May 5, 1975

The Honorable Thomas J. McIntyre
United States Senate
Washington, D.C. 20510

Dear Senator McIntyre:

I am replying to your inquiry of April 24 regarding discussions bearing on certain disclosures of information to the SEC by banks and bank holding companies. At the request of the SEC, an informal coordinating group has recently been formed consisting of representatives of the Federal Reserve, Comptroller of the Currency, FDIC, and SEC. The purpose of the group is to discuss questions of mutual concern, primarily in the financial reporting and disclosure area. The initial meeting of the group was held in early April and the Board's principal representative was Vice Chairman Mitchell.

A current issue of importance to all the agencies is the question of appropriate disclosure to be made in connection with registrations of new security issues by banks and bank holding companies. As you may know, regulatory authority over financial reporting by banks rests with the respective Federal bank supervisory agencies, while such authority with respect to financial holding companies resides with the SEC. This division of authority exists even though the principal activity of many financial holding companies consists of the operations of one or more subsidiary banks.

The SEC recently has been calling for increased disclosure in holding company registration statements relating to the amounts of credits on the books of subsidiary banks that may result in future loan losses. We at the Federal Reserve recognize that such loss exposure is a matter of legitimate concern to potential security investors, but we are also mindful of the dangers that exaggerated estimates of possible future loan losses would carry with respect to the other major class of bank creditors--that is, bank depositors.

On the basis of our experience as bank supervisors, we are very conscious of the difficulty of developing a meaningful indicator of future loan losses--one that will fairly measure loan portfolio quality and, at the same time, not expose the bank to widespread public misunderstanding or misinterpretation of its condition. The great bulk of the loans that are classified as problems by our examiners eventually are worked out and result in full repayment by borrowers. Similarly, most loans on which interest currently is not being accrued can be expected to produce full repayment to the bank over time; indeed, the very fact of non-accrual status indicates that the bank has recognized that a problem exists and is giving the loan special handling and remedial attention.

The question of what constitutes meaningful disclosure of loan quality thus is not a simple one. Moreover, the nature of the disclosures that are required is a matter of considerable potential economic significance. If unreasonable or misleading disclosure requirements are imposed, banks and bank holding companies will simply tend to avoid the issuance of new securities. This result would be most unfortunate, because many banks have expanded their assets over recent years to the point where capital coverage is approaching practicable minima. If new capital is not obtained through security sales as well as through the retention of earnings, asset growth necessarily will have to be constrained, and this could retard the recovery and the orderly expansion of economic activity that our nation requires.

As the new inter-agency working group addresses these and other substantial issues, I hope it can find the means of resolving the possible conflicts in public policy objectives represented by the differing interests of investors, depositors and the general public. The best interests not only of banks and bank investors but also of the economy will be served by an appropriate and early resolution of this matter.

Sincerely yours,

Arthur F. Burns

JCP/GWM:eh
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