UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W.
Washington, D.C. 20581

September 23, 1988

LEG 5/36

Re: Offering of

Dear :

By letters dated August 20, 1987, July 1, 1988 and July 29, 1988, as supplemented by discussions with Commission staff, you have requested on behalf of that Commission staff confirm that it will not recommend to the Commission that enforcement action be taken against in connection with a proposed offering of certificates of deposit with interest payable at maturity indexed in part to the spot price of gold (Indexed CDs). 1/

You represent that proposes to offer certain deposit-taking institutions the opportunity to issue, and its retail customers the opportunity to purchase, certificates of deposit with interest payable at maturity indexed to the spot price of gold. proposes to offer both "bear" direction Indexed CDs, where the amount of interest to be received will increase as the value of the index decreases, and "bull" direction Indexed CDs, where the amount of interest to be received at maturity will increase as the value of the index increases. In addition to a return based upon fluctuations in the price of gold, each Indexed CD will provide a guaranteed rate of interest that will equal or exceed 35% of the estimated annual yield at the time of deposit of a non-indexed CD of like maturity and denomination issued by the same bank. The principal amount of Indexed CDs will not be indexed and is required to be fully

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1/ Although certain of submissions relate to other instruments, the analysis and conclusions set forth herein pertain only to proposed marketing of gold-indexed CDs issued by Federal Deposit Insurance Corporation (FDIC)-insured, federally regulated national banks and FDIC-insured state-chartered commercial banks.

repaid at maturity. represents that in its opinion the full amount of principal, non-commodity-linked interest and commodity-indexed return of the Indexed CDs will be insured by the FDIC. No "upfront" fees will be charged by in connection with the sale of Indexed CDs. Indexed CDs will be subject to substantial early withdrawal penalties, except in the case of death or incapacity. represents that it will not make a secondary market in Indexed CDs and that no secondary market for Indexed CDs will exist.

In an Advance Notice of Proposed Rulemaking Relating to the Regulation of Certain Hybrid and Related Instruments (Advance Notice), 52 Fed. Reg. 47022 (December 11, 1987), the Commission has requested comment on a proposed regulatory framework which would exempt from Commission regulation certain otherwise-regulated instruments with incidental commodity option components. In view of the fact that the Advance Notice remains pending and that the Commission has not reached a final determination with respect to the proposals set forth therein, the staff believes that it is appropriate, in limited circumstances such as this, to address certain instruments on a case-by-case basis. Based upon the representations contained in the correspondence referred to above and in discussions with the staff, we understand the relevant facts to include the following.

(1) Term to Maturity

In the Advance Notice, the Commission proposed to establish a minimum term to maturity of three years for hybrid instruments qualifying for exemptive relief. proposes to offer and sell Indexed CDs having only a one-year term to maturity. You have explained that has proposed a one-year term for Indexed CDs because the market for CDs is overwhelmingly in shorter maturities. represents that in 1987 approximately 75% of the aggregate principal amount of CDs sold by it involved CDs with a maturity of one year or less. Further, advises that the "difficulty and cost" of longer term hedging for gold-indexed CDs currently are such as to render the pricing of deposits of longer term CDs "relatively unattractive to investors." further represents that there will not be a secondary market in Indexed CDs and that substantial penalties for early withdrawal would be assessed.

(2) Maximum Commodity-Based Return and Minimum Non-Commodity-Based Return

The exemption proposed in the Advance Notice also would be conditioned upon compliance with requirements that the hybrid instrument: (i) have a minimum annual yield or return independent of its commodity-related component equal to at least 35% of the estimated annual yield at the time of issuance for a comparable pure debt or depository instrument; and (ii) have no more than a maximum average potential return on its commodity-related component of 20% on an annualized basis of the total principal or face amount of the instrument. You have represented that each Indexed CD will have a guaranteed interest rate that will equal or exceed 35% of the estimated annual yield at the time of deposit for a CD issued by the same bank that is not indexed but has a like maturity and denomination. Further, you have represented that the purchaser of an Indexed CD will participate in no more than the first 20% of any per annum change in the underlying index of gold prices and that no index multiplier in excess of one will be applied to determine the investor's return based upon the commodity-related feature of the Indexed CDs. 2/

(3) Line of Business

The Advance Notice also proposed a "line of business" requirement that would limit the availability of exemptive treatment to those hybrid instruments in which the commodity component of the instrument is used in a principal line of business of the issuer. This requirement was proposed to assure that the issuer has commercial experience in addressing the commodity-related risks of qualifying hybrid instruments and that such risks are likely to be offset or reduced by reserves, inventories, forward contract commitments or other cover that could be expected to increase in value with the size of the issuer's or offeror's commodity-related obligations.

You have represented that federal and state banking regulations generally provide that commercial banks have the power to buy and sell gold and that a number of commercial banks participate in the institutional gold market. Although the proposed Indexed CD program does not appear to be limited to CDs issued by banks that participate in the gold market as a principal line of business,   has represented that each

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2/ Your have provided the following example concerning the calculation of the commodity and non-commodity-based yields on Indexed CDs. If a depositor owns a one-year bull direction gold indexed CD with a guaranteed rate of 6% and an Index Multiplier of .10 and gold prices increased 30% over the one-year term of the CD, the depositor would participate only in the first 20% of the price increase. The depositor's total return would be computed as follows:

Index Based Interest = .20(.1)	= 2%
Guaranteed Minimum Interest	= 6%
Total Interest at Maturity	= 8%.

bank participating in its Indexed CD program will be required to hedge fully its commodity-related obligations under the Indexed CDs through hedging agreements which "would result in the bank being indifferent to movements in the price of the underlying commodity." 3/

(4) Otherwise Regulated

Indexed CDs will constitute "securities" issued by a bank and therefore will be exempt from registration under the Securities Act of 1933 (Securities Act). However, the antifraud provisions of Section 17 of the Securities Act would be applicable to the Indexed CDs. In addition, , an SEC-registered broker-dealer, would be subject to the antifraud and customer protection rules of the Securities Exchange Act of 1934 with respect to its sales of Indexed CDs.

Issuing deposit institutions will be subject to regulation by federal or state banking regulators. Indexed CDs of each issuing deposit institution will be federally insured, together with other deposits at the same institution, to an aggregate maximum of $100,000 for each depositor. You have advised the staff that in the opinion of , both the principal and yield on Indexed CDs, including all returns based upon the commodity-indexing feature of the instruments as well as fixed interest payments, would be covered by FDIC insurance.

(5) Net Worth and Cover

The Advance Notice also proposed two "performance criteria," $100 million net worth and maintenance of cover, relevant to the issuer's ability to satisfy its commodity-related obligations under a hybrid instrument. You have represented that Indexed CD program would be limited to CDs issued by FDIC-insured national and FDIC-insured state chartered commercial banks whose net worth substantially exceeds $100 million. In addition, as noted above, has represented that each bank participating in its Indexed CD program will hedge fully its commodity-related obligations under the Indexed CDs such that it will not be affected adversely by movements in the price of the underlying commodity.

3/ Although has represented that it will require each participating bank to enter into a hedging agreement with or a affiliate, the staff does not intend to approve, or condition the position taken herein upon, any requirement that such hedging agreements be confined to or a affiliate.

(6) Minimum Unit Price

The Advance Notice proposed a $20,000 minimum unit requirement. Indexed CDs will be issued at a minimum unit price of $20,000.

(7) Marketing and Disclosure

agrees that it will not market the Indexed CDs as having the beneficial characteristics of commodity options or futures contracts, except as may be necessary to disclose fully the operation and financial consequences of the instrument.

(8) Special Calls

agrees to comply with Commission requests for information concerning all matters relevant to the staff's no-action position with respect to the issuance of the Indexed CDs, including the matters discussed above.

Based upon the representations made in your correspondence and discussions with the staff, the staff has determined that it will not recommend to the Commission that enforcement action under Section 4c of the Act be instituted against based upon the offer and sale of Indexed CDs. This position is based, among other things, upon the conclusion that in the circumstances delineated above, the sale of Indexed CDs would not be inconsistent with the exemptive framework proposed in the Advance Notice for certain otherwise regulated hybrid instruments with incidental commodity option components. While Indexed CDs would not have a term to maturity of three years as proposed in the Advance Notice, the staff is of the view that applicable penalties against early withdrawal, the fact that Indexed CDs will not be traded in a secondary market and the limited commodity component of Indexed CDs warrant an exception from the proposed term to maturity requirement. Similarly, although banks issuing Indexed CDs may not strictly satisfy the line of business criterion proposed in the Advance Notice, we believe that in the circumstances presented here other protections, including cover and FDIC insurance, substantially fulfill the performance and customer protection purposes of the proposed requirement.

This position does not excuse or the issuing banks from complying with any otherwise applicable provisions of the Commodity Exchange Act, nor does it address any other instrument or proposed instrument. Any different, omitted or changed facts or conditions might require a different conclusion. It should also be noted that this position is that of the staff and is not binding upon the Commission and that any subsequent determination by the Commission with regard to the rulemaking proceeding initiated by the Advance Notice of proposed rulemaking may require a reconsideration of this staff position.

Sincerely,

Marshall E. Hanbury

Marshall E. Hanbury
Co-Chairman
Off-Exchange Task Force

Paula A. Tosini

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