Garland W. Binns, Jr.
Dover Dixon Horne PLLC
Attorneys at Law
425 West Capitol, Suite 3700
Little Rock, Arkansas 72201
Telephone: (501) 375-9151
Facsimile: (501) 372-7142
Email: gbinns@ddh-ar.com
Web Site: www.GWBinns.com

JANUARY 2006

U P D A T E

News of Developments in the Financial Sector and Related Areas

* *IN THIS ISSUE* *

Trust Preferred Securities

During 2005, the Federal Reserve Board ("FRB") adopted a final rule that allows the continued limited inclusion of trust preferred securities in the tier 1 capital of bank holding companies. Under the FRB's final rule, bank holding companies may include trust preferred securities in tier 1 capital in an amount equal to 25 percent of all core capital elements (including trust preferred securities). The final rule provides a five-year transition period until March 31, 2009, at which time bank holding companies will be required to net goodwill, less any associated deferred tax liability, from this calculation. Amounts of restricted core capital elements in excess of these limits generally will be included in tier 2 capital. The final rule also eliminates the requirement for trust preferred securities to include a call option. In adopting the final rule, the FRB noted that a key advantage of trust preferred securities to bank holding companies is that for tax purposes the dividends paid on trust preferred securities, unlike those paid on directly issued preferred stock, are a tax deductible interest expense. Under the final rule, the issuance of trust preferred securities must still be approved by the Federal Reserve Bank in the district in which the bank holding company is located. A number of bank holding companies have issued trust preferred securities and continue to utilize trust preferred securities for a number of reasons. Trust preferred securities are advantageous to bank holding companies because they are treated as equity for bank regulatory purposes and as debt for tax purposes. Trust preferred securities are typically issued as non-perpetual cumulative preferred stock by a wholly-owned trust subsidiary of a bank holding company. The bank holding company owns all of the common stock of the trust subsidiary. Revenue from the sale of the trust preferred securities by the trust subsidiary is exchanged for junior subordinated debentures issued by the bank holding company. The debentures feature a coupon payment and term to maturity, which are identical to those of the trust preferred securities. The guidelines of the Federal Reserve provide that the subordinated debt and the trust preferred securities must have a maturity of not less than thirty (30) years and the subordinated debt must be subordinate to all other debt of the bank holding company. The bank holding company has the option to call the subordinated debt and the trust preferred securities after the expiration of five (5) years. Both the subordinated debt and the trust preferred securities must allow for a consecutive five (5) year deferral on interest and dividends, respectively. The bank holding company must guarantee the distribution, liquidation, and redemption rights of the trust preferred securities. Any redemption of the trust preferred securities must be approved by the Federal Reserve. Payments on the subordinated debt and the trust preferred securities are "interest only" until maturity. In accordance with the Financial Accounting Standards Board Interpretation Number 46 Revised, the subordinated debt is shown on the consolidated balance sheet of the bank holding company as long term debt and the securities issued by the trust are not consolidated. Trust preferred securities are useful for bank holding companies that are Subchapter S corporations. Although a Subchapter S corporation cannot have more than one class of stock, trust preferred securities are not considered a separate class of stock and purchasers of trust preferred securities will not be counted as additional shareholders. In Interpretive Letter No. 908, the Office of the Comptroller of Currency ("OCC") held that trust preferred securities may be purchased and treated as loans by national banks. The OCC noted that trust preferred securities are instruments that possess characteristics particularly associated with debt securities. Like debt holders, the holders of the trust preferred securities do not have voting rights in the management or the ordinary course of business of the trust. In addition, holders of the trust preferred securities do not share in any appreciation in the value of the trust and are protected from changes in the value of the principal of the instruments except for credit risk. Since the trust's only source of revenue for the dividends on the trust preferred securities is the interest on the underlying subordinated debt, the trust preferred securities must be redeemed upon redemption of the subordinated debt. Before purchasing trust preferred securities as loans, the OCC noted that a national bank should conduct a complete review of relevant credit information and loan administration practices, and determine that the purchase meets the bank's own internal loan underwriting standards. The interpret-tive ruling by the OCC provides a vehicle for a bank holding company to convert debt to equity while allowing a bank purchaser of the trust preferred securities to treat the purchases as loans. Trust preferred securities provide an excellent vehicle for funding of acquisitions, stock repurchases and internal growth.

Reverse Mortgages

Recent published reports indicate that there has been an increase in borrowers obtaining reverse mortgages. A reverse mortgage is generally a nonrecourse loan secured by a borrower's personal residence that provides cash advances to the borrower based on the amount of equity in his residence and requires no payment of principal or interest until the entire loan becomes due and payable. In order to qualify for most reverse mortgages, the borrower must be at least 62 years of age and live in his home. The proceeds of a reverse mortgage are generally tax-free and have no income restrictions. In a normal mortgage arrange-ment, the borrower must make monthly payments to the lender. However, in a reverse mortgage, the borrower receives the proceeds of the loan from the lender and generally does not have to pay it back for as long as he lives in his home. A reverse mortgage loan must be repaid when the last surviving borrower dies, the home is sold or the borrower no longer lives in it as his principal residence. Reverse mortgages may be of assistance to those homeowners who have substantial equity in their home, but who are having difficulty meeting their financial obligations. The older the borrower is, the more cash the borrower may obtain, while at the same time, the more the home is worth, the more cash that will be available to the borrower. As in other typical mortgage loan trans-actions, the borrower who obtains a reverse mortgage loan continues to be responsible for payment of property taxes, keeping the home adequately insured and maintenance and repairs to the home. Arkansas has a *Reverse Mortgage Protection Act* which, among other things, provides for certain disclosures in connection with reverse mortgage loan transactions.