

The SEC Proposes New Disclosure Requirements Relating to Short-Term Borrowings

On September 17, 2010, the Securities and Exchange Commission proposed new rules relating to disclosure of short-term borrowings by public companies. The proposed rules would be applicable to both financial and non-financial companies and would require disclosure about the use and impact of short-term borrowings in annual and quarterly reports, proxy or information statements that include financial statements, registration statements under the Securities Exchange Act of 1934 and registration statements under the Securities Act of 1933.

The objective of the new rules, as described by SEC Chairman Mary Schapiro, is to target “balance sheet window dressing” by companies, whereby short-term borrowings are reduced at period-end in order to present a healthier leverage and liquidity picture to investors. By requiring disclosure of a public company’s leverage throughout the course of the relevant reporting period, the SEC aims for companies to provide greater visibility into their intra-period borrowings and their overall financial position.

The SEC’s proposing release may be found on the SEC’s website [here](#).

Summary of the Proposed Rules

The proposed rules would require disclosure of public companies’ short-term borrowings on an annual and quarterly basis (other than foreign private issuers and smaller reporting companies, the treatment of which is described below). The new rules would apply to all companies that provide Management’s Discussion and Analysis of Financial Condition and Results of Operations disclosure (“MD&A”) and not just bank holding companies and other financial institutions. Companies would be required to provide tabular quantitative disclosure regarding short-term borrowings under a new subheading in MD&A, accompanied by qualitative discussion.

Definitions of “Short-Term Borrowing” and “Financial Company”

As proposed, “short-term borrowings” would refer to amounts payable for short-term obligations¹ in each of the following categories: (1) federal funds purchased and securities sold under agreements to repurchase; (2) commercial paper; (3) borrowings from banks; (4) borrowings from factors or other financial institutions; and (5) any other short-term borrowings reflected on the company’s balance sheet.

The proposed rules distinguish between “financial companies” and non-financial companies for the purpose of reporting maximum and average amounts of short-term borrowings outstanding during a given reporting period. A “financial company” would be a company that during the reporting period is engaged to a “significant extent” in the business of lending, deposit-taking, insurance underwriting or providing investment advice, or is a broker or dealer. Any entity that is, or is the holding company of, a bank, a savings

¹ Under US GAAP, short-term obligations are those that mature within one year of the company’s balance sheet date.

association, an insurance company, a broker, a dealer, a business development company, an investment adviser, a futures commission merchant, a commodity trading advisor, a commodity pool operator or a mortgage REIT would be considered a financial company. The proposed definition is non-exclusive and broad enough that it captures companies engaged in both financial and non-financial activities. However, such companies would be permitted to disclose their short-term borrowings separately for each of their financial and non-financial operations, calculated on a daily and monthly basis respectively, as further described below.

Quantitative Disclosure

The proposed rules would require tabular disclosure, **for each specified category of short-term borrowings**, of:

- the amount outstanding at the end of the reporting period and the weighted average interest rate thereon;
- for financial companies:
 - the maximum **daily** amount of short-term borrowings during the reporting period (meaning the largest amount outstanding at the end of any day in the reporting period); and
 - the average amount outstanding during the reporting period computed on a daily average basis (meaning the amount outstanding at the end of each day, averaged over the reporting period) and the weighted average interest rate thereon.
- for all other companies:
 - the maximum **month-end** amount of short-term borrowings during the reporting period (meaning the largest amount outstanding at the end of the last day of any month in the reporting period); and
 - the average amount outstanding for the reporting period (using an averaging period not to exceed one month) and the weighted average interest rate thereon.

The disclosure must be disaggregated by currency, interest rate or other meaningful category to the extent necessary to prevent the aggregate amounts from being misleading.

Qualitative Disclosure

In addition to tabular disclosure, the proposed rules would require companies to provide a narrative discussion and analysis of their short-term borrowings, which would include:

- a general description of the short-term borrowings included in each category (including any key metrics or other factors that could reduce or impair the company's ability to borrow under such arrangements and whether there are any collateral posting arrangements);
- the importance and business purpose of the short-term borrowings with respect to the company's liquidity, capital resources, market-risk support, credit-risk support or other benefits;
- the reasons for the maximum outstanding amount for the reporting period, including any non-recurring transactions or events, use of proceeds or other information that provides context for the maximum amount; and
- the reasons for any material differences between the average short-term borrowings for the reporting period and the period-end short-term borrowings.

The narrative should aid an investor's understanding of the data conveyed in the tabular disclosure and should also discuss the current or potential future effects of the company's short-term borrowings on the company's financial condition, revenues or expenses, results of operations, liquidity, capital expenditures and capital resources. However, the narrative is intended to complement, and not duplicate, existing MD&A disclosure relating to liquidity and capital resources. Companies would need to consider ways to integrate the proposed disclosure with disclosures of off-balance sheet arrangements, disclosures regarding cash requirements presented in the contractual obligations table, as well as other liquidity and capital resources disclosures in order to present a clear, comprehensive description of their liquidity profiles.

Reporting Period

As proposed, the new requirements would apply to annual and quarterly reports, proxy and information statements in which financial statements are included, and registration statements. For annual reports, information would be presented for the three most recent fiscal years and for the fourth quarter. For quarterly reports, information would be presented for the relevant quarter, without a requirement for comparative data. For registration statements with audited full-year financial statements, companies would be required to include short-term borrowings disclosure for the three most recent full fiscal year periods and interim information for any subsequent interim periods (without a requirement for comparative data).

Applicability to Foreign Private Issuers and Smaller Reporting Companies

Foreign private issuers (other than issuers that make filings with the SEC in accordance with the US-Canadian Multijurisdictional Disclosure System) would generally be subject to the new short-term borrowings disclosure requirements. However, a foreign private issuer would only be required to report the short-term borrowings disclosure on an annual basis (and not on a quarterly basis unless filing a registration statement that includes interim information). In addition, a foreign private issuer may base the categories of short-term borrowings according to the classifications of short-term borrowings specified by the accounting principles used by the company to prepare its financial statements, so long as the disclosure provides the same level of detail.

Smaller reporting companies would also generally be subject to the proposed disclosure requirements, except that quarterly disclosure would not be required unless material changes have occurred during the relevant interim period. In addition, information for the fourth fiscal quarter would not be required in annual reports. Furthermore, smaller reporting companies would be permitted to present short-term borrowings information for only two fiscal years, rather than three.

Transition Period

The proposed requirements would be phased in over a three-year span for companies that are not bank holding companies (or otherwise subject to disclosure requirements applicable to bank holding companies). In the initial year, such companies would be required to include short-term borrowings disclosure for the most recent fiscal year and may omit the information for the two preceding fiscal years. In the second year, such companies would be required to include disclosure for the two most recent fiscal years, and may omit the third preceding fiscal year. Thereafter, disclosure with respect to all three preceding fiscal years would be required.

Bank holding companies are already required to provide similar disclosure and, as such, would be required to comply with the rules when adopted.

Other Related Proposals

The SEC has proposed conforming amendments to the definition of “direct financial obligations” in Items 2.03 and 2.04 of Form 8-K. In addition, the SEC intends to update references to U.S. GAAP in Item 303 of Regulation S-K and Item 5 of Form 20-F to reflect the FASB Codification.

The proposing release also includes a request for comment on whether to extend leverage ratio disclosure requirements to companies that are not bank holding companies and how such disclosure would take into account the differences among various metrics and industries and still provide comparability.

Comment Period

The SEC is accepting comments on the proposed rules until November 27, 2010.

What To Do Now

Companies should become familiar with the proposed rules. A public company without the systems in place to comprehensively record and report average balances of short-term borrowings should consider implementing, or at least investigate implementation of, such systems in order to be in a position to comply with the proposed rules. Additionally, companies with both financial and non-financial operations should consider whether to present the short-term borrowings disclosure on a grouped or bifurcated basis.

In the wake of the financial crisis, the SEC remains focused on shedding light on companies’ borrowing practices, and it is likely that, even if not adopted in the proposed form, some version of the disclosure requirements summarized above will eventually be adopted.

If you would like to discuss these or any other securities law matters, please contact any member of Ropes & Gray’s Securities & Public Companies practice or your usual Ropes & Gray advisor.