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DECEMBER 2005

U P D A T E

News of Developments in the Financial Sector and Related Areas

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Banking Industry Continues to Consolidate

The banking industry continues to consolidate throughout the United States and the state of Arkansas. Consolidation in banking occurs from a number of factors, with banks experiencing loan portfolio problems resulting in inadequate capital on one hand and the pricing of banks in acquisition transactions on the other hand. Recent published reports reveal that the average price on the fifty-one transactions announced in the third quarter of this year had a price/book multiple of 2.49. There were 167 transactions which had been announced through the third quarter of this year. The Arkansas State Bank Department reports that the number of commercial banks in the state of Arkansas has dropped from 259 in 1985 to 170 in March 2005, or a thirty-four percent decrease. However, despite the consolidation in Arkansas, the number of branches has grown from 701 in June 1985 to 1,292 as of June 2004, for an eighty-four percent increase. The 2005 Summary of Deposits ("SOD") released by the Federal Deposit Insurance Corporation ("FDIC") reflects that as of June 30, 2005, there was an increase of three percent in growth of offices of insured institutions over the past year. Metropolitan areas reflect the largest growth in offices during the year. The numbers of offices in metropolitan areas increased three percent during the year and have risen fifteen percent since 1995. By contrast, non-metro counties showed no appreciable growth in offices since 2004 and just a six percent increase since 1995. Deposits grew by nine percent in metropolitan areas during the most recent year, with non-metro areas having an increase of just three percent for the year. During the year ending in June, there was an increase of 147 new charters, of which 127, or eighty-six percent, were headquartered in metropolitan areas.

Regulation of Banks by States

During 2004, the Office of the Comptroller of the Currency ("OCC") issued final regulations relating to the preemption of state laws by federal law over national banks. Because of the controversial nature of these regulations as to state versus federal regulation of national banks, a number of lawsuits were filed by state regulatory authorities regarding the position taken by the OCC as reflected in its regulations, particularly in the area of corporate subsidiaries of national banks and the applicability of preemption of state law relating to these corporate subsidiaries. In upholding the regulations issued by the OCC, the United States District Court of the Southern District of New York recently permanently enjoined the New York Attorney General from issuing subpoenas or

demanding inspection of books and records of any national banks in connection with his investigation into residential lending practices, holding that the regulations adopted by the OCC are a reasonable interpretation of the National Bank Act. This decision is similar to rulings that have been reached in court cases in California, Connecticut, Maryland and Michigan. The Arkansas Legislature enacted Act 2166 of 2005, known as the *Reverse Mortgage Protection Act* (the "Arkansas Act"), which among other things provides for certain disclosures in connection with reverse mortgage loan transactions. The Arkansas Act applies to reverse mortgage loan transactions entered into after January 1, 2006. Because of the preemption regulations by the OCC, it is questionable as to what applicability, if any, the Arkansas Act will have on banks and their subsidiaries. When requested, the OCC has consistently issued orders that laws such as the Arkansas Act do not apply to national banks or national bank operating subsidiaries. The Federal Deposit Insurance Corporation ("FDIC") held hearings on May 24, 2005, in response to a Financial Services Roundtable petition calling for the FDIC to publish a regulation offering state chartered banks operating across state lines the same preemption of host state laws that national banks currently enjoy. Those testifying at the hearings offered a wide range of views. Most, however, agreed that recent OCC preemption interpretations have put state banks at a competitive disadvantage in terms of their ability to operate interstate under a uniform set of requirements. The FDIC Board of Directors has authorized the issuance of a proposal that host-state laws would not apply to state chartered banks' out-of-state branches where a federal court or the OCC has concluded that the law is preempted for national banks. Under the proposal, state banks' operating subsidiaries and loan offices also may not have to comply with host-state laws under certain circumstances. The proposal by the FDIC seeks to put state banks on a competitive level with national banks in connection with the regulations issued by the OCC. Regardless of the outcome of the proposal by the FDIC, there is a legal issue as to whether or not the FDIC has the authority to promulgate a regulation which would in essence work like a wildcard for state chartered banks in providing them with parity with national banks.

Cases, Releases and Rulings

The Federal Deposit Insurance Corporation ("FDIC") is considering the implementation of an audit regulation which would increase from $500 million to $1 billion the minimum asset size at which banks must obtain external audits. The implementation of the proposed rule by the FDIC would exempt a large number of banks from the requirement of obtaining an external audit and having the auditor assess internal controls over financial reporting. The FDIC's Office of Inspector General in its comment letter on the proposed rule took the position that a financial institution should not be excluded from the audit requirement if the institution received less than a satisfactory exam rating.

The Federal Reserve Board has issued a proposal expanding the definition of *small bank holding company* ("BHC") from consolidated assets of less than $150 million to consolidated assets of not more than $500 million. The Federal Reserve is of the position that the proposal facilitates the ownership of small community banks by permitting debt levels that small BHCs that are higher than would be permitted for larger BHCs. In the past, small BHCs have been allowed to take on debt amounting to three times their equity in making acquisitions. According to the Federal Reserve, 55% of BHCs fit the current definition and under the proposed change 85% of BHCs would fit the definition.