February 24, 1983

MEMORANDUM FOR THE TASK GROUP ON THE REGULATION OF FINANCIAL SERVICES

SUBJECT: Consolidation of Disclosure Requirements of Financial Institutions Under the Securities Exchange Act of 1934

This memorandum explores the advantages of consolidating within a single agency administration of the disclosure requirements of banks and savings and loan associations under the Securities Exchange Act of 1934 ("Exchange Act"). These disclosures to shareholders are now administered by the SEC, the FRB, the FDIC, the OCC and the FHLBB.

I. OPERATION OF SECTION 12(i)

The federal agencies that regulate depository institutions (the "bank regulators") are required to administer and enforce certain aspects of the federal securities laws. Thus, Section 12(i) 1/ of the Exchange Act, as added by Congress in 1964,

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1/ Section 12(i) provides:

> (i) In respect of any securities issued by banks the deposits of which are insured in accordance with the Federal Deposit Insurance Act or institutions the accounts of which are insured by the Federal Savings and Loan Insurance Corporation, the powers, functions, and duties vested in the Commission to administer and enforce sections 12, 13, 14(a), 14(c), 14(d), 14(f), and 16, (1) with respect to national banks and banks operating under the Code of Law for the District of Columbia are vested in the Comptroller of the Currency, (2) with respect to all other member banks of the Federal Reserve System are vested in the Board of Governors of the Federal Reserve System, (3) with respect to all other insured banks are

(footnote continued)

requires bank regulators 2/ to issue within 60 days regulations "substantially similar" to those issued by the Commission under Exchange Act Sections 12, 13, 14(a), 14(c), 14(d), 14(f), and

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1/ (footnote continued)

vested in the Federal Deposit Insurance Corporation, and (4) with respect to institutions the accounts of which are insured by the Federal Savings and Loan Insurance Corporation are vested in the Federal Home Loan Bank Board. The Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board shall have the power to make such rules and regulations as may be necessary for the execution of the functions vested in them as provided in this subsection. In carrying out their responsibilities under this subsection, the agencies named in the first sentence of this subsection shall issue substantially similar regulations to regulations and rules issued by the Securities and Exchange Commission under sections 12, 13, 14(a), 14(c), 14(d), 14(f), and 16, unless they find that implementation of substantially similar regulations with respect to insured banks and insured institutions are not necessary or appropriate in the public interest or for protection of investors, and publish such findings, and the detailed reasons therefore, in the Federal Register. Such regulations of the above-named agencies, or the reasons for failure to publish such substantially similar regulations to those of the Commission, shall be published in the Federal Register within 120 days of the date of enactment of this subsection, and thereafter, within 60 days of any changes made by the Commission in its relevant regulations and rules.

2/ The Comptroller of the Currency regulates national banks. The Board of Governors of the Federal Reserve System oversees all other federal reserve member banks. The Federal Deposit Insurance Corporation regulates all other federally-insured banks (i.e., state banks that are not federal reserve members). Federally-insured S&L's are regulated by the Federal Home Loan Bank Board.

16, 3/ unless the bank regulators specifically find that such regulations would not be "necessary or appropriate in the public interest or for the protection of investors."

Consequently, publicly held banks and savings and loan associations ("S&Ls") are subject to rules promulgated, interpreted, and enforced by the banking authorities. Publicly held holding companies of banks and savings and loan associations are subject to the Commission's regulations regarding periodic reports, proxy solicitations, and certain other Exchange Act matters, even though the principal assets of such holding companies are banks or S&Ls. The SEC also administers such requirements regarding all other publicly-owned corporations.

II. PROBLEMS WITH OPERATION OF SECTION 12(i)

While one purpose of Section 12(i) was to promote uniformity, it has produced instead a fragmented system with dissimilar

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3/ These sections establish requirements regarding registration of classes of securities, periodic reports, proxy solicitations and information statements, tender offers, and recapture of short swing profits of directors, officers, and principal shareholders.

Section 12(i) does not require the bank regulators to adopt regulations comparable to the Commission's regulations under Section 14(b) of the Exchange Act. Pursuant to authority granted under Section 14(b), the Commission has adopted regulations requiring broker-dealers to mail an issuer's proxy materials and/or annual reports to its customers who are beneficial owners of the issuer's securities that are held of record by the broker-dealer, upon assurance that the issuer will pay the reasonable expenses incurred. Since most securities in street or nominee name are held by banks, similar regulations should apply to banks. This could be accomplished either by amending Section 12(i) to include Section 14(b) or by amending Section 14(b) to give the Commission authority to promulgate rules imposing such responsibilities on both banks and broker-dealers.

disclosure requirements. In addition, unnecessary duplication of staff exists since the SEC and the bank regulators must maintain separate staffs for promulgating and interpreting disclosure requirements, receiving and processing filings, and bringing enforcement actions for violations of the applicable rules. Consolidating responsibility for such requirements in a single agency would eliminate staff duplication and would result in more uniform disclosures to shareholders, which would facilitate comparative analyses of competitive investment opportunities. 4/

Dissimilar disclosure requirements have resulted from delays by the bank regulators in adopting regulations that are substantially similar to the Commission's regulations within the 60-day time period provided in Section 12(i). In some instances, the Commission's and the bank regulators' requirements have differed for several years. For example, the Commission's October 1980 annual reports amendments have not as yet been adopted by the bank agencies. The FHLBB automatically adopts such amendments with the same effective date. 5/

4/ An original justification for Section 12(i) -- that the bank regulators' expertise was necessary to establish reasonable disclosure requirements for depository institutions -- is no longer present. Since the Section's enactment in 1964, the Commission has developed substantial expertise regarding the particular problems of banks and S&Ls in the course of regulating disclosure by bank and S&L holding companies. Thus, Commission Guide 3 is a well-regarded format for disclosure by bank holding companies; it demonstrates that the Commission is capable of establishing workable disclosure requirements for all depository institutions.

5/ See footnote 9 infra.

In addition, disclosure requirements promulgated by the bank regulators have differed significantly from the Commission's regulations. Bank regulators (other than the FHLBB) do not require that financial statements in a bank's annual reports be certified by independent auditors. They accept financial statements that are verified by a bank financial officer or internal auditor.

Also, the Commission requires annual financial statements to be prepared in accordance with generally accepted accounting principles ("GAAP"). Banks prepare their financial statements in accordance with both GAAP and regulatory accounting principles ("RAP"), 6/ which differ depending on the bank regulator. Most significantly, the bank regulators have recently expressed support for some form of "mark-to-market" or "current value" accounting that would allow banks and S&L's to reflect assets,

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6/ The most prominent difference between GAAP and RAP is that GAAP allows goodwill to be written off over time and RAP does not (except with respect to the FHLBB). In addition, the FHLBB has recently allowed several deviations from GAAP that improve the balance sheets of S&Ls.

There are several other differences between Exchange Act filings made with the Commission and those filed with bank regulators. The Commission requires that filings include the registrant's income statements for three years, while the bank agencies, with the exception of the FHLBB, require only two years' income statements. The Commission also requires disclosure of "information relating to the issuer's industry segments, classes of similar products or services, foreign and domestic operations and export sales" (Rule 14a-3(b)(6)), and a "brief description of the business done by the issuer during the most recent fiscal year" (Rule 14a-3(b)(5)). Bank regulators do not require disclosure of this information, because they consider depository institutions to be engaged in one line of business that is already understood by the public. This assumption is increasingly questionable as banks and S&Ls offer diverse financial services such as discount brokerage.

liabilities, and operating results on a more favorable basis than is allowed by GAAP.

These differences in disclosure requirements create a potential for lack of comparability of bank filings and confusion among investors. 7/ Financial statements prepared under the bank agencies' regulations provide differing views of the financial condition of the bank or S&L depending on whether GAAP or RAP principles are applied, while financial statements filed with the Commission are prepared in accordance with GAAP. Bank agency financial statements also may lack the additional assurance and credibility of an independent auditor's certification. Moreover, certain information required by the Commission in bank and S&L holding company filings is not required by the bank regulators in filings by individual banks and S&Ls. Given these disparities, problems in comparing and evaluating bank and S&L securities are imposed on securities analysts and investors.

Section 12(i)'s fragmented division of responsibility among the Commission and four other regulators also requires that five separate staffs be maintained to perform essentially the same functions -- establishing, interpreting, processing and enforcing disclosure requirements under the Exchange Act. Consolidation

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7/ For example, approximately 572 bank holding companies file Exchange Act reports with the Commission. Pursuant to Section 12(i), Exchange Act reports are filed by approximately 380 banks with the FDIC, by approximately 350 banks with the Comptroller of the Currency, by approximately 72 banks with the Federal Reserve Board, and by 157 S&Ls with the FHLBB. Thus, approximately 959 banks and S&Ls file Exchange Act reports with the bank regulators.

of the staffs would result in cost savings and in more uniform and useful disclosures.

III. SOLUTION

Repeal of Section 12(i) would consolidate with the SEC the Exchange Act responsibilities of the 9,000 publicly owned corporations, including the 579 banks and S&Ls. 8/ Before adopting any rules affecting banks, the Commission should be required to solicit the comments of the bank and S&L regulators (as it does now when promulgating rules affecting such holding companies).

A compromise approach would be adoption by the bank regulators of rules automatically incorporating by reference the Commission's disclosure rules, unless specifically waived. 9/ The disadvantages

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8/ The Federal Securities Code as proposed by the American Law Institute ("ALI Code"), also proposes elimination of Section 12(i). 1 A.L.I. Fed. Sec. Code § 402, Comment (5) (1980).

9/ The FHLBB has adopted such a rule which provides:

> [T]he rules and regulations (including forms) prescribed by the [SEC] pursuant to [Sections 12, 13, 14(a), 14(c), 14(d) and 16 of the Securities Exchange Act of 1934] and in effect on such date or as thereafter amended shall continue to apply to securities issued by insured institutions [subject to supervision by the FHLBB] until this part has been amended to otherwise provide. [A]ll filings with respect to securities issued by insured institutions required by such rules and regulations * * * shall be made with the Board * * * and any related filing fees shall be paid to the Board.

12 C.F.R. 563d.1. Thus, S&Ls utilize Commission forms (e.g., the Form 10-K), but they file the forms with the FHLBB.

of this approach include the possibility of selective adoption of rules, and the maintenance of five separate staffs to interpret and enforce such regulations, which could lead to inconsistent results. Bank regulators could also choose not to follow Guide 3, which contains the Commission's bank disclosure requirements. In addition, no common repository for bank filings would be available. Finally, the rules incorporating by reference the Commission's disclosure rules could be revoked simply by agency action upon a change of Administration.