ATTACHMENT D

CURRENT SAFEGUARDS

Section 23A of the Federal Reserve Act restricts transactions between member banks and their affiliates, and the Federal Deposit Insurance Act extends the coverage of 23A to nonmember insured banks. Section 23A attempts to prevent the misuse of insured institutions by placing quantitative limitations on "covered transactions" between a bank and its affiliate, establishing collateral requirements for certain transactions, requiring that all transactions be on terms and conditions that are consistent with safe and sound banking, and prohibiting a bank from purchasing low-quality assets of an affiliate. "Covered transactions" include loans to an affiliate, purchases of securities issued by an affiliate, acceptance of securities issued by an affiliate as collateral, and the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate.

Section 23B of the Federal Reserve Act places additional limitations on federally insured banks and their affiliates, by providing that a bank may engage in certain transactions with its affiliates only on an "arm's length" basis. In addition to the "covered transactions" of Section 23A, Section 23B applies to the sale of securities or other assets to an affiliate, to service contracts between the bank and its affiliate, and to transactions with a third party where the affiliate has a financial interest in the third party.

The Federal Reserve Board has established prudential limitations on the activities of the "Section 20 companies" of bank holding companies (BHCs) that underwrite and deal in debt and equity securities to a limited extent. Among other things, in determining capital compliance, BHCs must deduct from consolidated primary capital any investment in an underwriting subsidiary, or any extension of credit that does not meet certain collateral requirements. BHCs and their subsidiaries are prohibited from: entering into any financial arrangement that might be viewed as enhancing the marketability of a bank-ineligible security issued by the underwriting subsidiary; extending credit to a customer to purchase a bank-ineligible security issued by the securities affiliate during or shortly after the underwriting period; or purchasing ineligible securities from a securities affiliate during or shortly after the underwriting period. Officer, director or employee interlocks between a BHC's underwriting subsidiary and any bank or thrift subsidiary are prohibited. An underwriting subsidiary must provide adequate disclosures that its products are not federally insured. There are limitations on the ability of affiliated banks or thrifts to provide investment advice regarding the purchase of securities underwritten or dealt in by the securities affiliate. Bank or thrift subsidiaries are prohibited from extending credit to a securities affiliate except

in certain limited instances, or from purchasing or selling certain financial assets to or from a securities affiliate.

On December 28, 1984, the FDIC implemented its regulation on securities activities of subsidiaries of insured nonmember banks and bank transactions with affiliated securities companies (12 CFR § 337.4). At that time, the FDIC determined that it is not unlawful under the Glass-Steagall Act for an insured nonmember bank to establish or acquire a bona fide subsidiary that engages in securities activities nor for an insured nonmember bank to become affiliated with a company engaged in securities activities if authorized under state law. At the same time, the FDIC found that some risk may be associated with those activities. In order to address that risk, the FDIC regulation (1) defines bona fide subsidiary, (2) requires notice of intent to acquire or establish a securities subsidiary, (3) limits the permissible securities activities of insured nonmember bank subsidiaries, and (4) places certain other restrictions on loans, extensions of credit and other transactions between insured nonmember banks and their subsidiaries or affiliates that engage in securities activities.

In our regulation, the term "bona fide" subsidiary means a subsidiary of an insured nonmember bank that at a minimum: (1) is adequately capitalized, (2) is physically separate and distinct in its operations from the operations of the bank, (3) maintains separate accounting and other corporate records, (4) observes separate corporate formalities such as separate board of directors meetings, (5) maintains separate employees who are compensated by the subsidiary, (6) shares no common officers with the bank, (7) a majority of the board of directors is composed of persons who are neither directors nor officers of the bank, and (8) conducts business pursuant to independent policies and procedures designed to inform customers and prospective customers of the subsidiary that the subsidiary is a separate organization from the bank and that investments recommended, offered or sold by the subsidiary are not bank deposits, are not insured by the FDIC, and are not guaranteed by the bank nor are otherwise obligations of the bank.

This definition is imposed to ensure the separateness of the subsidiary and the bank. This separation is necessary as the bank would be prohibited by the Glass-Steagall Act from engaging in many activities the subsidiary might undertake. Also, the separation safeguards the soundness of the parent bank.

The regulation provides that the insured nonmember bank must give the FDIC written notice of intent to establish or acquire a subsidiary that engages in any securities activity at least 60 days prior to consummating the acquisition or commencement of the operation of the subsidiary. These notices serve as a supervisory mechanism to apprise the FDIC of which insured nonmember banks are conducting securities activities through

their subsidiaries that pose potential risks to which the bank otherwise would not be exposed.

Activities of the subsidiary are limited in that it may not engage in the underwriting of securities that would otherwise be prohibited to the bank itself under the Glass-Steagall Act unless the subsidiary meets the bona fide definition and the activities are limited to underwriting of investment quality securities.

A subsidiary may engage in underwriting other than that listed above if it meets the definition of bona fide and the following conditions are met:

(a) The subsidiary is a member in good standing of the National Association of Securities Dealers (NASD);

(b) The subsidiary has been in continuous operation for a five-year period preceding the notice to the FDIC;

(c) No director, officer, general partner, employee or 10 percent shareholder has been convicted within five years of any felony or misdemeanor in connection with the purchase or sale of any security;

(d) Neither the subsidiary nor any of its directors, officers, general partners, employees, or 10 percent shareholders is subject to any state or federal administrative order or court order, judgment or decree arising out of the conduct of the securities business;

(e) None of the subsidiary's directors, officers, general partners, employees or 10 percent shareholders are subject to an order entered within five years issued by the Securities and Exchange Commission pursuant to certain provisions of the Securities Exchange Act of 1934 or the Investment Advisors Act of 1940; and

(f) All officers of the subsidiary who have supervisory responsibility for underwriting activities have at least five years experience in similar activities at NASD member securities firms.

A bona fide subsidiary must be adequately capitalized, and therefore, they must meet the capital standards of the NASD and SEC. As a protection to the insurance fund, a bank's investment in these subsidiaries engaged in securities activities that would be prohibited to the bank under the Glass-Steagall Act is not counted toward the bank's capital, that is, the investment in the subsidiary is deducted before compliance with capital requirements is measured.

An insured nonmember bank which has a subsidiary or affiliate that engages in the sale, distribution, or underwriting of stocks, bonds, debentures or notes, or other securities, or acts as an investment advisor to any investment company may not engage in any of the following transactions:

(1) Purchase in its discretion as fiduciary any security currently distributed, underwritten or issued by the subsidiary unless the purchase is authorized by a trust instrument or is permissible under applicable law;

(2) Transact business through the trust department with the securities firm unless the transactions are at least comparable to transactions with an unaffiliated company;

(3) Extend credit or make any loan directly or indirectly to any company whose obligations are underwritten or distributed by the securities firm unless the securities are of investment quality;

(4) Extend credit or make any loan directly or indirectly to any investment company whose shares are underwritten or distributed by the securities company;

(5) Extend credit or make any loan where the purpose of the loan is to acquire securities underwritten or distributed by the securities company;

(6) Make any loans or extensions of credit to a subsidiary or affiliate of the bank that distributes or underwrites securities or advises an investment company in excess of the limits and restrictions set by section 23A of the Federal Reserve Act;

(7) Make any loan or extension of credit to any investment company for which the securities company acts as an investment advisor in excess of the limits and restrictions set by section 23A of the Federal Reserve Act; and,

(8) Directly or indirectly condition any loan or extension of credit to any company on the requirement that the company contract with the banks securities company to underwrite or distribute the company's securities or condition a loan to a person on the requirement that the person purchase any security underwritten or distributed by the bank's securities company.

An insured nonmember bank is prohibited by regulation from becoming affiliated with any company that directly engages in the sale, distribution, or underwriting of stocks, bonds, debentures, notes or other securities unless: (1) The securities business of the affiliate is physically separate and distinct from the

operation of the bank; (2) the bank and the affiliate share no common officers; (3) a majority of the board of directors of the bank is composed of persons who are neither directors or officers of the affiliate; (4) any employee of the affiliate who is also an employee of the bank does not conduct any securities activities of the affiliate on the premises of the bank that involve customer contact; and (5) the affiliate conducts business pursuant to independent policies and procedures designed to inform customers and prospective customers of the affiliate that the affiliate is a separate organization from the bank and that investments recommended, offered or sold by the affiliate are not bank deposits, are not insured by the FDIC, and are not guaranteed by the bank nor are otherwise obligations of the bank. The FDIC has chosen not to require notices relative to affiliates because we would normally find out about the affiliation in a deposit insurance application or a change of bank control notice.

The FDIC has created an atmosphere in which bank affiliation with entities engaged in securities activities is very controlled. Although we have examination authority over bank subsidiaries and under Section 10(b) of the Federal Deposit Insurance Act we have the authority to conduct examinations of affiliates to determine the effect of that relationship on the insured institution, we have in practice allowed these entities to be functionally regulated, that is FDIC examination of the insured bank and SEC and NASD oversight of the securities subsidiary or affiliate.

The FDIC feels that its established separations for banks and securities firms has created an environment in which the FDIC's responsibility to protect the insurance fund has been met without creating duplicative regulation for the securities firms. However, our experience indicates that these separations may not be perfect. Insider maneuvering may be able to evade the intent of the firewalls, securities firms affiliated with nonbank bank holding companies may fall outside the regulatory coverage of Part 337.4, and if systemic problems were to develop in the securities industry, the difficulties may overwhelm the protection in place.

Therefore, the FDIC believes that functional regulation should not be designed in a fashion that would preclude the FDIC from examining securities subsidiaries and affiliates for matters which are unsafe and unsound. This would include reviewing insider involvement in the securities firms, monitoring financial transactions between the insured institution and the securities firm, reviewing securities firms records to assure that the restrictions contained in Part 337.4 are being adhered to, and regularly reviewing financial statements of the securities firms.

The FDIC is also maintaining an open dialogue with the NASD and the SEC concerning matters of mutual interest. To that end,

we have entered into an agreement in principle with the NASD concerning examination of securities companies affiliated with insured institutions and have begun a dialogue with the SEC concerning the exchange of information which may be pertinent to the mission of the FDIC.

The number of banks which have subsidiaries engaged in activities that could not be conducted in the bank itself is very small. The activities these subsidiaries are engaged in are underwriting of debt and equity securities and distribution and management of mutual funds. We have received notices from 444 banks that have subsidiaries which are engaged in activities that do not require the subsidiary to meet the definition of bona fide such as investment advisory activities, sale of securities and management of the bank's securities portfolio.

Since implementation of the FDIC's regulation, the relationships between banks and securities firms have not been a matter of supervisory concern. We believe in great part that this can be attributed to the protections we have in place. However, we are aware that in a time of financial turmoil that these protections may not be adequate and a program of direct examination may be necessary to protect the insurance fund and continuation of our examination authority in that area is important.