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JUNE 2004

U P D A T E

News of Developments in the Financial Sector and Related Areas

* *IN THIS ISSUE* *

Phantom Stock Plans

Phantom stock plans, which are also known as shadow or unit stock plans, is a type of stock based incentive compensation to permit key employees the ability to share in a company's success without giving the employee any actual equity in the business. Generally, phantom stock plans provide that dividends and changes in a company's capital structure are taken into account in valuing the participant's interest under the plan. If a dividend is paid on the company's outstanding stock, an equal prorated amount is credited to each unit held by a participant. In addition, if a company changes its capital through a stock split or stock dividend, the number of units held by a participant are adjusted accordingly in proportion to the change. Phantom stock option plans are generally administered by a committee, selected from non-employee members of the board of directors of the company who will not be participants, that award compensation units to key employees of the company. The award of units by the administrative committee does not convey any actual ownership in the company. A phantom share unit is a credit in a participant's account for an amount equal to the value of the company's actual shares. Once the units are awarded to the participant's account, it is credited with changes in share value, along with dividends and other distributions by the company to its stockholders of actual shares. There is generally no taxable income for the participants in phantom stock plans until units are redeemed in the participant's account. At the same time, there is no tax deduction for the company until it becomes obligated to pay the employee for units held in his account. Payments to participants are taxed at ordinary income tax rates. Since participants in phantom stock plans do not hold "real" shares or have any actual equity in the company, participants are not eligible to vote at stockholder meetings of the company. Phantom stock plans are ideal and provide flexibility for privately owned businesses, since units awarded to participants do not dilute the ownership interest of stockholders of the company. Phantom stock plans are also attractive to Subchapter S corporations. Under the provisions of the Internal Revenue Code, a Subchapter S corporation can have no more than 75 stockholders and may only have one class of stock. Phantom stock units are not treated as a separate class of stock and do not count toward the maximum number of stockholders. Phantom stock plans are an effective tool in providing incentives to attract and retain key employees, while at the same time maintaining the equity interest of the existing shareholders of a company.

Predatory Lending

Indiana has recently enacted the *Indiana Homeowner Protection Act* to protect consumers from predatory lending practices. Although approximately 31 states have predatory lending laws, Indiana is the first state to specifically exempt banks and credit unions from its application. The Office of the Comptroller of the Currency ("OCC") recently issued two final regulations relating to the preemption of state laws by federal law over national banks, taking the position that it has exclusive authority to examine, supervise and regulate the affairs of a national bank. Recently a number of trade groups, including the American Bankers Association and the Mortgage Bankers Association, requested Congress to preempt state lending loans with federal legislation that would apply to all lenders. The Arkansas legislature enacted Act 1340 of 2003, known as the *Arkansas Home Loan Protection Act*, which is designed to prohibit predatory lending in the home mortgage market. Since the enactment of the Arkansas law, the OCC has issued an order holding that the *Georgia Fair Lending Act* , which prohibits predatory lending, does not apply to any national bank or national bank operating subsidiary that engages in real estate lending activities in Georgia. It is unknown at this time what position the OCC will take in regard to the predatory lending law in Arkansas or what action Congress may take to preempt state lending laws.

2004 Retirement Confidence Survey

The 2004 Retirement Confidence Survey ("Survey") reflects that the percentage of Americans who say they are saving for retirement remains stagnant. The portion of workers who say they are currently saving for retirement has remained unchanged since 2001. The Survey gauges the views and attitudes of working-age and retired Americans regarding retirement, their preparations for retirement and their confidence with regard to various aspects of retirement. The Survey provides several reasons why some Americans are not saving for retirement and offers insight into what kind of educational approaches are most effective in prompting individuals to change their financial behavior. Unrealistic expectations and not knowing how much they need to retire comfortably add to American workers' optimistic sense of confidence that they will be adequately prepared for retirement. Almost half of workers (47 percent) who have not saved for retirement are at least somewhat confident about having enough money in retirement, with expectations that their retirement money will inevitably come from somewhere. The Survey shows that 58 percent of workers say they are currently saving for retirement but the amount they have saved is low, and 45 percent of all workers report total household assets, excluding the value of their home, of less than $25,000. The Survey is available on the web site of the Americans Savings Educational Council at *www.asec.org.*

Cases, Releases and Rulings

The federal bank regulatory agencies have recently issued an interagency advisory entitled *Interagency Guidance on Accounting for Deferred Compensation Agreements and Bank-Owned Life Insurance* which reflects that many institutions have incorrectly accounted for their obligations under a type of deferred compensation agreement commonly referred to as a revenue neutral plan or an indexed retirement plan, the typical characteristics of which are described in the interagency advisory. The benefits payable under these plans generally are based on the performance of bank-owned life insurance policies covering bank employees, sometimes referred to as "BOLI". The advisory notes that when accounting for bank-owned life insurance, only the cash surrender value of the policy payable to the institution by the insurance carrier, less any applicable surrender charges, may be reported by the institution as an asset.

The controversial proposal by the Financial Accounting Standards Board entitled *Share-Based Payment, an amendment of FASB Statements No. 123 and 95* which requires employee stock options to be treated as an expense (generally measured at fair value at the grant date) is available on its website at *www.fasb.org.*