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Clinton R. Hakes is the Manager, Agricultural Lender Marketing, at the Chicago Mercantile Exchange. He has been in that position for more than two years. Prior to joining the CME, he was President and CEO of Producers Livestock Credit Corporation for fourteen years and Executive Vice President for four years.

He holds a B.S. degree in Agricultural Economics from Arizona State University.

Educating Agricultural Lenders On Options

by Clinton R. Hakes

R. W. Collins has increased his comfort level with ag options, has performed a major educational service for large producers in his area, and has gained promising new business for his bank. He credits much of that progress to a seminar he attended last December.

Collins, vice president of the Bourbon (County) Agricultural Deposit Bank & Trust Company in Paris, Kentucky, represented Kentucky at a State Bankers Association Leadership Seminar on agricultural options that was held at the Chicago Mercantile Exchange (CME). Thirty states sent representatives.

"All of us knew about the use of straight futures, but few of us understood the newer tool of options," Collins reports. "They (the CME) began at the elementary level and spent the next 2 1/2 days educating us on puts and calls and explaining how and when options can protect our clients. On a scale of 1 to 10, my knowledge of options increased from about 5 to 8."

"At the conclusion of the seminar, the Mercantile people encouraged us to go back home and to hold an options seminar for our producers."

Upon returning to his bank, Collins looked over his ag loan portfolio (\$14,500,000) to determine which of his customers might benefit the most from a seminar. Next, he contacted Dr. Lee Meyer, an ag economist at the University of Kentucky, for help in setting up a program.

"We invited 27 of our customers and 8 other large producers," Collins reports. "Most of the producers in our area back ground cattle, but we also invited some hog producers. We had Dr. Meyer, Clinton Hakes from the Mercantile, and a commodities broker on the program."

Prior to that seminar, Collins had two customers who hedge in the futures market and nobody who used options. Today, those two producers also are using puts and calls, and four more producers have begun using puts. "In addition," says Collins, "we picked up two high-quality new customers as a result of the seminar. They transferred all their business to our bank. Even though they have not yet used options, they told me they appreciated our providing them with the information on options and said they were impressed with the bank's leadership in sponsoring the seminar."

Educational Benefits

CME wanted to describe Mr. Collins' experience because it's a prime example of what we're trying to accomplish in providing education on options to ag lenders. Our objective is to give lenders a working knowledge of options and to make certain they have a high comfort level when discussing options with a customer. This helps them to better serve existing customers who want to use options and also to attract new customers who are interested in options and are looking for a lender who

understands them.

In order to educate a larger audience, we've been taking our act on the road. During 1990 CME is sponsoring 10 agricultural lender seminars in key livestock producing states. This is up from eight in both 1988 and 1989. Each seminar is a one-day session.

The session begins with a review of the basics of hedging. Next, we introduce livestock options and follow that with an options workshop in which we use examples based on current prices of the livestock in the area.

The afternoon session covers how a producer can achieve forward pricing flexibility, without adding risk, through the use of hedging and options. We top off the day by having a local banker, who is familiar with the use of hedging and options, describe how his or her bank customers have used those measures as a part of their marketing strategies. The banker also explains such futures safety measures as a three-way agreement involving the bank, the borrower, and the borrower's broker. As spelled out in those agreements, the bank furnishes a borrower's margin money for hedging, but the money goes directly to the broker as needed. In return, the broker supplies the bank with records of all the borrower's futures transactions.

Throughout the seminars, CME emphasizes the backups and safeguards inherent in options. At the end, we invite questions and ask each attendee to evaluate the seminar.

Following each seminar we send attendees our monthly *Update* letter, which covers key issues regarding futures and options and provides of new information. During the past 12 months we have dealt, for example, with such subjects as "How Margins Work," "Changes in Put Pre-

miums Relative to Changes in Futures Prices," and "How to Choose an Option Strike Price."

An annual seminar, such as the one R. W. Collins attended, is also held at the Mercantile Exchange. This event is similar to those on the road except that generally a floor broker and/or an economist from the Federal Reserve Bank is on the program. The broker describes the internal workings of the CME.

Follow up

One purpose of the seminars is to help bankers set up ag options seminars for their area producers. A member of the CME Commodity Marketing and Education Department will conduct a seminar and tailor the content to the individual group, whether it be cow-calf people, cattle feeders or hog producers. The local banker also can invite an area commodities broker and/or extension livestock marketing specialist to be on the program.

In 1989 there were 12 follow-up meetings with a total attendance of 795 lenders and producers. By May 1 of 1990, there had already been 17 meetings, which drew 790 lenders and producers.

Study Materials

For those lenders who aren't able to attend an options seminar, we offer the following educational booklets: *A Self-Study Guide For Hedging With Livestock Futures, Ten Strategies For Forward Pricing Livestock Using Livestock Futures & Options, and Risk Management Guide For Ag Lenders*. To obtain these materials, please write to the Chicago Mercantile Exchange, Commodity Marketing Department, 30 S. Wacker Drive, Chicago, IL 60606, or phone 312/930-4597.

Advisory Committee

To make certain we are totally tuned in to the challenges and conditions faced by rural bankers, we have established a 13-member advisory committee of lenders that meets every other year. We also have contact with individual members during the interim. One of the committee's primary functions is to review our lender seminar program and make recommendations. Committee members often participate in CME Ag Lender Seminars.

Current members of the committee are:

Dave Hagen
First Central State Bank
De Witt, Iowa

Joseph Williams
American Heritage Bank
El Reno, Oklahoma

Mark Detten
American National Bank
Ponca City, Oklahoma

Bruce Baccus
Colorado National Bank
Denver, Colorado

John McMurry
First American Bank
Canton, South Dakota

Stan Herren
Deposit Guaranty National Bank
Jackson, Mississippi

Richard Kelley
Valley National Bank
Phoenix, AZ 850091

Steve Hatz
FirstTier Bank
Omaha, Nebraska

Don C. Anderson
Norwest Agricultural Credit
Sioux Falls, South Dakota

Jay Godwin
First St. Bank of Canadian
Canadian, Texas

Doyle L. Cook
Farm Credit Bank of Spokane
Spokane, Washington

Randy Woodley
Farm Credit Banks of Texas
Austin, Texas

Tom Powell
Farm Credit Services
St. Paul, Minnesota

Educating Examiners

In 1989, the CME was invited to a meeting in Iowa for 30 federal and state bank examiners, outside our normal ag lender audience. The session covered how to interpret the loan file of a producer who

uses the futures market for price protection, and it presented background information on futures and options as well as some simple options strategies used by producers.

Now Is the Time

Agricultural commodities traded on the CME—cattle, feeder cattle, and hogs—have recently been enjoying excellent prices. That's great news for producers and their lenders. Everyone in agriculture is hopeful the trend will continue. But all of us know painfully well that livestock production is a cyclical business, and prices won't always be as buoyant as they have been.

However, this is an opportune time to get ready for those coming days of tighter margins. Options can be a form of insurance in uncertain times, and CME is ready to provide information to lenders and their customers on the opportunities options provide.

R. W. Collins summarizes it this way, "It's not always easy to sell the idea of options in a rising market, but it's comforting to know they are there for the day when producers may need them for price protection insurance."