CHAIRMAN OF THE BOARD OF GOVERNORS
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

AUG 1 1977

The Honorable Harold M. Williams
Chairman
Securities and Exchange Commission
Washington, D.C. 20549

Dear Mr. Chairman:

I am pleased to respond to your letter of April 22 in which you requested the reactions of the Board of Governors to the proposed revision of Article 9 of the SEC Regulations S-X, providing for "specific requirements as to form and content for consolidated and unconsolidated financial statements of bank holding companies and banks." Pursuant to my letter of May 13 and your response of June 6, the SEC staff met with the staffs of the three bank regulatory agencies on June 23 for a discussion of the SEC proposals.

Please be assured that the Board shares the Commission's concerns about adequate and meaningful financial reporting and disclosure by banks and bank holding companies. Our reports on domestic operations were substantially revised and amplified a year ago, and the Federal banking agencies are now in process of revising the foreign aspects of Reports of Condition and Income, the major disclosure and supervisory documents required by the agencies. A staff draft of the revisions has been provided to the Commission staff. Under present plans, these revised reports would be made effective with the first quarterly reports required on 1978 operations. Conforming revisions will also be made at the time in the Board's bank holding company reports.

With respect to the current SEC proposals, the Board believes that there are serious deficiencies requiring careful study and probable reformulation before a revised Article 9 is adopted. I will comment on our general concerns with the proposals in this letter. Additional details on specific points are contained in the enclosed staff memorandum, in which the Board concurs.

One problem has to do with the timing of the proposals. We believe it would be advantageous to the Commission's development of effective disclosure requirements to gain more experience from the results of bank and bank holding company disclosure under SEC Guidelines 61 and 3 (and under the corresponding changes in relevant regulatory reports adopted by the banking agencies). At the time these Guidelines were

issued in August 1976, the Commission stated that the experience under the Guides would be monitored to determine by June 1978 if further changes in disclosure were needed. It does not appear to us that there is adequate justification for cutting short the evaluation of this reporting by well over one year.

Serious substantive problems arise from the application to banks and bank holding companies of formats and definitions that are "applicable to commercial and industrial companies." There is a need to look more carefully at the extent to which the form of bank and bank holding company disclosure can or should copy that deemed appropriate for predominately nonfinancial corporations. Similarly, there is a need to choose appropriate bank disclosure formats in light of the various purposes and different users that disclosure must serve. If one takes account of the interests of depositors, loan customers, and the public generally, as well as of present and potential investors, we believe that the primary focus in bank disclosure should continue to be on the liquidity attributes of the assets held rather than on "earning assets." This emphasis is reflected in the "traditional" banking format utilized not only for the 14,000 banks in the United States but also for banks in all major financial centers throughout the world.

The use of different formats to serve different needs for information is burdensome and confusing, both for the respondents and for the public. Specialized information for particular users may be necessary and desirable, but such information should be presented in subsidiary schedules rather than general purpose formats. We also believe that conflicting and overlapping disclosure requirements should be avoided to the extent consistent with statutory responsibilities, in line with the President's program for minimizing public reporting burdens. Before adopting definite rules, the Commission might want to examine more closely how its disclosure requirements for bank holding companies relate to other information demands by other agencies on the same respondents. In particular, it is our belief that careful account should be taken of the nature of the Federal Reserve's statutory and supervisory responsibilities over bank holding companies and of the content of [ ] system of bank holding company reports.

The Board is particularly concerned with the proposed requirement that banks and bank holding companies utilize a so-called "classified" format for their financial statement presentations--earning assets as against other assets, income from earning assets and costs of funds as against other income and expenses. The particular proposals for the division of assets and items of income and expense into these "classified" categories are inappropriate and potentially misleading to users of the data, and we can see no possibility of making any general distinctions of this kind in a meaningful way in the financial statements themselves. In the case of banks, where all aspects of portfolio management and current operations are expected to make a contribution to overall performance, arbitrary distinctions such as are proposed can have nonsensical results. As stated above, we believe that special purpose analyses of this kind can be provided more usefully as subsidiary schedules, pursuant to the requirements of Guides 3 and 61.

The other major new feature of the SEC proposals is the requirement for disclosure of foreign activities in the financial statement. This focuses on foreign customers as defined by domicile, while the proposed report revisions of the banking agencies place major emphasis on office location and provide information on foreign domiciled customers only for selected detail where it is significant. Before a final SEC revised Article 9 is issued, I would hope that further staff negotiation could result in the SEC's defining its foreign requirements in terms compatible with the revised reports of the agencies, which are influenced by statutory and supervisory needs. This desirable outcome might be accomplished, for example, if the SEC were to forego foreign customer detail in those instances where this is of little significance and the agencies were to require additional foreign customer detail where the SEC believes such disclosure to be particularly important.

Given these rather considerable points of disagreement, the Board believes that it would be premature and unwise for the SEC to use its present proposals as the basis for the adoption of a revised Article 9 for banks and bank holding companies. Instead, we would urge that the Commission give further attention to the defects in the present document and that a revised document be distributed for public comment. We would, of course, be glad to cooperate fully in the recommended review and reconsideration.

Sincerely yours,

Arthur F. Burns

Enclosure
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