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Financing the Agricultural Industry by Regional Correspondent Banks

Jim Timberlake

The agricultural industry in the United States annually has needs for millions of dollars to finance the goods and services that it produces for the marketplace. The products range from raw grain and seed to expensive and complex pieces of machinery to produce these goods. Nationwide, the industry is very complex, and it would be impossible to cover every financing need in this article. My experience in this area relates to agricultural credits in the southwestern United States, and I would like to briefly discuss some of the problems and solutions to financing the agricultural industry.

Fidelity Bank, N.A., of Oklahoma City is a regional bank with total assets of approximately $660,000,000. It is a downtown commercial bank in Oklahoma City which is heavily involved in correspondent bank services. At present, Fidelity has 330 correspondent bank customers. These banks are primarily located within the state of Oklahoma, with a small number of correspondent relationships from banks in the surrounding states. The state of Oklahoma has 491 banks which are individually owned, and a large majority of these banks are located in rural communities.

Agriculture is the No. 1 industry in Oklahoma. Financing for this industry is provided by a variety of financial institutions, including country banks, regional banks, Agricultural Credit Corporations, Production Credit Associations, Farmers Home Administration, and Federal Land Banks, as well as by companies producing agricultural equipment, products, and services.

There are a number of problems that regional banks face in trying to finance the agricultural industry:

1. The need for the funds to finance the agricultural industry

comes from the rural communities, but the concentration of deposits to make these loans is located in the intermediate size towns and the regional money centers.

2. The legal lending limit of many country banks is too small to take care of the needs of the customers. This means that the country banker either does not go beyond his legal lending limit, or he has to contact his upstream correspondent to obtain additional funds to take care of his customers' needs.
3. In some regional money center banks, there is a lack of commitment by the executive management to set funds aside for agricultural lending.
4. Sometimes, within a regional money center bank, there is a strong demand for loanable funds to be used locally rather than sending those funds to the country for agricultural loans.
5. Some regional money center banks are reluctant to bypass their downstream respondents and solicit loans directly from the rural area. This can undermine the relationship they have with their correspondent banks if those correspondents feel that the money center bank is bypassing them and going straight to their customers.
6. Another problem for the regional money center bank if it is soliciting loans directly from the rural areas is the ability of the regional money center bank to get to know its borrowers. What type of individual are they dealing with? How successful have they been in the agricultural business? And can the money center bank become familiar with their type of operation?
7. Sometimes country banks will not go beyond their legal lending limit for their customer and, consequently, the regional money center bank never has an opportunity to participate in the loan.
8. Another problem that exists between the country bank and the regional money center bank is the difference in interest rate charged to the borrower. Generally speaking, the cost of funds at the regional money center bank is higher than in the country and, Subsequently, the country banker charges a lower interest rate on the loan. When the country bank asks the money center bank to participate in the loan, it is necessary to make up this difference in interest rate in order that the loan be attractive to the money center bank.
9. Having qualified personnel in agricultural lending in the regional money center bank enables that bank to understand and

develop agricultural credits. Those people will deal directly with a country bank and its customers or contact the borrower directly. They also provide the expertise to present and explain the agricultural credit at the regional money center bank.

All of the aforementioned problems related to agricultural credits are certainly solvable. Once the commitment is made by the executive management of the regional money center bank, time, personnel, and programs can be implemented to solve these problems. Presently, the correspondent banking system does provide loanable funds to finance the agricultural industry. Correspondent bank balances that are carried at the regional money center banks are returned to the country in the form of loans in the agricultural industry.

What does the future hold for financing the agricultural industry through the correspondent banking system? I believe that there will be more competition for the agricultural loan in the future. There will certainly be more dollar needs to finance this industry. Interstate banking is a strong possibility in the 1980s. Banks in the money centers will be soliciting agricultural loans wherever there is that opportunity. Sometimes the loans will come through a regional money center bank and, in other cases, they will deal directly with the borrower. There is also the possibility that other financial institutions may entertain agricultural credits, with such institutions as savings and loan associations and credit unions viewing these loans as desirable. Another competitor for agricultural credits will be the Federal government. Extension of credit by various government agencies already plays an important role in financing some types of agricultural credits. At this time it remains to be seen how the Farm Credit Act will influence agricultural lending. Presently the Federal Reserve Banks provide seasonal borrowings for their member banks; however, it is doubtful that they will participate with their member banks on agricultural credits. I believe that competition for agricultural credits will intensify during the 1980s.

I would like to briefly mention three major pieces of banking legislation and how they may affect agricultural lending. The three pieces of legislation that I refer to are the Financial Institutions Regulatory Act, the Monetary Control Act of 1980, and the Farm Credit Act, which at this point is a proposed law. One restriction within FIRA is the limitation on the amount that a director can borrow from his own bank. In many cases, farmers and ranchers are directors of their local country bank. Those directors are now limited to borrowing only 10 per cent of the capital and surplus of the bank under FIRA. This has reduced the amount of money available to them to finance their agricultural operations. In this situation, the local banker has three alternatives: (1) He can participate that amount of the loan which is beyond his legal lending limit to an upstream correspondent, (2) The director can resign from the board, which will enable him to borrow more funds from that same bank, or (3) The director can do his borrowing from some other financial institution, which is a detriment to his own bank.

The Monetary Control Act of 1980 has changed the reserve requirements for all banks and financial institutions in the United States. It will increase the reserve requirements of the state nonmember banks and lower the reserve requirements of the larger national banks at regional and money center locations. Since many of the country's rural banks are state nonmember banks, this will have a tendency to take out of circulation more loanable funds and set them aside as reserves. This would mean in turn that the local bank would have fewer funds to lend to its customers for agriculture or any other purpose.

The Farm Credit Act, which will probably be enacted in late 1980 or early 1981, will definitely affect agricultural financing throughout the country. The bill expands the powers and permitted activities of the quasi-governmental Cooperative Farm Credit System (CFCS). This legislation moves CFCS increasingly out of agriculture and into competition for banks' commercial nonfarm customers. Cooperative Farm Credit System is primarily the nationwide competitor of banks and other lenders involved with agricultural related loans. Today CFCS provides 40 per cent of all farm loans. This is compared to banks' 34 per cent share of the market. In contrast, back in 1950, the banks held 50 per cent of all farm loans, while CFCS only had 17 per cent of the market. CFCS includes Federal Land Banks, Federal Land Bank Associations, Federal Intermediate Credit Banks, Production Credit Associations, Banks for Cooperatives, and the Central Bank for Cooperatives. The new law would permit these agencies to expand their lending to the agricultural industry, as well as the support industries that produce, transport, manufacture, and distribute farm-related products.

As you can see, this legislation will increase competition for agricultural related loans during the 1980s. I feel that regional money center banks are going to have to do a better job in order to maintain their portion of agricultural-related loans. The present trend is that the agricultural industry is moving away from the commercial banking system and seeking financing through other sources. The 1980s will definitely be a more competitive time for the commercial banking system as it provides financing for the agricultural industry.