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U P D A T E

News of Developments in the Financial Sector and Related Areas

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Consolidation in Banking

The banking industry continues to consolidate throughout the United States, but at a much slower pace than in past years. Consolidation 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. The Federal Deposit Insurance Corporation reports that the number of insured institutions has declined over 40% since 1992.

Recent published reports reveal that the average price on the 272 bank and thrift transactions announced in 2007 had a price/book multiple of 2.20 and a price/earnings ratio of 22.65. During 2006, there were 275 bank and thrift transactions announced at an average price/book multiple of 2.36 and a price/earnings ratio of 27.87. During 2005, there were 253 bank and thrift acquisitions announced at an average price/multiple of 2.28 and an average price/earnings ratio of 26.16.

There were only 12 transactions announced during January of this year, compared to 35 transactions in January 2007 and 20 transactions in January 2006. The mergers and acquisitions sector has substantially slowed in part due to loan portfolio problems facing banks and the uncertainty about the ability of banks to raise capital for bank acquisitions. Although there are still acquirers for banks, they are much more selective in the acquisitions that are being made.

Prior to 2007 there had not been a bank failure since the second quarter of 2004. During 2007 there were three bank failures, with the largest being NetBank located in Georgia with approximately $2.5 billion in assets and $2.3 billion in total deposits. During the first three months of this year, there have been two bank failures.

Probably the biggest issue facing banks during the coming year will be the ability to raise capital, not only for acquisitions but for credit quality issues relating to loan portfolios. Because of the higher interest rate spreads on trust preferred securities and noncumulative perpetual preferred securities with institutional purchasers, banks will need to look for alternatives for capital, one of which would be the private placement of its equity, debt or hybrid (trust preferred and noncumulative perpetual preferred) securities with local investors, existing shareholders and major customers.

Another area that is overlooked by banks in raising capital is the sale of trust preferred securities and subordinated debt in private negotiated transactions with other banks. 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 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 trust preferred securities do not have voting rights in the management or the ordinary course of business of the trust. In addition, the holders of trust preferred securities do not share in any appreciation in the value of trust and are protected from changes in the value of the principal of the instruments except for credit risks. In 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. This ruling by the OCC has provided a vehicle for banks to convert debt to equity in private negotiated transactions, while allowing a bank purchaser of the trust preferred securities to treat the purchase as a loan. With the commercial real estate sector not being the same source of loans as it was this time last year, the purchase of hybrid securities, such as trust preferred securities, is an excellent alternative for banks, particularly with the interest rate being above three-month LIBOR plus three percent.

Our firm is available to answer questions on the benefits of issuing securities in a private placement with local investors and with other banks.

Save Money on Franchise Taxes

Act 94 of 2003 ("Act 94") amended the *Arkansas Franchise Tax Act of 1979* to increase the annual franchise taxes effective for calendar years beginning January 1, 2004. Corporations, bank holding companies and banks (both state and national) organized under the laws of the State of Arkansas will want to consider amending their articles to provide for a par value of $.01 for each share of authorized stock. Bank holding companies and banks in Arkansas generally have a par value of $10.00 per share. Assuming that a corporation or bank had 500,000 shares of stock outstanding at a par value of $10.00 per share and all of its assets were in Arkansas, a corporation or bank would pay an annual franchise tax of $15,000.00 under Act 94. By amending the articles to provide for a par value of $.01 per share, the corporation or bank would only pay the new minimum annual franchise tax of $150.00, formerly $50.00 prior to Act 94. A corporation or bank would not want to amend its articles to provide for no par value since shares without par value are assessed at a rate of $25.00 per share, which if 500,000 shares were outstanding, would result in an annual franchise tax of $37,500.00 under Act 94. In Interpretive Letter No. 963, the Office of the Comptroller of the Currency concluded, in response to a request by our law firm, that a national bank had the authority to decrease the par value of its shares to $.01 per share in order to pay the minimum franchise tax.

Cases, Rulings and Releases

In Interpretive Letters Nos. 1093 and 1095, the Office of the Comptroller of the Currency confirmed the power of a national bank to sell debt cancellation contracts or debt suspension agreements to consumers through automobile dealers contingent upon the bank purchasing the retail installment sales contract that was originated by the dealer to finance a consumer's purchase of a motor vehicle. The automobile dealer would be acting as an agent for the bank in the sale of the debt cancellation contracts or debt suspension agreements.