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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 Federal Deposit Insurance Corporation ("FDIC") reports that the number of insured institutions has declined over 64% since 1992. As of January 8, 2021, there were 5,018 of FDIC insured institutions which reflects a decline of 141 (3%) insured institutions since the beginning of 2020.

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.

During the financial crisis, there were only 146 whole bank transactions in 2008 and only 110 whole bank transactions in 2009. The average price to tangible book was 1.1 to 1.6 during the financial crisis. Probably the most significant 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.

The year 2020 reflected a much lower number of whole bank transactions of 112 compared to 240 transactions that were announced during 2019. The average price to tangible book was 1.33% with an average price/earnings LTM ratio of 17.2 during 2020 for whole bank transactions with disclosed terms.

The medium seller in bank transactions during 2020 had approximately $125 million in assets compared to $207 million in assets in bank transactions for 2019. The average price to tangible book was 1.6% with an average price/earnings of 16.4 during 2019 for whole bank transactions with disclosed terms.

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 2010 when there were 157 failures. During 2015, there were 8 bank failures with the largest being Doral Bank En Espanol located in San Juan, Puerto Rico, with assets of approximately $5.9 billion and deposits of approximately $4.1 billion. Of the other seven banks that failed, each had assets of less than $294.2 million.

During 2016, there were 5 bank failures with the largest being First Cornerstone Bank located in King of Prussia, Pennsylvania, with assets of approximately $103.3 million and deposits of approximately $101.0 million. It is noteworthy that the other four banks that failed had assets of less than $67.1 million.

Only 8 banks failed during 2017 with the largest being First NBC Bank located in New Orleans, Louisiana, with assets of approximately $4.74 billion and deposits of approximately $3.54 billion. Of the other 7 bank that failed, five of them had assets of less than $166.3 million. There were no bank failures during 2018. During 2019, there were 4 bank failures, and during 2020, there were 4 bank failures.

The number of institutions on the FDIC's problem list has remained low since the third quarter of 2019 when there were 55. 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. 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 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. In making amendments a corporation needs to be careful in selecting the correct Act.