

## **Interpretive Letter 02-06 (May 1, 2002)**

### **National wildcard authority contained in Section 5(11) of the Act provides a state-chartered bank the authority to purchase and hold trust preferred securities as loans**

The Office of Banks and Real Estate, (the “Agency”) has received and reviewed correspondence regarding trust preferred securities. {} has asked whether the primary powers provided under Section 3 of the Illinois Banking Act, 205 ILCS 5/1 et seq. (the Act) authorizes state-chartered banks to purchase and hold trust preferred securities as loans under Section 32 of the Act, as opposed to an investment under Section 33 of the Act. {} has also asked whether the national wild card authority under Section 5(11) of the Act authorizes a state-chartered bank to purchase and hold trust preferred securities as loans. It is the Agency’s position that the authority to conduct a general banking business under Section 3 of the Act does not provide authority for a state-chartered bank to purchase and hold trust preferred securities as loans. However, application of the national wild card authority contained in Section 5(11) of the Act does provide a state-chartered bank the authority to purchase and hold trust preferred securities as loans, subject to the same limitations that apply to national banks.

A typical trust preferred security transaction involves the establishment of either a business trust or a limited partnership by a corporate business entity. The business trust or limited partnership issues both common and trust preferred securities. All of the common securities are purchased and held by the establishing corporation. The trust preferred securities are sold to investors either in a public or private transaction and the proceeds generated from the sale are used by the trust or limited partnership to purchase subordinated debentures from the corporate business entity. The duration and yield provisions of the trust preferred securities are generally identical to those governing the corporate debenture.

The Office of the Comptroller of the Currency (OCC) has previously concluded that trust preferred securities are debt-like instruments, OCC Interpretive Letter 777(4/08/97). The Agency agrees that trust preferred securities have many of the same characteristics as a typical debt instrument. Similar to a traditional debt instrument, the redemption of a trust preferred security depends on the ability of the corporate business entity to retire the subordinated debenture purchased by the trust or limited partnership. Given the attributes shared by trust preferred securities and more common debt instruments, it is the Agency’s position that state-chartered banks may purchase trust preferred securities for their own account, under the authority and subject to the same restrictions provided by Section 33 of the Act. Section 33 of the Act requires that investment securities purchased by a state-chartered bank be rated in the top 4 rating categories by national rating services and designated as investment grade or bank quality investment. In addition state-chartered banks are limited to a maximum investment in marketable securities of no more than 20% of unimpaired capital and unimpaired surplus.

Under certain circumstances, particularly when they are offered in a private placement, trust preferred securities do not qualify as marketable securities. The trust preferred securities are not normally rated and generally are not designated investment grade or a bank quality investment. You have asked whether state-chartered banks may instead treat trust preferred securities as loans rather than investment securities. A recent interpretation issued by the OCC authorizes national banks to purchase and hold trust preferred securities as loans, OCC Interpretive Letter 908 (4/23/01). The OCC concluded that the National Bank Act, 12 U.S.C. 24(Seventh), expressly authorizes national banks to conduct the business of banking. The OCC has determined that the business of banking includes the power to discount or negotiate evidence of debt and to hold debt securities as loans.

Section 3 of the Act provides that it shall be lawful to form a state-chartered bank for the purpose of discount and deposit, buying and selling exchange and doing a general banking business. Given the similarities in language contained in the National Bank Act and the general powers provided under Section 3 of the Act, it could be assumed that state-chartered banks may rely upon their general banking powers to purchase and hold debt securities as loans. However, it is the Agency's position that the general powers granted under Section 3 of the Act are subject to limitations or conditions contained in subsequent sections of the Act. The Agency finds no authority to give supremacy to a general banking power over the specific investment conditions provided under Section 33 of the Act.

State-chartered banks may utilize Section 5(11) of the Act to, in effect, borrow the authority granted under OCC Interpretive letter 908. Section 5(11) of the Act is commonly referred to as the federal wildcard power and allows a state-chartered bank to do any act and to own, possess and carry as assets property of the character, including stock, that is at the time authorized or permitted to national banks by an act of Congress subject to the same limitations and restrictions as are applicable to national banks. The Agency has previously determined that notwithstanding the limitations in Section 33, Section 5(11) of the Act would allow a state-chartered bank to purchase and hold non-rated investment securities subject to the standards and limitations applicable to a national bank, OBRE Interpretive Letter 94-024(11/1/94). Similarly, notwithstanding the conditions of Section 32 and 33 of the Act, a state-chartered bank may use 5(11) to purchase and hold debt obligations, including trust preferred securities, as loans in a manner and amount allowable to any national bank, but always subject to the *same* limitations imposed upon national banks. This means that state-chartered banks that purchase trust preferred securities and hold them as loans are subject to the federal lending limit requirements of 15% of unimpaired capital and unimpaired surplus as provided under 12 U.S.C. 84 and the requirements of Banking Circular No. 181.