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Financial Services *Alert*

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Developments of Note

♦ FASB Issues Final Statements Eliminating Pooling-of-Interests Accounting for Business Combinations and Goodwill Amortization

The Financial Accounting Standards Board ("FASB") concluded its controversial re-assessment of the accounting rules for business combinations by releasing two complementary statements, FASB Nos. 141 and 142. FASB No. 141, Business Combinations, eliminates the popular pooling-of-interests accounting method for business combinations initiated after June 30, 2001. FASB No. 142, Goodwill and Other Intangible Assets, requires that goodwill no longer be amortized, but instead be periodically reviewed for impairment. The amortization of goodwill ceases upon adoption of the statement, which, for most companies, will be January 1, 2002. In FASB's view, FASB No. 141 improves the transparency of the accounting and reporting for business combinations by requiring that all business combinations be accounted for under a single method, the purchase method, while FASB No. 142 provides investors with greater transparency regarding the economic value of goodwill and its impact on earnings.

♦ SEC No-Action Relief Permits an Unaffiliated Securities Lending Agent to Invest Collateral Received in Connection with a Fund's Securities Lending Activities through Joint Accounts

The staff of the SEC's Division of Investment Management (the "Staff") granted no-action relief under Section 17(d) of the Investment Company Act of 1940 (the "Act") and Rule 17d-1 thereunder to permit an unaffiliated securities lending agent to invest the cash collateral received by affiliated funds that participate in a securities lending program, through joint accounts (the "Joint Accounts"). The Staff indicated that affiliated persons of funds (other than affiliated securities lending agents) that have received exemptive orders under Rule 17d-1 permitting the use of joint accounts for the investment of cash balances, including cash collateral from securities lending activities, may rely on the no-action letter or on their exemptive orders. Because the Staff has granted this relief, funds that wish to implement joint account arrangements as described in the no-action letter will no longer need to seek exemptive orders from the SEC. The no-action relief is subject to a number of conditions including, among others, that (1) each participating fund's investment adviser will have sole responsibility for determining whether a fund is to participate in the Joint Accounts, pursuant to standards and procedures that would be established by the fund's board, (2) the investment adviser will be responsible for overseeing the administration of the Joint Accounts as part of its general duties under the advisory agreement and will not collect any additional fees for administering the Joint Accounts, (3) assets in the Joint Accounts will be invested in short-term securities such as repurchase agreements, commercial paper and short-term money market securities, (4) each participating fund's decision to invest through the Joint Accounts will be based on the same factors as its decision to make any other short-term investment, (5) each participating fund and its investment adviser will maintain records documenting each participant's daily aggregate investment in a Joint Account and its pro rata share of each investment in which the fund's cash is applied and (6) if a Joint Account is established by a custodian that is not a participant's regular custodian, the participant will appoint such custodian as a sub-custodian for the limited purposes of maintaining the Joint Account and will take all necessary action (including actions required under the Act) to authorize such custodian. *The Chase Manhattan Bank*, SEC No-Action Letter (pub. avail. July 24, 2001).

♦ FRB, OCC Officials Support FDIC's Deposit Insurance Reform Proposals, but Oppose Proposal to Increase $100,000 Coverage Limit on Individual Accounts

FRB Governor Laurence H. Meyer and OCC Comptroller John D. Hawke, Jr. each made presentations urging a U.S. House of Representatives Financial Services subcommittee to reform the deposit insurance system along the lines previously recommended by the FDIC (See *Alert* of April 10, 2001), but argued that Congress should not increase the current $100,000 FDIC insurance coverage limit on individual accounts. The FDIC had suggested that the $100,000 limit be indexed to account for inflation.

Merging BIF and SAIF. Messrs. Meyer and Hawke both agreed that the Bank Insurance Fund (the "BIF") and the Savings Association Insurance Fund (the "SAIF") of the FDIC should be merged because the powers and

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operations of banks and thrifts are now extremely similar, the insurance offered by the FDIC to each type of institution is identical and a merger of the BIF and the SAIF would diversify the insurance risk and reduce FDIC administrative expenses.

Statutory Restrictions on Premiums. Messrs. Meyer and Hawke also agreed that FDIC deposit insurance premiums should be made more sensitive to risk. They stated that every insured financial institution should be required to pay at least some premium, no matter how highly rated the institution may be or how high the FDIC insurance fund's reserves happen to be at any particular moment. Accordingly, Messrs. Meyer and Hawke concurred with the FDIC that the statutory restrictions on risk-based pricing should be eliminated. Mr. Meyer stated that "the [FRB] believes the FDIC should be free to establish risk categories based on any well-researched economic variables and to impose premiums commensurate with these risk classifications."

Designated Reserve Ratios and Premiums; Rebates and Surcharges. Both Messrs. Meyer and Hawke advocated: (1) elimination of the requirement that premiums for the lowest-risk financial institution be set at zero if the fund's reserve ratio exceeds 1.25% of insured deposits; and (2) the elimination of the flat 1.25% of insured deposits target. In its proposal the FDIC suggested that the flat 1.25% target be replaced by a target range with a system of rebates and surcharges being used to bring the insurance fund back into the target range. Mr. Meyer, on behalf of the FRB, suggested that a target range which is broader than that endorsed by the FDIC be used "in order to reduce the need to change premiums sharply." Mr. Meyer also suggested that the FDIC be granted the latitude to relax floor or ceiling ratios temporarily on the basis of then current or anticipated banking conditions. Both Messrs. Meyer and Hawke expressed support for the FDIC's proposal that rebates and surcharges be used to bring the insurance fund's assets back into what is ultimately selected as the target range. Moreover, both agreed that rebates should reflect, in part, the past contribution of the financial institution to the applicable FDIC insurance fund or funds.

FDIC Insurance $100,000 Individual Account Limit. Both Messrs. Meyer and Hawke rejected as unnecessary the FDIC's proposal that the $100,000 individual account insurance limit be increased. Although small banks have lobbied for increased coverage limits, Messrs. Meyer and Hawke stated that the growth rates of total deposits and of uninsured deposits at small banks have matched or exceeded the growth rates at large banks. Depositors themselves, noted Messrs. Meyer and Hawke, can always obtain increased coverage by opening accounts at more than one bank.

Costs of Bank Supervision. Mr. Hawke urged Congress to use the occasion of FDIC insurance reform to change the manner in which the costs of bank supervision are funded. Currently, the costs of supervising state nonmember banks is covered by FDIC insurance premiums while national banks pay both deposit insurance premiums plus additional OCC assessments to cover their costs of supervision. Mr. Hawke argued that the deposit insurance system should be modified to provide that FDIC insurance premiums would fund the costs of supervision of both state and national banks.

♦ OCC Issues Guidance on Bank Weblinking Relationships

The OCC published Bulletin 2001-31 (the "Bulletin") to highlight the risks and provide guidance concerning banks' weblinking relationships with third parties *(e.g.*, virtual malls and other arrangements whereby a customer may access a third party's website through a bank's website in order to obtain products and services). The Bulletin describes the reputational, transaction and other risks inherent in weblinking relationships. The Bulletin then discusses the appropriate method of planning a hyperlink strategy. In this regard, banks should (1) conduct due diligence of third parties (including review of financials, service standards and privacy and security policies); (2) enter into weblinking agreements with third parties that limit risk when the bank enters, maintains and terminates the relationship; and (3) develop contingency plans to cover privacy, security, and third party failure issues. The Bulletin also highlights the need for effective disclosures and disclaimers in a bank's weblink stating that, among other things: (1) the bank is not endorsing or guaranteeing the third party, (2) the bank is not liable for any failure of the third party, and (3) the third party may have a privacy policy different from the bank's. Additional burdens to differentiate the bank's product apply if the third party's product is financial in nature.

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