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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

April 23, 2001

**Interpretive Letter #908**  
**May 2001**  
**12 USC 84**

Re: [ ] Trust Preferred Securities

Dear [ ]:

This letter responds to your request for confirmation from the Office of the Comptroller of the Currency (“OCC”) that [ ] (“ ”) trust preferred securities may be purchased and treated as loans by national banks. Based on the information and representations you have provided, we conclude that national banks may purchase and treat [ ] trust preferred securities as loans, subject to the lending limits of 12 U.S.C. § 84 and the requirements of OCC Banking Circular No. 181 (Rev.) (August 2, 1984) (BC-181).

**Background**

[ ], the holding company for [ ] (“**BB**”), plans to issue and privately place between \$15 and \$20 million of trust preferred securities (“securities”). [**BB**] is a bankers’ bank, and [ ] anticipates that all of the purchasers of its securities will be national or state banks.

As proposed, [ ] will establish a [ ] business trust as a wholly-owned subsidiary for the sole purpose of issuing trust preferred securities to investors. This trust will lend the proceeds it receives from the sale of the trust preferred securities to [ ] in exchange for a subordinated debenture with terms (*i.e.*, coupon rate, maturity, redemption, etc.) that are identical to the terms of the trust preferred securities. [ ]’s payments on the debentures will be the sole source of cash flow from which the trust’s obligations to the holders of the trust preferred securities would be satisfied.<sup>1</sup>

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<sup>1</sup> This structure is used so that the securities will qualify for Tier 1 capital treatment for [ ] under the guidelines and policies for holding companies established by the Board of Governors of the Federal Reserve System.

The OCC has previously permitted national banks to purchase and hold trust preferred securities as Type III investment securities if the securities meet the applicable rating and marketability requirements of 12 C.F.R. § 1.2.<sup>2</sup> The [ ] securities may not qualify as Type III securities, however, due to several factors. The securities will be sold in a private placement, they will not be rated, and there will be no ready market into which they can be sold.

## Discussion

Section 24(Seventh) of the National Bank Act expressly authorizes national banks to conduct the business of banking, including “by discounting and negotiating promissory notes, drafts, bills of exchange and other evidences of debt.” 12 U.S.C. § 24(Seventh). This authority has long included the power to purchase and hold debt securities as loans, consistent with safety and soundness considerations.<sup>3</sup>

Trust preferred securities are instruments that, despite their label, possess characteristics typically associated with debt securities, such as corporate and municipal bonds.<sup>4</sup> Like debt holders, the holders of trust preferred securities do not have voting rights in the management or the ordinary course of business of the Issuer Trust. In addition, holders of trust preferred securities do not share in any appreciation in the value of the Issuer Trust, and are protected from changes in the value of the principal of the instruments (except for credit risk). Also, since the business trust’s

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Furthermore, [ ]’s proposal is typical of a trust preferred securities offering. In a typical trust preferred securities deal structure, a company forms a special purpose subsidiary, for example a [ ] business trust, and purchases all of its common stock. The trust issues preferred stock to investors for cash. The trust then uses proceeds from the sale of the common and preferred stock to purchase subordinated debentures with terms that mirror those of the trust preferred securities from the company. The trust uses the periodic interest payments on the subordinated debentures it receives from the company to fund its payments of dividends on the preferred securities.

<sup>2</sup> See Interpretive Letter No. 777 (April 8, 1997), *reprinted in* [1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-204.

<sup>3</sup> See Interpretive Letter No. 833 (July 8, 1998), *reprinted in* [1998 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-287; Interpretive Letter No. 834, (July 8, 1998), *reprinted in* [1998 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-288; Interpretive Letter No. 600 (July 31, 1992), *reprinted in* [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,427; Interpretive Letter No. 579 (March 24, 1992), *reprinted in* [1991- 1992 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,349; Interpretive Letter No. 182 (March 10, 1981), *reprinted in* [1981-1982 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,263.

<sup>4</sup> See Interpretive Letter No. 777, *supra*. Many substantive characteristics distinguish equity from debt securities. Common stock typically is perpetual and has broad voting rights, while debt securities generally have limited life. Common stock provides an ownership interest, and appreciation in the market value of the issuer and dividends. In contrast, debt securities offer investors periodic interest payments and a principal payment at maturity. In the event of the failure of an issuer, the claims of the common stockholders are subordinate to the holders of debt. Rating agencies typically do not rate equity instruments but will assign credit ratings to debt securities. Preferred stock is a hybrid and can be structured to resemble either debt or equity. See, e.g., *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 686 n.2 (1985); *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975); and ROBERT HAMILTON, *FUNDAMENTALS OF MODERN BUSINESS* (1989).

only source of revenue for the dividends on the trust preferred securities is the interest on the underlying subordinated debt, the trust preferred securities must be redeemed upon redemption of the subordinated debt. Thus, the trust preferred securities, like debt, are not perpetual. Further, the distributions on the trust preferred securities are cumulative and resemble the periodic interest payments on debt.<sup>5</sup> For these reasons, the OCC has previously concluded that trust preferred securities are debt-like instruments that may qualify as investment securities under 12 C.F.R. Part 1.<sup>6</sup>

Because they qualify as debt obligations, trust preferred securities may be purchased and held as loans under the authority to discount and negotiate evidences of debt. Moreover, they may qualify for purchase under this authority even if they do not satisfy the requirements for investment securities under 12 C.F.R. Part 1.<sup>7</sup>

### *Regulatory Limitations on Purchase of Trust Preferred Securities*

National banks that purchase trust preferred securities as loans must comply with the lending limit restrictions in 12 U.S.C. § 84 and may not purchase an amount exceeding 15% of the bank's capital and surplus.<sup>8</sup> Bank purchasers also must adhere to the prudential requirements in Banking Circular No. 181 (Rev.).<sup>9</sup> Before purchasing trust preferred securities as loans, a national bank should conduct a complete review of relevant credit information and loan administration practices, and determine that the purchases meet the bank's own internal loan underwriting standards.<sup>10</sup> The nature and extent of a bank's independent analysis is a function of the type of transaction at issue and the purchaser's lending policies and procedures.<sup>11</sup> A purchaser's acceptance of a favorable analysis of a loan issued by the seller, a credit rating institution, or another entity does not satisfy the need to conduct an independent credit analysis.

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<sup>5</sup> We also understand that the SEC has indicated that it will not object to a bank holding company treating trust preferred securities as debt under Generally Accepted Accounting Principles (even if the bank holding company classifies these securities as minority interests in consolidated subsidiaries for regulatory reporting purposes).

<sup>6</sup> OCC Conditional Approval No. 331, *Interpretations and Actions*, November 1999, Vol. 12, No. 11 (dealing in trust preferred securities is functionally equivalent or similar to arranging loan participations in commercial loans).

<sup>7</sup> See Interpretive Letter Nos. 833, 834, 600, 579, and 182, all *supra*.

<sup>8</sup> See 12 U.S.C. § 84(a)(1) and 12 C.F.R. § 32.3(a); Under 12 U.S.C. § 84(b)(1) and 12 C.F.R. § 32.2(j), the term "loan" is defined to include "any direct or indirect advances of funds to a person (a) made on the basis of any obligation of that person to repay the funds or (b) repayable from specific property pledged by or on behalf of the person."

<sup>9</sup> BC-181 defines "loan" as any binding agreement to advance funds on the basis of an obligation to repay the funds. See BC-181, *supra*.

<sup>10</sup> See *id.*

<sup>11</sup> See *id.*

A prudent purchaser may, however, consider such analysis obtained from the seller and other sources as factors when independently assessing a loan.<sup>12</sup>

National banks also must have continued access to appropriate credit and portfolio performance data as long as they hold the trust preferred securities.<sup>13</sup> Bank purchasers must maintain the analysis undertaken at the time they acquire trust preferred securities and on an ongoing basis as part of their fully documented loan files.<sup>14</sup>

### **Conclusion**

National banks may purchase and hold the [ ] trust preferred securities as loans under their authority to discount and negotiate evidences of debt. Banks that invest in these trust preferred securities as loans are subject to the limitations of 12 U.S.C. § 84 and the requirements of Banking Circular No. 181 (Rev.).

If you have any questions, please do not hesitate to contact me at (202) 874-5210.

Sincerely,

-signed-

Beth Kirby  
Special Counsel  
Securities and Corporate Practices Division

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<sup>12</sup> See *id.*; see generally, Interpretive Letter No. 779 (April 3, 1997), reprinted in [1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-206.

<sup>13</sup> See Interpretive Letter No. 600, *supra.*

<sup>14</sup> See *id.*