NEWS

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DISCLOSURE -- THE NAME OF THE GAME

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The banking industry, as well as our entire nation, has faced unusual difficulties during the past two or three years. In that period of time, our economy has experienced a boom with double-digit inflation, record interest rates, an energy crisis, the most severe recession since the 1930's, high unemployment, and a number of business failures. We have also witnessed the resignation of some of our highest government officials; one of our largest cities has been unable to honor its financial commitments; and we have discovered that some major international corporations have used corporate funds for illegal or questionable domestic and foreign payments.

During this period of economic and political stress, prices of equity securities declined substantially and corporations have had to rely heavily on borrowed funds to finance their operations. While some of these funds have been obtained directly from the public through the issuance of debt securities, the banking community has been called upon to supply a greater than normal proportion. In meeting these capital needs, some banks have permitted their liabilities to increase much faster than their capital, depended more on volatile funds, speculated in foreign currencies, acquired relatively large amounts of long-term securities, and have

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extended loans which may have seemed sound when made, but which have not performed as expected.

Concurrent with these operational difficulties, we have also experienced the three largest bank failures in United States history, the news media has reported sensitive information contained in bank examination reports and lists of banks which had problems of varying seriousness, and congressional committees have held hearings in which the structure, philosophy, and regulatory activities of bank agencies have been severely criticized.

With all of these problems, I guess it is understandable that bankers and bank regulators would be critical of the SEC for requesting greater disclosure of bank operations by bank holding companies during this same period of time. However, I believe that the events of the past few years have been such that the Commission could not have fulfilled its responsibilities to investors and the public without requiring additional disclosure.

When Congress enacted the Securities Act of 1933, it determined that, in order to promote fair and honest securities markets and to provide a basis on which investors could make informed investment decisions, issuers offering securities to the public would be required to make full and fair disclosure of all material facts relating to their securities. To effectuate this purpose, the Securities Act provides, subject

to specific exemptions, that prior to a public offering of securities, a registration statement disclosing all material information about the issuer and its securities must be filed with the Securities and Exchange Commission, and that a prospectus containing such information must be delivered to investors before or at the time of sale.

This disclosure concept was expanded in 1964 when the Securities Exchange Act of 1934 was amended to require issuers having assets of at least $1 million and a class of equity securities held by five hundred shareholders or more to provide continuous disclosure of material information to investors by filing current periodic reports with the Commission.

Until rather recently, banks have not been too concerned about SEC disclosure requirements because Section 3(a)(2) of the Securities Act exempted securities issued or guaranteed by a bank, and Section 12(i) of the Securities Exchange Act vested the authority to administer and enforce provisions relating to bank periodic reports, proxy statements, and insider trading in the bank regulatory agencies which have had the philosophy that bank problems and regulatory enforcement actions should not be disclosed to the public because such disclosure could erode public confidence in banks and cause depositors to withdraw their funds. However, because the securities of bank holding companies do not come within the exemption for bank securities, and because Section 12(i) does

not apply to bank holding companies, bank holding companies must comply with registration and periodic reporting requirements established by the Commission.

In past years, the SEC has been somewhat hesitant to require the same degree of disclosure by bank holding companies as has been required of non-bank registrants. This has been due partly to the less active markets in bank securities and the fact that bank securities were considered relatively risk-free, but also because of our concern that our broad disclosure requirements could impose a greater burden and a competitive disadvantage on the relatively few and small banks subject to the Commission's disclosure requirements through bank holding companies.

However, changes in the structure and operations of the banking industry have made it appropriate for the SEC to become increasingly insistent that bank holding companies provide more meaningful disclosure. Since the late 1960's, most major banks have become affiliated with holding companies, and, according to Federal Reserve Board statistics, more than two-thirds of all commercial banking assets and deposits are now held by holding company banks. Moreover, in 1974, Congress amended Section 12(i) of the Securities Exchange Act so that the bank agencies must either require substantially the same disclosure by banks under their regulatory jurisdiction as is required of registrants subject to the SEC, unless the bank

agencies find that such disclosures are not necessary or appropriate in the public interest or for the protection of investors and publish such findings and the detailed reasons therefor in the Federal Register.

While the responsibility to provide full and fair disclosure of material facts rests with each public company, and the securities laws generally specify the type of information that should be disclosed, the Commission does review disclosure documents and is granted broad discretionary authority to require additional information consistent with the public interest or for the protection of investors. In addition to reviewing and commenting on individual filings, the Commission has frequently issued general statements to alert registrants to disclosure responsibilities, and we have also developed registration forms and guides which contain minimum disclosure standards to assist issuers in making full and fair disclosure.

In December of 1974, because of our concern over the number of situations in which significant and increasing business uncertainties had not been adequately reflected in the financial reporting of some registrants, the Commission issued Accounting Series Release No. 166 which described in generic terms information that should be disclosed by real estate investment trusts, banks, public utilities, petroleum companies, and others in order to inform investors of unusual

business risks and uncertainties due to changing economic conditions.

The release, which was issued after consultation with the bank regulatory agencies, suggested that banks and other financial institutions "make appropriate financial statement disclosure to enable investors to understand the nature and current status of their portfolios" including a "sufficient breakdown of assets to give the investor insight into investment policies, lending practices and portfolio concentration." It further suggested that registrants highlight such factors as material increases in loans considered doubtful as to collectibility, large increases in delinquencies, and loans extended or renegotiated under adverse circumstances.

Our efforts to improve disclosure by bank holding companies were supported by auditors, academicians, investors, investment analysts, and influential members of Congress, but bankers and bank regulators severely criticized such disclosure both in terms of policy and methodology. We were told that the requested disclosures were neither meaningful nor material, and, indeed, might be misleading and counterproductive; that, even assuming that the disclosure requests were appropriate, the timing was not right; and that SEC disclosure requirements would inhibit or preclude banks from raising the capital necessary to finance a strong economic recovery. These comments were of serious concern to the Commission, and, after

several meetings with major bankers and the bank regulators, an Interagency Bank Disclosure Coordinating Group, composed of a Federal Reserve Board member, the Comptroller of the Currency, the Chairman of the Federal Deposit Insurance Corporation, an SEC member, and top staff members from each agency, was formed. The purpose of this Coordinating Group was to combine the expertise of the four agencies to develop and propose disclosure guides specifying categories of relevant information that would enable investors and depositors to make informed decisions, and integrating the terminology and requirements of banking and securities regulation to the extent possible in order to minimize the reporting burden on banking organizations. Despite the fact that registration statements are reviewed on an individual basis by the Commission staff, and that additional disclosure may be necessary to assure that statements are not misleading, we were sure that such guides could assist bank holding companies in meeting their disclosure responsibilities. After many meetings of the Coordinating Group during a period of six months, broad areas of agreement were developed, and, although some important differences remained unresolved, last October the Commission proposed Guides 61 and 3 for public comment. At the same time, the bank agencies issued proposals to revise and supplement their reports.

The guides proposed by the Commission are compatible with the proposed bank agency reporting requirements, but in some instances would ask for additional information. In general, the guides would require information with respect to the distribution of assets, liabilities, and stockholders' equity; a breakdown of the investment portfolio and the loan portfolio; the composition of deposits, long term debt, and borrowed funds; the percentage relationship of net income to average stockholders equity and average total assets; a comparison of interest rates earned and paid and the changes in income and expense for earning assets and borrowed funds; information with respect to international banking operations, loan commitments and firm lines of credit; and an analysis of loan loss experience and the factors which influenced loan loss provisions.

In response to our proposal, the Commission received 114 comment letters which evidenced considerable thought and careful analysis. The letter sent by the Bank Administration Institute and the submission by the joint committee on bank accounting, which included representatives from your Accounting Commission, were among the most helpful comments received. Many commentators claimed that the burdens imposed by the proposed guides, particularly on smaller bank holding companies, would outweigh any possible benefits to investors. There was also a general consensus that the proposed guides would have an unfair impact on companies with conservative management practices,

and that they lack objective standards that would ensure comparability of data. There were strong objections to the requests for information on nonperforming loans and for a breakdown of loan loss reserves. Numerous recommendations for technical definitional and instructional changes were also received.

On the basis of the comment letters and experience in processing the filings of registrants who have made good faith efforts to comply with the proposed guides, our staff recommended revisions in the proposed guides to the Commission. After reviewing the staff recommendations, last month we sent the revised guides to the bank agencies for their review and suggested that a meeting of agency representatives be convened as soon as conveniently possible to consider the guides before they are finalized and adopted.

It would not be prudent for me to discuss specific staff recommendations to revise the guides or try to predict the form in which the guides will be approved, but I can assure you that the Commission does not desire to burden bank holding companies with reporting requirements that do not provide benefits which outweigh the costs. You can also be sure that, whether or not you favor the final guides, they will be based on more informed decisions because of your participation in their formulation.

When finally approved, the guides will significantly assist registrants, but it is important to understand that providing the information requested by the guides does not necessarily assure that satisfactory disclosure has been made. Thus, the Commission staff will continue to consider bank holding company filings on a case-by-case basis, and, when it appears necessary, the staff will ask for supplemental information in order to determine whether the disclosure provided is adequate. Moreover, in the final analysis, the responsibility for full and fair disclosure remains with the registrant.

Beginning in late 1974, the staff has requested registrants to provide information similar to that described in the proposed guides. Initially there was considerable reluctance to provide the requested disclosure, but recently, there has been a much more responsive attitude, and, during the past year, nearly forty bank holding companies have registered offerings with the Commission for a total of over $1.5 billion of debt and equity capital. In every instance, these companies have provided disclosure satisfactory to the Commission, including, when appropriate, information regarding the aggregate amounts and income effect of "nonperforming" loans; book values and market or appraised values of municipal securities; loan commitments and lines of credit; interest-earning assets; foreign operations; loan loss experience; and

the method used to determine loan loss reserves. In many cases, registrants have provided significantly more disclosure than the Commission required.

The bank holding companies that made these disclosures have all been successful in obtaining capital from the market, and there is no evidence that either the banking system or economic recovery has been adversely affected. In fact, just last month, Chairman Arthur Burns of the Federal Reserve Board stated that banks have improved their capital position and that, "our banking system is sound, improvements are taking place within it, and our banks are well prepared to finance economic expansion."

Of course, it is not possible from this experience to determine whether other bank holding companies might have decided to enter the market for additional capital in the absence of Commission disclosure requirements. But, even though some holding companies were deterred from seeking capital by our disclosure requirements, it would not necessarily mean that our requirements are inappropriate or that they have a negative impact on the banking system. If our requirements deter public offerings of bank holding companies, it is because of judgments by the company and its professional advisers that, if the public is informed with respect to the assets and liabilities and other material facts about its banking operations, investors would not purchase the securities or the cost of

obtaining the capital in terms of the interest rate or the price per share would be higher than the holding company desired to pay.

Such a result is not contrary to the purposes of the securities laws. In fact, the major purpose of the federal securities laws is to require those seeking capital from the public to disclose material facts about their operations and financial condition so that investors can make informed decisions of this kind. Whether a bank is affiliated with a holding company or not, the offering of securities to the public without making full and fair disclosure of material facts is fraudulent; and because there are no exemptions for any person from the antifraud provisions of the securities laws, the utilization of any fraudulent device, scheme, or course of business or false or misleading statement in connection with the purchase or sale of bank securities clearly exposes a bank to an SEC enforcement action and a private right of action for civil damages.

It may very well be that SEC disclosure requirements make it more difficult or more expensive for a weak or poorly-managed bank to obtain capital and to retain or attract deposits than is the case for a strong well-managed bank. However, I find this result to be completely consistent with the concepts of free enterprise and a competitive capital market, and I believe that allowing the market forces of informed investor

and depositor decisions to have a greater impact on the banking industry would result in a stronger and safer banking system. Moreover, in my opinion, requirements for full and fair disclosure can lighten the burden of governmental bank regulation because disclosure provides a continuing strong incentive for bank management to adhere to safe and sound banking practices in order to obtain and maintain the confidence of depositors, investors, and the general public. As routine disclosure of all material facts with respect to bank operations becomes publicly available, interest in sensational reports of secret bank operational information, which we have experienced recently, should also be reduced or eliminated.

I would like to mention briefly two other areas in which SEC action will affect disclosure by banks. First, the Securities Acts Amendments of 1975 amended the Exchange Act to require institutional investment managers, such as banks, which exercise investment discretion over equity securities having a market value of at least $100 million to report basic information about portfolio holdings and transactions as prescribed by Commission rules. The staff of the Commission is presently considering various methods of implementing these requirements. We will, of course, publish a proposal for public comments before a reporting system is adopted, and I hope that you will give us the benefit of your views.

Second, in August 1975, the Commission published for comment various rules and amendments to rules with respect to

reporting by persons who acquire beneficial ownership of five percent or more of an issuer's equity securities. This proposal suggesting revisions in the reporting system and the definition of beneficial ownership is quite controversial, and we received more than 225 letters of comment. The staff has analyzed the comments, made further recommendations, and the proposal is now before the Commission. It should also be noted that a bill, S. 3084, which would substantially increase reporting responsibilities of persons acquiring beneficial ownership, is scheduled to be considered by the Senate later this week.

Bankers should understand that our actions with respect to bank disclosure are not unusual or revolutionary, but are part of an overall trend toward more meaningful disclosure of all business and government operations. That trend has strong public and congressional support as indicated by the Freedom of Information Act and the proposed Government in the Sunshine bills which require the SEC and other government agencies to disclose more of our internal operations. Another indication of the trend is the increasing recognition by corporate management, the accounting profession, and the Congress that conventional balance sheet and income statement presentations provide inadequate disclosure because they do not portray the effect of such factors as inflation, high interest rates, and the energy crisis upon assets, liabilities, income, and profits

in a manner that reflects economic reality. In order to make these accounting statements more meaningful to investors, last March the Commission determined to require large public companies to disclose the current replacement cost of inventories, productive capacity, the cost of goods or services sold at the time of sale, and of depreciation, depletion, and amortization expenses. This was an unusual step for the Commission to take because, although we have the authority to establish accounting practices and procedures to be used in documents filed with the Commission, we believe strongly that it is in the public interest for the private accounting profession to establish accounting standards to the extent they will accept and fulfill that responsibility. As our release on this issue stated, we were urged to delay the decision, but decided not to do so because we concluded "that under current economic conditions, data about the impact of changes in the prices of specific goods and services on business firms is of great significance to investors in developing an understanding of the current operations of any firm."

It has been suggested that some of the disclosures requested by the Commission from bank holding companies are "neither meaningful nor material" to investors. This, of course, is a matter of judgment on which reasonable persons might differ. However, those who may believe that the Commission is stretching the concept of materiality too far

in our requests for disclosure from bank holding companies should be aware that many members of Congress have not only supported our requests for additional bank disclosure, but have suggested that we have not gone far enough. In addition, late last month, against our strong objection, the Subcommittee on Oversight and Investigations of the House Committee on Interstate and Foreign Commerce publicly disclosed facts about corporate business operations which the Commission had previously determined were not material. The Subcommittee was critical of the Commission for not requiring more disclosure, and Chairman John Moss stated, "I have been dealing with these issues ever since being in government. I have not found disclosure harmful. It usually is one of the most beneficial things that occurs. It improves, it does not destroy; it strengthens, it does not weaken."

It is important to recognize that materiality for purposes of disclosure under the securities laws is a dynamic concept which has been defined broadly as that information which a reasonable investor might consider important in making an investment decision. What a reasonable investor might have considered important forty years ago, or even last year, may not be what a reasonable investor might consider important today. Changes in investor sophistication and attitudes, as well as changes in general economic or industry conditions, may have an affect on materiality. In some instances, the fact

that an economic issue has attracted widespread public attention and is "the topic of discussion" may render information with respect to that issue material to investors. In this regard, Mr. Rex Duwe, President of the American Bankers Association, recently stated that:

> A public with confidence in American institutions is willing to take a great deal on trust, as long as things appear to be running smoothly. But a public with its suspicions aroused is likely to ask for detailed information on every aspect of business and bank operations--information that the public formerly felt no need to know. It is precisely this kind of situation banks face today in the form of increased demands for disclosure of information about problem loans.

Things have not been running smoothly over the past two or three years and public suspicious about bank problems have been aroused by statements from bank regulators, headlines in the news media, congressional hearings, and the failure of the three largest banks in U.S. history. Public confidence in banks, our banking system, and bank regulation has been eroded, and nothing could contribute more to a restoration of trust and confidence than to show that banks are safe and sound through full and fair disclosure.