a wide range of taxpayers, including banks. These revisions deal with business use of cars and other property, interest-free or below-market loans, depreciation for real property, debt-financed corporate stock, industrial-development bonds, fringe benefits and employee stock-ownership plans.

Automobiles. The act closes down the perceived abuse of obtaining substantial tax benefits from autos, particularly luxury cars, used for business by limiting investment-tax credit (ITC) and depreciation benefits for cars placed in service after June 18, 1984.

Under prior law, a taxpayer who purchased an automobile generally was entitled to ITC and accelerated-cost-recovery-system (ACRS) deductions based on the proportionate business use of the vehicle and could deduct the business-use portion of actual operating expenses. A standard mileage allowance of 20.5¢ per mile of business use could be deducted in lieu of computing ACRS deductions and actual operating expenses.

The act provides that ACRS deductions and ITCs are available (subject to limitations described below) if at least 50% of an automobile's use in each of its first two years is for trade or business purposes. Otherwise, depreciation is based on the straight-line method over a five-year period and no ITC is allowed.

If an automobile is provided to an employee (other than a 5% shareholder or related person) as compensation, it will be considered trade or business use to that extent and the compensation amount will be treated as wages subject to withholding.

Use of a car provided as compensation for services by a 5% shareholder or related person does not qualify as business use and thus would not qualify for ITC or accelerated-recovery periods.

As under prior law, depreciation and investment credit only can be taken for the portion of basis attributable to the automobile's business use. The act stipulates that the proportion used for business never can be considered greater than that based on actual mileage. Commuting to work constitutes personal use.

The Tax Reform Act of 1984 is an extremely technical act that revises many code sections covering a broad range of areas. Readers should . . . seek competent advice relating to their particular situation to ensure compliance with the new rules.

The act also limits the amount of ITC and depreciation that may be claimed. ITC is limited to a maximum of $1,000 per automobile. Depreciation deductions for the automobile (under either ACRS or the straight-line method) are limited to $4,000 in the first year and $6,000 in all subsequent years. These limitations are reduced proportionately for personal use of the automobile. In the case of leased automobiles, limitations apply to the lessee.

The act requires a recapture of tax benefits if the percentage of business use of the automobile declines in later years. The reduction is treated as a partial sale for recapture purposes.

Employee-owned cars are not eligible for ITC and depreciation deductions unless use of the automobile is for the convenience of the employer and required as a condition of employment.

The 50% business-use test also must be satisfied to claim a business deduction for rent payments on automobiles leased by the taxpayer for a period of more than 30 days. A percentage of rent payments is deemed equal to the value of ITC and depreciation that would have been denied for personal use had the lessee owned, rather than leased, the car. Recapture rules similar to those for purchased automobiles apply.

These provisions apply with respect to property placed in service and leases entered into after June 18, 1984, unless a binding contact was entered into on or before such date.

Effective for taxable years beginning after 1984, the act requires taxpayers to keep adequate contemporaneous records (a detailed mileage log) supporting their business use of the property. Income-tax preparers are required to advise taxpayers of these rules and taxpayers must certify in writing to the preparer the existence of adequate records.

Other Property. For certain other property used partly in a trade or business and partly personal, the act restricts ITC and ACRS deductions. Property affected by these provisions includes: passenger cars; property used in transportation, i.e., trucks, boats, airplanes; property used for purposes of entertainment and computer or peripheral equipment.

If such listed property is not used more than 50% in a trade or business, the property does not qualify for ITC nor for accelerated deductions under ACRS. The taxpayer must use straight-line recovery over a five-, 12- or 40-year period for three-, five- and 15-year class property, respectively. This provision is effective for all property placed in service, or for leases entered into after June 18, 1984, except when a binding contract was in effect on June 18, 1984.

Interest-Free or Below-Market Loans. The tax treatment of interest-free or below-market-interest-rate loans has long been a matter of dispute between taxpayers and the IRS. Some courts have held that demand loans of this nature result in neither a taxable gift nor taxable income, but conflicting authority prevails regarding term loans.

In February, 1984, the U. S. Supreme Court put to rest the disagreement concerning the gift-tax consequences of an interest-free demand loan to a family member. It decided that the value of such a loan constitutes a transfer subject to gift tax. The case did not, however, address the income-

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tax treatment of such loans.

The act ends the remaining controversy by specifying that certain below-market interest-rate loans will result in a taxable gift from the lender and taxable income from an imputed dividend or compensation to the recipient. In addition, the borrower is deemed to incur interest expense and the lender to receive interest income.

Under the act, certain below-market interest-rate loans are recharacterized as arm's length transactions. The lender is deemed to have made a loan to the borrower in exchange for a note requiring payment of interest at a designated statutory rate. With recharacterization, the borrower is deemed to have paid interest on the loan. This interest may be deductible if the amount is not otherwise limited. The deemed interest is includable in the lender's income. The deemed interest payment also is characterized, depending on the circumstances of the loan, as a payment from the lender in the form of:

- A gift, if the loan is gratuitous;
- A dividend, if the loan is to any shareholder;
- Wages, if the loan is to an employee or independent contractor;
- A tax-avoidance transaction, if one of the principal purposes is avoidance of any federal tax; or
- Another type of transaction, if, to the extent provided in regulations, there is a significant effect on any federal tax liability of the borrower or lender.

Loans deemed gifts are subject to gift tax. Loans in the nature of wages result in a compensation deduction if the usual tests concerning reasonableness of compensation are met. In general, no income or gift-tax consequences occur with respect to a loan if the aggregate amount outstanding on all loans between the borrower and lender is $10,000 or less.

Depreciation for Real Property. The act increases the ACRS period for real property, other than low-income housing, to 18 years from 15 years for property placed in service after March 15, 1984.

Debt-Financed Corporate Stock. Leveraged investments in portfolio stock will be penalized if a direct tracing is demonstrated between borrowing and investment in dividend-paying stocks qualifying for the 85% dividend-received deduction (DRD). The act reduces the DRD to the extent of interest expense on the directly traceable debt with respect to stock, with a holding period beginning after date of enactment.

It is unclear how these rules will be applied to banks owning dividend-paying stock. Hopefully, deposits and related liabilities incurred in the normal course of a financial institution's business will not be presumed to have been incurred to carry the stock. Forthcoming regulations may address this specifically. In any event, the increasingly popular adjustable-rate preferred-stock offerings are likely to be less enthusiastically received in the marketplace under the new provisions, which are effective for stock withholding periods beginning after July 18, 1984.

Industrial-Development Bonds. Despite limitations imposed by recent tax legislation on the use of tax-exempt industrial development bonds (IDBs) to fund private activities, use of IDBs has continued to grow significantly. The act makes substantive changes that will reduce tax benefits available to most IDB-financed facilities and will further restrict issuance of IDBs to finance private activities. The act also extends the mortgage-subsidy-bond provisions first enacted by the Mortgage Subsidy Bond Act of 1980 and revises arbitrage rules for IDBs and certain other bonds.

The act imposes an annual volume limit equal to the greater of $150 ($100 in 1986) per state resident, or $200 million on the amount of most IDBs and student-loan bonds that may be issued within each state (including the District of Columbia) after December 31, 1983.

The act denies tax-exempt treatment to tax-exempt bonds where payment of principal or interest is the subject of a federal guarantee. This provision is a reaction to recent issues of tax-exempt bonds where proceeds were deposited in accounts insured by the FDIC or other similar deposit-insurance funds. Numerous exceptions are provided, however, including FHA-, VA- and FNMA-guaranteed bonds.

Fringe Benefits. The act sets forth new rules taxing fringe benefits. The intent is to continue the existing practice with regard to traditionally tax-exempt benefits, while taxing any benefit not specifically excluded.

The act sets forth several categories of benefits which, if granted to an employee, would be deductible by the employer and nontaxable to the employee. Those categories of fringe benefits are:

- No-additional-cost services, i.e., services normally offered to customers can be provided by the employer to employees at no substantial additional cost;
- Qualified employee discounts on purchases of employer products or services if the discount does not exceed the employer's gross-profit percentage;
- Working-condition benefits that otherwise would be deductible by the employee as ordinary, necessary and reasonable business expenses;
- De minimis fringe benefits that have a value so small that accounting for them is unreasonable or administratively impractical; and
- Athletic facilities.

These fringe benefits are exempt from employment taxes and income-tax withholding. Additionally, they will not be considered earnings that could reduce social-security benefits. These rules generally are effective as of January 1, 1985, and are subject to certain anti-discrimination rules. Transition rules allow continuation of certain existing practices.

Employee Stock Ownership Plan. An employee stock ownership plan (ESOP) is a qualified retirement plan designed primarily for investment in employer securities. An employer is allowed a deduction for contributions to an ESOP, within limits. Since January 1, 1983, a tax credit of up to one-half of 1% of compensation expenses has been available if an equivalent amount is contributed to a special type of ESOP known as a PAYSOP. An ESOP can borrow to finance an acquisition of employer securities without violating prohibited transaction provisions generally applicable to other qualified plans. Dividends received on stock held in an ESOP can be paid out immediately to plan participants. The act provides incentives for use of ESOPs, generally effective for taxable years beginning after the enactment date.

The act allows a bank, insurance company or other commercial lender that makes a loan to enable an *unrelated* ESOP to purchase employer securities to exclude from taxable income 50% of the interest received on the loan. This applies to loans made after the enactment date. Apparently, the excluded interest will not be subject to the 20% scale back of corporate-preference items that affects interest incurred to carry tax-exempt obligations.

Conclusion. The Tax Reform Act of 1984 is an extremely technical act that revises many Code sections covering a broad range of areas. We have attempted in these two articles to briefly summarize the major areas that will affect banks. Readers should be aware that many other areas of the act were significantly revised and should seek competent advice relating to their particular situation to ensure compliance with the new rules. ● ●

Nonbanks

(Continued from page 50)

of unified front against elimination of their new ventures by Congress. If the concept flies, it's possible that some banks and nonbanks will be joining together to protect their turfs.

While most nonbank publicity has been shining on bank-owned nonbanks, the people at Sears and other retailers have not been resting on their laurels. Sears officials envision providing a fully integrated national financial-services-and-banking system that will include ATMs and credit and proprietary-transaction cards. K mart is planning to test discount stock brokerage and real estate sales in its stores later this year, and J.C. Penney Co. intends to test offerings of unsecured loans, auto loans and leases, mortgages and real-estate brokerages this year.

Congress' failure to enact banking legislation last year has resulted in regulatory agencies taking on the duties of Congress, critics say. The big question is whether Congress will turn its legislation-creating powers over to these agencies without a fight. — **Jim Fabian, senior editor.**

● **Christmas Club a Corp.**, Easton, Pa., has appointed Christina Helderle and Gene Barber account executives. They serve the firm in Indianapolis and Marietta, Ga., respectively.

Index to Advertisers

By Dr. LEWIS E. DAVIDS
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Deregulating Fed Margin Requirements

THE FED'S margin requirements have been on the books so long they may have escaped the notice of those responsible for deregulating the banking industry.

The margin requirements (covered under Fed regulations X(12CFR224), G(12CFR207), T(12CFR220) and U(12CFR221)) tend to be lumped into what may be called "qualitative credit controls."

In the late 1920s, horrendous stories were told about bootblacks, clerks and the like, who, in the frenzied stock market situation, purchased securities through high borrowing on the various stock exchanges. When stock prices fell, many were wiped out because they couldn't meet their brokers' margin calls.

The nature of the margin calls was linked in some economists' minds to a dysfunctional impact on the stock exchange in that the calling of margins forced sales and the increase in sales drove down stock prices. Margin requirements were imposed to reduce leverage and probably to try to protect neophytes who had entered the stock market with the expectation of a quick kill.

The historical chart book of the Fed's Board of Governors shows that margin requirements initially were imposed at 25% in 1934 and were raised to more than 50% the following year. They declined to 50% in 1938, remained at that level for several years and moved up to 100% in 1946. After 1946, they periodically moved down and up, but remained above 50% until 1974. Since 1974, they have stood at 50% of market value.

I question whether a 50% margin requirement is rational or even necessary.

The governing boards of the New York Futures Exchange (NYFE) and the Kansas City Board of Trade (KCBOT) have adopted reduced margin requirements for specific inter-market ("spread") trades involving their stock index futures on the Chicago Board of Trade's (CBOT) new Major Market Index (MMI) stock index futures contract.

". . . the rightful place for margin requirements should be individual exchanges, and individual lending funds should be left to their customers."

The initial speculative margin for a combined position in MMI futures and NYSE index futures (traded on NYFE) is $750. Previously, when investors combined, initial margin would have totaled $3,850. Combined hedging margins have been reduced to $750 from $1,850 for inter-market transactions.

For a trade involving one KCBOT Value Line stock index futures contract and one CBOT/MMI futures contract, the new initial margin will be $1,400, reduced from $7,400. Hedging margins were reduced to $1,400 from $3,400.

What the 50% Fed margin requirements for stock and convertible bonds has done is to encourage speculative elements to move to the NYFE and the KCBOT as well as the CBOT. In other words, the typical speculator can get more action per buck by using such exchanges. This is clearly demonstrated by the fact that almost every week the CBOT issues a news release showing new trading highs. An examination of financial periodicals shows an exponential growth in the area of data on the futures market.

There is a basic issue concerned with the Fed's margin requirements: Who should be responsible for them? The history of qualitative credit controls has not been good. Frankly, it's relatively easy for knowledgeable individuals to bypass margin requirements, just as businessmen and banks developed the Eurodollar market for a number of reasons, including the impact of Regulation Q and reserve requirements. In other words, sophisticated investors are quite able to bypass and have been doing so for a considerable period of time.

But let's save and protect the little guy, the odd-lot buyer, the proverbial bootblack and file clerk. It appears inconsistent for a number of states to authorize legalized gambling and vigorously promote lotteries. Just recently, one individual in Chicago won $40 million in the Illinois lottery. Thus, in many states, gambling is encouraged; whereas, the Fed's Board of Governors is ineffectual in the stock market because professionals try to govern it by imposing margin requirements, stating that they constitute a desirable qualitative credit control.

Note the mention above of the changing margin requirements by the NYFE and the KCBOT. These are the parties that adopted reduced margin requirements.

By the same token, margin requirements are imposed by the NYSE and lenders, but to a large extent they are ineffectual as long as the Fed's margin requirements exist on stocks and convertible bonds.

The point of this article is that the rightful place for margin requirements should be individual exchanges, and individual lending funds should be left to their customers. The basic question is one of business risks involved and competing elements of other investments.

Now is the opportune time to determine whether the Fed's margin requirements should be eliminated and responsibility placed where it more properly rests — with the private sector. • •

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