



November 18, 2002

Mr. Kevin P. Murray  
Vice President  
Bankers Financial Services Corporation  
8800 N.W. 62<sup>nd</sup> Avenue  
Post Office Box 6240  
Johnston, Iowa 50131-6240

Dear Mr. Murray:

Thank you for sending us a copy of your October 16, 2002, letter to Jane Ahrens, Senior Counsel, Board of Governors of the Federal Reserve System ("Ahrens Letter"). That letter addresses the Regulation DD ("Truth in Savings") issues raised by FDIC Senior Attorney Joseph A. Genova Jr. in his letter to you dated February 27, 2002, concerning the "Dow Jones Indexed Certificates of Deposit" product ("Genova Letter"). In our recent telephone conversation you requested that we provide written confirmation that the resolution of the Regulation DD issues explained in the Ahrens Letter would allay our concerns about the Regulation DD issues. This letter is in response to that request. I have enclosed a copy of both the Ahrens Letter and the Genova Letter.

My colleague, Susan van den Toorn, and I have spoken to Ms. Ahrens who confirmed that the information in the Ahrens letter accurately reflects the views of the Federal Reserve legal staff on the Regulation DD issues. As such, our concerns with the Truth in Savings issues will be satisfied if the applicable disclosure documents are amended as indicated in the Ahrens Letter.

We hope this is fully responsive to your request. Please call me with any additional questions at 202-898-7349.

Sincerely yours,

Joseph A. DiNuzzo  
Counsel

Enclosures

cc: Joseph A. Genova Jr.  
Susan van den Toorn



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October 16, 2002

Jane Ahrens, Senior Counsel  
Federal Reserve Board of Governors  
Mail Stop #804  
20<sup>th</sup> & C Street NW  
Washington, D.C. 20551

Re: Bankers Financial Services Corp. Dow Jones Industrial Average Indexed Certificate of Deposit and Compliance with Regulation DD/Truth and Savings

Dear Ms. Ahrens,

We appreciated the opportunity to speak with you and your colleague, Ky Tran-Trong, regarding the disclosure statement for our Dow Jones Industrial Average Indexed Certificate of Deposit (ICD) to be issued by community banks. As you are aware, in a letter dated February 27, 2002, the Federal Deposit Insurance Corporation (FDIC) confirmed the eligibility of the ICD for deposit insurance and requested that we specifically address compliance with Section 230.4(b)(4) of Regulation DD, 12 C.F.R. § 230.4(b)(4) indicating that we provide an "explanation of how any fee will be calculated" and Section 230.4(b)(6)(i) of Regulation DD, 12 C.F.R. § 230.4(b)(6)(i) indicating "how the penalty is calculated" in the context of an early withdrawal event.

Regulation DD does not specifically address or recognize the unique features of an equity-linked certificate of deposit either in the context of the Regulation or the associated commentary. As such, we have sought guidance from the staff of the Board of Governors of the Federal Reserve System (BOG) to determine an approach to the disclosure statement that is consistent with the Regulation.

To address the concerns expressed by the FDIC, you suggested that we incorporate within the disclosure statement, a specific section that includes the required disclosures, which mirror model clauses and sample forms related to certificates of deposit included in Appendix B of Regulation DD. As part of this disclosure, an explanation of how fees and/or penalties will be calculated is required. As we have explained, the amount the consumer will receive upon exercising the early withdrawal feature is contingent upon what is termed as a Market Evaluation. In the context of this product, a Market Evaluation is expressed as a numerical percentage rate, applicable only when a consumer exercises the withdrawal feature and is based upon market factors at the time of withdrawal. The Market Evaluation is dictated to the bank by unrelated third-party sources and is not wholly contingent upon the value of the Index used for determining the value of the certificate of deposit at maturity. In light of these features, we agree that the disclosure statement must at least incorporate the following three elements to adequately identify how any fee and/or penalty would be determined as part of an early withdrawal event pursuant to Sections 230.4(b)(4) and 230.4(b)(6)(i) of Regulation DD:

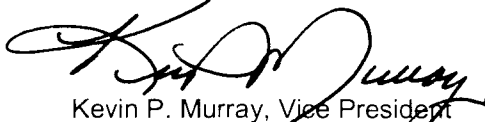
1. The principal amount is not guaranteed and the deposit holder could receive less than the original principal amount of his/her deposit;
2. The amount that the deposit holder will receive upon Early Withdrawal will not be calculated using the same formula that is used to determine the value of the certificate of deposit at maturity; and
3. The Early Withdrawal price will be based upon market conditions and third-party determinations of the market value of the deposit holder's investment at the time of withdrawal.

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The ICD disclosure statement has been modified to reflect these recommendations and has been attached for your reference. We understand that this guidance is applicable only to the issues identified in this letter with respect to the Early Withdrawal feature of the product. In addition, you have indicated your willingness to share your interpretation of Regulation DD as it relates to this product with other regulatory bodies, state supervisory agencies, or other interested parties. These parties may contact you or Ky Tran-Trong at the Division of Consumer and Community Affairs of the Board of Governors of the Federal Reserve System directly at 202-452-2412.

Our goal at Bankers Financial Services is to make a good faith effort to ensure full compliance with all laws and regulations and your assistance in this matter is greatly appreciated. If you have any questions or comments regarding our understanding of the aforementioned issues, please do not hesitate to contact me directly at 515-286-4231 or through my e-mail address at [kmurray@bdfs.com](mailto:kmurray@bdfs.com).

Respectfully,



Kevin P. Murray, Vice President  
Bankers Financial Services Corp.

Enclosures:

Model ICD Disclosure Statement  
FDIC Letter Dated February 27, 2002

cc: Adrienne Hurt, Assistant Director, Board of Governors of the Federal Reserve System  
Ky Tran-Trong, Attorney, Board of Governors of the Federal Reserve System  
Joseph Genova, Counsel, FDIC, Kansas City Office  
Joseph DiNuzzo, Counsel, FDIC, Washington D.C. Office  
Doug Slayton, Office of Banking and Real Estate (State of Illinois)  
Eric McClure, Acting Commissioner, Department of Economic Development  
(State of Missouri)  
Tom Gronstal, Superintendent, Iowa Division of Banking (State of Iowa)  
Mary Hughes, Acting Financial Institution's Bureau Chief, Idaho Department of Finance



Federal Deposit Insurance Corporation  
2345 Grand Ave., Suite 1200 Kansas City, MO 64108

Legal Division

February 27, 2002

Mr. Kevin P. Murray  
Institutional Production Manager  
Bankers Financial Services Corporation  
P.O. Box 6240  
Johnston, Iowa 50131-6240

Dear Mr. Murray:

This responds to your letter of January 21, 2002, addressed to FDIC Counsel Joseph A. DiNuzzo. In that letter, you request an opinion as to the insurability of "Dow Jones Indexed Certificates of Deposit" ("ICDs"). The product is a certificate of deposit whose interest is tied to the performance of the Dow Jones Industrial Average.

In August 2000 the FDIC issued a letter to the West Virginia Commissioner of Banking concluding that the insurance coverage for indexed certificates of deposit would be limited to the principal amount of the CD, inasmuch as the interest paid on the deposit, if any, would be determined as of the CD maturity date and the product had no guaranteed rate of interest. That product had a 10 year maturity and did not permit early withdrawals. You are asking for an updated opinion because the ICD differs somewhat from that which was the subject of the August 2000 letter. The maturity term is reduced from ten to five years and the product now has early withdrawal provisions.

As I discussed with you and indicated in prior correspondence, the inclusion of the early withdrawal provisions raised issues that the FDIC had not previously considered. In determining whether a bank product is a "deposit" eligible for FDIC insurance the FDIC considers, among other things, the purchaser's possible loss of principal. If the product is structured so that the principal amount of the product is at risk, so that the purchaser might not ultimately receive a return equal to at least the full amount of the principal, in the past we have concluded that the product is a non-deposit obligation of the bank and, thus, not eligible for FDIC insurance. Here, if the customer chooses to exercise the "early withdrawal option," principal is not guaranteed.

Based on the description of the early withdrawal option in the disclosure materials you provided to us, a customer may, during an annual withdrawal period, elect to liquidate his entire interest in the ICD.<sup>1</sup> If a customer exercises his/her early withdrawal option, an "early withdrawal price" will be determined by the Bank in its sole discretion. The "early withdrawal

<sup>1</sup> Partial liquidations are not permitted.

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price" appears to be the amount of money deposited by the customer net of any charges which the Bank decides to assess with respect to the transactions. The Disclosure Statement indicates that, in calculating the "early withdrawal price," the Bank may consider a number of factors including: the cost of liquidating any hedges entered into in connection with the ICD; the current value of the Dow Jones Industrial Average and its relationship to the value at the time the ICD was established; and the interest rates from the early withdrawal date to the specified maturity date. The disclosure indicates that the "early withdrawal price" may be less than the amount of the deposit, resulting in a loss of principal. Early withdrawals are also permitted at times other than the annual withdrawal date in the event of death of an account owner. Funds withdrawn from the ICD as a result of the owner's death are also redeemed at the "early withdrawal price."

The FDIC has taken the position in the past that a potential decrease in principal caused by the imposition of an early withdrawal *penalty* does not prevent a product from qualifying as a "deposit" for insurance purposes. Here the disclosure documents avoid discussing fees, penalties, and/or charges associated with the early withdrawal option by simply referring to the net amount to be paid to the depositor in the event of an early withdrawal. We do not view the potential decrease in principal stemming from the customer's exercise of the early withdrawal provisions as preventing the product from qualifying as a deposit for insurance purposes. Having reviewed the Disclosure Statement, we believe that, overall, the ICD is still more characteristic of a deposit than a non-deposit product.

In the instant case, we note that the difference between the amount of the deposit and the "early withdrawal price" set by the bank is clearly either a fee or an early withdrawal penalty. Section 230.4(b)(4) of Regulation DD, 12 C.F.R. § 230.4(b)(4) specifically requires a bank to disclose the amount of any fees that may be imposed in connection with an account **or an explanation of how the fee will be determined** and the conditions under which the fee may be imposed. On page 18 of the Disclosure Statement it is specifically stated that the depositor will not have to pay any "fees." If the amount deducted from the depositor's funds in determining the early withdrawal price is considered a fee, this portion of the Disclosure Statement is in error. Further, section 230.4(b)(6)(i) of Regulation DD, 12 C.F.R. § 230.4(b)(6)(i) specifically requires a bank to disclose the existence of any penalties that may be imposed for early withdrawal, **how the penalty is calculated**, and the conditions for its assessment. On Page 13 of the Disclosure Statement, there is a list of several factors which the bank may considered in establishing the early withdrawal price. If the amount deducted from the depositor's funds in determining the early withdrawal price is considered an early withdrawal penalty, the list of factors which can be considered does not adequately describe how the penalty is calculated.

You have asked us to note "key concerns and/or issues that examiners will consider as part of their review" of the ICD program. At the present time, the ICD program is still in the developmental stage. Numerous changes may be made before the product actually reaches the market. It is impossible for the FDIC to determine what the final product will look like, how it will be marketed, and how it will actually operate. As a result, it is impossible for us to predict what key concerns and or issues examiners might have with the product.

Mr. Kevin P. Murray

February 27, 2002

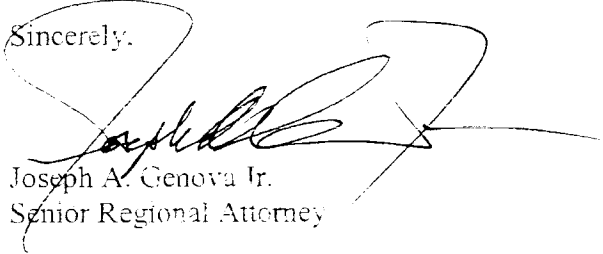
You have also asked us to identify "specific requirements of Federal law which should be addressed." FDIC has a great deal of expertise in Federal banking laws and regulations. Other areas of Federal law are outside of our area of focus. If you wish to obtain a comprehensive review of Federal law as it might relate to your particular product, we would suggest that you contact a private law firm with a broad Federal law practice.

Please note that the representations in this letter are for information purposes only. The FDIC does not recommend, approve, certify, sanction, or otherwise endorse investment products. We do not look favorably upon marketing tactics which suggest that such products have been approved by the FDIC.

Further, please note that this opinion is strictly limited to the facts as indicated in your Disclosure Statement. Deviations from this product may lead to a different result as to FDIC insurance issues.

Please contact me with any additional questions or comments.

Sincerely,



Joseph A. Genova Jr.  
Senior Regional Attorney