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UPDATE

News of Developments in the Financial Sector and Related Areas

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Repurchase Agreements

Earlier this year the Federal Deposit Insurance Corporation ("FDIC") issued its final rule entitled *Processing of Deposit Accounts in the Event of an Insured Depository Institution Failure*. The final rules establishes the FDIC's practices for determining deposit and other liability account balances at a failed insured depository institution. The final rule also requires institutions to prominently disclose to sweep account customers whether the swept funds are deposits and the status of the swept funds if the institution were to fail. In connection with the final rule, the FDIC has addressed the terms of the master repurchase agreement used in certain sweep account arrangements where the institution serves as the customer's custodial agent for securities held at another financial intermediary. One of the primary purposes for the utilization of a master repurchase agreement is to sweep funds in deposit accounts out of a depository institution that otherwise would be uninsured by the FDIC.

In a properly executed repurchase sweep arrangement, as of the depository institution's normal end-of-day, the sweep customer either becomes the legal owner of identified assets (typically government securities) subject to a repurchase agreement or obtains a perfected security interest in those assets. In such cases, where the sweep customer either owns or possesses a perfected security interest in the identified securities, upon an institution failure, the FDIC will recognize the customer's ownership or security interest in the securities. If the value of the securities at least equals the dollar amount of funds swept from the customer's account, the customer's swept funds will be fully protected in the event of failure. After failure, the disposition of the swept funds invested in securities will depend on the nature of the transaction structured by the FDIC. In a purchase and assumption transaction, the securities and the underlying repurchase arrangement will be transferred to an acquiring institution, which could include a bridge institution. Under this transaction structure, the funds normally would be swept back into the customer's deposit account on the business day following failure, thus giving the customer full access to these funds at that point. In a payoff of insured deposits, the customer would receive a check or other payment from the FDIC to reacquire the customer's interest in the securities according to the FDIC normal procedures.

The standard repurchase agreement used in banking contains a provision which allows the financial institution to substitute the originally purchased securities with different securities of the same type. The FDIC takes the position that the right of substitution renders a repurchase agreement used in connection with a sweep account defective based on the fact that the institution retains

excessive control over the securities. The result is that a customer's funds in a failed institution will be treated as if they never left the deposit account from which they originated. This means that the customer may have a significant amount of uninsured deposits in the institution while at the same time the institution should have reported the swept funds as deposits in their quarterly Consolidated Reports of Condition and Income or Thrift Financial Reports. Another aspect of the FDIC's position is that the financial institution may be in violation of Regulation Q, which prohibits the payment of interest on demand deposits.

In order to address the issues raised by the FDIC in its final rule, possible alternatives are as follows:

1. Drafting new repurchase agreements.

2. Amending existing repurchase agreements.

3. Modifying the daily confirmation which the institution provides to the customer stating that the substitution provision has either been deleted or suspended.

4. Entering into a tri-party agreement with the financial intermediary that is holding the securities so that it is clear that the customer has sufficient control over the securities in order to have a perfected security interest in the securities.

Beginning July 1, 2009, in all new sweep account contracts, in renewals of existing sweep account contracts and within sixty days after July 1, 2009, and no less than annually thereafter, institutions must prominently disclose in writing to sweep account customers whether their swept funds are deposits within the meaning of 12 U.S.C. 1813(l). If the funds are not deposits, the institution must further disclose the status such funds would have if the institution failed i.e., a general creditor status or secured creditor status. Such disclosures must be consistent with how the institution reports such funds on its quarterly Consolidated Reports of Condition and Income or Thrift Financial Reports. The disclosure requirements imposed under this provision do not apply to sweep accounts where: The transfers are within a single account, or a sub-account; or the sweep account involves only deposit-to-deposit sweeps, such as zero-balance accounts, unless the sweep results in a change in the customer's insurance coverage.

Save Money on Franchise Taxes

Act 94 of 2003 ("Act 94") amended the *Arkansas Franchise Tax Act of 1979* to increase the annual franchise taxes effective for calendar years beginning January 1, 2004. Corporations, bank holding companies and banks (both state and national) organized under the laws of the State of Arkansas will want to consider amending their articles to provide for a par value of $.01 for each share of authorized stock. Bank holding companies and banks in Arkansas generally have a par value of $10.00 per share. Assuming that a corporation or bank had 500,000 shares of stock outstanding at a par value of $10.00 per share and all of its assets were in Arkansas, a corporation or bank would pay an annual franchise tax of $15,000.00 under Act 94. By amending the articles to provide for a par value of $.01 per share, the corporation or bank would only pay the new minimum annual franchise tax of $150.00, formerly $50.00 prior to Act 94. A corporation or bank would not want to amend its articles to provide for no par value since shares without par value are assessed at a rate of $25.00 per share, which if 500,000 shares were outstanding, would result in an annual franchise tax of $37,500.00 under Act 94. In Interpretive Letter No. 963, the Office of the Comptroller of the Currency concluded, in response to a request by our law firm, that a national bank had the authority to decrease the par value of its shares to $.01 per share in order to pay the minimum franchise tax.

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