

SEC's Division of Corporation Finance Issues **Guidance on Disclosure of European Sovereign Debt Exposures**

On January 6, 2012, the Division of Corporation Finance (the "Division") of the Securities and Exchange Commission ("SEC") issued guidance regarding disclosure of SEC registrants' exposures to European sovereign debt holdings.¹ Given the "current uncertainties arising in connection with European sovereign debt exposures" and the noted inconsistency "in both substance and presentation" among registrants' disclosures in SEC filings regarding "the nature and extent of these exposures," the Division of Corporation Finance determined that investors would benefit from "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."

I. Disclosure Requirements

The Division identified the following disclosure requirements as relevant to registrants' disclosure of European sovereign debt exposures:

- **Management's Discussion and Analysis (MD&A)**: Registrants must identify "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 must "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."
- **Industry Guide 3 (Guide 3)**: Registrants that are bank holding companies must identify "cross-border outstandings to borrowers in each foreign country where the exposures exceed 1% of total assets" and must disclose "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.'"
- **Regulation S-K and Form 20-F**: Registrants must disclose risks, including risk factors and market risk.

II. Guidance Provided

The Division provided the following recommendations with regard to disclosure of European sovereign debt exposures:

- **Identification of Countries to be Included**: In order to identify the countries to be included in the disclosure, registrants should concentrate 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." Registrants are encouraged to include in their disclosure the basis for selecting the countries referenced.

¹ See *CF Disclosure Guidance: Topic No. 4, European Sovereign Debt Exposures* (Jan. 6, 2012), available at <http://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic4.htm>. All quotes in this memorandum are from this guidance.

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- Format of Disclosure: Registrants should provide disclosures “separately by country, segregated between sovereign and non-sovereign exposures and by financial statement category.” It is suggested that registrants separately provide disclosure of gross funded exposure, gross unfunded exposure, total gross exposure (funded and unfunded), and net funded exposure (each of which should be segregated by country and type of counterparty).
- Substance of Disclosure:
 - Gross funded exposure: In order to arrive at gross funded exposure, registrants should consider for disclosure loans and leases, held-to-maturity securities, available-for-sale securities, trading securities, derivatives, and other financial exposures.
 - Gross unfunded exposure: Registrants should consider the “key terms and any potential limitations of the counterparty being able to draw down on the facilities.”
 - Total gross exposure (funded and unfunded): Registrants should combine the gross funded and unfunded exposures in order to arrive at the total gross exposure. A footnote may be added to highlight additional relevant details.
 - Net exposure: Registrants should consider the effects of credit default protection purchased, as well as the fair value and notional value of the credit protection purchased, the nature of payout or trigger events under the credit protection contracts, the types of counterparties from whom the credit protection was purchased and the counterparties’ credit quality, and whether the credit protection “has a shorter maturity date than the bonds or other exposure against which the protection was purchased.”
 - Other risk management disclosures: Registrants should consider how management is monitoring or mitigating exposures to the countries identified, how management is monitoring or mitigating the effects of indirect exposure in analyzing risk, and any significant developments in the countries referenced since the financial reporting date and how those developments might affect the registrant’s reported financial condition, results of operations, liquidity, or capital resources.

III. Conclusion

The SEC’s guidance regarding the substance and format of disclosures relating to registrants’ exposures to European sovereign debt holdings is intended to foster consistency among registrants’ disclosures, thereby increasing the disclosures’ utility to investors.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; or Yafit Cohn at 212.701.3089 or ycohn@cahill.com.