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U P D A T E

News of Developments in the Financial Sector and Related Areas

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Annuities

In connection with the broad movements in the stock market, investors are looking at alternative investments such as annuities. An annuity is a contract with an insurance company whereby the insurance company pays a periodic payment to a policyholder for a specific period of time. If the payments under the contract are to begin immediately, the contract is referred to as an immediate annuity. If the payments are to be paid at a date in the future, the contract is referred to as a deferred annuity. There are basically two types of annuities. A fixed annuity is a contract offered by an insurance company that guarantees both the payout and the rate of return. The guarantee of both interest and principal makes fixed annuities somewhat similar to certificates of deposit purchased from a bank. However, unlike a certificate of deposit, an annuity is not insured by the Federal Deposit Insurance Corporation in that its strength is directly related to the financial stability of the company issuing the fixed annuity. A good resource concerning fixed annuities entitled *Buyer's Guide to Fixed Deferred Annuities* may be ordered from the National Association of Insurance Commissioners on its web site at *www.naic.org/1pubcat/consumer/htm.* A variable annuity is a contract offered by an insurance company with the rate of return to the policyholder dependent upon the performance of the securities or funds that a policyholder may choose as investment options. Because variable annuities are usually tied to investment products, they are securities. Variable annuities are generally designed by insurance companies as a vehicle for retirement savings. Unlike a conventional individual retirement account, the money placed into an annuity is not deductible from taxes and there is no limitation on the amount of money that can be placed into annuity. Although payments may go up and down, variable annuities are designed to provide income that will rise over time in order to keep pace with inflation. An excellent resource concerning variable annuities entitled *Variable Annuities: What You Should Know* is available on the web site of the Securities and Exchange Commission at *www.sec.gov/investor/pubs/varannty.htm.*

State Banks Chartered as LLCs

The Federal Deposit Insurance Corporation ("FDIC") is seeking comments on whether it should permit a state bank that is organized as a limited liability company ("LLC") to obtain federal deposit insurance. The proposal by the FDIC may help banks in decreasing their taxes. An LLC does not pay corporate taxes because the owners are taxed on the income of the bank. An LLC would also have fewer restrictions than a corporation which has elected to be taxed as a Subchapter S corporation. At the present time, the Internal Revenue Service does not permit banks to become limited liability companies. By being an LLC, the number of owners would not be limited. The maximum number of owners in a Subchapter S corporation is 75, and only individuals, estates, certain trusts and certain tax-exempt organizations may be shareholders. There is only one class of stock permitted in a Subchapter S corporation, and no nonresident aliens may be shareholders. One of the statutory requirements for a state chartered bank to be eligible for federal deposit insurance is that it be "incorporated under the laws of any State." The FDIC has recently received inquiries regarding whether a state bank that is chartered as a LLC could be considered to be "incorporated" for purposes of that requirement. The FDIC proposes to issue a regulation that would clarify that a bank that is chartered as an LLC under state law would be considered to be "incorporated" under state law if it meets certain criteria. Since banks are subject to periods of economic stress just as other businesses are, the FDIC believes that the owners of banks should have limited liability to encourage the maintenance of adequate capital. The FDIC believes that the free transferability of ownership interests also tends to aid in attracting and maintaining capital. Requiring the prior consent of remaining owners in order to transfer an ownership interest impairs an institution's ability to attract additional investors. The FDIC proposes each ownership interest in an LLC to be transferable without the consent of any other owner of the LLC. The proposal by the FDIC is available on its web site at *www.fdic.gov* under "Federal Register Citations."

Seminar Information

Mr. Binns will speak on the topic *Overview of State and Federal Securities Laws; Defining What is a Security* sponsored by the Securities Section of the Arkansas Bar Association and the Arkansas Securities Department on September 20, 2002, at the William H. Bowen School of Law, Little Rock, Arkansas. The presentation will address the applicability of federal and state securities laws and will illustrate practical examples of how anything may be treated as a security (such as the sale of land depending on the marketing techniques) and the prevention of potential problems for failure to comply with state and federal securities laws.

Charles Schwab Stock Rating System

Charles Schwab has developed a rating system for over 3,000 stocks. The A through F equity rating developed by Charles Schwab is based on return outlook over the next year. Charles Schwab rating is as follows:

- A - Strongly Outperform
- B - Outperform
- C - Marketperform
- D - Underperform
- F - Strongly Underperform

The stock rating system is available at *www.schwab.com.*

Consolidation of Special-Purpose Entities

The Financial Accounting Standards Board (FASB) has issued a draft interpretation that establishes accounting guidance for consolidation of special-purpose entities ("SPE") entitled *Consolidation of Certain Special-Purpose Entities*. Current accounting standards require an enterprise to include subsidiaries in which it has a controlling financial interest in its consolidated financial statements. The FASB is concerned that companies are retaining effective ownership of assets and liabilities even though the assets and liabilities are nominally transferred to a SPE. As a result, a balance sheet of a company may not accurately reflect its risk position. Under the draft interpretation, an enterprise's treatment of a SPE would depend on whether the enterprise is the entity's primary beneficiary. The FASB believes that if a business enterprise has a controlling financial interest in an SPE, the assets, liabilities and results of the activities of the SPE should be included in the consolidated financial statements with those of the business enterprise. The draft interpretation is available on the web site of the FASB at *www.fasb.org*.