Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #1061
May 2006
12 USC 84
12 CFR 32

April 28, 2006

Subject: Applicability of the Lending Limit to Loans secured by Certificates of Deposit

Dear **[ ]**:

This letter is in response to your inquiry in which **[ ]** (Bank) seeks a legal opinion as to the treatment under the lending limit, 12 U.S.C. § 84 and 12 C.F.R. part 32, of loans secured by insured non-negotiable certificates of deposit (CDs) issued by other institutions. In my opinion, such loans are subject to the lending limit. As described in further detail below, the loans do not qualify for the exception for loans secured by certain other loans in 12 C.F.R. § 32.3(c)(3)(i)(B) nor for the additional lending limit described in 12 C.F.R. § 32.3(a) for loans secured by readily marketable collateral.

The Bank would like to make loans to customers that are secured by non-negotiable CDs issued by other institutions and suggests that the loans would be exempt from the lending limit based on the availability of Federal Deposit Insurance Corporation (FDIC) insurance for the collateral CDs.

One lending limit exception cited by the Bank is set forth at 12 C.F.R. § 32.3(c)(3) as follows:

> (i) Loans or extensions of credit, or portions thereof, to the extent fully secured by the current market value of …(B)[l]oans to the extent guaranteed as to repayment of principal by the full faith and credit of the U.S. government, as set forth in paragraph (c)(4)(ii)[1] of this section.

[1] Section 32.3(c)(4)(ii) provides that the guarantee must be payable in cash or equivalent within 60 days after demand and be unconditional.

(ii) To qualify under this paragraph, the bank must perfect a security interest in the collateral under applicable law.

Section 32.3(c)(3)(i)(B) thus excepts from the lending limit loans that are fully secured by a perfected security interest in the current market value of other loans, provided that (i) those collateralizing loans are guaranteed as to repayment of principal by the full faith and credit of the U.S. government; and (ii) the guarantee is payable in cash or equivalent within 60 days after demand and is unconditional.[2]

For purposes of this exception, a bank is unable to fully secure loans with a perfected security interest in CDs issued by other institutions for three reasons. First, the rights of recoupment and set-off that those other institutions may possess are an impediment to obtaining a conforming security interest for purposes of the lending limit exception. For example, it is common for loan documents to provide for an explicit right of set-off and the right of set-off can also exist implicitly.[3] If the institution issuing the CD could establish such right of set-off, the lending bank's loan collateralized by the CD would not be fully secured by a perfected security interest for the purposes of the lending limit exception.

Second, Article 9 of the Uniform Commercial Code adopted in all states generally provides that a security interest in a deposit account held by an institution with which the deposit account is maintained has priority over a conflicting security interest held by another secured party, even if the security interest of the other secured party was perfected earlier. The other secured party has to take extraordinary steps to defeat the interests of the depositary. The other secured party must

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[2] A different exception is set forth in 12 U.S.C. § 84(c)(4), as implemented by paragraph (A) of 12 C.F.R. § 32.3(c)(3)(i) (Government Securities Exception). Subject to certain requirements, section 84(c)(4) excepts from the lending limit loans to the extent fully secured by the current market value of bonds, notes, certificates of indebtedness, or Treasury bills of the United States or "by other such obligations fully guaranteed as to principal and interest by the United States." A CD is not an "other such" (or "similar," the adjective used in the regulation) obligation for this purpose and thus this exception is inapplicable. Under the *eiusdem generis* rule of statutory construction, when general words are preceded by specific words, the general words are construed so as to apply only to items of the same general class as those specifically mentioned. The "other such obligations" include only the same types of obligations previously and specifically mentioned, all of which are government-issued obligations. Accordingly, the OCC has interpreted the Government Securities Exception as being applicable only to obligations fully secured by either issues of the United States, or issues of agencies of the United States that are fully guaranteed as to principal and interest by the United States. *See*, *e.g.*, letter of P. Stacy Powers, Senior Attorney, 1989 WL 418913 (O.C.C.) (Mar. 27, 1989). It is because the Government Securities Exception only applies to loans secured by government-issued obligations that the OCC needed in 1995 to promulgate the new exception in 12 C.F.R. § 32.3(c)(3)(i)(B) in order to except loans secured by certain obligations not issued by the government.

[3] Indeed, in the sample loan documentation that you provided for our review, the lender provides explicitly for a right of setoff in all accounts the borrower holds at the lender including accounts the borrower may open in the future. The borrower authorizes the lender, to the extent permitted by applicable law, to charge or setoff all sums owing on the loan against any and all such accounts.

either become the issuing institution's customer on the deposit or obtain a subordination of the depositary's interest in the account, if possible.[4]

A third impediment to the applicability of the exception derives from the FDIC deposit insurance limits. If the borrower were to have or make another deposit in the same ownership capacity at the institution issuing the CD, such deposit would be added to the borrower's collateralizing CD for purposes of computing the available federal deposit insurance[5] and the CD would only be insured, if at all, in the aggregate with those other deposits up to the deposit insurance limit.

While a bank could seek to guard contractually against the risks described above (*e.g.*, the borrower could agree not to make other deposits with the institution issuing the CD and that institution could purport to subordinate any right of set-off and security interests), such contractual protection would not constitute a security interest for the purposes of section 32.3(c)(3). If the contracts were breached or did not have the intended purpose, the lending bank would only have a contract claim at best which would not be covered by a government guarantee.

We conclude, therefore, that the protection afforded the Bank by a collateralizing CD is inferior than when it makes a loan secured by a traditional loan that is guaranteed by a government agency.[6] The Bank's loan cannot be fully secured by a perfected security interest for the purposes of the lending limit exception.[7] Accordingly, the lending limit exception in section 32.3(c)(3)(i)(B) is not available.[8]

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[4] *See* UCC § 9-327 and Official Comment 4 ("A rule of this kind enables banks to extend credit to their depositors without the need to examine either the public record or their own records to determine whether another party might have a security interest in the deposit account.")

[5] *See* 12 C.F.R. Part 330; *see also* letter of Joseph A. DiNuzzo, Counsel, FDIC (Jul. 29, 2003) (Insurance Letter) at http://www.fdic.gov/regulations/laws/rules/4000-1200.html.

[6] The examples given in the preamble to the lending limit rulemaking in which the exception in section 32.3(c)(3)(i)(B) was adopted are loans secured by qualifying Small Business Administration-, Federal Housing Administration-, and Veterans Administration-guaranteed loans. *See* 60 Fed. Reg. 8526, 8530 (Feb. 15, 1995).

[7] The Bank participates in a deposit placement program intended to allow a financial institution (Relationship Bank) to place a depositor's funds in excess of the deposit insurance limit with one or more other financial institutions (Issuing Bank(s)) and obtain full FDIC insurance coverage for the depositor. *See* Insurance Letter. This program contains some mitigants to the risks to a Relationship Bank posed by the impediments described above if the Relationship Bank should make a loan secured by a CD from an Issuing Bank. Under the program, the Issuing Bank issues a CD to an agent institution acting on behalf of the Relationship Bank acting on behalf of a depositor. Thus, the Issuing Bank would not ordinarily know the identity of the depositor and may not ordinarily be in a position to exercise a right of set-off or take a security interest. Nevertheless, the depositor could reveal his identity, or the Issuing Bank could take steps to ascertain whether a party that owed it an obligation was a party to which it had issued a CD under the program, and thus the risks to the Relationship Bank posed by those impediments may still exist. Further, the program does not avoid the risk posed to insurance coverage by the depositor making other deposits at the Issuing Bank. Under the program, depositors can require that certain institutions be excluded from the list of institutions that can issue CDs to the depositor and some other protections exist to help the depositor avoid losing insurance coverage by making other deposits at the Issuing Bank. However, ultimately the depositor retains

Lastly, the loans do not qualify for the additional lending limit for loans secured by readily marketable collateral. The lending limit regulation provides that only CDs that are negotiable qualify as readily marketable collateral.[9]

I trust this is responsive to your inquiry.

Sincerely,

/s/

Jonathan Fink
Special Counsel
Bank Activities & Structure

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the power to place other deposits at an Issuing Bank. Thus, the fact that the CD is issued under the deposit placement program does not change the analysis of the applicability of section 32.3(c)(3)(i)(B).

[8] In light of the analysis in this letter, it is not necessary to consider whether a loan secured by an insured CD is a loan secured by a "loan" that is guaranteed as to repayment by the "full faith and credit" of the U.S. government and whether the insurance proceeds are payable on an unconditional basis in cash or equivalent within 60 days after demand. It is also not necessary to consider whether FDIC *insurance*, the proceeds of which are only payable upon failure of the issuing bank and not upon other events of default, is a "guarantee."

[9] *See* 12 C.F.R. § 32.2(n) and 32.2(j). The fact that a non-negotiable CD is issued under the deposit placement program discussed in note 7 above does not change this analysis.