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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

## **Interpretive Letter #981 February 2004**

August 14, 2003

Subject: [ ] (“Bank”) Request for  
Interpretive Letter on Financial Subsidiary Debt Rating Requirement

Dear [ ]:

This is in response to your request for confirmation that the Bank may rely upon a rating from Standard and Poor’s (“S&P”) on the uninsured portion of the Bank’s long-term certificates of deposit (“CDs”) for purposes of the debt rating requirement the Bank must satisfy in order to establish a financial subsidiary engaged in certain financially-related activities as principal, such as securities underwriting and dealing.<sup>1</sup> For the reasons discussed below, we conclude that the Bank may use its investment grade rated CDs to meet this debt rating requirement.

### **Background**

Under section 121 of the Gramm-Leach-Bliley Act,<sup>2</sup> a national bank is authorized to establish a financial subsidiary to engage in activities, not otherwise permissible for a national bank, that have been determined to be financial in nature provided certain specified conditions are met.<sup>3</sup> Where the financial subsidiary will be engaged in such activities as principal rather than solely as agent, a bank that is one of the 50 largest FDIC-insured banks must have at least one issue of outstanding eligible debt that is currently rated within the three highest investment grade categories by a nationally recognized statistical rating organization (debt rating requirement).<sup>4</sup>

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<sup>1</sup> See 12 U.S.C. § 24a(a)(3)(A)(i), 12 C.F.R. § 5.39 and discussion below.

<sup>2</sup> Public Law 106-102, 113 Stat. 1338.

<sup>3</sup> See 12 U.S.C. § 24a.

<sup>4</sup> 12 U.S.C. § 24a(a)(3)(A)(i). A bank does not have to satisfy the debt rating requirement if its financial subsidiaries engage in newly authorized financial activities solely as agent and not as principal.

Based upon its consolidated assets as of December 31, 2002, the Bank is one of the 50 largest FDIC-insured banks. As a result, it must satisfy the debt rating requirement in order to acquire or establish a financial subsidiary that engages in financial in nature activities as principal, not otherwise permissible for a national bank, such as securities underwriting and dealing. At present, the Bank has not issued and does not have outstanding any issues of nondeposit debt.<sup>5</sup> The Bank does, however, have outstanding long-term CDs that are rated investment grade. S&P has assigned a long-term Certificate of Deposit issue rating to the Bank of “A-”.<sup>6</sup> This credit rating does not relate to the FDIC-insured portion of any CD issued by the Bank. The rating category “A” (Strong) is the third highest of S&P’s investment grade rating categories, and the addition of a plus (+) or minus (-) sign shows relative standing within a rating category. This rating applies to the uninsured portion of all the CDs that the Bank issues that are long-term and in an initial amount of \$100,000 or greater. S&P has advised the Bank that the ratings criteria, definitions, and methodology employed by S&P in assigning a long-term CD rating are the same as those employed by S&P in assigning a rating to an issue of long-term nondeposit debt. The Bank contends that its rated CDs satisfy the debt rating requirement because they are rated investment grade, and they qualify as eligible debt.

## **Discussion**

To qualify as “eligible debt,” the instrument must be “unsecured long-term debt that (A) is not supported by any form of credit enhancement, including a guarantee or standby letter of credit; and (B) is not held in whole or in any significant part by any affiliate, officer, director, principal shareholder, or employee of the bank or any other person acting on behalf of or with funds from the bank or any affiliate of the bank.”<sup>7</sup> The OCC’s financial subsidiary regulation defines the term “long-term debt” to mean “any debt obligation with an initial maturity of 360 days or more.”<sup>8</sup>

Consistent with those definitions, the Bank’s Jumbo CDs are unsecured and long-term, with an initial maturity of one year or longer, and in an initial amount of \$100,000 or greater. The CDs are not supported by any form of credit enhancement, including a guarantee or standby letter of credit.<sup>9</sup> And they are offered generally to the public and are not held in whole or in any significant part by any affiliate, officer, director, principal shareholder, or employee of the Bank

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<sup>5</sup> According to the Bank, this is due largely to the fact that the Bank is a wholly-owned subsidiary of [ ] (“Holding Company”), and the Holding Company issues all nondeposit debt for the Company and its subsidiaries.

<sup>6</sup> The total outstanding amount of the Bank’s long-term jumbo CDs as reported in the Call Report for [ ] was \$286,855,000.

<sup>7</sup> 12 U.S.C. § 24a(a)(3)(A)(i).

<sup>8</sup> 12 C.F.R. § 5.39(d)(8).

<sup>9</sup> The rated portion of the CD is not covered by FDIC insurance, and S&P does not take the existence of FDIC insurance into account in assigning its rating.

or any other person acting on behalf of or with funds from the Bank or an affiliate of the Bank.<sup>10</sup> The only remaining issue is whether they are “debt” of the Bank for purposes of the debt rating requirement.

The term “debt” is not defined in the statute or the OCC’s financial subsidiary regulation.<sup>11</sup> As a general rule of statutory construction, when the words of a statute are not defined, they are given their plain or ordinary meaning.<sup>12</sup>

The term “debt” ordinarily refers to an obligation owed to another person. *Webster’s Dictionary* defines “debt” as “something owed, as money, goods or services” and as “an obligation or liability to pay or render something to another.”<sup>13</sup> Similarly, *Ballentine’s Law Dictionary* defines debt as “an unconditional and legally enforceable obligation for the payment of money; it involves the relationship of debtor and creditor, or of borrower and lender.”<sup>14</sup>

A certificate of deposit falls squarely within those definitions. *Webster’s* defines a certificate of deposit as a “document evidencing ownership or debt,” and *Ballentine’s* defines a certificate of deposit as a bank’s “. . . promise to pay the depositor, whereby the relation of debtor and creditor between the bank and the depositor is created.”<sup>15</sup> Thus, like the ordinary meaning of “debt”, a CD is commonly understood as an obligation owed to another person.

That CDs are “debt” also is evident from their accounting treatment. For example, certificates of deposit, like other debt obligations, are reported as liabilities on the issuing bank’s balance sheet.<sup>16</sup> Similarly, a bank that issues a certificate of deposit is required to report it as a liability of that bank in the bank’s Consolidated Reports of Condition and Income (Call Reports).

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<sup>10</sup> The Bank has advised the OCC that the amount of CDs held by affiliates represents approximately [ ]% of the total long-term jumbo CDs issued by the Bank.

<sup>11</sup> See 12 U.S.C. § 24a and 12 C.F.R. § 5.39(d)(8). The OCC declined to define the term “debt” in its financial subsidiary regulation, reasoning, “in cases where there is a question about whether an obligation qualifies as debt, the issue is better addressed on a case-by-case basis.” 65 Fed. Reg. 12905 (2000).

<sup>12</sup> See generally, Singer, *Statutes and Statutory Construction* ¶ 46:01 (6<sup>th</sup> ed. 2000).

<sup>13</sup> *Webster’s II New Riverside University Dictionary* at 328 (1984).

<sup>14</sup> *Ballentine’s Law Dictionary* 311 (3<sup>rd</sup> ed. 1969). *Black’s Law Dictionary* defines debt as “a sum of money due by certain and express agreement.” *Black’s Law Dictionary* 210 (5<sup>th</sup> ed. 1983).

<sup>15</sup> *Webster’s* *supra* at 223 and *Ballentine’s Law Dictionary*, *supra* at 187. Similarly, *Black’s Law Dictionary* defines a CD as a “written acknowledgement by a bank . . . of a deposit with a promise to pay to depositor.” *Black’s Law Dictionary*, *supra* at 116.

<sup>16</sup> Under generally accepted accounting principals (“GAAP”), CDs, like other debt instruments, are treated as liabilities of the issuing bank. Although GAAP does not specifically define “debt”, it defines “liabilities” as “probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.” CDs and debt obligations both meet that definition of liabilities. See United States/FASB FASB Original Pronouncements as of 03/15/2003 - Statements of Financial Accounting Concepts - CON 6: Elements of Financial Statements - DEFINITIONS OF ELEMENTS.

Likewise, a certificate of deposit purchased by a bank and due from another bank is listed as an asset of the purchasing bank in the balance sheet portion of the Call Report. The OCC has characterized the uninsured portion of a certificate of deposit that a bank purchases from an issuing bank as an “unsecured debt of the issuing bank.”<sup>17</sup>

Defining “debt” to include certificates of deposit also is consistent with the purpose underlying the debt rating requirement. By imposing the debt rating requirement on large banks, Congress sought to ensure that the institutions were considered creditworthy by the financial markets. That purpose can be achieved with any highly rated debt issuance, including the Bank’s certificates of deposit. In fact, S&P has advised the Bank that it uses the same standards in rating certificates of deposit that it uses to rate nondeposit debt issuances.

Moreover, it is clear from the legislative history that Congress viewed deposits, which would include certificates of deposit, as debt obligations of the bank. For example, prior versions of GLBA had required that large banks have at least one outstanding share of subordinated debt rated within the two highest investment grade categories.<sup>18</sup> The term “subordinated debt” was defined, in part, as unsecured debt that “is subordinated as to payment of principal and interest to *all other indebtedness of the bank, including deposits. . . .*”<sup>19</sup> This subordinated debt requirement was replaced in the final version of GLBA with the eligible debt requirement. Replacing the term “subordinated debt” with the broader and more inclusive term “eligible debt” demonstrates that Congress did not intend to limit the type of debt required to nondeposit debt.<sup>20</sup>

Courts also have recognized that deposits, including certificates of deposit, are debt obligations of the issuing bank. Various courts have described certificates of deposit as “debt instruments,”

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<sup>17</sup> See OCC 1992 *Examiner’s Guide to Investment Products and Practices*.

<sup>18</sup> See Section 121, Title I, Subtitle C of Mark-up Draft of S. 900 and H.R. 10 as Proposed by Chairman Gramm, Chairman Leach and Chairman Bliley, October 9, 1999 (“Chairmen’s Mark”).

<sup>19</sup> See Chairmen’s Mark, *supra* (emphasis added).

<sup>20</sup> Another indication that Congress did not intend to limit the type of debt required to satisfy the debt rating requirement is evidenced by the use of the term “debt,” instead of the equally common but less inclusive term “debt securities.” Had Congress used the term “debt securities” in the debt rating requirement, CDs and other bank deposits may not have qualified since CDs are generally not considered securities for purposes of federal banking and securities laws. *See Marine Bank v. Weaver*, 455 U.S. 551 (1982) (certificates of deposit are not securities for purposes of federal securities laws because of the “extensive protections the federal regulatory scheme affords depositors.”) *But see, Holloway v. Peat Marwick*, 879 F.2d 772, 777 (10<sup>th</sup> Cir. 1989) (instruments similar to certificates of deposit, but not insured by the FDIC, were securities under the federal securities laws because they were “essentially debt instruments, representing a promise by the issuing entity to repay the principal amount, plus accrued interest at a specified rate, within a specified time period or on demand.”).

“long-term debt obligations,” and “evidence of indebtedness.”<sup>21</sup> And the relationship of a bank to a depositor has been described as that of “debtor and creditor, founded upon contract.”<sup>22</sup>

## **Conclusion**

The Bank may rely on its investment grade rated CDs to meet the debt rating requirement for establishing financial subsidiaries. The CD’s qualify as “eligible debt” as defined by statute. In addition, they have the required investment grade issue rating from a nationally recognized statistical rating organization. This conclusion is not intended, and should not be read, as an approval of a particular financial subsidiary of the Bank, however. The Bank must comply with the approval requirements under 12 C.F.R. § 5.39 before establishing or acquiring an interest in a financial subsidiary.

Sincerely,

**-signed-**

Julie L. Williams  
First Senior Deputy Comptroller and Chief Counsel  
Comptroller of the Currency

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<sup>21</sup> See, e.g., *Holloway v. Peat Marwick*, *supra* at 777; *Associates in Adolescent Psychiatry, et. al. v. Home Life Insurance Company of New York*, *et. al.*, 729 F. Supp. 1162 (N.D. Ill. 1989); and *MacKethan v. Peat, Marwick, Mitchell & Co.*, 439 F. Supp. 1090, 1094 (E.D. Va. 1977).

<sup>22</sup> *Bank of Marin v. England*, 385 U.S. 99, 101 (1966).