

## **INTERPRETIVE LETTER 97-02 (MARCH 11, 1997)**

**State Bank may accept and hold stock issued by a borrower, not as an investment *per se*, but rather as an incident to an attempt to work out a problem loan and maximize the bank's recovery.**

This letter is in response to your letter to the Office of Banks and Real Estate (AOBRE@) on behalf of \* Trust and Savings Bank (ABank@) in which you seek to confirm that the Bank may acquire preferred stock in the Bank's customer, ABC Corp. ("Borrower"), in partial payment for overdue and unpaid interest on two promissory notes. For the reasons set forth in this letter, and subject to the conditions and limitations stated, we conclude that the Bank may acquire the Stock.

The Borrower is a company that owes the Bank \$497,678.75 in principal and \$121,776.32 in accrued interest after a 1995 restructuring of debt, but the Borrower has not been able to make payments to reduce the debt. After detailed analysis and discussions, the Bank has concluded that the Borrower will likely fail unless it can obtain additional credit but the Bank is unwilling to advance further funds. However, the Bank has concluded that the Borrower should be able to obtain additional trade credit if the Borrower's total bank debt is reduced. Therefore, the Borrower has proposed that the Bank accept non-voting preferred stock in exchange for forgiveness of the outstanding interest. The preferred stock would have a "put" feature that would permit the Bank to require the Borrower to buy the stock back within a defined time period (5 years or less) if certain financial criteria are achieved by the Borrower during that time. It is the opinion of the officers of the Bank that this transaction will enable the Borrower to stay in business and will provide the Bank with its best hope to recover the principal amount of the loans.

### **State Bank Investments in Stock**

General powers of State banks include Adoing a general banking business,@ [Section 3 of the Illinois Banking Act (AAct@), 205 ILCS 5/3 (1994)] and State banks are permitted to hold stock in certain specific circumstances. These provisions of Section 5 of the Act cited in the footnote provide authority for state banks to make equity investments in corporations to conduct some part of the state bank's business or to engage in an activity that facilitates the bank's business, but these provisions do not provide authority to generally invest in equity interests in corporations.

OBRE recognizes that while a bank may not be authorized to invest in a particular stock, it may nevertheless accept and hold the stock, not as an investment *per se*, but rather as an incident to a permitted activity, or in this instance in an attempt to work out a problem loan and maximize the bank's recovery. We conclude, as you suggested in your inquiry, that as part of the general banking business a bank may accept assets in which the bank could not invest in the first instance and that the Bank may accept the preferred stock as described in your letter provided that the conditions described, including the maximum holding period, are observed.

In addition to its authority to conduct a general banking business and specifically enumerated powers, a state bank is also granted the authority in Section 5(11) of the Act:

[n]otwithstanding any other provision of...[the Banking Act]...to own, possess and carry as

assets...stock, that is at the time authorized or permitted to national banks by an Act of Congress, but subject always to the same limitations and restrictions as are applicable to national banks by the pertinent federal law.

205 ILCS 5/5(11) (1994).

Based upon Section 5(11) of the Act, the Bank is permitted to own stock to the same extent that a national bank is permitted to do so. The federal Office of the Comptroller of the Currency has issued a number of interpretive letters and no objection letters that would permit the proposed transaction if the Bank were a national bank.

Therefore, based upon the authority under Section 3 to conduct the general banking business, and based upon Section 5(11) providing authority comparable to that of a national bank, we conclude that the Bank may accept preferred stock as proposed in your letter.