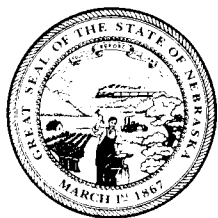


# STATE OF NEBRASKA



**Mike Johanns**  
Governor

June 19, 2003

DEPARTMENT OF BANKING AND FINANCE

**Samuel P. Baird**

Director

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Lisa M. Smith  
Vice President  
Bankers Financial Services Corp.  
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P.O. Box 6240  
Johnston, IA 50131-6240

Dear Ms. Smith:

This is in reply to your letter of May 22, 2003, regarding an indexed certificate of deposit program which Bankers Financial Services Corp. wishes to offer to Nebraska banks. You asked three questions of the Department.

1) Are state-chartered financial institutions allowed to sell equity-linked certificates of deposit in the State of Nebraska?

Answer: Yes, equity-linked certificates of deposit are products that Nebraska financial institutions may (and do) sell.

2) Are OTC option contracts, as a non-speculative risk management tool, a permissive investment under the laws and regulations of the Nebraska Department of Banking & Finance?

Answer: No, OTC options contracts are not a permissible investment for state-chartered banks under the regulations of the Department [See, 45 NAC 30, 004.05, attached]. Nebraska's wildcard statute, Neb. Rev. Stat. § 8-1,140 (LB 217, 2003), would, however, provide indirect authority for this form of investment. Section 8-1,140 provides that a Nebraska state-chartered bank has all rights, powers and privileges of a national bank doing business in Nebraska. It appears that under the guidelines of the Office of the Comptroller of the Currency (2002 Activities Permissible for a National Bank), national banks are authorized to utilize OTC option contracts as an investment for the purposes described in your letter.

As such, the Department determines that state-chartered banks may invest in OTC option contracts, as a non-speculative risk management tool, when the options are tied to the bank's sale of equity-linked certificates of deposit.

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The Department declines to give a blanket opinion with respect to the ability of state-chartered savings associations and credit unions to invest in these programs. Any such requests will be dealt with on a case-by-case basis for the individual financial institution.

3. Does the Nebraska Department of Banking & Finance currently have any policy statement and/or requirements regarding an indexed certificate of deposit program for community banks and financial institutions?

Answer: Similar to the OCC's guidelines, the Department will require the following:

- a) The bank must provide prior notice to the Department that it intends to sell this type of product. The notice must contain information describing the product, the option contract program, and a discussion of the program's effectiveness and efficiency in reducing risks.
- b) The bank must establish that it has an appropriate risk management program in place.
- c) The Department reserves the right to disapprove any individual bank's proposal to engage in these transactions.

This letter is not to be construed as an endorsement of the Bankers Financial Services Corp. indexed-linked certificate of deposit program, nor does it mean that the Department has passed upon the merits of the program. If applicable law or regulation change, or if there are material changes to the program, the Department's opinion is subject to change without notice.

I trust this is responsive to your inquiry. Should you have additional questions, please contact Department General Counsel, Patricia Humlicek Herstein.

Sincerely,



Samuel P. Baird  
Director

Enc.: 45 NAC 30

TITLE 45 - DEPARTMENT OF BANKING AND FINANCE

Chapter 30 - REQUIREMENTS FOR PURCHASES OF SHARES OF INVESTMENT COMPANIES

001 Scope and Application

001.01 This rule will govern certain investments made by a state bank pursuant to the provisions of Neb. Rev. Stat. section 8-148 (2) (Reissue 1987). Such investments include only the purchase of shares of an investment company registered under the Investment Company Act of 1940.

001.02 This rule addresses a state bank's purchases of investment company shares for its own account.

002 Statutory Limitation

002.01 The assets of the investment company must consist solely of and are limited to obligations that are eligible for investment by the bank.

003 Definitions

003.01 "Obligations that are eligible for investment" shall mean those specified in Neb. Rev. Stat. sections 8-141, 8-147, 8-148, 8-148.01, 8-148.02, and 8-148.03.

004 Investment Limits

004.01 When an investment company's assets consist solely of and are limited to obligations that are eligible for unlimited investment by a state bank, there is no limit on a bank's investment.

004.02 When an investment company's assets contain obligations which are subject to the bank's investment or lending limitations, investment by the bank must be limited to twenty-five percent (25%) of the paid-up capital, surplus, capital notes and debentures of the bank.

004.03 When an investment company makes use of repurchase agreements, the bank's investment is limited to twenty-five percent (25%) of the paid-up capital, surplus, capital notes and debentures of the bank, provided that all of the following conditions are met:

004.03A The repurchase agreements are fully secured by securities of the United States government or any authorized agency thereof.

004.03B Possession of the collateral is obtained by either the bank or a third party custodian designated by the bank under a written custodial agreement which explicitly recognizes the bank's interest in the securities as superior to that of any other person, or, in the case of book-entry securities by appropriate entry in an account maintained in the name of the bank by a Federal Reserve Bank;

004.03C The collateral is marked to market on a daily basis.

004.04 When an investment company makes use of repurchase agreements which do not contain the elements set forth in section 004.03 of this rule, and/or securities lending arrangements, the bank's investment is limited to ten percent (10%) of the paid-up capital, surplus, capital notes and debentures of the bank.

004.05 When an investment company makes use of futures and options, or has the ability to do so, the fund is not an eligible investment for state banks. A state bank may invest in an investment company which makes use of forward contracts, provided that the investment company maintains, in a segregated account, cash or cash equivalents or other portfolio securities equal in value to commitments to purchase securities, so that no leverage is employed.

#### 005 Requirements of the Investment Company

005.01 In addition to the eligibility requirements of the underlying assets of the investment company, the fund must provide that:

005.01A The shareholder must have a proportionate undivided interest in the underlying assets of the investment company.

005.01B The shareholders of the fund must be shielded from personal liability for acts or obligations of the investment company.

#### 006 Review and Documentation Requirements

006.01 The bank's formal investment policy, as adopted and approved by its board of directors, shall specifically provide for the investments addressed by this rule.

006.02 Specific prior approval of the bank's board of directors is required for the initial investment in specific investment companies. Such approval shall be noted in the official board minutes.

006.03 Procedures, standards, and controls for managing such investments shall be implemented prior to the investment being made. Such procedures, standards, and controls shall be in written form and approved by the board of directors.

006.04 A copy of the prospectus for each such investment shall be maintained in the bank's files for a period of one year after the investment is no longer held in the bank's own portfolio.

006.05 The bank shall conduct a review at least quarterly of its holdings of investment company shares to ensure that such investments are in accordance with its investment policy and statutory and regulatory requirements. Such review shall be noted in the official board minutes.

## 007 Reporting and Accounting Requirements

007.01 Existing instructions for the quarterly Reports of Condition require bank holdings of investment company shares to be reported at the lower of the aggregate cost or market value in Schedule RC-B SECURITIES. Reference the instructions for the Report of Condition, glossary entry for "marketable equity securities" and Statement of Financial Accounting Standards No. 12, Accounting for Certain Marketable Securities ("FAS 12").

007.01A Market value of "open-end" investment companies should be based on net asset value rather than offering price.

007.01B Shares in "closed-end" investment companies should be marked to the bid price.

007.01C At no time may the carrying value of investment company holdings be increased above their aggregate cost as a result of net unrealized gains.

007.02 Net unrealized losses on marketable equity securities and subsequent recoveries of net unrealized losses should be excluded from Schedule RI-INCOME STATEMENT and instead be reported (reduced by applicable income tax effect) in Schedule RI-A CHANGES IN EQUITY CAPITAL as an adjustment to "Undivided Profits and Capital Reserves." A loss on an individual investment which is other than temporary should be charged to noninterest expense on Schedule RI-INCOME STATEMENT.

007.03 As part of the market value determination referred to above, mutual fund sales fees, both "front end load" and "deferred contingency", must be deducted in calculating market value to more accurately reflect the current value of fund shares. Unless the market value of such shares increases sufficiently to offset these fees, the amount of these fees will be reflected as unrealized losses and effectively charged against "Undivided Profits and Capital Reserves."