

UPDATE

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. 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. Recent published reports reveal that the average price on transactions announced in the first six months of this year had a price/book multiple of 2.35 and a price/earnings ratio of 25.87. During 2005, there were 253 bank and thrift acquisitions announced at an average multiple of price/book of 2.28 and an average price/earnings ratio of 26.16. The number of insured financial institutions has continued to decline in the United States from 18,043 in 1985 to 8,832 at the end of 2005, representing a 51% decline. Conversely, California and Florida are the two states that represent the largest growth in new bank charters. During 2005, the deposits at the largest 150 banks grew 17% and their assets grew 14%. According to the FDIC, there are 5,462 one-state banks,

with assets of \$1.57 trillion, and 1,695 national charters located in one state with assets of \$960 billion. The number of insured depository institutions opting for Subchapter S status has risen since 1997 when there were 604 institutions having elected Subchapter S status, until March 31, 2006, when there were 2,366, representing a 75% increase.

Acquisition of Minority Shares in an Arkansas Bank

The Arkansas Banking Code allows for the acquisition of minority shares in Arkansas chartered banks. This acquisition of minority shares is accomplished through a state bank adopting a plan whereby an acquirer, such as an existing bank holding company that may already own a majority of the outstanding shares (or a newly formed bank holding company), enters into a plan of exchange with the bank whereby the remaining shares not owned by the holding company may be exchanged for cash, stock, other securities or a combination of cash, stock or other securities of the acquiring bank holding company. To effect the exchange with minority shareholders, a plan of exchange must be entered into between the state bank and the acquirer, setting forth the terms and conditions of the proposed exchange. Once the plan of exchange has been approved by a majority of the board of directors of the state bank and the acquiring entity, it is submitted to the shareholders of the state bank. Only a majority of the shareholders of the state bank are required to approve the plan of exchange. Although the provisions of the Arkansas Banking Code permitting the plan

of exchange are technical in nature, including requiring the approval by the Arkansas Bank Commissioner, these provisions may be an effective tool in eliminating costs associated with minority shareholders and for other purposes.

Cumulative Voting

Cumulative voting is generally referred to as that method of voting for directors of a company whereby each shareholder can multiply the number of shares he owns by the number of board positions to be filled. If the articles of incorporation of a company provide for cumulative voting, these rights can only be eliminated by a vote of the shareholders. Cumulative voting only applies to the election of directors and does not apply to other matters that may be brought to the shareholders for approval. An example of cumulative voting is where a shareholder owns 500 shares and there are three board members to be elected. The shareholder may vote 1,500 shares for one board position and not vote for the remaining two board positions or, alternatively, the shareholder may divide up his cumulative votes among the three candidates. Although cumulative voting improves a minority shareholder's ability to elect a director, the more common method for electing directors is to permit a shareholder to have one vote per share for each board position and not to accumulate votes.

Cases, Releases and Rulings

The Federal Deposit Insurance Corporation ("FDIC") has issued its *Quarterly Banking Profile* reflecting the financial results for the second quarter of this year. The report reflects that strength in both commercial and consumer loan demand for commercial banks and savings institutions remains high. Growth in retail deposits, which are cheaper and less sensitive to changes in interest rates than alternative sources of funding, did not keep up with the rapid pace of asset growth. For new assets, institutions turned

to larger-denomination time deposits and non-deposit borrowings for an increasing share of their funding. The number of institutions on the FDIC's "Problem List" increased from 48 to 50 during the quarter ending June 30, 2006. The report also indicates that over two years have elapsed since a FDIC-insured institution failed, with the last failure occurring on June 25, 2004.

The FDIC has set a date of October 10, 2006, as the deadline for the public to respond to twelve questions designed to help the agency decide if it should approve ownership by commercial firms, such as Wal-Mart Stores, Inc. and Home Depot, Inc., of industrial loan companies. The questions seek the input of the public as to whether the FDIC should use different criteria for considering applications for commercially owned industrial loan companies than those owned by registered bank holding companies. The *Federal Register* Notice containing the twelve questions is available on the website of the FDIC at www.fdic.gov.

A number of states have enacted legislation to ban industrial loan companies from opening bank branches on the site of a commercial affiliate. In Interpretative Letter No. 1068, the Office of the Comptroller of the Currency ("OCC") addressed the authority of both state banks and national banks under the Riegle Neal Interstate Banking and Branching Efficiency Act of 1994 ("Riegle Neal") to establish and operate interstate de novo branches under certain conditions. These conditions include the requirements that the host state have a law in effect that (i) applies equally to all banks and (ii) expressly permits all out-of-state banks to establish de novo branches in such states. Since the definition of a "State bank" includes an industrial bank, the OCC concluded that the establishment of de novo branches by an out-of-state bank would not be permitted in a host state that bars industrial loan companies from operating bank branches.