

# NORTHWESTERN BANKER Newsletter

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November 10, 1980

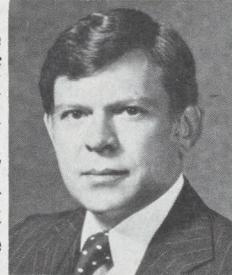
## Comptroller's Proposals Questioned

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

One proposal is intended to open discussion of how bank capital should be defined and what its role in banking regulation should be. The other proposal raises the subject of Adjustable Rate Mortgages (ARMs) and could lead to a much wider use of this instrument in the future.

### Definitions

The first proposal is to change the definition of "surplus unimpaired



JOHN G. HEIMANN  
Comptroller  
of the Currency

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

This proposal comes at a difficult time for banks. The only sources of capital that would be permitted to a bank if the proposed definitions were to become final would be equity and retained earnings. Bank stocks are and have long been generally undervalued and inflation has lowered earnings.

At the same time, inflation has also caused that stated value of assets to rise dramatically. Banks are therefore faced with the possibility of having artificially high asset levels and a reduced capital base against which those

asset levels will be measured.

### Complexity

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

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



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2 amendments to the governing statute."

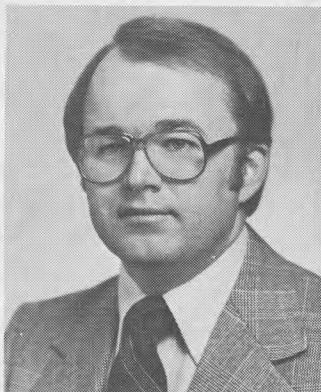
The Comptroller's interest in stimulating a dialog with the bankers is encouraging, because the dual questions of capital ratios and lending limits have long frustrated bankers themselves. The questions of capital adequacy is very complex, involving a careful balance of the desire to protect the depositors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

#### Solution

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

#### Mortgages

On another front, the Comptroller is suggesting that the use of alternative mortgage instruments—in particular of the adjustable rate mortgage (ARM)—should



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Correspondent Bank Officer  
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be formalized and expanded.

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

director for a seven-state area, including Iowa, during the recent American Bankers Association annual convention. As a regional director, he will also serve on the ABA board of directors.

**GRINNELL:** In observation of its 50th anniversary year, the Poweshiek County National Bank has dedicated its Grinnell beautification project at the corner of Fourth Avenue and Broad Street. The ceremony was followed by an open house.

#### Minnesota News

**DULUTH:** First National Bank has elected Jack Swanstrom a director. He is executive vice president of Diamond Tool and Horseshoe Co. of Duluth.

**MINNEAPOLIS:** Ken Leaf, former regional administrator of national banks of the ninth national bank region, has joined Miller-Sweeney Co. as a senior bank consultant. Miller-Sweeney provides advice and counsel to banks on unique or non-recurring banking matters as well as the brokerage of bank stocks.

**MINNEAPOLIS:** Fifth Northwestern National Bank of Minneapolis

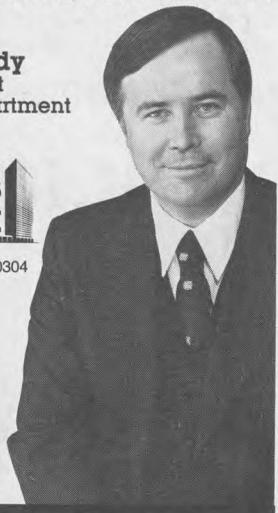
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#### Iowa News

**CLINTON:** James L. Menges has been appointed president and chief executive officer of First National Bank, effective January 1. The announcement was made by Hawkeye Bancorporation. Mr. Menges currently is president of American State Bank, a Hawkeye Bancorporation affiliate.

**DES MOINES:** The Iowa-Des Moines National Bank promoted three employees to second vice president, data services. They are Lowell A. Barkley, Greg R. Scharnberg and Larry E. Welch.

**DUBUQUE:** Christy F. Armstrong, president of American Trust & Savings Bank, was elected a regional

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## AN INTRODUCTION TO IOWA STUDENT LOAN REVENUE BONDS

The Iowa Student Loan Liquidity Corporation has selected the Carleton D. Beh Co. to be a senior manager of the group which will underwrite and market the proposed student loan revenue bond issue.

**The Issuer.** The Iowa Student Loan Liquidity Corporation, an Iowa nonprofit corporation, was incorporated in July 1979, at the request of Governor Robert Ray to finance the purchase, sale and general marketing of guaranteed student loans. As provided in the Higher Education Act of 1965, as amended, the Governor designated the Iowa Student Loan Liquidity Corporation as the sole agency for the purpose of providing funds and acquiring from lenders, student loan notes representing (a) loans to Iowa students attending schools anywhere, or (b) loans to students from other states attending Iowa schools.

The Corporation has an eleven member Board of Directors appointed by the Governor. The Board consists of the Iowa Superintendent of Banking, two members each representing Iowa banking institutions and the general public; one each representing Iowa savings and loan institutions, Iowa credit unions, the Iowa Board of Regents, Iowa private colleges and universities, Iowa area community colleges and the Iowa College Aid Commission.

The Corporation is empowered to issue tax-exempt revenue bonds under the provisions of Section 103(e) of the Internal Revenue Code. Bond proceeds will be used to purchase guaranteed student loans. It is anticipated that the difference between the interest rate on the bonds issued and the return on the student loans purchased will be sufficient to pay the costs of operating the Corporation and servicing the loans.

**The Student Loans.** Student loans can be originated by commercial banks, savings and loan associations, credit unions, and state agencies. These loans are authorized by the Higher Education Act of 1965, as amended. To be eligible the student must be attending an approved institution and carrying at least one-half of the full-time course load.

Beginning January 1, 1981, a "dependent" student may borrow up to \$2,500 per year for up to five years, and an "independent" student may borrow up to \$3,000 per year for up to five years. There are also additional programs for graduate students and there will be a "loan to parents" program. The interest rate for existing borrowers is 7%; for new borrowers after January 1, 1981, the rate will be 9%. While the student is in school and during certain specified periods thereafter, the interest is paid by Federal subsidies and the student is exempt from principal repayment.

In addition to the basic interest on the loan, the lenders will receive a "special allowance payment" on a quarterly basis. The special allowance is computed on the basis of the average bond equivalent annual rate of 91 day Treasury Bills auctioned during the preceding quarter, less 3½%, rounded upward to the nearest ¼ of 1%. For the quarter ending September 30, 1980, the allowance payment was computed at an annual rate of 6¾%.

These loans can be directly insured by the federal government through its Federal Insured Student Loan (FISL) program. More generally, they are guaranteed by a state agency which in turn reinsures with the federal government. The terms of the reinsurance provide for reimbursement to the agency of 80% to 100% depending on the claims experience for the current fiscal year. When the student leaves school and after a short grace period (10 months or less), he or she is required to begin making principal and interest payments. The principal repayment period is usually not less than five years nor more than ten years from the end of the grace period.

**The Guaranty Agency.** In Iowa, the guaranty agency is the Iowa College Aid Commission, which maintains as one of its divisions the Iowa Guaranteed Student Loan program staff. Pursuant to the Higher Education Act, the Iowa College Aid Commission and the Secretary of Education have entered into an agreement providing for federal reimbursement to the Commission for the amount expended by the Commission in discharge of its guarantee obligations. This agency pledges 100% reimbursement on each loan it guarantees and administers under the federal insurance programs. Because it is still within its first five years of operation (the agreement was signed in August, 1978), the Iowa agency is receiving 100% claims reimbursement from the federal program. At the end of this five year period, the federal reimbursement will change to a sliding scale based on actual claims experience. The actual claim rate to date is extremely minor (less than ½ of 1%), and the projected rate for the future is low enough (less than 5%), that the Iowa agency will continue to have 100% claims reimbursement by the federal program.

The Iowa agency is also required to maintain a "guarantee fund" equal to at least 2% of the loans guaranteed. This is funded by deducting a 1% guaranty fee from the face value of the loan at the time of its disbursement to the student. The Iowa guarantee fund presently has a balance of about \$2,700,000 and there are about \$100,000,000 guaranteed loans outstanding.

Carleton D. Beh Co.



### Interest Rate Futures Seminar

Savings & Loans and Industry Banks of all sizes are rapidly recognizing the importance of financial instrument futures as a means of providing stability in their interest margins. As interest rates become more volatile, an understanding of futures contracts, including their use, the regulatory constraints, the possible pitfalls, and the accounting principles involved, is becoming an essential part of every money manager's knowledge.

To meet these needs, the Financial Futures Division of FCC has developed a Financial Instruments Futures Program that will provide participants with an understanding of:

- How futures contracts can be used by Financial Managers to reduce the potentially damaging effect of volatile interest rates on earnings;
- The possible pitfalls and dangers to be avoided;
- How commodity exchanges and transactions work; and
- Regulatory and accounting considerations;

#### Who Will Benefit

A valuable resource for management and staff officers involved in accounting, finance, report preparation, financial analysis, investment management and operations. The senior management of banks engaged in forward and future contracts, or contemplating their use, will also benefit greatly from the material to be presented. In addition, the information will be of significant benefit to public accountants with bank clients.

Be sure to pass on a copy of this brochure to your public accountant.

#### General Information

**Schedule:** The seminar will start at 9:30 a.m. and adjourn at approximately 12:30. Luncheon to follow.

**Fee:** \$25

The registration fee includes hand-out materials and lunch.

**To Register:** Complete the attached form and return it with a check made payable to Farmers Commodities Corp., P.O. Box 4887, Des Moines, Iowa 50306. Please duplicate the registration form to register more than one individual from your bank or firm.

#### For further information contact:

Jim Eick or Alan Andrews  
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**Cancellation:** Full fee will be refunded upon notice received up to two days prior to the program.

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## Interest-Rate Futures Seminar

November 24, 1980  
Hyatt House  
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## Interest Rate Futures Seminar

Hyatt House  
Des Moines, Iowa  
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Years of Bank experience \_\_\_\_\_ yr. Time in present position \_\_\_\_\_ yr.

For multiple registrations, please duplicate this form. Print or type only please.

Registration information continued on reverse side.

### Banks' Experience in the Use of Interest-Rate Futures

Wayne Caviness, Vice President  
Financial Futures Division  
Drexel Burnham Lambert  
New York, N.Y. 10004

A former senior bank officer, experienced in the use of interest-rate futures, will describe his experiences with the use of interest-rate futures contracts, the benefits obtained and the pitfalls to avoid.

### Internal Control, Regulatory Compliance and Accounting for Interest-Rate Futures.

Don Kemp, C.P.A.  
Audit Partner  
Peat Marwick Mitchell & Company  
Des Moines, Iowa

The prescribed accounting for futures contracts is in a state of flux and can have a very significant impact on a bank's reported earnings. It is essential that the accounting and regulatory principles be understood before entering into futures contracts.

In addition, it is essential to understand the primary internal control features that need to be addressed by the bank, for filing with the regulators and for internal bank operations.

### Question and Answer Session

This session will enable participants to obtain additional information from the speakers by addressing specific questions from the audience.

Lunch  
Guest Speaker

Bob Zellner  
Vice President  
Senior Economist  
Drexel Burnham Lambert  
Chicago Mercantile Exchange  
Chicago, Illinois

## Seminar Program

Registration (coffee)

### Welcome

Jim Eick, Manager  
Financial Futures Division  
Farmer Commodities Corp.  
Des Moines, Iowa 50306

Hal Richard, V.P. & Manager  
Farmers Commodities Corporation  
Des Moines, Iowa 50306

B.J. (Jerry) O'Dowd, President  
AGRI Industries  
Des Moines, Iowa 50306

### Exchange Regulation, Operation and Trade Execution

Phyllis Fischell, Vice-President  
Manager, Floor Operations at  
Chicago Board of Trade  
Drexell Burnham Lambert  
Chicago, Ill.

What are commodity exchanges and how do they operate? What safeguards are provided to insure against any losses from defaults of brokers, the Exchange, or other parties to the transaction? How are trades executed on the Exchange and what procedures are necessary for a bank to buy or sell a futures contract?

Answers to these questions and the background of futures exchanges and markets, with emphasis on the rapid growth and use of interest-rate futures, will be presented.

### Basic Concepts and Strategies

Wayne Caviness, Vice President  
Financial Futures Division  
Drexel Burnham Lambert  
New York, N.Y. 10004

This session will be devoted to an explanation of exactly what interest-rate futures contracts are, how they relate to a bank's investment and loan portfolios and liabilities, and how they can be used by banks to protect the bank against interest-rate fluctuations.

Coffee

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promoted John Burrowski to assistant vice president and Julie Skeffington to commercial loan officer.

MINNEAPOLIS: First Bank Minneapolis named F. William Johnson and Karl Schroeter assistant vice presidents, and hired Jeffrey Figgatt as a commercial banking officer.

WESTBROOK: The Westbrook State Bank recently celebrated its 35th anniversary with an open house.

## Nebraska News

COLERIDGE: The Coleridge National Bank has announced the addition of Dwight H. Hansen as loan officer. He earned his BA degree from Wayne State College and his masters degree from the University of South Dakota in public administration.

DESHLER: The Nebraska Security Bank has announced plans to remodel and expand its existing building. The remodeling will feature an expanded lobby and a completely refurbished interior.

LINCOLN: Two seminars to acquaint agricultural lenders in Nebraska with the applications of the commodity futures markets will be held on December 1-2 at the Holiday Inn in Kearney and on December 3-4 at the Ramada Inn in Lincoln.

For additional information about registering for the Kearney and Lincoln seminars, please contact any of the sponsoring organizations or CBT Commodities Institute, Chicago Board of Trade, LaSalle at

Jackson, Chicago, IL 60604. Phone: 312/435-7213.

## South Dakota News

WATERTOWN: Mrs. Eula Hindreker, homemaker and civic leader, and Merlin F. Jeitz, president of Cook's Inc., were elected to the First National Bank's board of directors.

## North Dakota News

The 19th Annual North Dakota Bankers Association will hold its Agricultural Credit Conference at the Ramada Inn in Minot, November 18 and 19. Registration fees are \$70 for registrant and \$30 for spouse. Registration will be from 11:00 a.m. to 1:30 p.m. and from 5:00 p.m. to 6:30 p.m. Tuesday, November 18 in the Ramada Inn lobby. The conference will begin at 1:30 p.m. in the Norse Room. Adjournment will be at 11:45 a.m. Wednesday, November 19.

STRASBURG: The Federal Reserve Bank of Minneapolis has announced that it has approved an application by a Nebraska corporation to become a bank holding company through the acquisition of the Strasburg State Bank. The application was by Strasburg Bancshares, Inc.

## Colorado News

The Colorado Bankers Association reports that voters in that state overwhelming defeated a ballot proposal regarding branch banking. The proposition read, "Shall any bank, as of July 1, 1981, be permitted to establish one or more branch banking facilities separate

## "Opportunity Talks..."

Robert Scott,  
Correspondent Banker



from the principle office of the bank anywhere in the state..." With heavy voter turnout, 26% voted in favor and 74% were against the proposal.

## Wyoming News

CASPER: Pauline Marinich, Betty Rose and Brad Thomas have been named vice presidents at First National Bank. The announcement was made by Henry A. Hitch, president, after a recent meeting of the board.

POWELL: Dan Murray has joined First National Bank as a loan officer in the personal service loan department. He previously worked as an industrial loan officer for the Security Bank in Billings.

WORLAND: Dean M. Bartels, president of the First National Bank has announced the addition of Gerald F. Doerr Jr. to the staff. Mr. Doerr will begin in the capacity of assistant cashier. He previously worked for the Ranchester State Bank.

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**Tom Steffens**  
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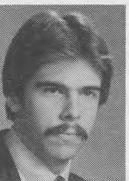
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