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JANUARY 2015

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 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. In some cases, the regulatory compliance cost for small community banks has caused them to seek merger partners.

The Federal Deposit Insurance Corporation ("FDIC") reports that the number of insured institutions has declined over 43% since 1992. As of September 30, 2014, there were 6,589 of FDIC insured institutions.

Probably the most factor in the decline in merger and acquisition activity during the financial crisis was from the closure of banks by the FDIC resulting in acquirers for banks purchasing the assets of the closed bank at a modest premium on the deposits, and the FDIC entering into a loss-sharing agreement with the acquirer in connection with potential loan and asset losses. Because of the 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. This is sometimes referred to as the *good bank bad bank* with the shareholders of the selling bank retaining certain of the nonperforming assets.

The number of bank transactions has continued to decline since 2006 when the average reflected a price/book multiple of 2.36 and a price/earnings ratio of 27.87 for the 296 whole bank transactions that were announced that year. In 2007 the average reflected a price/book multiple of 2.20 and a price/earnings ratio of 22.65 for the 283 whole bank transactions that were announced that year.

The year 2013 reflected a higher number of whole bank transactions of 224 compared to 216 transactions that were announced during 2012. The average price to tangible book was 1.27% during 2013 for transactions with disclosed terms compared to 1.22% during 2012. During the first nine months of 2014, the average price to tangible book was 1.38%. The average premium on deposits in connection with the sale of branch locations increased from 2.66% during 2013 to 4.98% for the first nine months of 2014.

Recent surveys indicate that the minimum asset level a community bank must achieve to remain independent is at least $1 billion or more. Because of regulatory reform and compliance costs, many community banks may be active in seeking a merger partner. Surveys reflect regulatory compliance continues to be an impediment for growth within community banks.

Prior to 2007 there had not been a bank failure since the second quarter of 2004. The number of bank failures peaked in 2009 when there were 140 failures. During 2013, there were 24 bank failures with the largest being First National Bank located in Edinburg, Texas with approximately $3.1 billion in assets and $2.3 billion in deposits. It is noteworthy that of these 24 failures, only 9 had assets of more than $135 million.

During first eleven months of 2014, there were 17 bank failures with the largest being The National Republic Bank of Chicago located in Chicago, Illinois with approximately $954 million in assets and $915 million in deposits. It is noteworthy that of these 17 bank failures, only 5 had assets of more than $150 million.

The number of institutions on the FDIC's problem list declined for a fourteenth consecutive quarter from 354 to 329 during the third quarter of 2014. During the recent financial crisis, the number of problem banks reached a high of 888 at the end of the first quarter of 2011. Problem banks are characterized as those institutions having a risk of failing and being closed by the FDIC.

As in the past, probably one of the biggest issues 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. Our firm is experienced and available to answer questions regarding the raising and placement of capital and matters relating to merger and acquisition transactions.

Save Money on Franchise Taxes

Act 94 of 2003 ("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. Some bank holding companies and banks in Arkansas 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 Interpretive 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.

Arkansas has two Business Corporation Acts. Although they are somewhat similar, there are material differences. A corporation should be careful in selecting the Act under which it is incorporated.

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