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U P D A T E

News of Developments in the Financial Sector and Related Areas

* *IN THIS ISSUE* *

New Bank Formations

The Federal Deposit Insurance Corporation ("FDIC") has been soliciting feedback on a number of topics, including ways in which the FDIC could or should support the continuing evolution of emerging technology and Fintech companies; aspects of the application process for deposit insurance that may discourage potential applications; possible changes to the application process for traditional community bank proposals; and other suggestions for improving the effectiveness, efficiency, or transparency of the application process.

The FDIC has established a voluntary process that gives organizers of new institutions the option of requesting feedback on a draft deposit insurance proposal before filing a formal application. The new process is intended to provide an early opportunity for both the FDIC and organizers to identify potential challenges with respect to the statutory criteria, areas that may require further detail or support, and potential issues or concerns.

The FDIC website reflections that during the first six months of 2018 two applications were approved, one application was returned and three applications were withdrawn. The processing days from the original receipt of an application for deposit insurance during this six month period averaged 181 days.

A number of articles have been written in recent years regarding the scarcity in the formation of new banks in the United States. A study by the Federal Reserve Bank of Richmond published in 2015 noted that the financial crisis that began in 2007 significantly altered the banking land scape. The study found that from 2007 through 2013 that the number of commercial banks in the United States fell by more than 800 representing a 14 percent decline. The drop was highly concentrated among small community banks with less than $50 million in assets representing a 41% decline.

The study noted that although many banks failed during the financial crisis beginning in 2007 that this decline was driven largely by the lack of new bank formations. The study found that the formation of new banks has fallen sharply since 2010. For instance, in 2012, there were no new banks formed in the United States, and in 2013 there was only one bank formation which was formed to serve the Amish community in Lancaster County, Pennsylvania. From 2011 through

2013, there were only four new banks formed in the United States compared to a yearly average of more than 100 from 2002 through 2008.

Some commentators take the position that the decline in the formation of new banks is due in large part to low bank profitability. An important factor in bank profitability is the net interest margin meaning the spread between deposit rates and lending rates. The Federal Reserve Board's policy of keeping the federal funds rate near zero since 2008 has pushed lending rates down resulting in the net interest margin being relatively low.

Other commentators are of the position that the following the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act compliance costs are a driving force for the lack of new bank formations. Other factors in the lack of new bank formations in the United States include, but are limited to, higher capital requirements, more frequent examinations by bank regulatory agencies and the lengthy application process to form a new bank.

The FDIC published an article in August 2016 entitled *De Novo Banks: Economic Trends and Supervisory Framework*. The article provides an overview of trends in de novo formation, the process by which the FDIC reviews applications for deposit insurance, the supervisory process for de novo institutions, and steps the FDIC is taking to support de novo formations. The information provided in the article reflects the FDIC's ongoing efforts to work with, and provide support to, groups interested in organizing a de novo institution. The article points out that of the more than 1,000 new banks formed between 2000 and 2008, there were 634 were still operating as of September 2015, but also noted that the failure rate of banks established between 2000 and 2008 was more than twice that of small established banks, this being consistent with previous research that found de novo banks to be susceptible to failure under adverse economic conditions. The article concluded by noting that the current economic environment with narrow net interest rate margins and modest overall economic growth remains challenging for the establishment of de novo institutions.

Our firm is experienced and available to answer questions regarding new bank formations and the consolidation of banks.

Preemptive Rights

Preemptive rights are generally referred to as the rights of existing shareholders to maintain their percentage of ownership of a company by having the right to buy a pro rata number of shares of any future issuances of common stock. Preemptive rights are often bargained for by investors, but usually are not contained in the articles of a company.

If preemptive rights are contained in the articles of incorporation, this provision can only be eliminated by a vote of the shareholders. If a company offers more of its stock, shareholders having preemptive rights are afforded the right to buy the shares to keep their percentage of ownership the same.

By having preemptive rights, shareholders can maintain their voting control and share of earnings. However, preemptive rights complicate financing. By forcing a company to offer its shares to existing shareholders before it offers the shares to outside investors, these rights can postpone or effectively eliminate the sale of shares by a company to outsiders.

Preemptive rights can also delay funding by an investor by requiring the company to first offer the shares to existing shareholders, creating a barrier to obtain financing by a company. Companies needing adequate financing and having to raise additional capital should consider eliminating preemptive rights if such rights exist in the articles of the company.

 Comments, ideas, opinions and questions - email gbinns@ddh-ar.com - telephone (501) 978-9923 - facsimile (501) 375-6484.