STATEMENT OF JOHN R. EVANS, COMMISSIONER, SECURITIES AND EXCHANGE COMMISSION, BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS IN CONNECTION WITH HEARINGS ON CERTAIN BANKING PRACTICES (September 28, 1977)

I am pleased to represent the Securities and Exchange Commission at these hearings on the banking practices described in the Report of the Comptroller of the Currency entitled "Inquiry into Certain Matters Relating to T. Bertram Lance and Various Financial Institutions." With me today is Richard H. Rowe, Director, and Linda L. Griggs, Staff Attorney, of our Division of Corporation Finance.

Last Wednesday, in response to many inquiries, the Commission determined it would be in the public interest to issue a press release stating:

> . . . it was in the early stages of an investigation into certain matters involving the National Bank of Georgia and others, but that no conclusions have been reached as to what action, if any, should be taken. Press reports concerning a proposed law suit against the National Bank of Georgia and Mr. Bert Lance are, accordingly, incorrect.

In light of the Commission's long-standing policy not to publicly discuss pending investigations, I believe it would be highly inappropriate for me to comment further on this matter.

Based on our experience in discharging our responsibilities under the federal securities laws, we have submitted a detailed Commission statement for the record responding to certain of the issues raised by the Comptroller's Report. However, because many of the issues being explored at these hearings are focused on the actual regulation of banking practices, we are not in a position to assist the Committee in these areas. In the interest of time, I would like to highlight briefly certain portions of the Commission statement.

While banks have always been subject to the general anti-fraud provisions of the securities laws, the Commission has only recently become deeply involved with specific bank disclosure requirements. The primary cause for this development has been the growth of publicly-owned bank holding companies, which are subject to all of the provisions of the securities laws and the Commission's rules thereunder. As of December 31, 1976, there were 1,912 bank holding companies registered with the Federal Reserve Board. About 450 of these bank holding companies, having over two-thirds of the total bank assets in the United States, are required to file annual reports with the SEC pursuant to the Exchange Act. The influence of the SEC over bank disclosure has also increased as a result of a 1974 amendment to Section 12(i) of the Exchange Act to require the banking agencies to "issue substantially similar regulations" for publicly-owned banks as those regulations adopted by the SEC for public companies, unless the bank agencies specifically find such regulations are not necessary or appropriate in the public interest or for the protection of investors and publish such findings in the Federal Register together with detailed reasons therefor.

During the last few years, the Commission has adopted and proposed amendments to our disclosure requirements which may be of interest to the Committee. During August 1976, the SEC adopted Guides 61 and 3, entitled "Statistical Disclosure by Bank Holding Companies." The guidelines, which are intended to assist bank holding companies in describing their business in registration statements and periodic reports, call for detailed disclosures relating to: distribution of assets, liabilities and stockholders' equity; investment portfolios; loan portfolios; summary of loan loss experience; deposits; return on equity and assets; interest rates and interest rate differential; foreign operations; and commitments and lines of credit.

At the time these guidelines were being considered, the Chairman and other members of this committee strongly supported our efforts to obtain increased bank disclosure by stating in a letter to the banking agencies that "in the final analysis and under the securities laws passed by the Congress, the SEC, and not the banking agencies, is the final judge of what constitutes material financial disclosure with respect to securities issued by banks or bank holding companies." Among the specific items of disclosure in which an interest was indicated at that time by the Chairman of this committee and which is pertinent to the purposes of these hearings is:

> The amount of insider transactions in the institution. All loans made to interests of stockholders, directors or officers should be disclosed. Both the gross amount of the loans should be disclosed and the percentage such loans occupy to total loans. Particular

> attention should be paid to requiring disclosure of any substandard credits in these categories and identified as such.

Although Guide 61 was a significant step in clarifying the type of disclosure that is appropriate for bank holding companies, it did not include specific requirements for the disclosure of insider loans because at that time the Commission's staff was undertaking a general review of reporting with regard to related-party transactions.

In an effort to determine whether investor protection would be served by additional disclosure regarding insiders of bank holding companies, we specifically requested comments during November 1976 on whether we should revise the existing reporting provisions relating to disclosure of loans made by bank holding companies and their bank subsidiaries to the officers and directors of the bank holding companies. We have also proposed amendments to the financial statement requirements applicable to bank holding companies which would require disclosure in a schedule to the financial statements of the amounts receivable from each underwriter, promoter, director, officer, employee, and principal holder of equity securities of the bank holding company and its affiliates who is indebted to the company for an aggregate amount in excess of $40,000. This proposal would exempt from disclosure only those amounts receivable for two types of loans: (1) those made for the purchase of such person's principal place of residence provided they were made in the ordinary course of business, on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons, and with no unusual risk of collectibility or unfavorable features; and (2) those made for ordinary travel and expense advances and similar items arising in the ordinary course of business. Further, an amendment was proposed which would require bank holding companies and their subsidiary banks to include in their balance sheets the total amount receivable from these persons excluding travel advances and similar business related expenses if this amount exceeds five percent of stockholders' equity.

Another recent action by the Commission, which may affect the disclosure made by bank holding companies, is last month's interpretive release emphasizing our view that the current reporting provisions require disclosure, within the aggregate remuneration reported, of all forms of management remuneration including salaries, fees, bonuses, and certain personal benefits sometimes referred to as "perquisites." The Commission stated:

> Among the benefits received by management which the Commission believes should be reported as remuneration are payments made by registrants for the following purposes: (1) Home repairs and improvements; (2) housing and other living expenses (including domestic service) provided at principal and/or vacation residences of management personnel; (3) the personal use of company property such as automobiles, planes, yachts, apartments, hunting lodges or company vacation houses; (4) personal travel expenses; (5) personal entertainment and related expenses; and (6) legal, accounting and other professional fees for matters unrelated to the business of the registrant. Other personal benefits which

> may be forms of remuneration are the following: the ability of management to obtain benefits from third parties, such as favorable bank loans and benefits from suppliers, because the corporation compensates, directly or indirectly, the bank or supplier for providing the loan or service to management; and the use of the corporate staff for personal purposes.

This release was issued in response to numerous inquiries, some of which may have been generated by the publicity given to recent SEC enforcement cases revealing the failure of certain corporations to disclose the value of various personal benefits received by members of management.

One of the personal benefits mentioned with which the Commission has had recurring experience is the utilization of compensating balances by public companies in connection with obtaining favorable loans for insiders. In 1973, we adopted amendments to our accounting regulations to require additional disclosure by corporations about compensating balances which distort the interest rate stated as to the corporation's outstanding debt. In the release which proposed these amendments, the Commission noted that:

> Compensating balances maintained for the benefit of affiliates, officers, directors or principal stockholders may be of particular significance to investors. Separate disclosure of such items may be required under other Commission rules and regulations even if they are not individually of a magnitude such that they would meet the materiality guidelines set forth above.

During investigations of corporations suspected of securities violations, our staff has found various examples of insiders benefiting from compensating balances. The Commission's statement describes seven cases in which we alleged inadequate disclosure by public companies that insiders had benefited personally from compensating balances maintained by these companies at banks.

Bank holding companies themselves also may be required to disclose the granting of favorable loans to management of customers because of the materiality of this information to a subsidiary bank. For example, in 1975 we instituted proceedings against Third National Corporation, a registered bank holding company in Nashville, Tennessee, for failure to disclose in filings with the Commission certain matters, including information about correspondent banking loans. Its principal subsidiary, Third National Bank, followed a general policy of making credit available to controlling stockholders of, or senior officers and directors of, the banks which maintained deposits with it and for which it performed clearing and various other services and from which it obtained loan participations and other business. Since correspondent banking was an important source of business the bank apparently engaged in this policy for the purpose of facilitating or promoting the correspondent relationships. In some instances, Third National Bank was alleged to have made loans to individuals of limited means, evidenced by a demand or shortterm personal note and secured by the pledge of the stock of a correspondent bank, for the purpose of acquiring a substantial block of the stock of the correspondent bank. Often these notes were not called or were extended for many years. Absent the correspondent relationship, these persons apparently would not have qualified for such loans or would not have received the favorable interest rates or terms. The Commission charged that the subsidiary bank's policy of granting these loans should have been described in the company's filings with the Commission. As a mitigating factor, Third National stated its opinion that the bank's practice of making loans to persons in control of or senior officers and directors of banks, secured by pledges of correspondent bank stock and for the purpose of obtaining or maintaining a correspondent relationship with such banks, is a practice engaged in by other banks both in their competitive area and elsewhere. The holding company represented that the bank's correspondent relationships were normal and that its policy of lending money for the purpose of acquiring correspondent bank stock may actually have strengthened independent banking in Tennessee. We accepted the offer of settment made by Third National Corporation and ordered the company to amend certain reports and to comply with its undertakings to, among other things, amend and redistribute its pending registration statement.

In addition to the various general administrative actions and specific enforcement actions which the Commission has taken, we are now reviewing the basic policy issue of whether we should require more detailed or comprehensive disclosure by publicly-held companies of management remuneration and transactions affecting management. On April 28, 1977, the Commission announced that it will conduct hearings to obtain assistance in our current re-examination of the proxy rules relating to shareholder communications, shareholder participation in the corporate electoral process and corporate governance generally. The hearings start tomorrow, here in Washington, followed by hearings in Los Angeles, New York and Chicago during October and November.

As I previously indicated, our interpretive release last month stated that certain favorable bank loans may in fact result in a form of remuneration to officers and directors of corporations which maintain banking relationships with the lender banks. To obtain more data regarding whether the practice of giving favorable bank loans is a common one and in order to determine whether bank holding companies should disclose additional information about loans to executives of corporate borrowers, including other banks, the Commission's staff has begun to request bank holding companies with pending registration statements filed under the Securities Act for information about such loans. The staff is also asking bank holding companies whether they or their subsidiaries have extended any loans to the parent's officers and directors on terms that were more favorable than could have been obtained by unrelated persons in order to determine whether such indebtedness should be specifically described. The results, to date, of our staff's inquiries are set forth in the Commission's statement.

You have specifically asked us to discuss, to the extent the SEC has any knowledge, whether banks commonly permit their officers, directors and customers to overdraw their accounts. Our investigations of securities violations have not provided us with significant knowledge about this practice. However, if officers and directors are permitted to overdraw their accounts, disclosure of the overdraft may be required because the amount of the overdraft is considered, for purposes of the disclosure requirements we administer, to be a loan to a particular officer or director of the corporation. As such, it would have to be reported if the aggregate indebtedness of such person exceeded the lesser of $10,000 or 1% of the issuer's total assets unless the loan had been made in the ordinary course of business and on terms that were no more favorable than could have been obtained by an unrelated person. In addition, a loan extended at a favorable interest rate to an officer or director by his employer corporation, including bank holding companies, is a form of remuneration which would have to be included in the aggregate remuneration reported. You also have asked whether we have any information about stock loans made by banks. Our investigations have revealed some situations involving stock loans or inflated valuations of collateral for loans granted by banks. While these examples may suggest inadequate loan approval procedures, we do not have enough experience in this area to be able to conclude that loan procedures, or stock loans more particularly, require additional regulation.

As described in our prepared statement, Representative Fernand J. St. Germain, Chairman of the Subcommittee on Financial Institutions Supervision, Regulation and Insurance, of the House Committee on Banking, Finance and Urban Affairs, has requested the SEC to undertake an in-depth study to determine whether banks and bank holding companies have made political contributions to domestic and foreign candidates, or have engaged in questionable payments or banking practices in order to obtain business abroad. In addition, he asked whether "banks, bank holding companies or their subsidiaries used hidden loan transactions or made questionable loans such as writing off a loan as a loss, or accepting inflated property for payment, to domestic or foreign officials, companies, or political parties and candidates . . . ." The Commission has made informal inquiries of six bank holding companies in order to determine whether they, or their subsidiary banks, have violated the federal securities laws by failing to disclose improper or questionable payments. Since these inquiries are on-going, however, we are unable to express any conclusions in this area.

In conclusion, the Commission has taken, and is in the process of taking, several administrative actions which I believe are relevant to issues being considered during these hearings. At this time, the Commission is not in a position to recommend any legislative changes with respect to banking practices. However, we believe that the events of the last few weeks have reconfirmed the fact that disclosure is a powerful regulator. Thus, we urge that if any banking legislation is enacted, it not impair our ability to require adequate disclosure of banking practices for investors, and not restrict our ability to obtain information and bank records from banks and bank agencies in carrying out our enforcement responsibilities under the federal securities laws.