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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

May 10, 2004

**Interpretive Letter #992**  
**June 2004**  
**12 USC 24(7)**

Re: Disposal of Stock Warrants Acquired Pursuant to 12 C.F.R. § 7.1006

Dear [ ]:

This letter is in response to your request on behalf of [ *Bank* ], [ *City* ], [ *State* ] (“Bank”), for confirmation that a national bank that has taken a borrower’s stock warrants in addition to or in lieu of interest on a loan to the borrower may dispose of the warrants in the manner described below. Based on the particular circumstances presented, the representations made in your letter, and for the reasons discussed below, we believe that the Bank may dispose of the warrants as described below.

**Background**

The Bank made a commercial loan to a borrower and received from the borrower warrants to acquire shares of the borrower’s common stock. The Bank received the warrants pursuant to its authority in 12 C.F.R. § 7.1006 to take such warrants in addition to or in lieu of interest on the loan to the borrower. The Bank now wishes to dispose of the warrants. However, in evaluating its ability to sell the warrants, the Bank has determined that no readily-identifiable market exists for the warrants.<sup>1</sup> With no market in which to sell the warrants, the Bank would be unable both to accurately determine a fair market price for the warrants and to sell the warrants for such price.

The Bank now proposes to exercise the warrants and convert them into shares of the borrower’s common stock, which the Bank immediately would sell. The Bank would exercise the warrants only after entering into an agreement to sell the resulting shares of the borrower’s common stock. To accomplish the sale of the warrants immediately after their exercise, the

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<sup>1</sup> The common stock underlying the warrants is publicly traded on the NASDAQ Stock Market.

Bank would place a sell order of the borrower's common stock with a registered broker-dealer on a particular date (the "Trade Date"), but would not deliver the shares of common stock until the third business day following the Trade Date ("Settlement Date").<sup>2</sup> The Bank would exercise the warrants and convert them into shares of common stock effective on the Settlement Date and immediately deliver the shares it receives to the selling broker for settlement of the trade made on the Trade Date.<sup>3</sup> The Bank would hold the shares only for the instant in which it takes the borrower's transfer agent to transfer the shares of common stock from the name of the Bank to the name of the selling broker. For that instant, the Bank would own less than one percent of the borrower's common stock.

By holding the shares only for the instant required for the borrower's transfer agent to transfer the shares of common stock from the name of the Bank to the name of the selling broker, and because it would be holding the shares solely for the purpose of effecting that transfer, the Bank would, as a practical matter, never have the ability to vote the shares of common stock. Generally, the "record date" for voting shares is as of the end of business on a particular date. Because the Bank would not be the record owner of the shares at the end of any business day, the Bank would at no time have the ability to vote the shares.

## **Discussion**

The OCC has long recognized the authority of national banks to share in the profit, income, or earnings of a borrower as a full or partial substitute for interest on a loan to the borrower.<sup>4</sup> The ability to share in a borrower's profit, income, or earnings permits the lending bank a greater degree of flexibility in its lending activities, allowing the bank to offer more competitive financing arrangements. Consistent with this authority, the OCC has found that the means by which a lending bank may share in the borrower's profit, income, or earnings can take different forms. One permissible means of such sharing, long-recognized in precedent<sup>5</sup> and

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<sup>2</sup> The Bank represents that delivery of the securities three business days after placing the sale order is consistent with industry standards. See Rule 15c6-1 promulgated under the Securities Exchange Act of 1934.

<sup>3</sup> The Bank represents that it would avail itself of the tacking provisions of Rule 144(d) promulgated under the Securities Act of 1933, as amended, in order to permit its immediate sale of the common stock it receives upon exercise of the warrants. See Rule 144(a)(3)(ii) promulgated under the Securities Act of 1933, as amended; Precision Optics Corp. S.E.C. No-Action Letter, reprinted at [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,627 (Jan. 14, 1993), 1993 WL 12387.

<sup>4</sup> 12 C.F.R. § 7.1006 (2004); Interpretive Letter No. 517, reprinted in [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,228 (Aug. 16, 1990); Letter from Thomas G. DeShazo, Deputy Comptroller of the Currency (Aug. 26, 1969) (unpublished) (profits).

<sup>5</sup> Interpretive Letter No. 517, *supra*; Letter from Patrick Parise, Regional Counsel (Oct. 16, 1970) (unpublished) (warrants); Letter from Robert Bloom, Chief Counsel (May 26, 1969) (unpublished) (warrants).

codified in 12 C.F.R. § 7.1006,<sup>6</sup> is a bank's acceptance of stock warrants issued by the borrower, provided that the bank does not exercise the warrants. The OCC has prohibited banks from exercising such warrants – and thereby converting them into shares of the borrower's stock – on the theory that doing so would be tantamount to a purchase of stock for its own account.<sup>7</sup>

Section 24(Seventh) includes language added by section 16 of the Glass-Steagall Act ("Section 16"), that is sometimes referred to as a prohibition on any stock ownership. Its purpose, however, was to prevent national banks from engaging in speculative activity through stock investment.<sup>8</sup> The OCC repeatedly has found that national banks may purchase shares of stock without violating Section 16 when the acquisition is not for speculative or investment purposes and the stock ownership is intended to facilitate a bank's participation in an otherwise permissible activity, or to enable the bank to receive needed services.<sup>9</sup>

Here, at no time does the Bank have an investment motive. The Bank did not use any of its assets to acquire the warrants; instead, the Bank received the warrants in addition to, or in lieu of, interest on a loan. The only Bank asset used in the initial lending transaction was the loan principal, which the borrower remains obligated to repay. When the Bank exercises the warrants and converts them to shares of the borrower's stock, the Bank would not use any of its assets to acquire the stock. The Bank represents that it would only exercise the warrants and acquire the shares of the borrower's stock with an agreement in place to sell the shares immediately. This series of transactions – purchase and immediate sale – can hardly be viewed as investment-driven.<sup>10</sup> Moreover, in this instance, the authority to exercise the warrants and purchase the shares of the borrower's stock would facilitate the Bank's participation in permissible activities –

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<sup>6</sup> Recognizing that the authority to accept warrants was well-established, the OCC added the authority to 12 C.F.R. § 7.1006 in 1996. 61 F.R. 4849 (Feb. 9, 1996).

<sup>7</sup> Interpretive Letter No. 517, *supra*; Letter from Richard V. Fitzgerald, Assistant Director, LASD (Jan. 13, 1976) (unpublished).

<sup>8</sup> See *Investment Company Institute v. Camp*, 401 U.S. 616, 630 (1976).

<sup>9</sup> For example, the OCC has permitted national banks to acquire and hold, for a moment in time, the stock of another depository institution to facilitate a permissible corporate restructuring. *E.g.*, Corporate Decision No. 97-13 (Feb. 24, 1997); Letter from Charles F. Byrd, Assistant Director, LASD (Oct. 1, 1987) (unpublished). The OCC has also permitted national banks to acquire and hold stock in organizations that facilitate access to secondary markets. *E.g.*, Interpretive Letter No. 427, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,651 (May 9, 1988) (stock in Federal Agricultural Mortgage Corporation).

<sup>10</sup> Indeed, the proposed transaction is analogous to riskless principal brokerage transactions. In such a transaction the bank, after receiving an order to buy (or sell) a security from a customer, purchases (or sells) the security for its own account to offset an immediate, contemporaneous sale to (or purchase from) the customer. The transaction is considered "riskless" because it is not entered into unless there is already an order from a customer that will generate an immediate, offsetting transaction. The OCC has found that these transactions are permissible under the express terms of Section 16 and present none of the hazards of speculation that the Glass-Steagall Act was intended to prevent. See Interpretive Letter No. 371, *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,541 (Jun. 13, 1986); see also Interpretive Letter No. 626, *reprinted in* [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 49,101 (Jul. 7, 1993).

making a loan to a borrower and sharing in the profit, income, or earnings of the borrower as a full or partial substitute for interest on such a loan.

Therefore, for the reasons and subject to the conditions and restrictions stated above, we find that the Bank, having acquired the warrants in conformance with 12 C.F.R. § 7.1006, permissibly may exercise the warrants and immediately sell the resulting shares of the borrower's common stock under the circumstances and in the manner described herein. If you have any questions, please contact Steven Key, Senior Attorney, at (202) 874-5300.

Sincerely,

*/s/ Julie L. Williams*

Julie L. Williams  
First Senior Deputy Comptroller  
And Chief Counsel