FREQUENTLY ASKED QUESTIONS ABOUT STRUCTURED CERTIFICATES OF DEPOSIT

Introduction

What are Structured Certificates of Deposit?

Structured Certificates of Deposit ("SCDs") are financial instruments representing a deposit of a specified amount of money for a fixed period of time. Like traditional certificates of deposit ("CDs"), SCDs entitle the holder to his or her principal investment, plus possible additional payments. However, unlike traditional CDs, which usually pay interest periodically based on a fixed or floating rate, SCDs often pay an additional payment at maturity or periodic interest payments based on the performance of an underlying asset, such as one or more equity securities, an index, or one or more currency exchange rates. SCDs are customizable and can be tailored to fulfill specific investment objectives.

What are sample terms of a Structured Certificate of Deposit?

Bank X issues a certificate of deposit with a two-year term, a 100% participation rate, and a minimum investment of $1,000. In lieu of a fixed interest rate, Bank X has offered to pay an amount equal to the appreciation of the Dow Jones Industrial Average Index (the "DJIA") over that two-year term. If the DJIA increases by 20% in the two-year time period, Bank X will pay $200 for each $1,000 invested plus the $1,000 in principal, or $1,200 in total. However, if the DJIA declines, Bank X will only pay out at maturity the principal amount.

What are some examples of underlying assets to which Structured Certificates of Deposit can be linked?

As discussed above, an investor is entitled to the principal amount invested plus a return based on the performance of an underlying asset. Examples of reference assets include equity indices (e.g., the Dow Jones Industrial Average and S&P 500 Index), foreign currency exchange rates (e.g., the BRIC Currency Basket), commodities (e.g., oil and gas or gold prices), or some combination of any of these.

How do Structured Certificates of Deposits differ from traditional Certificates of Deposits?

SCDs possess a number of characteristics not generally associated with traditional CDs.

First, unlike traditional CDs, SCDs do not generally pay interest at a fixed or floating rate; instead, they generally pay an additional payment at maturity or periodic interest payments based on the performance of the underlying reference asset.

Second, SCDs are customizable. This allows investors access to a number of investment strategies, as well as the opportunity to gain upside exposure to a variety of markets.

Third, SCDs may or may not be interest-bearing, and may offer a wide variety of payment calculations. For example, payments may be calculated using the percentage increase of the reference asset based on the starting level (determined on the pricing date) and the ending level (determined before the date of maturity), or may be calculated using the average of the levels of the reference asset, based on a series of observation dates throughout the term of the SCDs. In the alternative, the payments may be subject to a cap, or ceiling, representing a maximum appreciation in the level of the reference asset. Depending on the terms, the particular SCDs may also have a participation rate, which represents the exposure of the SCDs to movements in the underlying reference asset. For example, an investor in an SCD with a 90% participation rate will only receive 90% of the gains in the performance of the reference asset.

What are some benefits to investors associated with investing in Structured Certificates of Deposit?

SCDs can be a relatively low-risk alternative to other investment vehicles because they provide "principal protection" for the deposit amount. Regardless of how poorly the underlying reference asset performs, at maturity, a holder will still receive the original investment amount (provided that the issuing bank remains solvent).

However, it is important to note that this protection feature is only available if the investment is held to maturity.

As an added layer of protection, the deposit amounts of SCDs are insured by the Federal Deposit Insurance Corporation ("FDIC") and backed by the full faith and credit of the U.S. government. Currently, the FDIC insures up to $250,000 of an investor's deposits at the relevant bank. However, the determination of how the $250,000 limit applies to different types of accounts can be somewhat complex. The FDIC's website sets forth a variety of examples at the following page: http://www.fdic.gov/deposit/deposits/.

Another notable aspect of many SCDs is the "estate feature" (otherwise commonly known as a "death put" or "Survivor's Option"). To the extent provided in the terms of the particular SCD, if at any time the depositor of an SCD passes away (or, in some cases, becomes legally incapacitated), the estate or legal representative has the right, but not the obligation, to redeem the SCD for the full deposit amount before the date of maturity, without being subject to any penalty provisions. In the alternative, the estate or representative may choose not to exercise the estate feature and instead hold the SCD to maturity. This term is often offered by an issuing bank as an extra purchase incentive; an investor need not worry that his or her descendants will end up holding a long-term instrument that they don't wish to sell at a discount to face value.

FDIC Insurance

How much of an investor's deposit is insured by the FDIC?

FDIC insurance coverage applies to bank products that are classified as "deposits." Following the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the FDIC now covers up to $250,000 of an investor's deposits with the relevant bank.

Are there any limitations to the FDIC coverage?

The guarantee by the FDIC is limited to the principal invested and any guaranteed interest rate, but does not extend to the amount of any "contingent" interest. For example, in the hypothetical scenario outlined above, if the issuing bank were to fail prior to maturity of the SCD, the FDIC insurance would only cover the $1,000 investment, but not the $200 of earnings based on the performance of the DJIA. In addition, if an investor pays a purchase price for the SCDs that exceeds the par amount of the deposit, for example, paying $1,005 for a $1,000 SCD in the secondary market, the premium paid by the investor would not be covered by FDIC insurance.

Further, investors are still subject to the direct credit risk of the issuing bank for any dollar amount over the maximum applicable deposit insurance coverage. This would occur, for example, if the investor holds other deposits with the applicable bank that together exceed $250,000.

Other Banking Laws and Structured CDs

Can a Structured Certificate of Deposit be non-principal-protected?

Not if the SCD is intended to be covered by FDIC insurance. FDIC insurance extends only to those bank products that are regarded as deposits. The FDIC has taken the position that an instrument must guarantee the repayment of principal in order to be treated as a deposit. (See: "How much of an investor's deposit is insured by the FDIC?")

How does the Truth-in-Savings Act apply to Structured Certificate of Deposits?

Under Federal Reserve Regulation DD (which implements the Truth-in-Savings Act), issuing banks are required to make certain disclosures with regard to deposit accounts "held by or offered to" consumers in order to enable consumers to make informed decisions about accounts such as SCDs. Section 1030.8 of Regulation DD ("Section 1030.8") prohibits an issuing bank from advertising its deposit accounts in any way that is inaccurate or misleading. The regulation contains a variety of specific disclosure rules with which issuers of CDs must comply. For instance, banks are prohibited from using the word "profit" in referring to interest payments, or using the words "free" or "no cost" if a maintenance or activity fee is imposed on the account. Banks are also obligated to comply with Section 1030.8's advertising rules regarding rates of return. For example, an issuing bank must state certain types of interest payments as an "annual percentage yield," and disclose any and all fees associated with the deposit, such as ladder rates on various CDs, as well as any penalty fees that may be imposed for early withdrawal.

Are Structured Certificates of Deposit subject to the registration requirements of the federal securities laws?

Usually no. Section 2(a)(1) of the Securities Act of 1933 (the "Securities Act") includes "certificates of deposit" in the definition of the term "security." However, under relevant federal judicial and regulatory proceedings, FDIC-insured certificates of deposit are generally exempt from the definition of "security" under the federal securities laws. The Supreme Court, in its analysis of CDs, found that since holders of CDs are guaranteed payment of principal by the FDIC, and a variety of other protections are provided to depositors under applicable banking laws, it was not necessary to provide to CD holders the added protections afforded under the federal securities laws.

Under what circumstances can an SCD be deemed to be a security under the federal securities laws?

While CDs, including SCDs, are not generally considered securities under the Securities Act, there are limited instances when the courts have been willing to characterize CDs as securities.

In *Gary Plastics Packaging v. Merrill Lynch, Pierce, Fenner, & Smith Inc.*, 756 F.2d 230 (2d Cir. 1985), Merrill Lynch marketed insured certificates of deposit that it obtained from various banks. Merrill Lynch purportedly promised to maintain a secondary market to guarantee purchasers liquidity for their deposits, and represented to purchasers that it had reviewed the financial soundness of the issuing banks. Due to the fact that the broker's creation and maintenance of a secondary market was a critical part of its marketing efforts, and permitted investors to make a profit from these investments, the additional protection of the Securities Act was deemed appropriate. In its analysis, the Second Circuit Court of Appeals analogized CDs to "investment contracts." An instrument is an "investment contract" if it evidences: (1) an investment; (2) in a common enterprise; (3) with a reasonable expectation of profits; and (4) to be derived from the entrepreneurial or managerial efforts of others. Due to the fact that the broker's creation and maintenance of a secondary market was a critical part of its marketing efforts, and permitted investors to profit from these investments, the additional protection of the Securities Act was deemed appropriate.

As one result of this case, while brokers who offer these products indicate that they may make a secondary market in them (and in fact many do), these issuances do not involve a commitment or an agreement on the part of any broker to do so.

Are Structured Certificates of Deposit subject to other registration requirements?

Issuing banks that are engaged in the offer and sale of securities may still need to comply with the registration requirements of the Office of the Comptroller of the Currency (the "OCC"). The OCC's securities offering rules apply to U.S. national banks and federal branches and agencies of non-U.S. banks. The OCC's securities offering disclosure regulations provide that, absent an available exemption, no bank may offer or sell securities without meeting the registration requirements of 12 C.F.R. 16 ("Part 16"). Like the registration requirements under the Securities Act, Part 16 aims to provide the investing public with full disclosure of the material facts and circumstances regarding the offer and sale of securities by national banks. In fact, Part 16 incorporates by reference a variety of the definitions, registration, and prospectus delivery requirements of the Securities Act, as well as the implementing rules of the Securities and Exchange Commission (the "SEC"), including the definition of "security." As a result, most FDIC-insured SCDs issued by these banks are exempt from registration under the OCC's rules, for the same reasons that result in their exemption from registration under the Securities Act. (See "Are Structured Certificates of Deposit subject to the registration requirements of the federal securities laws?")

Do "Blue Sky Laws" apply to Structured Certificates of Deposit?

No. Since they are usually not considered securities under federal securities law, SCDs fall outside of the registration requirements imposed by each state's Blue Sky Laws. Further, under the National Securities Markets Improvement Act of 1996, federal law preempts the application of Blue Sky Laws to certain categories of securities, known as "covered securities." Included in the definition of "covered securities" are certain securities exempt under Section 3(a) of the Securities Act. These include any security issued or guaranteed by any bank. Because SCDs are issued by banks, even if they were securities, they would be "covered securities" and fall outside of the Blue Sky Laws.

Documentation for Structured CDs

What disclosure requirements must issuing banks comply with in connection with their Structured Certificates of Deposit?

While they are generally excluded from the registration requirements under the Securities Act, SCDs may not be excluded from certain disclosure requirements by the self-regulating organizations. For instance, in 2006, the New York Stock Exchange, or "NYSE," published Information Memo 06-12 addressing the disclosure and sale practices concerning SCDs. A key concern of the NYSE was the adequacy of the disclosure materials used in connection with the sale of SCDs and whether an investor would fully understand how these differ from conventional CDs. The NYSE required that its member organizations be able to identify the customer criteria that define the appropriate market for a particular SCD, and provide training to their registered representatives to assure that they can identify investors for whom the SCD may be suitable. From a disclosure standpoint, the NYSE required its member organizations to make appropriate disclosures to investors prior to, or at the time of, the sale. In addition, member organizations must clearly explain the risks associated with SCDs. Such risks include, but are not limited to, market risks, liquidity risks, tax implications, and any potential call features (if applicable).

The SEC has also indicated some of the concerns that it has had as to the disclosures made in connection with sales of SCDs. For example, the SEC added a page to its website, "Equity Linked CDs" (http://www.sec.gov/answers/equitylinkedcds.htm), which serves as a reminder to issuers and brokers of SCDs of certain key disclosure issues.

In addition, Federal Reserve Regulation DD (which implements the Truth in Savings Act) sets forth additional disclosure requirements. (See: "How does the Truth-in-Savings Act apply to Structured Certificate of Deposits?").

What are some advantages of mirroring the types of disclosures traditionally found in medium-term note programs?

Mirroring the types of disclosures traditionally found in medium-term note programs can allow an issuing bank to accomplish a number of objectives. First, the disclosures allow issuing banks to address potential disclosure concerns raised by the NYSE, FINRA, and Regulation DD. Second, the disclosures provide investors with the level and quality of information that regulators have traditionally deemed adequate for investors to make an investment decision. Last, since many issuing banks that offer SCDs also offer structured securities programs, providing similar types of documentation for SCDs provides some level of familiarity to investors (as well as the brokers that market SCDs).

What other offering documentation is used in a Structured Certificate of Deposit program?

While SCDs are not generally considered securities, many issuing banks treat, document, and market them in a manner that is similar to offerings under medium-term note programs. For the SCDs that are marketed by larger, more frequent issuers, the related documents that are prepared and distributed to investors often look and feel similar to those used in structured note offerings. For example, an issuer may provide its SCD investors with a "pricing supplement" which sets forth the specific terms of a particular SCD (including the terms of the SCD, a comprehensive discussion of the economic terms of the offering, a discussion of the underlying asset, specific risk factors, fees, and expenses), a "product supplement," and a base disclosure statement.

What types of documents and agreements are used to establish a Structured Certificate of Deposit program?

Establishing a SCD program typically requires a variety of additional agreements and documents, including:

- A brokerage or purchase agreement between the issuing bank and the brokers that will market the SCDs.
- A paying agency agreement with a paying agent (if necessary).
- Forms of master certificates that represent the SCDs.
- Documentation providing for the clearance of the SCDs through the facilities of the Depository Trust Company.
- Agreements with hedging counterparties, in the event the issuing bank is engaged in hedging activities. (See "Are Structured Certificates of Deposit subject to hedging transactions?").

Many brokers will often on-sell SCDs to third-party broker-dealers, who in turn sell them to retail accounts. A CD-specific selling group agreement will typically be used to document the relationship between the brokers.

Marketing of Structured CDs

How are Structured Certificates of Deposit marketed?

The marketing process for SCDs is similar to the process employed in offering structured notes that are issued under a medium-term note program. Banks that are frequent issuers of SCDs will market SCDs with specific structures, linked to different reference assets. Further, as with medium-term notes, an issuing bank can tailor a SCD offering with characteristics that are unique to the market, in order to meet the needs of specific investors (also known as a "reverse inquiry").

Are Structured Certificates of Deposit subject to hedging transactions?

As with medium-term note offerings, the issuing bank or any of its affiliates may engage in hedging transactions. An issuing bank will typically hedge to offset its payment obligations at maturity. This hedge transaction is typically arranged by the investment bank that is acting as broker for the SCDs.

Other Terms of Structured CDs

Can Structured Certificates of Deposit be withdrawn prior to maturity?

Usually not. However, depending on the terms of the particular SCD, an issuing bank may offer an "estate feature" (otherwise commonly known as a "death put" or "Survivor's Option"). In the event the depositor of an SCD passes away (or, in some cases, becomes legally incapacitated), the estate or legal representative has the right, but not the obligation, to redeem the SCD for the full deposit amount before the date of maturity, without being subject to any penalty provisions.

Can an SCD underperform a traditional certificate of deposit?

Yes. Unlike traditional CDs, which provide for a fixed rate of return, the rate of return for an SCD is contingent on the performance of the underlying asset. There may be no assurance of any return above the deposit amount. While an investor is guaranteed his or her principal amount, in the end, if the reference asset performs unfavorably, the investor will still experience an "opportunity cost," compared to having invested in a traditional, interest-paying CD.

What is a "participation rate"?

The "participation rate" is the exposure of a product to movements in the price or level of the underlying asset. A participation rate of 100% would generate a return equal to any increase in the value of underlying asset. Conversely, if the participation rate is 80%, an investor will receive 80% of the increase in the value of underlying reference asset. In such a case, the SCD will underperform the underlying asset if the value of the underlying asset increases.

What are some other features that could limit an investor's return at maturity?

Even if the asset performs favorably, depending on the terms of an SCD, the return on the investment may be limited by a predetermined return (a "cap") or some other term specific to a particular SCD. These types of features could cause the SCD to perform less well than the relevant underlying asset. Further, because SCDs are FDIC-insured, the premiums and assessments paid by the bank issuer to the FDIC are usually passed on to the investor in the form of a lower participation rate or a lower maximum payment, as compared to non-FDIC-insured investments.

What is a "call feature" and how does it apply to Structured Certificates of Deposit?

A "call feature" allows an issuing bank, at its discretion, to redeem a SCD at a call price on a specified call date or dates, prior to maturity. By agreeing to a specified call price, the investor effectively forgoes any possible returns that could be realized had the SCD not been called, or had the SCD been called on a later date. In addition, if an SCD is called, the investor may not be able to reinvest the proceeds in a similar instrument, since interest rates and the level of the underlying asset may have changed since the SCD was initially purchased.

How are investments in SCDs taxed?

The specific U.S. federal tax consequences to an investor depend upon a variety of factors, particularly the structure of the SCD. These tax consequences are typically discussed in the SCD's offering documents. Because many SCDs are typically subject to contingent payments during the term of the instrument or at maturity, they often require the holder to include in income "original issue discount," even though the holder may or may not actually receive a cash payment prior to maturity.

Is there a secondary trading market for Structured Certificates of Deposit?

Not always. Because they are not typically traded on any exchanges, SCDs are generally not liquid investments. Further, issuing banks rarely create a secondary market for SCDs, and even if a secondary market is created, such banks are under no obligation to maintain it. Market-making activities with respect to the SCDs are typically limited to the broker-dealers that originally offered them. As a result, if an investor decides to sell his or her SCD prior to maturity, the amount he or she receives could potentially be lower than the initial principal amount.

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