

UPDATE

News of Developments in the Financial Sector and Related Areas

* *IN THIS ISSUE* *

Mortgage Loan Prepayment Penalties

Trust Preferred Securities

What are Restricted Securities and Legend Stock?

Mortgage Loan Prepayment Penalties

The *Fair Mortgage Lending Act* (the "Act") was recently enacted by the Arkansas Legislature and became effective on January 1, 2004. The state agency with responsibility for the enforcement of the Act is the Arkansas Securities Department. The Act requires the licensing of certain persons who are not exempt from its provisions. The Act also prohibits certain activities in connection with any mortgage loan transaction. Prepayment penalties are one of the areas set forth in prohibited activities. Specifically, the Act prohibits a penalty for prepayment if the prepayment is made after the expiration of the thirty-six-month period immediately following the date on which the loan was made. In addition, prepayment penalties exceeding certain specified amounts are prohibited during the thirty-six-month period immediately following the date of the loan. Although state and federally chartered banks are exempt from the licensing provisions of the Act, the Act does not exempt banks from the prohibited activities, such as the restrictions on prepayment penalties. Purchasers of mortgage loans originated by banks in Arkansas have raised the question as to the applicability of the Act in those cases where the prepayment penalties exceed the amounts set forth in the

Act. In January 2004, the OCC issued two final regulations relating to the preemption of state laws by federal law over national banks. The first regulation clarifies to the extent the operations of a national bank are subject to state laws and identifies the type of state laws that are preempted by federal law under the National Bank Act. The second regulation is directed toward the exclusive authority of the OCC under the National Bank Act to examine, supervise and regulate the affairs of a national bank. Although a matter of controversy with state authorities, these two final regulations are a result of Advisory Letter 2002-9 which reflects the position of the OCC that it has exclusive authority over national banks and a later proposal by the OCC, Docket No. 03-16 certifying the authority of the OCC over national banks. The OCC's final regulations do allow courts to require national banks to produce witnesses or information, however the exception for courts does not permit a state authority to inspect, regulate or supervise national banks. Because of the controversial nature as to state versus federal regulation, there will continue to be litigation regarding the OCC's final regulations. In discussions with representatives of the Arkansas Securities Department, they have confirmed that the Act is not currently being enforced against state or national banks. It may be that additional legislation will be enacted by the Arkansas Legislature clarifying the applicability of the Act to banks.

Trust Preferred Securities

The Federal Reserve Board has recently issued a proposed rule that would retain trust preferred securities in tier 1 capital of bank holding companies, but with stricter quantitative limits and clearer qualitative standards. Under the proposal, after a three-year transition period, the aggregate amount

of trust preferred securities and certain other capital elements would be limited to 25 percent of tier 1 capital elements net of goodwill. This would mean that bank holding companies would have to deduct goodwill from its equity before making the calculation. A large number of bank holding companies have issued trust preferred securities and continue to utilize trust preferred securities for a number of reasons. The Board proposes to revise the quantitative limits applied to the aggregate amount of cumulative perpetual preferred stock, trust preferred securities and minority interests in the equity accounts of certain consolidated subsidiaries (collectively, restricted core capital elements) included in the tier 1 capital of bank holding companies. In January 2003, the Financial Accounting Standards Board issued Interpretation 46, entitled *Consolidation of Variable Interest Entities* ("Interpretation 46"). Interpretation 46 had raised the issue of how trust preferred securities should be treated in regulatory reporting by bank holding companies. The Federal Reserve Board in its proposal intends to preserve the tier 1 capital treatment of trust preferred securities for bank holding companies which it believes is not in conflict with generally accepted accounting principles. The proposal is available on the web site of the Federal Reserve Board at www.federalreserve.gov.

What Are Restricted Securities And Legend Stock?

Restricted securities generally refer to shares of a company that have not been registered in a public offering and may not be transferred or resold until certain events that exempt the resale from registration or comply with the registration requirements of both state and federal securities laws. Legend stock refers to a certificate representing shares of a company that carries a description, located on either the face or back of the certificate, of the restrictions on the ability of the holder of the certificate to sell or otherwise transfer the certificate. Generally, certificates of stock representing restricted securities bear a legend on the certificate

identifying the restrictions and limitations on the transferability. When issuing restricted securities, one of the requirements of state and federal securities laws is the requirement that investors represent in writing that they are purchasing the shares for investment intent and not with the intent to resell the shares. In addition to the requirements placed upon the issuance of securities under securities laws, in the event the holder of stock has entered into a shareholders agreement or agreed to some other type of restriction on his ability to own or resell the securities, these restrictions will also appear on the stock certificate. The purpose of having a legend on stock certificates is to alert potential purchasers to the restrictions imposed upon the stock. Shares in private companies that are not publicly traded should contain a legend on the certificate indicating that the shares represented by the securities may not be resold or transferred. However, the absence of the legend or restrictive language on a certificate does not mean that the stock is freely traded and unrestricted. Many times the legends and restrictions have been left off by accident or management of the company is not aware of the requirement to place the restriction or legend upon the certificate. A typical legend indicating that a certificate represents restricted securities would read: *The securities represented by this certificate have not been registered under federal or state securities laws, and were acquired by the registered holder pursuant to a representation that such holder was acquiring such securities for investment. These securities may not be sold, pledged, hypothecated, transferred or assigned in the absence of an effective registration statement for the securities under applicable federal or state securities laws or an opinion of counsel satisfactory to the company to the effect that registration is not required thereunder.* Because of the complexity of state and federal securities laws, a holder of legend stock representing restricted securities should consult an attorney before transferring ownership of a certificate representing stock in a company.