

UPDATE

News of Developments in the Financial Sector and Related Areas

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FASB Study on Loan Participations

The Financial Accounting Standards Board ("FASB") is continuing its study as to whether a loan participation qualifies as a true sale. In other words if the sale of an interest in a loan did not qualify, the asset would continue to remain on the balance sheet of the seller of the loan participation. Generally, a loan participation involves the sale of a portion of a loan with the seller continuing to service the loan. The borrower may not be aware of the sale of the participation in the loan. Generally, the sale of a loan participation has been treated in the past as removing the portion of the loan sold from the balance sheet of the seller. As part of its study, the FASB has addressed the right of a borrower to setoff the outstanding balance of the loan against uninsured deposits in those cases where a bank goes bankrupt. In the past, loan participations have been effective in areas as follows:

- Lending limit relief for a seller.
- Increased liquidity for a seller.
- Reduced concentration risk for both a buyer and seller with a greater portfolio diversification.
- Increased fee income opportunities.

- Access to external credit expertise and new and diverse markets.
- Improved capital adequacy management for both a buyer and the seller.
- Better use of a buyer's excess funds.

In connection with its study, the FASB will be issuing a proposal for comment which will require banks to obtain an opinion of counsel that the sale of a loan participation constitutes a true sale and that the originator of a loan participation must act in a custodial capacity in handling the loan and its proceeds and not commingle the loan with other assets of the originator. The originator must also pass loan proceeds directly to a participant owner of the loan, except for servicing fees, and must administer the loan under a standard that does not give the originator unfettered discretion in all matters.

Treasury Stock

Arkansas has two Business Corporation Acts. Although they are somewhat similar, there are material differences between the two Acts. The new Arkansas Business Corporation Act (the "New Act") which became effective on January 1, 1988, did not amend or repeal any provision of law under the Arkansas Business Corporation Act which was in existence prior to 1988 (the "Old Act") and which continues to be in existence today. Companies organized under the Old Act can elect to be governed by the New Act. The New Act is derived primarily from the American Bar Association's 1984 Revised Model Business Corporation Act, but also includes a number of provisions of Delaware law relating to indemnification of officers and directors. Treasury stock is generally referred to as stock which has been issued by a company to stockholders and thereafter

acquired by the company from its stockholders. Under the Old Act, shares acquired by a company of its own stock is treated as treasury stock. Treasury shares are not permitted under the New Act, since shares acquired by a corporation of its own stock constitute authorized but unissued shares. In other words, under the New Act the acquired shares are treated as if they had never been issued. A company will acquire its own stock for a number of reasons including, but not limited to:

- To help its stockholders get a better price for their shares.
- To be reissued to employees as compensation.
- To help maintain a market for its shares.
- To avoid a hostile takeover.

Assuming the shares are not cancelled or retired under the Old Act, treasury shares acquired by a company are recorded at cost. When treasury stock is retired by a company, the stock reverts to authorized but unissued shares. Depending on the circumstances, a filing under the Arkansas Securities Act (the "Act") will generally be required to be made and obtained prior to the issuance of authorized but unissued stock to a purchaser. In the event a filing is not made, the company will be strictly liable under the Act to a purchaser of the stock for the principal investment plus 6% interest and any expenses incurred by the purchaser. Some companies mistakenly believe that if the proper filing has been made in connection with the original issuance of authorized but unissued shares that no subsequent filings under the Act are required relating to the sale of treasury stock. A company would need to make the proper filing for the sale of treasury stock in order to avoid the liability provisions of the Act. For purposes of the filing requirements of the Act, treasury stock is treated the same as authorized but unissued

stock which has never been issued to stockholders.

Cases, Releases and Rulings

The Certificate of Deposit Account Registry Service referred to as *CDARS* is a service offered by Promontory Interfinancial Network ("Promontory") which acts as a clearinghouse matching deposits of one participating banking institution with another banking institution so that funds of depositors remain eligible for FDIC insurance. Promontory recently announced that deposits through its network are insured up to \$10 million. A number of banks and thrifts throughout the nation participate in the network. Deposits placed by a bank or thrift with other participating institutions are matched with an equal amount of deposits from other institutions so that the funds essentially remain on the balance sheet of each participating member and at the same time being insured by the FDIC. Information on the service provided by Promontory is available on its website at www.promnetwork.com.

The Office of the Comptroller of the Currency ("OCC") has issued a new handbook entitled *Related Organizations* as a reference to an examination guide to assist both bankers and examiners in understanding the various types of related organizations, risks that may be associated with these organizations and the responsibilities of a bank's board of directors and management in complying with the restrictions on transactions by a bank with its affiliates. The handbook is available on the website of the OCC at www.occ.treas.gov.

Mr. Binns is available to meet with your organization or group relating to shareholder issues, increasing capital, regulatory and compliance, areas of profitability, marketing and management responsibilities. He is a frequent speaker on matters regarding mergers, acquisitions, commercial law, securities and banking law. Prior to entering the private practice of law, Mr. Binns was an accountant practicing with an emphasis on securities regulation and regulatory compliance.
