

SECURITIES AND CAPITAL MARKETS

SEC PROPOSES RULES TO UPDATE INDUSTRY GUIDE 3 FOR BANKING ORGANIZATIONS

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In September 2019, the Securities and Exchange Commission (“SEC”) proposed new rules to update the statistical disclosures that banks, bank holding companies (“BHCs”), savings and loan associations, and savings and loan holding companies provide to investors according to Industry Guide 3, Statistical Disclosure by Bank Holding Companies (“Guide 3”). These proposed rules are intended to modernize the statistical disclosures for banks and to eliminate disclosures that overlap with SEC rules, generally accepted accounting principles in the United States (“U.S. GAAP”), and International Financial Reporting Standards (“IFRS”). The proposed rules would replace Guide 3 with a codification of updated disclosure requirements in a new subpart of Regulation S-K. Comments on the proposed rule changes are due to the SEC by December 2, 2019. The proposed rules will not become effective until the SEC has published a final rule.

Background

Guide 3, first published in 1976, was intended to provide investors industry-specific information relevant to BHCs by requiring BHCs to provide tabular and narrative disclosure applicable to their banking operations in addition to the information required in periodic reports and registration statements.

Since Guide 3 was last revised in 1986, the SEC, the Financing Accounting Standards Board (“FASB”), and the International Accounting Standards Board (“IASB”) have adopted new disclosure requirements and updated accounting standards, which have significantly changed financial reporting obligations. In addition, the availability of the SEC’s Electronic Data Gathering, Analysis, and Retrieval System (“EDGAR”) has made registrants’ historical filings much more accessible to the public. The proposed rules reflect the significant changes made in financial reporting in the last 30 years and would be the next in a series of updates banks, BHCs, and similar registrants must adapt to following the 2008 financial crisis, Dodd-Frank implementation, and Basel Pillar 3 disclosure requirements.

Summary of Key Proposed Rule Changes

Set forth below is a brief summary of the key proposed changes to Guide 3:

Expand Scope. The proposed rules would apply to banks, BHCs, savings and loan associations, and savings and loan holding companies (together, bank and savings and loan registrants). While Guide 3 explicitly applies to only BHCs, historically other registrants engaged in lending and deposit activities, such as savings and loan holding companies (“non-BHCs”), have also voluntarily provided Guide 3 disclosures. The proposed rules would formally expand the scope of Guide 3 to apply to non-BHCs.

In addition to non-BHCs, the proposed rules would apply to foreign registrants, with some flexibility to recognize the differences between U.S. GAAP and IFRS. However, the proposed rules would not apply to other companies engaged in lending or deposit activities, such as online marketplace lenders.

Harmonize Reporting Periods with Financial Statements. The proposed rules would reduce the reporting periods currently called for under Guide 3 and align the reporting periods with the number of years to be reported in the financial statements filed with the report.

Guide 3 currently requires BHCs to provide disclosures for each “reported period.” Guide 3 defines “reported period” as five fiscal years of loan portfolio and loan loss data and three years of all other information, although registrants with less than \$200 million of assets or \$10 million of net worth are only required to present two years of information. In addition, registrants must include information necessary to make the disclosures not misleading, including by adding interim period information.

In contrast to Guide 3, the proposed rules would define the term “reported period” to mean each annual period required to be included in registrants’ financial statements, except for certain credit ratios for new public reporters. The proposed rules would require registrants to disclose credit ratios for each of the last five years in an initial registration statement or offering circular under Regulation A.

Retain Average Balances. The proposed rules would continue to require disclosure of average daily balances of significant categories of assets and liabilities, including all major categories of interest-earning assets and interest-bearing liabilities. In addition to codifying the existing requirements, the proposed rules would further disaggregate the categories of interest-earning assets (separating federal funds sold and securities purchased with agreement to resell) and interest-bearing liabilities (separating federal funds purchased and securities sold under repurchase agreements and requiring the disclosure of commercial paper).

Eliminate Most Investment Portfolio Disclosures. The proposed rules eliminate investment portfolio disclosures called for by Guide 3 that are duplicative of U.S. GAAP and IFRS financial statement requirements, including book value information, the maturity analysis of book value information, and disclosures related to investments that exceed 10% of stockholders’ equity. The proposed rules, however, would retain disclosures for weighted average yield of debt securities by maturity but only if not carried at fair value through earnings.

Remove Certain Loan Portfolio Disclosures. The proposed rules would not include loan category disclosures, loan-risk portfolio elements, or interest-bearing asset disclosures currently required by Guide 3. Like the changes in investment portfolio disclosures, the SEC reasoned that similar disclosures are currently required by SEC rules, U.S. GAAP, or IFRS, or will be required soon, like the FASB’s new credit loss standard.

The proposed rules would retain the loan maturity analysis called for by Guide 3, but the loan categories would now be based on the loan categories required to be disclosed in registrants’ U.S. GAAP or IFRS financial statements. The proposed rules also would codify the Guide 3 instruction that determination of maturity should be based on contractual terms and clarify the “rollover policy” by requiring registrants to briefly disclose the policy and how non-contractual rollovers or extensions are considered for maturities classification. Additionally, the proposed rules would codify the requirement to present the total amount of loans due after one year that have (a) predetermined interest rates and (b) floating or adjustable interest rates, except that the proposed rule would require the loan categories disclosed in registrants’ U.S. GAAP or

IFRS financial statements to be disclosed and would not allow exclusion or aggregation of any specific loan categories.

Retain Net Charge-off Ratio and Allocation of the Allowance for Loan Losses. The proposed rules would not require the five-year analysis of loan loss experience and charge-offs required by Guide 3 but would retain the ratio of net charge-offs to average loans outstanding. In addition to the existing requirements, registrants would be required to present this ratio on a more disaggregated basis based on loan categories required to be disclosed in registrants' U.S. GAAP or IFRS financial statements. This addition ties into the SEC's goal of providing investors consistent categories to compare over time and among registrants.

The proposed rules would also retain a breakdown of the allocation of the allowance for loan losses called for by Guide 3 in tabular format (as opposed to narrative discussion) based on loan categories required to be disclosed in registrants' U.S. GAAP or IFRS financial statements.

Add New Credit Ratios. In addition to the net charge-off ratio already required under Guide 3, the proposed rules add the requirement for registrants to disclose three new credit ratios: (1) allowance for credit losses to total loans; (2) nonaccrual loans to total loans; and (3) allowance for credit losses to nonaccrual loans. The SEC reasoned that requiring these ratios would not be unduly burdensome for registrants because these consolidated ratios, or their components, are already reported to the SEC or registrants' banking regulators. These credit ratio disclosures would be required for each of the last five fiscal years in initial registration statements or offering circulars under Regulation A. In other reports filed under the Securities Exchange Act of 1934, the credit ratios are only required to be presented for the same periods as financial statements.

Retain and Revise Deposit Disclosures. The proposed rules would retain most of the deposit disclosure requirements set forth in Guide 3, with several key revisions. The proposed rules would replace the requirement to disclose the amount of time deposits in excess of \$100,000 with a requirement to disclose the amount of time deposits in uninsured amounts by maturity and to quantify the amount of uninsured deposits as of the end of each reported period in recognition of the Federal Deposit Insurance Corporation's ("FDIC") increase in the deposit insurance limit since Guide 3 was published. The proposed rules would also require separate presentation of time deposits in amounts in excess of the FDIC insurance limit and time deposits that are otherwise uninsured, by time remaining until maturity (three months or less, over three through six months, over six through 12 months, and over 12 months).

Eliminate Performance Ratios and Short-Term Borrowings. The proposed rules would eliminate the disclosure of return on assets, return on equity, dividend payout, and equity to assets as required by Guide 3. The SEC reasoned that these ratios are not unique to bank and savings and loan registrants, which are the subject of the proposed rules, and the SEC's guidance on management discussion and analysis regarding key performance indicators would require these disclosures when necessary to an understanding of registrants' financial condition and results of operations.

Furthermore, the proposed rules would eliminate short-term borrowings disclosures called for by Guide 3, with a few exceptions. The proposed rules would codify the requirement to disclose the average rate paid

for each major category of interest-bearing liability and to disaggregate the main categories of interest-bearing liabilities as described above.

Takeaway

The SEC's proposal to update and replace Guide 3 is the result of the SEC's initiative to review outdated and duplicative disclosure requirements and to improve those requirements to decrease the burden of compliance for registrants while providing enough information for investors to make an informed investment decision. Even though the proposed rules to replace Guide 3 are open for comment and will likely not yet be finalized for the upcoming 2020 annual report season, bank and savings and loan registrants should be aware of the proposed rules and should consider how the proposed rules, if adopted, would affect their annual reporting.

If you would like more information on the SEC's proposed rule changes to Guide 3, which can be found at this [link](#), please contact a member of Harter Secrest & Emery LLP's [Securities and Capital Markets](#) group at 716.853.1616, 585.232.6500, or visit www.hselaw.com.

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