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TELL IT LIKE IT IS

Address by

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Association of Registered
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I appreciate this opportunity to discuss the relationship of the Securities and Exchange Commission to banks and bank holding companies. If that relationship is to be one of mutual trust and confidence and result in benefits to the public in this period of time when there is so much mistrust and misunderstanding of our business and governmental institutions, we must at least understand each other. Hopefully, this occasion will help you become better acquainted with the Commission, its procedures, and its increasing responsibilities with respect to banks and bank holding companies.

When Congress passed the Securities Act of 1933, it determined that, in order to protect investors and to assure fair and honest securities markets, all material facts relating to securities and their issuers should be disclosed. The basis for this decision was that such disclosure would provide investors with an opportunity to make informed investment decisions. To implement this concept, the Securities Act provided that, subject to specifically defined exemptions, before securities could be offered to the public a registration statement must be filed with the Securities and Exchange Commission disclosing material information about the issuer

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and its securities, and that a prospectus containing such information must be delivered to investors prior to or at the time of sale. This disclosure concept was expanded in the Securities Exchange Act of 1934 which was amended in 1964 to require issuers having assets exceeding $1 million and a class of equity securities held by five hundred shareholders to file periodic reports in order to provide continuous disclosure of information to investors.

An exemption from the registration requirements was provided in Section 3(a)(2) of the Securities Act for securities issued or guaranteed by a bank, and Section 12(i) of the Securities Exchange Act vested the authority to administer and enforce periodic reporting by bank issuers in the bank regulatory agencies. However, because the securities of bank holding companies do not come within the Section 3(a)(2) exemption and because Section 12(i) does not apply to bank holding companies, they must comply with registration and periodic reporting requirements established by the Commission.

While the securities laws specify to some extent the basic information to be included in registration statements and periodic reports, the Commission was granted broad discretionary authority to require the disclosure of additional information. To facilitate registration of securities by issuers, over the years the Commission has adopted registration forms and guidelines which describe appropriate minimum standards of disclosure for various types of offerings.

These forms and guidelines are helpful, but they cannot cover all possible disclosure situations, and, as a general practice, the Commission's staff provides additional guidance to individual registrants through prefiling conferences and informal letters of comment. In order to evaluate the adequacy of disclosure, the staff frequently requests supplemental information in addition to that called for in a registration form or guideline, and, if it appears necessary, the staff may request that some of the supplemental information also be included in the registration statement or other disclosure document. It should be remembered, however, that, although the Commission attempts to assist registrants to provide adequate disclosure, the responsibility for full and fair disclosure remains with the registrant.

During the economic downturn in 1974, the Commission became concerned that some registrants were not adequately describing significant business uncertainties on their own initiative. Moreover, in the fall of 1974, some major public accounting firms which audit banks and bank holding companies informed the Commission's staff that the current economic conditions made evaluation of loan loss reserves and related items difficult, and that more specific disclosure guidance in this area might be helpful. The Commission decided that it would be appropriate to issue an exhortatory release reminding registrants that, when there are significant uncertainties or unusual financial risks, reporting entities

have a responsibility to disclose such facts in filings with the Commission.

This was accomplished in December of 1974 through Accounting Series Release No. 166 which described the type of disclosure that would be appropriate in various situations. Among other things, the release suggested that financial institutions disclose information necessary to enable investors to understand the nature and the status of loan portfolios, including a breakdown sufficient to provide investors with insight into investment policies, lending practices, and portfolio concentrations. Where material increases had occurred in delinquent loans, loans of doubtful collectibility, or in loans extended or renegotiated under adverse conditions, the release recommended that such facts be highlighted.

This Accounting Series Release did not constitute rulemaking or a change in disclosure policy by the Commission as some have suggested. Nor was it the basis on which the Commission has requested additional disclosures in the registration statements of bank holding companies filed with the Commission. The release was just an efficient method whereby registrants could be alerted to certain basic disclosure responsibilities prior to the filing of a registration statement or periodic report.

Officials of bank holding companies and the bank regulatory agencies expressed concern to the Commission that

the disclosures suggested in the release and being requested by the staff in registration statements could have an adverse effect on bank holding companies and inhibit them from seeking and obtaining needed additional capital. Recognizing that a basic purpose of our securities markets is to provide debt and equity capital to business enterprises, the Commission certainly has no desire to impede or restrict bank holding companies from publicly offering their securities. However, consistent with our statutory responsibilities, we must assure that, just as with other registrants, adequate disclosure of bank holding company operations is provided so that investors can make meaningful decisions among investment alternatives.

During the last 18 months, articles regarding problems in the banking industry have appeared almost every week in newspapers and national news magazines. These articles, often quoting federal bank agency officials, have discussed problems with real estate investment trust loans, tanker loans, loans to insiders or affiliates, problems with foreign currency and municipal securities transactions, declining bank capital ratios, laxity in bank regulation, and the failure of large banks. The public has been made aware that banking is a business in which there are risks, that there may be significant differences in the operations of individual banks, and that changes in economic conditions which could be detrimental to one bank might be less detrimental or even beneficial to another bank.

In the absence of adequate disclosure, banks which have operational problems and those which do not are painted with the same brush. This provides undeserved benefits in the form of deposits and higher security prices to problem banks at the expense of those which are problem free. Full and fair disclosure is a requirement to "tell it like it is" and provides a basis for those who so desire to differentiate between alternatives. To the extent depositors and investors do logically differentiate, they would be expected to patronize those banks which they believe to be sound and invest in those which offer the desired risk-reward investment opportunities. This does not mean that only the largest or strongest banks would attract investors. In fact, sometimes the best investments are made when others have over-reacted to the problems a bank may be having, and there are always investors who are willing to take greater risks with the prospect of greater returns.

The Commission discussed our disclosure philosophy and its impact on banks at meetings with top officials of the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller with which we believe we have a very good working relationship. The consensus reached in these meetings was that we should form an Interagency Bank Disclosure Coordinating Group which could combine the expertise of the four agencies to develop a proposal for bank holding company disclosure guidelines.

After several months and many meetings, the efforts of the Coordinating Group resulted in proposed Guides 61 and 3 which were published by the Commission on October 1 and on the same day the Federal bank regulatory agencies issued proposed changes in the reporting requirements for banks generally and supplemental requirements for large banks. While there is substantial accord between the SEC and the bank regulators on most issues in the proposed guides, there is not complete agreement. The comment period for the proposed guides expires on November 30, and the Commission will evaluate the comments received and make whatever changes seem appropriate before adopting the guides.

The guides will be helpful in indicating the type of disclosure expected of bank holding companies in both registration statements and periodic reports and should facilitate the processing of filings at the Commission. It is important, however, to realize that the guides will not contain all of the criteria for the preparation of registration statements and cannot be considered to be forms which, upon completion, will satisfy bank holding companies' disclosure responsibilities. Nor will they supplant the need for detailed staff review and comment on registration statements or preempt the staff from requiring additional disclosures.

There is no all-inclusive checklist or recipe of required disclosure because full and fair disclosure depends

on all the facts and circumstances relating to a particular filing. In addition to items contained in the guides, a registration statement or other report must set forth such information, if any, that may be necessary to make the required statements not misleading.

The proposed guides are compatible with the proposed bank agency reporting requirements in order to minimize reporting burdens for bank holding companies, but in some instances the guides would ask for additional information. In general, the guides would require balance sheet data as daily averages, percentages of total assets, total liabilities, and capital; information about 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.

Section 3 involves the loan portfolio and is perhaps the most controversial part of the proposals. That section would require disclosure of the daily average amount of various types of loans in the loan portfolio at the end of each of the last five years, information regarding the

sensitivity of portfolio loans to changes in interest rates, and the range of maturities of loans in the portfolio for the latest reporting period.

It would also request disclosures relating to risk aspects of the loan portfolio. Three alternative methods of reporting this information are proposed for comment. The first would require disclosure of the aggregate amount of loans, the interest or principal payments on which are 60 days or more past due, or the terms of which have been renegotiated to reduce or defer interest or principal payments because of a weakening position of the borrower and the impact the loss of interest on such loans has on income. The same information would be required for loans which, in management's opinion, involve a reasonable probability that principal and interest may not be collectable. The second alternative is the same as the first except that it does not call for disclosure of aggregate amounts in the various categories. The third alternative is the same as the second except that it would require information about loans involving expected losses and the aggregate amount of such loans.

One commentator has suggested that these alternatives are like offering a prisoner a choice among crushing in an iron maiden, garrotting, or the firing squad. Such a statement conveys the impression that the commentator does not support any of the alternatives, and, while it is very expressive, it is not very helpful. The Commission believes

very strongly that material information should be disclosed, but we realize that disclosure requirements must be considered in the context of reporting burdens. We do not want to burden bank holding companies with reporting requirements that do not provide investor benefits outweighing the costs, and, thus, we hope to receive thoughtful comments both from those desiring more disclosure as well as those who would be required to provide such information. In the event you believe that what is requested in the proposed guides is not reasonable, we would appreciate your suggestions as to how we could bring about our objectives in a more appropriate manner.

During the last six or seven months, the Commission's staff has been requesting bank holding companies to provide disclosure similar in substance to that which would be required by these proposed guides, and the staff will continue that procedure while the guides are being considered. Bank holding companies that have filed registration statements have provided the information requested and apparently have not been adversely affected in obtaining additional capital. Of course, one cannot determine from this experience how many other bank holding companies might have decided to enter the market for additional capital if such disclosures had not been required by the Commission, and it has been suggested that some have not entered the capital markets for just that reason.

This leads to a question which perhaps raises the central issue. Should banks be granted a preferred position

of seeking capital from the public without disclosing the composition of their assets and liabilities and other material facts about their operations upon which investors may evaluate the impact which economic events could have on their competitive position and earnings? Knowing that there are those who differ, I believe the answer to this question must be negative. Furthermore, I would assert that such disclosures will not bring about irrational behavior by depositors or investors. Some banks may be adversely affected, but others would be benefited. Disclosure may well make it more difficult for a weak or poorly-managed bank to obtain capital and deposits, but, in my opinion, that is the essence of a free, competitive, capital market. I do not believe it is in the public interest, or in the long run interest of our banking system, to insulate banks from such market forces.

Banks require full disclosure by those who seek to obtain funds from them, and decisions with regard to whether funds should be made available and the rate to be paid for such funds are made by evaluating the information provided. Moreover, there are possible criminal penalties for willfully furnishing false information in connection with these transactions. It seems only fair that, in turn, those who are solicited to provide the funds on which banks operate, either in the form of deposits or investment capital, should also be entitled to full and fair disclosure so that the

decision of whether to entrust a bank with deposits or to invest in its securities may be made on a more rational basis.

While there may be some disagreement with the disclosure requirements in the proposed guides, there should be a recognition that meaningful disclosure will be required, and that the SEC will have an increasingly important role in the disclosure that is required not only of bank holding companies, but also of non-holding company banks. The concept of more disclosure of all business and government operations has great public and congressional support. The Freedom of Information Act which is requiring the SEC and other government entities to disclose more of our internal operations, and the proposed Government in the Sunshine bill recently approved by the Senate without opposition, are hard evidence of support for this concept. Moreover, the Commission has received strong support from members of Congress and other sources to require significantly more disclosure than proposed in the bank holding company guides which we have published for comment.

It also appears that the SEC will have an increasing impact on disclosure by commercial banks which are not affiliated with holding companies. H.R. 11221, which was enacted in 1974, contained a provision requiring the bank agencies to conform certain bank regulations and reporting requirements to those issued by the Commission, unless the bank agencies found that it was not necessary or appropriate in the public interest or for the protection of investors to

make such revisions and reported their reasons for such a decision to Congress. This congressional directive was applicable to rules and regulations pertaining to periodic financial reports, tender offers, proxies, and insider trading transactions. The thrust of this legislation was that, at least in the areas enumerated, banks would be required to operate under the same general regulatory framework as bank holding companies and other public corporations.

There has also been considerable debate as to whether the Commission or the bank agencies should regulate the securities activities of banks. In the Securities Acts Amendments of 1975, which were signed by the President on June 5 of this year, although accommodations were made in recognition of the bank regulatory structure, the Commission was designated to carry the primary regulatory responsibility for certain bank securities activities, and, in my opinion, this trend will continue in the future.

In the municipal securities area, registration of both non-bank municipal brokers and dealers and bank dealers is to be with the Securities and Exchange Commission. Following the self-regulatory pattern of the securities industry, the newly appointed Municipal Securities Rulemaking Board, created by the 75 Amendments, will promulgate rules subject to Commission review for both bank and non-bank firms. In addition, the Commission has authority to establish rules on its own initiative. Examination and enforcement responsibilities

are divided among the appropriate bank agencies and the Commission, but the Commission may examine and bring enforcement cases against bank dealers when deemed appropriate or necessary. Similarly, although the bank agencies have a responsibility to establish safekeeping standards for bank clearing agency operations, the Commission, while directed to consult with the bank agencies, was granted ultimate decisionmaking responsibility over clearing agencies and transfer agents.

Banks and bank holding companies will also be affected by new reporting requirements applicable to institutional trading activity which will be implemented by the Commission under the Securities Act Amendments of 1975. Section 13(f) of the amended Securities Exchange Act requires institutional investment managers exercising investment discretion over holdings of equity securities which have an aggregate fair market value of at least $100 million to report such holdings as the Commission by rule may determine. These reports may include the name of the issuer and the title, class, CUSIP number, number of shares or principal amount, and aggregate fair market value of each security. The section also provides that transactions or a series of transactions having a market value of $500,000 or more may be reported for particular reporting periods. The Commission is directed to make this data conveniently and promptly available for the payment of a reasonable fee.

The section also grants the Commission a great deal of discretionary authority. For example, we can raise or lower the reporting levels for both securities holdings and transactions, specify the reporting form in which such information should be submitted, require additional information regarding the securities held and traded, and determine the frequency of filing reports. The Commission has begun to develop a reporting system, but it is too early to predict the nature of the requirements that will be proposed.

The development of this program will not take place in a vacuum. The law directs the Commission to consult with the Comptroller General, the Office of Management and Budget, appropriate regulatory agencies, and other federal and state authorities. A major objective of such consultation is to achieve a centralized, uniform, efficient system for all institutions and avoid unnecessary duplicative reporting. Already the staff has participated in meetings with other federal agencies to exchange views and to seek agreement concerning an acceptable reporting program. We have been asked whether national banks which are presently required to file reports on securities holdings and transactions with the Comptroller of the Currency should be excluded from the reporting system to be established by the SEC. There appears to be no basis for such an exclusion. Section 13(f) requires that all institutions report information to a single, central

repository in order to establish a common data base. Of course, the Commission will consider the needs of other agencies in establishing our reporting system and will make the information received through that system available to other agencies. If the Comptroller and other agencies, in order to fulfill their regulatory purposes, need information in addition to that which we may require, they may require supplemental information from those under their jurisdiction.

In addition, there are questions as to whether reporting might be appropriate only for those securities listed on NASDAQ or an exchange or whether it will be necessary to have reports on a much larger group of securities, and, whether, at the outset, the usefulness of certain optional information such as that regarding individual transactions would outweigh the costs involved. I encourage you to give us your comments, views, and suggestions on the reporting you believe to be appropriate while we are developing this new system. When we have developed what we believe to be reasonable and acceptable, the Commission will publish a reporting proposal for public comment.

The 75 Amendments also authorized and directed the Commission to undertake two rather broad studies that could eventually have an effect on bank securities activities. One study, referred to as the "street name" study, will consider whether the practice of registering securities in a name other than the beneficial owner is consistent with the objectives

of the Securities Exchange Act. The use of street name registration may impede communications between issuers and their beneficial owners, but, on the other hand, such registration facilitates timely and convenient transfers of ownership. The Commission must report its final conclusions and recommendations with respect to these conflicting objectives to Congress by June 4, 1976.

The second study, generally called the bank study, will consider the extent to which persons excluded from the definitions of broker and dealer in the Securities Exchange Act engage in securities activities, and, whether, in light of the existing regulatory framework applicable to the securities activities of such persons, the exclusions are consistent with investor protection and other purposes of the Act. We have already received public comments on some of these issues in response to our release soliciting views concerning bank-sponsored investment services. The Commission will undertake further inquiries including interviews with bank and nonbank institutions engaged in securities activities and perhaps will hold public hearings. In addition to our study, the Senate Committee on Banking, Housing and Urban Affairs has solicited public comments on its September 29, 1975, study outline entitled "The Securities Activities of Commercial Banks," which will consider the type of securities activities appropriate for commercial banks, and the Committee intends to hold Congressional hearings on this subject next month.

The trend towards greater SEC involvement in the regulation of bank securities activities appears to be continuing in other proposals being considered by Congress. On Thursday of this week, the Senate Committee on Banking, Housing and Urban Affairs is scheduled to consider a Committee Print of S. 425, the Foreign Investment Act of 1975, which, among other things, contains a section prohibiting any broker, dealer, or bank from effecting a transaction, or inducing or attempting to induce the purchase or sale of certain classes of securities if such broker, dealer, or bank knows, or in the exercise of reasonable care should have known, that a person holding 1/10 of 1% of such securities for himself or another person has not reported information with respect to the identity, nationality, or beneficial ownership of such securities to the issuer, other persons, or the Commission as the Commission by rule may prescribe.

Going even further, the Discussion Principles for a restructuring of regulations applicable to financial depository institutions recently released by the House Committee on Banking, Currency and Housing suggests, among other things, that the SEC participate in such regulation by including a member of the SEC on a newly created Federal Depository Institutions Commission. This new Commission would fulfill the regulatory and supervisory functions of the present bank regulatory agencies, the Federal Home Loan Bank Board, and the National Credit Union Administration. Moreover,

one section of the Discussion Principles states " . . . depositors, borrowers, and investors of depository institutions are entitled to more information than they now receive."

I should point out that the Commission has not requested the authority contained in these last two proposals nor have we formulated a Commission position on the proposition that an SEC Commissioner serve as one of the five Commissioners which would regulate and supervise financial depository institutions, but these proposals indicate a continuation of the trend I have discussed.

Regardless of developments that may occur in future legislation, it is clear to me that the SEC and the banking industry must work together if we are to fulfill our statutory responsibilities, and, at the same time, minimize the burdens that banks and bank holding companies must bear.