Garland W. Binns, Jr.
Dover Dixon Horne PLLC
Attorneys at Law
425 West Capitol, Suite 3700
Little Rock, Arkansas 72201
Telephone: (501) 375-9151
Facsimile: (501) 375-6484
Email: gbinns@ddh-ar.com
Web Site: www.GWBinns.com

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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 the past two decades and in particular since 2007. Consolidation occurs from a number of factors with banks experiencing loan and securities 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 ("FDIC") reports that the number of insured institutions has declined over 40% since 1992.

In some cases, depressed stock prices for publicly traded financial institutions is a factor in the decline in merger and acquisition activity because there is less buying power by an acquirer with the result that a healthy institution is unwilling to accept a lower price. Probably the most significant factor in the decline is the closure of banks by the FDIC resulting in acquirers for banks purchasing the assets of the closed bank at a modest premium of the deposits, and the FDIC entering into a loss-sharing agreement with the acquirer on potential loan and asset losses. Because of FDIC closure of banks and the utilization of loss-sharing agreements, acquirers have in some cases either excluded or escrowed problem assets in making an acquisition of a healthy bank thereby leaving the risk of collection of the problem assets with the shareholders of the acquired institution.

Although there are still acquirers for banks, they are much more selective in the acquisitions that are being made. The FDIC reports that the number of problem institutions is 844. Problem institutions are characterized as those institutions having a risk of failing and being closed by the FDIC.

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 2008 there were twenty-six bank failures with the largest being Washington Mutual Bank located in Washington with approximately $307 billion in assets and $188 billion in deposits. During 2009 there were one-hundred forty bank failures with the largest being Colonial Bank located in Alabama with approximately $25 billion in assets and $20 billion in deposits. During 2010, there were one-hundred fifty-seven bank failures with the largest being AmTrust Bank located in Cleveland, Ohio with approximately $12 billion in assets and $8 billion in deposits. For the first eleven months of 2011, there were ninety bank failures with the largest being Superior Bank located in Birmingham, Alabama with approximately $3 billion in assets and $2.7 billion in deposits.

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 and securities portfolios. 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.

Due Diligence

In the financial sector, due diligence is a term that has been used and defined in many ways, but the best meaning of it is the level of judgment, care, prudence, determination, and activity that a person would reasonably be expected to do under particular circumstances. Due diligence involves exercising the degree of care in investigating a matter by verifying facts in order to eliminate unknown risks.

The origin of the term due diligence came about following the passage of the Federal Securities Act of 1933 which afforded a defense to persons selling securities when accursed of inadequate disclosure of material information to investors. As a result, persons selling securities to the general public, such as broker/dealers, instituted a standard practice of conducting due diligence investigations into the company having a stock offering in order to protect themselves from nondisclosure of material information. Although the term was originally limited to public offerings of stock, it has now become associated with all types of investigations.

The purpose of exercising due diligence is to cut down the risk to a manageably small level. A considerable measure of judgment is involved, not only in deciding what to do, but in determining the level of investigation into a particular matter.

Due diligence investigations frequently arise in a number of different contexts. These include (i) acquiring a company, (ii) loaning monies to a company, and (iii) marketing a new product. For instance, in the acquisition of a company, a careful analysis of the target company would involve an analysis of financial statements, environmental reports on real estate, existing contracts, pending litigation and regulatory proceedings and a review of contingent liabilities not reflected on the financial statements.

In loaning money to a company, due diligence would involve reviewing the business plan of the company, analysis of financial statements, possible environmental issues if real estate is involved, and making sure that the lender is the first lienholder on any collateral for the loan. Due diligence in marketing a new product may involve such things as whether the product would infringe upon the rights of other similar products and whether a patent or trade mark is available for the new product.

In connection with the issuance of stock by a company, due diligence is a requirement on the part of the company as the issuer to insure that the offering does not misstate or omit material information to a prospective purchaser of its securities. To some degree, due diligence is involved in the day-to-day activities of everyone as they relate to a purchase of a car or home such as obtaining an appraisal, inspections and making sure that everything works.

In more complicated transactions, the due diligence will take place between the time of the signing of an agreement outlining the terms of the transaction, sometimes referred to as a letter of intent, and the execution of a definitive agreement which sets forth, among other things, the representations and warranties of the parties to the transaction. Due diligence reduces the risks by ensuring the creditability and accuracy of information.

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