



U.S. Securities and Exchange Commission

Division of Corporation Finance Securities and Exchange Commission

CF Disclosure Guidance: Topic No. 4

European Sovereign Debt Exposures

Date: January 6, 2012

Summary: This guidance provides the Division of Corporation Finance's views regarding disclosure relating to registrants' exposures to certain European countries.

Supplementary Information: The statements in this CF Disclosure Guidance represent the views of the Division of Corporation Finance. This guidance is not a rule, regulation or statement of the Securities and Exchange Commission. Further, the Commission has neither approved nor disapproved its content.

Introduction

Due to the recent uncertainties with regard to European sovereign debt holdings, we are concerned about the risks to financial institutions that are SEC registrants from direct and indirect exposures to these holdings. To date we note that disclosures about the nature and extent of these exposures that registrants, including foreign private issuers, have provided in reports filed or furnished with the Commission have been inconsistent in both substance and presentation. We believe this inconsistency may lead to disclosures that lack transparency and comparability for investors.

In response to our comments on their disclosure documents, registrants have provided incremental improvements in disclosures of exposures to sovereign debt in several countries during the year. However, we find that expanded and enhanced disclosures are not consistent from registrant to registrant. Therefore, we determined that investors would benefit from our providing additional guidance to assist registrants in their assessment of what information about exposures to European countries they should consider disclosing and how they should disclose this information with the goal of greater clarity and comparability.

In periodic reports filed by these registrants in 2011, we noted discussions of financial stress experienced by certain European countries. As examples of what we viewed as inconsistent discussions on the relevant issues, registrants generally provided information that addressed:

- Disclosure of aggregate exposure *or* separate quantification of exposure to each country of concern;
- Disclosure of aggregate exposure to sovereign debt, corporate-level debt and loans to retail customers in the identified countries *or* quantification of exposures with respect to each type of disclosure;
- Disclosure of net exposures *or* disclosure of both gross and net exposures; and

- Disclosure of the effect of purchased credit default swap contracts based on notional values *or* based on fair market values.

In reviewing these disclosures, we issued comments requesting enhanced disclosures for investors relating to European sovereign debt exposures. Our comments requested that for each country, registrants disclose:

- Gross sovereign, financial institutions, and non-financial corporations' exposure, separately by country;
- Quantified disclosure explaining how gross exposures are hedged; and
- A discussion of the circumstances under which losses may not be covered by purchased credit protection.

Disclosure Requirements and Guidance

Management's Discussion and Analysis (MD&A)¹ requires registrants to identify, among other items, known trends or known demands, commitments, events, or uncertainties that will result or that are reasonably likely to result in a material increase or decrease in liquidity and to describe any known trends or uncertainties that have had, or that a registrant reasonably expects may have, a material favorable or unfavorable impact on income.

In addition to the provisions of MD&A, Industry Guide 3 (Guide 3) provides staff guidance regarding the disclosure requirements for bank holding companies.² Specifically related to this topic, Item III.C.3 of Guide 3 calls for those registrants to identify cross-border outstandings to borrowers in each foreign country where the exposures exceed 1% of total assets. Guide 3 also calls for disclosure where "current conditions in a foreign country give rise to liquidity problems which are expected to have a material impact on the timely repayment of principal or interest on the country's private or public sector debt," including tabular disclosure of changes in outstandings, and in some cases tabular disclosure of restructured outstandings.

Registrants also are required to provide disclosure regarding risks, including risk factors³ and market risk.⁴ In making these disclosures, registrants should avoid generic "boilerplate" disclosure and instead provide disclosures that are tailored to their particular facts and circumstances.⁵

The current uncertainties arising in connection with European sovereign debt exposures, together with the lack of transparent, comparable information, have raised concerns about the adequacy of registrants' disclosures for investors. Under the circumstances, we believe our principles-based item requirements may call for more detailed disclosure on this topic.

In determining which countries are covered by this guidance, registrants should focus on those experiencing significant economic, fiscal and/or political strains such that the likelihood of default would be higher than would be anticipated when such factors do not exist. We expect that the countries covered by this analysis would vary and thus the disclosures should be sufficiently flexible to capture those risks as they change over time. We encourage registrants to disclose the basis used for identifying the countries included in this disclosure.

We believe that disclosures should be provided separately by country, segregated between sovereign and non-sovereign exposures, and by financial statement category, to arrive at gross funded exposure, as

appropriate. Registrants should also consider separately providing disclosure of the gross unfunded commitments made. Lastly, we suggest that registrants provide information regarding hedges in order to present an amount of net funded exposure. In deciding what disclosure is relevant and appropriate for the particular facts of each registrant, we encourage registrants to consider the following:

I. Gross Funded Exposure

a. Countries

- i. The basis for the countries selected for disclosure.
- ii. The basis for determining the domicile of the exposure.

b. Type of Counterparty

- i. Separate categories of exposure to Sovereign and Non-Sovereign counterparties.
 1. Sovereign exposures consist of financial instruments entered into with sovereign and local governments.
 2. Non-Sovereign exposures comprise exposure to corporations and financial institutions. To the extent material, separate disclosure may be required between financial and non-financial institutions.

c. Categories of Financial Instruments

- i. Categories to be considered for disclosure include loans and leases, held-to-maturity securities, available-for-sale securities, trading securities, derivatives, and other financial exposures to arrive at a gross funded exposure.
 1. For loans and leases, the gross amount prior to the deduction of the impairment provision and the net amount after impairment provision.
 2. For held-to-maturity securities, the amortized cost basis and the fair value.
 3. For available-for-sale securities, the fair value, and if material, the amortized cost basis.
 4. For trading securities, the fair value.
 5. For derivative assets, the fair value, except that amount could be offset by the amount of cash collateral applied if separate footnote disclosure quantifying the amount of the offset is provided.
 6. For credit default contracts sold, the fair value and notional value of protection sold, along with a description of the events that would trigger payout under the contracts.
 7. For other financial exposures, to the extent carried at fair value, the fair value. To the extent carried at amortized cost, the gross amount prior to the deduction of impairment and the net amount after impairment.

II. Unfunded Exposure

- a. The amount of unfunded commitments by type of counterparty and by country.
- b. The key terms and any potential limitations of the counterparty being able to draw down on the facilities.

III. Total Gross Exposure (Funded and Unfunded)

- a. The effect of gross funded exposure and total unfunded exposure should be subtotaled to arrive at total gross exposure as of the balance sheet date, separated between type of counterparty and by country.
- b. Appropriate footnote disclosure may be provided highlighting additional key details, such as maturity information for the exposures.

IV. Effects of Credit Default Protection to Arrive at Net Exposure

- a. The effects of credit default protection purchased separately by counterparty and country.
- b. The fair value and notional value of the purchased credit protection.
- c. The nature of payout or trigger events under the purchased credit protection contracts.
- d. The types of counterparties that the credit protection was purchased from and an indication of the counterparty's credit quality.
- e. Whether credit protection purchased has a shorter maturity date than the bonds or other exposure against which the protection was purchased. If so, clarifying disclosure about this fact and the risks presented by the mismatch of maturity.

V. Other Risk Management Disclosures

- a. How management is monitoring and/or mitigating exposures to the selected countries, including any stress testing performed.
- b. How management is monitoring and/or mitigating the effects of indirect exposure in the analysis of risk. Disclosure should explain how the registrant identifies their indirect exposures, examples of the identified indirect exposures, along with the level of the indirect exposures.
- c. Current developments (rating downgrades, financial relief plans for impacted countries, widening credit spreads, etc) of the identified countries, and how those developments, or changes to them, could impact the registrant's financial condition, results of operations, liquidity or capital resources.

VI. Post-Reporting Date Events

- a. Significant developments since the reporting date and the effects of those events on the reported amounts.

¹ See Item 303 of Regulation S-K; and Form 20-F, Item 5.

² See Instruction 13 to Item 303(a) of Regulation S-K; and General Instruction 6 to Industry Guide 3. Although these provisions refer only to bank holding companies, Staff Accounting Bulletin Topic 11:K provides that, "to the extent particular guidance [in Article 9 of Regulation S-X and Guide 3] is relevant and material to the operations of an entity [that engages in similar lending and deposit activities], the staff believes the specified information, or comparable data, should be provided."

³ See Item 503(c) of Regulation S-K; and Form 20-F, Item 3.D.

⁴ See Item 305 of Regulation S-K; and Form 20-F, Item 11. Item 305(b) of Regulations S-K calls for qualitative information about market risk and its Instruction 1.B. points the registrant to disclose "particular markets that present the primary risk of loss to the registrant."

⁵ Item 503(c) of Regulation S-K instructs registrants to "not present risks that could apply to any issuer or any offering" and further, to "[e]xplain how the risk affects the issuer or the securities being offered." See also Exchange Act Rule 12b-20.

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Modified: 01/06/2012