MID-CONTINENT BANKER

FEATURES

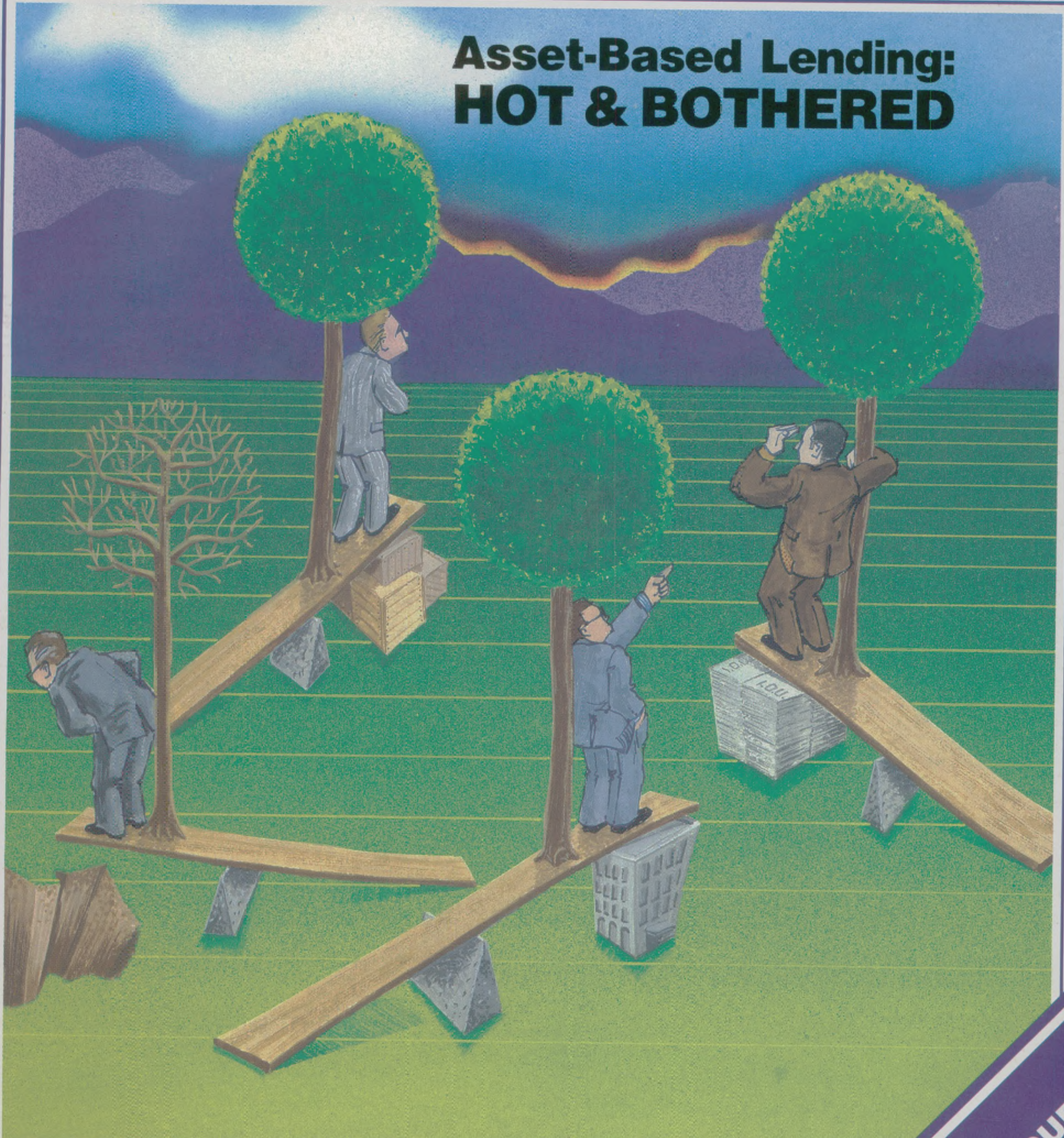
Is the Work Ethic Dead?

PC Holdouts, Your Days Are Numbered!

Finding Commercial-Finance Expertise

DECEMBER, 1985

Asset-Based Lending: HOT & BOTHERED



N

LEASING/SECURITY ISSUE

MID-CONTINENT
BANKER

Banking Wire

Late-Breaking News From the World of Banking

INTERSTATE ACTIVITY: Michigan has become the sixth state in the 18-state MID-CONTINENT BANKER region to enact regional interstate banking legislation. Michigan's bill was waiting for the Governor's signature at press time. The bill provides for regional interstate banking as of January 1, 1986, with Illinois, Ohio, Indiana, Minnesota and Wisconsin, and contains a trigger date for nationwide banking of October, 1988. Of the states named in Michigan's bill, Illinois, Ohio and Indiana also have passed laws, and Wisconsin may be close to doing so. (See state news section for article on new Illinois interstate law.)

* * *

CREDIT-CARD RATE CAP TO BE SOUGHT. Legislation to place a federal cap on credit-card interest rates was expected to be introduced by Sen. Alfonse D'Amato (R., NY) at press time. The legislation would propose that rates be limited to four points above the interest rate used by the IRS when it collects delinquent payments and pays late refunds. The IRS rate currently is 11%, which means the cap would be 15%. Bank rates now stand at 18% to 20%. The senator terms current bank rates "legal usury" and estimates consumers are paying from $2 to $3 billion more in credit-card-finance charges than they should. Similar legislation has been introduced in the House.

* * *

EX-FDIC CHAIRMAN AVAILABLE. William M. Isaac's future plans were cloudy at press time. He is reportedly being considered to head the new Farm Credit System Capital Corp., the vehicle that will sell off the FCS's bad assets. Mr. Isaac has had considerable experience in this line of work, since the FDIC is heavily engaged in disposing of non-productive assets of failed banks. Mr. Isaac also is thought to be considering joining a Washington law firm, where he would head an affiliated consulting firm to advise banks on a broad range of financial services.

* * *

A BAILOUT MEASURE for the Farm Credit System was approved by the Senate as this issue went to press. The measure would create a line of credit with the Treasury Department for use if and when the system no longer can rely on its own resources to remain in business. No amount of credit was specified. The bill also would force the FCS to pool its own assets better and give stronger powers to the Farm Credit Administration, the FCS regulator. The House is considering similar legislation.

* * *

BANKERS RECEIVED TOP PAY RAISES IN '84. A Conference Board study shows that total compensation (including bonuses) rose 14% in commercial banking, 11% among manufacturing/utility firms, 10% in insurance, 8% in retailing and 7% in construction firms. The report surveys total compensation received by the five highest-paid executives in more than 1,000 major firms.

* * *

CONTINENTAL TO PAY PREFERRED-DIVIDEND ARREARAGES. Continental Illinois Corp., Chicago, will pay full preferred-dividend arrearages and declare the current quarterly dividend on the corporation's adjustable-rate preferred stock, series 1, and adjustable-rate preferred stock, class A. Continental Bank will pay a $60 million dividend to its parent. Required approvals have been received from the FDIC and Comptroller.

* * *

LEONARD B. MARSHALL, JR., former commissioner of banking in Kentucky and former president, Liberty United Bancorp, Louisville, has been named president/CEO, Midwest Financial Group, Peoria, Ill. He succeeds William Barnes III, interim president/CEO. Mr. Marshall was Kentucky banking commissioner during the time 10 banks controlled by the Butcher brothers were sold following the collapse of the Butcher group.

* * *

A STATEWIDE VIDEO-BANKING PROGRAM has been launched by Banc One Corp., Columbus, O. Users of "Applause" will be able to inquire about balances in deposit and credit-card accounts, CDs and installment loans; transfer funds between accounts; pay bills electronically; reorder checks; and request stop payments. The service will be free to individual and small-business customers until April through Banc One's 20 affiliated banks statewide.

* * *

NEWLY-CONFIRMED COMPTROLLER Robert L. Clarke will be a keynote speaker at the ABA's 1986 Bank Investments/Funds-Management Conference February 25-28 in New Orleans. Conference theme is "Turning Paper into Profit." The conference will follow a new format that incorporates three concurrent program tracks covering all sizes of banks. The tracks are portfolio management, treasury issues and capital markets and dealer activities. For information, call 202/467-6738.

* * *

MORE FOR LESS: The average number of employees needed by banks to generate $1 million in net revenues dropped from 22.4 in 1979 to 15.1 in 1984, according to a report by Cole Surveys, Inc., Boston. Competitive pressures of the past few years have forced banks to look for efficiencies, and increased productivity is one result, according to Cole.

* * *

JOINT BANK-TECHNOLOGY CONFERENCES have been scheduled by the ABA for February 9-12 in Orlando, Fla. The Telecommunications and Financial Networks and Video Banking III conferences will be held simultaneously to give bank operations and telecommunications personnel an opportunity to explore the applications of both rapidly expanding areas of financial products/services. The programs will offer more than 25 concurrent sessions and seminars. Peer-group discussions have been added to the program and an exhibit display will be part of the event. For information, call 202/467-4193.

MID-CONTINENT BANKER

Volume 81, No. 12 (ISSN 0026-296X) **December, 1985**

Editorial/Advertising offices: 408 Olive St., St. Louis, MO 63102; 314/421-5445.

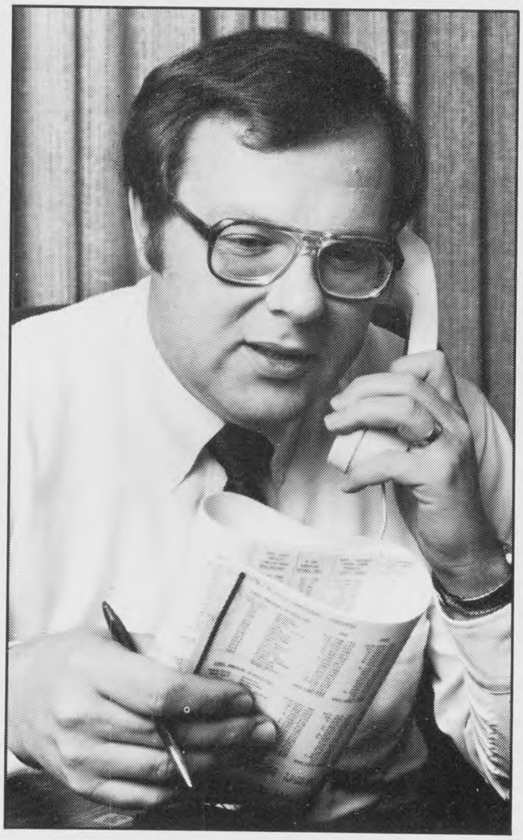
MID-CONTINENT BANKER is published monthly by Commerce Publishing Co., 408 Olive St., St. Louis, MO 63102.

POSTMASTER: Send address changes to MID-CONTINENT BANKER at 408 Olive St., St. Louis, MO 63102.

Printed by The Ovid Bell Press, Inc., Fulton, Mo. Second-class postage paid at St. Louis, Mo., and at additional mailing offices.

Subscription rates: Three years $27; two years $20; one year $12. Single copies, $2.50 each. Foreign subscriptions, 50% additional.

WHEN YOU WANT TO GET IT DONE, CALL A CORRESPONDENT WHO HAS BEEN THERE.



There are only a handful of correspondents who can say they've learned the needs of community banks firsthand.

Ernie Yake is one of them.

He successfully managed Commerce Bank of Moberly. And before that, he headed a suburban Kansas City bank on the Kansas side.

Today, Ernie runs the Correspondent Department at Commerce Bank of Kansas City. Ernie knows what bankers need.

And his knowledge is now channeled into providing services like fast, efficient transit operations, bond and investment services and bank stock loans. The same responsiveness he provided to his bank customers is now offered to you.

So give Ernie a call at 234-2483. He knows how to get it done for you, because he's already done it himself.

Commerce Bank of Kansas City NA

MEMBER FDIC

GETTING IT DONE

MID-CONTINENT BANKER

December, 1985/Volume 81, No. 12

In This Issue

FEATURES

13 **'Upscaling' Asset-Based Lending**
Increase loan size, decrease number of loans

18 **Asset-Based Lending for Mid-Sized Bank**
Among considerations: long-term commitment

24 **Your Bank's Security**
It's more porous than you think!

40 **Essentials of Bank Consumer Leasing**
It's a growing, lucrative market for banks

44 **Sound Collateral/Residual Strategies**
Improving collateral identification for commercial loans

DEPARTMENTS

29 **State News Section**
Transitions taking place in the mid-continent area

35 **Agriculture**
ABA ponders agri-future

37 **Legislation/Regulation**
Dealing with examiners, congressional aides

47 **Strategic Planning**
'We contemplate no changes' — II

49 **Computers**
PC holdouts, your days are numbered

52 **Marketing**
Marketing employee-benefit services

55 **Human Resources**
Is the work ethic dead?

57 **New Products/Services**
Help for security conscious

62 **The Banking Scene**
Worldwide banking proposal

Editorial/Advertising Offices
408 Olive St.
St. Louis, MO 63102
314/421-5445

Hot and Bothered

ATTENDING the National Commercial Finance Association (NCFA) convention in New Orleans last month, you began to understand what it must be like to stand on ground zero at a nuclear-test site.

On the one hand, being at the center of attention is gratifying, especially if you've traditionally been considered outside the financial-services mainstream. On the other hand, you're not entirely comfortable about your position if the bomb should go off.

There is no denying that the asset-based lenders who gathered in New Orleans had reason to celebrate. Their industry is hot. Leveraged buyouts have garnered considerable media attention in the past few months. A lot of people, especially banks, seem to want to get into the asset-based-lending industry despite the intensity of competition. NCFA membership has grown and the New Orleans convention was the association's biggest ever.

As NCFA Chairman Richard Dorgan said in his keynote address, asset-based lenders have gone from being the lender of last resort to the lender of first resort. Unfortunately, that's a rather uncomfortable position for the commercial-finance industry to be in. Mr. Dorgan was among those at the convention who expressed some cautionary notes.

He said he is concerned about the possible slippage of lending standards in the industry. Commercial-finance companies have long prided themselves on their ability to spot worthy loan customers that other lenders considered too risky, monitoring the customer's performance and being nimble in liquidating assets if the loan went sour. The sheer size of some of the much publicized leveraged buyouts (LBOs) seemed mind-boggling to some long-time NCFA members. How could anyone hope to liquidate assets supporting a multi-billion-dollar LBO? they asked. Others wondered whether the industry has available enough experienced personnel to adequately staff all of the firms that want to get involved in asset-based lending.

One panel of experts debated whether commercial lending is a product or a business. One wag suggested that it's more like a virus. Another said "it's a living."

If an asset-based loan is done properly, it can provide a very nice living indeed, which is why so many banks have been tempted to join the ranks of the competition.

The message from New Orleans is that asset-based lending requires a certain degree of expertise that not all lenders possess. Mr. Dorgan urged a return to the traditional hands-on lending standards the industry tries to maintain. The new competition isn't bad, he indicated, as long as it recognizes the inherent dangers involved in a risky business and follows time-proven principles for success. We should point out that Mr. Dorgan works for the commercial-finance division of a bank.

In his keynote address, Mr. Dorgan invoked images of the Depression a few times as a symbol of something he did not want to see repeated. He said he was confident that the mistakes of the past could be avoided, but he also sounded like a man who hears a bomb ticking somewhere nearby and is anxious to defuse it. — **John L. Cleveland, editor/associate publisher.** ● ●

See page 21 for a report on the NCFA convention

Mid-Continent Banker Editorial Schedule — January-June, 1986

JANUARY

- ATM/POS Equipment Review
- 1986 Economic/Legislative Forecast for Banks

FEBRUARY

- Financial-Services Telecommunications, including Review of ATM Networks
- Agri-Finance

MARCH

- Financial-Services Software
- Merger/Acquisition Report
- State Convention Previews

APRIL

- Bank Marketing/Sales
- Consultants' Directory
- State Convention Previews

MAY

- Bank Operations
- Bank Equipment Review
- Human Resources
- State Convention Previews

JUNE

- New Bank Products/Services
- Review of Bank Security Devices
- Financial Planning Services Offered by Banks

Finding Commercial-Finance Expertise

By John L. Cleveland
Editor/Associate Publisher

TOO MANY banks are getting involved in asset-based lending without adequate experienced human resources to do the job properly, according to Stephen J. Davis, executive vice president and director of operations, Equipment Finance and Lease Division of ITT Commercial Finance Co., St. Louis.

"I don't think there are enough experts in this business to adequately staff all of the companies and banks that would like to be in it," says Mr. Davis.

Despite the shortage of top-notch commercial-finance personnel, community banks frequently find themselves asked by valuable customers to extend asset-based loans. The bank must then decide which is more onerous — refusing the loan and risking loss of the rest of the customer's business or adding a loan to its portfolio it does not feel comfortable about.

Mr. Davis says there is a better alternative. The bank can tell the customer that it has a working relationship with a company like ITT Commercial Finance that has special expertise in asset-based loans. It thus can keep the customer happy, retain the expertise needed to evaluate and administer the loan and participate in the loan to the degree it wants. It's not uncommon for a bank to participate in 50% of the loan, says Mr. Davis, while other banks feel more comfortable not participating at all. The loan can be structured in myriad ways and each customer and situation has to be evaluated individually.

Asset valuation is one way an outside commercial-finance company is able to assist a community bank. A bank in Iowa may be able to get a fair approximation of the value of assets proposed as collateral if the assets are within the bank's market area. But what if the assets are in Florida or Hawaii? Can the bank trust the work of an appraiser in a distant city? Mr. Davis thinks that would be unwise.

"Appraisers may tell the guy paying the fee exactly what he wants to hear," he says. "You're going to have to have an appraisal as part of the documentation of the loan package. It's essentially a way to properly negotiate with your customer as to the value of his assets, but unless the person who engages the appraiser has a level of competence necessary to understand it, the appraisal isn't going to help you."

Unfortunately, the appraisal of the value of the assets at loan inception isn't the same as the value the assets will have if they have to be liquidated, a point banks unfamiliar with asset-based lending have been known to miss. The asset-based lender has to have channels through which it can liquidate repossessed assets. A broadly based asset-based lending company has contacts around the nation through which it can dispose of repossessed assets, says Mr. Davis.

There aren't enough experts in the commercial-finance business to adequately staff the banks that would like to be in it. — Stephen J. Davis

"In fact, if we know a loan is going badly, we may make contingent arrangements to sell the inventory while the case still is in court and we have yet to take possession," says Mr. Davis.

Asset-based lending, if done properly (i.e. "collected as well as made," says Mr. Davis), can be extremely profitable.

"A typical asset-based loan — 'typical' meaning it's a good risk and adequately collateralized — ought to carry a percentage to prime of at least four above prime," says Mr. Davis. "And depending on what type of loan it is and the relative level of loan to invested equity in the company — I'm thinking now of leveraged buyouts — you're going to want warrants as well. No purchaser equity means that you're making the acquisition possible through the loan so you're going to look for a participation in the company on that basis."

A community bank is not likely to be asked to participate in some of the huge leveraged buyouts that have garnered so much press in recent months, but it may face a situation in which a small local company has become the target of an outside raider and needs capital for a management buyout. In Mr. Davis's view, it is always preferable to go with the existing management rather than attempting to finance a takeover by a raider.

"The existing managers understand the company and its customers," he says. "There's continuity, whereas with an outside purchaser there's a possibility that the existing employees and customers may not stay."

During the early loan negotiation, a bank may not wish to let the customer know of the involvement of an outside commercial finance company. Eventually, the commercial lender will dispatch experts to the customer's facility to evaluate the proposal, but if the bank wishes to keep the asset-based lender in the background initially, that can be arranged. In fact, says Mr. Davis, the bank can arrange to collect payments if it feels uncomfortable letting an outsider fill that role.

"I would think that a bank would want us to service the loan because these are service-intensive loans," says Mr. Davis. "They require periodic review of financials and usually require periodic inspection of collateral. We don't preclude the bank from servicing the loan, however, if it agrees with us on servicing standards."

Mr. Davis said that banks needn't fear that in utilizing a commercial finance company they are cutting the cord that binds their customer to them. The loan and servicing arrangement can be structured to preserve the customer's ties to the bank, says Mr. Davis. Documenting and monitoring the loan is crucial and it is here that the community bank most needs the assistance of a commercial finance company. He recommends that the bank involve the commercial finance company earlier rather than later in the negotiations.

"These are tough deals to put together and they take a long time to structure," he says. ● ●

3-Party Factoring

It Eliminates Risks, Financial Commitments

By Paul Wagner

IN TODAY'S competitive banking environment, regional and local banks can gain a strong marketing edge by offering customers an accounts-receivable factoring service.

Factoring can help a bank develop new business and expand current portfolios with companies involved in manufacturing, wholesaling and importing. These companies usually have a high volume of credit sales, require advances for seasonal inventory buildups and often are acquainted with the benefits of factoring.

Most factoring organizations are owned by large money-center banks. Regional and local banks have refrained from offering the service because of the significant administrative burdens and the risk of bad-dept assumption. Since factoring is both a management service and a financing tool, a large skilled staff and sophisticated electronic systems are required to deliver credit and collection services. Moreover, because factors assume the customer-credit risk for their clients, reserves must be set aside for nonpayment of purchased receivables.

Mr. Wagner is vice president, Heller Financial, Inc., Chicago-based factoring firm.

Today, however, a financing technique called a three-party agreement is making it possible for banks to offer factoring without assuming bad-debt risk and administrative burdens. In fact, the technique may allow a bank to strengthen its collateral position by virtue of the credit protection afforded the bank's customer and the direct flow of proceeds of the factoring arrangement to the bank.

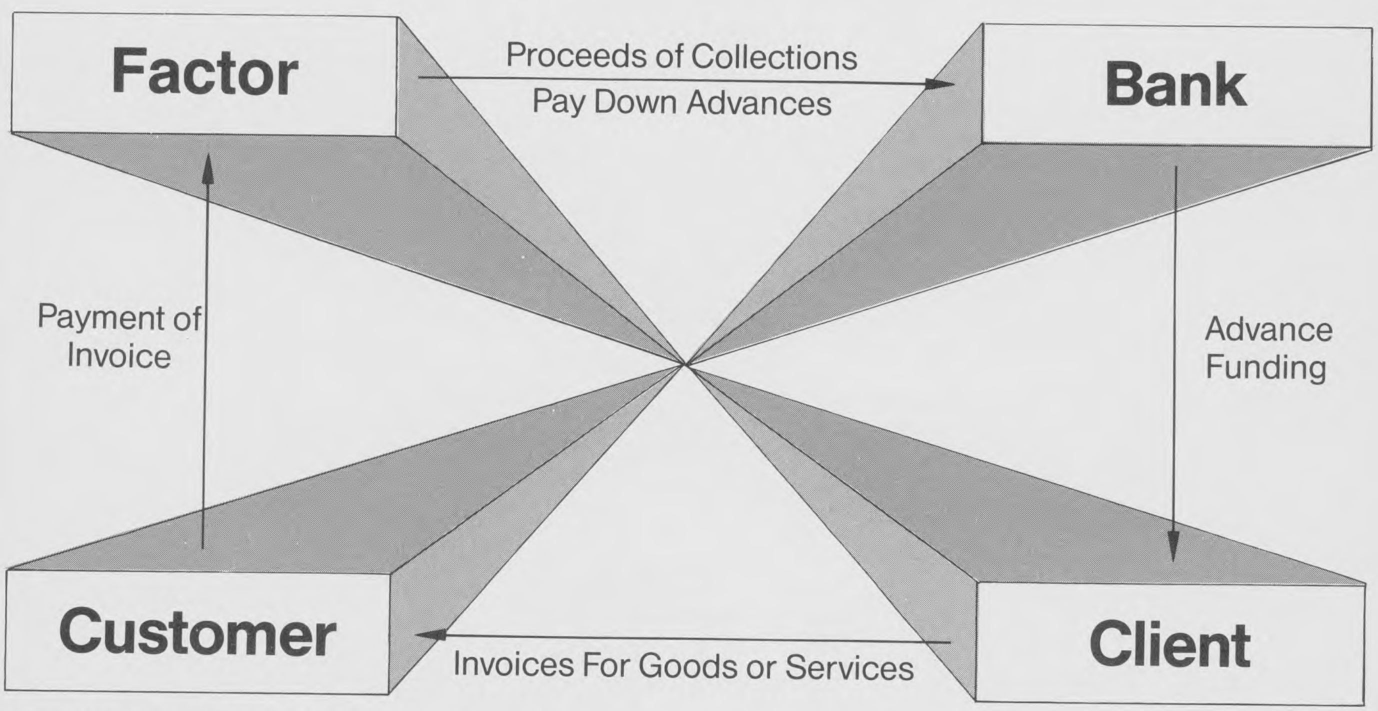
Three-party agreements allow a bank, its customer and a professional factor to enter into a relationship. The agreement enables the bank to offer a factoring service and make advances on factored receivables while the factor assumes customer bad-debt risk and performs all credit, collection and accounting functions for the bank's customer.

To understand how a three-party agreement works, a review of a traditional factoring relationship is in order.

Traditionally, businesses that sell large volumes of goods on credit have used professional factoring services as an alternative to internal receivables management and as a method of converting receivables into cash.

A factor assumes responsibility for credit investigations, establishment of credit lines, assumption of bad debt, collection of receivables and the entire receivables-management function. For these services the factor receives a fee or "commission," normally amounting to 1% of the client's factored sales.

The factor also provides the client with the option of converting receivables into cash prior to invoice maturity dates. This allows clients to accelerate cash flow and take advantage of



cash discounts and special purchases while providing funds for seasonal inventory buildups.

In a typical arrangement, a client submits all proposed sales information to the factor for credit review. The factor then indicates approval or nonapproval, in writing, of the proposed extension of credit by the client to its customer. The factor accepts the credit risk of nonpayment by the purchaser of the client's goods — on approved accounts. The client therefore is assured payment on approved — undisputed — accounts whether or not invoiced amounts actually are collected. As the factor purchases receivables, the client builds up a credit balance with the factor called a "reserve." The reserve is an asset of the client, representing the factor's contractual obligation to pay for purchased receivables.

As mentioned, a factor also can extend advances and/or open letters of credit for clients. These advances are secured by receivables sold to the factor.

In most cases, advances are 70% to 90% of the outstanding receivables on the factor's books, although at times overadvances are made to creditworthy clients. The factor charges clients interest on these advanced funds, usually at 1% to 3% over prime.

When a bank enters a three-party agreement, it replaces the factor as the funding source. In such an agreement, the factor continues to provide its traditional role of checking the creditworthiness of client customers. It also continues to approve or reject extension of credit to customers and makes all collections of remittances while performing the entire accounting function.

The factor, however, "unbundles" the financing component from its factoring package, allowing the bank to provide advances against the proceeds of the factoring arrangement.

The factor assumes a first security interest in the client's accounts receivable. The bank takes a second security interest in the client's accounts receivable and an assignment of the client's credit balance at the factor.

Remittances from the client's customers still are sent directly to the factor, who then wires proceeds of the factoring arrangement directly to the bank either at the time invoices become due or as they are collected. These remittances from the factor typically are applied against the bank's revolving loan that is secured by the receivables. The bank's collateral position is enhanced because the factor, not the bank's client, assumes the risk of bad debt.

Three-party factoring relationships provide a bank and its clients with the advantages of a professional credit checking and collection network.

Three-party factoring is a highly effective financing technique that provides numerous advantages to both a bank and its clients. A client company receives the financial management services of a professional factor while benefiting from bank financing. The bank, in turn, is able to offer highly marketable factoring services that allow it to pursue lending relationships with existing and prospective customers while strengthening its collateral position with little added administrative burdens. ● ●

Asset-Based Financing Guide is Published

A one-step reference guide for financial officers, attorneys and accountants involved in asset-based lending has been published by Matthew Bender & Co., New York.

Asset-Based Financing: A Transactional Guide is a four-volume work that provides treatment of the practical, legal and commercial issues pertaining to secured lending along with forms said to be previously unavailable in a single source.

Howard Rude, editor-in-chief of the publication, has a quarter century of lending experience. He served as vice president/general counsel for CIT Corp., asset-based-lending firm.

The Guide provides a step-by-step procedure for major types of asset-based transactions, along with forms, checklists and other materials.

Chapters included in the first two volumes deal with granting credit, Article 9, intercreditor agreements, interest/usury, lender remedies and bulk sales. Volumes three and four deal with accounts receivable financing, factoring, inventory financing, financing leveraged buy-outs, agricultural financing, equipment leasing and tax-oriented leasing.

Forms in the volumes include joint loan agreements, debt subordination, intercreditor agreements and letters of intent and commitment.

Cost of the four-volume set is $280. For information, call 800-223-1940.

● **NBD Bancorp,** Detroit, has changed the name of its asset-based-lending subsidiary, American Business Finance, to NBD Business Finance. The firm has offices in Detroit, Grand Rapids, Cleveland and Cincinnati.

'UPSCALING' *Asset-Based Lending*

It's Done by Increasing Loan Size, Decreasing Number of Loans

By Walter Macur
Executive Vice President
Exchange National Bank
Chicago

MANY individuals in the financial community continue to feel that asset-based lending is in trouble because of rapid expansion, due, in part, to financing leveraged buyouts.

Once or twice a year, we hear horror stories of an institution that has decided to discontinue its asset-based-lending services because of heavy losses.

If we were able to look behind the scenes, we would find that the losses are due to entry into the business with a staff that lacks the credit and administrative experience to properly structure and monitor the business they put on the books.

Lenders desiring to be in the asset-based-lending business should be prepared to spend the money it will take to bring in the number of experienced credit and administrative people needed to minimize the risks involved in this business.

Statistics developed by the National Commercial Finance Association indicate that average losses will approximate 1% of average funds employed. To arrive at this figure, the 25% with the best experience are excluded, as are the 25% with the worst experience.

If your bank is in the asset-based-lending business, or if its management wants to be in that business, it's essential to recognize that even the most experienced staff will have bad-debt write-offs, so pricing must be high enough to cover these expenses.

Financing leveraged buyouts can be profitable and risks can be minimized if the lender insists the transaction be done the "old fashioned" way. This means that the following must be incorporated into lending policy:

- The principals from the buying group must be at risk; i.e., they must provide equity and at least a limited guaranty.
- The transaction should be structured as a purchase of assets and, in a very few cases, purchase of capital stock.
- Legal documentation should be handled by experienced professionals with a proved track record in this area of the law.
- The financial plan of the buying group should be adequately documented, be within the control of the group and demonstrate that the target company can generate cash flow sufficient to service the debt.

For example, the best plans are those that rely on reducing expenses and improving operating efficiency. The weaker plans are those that rely on increased sales to generate the revenue needed to service the debt.

- Collateral pledged to support the debt should have enough liquidation value to repay the debt if the business fails.

Asset-based lenders currently are experiencing a paradoxical financial situation. While they are finding themselves experiencing downward pressure on rates and upward pressure on expenses, they continue to enjoy both increased volume and profit. This situation did not come about by chance.

Rate Competition a Challenge

Rate competition always has been a challenge. Borrowers always have felt that interest rates were too high and they continue to pressure their lenders for rate relief. This situation was somewhat exacerbated during the recent period when new asset-based lenders needed volume to cover start-up expenses. For many of these lenders, the easiest way to build volume and maintain credit quality was to quote lower rates (i.e., lower spread over prime). Consequently, spreads went down; and, as everyone knows, when spreads go down, it's virtually impossible to raise them again.

To mitigate the resultant lower revenue, a few lenders began to implement explicit charges for their field examinations. Initially, their clients

ASSUMPTIONS:	Cost to Service $1 Million Loan	Cost to Service $10 Million Loan
Prime	11%	11%
Transfer price of lender's funds	10%	10%
Rate to borrower	Prime + 3%	Prime + 1.3%
	14%	12.3%
Number of relationships	10	1
Average funds employed	$10,000,000	$10,000,000
Average size loan	$ 1,000,000	$10,000,000
Interest income	$ 1,400,000	$ 1,230,000
Cost of funds	$ 1,000,000	$ 1,000,000
Net spread over money cost	$ 400,000	$ 230,000
Cost to service	$ 200,000	$ 30,000
% of average funds employed	2%	.3%
Cost per relationship	$ 20,000	$ 30,000
Profit	$ 200,000	$ 200,000
Return on assets	2%	2%

were asked to cover out-of-pocket costs for travel, food and lodging. Some lenders now regularly pass on a per-diem charge for the examiner's time.

Another method of increasing revenue that many asset-based lenders have been able to take advantage of lately is in leveraged buyouts and ESOP/ESOT financing. Utilizing their special expertise by creating this type of financial package is worth a premium to the prospective borrower. However, after the transaction is funded, other lenders often are willing to step in and provide the ongoing financing at a much lower rate than the one originally booked (which took into consideration developing the original plan).

For this reason, they charge a reasonable fee, paid in advance to compensate for the experience, expertise and creativity expended in developing the package. A "normal" rate for the ongoing financing becomes imperative.

So much for rate pressures. On the expense side, the major item to consider is compensation. During the years of rapid expansion when new lenders were moving into the field, compensation increased because of the demand for highly talented individuals at all levels of employment. Now, coupled with the effect of inflation, the compensation line on the income and expense statement has a tendency to skyrocket out of sight.

Upscaling Is Solution

The solution? Upscaling, or increasing the average size loan and reducing the number of loans handled. Studies of the items that affect expenses indicate that costs are driven by the number of loans in the portfolio, not necessarily dollar volume. In other words, the cost to service a $1 million account is almost the same as the cost to service a $10 million loan. Therefore, with rising expenses and a shortage of experienced personnel, upscaling is the logical and practical solution.

Let's review some of the implications of upscaling. In the chart, net spread over money cost is $400,000 and cost to service is $200,000. Profit is $200,000, approximately 2% on assets.

If the average-size account is increased to $10 million, the cost to service will increase somewhat, but even if the cost to service increases 50%, which is unlikely, the lender can charge prime plus 1.3% and have a profit of approximately 2% on assets.

In this example, net spread over money cost is $230,000 and cost to service is $30,000 ($20,000 plus 50% = $30,000). Profit is 2% on assets.

Upscaling offers additional advantages to both lender and borrower. With fewer clients to handle, quality of service will be better and the lender has better control and, consequently, better safety.

Most lenders probably don't want to service extra-large loans, but there will be economies if the lender is able to move the average size loan from $100,000 to $200,000.

It is highly unlikely that asset-based lending will experience a debacle such as that experienced by REITs a few years ago. On the contrary, asset-based lenders who continue to adapt to economic conditions, control costs and apply sound credit policy will continue to do well.

Asset-based lending is not a glamorous, get-rich-quick business. It's one that requires sticking to the basics. If this is done, respectable profits can be enjoyed year after year. ● ●

D&O Liability Insurance Topic of New ABA Booklet

The ABA Community Bankers Council has developed a new *Competitech*, "Bank Directors and Officers Liability Insurance: What You Have — If You Can Get It," to help bankers understand director and officer insurance coverage.

This issue of *Competitech* provides an overview of directors and officers (D&O) liability-insurance policies. It explains the terms most commonly found in bank D&O policies, discusses the scope of the coverage afforded by those policies and reviews the procedures typically followed by insurers in handling claims.

Hardening Market

Also covered in this publication are the reasons for a hardening of the market for D&O coverage. Because many of the firms that write D&O coverage for financial institutions are no longer doing so, it's important to understand the reasons, state the authors, Victor G. Savikas and David R. Melton, attorneys and members of the law firm of Karon, Morrison & Savikas, Ltd., Chicago and Miami.

Director and officer insurance policies provide a necessary form of protection for the bank, its directors and officers. However, given the present state of the market, a thorough understanding of the coverage and coverage restrictions is necessary to make informed decisions when obtaining or renewing policies, says ABA Community Bankers Council Chairman, T. Charles Bruere, president, First State Bank, St. Charles, Mo.

Ordering Information

For more information or copies of this *Competitech* booklet contact ABA Order Processing, 44-B Industrial Park Drive, Waldorf, MD, 20601, (202) 467-4118. To order, request publication number 024804. Cost of the issue is $30; ABA member discounted price is $20.

The ABA Community Bankers Council represents the nation's 12,500 commercial banks with assets of $150 million or less.

Asset-Based Lenders Can Benefit Most As Last Part of Bank to Computerize

By Andrew H. Tananbaum, President
Century Data Services, New York City

ASSET-BASED lenders often regard automation with the same trepidation of a youngster who's picked last when sides are chosen for a sandlot baseball game. There's a lot more pressure to perform when you get up to bat so you can prove you're just as capable as everyone else.

Because they are new to using computers and their banking-company parents already are highly experienced in this area, asset-based lenders can feel uncertain about changing from a manual or old computer system to a new one.

The overburdened in-house data-processing department already is devoted to maintaining the technically advanced systems of the rest of the bank; it doesn't have time to create an asset-based-lending system from scratch.

Therefore, the initiative to computerize falls to the asset-based-lending director, regardless of how well prepared he feels to meet the challenge.

He understands that computerization is an inevitable fact of life rather than a luxury. Chief reasons for this include the increasing complexity of the business environment, the need to secure instant information and the opportunity to expand asset-based lending. Manual and antiquated methods are inadequate and profit-draining.

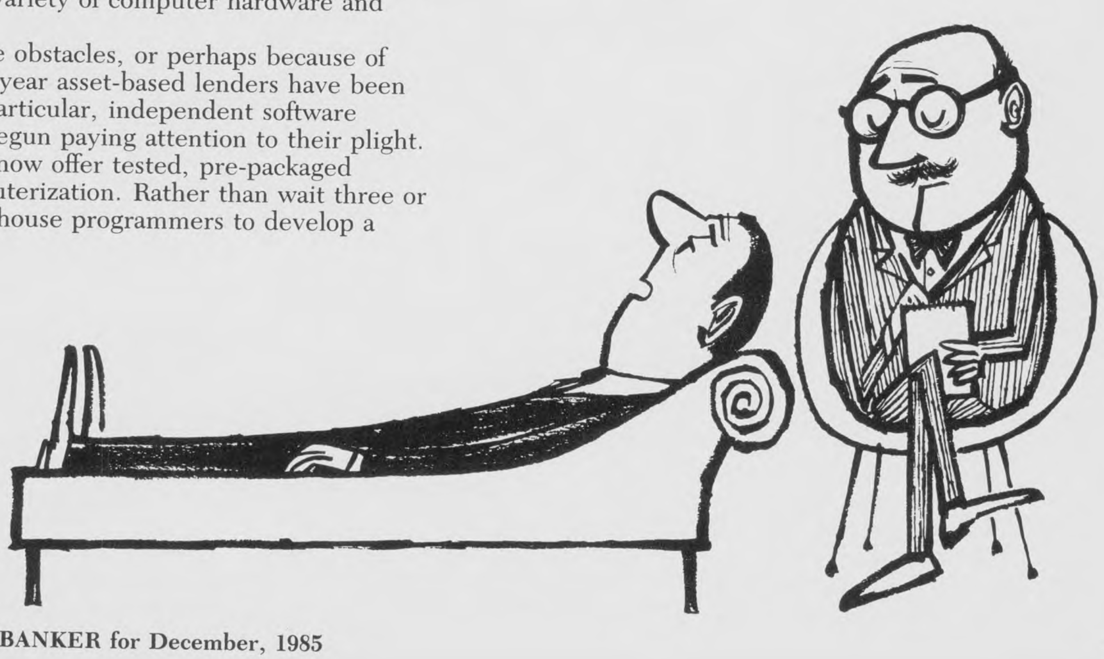
But the decision to automate carries with it many other decisions that are difficult for those without technical backgrounds. One major challenge is selecting from a confusing variety of computer hardware and software.

In spite of these obstacles, or perhaps because of them, in the past year asset-based lenders have been getting help. In particular, independent software companies have begun paying attention to their plight. These companies now offer tested, pre-packaged solutions to computerization. Rather than wait three or more years for in-house programmers to develop a program (at a potential cost of millions of dollars in expensive programming time), you save time and money by purchasing a time-tested package.

Asset-based lenders don't have to be pioneers in adopting computer systems to enjoy their benefits. A knowledge base of computer users in asset-based lending already exists and is expanding. You can benefit from their experience. Institutions already using a package can be an excellent source of counsel on how to proceed.

A knowledge base exists *within* the banking company on how to select, implement and maintain a software package. Many asset-based lenders are uneasy about asking their institution's DP department for help because they haven't received it before. But asking for counsel in purchasing a package is different from asking for a program to be developed from scratch. The request should produce a positive reaction. DP departments accept the necessity of purchasing packages and, in fact, have established procedures for selecting and implementing programs.

Indeed, the experience of in-house DP professionals with corporate mainframe computers provides a compelling reason for asset-based lenders to choose a package that runs on the existing mainframe rather than a micro or minicomputer. When a micro or minicomputer is used in the asset-based lending department, problems that arise usually have to be



Asset-based lenders have been getting help from independent software firms.

taken up with the hardware vendor's support services. When the corporate mainframe is used, DP personnel manage the problem.

In addition, downtime is minimal on the corporate mainframe because of the high degree of support. Asset-based lenders also benefit from security measures developed for the mainframe. While some asset-based lenders like the increased control that an in-department mini or micro gives, they acknowledge a tradeoff in terms of support, security and costs.

The fact that mainframe computers utilize the corporate database is attractive to asset-based loan subsidiaries of banks. They enable the asset-based-lending function to interface with DDA accounts and the general ledger.

Consider also that a mainframe-based system enables networking of terminals all over the country utilizing the corporate mainframe. As we move closer to an interstate-banking environment, this capability of tying together branches in any location becomes increasingly attractive. It is difficult to accomplish this with computerized systems other than the corporate mainframe computer.

Beyond Efficiency to Profits

Adoption of a computerized system enables you to concentrate on making money and managing accounts. The following sections of this article describe the key areas of benefit for the asset-based lender:

- *Account Management Control:* How daily decisionmaking can reach higher levels, no matter how large, or how complex, the asset-based loan portfolio.
- *Back-Office Efficiency:* How the computerized system provides a foundation for tracking and updating speedily and accurately, regardless of the nature of loan structuring.

Account Management Control

The computerized system can contribute considerably to the degree of *ongoing control* the asset-based loan officer or administrator has over account activities and the quality of daily decisions and account evaluation.

For example, suppose you are involved in a leveraged-buyout situation financed primarily through asset-based loans, a prime opportunity for business expansion. In such a situation, the company buying control more often than not borrows substantially all the funds needed against the assets of the business. And those loans are secured by several categories of collateral — accounts receivable, inventory, equipment, real estate, for example. If the company has several divisions, each may have its own categories of collateral. The overall loan to the company and to each division may have limits tied to the collateral type, division, loan type and may have overall loan limits and overall overformula loan limitations. The job of tracking them all can be monumental.

The system helps by making such a complex transaction with so many sub-accounts, sublimits and overall limits seem simple to look at in its component parts and on the whole. The loan manager can get to the level of detail he wants *rapidly*, whenever he wants it, and absorb updated information on account status in order to make decisions about loan disbursements and account evaluations. He doesn't have to wait while personnel wade through ledger cards or think of ways to get the information out of old computer systems not designed to handle the degree of complexity prevalent today. The system reduces or eliminates mechanical, repetitious staff work such as detailed computations or frequent sequential searches or review through large volumes of transaction data.

Andrew H. Tananbaum is president of Century Data Services, Inc., a New York firm that has developed, packaged and customized IBM mainframe computer systems for asset-based lenders, including NCFA members with portfolios in excess of $100 million. It also provides services and systems for those with smaller portfolios. The company is a subsidiary of Century Factors, Inc., a 105-year-old firm specializing in commercial financing, factoring and related credit-checking services.

In addition, reports are geared to the needs of the executive who wants them, from "one-liners" on a portfolio or by exception (for the use of senior management) to detailed reports for the loan administrator. Account-status-exception reports and account-evaluation reports can be designed to spot potential problem accounts on a predetermined frequency or on request.

The value of this capability is evident by the professionalism with which participations can be managed. The institution managing the deal is responsible for delivering to participants progress reports on the segments of the deal it has sold. This is a critical test for any computerized system you are considering adopting. It should give you the ability to provide reports on any segment of the deal for an unlimited number of participants quickly and accurately to meet their information requirements.

In addition, the computerized system should allow for troubleshooting via trend analyses and exception reports. How will a development or trend improve decisionmaking? Because the system keeps an online (up-to-the-minute, accessible) history of the account, preferably for the prior year, loan officers can spot variances and uncover patterns indicating an improving or deteriorating situation. For example, you might see that this year an account's sales are running at the same pace as last year, but advances are more frequent and larger. The computer system should permit you to analyze why, and react to this situation in an anticipatory way to offset potential problems. Similarly, you should be able to capitalize on positive trends.

A further benefit of the computerized system is that it can contribute to the growth of the asset-based loan portfolio and its profitability because added business can be handled by the current system without disrupting procedures or requiring additional personnel. And it can be used for regional expansion by means of local terminals that have access to the bank's mainframe and enable the head office to centralize control.

Back-Office Efficiency

The asset-based loan officer or administrator wants the peace of mind that comes from knowing his back-office operation can cope with routine accounting as well as special requests. The computerized system can give that to him. Examples:

- *Protect against overadvances.* When making advances, it's necessary for the loan officer to have access to the most up-to-the-minute information possible. With a computerized system, you should be able to come into the office in the morning and instantly have status reports on all accounts in overadvance or those coming within 5% of being in overadvance. You should be able to check them throughout the day, if you wish, and know that the most recent transactions have been posted.

Not all systems enable you to do this. Some provide printouts that report only up to the day, week, or month before — excluding recent transactions. Contrast this with the advantages of having ready access to the information. One institution, for example, holds all advance requests until a critical point in the day — until the latest transactions have been posted, which is noon — early enough so it still can make and implement decisions on the same business day.

With a manual system, you'd have to physically go through the ledger cards that only include transactions up to the last posting and may be far behind. In the worst case, you'd have to call up everybody in the organization who has worked on the account and ask them individually whether they had any recent transactions.

The computer is valuable when there is increased availability due to additional collateral, since that increase will be posted immediately.

Loan-Limit Enforcements

Another benefit of the computerized system is in the enforcement of loan limits that protect the asset-based lender from exposure beyond a predetermined amount. These limits can be built into the computerized system on a subaccount-by-subaccount basis and on a combined account or collateral basis, no matter what the level of complexity. In addition, overall overformulas and temporary limitations can be superimposed on existing availability.

• *Speed transactional lookup*. While the client is on the phone, the loan administrator can immediately check client records without digging up several files so that client inquiries on whether certain transactions have been posted are dealt with quickly.

• *Generate additional fees*. The capabilities of a computerized system enable you to unbundle your charges or develop new charges on an unbundled basis.

• *Maintain on-line records of UCC filings, insurance policies and collateral appraisals*. Because such information can be placed on the computer system, there is ready access to where you filed, when you filed, when filings expire, when you should refile and update appraised values.

• *Provide audit reminders*. The system provides management with a tool to schedule, track and control time spent in auditing.

• *Close faster and collect faster — accurately*. We know of more than a few asset-based lenders on manual or antiquated systems who are unable to send out monthly interest statements to borrowers and participants until the 15th of the following month. A computerized system can let you routinely send statements on the first of the month and also prepare settlements based on frequency dates. It also will generate customized statements that include participation settlements.

• *Perform collection-day calculations*. As asset-based lenders know, payments deposited today don't necessarily get credited the same day. Each client has agreed upfront to the number of collection days for which interest can be charged and the relative rate to be charged with respect to each collection date. Not only should the computerized system perform these calculations automatically, it also may make it possible for the lead lender to offer a new structure that provides the benefit of added leverage in negotiation. For example, suppose you offer three collection days and the client insists on two. You now have the ability to go in-between (2.5 days) without the back office complaining.

• *Back-value automatically*. The lag in posting transactions sometimes causes anguish for asset-based lenders when they discover on the 15th that they have a transaction that should have been posted on the second day of the month. Interest/collection days have to be recalculated manually and there is room for error. A computerized system can perform back-valuing calculations quickly and accurately.

• *Handles all kinds of rate structures*. When a client signs a contract, he agrees that interest will be based on the beginning, end of the month, or a day-to-day base rate, and on a contract spread, which will be calculated on business or calendar days. Consequently, the computerized system should be able to follow all types of interest rates that can be modified on an on-line basis. In addition, the system should allow for the sale of participations at the loan rate or any other agreed-on basis.

In addition, the computerized system should calculate interest for loans that are structured with steps and splits and minimum and maximum rates. And it should do so on both the loan and participation sides. The user need only to enter the contract information specifying the structure *once* — and the computer will take care of the calculations. The system should be able to compare the rate schedule plus the contract spread with the relative usury rate specified and use the lower rate.

• *Accommodates structuring the sale of participations*. The leveraged-buyout business has increased the use of participations in, and syndication of, asset-based loans. A computerized system should facilitate the lead lender's sale of participations and serve as a tool for enhancing yield and maximizing outstandings. The system does so by enabling the lender to apply the same concepts associated with the lending side to the sales side of a loan — such as buying and selling at a spread or for a fee, or even compensating a participant on a funded or unfunded risk-participation basis, depending on the cost of funds.

Automation in asset-based lending is no longer a luxury but a necessity. The benefits to be gained from adopting such systems begin with speed and accuracy. Today's computer software packages enable the asset-based lender to anticipate rather than react, increase negotiating power because he can take advantage of situations much more rapidly and expand his business without making an additional personnel commitment. The results are greater profits and the ability to handle the increased opportunities for expanding business today. • •

Asset-Based Lending

Among Basic Considerations:

Dennis B. Hirstein (l.) and Michael F. Timmerman serve as pres. and v.p., respectively, Landmark Commercial Corp., recently established asset-based-lending unit of Landmark Bank, St. Louis.

EDITOR'S note: Until recently, asset-based-lending departments have been limited to money-center and major regional banks. However, the service is being seen as attractive and practical by mid-sized institutions. One such operation is Landmark Commercial Corp., a wholly owned subsidiary of Landmark Bank, which is a subsidiary of Landmark Bancshares Corp., a $995-million-asset HC headquartered in St. Louis. Landmark operates six banks with 21 locations in St. Louis, Kansas City and Springfield, Mo.

Landmark Commercial Corp. was established this summer by Dennis B. Hirstein, president, and Michael F. Timmerman, vice president. Mr. Hirstein joined Landmark in July and formerly was president, Mercantile Business Credit Corp., St. Louis. Prior to that, he was with Heller Financial, Chicago. Mr. Timmerman joined Landmark in September, coming from Centerre Bank, St. Louis, where he was instrumental in establishing that bank's asset-based-lending department.

Landmark Commercial expects to have $10 million in loans outstanding on the books by year-end.

Messrs. Hirstein and Timmerman recently were interviewed by the editors of MID-CONTINENT BANKER on the considerations involved in setting up an asset-based-lending department at a mid-sized bank.

* * *

Q. Why do you feel U.S. regional banks are expanding their commercial-lending activities into the asset-based-lending area?

A. For three basic reasons. First, the market is expanding, particularly with the number of leveraged acquisitions taking place.

Second, traditional commercial-banking margins have been eroded through competitive pressures from domestic as well as foreign banks that are expanding their lending activities, particularly into the "middle market." Asset-based-lending margins also have been under pressure. However, they remain approximately 300 basis points higher than traditional loans; hence, asset-based financing offers an expanding market and a greater return on assets.

Third, market segmentation and product differentiation. In addition to leveraged acquisitions, the asset-based-lending market is made up of firms that are growing fast and experiencing seasonal or cycle fluctuations as well as those companies that are coming back from periods of unprofitability. The needs in these market segments really have not been successfully met through unsecured and secured loans done on a "blanket-lien" basis. As a product offering for these market segments, asset-based lending is another arrow in the commercial lender's quiver. By differentiating

for the Mid-Sized Bank

Commitment Must Be Long-Term

product offerings based on the tangible value the market perceives, a higher price usually can be realized.

Q. You allude to asset-based lending supporting commercial lending as a member of the commercial-lending-product line. Is it necessary that it support the bank's commercial-lending activities?

A. No, but is sure helps to maintain the bank's commitment. Establishing an asset-based-lending unit isn't for everyone, not only from the standpoint of market needs, but also from the standpoint of its philosophy and culture, which often doesn't mesh with the gears of traditional commercial lending.

Q. What are the essentials for setting up and operating a successful asset-based-lending operation?

A. Foremost, the bank's senior management must be committed to asset-based lending and actively support it. It's easy to say, "Sure, we're committed," but not quite as easy to support the activity due to some fundamental differences from commercial lending. It's important that senior management be made aware of the key differences and be prepared to allow asset-based lending to be different.

Q. What are the key differences and how does bank management handle them?

A. Asset-based lending is deal oriented where commercial lending tends to be relationship oriented. The client has a need and we have cash at a competitive price that is packaged professionally.

Another difference: asset-based lending is more labor intensive and requires specific skills. The skills needed to actively manage collateral assets normally are not found in a commercial bank and must be developed through training. Trained people have to be in place before the marketing function begins and training people takes time, involves up-front costs and must be done continually — not only when starting up but on an ongoing basis.

The third difference is the approach to credit judgment. In asset-based lending, we often look at collateral assets from the standpoint of liquidation under a worst-case scenario. Given this, management must understand that bankruptcy and liquidation don't necessarily mean a loss of principal when collateral assets are actively monitored as to quality and quantity. We don't get into a lending situation assuming we are going to liquidate the client; but, by the very nature of the business, the client normally will not have the equity position found in traditional commercial lending. Therefore, the loan has to be actively monitored and kept marketable so, if a deteriorating condition persists, the loan can be reduced and, many times, moved to another lender.

Last, charge offs will occur. Asset-based lending has an element of risk; however, loan pricing anticipates a level of charge offs, and net charge offs should not exceed those of other business units within the bank. Top management handles these differences by having a high degree of confidence in the professionals managing the asset-based-lending unit. It takes effective communication to achieve this comfort level.

Q. You mentioned commitment as a key element for success. How is this commitment maintained?

A. In the long run, through the unit's contribution to the bank in terms of quality earnings. It is important, particularly in the beginning, that the manager of the asset-based-lending unit report directly to the CEO or president in a mid-sized bank; or to the senior commercial-lending officer in a large regional institution. This level of visibility is necessary to maintain active communicaton at the top. Our top management is involved in credit approval and, because we are a bank subsidiary, these people also are on our board. Thus, they know the type of business we are doing and they have a forum to exchange views.

Q. Can staffing be found internally?

A. People with the necessary skills and talent will most likely have to be hired from the marketplace. This brings up the problem of finding qualified people in a competitive marketplace. There is a shortage of qualified asset-based-lending personnel due to increasing demand for this product, and this shortage will most likely drive up the cost of key employees. Associated with employee costs is the fact that asset-based-lending-industry compensation systems normally include incentive plans. Therefore, recruiting and retention of key people is partially dependent on compensation systems commensurate with the industry. By not offering an incentive-compensation system, management runs the risk of training good people and losing them to another bank that does offer such compensation.

Four functional areas of an asset-based-lending unit to be staffed are administration/credit, marketing, operations and audit. It's not unusual that the top person in each one of these areas will come from outside the bank; however, it is safe to say that initially these functional responsibilities can be combined, thereby holding down costs. As the unit grows, these areas should be fully staffed and headed by professionals with "street" skills.

Q. Is it common practice for asset-based-lending units to be set up as subsidiaries?

A. Yes, as evidenced by Citicorp Industrial Credit, First Chicago Credit Corp., First Wisconsin Financial Corp., and many others. All handle asset-based lending through subsidiaries, and most successful regional banks have followed this pattern.

The reason is simple. Our marketing effort is directed toward attorneys, accountants, investment bankers, venture capitalists and entrepreneurs. These professionals are keenly aware of the differences between bank lines of credit and asset-based lending. The subsidiary status tells these professionals that the bank recognizes the lending differences and that the clients they refer to us that are highly leveraged asset-based-lending customers will not be subjected to a bank's credit analysis.

Q. Is it true there is a tendency to transfer higher risk and marginal loans to an asset-based unit?

A. Yes, however, asset-based lending is a marketing unit, not a work-out group for existing marginal loans. The way to make sure the asset-based unit does not become a "dumping ground" is to give it the right of first refusal on all internal referrals and transfers. If a new or existing loan does not meet the credit criteria established by the unit, it should not come under its management. We've seen many instances of a loan transferred into a unit when there really is nothing that can be done for it.

There is a consideration that senior management must address: Under what circumstances does a loan belong in an asset-based-lending unit, particularly new business? We've seen instances that, by policy, leveraged acquisitions are automatically candidates for the asset-based unit.

Q. Do asset-based-lending differences mean existence of a different credit policy from other commercial areas?

A. Asset-based lending is a specialty product such as real estate, energy and transportation. From that standpoint, a separate credit policy should be established that is realistic in relation to the needs of the marketplace. While there is no substitute for cash flow in a lending situation, policy should concentrate on good collateral values — it simply must stress asset quality! Credit policy should be thoroughly discussed with top management so these individuals can live with it. Because asset-based lending is a separate credit product, it may be important that a separate loan-approval process be in place. A separate credit process can facilitate a lending situation that has to be acted on in a timely fashion.

Q. What other areas are essential for success in setting up an asset-based-lending unit?

A. Standard operating systems and procedures must be set up that provide for close monitoring of collateral assets. When you get right down to it, one of the distinguishing factors between traditional commercial lending and asset-based lending is the amount of hands-on management given to a client in terms of maintaining a handle on asset quality. For instance, this could include daily reporting and quarterly field audits. A few good software packages are available to automate monitoring collateral assets.

Another critical factor is having an adequate legal position through loan and collateral agreements. In the asset-based-lending operations in which we have been involved, we have drawn up standard legal contracts different from those of the bank. We also have chosen outside legal counsel that has liquidation and bankruptcy experience. These people know the courts and can develop appropriate legal contracts. Loan contracts become particularly critical when complicated lending situations — such as leveraged buyouts — are undertaken.

Another criteria in selecting counsel is responsiveness. Our attorneys have to be prepared to move fast if a loan deteriorates.

Finally, a realistic business plan — approved by senior management — should be established. The plan should state measurable objectives, strategies and tactics. For example, two key objectives could be to create marketing and financial plans and, in the case of a start-up situation, a timetable for implementing an asset-based-lending unit. The strategy should focus on the areas just discussed.

Q. What points would you stress to a bank considering starting an asset-based-lending unit?

A. The most important thing to keep in mind is that it's not a short-term venture. It takes time to hire and train staff and establish credibility in the marketplace. If the long-range commitment is there, the bank will end up with a material advantage in developing middle-market customers and will have a unit that can make a major contribution to earnings. ● ●

Executive Round Table for Bank CEOs

CHIEF executives of banks with $250 million — $5 billion in assets will find a forum at ABA's 1986 Executive Round Table, set for April 2-5 at the Camelback Inn, Scottsdale, Ariz.

This small meeting, exclusively for mid-size bank CEOs, has as its core a series of wide-ranging discussions on such issues as mergers and acquisitions, strategic planning and financial delivery systems.

"The issues facing banks of this size are somewhat different than for small or large banks," says James H. Duncan, who serves as dean of the Round Table. "This meeting is a chance for peers to compare their personal perspectives and assessments with others from around the country. The small meeting size and informal setting encourage a more candid gathering." Mr. Duncan also is chairman of First of America Bank Corp., Kalamazoo, Mich.

The program opens Wednesday evening with a keynote address by Federal Reserve Board Governor Martha Seger. On Thursday, the program theme is "Controlling Your Own Destiny," featuring an address by Peter Merrill, principal, Golembe Associates, Inc., Washington, D. C. Mr. Merrill's remarks will serve as the focus for extensive roundtable discussions later that day.

On Friday, Eileen Friars and William Gregor of the Management Analysis Center, Cambridge, Mass., will discuss "Turning Delivery Strategies into a Competitive Advantage." Following roundtables, they will return to lead a follow-up panel on this issue.

Registration for the ABA Executive Round Table is limited to 75 bankers. For more information, call the ABA Banker Education Network at (202) 467-6738.

Now a Lender of First Resort

Asset-Based Lenders Struggle to Adapt To a New Role

By John L. Cleveland
Editor/Associate Publisher

MEMBERS of the National Commercial Finance Association (NCFA) gathered in New Orleans last month to celebrate what by most standards has been a terrific year, but few of the asset-based lenders in attendance could pretend that their industry was without problems.

More than 1,200 people attended the 41st NCFA convention, and this in itself was indicative of some of the members' concerns. Executive Director Leonard Machlis recalled that 30 years earlier when the association had met in New York City, there were only 47 member companies. Today there are 225 member firms, 75% of which are banks or bank-connected. For the innovative asset-based lender the "pot is getting bigger," Mr. Machlis said, but that issue was hardly in dispute.

What was of concern is where the growth the industry has experienced will lead. Speakers expressed concern that the entry of new competitors might be stretching management resources thin. Intensity of competition could result in less rigorous lending standards, some said. The size of some of today's leveraged buyouts (LBOs) seemed mind boggling to some NCFA members who wondered aloud whether the industry might be moving into realms beyond what it can comfortably handle. In fact, there was considerable debate over just what it is that the industry has become.

Outgoing NCFA Chairman Richard J. Dorgan, group vice president, Wachovia Bank, Winston-Salem, N. C., warned against a trend toward speculative LBOs which he said could trigger serious economic dislocations unless financial institutions strengthen credit controls. Unsound loans have contributed to the increase in the business-failures rate to more than 100 per 10,000 — the highest since the Depression, he said.

Private debt in the United States has doubled (to $7.1 trillion) since 1978, and — when combined with the impact of the growth in public debt on the dollar — has exacerbated the problems of American manufacturing and agriculture, according to Mr. Dorgan. He complained that the rash of often unproductive corporate takeovers and LBOs is another cloud hanging over the industry.

"Leveraged buyouts continue at a lively pace and now account for more than half of the asset-based-lending industry," he said. "Many LBOs and management buyouts (MBOs) are financed by lenders speculating on an equity play because real assets to service the loans simply are non-existent. Some of these creative deals will work out well; some won't. And new entrants into asset-based lending will intensify competition and add further speculative pressures."

Asset-based lenders have gone from being lenders of last resort to lenders of first resort, Mr. Dorgan said, and the industry has yet to adapt to that new role. Asset-based lending is no less risky, he added, but there no longer seems to be the "attention to detail" that traditionally has been the asset-based lender's hedge against default. Nor can the industry rely on inflation to save it from its excesses.

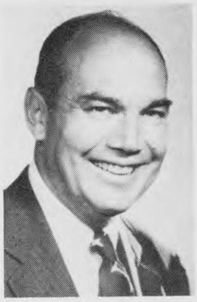
Only by maintaining time-tested, hands-on lending policies can asset-based lenders survive in the deregulated financial marketplace, according to Mr. Dorgan. Protectionist pressures are yet another potential blight. If the nations owing billions of dollars to U. S. banks are unable to sell goods in the U. S. market, they will be unable to service their debt, he said.

Product or Business?

A panel discussion on whether asset-based lending is a product or a business may not have resolved the question to everyone's satisfaction, but it did produce some agreement that asset-based lending is stratified by market niches in which innovative players can thrive.

One highly profitable market niche discussed at another panel discussion is entertainment-industry financing. Panelists included independent film maker Roger Corman, film distributor John Hyde and Completion Bond Co. President Bette L. Smith, all of Los Angeles, who attempted to persuade their audience that accepting the producer's presale of a motion picture as collateral and insuring that the project is delivered as specified can make en-

National Commercial Finance Association Officers


Frederick S. Gilbert
Ch.


Joseph E. Mariani
Pres.


Richard J. Dorgan
Retiring Ch.

tertainment-industry financing secure as well as profitable.

The panelists noted that filmmaking no longer is a West Coast monopoly. Film-production crews increasingly are venturing into the hinterlands for fresh locations and financing sources, they said.

Survival in the factoring business always has been tough, but never has been tougher than today, according to Francis X. Basile, Manufacturers Hanover Commercial Corp., New York City. He moderated a panel discussion on factoring that included Vincent Armino, president, Slavenburg Corp.; Marvin Nadler, vice president, Bankers Trust Co.; and Robert S. Sandler, executive vice president, Republic Factors Corp., all of New York.

Many factoring operations have lost money in the handling of imports, particularly textiles, Mr. Basile said. Panelists shared the view that longer distribution channels coupled with the style element involved in imported textiles (making liquidation of inventory difficult in the event of loan default) has created more risk at a time when interest margins are thin. Factors have little room for error in the conduct of their business today, he added, but he expressed confidence that factoring operations will continue to provide a service to traditional customers and to markets yet to be developed.

Many of the patterns that have created turmoil in the factoring business are discernible in the rest of the commercial-finance industry, Robert A. Miller, executive vice president, Congress Financial Corp., New York City, said during a roundtable discussion on industry problems. The factoring industry's troubles began in the late 1960s when financial institutions began to target factoring firms for acquisition. Once newcomers had gotten their "foot in the door," they began an aggressive search for market share that sent rates tumbling, according to Mr. Miller.

"We cut the cost of our product by a half from what it was 15 to 18 years ago," he said, "and we did it at a time costs were skyrocketing."

The rest of the commercial-finance industry currently is in a similar situation, said Mr. Miller, who indicated he foresees an era of consolidation ahead.

"It's going to be a different industry than we have now," he said.

William R. Gruttemeyer, president, James Talcott, Inc., New York City, said that yields clearly are below acceptable levels considering the risks involved. Both he and Mr. Miller lamented the shortage of skilled asset-based lenders. The industry has done a poor job of recruiting and training new personnel, they said.

Mr. Miller said the dimensions of some recent highly publicized LBOs — such as the multi-billion-dollar offer for Beatrice — seem to have taken asset-based lending into dangerous territory. "Who's going to liquidate $8 billion (recent estimates put the offer closer to $5 billion for Beatrice)?" he said. "That's not our business; that's the world of Wall Street."

The third panelist, Gerald Blum, president, Trefoil Capital Corp., New York City, took a more upbeat view. "We are a vibrant and good industry," he said. "We will survive."

Indeed, Mr. Miller and Mr. Gruttemeyer admitted that many commercial-finance companies are offsetting declining rates with fee income and equity positions in the companies they lend to.

Despite the industry's concerns, the industry could point to numerous success stories to demonstrate its worth. One of the greatest success stories, Charles Bird (C. B.) Vaughan Jr., former professional downhill skier and founder of CB Sports, Inc., Bennington, Vt., was honored for outstanding achievement through use of asset-based financing. Since 1980, CB Sports sales have zoomed by 443% and profits by 434%. ● ●

YOUR BANK'S

SECURITY

IS MORE POROUS THAN YOU THINK!

That's the opinion of an Ohio bank security expert, who says that he doubts he'd have trouble getting in and going anywhere he wanted in your bank as long as he wore a suit and didn't brandish a weapon.

By John L. Cleveland
Editor/Associate Publisher

RECENTLY a man entered a Texas bank through a back door and sauntered unchallenged through the bank's data-processing department.

From there, he headed down a corridor past a room where ATM cassettes were being loaded. He noted, matter of factly, as he passed the room that at least a quarter of a million dollars was in view of anyone who took the same path and no guards were in sight. He then walked into the retail area of the bank and stood behind a bank teller as she cashed checks for customers. He watched several transactions take place until, after about 10 minutes, a security guard took note of him and asked him if he could be of any help.

Had the man been a criminal, his natural reaction might have been, "No thanks, I've been helping myself." In this case, the man was no thief, but a security expert attempting to determine just how tight the bank's security was. His name is Norman L. Harris, president, HSH, Inc., a Columbus, O., security firm that specializes in conducting security audits of banks. He had received special clearance from the bank's management to attempt to penetrate the bank's security.

He found the Texas bank to be ridiculously easy to gain access to and that sensitive areas where large amounts of money were handled virtually were unprotected. Don't laugh, however, because, according to Mr. Harris, he probably could penetrate your bank's security just as easily.

"We've never found a bank yet that we couldn't get into and go just about anywhere we wanted," says Mr. Harris.

He is quick to point out that when he or his security personnel penetrate bank security, they do so without malicious intent. Imagine, however, how much damage a criminal could have done at the Texas bank had he/she had the same access and the same amount of time, he says.

"I have often wondered why anyone would go to the trouble of robbing a bank at gunpoint when you could get a lot farther and probably get more money if you walked in with a clipboard and wearing a suit," he says. "You go in with a gun, you take a chance on being shot. Go in in a suit and your chances of being caught and prosecuted are negligible."

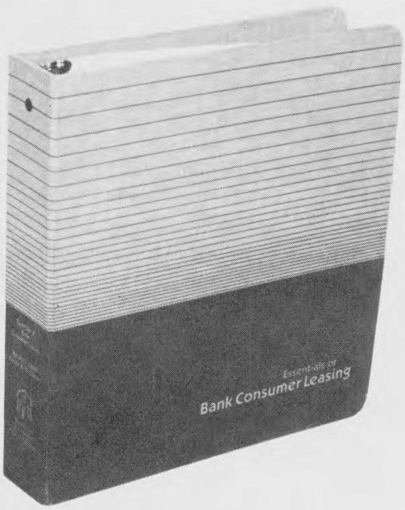
Mr. Harris says most bankers are surprised when they discover just how porous their supposedly secure institutions are. Doors that are supposed to be locked frequently are propped open with a piece of wood so that bank personnel don't have to bother with keys. Telephone and electronic closets frequently are plainly labeled. Security equipment provides the facade of security without fooling anyone but the banker.

Mr. Harris recalls taking a tour of a bank in Connecticut with the CEO who was especially proud of his institution's new electronic surveillance equipment. The banker was boasting about how rigidly film from surveillance cameras positioned at key locations around the bank was checked to determine if any strangers were wandering around.

Suddenly, Mr. Harris pointed to one of the cameras and said that something looked funny about it. As it turned out, someone had sprayed shaving cream over the lens so long ago it had hardened into a sticky film so tough "we could barely pick it off." The camera contained no film and, in fact,

Finally.

The First Comprehensive Bank Consumer-Leasing Guide Is Here!



If you are considering consumer-lease financing at your bank — either as a profit center or as a personal career and earnings opportunity — you can't afford to be without this indispensible reference.

Strengthen your present market share if you already offer consumer-lease financing.

No other book is as complete, analytical, descriptive and filled with ideas. Included in the 47 chapters are sections on tax considerations, balloon-note financing, data-processing requirements and more. Written over a three-year period, *The Essentials of Bank Consumer Leasing* provides a comprehensive guide to understanding and preparing consumer-lease programs.

Reviews Are In. . .

"The Essentials of Bank Consumer Leasing *is the most definitive, complete presentation that has ever been made available to our industry . . . indispensible reading. . .*"

Michael Haslam, President
BancAmerica Acceptance Corp.

"*. . . most complete source of information on automobile leasing that I have ever seen.*"

Dale C. Miller
V.P. and Regional Manager
Wells Fargo Bank

About the Authors

Ronald S. Loshin is president of Bank Lease Consultants Inc., an internationally-recognized firm serving leading banks and other key participants in the leasing and auto-finance industries. His expertise includes program design, marketing, financial analysis, data processing, mergers and acquisitions and program evaluation. He conducted his doctoral studies at the University of California, Berkeley.

Randall R. McCathren is executive vice president of Bank Lease Consultants, Inc. His areas of expertise include contractual, documentation and tax aspects of leasing as well as the regulatory environment of the banking industry. He is a graduate of Yale University and the University of California, Berkeley, School of Law.

ESSENTIALS OF BANK CONSUMER LEASING
Make payable to:
Commerce Publishing Co.
408 Olive St.
St. Louis, MO 63102

☐ Yes, I want the most comprehensive bank consumer-leasing guide ever published. Send ___ copies @ $195 each ______

☐ I want to take advantage of your volume discount; send ___ copies (orders of 3-5, 10% off; orders of 5 or more, 25% off). ______

Shipping and Handling $7.50
Total ______

Name ____________________
Company ____________________
Address ____________________
City ____________ State ____________ ZIP ________
Phone ____________________

had been turned off in a cost-cutting move. Security personnel at the bank continued to tell management that they were monitoring film from the cameras, however. Of course, the bank's CEO was embarrassed and more than a little angry.

The key to deterring crime is making the criminal's job more difficult. Telephone or electric closets that are plainly labeled as such or cabinets and drawers with a sign that says "checks stored here" help criminals locate vulnerable areas more quickly, says Mr. Harris. The more obstacles you can put in the criminal's way, the less vulnerable the bank will be to theft or vandalism, he adds.

Training Personnel

Bank personnel — if not properly schooled — can ease the criminal's path into the bank. Mr. Harris recalls that he once tried to gain access to a bank's data-processing department without authorization and was stopped by bank security personnel. Shortly later, he struck up a casual conversation with a bank employee who turned out to be the bank's data-processing-department manager. He followed the data-processing manager into his department and was given an extensive briefing on how the department functioned.

People like to be helpful to other people, says Mr. Harris. Ask a question and they usually are willing to tell you almost anything you want to know. Unfortunately, at a bank, such behavior can have unwelcome side effects. He tells management that if they want to get control of security at their banks they must train their people not to talk about business to strangers. It's okay to be helpful but not to give away vital information that a criminal might use to cause injury to the bank or its customers.

Bank personnel rarely are given cross-training in order to do someone else's job in the event of a vacation or illness. As a result, when a person is gone from the bank for prolonged periods, their desk sits unused and constitutes an invitation to criminals. Anyone can come in and gain access to vital or sensitive information, says Mr. Harris.

Mr. Harris recommends that banks cross train and periodically rotate personnel, not only to stop the outside criminal but also to discourage the insider who has a tendency to rip off his employer. People are more likely to be honest if they know that someone else is going to be doing their job while they are away on vacation, says Mr. Harris.

Software safeguards that allow access to sensitive databases only from specified points of entry that can be monitored are among Mr. Harris' recommendations for cutting down on computer crime.

The Computer-Crime Problem

Congress is debating a far-reaching computer-crime bill because laws regarding crimes committed by computer are so weak that a criminal — if caught — stands only one chance in 27,777 of going to jail, says Mr. Harris. Financial institutions remain one of the primary targets of computer criminals and, by most estimates, the problem is worsening at a staggering pace. According to Mr. Harris, the average computer theft that was detected was \$430,000 less than three years ago, but is now estimated at more than \$600,000. No one really knows how much is lost annually due to computer theft, but estimates range above \$1 billion.

Banks are especially vulnerable to computer crime because they have so many unprotected points of entry into their systems, says Mr. Harris. He recalls a Midwest bank that had a terminal set up in an unguarded training area so platform personnel could be taught how to cross sell. Mr. Harris asked whether the terminal might be used by unauthorized personnel, but was assured that while the terminal was unprotected, the user could only get access to a dummy file set up for training purposes.

Mr. Harris sat down at the terminal and, after a few tries, found he had access to what he thought was the dummy file he'd been told about. As his fingers flew across the keyboard and customer-account data scrolled up the screen, Mr. Harris had to admit he was impressed by the size and complexity of the file that the bank had set up only to train personnel.

As it turned out, the information on the screen was real. Inadvertently, he'd gained access to the bank's central customer-information file. The software the bank had installed was so poorly written that even someone who was unfamilar with the system could accidently stumble into the central database and cause all manner of mischief.

"I could have done almost anything I wanted," says Mr. Harris, "transfer funds from one account to another, look up customer's balances and addresses."

Software safeguards that allow access to sensitive databases only from specified points of entry that can be monitored are among Mr. Harris' recommendations for cutting down on computer crime. Among others: Let people in the bank know that the institution is closely monitoring the potential for computer crime. Have a "disinterested third party" — a security audit firm — come in to audit the bank's computer security procedures. Finally, have an external audit program set up to monitor computerized accounting procedures. External auditors should have data processing as well as accounting experience, says Mr. Harris.

Computer crime flourishes because laws designed to prevent it are so weak and companies are so unwilling to prosecute when they do detect it, says Mr. Harris. One data-processing manager who had diverted at least \$400,000 into a shell corporation he owned before he was caught was fired by the bank, according to Mr. Harris. The data-processing manager was not prosecuted, however; nor did he have to tell his next employer why he left his past job. As far as Mr. Harris knows, the man is working in another job somewhere "getting ready to do the same thing."

Mr. Harris did not have to say the obvious. That "somewhere" could be your bank! ● ●

Centerre's Security Goes Modular

Proprietary System Monitors Tower Complex

WHEN Centerre Bancorp., St. Louis, was planning what would become the largest bank facility in Missouri, management insisted on the best in security systems. The bank's security officers, with the assistance of a security consultant, laid out tight and detailed specifications covering all aspects of current and anticipated security requirements. Several major security-equipment manufacturers were considered for the project.

The HC makes its headquarters in 14 floors of 30-story Centerre Plaza. This glass tower and adjacent low-rise office annex offer 900,000 square feet of office space, making it one of the largest buildings in Missouri.

After an extensive review of proposals, Centerre selected Mosler to design and install electronic and physical security and drive-in banking equipment. Contributing heavily to this selection was the availability of the Mosler COMSEC™ proprietary security system.

Modular Feature Appreciated

According to John R. Hawken, Centerre's security officer, "The COMSEC system is one of the most advanced security systems in the world. It met our comprehensive specifications more closely than any other proposed system, and it is modular, a feature of which we've taken advantage."

In the security-operations center, deep in the heart of the tower, a single console operator is able to monitor all security-related activity throughout the building — from Centerre Bank's seven-lane drive-in facility to the safe-deposit vault. A network of electronic sensors, known as remote terminal units (RTUs) and an extensive CCTV system, which is connected to the COMSEC control panel, also are an integral part of the security system. The Centerre system has 20 RTUs installed, each with a capability of monitoring 496 points.

Camera Views Can Be Locked In

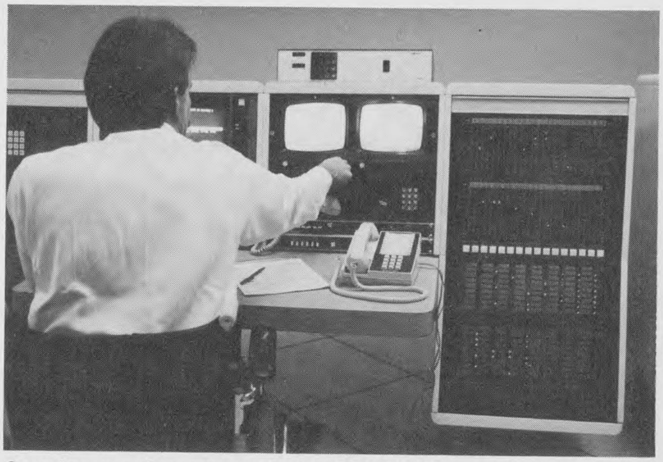
Sixty CCTV cameras supplied by Mosler cover teller stations, elevator consoles, interiors of vaults, the parking garage, loading docks and some elevator cars. The security operator can lock in any camera's view to the large-screen monitor and record the scene on tape at will. If an alarm is activated — by a teller, for example — the camera focused on that teller's station automatically is switched to a large CRT and its signal is recorded.

Three 35mm hold-up cameras in the banking hall are activated by tellers' hold-up alarm systems, which, in turn, are connected to the COMSEC console.

Security-sensitive door access also is controlled by the console operator. Floors, mantraps and hallways leading to bulk-cash-handling areas are monitored by cameras. Electric door-locking systems, even in access mode, can be overridden by the operator if required.

Security Sensors Report to Console

Security sensors throughout the building complex report to the COMSEC console in the security-operations center. If an alarm is activated, an audible signal alerts the operator and the nature, location and time of the activation appear on the console monitor (CRT) in color coding. According to a pre-determined procedure that can be changed as the situation dictates, the operator will verify the alarm



Security guard operates Mosler COMSEC™ proprietary security system that monitors Centerre Bank and Centerre Bancorp offices in 30-story Centerre Plaza, St. Louis.

and, if required, call law-enforcement agencies and bank personnel. Their names and telephone numbers automatically are displayed on the console CRT. For permanent records, a hard-copy printer records each alarm and the response made to it.

The COMSEC console monitors only bank premises in the Centerre Plaza Building. The bank is studying the feasibility of monitoring other Centerre Bancorp. banking facilities throughout Missouri from this one central location. The COMSEC system's modular design will accommodate the additional security load. Since the initial installation, Centerre branches in Frontenac and Ladue — two high-income St. Louis suburbs — have joined the COMSEC security network.

Alarms and other security breaches are reviewed by Al Pruett, assistant security officer/investigator. His investigations assist in preparing recommendations on how such incidents may be prevented in the future. The COMSEC print-out of entrances and exits makes it easier to determine means of preventing security foul-ups.

A large 8,000-square-foot vault from Mosler secures (with appropriate partitioning) safe-deposit boxes, customer's bulk valuables, financial securities and currency. Three electric 25-inch-thick vault doors secure vault entrances.

Bulk currency is handled at the commercial facility at the rear of the building. Armored trucks move in and out of loading docks protected by two interlocking sets of overhead doors also controlled by the COMSEC console operator. Inside individual docks, bulk cash is unloaded and passed into the bank by using package and cart pass-throughs. As a result, bank messengers have room to park their cars securely within this facility. They complete their transactions in individual rooms equipped with Mosler bullet-resistive service windows.

Guard Supervisor Tom Calvert is responsible for ensuring that proper procedures are followed so that the system's degree of security is not compromised.

Card Access System Designed

In addition, Mosler designed a card-access system to fit into Centerre Bank's system to restrict access to high-security areas on a "need-to-enter" basis. The security access coordinator, Ken Mueller, issues plastic cards to authorized personnel along with a personal identification number (PIN) which the employee memorizes. A magnetic stripe on the card is encoded with an identifying number plus a code that will unlock certain doors. To pass through a restricted doorway, the cardholder must insert his card in a reader and enter his PIN number on a keypad.

Cards are encoded by a computerized control unit in the security operations center. This unit permits instant cancellation of a card's priorities (in case a card is lost or stolen, for example) and can record, if needed, a hard-copy record of card usage.

Centerre uses 64 card readers located at entrances to mantraps, vault areas, cash-handling rooms and on the perimeter of "security envelopes" on each executive floor.

Echoing the view of many security officers around the nation, Mr. Hawken feels that security training is as important as physical security at the bank. For instance, Security Trainer Dave Battle provides security training for each teller four times a year, covering aspects of security from robbery procedures to bunco schemes.

Training films produced by the Mosler Anti-Crime Bureau are used as teaching aids in this program.

"We've had good success with the system," Mr. Hawken says, "and since the initial installation, we have added our warehouse (which houses bank supplies and records) and a safe deposit affiliated company to the system with the same degree of dependable service we've come to expect from Mosler. As the Centerre network continues to expand, our security needs will grow accordingly. Our security system is in a position to grow with these needs." ● ●

Security Notebook

● **An hour-long video tape** outlining a hostage/robbery incident at Central Bank, West Allis, Wis., is being produced by Financial Marketing Corp., Prairie du Chien, Wis. It's titled "Do Exactly as You Are Told," and it features interviews with Central Bank Executive Vice President Richard Woodcock, his wife, his daughter and Vice President Edward Lentz, all of whom were involved in the incident, which occurred last September 2. The video contains procedures that should be followed during a hostage and/or robbery incident. The tape is designed for viewing by all bank employees and their families. It will be available in January. For information, call 608/326-4444.

* * *

● **A new standardized process** for protection of sophisticated data security for electronic transfer of funds is available through the ABA. It was developed by X9, the accredited-standards committee on financial services operating under the procedures of the American National Standards Institute. It provides a uniform process for the protection and exchange of cryptographic keys for the authentication and encryption of sensitive information. Cost per copy is $40. Order publication number 091000 from the ABA's Order Processing Department, 202/467-4118.

* * *

● **Bank of America** is offering for sale to financial institutions a 15-minute employee-training video tape designed to help banks comply with the reporting requirements of the Bank Secrecy Act. The Act is designed to crack down on organized crime and drug trafficking by monitoring bank deposits of more than $10,000 by individuals and non-exempt businesses. The video explains the following: valid identification, what to do if a transaction involves many different types of foreign currency, how to handle transactions involving many different checks, who is exempt from reporting transactions, how to handle forms returned by the IRS and what to do if a customer makes deposits of less than $10,000 into multiple accounts. The video is available at $400 per copy from the BofA Media Services, 180 Montgomery #3630, San Francisco, CA 94104.

* * *

● **Visa USA** reports that counterfeit losses reported on Visa cards declined more than 12% in the year ended April 30, to $34.4 million from $39.3 million for the same period a year earlier. It's the first such decline since counterfeiting became a problem in 1982. High losses prompted Visa to, among other things, form a professional security department, integrate anticounterfeiting properties into a new card design, develop a computerized system of identifying merchants who submit a disproportionate amount of fraudulent transactions and promote new federal laws.

* * *

● **The United Security Professionals Association** (USPA) has been organized to provide better security training and communication for financial institution and law-enforcement personnel. USPA sponsors training seminars and workshops; a resource library; and a crime "hotline" devoted to financial crimes. USPA's phone number is 608/831-0003.

Marine Banks' Survey Finds:

Manufacturers Optimistic About 1986

MANUFACTURERS in Wisconsin are looking to 1986 with optimism.

According to Marine Banks' semi-annual business-conditions survey of manufacturers, the Wisconsin economy will continue to expand in 1986 at a slightly higher rate than in 1985.

Marine Bank asked manufacturers to predict their companies' results for 1986 in 14 economic areas.

- The majority, 68% of the 752 responding manufacturers, plan to increase their employment levels in 1986, with an average growth rate of 2.6% expected. This compares with the 1.7% growth rate predicted in the survey done in May, 1985.
- Sales revenues are expected to increase by an average of 7.5%.
- Capital expenditures are anticipated to increase, with 67% of the manufacturers projecting increases over 1985 spending levels.
- Profits are predicted to increase an average of 4.7% in 1986.

The growth rate predicted for each indicator is up slightly from what was projected last spring by the same manufacturers.

- Respondents expect the prime interest rate to remain near the 10% level during 1986. Specifically, the rate is expected to be 10.2% at year-end 1985, and 10.9% on June 30, 1986. These predictions are a slight increase over the current 9.5% rate. However, these are the lowest interest-rate predictions in the six years of the survey, according to Marine Banks.
- Inflation and price increases of manufactured goods will remain low in 1986 with a projected inflation rate of 4.3% and a projected price increase of 1.9%.

These low expectations for inflation translate into low predictions for employee-compensation increases, with wages expected to rise 3.7% and fringe-benefits costs expected to increase 2.3% in 1986.

In addition to the econonic-outlook questions, two additional questions were asked relating to Wisconsin's business environment.

The Wisconsin state legislature recently passed a bill that will allow utility companies to diversify by forming holding companies. A majority of the manufacturers favor allowing utilities to form holding companies.

Finally, the survey asked what inheritance and gift-tax policy changes the state should adopt. Of those responding to this question, 98.4% felt that inheritance and gift taxes to lineal descendants (sons and daughters) should either be reduced or eliminated. • •

Wisconsin Transitions

- **Wisconsin's** regional interstate banking bill, AB596, has been passed by the assembly and awaits action by the Senate, probably in late January. The bill would allow reciprocal interstate banking with Illinois, Iowa, Indiana, Michigan, Minnesota, Missouri and Ohio.
- **Valley Bancorp.,** Appleton, has announced that it will acquire Spring Green Bancshares, Inc., and Bank of Spring Green. With the recent announcements of acquisitions of First National, Minocqua and Woodruff; Commercial Bank, Chilton; Peshtigo State; and First National, Beaver Dam, this affiliation will bring Valley Bancorp.'s total assets to about $2 billion.
- **Rudolph P. Hanamann** has been named president/CEO of Valley Bank, Casco. He succeeds William D. Bushner, who was named president at Valley Bank, Oregon.
- **Barry James** has been promoted to senior vice president/lending and personal banking.
- **James C. Hazzard** has joined F&M Bank, Menomonee Falls, as senior vice president, personal banking. He was formerly senior vice president/community banks division and vice president, Heritage Wisconsin Corp.

Regional Banking Comes With Price

ILLINOIS bankers got their regional interstate banking law last month, but with a few compromises. The law includes something for consumers and something for independent banks that desire to stay that way.

The law, scheduled to take effect July 1, 1986, allows interstate banking with the contiguous states of Wisconsin, Michigan, Indiana, Kentucky, Missouri and Iowa. Michigan is across Lake Michigan from Illinois.

Reciprocity is required. Of the states named in the Illinois law, Indiana and Kentucky have passed regional banking laws that include Illinois in their regions.

Even with the amendments to the Illinois law, "we're delighted with it," said G. Thomas Andes, president of the Illinois Bankers Association (IBA) and of First National, Belleville. Illinois bankers paid a reasonable price to get what they wanted, he added.

The Illinois law requires out-of-state or in-state banks to have a 7% total-capital-to-assets ratio to buy an Illinois bank. Independent banks had the requirement added to slow down the big banks, but it probably will have little effect, according to a spokesman for Governor James Thompson.

"It was aimed at the big banks, but they probably can get around it," said Eric Brenner, assistant to Gov. Thompson.

Mr. Andes, IBA president, agrees. "I don't think it will present any major problems to Illinois banks. Seven percent is a reasonable figure to have in there," he said.

"The only problem with it is that it muddies the water as far as reciprocity."

The law also includes an opt-out provision similar to one in Indiana's law. Banks that invoke the provision may not acquire or be acquired by another bank for a period of two years.

Once again, Mr. Andes sees little impact from this amendment. "I'll be surprised if any bank opts out,"he said. If a board withdraws its bank from the acquisition market and another bank comes along later that desires to purchase it but is stymied, the first bank's board may expose itself to action from shareholders, Mr. Andes added.

The Illinois law also contains several consumer-related amendments. "There is tremendous pressure from consumer groups in Springfield," Mr. Andes said.

Basic banking for people age 65 and over is mandated, requiring free checking with no minimum balance and 10 free checks per month. This amendment includes savings and loans and credit unions.

"Surveys by the IBA have shown that the majority of banks by far are already providing some type of basic banking for senior citizens," Mr. Andes said.

In addition, checks holds are limited by the law to one day for government checks, four days for in-state checks and seven days for out-of-state checks. Once again, "surveys by the IBA have shown that Illinois banks should have no problem with that," Mr. Andes said.

The law also sets rules for disclosure of interest rates on checking and savings accounts, which also will not be any great burden for banks, Mr. Andes reported. The law includes community reinvestment rules, which simply puts in state law what is already in federal law, he added.

The law eliminates the five banking regions in Illinois. Previously, bank holding companies were limited in their acquisitions to banks in their own and one contiguous region.

Mr. Andes sees a midwestern banking region shaping up by the end of next year. Indiana and Kentucky already have passed regional banking laws. Wisconsin and Michigan are getting close. Regional banks in Missouri hope to have a law early in 1986, Mr. Andes said. Iowa will be delayed for a while with its agricultural problem, he added.

Ohio passed a regional-banking law earlier this year that names a liberal region of 13 states, including Illinois. However, the Illinois law does not include Ohio. ● ●

Illinois Banks Will Have Time To Deal With "Onerous" Amendments

"THERE is a lot of trash in that bill that we will administer," Illinois state banking commissioner William Harris told bankers recently when discussing the state's new regional interstate-banking law.

However, "there will be an opportunity to deal with the onerous aspects before implementation," he added. The law takes effect July 1, 1986. It includes sections that mandate free lifeline checking for senior citizens, maximum check-hold periods and a minimum capital ratio to participate in interstate banking.

Mr. Harris spoke at the annual correspondent bankers conference of Centerre Bank, St. Louis, last month.

Community banks, despite their opposition to interstate banking, will have one major advantage in competing against the larger banks, Mr. Harris said. That is their capacity for direct, personal service.

"Community banks can flourish in this remarkable flux situation existing today if they concentrate like crazy on profitability," he added.

Most community banks today are overstaffed, he said. Bank boards must do all they can to make their banks profitable, which may mean trimming staffs.

Directors should ask themselves what their institution's mission is, Mr. Harris said. The board should set a specific course that concentrates on what the bank does best, he said.

Illinois joined a growing Midwestern regional-banking compact late last month when Gov. James Thompson signed SB525, permitting reciprocal interstate banking with contiguous states as of July 1, 1986. At r. is G. Thomas Andes, pres., Illinois Bankers Association, and pres., First National, Belleville; standing are state representatives. Signing ceremony took place at correspondent banking conference sponsored by First Nat'l, Chicago.

Arkansas Commissioner: Interstate Banking No Threat to Independent Community Banks

MARLIN D. JACKSON, Arkansas banking commissioner, has some advice for community bankers who are afraid that the spread of regional interstate banking will be the end of life as they know it: Don't be.

"If I am convinced of anything at all . . . if pigs like slop, if bank commissioners like beautiful women, if bankers like high profits . . . there is a place among the multi-bank holding companies for the independent community bank," he said.

Mr. Jackson spoke recently at the annual meeting of Region 5 of the Illinois Bankers Association, giving a talk laced with his folksy humor.

Illinois Gov. James Thompson had signed the state's regional interstate banking law the week of the meeting.

"The well-managed community bank has the best of all worlds. You have all the options," Mr. Jackson told the group of more than 400 mostly community bankers.

"You can remain independent and make great earnings that would make the money barons of Wall Street green with envy. You can buy other small banks, if you are well-managed, and enjoy economies of scale. You can be acquired; the value of well-run community banks has gone up 50% in recent times," Mr. Jackson said.

Community bankers who do not own a piece of their banks also should have little worry of losing their jobs, Mr. Jackson told the group.

"Those of you who are in small banks and worry about your careers, you have nothing to worry about. Acquiring banks want to buy the customer list more than anything and you are the tie to those customers. The better manager you are the better premium you will command. I have seen acquiring banks come in and retain incompetent management simply to retain that tie to customers.

"I am convinced there has never been a better time for the community bank to remain independent, or affiliate with another bank, or affiliate with an out-of-state bank, or something in between." • •

First National, Lincolnshire Refunds Credit-Card Interest

First National, Lincolnshire (Ill.) is giving its Visa cardholders a holiday gift of a refund of 6.67% of the interest paid on their bank-card accounts.

The bank claims one of the lowest credit-card interest rates in the country and charges no fee on its Idea Visa card.

Public response to the bank's Visa program since it was introduced in January, 1985, has exceeded the bank's predictions, with cards being issued across the U. S.

"This is our way of saying thank you to our customers for making our programs extremely successful in 1985," said Saul Binder, bank president.

Indiana/Illinois Transitions

• **CNB Bancshares,** Evansville, Ind., has reached an agreement to acquire Peoples First Bancorp, Madisonville.

• **Old National Bancorp,** Evansville, has received Fed approval to acquire Greencastle (Ind.) Bancorp, parent of First Citizens Bank, Greencastle.

• **Indiana National,** Indianapolis, has purchased non-classified and non-delinquent loans and assumed deposits of the failed Allen County Bank, Leo. The main office and three branch locations of the failed bank were reopened as branches of Indiana National. In addition, Indiana National has announced the formation of Indiana National Brokerage Services, a subsidiary offering discount-brokerage services.

• **Kenneth J. Roeh** has been elected senior vice president/executive trust officer of Mercantile National, Hammond, Ind.

• **Jerry J. Roberts** has been elected executive vice president at American Fletcher National, Indianapolis.

• **First Colonial Bancshares Corp.,** Chicago, has reached an agreement to acquire all assets of Colonial Group, including All American Bank, Chicago, and Northwest Commerce Bank, Rosemont. All American and Northwest previously operated as affiliated members of First Colonial. As wholly-owned subsidiaries, they will bring First Colonial's assets to $596 million.

• **Americorp Financial,** Rockford, has acquired Illinois National, Rockford, and has merged it with American National, Rockford. The bank has been named Amcore Bank. Eventually all banks owned by Americorp Financial will be renamed Amcore banks.

• **First Midwest Bancorp,** Joliet, has consolidated Union National and National Bank, both of Joliet, into a single bank, called First Midwest Bank/Joliet.

Ohio, Michigan Banks Acquire Firms

BANKS in Ohio and Michigan plan to acquire firms offering services non-traditional to banking.

Fifth Third Bank, Cincinnati, has announced an agreement to acquire C. H. Reiter & Co., Inc., a Cincinnati brokerage.

Fifth Third will consolidate its own stock and brokerage activities into the Reiter firm, which will retain its name.

The combined firm will employ 15 registered brokers and offer a full range of stock and bond products, including options, margin accounts, self-directed IRAs and tax-free investments.

The bank's relationship with the brokerage has extended over 60 years.

In Michigan, First of America Bank Corp., Kalamazoo, has announced the purchase of Securities Counsel, Inc., Jackson, an investment-advisory firm.

Securities Counsel provides investment advisory services to individuals and institutions and manages $200 million in assets.

The acquisition is intended to complement First of America's trust division, which has assets of more than $2 billion. First of America has total assets of more than $5 billion. ● ●

Mich./Ohio Transitions

● **BancOhio National,** Columbus, has elected as vice presidents Richard L. Heston and William O. Wick Jr. in corporate banking and Steven C. Veno in retail services.

● **Toledo Trustcorp, Inc.** has completed acquisition of Society National of Northwest Ohio and Society National, Mid-Ohio. With these acquisitions and the pending acquisition of Sylvania Bank, Toledo Trustcorp assets are expected to reach $3 billion.

● **Comerica, Inc.,** Detroit, has appointed Ina G. Fernandez and James E. Rohan vice presidents/auditing; Prodyodth K. Chatterjee, vice president, Comerica Acceptance Corp.; and Gerald P. Piontkowski, vice president/central bookkeeping, Comerica Bank, Detroit.

● **National Bank of Detroit** has appointed as senior vice presidents Robert A. DeAlexandris, western metropolitan regional banking division; Philips S. Jones, credit-administration division; Donald M. Nowicki, Michigan banking division; Noel L. Peterson, financial-services division; and Kevin F. Walsh, mortgage division.

Banks Receive MICR Data Over Phone

TWO Minnesota banks are participating in an experimental MICR data-capture program promoted by the Minneapolis Fed.

Security State, Sebeka, has been saving from two to four hours of personnel time daily with the program.

Earl Keskey, president of the $15-million-asset institution, says the new service announced by the Fed in September called "MICR Data Capture Transmission" allows the bank to receive and process its daily cash letter and ACH items over telephone wires without handling any documents manually.

Mr. Keskey told MID-CONTINENT BANKER that the only expenditure necessary was for a modem and additional software. Total cost to the bank was about $1,500.

Financial information from the Fed is transmitted directly from Minneapolis to Security State's Texas Instruments mini-computer. Entry errors, common under the former manual system, have been reduced, he says.

"As far as we know, we're the first bank to try this new system," Mr. Keskey says. "Of course, the next logical step would be for us to transmit our information directly to the Fed."

A second test of the system is underway at Janesville State. Joe Finley, president, says his bank was selected because it uses the same Texas Instrument mini-computer. The system soon will be made available to other banks in the 9th Federal Reserve District, according to the Minneapolis Fed. • •

Minn.-Iowa Transitions

• **Sophie Bell** has been promoted to vice president by First Bank Saint Paul. She joined the bank in 1983.

• **Patricia Goodwin** has been promoted to vice president/corporate communications by First Bank Minneapolis.

• **Andrew R. Guzman** has been named vice president/marketing director by Marquette Bank Minneapolis. He directs marketing efforts for all Marquette banks.

• **National Bank,** Waterloo, Ia., has acquired Gilbertville (Ia.) Savings. National Bank has assets exceeding $300 million; Gilbertville Savings has approximately $21 million in assets.

• **Shirley Poertner,** assistant vice president, First Interstate of Iowa, Des Moines, placed first in the 1985 scholarship-award program of the National Association of Bank Women.

Iowa Banker Gives Bankruptcy Hints At ABA Ag Bankers' Conference

By Jim Fabian
Senior Editor

HINTS for ag bankers dealing with farm bankruptcies were given by a panel of experts at last month's ABA National Agricultural Bankers Conference in Dallas.

Iowa banker Paul M. Quam, senior vice president/administrator, Hayesville Savings Bank, moderated the panel. He told ag bankers attending the special-interest session that his bank experienced one farm bankruptcy last year, and was anticipating a total of four or five this year.

Paul M. Quam (l.), s.v.p. at Hayesville Savings Bank, chats with others on farm-bankruptcy panel at last month's ABA ag conference. James G. Lauck, Indianapolis attorney, is 2nd from l.; Dean M. Gandy, bankruptcy judge from Dallas, is at r.

He advised that bankers gain as much knowledge as they can as quickly as they can about dealing with farm bankruptcies, since the outlook calls for more.

"Prior to the ag crisis, most bankers had a little fat in their accounts," he said. "We've lost some of that fat because of bankruptcies and we can't afford to lose any more of it."

He advised that bankers make the following provisions to help deal with bankruptcy cases:

• Retain good legal counsel.

• Don't attempt to transfer responsibility for dealing with bankruptcies to the bank's attorneys.

• Tell bank counsel what the bank wants to do in each case and listen to counsel's advice as to the wisdom of the course of action.

• Maintain an ongoing journal that includes what happened, who communication is with and each entry.

Bankruptcy cases go on and on, Mr. Quam said. Bankers should realize that they have to stay on each case and push it along until it it resolved.

Bankers should realize that the bank doesn't have the use of the bankrupt's assets during a bankruptcy situation. For that reason, it may be wise to make a negotiated settlement.

There is no room for vengeance in a bankruptcy situation; acting with anger is not acting prudently.

Not All Bad

Having one debtor in bankruptcy may not be all that bad, Mr. Quam said. It might be a good thing because a bankruptcy can represent an improved situation when it involves a client who hasn't been conforming to bank rules. At least in a case of bankruptcy, he added, you have help with the situation!

Additional information was supplied by Dean M. Gandy, an attorney and bankruptcy judge from the Dallas area.

Referring to Mr. Quam's recommendation about keeping a journal of events associated with a bankruptcy case, Judge Gandy said such diaries are subject to discovery, hence bankers should be careful about what they record in them! • •

• **Dick Holthaus** has joined the staff of the Iowa Bankers Association as marketing director. He formerly was with Merchants National, Cedar Rapids.

ABA Ponders Agri-Future

Consultants hired to assess, possibly remedy, pickle ag banks find themselves in

By Jim Fabian
Senior Editor

IT'S DEBATABLE if all went well for ag bankers at last month's National Agricultural Bankers Conference, sponsored by the ABA in Dallas.

Ag bankers have long been adamant in their view that any government bail-out for the troubled Farm Credit System (FCS) *must* be nondiscriminatory — that is, it must also benefit commercial ag bankers. But remarks slipped out rather regularly during the conference that such would not be the case.

The Farmer Credit Association (FCA) doesn't think much of the idea of assisting ag bankers as part of a federal rehabilitation of the FCS. Marvin Duncan, senior deputy governor of the FCA, said FCS banks are being hit harder than commercial banks, a remark that made the majority of his listeners wince.

If that wasn't enough, U. S. Undersecretary of Agriculture for Small Community and Rural Development Frank W. Naylor Jr. made things quite plain: Commercial bankers should not expect to be treated equally with the FCS because banks can make use of the Farmers Home Administration as a tool. He termed the FmHA the only major tool available to banks for the 1986 lending season.

But, all is not lost. If the ABA ag division has its way, ag bankers will have another tool to help them extract themselves from the pickle they're in. It took almost a year to arrive at a consensus in the association's headquarters, but persistent plugging by Alan R. Tubbs, who recently retired as ag division chairman, and others on the division roster, the ABA has agreed to turn the ag crisis situation over to a group of consultants charged to come up with a remedy.

The catch is that the remedy won't be ready for quite a while — sometime next year, which means another "crop" of ag banks could be "harvested" along with the corn and milo next year.

Mr. Tubbs, who is president, First Central State, DeWitt, Ia., should be cannonized for the time and effort he has devoted to the ag situation over the years. He was justly recognized during the conference by ABA President-Elect Mark W. Olson, who presented Mr. Tubbs with the ABA's Eagle Award for distinguished service to banking.

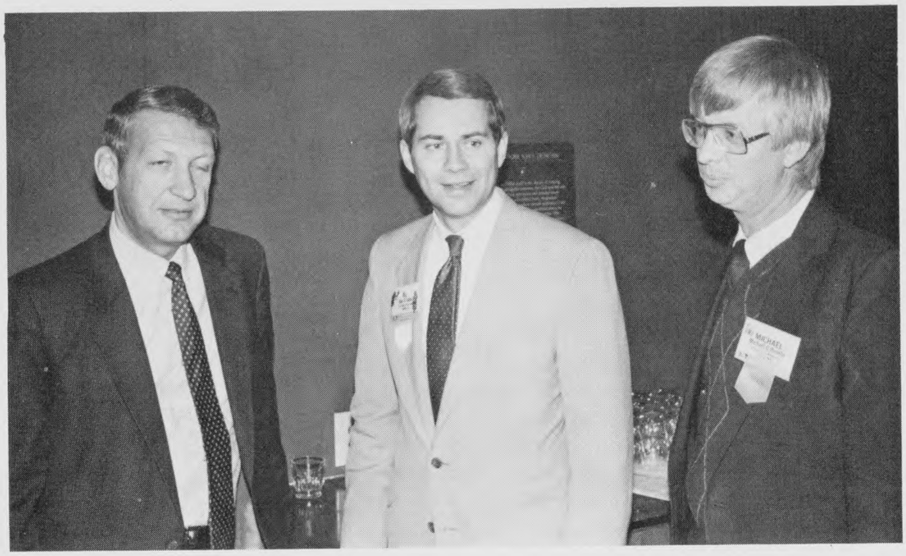
Mr. Tubbs explained the developments leading up to the engagement of Texas-based consultants Hopkins & Associates to embark on a major research study on the future of the agricultural-banking industry.

A good portion of one general session was devoted to an explanation of the future prospects of agriculture according to scenarios developed by the Hopkins firm based on differing versions of the forthcoming farm bill as envisioned by both Congress and President Reagan. Neither scenario bodes well for agriculture or ag bankers, according to the consulting firm.

Bankers in attendance were asked to fill out a comprehensive questionnaire that will enable the Hopkins firm to assess existing and future trends in agriculture and agricultural finance.

Speaking to the issue of rehabilitating the Farm Credit System, the ABA's Mr. Olson, who is president, Security State, Fergus Falls, Minn., reiterated the ABA's policy pertaining to the FCS. It's a given, he said, that the FCS must not be permitted to go under. Too many banks hold FCS bonds and the FCS holds too much of the real estate underlying commercial

ABA Pres.-Elect Mark W. Olson (c.), pres., Security State, Fergus Falls, Minn., is flanked at Ag Conference by Michael E. Fitch (l.), ag-div. ch., and v.p., Wells Fargo, San Francisco; and Jack Harmon (r.) of ABA staff.



Frank W. Naylor Jr. (l.), representing U. S. Agriculture Dept., appeared at "Restructuring Agriculture" session during ABA National Ag Bankers Conference. With Mr. Naylor are Alan R. Tubbs (c.), pres., First Central State, DeWitt, Ia., and Michael D. Boehlje, ag consultant from University of Minn., St. Paul.

bank loans for such an event to be permitted.

"We support the survival of the FCS but strongly believe that whatever actions are taken to shore the system up must be taken with three fundamental principles in mind," he said.

• "Policymakers must consider the future role of the FCS in agricultural finance. Long-term solutions must not be obscured by short-term demands. Propping up the FCS now should not be taken as a sign of greater reliance on governmental and quasi governmental agricultural lenders in the future. The ABA believes the future needs of the agricultural economy can be met only with a greater reliance on private lenders.

• "Assistance to the FCS should be offered only if adequate regulatory safeguards are put in place. The FCS needs desperately to put its own management house in order. It must be subject to independent audits, carefully defined capital requirements and prudent and standard internal practices to assure soundness. The system would benefit from a strong independent regulatory agency such as the FDIC.

• "There must be quality of treatment of agricultural borrowers. Commercial-bank borrowers must not be discriminated against."

This last point is the keystone of the ABA's support of aid to the FCS.

Mr. Olson called for "rural American common sense" to solve the ag crisis. He also called for a balanced budget and retaining the loan-loss reserve in the tax bill.

The FCA's Mr. Duncan called for "something to be done" to make the adjustment going on in agriculture less painful.

His agency favors the following proposals for the FCS in addition to any monetary aid:

• Enhanced enforcement capabilities for the FCA, including intermediate enforcement powers such as cease-and-desist orders, authority to suspend directors, etc. He also favors resumption of direct examinations at FCS affiliates to ensure safety and soundness.

• The FCS should make full use of its own resources through the Farm Credit Capital Corp. through a $5 billion revolving line of credit that comes available only after the FCS has utilized its own reserves. This provision will ensure that the FCS deals with its problems before going to the government for aid.

He said commercial bankers have a stake in the survival of the FCS since they are the largest single group of investors in FCS bonds, they provide lines of credit to FCS affiliates and lend to Federal Land Banks in structuring loan packages.

One of Undersecretary Naylor's themes was that the FCS would be in much better shape today if it were managed more prudently. The Reagan administration favors a policy that requires the FCS to marshal its reserves and use them to deal with its problems. Only then would the administration be willing to consider any bail-out aid, he said.

During a workshop on restructuring agriculture, Mr. Naylor said a veto of any farm bill is likely and a veto may be the only way Congress can deal with the impasse it is in. Everyone wants to avoid a veto, but Congress doesn't have the ability to satisfy everyone right now, he said.

If a farm bill doesn't make it this year, it will be a long time — Spring at least — before a new attempt is made to pass legislation. He termed 1986 the most difficult credit lending year of the last several years.

Speaking to the FCS legislation, Mr. Naylor said there is much disagreement as to the type of assistance that should be granted. Federal intervention is seen as inadequate to help the financial-stress situation. Also, it's difficult to make an accurate assessment of the problem. The FCS is disorganized and its records are not consistent. It can't get its arms around the problem, he added.

He said the FCS needs the authority to use its own surpluses. The system has capital and assets that are higher than those most banks have, he added.

He said access to financial markets is more important than government guarantees. But this access is becoming difficult because of the gloomy statements about the FCS being made by its own people.

The conference atmosphere was not one of gloom and doom, but there were noticeable differences from previous meetings: Attendance was down, with some states being represented by just handfuls of their bankers; there was only one exhibitor, whereas previous conferences featured exhibit halls (the ABA expects to have an exhibit area next year); and consultants/economists were more visible than usual.

Conference Chairman Michael E. Fitch, vice president, Wells Fargo Bank, San Francisco, managed to appear optimistic about the future of ag banking. "We have survived difficult times and we will solve our current problems and grow stronger as a result," he said. • •

Dealing With Examiners

Bankers learn how regulators regulate and how legislators legislate at ABA sessions

By Jim Fabian
Senior Editor

INSIGHTS for bankers into the regulation and legislative arenas were provided bankers attending two of the many concurrent sessions conducted during the ABA National Agricultural Bankers Conference in Dallas last month. One covered dealing with bank examiners, the other focused on the congressional staff perspective regarding current political issues in agriculture.

The bank-examiner panel featured John Ryan, former director of banking supervision for the Federal Reserve System, and Dave Meadows, FDIC associate director responsible for bank supervision and failing banks. The panel was moderated by Ron R. Poor, president, City Bank, Moberly, Mo.

Mr. Ryan, who now is a bank/financial consultant, spoke to the issue of bankers facing enforcement actions by regulators. He listed the three types of actions taken by examiners in their efforts to get banks to shape up, namely memos of understanding, which can be issued on either an informal or formal basis since they have no statutory support; letters of agreement, which cover more serious offenses; and cease-and-desist orders, which cover the most urgent infractions. All three differ little in their intent; but the pressure for bankers to comply is greatest under cease and desist.

Regulators issue such actions because they want banks to do one or more of the following, Mr. Ryan said:

- Either prohibit dividend payments or reduce them to a figure based on an earnings formula. Reducing the dividend usually is the best course to take.
- Develop a capital-improvement plan. Agencies will state the minimum amount to be raised over a period of time. It takes innovative thinking to raise capital under today's conditions, but this route generally is favored over the alternative, which is to reduce assets.
- Review the adequacy of the bank's loan-loss reserve and bring it up to a level that's acceptable to regulators. Bankers also should review their loan portfolios with a critical eye and make sure actions are documented.
- Review credit lines to directors. Those with loans that exceed the bank's legal loan limit will find these loans being classified and the directors asked to resign as well as ante up the funds to pay the bank back. One way to avoid such situations would be to move such loans to another bank.
- Banks with high volumes of classified loans must reduce them or devise a plan to deal with each major classified loan.

If management is inadequate to take proper action, regulators could require the institution to hire a replacement for the CEO, Mr. Ryan said.

He advised bankers to deal with issues of this nature before being forced to by regulators. He also advised bankers to negotiate the terms of regulatory actions against their banks.

"Avoid signing an agreement you can't fulfill," he said. "In most cases, regulators will be realistic and will listen to well-thought-out arguments."

Regulators' first concern is for safe and sound banks, the FDIC's Mr. Meadows said. He advised bankers to be knowledgeable about their borrowers. Examiners look for evidence of this in the form of loan documentation.

Bankers can make examinations go smoother by providing examiners with adequate space that's away from public view and out of employee earshot, he said. The bank also should provide examiners with a list of key personnel they may need to contact during the examination.

Panelists at dealing-with-examiners session at ABA ag conference were, from l., John Ryan, representing the Fed's viewpoint, and Dave Meadows from the FDIC. At r. is Ron R. Poor, pres., City Bank, Moberly, Mo., panel moderator.

Examiners must explain their comments and/or criticisms, Mr. Meadows said. But it's up to bankers to make sure they understand examiners' remarks. And it's up to bankers to take whatever actions are necessary to correct deficiencies during an examination.

"Don't wait for the report to arrive before taking remedial action," he advised. "Waiting is a big mistake. The bank's manager should make it a point to find out what criticisms examiners have before the next board meeting."

Questions from the floor dealt with the following topics:

- Getting rid of undesirable directors. The FDIC does not get involved in such matters, according to Mr. Meadows, unless there are grounds for removal under FDIC statutes. The board should have authority as to which directors continue to serve. The FDIC is interested in what develops.

Mr. Ryan advised the adoption of a general policy covering director behavior so that directors not observing the policy can be asked to resign. Such a policy should be in the bank's bylaws, he added.

• Procedure for termination of FDIC insurance. When such a drastic step is imminent, banks generally are given from 20 to 120 days to restore themselves to a safe and sound condition, Mr. Meadows said. The requirement usually involves raising additional capital. Compliance is assessed by an examination and, if the FDIC is not satisfied with the results, it calls for a hearing before an administrative law judge. After the judge makes a decision, the FDIC board decides whether to proceed with the action. Should deposit insurance be terminated, the affected bank is required to tell its depositors that new deposits won't be insured. In most cases, the bank either merges with another bank, fails or recapitalizes before insurance termination takes place.

• The possibility of negotiating a memo of understanding or a cease-and-desist order. In most cases, these actions are negotiated, Mr. Meadows said. The FDIC operates from the premise that the action should be one that both the bank and the agency can live with. But there is room for negotiation, which often is undertaken before a document is signed.

Bankers were cautioned to have well-documented arguments when they negotiate. They should not hold the attitude that they won't receive a fair audience with the agency; thus, they needn't make the effort to develop well-thought-out arguments. They never should tell regulators they can't live with the terms of an action without being able to explain why, Mr. Ryan said.

• Procedure for closing a branch. Neither the FDIC nor the Fed regulates branch closings, but the agencies want to be informed when such action occurs. It would be well for management to be mindful of the provisions of the Community Reinvestment Act (CRA) when considering closing a branch, Mr. Ryan said, especially if the branch is in an area in which there would be no banking services without the branch. Under the CRA, individuals could make it difficult for the bank to open a branch somewhere else if they felt the branch closing resulted in a hardship to those who had patronized the branch.

Both panelists agreed that there may be a need to combine the FDIC and the FSLIC deposit-insurance funds at some point in the future, but that there is little pressure to do so at this time.

Moderator Poor gave credit to regulatory agencies for making banking such a desirable business that all sorts of other businesses want to become banks. Banking has a unique ingredient going for it, he added: The independent system of regulators that provides confidence to its customers.

Political-Issues Session

The political-issues session dealt with the procedure for getting legislation through Congress. Panelists included Gregg Frazier from the staff of Rep. Dan Glickman (D.,Kan.), Allan Ott from the staff of Sen. Nancy Kassebaum (R.,Kan.) and Jim Webster, former chief clerk of the Senate committee on agriculture.

Mr. Frazier told of the difficulty he has had in correcting the problems of the 1981 farm bill in new legislation for this year. Work was started in 1982, but progress has been slow due to the peculiar position facing Kansas legislators because of the seriousness of the farm crisis in that state, strong political pressures supporting various interests in agriculture, limiting budget restraints and the difficulty of satisfying various groups of constituents.

Mr. Ott reported that it's difficult for Sen. Kassebaum to get anything accomplished in the ag area because she's not on the agriculture committee. She has to be content to try to influence key committee members, but can't do much until a bill gets out of committee and onto the Senate floor, at which time amendments can be made. Kansas ag interests are demanding amendments, some of which the senator doesn't support, he said.

Mr. Webster said the 1985 Farm Bill should be called the Ag Economists' Full-Employment Bill! He added that the realities of politics played a role in the issue: The administration took itself out of the picture by submitting an unacceptable proposal that Congress was forced to reject because it was considered deadly to the tenure of congressmen. He said the social and economic aspects of the ag situation must be separated before any progress can be made.

Moderator Floyd Stones, ABA legislative representative, reminded bankers that many issues in the ag sector are beyond the control of congressional committees and that congressmen not on the ag committee have little influence in the creation of an ag bill. Their only recourse is to vote "no" if a bill doesn't reflect the wishes of their constituency. Another important point: Urban congressmen are not beholden to agricultural interests and they now are in the majority in Congress. Still another obstacle: the farm situation ecompasses an area that's larger than that over which the ag committees hold jurisdiction.

The mindset for the last 50 years was "What's good for the family farm is good for farming in general." This no longer is the case, Mr. Stoner said. Family farms are no longer viable in most cases, but legislators and the administration haven't yet recognized this fact. Their efforts to preserve the family farm are not necessarily beneficial for agriculture as a whole. • •

Legislative staffers Alan Ott (l.) and Gregg Frazier (3rd from l.) flank Harold Stones, e.v.p., Kansas Bankers Assn., at reception given by KBA at ABA ag conference. At r. is James Darrah, ch./pres./CEO, Chapman (Kan.) State, who is KBA's ag task-force ch. Messrs. Ott and Frazier spoke at congressional staff-perspective session during conference.

Essentials of BANK CONSUMER LEASING

Consumer leasing is a growing, lucrative market for banks. A new book tells why your bank should be involved and how to get started.

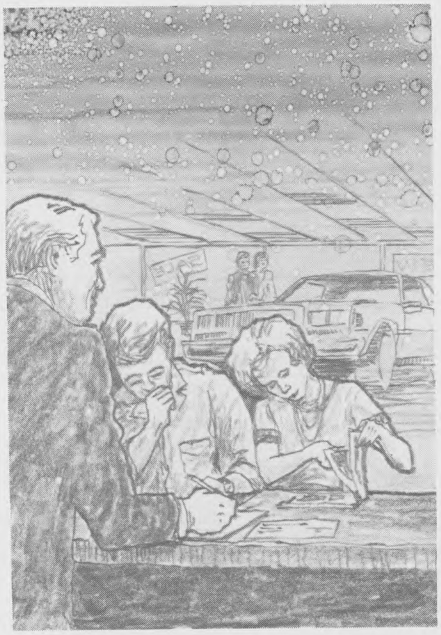
By Ronald S. Loshin and Randall R. McCathren
Bank Lease Consultants, Inc.

WHEN the first bank leasing programs began in 1964, direct leasing was the only type offered.

In direct leasing, the bank offers vehicle leasing directly to its customers and obtains the desired vehicle at fleet cost from a dealer, thereby earning the vehicle price markup. Although each lease could be highly profitable, volume was difficult to build because dealers had advantages in soliciting leasing customers. To address this problem, indirect leasing through automotive dealers was developed. Banks had two important advantages over dealers engaged in direct leasing: lower cost of funds and expertise in administering periodic consumer-loan payments efficiently.

These assets could be capitalized on in the consumer-leasing market, particularly by banks that could convince new car dealers of the mutual advantages of indirect leasing. A great deal of commercial credit for vehicle flooring was provided by banks to dealerships in their area; and finance acceptance programs were common. Since the dealers represent the first customer contact and banks had strong relationships with dealers, indirect leasing — wherein the dealer leases the vehicle and then sells lease contracts to the bank in return for his sales price — was a natural progression.

Banks offering direct leasing soon recognized the advantages of indirect leasing. Most important, they realized that volume potential could be enhanced greatly. Although there was less gross profit in individual transactions since the bank had to share profit with the dealer, greater volume and lower per-unit administrative costs produced much larger overall leasing profits. Since the bank bore the lessor risks under a direct-leasing program, it was a relatively easy decision for the bank to purchase lease assets without recourse to the dealer so long as the bank controlled credit approval, program specifications and program administration.



Banks Slow to Move. Although some banks have developed aggressive and creative leasing programs, most have not pursued consumer leasing, even in their established markets. Commercial banks traditionally have supported the growth of leasing by extending lines of credit to dealers and independent leasing companies engaged in retail leasing operations. The great increase in leasing tax benefits beginning in 1981 and the decline in the market importance of independent leasing companies has led many banks to prefer their own leasing programs over lease line financing.

Bank interest in consumer leasing has been stimulated largely by the favorable tax benefits of leasing. The Economic Recovery Tax Act of 1981 (ERTA) tripled the effective tax benefits of leasing for banks. Institutions with tax liability could earn greater yields from consumer leasing than from almost any other alternative investment. Other banks with active dealer-finance programs have moved into leasing to protect their dealer relationships. With their natural market advantage as full-service financial institutions, banks have gained significant market penetration and extensive profits from consumer lease financing.

For banks with tax liability, gross yields are extremely attractive. The tax benefits of leasing typically contribute 1,000 basis points to pretax tax-book yield and more than 500 basis

PITFALLS TO AVOID IN STARTING A LEASING PROGRAM

THE AUTHORS recommend conducting a feasibility study to determine whether the bank should get involved in leasing based on market potential and management commitment to the project. Once a study of the competition and the market scope is concluded, a tentative leasing program should be outlined that will serve as the bank's blueprint for subsequent financial analysis and projections.

A feasibility study is most important when a bank is considering a large-scale consumer-leasing program; i.e., large in terms of its absolute size or its size relative to total assets or to the lending program. If the bank plans for the program to capture a significant market share or provide a primary income source, a full feasibility study is needed. The purpose of the study is to determine whether the intended resource commitment and resultant revenue return is realistic in light of market realities.

If a bank is primarily interested in offering consumer leasing as a necessary adjunct to its existing dealer-finance products or to generate modest tax benefits without seeking a prominent position in the leasing market, an exhaustive and expensive feasibility study may be unnecessary. The bank should limit the feasibility study to the analysis needed to show that a profitable program can be initiated or that it cannot. If it can, the bank can then proceed to the implementation tasks.

According to Messrs. Loshin and McCathren, the "period between the decision to initiate a new consumer leasing program and the commencement is devoted to hectic planning, usually with a large dose of trepidation. . . . While no set of planning formulae ensure success, some general principles and caveats deserve discussion." Among their recommended pitfalls to avoid:

Do not undercut credit standards. Lease financing does not have a margin for credit errors. They simply are too expensive. No one likes to turn away business; however, for a very good reason, the established leasing firms have evolved firm credit standards. . . . At program inception, high standards with few exceptions should be the policy.

Do not set higher residual values. Here again, adherence to industry convention is a good starting point for setting residual values. This conservative approach will be reinforced by residual-value insurance programs if full coverage is sought. The current downward trend in used-car prices due to low new-car inflation and greater foreign competition requires greater caution for programs without full coverage residual insurance.

Do not begin with large volume. A new leasing program will tax management and staff to the fullest — even experienced staff recruited from another program. Every program has a "shake-down" period in which the design, use and integration of the major program components are tested. . . . A sustainable, consistent high quality of service should be the limiting factor for program growth. A bank program should control its expansion rate rather than having it determined by demand.

Do not select staff hastily. A lease-program manager must have many skills which extend beyond conventional banking. In a direct program, the ability to sell and to manage a sales effort is necessary.

In an indirect program, familiarity with the retail automobile industry in addition to sales experience, knowledge of banking practices, the ability to work within banking policies without comprising innovation, the ability to make and implement decisions quickly and the capability to work with senior bank management on special policies and technical matters for the leasing program also are required. . . . Recruiting a top-notch business manager who understands how to run the retail leasing division as a profit center can be the single most important step senior bank management can make in establishing the bank's program.

Do not promise permanently low lease rates. A bank may wish to launch a program with low, attractive lease rates. However, since a bank cannot forecast its long-term rate structure, it should not promise permanently low lease rates.

Do not rush into buying a lease-accounting system. Selection of a lease-accounting system or service bureau should be done in a relaxed, deliberate manner. A mainframe system should not be selected without careful review of new mini-computer and micro-computer alternatives. Selection of a data-processing system should follow program design, not precede it.

Do not copy lease documentation verbatim. While the lease documentation of other programs is a good guide and can provide suitable language in some instances, it never should be copied exactly. First, different state legal requirements will mandate different responses, particularly if program policies vary. Second, the documentation contains a balancing of risks and benefits idiosyncratic to the institution based on its program policies. . . . Expert counsel should review all forms, particularly the lease agreement, before any documentation adapted from another institution is used.

Do not let tax counsel dictate uncompetitive terms without an outside review. Leasing is a sufficiently specialized legal field and bank tax counsel may be inclined toward conservative approaches if not familiar with the history and practices of bank leasing. Counsel's views should not be accepted to force a program to include uncompetitive elements or policies until an outside review by expert counsel has been obtained.

Although the Consumer Bankers Association 1984 Survey convered only a limited number of banks engaged in leasing, it is indicative of the concentration of leasing on the West and East coasts.

NATIONAL DISTRIBUTION OF BANK CONSUMER LEASING (1984)

Region	Number of Banks	Ave. Number of Leases	Percent of Total Leases	Average Lease Balance (MM)	Percent of Total Lease Assets
Western	12	11752	52.8%	166.8	55.6%
Rocky Mountain	2	3540	2.7%	36.2	2.0%
Midwest	3	2057	2.3%	29.0	2.4%
Mideast	15	3914	22.0%	40.5	16.9%
Eastern	27	2001	20.2%	30.9	23.2%
TOTAL	**59**	**4526***	**100.0%**	**61.1***	**100.0%**

*Weighted Average
Source: Consumer Bankers Association, *1984 Survey of Bank Automobile Leasing.*

points to the pretax finance-book yield. Leasing also usually includes a non-interest-bearing security deposit, an acquisition fee and a purchase or disposition fee, which further increase the yield.

The following are typical gross pretax yields for a bank with a 46% tax rate showing the incremental increase as each lease yield component is added.

Lease Component	Tax Book Yield	Finance Book Yield
Base Yield	11.39%	11.39%
Yield w. Acquisition Fee	11.84%	11.84%
Yield w. Disposition Fee	12.02%	12.02%
Yield w. Security Deposit	12.57%	12.36%
Yield w. ITC	17.69%	16.11%
Yield w. ACRS	23.12%	18.05%

The Accelerated Cost-Recovery System (ACRS) tax benefits are worth much more for leases beginning the end of the tax year, so competitive base rates often drop at the end of the year.

Emergence of dealer tax-benefit leasing. Pioneered by BancOne of Ohio, a new form of limited-recourse leasing is beginning to emerge across the country. Known by a variety of names, "dealer-tax leasing" seems an appropriate title for this new type of hybrid financing which has characteristics of both nonrecourse leasing and lease-line financing. The dealer initiates the lease and the bank services it; however, the dealer remains the lessor for legal purposes and retains sufficient credit and residual risks to be the vehicle owner for tax purposes, entitling him to the Investment Tax Credit (ITC) and ACRS deductions.

This gives the dealer the central benefits of lease-line financing without the main disadvantages since the bank: (1) advances the whole capitalized costs, (2) accepts the primary credit risk; and (3) performs all servicing functions. As this type of product is standardized and becomes available around the country, dealers and independent leasing companies across the country may begin to shift a portion of their leasing to dealer-tax leasing since they get the leasing-tax benefits without the negative cash flow, credit risk and administrative burden of lease-line financing.

Other attractions of consumer leasing: In addition to the tax benefits, banks are attracted to leasing because more installment credit is extended on a lease transaction than on a new car loan. A lease combines a larger initial funding outlay with a balloon-payment transaction resulting in a lower repayment or amortization rate than offered on a loan.

In essence, the bank makes two investments: a term investment for the residual value of the vehicle (repaid by the return of the vehicle or a balloon payment repurchase) and a simple-interest declining-balance investment for the expected depreciation of the vehicle. The lower down payment and reduced monthly payment result in a higher average balance. Also, leased vehicles, as a group, are higher priced than purchased vehicles, which further raises the average outstanding balance. Since a lease allows a bank to extend more credit per transaction, more income is generated. Many banks find that the average lease balance per transaction is twice the average loan balance over the course of the transaction.

Leasing can be conducted in states outside the bank's state of origin through various bank structures. Moreover, banks have found that they can effectively manage an out-of-state leasing operation. The limited number of banks currently engaged in this activity invite experienced banks to attempt to gain a foothold in new geographic markets. • •

Tax Reforms Going Way of Compromise, Say Leasing Experts Loshin, McCathren

CURRENT tax-reform efforts may succeed in diminishing the ITC benefits that make leasing operations so attractive to banks, but neither Ron Loshin nor his partner Randall McCathren foresee much likelihood that those tax benefits would be reduced to the point that banks would abandon the leasing market.

All proposed tax reforms seem to be going the way of compromise, says Mr. Loshin, and he expects the debate over ITCs to go the same route. In the end, he says, tax benefits will be sufficient to maintain leasing as a profitable product.

What may happen is that the differences in the tax treatment of lease financing and balloon-loan financing with a buy-back provision could erode to the point that the two products are indistinguishable, according to Mr. Loshin. Both products embody those characteristics that consumers find so attractive, he says: low monthly payments, 100% financing and a provision to return the vehicle. Mr. Loshin even proposes a generic term to cover any financing product with those characteristics: leveraged finance.

Mr. McCathren says, however, that balloon-loan financing with a buy-back provision has some conceptual problems from the bank's perspective that has caused some institutions to rethink their approach to the product. The buy-back provision makes the product much more difficult to administer and could create numerous headaches for the bank.

Under the buy-back provision, the consumer owner can return the vehicle to the bank, which is obligated to repurchase it. Serious conflicts can arise over what the residual value of the vehicle is when the customer tries to return it. The bank and the insurance company that guaranteed the loan could, like most buyers of automobiles, "see more deficiencies than the seller does." If the bank values the customer relationship enough to give the customer more for the vehicle than the insurance company thinks its worth, it could get into a legal wrangle with the insurance company.

"The conventional balloon loan makes more sense for banks," says Mr. Loshin.

Both men expect lease financing to grow. Mr. McCathren points out that tax-reform efforts could create tax incentives for consumers to lease rather than buy. For example, if tax-simplification efforts cause fewer taxpayers to itemize, interest deductions no longer have any value for consumers who take that route. In a lease-versus-finance analysis, says Mr. McCathren, many consumers will notice that, absent interest deductions, financing is less attractive than leasing.

Nor does Mr. McCathren expect that the psychological benefits of ownership will continue to deter some consumers from leasing. Older consumers may still cling to the psychological benefits of ownership, but younger consumers consider the purchase of an automobile an investment. They realize that automobiles generally depreciate in value while real estate appreciates, he says.

Given a choice between investing in real estate or an automobile, most of them can see that they are better off owning real estate and leasing their cars. ● ●

Balloon-Loan Financing as Alternative to Leasing

BALLOON-loan financing is an attractive adjunct or alternative product to consumer leasing programs for banks.

For institutions that cannot use the tax benefits of leasing, balloon-loan financing may offer higher yields than leasing. If a tax-reform consensus is reached to eliminate the ITC and reduce ACRS benefits, the attractiveness of balloon-loan financing to financial institutions would be greatly increased. Balloon-loan financing is attractive to many customers because it combines many of the desired leasing and purchasing attributes. One major California bank has heavily advertised the balloon loan as the "lease-alike loan" and has achieved great success.

While having the reduced down payment and lower monthly payment benefit of leasing, balloon-loan financing retains the economic and psychological benefits of ownership wanted by many business and consumer customers. As the tax owner, the customer can deduct the finance portion of the monthly payment as interest expense. If the customer uses the vehicle primarily for business, he also can claim the ITC and ACRS (for his percentage of business use).

Because of these customer benefits, a balloon-loan-financing program usually can sustain a higher interest rate than a conventional loan program, usually 1-2% higher. With the higher interest rate and larger average loan balance than conventional financing, balloon financing can be a popular and profitable product in any part of the country for any size bank.

Because balloon financing risks-larger losses on default than conventional lending, higher credit standards are required that are more equivalent to leasing. A balloon-loan program does not involve most of the complexities of leasing, which can be intimidating for smaller institutions. Thus, balloon financing can be a comfortable product for any size institution to initiate and administer. Among other obvious benefits, no special accounting system is required.

A balloon-loan program can be marketed in conjunction with consumer leasing or even as a lead product among an array of auto-finance options. In conjunction with leasing, the balloon loan is an attractive alternative to some customers, particularly if the down-payment requirement is not too high or the customer has a trade-in vehicle to offset the payment. A finance-versus-lease comparison could be made available to the customer so the full impact of his decision on the acquisition financing can be presented to him. This can be done in either a direct or indirect program.

This customer-oriented approach to financing should be a strong plus for any bank wishing to establish a reputation for helpfulness and competence with its direct banking customers. ● ●

Sound Collateral/Residual Strategies

Improved collateral identification for commercial loans helps determine lending risk

By Terry J. Winders

FOR MANY YEARS, the equipment-leasing industry has had to deal with the risk of equipment values as a natural phenomenon of pricing the equipment lease. The current trend for all banks to enter the equipment-leasing industry and the training for equipment issues has supported an improvement in collateral identification for commercial loans and helps determine the risk in lending.

Guidebooks, vendors and manufacturers generally do an excellent job of establishing the price for a new piece of equipment. However, when a customer requests a lease or a loan, the bank has to deal with determining the value of the asset in question over the period that the obligation is in force. Too often, banks yield to guidebooks and guessing to determine the actual value of the asset and, in some rare cases, do not even look at that value when trying to determine the risk factor in extending the credit request. Asset/collateral management is a key factor if losses are to be kept at a minimum and the true risk of extending the credit is assessed.

Most lessors and banks equate residual assumptions in equipment leases at projected fair-market value (FMV) and typically express them as a percentage of the equipment's original cost. In reality, the residual assumption is a number refined from what one expects the equipment's future value to be, taking into account the selling costs that will affect actual value received. It is immaterial as to whether a leased asset or a collateral repossession forces the bank into a mode of having to remarket the equipment.

Banks historically have been poor marketers of equipment and, generally speaking, did not consider selling cost when establishing its assumed collateral or residual value.

Selling costs that come to bear should the lessee return the equipment or should the equipment be repossessed include insurance, transportation, preparation, storage costs, advertising, technical costs and any commissions that must be paid to remarket the equipment; not to mention the time it takes you or your staff to effectively organize the equipment's disposal.

At lease termination or on repossession, the customer's responsibility to insure the equipment expires. In order to prevent loss due to theft, vandalism, property damage or personal injury, it is necessary to provide your own coverage in the proper amounts on possession of the equipment.

In an equipment-lease contract, the language in most cases requires that the lessee return the equipment to the lessor. However, instances can arise requiring that it be transported from one place to another. Many contract haulers are in business to provide this service and they are paid handsomely for their time. A quick check into what these costs can be can save much grief at a later date. This applies to the cost of repossession as much as it does to the cost of receiving a leased asset at termination.

Distance also is an issue, perhaps not in the sense that the equipment is in immediate proximity to your operation; but from a business-climate standpoint. Even though lease agreements call for return of the equipment to the lessor at the lessee's expense (or in the case of a repossession, at the bank's expense), you may not be in the right market area to allow its resale in a timely manner. Distance creates costs; increased phone costs, advertising cost, storage, insurance and what not; as well as the logistical problems of restricted selling capacity and restricted selling effort. You should not discover at lease termination or repossession that this particular customer is the only one who has use for the equipment in a 1,000-mile radius. You must determine before the fact where the equipment's prospective market is and, if it is different from your location, cost must be assessed and collateral value or residual assumption reduced accordingly.

Preparation costs, although generally to be avoided, sometimes are necessary in order to make the equipment more attractive to prospective buyers.

Storage costs are determined by the type of equipment to be stored. The cost for storage facilities can be as much as $10 per day.

Advertising cost must be closely examined because, depending on the type of publication used, it can run into the thousands of dollars.

Technical costs and commissions are those costs that must be paid to dispose of unfamiliar or highly unusual equipment. In these cases, it sometimes is best to determine at the outset that an outside organization should be used for equipment disposal in order to maximize return.

Time is required to complete the marketing exercise. Allowances should be made in advance to account for the time you are required to spend to dispose of used equipment. Disposal times for nontechnical equipment such as a forklift or a dump truck can be

Mr. Winders is president, First Lease & Equipment Consulting Corp., Louisville. His 20 years' experience in equipment leasing includes major leverage-lease transactions and his 15 years' experience in banking includes knowledge of all phases of bank leasing and marketing.

30-60 days. However, unusual or highly technical equipment such as a machine center or a scanning electron microscope can require six months or more. These disposal times must be realistically assessed, their time value determined and the residual assumption and/or the collateral value reduced accordingly.

Utilizing Selling-Costs Analysis

You will find that the largest impact on selling costs stems from what kind of equipment is involved and how long it will take to dispose of that equipment after repossession or lease termination. To illustrate, let us examine the forklift and the electron microscope which, over an identical term, have similar projected fair-market values, but radically different residual assumptions. This example, while demonstrating the exercise a leasing company must go through to determine residual values, has a great deal of importance in a commercial-loan situation.

Selling cost may be difficult to assess, but it is easy to realize that you will have less trouble disposing of multiple-use equipment in a large community than special-use equipment in a small community.

Let us say that your customer has elected to either lease or borrow money and, after a close investigation, it has been determined that at the end of the loan or lease the equipment will still maintain 25% of its original value. In a commercial loan, this would appear to be a safe risk. In an equipment lease, it would appear that a 25% residual assumption would be in order. After closer review, however, it is determined that the forklift has in fact a residual assumption of 20.5% and the microscope an assumed value of only 12.5%.

Let us examine the reasons for the difference in the recommended residual assumptions.

In the case of the forklift, research indicates that the secondary market is strong. The equipment is durable; it suffers little from technical maturity; vendor contacts are good; and in the worst case, 60 days would be required to dispose of it. Therefore, we have a limited exposure to selling cost.

The microscope, on the other hand, has a limited secondary value: technology has advanced rapidly over the years; likely by lease-end or on repossession the only interested parties would be small colleges, hospitals or perhaps a wholesaler specializing in used lab equipment. This equipment would require six months' disposal time, so your exposure to selling cost is greatly magnified. That is to say, the cost for insurance, storage, advertising, time involved, commissions and so on is less for two months than for six months.

You can see that in order to project selling costs, factors must be converted from percentages to actual numbers. Both one-time and recurring costs are involved. These must be totaled, subtracted from the then fair-market value and reconverted to expressed percentages of original cost to be used as a residual assumption or collateral value.

You also can see from the chart how different types of equipment (i.e., the forklift in one case and the microscope in the other) have brought different selling costs to bear. True enough, I have manufactured these two examples for the sake of this article; however, the costs illustrated have come from experience in dealing with different types of equipment at lease termination and these costs are real. These exercises also help to demonstrate the wisdom of taking little or no assumptions on transactions of $25,000 or less, because any proceeds that one might hope to gain from the sale of equipment at lease-end can rapidly be eaten up in selling cost. It also puts in perspective the true collateral value on a loan.

The chart indicates the cost as it applies to both the forklift and the microscope. Even though the assumed value of the equipment at lease termination or at the end of the loan term was 25%, by the time we subtract the assumed selling cost in an equipment-lease transaction, a residual for the forklift would be in the neighborhood of 20%; but the residual for the microscope

Forklift Cost Analysis

	$ Amount	% of Total
Estimated Disposal Time (2 Mos)		
Original Cost	60,000.00	100
Projected Fair-Market Value	15,000.00	25
Cost Factors:		
Insurance (60 days)	148.00	.25
Transportation	100.00	.17
Preparation	250.00	.42
Storage (60 days @ $4.20 per day)	252.00	.42
Advertising (60 days)	450.00	.75
Commission ($15,000 @ 10%)	1,500.00	2.50
	2,700.00	4.51
Projected Fair-Market Value	15,000.00	25
Projected Selling Cost	2,700.00	−4.51
Rec. Assumption for Pricing: 20.5%	**12,300.00**	**20.49**

Microscope Selling-Cost Analysis

Estimated Disposal Time: (6 Mos)		
Original Cost	100,000.00	100
Projected Fair-Market Value	25,000.00	25
Cost Factors:		
Insurance (6 Months)	1,200.00	1.2
Transportation (Special Crating)	900.00	.9
Preparation (Clean & Recalibrate)	2,400.00	2.4
Storage (180 Days @ $5.50 per day)	990.00	.99
Phone (6 Mos. LD Vendor Contact)	450.00	.45
Advertising (Technical Pubs)	3,000.00	3.0
Technical Costs (Consultants)	1,100.00	1.1
Commission ($25,000 @ 10%)	2,500.00	2.5
	12,540.00	12.54
Projected Fair-Market Value	25,000.00	25
Projected Selling Cost	12,540.00	12.54
Rec. Assumption for Pricing: 12.5%	**12,460.00**	**12.46**

would be more apt to fall in the 10% area.

A close study of these costs should lead a commercial lender to question the collateral value of the two assets over the term of a loan. Also, while it may seem a paradox, the higher the value of the loan, generally speaking, if the collateral value also is high, selling costs as a percentage are reduced. The most difficult collateral or asset value is a transaction that is small to begin with, where the actual profit from making the loan or the lease does not warrant the exercise of making the collection calls or selling the repossessed equipment.

Additional Considerations

In an equipment lease, even though the chart indicates responsible residuals that should be taken, additional considerations are important to determine what residual assumption should be placed on the books for both pricing and negotiation with the customer at lease termination.

To illustrate, let's use the microscope transaction on which a 25% projected fair-market value has been determined and the equipment department has established a 12.5% recommended residual assumption. We know that, even though we expect its fair-market value to be 25% if not sold to the lessee, we would have to begin the marketing exercise and net all cost we actually would receive at 12.5% rather than 25%. If we first look at the sale option, we can see that we have a great motivation, in that we have demonstrated that it would take roughly half our expected proceeds to remarket the equipment. We therefore can offer the lessee a substantial savings by allowing him to purchase the equipment at 12.5%. This cannot be considered a nominal purchase option, in that the net of all expenses, 12.5%, is what we would have realized from the fair-market selling price of 25%.

If the lessee wishes to renew, the renewal option raises some issues unique unto itself. Let's assume that the original lease called for 60 payments with a payment factor of 2.10 and a yield requirement of 18%. And again, let's use the equipment department's 12.5% residual recommendation. If the customer renews, we cannot divide 12.5% evenly by 2.1. The 12.5% number is good only if it is received as the 61st payment. It does not account for the time value of money for the renewal term; so, we must view it in the sense that the lessee is borrowing our 12.5% for the requested renewal-term length. A more appropriate assumption would include a renewal residual easily divisible by the payment, including both the 18% original yield requirement and the time period requested.

In this case, let's assume that six months is a logical renewal term. Six times 2.1 (the payment factor) gives us 12.6, which is close to the equipment department's recommended assumption. We then discount the 12.6 by the 18% yield requirement for six months, which gives us 11.52.

If we book 11.52 as our residual assumption, we can offer the lessee a renewal at the same payment factor as the original term and be comfortable in the assumption that we have received the actual residual value we needed to get out whole.

Residual assumptions are an important part of almost every lease transaction. The importance lies in the correctness of the assumptions made. If you scrutinize equipment issues properly, you will find a few deals will be lost because some other individual was willing to take a higher residual.

I suggest that if you practice the procedures outlined in this article and make sound informed decisions, you will find yourself a hero five years down the road. ● ●

Business-Investment Gain To Duplicate '85 Figure

The aggregate gain in business investment in 1986 should be similar to the 3% advance projected for 1985 despite conflicting trends in various investment categories, says an economist at Continental Bank, Chicago.

"Because this gain is in line with the economy's trend rate of expansion, the impact of business investment next year should be indiscernible — neither pulling up nor dragging down the overall rate of economic advance," said Joan D. Schneider, a Continental vice president.

"This investment pace should keep productive capital growing in line with output, causing overall utilization rates to remain near current levels," she added.

"Consequently, investment should be sufficient to generate some advances in employment and incomes, helping to keep the economic expansion under way, yet not so strong as to prompt production bottlenecks or intensify inflationary pressures," Ms. Schneider said.

She predicted modest advance in equipment investment and said near-term investment gains will be limited by relatively low utilization rates, weak profit growth and anticipation of moderate economic activity next year.

"Real spending for commercial and industrial building in 1986 will be flat at best, reflecting diverse trends in the sector," she noted.

● **The Fed** has approved the application of Fourth Financial Corp., Wichita, Kan., to acquire First National, Topeka, Kan. Fourth Financial has deposits of $1.5 billion and First National, Topeka, has $320 million in deposits.

'We Contemplate No Changes' — II

In the final installment of his two-part article on post-merger management changes, Dr. Austin offers practical advice to the acquiring board and management.

By Dr. Douglas Austin
Chairman/Professor, Department of Finance,
University of Toledo

AS WE SAID in the first installment of this article, financial institutions have undergone the most expansive and volatile period in their history during the past 20 years, a period characterized by an escalation of mergers, consolidations and acquisitions.

These actions have brought substantial benefits to the industry, but have a negative by-product — the elimination of the staff whose functions are redundant once institutions merge. It's never easy for the board of the acquiring bank to perform this role, but it is necessary. Another important function the board must perform is ensuring that the competent and necessary staff of the acquired institution doesn't leave.

Most often, the failure to protect the target bank's employees is the fault of the acquired bank's board of directors at the time of specific agreement. Flippant though it may sound, bank boards often don't make provisions for their valued employees in negotiating a merger. After 20 years of experence in this field, I've come to that conclusion.

The board generally is concerned more about the price to be paid, the format of the price and other factors involved in consummating the deal than in employee retention. I don't mean this to be an indictment of bank boards. Of necessity, they must protect shareholder investment and, in some cases, that means employees' interests take a back seat.

Some boards attempt to gloss over this reality by accepting statements from the acquiring bank like "we contemplate no changes in personnel" and passing them along to employees at face value. Other boards insist that such statements be incorporated into the merger agreement, but go no further in protecting employees. A number of states have construed that statements similar to "we contemplate no changes in personnel" mean that employees have lifetime tenures and thus such statements should not be used in merger contracts. Of course, individual employees can be protected with employment contracts.

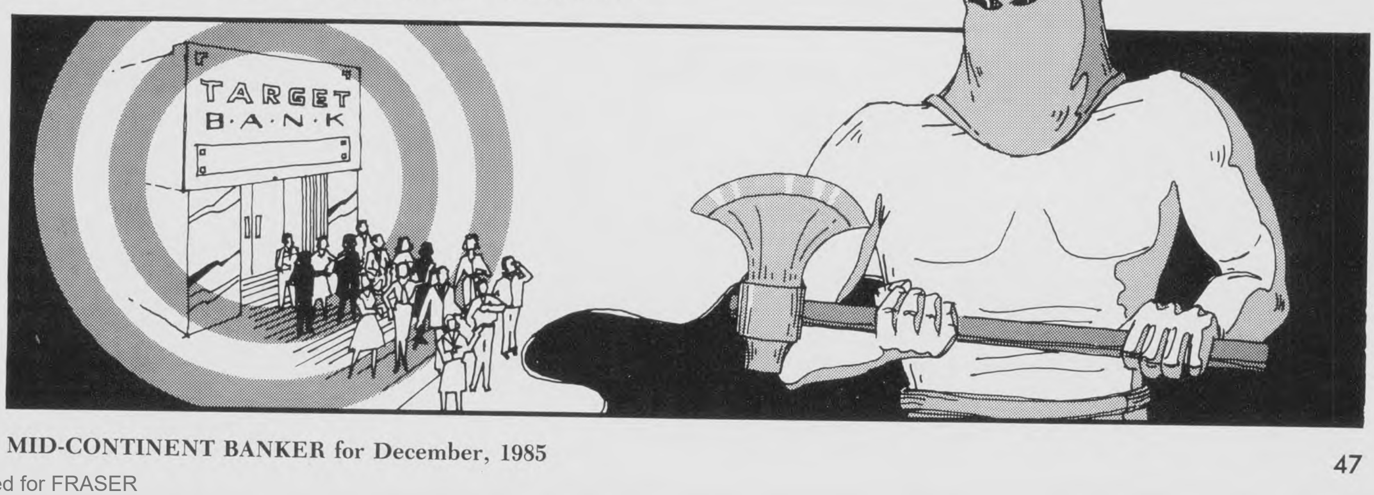
The Board's Responsibility

In any bank merger, the reality is that some employees will be terminated, others will be demoted and some may be promoted. The board cannot entirely avoid some personnel changes; however, it has a responsibility to protect employees it feels should be retained. In fact, employee retention should be an important part of the reorganization negotiations.

We're not speaking only about the CEO and senior management. Other dedicated, long-term, loyal employees who may be more vulnerable to employment risk than senior management also are the board's responsibility.

Nor are we concerned with "golden parachutes." We are talking about employment contracts at current wages for definite time periods for employees who have worked with considerable merit for the bank over many years. Some of these employees may not be officers, but they have demonstrated loyalty, meritoriousness and expertise and often are close to retirement. Younger employees could replace them at a lower

Employees of a target bank may view new management with alarm. They may feel that the acquiring bank plans wholesale personnel changes once the merger has been completed. Employment contracts can alleviate some of the fear and confusion.



wage, but the newcomers would not have similar depth of experience.

In a recent merger negotiation in which I was involved, four employees were protected by employment contracts, only one of whom was an officer. The others were employees with over 25 years of experience who were seven to 10 years from retirement. These employees were protected by simple employment agreements with the acquiring organization that guaranteed continued employment at a salary at least equal to their current salaries and in functional areas — determined by mutual agreement of the parties — somewhere in the acquiring organization's system.

These were not golden parachutes, but rather a continuation of similar employment. This kind of contract doesn't mean that the employees could not be fired if they were found to have jeopardized the safety and soundness of the bank. Rather, the contracts simply guaranteed the employees would have jobs until retirement as long as they continued to fulfill the new employer's reasonable expectations. The acquiring organization might consider such contracts a point of negotiation, but they are not prohibited by any law, regulation and/or banking-industry practice.

The Acquirer's Perspective

It may surprise you to know that in the past 10 years I have never encountered a situation in which the acquiring institution was unwilling to protect certain key employees of the selling organization. The acquiring organization realizes that once the acquisition is final, changes — sometimes wholesale changes — will be necessary. On the other hand, management of the acquiring bank recognizes that there are expert, efficient and qualified employees within the target institution who must be retained for the organization to function.

Personnel of the acquired bank are part of the assets that give value to the institution. Good bank employees are scarce, so the management and board of the acquiring institution usually are willing to listen to a reasonable argument for the retention of particular employees. In fact, since the management and board of the target bank theoretically know their employees better than anyone, they are in an excellent position to recommend which employees might have a role to play in the revamped organization.

Of course, some banks become acquisition targets because they are in financial difficulty and the employees may — deservedly or not — be considered something of a liability. In my experience, most bank mergers do not occur for this reason. Usually, the board of the acquired bank simply feels that selling to another bank is a better alternative than trying to remain competitive in today's highly turbulent banking climate. Regardless of the reason for the merger, every acquired bank has hidden assets in its employees and their worth should be evaluated before they are terminated.

> The bank board's responsibility is to protect valued employees

Employment Contracts

Although management of the acquiring institution often is willing to agree to protect certain people at the acquired bank, it may be reluctant to extend employment contracts, especially if none of its own people are protected by contracts. "Why them and not our people?" is a reasonable question, and my response would be, "Why not your people as well?"

Indeed, the acquiring bank can expect a groundswell of interest in employment contracts within its own organization if it extends employment contracts to personnel at the target bank. That's not necessarily a bad development, however. Employment contracts are one way of alleviating some of the fear and confusion created by any merger. They help lock in good and useful personnel and can shorten the consolidation phase of the merger. They present concrete evidence of the new management's intentions and are more likely to be believed than a vague "no changes" policy statement.

What About the Rest?

Once the merger has been completed, the reorganization set in motion and employees evaluated, new management will have the never-easy task of letting some employees go. There may be a natural tendency to get this phase of the merger over as quickly as possible, but the worst possible approach is to terminate employees in wholesale lots without regard for their — or the new organization's — future. Nothing will come back to haunt a bank faster in future merger negotiations than a reputation for insensitivity in handling post-merger terminations.

Assistance in job placement will be greatly appreciated by employees whose services no longer are needed and will help maintain morale of retained employees. Giving employees three to six months to find new employment will be another sign to retained employees and to the community at large that the bank values and respects people.

Since banking is a people business, that's not a bad reputation to have. ● ●

Win Through Negotiation Topic of ABA Videoclass

Increased competition, from changes in government regulations and the economic environment, has made the ability to negotiate an integral part of a banker's success, the ABA says.

"Win-Win Negotiations" is the title of an ABA Banctraining video tape that shows bankers how to use the power of negotiation by identifying issues, separating needs from solutions, communicating acceptance of the other's need, generating multiple solutions and choosing the best alternative.

"The strength of any bank depends to a large extent on the ability of its bankers to negotiate internally and externally," says T. Charles Bruere, president, First State, St. Charles, Mo., and newly appointed ABA Community Bankers Council chairman.

Negotiation tips emphasized in the videoclass include focus on the future, put the past behind you; speak only for yourself; separate evaluation from idea generation; encourage the other person to generate ideas; ask questions, don't make pronouncements; invite other's reactions; and under pressure, reemphasize a desire to meet both needs.

The video tape includes a discussion-leader's guide that contains information to enhance learning retention, an overview of the tape, discussion topics, pre- and post-tests and reproducible participant worksheets.

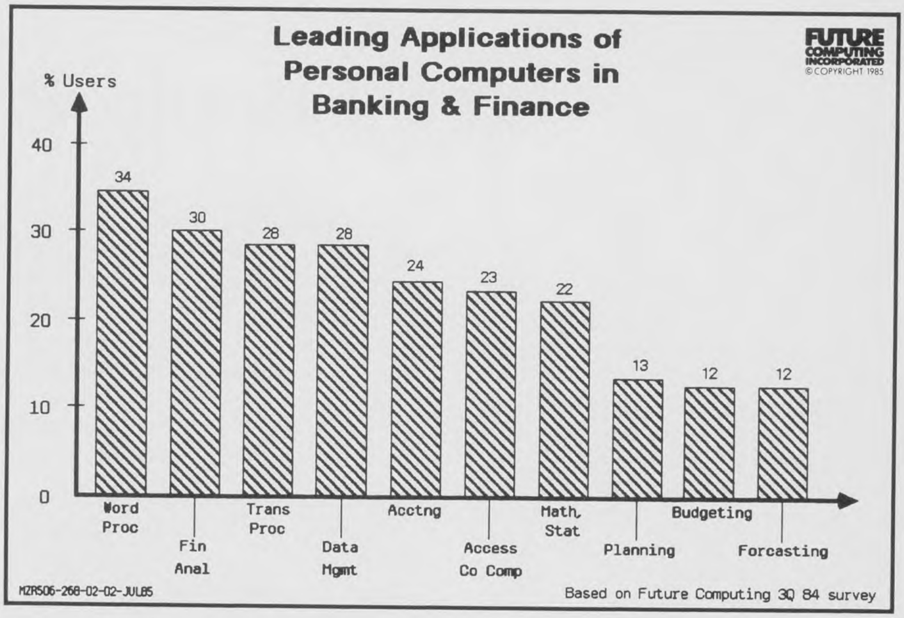
Information on purchasing or previewing the tape is available by calling the ABA at 1-800-247-0010. In Iowa call 1-800-622-0022.

● **Kathleen M. McShare** has been named director of marketing for MasterCard's corporate card. She formerly was a vice president/marketing for Citicorp Diners Club, Chicago. Prior to that, she was with American Express.

PC Holdouts, Your Days Are Numbered

Number of PCs in banking and finance to triple in next five years, study says

By John L. Cleveland
Editor/Associate Publisher



Study showed that word processing led other work categories in uses for PC in banking and finance. There were considerable differences in how PC was used when individual job classifications were considered, however. Bank managers put a high priority on financial analysis, accounting and mathematics/statistics.

ARE you among the computer phobes at your bank who still do not have a personal computer (PC) in your office? A newly released study indicates your days as a holdout in the computer revolution may be numbered.

The study, *Vertical Markets: Banking and Finance*, conducted by Future Computing, Inc., a Dallas-based market-research firm specializing in information on micro-computers, shows that, over the next five years, the installed base of personal computers in the banking/finance industry will increase threefold. According to the company's research, there were 640,000 micro-computers in the banking/finance field in 1984. By 1990, there will be 1.9 million units in place.

Banking and finance professionals are discovering in growing numbers that by reducing time spent on manual calculations, they can spend more time selling products and servicing customer's needs, Future Computing's Senior Analyst Laurie Windam told MID-CONTINENT BANKER. Competition is forcing bankers to use micro-computers. As in most industries, word processing accounts for the majority of personal computer use, says Ms. Windham, but the numbers differ depending on which bank occupation one happens to be considering.

It shouldn't come as any surprise to find, for example, that the majority of bank financial analysts use their PCs primarily for financial analysis or that data-processing personnel consider programming to be the primary use for their PCs. Most bank business managers also use their PCs for financial analysis (57%), but accounting (40%) and mathematics/statistics (39%) were the second and third most commonly cited uses for this occupation group, according to Ms. Windham.

The study indicates that while the computer revolution has crested in some industries, there remains room for considerable growth in banking and finance. In the future, says Ms. Windham, individuals in departments and offices where micro-computers currently have to be shared by a number of people will have computers of their own on their desks. Of course, those new PC users will want the capability of exchanging data with others in their bank and local-area networks will become increasingly common.

In the recent Future Computing report, 43% of banking/finance PC users surveyed had stand-alone PCs and 43% had PCs connected to mainframe computers. Thirteen percent said their PC was connected to a mini-computer and 18% said their computer was a node in a local area network.

PCs tied into larger systems in the bank are posing a tremendous security problem, says Ms. Windham. In an effort to control access to sensitive data, many banks are installing software with built-in security features. Lockable disk drives on PCs are another method banks are using to limit potential use of the system by unauthorized personnel.

"One of the biggest challenges facing banks is how they can permit personnel to communicate with one another and larger systems while controlling potential abuses," she says.

Smaller banks will not be immune to these problems, she adds. Although larger banks were first to experiment with PCs and the first to experience the related security and compatibility problems, smaller banks, S&Ls and credit unions will be among the next group to jump on the micro-computer bandwagon.

The Future Computing study also demonstrated the dominant position IBM products play in the banking/finance industry. Forty-seven percent of the banking/finance respondents said their PCs were IBMs compared to only 32% of respondents in the insurance industry who gave that answer. Although Apple has 22% of the total PC market, only 10% of respondents in banking/finance said they had Apple micro-computers, says Ms. Windham.

S&Ls Wrestle With Problem Of Anemic Insurance Fund:

Who Should Pay?

By Joe Lawler
Assistant Editor

THE thrift industry met in Dallas last month for the annual convention of the U. S. League of Savings Institutions with talk of a good year, but with disagreement over who should pay to boost the FSLIC's ailing deposit-insurance fund.

FHLBB Chairman Edwin J. Gray has put the FSLIC's unobligated reserves at $3.2 billion. Mr. Gray has repeatedly characterized the situation as a crisis.

Some relief has come from the FHLBB's Management Consignment Program, Mr. Gray said. Under this arrangement, managers from the healthy thrifts are running 17 failed thrifts. "This puts them in a holding pattern under sound management until ultimate resolution can be achieved," Mr. Gray says. This has relieved some of the pressure on the FSLIC's reserves.

In addition, the new Federal Asset Disposition Association is expected to liquidate some of the $2.5 billion in distressed assets acquired by the FSLIC from failed thrifts.

Nevertheless, Mr. Gray has called the state of the deposit insurance fund his top priority, and the subject also was the top concern of S&L executives in Dallas last month.

One possibility recently floated by Mr. Gray — a one-time assessment of 1% of assets held by S&Ls — was quickly shot down by loud opposition from the thrift industry.

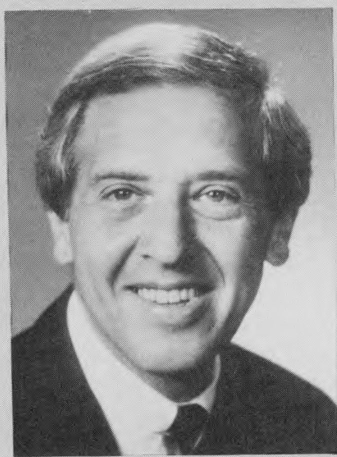
Mr. Gray called on the thrift industry to work with the FHLBB in developing legislative solutions to the problems of the thrift industry and the insurance fund. "The ball is in your court," Mr. Gray told the assembled thrift executives.

Gerald J. Levy, incoming chairman of the U. S. League, quickly handed the "ball" to a committee.

In his inaugural speech, Mr. Levy announced that the league would form a task force to develop solutions to the insurance fund problem.

The U. S. League opposes the obvious short-term solutions to the insurance fund's woes:

- An appropriation from Congress is seen as out of the question in this period of concern over the ballooning federal debt.
- A merger of the FDIC and FSLIC is opposed on the grounds that it would be the beginning of the end of the thrift industry as a distinct industry.
- The one-time 1% assessment was fought on the grounds that it would be unfair to many healthy S&Ls which have practiced prudent management, and would push many ailing S&Ls over the edge into insolvency. "I come from a conservative area," said one attendee from Kentucky. "Our capital is above 10%. Why should we pay the bills for the high fliers?"



Gerald J. Levy, chairman/president, Guaranty Savings & Loan Association, Milwaukee, was installed as chairman of the U. S. League of Savings Institutions at the league's annual convention in Dallas last month.

Guaranty Savings has $210 million in assets and nine offices in southeast Wisconsin. Mr. Levy has been managing officer of Guaranty for 12 years. He joined the industry in 1959.

Risk-based premiums in general are opposed by the league. "It's very hard to identify front-end what the risks are," Mr. Levy said. "By the time you identify the risks, it's too difficult to raise the premiums," he added.

A better solution is to increase insurance premiums on S&Ls that enter non-traditional activities, such as real-estate development, he said. "If you think you're right, put up the money," Mr. Levy added.

For long-term solutions to the insurance-fund problem, the U. S. League supports FHLBB efforts to curb direct investment; tighten net-worth requirements and limit growth; restrict the use of brokered deposits; require tighter accounting on acquisition, development and construction loans; and limit the use of subordinated debt to meet net-worth minimums.

L. William Seidman, newly-installed chairman of the FDIC, announced his opposition to a merger of the FDIC and FSLIC. "Frankly, we already have plenty to do at the FDIC," he told attendees.

"The FDIC is structured to underwrite diverse commercial-banking activities. Savings institutions that have decided to avoid asset specialization can apply for FDIC insurance. If the thrift industry continues as a different kind of financial institution, it should have its own fund if this is financially possible," Mr. Seidman said.

He urged the S&L industry to use its own resources to bring its insurance fund back to health. "The potential for regular special assessments is a real, but painful, alternative." ● ●

Industry Enjoys Advantages Of Rate-Sensitive Assets

Thrifts Celebrate Good Year

Income to set record, but turnaround could take "six or seven years"

By Joe Lawler
Assistant Editor

DELEGATES to the U. S. League's annual convention had something to celebrate this year — healthy profits.

The league is projecting net income of $5 billion for this year, which would top the record $3.9 billion of 1978. The league projects after-tax return on average assets at about 0.5% for 1985.

Lower interest rates and greater use of interest-rate-sensitive assets, especially adjustable-rate mortgages, have aided the industry.

Nevertheless, a recent study by the General Accounting Office reported that 42%, or 1,343 savings institutions, were in trouble at the end of 1984 and that most of these still were losing money this year.

The GAO estimates the cost of liquidating the troubled institutions at between $15 billion and $20 billion. Officials of the FSLIC have estimated the cost at $30 billion to $50 billion. The FSLIC has unobligated reserves of $3.2 billion.

U. S. League Chairman Gerald J. Levy admitted that the S&L industry has not completed a turnaround. "We're going to have an extraordinary change in the capital position of this industry," Mr. Levy said at a press conference in Dallas. "But we can't do it in three years. We're going to need six or seven."

The thrift industry will continue to look at consumer and commercial lending as a permanent part of a diversified portfolio while remaining committed to the home mortgage market, said Mr. Levy.

However, these new powers granted by the Garn-St Germain Act of 1982 are no longer being used to turn around failing thrifts, Mr. Levy added. "I think the industry is beyond that kind of thinking," he said.

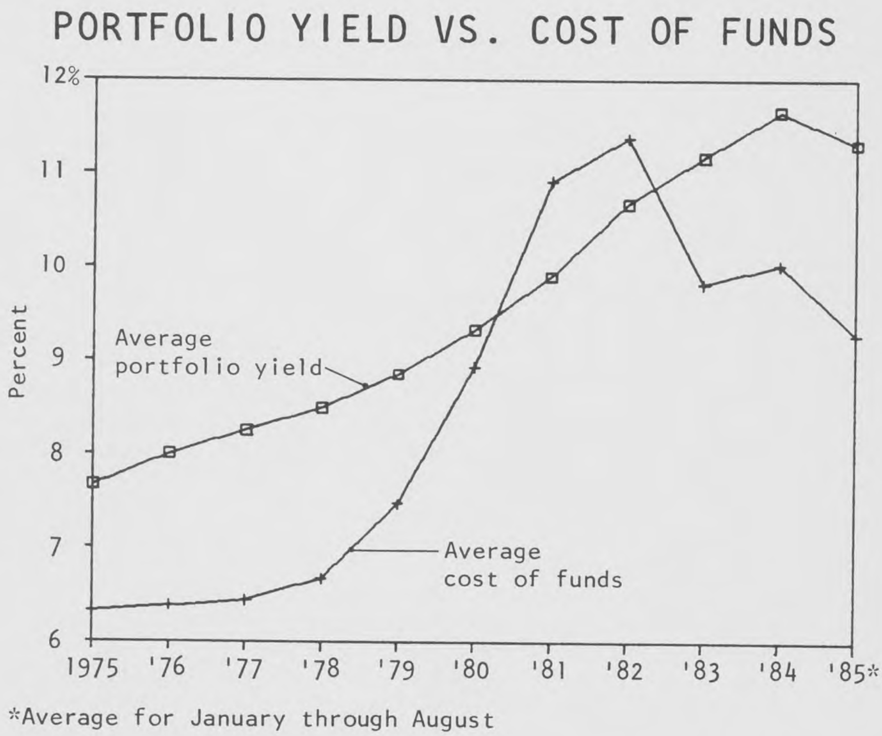
On the other hand, FHLBB Chairman Edwin J. Gray faulted some S&Ls for ignoring the intent of the Garn-St Germain Act.

"The preamble (to the Act) says that this is 'an Act to revitalize the housing industry by strengthening the financial stability of home-mortgage lending institutions and ensuring the availability of home-mortgage-loans,'" Mr. Gray said.

"The Garn-St Germain Act was not fashioned to make thrifts the functional equivalents of commercial banks," he said.

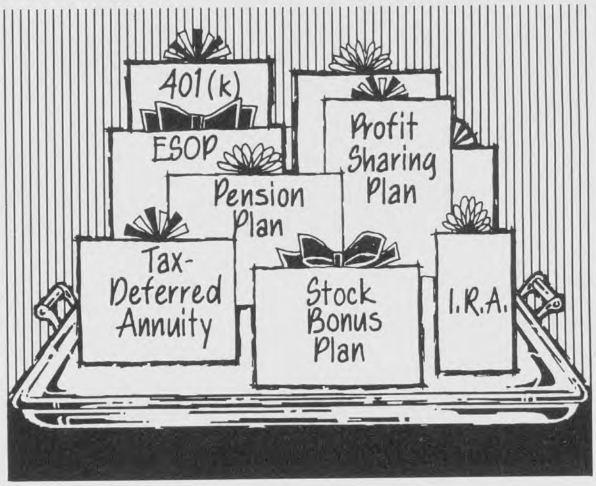
"The asset-related provisions of the Act were intended to provide thrifts a way to work out of their portfolio problems over time," Mr. Gray said.

Thrifts currently have 4% of their assets in consumer loans and 1.5% in commercial loans. ● ●



Thrifts now are enjoying a 2% spread, thanks to lower interest rates and the use of adjustable-rate mortgages and other interest-rate-sensitive assets.

Marketing Employee-Benefit Services



Rewards are waiting for the trust division that develops a plan and goes after employee-benefit business

By Steven L. Finerty
Vice President, Trust Marketing
Boatmen's National Bank, St. Louis

AXIOM One: *Never assume anyone understands employee benefits and related trust products.*

Axiom Two: *Never assume any one* remembers *anything about employee benefits and related trust products just because you have explained them once.*

These axioms reflect both the frustrations and opportunities inherent in marketing employee-benefit trust services.

On the one hand, prospects are easily confused about employee-benefit products and, as a result, the products can be difficult to market.

On the other hand, prospects generally recognize the importance of offering a quality employee-benefit package to employees and that they must rely on professionals, such as trust officers, to keep up-to-date.

As a trust-marketing officer, I enjoy soliciting employee-benefit business. Not only is there a virtually endless supply of prospects, the rewards to the trust division can be considerable. Employee-benefit accounts generally increase in value each year, multiplying trust-division revenues and enhancing prestige. They also help cement the bank's relationship with the customer.

Let's consider three areas of importance to any trust division seeking to market employee-benefit services. These topics are developing a marketing plan, developing prospects and motivating prospects. The ideas presented under each topic should prove as effective for a one-officer trust division as for divisions managing billions of dollars.

Developing a Marketing-Action Plan

There are no prescribed formulas to follow when preparing a marketing-action plan. A few general rules, though, are important.

First, don't apply one basic plan to all prospects. Instead, prepare what many writers term a multi-level approach with the action plan dividing various prospects into two or more market tiers. My experience is that only two tiers are necessary. Tier One includes organizations with a need for master or prototype retirement plans and corporations and partnerships with plan market values of under $1 million. Tier Two includes everyone else, specifically, plans with more than $1 million in plan assets or new plans with exceptionally large annual contributions.

Second, recognize that an action plan must address both the *marketing* and *sales* aspects of the job. They are not the same. Marketing involves advertising services and products, while sales means establishing personal contact with companies. For example, marketing will focus on the use of media, direct mail, panel-program participation and brochure purchase or preparation.

Sales will focus on:

- How to specifically identify prospects.
- Frequency and manner of contacting prospects.
- Frequency of call reports to superiors.
- Target number of calls to both existing prospects and previously unsolicited prospects.

Third, define in writing who is a good trust prospect for your trust division. This definition will vary, of course, with the size of your trust division.

Defining good prospects is important as it forces the trust-marketing officer to decide what is to be his/her target market. More important, a good definition will contain specific examples of prospects that can be distributed to other bank officers. Since we expect other

bank officers to refer quality prospects, we must accept the responsibility for educating them as to how we define our target market.

Fourth, include specific numeric goals on what is expected to be accomplished. Project:

- Number of accounts to be opened.
- Total dollar volume of both new managed accounts and new directed or custodial accounts.
- Total first year's fees to be generated.

Set realistic goals. They should be challenging, but not impossible to attain.

Developing Prospects

Prospects must be found; rarely will they come to you. There are many sources which can be used to identify prospects. The best place to start is with existing employee benefit, endowment and personal-trust customers. Look to existing customers to provide your trust division with as much of their business as possible.

Existing customers should provide your trust division with as much of their business as possible.

Relationship Development

In addition, commercial-lending officers can be helpful in developing *bank* relationships into *trust* relationships. To improve communications between trust and lending officers, schedule periodic meetings to discuss trust investment and administrative services. Also, review commercial-lending accounts and ask about companies you feel are trust prospects.

Numerous publications can be used in identifying prospects, including:

- Business sections of local newspapers.
- Directories listing virtually *all* tax-qualified retirement plans in any geographic region.
- Directories of national unions.
- Dun & Bradstreet reports.

One more suggestion: Keep fellow trust officers informed of employee-benefit services and profitability. My experience is that most trust officers concentrate almost totally on personal trust accounts and often know little about the employee-benefit side of the business.

Motivating Prospects

Once a prospect has been identified, trust-marketing officers must motivate them to action. How this is done depends a great deal on the use of *communication* and *timing* skills. Communication means understanding customer needs and translating them into needs the trust division can satisfy.

Timing may involve:

- Selling master or prototype plans subsequent to law changes.
- Selling investment performance when your portfolio returns are superior.
- Calling on prospects when new products such as Section 401 (k) appear.
- Calling on prospects when there has been a change in personnel to see if the new employee wants to place his/her own stamp on the employee-benefit program.

Communication and timing skills should be combined with a thoughtful and professional approach:

- Have well-thought-out responses to objections to performance results, fees or administrative limitations. Never give the appearance of agreeing with a prospect's statement casting trust services in a bad light.
- Never forget to ask for the business. If it is not forthcoming, casually ask, "why not?"
- If a prospect is satisfied with a relationship with another institution, consider selling the concept of dual investment managers. Suggest that the hiring of another investment manager need not upset existing relationships, and that they may wish to consider placing just new annual plan contributions with your trust division.

Hiring two investment managers can be very appealing to companies. Competition is viewed as healthy, and in addition, prospects may find it beneficial to have more than one bank relationship when the need arises for more typical commercial needs.

- Sell the benefits of using a bank as trustee. Too often we fail to tout the advantages appropriately:

— Low cost, generally without acceptance fees or termination penalties.
— Flexibility in plan design.
— Local administration.
— Investment flexibility and good performance.

- Do your homework. Study the notes from prior conversations. Remember the type and size of the prospect's employee-benefit plans. Also, be familiar with existing bank and trust relationships.
- Be on time for appointments and promptly forward any written materials that were promised. Follow up with a letter that reminds the prospect of how his company will benefit from your services.
- Be impatient. "Call reluctance" is the biggest drag on a prospect's momentum.

The Ten Commandments

There are certain rules to follow which I believe can help make anyone a more effective salesperson of employee-benefit services. These are my Ten Commandments:

1. Avoid overselling. Be realistic in speaking about fees and investment performance.
2. Never talk down another institution. Instead, talk up your trust division.
3. Never assume the person you are speaking to understands employee benefits and investment lingo.

Avoid loss leaders and marginal accounts. Today's unprofitable business rarely becomes profitable later.

4. Make certain you are speaking with the decision-maker.
5. Know your competition. A competitor's performance, services and fees can be used as a guide for marketing your own services. Remember, few good ideas are original.
6. Avoid loss leaders and marginal accounts. Currently unprofitable business rarely becomes profitable later.
7. Don't be all things to all people. Recognize your strengths and exploit them.
8. Always seek to improve products and services. No institution can succeed in the long run without regularly improving internal operations, soliciting new business and developing new products.
9. Follow up after each sale. Make certain that a new customer's first impressions are good.
10. Never forget to cross-sell bank services.

Opportunities Are There

The time is ripe for trust divisions of all sizes to reevaluate their employee-benefit services, products and marketing efforts. By carefully planning and implementing a strategy to increase market share, your trust division can reap the benefits. • •

Is the Work Ethic Dead?

Before managers can motivate employees, they must learn what makes them tick

By V. R. Buzzotta,
Chairman
Psychological Associates,
St. Louis

AS more and more banks venture into untried activities, executives are realizing that today's bank employee must be resourceful and innovative, sales-oriented as well as service-oriented.

Many banks have turned to professional training to give employees the new skills they need to work productively with bank customers and fellow employees.

All but the most hidebound banker will acknowledge that training can improve employees' skills. But many bankers wonder if anything can motivate today's employees to strive for corporate goals. Why spend money teaching skills to people who just want to get by as effortlessly as they can? Why spend time on training when the work ethic seems moribund?

Is the work ethic in America dying? The best evidence comes from Yankelovich, Skelly & White, a survey-research firm that has been tracking the work ethic for years.

The firm wrote in 1980 that it had uncovered two groups of workers: "old-values" workers, for whom "the job" was most important, and "new-values" workers, for whom "psychic kicks" and leisure were most important. From this, readers would have predicted that the work ethic soon would be dead.

But in 1985, Daniel Yankelovich writes that what he once called the new breed will work hard if it sees a payoff. New-values workers will produce — if they feel they will be rewarded.

The work ethic has not died; it has changed from outer-directed to inner-directed. Old-values workers take their cues from outside sources. The company's definition of a good day's work becomes the worker's definition.

The new-values worker defines a good day's work himself — what's interesting, challenging, fulfilling, worthwhile. New-values workers (who can be of any age) work hard for personal satisfaction. Each worker determines for himself what's satisfying.

For Midwestern banks, this is both good news and bad news. The good news is that the work ethic isn't dead; hard work isn't obsolete. The bad news is that motivating people to work hard may be more difficult than ever before. Workers must be convinced that the reward, which includes personal satisfaction, is worth it.

To motivate the new breed of banker, which is fast becoming the dominant breed, bank managers must show employees the link between hard effort and personal satisfaction. That isn't easy.

Still, as many banks are proving, it can be done. In fact, they are training their managers to do it. Centerre Bank, St. Louis; First National, Chicago; and National Bank of Detroit all have conducted seminars that teach managers how to motivate new-breed employees.

Centerre, for example, has been using a program called Dimensional Management Training for its managers and supervisors. The program teaches individuals how to understand and manage the behavior of others. Here's how it works.

The program consists of a week-long seminar with 25 managers or less. The seminar relies on role-playing sessions. Beginning with the first day, students are divided into groups and spend the rest of the week testing what they have learned through situations that simulate on-the-job problems.

They are first taught a shorthand guide for interpreting behavior — a lesson in the fundamental ways a boss and subordinate usually deal with each other. For example, how many times have you encountered an employee who flares up and argues at every criticism, who blames his failings on everything from his colleagues to the weather? Or the employee who gets quiet and crawls into a shell at every negative comment? Or the employee who laughs and jokes and agrees to anything — but won't really tell you what's on his mind?

None of these behaviors are conducive to commitment. They are evasions.

Until the supervisor and employee address their real feelings about the job, and then explore how the bank can react to them, productivity always will be less than it could be.

It's the boss's job to change evasive behavior, whether it's the subordinate's or his own. That is a big part of what's taught next in the seminar.

There are five essential people-skills. These are:

- Sizing-up skills. Managers learn to figure out subordinates, particularly what each employee wants from the job, how each defines personal satisfaction. The seminar teaches managers how to determine if a subordinate is seeking recognition, security, acceptance, personal growth, or whatever.
- Communicating skills. Managers learn to talk with subordinates rather than past them. Managers learn how to ask questions, how to listen openly and attentively, and how to convey their own ideas clearly and convincingly.
- Coaching skills. Managers learn to demonstrate the connection between the subordinate's personal goals and the bank's business goals.
- Motivating skills. Managers learn techniques for establishing a direct link between personal goals and the bank's business goals.
- Strategy-planning skills. Managers learn to understand each subordinate as the unique individual he or she is. How else can the manager prove to the subordinate that doing the job well will pay off in personal satisfaction if the manager does not have this understanding? Obviously, one strategy will not work with all employees. That's why managers must learn to develop strategies that fit each individual.

The seminar leader explains what motivation is and how motivating skills can be used to enlist the commitment of subordinates. The skills then are demonstrated. Videotapes show how to use the skills, giving examples to emulate.

Next the managers practice the skills. Using real problems that exist with subordinates, managers role-play the boss and subordinate in simulated coaching sessions, using the skills to coach and motivate the "subordinate." This is crucial; practice transforms the skills from something managers understand to something they can use.

Practice is followed by feedback. Managers who play the boss in each mock session get a report on how it went and how it might have gone better.

Finally the seminar covers ways to apply the skills back at the bank. Managers must use these skills on the job continuously or they are likely to forget them.

By using these skills, managers can show employees how helping the bank to attain its external, objective goals will help them attain their own internal, subjective goals. The message is: What's good for the bank, as the bank defines good, is good for you, as you define good. ● ●

Communications: A Two-Way Street

Effective communications with employees is key to reaching the bank's goals

By Gloria A. Hagler
Comptroller,
Eufaula (Ala.) Bank & Trust Co.

COMMUNICATIONS in banks have come a long way over the years.

No longer are decisions made in the front office and shared with only a few officers. In-house newsletters now range from color magazines complete with photos to one-page "poop" sheets; memos frequently are seen floating across employees' desks. But are bank communications really what they ought to be? Do employees feel they really know their organizations? I think not — we still have a long way to go.

Let's first determine *why* in-house communications are necessary. The goals are employee teamwork, motivation, education and, most important, customer service. Knowledge enables employees to cross-sell services. All employees should know the interest rates the bank pays on deposits and the rates charged on loans. Customers ask employees these questions outside the bank.

Communications should be timely and effective in order to strengthen teamwork in the organization, to maintain employee morale, to enable employees to cross-sell services and in general to develop a superior operation.

Next, let's determine *how* to develop an effective communications process. This process may consist of the six steps covered in the book "Management: The Art of Working With and Through People," by Donald C. Mosley and Paul H. Pietri Jr.

The first step is to establish a proper climate for communicating, a climate of mutual trust. Subordinates are more willing to talk frankly about job problems and are more willing to express their ideas when they trust their superiors. Supervisors can build this trust by representing employees' interests to top management and by respecting the abilities of employees.

The second step is to determine the objectives of our communications. For example, suppose you are talking to an employee who will be entering a training program. The objective would be to gain the employee's acceptance of, and enthusiasm for, the program.

The next four steps relate to planning. Number three is to engage in two-way communications. This allows us to understand the receiver, his reaction to what we are saying and his point of view.

The fourth step is to relate our message to the receiver's self-interest. Show how the message will add to the receiver's development, how it will benefit him. This increases the probability that the message will be accepted.

The fifth step is to be sensitive to the language we use. We should say what we want to say, use understandable words or phrases and as few words as possible. Repetition will reduce the risk of incorrect assumptions and reinforce the message.

The sixth step is to gather feedback, which aids understanding. We need to ask for questions, opinions, suggestions and feelings toward the subject.

By planning our communications and using these six steps, we can become better communicators. Effective in-house communications is a key to a successful organization. ● ●

Help for Security Conscious

New security-related products come to market to make job of security officials easier.

THE importance of financial-institution security never wanes, a fact attested to in part by the multitude of new security-related products and services coming on the market in a continuous stream. Following is a sampling of new products that have become available in recent months.

New Security Products Marketed by Mosler

Mosler is marketing three new security-related products: a closed-circuit TV system that monitors facilities, assets, customers and personnel; data safes; and an access-control system.

• The CCTV provides continuous monitoring of check-cashing and other potentially fraud-prone operations, parking lots, building entrances, ATMs, etc. It also can be used for live-action viewing of equipment operation or employee activity.

Mosler CCTV system monitors bank facilities, assets, customers and personnel.

Systems are tailored to monitoring requirements and can interface with networks like Mosler's COMSEC™ security-communications system.

• Data safes for protection of information processing and computer media have been added to the Mosler line of record and money safes.

The data safes are rated to protect floppy discs and have passed the German Braunschweig fire-and-impact test, which simulates fire conditions. The safes come in four sizes and a line of interior arrangements is available.

• The advanced-access-control system has the capability of operating off-line with a Mosler Century® 22 alarm control; on-line with a Mosler COMSEC™ proprietary system; and can be used with a computer for management reporting and activity-record retention.

A security feature of the system is its distributed-processing architecture, which keeps the system in operation should communication with the central console be lost, assuring that no aspects of security are lost. PIN pads and/or intercoms can be added and high-security encoding also is available to prevent unauthorized duplication of cards.

For information on these security products, write: Mosler, Marketing Communications Dept., 1561 Grand Blvd., Hamilton, OH 45012.

IBM PC Security System Offered by Enigma Logic

SafeWord PC-Safe is a security system for the IBM PC and compatible personal computers that's manufactured by Enigma Logic, supplier of the SafeWord™ family of computer-system security products.

Using the SafeWord ID verification technique, authorized PC users are issued a calculator-like SafeWord decoder and key set that acts as a "PassWord" dispenser. Users requesting access are asked for a changing SafeWord PassWord that can be generated only by the decoder and key. When the identity of the PC user is confirmed, the unit secures all disk drives so they cannot read or write unencrypted data.

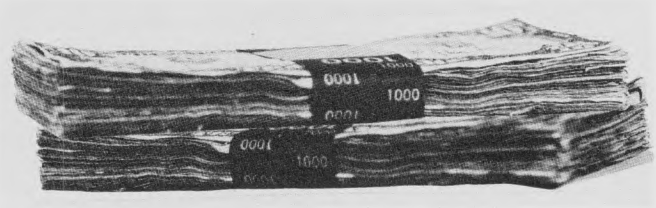
SafeWord PC-Safe includes a second SafeWord key kept by supervisory personnel that controls supervised importing or exporting of data to or from the encrypted environment. This key enables administrators to specify automatic DES encryption, automatic Enigma Logic DAS encryption or plaintext operation for each disk

Enigma Logic decoder and key set acts as "PassWord" dispenser.

drive. Audit trails of every configuration change and each user's daily ID verification is automatically maintained.

For information, write: J-C. Spender, vice president, marketing, Enigma Logic, Inc., 2151 Salvio, Suite 301, Concord, CA 94520.

Currency Device Foils Robbers



Trap Pack II™ is a stack of real currency that houses tear gas, smoke, dye and digital electronics equipment. Placed in a teller drawer and given to a robber along with other currency, the device ignites after the robber leaves the bank, thereby disrupting escape and assisting in funds recovery. For information, write: Protection Products Corp., PO Box 13948, New Orleans, LA 70185.

Security-Product Family Introduced by Tandem

Tandem Computer, Inc., has announced a new SAFE™ system security-product family, an integrated set of security tools for users of Tandem systems.

Initial product offerings include SAFEGUARD™ software and SAFE-T-NET™ data-encryption subsystem that gives users increased control in securing access to information that might be distributed across devices, files and systems on a Tandem network.

SAFEGUARD software provides users of distributed networks with authentication, authorization and auditing services. It's designed to work with Tandem's GUARDIAN 90™ operating system to control access to shared resources, including terminals, processors, printers, encryption devices, tape drives and communication lines.

SAFE-T-NET is a channel-attached peripheral that provides for encryption, message authentication and an online master key change mechanism.

For information, write: Tandem Computers, Inc., 19333 Vallco Parkway, Cupertino, CA 95014.

Power-Line Monitor Detects Computer Problems

The Lakontek Office Power Monitor now is available to classify and display various power-line problems that occur in bank-automation systems.

The monitor displays lights that indicate problems such as line sags, surges and impulses. One set of color-coded LED lamps indicates the presence and magnitude of voltage sags and surges. Another set indicates the presence and magnitude of voltage spikes.

The monitor has an internal rechargeable battery that maintains the memory of the power-line problem for later reading should a power failure occur. The monitor's "smart lights" enable personnel to pinpoint specific power problems as the cause of lost or scrambled data.

For information, write: Lakonteck, Inc., 2385 S. Clinton Ave., South Plainfield, NJ 07080.

Devices Offer Privacy For Confidential Viewing

Privacy for financial institutions is provided by Micro Design models 855 and 865 readers that have direct projection systems to shield screen images from passersby.

Both machines serve a variety of ¾ computer-output microfilm or source document needs with dual-lens option. The 855 unit magnifies from 18x to 66x and the 865 offers 24x to 58x for microform viewing.

The units are energy-efficient to cut operation cost and a fanless system utilizes convection cooling to maintain film-plane temperatures below industry standards.

For information, write: Sue Stern, Micro Design, 857 W. State St., Hartford, WI 53027.

New Catalog Offered By Anti-Crime Bureau

A new catalog describing Mosler Anti-Crime Bureau (MACB) security-training materials and programs now is available. It features descriptions of 10 16mm films (also available in video) produced by MACB for use in security-training programs.

The catalog provides particulars about other MACB materials and services, including books, pamphlets and stuffers, packaged training kits and slide presentations.

MACB is celebrating its 25th year. In addition to the training materials and programs described above, MACB offers two-day security-training seminars open to security professionals and held in major cities, an annual week-long security-officers-training school and an annual week-long advanced security-officers-training school.

For information, write: Mosler Anti-Crime Bureau, 1561 Grand Blvd., Hamilton, OH 45012.

Training Manual Cuts Effect of 'Paper Thieves'

A new training manual is available that shows how to prevent losses from bad paper. The manual gives examples of bona-fide and counterfeit checks, credit cards, identification cards and travelers checks. Sections are devoted to spotting false credit applications, cashiers checks and counterfeit currency.

Editorial comments inform readers about tricks of the trade used by individuals who present false IDs and make purchases with counterfeit documents.

The manuals are useful for instruction at seminars conducted by banks for retailers whose employees must be able to detect "paper thieves."

For information, write: Publishers Services, 6318 Vesper Ave., Van Nuys, CA 91411.

Understand Customer Base, Pricing For 'Q'-Less Society, Says Consultant

LARGE banks have decided to throw out a lot of new products to consumers while smaller ones are leaning toward selective pricing of products when Reg Q bites the dust next March 31, says a Chicago-based consultant.

Larger banks are already test marketing new products, said G. M. Moebs, president of a firm bearing his name, at a recent meeting of the St. Louis chapter of the Bank Administration Institute.

He warned bankers that they won't be able to price products intelligently unless they have adequate information about their customer bases and products. No longer is it feasible to look at prices the competition across the street is charging; chances are those prices are based on prices charged by another competitor further down the street!

He chided commercial-loan departments for not building profits by requiring compensating balances more often. The give-it-away-for-nothing attitude still is prevalent in some banks.

S&Ls are taking customers from banks simply by providing account analyses, which most banks don't provide at all. Bankers can solidify customer relationships by asking commercial customers how they want the bank to invest their excess balances. Most customers will be grateful, he said, and less likely to take their business to another institution.

He predicted that there will not be much movement in minimums for money market demand accounts come April 1, 1986. Most large banks already have lowered their minimums and, interestingly, most small S&Ls have too.

He advised that the best way for community banks to sell services is by direct mail or phone. He told of a bank in Indiana that calls every one of its customers by phone during the IRA season. For one month employees phone customers during evening hours as followups to a letter. Customers are reminded that "this is the last chance to get an IRA this year." The bank has 15 IRA products and it has only $90 million in assets.

Banks should strive to establish total relationships with customers because that's the most profitable type of relationship. Banks will discount some services to get such relationships, but they still can profit.

Mr. Moebs advised against tiering of rates within a single product. He said some banks are again issuing passbooks because customers want them and they are willing to take less interest on their savings in order to have them.

"Give the customer what he/she wants," Mr. Moebs said, "but price the product higher because there is a demand for it."

He advised against offering variable-rate auto loans because they not only are less profitable, they are not in demand.

In preparation for April 1, 1986, bankers should start trying to better understand their institutions' customer bases so they can offer the products customers want and parlay customer desires for services into profits for the institution. ● ●

Retail Banking Revolution Brings Challenges and Choices to Bankers

"MANAGING change" is a good definition of retail banking today, according to Jack Shipman, executive vice president, Liberty National, Louisville.

Mr. Shipman was the keynote speaker at the Kentucky Bankers Association Retail Credit Conference held recently.

The new financial products being offered to consumers today have drastically changed retail services, he said. Such products include self-directed IRAs, discount-brokerage services, ATM services and revolving personal credit lines secured by real-estate equity, among others.

Banks must develop a sales culture in order to sell these new services, Mr. Shipman said. Using the sales-team approach at Liberty National as an example, he talked of the importance of a well-planned and implemented sales management, training and incentive program.

Retail bankers face stiff competition in the days ahead, Mr. Shipman said, particularly from new nonbank competitors such as Sears. Bankers must strongly support new products and EFT systems in order to retain and expand their markets, he added.

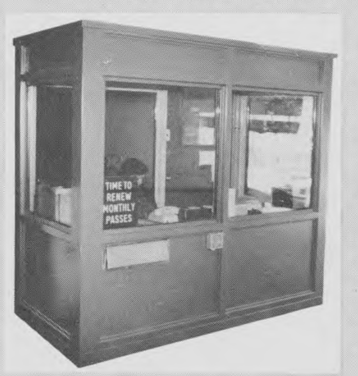
Bankers also should be wary of the potential impact of pending legislation, including two bills recently introduced in the U. S. House that would limit the amount of interest that may be charged on credit-card balances, Mr. Shipman said. While recent ABA testimony before the House Banking Committee was received favorably and the ABA Government Relations Council does not expect these bills to develop into major issues this year, the topic remains hotly debated and bankers should be vigilant, he added.

He also recommended that bankers keep a watchful eye on the issue of life-line banking, as well as a probable regulatory review of banks' compliance with the Community Reinvestment Act.

Retail banking is a highly complex business, evolving in an environment of deregulation, new technology and stiff competition. Success depends on a constant awareness of market changes and careful selection of a distribution system, Mr. Shipman said.

"Most of all, it requires everyone at the bank, from top management on down, to re-orient themselves toward sales and develop a retail-banking sales culture," he said. ● ●

Bullet-Resistant Buildings Offered



A new line of prefabricated threat-resistant structures and components is available from Henges Manufacturing, Inc. It offers bullet-resistant window assemblies, doors, walls, panels and steel or aluminum pre-assembled buildings that can resist penetration up to and including high-powered military rifles. For information, write: Henges Manufacturing, Inc., 12100 Prichard Farm Rd., Maryland Heights, MO 63043.

Farm-Crisis Losses Predicted To Cost Banks $20-$25 Billion

THE FARM crisis could lead to losses totaling $20 billion to $25 billion by financial institutions in the next few years, according to a recent Wharton Econometrics study. And that could lead to:

- An increase in interest rates of 75 to 125 basis points for all types of loans.
- The loss of 175,000 to 275,000 jobs, not just in the farm sector but throughout the U. S. economy.
- A $30-billion to $50-billion reduction in GNP.
- A $14 billion to $21 billion increase in the federal debt because of lower tax income and higher debt service costs resulting from higher interest rates.

This bleak picture was presented by Michael Boehlje, former assistant dean of the College of Agriculture at Iowa State University during the recent annual convention of the Iowa Bankers Association. He recently joined the University of Minnesota in a similar capacity.

Figures Significant

"Some people find it hard to believe that the farm crisis would spin through the economy to that extent," he said. "But even if you halve the figures, it's still significant."

He added that many people are arguing that it would cost less for the government to act to ease the problem rather than waiting to deal with widening problems later. "From the government's and public's perspective, you pay now or pay later," he said.

He termed today's farm-sector problems structural rather than cyclical and added that the painful transition could take another three to four years, even if farm commodity and land prices were to improve.

He predicted that about 15% of the farmland in Iowa will not produce enough income under any circumstances, which means tough decisions for lenders who must decide which farmers they will continue to support.

Friction Predicted

Bankers are going to have to tell more farmers to either pay off their debts or get rid of some assets, he said, and that means more friction between farmers and lenders.

The impact of the farm crisis is important to the public, not because of food prices, but of what it will do to the financial markets.

"I see more and more an unwillingness on the part of the farm community to cooperate with the lending community," he said. "That disturbs me. I think we need to be concerned and aware that in this environment we have the potential for a very divisive situation where the concept of partners is no longer there."

Referring to the farm crisis, Dr. Boehlje said it can't be contained or limited to just financially stressed farmers. "You can't put a wall around it."

He added that financially stressed farmers who have been hit by the "first wave" of structural changes in agriculture are suffering the most at present.

But a "second wave" is affecting financially strong farmers whose assets are being eroded by declining farmland and machinery values. A "third wave" has hit local communities, where retail sales have declined and farm-related businesses and banks are suffering from unpaid bills and delinquent loans.

Still a "fourth wave" will hit the entire nation "when financial institutions — banks, insurance firms and the Farm Credit System — start encountering problems," he added. "The impact is important to the American public, not because of food prices, but because of what it will do to the financial markets." ● ●

Three Midwestern State PCAs Merged into Single Unit

Farmer-stockholders throughout Arkansas, Illinois and Missouri have voted overwhelmingly to merge their 32 Production Credit Associations (PCAs) into a single PCA that will begin serving customers on January 1.

The district-wide PCA will be headquartered in St. Louis, but farmers will continue to receive credit services from local offices in 19 new Farm Credit Services territories in the three states.

In voting to implement the mergers, stockholders approved grassroots restructuring proposals adopted by their locally elected directors over the past several months.

The vote was termed "significant" by the chairman of the Sixth District Farm Credit Banks board.

Davids

(Continued from page 62)

and it provides most services commercial banks provide. Until recently it was a tax-sheltered organization that paid no federal income tax.

The DOD-proposed central bank would, it is believed, permit the issuance of a special credit/debit card. Until now, lower-grade enlisted personnel have not had access to major credit cards, as a rule.

While there would be regulations and restrictions limiting garnishment of military salaries in the event of delinquencies, it should be recognized that there is a strong psychological pressure in the military to see that individuals do not abuse the system.

Maybe history will repeat itself. To illustrate: The introduction of social security insurance in the 1930s was opposed by the insurance industry. The same industry later was amazed to find that social security coverage, rather than diminishing the public's desire for insurance, actually increased it. People who never before bought insurance became interested in broadening their coverage through the private sector because of their experience with social-security insurance.

Would it be sanguine to anticipate that the DOD's proposal could be structured to be mutually beneficial and profitable to federal employees as well as the private banking sector? ● ●

Index of Advertisers in This Issue

Austin & Associates, Inc., Douglas 29
Bank Board Letter 33, 53
Banking Consultants of America 22
Barclays American/Business Credit 32
Boatmens National Bank, St. Louis 64
Central Bank of the South, Birmingham, Ala. 29B
Commerce Bank, Kansas City 5
Commerce Publishing Co. 25
Dimensional Data 14
FIC Banking Consultants 33B
First Lease & Equipment Consulting 39
Foothill Capital Corp. 63
Getzler & Co., A. E. 9
Globe Life & Accident Insurance Co. 33A
Hagan & Associates, Tom 60
Illinois Code Co. 23
Liberty National Bank, Oklahoma City 2
MPA Systems 35A
Mercantile Bancorp., St. Louis 31B
Money Maker 31
North Central Life Insurance Co. 2
Page-Ruane, Inc. 43
Sales Training Systems 10
Stucky & Associates, William 17
Swords Associates, Inc. 12
Transamerica Financial Systems 46
Whitney National Bank, New Orleans 33

Coming Events

Jan. 26-29: **Bank Administration Institute Conference on Productivity,** Bal Harbour, Fla.

Jan. 28-31: **ABA National Insurance and Protection Conference,** New Orleans, Hyatt Regency.

Jan. 29-31: **Dealer Bank Association Sales Managers' Seminar,** Palm Springs, Calif., Americana Canyon Hotel.

Feb. 2-5: **ABA National Trust Conference,** Orlando, Fla., Hyatt Regency Grand Cypress.

Feb. 2-3: **Robert Morris Associates Loan Review Seminar,** St. Louis, Chase Hotel.

Feb. 9-11: **Consumer Bankers Association Innovations in Retail Banking Conference,** Atlanta, Ramada Renaissance.

Feb. 9-12: **ABA National Telecommunications & Financial Networks/Video Banking III Conference,** Orlando, Fla., Hyatt Regency Grand Cypress.

Feb. 9-21: **ABA National School of Retail Banking,** Norman, Okla., University of Oklahoma.

Feb. 16-19: **ABA National Assembly of Community Bankers,** San Diego, Hotel Inter-Continental.

Feb. 19-21: **ABA Construction Lending Workshop,** Denver, Fairmont Hotel.

Feb. 23-26: **National Council of Savings Institutions Operations Conference and Exhibit,** Washington, D. C., Sheraton Washington Hotel.

Feb. 26-29: **ABA Bank Investments Conference,** New Orleans, Hyatt Regency.

Mar. 2-5: **Bank Marketing Association Electronic Banking Product Strategies Conference,** San Francisco, Fairmont Hotel.

Mar. 9-11: **ABA National Corporate Banking Conference,** San Francisco, St. Francis Hotel.

Mar. 9-12: **Bank Marketing Association Community Bank CEO Seminar,** Palm Springs, Calif., Americana Canyon Hotel.

Mar. 9-13: **Independent Bankers Association of America National Convention,** Las Vegas, Las Vegas Hilton.

Mar. 9-15: **ABA National Compliance School,** University of Oklahoma, Norman.

Mar. 11-14: **Tillinghast, Nelson & Warren International Captive Insurance and Reinsurance Forum,** Hamilton Princess Hotel, Bermuda.

Mar. 16-19: **ABA National Fiduciary & Securities Operations Conference,** Marriott Marquis, Atlanta.

Mar. 18-21: **Bank Administration Institute Check Processing Conference,** Las Vegas.

Mar. 19-20: **Robert Morris Associates Loan Participations and Purchases Workshop,** Hotel Inter-Continental, New Orleans.

Mar. 23-26: **Bank Marketing Association Business Development Training Conference,** Wyndham Franklin Plaza Hotel, Philadelphia.

Worldwide-Banking Proposal

Are the fears of the banking industry valid concerning establishment of a worldwide central bank for federal employees?

By Dr. Lewis E. Davids
Professor Emeritus/Finance
Southern Illinois University
Carbondale

THE Department of Defense (DOD), the U. S. Air Force and some major banks are supporting the idea of establishing a central bank to serve government employees on a worldwide scope.

The Independent Bankers Association of America is opposed to the idea. The trade association for banks with facilities on military bases has mixed views on the subject. The only way to get commercial banks to support the concept would be to grandfather their existing facilities and let these banks benefit from having a federal central bank. If cut out of the action, they would oppose the proposal.

Most managers of the nation's 15,000 banks could care less about the issue as a practical matter. This is because only a small number of banks are competing for accounts from military personnel. However, taking a philosophical viewpoint, many banks see the concept as contrary to the free-enterprise system and, thus, oppose it.

Proponents of the federal-employee central bank view opposing bankers as knee-jerk reactionaries adverse to any change that might result in heightened competition.

One of the more interesting facets of much of the myopia on the part of commercial bankers is that they tend to look at the short-run banking environment rather than at the long-term — and much broader — picture.

To illustrate: Since the 1930s, bankers, especially unit-community bankers, for the most part espoused restrictions on branching and multi-bank HCs, although they supported the chain-banking concept.

But their competitors, including savings and loans, with few exceptions, supported both inter and intrastate operations, as well as expansion of services they are permitted to offer.

From the 1930s through the 1970s, statistical data show that S&Ls had a much higher growth rate than commercial banks and that much of this growth was at the expense of the latter.

The disintermediation of the early 1980s suspended this trend for a period. However, such factors as lower capital requirements for S&Ls and the more proponent and accommodating attitude on the part of thrift regulators vis-a-vis tougher requirements made on banks by bank regulators, suggests that bank competitors will continue to be, over a period of time, in a position to grow at a faster rate than that predicted for commercial banks.

A federal regulator explains this phenomenon by comparing the sense of unity displayed by thrifts to the sense of disunity displayed by banks. A unified front makes legislators more willing to consider industry issues than they would be if their constituency is divided and can't get its act together.

Further, S&Ls were astute in phrasing their requests for broader powers in terms of benefitting the general public. Lower capital requirements would mean thrifts could make more home loans, an argument sure to please congressmen and women.

However, it's my opinion that lower capital requirements for S&Ls may have encouraged more aggressive mortgage lending but proved to be an imprudent regulatory step that has resulted in higher proportions of problem S&Ls. They also are tilting the level playing field of competition between the various types of financial institutions.

A dilemma that confronts most regulators is that, in many areas, they don't know the correct action to take. They can only estimate what is correct. Sometimes they are correct in the short run but incorrect in the long run. Regulation "Q" is a classic example of this situation.

Proponents of the federal-employee central bank view opposing bankers as knee-jerk reactionaries adverse to any change that might result in heightened competition.

Often there is a question that, if the U. S. doesn't or can't take certain actions it will lose business, market share, etc., to foreign competitors that are less regulated. If it is good business, we would like to have it; if it is bad business, naturally we are glad to not have it. However, it is not initially obvious whether some business is good or bad. In this context, some questionable third-world loans were encouraged by U. S. government agencies.

Will the DOD's sponsorship of a worldwide network of facilities with a central bank for government employees fly?

I don't know. But I do know there is a large credit union of Navy employees that already operates on a worldwide basis. It's a billion dollar-plus organization

(Continued on page 60)


Warmest Wishes
for a Happy
Holiday Season..
BOATMEN'