CLEARY GOTTLIEB

ALERT MEMORANDUM

# Guide 3 Requirements for Banking Registrants Codified

## Current requirements streamlined to eliminate overlap with other regimes but additional banking-specific disclosures also introduced

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On September 11, 2020, the SEC issued final rules updating and codifying the disclosure requirements for banks, domestic and foreign bank holding companies, savings and loan holding companies and savings and loan associations ("banking registrants") set forth in Industry Guide 3, *Statistical Disclosure by Bank Holding Companies*. The final rules, which provide several welcome simplifications to the disclosure requirements for banking registrants, were adopted substantially as proposed, although the final rules have been modified slightly with the intent to reduce the compliance burden. The SEC also provides certain helpful clarifications in the adopting release to address commenter concerns.

The final rules update the SEC's disclosure requirements for banking registrants to eliminate Guide 3 disclosure items that overlap with other SEC rules, U.S. GAAP or IFRS. However, the final rules also expand upon certain disclosures called for in Guide 3 and will require additional information regarding interest-earning assets and interest-bearing liabilities, loan portfolio maturity, credit ratios, allowance for credit losses by loan category and uninsured deposits. Although the SEC aimed to streamline banking registrants' compliance efforts by decreasing the reporting burden, the final rules will impose certain near-term costs by requiring registrants to modify their systems to track and report this additional information.

The final rules govern disclosures on five topics relevant to investors and bank registrants: (1) distribution of assets, liabilities and stockholders' equity; interest rates and interest differential, (2) investment portfolios, (3) loan portfolios, (4) summary of loan loss experience, and (5) deposits. Our key takeaways from the adopting release are included below, organized by topic as they will appear in the new subpart 1400 of Regulation S-K, which replaces Guide 3.

The final rules will be effective 30 days following publication in the Federal Register and will apply to fiscal years ending on or after December 15, 2021. However, the SEC will permit voluntary compliance with the new rules in advance of the mandatory compliance date. Guide 3 will be rescinded effective January 1, 2023.

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## Overview and Key Takeaways

Item 1401 – General Instructions

— ***Scope of Guide 3's application preserved.***

Although certain commenters suggested the scope should be expanded to cover other registrants in the financial services sector (*e.g.,* insurance and fintech firms), the SEC determined in the final rules[1] not to expand the scope of the Item 1400 disclosures beyond banking registrants, noting it did not receive feedback from investors or others explaining how the Item 1400 disclosures would be valuable for assessing non-bank registrants.

- Consistent with Guide 3, the Item 1400 disclosures apply to both domestic and foreign registrants, although foreign private issuers applying IFRS are explicitly exempted from certain disclosure requirements that are not applicable under IFRS.

— ***Flexibility on location of disclosure requirements preserved***. Although the proposal[2] requested comment on whether the SEC should require the disclosures to be provided in notes to the financial statements, the final rules preserve banking registrants' flexibility to determine where to include the required disclosures. The adopting release also clarifies that the disclosures would not be required to be audited or provided in a machine-readable formal using XBRL so long as they are provided outside the banking registrant's financial statements (*i.e*., within Management's Discussion and Analysis ("MD&A") or in the Business section).

— ***Reporting periods aligned with financial statement periods.*** The SEC adopted commenters' suggestions to tie the reporting periods for the Item 1400 disclosures to annual reporting periods of the relevant financial statements (*i.e*., two years for balance sheets and three years for income statements, other than emerging growth companies in IPOs, which may provide two years of income statements). The proposal, by contrast, would have required certain credit ratio disclosures for each of the registrant's last five fiscal years in initial registration statements and initial Regulation A offering statements.

Item 1402 – Distribution of Assets, Liabilities and Stockholders' Equity; Interest Rates and Interest Differential

— ***More granular disclosure of average balance sheet assets required, subject to a materiality qualifier***. Item 1402 codifies Guide 3's current average asset and liability disclosures but further requires banking registrants to disaggregate interest-earning assets and interest-bearing liabilities to include the following new categories:

- federal funds sold;
- securities purchased with agreements to resell;
- federal funds purchased;
- securities sold with agreements to repurchase; and
- commercial paper.

— Despite commenter opposition to this disaggregation, the SEC preserved these new categories in the final rules. However, in contrast to the proposal, the final rules do include a materiality qualifier that allows registrants to omit any of the enumerated categories in Item 1402 when they determine such information would not be material to investors.

**Item 1403 – Investments in Debt Securities**

— ***Requirements overlapping with U.S. GAAP or IFRS disclosure requirements eliminated.*** Item 1403 does not codify the Guide 3 disclosure items involving (a) the book value of investments in debt securities; (b) the maturity analysis of book

[1] The SEC release adopting the final rules, "Update of Statistical Disclosures for Bank and Savings and Loan Registrants" (the "adopting release") is available here.

[2] Update of Statistical Disclosures for Bank and Savings and Loan Registrants, Release No. 33-10688 (Sept. 17, 2019), 84 FR 52936 (Oct. 3, 2019) (the "proposal").

value information; and (c) disclosures related to investments exceeding 10% of stockholders' equity because these disclosures are made in bank registrants' U.S. GAAP or IFRS financial statements.

- However, the final rules do codify the Guide 3 requirement to disclose weighted average yield for each range of maturities by category of debt securities disclosed in U.S. GAAP or IFRS financial statements (but this requirement applies only to debt securities that are not carried at fair value through earnings).

Item 1404 – Loan Portfolio

— ***Requirements overlapping with U.S. GAAP or IFRS disclosure requirements eliminated, but additional disclosures on loan maturities now required.*** Item 1404 does not codify current Guide 3 disclosures that are similar to those already required under U.S. GAAP or IFRS, including information about type of obligor, loan concentrations and other risk elements, or the nature and amount of other interest-bearing assets.

- Item 1404 codifies the maturity and interest rate sensitivity disclosures currently called for by Guide 3, but also expands the disclosure to each category of loans required to be disclosed under U.S. GAAP or IFRS financial statements.

- The SEC also clarifies the "rollover policy" for these disclosures in Item 1404, which provides that to the extent non-contractual rollovers or extensions are included for purposes of measuring the allowance for credit losses under U.S. GAAP or IFRS, such non-contractual rollovers or extensions should be considered for purposes of the maturities classification and the policy should be briefly disclosed.

- Although commenters requested that the final rules permit banking registrants to exclude certain loan categories from their Item 1404 disclosures, the SEC determined not to provide registrants with such discretion because they believe that immaterial loan categories are generally not presented in financial statements and therefore not required under Item 1404. However, the adopting release also clarifies that the SEC does not expect loans aggregated in an "other" loan category in a registrant's financial statements to be disaggregated for purposes of Item 1404 disclosures.

- *Additional maturity categories introduced*. In response to commenter feedback about large portfolios being concentrated in a single maturity category, the final rules require more maturity categories than originally proposed. The proposed "after five years" maturity category has been split into two categories: (1) after five years through 15 years and (2) after 15 years.

- The SEC intends for the additional maturity categories to elicit more decision-relevant information for investors by capturing the maturity periods of commonly offered residential loan products, such as 15-year and 30-year residential mortgages. Accordingly, under the final rules, residential mortgage loans will no longer be categorized in a single maturity category, and outstanding loans may migrate over time into different maturity categories.

Item 1405 – Allowance for Credit Losses

— ***Requirements overlapping with U.S. GAAP or IFRS disclosure requirements eliminated, but additional credit ratios now must be disclosed.*** In keeping with the SEC's intent to streamline its disclosure requirements, Item 1405 does not codify current Guide 3 disclosures that are similar to those already required under U.S. GAAP or IFRS, including certain information about loan loss exposure, recoveries and net charge offs and

provisions. However, the final rules introduce expanded credit ratio disclosure requirements. Item 1405 requires the disclosure of credit ratios for each reporting period, along with each component of the ratio's calculation. This disclosure must be provided for each loan category required in the registrant's U.S. GAAP or IFRS financial statements.

- *Additional credit ratios required*. Under the final rules, banking registrants must now disclose the following credit ratios at each period, along with each of the components used in their calculation: (1) allowance for credit losses to total loans; (2) nonaccrual loans to total loans; (3) allowance for credit losses to nonaccrual loans; and (4) net charge-offs to average loans.

- The first three ratios may be disclosed on a consolidated basis, but the fourth (ratio of net charge-offs to average loans) must be disclosed by loan category consistent with the registrant's financial statements.

    - Foreign private issuers applying IFRS are not required to disclose the ratios above that relate to nonaccrual loans as there is no concept of nonaccrual loans in IFRS.

- *No changes to the final rules due to CECL or IFRS 9*. Some commenters urged the SEC not to require disclosure of these ratios given potential changes arising from adoption of CECL and IFRS 9.[3] The SEC notes in the adopting release that these credit ratios have been customarily disclosed by most banking registrants with material loan portfolios, and such registrants have continued to provide these disclosures in their earnings releases and period reports following the adoption of CECL and IFRS 9.

    - The adopting release does not discuss the optional adjustments to regulatory capital that the federal banking agencies have provided to U.S. banking organizations to delay and smooth the impact of CECL's expected adverse impact on common equity tier 1 capital.[4]

    - U.S. banking organizations that opt into these adjustments to regulatory capital must disclose these adjustments on their call report or form FR Y-9C, and most banking registrants have also included a discussion of such adjustments in their periodic SEC disclosures.

- A discussion of the factors that drove any material changes in these required credit ratios, or related components, is also required under the final rules despite opposition from some commenters.

- The SEC notes in the adopting release that such narrative disclosure is necessary for an investor's understanding of the material

[3] Accounting Standards Update 2016-13- Financial Instruments – Credit Losses (Topic 326) ("CECL") replaces the current U.S. GAAP incurred loss methodology with a current expected loss methodology that reflects expected credit losses over the entire contractual terms of the financial instruments. Absent an election to suspend adoption under Section 4014 of the Coronavirus Aid, Relief, and Economic Security Act, the CECL became effective for public business entities that meet the definition of an SEC filer for their fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Pub. L. No. 116-136, 134 Stat. 281 (Mar. 27, 2020). IFRS 9 – Financial Instruments became effective January 1, 2018 for calendar year companies and requires a 12-month expected credit loss measurement unless there has been a significant increase in credit risk, in which case it is a lifetime expected credit loss measurement.

[4] *Regulatory Capital Rule: Revised Transition of the Current Expected Credit Losses Methodology for Allowances,* 85 Fed. Reg. 17723 (Mar. 31, 2020).

changes in the ratios and the credit quality of the portfolio, and that such discussion could be provided with MD&A.

Item 1406 – Deposits

— ***Proposed requirements to disclose additional information on uninsured deposits adopted with some modifications aimed at reducing burden.*** Consistent with the proposal, the final rules now require disclosure of (1) U.S. time deposits in excess of the Federal Deposit Insurance Corporation ("FDIC") insurance limit and (2) time deposits that are otherwise uninsured by time remaining until maturity of: (A) three months or less; (B) over three through six months; (C) over six through 12 months; and (D) over 12 months.

The final rules also codify the existing Guide 3 disclosure requirements related to the average amounts of and the average rates paid for specified deposit categories that exceed 10% of average total deposits, the amount outstanding of certain time deposits of $100,000 or more and the aggregate amount of deposits by foreign depositors in U.S. offices, if material.

- However, in a change from the proposal intended to address commenter concerns about undue burden, the final rules permit banking registrants to disclose uninsured deposits at the reported date based on an estimate of uninsured deposits if it is not reasonably practicable to provide a precise measure of uninsured deposits. To avail itself of this accommodation, a registrant must disclose that the amounts are based on estimated amounts of uninsured deposits, and the estimates must be based on the same methodologies and assumptions used for the bank or savings and loan registrant's regulatory reporting requirements, such as the FDIC rules.[5]
- The final rules also modify the proposal's definition of uninsured deposits to clarify that the amount to be disclosed for uninsured deposits is based on the portion of the account balance greater than the FDIC insurance limit and that registrants may consider other similar state deposit insurance regimes in evaluating whether a deposit is insured. The SEC also eliminated the reference to "individual" deposits in the revised definition to address commenter feedback seeking clarity on whether uninsured deposits are measured based on each individual account, or include all accounts or persons to whom the insurance limits apply.
- In another change aimed at reducing compliance burden, the final rules specify that all registrants should determine the amount of uninsured deposits for purposes of Item 1406 based on the same methodologies and assumptions used for regulatory reporting requirements, to the extent applicable. This clarification intends to align the final rules with U.S. bank regulatory reporting requirements and provide some additional parameters for foreign registrants that may operate in several different jurisdictions and therefore may be subject to different insurance regimes.

Guide 3 Items Not Required under the Final Rules

— ***Return on Equity and Assets.*** Consistent with the proposal, the final rules will not require disclosure of four ratios called for under Guide 3: (i) return on assets, (ii) return on equity, (iii) the dividend payout ratio and (iv) and the equity to assets ratio since these are not unique to bank registrants, and SEC guidance on MD&A regarding key performance indicators requires these disclosures when necessary to an understanding of the

[5] *Recordkeeping for Timely Deposit Insurance Determination,* 12 CFR Part 370.

registrant's financial condition and results of operations.

— ***Short-Term Borrowings.*** The final rules do not codify the short-term borrowing disclosures currently called for by Guide 3 in their current form. Instead, the final rules require additional information for each major category of interest-bearing liability disclosures, as discussed above with respect to Item 1402, and require further disaggregation of the major categories of interest-bearing liabilities to include those referenced in Article 9 of Regulation S-X.

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