V C.2

FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

NEWS RELEASE

FOR RELEASE ON DELIVERY PR-50-75 (7-11-75)

Statement on

DISCLOSURES BY BANKS AND BANK HOLDING COMPANIES IN CONNECTION WITH MARKETING THEIR SECURITIES

Presented to the

Committee on Banking, Housing and Urban Affairs
United States Senate

by

Frank Wille, Chairman
Federal Deposit Insurance Corporation

July 11, 1975

As Chairman of the Federal bank regulatory agency which insures deposits in virtually all banks and examines and supervises almost 8,800 State-chartered commercial banks and mutual savings banks which do not belong to the Federal Reserve System, I welcome the opportunity which these hearings present to testify on the disclosures which banks and bank holding companies should make when they offer securities to the general public.

At the outset, may I say that the FDIC is not opposed to the disclosure of material facts which a reasonable investor should have in order to make an informed decision when contemplating the purchase or sale of a bank security. I am one bank regulator who believes that greater disclosure of material facts by individual banks is beneficial in almost all cases not only to investors but also to depositors and to public officials charged with bank supervision.* The interests of depositors and bank supervisors are not fundamentally in conflict with the interests of investors, although I would be the first to concede that in the case of "problem" banks -- a group which seldom numbers more than two percent of the nation's 14,500 banks -- ill-timed disclosures of material facts can frustrate supervisory efforts to work out long-term solutions. The short answer, however, in the context of these hearings, is that banks which anticipate a significant runoff of deposits or even consider failure a possibility if they are forced to make full and adequate disclosure of material facts should not be issuing securities of any kind to an unsuspecting public. Needed capital in such cases should be raised directly from insiders or by private placements with institutional lenders based on full disclosure.

There has been a steady and accelerating increase since 1964 in the volume of information publicly available about bank operations. In that year, the Federal securities laws were amended to impose reasonably full requirements for periodic disclosure on publicly held banks with more than 500 shareholders. The three Federal bank agencies were assigned separate enforcement responsibility as to banks which they regularly examined, and their requirements for disclosure became increasingly uniform as the years went by. Last year, further amendments to the Federal securities laws directed the bank agencies to review such regulations for conformity with comparable SEC requirements, or explain why such requirements were not appropriate for banks, and each of the bank agencies recently released for public comment proposed amendments to their regulations in compliance with the statutory mandate. Today, approximately 730 banks are subject to such periodic disclosure requirements, 319 of them falling within FDIC's jurisdiction.

For years the balance sheets submitted by all insured banks to their Federal supervisory authority as of call report dates have been available to the public, but it was not until year-end 1972 that the three bank agencies undertook to release upon request all information received on the two reports regularly filed by all banks. Since then, in addition to the balance sheets on the front of each Report of Condition, the detailed schedules regularly reported on the back of

---

* My views on this general subject were expressed in a November 1972 speech in which I announced the FDIC's decision to make publicly available upon request all condition reports and reports of income filed by State nonmember banks with the FDIC. That speech, in its entirety, is attached for entry into the record of these proceedings.

each Report of Condition and the full Report of Income received annually from each bank have been made available to any person requesting the information -- and we at FDIC have filled thousands of such requests in the intervening three years. A continuing staff group composed of representatives of each of the three bank agencies meets periodically to consider revisions in these uniform reports, and extensive revisions are currently in process which will lead to even greater public disclosure in 1976 and thereafter. So that the extent of the information now reported on these forms and publicly available for all banks is known to the Committee, I would like permission to enter into the record the forms we are currently using.

The Comptroller of the Currency, in addition, requires all national banks with less than 500 shareholders to send less detailed but nevertheless similar financial information to shareholders each year, and carefully reviews the offering circulars of each proposed new national bank. The FDIC has outstanding a proposed regulation requiring detailed offering circulars of all existing and proposed nonmember banks which contemplate a public offering of their securities, regardless of the number of their shareholders. Numerous publications are prepared each year by the FDIC and the other agencies which make available to the public bank operating statistics on an aggregated basis. The growing reach of the Freedom of Information Act is making public on an individual bank basis a number of special reports regularly filed by both sample groups and the universe of the nation's banks. The surge of bank holding company activity since 1970 has brought more and more of the nation's banks under full SEC disclosure requirements on a consolidated basis with their parent holding companies. While the report of individual bank examinations regularly prepared by professional examiners in each of the three agencies has remained confidential, our staff routinely compares such FDIC reports to offering circulars and proxy statements filed with the Corporation or transmitted to us by the SEC to determine whether material omissions in such filings are apparent, If we believe there is such a material omission based on the report of examination of a nonmember bank, such information is immediately passed on to the reviewing office.

Additional disclosures may, of course, appear desirable on an industry-wide basis in the light of experience and changing regulatory requirements, but it would be totally erroneous to assume that potential investors and the investment community at large do not have access -- at the present time -- to significant, material and vital information about individual banks which seek to market their securities on a public basis.

Returning to the subject of today's hearing, let me say that I am sure that all three of the Federal bank agencies subscribe to the general proposition that material facts should be disclosed whenever a bank or bank holding company issues securities to the general public. In the past, however, reasonable men within the various bank agencies and in the SEC have differed and perhaps will continue to differ, over what specific information as to a bank's operations <u>is</u> material for an informed investment decision. Banks are not industrial corporations.

Their raw material is basically "other people's money" and they put it to work in thousands of daily investment and loan decisions. By the nature of their business, all banks -- and commercial banks in particular -- take risks, and these risks affect a bank's assets, its liabilities and its flow of earnings. Good banks know how to manage and balance these various risks and years of experience have taught the bank regulatory agencies that diversification of risk or the lack of such diversification is far more important than the mere fact of risk in evaluating the condition of a given bank.

Several months ago, when a number of large member banks and bank holding companies attempted to come to market with public issues of securities, there was considerable concern among prospective registrants and their respective bank supervisory agencies that the SEC had a significantly different view of what was "material" for purposes of investor disclosure than they did, even allowing for differences in view between the registrants and their Federal bank supervisors and between the three bank regulatory agencies themselves. The principals of the SEC, the Federal Reserve, the FDIC and the Comptroller's Office were prompt to agree that if at all possible the Government should speak with one voice as to the types of disclosure that might be desirable and that even if agreement on all points remained elusive, a better understanding of each other's positions was likely to result from a thorough exchange of views.

From April 1 of this year to date, eight interagency meetings have accordingly been held, three exclusively among designated top level staff members from all four agencies and five others with staff and one or more principals from each agency.* Significant areas of agreement were identified early in the discussions and the participants agreed to attempt a draft of recommendations for more extensive disclosure which might be transmitted to the SEC for review and eventual release by that agency for public and industry comment. Since the three bank agencies had been considering a general revision in the form and frequency of the call report information submitted periodically by all insured banks, it also appeared desirable to integrate the two efforts so that disclosures by a bank or bank holding company issuing securities could be more readily compared with similar information aggregated as of a common and relatively recent date for a larger number of banks. Throughout, it was recognized that standards of materiality for bank disclosure could not be fixed forever as of a given date, but would be subject to modification, addition and deletion in the light of experience, changing circumstances and new banking practices. We also recognized that even though we were

---

* The principals involved in each of these five meetings were: John R. Evans, Commissioner, SEC; George W. Mitchell, Vice Chairman, Federal Reserve; James E. Smith, Comptroller of the Currency; and myself for the FDIC. Deputy Secretary of the Treasury Stephen S. Gardner was also present as an observer at several of these meetings.

striving for a "standardized" disclosure policy, ad hoc disclosures of a material nature might be required of some banks coming to market that would not be appropriate for all banks.

With those caveats, I can report substantial progress within the four-agency group in arriving at a common view of what types of financial information any material for purposes of evaluating the bank or bank holding company which publicly issues securities. We seem agreed, for example, subject to revision based on the public comments which may be received, that:*

For All Banks:

1. The basic categories of loans to be used for disclosure purposes should conform with Schedule A on the Report of Condition, Schedule A being expanded to include a separate itemization under "Real Estate Loans" for "construction loans" and a separate itemization under "Loans to financial institutions" for loans to financial institutions "engaged primarily in real estate financing".

2. A maturity breakdown for each major category of investments held by the nation's commercial banks (U. S. Treasury, Federal agencies and State and political subdivisions), which was collected on a special basis from all insured banks as of June 30, 1974 and is again being collected on a special basis as of June 30, 1975, should be added as a permanent schedule to the back of the Report of Condition.

3. A segregation of time deposits held in denominations of $100,000 or more should be added to each Report of Condition, and each Report of Income should reflect as a separate item interest paid on such time deposits, thereby identifying both the volume and the aggregate interest cost of one of the most interest-sensitive portions of a bank's total funds.

For Larger Banks:

1. The effect on income for a given accounting period of the non-payment of interest on all loans past due 60 days or more with respect to the payment of interest or principal should be regularly reported to the bank supervisory agencies and publicly disclosed as a dollar amount, although banks could supplement this presentation by reporting, for example, an earnings impact per share.

---

* The information on the next two pages does not purport to be a complete statement of the items discussed or even the agreements reached by the four-agency group, whose deliberations will undoubtedly continue in the months ahead.

2. Claims on foreigners and liabilities owed to foreigners, broken down by broad general and geographic categories, should be regularly reported to the bank supervisory agencies and publicly disclosed.

3. Gross loan charge-offs and recoveries should be regularly reported to the bank supervisory agencies and publicly disclosed in six major loan categories, i. e., consumer, home mortgages (1-4 family), other real estate (including construction loans), commercial and industrial, foreign, and "all other" for each accounting period which is the subject of the report.

4. Unused commitments to extend credit for which a fee has been paid and outstanding loans made under commitments for which a fee has been paid should be reported on a regular basis to the bank supervisory agencies and publicly disclosed.

We are also in agreement that the Report of Income which is now filed only once each year by all insured banks should be required semiannually from all banks and on a quarterly basis, possibly in abbreviated form, from larger insured banks. In addition, we are considering, at least for the larger insured banks, more frequent reporting and disclosure of some of the schedules now completed only once or twice a year in connection with Reports of Condition. These two basic reports, once filed, are now made available upon request to any member of the public and would, of course, be available in the future for disclosure purposes on both an individual bank or aggregated basis.

While many of the items of disclosure raised by Chairman Proxmire's letter of June 17 are covered in the partial list of agreements reached by the four agencies which I have indicated above, I have made no mention of several other items in the Chairman's letter and should do so at this juncture.

One of these, i.e. (3), inquires as to the disclosure which should be required of "the amount of substandard quality, high risk loans, or concentrations of credit which [banks] hold in various sectors of the economy (e.g., real estate investment trusts, retail companies, airlines, building developers)." No single disclosure issue has been discussed at greater length by the four-agency group, and it is the one issue which the bank supervisory agencies, at least, believe is neither suitable nor feasible in a standardized disclosure policy. Each of the four sectors of the economy specified in your Chairman's letter have both good credit risks and bad credit risks, a situation which is true of almost any industry category one might select. Moreover, if one or more Government agencies single out a particular industry for special disclosure of loan volume, past due loans and management estimates of future charge-offs and adverse earnings impact, members of the public might well conclude that the Government considers all firms in that industry to be unsound or unworthy of investment or credit regardless of individual performance, the security offered or the rate of return paid. In such an industry a sluggish earnings performance may change quickly as economic conditions change, yet special disclosure requirements may inhibit the very recovery which the Government itself seeks.

Obviously, a large concentration of credit in troubled firms of a particular industry could indicate a significant problem for an individual bank, and would constitute a material disclosure for that bank, but it does not follow that the same disclosures are material for all banks or bank holding companies coming to market. I share the view of the other bank regulatory agencies that special disclosures of the status of bank credits to particular industries should be approached cautiously in all cases and should be required for individual banks only after a careful and current investigation indicates that the disclosure is significant in evaluating that bank's condition. The interagency group ended up by concluding that the issue seems one best handled by continuing consultation between the SEC and the three bank agencies.

Another of these, i.e. (4), inquires as to the disclosure which should be required of "the amount of loans which [banks] hold made to interests of directors or officers." This subject has not been specifically discussed by the four-agency group, but I think it would be the unanimous view of all the participants that any significant concentration of loans in the total loan portfolio and any material transaction attributable to officers, directors or their various interests, particularly those that were made on more favorable terms than comparable loans to outsiders, would constitute material facts which might be important to an investor's evaluation of the character of the bank's management. This is the view taken by existing regulations and interpretations for banks with more than 500 shareholders (See, e.g., FDIC Regulation Part 335.41, Item 12) and is also the view taken by the FDIC's proposed regulation on required disclosures for public securities offerings by other banks (Proposed FDIC Regulation Part 340.41, Item 15). Furthermore, whenever the SEC staff requests FDIC to review a proposed registration statement, any significant concentration of self-serving loans held by a bank holding company subsidiary or affiliate which is known to the FDIC through its examination process at the time of offering is brought promptly to the SEC's attention.

With respect to a portion of Item (5) in Chairman Proxmire's letter, i.e. the extent of depreciation in a bank's securities holdings, this figure is now required in bank holding company filings with the SEC and is being volunteered with increasing frequency by non-holding company banks in their certified financial statements, although it is not presently required in any filings with the bank regulatory agencies. Historically, the bank agencies have been reluctant to require the disclosure of this figure for several reasons. The figure can fluctuate significantly over short periods of time depending on the general movement of interest rates and on other market developments since the reporting date. Some issues held by banks, particularly infrequently traded municipals, are exceedingly difficult to price without being sold. The depreciation figure, in many cases, could alarm an ill-informed investor who fails to recognize that most banks seldom have to sell such investment securities at any significant loss to provide short-term liquidity. Some investors, on the other hand, may find the figure helpful in assessing a bank's ability to reinvest assets in the event of adverse developments in its liability structure or its earnings performance. The absence of a depreciation figure is mitigated for such investors by the availability of income figures by type of security holding and the detailed data which will soon be made available on a regular basis as to the maturity distribution of such holdings. Nonetheless, with increasing sophistication among bank shareholders and the investing public, the time may be at hand for the banking agencies to reexamine the desirability of requiring a current market figure to supplement the historical cost of such security holdings now reported in the body of the balance sheet.

With respect to Item (7), i.e., the disclosures which should be required of "risks involved in [bank] leasing transactions and standby letter of credit commitments," these items (which to date affect mostly large banks) are under continuing review by the bank regulatory agencies. All three bank regulatory agencies have adopted regulations governing the use of standby letters of credit, the gist of which is to require the principal amount of such commitments to be included with outstanding loans in determining whether the bank has complied with applicable lending limits to a single customer. These regulations have greatly reduced the risk of excessive concentrations of credit to a single customer and concomitantly the materiality of such standby letters of credit to an informed investor. The total volume of such standby letters of credit, moreover, is now reported as a memorandum item on the face of the Report of Condition filed four times a year by all insured banks and is available to any interested person on an individual bank basis. All three agencies are also monitoring both leasing transactions and standby letter of credit developments in their examination process and would, I feel confident, require disclosure of material concentrations involving unusual risks known to the agencies if the lending bank seeks to issue securities to the public.

I think this recitation of disclosure developments on the part of the FDIC, the other bank regulatory agencies and the SEC should reassure the Committee that all four agencies take seriously their respective responsibilities to the investment community where publicly offered securities of banks and bank holding companies are involved. Access to material information about bank operations has been significantly expanded over the past ten years, and I have little doubt that this evolutionary process will continue in the months and years ahead.