



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

December 13, 2001

Interpretive Letter #922
January 2002
12 CFR 16

Re: [] (“Bank”) Proposal to Offer FDIC-insured Deposit Notes

Dear []:

This responds to your letter of May 8, 2001 requesting an interpretive opinion¹ that certain Deposit Notes of the Bank to be offered and sold through the Bank’s affiliated retail securities broker-dealer network, would not constitute the sale of “securities” as defined in OCC securities offering regulations at 12 C.F.R. Part 16. Based on your representations and the facts that you provided, it is our opinion that the Bank’s Deposit Notes are not securities and, therefore, not subject to registration under Part 16.

A. Background

The Bank proposes to issue and market certain FDIC-insured Deposit Notes through the retail distribution network of [] (“ ”).² [] is a wholly-owned indirect subsidiary of [] Corporation, a bank holding company that in turn owns 100% of the Bank. [] is a broker-dealer registered with the Securities and Exchange Commission (“SEC”) under the Securities Exchange Act of 1934 (“Exchange Act”).

Deposit Notes represent transferable individual time deposits of the Bank held in book entry form. The Bank will offer Deposit Notes in denominations of \$5,000 or \$10,000 for terms ranging to 20 years, with fixed or floating rates of interest. The Bank, through [], will provide purchasers a disclosure statement (“Disclosure Statement”) describing all material terms of the Deposit Notes, such as restrictions on early withdrawal by customers and information

¹ We limit our opinion to the applicability of Part 16 to the offering of Deposit Notes. We offer no views as to any other legal issues the introduction of this product may raise.

² The Bank in future may sell the Deposit Notes through unaffiliated broker-dealers or through its other affiliated broker-dealer, [], under the same general terms and conditions.

required by Regulation DD³ of the Board of Governors of the Federal Reserve System (“Federal Reserve Board”) to implement the Truth in Savings Act.⁴ The Deposit Notes will be the Bank’s direct deposit liabilities and FDIC-insured. The Bank will include its liabilities for Deposit Notes in its report of deposits to the local Federal Reserve Bank and maintain reserves in compliance with Regulation D of the Federal Reserve Board.⁵

The Bank will market Deposit Notes through []’s broker-dealer network. [] customers will deliver their funds for deposit to []. [] will act as the customers’ agent in accepting and transferring the money to the Bank for deposit. The Bank will compensate [] on a transaction-related basis for the services it provides. [] will not charge depositors any fees on Deposit Note purchases. Purchasers will receive the same rate of interest regardless of whether they purchase the Deposit Notes directly from the Bank or []. Although the Deposit Notes are transferable, the Bank will disclose that [] has sole discretion to maintain a secondary market for Deposit Notes. Depositors will not receive any liquidity guarantees or assurances with respect to Deposit Notes.

B. Law

1. The Securities Act and OCC Regulation

The OCC’s securities offering disclosure regulations provide that, absent an available exemption, no person may offer and sell a security issued by a national bank without meeting the registration and prospectus delivery requirements of Part 16.⁶ Part 16 attempts to achieve the purposes underlying the registration requirements of the Securities Act of 1933 (“Securities Act”), i.e., to provide the investing public full disclosure of the material facts and circumstances regarding the offer and sale of securities by national banks.⁷

Part 16 generally incorporates by reference the definitions, registration and prospectus delivery requirements of the Securities Act and SEC implementing rules, including the Securities Act definition of “security.”⁸ The Securities Act, however, exempts “any security issued or

³ 12 C.F.R. Part 230.

⁴ 12 U.S.C. § 4301 *et seq.*

⁵ 12 C.F.R. Part 204.

⁶ 12 C.F.R. § 16.3(a)(1) and (2).

⁷ Office of the Comptroller of the Currency, 12 C.F.R. Parts 5 and 16, 59 Fed. Reg. 54,790, 54,798 (Nov. 2, 1994).

⁸ 12 C.F.R. § 16.2. The Securities Act defines a security as “. . . any note, stock, treasury stock, . . . bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, . . . or, in general, any interest or instrument commonly known as a ‘security’” 15 U.S.C. § 77b(1). In 1994, the OCC revised Part 16 to provide that its registration requirements applied to bank-issued senior and subordinated debt. At the same time, however, the OCC made clear that it did not intend the definition of security in Part 16 to cover insured or uninsured bank deposits or traditional bank products. The preamble to Part 16 stated that “[t]he definition of ‘security’ in the final rule does not specifically exclude traditional bank products. Nevertheless, the OCC does not

guaranteed by any bank.”⁹ Part 16 does not incorporate this exemption; it applies to securities issued by banks. Accordingly, the registration and prospectus delivery requirements of Part 16 would apply to the offer and sale of Deposit Notes if those bank-issued instruments meet the definition of security in the Securities Act. Although this definition does not specifically include “deposit notes,” the definition is broad and courts have construed it broadly.

2. Case Law

The Supreme Court in *SEC v. W.J. Howey*, held that an instrument is an “investment contract” and thus a security for purposes of the Securities Act if it evidences: (1) an investment (2) in a common enterprise (3) with a reasonable expectation of profits (4) to be derived from the entrepreneurial or managerial efforts of others.¹⁰ Applying that test, the Supreme Court held that bank-issued insured certificates of deposits (“CDs”) were not securities for purposes of the antifraud provisions of the Federal securities laws, given the extensive protections that the federal bank regulatory scheme affords depositors.¹¹

In *Marine Bank v. Weaver*, the Supreme Court recognized an important difference between a bank-issued certificate of deposit¹² and other long-term debt obligations that are securities, since the CD issuer, a federally regulated bank, is subject to a comprehensive set of regulations governing the banking industry. For example, insured deposits in federally regulated banks are protected by reserve, reporting, and inspection requirements. The Court distinguished CDs from ordinary long term debt securities that carry a risk of the borrowers’ insolvency and found it unnecessary to provide additional protection under federal securities law. However, a CD does not invariably fall outside of the federal securities law definition of security. Each transaction must be analyzed “on the basis of the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole.”¹³

The Court of Appeals for the Second Circuit, in *Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., et al.*, relied on this opening, holding that the insured CDs

intend that the definition cover insured or uninsured deposits or other traditional bank products, including letters of credit, banker's acceptances, or repurchase agreements.” 59 Fed. Reg. at 54,798.

⁹ 12 C.F.R. § 16.5.

¹⁰ *SEC v. W.J. Howey*, 328 U.S. 293 (1946) (“*Howey*”).

¹¹ *Marine Bank v. Weaver*, 455 U.S. 551 (1982) (“*Marine Bank*”). The Court considered the Exchange Act, rather than the Securities Act definition of security, but noted both definitions are “essentially the same.” *Id.* at 555 n.3.

¹² Although the Exchange Act definition of security includes a “certificate of deposit, for a security,” that term refers to instruments issued by protective committees in corporate reorganizations, rather than bank-issued CDs. *Id.*, 455 U.S. at 557 n. 5. Accordingly, to qualify as a security, a CD must be either a note or an investment contract.

¹³ *Id.*, 445 U.S. at 558, 560 n. 11.

marketed and sold by a broker-dealer were securities under the federal securities laws.¹⁴ A broker created a program to market bank-issued CDs to its customers. The broker purchased from issuing banks CDs with interest rates below those that the same banks sold directly to customers. The broker resold the CDs at the same, lower rates to its customers. The issuing banks paid the broker as compensation this differential in interest rates between the two types of CDs. The broker also created and maintained a secondary market in those CDs.

The Second Circuit distinguished the CDs in *Gary Plastics* from those in *Marine Bank* based on the activities of the broker. The *Gary Plastics* broker was investigating issuers, marketing CDs, and establishing a secondary market in those instruments, thus creating a “common enterprise” within the meaning of *Howey*. The instrument offered purchasers the possibility of price appreciation due to interest rate movements and an ability to capitalize on those movements in a secondary market. The court found that the broker also contributed expertise to the project by maintaining a pool of willing CD issuers.¹⁵

Given the differences between the conventional CDs in *Marine Bank* and the investments in *Gary Plastics*, the court found that, “absent the securities laws, plaintiff has no federal protection against fraud and misrepresentation by the defendants in the marketplace.”¹⁶ However, the Second Circuit reaffirmed the *Marine Bank* holding that federal banking laws protected CD purchasers from possible abuses by the issuers. Additional federal securities law protection was necessary to protect only against abuses by the *broker* in administering the program.¹⁷

C. Analysis

¹⁴ *Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., et al.*, 756 F.2d 230 (2d Cir. 1985) (“*Gary Plastics*”).

¹⁵ *Id.*, 756 F.2d at 240.

¹⁶ *Id.*

¹⁷ The Supreme Court in *Reves v. Ernst & Young*, 494 U.S. 56 (1990) (“*Reves*”) later found that application of the *Howey* test for investment contracts may be meaningless in considering whether a different type of instrument, such as notes, is a security. It developed a separate analysis for determining whether a note is a security under the federal securities laws. The Court began by presuming that every “note” is a security, then recognized that some notes “obviously” are not securities. It identified four criteria for determining whether a note has the “family resemblance” necessary for inclusion in a list of notes that courts previously held are not securities. If a note is not sufficiently similar to others on that list, the reviewing court may apply these criteria to determine whether to add another category. These criteria involve the motivations of both parties to the underlying transaction, the plan of distribution for the note, and the reasonable expectations of the investing public. A court then considers whether another factor, e.g., the existence of another regulatory scheme, reduces the risk of the instrument. For example, if the seller intends to finance a general business enterprise and the buyer is motivated by a profit, the note is likely to be a security. But, if the seller has a commercial or consumer purpose, or the buyer has another purpose, e.g., the right to purchase housing, the note is less likely to be a security. If there is “common trading for speculation or investment,” the note is more likely a security. A court is likely to affirm the views of the investing public if it reasonably views a note as a security. If there already is a comprehensive regulatory scheme, a court does not also apply the securities laws to the instrument.

Application of both the *Howey* and *Reves* tests confirms that the Deposit Notes are not investment contracts or notes, and thus not securities for purposes of Part 16. Deposit Notes are not investment contracts, but deposit liabilities subject to the same regulatory scheme that applied to the CDs in *Marine Bank*. The Bank will include its liabilities for Deposit Notes in its report of deposits to the local Federal Reserve Bank and maintain reserves pursuant to Regulation D of the Federal Reserve Board. Depositors are assured of the return of their principal and interest, subject to applicable FDIC insurance limits. The Bank must meet the requirements of the Truth in Savings Act and Regulation DD in marketing the Deposit Notes. Since the Bank and its Deposit Note program are subject to an extensive regulatory scheme, it is unnecessary to impose additional federal securities law requirements or corresponding Part 16.

[]'s participation in the sale of Deposit Notes does not change this analysis. []'s activities do not resemble those of the broker-dealer in *Gary Plastics*, which actively designed and administered a deposit-gathering program. [] is limiting its role to a sales agent for retail customers, accepting customer funds for deposit with the Bank. [] is not creating certificates or monitoring the creditworthiness of bank issuers. [] does not contribute expertise by maintaining a pool of CD issuers. The Bank is the only issuer of deposits in this program.

In *Gary Plastics*, the defendant's creation and maintenance of a secondary market was crucial in its marketing efforts and permitted holders to profit from interest rate movements. [], in contrast, is making no assurances to depositors concerning the existence of a secondary market. Although the Deposit Notes are transferable, the Bank will disclose that [] has sole discretion to maintain a secondary market in the Deposit Notes. Depositors will not receive any liquidity assurances with respect to Deposit Notes. Because there is no assurance that Deposit Notes will be more liquid than CDs or other deposits generally, the Bank does not offer purchasers an enhanced possibility of price appreciation due to interest rate movements.

The compensation structure in this case is unlike that in *Gary Plastics*. [] will receive compensation from the Bank on a transaction basis for the services it provides. [] will not charge depositors any fees for Deposit Notes purchases. Purchasers will receive the same rate of interest regardless of whether they purchase Deposit Notes directly from the Bank or [].

Given the limited role of [] in the program, additional protections afforded by the federal securities laws are unnecessary to protect Deposit Note purchasers from fraud or other possible abuse. There is no need to treat Deposit Notes as investment contracts and, thus, securities.¹⁸

¹⁸ Application of the *Reves* factors confirms that Deposit Notes are not securities. Deposit Notes do not resemble the instruments that courts previously determined are not securities, but applying the *Reves* factors warrants adding Deposit Notes to the list of instruments that are not securities. Although a seller's use of funds gathered through a program for its general business can indicate a security, this reasoning is not sensible in a *banking* context. Banks raise virtually all their deposits for their general banking business and deposits are virtually never securities. The purchaser's motivation will be to obtain an interest-bearing deposit and the Bank's motivation is to market a deposit. The investing public cannot reasonably view Deposit Notes as securities. They will be denominated as deposits, carry FDIC insurance, and will be subject to the same reserve and reporting requirements applicable to deposits generally. The Bank will disclose to customers that there are no assurances of a secondary market for Deposit Notes. Instead, Deposit Notes will be subject to the redemption restrictions that normally apply to deposits. Finally,

D. Conclusion

For the reasons discussed above, based on your representations and the facts you have provided, it is our opinion that the Bank's Deposit Notes are not securities and, therefore, not subject to registration under Part 16. If you have any questions, please contact me at 202-874-5210.

Sincerely,

-signed-

Nancy Worth
Counsel
Securities and Corporate Practices Division

Deposit Notes are subject to precisely the same regulatory scheme that applied to the CDs in *Marine Bank*. Federal banking laws and FDIC insurance obviate the need for additional protections under the federal securities laws.