MID-CONTINENT BANKER

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FEBRUARY, 1985

AGRI—BANKING

Debtor Distress

Commodity Hedging Pioneered

Leasing: A Profit Booster

CORRESPONDENT BANKING

Tailoring Respondents' Services

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CONVENTION CALENDAR

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 5-8: Inter-Financial Association's EXPO 85 — Electronic Banking Conference/Equipment Exposition, San Francisco, Hilton Hotel.

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 24-26: Inter-Financial Association's Travel Services for Banks Conference — New Fee Opportunities, San Francisco.

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 29-April 2: Association of Reserve City Bankers Annual Meeting, Wesley Chapel, Fla., Saddlebrook Resort.

March 31-April 3: ABA National Retail Banking Conference, San Francisco, Hilton/Tower.

April 11-14: Assembly for Bank Directors Assembly 61, White Sulphur Springs, W. Va., The Greenbrier.

April 14-16: Conference of State Bank Supervisors Annual Convention, Phoenix, The Pointe.

April 14-17: National Automated Clearinghouse Association Conference, Phoenix, Hyatt Regency Phoenix.

MID-CONTINENT BANKER

(Incorporating MID-WESTERN BANKER)

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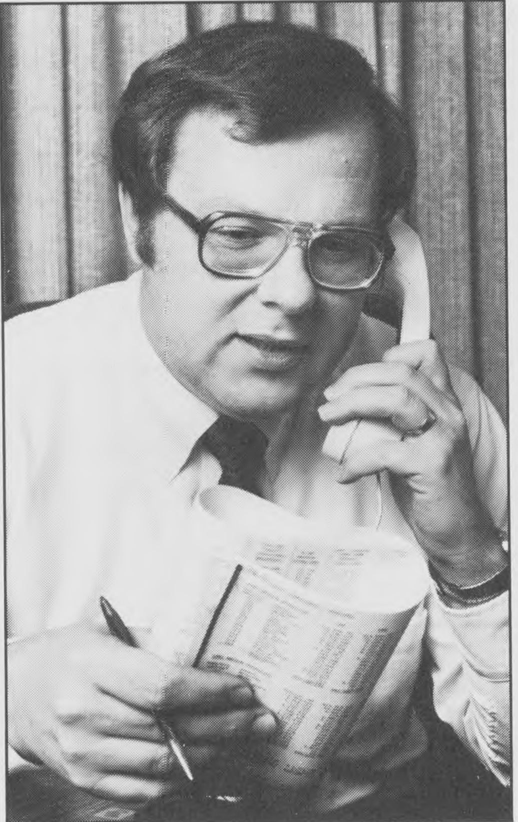

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A 'Survival Kit' for 1980s —

Nontraditional Services Offered Community Banks By Upstream Correspondents

New programs include financial planning for customers of correspondent banks, employee training, schools for employees, A/L-management consulting and franchising/licensing agreements.

TODAY'S BANKERS must be entrepreneurial, must know about and be able to offer new banking services to a public that, on the whole, is more sophisticated and knowledgeable about the financial-services industry than it was just a few years ago. This holds true for community banks as much as it does for large, money-center banks.

However, how are the smaller banks going to develop the innovative services they must offer if they are to remain competitive with other banks, thrifts and a growing number of nonbanks? Most smaller banks don't have the expertise and funds to develop such services on their own.

The solution to this problem can be found at upstream correspondent banks. According to a MID-CONTINENT BANKER survey of these banks, a growing number are selling services they developed for themselves to smaller banks.

'Sharing' Theory

As explained by Lad. Kvasnicka Jr., vice president, American National, Chicago, the assumption is that his bank can share products it already has developed with its respondent-bank customers and thereby help them to service their own customers while keeping their development costs to a minimum.

Many of these services are far removed from the traditional correspondent-bank services offered for so many years. New programs available include financial planning for customers of correspondent banks, discount brokerage, interest-rate swaps, employee training, schools for employees, asset/liability-management consulting, marketing support, franchising/licensing agreements and insurance.

The term "private label" is used by several correspondent banks to describe some of their services. That is, when smaller banks buy such services, they, in turn, can offer them to their customers as though they originated them. Names of the large correspondent banks that created the services are transparent or not used.

A case in point is Chicago's Northern Trust, where, says Commercial Banking Officer Lorey H. Ford, the emphasis the last year has been to tailor existing products to meet current needs of its correspondents. This means, she continues, that services provided by Northern Trust for retail/corporate customers have been redesigned as "private-label" or "ghost" services for correspondent customers. These new services cover a wide range — from more traditional cash-management products, such as lockbox, to discount brokerage and interest-rate swaps. Some of these products, for instance, discount brokerage and financial futures, resulted from formations of new subsidiaries. According to Ms. Ford, these products generally have been well received. As she puts it, "Correspondent banks seem more comfortable turning to their correspondents rather than to other financial institutions for these services."

Northern Trust offers correspondents a private-label discount-brokerage service in which Northern Trust is transparent to a correspondent's customers. The product is provided through a new subsidiary, Northern Trust Brokerage, Inc., already a well-established discount-brokerage firm when it was purchased in late 1983. Three types of services are available, including one used by correspondent trust departments. Commissions, liability and involvement of the correspondent vary with type of service used. A free marketing package and full-day training session are attractive features of the service, Ms. Ford points out.

Insurance Consulting

Other Northern Trust services include depository custody, special investments, private-label cash management and credit. It also offers insurance consulting. Northern Trust packaged its in-house expertise in determining its corporate-insurance program and offers it to its midwestern correspondents on a consulting basis. A correspondent's policies are completely analyzed with an emphasis on uninsured exposures and an evaluation of premium payments.

Financial Planning. A product St.

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Louis' Mercantile Trust says is gaining popularity is financial planning, which the bank has been offering for several years. The bank also has developed MERCPLAN, a software package that enables banks of any size to offer financial planning to their customers. MERCPLAN consists of a series of interrelated financial models that have been designed to provide a client with a complete financial plan. The finished plan consists of financial overview, education, insurance, retirement, investments and estate planning.

MERCPLAN, says Senior Vice President Eugene A. Leonard, offers the following advantages: flexibility, user friendly, easy to learn, "what-if" capabilities, complete integration, inexpensive and professional appearance.

Another Mercantile product is FlexWire, which provides the bank's customers with electronic access to its wire-transfer system directly through their desk-top terminals or personal computers. According to Mr. Leonard, it's no longer necessary to wait for wire-transfer confirmations or telephone notifications of incoming transfers. FlexWire's daily-transaction reporting, Mr. Leonard continues, can provide customers with all needed information immediately, and it's not limited to the everyday wire-transfer customer. Mr. Leonard says it can offer the same advantages to all users, whether it's for repetitive, semi-repetitive or non-repetitive transfers or drawdowns. He adds the product offers advantages of enchanced security and lower transaction costs.

Cash-Letter Detail

Mercantile also offers what it calls cash-letter detail, which is available to customers with interactive computer terminals. Cash-letter detail provides previous-day deposits, and its associated float, for all cash letters. A hard-copy report is generated. Mr. Leonard says this product can be combined with the bank's automated-reporting service to complete customers' transaction information.

International Banking. MERCSTAR is Mercantile's international-banking system. It encompasses letters of credit and trade finance/foreign exchange. As for letters of credit, MERCSTAR can be delivered directly to offices of correspondent banks' customers. This allows them to issue and amend their own letters of credit as well as request and receive management reports within seconds.

Mercantile offers a full range of export-financing alternatives to correspondents' customers' foreign business, including short- and medium-term financing, in cooperation with a variety of U. S. agencies.

Aided by MERCSTAR's fully automated communications system, says Mr. Leonard, a bank's specialists are able to advise its customers on both spot- and foreign-exchange contracts and execute requests promptly.

The bank's drawing-book service is available to all domestic correspondents. With this service, the bank's

'Provider-Bank' Concept Is Basis For Financial-Institutions Group

LAST JULY, The Marine Corp., Milwaukee, established its financial-institutions group by consolidating those functions most closely identified with serving financial institutions. Those functions include: traditional correspondent-banking services; marketing of data-processing services, including transaction data processing and a new on-site data-processing system; out-of-state investment affiliations/license agreements; all bank credit/debit-card services; and advisory services. According to a Marine spokesperson, the consolidation demonstrates its commitment to the "provider-bank" concept.

Marine's new organizational concept was inspired in part by a study on effects of banking deregulation by Dwight Crane, a Harvard University professor. Focal point of the study is the theory of "provider" and "distributor" banks. Professor Crane bases this theory on the assumption that community banks can continue to survive and prosper in the evolving financial-industry structure by focusing their efforts on distribution of financial services. He believes community banks will continue to originate loan/deposit services; however, they will look increasingly to larger provider banks for services such as communications and data processing, mortgage banking, marketing support, including franchising or licensing agreements, and other services to gain efficiencies from economies of scale.

Marine, which already was providing correspondent-banking services in Wisconsin and Illinois, plans to expand its market coverage into a six-state area that includes Michigan, Minnesota, Indiana and Iowa. Within this area, there are more than 3,000 banks with average assets of less than $150 million.

Marine says a key service now offered is the new on-site data-processing system, which is comprised of a software package developed by Jack Henry & Associates, Inc., Monett, Mo. The system, which operates on an IBM System/36 computer, will enable community banks to obtain cost-effective in-house data processing designed to provide integrated information on customers, products, services and performance. Marine says the unique advantage of this system is Marine's total support from initial planning, training, conversion and installation to future enhancement, regulatory updates and advisory consultations. In addition, Marine will expand its advisory/consulting services to further help community banks support their on-site data-processing needs.

Another development at Marine involves an investment affiliation with Elm Marine Bancshares, a $400-million multi-bank HC located in Elmhurst, Ill. The combination of a 4.9% equity investment, subordinated debentures with mandatory stock-purchase contracts and a license agreement, according to a spokesperson, "demonstrates Marine's commitment to corporate and correspondent business while providing Marine with a significant investment in Illinois."

Marine Bankcard Corp. continues to increase its marketing efforts in Wisconsin, Illinois, Michigan and Minnesota. For example, during 1984, Marine established a complete in-house embossing operation for all plastics issued by The Marine Corp. and its other service customers. This resulted in cost reductions and increased customer service.

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customers can give their customers drafts drawn on Mercantile's foreign correspondents. Mr. Leonard points out that this enables a correspondent's customer to send checks drawn on foreign banks to individuals and companies abroad. The Mercantile name doesn't appear on drafts correspondents give their customers.

Mr. Leonard says Mercantile is the only bank, to his knowledge, that has its own licensed U. S. customs brokerage house as a subsidiary. This enables Mercantile to give prompt and expert services to correspondents' customers. Services include document preparation, tariff payments and helping with ocean/rail/truck/air-transportation arrangements.

Schools. First National, Louisville, offers schools for community banks and has added three new ones for 1985. The bank has developed two additional marketing products to complement its officer-call program.

A two-day personnel-administration school, offered in February and November, is designed for individuals responsible for establishing, documenting, administering and communicating personnel policies of their institutions. Participants work from a manual that addresses such issues as salary administration, regulatory requirements, a policy manual and affirmative-action plans. Instructors are responsible for development and administration of these policies at First of Louisville.

A one-day course on communication skills for bank managers/supervisors was developed under leadership of Jeffries & Associates, a human-resource-development firm. It's held in March and October.

A one-day advanced teller-training seminar, held in May and October, has a curriculum modeled after the advanced training program required for First of Louisville's own tellers and is designed for tellers with at least six months' experience.

First of Louisville also offers a prob-

Are You Listening, Correspondent Bankers?

Training Heads List of Services Respondents Want

CORRESPONDENT bankers take note! Respondents aren't getting all the services they would like from their big-city brethren. And some have gripes about the service they're receiving.

A recent poll of selected respondent bankers in the Mid-Continent area reveals that a number of needs of these banks are not being filled by correspondents. The problem is, however, that few respondents want the same services.

Only one category was mentioned by more than one bank and that was training. Not just one type of training, such as teller-efficiency enhancement, but several types, ranging from improved cash-management techniques to how to develop new products.

Among other services on respondents' wish lists are summaries of regulatory changes, rate monitoring, hedging, internal-policy consultation, profit planning, loan participations, entry to the secondary mortgage market, data-processing refinements and a service that permits a respondent to interface its micro-computers with the correspondent's mainframe for easier retrieval of stored data.

One respondent's wishes are less technically oriented: He wants his correspondent to provide tickets to basketball games! His request isn't unusual, considering that his bank already is receiving football-game tickets from its correspondent!

Respondents also were asked to list services they expect to be needing from correspondents in the future.

The list includes ACH expansion, over-line participations, merger/acquisition assistance, access to ATM networks, personal financial planning for customers and improved asset/liability management systems/reports.

By a two-to-one margin, respondents participating in the survey favor fees over balances to pay for correspondent services, although almost as many opt for a combination of fees/balances as for fees alone.

Respondent banks, on the whole, are quite loyal to their correspondents. A number of them said they go to their correspondents for 100% of their cash-letter services. More than 80% are giving their correspondents 50% or more of this business.

Despite this loyalty, some bankers are quite vocal in their opinions about the services — or lack of them — obtainable from correspondents.

One banker had this to say about funds availability: "We often feel we are ripped off when comparing our balances to what our principal correspondent says is available to invest."

Another addressed loan over-lines: "They are our biggest problem. Correspondents require reams of information, always want to structure the loan differently no matter how we propose it. Loan officers are patronizing and condescending to us, yet they can't shovel the money out the door fast enough for foreign countries and the likes of Penn Square!"

Another banker has this to say: "I would like to see correspondents come to us with specific thoughts, ideas and suggestions rather than just making 'good guy' calls."

Other respondent gripes deal with quality of services from correspondents:

"We'd like a direct-dial phone directory so we can reach the individual we want to speak to without getting transferred or cut off."

"I'd like to see an improvement in the quality of calling people, as well as in response time."

"They are trying to sell us services, yet at the same time they are a competitor in the market."

"Small banks don't seem to be as important to the big banks now as we were 10 years ago."

Respondent gripes are summed up by this comment: "Correspondents advertise that they are here to help. What they're really saying is, 'We're here to help — until you need something!'" — **Jim Fabian, senior editor.**

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lem-loan school/workshop, credit-analysis school/workshop, professional-sales school, ag-lending school/workshop and loan-review school/workshop.

In 1984, the bank received approval from the University of Louisville for the awarding of continuing education units (CEUs) for each school. The CEU and its record system help individuals gain recognition for their efforts, keep up to date and improve their capabilities by taking part in non-degree continuing education/training activities. The CEU is a measure of the amount of organized study a person has completed. It's defined officially as 10 contact hours of participation in an organized continuing-education experience under responsible sponsorship, capable direction and qualified instruction.

Schools Attract

According to Ken S. Reinhardt Jr., vice president/manager, correspondent-consulting services, First of Louisville, in two years, the bank's schools have been attended by 400 officers from 200 financial institutions in seven states. There now are seven banks in its officer-call program. Mr. Reinhardt says that for these seven banks, First of Louisville has conducted 14 total-training sessions for 140 calling officers.

Besides the school series, First of Louisville offers a retail-sales-incentive program and an IRA seminar.

Software Programs. One of the major new services offered by Fourth National, Wichita, is profit-planner budgeting/asset-and-liability software. According to Wayne Becker, vice president, the system is written in Lotus 1-2-3 and VisiCalc and includes four modules: budget manager; rate-sensitivity/remaining-maturity analysis; public-funds pricing; and deposit pricing. Its selling price includes five days of training.

Mr. Becker points out that the program is useful for doing "what-if" analyses in these areas: account balance, interest-rate scenarios and pricing relationships. Fourth National sends quarterly printouts with interest-rate forecasts that users can plug into the system to perform the analyses.

For example, says Mr. Becker, a user could say his loans normally price at prime plus two and three quarters, but he may want to put his loans on at prime plus 1½. If so, what would that do to earnings? The Fourth National program can tell him.

The software, continues Mr. Becker, is especially good for doing such forecasts of asset/liability roll-offs and impacts of balance shifts on balance sheets/income statements.

Fourth National developed the program in-house and has been using it since January, 1983. It supposedly will run on any computer capable of running Lotus or VisiCalc software.

The bank has introduced several other new services: cashless-ATM operations; on-line point-of-sale credit-card authorization; international banking; captive-cash-letter transportation; and remote fine-sort cash-letter clearing.

Micro-Computer Program. Bankers Trust, Des Moines, Ia., offers a correspondent service called SCAN (software for credit analysis). SCAN, says Brad Hansen, is a series of micro-computer programs developed in-house, programs capable of performing credit analyses on potential cash flows for a variety of businesses, including these in the commercial-loan area: manufacturing/wholesaling/retailing/construction.

There also are program modules capable of doing agricultural or bank-stock analysis.

Mr. Hansen says a loan officer or other officer of a bank can call up the

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program he or she needs, depending on type of analysis being done. Programs can be bought as individual modules or purchased as a package.

The software runs on Apple or IBM compatibles, and a hard disk is required for large data bases, but, says Mr. Hansen, some of the banks that have bought the software are using it on floppy disks.

Utilizing a typical spread-sheet environment like Lotus 1-2-3, VisiCalc or MultiPlan, a loan officer can utilize the software to do a complicated "what-if" analysis of a credit customer, based on the customer's financial statements. The software is written so that a bank president or bank clerk can run it effectively, according to Mr. Hansen.

Other Micro Services. Citizens National, Decatur, Ill., is offering its bank customers micro-computer services that include word-processing to help bank-marketing efforts and are made available within 24 to 48 hours with advanced scheduling. Direct mail can be keyed to market segments in the area with purchased lists or a bank's own listing.

Jack Dolan, assistant vice president at Citizens National, says the bank offers optical-character-reading services, which will transfer typewritten text or data automatically to a computer floppy disk without re-keying information. Time needed for building disk records can be cut dramatically, saving hundreds of keystrokes, according to Mr. Dolan.

The bank offers classes in micro-computer orientation and operation geared for management and/or staffs.

Other micro services include: document printing (1099s, W2s, customer receipts, etc.); account analysis for business, farm or personal accounts; financial-statement spread sheeting; stockholder mailings; inventory management/reporting; assembly and printing of employee/departmental manuals; contract drafting/printing; bank loan/deposit analysis and graphics for reports, transparencies.

Citizens National has a totally separate subsidiary called Central Computing, which has its own staff and computer hardware. Mr. Dolan says this division does commercial data processing for nonbank customers and offers services that are available to customers of its correspondent banks. The latter can earn fee income and provide a needed service for their customers, Mr. Dolan points out.

In addition, administrative terminals soon will be available for Citizens National's correspondents on the *easy-answer* program. These terminals will offer updating capabilities and, says Mr. Dolan, save a bank the expense of buying a personal computer and doing the input itself. He says Citizens National will have its own terminal.

Money-Transfer System. RepublicBank Dallas reports two new products it believes to be of particular interest to its financial-institution customers: automated money-transfer capability and a fractional/as-of-availability-schedule option.

Customer direct link (CDL), says Jill M. Wilcox, cash management officer, enables users to communicate directly to RepublicBank's money-transfer system via terminals or micro-computers. This real-time, on-line access allows users to initiate a variety of wire transfers, access balance information and monitor wire activity in and out of their accounts each day. From their terminals, customer banks can initiate repetitive, semi-repetitive, non-repetitive and drawdown transfers.

RepublicBank's CDL service provides a secondary-authorization feature for greater security and control over wire initiation. Before wire trans-

Selling Services to Respondents: Large, Small Banks Can Benefit

THERE are advantages for community banks and large correspondent banks when the latter develop innovative services and market them to downstream respondents. This was pointed out in a talk given at the Bank Marketing Association's 1984 convention by Steven E. Kocen, vice president/marketing director, First Security National, Lexington, Ky.

Mr. Kocen pointed out that community banks can offer their customers state-of-the-art services they could not afford to design and implement themselves. At the same time, he continued, larger banks can create another source of income at a time when they want to reduce their dependence on some lending activities because of shrinking interest margins, narrow gap positions and fluctuating rates.

Perhaps, he added, another consolation for larger banks is their belief that such new-product development and usage by bank customers will increase the banking industry's survival in the face of increased competition from brokerage houses, insurance companies and similar nonbank financial entities.

Mr. Kocen described for BMA conventioneers First Security's product-development strategy. His bank is a $1-billion one-bank HC and, according to Mr. Kocen, is ranked fourth in size in the 325+ banks in Kentucky. Its correspondent network is made up of about 250 of these banks, plus S&Ls and credit unions. The bank has made a significant investment in hardware and software since 1980.

Being the largest bank in the county with 48% share-of-market (of eight banks), said Mr. Kocen, First Security felt it had to be on the leading edge of technology in ATMs, POS, automated-fuel systems and credit services. This technology, he said, brought the bank state-of-the-art banking at a state-of-the-art price tag. Therefore, the bank's management saw an opportunity to accomplish two objectives: 1. Protect its correspondent base. 2. Enhance incremental income by providing many of these new services to its correspondents as well as to other financial institutions.

Mr. Kocen then discussed three such services and how they have helped many community bankers in Tennessee, West Virginia, Illinois and Kentucky. The first is a revolving, paper-based line of credit. Developing and perfecting this system cost the bank nearly $100,000, but First Security offered it as a franchise for only about 5% of developmental cost. The bank then provided ongoing maintenance of accounting, billing and payment services on a per-item cost basis. This method, according to Mr. Kocen, provides First Security with an additional source of fee income that's explicitly priced. He said the program is unique in that licensee banks own their own credits or loan outstandings. At the time he gave his talk, 46 community banks had booked more than $8 million in new-loan volume, with the average outstanding loan at $9,700. These loans are priced at two points over prime. He pointed out

(Continued on page 56)

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fers are released, a second individual at a customer bank reviews and approves transactions. Passwords are selected by individual users and are not accessible to anyone.

Since last November 1, Republic-Bank's customers have had the option of being placed on a fractional-availability schedule or the whole day with an as-of adjustment schedule.

Training Help. Although 1984 was a difficult year for Continental Bank, Chicago, says Vice President Daniel T. Zapton, it continues to make its correspondent-banking relationships a high priority. An important element of this emphasis continues to be the bank's advisory-services unit, which continues to develop, in various stages, in-house programs for use by correspondent banks of basically any size.

"Train the Trainer"

Last year, Continental's "Train the Trainer" was a new product and has had reasonable acceptance in the marketplace even though, as Mr. Zapton points out, it wasn't made available until late in the third quarter. "Train the Trainer" is described as a reusable self-instructional tool that builds trainers' skills and confidence in six easy-to-follow units. The complete program includes three videotapes, two audiotapes, three copies of the workbooks and three planning pads.

Also in a research-and-development phase is a product called "Supervisory Training," which should be completed by the end of the second quarter and made available to Continental's correspondent network nationwide, again under the advisory-services unit.

Since 1981, says Mr. Zapton, the bank has added three new products and continues to make available at least one new product a year.

Late last year, the bank moved its portfolio-advisory-services products out of the bond department into one of its Midwest commercial-lending units. According to Mr. Zapton, the bank believes this product, which basically is asset/liability management, is an excellent training ground for line personnel, and transferring it puts the product closer to the markets and needs of customers.

A/L-Management Consulting. American National, St. Paul, offers a consulting service for asset/liability management. Its correspondent department, says Vice President James A. Russell, maintains an experienced investment adviser to help a bank analyze its A/L situation, establish investment and A/L policies and an A/L committee and work with the latter for a time to manage this aspect of the bank from proved profitability. This service doesn't require micro-computers or related software unless the customer bank believes this is necessary. If it does, American National will help in selecting these items, but it is not marketing them actively.

Its major products and services include: ownership loans for bank HCs and individuals; financing of employee-stock-ownership plans; purchase of over-line loans; investment services through its money-market center; bank-operations consulting; and data processing by remote data capture or by batch entry.

"We have plans that hopefully will improve service in all areas of correspondent banking, which is healthy at Am South. We are optimistic about its future environment. We want to keep it this way by showing our customers we truly care about them." — Charlie T. Gray, vice president.

In the upper Midwest, Mr. Russell points out, the correspondent market is changing as major HCs reposition their perspectives toward servicing downstream banks. However, American National re-emphasizes that it is continuing its long service of support to independent banks in its region. This may not be a new service, says Mr. Russell, but it is contrary to what some major correspondents are doing in abandoning this marketplace.

MBank Houston, effective last month, added an asset/liability management-advisory service for institutions in the $50-million-to-$500-million range. Fees for this service vary by size of institution and include the setup; at least quarterly maintenance; at least three personal visits by MBank's management group; and market and ratio projections on bonds, prime, etc.

By the way, the bank has changed the name of its correspondent-banking division to financial-institution division, allowing MBank to service S&Ls, credit unions, insurance and mortgage-service companies as well as commercial banks.

Data Processing. Capital Bank, Baton Rouge, founded its correspondent-bank relationships on a commitment to bank data processing. In recent years, however, says Sal C. Quartararo, senior vice president, deregulation has forced banks to become more competitive, sales oriented and better managed. To help its correspondent banks meet these challenges, he continues, Capital Bank identified three of its many services as those that should receive priority consideration. These services are used in the bank's own day-to-day operations and are tried and proved to be effective. They are: 1. Training — sales, tellers, operations. 2. Budgeting and asset/liability management on micro-computers. 3. Security seminars/systems needed to avoid financial and data-base risk.

Discount Brokerage. Frost National, San Antonio, Tex., provides a broad range of services to financial institutions, says A. Leonard Magruder, senior vice president, correspondent division. Most recently, it addressed new product and compliance requirements for its banks with the addition of Discount Brokerage Services and establishment of a direct relationship with Depository Trust Co. (DTC), he says.

Through Frost's Discount Brokerage Services and its clearing broker, National Financial Services Corp., correspondent banks can offer brokerage services to their customers. These customers use Frost's toll-free number to place all their trades.

The new relationship with DTC, according to Mr. Magruder, has expedited the securities-clearance process of confirmation and settlement of trade transactions.

In discussing his bank's correspondent-bank relationships, Mr. Magruder uses the terms "professional" and "personal" as key concepts for providing correspondent services in today's rapidly changing marketplace. He says now, more than ever, a personal response to each correspondent's needs is vital to the future success of all financial institutions.

"Flexibility and excellent service," he points out, "will be deciding factors in forming and maintaining correspondent relationships, especially in the lending function."

(Continued on page 56)

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Centerre Bank Wins One From the Fed By Providing Respondents With Regional-Clearinghouse Option

Financial-Services Tool, Computerized Wire Transfer Also Introduced

IS CORRESPONDENT banking dead? No! Can the city correspondent compete with the Fed for cash-letter business? Yes!

These are responses from Thomas E. O'Meara to questions asked by this publication during a recent interview. Mr. O'Meara joined Centerre Bank, St. Louis, less than two years ago as vice president/correspondent-division manager.

Although he didn't possess long-term banking experience, Mr. O'Meara brought to the job a strong innovative ability and a competitive nature that were sharpened during his seven years of sales experience in the steel industry.

Centerre's correspondent division has a philosophy that revolves around two major premises: (1) Find out what the customer needs, and — using Centerre's resources — (2) fulfill those needs. Simple? Maybe, but it takes a bit of doing!

When Mr. O'Meara started at Centerre, he was faced with new competition from the Fed for cash-letter business. This wasn't unusual among larger correspondent banks, but Centerre's solution to the problem was. Development of a regional clearinghouse (RCH) proved to be a solution that exemplified Centerre's basic philosophy of service.

The RCH concept gave the bank strong ammunition to combat the increasing competition it was facing from other correspondents as well as the Fed.

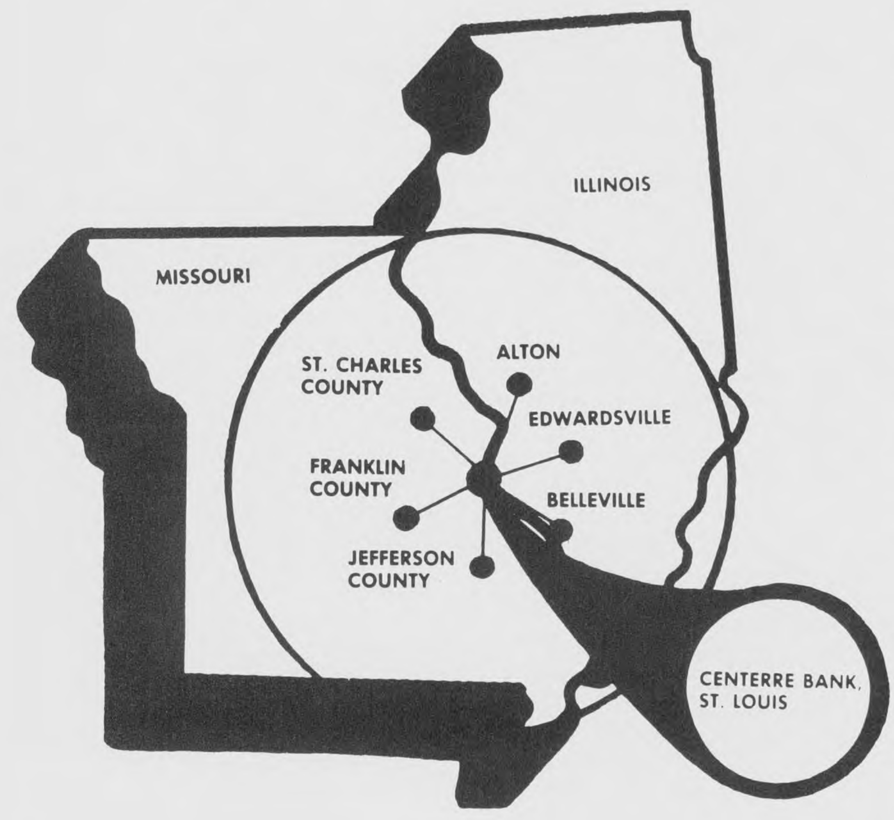
Centerre's new product was designed to allow member respondents to clear items on one another more efficiently while eliminating the additional expense of processing through the Fed.

Each of six clearinghouses is made up of a cluster of banks located near one another. All are in a 22-county area circling St. Louis in Missouri and Illinois that's within the St. Louis Regional Check Processing Center (RCPC).

RCH members agree to send all their RCPC items to Centerre, which processes all checks between these banks at no charge. Centerre also will process checks drawn on banks outside the clearinghouse for member banks at a fee that's competitive with that charged by the Fed.

Mr. O'Meara gives an example of the cost-savings for RCH-member banks: "A $20-million bank with about 12,500 items processed a month saved $450 per month by joining our system." Member banks also reduce or eliminate processing requirements and avoid multiple settlements, thereby reducing transportation costs.

Centerre also offers better daily deadlines, which translates into better funds availability. The new cost to each



Centerre Bank's regional clearinghouses are clustered around the St. Louis headquarters of the bank. Six centers serve 22 counties in Illinois and Missouri that are within the St. Louis Regional Check Processing Center. Nina Cleveland, staff artist

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Centerre Wins One From Fed

member bank is lower than that of processing through the Fed or with other competitors. Centerre recently extended its cutoff time by four hours — from 3 to 7 p.m. — for next-day availability on St. Louis country items.

Customers need not be RCH members to take advantage of Centerre's later cutoff time. They, too, benefit from more rapid collection of county items and significantly improve the availability of investable funds.

Taking a cash-management approach to clearing checks involves focusing on expense control, penny pricing and managing non-earning assets to minimize float, Mr. O'Meara says.

Tom O'Meara, v.p./corres. dept. head at Centerre Bank, St. Louis, chaired session about bank's new products for respondents at recent annual Centerre Correspondent-Bank Conference.

Centerre also is able to clear checks outside the RCH area. The benefit, again, is improved funds availability; but a slightly higher price is charged for these other-Fed-district items.

"The value of these investable funds more than offsets the incremental cost of processing," Mr. O'Meara says.

Centerre's direct-send service offers an increased number of direct-send points and often extra deliveries per day. This enables banks to have funds available faster — often one day sooner than was possible through the Fed, Mr. O'Meara says. Thus, even though Centerre has a slightly higher per-item charge than the Fed, additional earnings on available funds more than offset this cost.

The RCH/direct-send service isn't the only new service Centerre is offering to respondents. Last November, CenSTAR came on line. It's described by the bank as a "new financial-analysis tool that's designed to help bank loan officers make better and more informed lending decisions through comprehensive and insightful financial-statement analysis."

CenSTAR is a computerized financial-statement-analysis system that runs on the IBM personal computer. The software is being sold to customers who can operate the program on their own office computers.

"The system's key feature is its flexibility," Mr. O'Meara says.

The tool generates a number of reports in both historical and forecasting contexts, including balance sheets, income statements, net-worth reconciliations, ratio and trend analysis and financial summaries. CenSTAR permits users to tailor spreads and cash flows to portray the potential borrower's financial condition and debt-repayment ability.

Regulators had been critical of banks because they were placing too much emphasis on collateral in case of foreclosure rather than concentrating on cash repayment. CenSTAR helps bankers analyze credit up front to determine whether the customer's financial situation is solid and the cash flow is adequate to service the debt.

In December, Centerre introduced a state-of-the-art computerized wire-transfer service that enables customers to initiate wire transfers on their own office computers. Centerre claims to be the first bank in Missouri to offer this service, which is called Customer Direct Access (CDA). CDA speeds funds transfer by taking maximum advantage of computer technology.

A CDA wire transfer is sent by a customer's computer to Centerre's computer, eliminating the need for an intermediate party. All CDA wires are monitored by Centerre, sent out and settled the same day.

"CDA offers a cost-effective, quick and secure means of transferring funds and significantly reduces the possibility of human error," Mr. O'Meara says.

Summing up his department's philosophy, Mr. O'Meara says, "We're operating from the standpoint that we must satisfy the needs of our customers. We don't view Centerre as a competitor of the respondent, and we don't want to view a respondent as a competitor. We want to be looked on as a supplier of services other banks need to help them do a better job for their customers.

"Centerre, working in partnership with its respondents, can effectively serve the needs of customers of all banks in this area," he says. — **Jim Fabian, senior editor.**

Loan Fund for Women's Businesses Established by First Bank System

A LOAN FUND to aid women entrepreneurs has been established with initial funding from the foundations of First Bank Minneapolis, First Bank Saint Paul and First Bank System.

Purpose of the fund, which is administered by the Women's Economic Development Corp. (WEDCO), is to finance businesses owned by women who fail to qualify for traditional financing. The fund is seen as a last resort for women who lack collateral or equity, but want to start or expand a business. Primary focus is on women who are either underemployed or unemployed and striving for economic self-sufficiency.

The bank foundations have pledged $50,000 per year to WEDCO and also have agreed to provide loan-packaging assistance and referrals to personal or small-business officers at all First Banks.

To qualify for a loan from the fund, a woman must have completed a WEDCO evaluation process and received appropriate training and technical assistance; been denied a loan from a traditional lending source; and received approval from the WEDCO loan committee.

Financing available through the fund includes direct loans, loan guarantees and co-participations for various uses, including seed capital, working capital and expansion capital.

Contributions to the fund are being solicited from individuals, foundations and corporations.

WEDCO has been in business since January, 1984, but the loan fund became available only recently.

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Why does a bank in New York City have its data processing done in Pittsburgh?

"With Mellon's service, we can offer new products far sooner than with our own processing operation."

Sotiros N. Cachules
Vice Chairman
Atlantic Bank of New York

Atlantic Bank of New York is one of more than 200 financial institutions from Vermont to Arizona that use Mellon's Datacenter Services.

"We had our own data processing system for many years," says Cachules, "but to introduce new products after deregulation, we would have had to acquire new and costly resources. We chose Mellon because they're bankers and understand our needs, they have a great track record, and their pricing is reasonable. The results have been excellent."

Mellon was one of the first banks to apply electronic systems to banking, in 1955, and we've been in the forefront of development ever since. A staff of more than 500 bankers who are data processing professionals, supported by an annual development budget in excess of $40 million, ensures that commitment. Mellon's Datacenter shares in those resources, giving its customers a distinct financial and competitive advantage.

If you're concerned about maintaining cost-effectiveness while providing the new services that staying competitive demands, compare your processing costs and capabilities with those of Mellon's Datacenter.

Just call Dick Meyer, vice president, (412) 234-4861. Or write to him at Mellon Bank, Datacenter Division, One Mellon Bank Center, Pittsburgh, PA 15258.

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Community Banks: Building From Positions of Strength

IN THE FACE of continuing deregulation, proliferation of nonbank banks and a growing number of multibank HCs, where do community banks stand? What is their future? Will they survive?

To obtain answers to these questions and to get a perspective on community banking, MID-CONTINENT BANKER editors asked Randall A. Killebrew, 1984-85 chairman of the ABA's community bankers council, for his opinions on the subject. Following are the questions posed to Mr. Killebrew, president, First National, Petersburg, Ill., and the answers he gave.

* * *

Q: How would you define a community bank?

A: About three years ago, the American Bankers Association sponsored a contest to define a community bank. Michael L. Gibson, vice president, Miami County National, Paola, Kan., won the competition with this definition:

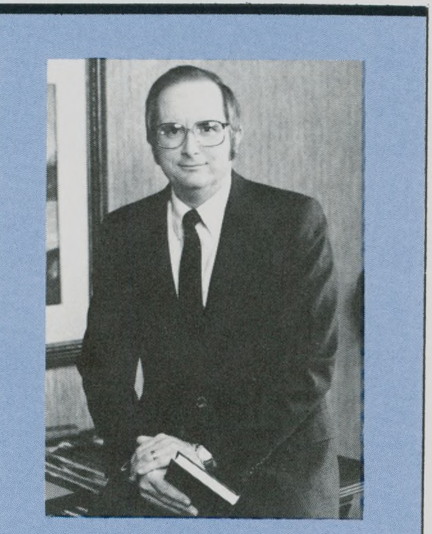
> A community bank is the financial lifeline of the community, providing the resources through which consumer and commercial customers perform the financial transactions of the local economy. It renders these services personally, confidentially and economically while striving for community improvement and achievement of the investment-return expectations of its shareholders.

I think Mr. Gibson's definition provides considerable insight into this thing called a community bank. Is size a factor? Maybe. Is location important? Probably not. Is it a philosophy of operation? Most definitely.

I would summarize my definition of a community bank by saying if it looks like a community bank, if it acts like a community bank and if it operates like a community bank, then it probably is one.

Q: What are the major challenges facing community banks?

A: Nonbank competition, interstate banking, availability of human resources, agriculture loans and maintaining confidence are but a few of the major issues that concern community banks. Which of these issues poses the greatest threat to the community bank is a matter of perception.



Randall A. Killebrew, chairman, ABA community bankers council, has this to say about community banks: "Providing distinguished service requires personnel who not only are able, but also personable and devoted to their communities. Then, these staff persons must be thoroughly trained. They must know what each product is, how it will help the customer, how it's priced and . . . be able to justify the price in terms of bank costs and customer benefits."

To me, however, the greatest long-term threat to my bank and other community banks is the hypocrisy that exists between the way banks and other providers of financial services are regulated. Let me give you a few examples.

By opting to make commercial loans *or* accept consumer deposits, but not both, the so-called nonbank bank operates on a playing field all its own. A nonbank bank owned by a bank holding company can maintain offices across state lines despite the Douglas Amendment to the 1956 Bank Holding Company Act. Diversified companies, such as Sears, want to own nonbank banks for numerous reasons, including gaining access to consumer deposits or expanding financial services and products.

Capital standards for banks are another subject of much debate today. When the final percentages are agreed on, we can plan on banks' capital requirements being substantially higher than those required of our thrift competitors. This places banks at a substantial disadvantage when considering pricing policies designed to achieve a competitive return on equity.

Increasing disclosure requirements require banks to publicize their nonperforming assets and their past-due loans. Most of our competitors, like the thrifts, are not burdened by similar requirements.

Services banks may offer are confined to the list of bank-like activities approved by the Fed, while our competitors have no such restrictions. S&Ls have been in the insurance busi-

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ness for years, yet many banks cannot offer this service. It is not uncommon to find insurance men offering auto financing, Production Credit agencies selling crop insurance or thrifts taking equity participations in real estate, while banks are restricted to those activities approved by the Fed.

While banks must file Community Reinvestment Act statements to document their sincere commitments to their communities, most other financial-services providers do not. This allows these competitors to freely drain funds from the community, selling them to the highest bidder.

These factors and others are eroding the value of the bank charter. I believe the recent conversion of Old Stone Bank, Providence, R. I., from a commercial bank to a federal savings bank is an omen. By shifting its charter, it received several benefits.

1. Reduced capital requirements, from 6% to 3%.

2. Access to the below-market-rate-lending facilities of the Federal Home Loan Bank System, in addition to the Fed discount window.

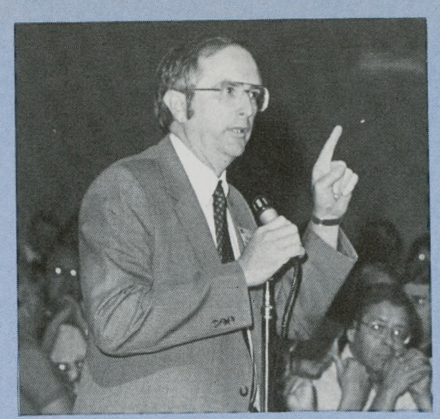
3. Elimination of most disclosure requirements, other than those of the Securities and Exchange Commission.

4. Ability to engage in a much broader range of activities, including real-estate development, data processing and insurance underwriting.

These disparities in law and regulation must be addressed. Failure to bring about competitive equity will pose serious questions regarding the future viability of all banks, which are the pillars of their communities.

I have one additional thought on this subject. As we debate proposals designed to correct these inequities, let us not forget these are banking issues and not consumer issues. Consumer groups have a list of banking concerns quite different from ours. Their list includes placing limits on the time banks may hold checks before allowing customers access to funds, requiring increased disclosure of terms on savings instruments and other services, imposing limits on bank fee increases and requiring banks to provide basic financial services at low or no cost.

The contrast in priorities will provide the fuel for a heated debate. Bankers must be prepared to address these consumer concerns if they want Congress to listen to their "wish list."



"Community banks are building from positions of strength. Our real strength lies in our ability to serve the customer diligently. Relationship banking remains our strong suit. We will continue to expand and upgrade our product menus to meet consumer needs." — *Randall A. Killebrew, chairman, ABA community bankers council.*

Q: What opportunities are available today to improve profitability and productivity?

A: Much has been written about the need to increase noninterest income during these times of shrinking margins. *I would like to put my plug in for controlling expenses!* Community banks traditionally have relied on processing and delivery systems that are labor intensive. As community bankers, we must re-evaluate these systems and attempt to find more productive ways of utilizing our personnel.

People are the most expensive resource on the bank's operating statement. They also are the most critical element in maintaining the quality of our service. We must find ways to use technology to process routine transactions and carefully choose those people who deliver our bank's products and services. Ways must be found to have our people work smarter and not necessarily harder.

Controlling expenses cannot stop with personnel. Every line item of expense must be reviewed. There can be no sacred cows. The result should be a much leaner organization that produces higher-quality services at reduced cost.

In marketing products and services, community bankers must find ways to differentiate their institutions from their competitors. One of the most effective ways of accomplishing this is through the choice of the people who deliver the bank's products and services.

Providing distinguished service requires personnel who not only are able, but also personable and devoted to their communities. Then, these staff persons must be thoroughly trained. They must know what each product is, how it will help the customer, how it's priced, and — for today's questioning consumers — be able to justify the price in terms of bank costs and customer benefits.

We also must remember that in today's increasingly competitive environment, having the most active Kiwanian, the most effective United Way solicitor and the most energetic Chamber of Commerce worker is not enough. They won't offset noncompetitive pricing, antiquated products, poor processing systems and ineffective delivery systems.

To improve the marketing of community-bank services while increasing the productivity and profitability of the organization, the CEO of the community bank must:

1. Bring enthusiasm to the organization. Be optimistic about his bank and his business. It is the attitude and demeanor of the CEO that will prevail throughout the bank.

2. Be professional. The community should look to its community bank with respect. Talents of the bank's staff should be admired. This means everyone must train, read and study to stay on top of his or her business. This knowledge and skill must be made available to the bank's customer so that the customer likewise can be more productive and profitable.

3. PLAN. PLAN. PLAN. Success won't come without a great deal of thought. Goals and objectives must be formulated. Strategies must be outlined that will serve the needs of the market while, at the same time, supporting the bank's goals.

4. Budgets must be prepared that support the bank's goals. Sacrifices will have to be made. The choices will be hard, and feelings will be hurt. Once the budget is in place, results must be monitored. This will help avoid financial surprises. This discipline will help everyone say "no" to those requests that are always tempting, but that we cannot afford.

5. Above all, the CEO must manage. He must know what he is doing

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and what those he is managing are doing. He must reward and recognize producers. He must realize mistakes will be made and be willing to learn from them. After all, mistakes are only detours on the road to success.

Q: What is the future of community banking?

A: Many researchers and authors have portrayed the '80s as the decade when the role of the community bank would decline. According to this theory, the number of banks in the U. S. would decrease dramatically, and most of this decline would come at the expense of the small community bank. However, we are approaching the midpoint of this decade, and the number of community banks in this country has grown.

During 1984, there were a record number of bank mergers and the greatest number of bank failures since the Depression. Despite these facts, the FDIC ended the year with more insured banks than it had at the start of the year because of entrepreneurs who perceive a positive future for the industry.

I am enthusiastic about the future of community banks and their role in providing financial services to their markets. Like most businesses, community banks will have to change to meet the changing demands of their consumers, but they can do it.

Community banks have proved to be extremely durable. Many have adjusted to deregulation much faster than some of their larger cousins.

Community banks are building from positions of strength. Our real strength lies in our ability to serve the customer diligently. Relationship banking remains our strong suit. We will continue to expand and upgrade our product menus to meet consumer needs.

Former Independent Banker Cites Advantages of HCs

AN independent bank, now a member of a bank-HC group, still is a community bank, according to its president. It has lost none of its community-bank status as a result of its affiliation with a holding company.

Gilbert E. "Gib" Coleman, chairman/president, Security Bank, Mt. Vernon, Ill., has this to say about the support services received from the HC and also tells other independent banks that being part of a holding company is "not all that bad."

Security Bank is a $125-million bank located about halfway between St. Louis and Evansville, Ind. The town has 17,500 population, with about 35,000 persons living in its county (Jefferson). In October, 1983, Security Bank was merged into St. Louis-based General Bancshares, a multi-bank HC with assets of $2 billion and owning banks in Missouri, Illinois and Tennessee (General Bancshares is able to acquire banks in the latter two states because it was formed and was operating in those states before the Douglas Amendment to the Holding Company Act of 1956 was adopted, and thus it operates under a grandfather clause).

As a former independent banker who now has worked more than a year in an institution owned by a multi-bank HC, Mr. Coleman is upbeat about bank HCs. He says bankers concerned about affiliating with HCs and losing their "so-called" independence should not worry. As an affiliate of HCs, according to Mr. Coleman, banks can have:

- Greater stability through a larger capital base.
- Quicker and better advice through the HC's legal/administrative departments, as well as interpretation of banking regulations.
- Larger lending limits for a bank's large and good customers.
- Opportunity to buy participation loans if a bank's loan demand is down.
- Investment advice concerning purchase or sale of securities.
- For senior management, better job security because performances are judged by bankers and not by nonbankers.
- For shareholders, investments are more secure than in an independent bank.

Mr. Coleman has this advice for the independent banker:

1. Do not be paranoid about losing your independent status; it may be the best thing that happens to you.
2. Do not put your own welfare ahead of the stockholders; you are hired to represent them.
3. Do not mislead your directors and shareholders about the *real* value of their stock. You might sell 50 or 100 shares at book and a half; you probably cannot sell 5,000 shares at that price.
4. Keep an open mind! What may not seem to be a viable option today may be the best solution tomorrow.
5. Do not wait until your bank is in trouble before considering selling; sell when the bank is in excellent shape. You will get a much better price.

National Figures Booked To Address Independents At March Convention

Fed Chairman Paul Volcker and House Majority Leader Jim Wright (D.,Tex.) will be heading the list of national figures addressing members of the Independent Bankers Association of America (IBAA) March 6-10 in San Antonio at the association's annual convention.

Others to appear on the podium include U. S. Senator Thad Cochran (R.,Miss.), chairman, appropriations subcommittee, Senate Agriculture Committee, and secretary to the Republican Conference; CBS News Correspondent Charles Kuralt; San Antonio Mayor Henry Cisneros; and A. J. King, IBAA president, and president, Valley Bank, Kalispell, Mont.

Topics that will dominate the two business sessions will include the economy, tax reform, financial legislation and the agricultural situation.

Special-interest sessions will deal with one-bank HCs, micro-computer use in banks, commercial lending and bank management. Attorneys William P. Johnson and John J. Kendrick will speak at the HC session; M. Arthur Gillis, a consultant, will present the micro session; and Allen R. Houk, president, Diversified Group, Houston, will conduct the commercial-lending meeting.

Also on the program will be a session for young bankers, featuring George Blanda, former National Football League player, as guest speaker.

Entertainment will be provided by Charlie Pride, country-western singer; comedian Danny Gans and vocalist Julie Dees.

Convention sessions will be held in the San Antonio Convention Center.

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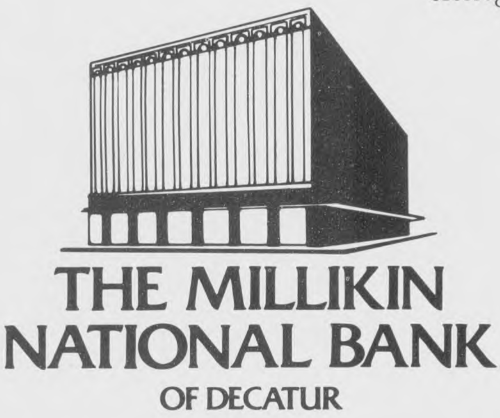
For loan participation, check clearing or safe keeping, trust Millikin Bank. They'll meet all of your correspondent banking needs plus one thing more...they'll talk to you face to face.



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How to Plan for Development Of an Insurance Profit Center

By William J. Ahearn and Robert A. Vecchiotti
Organizational Consulting Services, Inc., St. Louis

COMMUNITY banks have a natural advantage when it comes to distribution of insurance products to customers. This strength applies equally to all banks, no matter their size.

Three overriding reasons for focusing on this area are: (1) The prospect for significant deregulation at the federal level seems to have gone aglimmering, partly because of apprehensions raised by the debacle at Continental Illinois, Chicago; (2) congressional concerns of whether to allow banks to assume the risk of underwriting insurance and (3) evidence that most banks would not embrace the risky underwriting side of insurance even if they could. This attitude has been heavily reinforced by the poor financial performance of the property/casualty industry over the past three years.

Consequently, with only a handful of banks having the resources and inclination to leap into the insurance business with both feet — and a Congress not in the mood to let them — it can be safely assumed that banking's role in insurance will be restricted largely to the marketing side — where its natural strength lies.

Community banks have two basic marketing choices, when permitted by law or regulation: (1) Dealing directly with an insurance firm through a captive agency and (2) turning the function over to an outside insurance agency and acting more or less as a conduit between the agency and the customer.

Most insurance companies favor arrangements in which they perform all but the agency function. Their strategy is simple and straightforward: Limit the bank's insurance role while capturing market share. The bigger the bank, the more attractive it is to an insuror. The same rationale applies to the major insurance agencies.

Where does all this leave smaller community banks — those with assets of $100 million or less? Collectively, these banks represent a formidable force of more than 12,000 of the nation's more than 15,000 banks and one-third of the system's total deposits. Despite their collective weight, these banks aren't likely to be wooed by the insurance establishment and consequently must take the initiative if they want a piece of the action.

From a relative standpoint, insurance stakes are just as great for the community bank as for industry giants: If, for example, Citicorp can market insurance products to 10% of its customers, thereby boosting profits by 5% to 10%; perhaps, so too, can a community bank. The leverage is the same in both cases.

If a community bank is fully committed to establishing an insurance profit center, the same two agency choices are available: bank-owned-and-managed or outside-owned-and-managed.

A substantial commitment by management is required to pursue the bank-owned-agency approach, including start-up expense, organization, staffing, training/supervision of administrative/sales personnel, appointment of an experienced marketing manager to supervise day-to-day operations and interface with insurance carriers. An executive with ultimate responsibility for profit-center success must be found, and — most crucial of all — a strategic operating plan for an insurance profit center must be developed. Key to the agency's success is the manager with skills in both marketing and administration. As the agency grows, these functions can be separated.

Overall supervisory responsibilities would include recruiting/training/licensing of sales/office personnel; development/maintenance of record-keeping systems; assignment of sales

Messrs. Ahearn and Vecchiotti serve Organizational Consulting Services as vice president/financial services and president, respectively. The firm specializes in strategy planning, change management and organization effectiveness.

Banks Reveal Insurance Plans

A RECENT survey of 55 Mid-Continent-area bankers about their institutions' eventual plans to engage in insurance services revealed the following:

- Likelihood of owning an insurance agency: 20% highly likely; 36% somewhat likely; 33% not at all likely; 5% not sure.
- Likelihood of renting lobby space to an independent insurance agency: 6% highly likely; 50% somewhat likely; 34% not at all likely; 10% not sure.
- Likelihood of selling customer lists to independent insurance agencies: 4% highly likely; 13% somewhat likely; 73% not at all likely; 8% not sure.

Surveyed bankers represent institutions ranging in size from $50 million to $500 million. Five percent of the banks already owned insurance agencies.

The survey was taken at a seminar sponsored by Financial Products Group, Chicago.

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goals/quotas; maintenance of statistical information on sales performance; holding producers responsible for results; monitoring performance; and finally, a myriad of administrative/ sales controls necessary to proper management of an insurance agency.

Financial rewards from a bank-owned-and-managed agency can be substantial. With the middleman removed, the agency receives the full commission on business written from insurance firms. An additional benefit is direct leverage with the insurance firm, which can be helpful in smoothing out bank-customer dissatisfaction arising from service/claim problems.

The bank's second choice — and a more passive approach — is to purchase the services of an outside insurance agency to perform all or some agency functions. The more functions performed by the agency, the lower the commission rate received by the bank. The assumed advantage of an outside agency is that the "professional" will be able to penetrate the customer base more quickly and more deeply, thereby producing more total commission dollars for the bank, despite the lower commission rate.

Keys to success in working with an outside agency are developing a strategic plan for an insurance profit center to which the agency can agree; selection of the "right" agency for the particular customer base; negotiating the most favorable terms with the agency; committing the agency to support the bank's marketing, financial and customer-service goals and customer-relations standards.

Last, bank management should develop a strong, positive working relationship with agency principals and producers, communicating their special knowledge concerning expectations and sensitivities of customers.

What follows is a brief description of an innovative agency approach to marketing a bank's customer base. It illustrates the type of creative arrangements emerging from an industry undergoing drastic change.

An insurance agency based on the East Coast sees banks, not as intruders poised to capture agency markets through unfair advantage, but, rather, as partners in joint ventures with agencies. The agency, acting as an insurance marketer for seven financial institutions, produced $18 million in premiums in 1983. A higher figure is expected for 1984.

Crediting banks with much of its success, the agency maintains that banks want to market their customer bases, but don't want to do the selling because of administrative headaches and expense involved.

This is how its system works: The agency handles all marketing, sales and service of insurance to bank customers. The bank forms an in-house insurance agency with a single licensed employee. A contract is agreed to between the outside agency and the bank agency — usually for five years — allowing the outside agency to market agreed-on insurance products on the bank's behalf.

The outside agency receives 70% of the commission; 30% goes to the bank agency. The bank, however, "owns" the policies. At the end of five years, if the bank doesn't want to renew the contract, it has two options: Sell the policies to the agency for 1½ of the annual commission or keep the policies and pay the agency 1-¾ of the annual commission.

If the agency doesn't want to renew, the bank has two options: It can insist that the agency buy the policies or it can place the policies with another agency or an insurance company. It appears that the bank owns the policies *only* if the agency decides not to renew the contract.

The agency isn't interested in doing business in bank lobbies, but works out of its own offices. Actual solicitation and selling aren't done face-to-face with bank customers, but through effecting low-cost mailing and telecommunication techniques.

Key to the program's success is bank sponsorship, which is a dynamic motivator. Letters of solicitation are mass produced on bank stationery and mailed to bank customers along with promotional brochures subsidized by insurance companies. Telephone solicitors contact customers for policy expiration dates and, finally, producers are put to work on the phone to clinch sales. Insurance applications are received from nearly half of those called.

As a first step in establishing an insurance profit center at a bank, a market survey should be completed. This

(Continued on page 38)

Banks, Insurers Are Urged To Create Joint Ventures

"I'm convinced the sale of life insurance is such a logical and natural marketing opportunity, and fulfills such a basic consumer need, that possibly by the end of this century, financial institutions have the opportunity to become the dominant distributors of such products." So said Robert MacDonald, president/CEO, ITT Life Insurance Corp., Minneapolis, in a speech to the Town Hall of California.

Mr. MacDonald said the sale of life insurance by banks and thrifts in "scaled-down" financial-service centers can resolve problems that threaten profit margins in the two industries, while providing consumers with policies at less cost and greater convenience.

"It's time," he continued, "to merge the strengths of our two industries into a strong alliance that will help overcome respective weaknesses and provide both sides with the opportunity to grow and prosper."

Mr. MacDonald said life insurance provides banks and thrifts with the high-margin product necessary to ease the profit squeeze caused by deregulated interest rates and high costs of operating branch networks. It also enables them to broaden their product/service lines, thus helping to retain current customers and add new ones.

He argued that insurance companies also benefit, by relying on expansive branch networks with large walk-in traffic to help insurance agents identify prospects and by conducting their business in an atmosphere more conducive to consumer trust and acceptance.

According to Mr. MacDonald, medium-sized banks/thrifts, vulnerable to one-stop financial-service superpowers, especially should consider joint-venture strategies. As he put it, "Creating scaled-down financial-convenience centers that mimic offerings of the larger competitors" is a way to survive.

Mr. MacDonald has negotiated joint ventures between his firm and several banks and thrifts over the past year. In 1983, ITT Life signed an agreement with Norwest Corp., Minneapolis, to sell ITT Life policies through 64 Norwest agencies within a seven-state, upper Midwest region.

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Cooperation Among Banks, Cities For Public-Financing Grants Stimulates Community Development

A NEW shopping center called Towne Centre is operating in Danville, Ill., and it's giving the city an economic boost that is making it a better place to live and work.

A new regional shopping center called Penn Central Mall is about to be constructed in Oskaloosa, Ia., that is expected to vastly improve the business climate of that community.

Both projects were developed with the assistance of local banks, which stand to reap considerable benefits from development of their communities.

These projects stand as a testimonial to cooperation among municipal government, financial institutions, the business community in general and a firm called Urban Programming Corp. (UPC), located in St. Louis.

UPC serves as a sort of clearinghouse for financing for community-development projects. It specializes in public financing development planning, real estate and marketability consultation for various developments.

Although UPC is a private firm, it encourages communities to take advantage of the Urban Development Action Grant (UDAG) program that came into being in 1977 and is administered by the U. S. Department of Housing and Urban Development (HUD). Nationally, more than 1,000 eligible communities have used $3.6 billion of UDAG funds at low interest rates to attract $20.3 billion in private investment and generate new jobs, says J. Terrence Farris, UPC vice president.

UDAG funds typically are used to finance manufacturing facilities, hotels, office buildings, financial institutions, shopping centers, health-care centers and capital equipment. The program offers fixed-rate secondary financing for as low as 5%, amortized over terms as long as 30 years.

UDAG funds are passed from HUD as a grant to an eligible community in order to be loaned to a private entity at low interest — usually in a form of a second mortgage — to finance about 20% of a project's total cost, Mr. Farris says. The balance of the financing must be private and can be arranged through industrial revenue bonds, pension funds, syndication proceeds, retained earnings or other conventional means. UDAG loan proceeds may not be used for working capital or inventory.

UDAG funds are used as gap financing to make projects economically feasible that otherwise are not feasible through strictly conventional financing, Mr. Farris says. The funds have saved many projects that never would have gotten off the ground — but only because their availability was known to officials of involved financial institutions, municipalities or the business community.

UDAG funds are loaned at an interest rate and term that provides an adequate return on investment, Mr. Farris says. Funds may be used for direct construction or rehabilitation of a facility as well as for such activities as clearance, site improvements and provision of infrastructure.

Towne Centre in Danville, Ill., is result of cooperation among banks, municipality and retail firms. Urban Planning Corp., St. Louis, served as consultant for $16-million project. First Nat'l, Danville, moved headquarters to center, occupying three-story building at r.

In order for a community to participate in the UDAG program, it must be included on HUD's list of eligible communities, which is determined annually. Approximately 8,400 of the nation's 19,000 communities now are eligible, he says.

In Danville, an urban-renewal program succeeded in eliminating a 21-acre blighted area in the southern section of the downtown portion of the city. The project successfully attracted an investment of more than $15 million for a new bank building, a civic center and public-safety building. However, the area was not completely developed.

UPC was called in to make recommendations. It advised the city to invite shopping-center developers to a redeveloper's workshop, at which an informational kit and presentation materials were distributed to provide facts about the city, the site and what the city was willing to do to attract development.

Of the 40 developers attending, 14 submitted letters of interest and a deal was struck, with the city acting as a public entrepreneurial partner. The result was a project considerably larger than first envisioned, both in acreage and value.

Danville's three downtown banks were supportive of the project, Mr. Farris says. Palmer American, First Midwest and First National committed themselves to buying short-term notes for the city's land-assemblage costs. In addition, First National became the key anchor of an office building in the center and cooperated with the developer in selling its existing downtown facility to the developer for future office use.

Oskaloosa had a deteriorating downtown. A local businessman took the lead in pushing for development of an enclosed regional mall on a 20-acre site in the heart of the community. The project was a natural for the community of 10,000, since the nearest comparable shopping center was 60 miles distant.

With the assistance of UPC, the project received a 3.3-million loan

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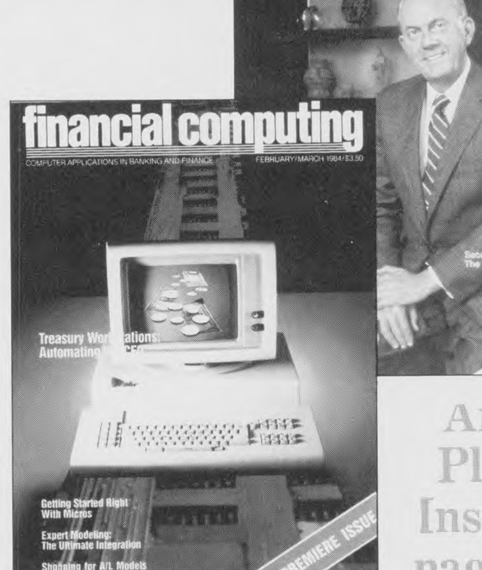

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Debtor Distress In Agriculture

By Neil E. Harl

AGRICULTURE is going through the most wrenching financial adjustment in a half century. Not since the 1930s have issues of debtor distress and creditor remedies gripped the farm community as they have in the 1980s. Quite clearly, the 1980s are setting modern-day records for financial difficulties by farm and ranch firms and by nonfarm firms in rural communities.

Available data on amount and distribution of debt in agriculture leave little doubt about the seriousness of the financial stress gripping a substantial part of the sector. Moreover, prospects are for approximately one-third of the farmers to continue to slide toward insolvency unless (1) interest rates fall sharply or (2) farm income rises dramatically. Neither outcome seems likely at the moment. With a chronic and persistent capacity for agriculture to overproduce, and with many of the countries most likely to increase food imports to improve diets pressured by heavy debt loads and high and rising interest rates, only adverse weather is likely to produce substantial upward pressure on net farm income. With respect to interest rates, changes rest with national fiscal and monetary policy and international financial conditions and are likely to be determined by such groups as congressional budget committees, House Ways and Means Committee and Senate Finance Committee, the Fed and departments of Treasury, Commerce and State. Groups focusing on traditional agricultural policy are likely to have limited impact on interest rates.

Roots of the Problem. The current wave of financial problems has numerous roots: 1. Adverse weather conditions in some areas. 2. High real rates of interest. 3. Over-expansion in the 1970s under an assumption of continued inflation. 4. Reductions in land values as the inflation rate has fallen.

The single most significant factor appears to be the Fed's decision in late 1979 to wring inflation out of the U. S. economy. That action led to tight money, high interest rates and a dramatic slowing of the inflation rate. The problem has been compounded by massive budget deficits, which have contributed to high real interest rates. The result for farmers has been staggering real rates of interest and falling land values, sufficient to cause lenders to develop concerns about a substantial proportion of farm borrowers. A similar situation exists among debtor countries as high real interest rates have created debt-repayment problems.

Neil E. Harl is Charles F. Curtiss distinguished professor in agriculture and professor of economics, Iowa State University, Ames, and a member of the Iowa Bar. Dr. Harl gave the talk on which this article is based at the ABA national agricultural bankers conference late last year.

Of the four major elements of the problem, one — weather conditions — is outside the realm of human intervention. Another — over-expansion in the 1970s — is history, and nothing now can be done to change the fact that it occurred. The other two, high real interest rates and falling land values, can be affected by appropriate policies.

First, a word should be said about over-expansion. During the 1970s, almost everyone sought to accommodate inflation. Social-security benefits were indexed; some labor contracts were indexed; compensation of federal employees was indexed. Farmers accommodated inflation in some instances by anticipating future capital needs with purchases on accelerated bases. Some home owners pursued the same strategy. It is important to note that the way individuals sought to accommodate inflation had a great deal to do with their economic status when policies shifted toward a low-inflation economy.

Amount/Distribution of Debt. Viewed from the standpoint of individual farmers, perhaps never in the history of agriculture have problems of debtor distress occurred at a time when there was greater heterogeneity among farmers. Thirty-six percent of the farmers in Iowa owe little or no debt and are doing relatively well, economically. Those with substantial debt — and that is between 30% and 40% of all farmers — are in various stages of difficulty.

From the standpoint of what can — or should — be done to ease the prob-

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lem with legislation, the big question is the magnitude of the problem for those in imminent danger of becoming insolvent. Most recent data are from an Iowa survey in March, 1984. The study was carried out by the Iowa Crop and Livestock Reporting Service with much of the analysis by Robert Jolly, Iowa State University.

• The category of farmers in the most serious financial bind are those with debt-to-asset ratios of greater than 70%. That means for every $10 of assets, the farmer has more than $7 of debt. In the Iowa study, 10% of the farmers, holding 9% of the assets, fall into the over-70% category. That group, however, *holds more than 25% of the total debt*.

With a greater than 70% debt-to-asset ratio, there's little hope of economic survival. An average interest rate of about 11% — and those with heavy short-term borrowing or variable-interest-rate mortgages or both may be paying 15% or 16% — would require an almost 8% rate of return on all assets just to pay the interest bill. And that's nothing for consumption. Most studies show a rate of return in the 3%-5%-range. The clear message: Those over the 70% mark are headed toward insolvency — and at a remarkable pace.

• Farmers with debt-to-asset ratios of greater than 40% are facing financial problems. Most are losing net worth. With a 40% debt-to-asset ratio and paying an average of 11% interest, it would take a net return of nearly 4½% just to pay interest costs.

In the Iowa study, 28% of the farmers with 30% of the assets fall into that category. *And they account for 65% of the debt*.

The picture actually may be more grim than these numbers indicate. There is some evidence assets may be overvalued and amount of debt understated.

Farmers from all size categories are in the over-40% group. Data indicate the bulk of those in difficulty are full-time family operations.

Figures from a Fed study tell a similar story. Nationally, data show 8% of farmers with 8% of the assets have debt-to-asset ratios of greater than 70%. That group holds 31% of the debt.

Data on total farm debt dramatize the magnitude of the problem nationally. In 1971, total farm debt outstanding in the U. S. totaled slightly more than $54 billion. As recently as 1976, that figure stood at slightly more than $91 billion. In the next eight years, the figure climbed to $216 billion. Farm debt as a percentage of farm income stood at 215% in 1960, rising to 334% of net farm income in 1975 and skyrocketing to 1,350% of net farm income in 1983. Unless inflation permits payment from increases in asset values, indebtedness eventually must be paid from income.

For a substantial segment of the 30% of farmers concerned with economic survival, repayment would be feasible only if commodity prices were substantially higher than at present; interest rates were reduced or principal repayment requirements were eased. Much of the debt is short term with interest rates tied to current loan rates. Even much of the real-estate indebtedness is based on variable-interest-rate financing, as with Federal Land Bank financing, or is based on contract purchases with amortization over 10 years or less. A substantial amount of real estate was acquired in the late 1970s with relatively short contracts (some as short as five years) with balloon payments at the end of the initial payment period. A number of such balloon payments came due in 1984 and will become due in 1985.

"The current wave of financial problems (in agriculture) has numerous roots: 1. Adverse weather conditions in some areas. 2. High real rates of interest. 3. Over-expansion in the 1970s under an assumption of continued inflation. 4. Reductions in land values as the inflation rate has fallen."

Lenders holding land as collateral, principally the Federal Land Bank and sellers under land contract, report relatively low default rates. However, willingness of short- and intermediate-term lenders to provide credit needed to keep land payments current appears to be diminishing rapidly.

Higher Price-Support Levels. If price- and income-support policies were to be sufficiently favorable to farmers to solve the economic problems of the 30% with the greatest debt, serious problems of pricing U. S. commodities out of world markets and problems of production control likely would emerge.

Possible Scenarios. Undoubtedly, the most crucial question in framing solutions to problems of farm-debtor distress is what can be expected over the next two to five years with respect to: (1) interest rates, (2) farm income and (3) strength of the general economy both domestically and worldwide. Substantial uncertainty surrounds each of those variables. For purposes of discussion, four scenarios are identified.

1. Continued high real interest rates, possibly rising over the near term, with stable or slightly lower farm-commodity prices. At some point, high interest rates will choke off economic activity in the general economy with a recession resulting. A decline in private-sector borrowing should weaken interest rates.

2. Value of the U. S. dollar relative to other currencies, presently high by historical standards, could decline sharply because of the effects of the record-setting trade deficit (expected to total $120-$130 billion for the 1983-84 federal fiscal year) and a decline in interest rates domestically. The result presumably would be increased exports with a positive effect on farm income.

3. The Fed, concerned about economic pressure on Third-World debtor nations (over $800 billion owed, much of the total to U. S. financial institutions) and pressure on some sectors of the U. S. economy, might relax credit controls with an increase in the money supply and resulting higher rates of inflation. After some lag, farmland values likely would be affected. However, it is unclear in a world of deregulated financial markets what the impact would be on real interest rates.

4. If high and rising interest rates cause Third-World nations to default on their debt obligations, an international liquidity crisis of major proportions could occur. The effects would be highly destabilizing within and outside the U. S. Obviously, every effort will be made to avoid such a financial catastrophe. Probability of such a default would seem to be quite low.

Traditionally, distressed debtors have pursued several different remedies, ranging from informal liquidations of part or all their assets through bankruptcy as the most formal remedy available. In some instances, moratoria have been made available.

Bankruptcy. If nothing is done beyond maintaining present federal farm-loan programs, farmers facing the most serious financial problems would be expected to turn increasingly to Chapter 7 (liquidation) or Chapter 11

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(reorganization) bankruptcy. If economic pressures continue, bankruptcy will appear to be increasingly attractive to debtors. For a substantial number, Chapter 11 reorganization is not a realistic alternative as the inexorable trend is a decline in net worth under about any realistic scenario.

Major effects of an increase in rate of bankruptcy filings would be felt in rural communities. Lenders would experience an increase in nonperforming loans with some lenders facing loan losses sufficient to raise questions of lender survival. Vendors of farm inputs and other merchants in rural communities also would be substantially affected by an increase in bankruptcy filings. A significant number of sellers of land on contract, many of whom are retired farmers, also would be affected. Although bankruptcy would give farm borrowers a new start, the ripple effect in rural communities likely would lead to an increase in bankruptcy filings by others in the community. Encouraging farm debtors to remain with their loans and keep the loans in performing status surely is in the public interest. It is important to keep in mind that formal bankruptcy filings account for only a relatively small portion of total number of farm firms disappearing because of insolvency or exhaustion of credit. The effect of termination of indebted firms on lenders and other creditors is approximately the same in either instance although obligations may not be formally discharged in nonbankruptcy situations.

Quite clearly, the only hope for farm debt to be paid is to create a realistic opportunity for the debtor to remain in production and generate sufficient cash flow for debt repayment.

Moratorium. Another remedy would be for states to utilize moratoria, either those presently available (as in Iowa) or available through enactment. In the 1930s, as the level of debtor distress rose, indebted farmers sought a general moratorium on real-estate-mortgage foreclosures as a political solution to the problem. Most agricultural states enacted moratorium legislation beginning in the early 1930s. The legislation was held by the U. S. Supreme Court to be constitutional if a state of economic emergency existed. If no other solution is in place and functioning, pressure is likely to build for states to enact (or to activate) moratorium legislation. The moratorium remedy would provide a period of debtor relief as to affected obligations. The Iowa statute, as one example, affects only real-estate obligations. To be an effective remedy, a moratorium also should affect non-real-estate indebtedness. There is little justification now for treating the two types of indebtedness differently.

Perhaps the most serious shortcoming of a moratorium is that it shifts the burden to creditors, who then respond by reducing exposure to borrowers who are the most likely candidates to invoke the moratorium. Thus, it would likely end up impacting adversely borrowers in greatest need of assistance.

Federal Initiative. Following several days of intense behind-the-scenes activity, President Ronald Reagan on September 18 announced a four-point program to deal with problems of debtor distress in agriculture. Two of the four initiatives involve debt restructuring.

Debt-restructuring plans typically seek to accomplish two basic objectives: 1. To provide an opportunity for worthy farmers (in terms of management skills and overall financial situations) to work themselves out of their financial plights and maintain their loans as performing loans. 2. To help stabilize factor markets by reducing amounts of land and machinery coming onto the markets as loans are liquidated and loan collateral is sold.

FmHA Debt Set-Aside. The first initiative in the four-point program involves setting aside a portion of the principal and accrued interest on some Farmers Home Administration (FmHA) loans of farmers indebted to the FmHA for farmer-program loans on or before September 18, 1984. The set-aside is for a period of up to five years with no interest on the set-aside amount during that period.

The maximum set-aside is 25% of total FmHA indebtedness or $200,000, whichever is less. Thus, the largest amount of set-aside would be $200,000. For set-aside amounts above $100,000, approval of the FmHA district director is required. Payments are to be rescheduled on the amount of indebtedness *not* set aside. The set-aside amount is to be rescheduled or amortized over the remainder of the loan with payments beginning after five years. Again, no interest is due on the set-aside amount for the five-year period.

An important point is that only that part of the debt is to be set aside needed to create a positive projected cash flow. For this purpose, cash flow is defined as income necessary to pay all farm-operating expenses, family living costs, amount needed to service debts and a contingency amount for unplanned expenses such as machin-

(Continued on page 46)

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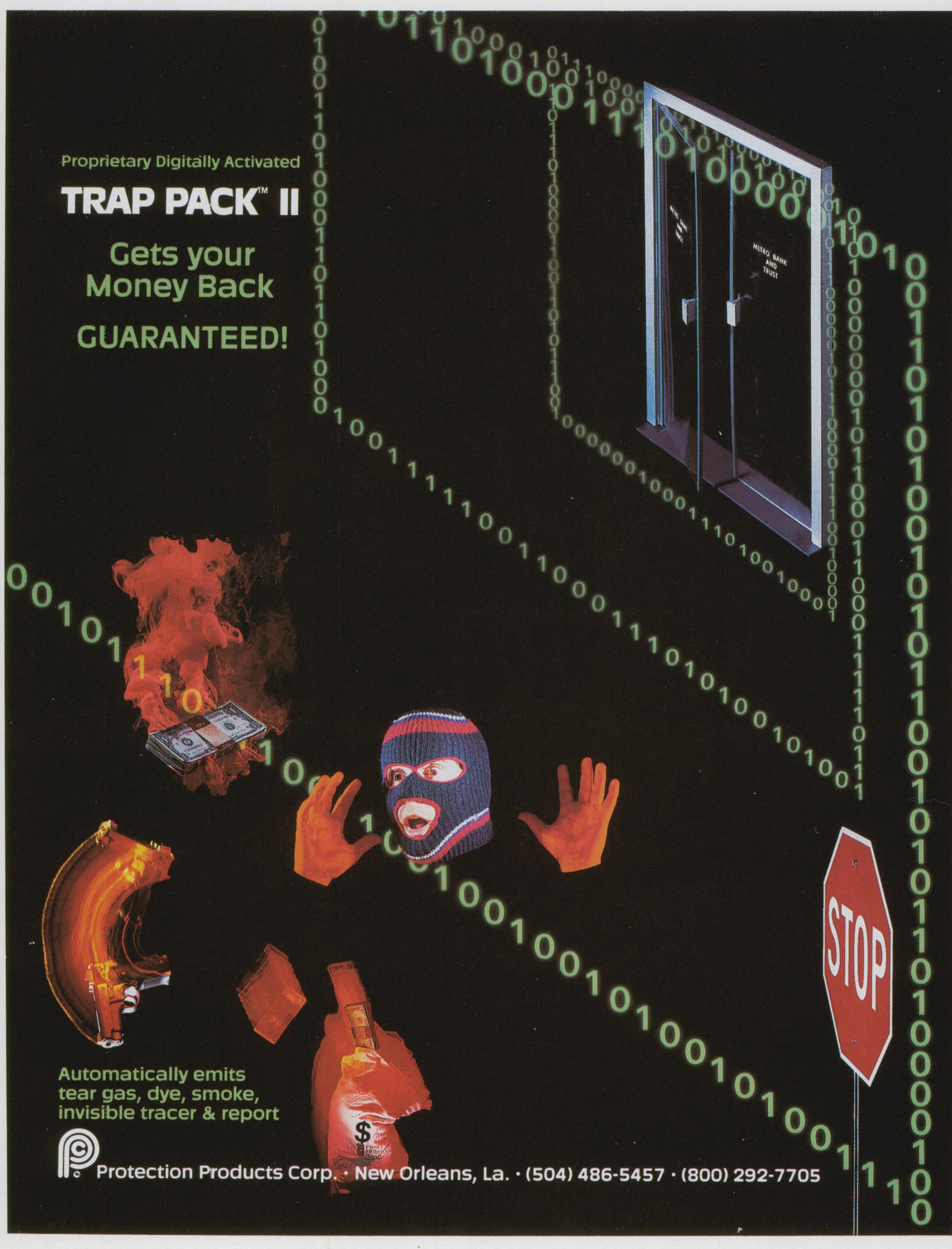

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NEWS About Banks & Bankers

ILLINOIS

Frank C. Rubinic has joined American National, Rockford, as senior vice president. He formerly was president/ CEO at First National, Wheeling.

Joseph Migely has joined Drovers Bank, Chicago, as senior executive vice president/director. He formerly was with Marine Bank, Milwaukee, and First National, Chicago.

Bruce I. McPhee has been promoted to president/CEO at First Illinois Bank, Evanston. He joined the bank in 1978 and succeeds Howard B. Silverman, who now is chairman.

Jean E. Marshall has been elected senior vice president/personnel and administration at Edgewood Bank, Countryside. She joined the bank in 1967.

Karl T. Barthelmess Jr. has been appointed senior vice president/auditor at Continental Illinois Corp. and Continental Illinois National, Chicago. He succeeds William D. Plechaty as auditor and joined the bank in 1970.

INDIANA

Terre Haute First National has promoted Ray G. Ingram and John W. Perry to senior vice presidents; Morris Crumrin, Harold V. Rost and Leland S. (Bob) Sutherland to vice presidents/ banking-center managers; and Michael A. Carty to vice president/ controller.

Union Bank, Greensburg, has elected Robert R. Friedersdorf and Philip D. Metz to its board. Both are farmers and served previously before the bank was merged into Indiana United Bancorp in mid-1983. In other action, Carmen L. Glenn was appointed auditor.

Robert S. Kaspar has been elected vice president/controller at Irwin Union Bank, Columbus. He joined the bank last November, coming from a CPA firm in Indianapolis.

Fort Wayne National has named Thomas L. Baumgartner senior vice president/chief operations officer, Stephen R. Gillig vice president/controller and Margaret L. Harden vice president/trust officer.

Lincoln National, Fort Wayne, has appointed Alvin R. Moll Jr. senior vice president/chief financial officer and promoted Kenneth G. Sterling to vice president/cashier. Mr. Moll formerly was with Toledo (O.) Trust and Mr. Sterling formerly was vice president/ director of operations.

IOWA

American Trust, Dubuque, has promoted Bill Schrup and Jeffrey P. Mozena to vice presidents/commercial loan officers. Lynn A. Sanders was appointed second vice president, financial accounting, and Arlys C. Runde was named personal banking officer. Mr. Schrup was with the FDIC's liquidation division when he joined American Trust in 1982. Mr. Mozena has been with the bank since 1975, as has Mr. Sanders. Mrs. Runde, who joined the bank in 1966, is manager of the downtown drive-up banking service center.

Robert A. Harris has been elected president/CEO at Norwest Bank Keokuk, succeeding J. Agnew Rovane, who has retired after 12 years with the bank. Mr. Harris previously was with Norwest Bank Marion as senior vice president/consumer-banking group. He has been with Norwest since 1975. Mr. Rovane had been president since 1980. He joined the bank in 1972.

Mark G. Kilian has been promoted to internal auditor at Valley National, Des Moines. He joined the bank last April as staff auditor.

Richard E. "Dick" Retz has been promoted to vice president, correspondent banking division, Merchants National, Cedar Rapids. He joined the bank last July, coming from Home State, Jefferson.

MICHIGAN

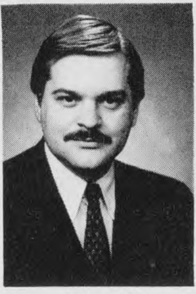
Dearborn Bank has promoted Peter P. Hanoian and Barbara Pittiglio to vice presidents. Mr. Hanoian is branch administrator; Ms. Pittiglio is personnel director.

Manufacturers National, Detroit, has named Patrick M. McQueen senior vice president and Paul A. Aramian, William A. Cole, Richard C. Kluge and Patrick J. Callahan vice presidents. Mr. McQueen joined the bank in 1970 and is in charge of consumer loans.

NBD Bancorp and National Bank, Detroit, have elected James E. Barlett and Louis Betanzos executive vice presidents for both firms. The bank has appointed John W. Fisher III first vice president/international division and Angelo M. Guerreso vice president/ Instaloan division.

MINNESOTA

Wallace V. Blomquist has been named senior vice president at First Bank Saint Paul. He joined First Bank Min-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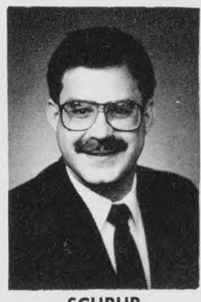
SCHRUP

RETZ

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neapolis in 1955 and had been a senior vice president/special loans/commercial division. He now heads commercial-loan workout activities at both banks.

Levor (Bud) Garnaas has been promoted to vice president at First Bank Minneapolis. He joined the bank last month and had been assistant vice president, government trading/sales division, capital markets/treasury group.

Dharani (Darin) P. Narayana has been named executive vice president/national/international department at Norwest Bank Minneapolis. He joined the bank in 1969 and continues to manage the financial-institutions business group.

Robbery-Reward Program Reverses Crime Trends

Many bank robbers are going to jail because of programs like the robbery-reward program sponsored by the Minnesota Bankers Association, says Gerald Thomas, chairman, MBA security committee, and vice president, Midway National, St. Paul.

Since 1979, the MBA, in cooperation with the FBI and other law-enforcement agencies, has been conducting a statewide reward program. The MBA pays up to $5,000 to any eligible person who provides information leading to the arrest and indictment of anyone suspected of committing or attempting to commit a robbery, burglary, larceny or extortion of a member Minnesota commercial bank.

Amount of the reward depends on the seriousness and circumstances of the crime, and bank and law enforcement personnel are not eligible.

The program was established because of an increase in bank robberies and a low solution rate. Since it began, these trends have been reversed, Mr. Thomas says.

Work Starts on Norwest Center

Construction has begun on Norwest Center, Minneapolis, following ground breaking ceremonies last December. The 66-story office tower will be 950 feet high, include a four-story shopping gallery at its base and a three-story Norwest Bank pavilion. Site of the structure is the city block bounded by Sixth and Seventh streets, Nicollet Mall and Marquette Avenue. Norwest will occupy approximately 700,000 square feet of the more than two-million-square-foot building. Norwest Bank Minneapolis will occupy the pavilion on the first and second floors of the four-story base and will have offices in the tower portion. The bank's main entrance will be at Seventh and Marquette. Photo shows how tower (c.) will affect Minneapolis' skyline.

MBA Announces Scholarship

The Minnesota Bankers Association, in partnership with the Business Economics Education Foundation, will sponsor Minnesota Business Venture, a week-long summer program for high school students to learn more about business and economics.

Purpose of the program is to enable students and teachers to understand the private-enterprise system and the role of business in society; to learn about state, national and global economics; and to gain leadership skills and insight into career opportunities.

MBA-member banks will provide scholarship funding and will encourage students from their communities to participate. Two sessions are scheduled for July.

OHIO

Citizens Banking Co., Sandusky, has awarded a $2.5-million contract to HBE Bank Facilities, St. Louis, for a new 23,300-square-foot, three-story, L-shaped building. The project will feature on-site parking, four drive-up teller lanes and a two-story arched entry into the first-floor lobby. Completion is expected by February, 1986.

Central National, Cleveland, has elected Richard W. Owens and William H. Robinson Jr. vice presidents. Mr. Owens is in the foreign-exchange department and Mr. Robinson is in the Ohio division. Mr. Owens joined the bank in 1983; Mr. Robinson recently rejoined the bank after leaving last year.

David L. Kiesling has been elected a vice president of BancOhio National, Columbus. He is manager, special-assets department/personal-trust division.

Toledo Trust has acquired 14 branch offices in Allen, Defiance, Fulton, Williams, Henry and Paulding counties due to its merger with Maumee Valley National, Defiance.

Toledo Trustcorp has filed applications to establish a new bank in Columbus to be named Trustcorp, Inc. Paula Kauffmann has been elected president of the new bank. She formerly was deputy director of the Division of Economic Development Financing, Ohio Department of Development.

Robert W. Gillespie has been elected president/CEO, Society National, Cleveland. He formerly was president/chief operating officer. Former Chairman/CEO Gordon E. Heffern continues as chairman. Mr. Gillespie joined the bank in 1968.

GILLESPIE

WISCONSIN

Valley Bank, Shawano, has elected William Blythin chairman and John A. Hennessy president/CEO. Mr. Blythin is former president/CEO and has been with the bank five years. Mr. Hennessy was executive vice president and joined the bank last summer, following service as president, Valley Northern Bank, Appleton.

Marine Corp., Milwaukee, has elected James W. Eyster and Jon H. Stowe senior vice presidents and the following to vice presidents: Norman C. Hansen, Raymond E. Riekkoff, John R. Nowicki, Bruce E. Thompson, Jane C. Arnold, Ralph F. Patek, Gerald W. Smith, Brantly K. Chappell and Gerald E. Olley.

Dale Thomas Tietz has been appointed assistant vice president/branch manager at F&M Bank Slinger. Mr. Tietz formerly was with F&M Bank Menomonee Falls.

First Interstate Bank, Sheboygan, has acquired Gottsacker Insurance Agen-

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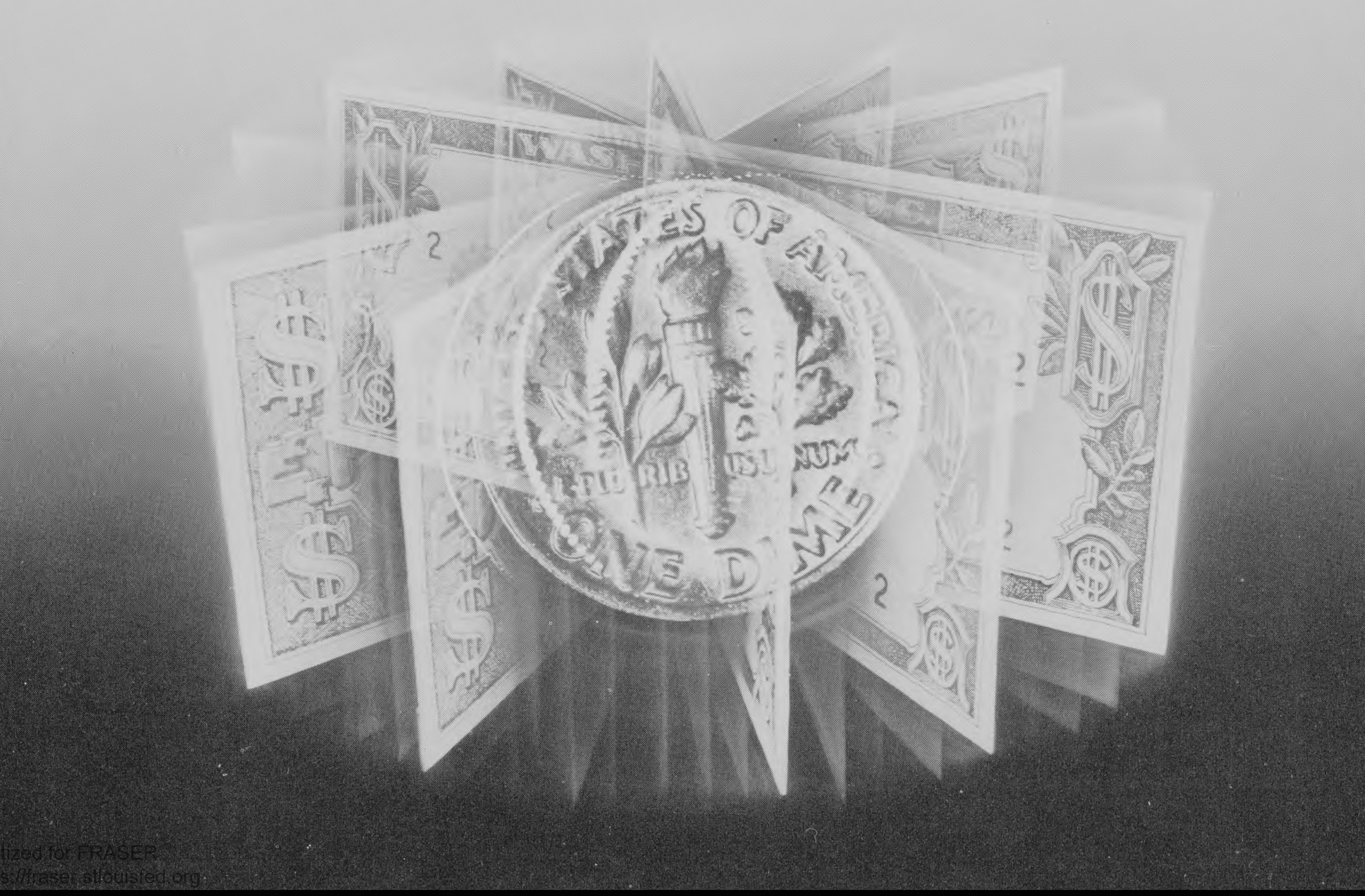

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cy. The firm will continue to operate as an independent agency.

Export-Trading Company Formed by First Wisconsin

First Wisconsin Corp., Milwaukee, is cooperating with three major U. S. firms to form an export-trading firm to specialize in exporting processed foods and other associated products.

Called Intercontinental Trading Co., the firm will be a joint venture of processed-food producers and financial institutions interested in expanding exports of U. S. foods and related products.

In addition to First Wisconsin, investors are Wilson Foods Corp., Oklahoma City; Walter E. Heller Overseas Corp., Chicago; and Land O'Frost Corp., Lansing, Ill.

The firm is being formed under the export Trading Act of 1982, which was designed to promote growth by allowing producers to join with financial institutions and other firms that offer export-related services.

The company is headquartered in Rolling Meadows, Ill.

Accreditation Program Announced For State Banking Departments

THE Conference of State Bank Supervisors (CSBS) has begun an accreditation program designed to promote and recognize excellence in state regulation and lead to reduction in federal-regulatory/supervisory activity in well-managed state-chartered banks.

Illinois already has completed the formal accreditation process performed by review/audit teams composed of out-of-state professionals examining the operations and capabilities of the department. Iowa has moved through several steps in the review process, while several other states are in the initial self-evaluation process.

The program has two basic goals.

1. To strengthen capabilities of state banking departments to assure the safety and soundness of banking within each respective state and otherwise to assure good banking services to each state.

2. To achieve recognition in Congress, in federal agencies and within each state of the high level of capability of each accredited state banking department.

The CSBS accreditation program is comprehensive and highly disciplined, involving a six-step process:

1. The state banking department evaluates itself using comprehensive performance criteria set forth in the Self-Evaluation Guide.

2. The state banking department submits a request for accreditation review to the CSBS performance standards committee (PSC), accompanied by a copy of the department's self evaluation, supporting documents and narratives and a statement of financial support for the accreditation-review process.

3. An accreditation-review team appointed by the PSC conducts an on-site evaluation, using the same form and criteria as the banking department and its self evaluation.

4. The accreditation-review team analyzes and submits its findings to the PSC.

5. An audit team then evaluates the review team's procedures and substance of its report for consistency with performance guidelines and criteria. This assures a high and consistent level of discipline between each accreditation-review-team evaluation. The audit team also determines that standards and procedures as required for accreditation are followed and that review findings justify a public proclamation that an evaluated department merits accreditation. These findings are reported to the PSC.

6. On formal recommendation of the PSC, the CSBS board officially notifies the department that it is an accredited state banking department for a five-year period. Maintenance of accredited status is contingent on a satisfactory annual self evaluation and filing of a full report with the PSC.

Sidney A. Bailey announced the new program. He is PSC chairman and Virginia commissioner of financial institutions. PSC vice chairman is Eugene Kuthy, Michigan commissioner of financial institutions.

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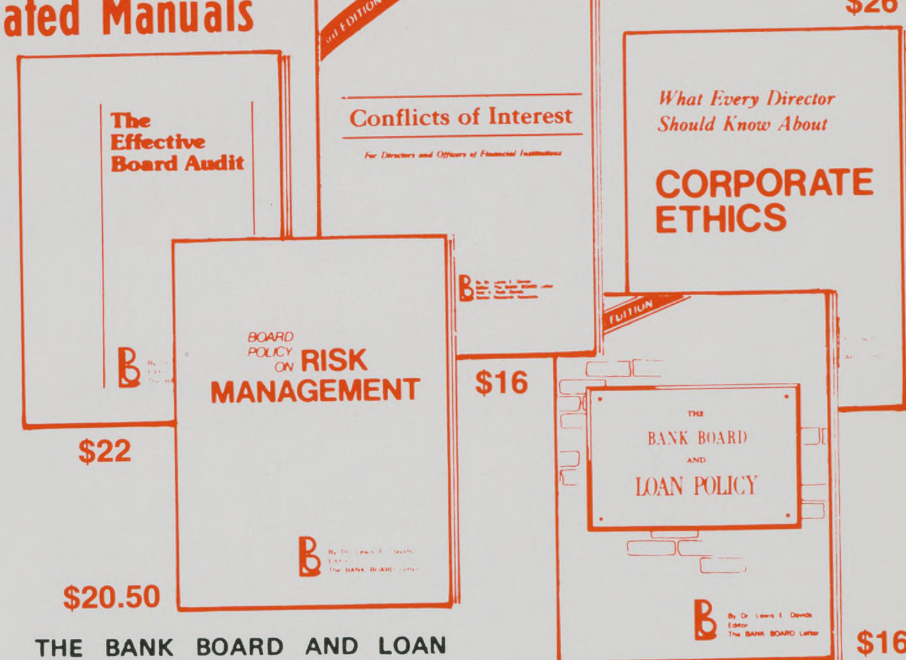

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How to Improve Effectiveness Of Board Meetings

By John Donald Wright

NOTHING is more common around many banks than a meeting. Recently, I started calling for the officers of a bank about 8:30 in the morning. I tried three or four and in each case the secretary simply said, "He is in a meeting." Finally, at 10:15 I had word one of these officers was out of the meeting, but before I could get to him he was back in another!

This is not the kind of thing that bank wanted, and if one of its directors had been trying to get some service at that same time, I expect he would (and should) have alerted the CEO to the need to schedule meetings as far as possible at hours that do not interfere with service to customers, perhaps reduce the number of meetings and certainly have them conducted in an expeditious way. He probably might have mentioned also that the secretary could be a great deal more helpful to a customer than to simply say, "He is in a meeting."

The same time and customer inconvenience can be caused by directors' meetings, especially committee gatherings. Directors should ask themselves how much staff time is involved in meetings of board and committees, how many bank officers are sitting in these meetings and how much are the meetings *really costing*. Of course, this goes to the number of directors' committees the bank has and the frequency of such meetings.

Importance of Meetings. However, this does not begin to get to the importance of meetings of the bank board and of its committees because the board is the center of the decision-making process of most financial organizations. Committees can add to the ability of one individual by bringing to bear the whole intelligence and experience of a group. On the other hand, the effect of a committee can be just the opposite.

Recently the *New Yorker* carried a series of articles on decision-making processes at General Motors. Obviously, the brightest stars in big corporations like GM are assigned to the important committees. But the thrust of the article was to the effect that many decisions came out of those committees that have contributed to the erosion of our automobile industry.

The Edsel is said to have cost Ford over $200 million. That may be a pittance by today's standards, but it was big money then. No doubt, it was approved by a committee of the best and brightest.

David Halberstam, in a book in fact called "The Best and The Brightest," has detailed the processes of committee meetings in the Kennedy, Johnson and Nixon administrations concerning the Viet Nam War. His book brilliantly illustrates how bad, disturbing and even irrelevant information and psychology can come to bear to make committee decisions far worse than most individual decisions. Nobody wanted to tell the President something he did not want to hear. Nobody wanted to back up on positions previously taken. Some strong members of the committee wanted to be heroes and advance their standing in the administration. All wanted to continue to the next administration. So, some of the ablest and most sincere people in the country made one bad recommendation after another.

This article is taken from the book, "The Effective Bank Director," by John Donald "Don" Wright, pres., Don Wright Associates, Inc., Dallas-based bank-consulting firm.

"The Effective Bank Director" (R1565-2, cloth, $29.95) and another book by Mr. Wright — "Banking: A Dynamic Success" (R0380-7, cloth, $28.95) — are available from Reston Publishing Co., 11480 Sunset Hills Rd., Reston, Va. (800/336-0338).

These same forces bear on bank board and committee meetings. We could detail them right down the line. The process of bringing keen minds together, willing to discuss and listen and to arrive at committee decisions that are better, not worse, than individual decisions, not only is important, it is vital. We set so much store by committee processes, particularly those of the directors and officers loan committees, that poor results can be disastrous.

This first important point goes to the leadership of the board or committee. The second goes to the membership. Unless each committee member can speak out, unless each can listen, unless each can evaluate, the whole committee process on which we depend is a poor one.

What Interferes? What are the usual mistakes in board and committee meetings? Directors with whom I have spoken have listed these:

1. CEO talks too much or too little — probably the first.
2. Staff reports are too long and not properly prepared.
3. Lack of preparation, possibly because material for prior study was not sent on time.
4. Directors or committee members become involved in solving a few small problems instead of taking a broad view and concentrating on the most important issues.
5. The agenda is not properly arranged for the directors or members to provide real input. Sometimes the real issues come up when everybody is eager to leave.

How to Improve. So let's start with the agenda as the handiest tool for improving our meetings. Recently, I had the opportunity to serve on the boards of other companies and wish I had had

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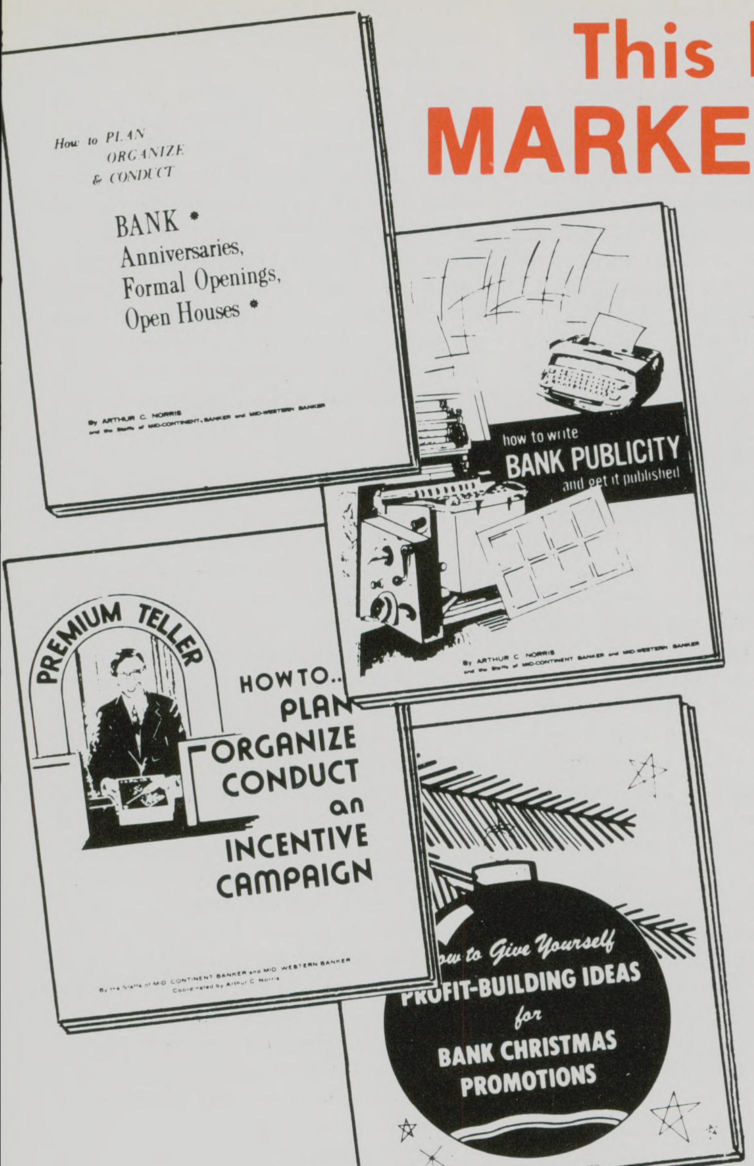

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this chance long ago. One company is headed by a brilliant entrepreneur who has started companies before, has always been successful and is on the road to another fine achievement. But that does not mean he is the best hand at running meetings. At a recent meeting, we heard outstanding reports from the staff for an hour and 45 minutes, but they could have been condensed to 30 minutes. Just when everyone was getting ready to adjourn, the chief executive said, "Now I'd like you to consider whether we should sell a division of the company."

Here was the only thing in the whole meeting directors could put their teeth into. It is probably the most important question to which the board could contribute in a year, and it comes up at the tail end of a meeting when it will receive the least consideration.

I thought how often I have made that same mistake. How often do we bring our most important loans up at the last of the loan meeting? All this goes to the agenda. Just because the agenda for a board or committee meeting has once been structured in a certain way does not mean it has to remain that way forever; nor do we need to stay in a rut because law or regulation may require that we cover certain things in each board meeting. The CEO's operating reports may always have been scheduled first, but that is not a requirement. One of our directors recently asked that the agenda be set up so the items on which the board could make the major contribution are placed first, and I think that is an outstanding suggestion.

When and Where to Meet? Every once in a while, every board or committee should ask itself, "Are we meeting at the best time of the day?" We'd like to meet when our minds are fresh. But we also would like to meet when directors are under the least time pressure. Ideally, they should be able to come in a few minutes ahead of time to look at their information and should feel there is nothing more important for them *at that particular time than this meeting*. It is disruptive if directors have to leave the meeting, especially if the chairman must leave. Early morning meetings have an advantage, but often directors must leave to make an appointment or catch a plane. Late afternoon meetings may strike the director at the time of his lowest physical and mental energy. Night meetings particularly run into that problem. One bank has a program in which directors can come at 11 a.m. (if they desire), look at their material, have lunch and then get into a formal board meeting immediately after. This has a good deal to recommend it if members are willing to cut into the middle of their days.

Where should the board meet? Of course, the usual answer is in the boardroom. But years ago, our board went to a place on the lake that was owned by one of our fine directors, and we met in two adjacent rooms forming an L-shape. The arrangement was such that some of the directors could not see the entire group. We all were sitting in straight-backed chairs, and few had the luxury of a table. We did not have a lot of high-powered audiovisual equipment. But we did have the *finest communication* we had ever had at any board meeting. The relaxed setting just invited easy discussion.

This is not to say a lot of meetings should be held away from the bank — but perhaps occasionally one should.

Of course, we all know many banks have elegant boardrooms with large tables, and these are impressive showplaces. But the test of the large expenditure generally made on boardrooms is, do they really contribute to director communication and good decisions? We all have had a feeling on entering certain rooms that they were quiet, dignified, comfortable and pleasant. These are the things that will help make good concentration and communication and thus good decisions. Anything that contributes to good decisions will help pay for the boardroom.

Preparation and Conduct. Board and committee meetings are important enough for significant advance preparation. The CEO and other staff members who are going to report should rehearse to stay within time limits. Whatever maps, charts and slides are going to be used should be ready. If the directors are to receive handouts, the latter should be passed out at the proper time, not when something else is being considered. Needless to say, the room needs to be properly lighted and air conditioned, and all other efforts should be made to keep down those peripheral and subtle irritations that make it difficult for the mind to focus on a complicated thought.

The conduct of the meeting is so significant! Frequently, someone wants to arrive at a conclusion before the subject is even properly introduced. Others insist on having more than their due weight of influence. Sometimes, it's apparent in any meeting that some members have teamed up in advance. All these things tend to destroy the true genius of a meeting. Frequently, the attitude of the chairman or the CEO or one or two strong directors is all determining. Who has not been in a bank officers' loan meeting, for example, where everybody waited until the old man expressed some thought, and then everybody rushed to get out in front on that idea? The same kinds of psychology can be applicable in a board meeting if the chairman or president presents something in such a way that an open discussion cannot be held and alternatives cannot be considered.

All these failings have given rise to a well-known expression: "A camel is a horse designed by a committee."

Summary. It does not need to be that way. By naming the right people to the committees, counterbalancing one strong influence with another, by not having people there whose presence is unnecessary or detrimental, by proper preparation (and sometimes by an expression of ground rules in advance) and by quiet, deliberate, cooperative comments, boards and committees can elicit information and attitudes from a broad range of backgrounds that should ensure the finest possible decisions. And the finest possible decisions are what the bank and the industry will need more in the next few years than ever before. It is well to also consider every meeting as a sales gathering. People leave feeling better or worse. Let's try to always go out with the feeling that we are on the right track, working together and "that was a good meeting." ● ●

Student Given Chance To Live In Paraguay With Bank's Help

Thanks to Chicago's First Security Bank, a high school student spent the past summer living with a family in Asuncion, capital of Paraguay.

Each summer, the American Field Services (AFS) Scholarship Program exchanges 8,000 students and teachers among 60 countries. The objective is to give those involved the opportunity to get to know and understand countries other than their homelands. However, while some students are able to finance their trips themselves, many city students cannot and so miss out on this educational experience. In its first year as a member of the Chicago Business AFS Scholarship Program, First Security sponsored the high school student by paying her participation fee.

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Cooperation

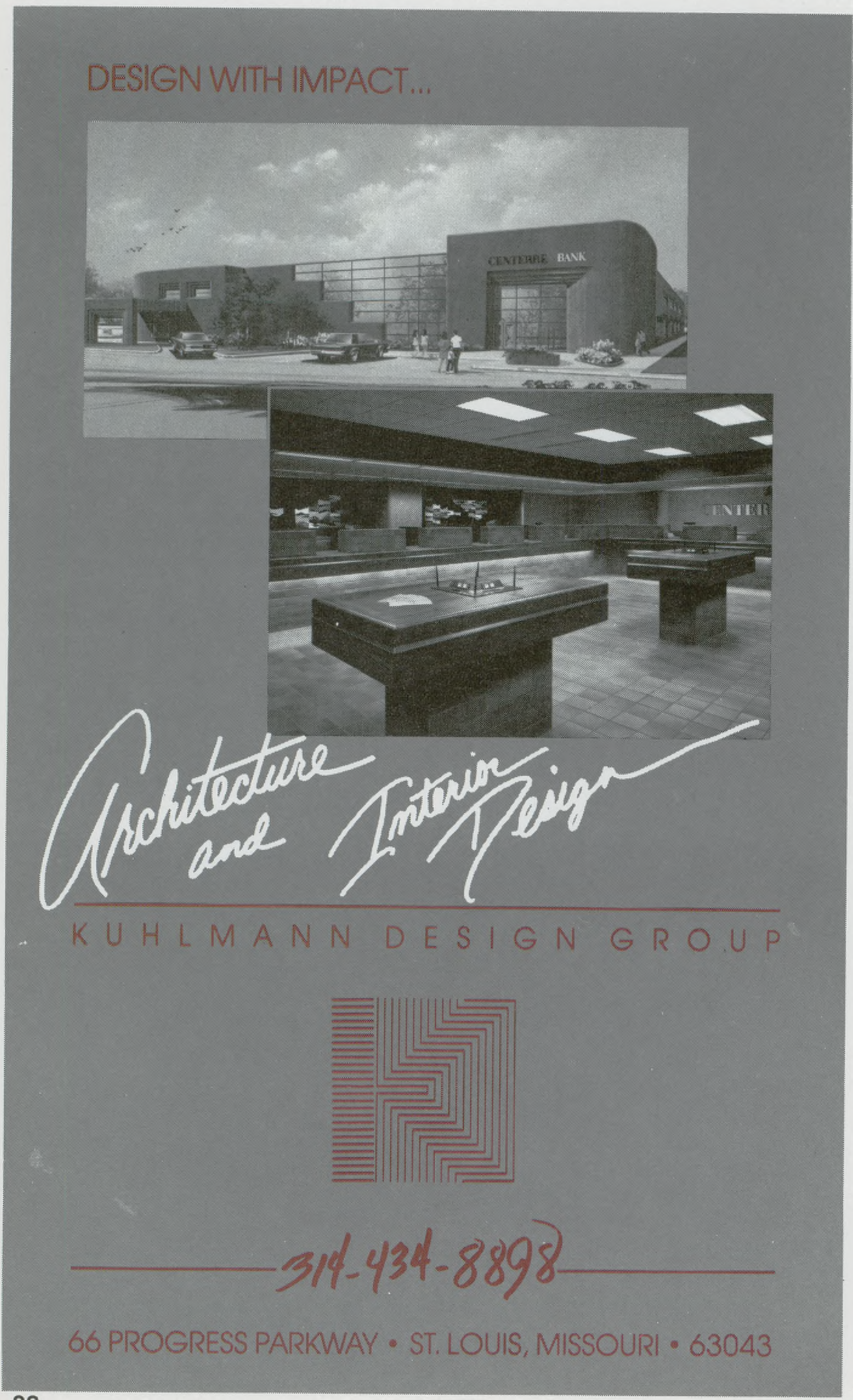
(Continued from page 22)

from UDAG.

Iowa Trust and Savings, Mahaska State and an S&L were instrumental in negotiations with the UDAG office by providing adequate commitment for financing the project, which eventually was replaced by a bond program. These institutions also actively supported the developer by financing initial land-assemblage efforts and participated in providing technical assistance and financing to businesses being relocated from the cleared area.

Mr. Farris says financial institutions have the ability to encourage use of UDAG programs, when necessary, through individual business-customer assistance on particular projects, workshops/luncheons for business customers, workshops for the business community sponsored by an economic-development organization such as the local chamber of commerce and discussions with others in the real-estate industry, such as appraisers, accountants, realtors, engineers, architects, etc.

Mr. Farris sees UPC's role as that of an intermediary between the private and public sectors in order to expedite project developments. — **Jim Fabian, senior editor.**



How to Plan

(Continued from page 21)

identifies profit potential based on number of home/auto owners in the community. The survey can be conducted with or without direct contact with bank customers. Management may wish to consider direct contact to measure interest in particular insurance products.

Another important step is to identify key insurance agents within the community with the capacity to market to and serve the needs of the bank's customer base. Discussions of an arrangement to sell insurance in the lobby or by direct mail would follow. In some areas where a customer base may be too small for an individual bank to establish an insurance profit center, a regional consortium of banks could seek a common agent to offer insurance products to their combined customer base.

It's evident, then, that community banks can establish insurance profit centers that tap the dormant asset value of their customer bases, as several large banks already have done. Bank management should explore the wide range of marketing options available, selecting the one best suited to its situation.

The potential for significant earnings already exists. It remains only for management to put programs in place to create these profits. The resiliency and quick reaction-time capability of community banks should be a substantial advantage in achieving this goal.

• **The St. Louis Fed** has appointed 10 new officers: Dallas S. Batten, Hillary B. Debenport, Rik W. Hafer and Michael E. Trebing, research officers; Dennis W. Blase and Harold H. Rieker, supervisory officers; Judie A. Courtney, human resources officer; Gregory S. Pusczek, general services officer; Frances E. Sibley, systems officer; and Harold E. Slingerland, credit officer.

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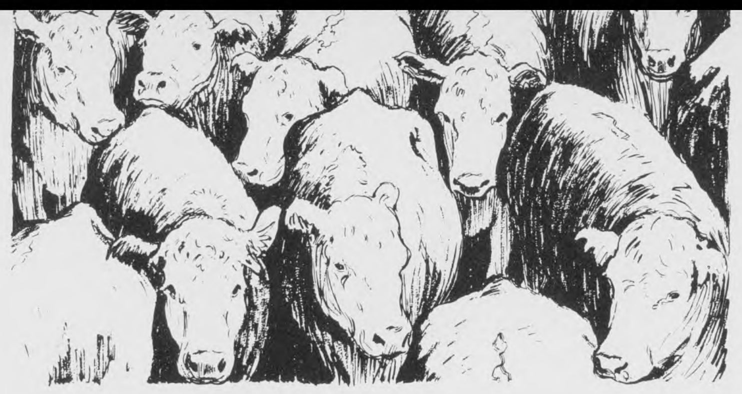
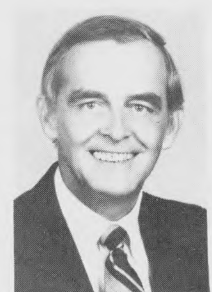


Matching Production to Resources Key to Survival in Beef Business

By H. H. Dickenson



H. H. Dickenson is executive vice president, American Hereford Association, Kansas City.

BEEF-CATTLE PRODUCTION in the U. S. will be required to adjust to the changing structure and economics of the industry.

The National Cattlemen's Association has discussed today's beef-cattle business as a "mature" industry. A mature industry is one that must cope with slower population growth; hence, slower growth in per-capita consumption of the product.

In addition, the present economic status suggests this mature industry cannot count on rapid, or prolonged, increases in prices paid for the product. This leveling out of growth, and to a lesser degree prices received, poses new concerns for the producer who must change his management practices to effectively cope in a new competitive market.

Optimizing Production

Over the lifetime of most cattlemen, the direction of the beef industry has been toward maximum production. Choice of breeds, feed supply, labor intensity and a host of other cost factors were not major considerations in efforts to maximize production so long as the industry was a growth industry. However, under a mature-industry scenario, production goals must be adjusted to better relate to a cost-benefit analysis. Optimum production with net profit being the only maximum consideration is perceived by many to be the only sure route to profitability in the beef industry of today and tomorrow.

Optimum production means matching production to available resources. For the most part, this means a careful analysis of available feed supplies and how management must adjust to adapt to the environment. A goal of higher weaning weights may need to be replaced by a goal of more calves with lower unit weights. Increased milk production may be costly when plotted against the cost-benefit analysis of what it costs to achieve greater milk production. To a degree, even lower prices received for calves may prove beneficial if the cost of producing those calves can be reduced significantly.

Optimum production requires trade-offs. Through genetic selection, man can change cattle significantly and still not defeat the basic purpose of beef cattle. But there are biological limitations, and it is the cost-benefit of these trade-offs that must be considered when looking at optimum versus maximum.

From an economic value, reproduction is by far the most important of the trait groups. Therefore, this is where most emphasis should be placed. Without a calf to sell every year, a cow cannot pay her way. After achieving a goal of a live calf for each cow, then growth, or weaning weight, becomes the priority item. Last, in economic value, is carcass merit.

Calving ease thus becomes a high priority for the commercial man. To obtain maximum calving ease generally requires a trade-off with growth. Heavier weaning weights mean heavier birth weights, and this translates to more calving problems. By the same token, selecting for calving ease alone means lighter weaning weights. Selection for optimums in this area thus is an important consideration.

Cow size has been a controversial subject for some time. Larger cows generally have heavier calves, but cost of maintaining larger cows may well offset the benefits of heavier sale weights. Again, the producer's ability to adjust to environmental restraints is the key to his choice of cow size.

Thus, optimal production in the beef industry involves the merger of a number of biological and economic functions that allow cattle to be the most efficient type for a given farm or ranch. Adjusting one's operation to the optimum-production concept does not necessarily mean that growth, size or

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milk production must be decreased. Rather, it implies there are limits for any of these traits at which point beef animals become counterproductive.

However, there is little doubt that striving for optimum production is the key to survival for most beef operations in the future. The cost-benefit ratio is contingent on matching production to available resources, and financing beef-cattle operations in the future must take this aspect into consideration. In the final analysis, profitable beef production must be based on this formula.

Profit Margin = (Average Weaning Weight) × (% Calf Crop) × (Average Sale Price/Lb. of Calf) × (Number of Cows in Herd) Minus Annual Cost of Operation.

In making this formula work, the producer must consider a number of proved production truths and economic facts that have an impact on profitability.

Production Truths

Frame and Growth. Frame size is primarily an indication of (1) birth weights; (2) weight at choice grade and (3) mature weight. Selection for growth should occur within frame size. Within a frame size, faster-gaining cattle generally are more efficient.

Cow Size. Biological extremes seldom represent maximum economic efficiency for the commercial producer. Beyond the need for an optimum range in size to meet market-weight criteria and to suit environmental adaptability, the impact of cow size on economic efficiency is minimal.

"Over time, premiums or discounts for a specific breed or type are largely a matter of supply and demand. Under current economics, there may be just as much opportunity for improving profitability through lowering input costs as there is through increased output or increased prices."

Milk Production. A high-quality environment can accommodate a wide range in milk-production potential, but a less-favorable environment must use the moderate- to low-milking cows to be most efficient.

Cattle Type. Cattle type should not stray far from the economically available feed resources on the home farm or ranch. Low levels of nutrition favor smaller-breed types. Moderate levels of nutrition are best suited for medium-breed types. High levels of nutrition can accommodate large-breed types.

Crossbreeding. Breeds used in rotational-crossing systems should be relatively similar rather than different in type. The spread in cow size between breeds should not exceed 200 pounds, and milk-production differences should not exceed eight pounds daily production.

The Functional Cow. She works for her owner instead of her owner for her. She is trouble free. If she costs extra time and labor, she is nonfunctional.

Total Cow Herd. Success or failure in a commercial cow-calf enterprise is measured at the *herd level*, not at the individual cow level. In most environments, cows in the herd should not be extreme in any one production trait. They should be moderate in most traits so as to withstand volatile changes that occur in climate, cattle prices and production costs.

Aggravation Factor. While not tied directly to the profit formula, a trait or characteristic such as disposition has a powerful impact on management efficiency. Ease of handling can be a breed asset or a breed liability that warrants consideration. Likewise, economic traits such as feet and udder soundness are either a plus or a minus as it relates to labor requirements.

Economic Truths

Cattle Prices. Over time, premiums or discounts for a specific breed or type are largely a matter of supply and demand. Under current economics, there may be just as much opportunity for improving profitability through lowering input costs as there is through increased output or increased prices.

Feedlot Demands. Predictability will become a major component in overall acceptance by feedlots. Knowledge of the performance potential of a pen of cattle is money to the modern feeder. Shorter feed periods cut down on both feed costs and interest owed. Contrary to what many predicted a few years ago, cattle with ability to grade choice on shorter feed periods are most in demand. Feedlot cattle must be able to perform satisfactorily under climatic extremes.

Packer Demands. Boxed beef accounts for nearly 60% of the carcass beef sold today, and the trend is toward an even higher percent. Acceptable carcass weights for most boxed beef programs are 600 to 800 pounds or 1,050 to 1,300 pounds live weight. Because of restaurant demand for certain size cuts of steaks and roast, the most optimum carcass weight is 725 pounds, which translates into a 1,200-pound live weight. Yield grades two and three will remain the most desirable from a cutability standpoint. ● ●

Merger/Acquisition Plan Published

A SURVIVAL game plan of alternatives and strategies for unexpected takeover attempts and impending mergers and acquisitions has been published by the Touche Ross Financial Services Center (FSC), New York City.

The publication, titled "The Banking Shakeout," is aimed at directors, CEOs and chief financial officers of financial institutions. Its issuance was prompted by the increasing number of banking mergers and acquisitions in recent months.

"There is an immediate need to focus on the rapidly changing banking environment," says J. Thomas Presby, FSC partner in charge. "Banking executives, particularly those associated with small to mid-size institutions, recognize the urgency with which they have to deal with a merger, acquisition or consolidation. Early planning is the key when bankers are faced with shrinking earnings and growing expenses."

The publication examines the acquisition/divestiture process from feasibility review to integration of operations and human resources. It discusses a range of alternatives and considerations to be made in the event of an acquisition or takeover with key questions that should be asked by banking management.

Copies are available at no charge from William K. Smith, director, bank mergers/acquisitions, Touche Ross Financial Services Center, One World Trade Center, New York, NY 10048.

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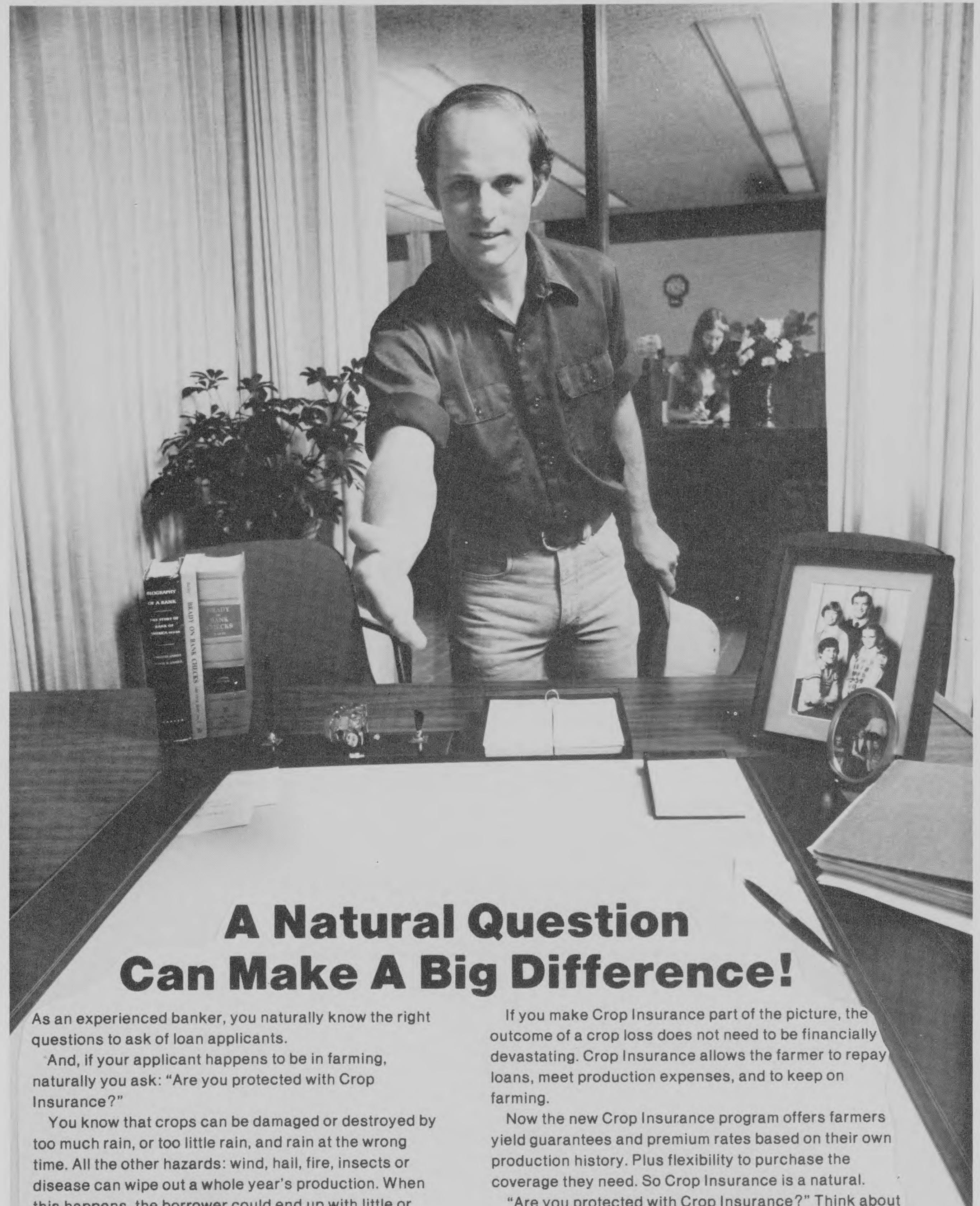

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Cut Ag-Loan Defaults By Sharpening Lenders' Skills

By James Bullard

James Bullard is vice president, credit administration, Hawkeye Bancorp, Des Moines, Ia.

"COUNSELING agricultural borrowers is an area where our bankers need to do a better job." That comment, by a bank president in the Hawkeye Bancorp system, summarizes a problem facing agricultural lenders across the country: the need to sharpen lender skills as a way to cut the escalating number of agricultural-loan defaults.

Complicating the situation is a major change in the way Hawkeye Bancorp and other banks are approaching agricultural lending. Lenders trained to look primarily at net worth — a farmer's assets and liabilities — now must focus more closely on his or her real ability to repay loans from cash flow of the operation.

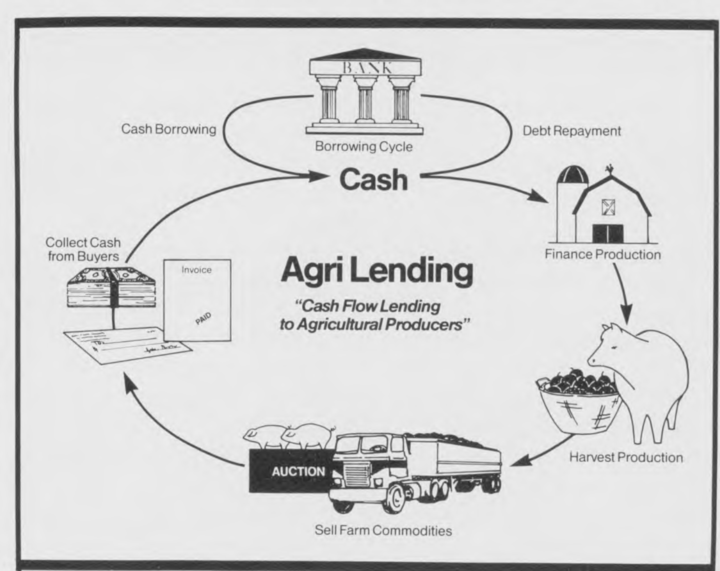
The problem has become more distinct in the past two years. Through the 1970s, most agricultural lending was asset based. Because of inflation in land and equipment values, stable or improving commodity prices and favorable livestock markets, little or no attention was paid to the ability of a farming operation to service debt from current cash flow. When the inflation pattern reversed in the early 1980s and markets began their downtrends, banks found themselves with large numbers of agricultural borrowers who didn't have the assets to support the amount of credit that already had been extended. The result: agricultural loan defaults in record numbers. An approach to agricultural lending emphasizing cash-flow analysis clearly was necessary.

"The lender has a great deal of responsibility for a lot of the capital decisions his customers make and is likely to have more in the future," according to Glen Determan, loan administrator for Hawkeye Bancorp.

"We need to form closer relationships with our borrowers and help them become better marketers with the assistance of good cash-flow programs. Our role is not to manage their businesses for them, but to give them the guidance they need to make intelligent decisions," says Mr. Determan.

At Hawkeye Bancorp, a major concern was finding the tools to help our agricultural loan officers examine farming operations from a true cash-flow basis and enhance the agribusiness background they need to do better as financial advisers. We also needed a training system that could be customized to our specific needs and that could help standardize agricultural-lending practices in the 36 banks affiliated with the Hawkeye Bancorp system.

Agri Lending, a new training system from San Francisco-based Omega, Consultants to Bank Management, was selected as the basis for such a program. The *Agri Lending* system was implemented on a trial basis at two Hawkeye Bancorp banks in the fall of 1984. The 10 trainees who participated included bank presidents, senior loan officers and apprentice agricultural lenders.



The foundation of the *Agri Lending* system used at Hawkeye Bancorp is the Decision Strategy, a step-by-step process for reaching a credit decision that helps our lenders gather, organize and assess borrower data systematically. The four major steps in the Decision Strategy process are 1. Loan request/applicant review. 2. Financial position and past performance. 3. Projections. 4. The credit decision. Each step of the Decision Strategy represents a hurdle that must be passed before the loan officer can proceed.

Agri Lending is struc-

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tured as a two-part curriculum. *Agri Lending I: Agrifinance* teaches our trainees the fundamentals, including the nature of agribusiness and the financial tools necessary for credit analysis. In *Agri Lending II: Credit Analysis*, our lenders learn the more advanced techniques of loan analysis, including the Decision Strategy. Although lenders with strong accounting backgrounds and familiarity with the agricultural-lending environment can test out of part I, Hawkeye Bancorp lenders who completed the training recommend including it, even though the material might seem elementary to experienced lenders.

One trainee, a senior loan officer, commented that *Agri Lending I* "provides a common groundwork of terminology and information for everyone for the remainder of the course. It also provides a logical thought process for analyzing loan applications, along with the tools to measure repayment capacity, workability and risk for both lender and borrower before making loan decisions."

In addition to providing a structure for determining agricultural-credit risk, *Agri Lending* also serves as a checklist for gathering necessary financial data — a crucial process in a lending area where audited financial statements are rare. In other types of commercial lending, we assume that books are set up on an accrual basis, with the borrower supplying the necessary financial data. Most farmers, however, use cash-based accounting for the few financial statements they do prepare.

Within Hawkeye Bancorp and its primarily "country-seat" agricultural trade-center banks, collecting information is 50% of the work in agricultural lending. Lenders must gather data, put the information together and verify its accuracy before they can begin an analysis. This information-gathering and verifying process, which is missing in most other commercial lending, is a major training need addressed in *Agri Lending*.

According to Kevin Fisher, Omega product specialist, development of the *Agri Lending* training system began in 1979 as a joint venture between Omega and the Baltimore Farm Credit banks and reached its final form in 1982 in field tests with the Omaha Federal Intermediate Credit Bank. Its purpose was to provide an alternative to the traditional apprenticeship method of training agricultural lenders, which can be inefficient and time consuming.

"In researching *Agri Lending*, we found that apprentices can watch an experienced lender make 50 loans and feel they have witnessed 50 unique decisions because of the complexities involved in agricultural lending," Mr. Fisher says. "Lacking a clear frame of reference, they tend to see the differences, not the similarities. *Agri Lending* offers a considerable shortening of training time by combining the step-by-step Decision Strategy with on-the-job training experience — the traditional apprenticeship method."

At Hawkeye Bancorp, Training Director Kevin Remillard said completion of the *Agri Lending* system took 14 weeks — 90 to 100 hours — compared with the estimated two to three years required to reach a comparable level of expertise in the traditional on-the-job training approach.

"In addition to shortening the training time, the Decision Strategy technique also shortens the credit-analysis process," Mr. Remillard says. "Documenting the information necessary for agricultural loans can take twice as much time as preparing other kinds of commercial loans, especially if you don't understand what you're looking for and what the ratios mean. That was a problem especially with our junior lenders. The Decision Strategy taught them how to start and what to focus on. That's critical."

In addition, Mr. Remillard says *Agri Lending* gave Hawkeye Bancorp trainees a common basis for communication, which will become in-

Agricultural Lending: Making Credit Decisions — **Decision Strategy**

Loan Request and Applicant Review
- The Loan Request
- The Business Entity
- Farm and Financial Management

↓

Financial Position and Past Performance
- Current Financial Position
- Past Year Profitability
- Past Loan Performance
- Financial Trends
- Borrowing Cause

↓

Projections
- Operating Plan
- Cash Flow
- Profitability
- Pro Forma Balance Sheet
- Workability
- Security
- Risk

↓

The Credit Decision
- Assessing Creditworthiness
- Making the Credit Decision
- Loan Servicing

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Foundation of *Agri Lending* system used at Hawkeye Bancorp, Des Moines, is Decision Strategy, outlined in this chart. It's step-by-step process for reaching credit decision.

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There's a major change in the way Hawkeye Bancorp and other banks are approaching agricultural lending. Lenders trained to look primarily at net worth — a farmer's assets and liabilities — now must focus more closely on his or her real ability to repay loans from cash flow of the operation.

creasingly important as training is offered in other banks in the system. If our lenders don't have an ability to communicate on a common ground, it will be difficult to improve technique. "Excellence comes only with consistency. If I were to choose one thing apprentices and senior lenders alike got out of the training, it's a consistency of approach to lending decisions."

As an example, one trainee — a senior vice president who has 10 years' experience in agricultural lending — says: "I've been looking for this kind of a course ever since I became involved in ag lending. It's given me a basis in accounting for things I've been doing for 10 years, knowing they were correct, but not being able to explain them adequately to customers or my junior loan officers."

One of the two Hawkeye Bancorp system bank presidents who completed the course echoes that opinion, adding: "I have noticed a marked improvement in the approach loan officers are taking in analyzing credit. They have a better understanding of accounting procedures. They are asking the right questions regarding the profitability and workability of credit lines and seem better equipped to relate the necessity of these matters to their customers."

The second bank president who participated in the training comments that his bank could have avoided $400,000 in bad loans during 1984 if he had been through the course at the beginning of the year.

Because of these results, Hawkeye Bancorp is planning to implement the *Agri Lending* training program in an additional 28 banks in the system during 1985. *Agri Lending* will be the basis for all Hawkeye Bancorp's ongoing training and educational efforts in the agricultural-lending area. Future plans include adapting the *Agri Lending* material to produce computer-prepared cash-flow and financial pro formas and enhancement of interview and counseling techniques. • •

Investment-Policy Danger Signals Noted

BANK DIRECTORS who oversee their institutions' investment policies should be alert to eight danger signals that might lead examiners to suspect trading activities, say attorneys with the financial section of Borod & Huggins, Memphis law firm that specializes in financial-institution representation.

If regulators find evidence of trading activities, they will require the institution to mark-to-market the value of its investment portfolio, which can result in a tremendous write-down on capital. If municipal securities are involved, forced registration as a municipal-securities dealer is inevitable.

The following situations act as red flags to regulators:

- Assets purchased with an intent to resell, often evidenced by high turnover of investments in the portfolio that are held for far less than maturity.
- Undue preoccupation with whether money rates are high or low and the financial structure of the economy when investment decisions are made, leading to conclusions by examiners that speculation formed the basis of the trading decision.
- Emphasis on income from investments versus the value of holding investments to maturity.
- A species of security (sub-investment) that itself evidences a speculative intent, such as futures contracts rather than municipal bonds.
- "Churning" the portfolio to take profits from short-term price movements, often evidenced by volume purchases and sales of securities held for a brief holding period, rather than engaging in purchases and sales to improve portfolio character.
- An executive in charge of an institution's investment portfolio who is not well versed in sophisticated market products and techniques, but who is engaging in financially complex transactions.
- A regular pattern of engaging in volume, speculative trades as opposed to occasional purchases and sales for specific investment goals, such as laddering of maturities or ridding portfolios of issues that have declined in credit quality.
- Sales of portfolio securities with price differentials or markups to bank customers or other banks used as a source of income.

Structuring investment policies and practices in conjunction with counsel is advised, rather than trying to defend against imposition of regulatory sanctions or regulatory requests to restate call reports, says Borod & Huggins.

• **Bank Building Corp.** Gary Strong and Richard T. Breitenfeld have joined the firm as marketing manager/financial facilities and sales manager/Mid-Continent region, respectively. Mr. Strong formerly was marketing manager for the St. Louis Fed; Mr. Breitenfeld was with Golden Real Estate Enterprises and Hilti, Inc., where he was area sales manager.

STRONG

BREITENFELD

Area Weavers Show Work In Exhibit at Bank

The ancient art of weaving from baskets to tapestry was the subject of a display at Toledo (O.) Trust's Atrium, Three SeaGate. The exhibit was called "Fibers Alive, an Exhibition of the Best of Northwest Ohio's Fibers."

Shown were approximately 30 pieces representing the best work of northwest Ohio weavers, entrants in the fiber-arts competition sponsored by the Toledo Area Weavers Guild.

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Attention Bank CEOs:

How Does Your Bank "Introduce" the New Director To His New Job?

THE NEWLY ELECTED bank director probably seems overwhelmed with the responsibilities of his new job and the complexities of the banking system. So, you'll want to acquaint him with his "new chair" as quickly and as "gently" as possible.

Your bank undoubtedly has a portfolio of material to hand to the new director. Our instructional folder, entitled *"Briefing the New Bank Director,"* can be a useful addition to your introductory material. It is written by Dr. Lewis E. Davids, editor of The BANK BOARD Letter.

"Briefing the New Bank Director" provides the recipient with an overview of the director's job and responsibilities and also offers suggestions on "homework" and "reading" assignments that will bring him quickly up-to-date in his job.

This 8-page folder concludes with what the author has termed the "20 Commandments for Bank Directors" starting with "Thou shalt not attempt to usurp prerogatives of management," and ending with "Thou shalt submit thy resignation gracefully and with dignity when no longer making a positive contribution to the bank."

For a FREE copy of this folder, fill in the coupon below. You'll receive this plus other information concerning the bank director's job that can be useful to him and, of course, to the bank.

The BANK BOARD Letter
408 Olive St., St. Louis, MO 63102

Please send me a FREE copy of "Briefing the New Bank Director" along with other information about The BANK BOARD Letter.

Name ______________________ Title ____________________

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Debtor Distress

(Continued from page 26)

ery repairs and illness of family members.

If a set-aside of 25% does not produce a positive projected cash flow and a 10% margin to cover unanticipated expenses, preliminary indications are that no part of the debt can be set aside. The FmHA county supervisor is to help the borrower in seeking a voluntary debt adjustment from other creditors. If that produces a positive projected cash flow and the 10% margin, the set-aside can be approved.

The FmHA will require the "best lien obtainable" on all assets owned by the borrower except a personal automobile or automobiles and household goods.

This part of the program continues until September 30, 1985, unless extended. Date of approval is when the five-year period begins.

Loan guarantees. The second element of the new set of federal initiatives involves restructuring of debts held by commercial banks, production credit associations (PCAs) and other eligible lenders under federal-guaranty rules. Only farm loans classified as "problem loans" are eligible for the guarantee.

As a condition for the guarantee, the lender must write off at least 10% of total principal and interest outstanding on the loan. The write-off must be a permanent cancellation of the amount. A new note is to be written for the adjusted amount due. Thus, the farmer receives the benefit of the write-off. There can be no agreement between lender and borrower to reinstate the portion of the debt written off.

Note that the 10% write-off is the *minimum* amount that must be canceled. The write-off must be enough to provide for a projected cash flow sufficient to pay farm operating expenses, service all debt, provide for family living expenses and cover taxes expected to become due.

The FmHA can guarantee up to 90% of indebtedness remaining after the write-down. But preliminary FmHA rules state the guarantee may be less than 90% to assure an appropriate sharing of risk between the private lender and the federal government.

The debt-adjustment plan to be prepared by the creditors and the borrower presumably will provide for necessary crop and livestock financing for at least 1985.

The FmHA will not guarantee loans if the rate charged exceeds the lender's best rate for its best farm borrowers.

Lenders participating in the new loan-guarantee program are encouraged to apply for the Approved Lender Program, but participation isn't limited to lenders with Approved-Lender-Program status.

The guarantee involves a 1% initial fee.

FmHA rules also state that lenders applying for loan guarantees are expected to enter into any necessary debt-adjustment negotiations with the borrower's creditors who have provided supplies or dealer-type open credit.

The President's announcement on September 18 indicated that $630 million of loan guarantees would be made available for the program. Each dollar of guaranteed loan offsets a dollar of loan-guarantee authority.

Contracting for Assistance. Under the third element of the four-part program, the FmHA has taken steps to provide expanded management and financial services to farmers under stress. The FmHA can contract with "farm-management associations, agricultural lenders, private farm-management firms and agricultural consultants." Former U. S. Department of Agriculture or FmHA employees are not eligible, however.

The idea is to make management and financial expertise available at the county level. Services of those contracting to assist in the effort are to be made available to individual farmers, agricultural lenders and the FmHA.

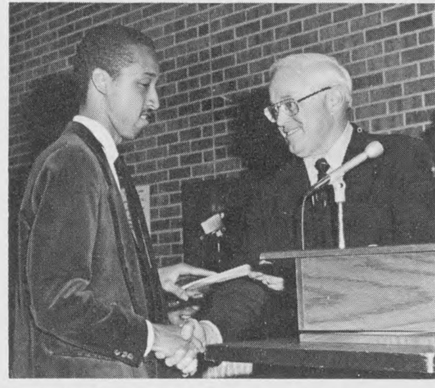
Authority for hiring individuals and firms expires September 30, 1985.

Help With Loan Servicing. The fourth and final element in the federal program is authority for the FmHA to contract with private-sector lenders to provide assistance in servicing FmHA-insured farmer-program loans. FmHA county supervisors are authorized to contract with any approved lender in the normal trade area.

Conclusion. The four-part federal program represents a modest, but heartening, first step toward easing the massive debt problem in agriculture. The guarantee authority likely will fall far short of what eventually will be needed. But if the program is handled responsibly, additional guarantee authority from Congress would seem not to be out of the question. The spotlight now is on all of agriculture — farmers, lenders, farm managers, input suppliers and universities — to address the debt problem in a manner that will merit the confidence of the nonfarm world. • •

Current-Events Quiz Contest Sponsored by Bank, Schools

The sixth annual Manufacturers Bank-Detroit Public Schools Current-Events Quiz Contest attracted more than 16,000 students from 24 Detroit high schools participating.



Paul L. Hussey (c.), e.v.p., Manufacturers Nat'l, Detroit, congratulates Robert Scott of MacKenzie High School, one of 24 participants in current-events contest sponsored annually since 1979 by bank and Detroit Public Schools.

Purpose of the contest is to motivate Detroit high school students to read newspapers to learn about current events, particularly local issues.

Each year, a student from each of the participating schools is honored as "champion" for his/her school.

Manufacturers National donates the prize money and the cost of all Detroit *Free Press* newspapers used throughout the program.

• **Bank Earnings International.** Competitor Series is the name of a new product designed to give financial institutions under $200 million in assets a competitive edge that increases earnings by reducing costs, enhancing work flow and improving service. The series offers three separate earnings-improvement tools. The program identifies earnings opportunities within the financial institution and develops a tactical plan with specific action steps that enhance earnings. Follow-up plans include Horizon Management, which develops long-range strategic plans, and Executive Manager, which is a software application for micros that allows for comparisons of the bank's performance to the appropriate peer group to determine strengths/weaknesses. Write: Bank Earnings International, 3420 Norman Berry Dr., Suite 623, Atlanta, GA 30354.

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Ag-Bank News Not All Bad: Leasing Boosts Iowa Bank's Yield

NEWS HASN'T BEEN GOOD for agricultural banks lately, so when an ag bank finds a service it can offer that is helpful in retaining customers, keeping local funds from leaving the area and posting an average yield of 20% before taxes, things begin to look much better!

All these things have been happening for the past year at Maquoketa (Ia.) State, according to Florian Steffen, senior vice president.

About a year ago, the bank contracted with Dodgen Financial Group, Inc., Des Moines, to put an equipment-leasing program in place. Considerable investigation and inquiry had been made about the benefits of equipment leasing in previous months and expectations for a successful venture were high.

Factors that prompted the offering of this service included a tendency for the bank's farm customers to opt for leasing rather than purchase when they needed new equipment. The local farm-implement dealer was more than happy to provide leasing arrangements while Mr. Steffen and the half-dozen or so loan officers at Maquoketa State were powerless to prevent consummation of the leasing deals.

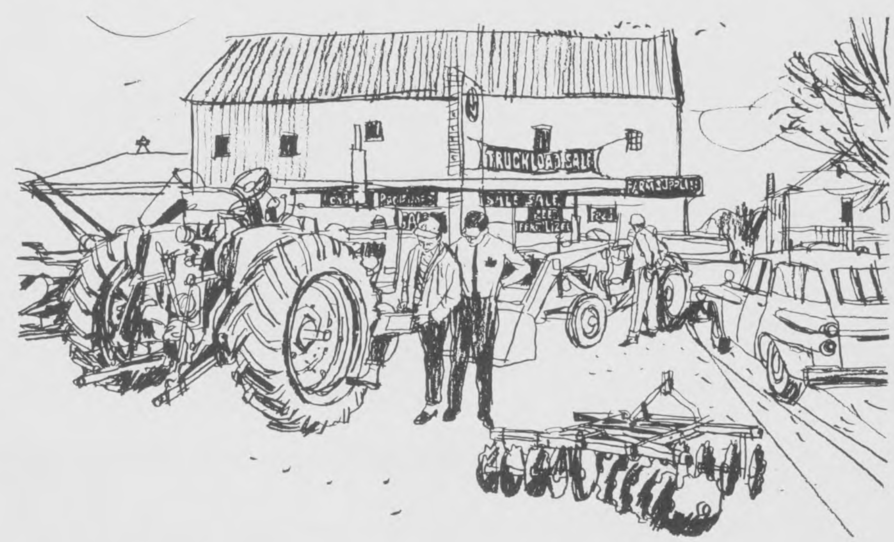
Not only were the bank's customers going elsewhere for the type of financing they preferred, the funds they expended for leases were going out of state to the headquarters of the leasing firm (a division of the farm-implement manufacturer).

Mr. Steffen says Dodgen Financial Group sold the bank a packaged leasing program that included software compatible with the bank's computer hardware. The program handles record keeping, and updates are provided periodically (six times so far during the first year of the program!).

Mr. Steffen was impressed with the simplicity of the software. It's so easy to use, he says, that even loan officers who were skeptical of using a computer now feel at ease when quoting leases to dealers and customers. They say it's simpler than the bank's loan-processing procedure.

The supplier keeps a representative in the area to serve as a troubleshooter. All Mr. Steffen has to do when he has a question about the program is make a phone call to the representative.

The program's existence has made it possible for loan officers to make new contacts with dealers that have resulted in referrals of names of farmers who, after a call from the bank, have signed on as bank customers.



Mr. Steffen says he used to become irked when a good, long-time farm customer traded machinery and signed a lease with the machinery manufacturer.

"Now we are keeping this business in the bank and getting a better yield than if we had made a loan," he says.

He sees the potential of the leasing program as great. But full benefits won't be realized until the farm situation improves. As of last November, the $83-million-asset bank had about $200,000 in leases.

"We're getting our fair share of the leasing business," he says, "despite the fact that not much machinery is being sold due to a short crop in 1984."

William D. Dodgen, president, Dodgen Financial Group, says that it's not uncommon for a bank to realize before-tax yields of 20% to 25% from a leasing program. Such a yield looks pretty good at a time when effective financing rates to bank customers range from 10% to 13%.

He terms leasing as "a powerful financial service to bring in new customers and one that keeps dollars at home."

Farmers whose incomes have declined materially are more likely candidates for leasing programs, he says, for these reasons:

- The farmer can't take advantage of depreciation schedules or tax-investment credits.
- The bank, as owner of the leased equipment, *can* take advantage of these tax credits.

The result: The bank can offer a lower-cost leasing package to the farmer and both the bank and the farmer are winners.

Mr. Steffen says that, without the assistance of the Dodgen firm, "we would be ill informed about leasing and probably would still be leaving the machinery companies and large HC lessors walk away with the business."

— Jim Fabian, senior editor.

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Bank's Commodity-Hedging Program Well Received by Local Farmers

WHEN a banker can assist a farmer during this period of hard times, that's news. And $39-million-asset Watseka (Ill.) First National has been in the news quite a bit during the past year.

It's all because of the bank's new concept in commodities futures trading called an "introducing broker." The bank opened such a brokerage in-house about a year ago.

The program isn't a carbon copy of some other bank's service; it's a new animal, so to speak — one that was originated at the bank (although other banks have since adapted it). Considerable ag-press coverage has been given to it.

The new service is strengthening existing customer relationships and bringing new farm-client customers to the bank.

It amounts to a form of "price insurance" for farmers, even before they plant their crops, says Kerry A. Bell, vice president. It allows farmers to market their products in the longest time frame possible — almost two years.

Although the bank doesn't offer advice on price, its loan officers do sit down with farm customers to map out their cash flows, costs and any other factors to arrive at a break-even point, Mr. Bell says. After the price the farmer desires is established, the bank automatically phones orders in to the Chicago Mercantile Exchange for the farmer when the established price is met.

The bank doesn't predict the price of a commodity; rather, it designs a scale-up plan for each customer. If a farmer decides to sell a percentage of his commodities at a nickel a bushel higher than a break-even price, the bank phones the exchange floor when that price is met.

If prices rise 10 cents above the break-even point, another percentage is sold. This procedure continues until all commodities and livestock are sold, Mr. Bell says.

A hedging program was seen as an aid to farmers after Mr. Bell learned that many farmers in the bank's trade area were uncomfortable dealing with traditional commodity brokers because of the speculative nature of the deals.

They didn't like to think about marketing their crops; they were primarily concerned about producing them. That's the mind-set they inherited from their fathers and grandfathers operating the farms in the past. Farmers were conditioned to letting outside factors influence their decisions, factors such as a maturing note, a rent payment that was due or selling plans of neighboring farmers, Mr. Bell says.

The realities of the farm situation have begun to force change on farmers. They've been strapped with increasing production costs, higher interest rates and depressed crop prices. Shrinking profit margins and deflating values of farmland have led to lower net worths. Farmers had difficulty projecting cash flows before planting because they had no concept what the market price would be at harvest time.

The volatile nature of commodity prices added further complications because farmers would neglect to take advantage of prices when they were high and end up selling during a trough price period, Mr. Bell says. This was going on despite the availability of adequate marketing information.

Many of the bank's farm customers were familiar with the use of commodity futures for marketing crops, but few were pleased with results obtained. The poor showing was attributed to unfamiliarity of brokers with the farm business. They didn't have time to learn and develop proper marketing techniques, Mr. Bell says.

So the ground was fertile for the bank to develop its own program. It saw itself as uniquely qualified to educate farmers about hedging as a way to improve profits because of its understanding of the farm business and its special financial-planning needs. The bank has the ability to develop an annual financial plan that fits in with farmers' production plans and it lends operating money.

The bank also was mindful of the fact that it needed more services to attract new customers, retain old ones and promote itself in the community. In so doing, it could blunt the effects of lost business due to deregulation.

Establishing the service wasn't easy, due primarily to obtaining necessary approvals from various agencies, not

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the least of which was the Comptroller of the Currency, Mr. Bell says. It took five months to convince that agency that the service was incidental to banking.

It was necessary to seek approval from the National Futures Association (NFA), which also took five months; have bank personnel pass commodities exams and arrange for dues to be paid to the NFA.

Two programs are offered — managed and nonmanaged. The only difference is that the first is implemented automatically by an outside adviser while the second is monitored and acted on by the farmer himself.

Steps in developing market plans include determining the production cost or break-even price and adding a profit goal so price targets can be attained. When target prices are attainable, managed accounts are transacted automatically.

Margin calls for each client are made directly to the bank and a line-of-credit loan is used for margin purposes, Mr. Bell says. When excess equity is built up in the futures account, it's forwarded back to the bank and applied to the margin loan. Excess equity beyond the loan balance is placed in an interest-bearing account.

Managed accounts are most popular with farmers, with about two-thirds of the bank's farm customers opting for them. Approximately one-third of the accounts were opened by farmers not previously dealing with Watseka First National.

To spread the word about the service, the bank held seminars in surrounding communities. During the seminars, bankers first show farmers how the markets have performed during the past few years. Then they show them how the hedging plan works.

Although no attempt is made to give advice about future conditions, it's obvious that the bank's service is having a favorable effect on the futures of participating farmers! — **Jim Fabian, senior editor.**

• **The Kansas City Fed** has promoted Vice President Jerry D. Shreeves to general auditor, succeeding the retiring Louis W. Kupersmith; John E. Moore, securities department manager, to operations officer and David K. Webb from operations officer, Denver Branch, to assistant vice president. Mr. Kupersmith joined the bank in 1970. Mr. Moore has been named supervisor of the electronic communications department.

Hedging Program Benefits Farmers In Marketing Crops, Locking in Costs

A HEDGING PROGRAM was developed about three years ago at Farmers & Merchants State, Bushnell, Ill., to give farmers an additional tool to market their crops and livestock and to help lock in input costs in the case of a long hedge.

In general, accounts are handled as follows, says Daniel F. Hennenfent, farm loan officer:

• The bank helps farm customers open hedging accounts with a brokerage firm of their choice.

• Hedging decisions are made by mutual consent of the farmer and the bank and orders to brokers are placed at the farmer's direction.

Although Mr. Hennenfent is careful to avoid influencing farmers as to which broker they should use, many ask him what firm Farmers & Merchants State uses and is happy with. The response is Heinold Commodities, Chicago, the firm the bank uses for most of its trades.

• Copies of all trades are sent to the bank so it can monitor account activity.

• Margin calls are sent directly to the bank, where they are paid by money order. A separate line of credit funds margin calls.

• A security agreement covering funds in hedging accounts requires that all funds drawn from an account be sent to the bank and be used to repay loans.

"Hedging is only one of the tools a farmer can use to market his crops and livestock," Mr. Hennenfent says. "By taking advantage of high prices to market products and taking advantage of low prices to lock in input cost for the livestock feeder, we feel we are reducing our risk on other production loans, making the farmer and the bank less likely to suffer from adverse price fluctuations."

He adds that use of the futures market isn't always the best marketing alternative. Use of basis contracts, forward cash sales, delayed pricing and cash sales to market production also are encouraged. He adds that the use of options on futures will become a tool in the future.

Mr. Hennenfent believes use of futures and options on futures under close bank supervision offers additional advantages for farmers:

• Farmers can overcome any fear they may have of the futures market by working with bankers they trust. Most farmers have no previous experience with the futures market and lack the confidence to open an account and follow a marketing plan.

• The psychological fear of having a margin call come to the farmer's home is eliminated when the account is with his bank.

There are additional advantages for the bank, too, he adds:

• The bank acts as an insulator between the farmer and the broker. This prevents speculation by the farmer and the "churn-and-burn" hedging practiced by a small minority of brokers.

• Margin money and funds drawn from hedging accounts always are controlled by the bank, preventing any diversion of funds.

"We feel our program has been successful and has helped many farmers take advantage of marketing opportunities over the past few years," Mr. Hennenfent says. "Marketing generally is one of the farmer's weaknesses. We believe the farmer who will survive these rough times must not only be a superior producer, he must be an expert in marketing and financial management." — **Jim Fabian, senior editor.**

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Real-Estate-Lending Program Designed to Help Banks Retain Ag Customers

By Carol Wormer

DOING business in an agricultural environment suffering from economic crisis is a tough assignment for anyone, especially a newcomer, but MASI is tackling that challenge.

MASI (MABSCO Agricultural Services, Inc.) was conceived in 1981, when several rural agricultural bankers began exploring ways to halt the flight of farm loans. A year later, MASI was incorporated as a subsidiary of MABSCO Bankers Services, Inc., a consortium of 12 midwestern state bankers associations established to fund research and development of bankers' service companies. MASI has since experienced dramatic growth, having expanded into Indiana, Montana and Oregon — territory outside the original MABSCO borders of Arkansas, Colorado, Illinois, Iowa, Kansas, Michigan, Minnesota, Missouri, North Dakota, Oklahoma, South Dakota and Wisconsin — and is exploring new horizons in services.

The initial challenge tackled by MASI was that of providing agricultural bankers with a reliable, reasonably priced source of funds for farm and ranch production, operating and equipment loans, with a somewhat lesser emphasis on loans to community-scale agribusinesses. The company contracted with Rabobank Nederland to tap wholesale money-market-priced funds for the program. Rabobank, a Dutch bank with strong ag-lending experience and orientation, purchases the loan participations via its branch in New York City.

MASI is a service company, developed by bankers for agricultural bankers, to provide over-line and liquidity credit needed by rural community banks.

"The decision to diversify and move ahead in expanding services was reinforced by the enthusiastic response from participating banks," says Jim Potter, MASI executive vice president/chief operating officer. "As a result, we have formed a new products committee, which meets quarterly. The committee currently is looking at a proposal for purchasing the guaranteed portion of Small Business Administration (SBA) loans by participation. Also nearing completion is a 'surplus-funds-investment program,' whereby member-MASI banks can place their excess funds with Rabobank for time intervals ranging from overnight to several months."

MASI currently has marketing representatives calling on an enrollment potential of more than 6,500 community banks in 15 states. Through aggressive marketing and prudent management, the loan-funding program continues to thrive in spite of economic adversity. To date, MASI has 132 banks signed up, with total outstandings holding steady over the winter months at approximately $45 million. Participations, involving over 400 borrowers, average $185,000 in size. MASI's budget for 1985 projects that volume will double by mid-year.

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Les Peterson, pres., Farmers State, Trimont, Minn., is pres., MABSCO Agricultural Services, Inc. (MASI), Des Moines, Ia. Walter W. Minger, retired s.v.p., Bank of America, San Francisco, is v. ch. of MASI and ch. of its credit committee. Mr. Minger, highly regarded as agricultural lending specialist, has represented MASI at many seminars and speaking engagements throughout U. S.

Walter W. Minger, recently retired senior vice president, Bank of America, San Francisco, a nationally known and highly regarded agricultural lending specialist, is one of MASI's foremost proponents. Mr. Minger was invited to join MASI's board in April, 1984, as vice chairman. Since then, he has represented MASI at numerous seminars and speaking engagements throughout the country. Shortly after joining the firm, Mr. Minger was elected chairman of MASI's credit committee, where he has been instrumental in helping fine-tune credit criteria for farm and ranch loans and expand the criteria to encompass agribusiness loans.

Having met the challenge of providing a dependable source of low-interest funds for farm/ranch and agribusiness loans — and evolving comprehensive loan criteria — MASI has made an auspicious beginning into two other service areas: a Farmers Home Administration (FmHA) guaranteed-loan-funding program and intermediate-term-real-estate-lending program.

Ed Tubbs, chairman, Maquoketa (Ia.) State, and chairman of MASI, explains the rationale behind the FmHA program, which was inaugurated in May, 1984.

"MASI's 'FmHA guaranteed-loan-funding program' allows originating banks to sell, by participation instead of assignment, the guaranteed portion of these loans in their portfolios. Banks are permitted to sell in this manner for specified periods of not less than 120 days nor more than one year. This pro-

Carol Wormer is assistant secretary, MABSCO Agricultural Services, Inc., Des Moines, Ia.

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vides a liquidity valve for participating banks. At the end of the initial participation period, the bank can repurchase the loan if its liquidity situation warrants or renew the participation with MASI for another term."

Response to a survey mailed to all participating banks in the spring of 1984 showed an overwhelming need and tremendous interest in real-estate financing. Ninety-two percent of bankers surveyed indicated they would use the proposed program.

Hugo Steensma, Rabobank's general manager for North America, is enthusiastic about MASI's long-term prospects and believes the new real-estate-lending program will enable rural banks to maintain their agricultural customers.

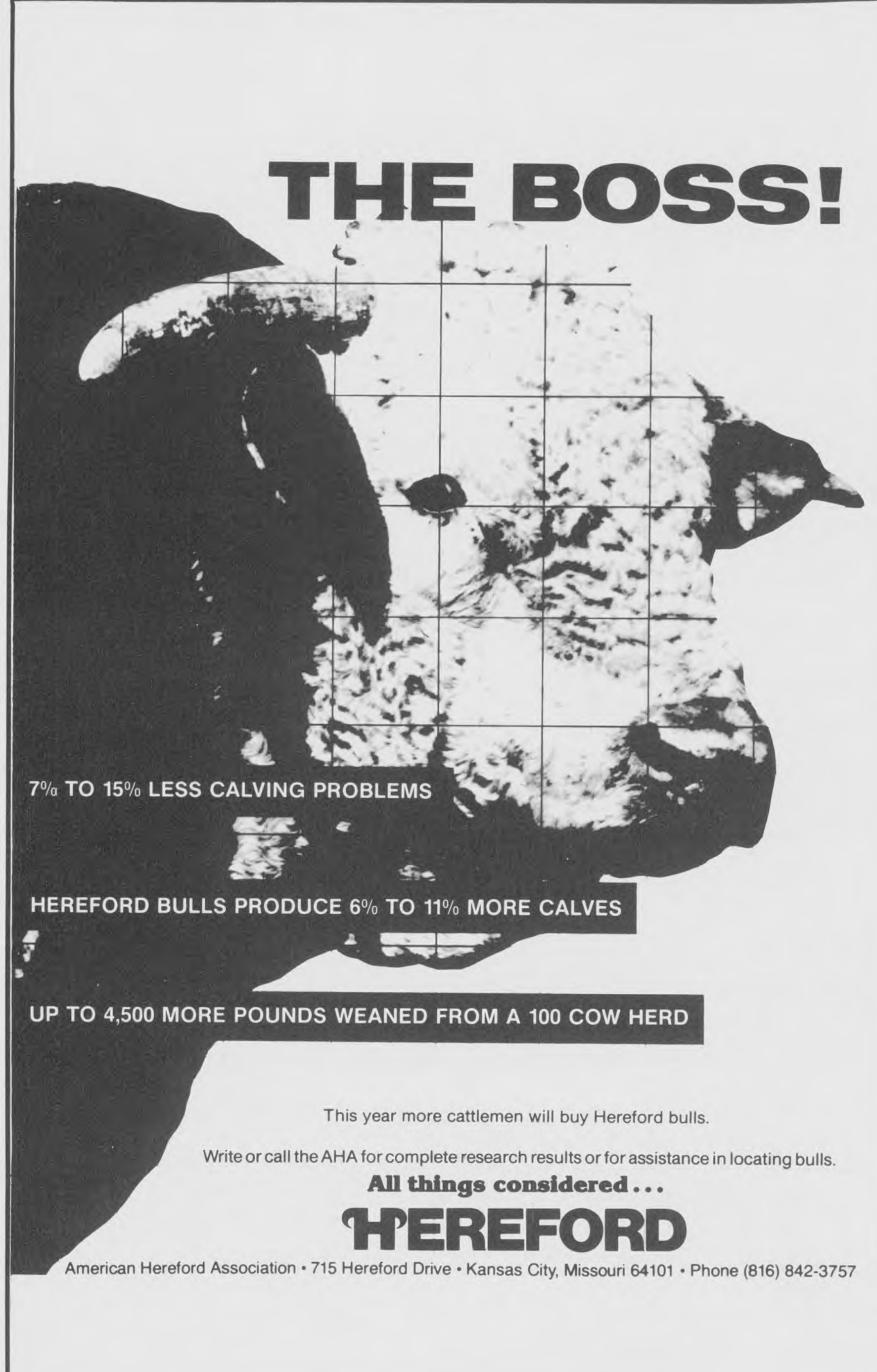
"Rabobank's support for an intermediate-term-real-estate-program demonstrates its long-term commitment to MASI and to U. S.-production agriculture. At a time when several major midwestern banks appear to be abandoning their correspondent participations in agricultural loans, Rabobank is willing to provide commitments for up to five years to qualified farmers," Mr. Steensma points out. "Agriculture is cyclical, and new pressures are forcing some restructuring. It is Rabobank's objective through the real-estate program to provide a longer-term financing vehicle appropriate to the variance in agricultural cash flows."

"Expanding into the real-estate market will create increased activity for community banks and MASI," adds Jim Potter. "A real-estate-lending program will be available in early 1985 and will enable participating banks to place first and second mortgages. We feel that having this lending capability will enable community banks to keep real-estate equity under their collateral control," Mr. Potter continues. "The advantage to the bank is a strengthened overall position as opposed to sending the real estate to other long-term lenders.

"Banks are especially pleased with the concept because it allows them to control the principal collateral of their customers. Loans with longer-term amortizations are attractive to bankers since they keep the collateral to bolster their operating lines. This affords originating banks the opportunity to match the term of agricultural credits — extended on the basis of real-estate collateral — with actual projected repayment capabilities of its borrowers. Such restructuring of debt in accordance with the underlying security generally permits better utilization of the borrower's cash flow. Further, if a borrower buys more land, the bank can carry the note for two to three years until the customer wants a long-term loan. The net result is that bankers have greater flexibility to extend credit to their farm customers in a more prudent manner; a flexibility that is desperately needed in today's tight farm economy."

Agricultural enterprise has been hard-hit by sustained high interest rates, declining land values that have eroded farm equity, commodity prices below cost of production and successive years of weather-related problems. In spite of the current agricultural situation, Walt Minger feels that "as bank loan-to-deposit ratios return to their previous high levels, banks really will need the MASI services."

Comments from MASI originating banks are consistent in their praise of the fast, courteous service and opportunity afforded to increase bank yield. According to Les Peterson, MASI's current president and president, Farmers State, Trimont, Minn., "MASI is taking additional steps to ensure that it will offer a package of services unequaled in its endeavor to enable country banks to be competitive and to provide the support their agricultural customers deserve." • •



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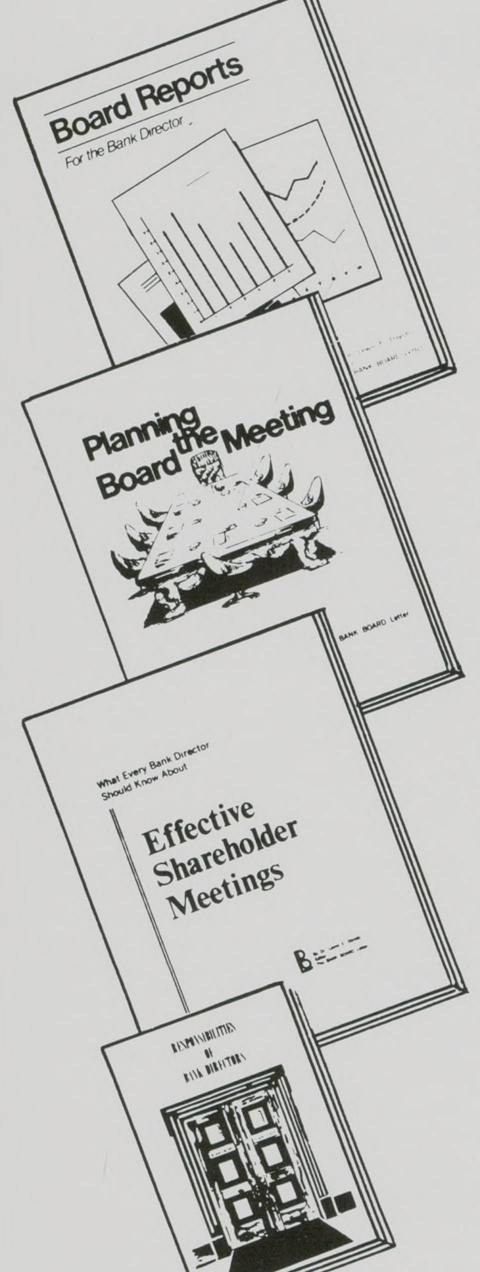

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Banks' Ag-Software Helps Farmers Make Hard Business Decisions

OVERLOOKED in media attention given the farm-debt-distress problem plaguing the nation's midsection have been the variety of services financial institutions frequently provide their agricultural customers.

The rural bank often is more than just a source of loans; it is a source of financial advice that enables a farmer to surmount the difficult challenges farming presents today. A couple of recent Hollywood movies revived the image of bankers as a farmer's adversary, but the reality is that farmers and bankers usually are partners working toward the same end.

As the sophistication of farmers grows, those who do not want to go to the trouble and expense of purchasing their own computer software and hardware will turn to their business ally — their banker — for financial-computing services, providing banks not only with a source of fee income, but also a natural insurance that their most valued customers are steering clear of economic difficulty.

A number of rural banks provide farm customers with access to computer-generated financial data about their operations that otherwise might not be available. For more than eight years, Greene County Bank, Carrollton, Ill., has been offering its farm customers a financial-reporting and counseling service. Philip Daum, president of the $30-million bank, says the dozen or so customers who utilize the service seem to find it useful.

Computer software that makes the service possible is supplied by Agro-Systems, Lubbock, Tex. Although Agro-Systems makes the software available for use on a bank's in-house micro-computer, Greene County Bank has its customers' financial reports run on a computer at Agro-Systems' regional office 14 miles distant. Customers' checks are picked up at the bank and used to compile monthly financial statements. Then, representatives of the software company schedule conferences with the bank's participating customers to go over the reports.

During the conference with the customer, the advisors supply expert advice on business problems the customer may be having. Mr. Daum says that generally it's easier for an unbiased expert adviser to spot key elements in the financial report than it is for the farmer involved. Depending on the complexity of the farm customer's operations, the computer printout can be 30 or 40 pages long.

"The customer can get a lot of information out of the report if he uses it," Mr. Daum says. "Of course, there always are those customers who will throw the report into a corner somewhere and never look at it."

Mr. Daum says he feels the bank is supplying information to his customers they otherwise might not have — at least not at a reasonable cost. Operating a farm is so time consuming that it's not easy for a small farmer to compile the lengthy financial reports needed for analysis and tax purposes.

Peoples Bank, Albia, Ia., runs financial reports for its customers on its in-house Tandy 2000. Software is supplied by FBS Systems, Inc., Aledo, Ill. Peoples Bank has been using FBS Systems' Coordinated Financial Statements (CFS) software to provide income and expense reports to its customers, but, according to John Judge, vice president/farm representative, the bank recently purchased FBS Systems' TransAction Plus software, which will enable the bank to generate balance sheets and other financial reports.

Customers have been paying a $25 setup charge and $15 monthly fees to use the service. The new software runs so much faster that Mr. Judge says he is hopeful the bank will be able to maintain the same fee schedule even though the bank will be able to provide more elaborate reports than it previously has.

"There always is something better available, and we're trying to upgrade our service to farm customers," says Mr. Judge.

Of the 25 or so customers currently participating in the program, a couple represent large hog farms, but most own small family farms. Customers must sign a release saying they agree to allow access to the financial documents that serve as the basis of the reports.

Obviously, a loan customer who has access to accurate, financial data is less likely to make seat-of-the-pants business decisions that can get him/her into difficulty. This logic partially was what persuaded Clinton County Bank, Frankfort, Ind., to set up a computerized farm record-keeping system for its farm-loan customers. The fee for using the service is $500 annually.

Jim Need, vice president, says the dozen or so customers presently participating in the program can use the reports to see variances in actual versus projected cash flows so that corrective measures can be taken in time to produce favorable results. Farmers enter their financial information in a special journal, which they then bring into the bank so that data can be put into the bank's micro-computer.

Software Clinton County Bank uses is called AccuFarm-GL and is supplied by Ontario Systems Corp., Muncie, Ind. Once the farmer's financial information has been entered in the

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computer, balance sheets, income statements, general-ledger transaction listings, trend-analysis reports, profitability reports, enterprise-income statements, tax reports, inventory-balance reports and fixed-asset management reports can be generated. Farmers love the service not only because they get excellent management information, but also because year-end reconciling is easy.

"Of course, we like the system because we feel we can keep closer tabs on a loan throughout the year and have greater confidence that our loan customers are operating from a correct set of data," says Mr. Need.

The bank's loan officers do have a chance to review the financial reports for loan customers, and if "they spot something in one of the financial statements that causes concern, they will question (the customer about) it," says Mr. Need. Customers using the service "run the gamut" from those regarded as the best to those deemed to be problems.

Mr. Need hastens to add, however, that Clinton County Bank has not had as much of a problem with farm loans as banks in other parts of the county have reported. He credits the bank's good fortune to a combination of good climate, fertile soil, superior local markets, a greater dependence on livestock rather than grain and some extremely sophisticated local farmers.

"We're just down the road from Purdue University, and many of our farmers attend sessions there to improve their knowledge of the business of farming," he says.

At First Fidelity Bank, Burke, S. D., John Lillibridge, chairman, says he is planning to use software recently developed by Homestead Management Systems, Inc., Des Moines, Ia., to run complicated "what-if" simulations and improve farm-lending decisions. The software is called the Homestead Farm Financial Planner. To Mr. Lillibridge, it seems to be the fulfillment of a dream he's had for at least two years.

"Let's say a farmer comes in to one of our six banks and wants a loan to buy 200 head of feeder cattle and put them on the pasture in May," says Mr. Lillibridge. "He wants to know what his costs are going to be, and I'm tired of having to guess."

The software can simulate possible outcomes of the lending decisions based on the farmer's own data and state average cost data (updated quarterly) that is included as part of the system.

"We've seen a lot of software packages that do after-the-fact spread-sheet analysis, but this is the first one we've seen that permits us to do complicated 'what-if' simulations of actual conditions," says Mr. Lillibridge. The agricultural area around Burke is highly diverse so the software had to be able to accommodate a wide variety of agri-lending situations. The Homestead system is accommodating, so much so that Mr. Lillibridge says he feels as though First Fidelity was the "guinea pig" for which the system was developed.

"We'd ask if this feature was in the system and if it wasn't, Homestead would run back and reprogram so that it was," Mr. Lillibridge says.

For now, Mr. Lillibridge is content that the system will be able to help him spot marginal and solid loans. One day, he says, First Fidelity may purchase a farm record-keeping system supplied by the same vendor and start a computer service bureau for First Fidelity's farm customers. The bank used to provide a manually operated service bureau until about nine years ago when the service became too unwieldy to maintain.

Today's computer technology may make it feasible for First Fidelity to reinstate the service, according to Mr. Lillibridge. Providing his farm customers with simulations of the outcomes of their alternate business decisions would be a service many of his customers would find helpful. He cautions, however, that his experience has been that farmers who want the simulations run are those who already have a good grasp on the details of their business and who really don't need the service. The marginal-loan prospects are the customers who don't see much need for simulations, he says.

Most bankers would agree, however, that farmers today are a much more sophisticated group of businessmen than they were just a few years ago. Many are as at home with a complicated financial report as they are driving a tractor. As the sophistication of farmers grows, those who do not want to go to the trouble and expense of purchasing their own computer software and hardware will turn to their business ally — their banker — for financial-computing services, providing banks with not only a source of fee income, but also a natural insurance that their most valued customers are steering clear of economic difficulty.

— John L. Cleveland, assistant to the publisher.

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Selling

(Continued from page 10)

that's over $1 million in interest income for these banks.

In 1982, First Security developed a Visa debit card. Like the revolving line of credit, the debit card initially was developed for First Security's exclusive use. At the end of the first year, said Mr. Kocen, the bank had income of $240,000, with back-office savings of $9,000 in processing and postage. Developmental costs were recovered in the first year. Here, too, he said, was an opportunity to boost fee income.

The bank offered the Visa debit-card service to its network, and community banks, S&Ls, even credit unions responded. The franchising fee was still pegged at 5%. He believes many of the franchisees will recover their investments in only one or two years. As of the time of the speech, 41 institutions had issued nearly 35,000 debit cards; total volume had reached $12 million; average debit-card transaction was $34.71; and merchant-discount income had exceeded $250,000.

The third service Mr. Kocen discussed was discount brokerage. Under First Security's discount-brokerage program, much, if not all, the capital commitment is eliminated for the participating community bank, which simply earns a percentage of its client's sales commission as straight income. According to Mr. Kocen, the community bank earns between 20% and 30% of its client's paid commission and has no liability or expenditures except those marketing related. Again as of the time the speech was given, 48 institutions were in the program with more than 2,500 clients; average sales commission was $71 per trade; earnings to community banks per trade were $14.20; and two banks were at 30% and were earning more than $21 per-trade average.

Another approach to new-product development may be through franchising, said Mr. Kocen. In a franchise relationship, he continued, franchisor and franchisee enter into a contractual arrangement for mutual benefit. Franchising, he said, provides the franchisee with economies of scale, a coordinated approach to the market, increased advertising power and management/marketing techniques developed and tested by others. The franchisor, said Mr. Kocen, enjoys rapid entry into new markets with little additional capital and state-of-the-art product offerings. • •

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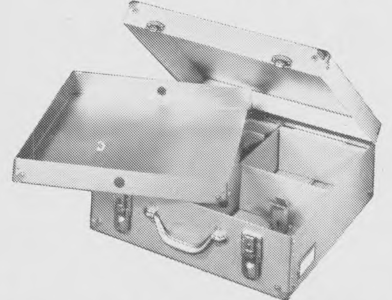

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'Survival Kit'

(Continued from page 11)

Strategic-Planning Seminar. First National, Chicago, says Vice President Thomas M. King, is endeavoring to serve the community-bank market with timely professional information and services. This is part of the bank's strategy to enhance its position in this marketplace by supplementing the more traditional services with information and techniques to compete effectively in the ever-changing deregulated financial marketplace.

As an example of this philosophy, First National is presenting a series of three strategic-planning seminars at the Chicago Marriott Downtown. Two were held last month, and the third is scheduled for February 26-28.

Called "Strategic Leadership: Through Planning and Implementation," the seminars have two purposes: To enable attending banks to design and/or sharpen their strategic-planning processes and to bring to these banks shirt-sleeve sessions with a practical workbook approach developed from First National's planning experience.

As listed by the bank, attending banks will receive the following benefits from the seminars: methods to motivate their managers to think strategically; processes for implementing/monitoring well-written strategic plans; factors important to their customers; appraisals of their banks' competitive strengths and weaknesses; alternatives for evaluating performances of their senior managers; focused action plans for their departments/divisions; and ways to enhance their leadership with director involvement/approval.

At the wrap-up sessions, attending bankers will hear experiences of bankers who have instituted this strategic-leadership process.

Mr. King says these seminars are intended to be of measurable assistance to community banks' senior-management teams. He adds that First National believes this is what respondents expect of their correspondent relationships.

American National of Chicago's Vice President Lad. Kvasnicka Jr. says many services it offers its own customers also could be part of the product offerings of its respondent banks. These include private-label lockbox and the bank's newly introduced discount-brokerage service. The bank also is investigating the possibility of offering other products, including insurance and investment services.

In addition to offering products American National's respondents can sell to their customers, it also recently introduced or modified other services for respondents' own use. These include a new Chicago coupon-collection product, reduced prices for cash-letter clearing and — soon — a "credit markets" newsletter.

"We have just completed a comprehensive review of our correspondent business," Mr. Kvasnicka says, "and have concluded it does make sense for American National to continue to serve this market. We believe opportunities exist to serve community banks, which means we must provide services they can sell profitably to their customers or services they themselves can use internally."

Bailee Service. Merchants National, Cedar Rapids, Ia., offers bailee services for public funds through its investment department. This product came as the result of a new state law, which requires that a "bailee" bank hold securities pledged for public

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funds. The law followed dissolution of the state sinking fund. Merchants National maintains all necessary documents and performs any additional duties as described in the Bailment Agreement and outlined in Iowa Code Section 453 as amended. This includes issuing joint receipt for custody of securities held, verification to the public body that there's sufficient collateral to secure its deposits and providing audit confirmations as required.

Another service — reserve-requirement calculations/maintenance — was the result of the Fed's newly imposed contemporaneous-reserve requirements.

"Through input of balance information into our computer system," says Lynn Whiteman, correspondent banking officer, "either by Merchants National or the respondent bank, reserve requirements can be calculated and then maintained for state banks."

Another Iowa bank, Security National, Sioux City, says it has established a regional clearinghouse center in Mitchell, S. D. This center, according to Wilma Weeks, correspondent services officer, improves both availability and charges for banks in the area because most of their South Dakota items don't leave the state.

Comprehensive DP System. Louisiana National, Baton Rouge, offers a comprehensive data-processing system and package of support services to financial institutions that want to develop their own in-house data-processing capability without the associated cost of highly trained programmers and operating personnel. The bank says it provides inexpensive, quality conversions and a flexible system with an in-house computer capability that will support a respondent bank's efforts, not control them.

AmSouth's Priority. Charlie T. Gray, vice president, AmSouth Bank, Birmingham, says his bank is looking at new services and product development in the correspondent-banking area. However, as the bank moves into 1985, the correspondent emphasis will not be on new services.

"Our priority," continues Mr. Gray, "will be placed on *customer service*. We have the full menu of services, as do most correspondents, to meet the needs of downstream customers. What we need to do is ensure that these customers are served in a manner that justified their confidence in us.

"We have plans that hopefully will improve service in all areas of correspondent banking, which is healthy at AmSouth. We are optimistic about its future environment. We want to keep it this way by showing our customers we truly care about them." — **Rosemary McKelvey, editor.**

• **NAC/Heller.** Michael A. Parker has been named manager, new-business development, in the Central Commercial Finance Division, St. Louis. Michael S. Stern has joined the St. Louis office as manager, credit/operations. Mr. Parker is responsible for new-business development in Missouri, Iowa and southern Illinois.

Correction

An article in the December, 1984, issue titled "Bank's Balloon-Note Financing Makes Auto Loans Affordable," stated that the "Good Buy Car Loan" program at First National Bank of Commerce, New Orleans, is serviced by Wheelways Insurance/ Financial Services, Wynnewood, Pa. The correct servicer is American Security Insurance Co., Atlanta.

MID-CONTINENT BANKER regrets the error and any embarrassment it may have caused.

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Auto Leasing: *A Tax Maze for Bankers*

By Terry J. Winders

THE RISING cost of automobiles and the 1984 Tax Reform Act have combined to make motor-vehicle leasing an attractive alternative for both professional and personal use. However, current federal tax laws make for confusion for bankers trying to decide how to handle a customer's request for an auto lease.

Motor-vehicle leasing generally is categorized under the heading of commercial or consumer leasing. A commercial lease is handled much the same as a traditional equipment lease and, with the exception of a few peculiarities that apply to autos, documentation isn't difficult.

Consumer leasing, on the other hand, must address many disclosure issues and a multitude of differing state laws. Therefore, I suggest that bankers pay careful attention to consumer laws in their states (to see if provisions are similar to or different from) federal income-tax regulations. Kentucky, for instance, restricts state-chartered banks from leasing motor vehicles.

This article deals with the generic difficulties of different types of auto leasing for federal income-tax purposes. It's always prudent to check with local tax counsel to determine the differences between state/federal tax issues to make sure the bank is in compliance with all rules/regulations.

The ability of a leasing firm to offer lower rentals on a motor-vehicle lease depends on two variables:

- Residual value of the auto at lease termination, and
- Use of depreciation and investment tax credit (ITC) to reduce the lessor's tax bill.

How much of the value of these variables is passed on to the lessee is dependent on both competition and the lessor's profit motive.

The 1984 Tax Reform Act. Federal tax laws that allow for recovery of costs on motor vehicles for income-tax purposes through depreciation and the ITC recently were modified.

The 1984 Tax Reform Act places restrictions on the amount of cost recovery allowed for "luxury" autos. Therefore, if a taxpayer requires use of an auto priced at more than $16,667 and intends to use it more than 50% of the time for business purposes — and intends to take a tax deduction — he will find a restriction or limitation on the amount of the ITC and depreciation he can take on his tax return. (Limits apply to four-wheeled vehicles rated at 6,000 pounds or less that are manufactured primarily for use on public roads. Limits don't apply to ambulances, hearses, trucks, vans and other vehicles used directly in the trade or business of transporting persons or property for compensation or hire.)

The ITC is limited to $1,000 unless the taxpayer elects to use a reduced investment-credit percentage. Then the credit limitation is reduced to two-thirds of what it would be otherwise. The depreciation deduction, including the Section 179 expense deduction, is limited to $4,000 for the taxable year the auto is placed in service and $6,000 for succeeding taxable years.

Special Note: Leasing firms, financial institutions or corporations actively engaged in auto leasing as a business are not affected by ITC or depreciation limits. However, for leases of 30 days or more, the lessee is denied a deduction for a percentage of his lease payments that is substantially equivalent to restrictions placed on the ITC and depreciation deductions just described.

This means that, if the bank is actively engaged in equipment or auto leasing and the motor vehicle is used by the customer (lessee) and not to conduct bank business, there are no restrictions on the ITC or depreciation, *provided the transaction is a true lease*.

(A true lease is one that qualifies as a lease under the Internal Revenue Code so the lessee can claim rental payments as tax deductions and the lessor can claim tax benefits of ownership, such as depreciation and the ITC.)

This also means that a lessor may reduce payments to a potential lessee to reflect the value of the ITC and depreciation taken on the full acquisition cost of the vehicle.

The lessee, on the other hand, is restricted as to the amount of deducted rental payments (restrictions are the same as those on the ITC and depreciation). However, the lessee has received the value of the full ITC and depreciation by virtue of the lessor reducing his rentals equal to that value.

The ability of a leasing firm to take full tax benefits and pass on a lower cost to the customer makes auto leasing an attractive alternative to outright purchase for financing "luxury" autos.

Leasing of autos priced less than $16,667 also is attractive because the lessor reduces his rentals by taking advantage of tax credits, depreciation and estimated value of the motor vehicle at lease termination. The amount of cash ordinarily necessary to amortize a traditional loan usually is a great deal higher than the amount of cash necessary to meet rental payments on an auto lease.

The 1984 Tax Reform Act went even

Mr. Winders is president, First Lease & Equipment Consulting Corp., Louisville. His experience includes 20 years in equipment leasing and 15 years in bank leasing/marketing.

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further and finally approved a practice that, while being used by major auto lessors on fleet leases for years, had been considered a questionable practice. It's a special option at the end of the lease called a "terminal rental-adjustment clause" (TRAC).

A TRAC is an option at the end of an auto lease that permits the following, providing all other aspects of the lease meet IRS standards for a traditional true lease:

The vehicle must be disposed of at termination of the lease by sale to an unrelated third party. This sale establishes the true fair-market value (FMV) of the vehicle, and it can be determined whether the residual assumption (end value) of the lessor was correct. If the sale of the vehicle was for an amount greater than the residual value stated by the lessor in his original documentation, the lessee, because he took better care of the vehicle than originally assumed, receives an adjustment of his rents paid equal to the difference between the lessor's residual and the *net* selling price.

If the vehicle sells for an amount somewhat less than the residual assumption stated by the lessor in original documentation, there is an assumption that the lessee used the vehicle harder than originally expected and an adjustment of rents paid is made to reflect the increase necessary to compensate the lessor for the difference between the vehicle's net sale value and the residual assumed.

The TRAC is allowed only on motor-vehicle leases. All other provisions of the lease must meet IRS standards for a traditional-tax lease. That means that, if a TRAC is included in a motor-vehicle lease and the lessor intends to take full tax benefits, there are some restrictions as to what is allowed for the lessee at the end of the lease.

If the lessee wants to acquire title to the vehicle, he is forced to pay its actual FMV or the residual amount, *whichever is higher*, because this is one of the provisions the IRS requires to prove the transaction was a true lease. The "owner" (lessor) retains the value as well as the risk of asset ownership.

Because the TRAC forces the vehicle to be sold to an unrelated third party, it establishes the true cost of the lease for the lessor without allowing the lessee to acquire title at a bargain price.

Any attempt to sell the motor vehicle to the lessee for an amount less than its FMV would place the true-lease nature of the transaction in question with the IRS. The TRAC would appear to be in conflict with the true-lease nature of the transaction; however, it was made a part of the 1984 Tax Reform Act and, therefore, currently is allowed on auto leases only.

An auto lease handled on a true-lease basis that doesn't include a TRAC usually carries three options for the lessee at termination:

- Purchase the auto at its fair-market value.
- Renew the lease at its fair-rental value.
- Return the motor vehicle to the lessor with no obligation.

Many schools of thought exist as to whether or not a definite purchase option is allowed for the lessee in a true-tax lease. The reason for lack of agreement is that an auto's actual value, because of historical data, can, with mileage adjustments, be fairly well determined at the end of a three-year lease. Therefore, if the purchase option approximates the FMV of the equipment at lease termination, it can't be considered a bargain and, therefore, wouldn't be outside IRS re-

AUTOMOBILE LEASING

TYPE OF LEASE	ITC	DEPRECIATION	DEDUCTIONS ON INCOME TAX	PURCHASE OPTION	TERMINATION RENTAL ADJUSTMENT
Commercial Non-Tax Lease	Only used by Lessee. Retricted to $1,000.00.	Only used by Lessee. Retricted to $16,667.00.	Lessor nothing. Lessee ITC, Interest and depreciation (up to restrictions.)	Okay	Okay
Commercial True Tax Lease	Used by either Lessor or Lessee (not both)	Only used by Lessor. (No limit)	Lessor-depreciation and ITC. Lessee-rentals. (Restricted to like amount as depreciation and ITC.)	Not Advisable	Not Allowed
Commercial Tax Lease Rental Adjustment Clause.	Used by either Lessor or Lessee (not both.)	Only used by Lessor. (No limit.)	Lessor-depreciation and ITC. Lessee-rentals. (Restricted to like amount as depreciation and ITC.)	Not Allowed	Okay. Autos only Provided auto sold to unrelated third party.
Consumer Non-Tax Lease	Not Available	Not Available	Lessor-nothing. Lesse-Interest.	Okay	Okay
Consumer Tax Lease	Used only by Lessor.	Used only by Lessor.	Lessor-ITC and depreciation. Lessee-nothing.	Not allowed	Not allowed

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quirements.

The difficulty generally comes when a purchase option is for an amount less than the FMV at termination because of a change in economic conditions or popularity of the auto. This area of federal tax law isn't as clear as it should be and, therefore, a bank in the auto-leasing field would be prudent to be conservative and not offer a defined-purchase option, especially if a TRAC is included.

An equipment lease in which the lessor doesn't take the ITC and depreciation is a nontax lease and takes on the appearance of a conditional sales contract. However, it's not called a conditional sales contract because the lessor usually determines a value for the motor vehicle at lease termination and then risks his ability to realize this residual value by disposing of the vehicle at lease termination. The lessor uses this residual value to reduce lease rental requirements over the lease term. The lessee has no responsibility for this residual value and, therefore, the lessor is "at risk," making the transaction a lease instead of a conditional sales contract.

An auto lease in which the lessor doesn't take the tax side of the transaction allows for a variety of options at termination. These options include a defined-purchase option, bargain renewal or a TRAC. These plus many more options are allowed because the lessor has no fear of losing any tax deductions and because the only income the lessor has included in the transaction is interest.

Consumer Leasing. One provision of current tax law that needs explanation involves a lessor actively engaged in auto leasing who leases a passenger car to a consumer. As explained above, it's necessary that state consumer laws be checked. But for federal income-tax purposes, the 1984 Tax Reform Act, Section 179, adding Code Sections 280(f) and 6653(h), and amending Code Section 274(d) and 6653, casts significant light on what Congress believed to be the effect, under prior law, of personal use of an auto by a lessee.

When it enacted the new Section 280(f), Congress obviously believed a lessee's personal use is irrelevant to the lessor's tax treatment. If the law stated that personal use by a lessee precludes the lessor from taking the ITC, enactment of subsection (c)(1) of 280(f) to the effect that the ITC should not be denied to a lessor by virtue of the application of Section 280(f) would have been wasted.

It means that a lessor actively engaged in motor-vehicle leasing who leases an auto to a consumer for his personal use still is allowed to take the full ITC and depreciation benefits, provided the customer doesn't have an opportunity to buy the car for something less than its FMV at lease termination. It's important that the banker realize the consumer has no deductions whatsoever at income-tax time.

A consumer who leases an auto where the lessor has taken the ITC and depreciation merely is renting an auto over a long-term agreement and doesn't have any interest or deductions on his personal tax return at the end of the year. He has received what benefits there are in the form of reduced rentals. This may vary by state for income-tax purposes, but it's clear that, for federal income-tax purposes, the tax side of the transaction — provided the lease remains true — is available to the lessor.

The chart on page 59 illustrates who receives what form of tax deduction for federal income-tax purposes and whether a purchase option or TRAC is permissible on one of five types of leases.

- A commercial nontax lease functions like a conditional-sales contract when the lessor retains legal title and takes a residual assumption, but passes to the lessee the ability to take the ITC and depreciation.
- A commercial tax lease assumes the lessor is retaining full tax benefits, thereby lowering the rental fee to the lessee accordingly. The lessee has the right to deduct rentals, provided the transaction meets IRS standards for true leasing.
- A commercial tax lease with a TRAC must meet the traditional standards of a true lease with exception of the TRAC.
- A consumer nontax lease functions as a conditional-sales contract when the only reduction in rents comes from the lessor's ability to assume a risk as to the value of the vehicle at lease termination.
- A consumer taxable lease provides the lessor with the ability to take full tax advantages from ownership of the vehicle and assume a value for the vehicle at the end of the lease and thus reduce the lessee's rentals accordingly. The consumer lessee receives no deduction.

Auto leasing is a unique form of equipment leasing. A close review of state laws as they pertain to both consumer and commercial leases and a review of federal and state tax laws are necessary before the bank enters this complicated form of financing.

Auto leasing is an attractive, profitable form of financing. However, it requires diligence on the banker's part to make sure the bank is covered from a tax/legal standpoint with the right documentation and the right amount of compensation for its efforts. • •

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Davids

(Continued from page 62)

tional cost involved.

Although these services were appreciated by corporate accounts, the rise of money-market rates tended to stimulate a more lean money-market management policy. Most major accounting firms actually provided tremendous assistance to corporate treasurers, so that, in effect, by the creative use of float, there were times when corporations were able to operate with negative balances while their bank accounts indicated positive balances.

Almost every study shows that when a customer — corporate or personal — is asked whether he would prefer implicit or explicit interest, explicit interest wins out.

It's my conviction that explicit interest on corporate accounts generally is preferable to implicit interest. Corporate treasurers prefer it, though many commercial bankers don't.

When turnover of demand deposits at New York City banks reaches a velocity of 2,000 times a year, and when daylight overdrafts among such banks exceed tens of billions a day — sometimes on one bank alone — I am concerned about the possibility of an electronic glitch developing.

Much of the velocity is a result of banks being prohibited from paying interest on corporate accounts. It's mind boggling to think that 2,000 deposit turnovers per account per year is an *average* for New York City money-market banks.

It's appropriate for serious bankers to look into all ramifications of payment of interest on corporate deposits.

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By Dr. LEWIS E. DAVIDS
Professor of Finance
Southern Illinois University, Carbondale

Is Corporate-Checking Interest a Good Idea?

I DISCUSSED the probability of interest being paid on personal checking accounts with a leading Missouri banker more than a decade ago. The discussion was prompted by the growing popularity of money-market funds that were siphoning off the cream of personal accounts by paying high interest rates, yet providing demand withdrawal by use of drafts.

This arrangement had certain advantages over checks, especially when it came to float.

The Missouri banker contended that permitting interest payments on personal checking accounts would sound the death-knell of community banks. Our discussion included reference to the fact that, prior to the imposition of Regulation Q in 1933, banks traditionally paid interest on such accounts, and they operated profitably in such a situation.

Looking back, it's clear that many country bankers would have preferred not to pay interest on personal checking accounts, but the tides of change made it inevitable if banks were to compete effectively. It's also clear that banks have learned to live with the situation by finding sources of revenue to offset the interest expense.

There still is a great fear among bankers concerning the implications of exempting corporate checking accounts from Regulation Q. In that connection, there are some numbers with which bankers should be familiar. They are from a recent issue of the *Federal Reserve Bulletin* dealing with deposit turnover.

For all insured banks for more than the last nine months, demand deposits have turned over more than 400 times a year. For the major New York banks, the turnover figure ranges from 1,600 to close to 2,000 times a year. Other banks experience demand-deposit turnover exceeding 200 times a year.

Yet turnover for NOW accounts averages only 15 to 16 times a year.

These not-seasonally-adjusted figures show a dramatic increase in turnover velocity during the last decade or two. A good bit of that velocity was induced by the fact that corporate treasurers tend to pool funds from various banks into a central bank, keeping a zero balance overnight with that institution by placing the funds in the money market. This has caused some students of banking to be concerned about the literally tens of billions of dollars of daylight overdrafts taking place in major money-market banks.

Almost every study shows that, when a customer — corporate or personal — is asked whether he would prefer implicit or explicit interest, explicit interest wins out.

To a large extent, the situation is fueled by the Fed's shortsightedness in not permitting interest payments on corporate checking accounts. Such a policy would have encouraged corporate treasurers to leave their funds at banks rather than investing them in the money market.

The policy would have motivated corporate treasurers to keep their funds at the bank because they knew the bank was paying a reasonable amount of interest to keep the funds.

Most community bankers are reluctant to think about the possibility of payment of interest on corporate checking accounts. This is understandable. Some bankers, while conceding that corporate interest will come, feel that the longer it is delayed the better. In the meantime, velocity figures will increase. It's not too late for bankers to be thinking of the implications on their own institutions of interest on corporate checking accounts.

I don't know whether the Fed will implement corporate-interest payments in the near future or, if and when they are implemented, whether the Fed will restrict the amount of interest paid on such accounts, as was the case under old Regulation Q. It's logical to expect a phase-in period during which rates would be controlled to give banks time to become acclimatized to the situation. However, attempts to legislate interest-rate ceilings have failed in the past.

A decade ago, a customer visiting a bank was likely to see inducements for making a deposit such as premiums and trips to exotic places. The value of the gift was correlated directly to deposit size. The so-called "gifts" were a form of interest in economic terms called "implicit," as distinguished from the monetary payment of interest, which is called "explicit."

Implicit interest tried to equate the prevailing explicit interest that was legally payable under "Q" to the prevailing real market rate, which was higher. In one sense, the fact that a bank could acquire premiums at wholesale prices permitted it to advertise these premiums at retail value and tended to make the spread between implicit and explicit interest rates and the market rate less obvious. To a similar extent, corporate accounts were wooed to maintain balances in checking accounts by services, such as check reconciliation, security safekeeping and the like.

Some services were provided by banks using computers that were not fully utilized, permitting the services to be dispensed at a low marginal or incremental cost. A study some years ago on correspondent service pricing revealed a tremendous range of prices charged to respondent banks, some obviously below any reasonable func-

(Continued on page 61)

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