



JENNIFER M. GRANHOLM
GOVERNOR

STATE OF MICHIGAN
OFFICE OF FINANCIAL AND INSURANCE SERVICES
DEPARTMENT OF LABOR & ECONOMIC GROWTH
DAVID C. HOLLISTER, DIRECTOR

LINDA A. WATTERS
COMMISSIONER

April 7, 2004

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YYYYYYY

Dear XXXXX:

I am writing in reply to your inquiry regarding Michigan laws and regulations applicable to your firm's indexed certificate of deposit (ICD) program. In your letter, you asked:

1. Are state-chartered financial institutions allowed to sell equity-linked certificates of deposits [sic] in the State of Michigan?
2. Are OTC options contracts, as a non-speculative risk management tool, a permissible investment under the laws and regulations of the Division of Bank & Trust?
3. Does the Division of Bank & Trust currently have any policy statement and/or requirements regarding an indexed certificate of deposit program for community banks and financial institutions?

As represented in your letter and its attachment, the new product, the _____ Indexed Certificate of Deposit Program (Program), is a "certificate of deposit with interest calculated based upon a designated percentage of any increase in the _____ (___) Index" over the ICD term. You noted that the program minimizes the potential risk to the ICD issuer of excessive performance of the index by fixing the bank's cost of funds at inception through participation in an OTC option contract with an option seller. Your firm (YYYYY) would act as aggregator of notional sales of Program ICDs of participant banks and as agent for the participants in the OTC option purchase transaction, and would receive a fee for its services. Participant banks would share proportionate ownership and any future benefits derived from the OTC option contract at maturity.

Program ICDs, themselves, are represented in your letter as being issued for terms of 5 years and only on the 15th of a month; having a minimum subscription of \$1,000 and principal-only insurance until maturity to the usual standard by the Federal Deposit Insurance Corporation; subject to potential early withdrawal penalty that could cause loss of principal; non-renewable; redeemable each year on the anniversary date; and transferable on notice to the issuing bank.

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1. Michigan law does not prohibit a state-chartered bank or savings bank from offering equity-linked certificates of deposit to Michigan residents.
2. YYYYYY Program materials clearly represent the OTC option contracts as not readily marketable. Thus, OTC option contracts do not qualify as “investment securities” for purposes of the Michigan Banking Code of 1999. As a specific hedge against the risk of a high rate of return on the Program CD, however, such a purchase, if not speculative, is a permitted activity.
3. Just as an indexed certificate of deposit is not appropriate for every depositor, an ICD program is not appropriate for every bank. This agency expects that banks choosing to participate in such programs will do so in a safe and sound manner and will:
 - a. Evaluate prior to participation
 - i. funding costs of ICDs vis-à-vis other funding sources;
 - ii. credit risk associated with the option seller;
 - iii. performance capability of the agent and escrow agent;
 - iv. interest rate, legal, reputational, and other risks associated with ICDs.
 - b. Adopt appropriate policies to guide an ICD program.
 - c. Implement procedures and management reporting to identify, manage and control risks in the ICD program.
 - d. Employ staff with sound expertise in hedging and options.
 - e. Avoid unsound overreliance on this funding source.
 - f. Market Program ICDs responsibly, considering suitability for the customer.

This letter should not be construed as an endorsement by the Office of Financial and Insurance Services of the YYYYYY ICD Program. If you have questions regarding this letter, please contact me.

Sincerely,

/ss/

Peggy L. Bryson, Deputy Commissioner
Bank and Trust Division