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Statement by

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before the

Committee on Banking, Housing and Urban Affairs

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I am pleased to appear before you today to present the views of the Board of Governors on the important question of disclosure of data for investor analysis of banks and bank holding companies. We approach this subject with full appreciation of the need, as expressed in our securities laws, for providing the investor with sufficient public information to reach informed opinions on the current and prospective financial conditions of individual institutions.

The Board recognizes the primary role of the SEC in matters of disclosure for investor purposes. Since 1964, when the Board was given responsibility for certain disclosure provisions of the Securities Exchange Act of 1934 as they apply to State member banks, our requirements have followed substantially the counterpart regulations imposed by the SEC on other corporations. With respect to other banks, very similar disclosures have been imposed by the reporting requirements of the other Federal bank supervisory agencies. A great many banks are not subject to the disclosure requirements of the 1934 Act because they have less than 500 stockholders; they also are required by the bank supervisory agencies to file similarly detailed income and balance sheet data subject to disclosure.

In recent years, the bank supervisory agencies have acted on several occasions to expand the amount of individual bank financial data collected and released to the public. We believe that still more disclosure is needed at the present time, and our reporting requirements will be revised accordingly. Banking practices have undergone rapid modification in recent years as banks have accommodated to changes in the "state of the art" and to the economic environment, and further substantial changes are undoubtedly in store over the years to come. Accordingly, I can assure you that the question of disclosure will remain under continuing review by the Federal Reserve and we stand ready to make further adaptations in reporting as conditions warrant.

While fully recognizing the need for disclosure, we also have been aware that, as with all worthy objectives of public policy, provision for meeting the informational needs of the investor involves certain costs. In extreme cases, those costs could far outweigh possible benefits to the investor that the additional information would provide. For banks and other depositary institutions with liabilities withdrawable on demand or on short notice, disclosure requirements need to guard against triggering unwarranted rumors that could impel large outflows of funds. Thus, the Board has approached the disclosure problem mindful of its statutory responsibilities as a bank regulator and supervisor to maintain an environment in which the banking system can adequately serve the public interest.

In providing for investor informational needs, the Board believes that the public interest will be served most effectively if essential disclosure is achieved as fully as possible through regular reporting requirements imposed by Federal bank supervisory agencies and the SEC. Only with comprehensive, standardized, periodic reporting can the necessary time series of financial information be provided that will enable the investor to discern significant trends in individual bank performance and make an adequate assessment of future prospects. Moreover, with such a factual base, substantial changes or differences in the performance of individual banks can be examined in the broad context of contemporary developments at comparable banks. More importantly, a requirement of meaningful regular reporting should help to minimize the need for ad hoc disclosure at the time of proposed financings. Such disclosure carries a risk that individual banks issuing securities will be required to release types of information not available for other banks that might be misleading or misinterpreted by the market.

The Board also believes that the major focus, in constructing a disclosure framework for banks and bank holding companies, should be on earnings performance as reflected in the income statement. Fundamentally, what the investor in any enterprise is purchasing is management ability and market opportunities. Over time, these are effectively reflected, in distilled form, by earnings performance. In recent years, the undue attention that often has been focused, by investors as well as management, on size or "footings" rather than on operating results, sometimes has led to misinterpretation of the true picture of financial strengths or weaknesses of banks and bank holding companies.

To effectively serve its informational function, the income statement should portray not only what the bank or company has done, but also should reveal enough of the institution's sensitive vital signs so that the investor can make an informed estimate of the prospective income flows. The present income statement required to be filed by all Federally supervised banks provides extensive detail directed toward meeting these needs. Included in such statements are refined breakdowns of income and expenses, loan loss and recovery experience, provision of reserves against future losses on loans and securities, and segregations of income earned in certain specialized activities such as foreign branch and trading account operations.

But even more income-statement detail now seems desirable in order to enable the investor to make an adequate assessment of future earnings possibilities and to forecast an institution's ability to adjust to the more fluid market environment that has been emerging. In particular, we are contemplating additional reporting to provide for:

1) a more comprehensive measure of the cost to the banks of interest-sensitive funds;

2) a breakdown of loan charge-offs and recoveries; and,

3) a measure of the effect on bank income of loans that are past due or have otherwise been subject to reduction or deferral of interest or principal because of problems associated with the borrower.

Detailed information regarding the composition of assets and liabilities of banks and bank holding companies is also an important ingredient for adequate investor analysis. Such data are needed to aid in the interpretation of the income statement, to determine trends and current status of the bank's operations, and to appraise the bank's liquidity, capital adequacy, and general financial condition. The present supervisory "Call Report," which includes over 100 separate asset and liability items, already provides the bulk of the information needed for these purposes.

Nevertheless, some additional balance sheet reporting may now be advisable to reflect recent changes in banking activity and in the environment in which banks operate. We have been discussing possible major additions to regular reporting subject to disclosure by at least the larger banking organizations. These might include:

1) a maturity breakdown for major categories of investments;

2) a classification of loans according to whether the rate charged is fixed or floating;

3) a breakdown of the outstanding amount of time deposits in denominations of $100,000 or more; and,

4) information on the amount of outstanding loan commitments and the amount of outstanding credit under those commitments.

More frequent reporting of income and balance sheet information also seems desirable for adequate investment analysis in a rapidly changing economic environment. Accordingly, we are considering a requirement that reporting of income, now required annually, be set on a quarterly basis for large banks and semi-annually for smaller banks. In addition, the spring and fall Call Reports, which currently are less detailed than those for June 30 and December 31, may be expanded to include the greater detail.

As the Committee is aware, the bank supervisory agencies, at the request of the SEC, have been participating in intensive interagency consultations over the past three months for the purpose of seeking a common understanding regarding questions of appropriate financial disclosure for banks and bank holding companies. I think the group has made important progress toward that goal. Substantial agreement has been reached regarding the areas in which additional disclosure is needed and most of the specific types of information that would best meet investor needs. All the agencies involved have shown a keen awareness of the need to obtain increased disclosures in ways that will minimize the risk of misinterpretation or unjustified disturbance to confidence.

The interagency coordinating group has been grappling with highly complex issues, and some further discussions will be necessary. We are pressing forward as rapidly as possible, and there is every reason to expect, on the basis of progress to date, that we will soon be in a position to publish both the new disclosure guidelines and the revised bank reporting requirements.

Many suggestions for increased bank and bank holding company disclosures are being offered in the course of these Congressional hearings. I would caution that, in evaluating these suggestions, it is vital to take into account a variety of considerations that bear on the extent to which disclosure serves the public interest. Certainly the investing public must have access to all material information needed for intelligent investment decision-making. But unreasonable or excessively detailed demands for information or requirements for disclosure of information that might be misleading, could be counterproductive. Such demands could fail to serve the interests of the investor, who is the intended beneficiary. More importantly, they might injure a bank's depositors and borrowers, and thus the general welfare of the community that it serves. Finally, they could create an unjustifiable and costly burden on the reporting institution.

It is most important that the type and form of disclosure imposed on banks be carefully weighed so as to avoid undermining the willingness of banks to assume risk or eroding the confidence of depositors--a critical determinant of banks' ability to attract the funds needed to finance lending activities. The evaluation and assumption of risk are basic attributes of commercial banking. Only if a bank is willing to assume reasonable risks will it be able to help its local community to grow and prosper. This can be done prudently if the institution maintains adequate diversification, so that losses are relatively predictable, and if the bank's charges are commensurate with its costs, including the risk of losses that may be incurred on its portfolio of loans and investments.

We must keep in mind that some loan losses are to be expected when a bank is fully serving the needs of its customers. To overemphasize disclosure of such losses could jeopardize the depositor confidence so necessary to the health and progress of a financial institution. Release of information that the public has little or no experience in evaluating may suggest possible trouble at a bank or bank holding company and thus bring on sizable deposit outflows, especially of impersonal money market funds. We, therefore, have had to seek a fine balance between the attainment of the level of disclosure needed for intelligent investor decision-making and the avoidance of the kinds of information that might damage the public interest in maintaining stability and responsiveness in our banking institutions.

Also of major significance, particularly at this juncture, is the potential impact that ill-conceived disclosure requirements might have on the willingness and ability of banks to acquire additional capital through public issuance of securities. Owing to rapid asset growth in recent years, capital positions at a number of banks have approached minimum acceptable levels. These banks need additional capital if they are to participate fully in meeting the loan demands that will be generated by vigorous economic recovery. But they may not be willing or able to raise the capital that is required, unless the channels for long-term market financing are kept free of artificial impediments.

In summary, we at the Board are well aware of the need for full and meaningful disclosure of the information on the affairs of individual banks required for sophisticated and intelligent investment analysis. We intend to call for such disclosures, insofar as State member banks are concerned, and we are confident that the other agencies--all of whom have benefitted by the deliberations of the coordinating group--will do the same. But we are also most mindful of the other public policy objectives that must be served. The continued stability of our financial system, the need to encourage reasonable risk-taking by our banking community, and the need to raise the additional capital required to support a vigorous expansion in bank lending in support of economic recovery are among the most important of these other considerations.

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