**INTERPRETIVE LETTER 95-15 (DECEMBER 20, 1995)**

**Foreign banks that possess certificates under Foreign Banking Office Act have the same powers as state banks which in turn have the same powers as national banks to own, hold or trade financial derivatives.**

We are writing in response to your correspondence dated *. You indicated that you represent a large financial services company ("Company") that engages in hedging transactions involving various types of derivative contracts, including swaps, caps, collars and floors. You further indicated that Company was contemplating entering into one or more such contracts with the Illinois state branches of foreign banks ("Banks"). You asked whether Company could be certain that under Illinois law, Banks have the power to enter into such contracts, even though Banks may not have obtained our approval for such activities. For the reasons set forth below, and subject to the enumerated conditions, we conclude that Company may presume that Banks have the power to enter into such financial derivative contracts.

Section 3 of the Foreign Banking Office Act ("FBOA"), 205 ILCS 645/3 (1994), confers upon foreign banking corporations the same rights and privileges as state chartered banks in Illinois. Thus, the Illinois Banking Act ("Act"), 205 ILCS 5/1 et seq (1994) defines the rights and privileges of foreign banking corporations in Illinois. The general statutory authority for Banks to conduct banking activities is contained in Section 3 of the Act, which states in relevant part, "It shall be lawful to form banks ... for the purpose of ... doing a general banking business." Additional authority for Banks to conduct banking activities is found in Section 5 of the Act which grants banks "chartered under or subject to this Act" enumerated powers. One of these powers is found in Section 5(11) of the Act, which is sometimes called the "wildcard" provision. Section 5(11) permits a state chartered bank, and therefore, a foreign banking corporation pursuant to the FBOA, to do any act or to own any asset so authorized or permitted to a national bank.

In our Interpretive Letter 94-019 (September 15, 1994) ("IL 94-019"), we found that a bank may trade commodity-related derivatives for its customers pursuant to Section 5(11), provided it has the management and controls necessary to ensure safe and sound banking practices. In IL 94-019, we analyzed interpretations by the Office of Comptroller of the Currency ("OCC") which state that financial derivatives-related trading by national banks is "incidental to banking" under Section 24(7) of the National Banking Act, 12 U.S.C. Section 24(7). Financial derivatives include a wide range of financial instruments, such as swaps, futures and options, all of which derive their value from the performance of assets, interest or currency exchange rates, or indexes. In IL 94-019, the bank was dealing in energy derivatives to provide risk management or to provide an efficient financial vehicle to its customers.

IL 94-019 discusses OCC Banking Circular 277 ("BC-277") (October 27, 1993), *reprinted* in Fed. Banking L. Rep. (CCH) **&** 58,717, which states that national banks

whose financial derivatives involve dealing or active position-taking should have risk measurement systems that can quantify risk exposures arising from changes in market factors. These systems must be in place to ensure that the banks are acting in a safe and sound manner. Among other general guidelines, BC-277 sets forth market risk management guidelines for banks whose derivative activities involve dealing or active position-taking. IL 94-019 also discusses several interpretations which the OCC has issued which confirm that national banks are permitted to engage in financial derivatives-related transactions similar to those proposed to be conducted by Banks.

In IL-94-019, we concluded that we would not permit a state chartered bank or a foreign bank corporation under our jurisdiction to engage in energy derivatives trading unless we determine that the bank has the management and controls necessary to ensure that such activities are carried out according to safe and sound banking practices. We therefore stated that we would require that these banks present a detailed plan to us evidencing proper management and controls before engaging in such activities. We will continue to require state chartered banks and foreign banking corporations under our jurisdiction that engage in derivatives trading activities or that hold derivatives contracts as assets to obtain our approval before engaging in such activities, in order to assure that such activities are carried out according to safe and sound banking practices. Where a bank has not obtained such approval, however, under Section 5(11), it nevertheless possesses the corporate power to engage in derivative trading activities and to hold derivatives contracts as assets to the extent permitted to national banks, subject to the restrictions applicable to national banks by the pertinent federal law. Any other interpretation would be contrary to the intent of Section 5(11), that the corporate powers of state-chartered banks include all powers available to national banks. Accordingly, a bank which is engaging in derivatives trading activities or holding derivatives contracts in a manner permitted to national banks but which has not obtained our approval for such activities or assets is not engaging in *ultra vires* acts beyond the scope of the bank's powers.

We therefore conclude that Banks have the corporate power under Section 5(11) to engage in financial derivatives-related trading with, and to own and hold derivatives contracts of, Company to the same extent, but subject to the same limitations, as applicable to national banks by the pertinent federal law. In order to assure that such trading activities, and the holding of such assets, are carried out according to safe and sound banking practices, Banks are required to obtain our approval before engaging in such activities or holding such assets. The failure of Banks to obtain our approval, however, does not render such trading activities or the holding of such assets *ultra vires*, but would rather subject the Banks to regulatory actions pertaining to the Agency's supervision of safety and soundness.