NEWS

SECURITIES AND
EXCHANGE COMMISSION
Washington, D. C. 20549
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BANKING AND THE SEC--SOME PERSPECTIVES

An Address By

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Securities and Exchange Commission

July 17, 1975

NATIONAL GOVERNMENTAL AFFAIRS
CONFERENCE
AMERICAN BANKERS ASSOCIATION

SHOREHAM AMERICANA HOTEL
WASHINGTON, D.C.

When I was invited to speak this morning, it was suggested that a suitable topic might be the bank controversy. I might respond to that by asking, what bank controversy?, or, on the other hand, which bank controversy? It would be pleasant to say, in the spirit of detente and Apollo-Soyuz, that there are no controversies between our Commission and banks and bank regulators -- only areas of mutual concern in which somewhat different points of view are occasionally discernible. But, if we admit that a difference of views constitutes a controversy, then there are more than one of them -- actual and prospective.

In recent months, the most widely publicized area of mutual concern has been the question of appropriate disclosures in bank holding company prospectuses. On this matter, it is fair to say that there has been some divergence of views. At one point, late this Spring, I was described in certain quarters as single-handedly preventing our economy from pulling out of the recession by denying our banks access to the additional capital essential to enable them to finance recovery.

Contemplating the possession of that kind of power produced a pretty heady sensation. But I always knew, in my own heart, that it was an exaggeration. I was never really the most powerful official in Washington. Because I know that I cannot do these things alone. After all, we have five members on the Commission and a most able staff. And, even collectively, I never really believed that the Commission was denying banks access to the capital markets, although it took awhile for this to be demonstrated. During that period, the temperature rose as we approached the summer solstice, and publicists performed their favorite role of fanning the flames -- as I perform my customary role of mixing metaphors.

Looking back on the past six months or so, we can see tactical errors on the Commission's side, things we could have done or avoided doing that would have caused events to flow more smoothly. But I am sure that the same is true for the other participants. And there were a few salvos fired that were unnecessary, but they drew no blood, and overall I think the exercise has been a creditable example of intra-governmental cooperation. At the hearings conducted by Senator Proxmire and his Committee on Banking, Housing and Urban Affairs, we have been able to report that the Commission and the bank regulators are in substantial accord on the appropriate additional disclosures to be required of banks, with only some particular details of implementation to be settled upon.

The process has been a progressive learning experience for us and, I believe for them. When our staff, in all innocence, suggested that the simplest way to become educated about a loan portfolio was to have a look at the most recent examiner's report, we learned -- from the shock of disbelief with which the request was received and went reverberating through the banking community -- that an examiner's classifications are a better kept secret than any of the Pentagon's or the CIA's -- if they still have any. In the course of time, we also learned that our beguilement with loan portfolios had diverted us from the significance of interest differentials. And I think it took a little learning on the bank regulatory side to understand why we were not satisfied merely with assurances that a bank was sound and not likely to go under.

Throughout the process, we have been aware of the peculiar sensitivity of banks to mutual confidence. Some of us, including me, even remember when all the banks were closed during the great holiday. We have no desire to spook depositors through overly dramatic and misunderstood revelations. The bank regulators, on the other hand, have shown awareness of the importance of confidence in the capital markets that investors are being told what they ought to know.

In some quarters, I have sensed a feeling that the capital requirements of banks are so important that meeting them is worth a little flim-flamming of investors in order to get their money. No bank regulator ever expressed such a dirty thought. They are all, I am sure, wise enough to know that that would be wrong and would not work anyway. We have, indeed, been much gratified with the good-will and willingness to listen and learn displayed by the bank regulators. I hope we have reciprocated.

I realize that this era of good feeling achieved by the regulators may not extend to the regulated. You may not be charmed by the guidelines which we propose to issue for comment shortly, or with proposed new reporting requirements of the bank regulators. You will, in due course, have an opportunity to express your views. I can assure you, however, that any dissatisfaction on your side will be matched by dissatisfaction on the part of some analysts and others who will think we have not gone far enough.

Much of our problem and yours can, I think, be described as a sort of mutual culture shock. We thought we were behaving in our customary manner to respond to evolving economic events. Some of you and some bank regulators thought we were breaking out of our proper cage and threatening confidence in banks while defying notions of due process in rulemaking. None of us knew the other very well.

From the beginning, bank stocks and other securities have been exempt from the registration provisions of the Securities Act. They are not exempt from the general "fraud" provisions of the securities laws -- and fraud in this context covers a broader area of behavior than does the popular meaning of the term -- but this had not received much attention, and, in any event, a public offering of bank stock or capital notes does not have to be registered with us before it can be offered. So, until the advent of the bank holding company as a popular device, we had very limited experience with bank offerings under the Securities Act and bank managers had no experience with us.

Under the Securities Exchange Act, prior to 1964, banks remained exempt from registration -- and thus from its periodic reporting and proxy solicitation requirements -- because their stocks were not listed on any national securities exchange. The 1964 amendments changed that to require registration of the stock of any bank that was publicly-held, as defined, but administration of the Act was vested, as to banks, not in the Commission, but in the appropriate federal bank regulatory agency. So we still saw very little of banks.

Then came the bank holding companies which, under the securities laws, are not banks. Their securities enjoy no exemption from the Securities Act and, as to them, we administer the Exchange Act. By setting up holding companies, banks walked into our parlor, whether or not they were fully aware of the consequences. For several years, however, this produced no particular distress to the holding companies nor indigestion on our part. Conscious of no particular problems confronting banks, we raised no embarrassing questions about their financial reporting and descriptions of their business in filings with us. But things began to change in 1973.

The unsettled economic conditions of 1974 caused concern at the Commission that registrants generally make meaningful disclosure about the possible effect of the economic changes on their businesses. Bank loan portfolios seemed an obvious area that would be affected by the rather drastic changes in the economy and we were advised by independent accountants and others to press for more information from banks. Thus, the Commission's policy statement, Accounting Series Release No. 166, issued in December, 1974, urged all registrants to communicate to investors any unusual circumstances or significant changes in the degree of business uncertainty existing in a reporting entity. Specifically, the release urged disclosure to help investors to understand the nature and current status of loan portfolios of financial institutions such as banks. This release was exposed by the staff to the federal bank regulatory agencies for their comments prior to its release and some revisions were made in it in response to their comments.

A number of bank holding companies were contemplating public offerings of their securities in early 1975. Accounting Series Release 166 became the focus for certain questions concerning the nature and extent of disclosure about the characteristics of loan portfolios and the application of the concept of materiality under the securities laws. It seems clear, however, that these questions would have arisen even in the absence of ASR 166.

Many of these questions arose in connection with a registration statement filed by Chemical New York Corporation. The staff met with representatives of Chemical on several occasions in an attempt to develop satisfactory disclosures that would be meaningful to investors, including quantitative data concerning the quality of the loan portfolio. Our staff requested that Chemical amend its prospectus to disclose the amount of non-income producing loans as of the end of each of the last three years. Chemical described non-income producing loans as those on which interest payments have been past due for sixty days, plus certain others which had been placed in that category by loan officers. In addition, there was disclosure of the aggregate amount of loans outstanding to real estate investment trusts, the amount of commitments to make additional loans to REIT's, and the dollar amount of REIT loans which were included in the non-income producing loan category. The revised prospectus of Chemical included narrative and statistical disclosure related to troublesome loans and to REIT's that had not been in the initial prospectus.

This was all customary behavior on our part as related to a particular development. ASR 166 was pretty general in its terms and not a rule. But, our registration forms are themselves rather general in many respects and all are qualified by our Rule 408, which is worth quoting because, although it is an accepted canon in securities practice, it seems not to be familiar to bank executives. Rule 408 states:

> In addition to the information expressly required to be included in a registration statement, there should be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances in which they are made, not misleading.

In other words, no registrant is necessarily "home free" simply because he has complied with the specific, affirmative disclosures required by whatever form he is using. He must add whatever is necessary to give the whole picture. Securities lawyers all know this. Bank executives would do well to learn it. Put in context, ASR 166 was intended to inform registrants of our views of what "further material information" might be necessary to comply with Rule 408.

Furthermore, it is quite customary for the details of what further material information is necessary to be worked out with the staff, either in pre-filing conferences or in response to staff comments about the initial filing. In this process, the staff frequently requests further data as so-called "supplementary information" to help it in arriving at an informed judgment. A request for supplemental information does not indicate any staff view that such information must go into the prospectus. But, if a reasonable request for supplemental information is refused and the staff feels unable thereby to have any judgment on the adequacy of the disclosures, then it is justified in declining to grant acceleration. That is how the game has been played for 40 years and will continue to be played.

That is what went on with the Chemical filing. It was not exactly routine. because the particular subject matter was new. And because of the concern of the bank regulatory agencies there was extended consultation with them, specifically with the Fed. I do not mean to shift to them responsibility for what was done. That would not be correct -- but there was consultation.

As we all know, the Chemical offering came a-cropper and spread instant alarm and despondency. It was widely reported that the SEC's last minute demand for disastrous disclosures killed the deal and demonstrated that no bank holding company could satisfy our notions of adequate disclosure and raise new capital. I have been in office long enough to learn something about how to handle such matters. Consequently, during the week when that registration became effective and the offering was subsequently withdrawn, my wife and I were lost in the English Cotswolds.

On my return, however, I devoted a good deal of time to studying the whole episode -- the timing and reasonableness of the staff comments in view of ASR 166, the registrant's decision not to recirculate the amended preliminary prospectus, the market during the critical week, and the considerations that appeared to have led to the decision to withdraw the offering. It seemed clear to me that the reading being given by some banks and some commentators was not justified. While one can never prove that something that did not happen would have happened had it been done differently, neither did it prove that the new disclosures were fatal or would have been had they been in the initial filing.

It was equally clear that enough people were profoundly worried to call for extraordinary measures. This led to the formation of an Interagency Bank Disclosure Coordinating Group with representatives from the Federal Reserve Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and Commissioner Evans from the SEC.

After exploring several ideas, this Group concluded that more comparable disclosures could be obtained, and bank holding companies would better understand what was expected of them, if more specific, standardized data are required of all banks and bank holding companies. Through a task force this has led to what, for us, will be designated as "Guidelines for Statistical Disclosures for Bank Holding Companies."

It is our expectation that the bank regulatory agencies will modify their reporting requirements generally along the same lines. The types of information I am talking about are primarily statistical disclosures relating to loan portfolios, investment portfolios, asset structure, deposit and debt structure, interest rates and differentials, commitments, loan loss experiences and international operations.

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This is information that we hope will help investors differentiate among bank holding companies as sources of income and exposure to risks. We hope to have these guidelines available shortly. But I will not disclose or debate the particular elements of the proposed Guidelines at this time. It will be published for comment before adoption, and we can argue about it then. While we are more than willing to commit our ideas of appropriate disclosures to more detailed form and, especially, to achieve coordination with bank regulatory reporting, we are always chary of lulling registrants into complacency with too much specificity. Don't forget Rule 408!

As to the substance of all this, I would say only a word. Traditional bank financial reporting as required by bank regulators has been primarily devoted to demonstrating solvency and the safety of deposits. This is not enough for an investor in a holding company security. He is, of course, interested in solvency, but he is also interested in earnings prospects. Even a straight debt security of a holding company is dependent, not just upon the solvency of the subsidiary bank, but upon its ability to generate earnings to support dividends to the parent to enable it to service its debt. We have no responsibility for expressing a view on the best level in the corporate hierarchy for external financing. Presumably, even the holder of capital notes of the bank itself is concerned with the income statement as well as the statement of position. But it is very clear that that is where the holder of the parent's securities must look.

When you add to this the growing complexity of bank holding company operations, geographically as well as type of business, and anxieties born of rumored and real difficulties in some industries, and thus in some loan portfolios, we think the need for more corporate disclosure is quite apparent. We are continuing to process bank holding company registrations along these general lines. The capital formation process is working effectively, when market conditions permit. We are learning once again, that rumors, fear and doubt are worse than truth and reality. While we appreciate that most of you would prefer that we do not do you any more favors, we are confident that the access of bank holding companies to our capital markets is better, and will be better, with better disclosures.