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AUGUST 2002

UPDATE

News of Developments in the Financial Sector and Related Areas

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Broker-Dealer Registration by Banks

As reported in the August 2001 issue of Update, the Securities and Exchange Commission ("SEC") adopted interim final rules addressing the bank exceptions to registration as a broker-dealer which were effective as of May 12, 2001, and replaced the long-standing exception by banks from the broker-dealer registration provisions under the Securities Exchange Act of 1934. The interim rules gave banks until October 1, 2001, to register as a broker-dealer and gave banks until January 1, 2002, before their compensation arrangements must meet the conditions of certain statutory exceptions. Under the interim final rules, banks with non-exempt securities activities would have to register as broker-dealers or move the activities into a broker-dealer affiliate. Many banks would prefer to avoid registration because it subjects them to more regulation by another regulatory agency. Federal bank regulators argue that the rules go beyond the SEC's power and are based on a misunderstanding of banking industry practices. Criticism of the rules by federal bank regulators, include excluding some traditional trustee relationships from the definition of "trustee"; the rules' exemption for investment advice given for a fee is narrower than intended by the Gramm-Leach-Bliley Act (the "Act"); and the Act allows a bank employee to receive a nominal one-time fee of a fixed amount for referring customers to an associated broker-dealer, but the SEC rules limit this by restricting the fee to no more than one hour's compensation and prohibiting the payment of bonuses. Under pressure from the bank regulatory agencies, the time periods were extended until May 12, 2002. Based on discussions with industry participants, the SEC has recognized that some of the rules in their current form will need to be amended. As such, the SEC in its Release No. 45897 has extended the exemption for the definition of "broker" until May 12, 2003, and the definition of "dealer" until November 12, 2002, in order to prevent banks from unnecessarily incurring costs to comply with the statutory scheme based on the current rules rather than the rules when amended and to give the SEC time to consider comments received on the rules.

Hedge Funds

A *hedge fund* is defined as a fund which is managed aggressively to get maximum rates of returns by using derivatives and swaps, selling short, and using arbitrage techniques. In comparing the fees of managers of hedge funds to mutual funds, managers of hedge funds will normally receive higher fees including performance fees. Because hedge funds involve a variety of risks, investors in hedge funds are traditionally high net worth individuals and institutional investors such as insurance companies, financial institutions and pension funds. A hedge fund will generally be organized as a limited partnership or a limited liability corporation. Depending on the sophistication and type of an investor in a hedge fund, a filing may be required under the applicable provisions of the Arkansas Securities Act of 1959, as amended ("the Act"). In the event a filing was not made, the fund would be strictly liable under the Act to an investor

for the amount of his principal investment plus 6% interest and any expenses incurred by the investor. A controlling person of the hedge fund such as a manager may also be liable under the Act.

Insurance Activities of National Banks

The Office of the Comptroller of the Currency ("OCC") has issued a Comptroller's Handbook entitled *Insurance Activities* which provides information to national banks and OCC examiners on the risks, controls and supervision of national bank insurance activities. The booklet describes the various insurance activities permissible for national banks and their subsidiaries and the organizational structures within which these activities may be conducted. The booklet outlines the OCC's regulatory and supervised responsibilities under the Gramm-Leach-Bliley Act and clearly defines how these responsibilities differ from those of other regulators under functional regulation. The booklet also contains extensive legal guidance. It addresses the role of state insurance regulators, who enforce state laws on insurance, including the licensing of agents or agencies, the financial stability of insurance companies, marketing and trade practices, the content of insurance policies and the setting of premium rates. The booklet focuses on the effectiveness of the bank's oversight systems for monitoring and controlling the risks from insurance activities. The booklet cautions national banks regarding inappropriate insurance sales practices. The booklet is available on the web site of the OCC at *www.occ.treas.gov.*

Cases, Releases and Rulings

The National Association of Securities Dealers, Inc. ("NASD") has issued a new publication entitled *Smart Savings for College – Better Buy Degrees* which provides information and guidance about college savings plans including college costs, amount needed to be saved and different tax options to save for college. The publication is available on the web site of the NASD at *www.nasd.com.*

In Interpretive Letters 932, 933 and 934, the Office of the Comptroller of the Currency concluded that national banks are authorized to charge non-account holders a fee for cashing a check drawn on the bank under the incidental powers granted under 12 U.S.C. §24 (Seventh) and 12 C.F.R. §7.4002 which gives national banks the authority to impose charges and fees.

The Securities and Exchange Commission ("SEC") has issued proposed rules to improve accountability of auditors of public companies that would establish a Public Accountability Board comprised of nine members, six of which would be independent public members, with authority to establish audit standards and disciplinary powers for violation of professional standards. The SEC release 2002-91 regarding the proposed rules is available on the web site of the SEC at *www.sec.gov.*

In *SEC v. Zandford,* No. 01-147, the United States Supreme Court held that a stockbroker who bought and sold securities for a client but converted the proceeds to his personal use was a violation of both Section 10(b) of the Securities Exchange Act of 1934 (the "Act") and Rule 10b-5 thereunder concluding that the taking of funds by the stockbroker from the client's account coincided with the sales of securities in the account, and there is no requirement that there be a misrepresentation about the value of a particular security in order to run afoul of the Act.

Anderson v. H&R Block, Inc., Case No. 01-11863, the United States Court for the Middle District of Tennessee held that usury claims in connection with tax refund anticipation loans brought against a national bank in state court could not be removed to federal court since state courts were presumed to follow federal law.

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