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News Bulletin

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OCC Proposed Regulations Impacting Bank Note Offerings

In November 2011, the U.S. Office of the Comptroller of the Currency (the "OCC") proposed amendments to Part 16.6 of its securities offering rules. These rules govern the exemption from OCC registration of certain types of offerings of bank notes. The proposed rules are designed to remove the references to credit ratings in Part 16.6. Unfortunately, however, the proposed rules may introduce a degree of uncertainty into the offering process.

The proposed amendments may be found at the following link: http://www.occ.treas.gov/news-issuances/news-releases/2011/nr-occ-2011-140a.pdf.[1]

Part 16.6

Bank notes enjoy an exemption from registration under Section 3(a)(2) of the Securities Act of 1933 (the "Securities Act"). However, national banks and U.S. federal branches and agencies of non-U.S. banks are subject instead to the OCC's registration rules, which require OCC registration of bank note offerings unless an exemption is available.

A widely used exemption from OCC registration is Part 16.6.[2] Part 16.6 provides an abbreviated registration regime for certain debt securities ("non-convertible debt")[3] that satisfy the following criteria:

- the bank issuing the debt has securities registered under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), or is a subsidiary of a bank holding company that has securities registered under the Exchange Act;
- the debt is offered and sold only to "accredited investors" (as that term is defined in Regulation D under the Securities Act);

[1] In addition to the proposed rule amendments relating to the securities offering rules, the proposed amendments also address the rules governing whether a proposed purchase of a security by a bank is permissible. The OCC is also seeking comment on proposed guidance that helps explain the due diligence that national banks and federal savings associations should conduct in purchasing investment securities for their investment portfolios, and to reiterative supervisory expectations for the securities that are in fact purchased.
[2] The current version of Part 16.6 can be found at the website of the U.S. government printing office, using the following link: http://www.gpo.gov/fdsys/pkg/CFR-2011-title12-vol1/xml/CFR-2011-title12-vol1-part16.xml.
[3] "Non-convertible debt" is defined under the OCC rules as "a general obligation of the bank, whether senior or subordinated, that is not convertible into any class of common or preferred stock or any derivative thereof."

- the debt is sold in minimum denominations of $250,000, and each applicable note or debenture is legended to provide that it cannot be exchanged for notes or debentures in smaller denominations;
- the debt is rated investment grade; prior to or simultaneously with the sale of the debt, each purchaser receives an offering document that contains a description of the terms of the debt, the use of proceeds, and method of distribution, and incorporates certain specified reports filed by the bank and/or its bank holding company; and
- the offering document and any amendments are filed with the OCC no later than the fifth business day after they are first used.[4]

Proposed Amendment

The proposed revision to Part 16.6 arises from Section 939A of the Dodd-Frank Act, which requires federal agencies to review, and potentially remove, references to credit ratings from their rules. The proposed amendments would replace the "investment grade rating" condition of Part 16.6 with a new condition that the notes must be "investment grade."

This new "investment grade" test would not require a specific rating for the relevant notes. Rather, this condition would be satisfied if "the issuer of a security has adequate capacity to meet financial commitments under the security for the projected life of the asset or exposure. An issuer has an adequate capacity to meet financial commitments if the risk of default by the obligor is low and the full and timely repayment of principal and interest is expected."

This test appears to be somewhat subjective in nature, and does not provide specific parameters for making this determination. In addition, the longer the term of the debt in question, the harder it will be for an issuer to satisfy itself that this condition is satisfied.

Effect of Provision

The new condition could impose a degree of uncertainty on offerings and programs that are intended to qualify under Part 16.6. Instead of the existing objective standard – the notes have an investment grade rating – offering participants would need to make a determination that the new standard described above is satisfied.

Presumably, the fact that the notes carry an investment grade rating could be one factor that offering participants take into consideration. However, the rules are silent as to what other factors offering participants should use to make this determination. If the rules are enacted in their present form, any law firms that are called upon to deliver a legal opinion to the effect that OCC registration is not required due to Part 16.6 would be required to rely upon the issuer's factual representation that the low probability of default condition is satisfied. Underwriters would likely seek to make their own independent determination that the requirement is satisfied. In cases in which the offering participants were uncertain as to the availability of the exemption, the parties may seek to restructure the offering to comply with another exemption from the OCC's offering rules, such as Part 16.5(e) (which provides an exemption if the offering complies with Rule 144A under the Securities Act), or Part 16.7(a)(1) (which provides an exemption if the offering complies with Regulation D under the Securities Act).

[4] The impact of the second and third bullet's is to generally limit the use of Part 16.6 to offerings intended for institutional investors, because (a) not all of the investors in a retail offering will be accredited investors and (b) many offerings to individual investors do not satisfy the $250,000 minimum denomination requirement.

Effectiveness

A 30-day comment period as to the proposed rule revision will expire on December 29, 2011. If the proposed rules are adopted in their present form, issuers and underwriters (as well as law firms) would need to evaluate their existing offering documents and programs in order to evaluate what changes would be needed to effect any new offerings.

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