

UPDATE

News of Developments in the Financial Sector and Related Areas

* *IN THIS ISSUE* *

Trust Preferred Securities

Directors' Qualifying Shares

Seminar Information

Durable Power of Attorney

Trust Preferred Securities

On March 1, 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, net of goodwill less any associated deferred tax liability. Amounts of restricted core capital elements in excess of these limits generally will be included in tier 2 capital. The final rule provides a five-year transition period and the quantitative limitations prescribed in the preceding sentence will not be effective until March 31, 2009. 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 approximately 800 bank holding companies have outstanding over \$85 billion of trust preferred securities. The FRB also 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. It is interesting to note that only one comment letter from the Federal Deposit Insurance Corporation opposed the adoption of the final rule by the FRB, taking the position that trust preferred securities are accounted for as a liability under generally accepted accounting principles. 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.

Directors' Qualifying Shares

In Interpretive Letter No. 1020, the Office of the Comptroller of the Currency ("OCC") responded to an inquiry about whether national bank directors may purchase trust preferred stock ("TPS") to meet the requirement that they own director's qualifying shares under the requirements of the National Bank Act. The facts in this Interpretive Ruling reflect that a national bank was seeking to add new directors to its board. Under its proposal, the bank holding company for the bank would form an entity for the issuance of TPS to the new bank directors in exchange for cash. The entity being formed by the bank holding company would then use the proceeds from the sale of the TPS to the new directors to purchase junior subordinated debentures issued by the bank holding company. The transaction was structured so that the TPS qualified as tier 1 capital for the bank holding company. The National Bank Act

(12 U.S.C. § 72) generally requires that every director must own capital stock of a national banking association in which he or she is a director, the aggregate par value of which is not less than \$1000, or an equivalent interest as determined by the OCC, in any company which has control over the national banking association, i.e., a bank holding company. The purpose of the statute is to insure that a national bank director has a financial stake in the operations of the bank (or its bank holding company) so that the director will have the incentive to be vigilant in protecting the bank's interest. 12 C.F.R. § 7.2005 generally provides that (i) a national bank director must own a qualifying equity interest of common or preferred stock with a value of \$1,000 in the national bank or in a company that controls the national bank; and (ii) the OCC may consider whether other interests in a company controlling a national bank constitutes an interest equivalent to \$1,000 par value of national bank stock. The OCC was of the position that the proposed TPS investments have characteristics similar to equity holdings and create comparable incentives for bank directors to be vigilant and that TPS has a long life approaching economic perpetuity since investors are repaid from income on a 30-year subordinated debenture. TPS holders also have considerable risk of loss of dividends if the bank performs poorly, since dividends may be deferred up to 20 consecutive quarters to provide financial support to troubled subsidiaries. The OCC also noted that TPS investors hold a position that is subordinate to all obligations of the holding company, other than common and preferred shareholders and due to their deeply subordinated position, directors owning TPS have a substantial risk of loss if their oversight results in the bank's failure. The OCC said that, altogether, the long life, potential dividend deferral, and a substantially subordinate position of TPS creates incentives similar to equity holdings

for directors to assure the financial success of the bank. The OCC also felt that its position was supported in that the Federal Reserve Board permits TPS to qualify for inclusion in a bank holding company's tier 1 capital, and this treatment of TPS is consistent with the notion that TPS represents funds that are at risk in the bank giving the directors a financial stake tied to the success or failure of the enterprise. As a result of its reasoning, the OCC determined that TPS qualify as directors' qualifying shares.

Seminar Information

Mr. Binns will speak at the University of Arkansas William H. Bowen School of Law on June 20, 2005, in Little Rock, Arkansas. The presentation will address recent developments in the banking sector, including growth and pricing of banks.

Durable Power of Attorney

Since most people do not plan on being disabled as a result of an injury, accident, illness and in some cases old age, a person may be left without the ability or capacity to carry on his routine activities. A *general power of attorney* allows a person to name another person or entity as his agent in handling his affairs or may allow the agent to do only a specific thing such as the sale of property. It is important to note that a general power of attorney will be revoked and terminate in the event of a person's incapacity or incompetency. However, a *durable power of attorney* will not terminate in the event of a person's disability and may be drafted to be effective only upon disability. In selecting an agent, a person should designate someone in whom he has confidence and trust. Although most people are aware of the importance of having a will or an estate plan, they fail to plan for their disability. Proper planning includes having a durable power of attorney in the untimely event of a disability.