

## Small Business Securities Bulletin

*A periodic bulletin keeping small businesses informed about current developments in securities law and related matters*

### SEC Guidance on Liquidity and Funding Risks; SEC Proposed Rules on Short-Term Borrowings Disclosure

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#### SEC Guidance on Liquidity and Funding Risks

Last month the Securities and Exchange Commission (SEC) issued an interpretive release, available at [www.sec.gov/rules/interp/2010/33-9144fr.pdf](http://www.sec.gov/rules/interp/2010/33-9144fr.pdf), aimed at improving liquidity and capital resources disclosure in the Management's Discussion and Analysis (MD&A) section of reports and registration statements to facilitate investor understanding of the liquidity and funding risks facing SEC reporting companies. As guidance on existing rules, the release is effective immediately.

The release reminds reporting companies that under existing requirements they must separately identify and describe "internal and external sources of liquidity, and briefly discuss any material unused sources of liquidity." In this regard, the release cites to the SEC's [2003 interpretive guidance \[PDF\]](#) and [2002 interpretive guidance \[PDF\]](#). The release identifies additional important trends and uncertainties relating to liquidity, in addition to those outlined in the 2002 guidance, for which disclosure might be required, including "difficulties accessing the debt markets, reliance on commercial paper or other short-term financing arrangements, maturity mismatches between borrowing sources and the assets funded by those sources, changes in terms requested by counterparties, changes

in the valuation of collateral, and counterparty risk.” The release also states that, with respect to liquidity and capital resources, a discussion in the company’s MD&A “to enable an understanding of the amounts depicted in the financial statements” may be required if its financial statements do not adequately convey financing arrangements during the period, or the impact of those arrangements on liquidity, because of a known trend, demand, commitment or uncertainty. For example, disclosure of intra-period variations may be required when borrowings during the period were materially different than period-end amounts. The release also states that companies should consider describing cash management and risk management policies relevant to an assessment of financial condition, specifically referencing banks’ policies and practices to meet applicable banking agency guidance on funding and liquidity risk management and policies and practices that might differ from applicable agency guidance.

The release also reminds companies that capital or leverage ratios or other measures disclosed in MD&A should be accompanied by a clear explanation of how the ratio was calculated and disclosure as to why the ratio or measure is useful to an understanding of the company’s financial condition. With respect to any ratio for which there are no regulatory requirements prescribing how the ratio is calculated, companies need to consider whether additional disclosure for non-financial measures pursuant to the 2003 interpretive guidance or required disclosures for non-GAAP financial measures is required.

The release also states that with respect to the required table of contractual obligations, companies should highlight any changes from the prior table and consider additional narrative disclosure where necessary for an understanding of the information in the table.

## **SEC Proposed Rules on Short-Term Borrowings Disclosure**

The SEC has also [proposed amendments \[PDF\]](#) to existing MD&A requirements to require reporting companies to provide “a comprehensive explanation of [their] short-term borrowings, including both quantitative and qualitative information.” This is targeting, for example, the tendency of some companies to repay significant amounts of short-term borrowings just prior to the end of a reporting period, which may be re-borrowed shortly thereafter, such that period-end amounts may not reflect the company’s true funding needs, activities during the period, business operations and risks.

Under the proposed amendments, SEC reporting companies would be required to provide information with respect to their short-term borrowings similar to that currently required of bank holding companies pursuant to Industry Guide 3, Statistical Disclosures by Bank Holding Companies (Guide 3). The categories of short-term borrowings for which disclosure would be required include federal funds purchased and securities sold under

agreements to repurchase, commercial paper, borrowings from banks and other financial institutions, and any other short-term borrowings reflected on the balance sheet. Similar to Guide 3, the amendments would require tabular disclosure, for each specified category of short-term borrowings, of the period-end amount outstanding and weighted average interest rate thereon, the average amount outstanding during the reporting period and the weighted average interest rate thereon, and the maximum amount outstanding during the period. Unlike Guide 3 however, the amendments would also require a narrative discussion and analysis that includes the reasons for the company's use of the particular type of financing and the drivers of the differences between average amounts and period-end amounts. Bank holding companies and other "financial companies" would be required to disclose the maximum daily amounts of borrowings outstanding during the reporting period, instead of the maximum month-end amounts currently required by Guide 3, and calculate average amounts outstanding on a daily average basis. Non-financial companies would report maximum month-end amounts, and could calculate average amounts using daily, weekly or month-end amounts outstanding during the period. Disclosure would be required annually for smaller reporting companies (absent material changes during a quarterly interim period) and on a quarterly basis for all other reporting companies.

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### **About Me**

I am a former SEC attorney who also has prior "big firm" experience. I assist public as well as private companies with compliance with federal and state securities laws, including assisting public companies with their reporting obligations under the Securities Exchange Act of 1934, at competitive billing rates. Please contact me if you would like more information about my practice or to discuss how I can be of assistance to you. Visit my bio at [www.ober.com/attorneys/penny-somer-greif](http://www.ober.com/attorneys/penny-somer-greif).

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