

UPDATE

News of Developments in the Financial Sector and Related Areas

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Trust Preferred Securities

A number of bank holding companies are considering the use of trust preferred securities for a number of reasons. 25% of the amount of trust preferred securities may be included in Tier 1 capital of a bank holding company with the remainder being classified as Tier 2 capital. At this time, there is no formal regulation on the issuance of trust preferred securities by the Federal Reserve Board, however, prior approval for the issuance of trust preferred securities must be obtained from the Federal Reserve. Trust preferred securities are typically issued as non-perpetual cumulative preferred stock and are issued by a wholly-owned trust subsidiary of a bank holding company. The 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. Generally, the term of the subordinated debentures and the trust preferred securities will be 30 years. A unique feature of the trust preferred

securities is the option of the bank holding company to defer any payments that come due to a future date which is generally up to 5 years. Under the applicable provisions of the Arkansas Securities Act (the "Arkansas Act"), a filing will generally be required to be made and obtained prior to the issuance of trust preferred securities. In the offering of trust preferred securities there are a number of securities involved such as (i) the trust preferred securities; (ii) the subordinated debentures; (iii) the guarantee issued by the bank holding company for the benefit of holders of the trust preferred securities; and other securities, such as common preferred securities. In the event a filing is not made with the Arkansas Securities Department, the bank holding company would be strictly liable under the Arkansas Act to a purchaser of trust preferred securities for the amount of the principal investment plus 6% interest and any expenses incurred by the purchaser. A controlling person of the bank holding company such as an executive officer or director may also be personally liable under the Arkansas Act. In Interpretive Letter No. 908, the Office of the Comptroller of the Currency ("OCC") held that trust preferred securities may be purchased and treated as a loan 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 trust preferred securities do not have voting rights in the management or the ordinary course of business of the trust. In addition, holders of trust preferred securities do not share in any appreciation in the value of the trust and are protected from changes in the value of principal of the instruments except for credit risks. 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 purchases meet the bank's own internal loan underwriting standards. The interpretive 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. Recently the Office of Thrift Supervision ("OTS") issued Thrift Bulletin TB 73a which replaced bulletin TB 73. The bulletin discussed the due diligence that should be performed by savings associations which should include among other things that the issuer of the trust preferred securities have the financial capacity to meet the repayment of the investment, the expected performance of the issuer and any underlying assets and the liquidity of the proposed investment. Thrift Bulletin 73a reflects that a savings association may not use its lending authority to invest in trust preferred securities noting that the statutory lending authority and definition of a loan for national banks is different from the authority for savings associations.

Accounting and Derivative Instruments and Hedging Activities

The Financial Accounting Standards Board ("FASB") has prepared a new updated edition of *Accounting for Derivative Instruments and Hedging Activities*. The publication brings together in one document the current guidance on accounting for derivatives. It presents Statement 133 as amended by Statements 137 and 138 and includes the results of the Derivatives Implementation Group as cleared by the FASB with cross-references between the issues and the paragraphs of the Statement. Information for ordering the publication is available on the web site of the FASB at <http://www.fasb.org>.

Privacy Rules Permit Borrower's Loan Number on Recorded Documents

In a Joint Agency Letter issued by the federal bank regulatory agencies, the National Credit Union Association and the Federal Trade Commission, lenders may place a borrower's loan number on mortgage loan documents before they are publicly recorded. The Joint Agency Letter was issued in response to whether the disclosure of account numbers fits within the exceptions to the opt-out requirements and whether permissible in light of the prohibition against disclosing account numbers to third parties for use in marketing. Under Section 502(e)(1) of the Gramm-Leach-Bliley Act (the "Act"), the disclosure of the borrower's account number on the mortgage loan document which will be publicly recorded fits within the exception to the opt-out rules for disclosures that are "necessary to effect, administer, or enforce a transaction requested or authorized by a consumer." In addition, the disclosure of the borrower's loan account number does not fall within the prohibition of Section 502(b) of the Act which generally prohibits a financial institution from disclosing account numbers for use in marketing since the disclosure in question is not "for use in marketing" between the parties.

Custody Services Handbook

The Office of the Comptroller of the Currency ("OCC") recently issued a handbook for examiners on custody services. The handbook is helpful to banks that provide custody services and will assist examiners in determining whether a bank has an adequate system to identify, monitor, and control the risks undertaken in custody services. The handbook applies the OCC's supervision by risk framework to custody services by outlining risk factors such as compliance and pricing to these services. The handbook is available on the web site of the OCC at www.occ.treas.gov.