

UPDATE

News of Developments in the Financial Sector and Related Areas

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Real Estate Activities of Financial Holding Companies

In connection with the proposed rule permitting real estate brokerage and management activities for financial holding companies, their subsidiaries and subsidiaries of national banks, the Federal Reserve Board and the Treasury Department has continued to delay action on the proposed rule. The proposed rule would have permitted financial holding companies and financial subsidiaries to provide real estate brokerage and servicing including, among other things, acting as agent for a buyer, seller, lessor or lessee of real estate; listing and advertising real estate; providing advice in connection with real estate transactions; and providing real estate management services, including procuring tenants, negotiating leases, and generally overseeing the inspection, maintenance and upkeep of real estate. The National Association of Realtors opposes the proposed rule and takes the position that real estate brokerage is a commercial and not a financial activity, and the proposed rule would allow financial holding companies and financial

subsidiaries to buy up large brokerage firms and force the closure of smaller brokers who are unable to compete with the financial resources of banking entities. Proposed legislation has been introduced in both the United States Senate and the House of Representatives which would bar banks from such activities and which would prevent federal regulators from finalizing a rule allowing banking companies into the real estate business. The Financial Services Roundtable has opposed the legislation backed by the National Association of Realtors arguing, among other things, that allowing financial institutions to offer real estate brokerage would create competition in the industry and benefit consumers. The banking regulatory agencies have received approximately 50,000 comment letters most of which are in opposition to the proposed rule. However, according to the American Bankers Association, more than half of the states permit activities including allowing banks to engage in real estate brokerage, allowing bank trust departments to engage in brokerage and management activities on behalf of trust estates, and permitting bank holding companies and their subsidiaries to engage in a number of real estate related activities including acting as finders and bringing together buyers and sellers and helping third parties to obtain commercial real estate equity financing.

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. However, unlike mutual funds, hedge funds and their fund managers are generally not registered under federal securities laws. The National Association of Securities Dealers, Inc. ("NASD") has advised in a Notice to Members 03-07 that it is concerned about the sales practices of some of its members who sell direct interests in hedge funds and indirect interests through funds of hedge funds because of the popularity of the funds. As a result of a recent review of members that sell hedge funds, the NASD staff indicated that members may not be fulfilling their sales practice obligations when selling these instruments, especially to retail customers. A member firm that recommends hedge funds must have a belief that the product is suitable for any investor by examining the customer's financial status, the customer's tax status, the customer's investment objectives and such other information used or considered to be reasonable in making recommendations to a customer. In its Notice to Members, the NASD indicated that retail customers may not understand the risks associated with investing in hedge funds.

State Banks Chartered as LLCs

The Federal Deposit Insurance Corporation ("FDIC") has adopted a final rule regarding the eligibility of state banks chartered as limited liability companies for purposes of granting deposit insurance coverage. One of the statutory requirements for a state chartered bank to be eligible for federal deposit insurances is that it be "incorporated

under the laws of any State." The FDIC had received two inquiries regarding whether a state bank that is chartered as a limited liability company would be "incorporated" for purposes of obtaining deposit insurance. The final rule provides that a bank that is chartered as a limited liability company under State law would be considered to be "incorporated" under State law if the four traditional corporate characteristics are met which are (i) perpetual succession (ii) centralized management (iii) limited liability and (iv) free transferability of interests. The FDIC noted that unlike other limited liability companies and Subchapter S corporations, a state bank chartered as a limited liability company would not qualify under existing Internal Revenue Service regulations for partnership tax treatment. Information on the original proposal by the FDIC is on the Update web site at www.GWBinns.com by clicking on Update Archives in the September 2002 issue under the heading entitled State Banks Chartered as LLCs.

Cases, Releases and Rulings

Rhodes v. Veith, 2003 Ark. App. Lexis 71, is a recent case by the Court of Appeals of Arkansas which holds that a shareholder of a corporation may not assert the doctrine of piercing the corporate veil and hold directors and other shareholders personally liable because this doctrine is only available to third parties who deal with the corporation.

The Federal Banking Regulatory Agencies have issued an updated policy statement regarding accountants who provide banking institutions with both external and internal audit services. Although the revised policy applies to depository institutions with \$500 million or more in assets, it encourages non-public depository institutions with less than \$500 million in assets to refrain from outsourcing internal audit activities to their external auditor. The revised policy means that non-public depository institutions may have to find a second accounting firm to

perform outsourcing functions such as bookkeeping, consulting on information technology systems, valuation and actuarial services.