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FDIC REPORT ANALYZES FARM BANK PROBLEMS AND PROPOSED POLICY OPTIONS

Changes in federal and state banking laws, limited deferral of loan losses and the use of special procedures for handling ailing banks and their borrowers are among suggestions for dealing with problems in the agricultural sector evaluated in a report by the Federal Deposit Insurance Corporation.

"The basic problem facing the farming sector is not a banking problem, rather it is an agricultural problem," according to the FDIC report. While a substantial rebound in the farm economy over the next couple of years is unlikely, the FDIC said some of the proposals might help reduce the impact the poor agricultural economy is having on farmers and farm banks while Congress decides how to address the fundamental changes underway in the agricultural economy.

The FDIC report, "Farm Bank Problems and Related Policy Options," was submitted by request to the Senate Banking Committee. According to the FDIC review, projections indicating a growing export market made in the early 1970s were the basis for many farm expansions. These projections have not proved valid. Instead, dwindling export markets (fueled in part by unfavorable exchange rates), massive deflation in land values, and interest rate fluctuations are acting together to reduce farm income.

While most of the nation's 4,000 farm banks are small, making up only four percent of total U.S. commercial bank assets, the FDIC said performance and loan quality data indicate growing problems in that sector of the industry.

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The FDIC's study predicts that farm bank failures will at least equal the level experienced in 1985, when 62 of the 120 failures involved agricultural banks.

The FDIC said accounting tools such as loan loss deferrals might buy time for farmers and bankers. While some liberalization of accounting rules may have only limited impact on the overall picture, they can be effected with only minor costs if Congress decides such action is appropriate and needed.

In addition, the FDIC reviewed possible changes in state banking laws such as restrictive branching statutes -- which impair efforts by regulators to merge failing banking institutions.

The FDIC report evaluated several possible ways to minimize the effects of failures on farm bank communities by ensuring that a bank's customers continue to receive banking services and not have their accounts placed in receivership. Two approaches reviewed include providing financial assistance to facilitate a merger before a bank becomes insolvent and increasing the amount of assets passed on to acquiring institutions when failures occur. Both of these approaches would promote the retention of farm assets within the banking system and reduce the amount of assets subject to liquidation. Another step evaluated would be to revise the agency's statutory cost test to permit greater use of mergers of failed banks.