MID-CONTINENT BANKER

FEATURES

Tax Reform Changes Employee Benefits

Facility Sale-Leasebacks

How to Combat Foreclosure-Delay Tactics

DECEMBER, 1986

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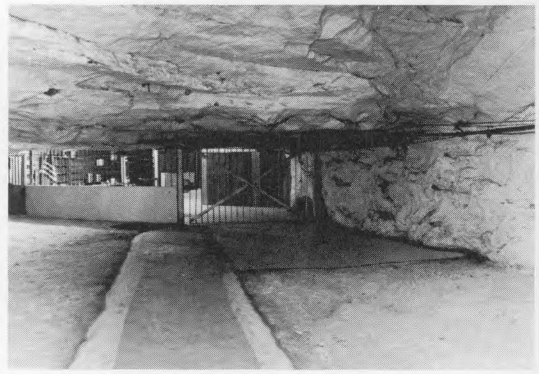

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MID-AMERICA'S BANKING PUBLICATION

BANKING WIRE

MID-CONTINENT BANKER

December, 1986

Late-Breaking News From the World of Banking

AGRICULTURAL BANKERS are projecting only a small additional decline in loan quality for the year ending in mid-1987. The number of bankers expecting decreases and increases in the overall quality of their farm-loan portfolios is projected to be more evenly balanced than in any year since 1980. Despite this somewhat rosy outlook, there is continued evidence that farm financial problems continue to be serious, with many ag banks and their farm customers in a weak and difficult financial position, says the ABA.

AN INSURANCE-VENTURE REEVALUATION is taking place among financial institutions that includes reassessments of strategies and the appearance of many second-generation deals, according to an independent consultant. For the most part, first-generation arrangements were made with insurance firms, but now some financial institutions have become sources of services, with some even manufacturing their own insurance products.

EVER WONDERED HOW MUCH CASH CAN BE WITHDRAWN FROM AN ATM IN 30 MINUTES? The answer is $5,600. That's the amount the grand-prize winner in an ATM sweepstakes sponsored by Oklahoma's TransFund managed to coax from a machine. Second- and third-place winners withdrew $3,300 and $1,700 respectively during 20-minute and 10-minute stints at ATMs. The promotion was termed the biggest ever held in Oklahoma.

NACHA LAUNCHES RULES-INFORMATION SERVICE. It's for organizations interested in the ACH payment system and its continued changes. Subscribers receive informational copies of all mailings regarding changes to the NACHA Rules and an annually updated edition of the rules, which contain operating regulations of eight local ACH associations, the U. S. Treasury's Green Book of Treasury Payment rules and Fed Regulation E with Official Staff Commentary. Subscribers also are able to comment on proposed amendments as they are being developed.

FINANCIAL-SERVICE MARKETERS are seen to be following in the footsteps of packaged-goods marketers in an effort to increase share by using more systematic, consumer-oriented approaches to the development of new bank products and services and more sophisticated market-segmentation techniques. Banks also are acting to protect their bank cards from onslaughts from retailers, providing more individual services and positioning products to

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Turn to Reader Response Page (following page 40)

differentiate them from those of competitors, according to Rose Sexton, New York City.

A NEW 15-YEAR CONVENTIONAL MORTGAGE that takes 72 hours or less for approval and two weeks to close is being offered by First American National, Nashville. "Express Mortgage" is designed to meet the two most important consumer-selection criteria, according to the bank--speedy approval and minimal costs. It carries no points, no private mortgage insurance and features reduced appraisal/attorney fees and no escrow for taxes and insurance. Rates are adjustable every five years.

THE FDIC IS CALLING ON PRIVATE ACCOUNTANTS to aid with bank examinations due to an examination staff that has been spread thin because of the large number of problem banks. The agency is developing a pilot program under which accountants visit banks under FDIC supervision. The pressing need for examiners precludes developing experienced examiners by the FDIC. The agency has about the same number of examiners now as it had in 1981, when the problem list was considerably shorter than it is now.

RICHARD W. SHEALEY, president/chief operating officer, Independence Bank, Chicago, has been elected chairman, National Bankers Association, to serve a two-year term. Independence Bank is the third-largest black-owned bank in the U. S. Mr. Shealey joined the bank in 1983, coming from Continental Illinois National, Chicago.

MERCANTILE BANK OF KANSAS CITY has been formed by the merger of four area banks--Mercantile Bank & Trust, Mercantile Regional Bank, Mercantile National of Clay County and Noland Road Mercantile Bank. Michael F. Mayer is chairman/CEO, with F. C. Edmunds as president/chief operating officer and J. J. Lanning as vice chairman. Assets of the new bank exceed $542 million.

DAVID W. KEMPER has been elected to the board of the St. Louis Fed, effective January 1. He is chairman/CEO, Commerce Bank of St. Louis, and president/CEO, Commerce Bancshares, Kansas City.

BANK IV WICHITA is the first bank in Kansas to open a fourth full-service branch. Recent legislation permits banks to increase their number of detached branches from three to four. The new Northrock branch is on the first floor of the Equlcor Building in an office/shopping complex.

A HANDBOOK ANALYZING ELEMENTS OF THE HIGHER-EDUCATION AMENDMENTS OF 1986 is available from the Consumer Bankers Association. The amendments reauthorize federal guaranteed student-loan programs for five years. The "CBA Guaranteed Student Loan Handbook" has a subject-matter index that brings together citations for statutory language, explanatory conference-report language and effective dates. For information, call 703/276-1750.

MID-CONTINENT BANKER

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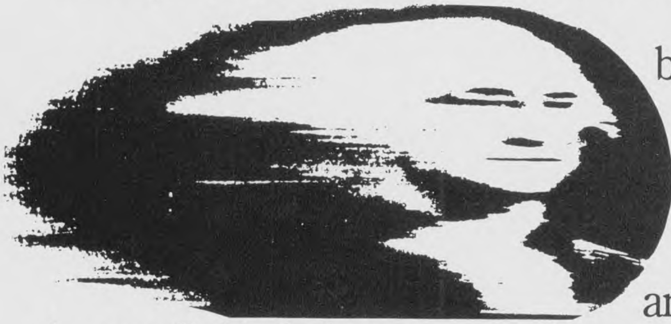

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December, 1986/Volume 82, No. 12

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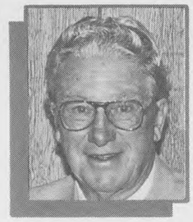

Good-bye and Thanks

Commerce Publishing Co. Sells Banking Magazines to Bank News

THIS is the final issue of MID-CONTINENT BANKER published by Commerce Publishing Co.

MID-CONTINENT BANKER and two other Commerce Publishing banking-related publications, *The Financial Buyers Guide* and *The Bank Board Letter*, have been sold to the Kansas City-based publishers of *Bank News*. All future decisions related to these publications will be made by them.

It is not without regret that Commerce Publishing Co. ends its long association with the banking industry. For many years, MID-CONTINENT BANKER was the flagship of the company, indeed, the foundation on which it was built. We're proud of our association with banking and hope we're able to retain the many friendships we've established in the industry over the years.

Actually, the roots of MID-CONTINENT BANKER stretch all the way back to 1904. At that time, the magazine was known as *Commerce Monthly* and was a house publication of National Bank of Commerce, St. Louis, now known as Mercantile Bank. By 1907, the publication had been acquired by Commerce Publishing, and six years later the magazine's name was changed to *St. Louis Banker*, a move that coincided with new management taking over at Commerce Publishing.

The name MID-CONTINENT BANKER appeared for the first time in 1918, when Commerce Publishing again was sold. At that time, the magazine was covering banking news in 12 states and the publishers were eager to eliminate the impression the magazine covered only St. Louis banks.

In 1924, Donald H. Clark — who died last month in St. Louis at the age of 90 following a long illness — acquired Commerce Publishing and with it, MID-CONTINENT BANKER. He went on to establish *Life Insurance Selling* and *American Agent & Broker* and to buy *Club Management*, *Decor* and *Mid-Western Banker*. *Mid-Western Banker*, published for a time out of Milwaukee, was merged into MID-CONTINENT BANKER in 1982. With the merger, MID-CONTINENT BANKER expanded the total number of states it covered to 17 and, with the addition of Iowa in 1984, to 18. Other publications founded or bought by Donald Clark continue, and indeed, are the leading publications in their fields.

A number of dedicated and hard-working people have been associated with MID-CONTINENT BANKER over the years. In addition to my uncle, Donald, James J. Wengert, who died at Cedar Rapids, Ia., in October at the age of 86, Harold R. Colbert, also deceased, and Ralph Cox, who retired in 1985, have served as publishers of the magazine. Rosemary McKelvey served as editor of the publication for a number of years prior to her death last year.

The current staff consists of Lawrence W. Colbert, vice president/advertising, son of Harold Colbert; John L. Cleveland, editor/associate publisher; Jim Fabian, senior editor; Joe Lawler, assistant editor; and Nancy Gilbreath, staff assistant, as well as myself. All MID-CONTINENT BANKER staff have been retained by Commerce Publishing Co. and have been assigned to other duties.

We're happy that the buyer of our properties in the banking field is a friend of the banking industry and is well known to us. R. W. (Bill) Poquette, an owner of *Bank News*, is a former employee of Commerce Publishing and, as the publisher of *Bank News*, certainly is no stranger to bankers. We have the highest regard for his dedication to the industry and integrity and wish him well with his new acquisitions.

All future inquiries regarding MID-CONTINENT BANKER should be directed to the new publisher at 912 Baltimore, Kansas City, Mo. 64105 (816/421-7941).

We also want to thank you — our readers and advertisers — who have given us support over the years Commerce Publishing owned MID-CONTINENT BANKER, *The Bank Board Letter* and *The Financial Buyers Guide*. Eighty-three years is a long run for any publication and without the support, guidance and enthusiasm of people like you over a long time, MID-CONTINENT BANKER would not have been possible.

— **Wesley H. Clark**
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Expect to See Acquisitions,

Agriculture Will Be Weakest Economic Sector

Some good news may be in store for lenders but the year ahead will be far from a return to boom times

By Jim Fabian, Senior Editor

Strategic Maneuvers Planned for '87
(by survey respondents)

Modernize an existing facility	27%
Build a new facility	12%
Participate in an acquisition	56%
Merge with a bank of equal size	7%
Close an existing facility	15%
Sell out to a larger bank	1%

ALMOST three-quarters (71%) of the bankers responding to this publication's 1987 economic-outlook survey predict there will be no recession next year.

More than half (56%) expect to participate in an acquisition next year.

Slightly more than half (51%) predict that farm land prices will be steady during 1987 while 58% predict agriculture will be the weakest sector of the economy in the New Year.

What do these predictions add up to? Some — but not all — good news for 1987.

* * *

Prime-Rate Predictions

Bankers were asked to predict the highest rate the prime would reach in 1987. Responses ranged from 6% to 12%. However, the largest group (29%) selected an 8.5% rate, while 22% chose an 8% rate and 17% picked a 9% rate.

Responses to a request for the lowest prime rate they foresaw for 1987 ranged from 5% to 8.5%. Forty-one percent of respondents selected 7% as the lowest rate while 36% chose 7.5%.

Predictions as to what the prime would be a year from now ran the gamut from 5% to 10.5%. However, 27% of respondents selected an 8.5% rate, 17% chose 8% and 12% predicted 7%.

Unemployment-Rate Predictions

There was little agreement on this category; however, 17% of respondents selected 8% as the highest unemployment rate for 1987, while 15% chose a 7% rate and 12% pinpointed a rate of 7.5%.

When predicting the lowest unemployment rate for the coming year, 24% of respondents chose a 7% rate while 22% selected a rate of 6.8% and 15% predicted a 6.5% rate.

The unemployment rate as of December, 1987, will be 7%, according to 19% of respondents, while 12% selected a 7.2% rate and 10% each picked rates of 7.7% and 8%.

Dow-Jones Industrial Index Predictions

Highs for the Dow predicted for next year varied from 1850 to 2400, with 49% going for "about 2000." Predicted lows ranged from 1300 to 1800, with 27% of respondents selecting 1700, 24% going for 1600 and 17% choosing 1750.

The Dow will stand at 2000 or more in December, 1987, said 32% of respondents, but 22% selected a more conservative 1800 figure.

The Agriculture Situation

Bankers were asked to make predictions concerning commodity prices, land prices and ag-bank prospects for 1987.

The moderate view won out in all three categories. Commodity prices will be steady, said 46% of respondents, with 36% predicting prices would be higher and 15% stating prices would be lower.

A somewhat optimistic view of farm land prices was expressed, with 51% of respondents stating prices would be steady, 34% expecting lower prices and 12% going for the "higher-prices" category.

Prospects for ag banks in 1987 will be as follows, according to respondents: "Same" — 44%; "Worse" — 34%; and "Better" — 19%.

No Recession, Say Bankers

Tax Bill, Legislation to Have Little Effect

Strongest/Weakest Economic Sectors

Bankers were asked to rate economic sectors that would be strongest in 1987. The top three categories selected were service industries (24%), consumer products (17%) and retailing (12%). Industries expected to be weakest next year include agriculture (58%), energy (39%) and capital goods (22%).

Highs/Lows for Oil Prices

The highest price per barrel of oil in 1987 will be $20, said 29% of respondents. Seventeen percent selected $18 and 15% expect $22 to be the top price. The lowest price for oil will be $12, predicted 24% of respondents. Nineteen percent selected $15 and 15% chose $14.

The price per barrel of oil in December, 1987, will be $20, said 17% of respondents, with $19 and $16 per barrel each selected by 12% of bankers.

Bank-Failures Could Hit 200

Bankers were asked to predict the number of bank failures expected in 1987. Numbers ranged from a low of 55 to a high of 200 or more. The figures of 100 and 150 each were selected by 19% of respondents, while 15% chose the "200-or-more" category. Another 15% predicted that the number of failures next year would be more than the total for this year (which stood at 123 at the time survey results were tabulated).

Overall Direction of the Economy

A series of questions was asked regarding this topic.

- Will there be a recession in 1987? Seventy-one percent predicted "no."
- Will there be continued slow growth of the economy? Forty-four percent responded in the affirmative.
- Will the economy experience strong growth in 1987? "No," said 41% of respondents.

New Bank/Service Introduction

Bankers were asked what new products/services they expect to introduce in 1987. The three mentioned most were home-equity lending (19%), financial planning (15%) and "none" (a surprising 17%).

Bankers also were asked what existing products/services they would "push" in 1987. Home-equity lending led the pack with mention by 43% of respondents, followed by credit cards (17%) and commercial loans (12%).

Strategic Maneuvers Planned

The top five maneuvers being planned for 1987 by bankers are: participate in an acquisition (56%), modernize an existing facility (27%), close an existing facility (15%), build a new facility (12%) and merge with a bank of equal size (7%). Only one respondent plans to sell out to a larger bank.

Strategies for Improving Profits

Bankers were asked to indicate which of the following factors they believe to be most important in realizing higher profits in 1987:

- Improved bank sales culture — rated "most important" by 19% of respondents.
- Better use of human resources — rated "most important" by 17%.
- Improve asset/liability management techniques — rated "most important" by 12% of respondents.
- Improving yields on investment portfolios — rated "most important" by 8%.

Little importance was given to the following: better use of fixed assets; installing new productivity-enhancing equipment; improved marketing/advertising; and improved customer convenience with more branches, ATMs or POS facilities.

Importance of Banking Issues

Respondents were asked to rate the importance of a number of issues facing banking in 1987.

- Profitability was rated "most important" by 27% of

Higher-Profit Factors

(selected as "most important" by respondents)

Improved A/L-management techniques	12%
Better use of human resources	17%
Improved bank sales culture	19%
Productivity-enhancing equipment	19%
Improve investment yields	8%
Improve marketing/advertising	8%
Improve customer convenience	1%

More of Same for 1987?

NO GREAT CHANGE in the economy is predicted for 1987 by representatives of major financial institutions and consulting firms.

A sluggish economy is predicted for 1987 by Sung Won Sohn, chief economist, Norwest Corp., Minneapolis. He cites weaknesses in consumer spending on big-ticket items and in business investments on equipment and commercial construction as the principal causes of the sluggishness.

These weaknesses will be partially offset by improvements in the trade deficit. Mr. Sohn sees no recession soon because of the growing importance of the service sector of the economy and a boost in manufacturing employment, which will benefit from the narrowing trade deficit.

The deficit picture is improving, he said, because U. S. exports are becoming more price-competitive and orders from overseas are rising, thanks to the dollar's depreciation. Result: increased exports.

Any near-term increase in inflation is likely to be moderate, said Eugene A. Leonard, senior vice president, Mercantile Bank, St. Louis. Somewhat higher prices are likely, due to high demand for goods and services, declining imports and the likelihood that energy and commodity prices are close to the bottom of their declines.

Economic growth in 1987 will be restrained because of effects of the Tax Reform Act of 1986 and production cutbacks in the auto industry, according to John H. Blixen II, Mercantile senior vice president. Real growth in 1987's first half will be at a 1.7% annual rate, rising to 2.6% in the second half.

Mr. Blixen said the tax law will trim as much as a one-percentage-point reduction in real GNP growth because its provisions are likely to adversely affect construction spending and capital investments.

Inflation fears have been renewed because of higher oil prices and the dollar's depreciation, but other factors will serve to balance those concerns, holding inflation under 4% through 1988, Mr. Blixen said.

Moderate growth throughout 1987 was predicted by an economist at the Kansas City Fed. Lower interest rates and greater household wealth are encouraging further gains in consumer spending, according to Alan Garner, and the substantial decline in the foreign-exchange value of the dollar should discourage imports and make U. S. goods more competitive in world markets.

respondents.

- Asset quality was rated "most important" by 19%.
- Interstate banking was checked as "most important" by 17%.
- Nonbank competition was selected as "most important" by 8%.
- The economy was selected "most important" by 7% of respondents.

Little importance was given to the agriculture crisis, deregulation, the price of oil, general competition, public confidence in banking, balance-sheet strength and consumer issues.

Anticipated Banking Legislation

Bankers were asked to list banking legislation they expected to see enacted in 1987 at the federal level.

"None of significance" was the most-listed response (19%) and in second place was closing the nonbank loophole (15%), followed by FSLIC bailout, interstate banking and legislation authorizing new services for banks (such as insurance, real estate, brokerage).

No legislation is expected at the state level by 29% of respondents. Those who do expect such legislation think it will be in the nature of regional and/or interstate-banking authorization.

Tax-Law's Effect

Bankers listed the following effects they expect the Tax Reform Act to have on banking: lower earnings/profits — 24%; reduced importance of municipal bonds — 17%; higher tax rate — 15%; change in asset mix — 7%. Seventeen percent said there would be little, if any, change at their banks. • •

What Bankers Said Last Year

Predictions for 1986 by bankers surveyed by this publication and published in the January, 1986, issue, revealed the following:

- Bank failures would increase in 1986 over 1985 by as much as 10%.
- Prospects for a recession in 1986 are "even."
- The Dow Jones Industrial Index would not go above the 1550 mark.
- Little new-product introductions were expected.
- Economic conditions for farmers would worsen in 1986.
- The inflation rate would range between 3% and 6%.
- The prime rate would not drop below 9% or rise above 10.5%.
- Unemployment would stay in the 7% to 7.5% range.
- Consumer services would be the strongest sector of the economy while agriculture would be the weakest.

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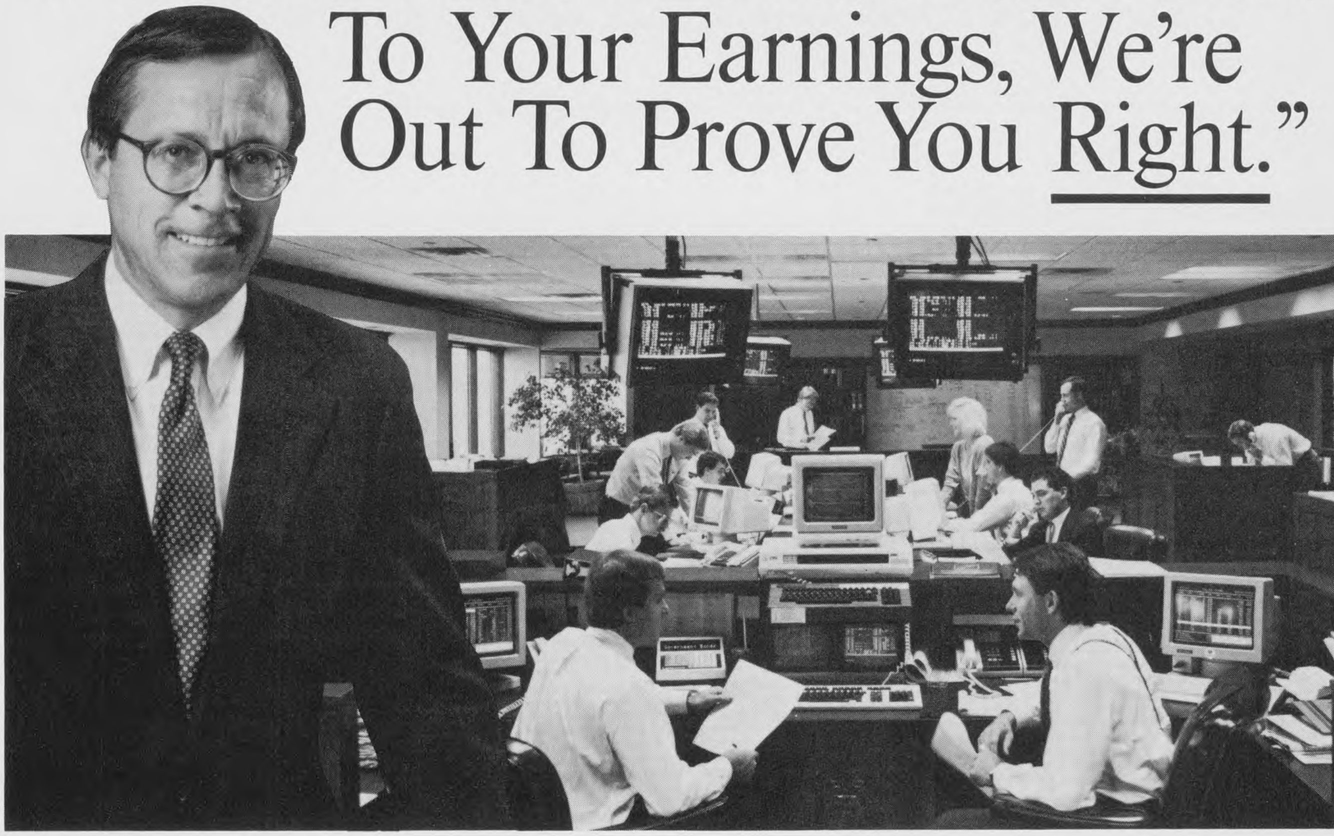

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Credit Outlook for 1987

Special Reports on Areas Critical to Banking

Asset-Based Lending

Commercial lenders, more sober in assessing opportunities, worry about restrictive legal trends

By John L. Cleveland
Editor/Associate Publisher

A YEAR ago, asset-based lending was getting a considerable amount of attention in the press. The newspapers were full of reports of mergers financed by the assets of one of the parties to the merger. Some of the reported deals were staggering by historical standards.

Since then, asset-based lenders have begun to take a more sober view of leveraged buyouts (LBOs) and, for a variety of reasons, LBO activity no longer seems to be page-one news, says Peter Schwab, president of Foothill Capital Corp., Los Angeles.

"Interest in LBOs remains strong even though lender appetite has died off somewhat," Mr. Schwab says. "We're being more careful because — to be frank — some of the LBO deals have not worked out very well. That doesn't mean that there aren't deals out there to be made. Just because our industry has changed doesn't mean that the companies in the market for LBOs have gone away."

Mr. Schwab says that Foothill expects to see continued growth in the two areas that have traditionally supplied asset-based lenders with the core of their business: firms in either sharp inflationary or deflationary cycles and which for those reasons have not been successful in getting financing through traditional sources.

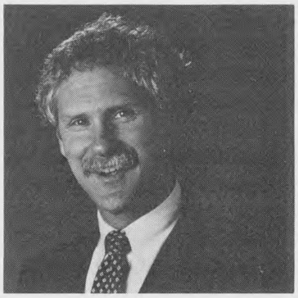
Many so-called asset-based financing deals put together today don't really fit the traditional definition of asset-based lending, according to Mr. Schwab.

"Look at them carefully and you'll see that they have excellent cash flows and excellent collateral," he says. "In effect, what some of the large, bank-owned asset-based lenders are doing is looking for bankable, secured loans they can call asset-based loans."

Companies in need of financing that doesn't quite fit the mold still exist and many banks in smaller communities have such firms as customers, Mr. Schwab says. Such customers can be a profitable source of business if the bank finds outside expertise to handle the intricate details of the asset-based loan. The bank can either participate in the loan or refer the customer to a commercial lender while still retaining a business relationship with the customer in other areas, he says.

Commercial-lending expertise continues to be in short supply, according to Steve Leskovsky, executive vice president of ITT Commercial Finance Corp., St. Louis. Some of the people who jumped into commercial lending within the past couple of years did not have people adequately trained in monitoring collateral and other aspects of asset-based lending necessary for success.

All commercial lenders "roll the dice a little" on every loan, Mr. Leskovsky says, but unless the lender has the ability to assess the worth of the collateral underpinning the loan at the time the loan is made and what that worth could be three or four years down the road, the risks become extreme. A number of smaller banks have had difficulty in asset-based lending because they don't have the resources to monitor the collateral carefully, foresee problems before they arise so they can take early corrective action and dispose of assets in an efficient manner if the loan goes sour.



"Interest in LBOs remains strong, even though lender appetite has died off somewhat."
— Peter Schwab

In addition to a shortage of people with sufficient expertise in asset-based lending, current legal trends are helping to restrict the growth of asset-based lending. At the National Commercial Finance Association convention held last month in Boston, Frederick S. Gilbert Jr., chairman of the association and executive vice president with Citicorp Industrial Credit, said that enlightened court interpretations of existing laws and revisions in bankruptcy laws as they pertain to asset-based lending are needed. He called for the establishment of a national fraudulent-conveyance law.

Citing recent court interpretations holding lenders responsible for the enforcement of environmental regulations, Mr. Gilbert said that just as it has in the insurance industry, the "chilling spectre" of liability litigation haunts asset-based lenders and inhibits their ability to do business.

"It's obvious that the laws need more clarity and the rules have to be understood by all, including the courts," he said. "The asset-based financial-services industry wants no special treatment, just the ability to take risks with the reasonable expectation of having business agreements backed by the legal system."

He urged attendees to stump for a revision of bankruptcy laws to eliminate hidden liens. "We need a na-

tional structure under which creditors could safely do business without being blind-sided by hidden liens under a liquidation scenario," he said. ● ●

Liens

New law complicates things for farmers and lenders. How you can protect your security interest in farm products

By Kenneth N. Linker
Vice President-Compliance
Banconsumer Service, Inc.

THE Federal Food Security Act of 1985, which takes effect December 23, was designed to prevent laws which subject purchasers of farm products to possible double payment; once at the time of purchase and again if the farmer failed to repay his creditor.

However laudatory the motives behind the law, it flies in the face of existing UCC law, which provides that buyers of farm products do not purchase those goods free of any security interest. This act will provide numerous problems for buyers and sellers alike, not to mention marginal farmers who could be forced out of the credit markets altogether.

Briefly, the Act provides that the buyer of a farm product is free of a security interest in those products unless:

- The secured party has filed an effective financing statement in a central filing system established by the state which the Secretary of Agriculture has certified, or
- Prior to sale, the secured party has served the buyer with written notice of the security interest in a form required by the Act.

The concept behind a central filing system is that this will provide a mechanism that would allow a creditor to submit a statement to a central location which would indicate his interest in specified farm products. This list would then be made available to purchasers of farm products who would register with the central filing system. Registered purchasers would receive periodic lists showing creditors with a security interest in the products they are purchasing. If a buyer failed to register with the system, he could not buy the farm products free and clear of any lien.

Only a few states have thus far requested certification and in those states in which no provisions for a certified central filing system have been established, creditors should take the following steps to protect their security interests:

1. The farmer must furnish the lender with a "buyer's list," i.e., a list of all names and addresses of all buyers with whom he deals. Herein lies a rather intriguing "Catch 22" situation. The Act specifically says that a farmer who does not provide such a list is subject to a penalty of $5,000 or 15% of the value of the farm product sold. In order for the penalty to be operative, however, the underlying security agreement must contain a provision describing that penalty. Therefore, creditors should consider amending their existing security agreements to include the penalty provision. The penalty is generally described as a fine — generally a government-enforced penalty — and therefore is not something a private party can collect. Creditors get no benefit from this potential penalty unless the farmer is aware of it and fears government enforcement.

2. The creditor must send an adequate notice to each buyer apprising him of the creditor's security interest in the farmer's products. This notice should contain the debtor's name, address, social security or tax-identification number, name and address of the creditor, type of crop, livestock or farm product (location where the product is produced should be specific), and instructions regarding payment (i.e., should the check be sent to the secured party or debtor and whose name should appear on the check). It is recommended that this prepurchase notice of lien be sent by registered mail since the Act makes clear that state law will determine what constitutes receipt of notice.

The purchaser of farm products who receives the notice of security interest within one year before the sale will take the farm product subject to the security interest. The notice will lapse either on the expiration period of the notice (one year from date received) or transmission of a notice signed by the creditor that the notice has lapsed.

The creditor will be required to renotify what remains unsold after one year from the date the notice was received. A separate notice is required for every new crop year. Finally, any amendments to the notice must be in writing and sent within three months of the effective date of the amendment and signed by the creditor.

Creditors in states that have laws requiring presale notice to buyers of farm products should review the new act carefully for any inconsistencies with their state laws. If the state law is inconsistent with federal law, creditors may have to review their current procedures for prenotification as well as amending their current security agreements.

Note that the new law does not expressly pre-empt basic state law for the creation, protection or priority of a security interest. Therefore, in order to avoid potential lien-creditor problems (i.e., bankruptcy), the creditor still should file under the Uniform Commercial Code.

Leasing

Loss of 10% ITC could drive out leasing firms with tax appetites, leaving room for newcomers

By John L. Cleveland
Editor/Associate Publisher

LOSS of the 10% investment tax credit (ITC) probably will drive some institutions with hearty tax appetites out of the leasing business beginning next year. On the other hand, a number of other firms with appetites for a share in what should continue to be a growing market should find leasing more attractive now that the firms which primarily were interested in the leasing business as a tax shelter will be falling by the wayside. That's the opinion of a number of leasing experts contacted by MID-CONTINENT BANKER in November.

The Economic Recovery and Tax Act of 1981 created a surge of tax advantages that have benefited firms involved in equipment leasing, says Terry Winders, pres-

ident of First Lease & Equipment Consulting, Louisville. A lot of major companies got into the leasing business to take advantage of those tax benefits, making it difficult for firms without similar tax appetites to compete, he says.

The new tax-reform legislation shifts the tax advantages of leasing from the balance sheet of the lessor to the lessee, says Mr. Winders. That should mean that as quickly as accountants assimilate the meaning of tax reform and come to recognize the advantages of leasing versus purchasing durable goods, business and consumer demand should pick up. A host of new firms, including banks, will find that leasing will become a boom industry during the next couple of years, he predicts.

"The new tax-reform legislation shifts the tax advantage of leasing from the balance sheet of the lessor to the lessee." —Terry Winders

Equipment leasing is now nearly a $100 billion industry, larger than any other form of equipment financing, Mr. Winders says. Under tax reform, leasing allows businesses to tie equipment expenses to the accounting period in which they were incurred, something that purchasing no longer does, he says. In effect, leasing gives businesses greater control over their income statements and taxes and that's something business people increasingly will come to appreciate.

Ron Ruane of Paige-Ruane, Inc., King of Prussia, Pa., an automobile-leasing consultant, says that many of the same factors cited by Mr. Winders also will help to stimulate the consumer-leasing business next year.

"We're living an age of instant gratification," he says. "Leasing allows a consumer to walk into an auto dealership today and drive out tomorrow with that automobile of his dreams without having to reshuffle his finances to do it."

Banks considering profit opportunities in the leasing business should remain clear-headed about the business even if their customers are not, Mr. Ruane warns.

"If bankers think of the lease business as a substitute for no-downpayment financing, they'll be sleeping in the streets," he says. "You cannot afford to compromise your credit principles. If you wouldn't loan someone the money to buy a car, you don't want to lease it to them." • •

Charge-Cards

Competition to tighten as charge-card market becomes saturated

THE FACT that bank charge cards have entered the mature-product stage of the product life cycle will become more apparent in 1987, according to Ken Ragan, vice president, Bank Card Center, Commerce Bank, Kansas City.

No longer are there large groups of credit-worthy customers desirous of having a charge card waiting for a bank to place an application in their hands, he says. When a product reaches the mature-product stage, competition intensifies with pricing and product segmentation with the introduction of new card products — such as gold cards, corporate cards, affinity cards — that are developed for specific targeted-market segments.

Further closing of the annual-fee gap is expected in 1987, Mr. Ragan says. Currently, 94% of all MasterCard and Visa accounts nationally carry annual fees.

He says that 1987 will see increased emphasis in the industry nationally on improving delinquency and loss ratios and on improving operating efficiencies. The new year also should see continued emphasis on new card products, increased competition from banks marketing lower rates and a continuation of the trend toward more and larger annual fees. • •

Investments

Significant changes for munis, higher market yield necessary

By Douglas A. Williams

Assistant Vice President
Centerre Bank
St. Louis

TAX reform and its potential impact on fixed-income markets have been in the headlines of industry publications for the past few years. During that period, the investment decision process included a "best guess" on the outcome of the tax movement. Now that the bill has become law, it is clear that the financial markets will change in 1987.

The U. S. Treasury market will be least affected by tax reform, primarily because foreign investors will continue to help finance our debt. With regard to the performance of that market, the most likely scenario is a slight increase in inflation and a fairly stable economy.

How the other fixed-income markets trade in relation to U. S. Treasuries will be interesting.

The municipal market will experience some significant changes due to tax reform. The volume of new issues will be reduced dramatically in 1987. Many private-purpose projects will no longer be allowed to use tax exempt financing. In addition, state caps will limit the volume of those private-purpose issues that are approved. Since these bonds will be included in the alternative-minimum-tax calculation for both individuals and corporations, the risk of taxation means they will have to offer a higher market yield.

The volume of advance-refunding issues will drop due to new arbitrage restrictions and limits on the number of times a bond issue can be advance refunded.

There are no volume limits on public-purpose bonds, but there will be stricter qualification requirements.

As a result of these changes, some traditional issuers of tax exempts will move into the taxable market in 1987, probably having to structure their offerings differently to suit the demands of taxable investors. The pricing of taxable municipals will be influenced by the corporate bond market as well as U.S. Treasuries.

As tax rates drop over the next two years, it would appear that tax-exempt interest rates will have to rise relative to taxable rates. But because the supply of tax-exempt securities will drop substantially and alternative tax-advantaged investments are no longer available, the yield relationship between tax-exempts and taxables will not change as significantly as might have been expected.

Banks will not be a factor in tax-exempts for other than small "bank-qualified" issues, for which 80% of the interest carrying cost will continue to be deductible against interest income. The household sector will take up the slack, so tax-exempts will be priced for this market. Individuals subject to a high state income tax will be especially interested in the municipals of their own state, since state levies will become a larger percentage of the overall income-tax burden as the federal tax rate declines.

Because of the exodus from the tax-exempt market of banks, which normally buy five- to 10-year bonds, there could be a flattening of the tax-exempt yield curve; that is, intermediate term rates might move up.

The mortgage market will continue to prosper as banks and individuals search for higher-yielding investments. 1986 was an educational experience for participants in this market as lower interest rates triggered a flood of refinancing and encouraged new innovations from Wall Street, such as CMOs. Investors generally are becoming more comfortable with mortgage-backed securities, at least the vanilla type, and will continue to support this market. Banks will increase their holdings of these securities as their municipals mature. • •

• "**Branch Consolidations:** An Action Plan for Success" is the title of a new ABA manual that helps banks alleviate many potential community and regulatory challenges raised by branch consolidation. Copies are available from the ABA Branch Administration Division at $125 for members and $200 for non-members.

Bankers, Economists Make '87 Forecasts

Bankers responding to an economic-outlook survey by First Wisconsin National, Milwaukee, predict the following events by next October: 61% see a higher prime rate; 52% expect a higher bond yield; 53% are bullish about the Dow; real growth will be in the 2% to 4% range; inflation will increase from 2% to 6%; the third quarter is the one most likely to see a recession; and federal taxes will be raised.

The GNP will grow from 2.5% to 3.5% and inflation is expected to rise slightly to about 3.5% next year, according to James Christian, chief economist of the U. S. League of Savings Institutions.

Single-family housing starts will be close to the 1.2-million figure for 1986, but real consumer spending will slip to the 3% to 3.5% range. Big-ticket items will suffer most, business investment in plant and equipment will remain soft and 10-year Treasury-bond yields will range from 7¼% to 8¼%.

Home-Equity Credit

Tax reform has made it the retail product of the year. But is it a must for every bank?

By Joe Lawler
Assistant Editor

NOT SINCE Henry Higgins turned Eliza Doolittle into "My Fair Lady" has such a rapid transformation been worked.

The U. S. Congress, through its Tax Reform Act of 1986, has turned the home-equity line of credit from a quiet, moderately-successful item into the hottest retail product of the year.

Congress accomplished the change by phasing out the deductibility of interest on consumer loans, but leaving a loophole for interest paid on loans secured by home equity. (See sidebar, What's Deductible? on 26.)

Hence, interest payments on the typical credit-card purchase, educational loan, auto loan, or other consumer loan no longer will be tax deductible with the phase-out beginning in 1987. Yet these same interest payments will be tax deductible if the purchases are financed with credit secured by equity in the consumer's home.

Because of media exposure being given this loophole and the resulting popularity predicted for such products, banks across the country are scrambling to push the home-equity line of credit, or introduce the product if they haven't already.

In a recent MID-CONTINENT BANKER survey, bankers were asked to name any new products they planned to introduce in 1987 and name the existing products they planned to push. Although it was mentioned with many different names (second-mortgage loan, equity-secured line of credit, etc.), the product was mentioned most often in both categories, far ahead of such products as credit cards, financial planning and insurance.

A Strategic Necessity?

Some bankers and consultants are calling the home-equity line of credit a vital part of every bank's arsenal, if only for defensive purposes.

"I think just about every bank is going to have to offer it or they risk losing some of their best customers," says Terry S. Utterback, president of a marketing firm that bears his name, in Woodland Hills, Calif.

"About 15% to 20% of the customer base will use it," he says. "The problem (for bankers who fail to offer this product) is that it's your top 15% or 20%."

"Three-fourths of my clients have either launched, or we're helping them launch, the product."

Mr. Utterback recommends that bankers move fast. "People are getting bombarded with offers. There is a window of opportunity presented by the change in tax laws," he says. This product is in the spotlight now, and the people who want it will be getting it soon.

Donald W. Grigley, senior vice president/retail lending, at Connecticut National, New Haven, agrees that it's a necessity. "Bankers are missing an opportunity — if they don't have it available, the customer is going to go elsewhere. You have to do it for retention of your existing customers," he says.

The home-equity line of credit is an important part of his bank's strategic plan, Mr. Grigley says. "When we adopted our strategic plan in 1985, this was the #1 product to be sold as far as retail loans to attract the segment of the market we're after and to give us the opportunity to cross-sell."

Likewise, NCNB National, Greensboro, N.C., has enjoyed good success with its home-equity line of credit, says Douglas D. Stensvad, vice president/consumer credit.

"We first introduced the product about two and a half years ago. We felt there was a demand for it. We were already making a lot of second mortgages, and our unsecured line was very successful. We realized we could have a much more successful product by securing it to equity," he says.

Now that tax reform has given the product a new advantage, the bank will market it more heavily. "We will do more direct mail and highlight the tax advantage. We are already getting a

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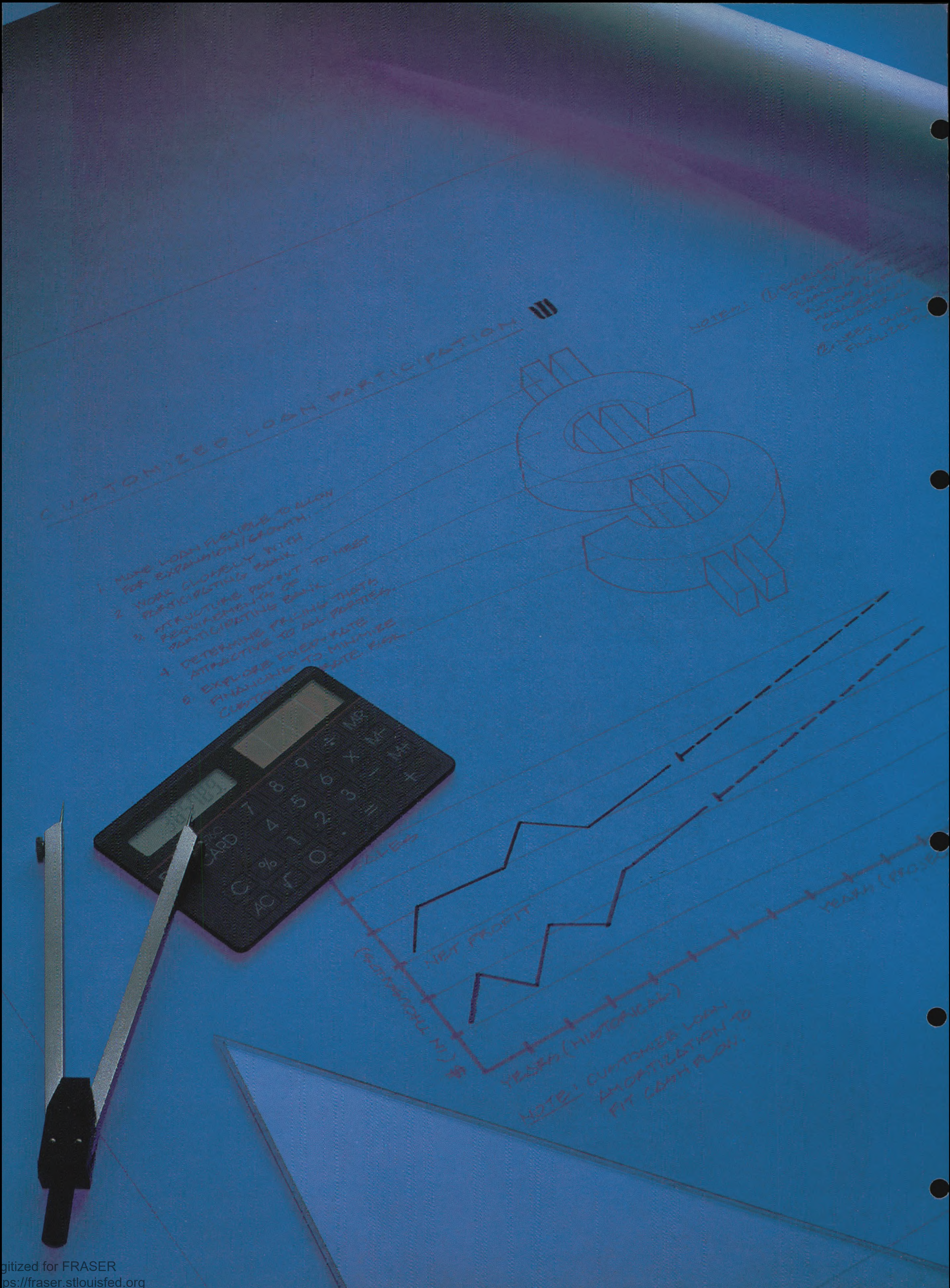
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lot of response on a mailing we did recently," he says. Much of that response is due to the media exposure this type of product has received, Mr. Stensvad says.

"Our volume doubled in a month. And it wasn't bad the month before that."

Marketing Suggestions

While most banks contacted tout the tax-deductible feature of this product, Mr. Utterback recommends against this.

The tax-deductible feature essentially is a loophole and loopholes can be closed. "I see two ways in which this loophole could be closed," Mr. Utterback says.

"First, the IRS could interpret that the intent of Congress was not to allow deductions for interest on consumer purchases." In this case, the loophole could be closed through an IRS ruling.

"Second, Congress could amend the law to close the loophole."

Because of this uncertainty, "we've suggested to people that they stay away from marketing the deductibility — let the media do it. Market this as a flexible, lower-cost line of credit."

As for the niche to be targeted and the media to be used, Mr. Utterback recommends defensive and offensive techniques:

"First, market to your existing customer base. Get it in their statement stuffers right away. I've already received four or five solicitations in the mail in the last few weeks. Get this out to your customer base before the end of this year, if you can.

"Second, try to expand into selected areas. This may call for some demographic information on your bank's market areas. Go into the areas of high home equity. We recommend that it be a rifle-shot approach, targeted by direct mail." Three percent can be considered a good response rate, he adds.

Patrick W. Harrison agrees that di-

Study Shows Four in 10 Homeowners Have Interest in Equity Lines

By Kenneth Owenby

Mr. Owenby is a research associate with Synergistics Research Corp., Atlanta.

HOME-EQUITY LINES of credit will become an increasingly important consumer-credit service as tax reform makes other forms of consumer credit less attractive.

This is one of the preliminary findings of Synergistics Research Corp.'s study, *The Impact of Tax Reform on Consumer Financial Services*.

A national telephone survey of 500 consumers with household incomes of at least $25,000 was conducted in August, 1986. Results show that presently only 13% of homeowners with incomes of $25,000 or more have an equity line of credit.

However, Synergistics believes the potential for this service is much greater than the present level of penetration indicates. Nearly four in 10 homeowners (39%) express some interest in equity lines.

This prospect group can be segmented into three components. About a third are strong prospects who are willing to pay closing costs of $500. Another one-fourth are prospects only if the provider takes care of the closing costs and about four in 10 are weak prospects in that they are initially uninterested, but say the tax advantage of the equity line makes it more attractive.

Of these self-professed prospects, Synergistics believes that half may actually apply for an equity line. This conclusion is based on the finding that half of all prospects express some reluctance in using their homes as collateral for any type of loan other than to purchase the house or make improvements on it.

The expense of closing costs also is expected to curtail the number of prospects who will enter the market.

Equity-line users tend to be younger than consumers who are not interested in the service, with 40% of the Rejector group being age 50 or older, compared to 23% of the Users and Prospects.

Strong Equity Line Prospects, those willing to pay closing costs, presently are key users of credit services. Seven in 10 are itemizers who extend payments on their credit cards and they are among the most likely to have a personal loan other than an automobile loan. Furthermore, their use of credit will be affected only a little by tax reform, further illustrating the potential for equity lines among these consumers.

The equity line may be one of the best preemptive devices ever available to providers for establishing credit and overall relationships with consumers. Consumers are not likely to have more than one equity line, and the provider of this line is likely to have the tremendous advantage of acquiring virtually all the credit business of consumers who are sensitive to interest deductions. The equity-line provider also is likely to gain all of the consumer's installment and revolving credit-card borrowing.

Many consumers probably will do less comparison shopping for automobile loans, and credit cards may be tied increasingly to equity lines as a means of preserving tax deductions for finance charges.

To sum up, financial institutions that are developing marketing strategies for equity lines must address consumers' concerns over using their homes as collateral and the resistance of some prospects to paying closing costs. Providers should assure customers that equity lines are an astute means of managing personal finances and of taking advantage of a legitimate tax deduction.

Those providers who have promoted equity lines by waiving closing costs may have made inroads into that segment of the market unwilling to pay them, but we question whether that strategy can be continued profitably.

Despite these obstacles, the equity line has high potential for tapping an ideal market.

rect mail will be the most effective medium for this product. He is executive vice president of Commerce Union, Nashville, and chairman of the consumer credit division of the ABA.

He adds that existing mortgage customers are a good niche for direct mailing. His bank also has used mass media, reinforced by an information line that is manned from 5 to 9 p.m.

NCNB National, Greensboro, had good results selling the product one-on-one to customers who came in to apply for traditional consumer loans, reports Mr. Stensvad.

J. Franklin McCreary, attorney and consultant with Borod & Huggins, Memphis, suggests that bankers consider a mailing to existing customers who have unsecured lines of credit, spelling out the tax advantages of taking a secured line of credit.

In addition, he recommends staying in touch with customers who take out a line but don't use it right away.

"Send them a letter, letting them know how they can use it. After a while, people forget they have it, or they aren't sure whether it's still available," Mr. McCreary says.

He recommends letters rather than statement stuffers for such communications. "There are so many statement stuffers these days that the statement stuffer doesn't get as much attention as a letter."

Connecticut National surveyed users of this product, says Mr. Grigley. "We found the typical user of this product to be the two-wage-earner families with a mean income of $50,000, 30 to 45 years in age, with two children. They typically need the credit for children's educations or for consumer purchases such as cars, appliances or home improvement."

What's Deductible?

The deductibility of interest on consumer loans will be phased out according to the following schedule:

For 1987, 65% of consumer interest will be deductible; in 1988, 40%; in 1989, 20%; in 1990, 10%. Beginning in 1991, no consumer interest will be deductible.

According to Michael P. Morgan, attorney and associate in the investment-banking division of Borod & Huggins, Memphis, qualified residents' interest will remain fully deductible. Qualified residents' interest is interest paid on debt secured by a security interest on the taxpayer's principal or second residence. The amount of debt cannot exceed the taxpayer's cost basis (purchase price) of the residence, plus any improvements.

One exception: Any debt incurred with security in the residence, in excess of this limit, to be used for educational or medical purposes, also qualifies as deductible.

How it Is Structured

The equity line of credit basically is a second mortgage, a revolving line of credit secured by the customer's home. As such, it requires an appraisal, a title search and title insurance. "Most lenders charge $200 to $800 for closing costs, or a percentage of the line," says Mr. Utterback.

The credit limit usually is about 80% of the appraised value of the home, less any outstanding mortgage amounts. For example, on a home appraised at $120,000, with a $60,000 mortgage balance outstanding, the line

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An Unwelcome Gift

Namely, new accounting rules for loan fees and loan-origination costs

By Mitchell M. Krasnoff

BANKS and other lenders are about to receive a 1987 gift from the Financial Accounting Standards Board — a new set of accounting rules for loan fees and loan-origination costs.

The industry has spent the better part of 1986 trying to return the gift, only to learn that the FASB is not a Bloomingdale's or Neiman Marcus whose merchandise is returnable. Fortunately, the gift may be exchangeable to some degree, but the industry is finding out that even exchange privileges, although sometimes granted by the FASB, are not easy to come by.

Advance notification of the gift came in the form of the FASB's December 31, 1985, exposure draft of a proposed new accounting standard titled "Accounting for Nonrefundable Fees and Costs Associated with Originating and Acquiring Loans." If issued in its present format, the new pronouncement will dramatically impact the reported earnings of just about all financial institutions heavily involved in lending activities. This is why the banking community has been lined up en masse to protect its earnings by challenging the FASB on its conclusions, which are scheduled to take effect in calendar year 1987.

The exchange potential results from the FASB's due-process procedures followed in issuing new accounting standards. These procedures explain why accounting standards generally take several years to be developed.

Due-process procedures begin with the issuance of a preliminary discussion document presenting the issues on a neutral basis — in this case, a September, 1984, invitation to comment. The next step is an exposure draft of the proposed new standard, developed after giving consideration to comments received on the discussion document. The exposure draft also requests written comments from interested parties.

The loan-fee exposure draft had a 120-day comment period and elicited more than 800 letters of comment — one of the largest responses ever received by the FASB. This was followed by public hearings on the exposure draft, which were held in Washington, D. C., on July 16-18, 1986.

The final step — in process right now — is the evaluation of this input, to decide whether any changes to the exposure draft should be made. The new accounting standard is scheduled for issuance by the end of 1987.

Present accounting requirements for financial institutions, contained in various audit guides of the American Institute of Certified Public Accountants, are industry rather than transaction oriented. This resulted in the current practice, which permits diverse accounting treatments for similar transactions by different types of financial institutions.

These inconsistencies were not as apparent in the past when financial institutions tended to specialize in one particular type of lending activity. In recent years, however, the industry has changed. Today's financial institutions are financial-service conglomerates, with all types of institutions making virtually all types of loans. This problem is solved by the FASB's overall premise that all lending activities are the same, regardless of the type of loan or the type of financial institution lending the funds. Thus, the account for loan fees and costs should be consistent for all types of lending.

The pronouncement addresses all nonrefundable fees received in the acquisition, origination or refinancing of loans. In practice, these fees have taken a variety of names, such as application fees, arrangement fees, points, buydown fees, management fees and restructuring fees. For accounting purposes, all such fees, regardless of their names, are to be categorized and accounted for based on their substance as whether origination fees, commitment fees or syndication fees.

The pronouncement also covers accounting for costs incurred in the loan acquisition, origination or refinancing process. This is essential, since any desired effect of fee recognition on reported earnings can be either achieved or negated by the treatment of loan costs.

The principal proposed account requirements are summarized as follows:

- Loan-origination fees should be deferred and recognized as income (using the interest method) as an adjustment of the yield of the related loan.
- Loan-commitment fees generally should be accounted for the same as loan-origination fees (i.e., deferral and recognition as a yield adjustment of the related loan). If the commitment expires unexercised, the deferred fee should be recognized as income in its entirety on expiration. Exceptions are made for the following two situations:

1. Recognition by the straight-line

Mr. Krasnoff is national director of accounting at Laventhol & Horwath, Philadelphia.

RMA Names High-Loss Industries

THE TOP THREE high-loss industries in 1985, ranked by dollars charged off, were oil/natural gas extraction and field services, real-estate brokers/agents and subdividers/developers.

The top high-loss industries nationwide by the number of times cited were personal borrowers, general farms and eating/drinking places.

This information is contained in the 15th annual loan charge-off report published recently by Robert Morris Associates.

RMA members predicted personal borrowers, eating/drinking places and oil/gas services would be the top three high-loss industries for 1986.

method over the commitment period when the probability of exercise is remote (e.g., fees for letter of credit arrangements), and

2. Recognition as billed when assessed retrospectively as a percentage of an unused line of credit.

- Incremental direct costs of loan acquisition or origination should be deferred and recognized (using the interest method) over the life of the related loan as a reduction of its yield. All other origination and acquisition costs should be expenses as incurred. (Incremental direct costs are defined as costs that result directly and jointly from the lending transaction and would not have been incurred absent the transaction.)
- Loan-syndication fees generally should be recognized when the syndication is complete.
- All deferred loan fees and costs should be amortized over the contractual loan-repayment period; expected loan prepayments should not be considered.

The FASB knew that its conclusions, which will result in the most conservative possible accounting, would generate extensive controversy. Banks and thrifts, together with the various organizations that lobby on their behalf, have been especially vocal in their opposition. The requirement to treat all loan origination fees as a yield adjustment will result in a significant change in practice.

Most financial institutions today either recognize certain fees as revenue at loan inception or recognize a portion of the fees to offset costs incurred to originate the loan. (The latter practice of neutralizing the effect on earnings of origination costs as incurred is especially prevalent with thrift institutions.)

The negative impact on earnings of this change is not being accepted without strong protest. The proposed accounting for loan-commitment fees also has encountered opposition, especially by commercial banks. To support the required deferral of most of these fees as a yield adjustment, the FASB indicates that there is "little substantive difference" between the activities involved in loan origination and loan commitment. Thus there is a presumption that commitment fees are no different than origination fees. There probably are few bankers involved in the lending function who agree with this rationale.

Another conclusion considered inappropriate, especially by thrift institutions heavily involved in mortgage lending, is the proposed requirement to amortize deferred fees (and costs) over the contractual life of the loan. Thrift institutions argue that most long-term mortgages do not remain outstanding to maturity and past experience permits reliable estimation of an average expected life of a mortgage portfolio.

Predominant practice today, therefore, is to amortize deferred fees into income over that shorter average expected life.

Finally, the proposed limitation of deferrable loan origination or acquisition costs to incremental direct costs has been challenged. Most financial institutions take the position that deferrable costs should include all direct costs as well as an allocable portion of those indirect costs related to the loan-origination function. This broader cost concept presently is used by many institutions (especially S&Ls) to quantify fee revenues recognized at loan inception to offset origination costs incurred. If the FASB is going to preclude up-front loan-fee-income recognition, the impact on earnings should at least be mitigated to some degree by permitting more liberal cost deferral.

Will the FASB reconsider its conclusions on some of these controversial areas, or will it hold the line and say that its proposed 1987 gift to the financial-services industry is nonexchangeable in any way? If attention is paid to the industry's overwhelmingly negative reaction, revisions to the tentative conclusions would be substantial.

The more realistic view, however, is that few revisions will be made (remember, exchange privileges are not easily granted by the FASB!) and the final pronouncement will resemble the exposure draft in most respects.

While financial institutions may not be happy with their new accounting requirements, they will at least have the satisfaction of knowing that they went down fighting. • •

Loan Rules Eased

FASB has pushed back the effective date of its new rules on accounting for fees from the origination or acquisition of loans, referred to in the adjoining article. The rules will be effective for fiscal years that begin after December 15, 1987, rather than 1986, as originally proposed. Lenders also will have the option of applying the new accounting procedures prospectively or restating prior-year earnings to reflect the changes.

Fed Sets Later Deposit Deadlines

THE Federal Reserve Bank of St. Louis has announced that it will extend seven deposit deadlines, giving financial institutions up to an extra 90 minutes to accumulate, prepare and deposit checks.

In some cases, these new deadlines will enable institutions to accelerate funds collection by an entire day, according to the Fed. Changes are effective January 2, 1987. Collection fees are being held at current levels.

Three deadlines will be extended one hour, to 8 p.m.; the evening deadline for mixed deposits, the other Fed item-deposit deadline and the country unsorted-deposit deadline.

The deposit deadline for country fine-sort items will be extended one hour, to 10 p.m.

Two deadlines are being extended by 90 minutes, to 1:30 p.m. — the Regional Check Processing Center (RCPC) unsorted-deposit deadline and the early morning mixed-deposit deadline. The RCPC premium-deposit deadline will be extended 45 minutes, to 3 a.m.

The new deadlines are easy to use and require no special deposit preparation, the St. Louis Fed reports.

Almost 50 deposit deadlines will be extended in December and January by Federal Reserve banks across the country. Also, 59 fees will be reduced by Reserve Districts, with six fee increases planned.

Called the biggest improvement in its check-collection program in recent years, the new deadlines reflect the Fed's goal of improving the payment mechanism and accelerating funds collection whenever possible, reported a Fed spokesperson.

- **William J. Stolte** has been named chief national bank examiner at the Comptroller's Office. He succeeds John Downey, who resigned.
- **The Minneapolis Fed** has named Richard L. Kuxhausen vice president/business development, James H. Hammill assistant vice president/corporate secretary, Keith D. Kreycik assistant vice president for computer services and Warren E. Weber research officer.

Designing Jobs For Productivity

Discover and eliminate unnecessary costs hidden in your employees' jobs

By Mary K. Smith
Vice President
Human Resource Technologies, Inc.
Roseville, Minn.

WHEN OPERATIONAL costs increase without a corresponding increase in employee productivity, some typical reactions are to fire poor performers, "motivate" everyone, or automate as much as possible.

A less-expensive reaction would be to first examine the job content of employees' positions and identify cost-saving possibilities through job design.

Job design is the process of structuring the work content of positions.

Unless the bank's managers carefully control position content, employees may informally design their own jobs to suit their own abilities, interests, or energy levels, resulting in:

- The employee concentrates efforts on the most interesting or fun aspects of the work while ignoring the tedious work;
- A high achiever assumes more responsibilities because another employee can't handle certain responsibilities;
- A low achiever avoids performing work that is too difficult;
- A lazy employee shunts work assignments to others, or exaggerates the time required to perform the work.

These are but a few illustrations of the problems that can arise when bank management does not control position content and allows employees to design their own jobs.

This situation can result in these effects:

- Work flow is disrupted (e.g., deadlines are missed, error or rejection rates are high);
- Employee morale falls (because of under- or over-utilization of employees, creating stress and tension; "I'm always busy but they're not");
- Employees perceive salary inequities (e.g., "My job is more responsible but I get less money") for which the organization is held accountable;
- Management lacks a coherent job framework on which to base decisions (e.g., how to improve productivity).

To regain control over the work content of employee positions, management should:

1. Define all work performed in the organization, by work area.

To do this, prepare simple work-flow charts for each work area. Prepare a numbered listing of brief task components (key words) to describe work to be performed (e.g., #699 prepares work-area budget, #100 operates copy machine, #905 issues/redeems savings certificates). Then place appropriate task numbers next to each segment of the flow chart.

Unless managers carefully design jobs, employees will design them to suit themselves.

2. Prepare a checklist of tasks for completion by each employee. Ask each employee to estimate the amount of time, or percentage of time, required to perform each task.
3. Compare checklist results with your flow chart.
4. Identify redundant, omitted and inappropriate tasks.
5. Using this information, redesign existing jobs to meet the operational task needs outlined on your flow chart.
6. Prepare job descriptions for each position using your job designs. For job descriptions, expand the task components into more detailed task statements that describe tasks to be performed.
7. Discuss the job-description content and your performance expectations with each employee.
8. Audit job content at suitable intervals. Redesign positions as necessary to meet operational needs.

The above procedure can be very effective in increasing employee productivity.

For example, in the marketing office of a Fortune 100 company, a job-design study revealed that 20 secretarial positions were accountable for distributing mail twice a day to and from the internal mailroom. Each trip was expected to take 15 minutes. However, employees often stopped to visit one another or take other informal work breaks. The average mailroom trip took 30 minutes.

The company removed this task from the 20 positions, hired two part-time employees (from a vocational rehabilitation program) to share an eight-hour day performing this task plus other tasks. This saved 12-plus hours of employee time per day and gave public recognition for hiring the handicapped.

In another example, a small business had a problem. Telephones were not being answered, resulting in lost business. The job study revealed that this task was listed in only one position description. Management added this task to other position descriptions and told affected employees they would be accountable. This resolved the problem of the unanswered telephones.

A job-design study also will reveal that some positions are underutilized. These positions then can be directed to other needs.

For example, one organization had a backlog of accounts receivable. Because the organization could identify underutilized positions, the organization was able to consolidate several positions and free one position to handle accounts-receivable telephone contacts.

When bank management has control over existing job content, management will be able to remove hidden costs that reduce productivity. In

(Continued on page 32)

Combatting Foreclosure-Delaying Tactics

Ag bankers should be alert to detect and combat frivolous and Chapter 11 measures taken by borrowers

By Jim Fabian
Senior Editor

AGRICULTURAL-crisis stress among farmers has resulted in extreme measures being taken by some borrowers to avoid foreclosure, according to an Illinois attorney.

Gregg Grimsley termed these measures the "cocaine" of the farm industry at a recent agricultural conference sponsored by the Illinois Bankers Association. The term is apt, he said, because the measures are entering Illinois from outside its borders similar to the influx of drugs entering the U. S. from other countries.

These tactics are nothing more than "pipe dreams" that farmers hope will keep them on their property while courts adjudicate their claims against lenders, according to Mr. Grimsley.

One ploy being used in Illinois is the filing of federal land patents based on the assumption that Illinois land is part of the Louisiana Purchase of 1803 and that such land is exempt from mortgage covenants by the treaty signed by President Thomas Jefferson with the French government.

Mr. Grimsley termed this defense "garbage" and said the 7th Circuit Court of Appeals in Wisconsin recently termed a suit resulting from such a claim to be frivolous and fined a farmer for filing it! (The case is State of Wisconsin vs. Glick, January, 1986.)

Another ploy is to use common-law liens, the purpose of which is to "mess up" land records, Mr. Grimsley said. The idea was given to farmers by some farm journals, and has proved to be lacking in merit.

A third effort to avoid foreclosure involves family-preservation trusts, a concept that is being "sold" to farmers by money-hungry individuals.

At a time when the farmer is insolvent, his land goes into the trust and a corporation may be established into which the equipment is transferred. Mr. Grimsley cautioned bankers to be especially careful if confronted with such a situation.

When the farmer is insolvent, fraud against the lender is the presumed purpose of these ploys, he said.

Payoffs by fractional-reserve notes instead of cashiers checks is another thing to watch out for, he said. Fractional-reserve notes look authentic, but aren't. They extend "credit" at the farm, which results in the bank receiving credit rather than currency — credit that is useless to the lender.

The purpose of these ploys is to buy time, Mr. Grimsley said.

Banks can take actions against such ploys, he adds. They can keep each case moving by staying on the offensive.

"Keep your lawyer busy," he advised. "Contact federal criminal authorities because violations of federal law could be involved due to farmers selling collateral out of trust or lying about existence of collateral when their loans were negotiated.

"Watch for symptoms of fraud," Mr. Grimsley said, "then react quickly." One way to try to get quick action from federal authorities is to get fellow bankers to visit them en masse to request action.

The most common rational defense borrowers take to avoid foreclosure is Chapter 11, which results in automatic stoppage of foreclosure action. The banker must get the stay lifted in order to collect his collateral, thus, bankers should file motions for relief of the automatic stays right away.

This forces a meeting with the

debtor, Mr. Grimsley said, which is important, because most debtors want to avoid such a meeting — at least at the outset. At the time of this meeting the banker should look for soft and hard collateral. He should tell the lender that he either must turn over the collateral or pay the bank for it.

The banker should learn the details about the current crop, such as what disposition is being made of it, Mr. Grimsley said. He then should look at the land and machinery and get the borrower to pay rent to use any excess collateral. If no payment is made, the automatic stay is lifted and the banker is free to possess the collateral. • •

Designing Jobs (Continued)

addition, bank management can take several pro-active steps through job design to:

- Properly utilize positions and restructure positions that are over- or underutilized;
- Promote continuity of work flow;
- Improve employee morale by monitoring job content to ensure that the work is distributed fairly;
- Demonstrate commitment to work equity based on a well-defined description of position content.
- Give managers knowledge of work content that will assist management in making organizational decisions, especially decisions on improving productivity. • •

Softer '87 Economy Seen by Lyle Gramley

A general softening of the economy has been predicted for 1987 by Lyle E. Gramley, chief economist, Mortgage Bankers Association, and former Fed governor.

Mr. Gramley sees a 2.5% GNP growth rate next year, with weaknesses in consumer spending and commercial construction. Federal spending will be reduced from $221 billion to $190 billion because of Gramm-Rudman (he termed this a "tremendous" slowdown, representing 20% of the economy).

Mr. Gramley sees an increase in exports, which is expected to be good for the economy, along with rising inventories.

The Consumer Price Index will see a 4% upturn, which gives no cause for concern, he said, and an end to low oil prices.

He sees lower interest rates, low inflation, moderate economic growth and rising cost of capital due to tax reform, which will force rates down.

Mr. Gramley predicted additional cuts in the discount rate early in 1987 because the Fed wants the economy to maintain satisfactory growth.

Single-family housing starts will hit 1.25 million, which is lower than 1986 starts. New single-family-home sales should be 300,000 in 1987, with total home sales reaching about 3.3 million.

Former MCB Publisher Dies

DONALD H. CLARK, former publisher of MID-CONTINENT BANKER and founder/chairman, Commerce Publishing Co., the magazine's parent firm, died last month in St. Louis following a lengthy illness. He was 90.

Mr. Clark came to St. Louis in 1922 to edit MID-CONTINENT BANKER. He purchased the magazine two years later and served Commerce Publishing for more than 50 years.

During that time he founded *Life Insurance Selling* and *American Agent & Broker* and bought *Club Management* and *Decor* magazines.

Mr. Clark was a past president of Sigma Delta Chi, national society of professional journalists.

His journalism career began in Des Moines following graduation from Grinnell College in 1918. During his working years, he continued his education at Columbia University, New York City, the University of Wisconsin, the University of Berlin and the Instituto Allende in Mexico.

Mr. Clark is survived by a nephew, Wesley H. Clark, current chairman of Commerce Publishing Co. and publisher of MID-CONTINENT BANKER, and two grand nephews.

Facility Sale-Leasebacks

Practice gives banks alternative to raising capital in today's marketplace

By Jim Fabian
Senior Editor

THE SALE and leaseback of corporate real estate has emerged as a major alternative financing source for banks, says Sidney Domb, president, United Trust Fund, Miami.

United Trust Fund is active in arranging sale-leasebacks for banks wishing to gain the maximum advantage from their headquarters buildings and branch facilities.

"Banks are joining the ranks of firms that are freeing up equity that's lying dormant in brick and mortar," says Mr. Domb, "as their CEOs become aware of the advantages of this financing vehicle."

Explaining the practice, Mr. Domb says a sale-leaseback converts noncurrent fixed assets — real estate — into current liquid assets — cash. The bank also generates a gain on the sale when the properties have market or appraised value greater than their depreciated book value.

"Rental expense should be significantly lower during the early years of the lease term under a well structured sale-leaseback," Mr. Domb says. "Consequently, earnings could be improved by reinvesting the cash at a higher rate, retiring high-cost debt, funding mergers and acquisitions, expanding operations or taking advantage of special investment opportunities."

Cash received from the sale-leaseback can help commercial banks improve their primary capital-to-assets ratio and their total capital-to-assets ratio. Profit on a sale-leaseback from depreciated value to current appraised value can significantly increase net worth under GAAP or RAP accounting procedures. It also can utilize otherwise lost net-operating-loss tax-carryforward benefits.

Simultaneously with the sale, the bank would lease back the facilities for an initial lease term of typically 20 years, with five five-year options, he explains. In effect, this provides the bank with total control of its real estate for at least 45 years. "This would be identical to ownership, through options, for the normal useful life of the facilities," he says.

Another sale-leaseback benefit seen by Mr. Domb is made possible by structuring an "operating lease" so that the transaction would not require capitalization under FASB 13 criteria. In turn, he says, this would allow "off-balance-sheet" treatment, which, in effect, would have a more favorable impact on the bank's earnings and improve important financial ratios.

"The sale-leaseback is a quick and economical method of raising capital when compared to the process of originating a new stock issue," Mr. Domb says. Not only is the cost of issuing bonds expensive and a lengthy process, but results in the unfavorable situation of requiring the bank to increase its long-term debt position. Issuance of new stock may result in an ownership dilution at either unfavorable prices or with unwanted investors. The leaseback is a low-cost technique that avoids both consequences, he adds.

"As a rule, the sale-leaseback should provide capital at an effective cost of between 100 and 200 basis points below that of long-term mortgage financing or the long-term conventional-debt market," Mr. Domb says. "However, unlike the conventional-debt market, the sale-leaseback has no restricted convenants and, after all lease payments have been made, there is no principal repayment."

Mr. Domb says that, in a typical sale-leaseback transaction, the bank would recapture 100% of its costs relating to the current market value of its headquarters or branches, including legal fees, surveys, architectural, engineering, title and any other closing costs or fees relating to the properties. This contrasts to conventional long-term mortgage financing, which usually is restricted to 75% or 80% of current market value.

A sale-leaseback of property will provide financial institutions with another advantage over mortgaging their property under the 1986 Tax-Reform Act. A bank's deduction for interest expense may be reduced if the bank holds a significant portfolio of municipal bonds.

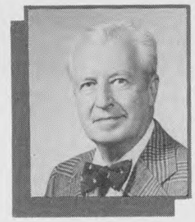
The new tax act entirely disallows a deduction for interest expense accrued by a bank allocable to the bank's portfolio of municipal bonds purchased by the bank after August 7, 1986. Interest expense accrued by a bank, allocable to the bank's portfolio of a certain limited class of public-purpose bonds purchased by the bank after August 7, 1986, is subject only to a 20% disallowance of allocable-interest expense.

Interest expense accrued by a bank, allocable to all the bank's municipal bonds purchased between January 1, 1983, and August 7, 1986, is subject to a 20% disallowance. This disallowance does not apply to the rentals paid by a bank pursuant to a sale-leaseback, but would apply to the interest paid by a bank on the mortgage it obtained on the property.

Sale-leasebacks usually are completed as quickly as the bank and the buyer mutually agree to the terms, seldom longer than 90 days, according to Mr. Domb. "This is by far the most expeditious method of obtaining capital today," he says.

Some banks that owned multi-tenanted office buildings have sold the buildings for the appreciation and capital-gain profit and have leased them back for long terms to find that, over the years, the other tenants' increased rent has cut the corporation's cost to less than half the market rent, he says.

The sale-leaseback affords a bank the opportunity to convert its real estate into cash while still maintaining lifetime control of the property through the lease agreement," Mr. Domb says. And it can do this at an effective cost savings of up to 200 basis points under its long-term borrowing rate, receiving 100% of the current market value, having it treated off-balance sheet and improving its net worth and earnings, he adds. • •



A Question of Ethics

It's a topic that makes bankers uncomfortable because there is disagreement over what is and what isn't ethical

By Dr. Lewis E. Davids
Professor Emeritus Finance
Southern Illinois University

THE CURRENT stress on the importance of ethics in business affairs reminds me of the reception a manual I wrote titled "Ethics in Banking" received when first published several years ago. It never made it to a second printing!

I discussed this with a banking educator who noted that the topic of ethics makes many bankers uncomfortable. The keystone position of ethics as it relates to confidence is well recognized, but there is considerable disagreement as to what is considered unethical. A questionable act in one individual's view might be considered as merely a sharp business practice in another's view.

Deregulation Raises Ethics Issue

But deregulation of banking is raising the ethics issue. When a regulation states how an issue is to be handled and the bank follows the regulation, it is following the law. The ethics of the regulation rest with the regulators. A classic example of regulators' unethical regulations is Regulation Q, which not only distorted market forces and subsidized borrowers at the expense of savers, but unfairly discriminated against banks in their ability to compete with other financial institutions and the financial market. Banks have paid and still are paying the price of Q, although in its early years most bankers supported it.

The philosopher Santayana said that those who don't learn from the past are doomed to repeat it. But sometimes the past is ambiguous.

Frequent Flier Program

To illustrate: The frequent-flier programs of airlines encourage corporate travellers whose tickets are paid for by their firms to use one airline over another to earn rewards. Does anyone get hurt? The executive has to travel — why not get a personal bonus for using one airline over another? The bank probably would pay the same fare and the banker earns a "free" vacation trip. Maybe!

The point is that the trip has value and the bank, not the individual, should get the benefit of travel it pays for. This is known as the doctrine of corporate opportunity.

Who should make bank policy in such areas? The board, the CEO, the personnel officer? How should this policy be policed? And if violated, what action should be taken?

I recently received a marketing-research questionnaire from a major credit-card-issuing bank. It is moving into corporate credit cards in a significant manner. The questionnaire asked my thoughts in terms of "yes" or "no" on a number of topics, including earning bonus points from use of its credit card. A series of "gifts" could be earned depending on how much corporate use was made of the card. It was unclear whether the gifts went to the individual using the card or to the corporation. But, again, the question is, who loses and what are the ethical nuances involved?

An individual may not be able to define ethics, but he should be able to recognize an unethical situation when he sees one.

We should remember one U. S. Supreme Court justice's statement on pornography. He said words to the effect that he could not define it, but he knew it when he saw it. Maybe we cannot at this stage of our culture define in a definitive way bank ethics, but we should be able to distinguish actions that are ethical from those that aren't.

My conviction, based on substantial experience in three banks, is that the board and top management sets the tone and attitude on ethics. If top management and the board implement and follow their written ethics policy, there will be a high degree of — although maybe not perfect — compliance. ● ●

Tax Reform Changes Employee Benefits

Congress attempts to make benefits more equitable to rank-and-file employees

By Lawrence A. Luebbers
Tax Manager
Arthur Andersen & Co.
St. Louis

THE TAX REFORM Act of 1986 not only will change the shape of many banks' balance sheets, it also makes major changes to the tax rules for employee benefits, including retirement, life insurance and health plans.

In an effort to make employee-benefit programs more equitable toward rank-and-file employees, Congress has created complex new nondiscrimination rules which will require increased employee coverage and benefits, thus increasing the cost to employers of these benefits.

Nondiscrimination Rules

The new law sets strict nondiscrimination rules for most employer-offered fringe benefits. If a benefit discriminates in favor of "highly-compensated employees," these employees generally will be taxed on the discriminatory portion of the otherwise tax-free benefit.

If the employer does not report correctly the discriminatory income amount given to the highly-compensated employee, the employer generally will be subject to a nondeductible excise tax. This tax would not apply if the employer could demonstrate that the failure to report was due to reasonable cause.

Each option for a different benefit under a plan generally will be treated as a separate plan and must be tested individually for nondiscrimination.

In addition to separate testing, the new law will increase employer recordkeeping requirements that establish that a plan is providing coverage for the required percentage of the work force. The new law will require information returns for accident, health and group term life-insurance plans.

Complying with these new nondiscrimination rules will increase the cost to employers, particularly for health and accident benefits provided under an insured plan that was not subject to nondiscrimination rules in the past.

To hold down these costs, employers should consider establishing cafeteria plans as a means of reducing or sharing the increased cost with employees, reducing employer health costs by providing an HMO option and amending benefit programs to eliminate any nonessential benefits.

The new law toughens nondiscrimination rules for most fringe benefits

Employee Fringe Benefits

Certain fringe benefits are retained under the new law while many have been changed. Benefits previously excluded — no-additional-cost services, qualified employee discounts, employer-provided meals, dependent-care assistance and qualified tuition reductions — are retained with some modifications. Educational-assistance plans and legal-services plans are scheduled to expire for tax years beginning after December 31, 1987. All employee awards, with certain exceptions, will be treated as taxable compensation for tax years beginning after December 31, 1987.

Accident or Health Plans

Under prior law, health benefits, medical benefits and reimbursements provided by an employer through an insurance company were excluded and the exclusion was not conditioned on nondiscrimination. Under the new law, these plans are subject to nondiscrimination tests. As a result, employers will need to review all plans to assure compliance.

Cafeteria Plans

A cafeteria plan allows employees to select from a menu of fringe benefits with the value of those benefits not included in the participant's income. The new law changes the term "cafeteria" to include a plan in which all participants or employees may choose either (1) among two or more benefits consisting of cash or qualified benefits, or (2) among two or more qualified benefits.

Prior discrimination tests are retained but are affected by new uniform definitions and dollar limits. The former special cafeteria plan benefit test has been eliminated.

Each type of benefit available or provided under a cafeteria plan is subject to its own nondiscrimination rules and to any applicable concentration test. Employers may choose to aggregate different types of benefit plans for purposes of the average-benefits test.

Qualified Retirement Plans

The new law makes many changes in the rules for qualified retirement plans to increase overall participation. Virtually all qualified plans must be amended to meet these new rules. Noncompliance will subject an employer to excise taxes.

Cash or deferred arrangements, otherwise known as 401(k) plans, are substantially altered under the new law. Previously, an employee could defer a maximum of 25% of compensation or $30,000, whichever was less, depending on whether the employee participated in another tax-favored retirement plan.

The new law reduces this limit to a maximum salary reduction of $7,000, which is reduced dollar-for-dollar by contributions to other salary-reduction retirement arrangements.

Amounts contributed above the new \$7,000 limit are taxed retroactively to the year of the salary reduction. Employers will have to monitor strictly any 401(k) reduction amounts so that any amount greater than \$7,000 may be distributed favorably.

The new law modifies the special antidiscrimination provisions applicable to 401(k) plans and levies a 10% excise tax on the employer for any contributions made by highly-compensated employees that violate these rules, unless these excess contributions are distributed with earnings within 2½ months of the close of the plan year of the contribution. In addition, the plan will lose its qualified status if these distributions are not made by the deadline. This could hurt all participants in the plan.

Also changed was the tax treatment of distributions from tax-favored plans. In general, the new law changes the timing of when benefits must commence from plans, requires additional income tax for failure to meet minimum-distribution rules and places new restrictions on early distributions.

Individuals planning to take early distributions or retire will be affected. These distribution rules apply for both lifetime and after-death distributions on all tax-favored plans, including individual retirement accounts and tax-sheltered annuities.

Prior law allowed a lump-sum distribution from a qualified retirement plan to receive a special 10-year forward income averaging. A portion of a distribution attributable to participation prior to January 1, 1974, could receive capital gains treatment. These provisions are replaced with a one-time five-year forward averaging.

Also changed are ordering rules applying to distributions from qualified plans when the distribution includes after-tax employee contributions. Each payment received by the employee is treated partially as a return of the employee's contribution and partially as taxable income. The total amount excludable from income is limited to the total of the employee's contribution.

Maximum benefit and contribution limits have been lowered, which will affect primarily highly-compensated employees. For example, changes made in the actuarial reduction rules can reduce plan benefits significantly. All plans should be reviewed to determine if they conform to these new rules.

Nondiscrimination requirements for qualified retirement plans and tax-sheltered annuities have been changed

(Continued on page 39)

Operational Efficiency's Impact On the Value of Your Bank

It has an important bearing on determining the bank's value when a merger or acquisition is being considered

By Dick G. Shirrell

A RECENT study by a major accounting firm indicates that the current trend of bank consolidations will continue; projecting 5,000 mergers or acquisitions in the next five years. Moreover, banks are acquiring new types of businesses and other financial-service companies are entering the banking business.

These trends — as well as general uncertainties in the marketplace — have bank executives reevaluating their business plans and competitive market positions. They are asking themselves if their institutions should remain independent, sell or merge. In each situation, a key question is: "What is the value of this bank?"

The value of a financial institution, like any other business enterprise, means its "fair market value," which has been defined by the courts as "the price at which property would change hands in a transaction between a willing buyer and a willing seller, neither being under compulsion to buy nor sell and both being reasonably informed as to all relevant facts."

Three principal valuation techniques normally can be used to establish the fair market value of any asset or business. First is the market approach based on market prices indicated by recent transactions and on asking prices for currently available like assets or businesses. Second, the cost approach, based on the principle of substitution, considers that a prudent investor would pay no more for an asset or business than the amount required to replace the asset or business. Third, the income approach, in which fair market value is determined based on the income an asset is expected to generate over its remaining useful life.

Typically, the cost approach is not relevant in assessing the value of a bank as an on-going business. The market approach is useful when the bank being valued is widely traded and its stock can be directly compared with other banks' stocks. Most banks in the U. S., however, are not widely traded, which means the income approach often has the most relevance in assessing value. The income approach reflects value based on the bank's future earnings capacity. Therefore, for a financial institution, the higher its earnings, the greater its market value.

Consider this example: Two banks each have assets of $400 million. Bank A, a slightly below-average performer with an ROA of 0.7%, creates a market value of $33.7 million. Bank B, an above-average performer with an ROA of 1.2%, creates a market value of $57.8 million. Because of its higher earnings, Bank B would yield an additional $24.1 million in value for its stockholders (see chart).

	Bank A	*Bank B*
Average Earnings Assets (mm)	$400	$400
Net Income (mm)	$2.8	$4.8
ROAA	0.7%	1.2%
Price/Earnings Multiple	12	12
Market Value (mm)	$33.7	$57.8

Since earnings affect the market value of a bank, a key concern should be the factors that create earnings. Basically, a bank generates income from three principal sources:

- Interest income from loans;
- Interest income from investments; and
- Fees and service charges.

Expenses can be categorized in three major areas:

- Interest expense on deposits and other funding sources;
- Operating expenses; and
- Taxes.

A highly abbreviated model of bank earnings using the six factors contributing to earnings is:

  Interest income from loans
\+ Interest income from investments
\+ Fees and service charges
− Interest expense on deposits and other funding sources
− Operating expenses
− Taxes
= Net income (earnings)

For the most part, interest income from loans and investments, interest expense and taxes are not under the direct control of the bank. (Assuming, of course, the bank desires to be generally rate competitive.) Therefore, the areas in which a banker has the greatest control is in fees, service charges and operating expenses. The most overlooked area of potential increases in earnings is operations expenses. Experience has shown that improvements in operations can result in an additional ROA of up to 1.0% or more. These additional earnings are not one-time, but on-going.

In order to improve operational efficiency, it is necessary to take a hard look at operational systems and procedures. Such an operations review is thorough analysis of all areas of the bank for the purpose of improving the bottom line.

Following are a few of the key areas on which an operations review should

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Mr. Shirrell is senior consultant, financial industry group, Marshall & Stevens, Inc., St. Louis.

concentrate:

- Bookkeeping — Observe all activities to assure uniformity and eliminate unnecessary tasks.
- Cash and Float Management — Look for ways to reduce cash carrying and delivery cost and maximize availability of funds.
- Data Processing — Concentrate on verifying that the system is operating in accordance with policies and procedures and that it is being used to its maximum potential.
- Item Processing — Review all float tables for accurate float assignment and to assure that your transit department is operating productively with optimal sort patterns, cash letter delivery, etc.
- Loan Administration — Observe the procedures used to process all types of loans to uncover and eliminate unnecessary or unproductive steps.
- Policies and Procedures — Study each area of the bank to assure each is complementary of the other and not in competition.
- Teller Operations — Observe or track customer-arrival patterns to assure that staffing levels coincide with customer-demand patterns.
- Workflow and Procedures — As a general observation, track various activities to assure they are as efficient as they can be as well as supportive of other affected areas.

During a period of consolidation such as is occurring in the banking industry, there will be thousands of mergers and acquisitions. If your bank's strategic plan envisions participation in a consolidation as a buyer or seller, it is imperative to know the value of your bank and ways to increase that value. Since earnings are the major determinant of market value, to maximize value, maintenance of current earnings levels and a continued effort toward earnings improvement must play a major role in long-range planning. Higher-earning banks are more desirable targets if you want to sell, more defensible if you want to stay independent and financially stronger if you want to acquire.

Too often, strategic decision making on mergers and acquisitions is divorced from day-to-day operations. This is a mistake. The operational aspects of a bank can have as big an impact on profitability — hence market value — as the loan and investment areas. And, since operations usually are the most controllable element of your bank's income and expenses, efficient and cost-effective operations can be a major determinant of future stockholder value. ● ●

Home Equity (Continued)

would be limited to $36,000.

The rate typically is variable, such as prime plus two percent.

The line typically is accessed by check, separate from the customer's regular DDA. Repayment terms tend to be very liberal. Interest plus 2% of the balance, or even interest only for 10 or 15 years is not unusual.

Bankers have found that customers who apply for the product tend to use it, because of the closing costs. Losses are running low, about .5%.

Rate Wars

Competition to sell equity lines of credit has heated up to such a degree that institutions in many areas are cutting fees and closing costs and offering low introductory interest rates to attract customers. Some examples:

- Commerce Union, Nashville, launched its product in October with a 6.9% rate for the first 90 days and a $69 closing fee.
- Connecticut National charges $75 for closing costs.
- MidAtlantic Bank of New Jersey offers an introductory rate of 7.5% for the first 90 days.
- United Bank, Denver, charges top customers a rate of 8.5%.
- Mercantile Bank, St. Louis, has waived all closing costs for three months.

"I think terms are what's made us successful," says Mr. Grigley of Connecticut National. "We don't charge any points. We don't use an attorney to close. We use a title search. We use a drive-by appraisal if one is needed."

On the other hand, Mr. Utterback feels bankers are giving away too much when they waive closing costs.

"Most of the profit in this product I see as being in the fees. I recommend a flat $500 closing fee. Some banks charge points, but a lot of people don't like that because they don't know exactly what the amount will be. They prefer a flat fee.

"When you waive the closing fees, there goes a big chunk of your profit right there.

"I'm not a fan of the low introductory rate, either. I think it looks a little hokey. Maybe I'm an old-fashioned marketer, but I think integrity in financial services means a lot. When you start looking like a snake-oil salesman, you turn people off," he says.

Small Banks Can Implement

No bank is too small to offer a home-equity line of credit, says Mr. Utterback. "Small bankers are familiar with unsecured lines of credit and secured loans. There are not too many differences. This is fairly safe."

Small banks that need help "may find their correspondent banks can handle it for them operationally," says Mr. Harrison of Commerce Union. "The disclosures are significantly different from traditional consumer installment debt. You may need the help of an attorney," he adds.

Almost all the software written nowadays also will run on PCs, points out Mr. Utterback, so small bankers can take advantage of it.

Inserve, Inc., Tulsa, Okla., is one software house that markets a home-equity product that runs on PCs. It's called HELP (Home Equity Loan Processing).

"Since this product runs on a PC, we originally thought it would be only the smaller banks that would be interested," says Charles Raney, marketing director of Inserve.

"But surprisingly, we have found a lot of interest among the larger banks — those over a billion dollars. They are looking for a way to get into this product quickly.

"The smaller banks seem to show interest but no action. The smaller banks are holding off a little bit to see how much interest the new tax law creates."

Some Caveats

Bankers typically allow a maximum line of credit equal to 75% to 80% of the appraised value of the home, less the outstanding balance of the first mortgage. There are several good reasons for being vigilant about maintaining that buffer of equity and not overburdening the borrower with debt.

"Some small banks are dropping down to 60% or 70% (of equity) to allow for fluctuations in real-estate values," says Mr. Harrison of Commerce Union.

"Bankers are missing an opportunity — if they don't have it, the customer is going to go elsewhere," says one banker.

"If the unemployment rate in the banker's area is 8%, he may want to drop the limit to 70% of appraised value. If the unemployment rate is 4%, you're safer going to 80%," Mr. Harrison says.

"It is possible for equity to decrease," says Mr. McCreary of Borod & Huggins. "I think there are a lot of bankers who will forget about that."

In addition, in the event of a default, there is a high probability that the first mortgage already is in default and that the property has not been well maintained. You would have to go in and buy out that first mortgage, put some money into that house, fix it up and hope to resell it," Mr. McCreary says.

The appraisal industry, subject of recent controversy, also presents possible risks. "You should use an appraiser you have confidence in," recommends Mr. McCreary. "If you must use someone new to you, get references from someone else.

"The very worst you can do is let the borrower come in with the appraisal and use that. I've seen that done."

Mary-Liz Meany, assistant public relations manager with the ABA, also urges bankers to follow prudent lending criteria.

"Our main message to date is that, while it can be an important tool, it is not for everybody. It's important that banks not encourage consumers to overextend. Both borrowers and lenders should exercise caution, because this loan is secured by the home, which is so important to the consumer.

"Years ago, tapping your home equity for a second mortgage to get cash was seen as a last resort," she reminds lenders.

Keep an eye on the inflation rate, advises Mr. Grigley of Connecticut National. "Everything's great today because the economy's been stable for several years. But what about when interest rates go up and disposable income goes down? When the consumer has a variable rate on the first mortgage *and* the line of credit? Or when the first mortgage is a balloon note?"

His bank follows its traditional lending criteria in granting equity lines, Mr. Grigley says. Most important is ability to repay, both present and future; second is past credit history; and third is equity.

Window of Opportunity

Meanwhile, the battle over home-equity loan customers continues to heat up, and promises to get hotter.

"Congress will leave this alone until it sees how it works, at least for a few years," predicts Mr. Grigley.

"Meanwhile, banks that want to keep their best customers will have to offer it. The upscale customers who need it will be getting it soon. There is a limited window of opportunity brought on by the exposure given the Tax Reform Act."

Mr. Harrison of Commerce Union, Nashville, believes this product will remain popular, even if the tax loophole eventually is closed. "Once a customer gets used to using a home-equity line of credit, gets used to the convenience of writing a check, and not having to pay back a large sum all at once, the customer will continue to use it." ● ●

Tax Reform (Continued)

by the new law. The changes are so extensive that virtually every plan must be reviewed to assure compliance. Changes include new minimum-coverage requirements, new minimum-participation requirements, more rapid minimum-vesting standards, rules for matching employer contributions and tighter rules for integrating plans with social security.

Broader Participation

Congress has applied a broad-brush approach in an effort to provide more equitable benefits for rank-and-file employees. To accomplish this, the new law imposes tougher discrimination tests, faster vesting schedules and lower maximum benefits and contributions.

As a result, virtually all plans need to be revised and closely monitored to ensure all the new requirements are satisfied, resulting in increased cost to employers who provide benefits to their employees. ● ●

NEW PRODUCTS/SERVICES

Use the Reader Inquiry Service on facing page to obtain further information about the products reviewed on this page.

• **DBi Software Products** has released a new IBM version of Trajectories Statistical Processing System that offers PC users increased speed and new statistical procedures, including enhanced ANOVA routines. More than 40 programs in Trajectories are oriented to corporate users. A 200-page manual provides step-by-step instructions, screen examples and algorithm references.

For information, circle 101

* * *

• **Message Processing Systems, Inc.**, has introduced the VRS voice-message-processing system that serves as a "post office" for voice messages. VRS provides flexibility by allowing a range of recording, message editing, message alert and distribution functions, according to the manufacturer.

For information, circle 102

* * *

• **Davox Corp.** has introduced a new generation of multifunction workstations and a computerized autodialing phone-management system. The new Series 4900/5900 workstations add windowing capabilities and VT220 terminal emulation to the full 3270, asynchronous and voice features in current Davox Series 1900 workstations.

For information, circle 103

* * *

• **Michael Business Machines Corp.** has issued a new catalog illustrating and describing various paper shredders in its DESTROYIT line. Four sections show desk-side, central office, continuous data-processing forms and high-capacity shredders.

For information, circle 104

* * *

• **Fairfield Management Resources, Inc.**, has introduced a new microcomputer-based system called ProFiler — Personal Contact File System. It's designed for bankers to use to keep track of their personal contact lists. ProFiler can be used to generate labels and/or envelopes and interfaces with spreadsheet, word processing and data-base management systems.

For information, circle 105

• **Interactive Planning Systems** has enhanced its Shareholder Accounting Software to assist banks that are manually handling stock trading, stock splits, shareholder histories, shareholder reports and IRS reports. The software provides shareholder registers, calculates dividends, handles stock splits and coordinates dividend reinvestments.

For information, circle 106

* * *

• **Battelle Columbus Division** has issued a second version of its BASICS-PC software to calculate cross-impact analysis and generate scenarios of future conditions for use in forecasting and strategic planning. The program is designed for planners without formal training in computers.

For information, circle 107

* * *

• **Tolerant Systems** offers its Eternity Series P200, a multicomputer system designed to perform on-line transaction processing and keep pace with computing needs of growing banks. The P200 can process 8.0 TP1 transactions per second, with an average response time of 1.5 seconds.

For information, circle 108

* * *

• **Tension Envelope Corp.** has a new ATM deposit envelope that provides a cost-effective method of verifying that a customer's cash or check has been included in the envelope before the envelope is opened. The envelope absolves the bank in cases when checks have inadvertently not been enclosed in deposit envelopes, according to the manufacturer.

For information, circle 109

• **Bell & Howell** has introduced new image scanning and display terminal product lines. The firm's Copyscan scanners feature rapid scanning and digitization of any standard-sized document containing text, drawings or photos. Its Displayscan image-display terminals offer full-page viewing of alphanumeric, graphic and image documents.

For information, circle 110

* * *

• **Ithaca Peripherals, Inc.** has a new PcOS Series 50 standalone 40-column dot-matrix printer for banking applications. Three models are available: Model 51 receipt printer, Model 52 journal/receipt printer and Model 53 enhanced journal/receipt printer.

For information, circle 111

* * *

• **Datavox** has developed BankTalk, which permits banks to handle most transactions and provide general information using synthesized voice technology in response to phone inquiries. BankTalk enables customers to transfer funds electronically, gain access to account balances, request check-clearing information and speak with appropriate bank representatives.

For information, circle 112

* * *

• **Diebold, Inc.**, is offering a new 100 IBM 3624 Emulation Software package that links multiple Diebold ATMs, on- and off-premise, to any host system that supports the IBM 3624. Customers can use the package to upgrade their existing ATM base systems to the Diebold 1000 Modular Delivery System family of ATMs.

For information, circle 113

* * *

• **SecureData Corp.** has released new literature featuring the Collector, the firm's new credit-collections software. The brochure explains how the real time, on-line software improves management controls and boosts effectiveness and productivity of collectors.

For information, circle 114

Reader Response Page

December, 1986

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Coming Events

Jan. 27-30 **ABA National Security and Risk Management Conference,** Sheraton Harbor Hotel, San Diego.

Feb. 15-18: **BMA Community Bank CEO Seminar,** Marriott's Mountain Shadow Resort, Scottsdale, AZ.

Feb. 22-25: **BMA Electronic Banking Product Strategies Conference,** Phoenix Hilton.

March 8-11: **ABA National Conference for Community Bankers, Hyatt Regency and Hilton,** Phoenix.

March 15-18: **NACHA Annual Conference,** Intercontinental Hotel, San Diego.

March 29-April 1: **ABA National Retail Banking Conference,** Atlanta Hilton & Towers.

April 1-5: **Independent Bankers Association of America Convention,** Marriott's Orlando World Center.

April 9-12: **Louisiana Bankers Association Convention,** New Orleans Hilton.

May 7-9: **Oklahoma Bankers Association Convention,** Shangri-La Resort, Afton.

May 11-14: **Alabama Bankers Association Convention,** Colonial Williamsburg, Williamsburg, VA.

May 13-15: **Kansas Bankers Association Convention,** ExpoCentre, Topeka.

May 13-15: **Texas Bankers Association Convention,** Corpus Christi.

May 14-17: **Mississippi Bankers Association Convention,** Biloxi

May 20-22: **Association of Bank Holding Companies Annual Meeting,** Westin Corley Place, Boston.

May 31-June 4: **ABA National Operations and Automation Conference (NOAC),** San Francisco.

June 7-10: **Tennessee Bankers Association Convention,** The Breakers, FL

June 9-11: **Indiana Bankers Association Convention,** Adams Mark Hotel, Indianapolis.

June 15-17: **Wisconsin Bankers Association Convention,** Embassy Suites Hotel, Green Bay.

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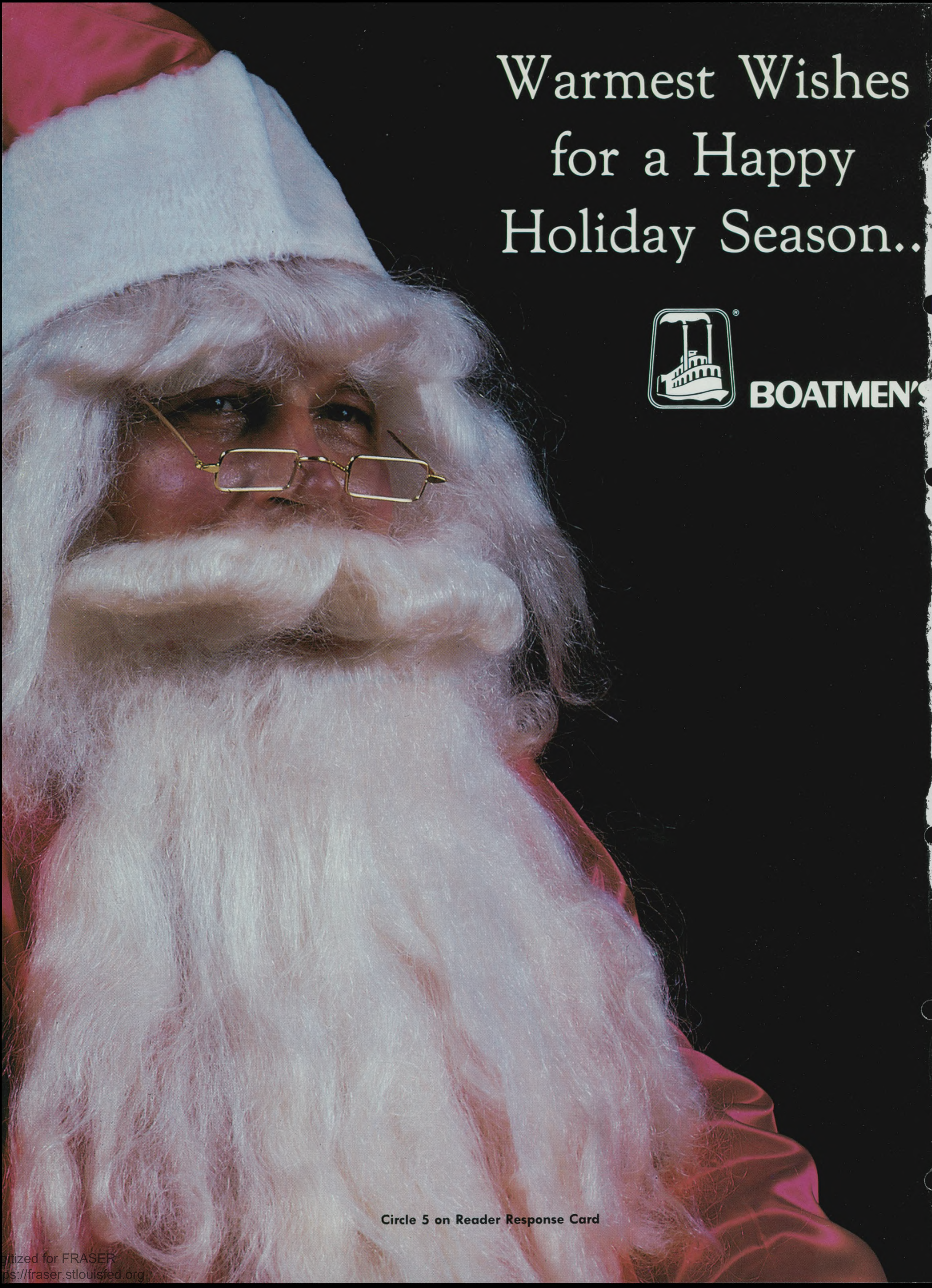
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