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December 20, 2001

Mr. Kevin P. Murray
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Dear Kevin:

This letter is written in response to your request for the views of the Division of Banking with respect to time certificates of deposit the interest on which depends on the performance of the Dow Jones Industrial Average ("DJIA"). It should be understood that this letter does not constitute an endorsement of the CD or an opinion as to the suitability of the CD for state banks or their customers.

The product described in the following is generally referred to as an "indexed time certificate of deposit" ("CD"). As we understand it, the CD would have a maturity of five years and would be issued in multiples of \$1,000. As we further understand it, interest would be paid at maturity of the CD based on the average performance of the DJIA during the five-year term of the CD. The performance of the DJIA would be based on a participation rate equal to the percentage the depositor would share in any increase in the DJIA. The beginning index value would be based on the closing price of the DJIA on the issue date. The final index value would be based on the average of the closing price of the DJIA during the final 12 quarters of the CD.

It is further understood the principal of the CD would be guaranteed by the state bank issuing the CD, thus, if the average performance of the Dow Jones stocks for the five-year term of the CD is negative, no interest would be paid on the CD but the depositor would get his or her original deposit back in full. Conversely, if the average performance of the Dow stocks is positive, say 10 percent, the depositor would receive a return of slightly more or less than 10 percent due to averaging.

Somewhat like ordinary time certificates of deposit, the indexed CD may be withdrawn prior to maturity on dates and at prices established by the issuing bank at some possible loss of principal to the depositor. It is further understood that the CD would be insured by the Federal Deposit Insurance Corporation to the extent and subject to the conditions that other bank deposits are insured.

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Banks issuing the CDs would be subject to what amounts to an interest rate risk in the event of extraordinary average increases in the DJIA. Whether any significant liquidity risk would arise from issuance of the CDs would depend on the total amount of such CDs having approximately the same maturity. To hedge against increases in the DJIA, the issuing state bank would enter into an arrangement with a hedge provider to assume the risk of paying to the state bank an amount equal to the performance of the DJIA. This arrangement may be in the form of a swap or upfront purchase of a hedging contract. The issuing state bank would then pass the funds received from the hedge provider on to the depositor at the maturity of the CD as interest due on the CD. In the case of a decline in the DJIA, the depositor would not receive any interest for the term of the CD and the cost to the bank for the use of the depositor's money would consist of that part of the original amount of the CD paid to the hedge provider. Whether interest would be due to the depositor consistent with an increase in the DJIA or no interest would be due as the result of a decline in the DJIA, the issuing state bank would be responsible for paying the original principal amount of the CD to the customer.

Due to the complicated nature of the product, it will be incumbent on the issuing bank to make sure its employees are properly trained to fully explain all of the ramifications of the product to its customers. The tax and accounting considerations involved in the issuance of the CDs and hedging the interest rate risk can be significant. State banks issuing indexed CDs will need to seek the advice of an accounting firm to understand and comply with accounting and tax reporting requirements.

Based on the above understanding and information supplied to the Division of Banking, it is our belief that state banks, in the discretion of management, may legally issue indexed time certificates of deposit. It should be understood that prior approval of the Superintendent is required pursuant to Section 524.901(9) of the Iowa Code for a state bank to enter into the type of hedging contract described in the information supplied.

Very truly yours,



Holmes Foster
Superintendent of Banking

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cc: State Banking Board