Chapman and Cutler LLP

Chapman Client Alert

October 4, 2019 Current Issues Relevant to Our Clients

SEC Proposes New Rules to Update Statistical Disclosures for Banking Registrants

On September 17, 2019, the U.S. Securities and Exchange Commission (the "*SEC*") announced proposed rules to update the statistical disclosures that bank and savings and loan registrants provide to investors and eliminate disclosures that overlap with other SEC rules, U.S. GAAP or IFRS. The proposed rules would codify certain disclosures from Industry Guide 3, *Statistical Disclosure by Bank Holding Companies* ("*Guide 3*"), as a new subpart of Regulation S-K under the Securities Act of 1933, as amended ("*Regulation S-K*"), and rescind Guide 3. The proposed rules will streamline the statistical disclosures required by banking registrants and conform such registrant's SEC disclosures more closely with existing requirements under the Generally Accepted Accounting Principles ("*U.S. GAAP*") or the International Financial Reporting Standards ("*IFRS*"), and should be viewed as beneficial by the banking community. The proposed rules impact required disclosures regarding:

- distribution of assets, liabilities and stockholders' equity, the related interest income and expenses, and interest rates and interest differential;
- investment portfolios;
- analysis of loan portfolios;
- allowances for credit losses and credit ratios; and
- information about bank deposits, including amounts that are uninsured.

Guide 3 was initially published in 1976 and applies to bank holding companies ("*BHCs*") and other registrants with material lending and deposit activities, such as savings and loan holding companies. Since the most recent substantive revision of Guide 3 in 1986, the Commission has adopted disclosure requirements and the relevant accounting standard boards (both the Financial Accounting Standard Board ("*FASB*") and the International Accounting Standards Board ("*IASB*")) have changed the financial reporting obligations for registrants engaged in financial services. The result has been an overlap of Guide 3 required disclosures with subsequent SEC rules, U.S. GAAP and/or the requirements of IFRS.

The proposed rules would create a new Subpart 1400 under Regulation S-K to codify certain Guide 3 disclosures. The proposed rules aim to provide clarity as to which registrants must make the required disclosures, providing that the rules are applicable to banks, BHCs, savings and loan associations, and savings and loan holding companies (collectively, "*Bank and Savings and Loan Registrants*"). Both domestic and foreign registrants would be subjected to the proposed rules, which should enhance comparability amongst Bank and Savings and Loan Registrants while not being overly burdensome. The SEC believes that the flexibility of the proposed rules allow for registrants to comply with the requirements of either U.S. GAAP or IFRS by explicitly linking certain SEC disclosure requirements to U.S. GAAP or IFRS standards.

The full text of the proposal is available here. The following is a summary of the principal elements of the proposed rules.

- **Distribution of Assets, Liabilities and Stockholders' Equity; Interest Rate and Interest Differential**. The SEC notes that investors (and other users of Bank and Savings and Loan Registrant disclosures) would benefit from understanding the individual components of a registrant's net interest earnings to better evaluate the impact of potential future changes in interest rates, or other economic conditions which could have a significant impact on a registrant's performance. As such, Proposed Item 1402 of

Regulation S-K would, among other things, codify all of the current disclosures required by Item I of Guide 3, and would further disaggregate categories of interest-related assets and liabilities. For example, the proposed rules would create new categories of interest-earning assets to represent the separation of federal funds sold and securities purchased with agreements to resell. Additionally, the proposed rules would codify the instructions related to foreign activities under General Instruction 7 and Instruction 5 of Item I of Guide 3, which the SEC believes provides insight into the drivers of changes in business focus as well as factors driving material changes in interest-related assets and liabilities.

- **Investment Portfolio.** Under Item II of Guide 3, investors are provided with information about a registrant's investments (types of investments, earnings potential of such investments and the risk characteristics, a maturity analysis, among other items). The FASB and IASB have issued accounting standards that require disclosures similar to many of Guide 3's investment portfolio disclosures. After receiving comments on which disclosures are material for investors, the SEC's proposed rules would not codify and thereby eliminate the following SEC-required disclosures currently contained in Item II of Guide 3: (a) book value information; (b) the maturity analysis of book value information; and (c) the disclosures related to investments exceeding 10% of stockholders' equity. The proposed rules would codify the weighted average yield disclosure for each range of maturities by category of debt securities currently called for under Item II.B of Guide 3. However, the proposed rules would change the categories presented to conform to those required to be disclosed in the registrant's U.S. GAAP or IFRS financial statements.

- **Loan Portfolio.** The SEC observed that loan portfolio compositions differ significantly among registrants, and that different loan types have different characteristics. Currently Item III of Guide 3 aims to provide investors with information about a registrant's loan investment policies and lending practices. The proposed rules would not carry forward the loan category disclosure currently included in Item III.A of Guide 3, the loan portfolio risk elements required under Item III.C or the interest bearing assets disclosure required under Item III.D, as these items are substantively similar to those required disclosures currently required under separate SEC rules, U.S. GAAP or IFRS. Rather, Proposed Item 1404 of Regulation S-K would codify the maturity by loan category disclosure currently required under Item III.B of Guide 3, with some small revisions. The SEC asserts that the proposed rules would elicit the information material to an investment decision, while not overlapping with other existing disclosure requirements or principles.

- **Allowance for Credit Losses.** Item IV of Guide 3 currently requires a five-year analysis of loan loss experience, the disclosure of the reaction of net-charge-offs to average loans outstanding, factors that influenced management's judgment in determining the amount of additions to the allowance charged to operating expenses and a breakdown of the allowance for loan losses by category, among other requirements. Since the 1986 amendments to Guide 3, new disclosure requirements regarding credit losses have been added by U.S. GAAP and IFRS (though there are some differences in standards between the two). The proposed rules would require the ratio of net charge-offs during the period to average loans outstanding, since this disclosure does not overlap with any existing SEC, U.S. GAAP or IFRS requirements. This disclosure would be more detailed than currently required under Guide 3. The proposed rules would also codify the breakdown of the allowance disclosures required under Item IV.B of Guide 3, with some revisions (requiring a tabular breakdown of the allowance applying or reconciling to U.S. GAAP, rather than permitting an alternative narrative discussion). The proposed rules would eliminate the disclosure of the analysis of loss experience by registrants currently required under Item IV.A of Guide 3. Additionally, no disclosures related to the proposed accounting standards update 2016-13-*Financial Instruments – Credit Losses* (*Topic 326*) (under U.S. GAAP, which when effective will replace the current incurred loss methodology) are being proposed by the SEC.

- **Deposits.** Deposit disclosures under Item V of Guide 3 currently require the presentation of the average amounts of and the average rates paid for specified deposit categories exceeding 10% of average total deposits, disclosing any material foreign depositors in U.S. offices (in aggregated amounts) and the disclosure of certain time certificates of deposits with a maturity analysis, among other requirements. These requirements are similar to those required under U.S. GAAP rules and other SEC rules (IFRS does not specifically require deposit disclosures that overlap with those required under Item 3). Proposed Item 1406 of Regulation

S-K would codify the majority of current Item V under Guide 3, with some revisions. The proposed rules would change the required disclosures under Item V.D to disclose the "amount of time deposits by uninsured accounts" by maturity rather than having a threshold of greater than $100,000. This change provides a registrant with the flexibility under the proposed rules to change with FDIC insurance limit changes as needed, rather than complying with the current fixed-dollar threshold. The proposed rules would also require Bank and Savings and Loan Registrants to quantify the amount of uninsured deposits as of the end of each reported period. The SEC notes that since U.S. GAAP and IFRS require different levels of detail than that currently required by Item V of Guide 3, the proposed rules would increase transparency regarding a registrant's sources of funding and provide material information to investors.

- **Certain Other Existing Guide 3 Disclosures that Would Not be Codified in the Proposed Rules and Therefore Would be Eliminated.** In addition to the above, the proposed rules would not codify Item VI of Guide 3 which calls for disclosure of four specific ratios: (i) return on asset; (ii) return on equity; (iii) a dividend payout ratio; and (iv) an equity to asset ratio. Item VI also currently requires disclosure of any additional ratios a registrant determines is necessary to explain their operations, which also would not be codified in the proposed rules. Further, the following required information regarding short-term borrowing disclosures by category (among other things) under Item VII of Guide 3 would not be codified: (i) the period-end amount outstanding; (ii) the average amount outstanding during the period; and (iii) the maximum month-end amount outstanding. However, disclosures currently required under Items I.B.1 and I.B.3 of Guide 3 would be codified under the proposed rules, which the SEC asserts substantially cover the disclosures contemplated in Item VII and therefore inclusion of Item VII would be redundant.

How to Comment

The comment period for the proposed rules will be open until December 2, 2019 (60 days after publication in the federal register which occurred on October 3, 2019). Comments may be submitted through the SEC's internet comment form or by emailing rule-comments@sec.gov.

For More Information

If you would like to discuss any topic covered in this Client Alert, please contact a member of the Corporate and Securities or Banking practice groups, or visit us online at chapman.com.

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