

# UPDATE

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## News of Developments in the Financial Sector and Related Areas

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#### *How Much is a Bank Worth?*

How much is a bank worth is a question shareholders of banks are asking. Available information reflects banking transactions for the first six months of this year with price/earnings multiples in the mid 20 range, while at the same time the medium price/book multiple was approximately 2.5. Published reports reveal that the averages for the top 123 transactions completed in the first half of this year had a price/earnings ratio of 28.67, with a price/book multiple of 2.17. In August, it was announced that WestAmerica Bancorp is paying five times book value for Redwood Empire Bancorp, a \$515 million bank holding company in California. The value of a bank depends upon a number of factors including, but not limited to, growth of both the local community and the institution, competition, market share and elimination of overhead costs.

#### *Save Money on Franchise Taxes*

Act 94 of 2004 ("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 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 under Arkansas law.

#### *Check 21 Act Becomes Effective October 28*

On October 28, 2004, the *Check Clearing for the 21<sup>st</sup> Century Act*, generally referred to as the "Check 21 Act," will become effective and all banks will be required to handle substitute checks. Regulation CC, promulgated by the Federal Reserve Board, sets forth the requirements of the Check 21 Act that applies to banks, provides model disclosure and notices relating to substitute checks and sets forth bank endorsement and identification

requirements for substitute checks. Although the Check 21 Act does not require banks to accept checks in electronic form and does not require banks to use the new authority granted by the law to create substitute checks, banks will have to be prepared to handle substitute checks at a minimum. Prior to the Check 21 Act becoming effective, clearing paper checks was basically an inexpensive process on a per-check basis. According to information released by the Federal Reserve Financial Services Policy Committee, Reserve Bank's check volume declined at about five percent for the year 2003 and for 2004, check volumes have declined at an accelerated pace compared to the same period last year. Because of the passage of the Check 21 Act, these volumes are expected to decline substantially in the coming years. Federal Reserve Banks are required to set prices to cover their total operating costs of providing payment services to depository institutions, as well as the imputed costs they would have incurred and the imputed profits they would have expected to earn had the services been provided by a private business firm. Recently, the Federal Reserve announced its intent to close nine check-clearing centers in 2006. This is in addition to thirteen centers announced in 2003. By early 2006, the number of Federal Reserve check-clearing centers will fall from 45 to 23. With the passage of the Check 21 Act, the clearing of paper checks will become more expensive as the volume of clearing of paper declines, resulting in more banks converting to electronic methods through agreements with third-party providers in order to control their costs. Although the changes in payments technology should make the banking industry more efficient, one thing is for sure, the cost of clearing paper checks will become higher over time.

### ***Regulation of National Banks by States***

In January of this year, the Office of the Comptroller of the Currency ("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 types of laws that are preempted by federal law under the National Bank Act. The second regulation is directed toward the exclusive authority of the OCC over national banks to examine, supervise and regulate the affairs of a national bank. Recently, the United States District Court for the Western District of Michigan held that Wachovia Mortgage Co., a subsidiary of a national bank, was not subject to licensing and supervision by the Michigan Office of Insurance and Financial Services and upholding the OCC's regulations interpreting the National Bank Act. The decisions in the United States District Court in Michigan are similar decisions reached by courts in Connecticut and California. However, there are similar cases currently pending, related to these same issues, in New Jersey and Maryland. The Arkansas Legislature enacted Act 1340 of 2003, known as the *Arkansas Home Loan Protection Act*, which is designed to prohibit predatory lending in the home mortgage market. Subsequent to the enactment of the Arkansas law, the OCC issued an order holding that the *Georgia Fair Lending Act*, which prohibits predatory lending, does not apply to a national bank or a national bank operating subsidiary that engages in real estate lending activities in Georgia. In Interpretive Letters No. 1000 and 1002, the OCC clarified its order relating to the application of the *Georgia Fair Lending Act*, stating that the Act was preempted on the financing of credit life insurance and that loans arranged by an unaffiliated mortgage broker, but made by national banks or their operating subsidiaries, are not governed by the Act. However, if the unaffiliated broker establishes the terms of the loan or provides funding for the loan, the broker is not covered by the preemption. In Interpretive Letter No. 998, the OCC stated that state anti-discrimination laws are not preempted.