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SEC Focus Areas for Bank Disclosures

At the recent 2024 AICPA & CIMA Conference on Banks & Savings Institutions, Stephanie Sullivan, associate chief accountant of the Division of Corporation Finance (Corp Fin), discussed the SEC's expectations for more detailed and disaggregated disclosures on material risk concentrations as well as several other focus areas for upcoming reviews. The remarks reinforce themes from SEC comments and speeches made in April and June. Here is what you should consider for upcoming regulatory filings.

> "I encourage every bank to take a fresh look at their allowance for loan loss disclosures in their 10-K." – Stephanie Sullivan

Existing Management Discussion & Analysis (MD&A) Requirements

Banks should evaluate if existing disclosures provide the level of detail necessary for financial statement users to understand material identified risks in the current economic environment. The following Regulation S-K guidance was highlighted to support the SEC's expectations and as a starting point for registrants in re-evaluating disclosures:

- Item 303 (a). The objective of the discussion and analysis is to provide material information relevant to an assessment of the financial condition and results of operations of the registrant. The discussion and analysis must focus specifically on **material events and uncertainties known to management** that are reasonably likely to cause reported financial information not to be necessarily indicative of future operating results or of future financial condition. This includes descriptions and amounts of matters that have had a material impact on reported operations, as well as matters that are reasonably likely, based on management's assessment, to have a **material impact on future operations**.
- Item 303 (b)(2)(ii). Describe any known **trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact** on net sales or revenues or income from continuing operations.

Since the allowance for credit losses (ACL) is always a critical accounting estimate, registrants should consider:

- Item 303(c). Provide **qualitative and quantitative information** necessary to understand the estimation uncertainty and the impact the critical accounting estimate has had or is reasonably likely to have on financial condition or results of operations to the extent the information is material and reasonably available. This information should include why each critical accounting estimate is subject to uncertainty and, to the extent the information is material and reasonably available, **how much each estimate and/or assumption has changed over a relevant period, and the sensitivity of the reported amount to the methods, assumptions and estimates underlying its calculation**.

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The items below are not bright-line requirements. They are subject to the unique facts and circumstances for each financial institution.

Material Concentrations

"… Division staff has been considering, and will continue to consider how, among other matters:

1. Banks are disclosing disaggregation of loan portfolio characteristics, geographic and other concentrations, loan-to-value ratios, loan modifications, nonaccrual loan policies, policies around timing, frequency and sources of appraisals, and risk management; and

2. Office and retail REITs are describing default risks or liquidity issues and any mitigating efforts, debt maturity and lease term schedules, trends in lease renewals, major tenant rollovers, financial viability of tenants, property dispositions, asset impairments, and tenant receivables."[1] – Erik Gerding, Director, Division of Corporation Finance

If there are material concentrations in a loan portfolio, the SEC is looking for expanded disclosures:

Commercial Real Estate (CRE) Exposures

- Disaggregation by portfolio category, borrower class/subtype (owner occupied/nonowner occupied), geography, etc.
- Discussion of whether deterioration stems from many small borrowers or a small number of large borrowers.
- More specific details on risk strategies (procedures and policies). This includes those strategies currently applied in risk management functions.
- Any unique circumstances about preparer-identified material exposures.

Appraisals for Collateral-Dependent Loans

- How and when appraisals are used.
- Timing of appraisal and management's evaluation of how changes in market conditions have impacted valuations.
- How and when the appraisal values impact charge-offs.

[1] "The State of Disclosure Review," sec.gov, June 24, 2024.

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- Nature of appraisal used in collateral-dependent evaluation: “as completed”/“as stabilized” value or “as is” value.
- Cases where properties are not subject to appraisal and applicable policies that allow a lack of appraisal.
- Alternate methods of valuation (how valuation is determined in the absence of an appraisal).

Many financial institutions have a policy of not requiring an appraisal until there are indicators of credit deterioration; therefore, the SEC is also looking for greater details on loan-to-value (LTV) ratios:

- Is a bank using LTV at origination or a more recent update?
- Banks should consider disclosures that provide quantitative data related to the portion of the CRE loan portfolio valued using the LTV at origination and using LTV based on updated/ current appraisal values.

Q Factors

The SEC noted that many filings include a list of Q factors that may be relevant and applied in calculating the ACL. However, no disclosure is made as to the weighting or magnitude of each Q factor or which factors are significant in calculating the ACL. Disclosures should:

- Accurately reflect the magnitude of the Q factors relative to the ACL
- Outline the Q factors that have an impact for the period versus a list of all the Q factors that were “considered”
- Discuss which Q factors have higher weighting in the ACL
- Note if one of the Q factors drives the change in the ACL from period to period

Earning Presentations Versus Form 10-Q/10-K Disclosures

The SEC observed that filers provide users with additional details and disaggregation data related to loan portfolios and credit quality through earnings calls and investor presentations. Corp Fin believes additional information considered relevant to understanding financial position, earnings, and credit quality should be included in 10-K and 10-Q filings. Financial institutions should consider including additional relevant information from earning presentations to provide investors transparency and precision in understanding the results of operations. Some items noted:

- CRE loan data, further disaggregated by maturity/duration, borrower class/subtype, *e.g.*, owner occupied/nonowner occupied, geography, etc.
- Asset repricing frequency and other data relevant to understand rate sensitivity
- Deposit statistics and uninsured deposit levels
- Liquidity and borrowing capacity
- Duration and maturity of AFS debt securities
- Efficiency and liquidity ratios

The SEC will be reviewing for any inconsistencies or different trends in earnings presentations and 10-K and 10-Q filings.

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Sensitivity Analysis

Corp Fin has observed that many filers include rate sensitivity disclosures within the MD&A using a generic rate shock that may not be reflective of the current rate/economic environment or the potential rate shift over a 12-month time horizon. Registrants should consider disclosure of rate shocks that are reasonable in the near-term economic environment.

Weighted Average Yield Disclosures for Investment Securities

In 2020, the [SEC codified previous GAAP guidance] (previously addressed in Guide 3) into Subpart 1400 of Regulation S-K, requiring the disclosure of the weighted average yield by maturity bucket for investment securities. No specific methodology is required, but disclosure is required for the calculation used. Corp Fin staff is looking for additional granularity in these calculation descriptions:

- Is the basis for presentation amortized cost or fair value?
- Is amortization of premiums or discounts included in weighted average yield?
- Is yield to maturity or current yield presented?
- Is yield provided pretax or post-tax?
- Are effects of hedging included in weighted average yield?

Conclusion

Forvis Mazars can help your financial institution tackle issues inherent to the industry, including market growth, internal control threats, industry consolidation, and compliance. Forvis Mazars is a leader when it comes to audit work for financial institutions, holding the number two position as auditors of public banks in the U.S., according to data from S&P Global. Our team of dedicated professionals has concentrated experience in the financial institutions, mortgage banking, broker-dealer, specialty finance, and asset management industries.

Combine our focus on **Unmatched Client Experience**® with the resources of a global firm, and you will find that Forvis Mazars is the trusted advisor your institution needs. Serving you is our passion and privilege.

If you have any questions or need assistance, please reach out to a professional at Forvis Mazars.

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