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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

January 7, 2005

**Interpretive Letter #1013**  
**February 2005**  
**12 USC 24(7)**

Subject: Gold Shares

Dear [ ]:

This responds to your inquiry, on behalf of [ ] (“Bank”), whether the Bank may buy and sell, for its own account, exchange-traded units of beneficial interest in gold (“Gold Shares”) issued by the [ ] (“Co.”). For the reasons discussed below, we conclude that this activity is permissible for the Bank, provided that the Bank demonstrates to the satisfaction of its examiner-in-charge (“EIC”), prior to commencing the activity, that the Bank has the appropriate risk management systems in place to conduct the activity in a safe and sound manner.

## **I. Background**

The [ Co. ] provides an exchange-traded vehicle for investors to buy and sell interests in a pool of gold, through the purchase and sale of Gold Shares.<sup>1</sup> The [ Co. ] will be an investment trust formed under [ State ] law.<sup>2</sup> [ ] will be trustee (“Trustee”) of the [ Co. ]. The Bank’s [ ] branch will serve as custodian of the assets of the [ Co. ], which will be limited to gold bullion and cash. [ Co. ] will issue Gold Shares that will be registered under the Securities Act of 1933 (“Securities Act”). The

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<sup>1</sup> The [ Co. ] is sponsored by [ ABC ], a subsidiary of the [ XYZ ], an association of gold mining companies. The [ Co. ] is not a registered investment company under the Investment Company Act of 1940. [ ]

<sup>2</sup> “An investment trust is an unincorporated trust or association managed by trustees not holding any property for sale to customers in the ordinary course of its trade or business, the beneficial ownership of which is evidenced by transferable shares or by transferable certificates of beneficial interest offered for sale to the public.” [ ]

Gold Shares will represent undivided units of beneficial interest in gold held by the [ **Co.** ]. Gold Shares will be traded on the New York Stock Exchange.<sup>3</sup>

Certain registered broker-dealers and securities market participants (“Authorized Participants”) may effect purchases and sales of Gold Shares directly with the [ **Co.** ] through the creation and redemption of blocks of 100,000 Gold Shares, called “Baskets,” upon payment of a transaction fee to the Trustee.<sup>4</sup> The [ **Co.** ] will not engage in sales or redemption transactions with investors generally. After receiving an appropriate amount of gold bullion from an Authorized Participant, the [ **Co.** ] will create and issue a corresponding number of Baskets to the Authorized Participant. An Authorized Participant may redeem Baskets in exchange for a corresponding amount of gold from the [ **Co.** ]. Authorized Participants will act both on a proprietary basis and as agent for other investors. [ **Inc.** ], a broker-dealer affiliate of the Bank, intends to be an Authorized Participant.<sup>5</sup> The Bank will buy, hold and sell Gold shares only for its own account and will not be a broker, market-maker or distributor of Gold Shares or become an Authorized Participant.

Initially, the [ **Co.** ] will exchange one Gold Share for each tenth of an ounce of gold deposited by an Authorized Participant. Because Gold Shares represent undivided interests in the underlying gold, it is expected that Gold Shares will initially trade at a price close to one tenth of the spot market price for an ounce of gold.<sup>6</sup> However, the [ **Co.** ] will periodically sell bullion to pay its expenses. When the [ **Co.** ] sells gold, the Gold Shares may experience dilution (*e.g.*, where the ratio of outstanding Gold Shares to the underlying gold increases and the price of Gold Shares falls accordingly). As the [ **Co.** ] sells more gold over time to meet expenses, the net asset value (“NAV”) of Gold Shares may continue to diverge from the spot market price of gold.<sup>7</sup> Under these circumstances, a Gold Share and an ounce of gold would no longer be exchanged by the Trust on a ten to one basis, but would be adjusted to reflect the amount of gold bullion and cash underlying each outstanding Gold Share. Nevertheless, for many investors, the risk of dilution and cost of investing in Gold Shares could be less than the cost of buying, transporting, storing, insuring, and selling gold bullion.

The [ **Co.** ] represents that trading in Gold Shares is similar to trading gold. Holding Gold Shares will present virtually the same rights, liabilities, and risks as owning the underlying gold bullion directly. There is only one class of Gold Shares, with equal rights and privileges. Each

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<sup>3</sup> See Registration Statement.

<sup>4</sup> *Id.*

<sup>5</sup> [ **Inc.** ] is a subsidiary of [ ], which is indirectly controlled by [ **Controller.** ].

<sup>6</sup> For example, on June 30, 2004, the spot market price of an ounce of gold was approximately \$393. It is therefore expected that Gold Shares will initially trade at approximately \$39.30. A single Basket would represent approximately \$3.93 million in gold bullion.

<sup>7</sup> Any differences between the price of a Gold Share and the spot market price of gold would present arbitrage opportunities.

Gold Share is transferable, fully paid and non-assessable, and entitles the holder to one vote on the limited matters set forth in a trust indenture (“Trust Indenture”).<sup>8</sup> Gold Shares do not provide conversion or pre-emptive rights and have limited distribution rights.<sup>9</sup> Gold Shares do not carry the rights normally associated with the ownership of the stock of a corporation. Instead, the rights of holders of Gold Shares are limited to withdrawing gold bullion through redemption and liquidation of the [ Co. ]. The right to redeem the Gold Shares is limited, however, as the [ Co. ] will redeem Gold Shares only through Authorized Participants and only in Baskets.

The Bank views the Gold Shares as an alternative source of liquidity for its physical gold holdings. The Bank expects that the transaction costs of buying and selling Gold Shares in the secondary market will be less than the cost of maintaining a position in gold bullion.

The Bank intends to use the Gold Shares to hedge physical gold positions. For example, where a customer buys or sells gold from or to the Bank in the over-the-counter spot or forward market, the Bank could hedge this position by buying or selling Gold Shares. More specifically, the Bank could buy 10,000 ounces of gold at the current price from a customer and short Gold Shares to hedge the long spot position. The Gold Shares will provide another mechanism that the Bank may use to hedge its gold exposures.

The Bank believes that trading Gold Shares will be straightforward to monitor and control within the Bank’s existing risk infrastructure. For market risk purposes, the Bank will treat the Gold Shares as the bullion equivalent and will consolidate its positions in Gold Shares and gold bullion. The Bank will book and manage Gold Shares in its existing metals trading system, which feeds into its market risk system. In this way the Bank may calculate, consolidate, and monitor its gold exposures with the rest of its precious metal positions. The Bank believes its trading of Gold Shares will not present any material modeling or analytical issues.

The Bank's ownership of gold is recorded in its trading book. The Bank may hold gold in its vault in connection with its precious metals business. When the Bank purchases gold through COMEX, the Bank’s ownership of the gold is reflected by a certificate of receipt verifying that the gold is held in a COMEX authorized depository, in the Bank’s name and for its account. Because the Bank itself is an authorized COMEX depository, the Bank typically converts the receipt by having the gold moved to its vault and issuing a new receipt indicating that the Bank is the depository.

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<sup>8</sup> The Trust Indenture provides that holders of Gold Shares generally have no voting rights. However, a vote of the holders of 66 2/3% of the shares may remove the Trustee or terminate the Trust. In addition, a majority vote or unanimous consent of the shareholders is necessary to make certain amendments to the Trust Indenture. *See* Registration Statement.

<sup>9</sup> Distributions can occur only in two circumstances. First, there may be a cash distribution to shareholders should the Trustee determine that the [ Co. ]’s cash account balance exceeds the anticipated expenses of the [ Co. ] for the next 12 months and that excess amount exceeds \$0.01 per share. Second, upon the liquidation and termination of the [ Co. ], there will be a *pro rata* distribution to shareholders of amounts remaining after the satisfaction of the Trust’s liabilities. [ ].

## II. Discussion

### A. Trading of Gold Shares is Authorized under Express Authority in the National Bank Act and as Part of or Incidental to the Business of Banking

It is permissible for a national bank to buy and sell, as agent for customers and for its own account, gold, silver, platinum, palladium and copper coins and bullion under the express authority in 12 U.S.C. § 24(Seventh) to buy and sell “exchange, coin, and bullion.”<sup>10</sup> The Bank’s trading of Gold Shares for its own account represents a natural and logical extension of the Bank’s ability to purchase and sell gold. Gold Shares are substantially the operational and economic equivalents of gold bullion that national banks have clear authority to buy and sell.

Gold Shares will provide holders with substantially the same rights, liabilities and risks as if they held physical or certificated gold and a cost effective and liquid means of investing in gold. Holders of Gold Shares are entitled to redeem their interests for gold bullion. The Bank expects the prices of Gold Shares and gold bullion to be closely correlated, although the prices may diverge over time, as the [ *Co.* ] sells gold to cover expenses. The cost of buying and selling Gold Shares in the secondary market, however, is expected to be lower than the cost of obtaining and maintaining positions in gold bullion. And, even though the Gold Shares are registered securities under the Securities Act, holding the Gold Shares is substantially the same as holding gold certificates because both holdings represent interests in gold. When there is reduced liquidity in the gold market, the Gold Shares may provide a needed source of liquidity. While the liquidity enjoyed by holders of Gold Shares comes at a price reflected in the NAV, there are also costs and burdens associated with holding potentially less liquid physical gold or certificated gold that are not reflected in the price of gold, *e.g.*, purchase, transportation, storage, delivery and insurance costs. Nonetheless, the costs associated with holding physical or certificated gold are as much a part of bank permissible purchases and sales of gold, as are the fees and expenses associated holding Gold Shares.<sup>11</sup> Accordingly, the Gold Shares provide the Bank with a means of holding an interest in gold that may be more cost effective and liquid than holding physical or certificated gold.

The Bank intends to use the Gold Shares to hedge physical gold positions. Hedging risks arising from permissible banking activities is part of the business of banking.<sup>12</sup> Because the Gold Shares are the substantive equivalent of holding gold, which banks may permissibly buy and sell, their use as a hedge is equally permissible as part of the business of banking. A national bank can

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<sup>10</sup> OCC Interpretive Letter No. 693 (November 14, 1995); OCC Interpretive Letter No. 685 (August 5, 1995); OCC Interpretive Letter No. 553 (May 2, 1991).

<sup>11</sup> *See e.g.*, OCC Interpretive Letter No. 994 (June 14, 2004).

<sup>12</sup> OCC Interpretive Letter No. 892 (Sept. 13, 2000).

protect itself against changes in the value of a bank permissible transaction by taking an offsetting (long or short, as appropriate) position in a related instrument.<sup>13</sup>

### **B. National Banks May Purchase Interests in an Investment Trust Composed of Bank-Permissible Assets**

The Bank also may purchase and sell Gold Shares in reliance on the authority of national banks to purchase and sell interests in entities that hold bank-permissible assets.<sup>14</sup> In general, the OCC has allowed national banks to invest in registered investment companies and unregistered entities that hold bank-permissible assets where the investment represents an interest in the entity's underlying assets.<sup>15</sup> The particular entity that serves as the vehicle for obtaining an interest in bank permissible assets may be, for example, a partnership, investment company or trust.<sup>16</sup> The nature of the interest national banks may acquire in certain entities holding bank permissible assets include equity interests.<sup>17</sup> Where a national bank holds interests in entities whose underlying portfolios consist of bank permissible assets that are subject to investment limits, those limits are imported to the interest the bank holds in the particular entity. Thus, as a general matter, where a national bank uses its lending authority to hold an interest in an entity that invests in loans, the lending limits in 12 U.S.C. § 84 apply.<sup>18</sup> Conversely, a national bank investment in an entity that invests solely in bank permissible assets that are not subject to investment limits may hold unlimited interests in such entities, subject only to safety and soundness restrictions. The assets held in the [ *Co.* ] are bank permissible assets, thus national banks may potentially hold unlimited equity interests in the Trust.

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<sup>13</sup> *Id.*; See OCC Interpretive Letter No. 935 (May 14, 2002).

<sup>14</sup> See e.g., 12 C.F.R. § 1.3(h)(1) (national banks may purchase investment company shares if the investment company's portfolio consists exclusively of assets that a national bank can purchase directly); 12 C.F.R. § 1.3(h)(2) (national banks may invest in an entity that is exempt from registration as an investment company if the portfolio of the company consists exclusively of assets that a national bank may purchase and sell for its own account); OCC Interpretive Letter No. 911 (June 4, 2001) (national banks may acquire beneficial interests in a privately offered investment fund that invests in loans, cash and cash equivalents, and an offshore fund that invests solely in loans, as securities under the reliable estimates standard of Part 1, subject to a 5 percent aggregate investment limits or as loan participations, subject to the requirements of Banking Circular No. 181 (Rev.) (August 2, 1984)); OCC Interpretive Letter 687 (September 5, 1995) (national banks may become limited partners in a limited partnership that invests solely in fixed income securities in which national banks may invest directly subject to the restrictions in 12 U.S.C. § 24(Seventh) and 12 C.F.R. Part 1; OCC Interpretive Letter No. 388 (June 16, 1987) (national banks may issue and sell certificates evidencing interests in a pool of its mortgage loans).

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> See e.g., OCC Interpretive Letter 912 (July 3, 2001) (a national bank may purchase for its own account shares in a mutual fund with a portfolio consisting of bank eligible investment securities).

<sup>18</sup> See e.g., OCC Interpretive Letter No. 779 (Apr. 3, 1997).

### **C. Trading in Gold Shares is not Prohibited by Section 24(Seventh)**

The Bank's trading in Gold Shares for its own account does not violate Section 24(Seventh)'s restrictions on national bank purchases and sales of certain securities for its own account. Section 24(Seventh) provides that "[e]xcept . . . as otherwise permitted by law, nothing herein contained shall authorize the purchase by the association for its own account of any shares of stock of any corporation." The authority for the Bank to hold Gold Shares is found in the express authority in Section 24(Seventh) for national banks to buy and sell "exchange, coin, and bullion," *i.e.*, gold bullion, and engage in activities incidental thereto. Thus, the activity is "otherwise permitted by law." Because the activity is "otherwise permitted by law," Section 24(Seventh) does not prohibit the activity.<sup>19</sup>

### **III. Conclusion**

The Bank may buy and sell the Gold Shares for its own account under the express authority granted to national banks to buy and sell "exchange, coin, and bullion," and the Gold Shares, as interests in gold, may be used to hedge purchases and sales of gold as part of or incidental to the business of banking, provided that the Bank demonstrates to the satisfaction of the EIC, prior to commencing the activity, that the Bank has the appropriate risk management systems in place to conduct the activity in a safe and sound manner.

Sincerely,

*/s/ Daniel P. Stipano*

Daniel P. Stipano  
Acting Chief Counsel

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<sup>19</sup> *See, e.g.*, United States General Accounting Office, Equity Hedging —Report to the Honorable James A. Leach, House of Representatives, GAO-01-945 (August 2001).