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LEGAL UPDATES AND NEWS

Guidance for Public Company Financial Institutions: Disclosures in SEC Filings Related to COVID-19

The following memorandum provides guidance that public financial institutions should consider when preparing their upcoming earnings releases and quarterly reports on Form 10-Q as a result of the coronavirus pandemic (COVID-19).

I. SEC Guidance

On March 25, 2020, the Division of Corporation Finance of the Securities and Exchange Commission (the "SEC") provided public companies with general guidance for additional disclosures related to COVID-19. The guidance can be found **here**. On April 8, 2020, the SEC supplemented this guidance with a statement from the SEC's Chairman and the Director of the Division of Corporation Finance, which can be found **here**. The SEC acknowledged that "it may be difficult to assess or predict with precision the broad effects of COVID-19 on industries or individual companies. We also recognize that the actual impact will depend on many factors beyond a company's control and knowledge." However, the SEC indicated that disclosure should be provided with respect to "the effects COVID-19 has had on a company, what management expects its future impact will be, how management is responding to evolving events, and how it is planning for COVID-19-related uncertainties." The SEC has further reminded public companies that insiders, as well as the companies themselves (through repurchases), should refrain from trading when in possession of material, non-public information, which reinforces the importance of enhanced disclosures.

The SEC specifically focused on disclosures in the following areas:

- The impact on financial condition and results of operations, and the expected impact on future operating results and near- and long-term financial condition;
- Capital and financial resources, including liquidity; the cost of or access to capital and funding sources; and contingencies;
- Accounting matters, such as significant changes in judgments in determining the fair value of assets measured in accordance with GAAP;
- Possible material impairments (e.g., with respect to goodwill, intangible assets, long-lived assets, right of use assets and investment securities), increases in allowances for credit losses, or restructuring charges;
- The effects of remote work arrangements, including reduced productivity, as well as the ability to maintain operations, financial reporting systems, internal control over financial reporting and disclosure controls and procedures; and any changes in such controls and procedures;
- Challenges in implementing business continuity plans;
- Changes in the demand for products or services; and
- The effects of travel restrictions and border closures.

II. Recommendations For Financial Institution Public Companies

The economic impact of the COVID-19 pandemic on a company's operations is not likely to be significantly reflected in March 31, 2020 operating results. However, financial institutions should assess the types of data, including tabular data, they can include in their filings and releases that will give investors a better understanding of the potential impact of the pandemic without having to make predictions or provide specific guidance about future performance.[1] As the SEC has noted on several occasions when commenting on mandated disclosures, Item 303 of SEC Regulation S-K, which is management's discussion and analysis of financial condition and results of operations, requires disclosures of any known trends or uncertainties that have had or that the company reasonably expects will have a material impact on the company's operations, financial condition, liquidity and capital. When assessing the types of historical data that can be provided to address the company's affected activities and potential risks, companies must be mindful of ensuring that such data is confirmable for audit purposes and trackable for updating future disclosures. Some of these new disclosures may be included in the March 31, 2020 Form 10-Q, and/or in an earnings release, which typically is released in advance of the Form 10-Q. Some of the new disclosures could be included in the notes to the financial statements. However, we recommend that you initiate discussions with your independent accountants, as some of the disclosures may be better suited as a subsequent development to the March 31, 2020 period, or only disclosed in management's discussion and analysis of financial condition and results of operations and not in the notes to the financial statements.

A. Risk Factors and Forward-Looking Statements

SEC Form 10-Q requires a public company to include any material changes from the risk factors previously disclosed in the annual report on Form 10-K.[2] Providing the required disclosure can be accomplished through the addition of new risk factors and/or updating previously disclosed risk factors. Some annual reports on Form 10-K already include comprehensive disclosure about the general risks noted by the SEC in their guidance (economic, changes in interest rates, access to liquidity, the adequacy of the allowance for loan losses, etc.) It may not be practical to update every individual risk factor included in an annual report to reflect adjustments or updates for COVID-19. At a minimum, we recommend that a public company that is required to update its risk factor disclosure include a comprehensive COVID-19 risk factor to update its existing risk factor disclosure. In this regard, the SEC has encouraged companies to provide disclosures that allow investors to evaluate the current and expected impact of COVID-19 through the eyes of management. Such risk factor should mention how the institution's business, financial condition and results of operation and liquidity have been, and may be, negatively impacted by the following:

- a decline in the demand for products and services;
- an increase in loan delinquencies, problem assets and foreclosures;
- a decline in collateral value;
- a work stoppage, forced quarantine, or other interruption or the unavailability of key employees;
- an increase in the allowance for loan losses;
- a reduction in wealth management revenues;

[1] On April 8, 2020, the SEC released a statement encouraging public companies to disclose information describing how the company stands today, operationally and financially, acknowledging that historical information may be less relevant. The SEC also reminded companies to avail themselves of the safe harbors for forward-looking statements.

[2] This requirement is not applicable to a Smaller Reporting Company ("SRC"), as an SRC is not required to include risk factors in an annual report on Form 10-K. Although some SRCs voluntarily include risk factors in their SEC filings, we recommend against an SRC providing new risk factor disclosure if it has not done so previously. Instead, we anticipate than an SRC will provide similar disclosure elsewhere in its Form 10-Q, such as in forward-looking statement disclosures.

- an increase in Federal Deposit Insurance Corporation premiums;
- a reduction in the value of the securities portfolio; and
- a decline in the net worth and liquidity of loan guarantors.

We can provide you with sample risk factor disclosure and assist in preparing a more detailed risk factor that reflects your institution's specific situation.[3]

Similar disclosure should be added to the bullet-point lists of items that are included in "forward-looking statements" disclosure of both an earnings release and a Form 10-Q. Such disclosure would be applicable for all public companies, including SRCs.

B. Loan Portfolio

While March 31, 2020 operating results may not fully reflect the effects of COVID-19, financial institution public companies should nonetheless consider providing investors with more granular historical information about their loan portfolios, specifically, those portfolios that may be disproportionately adversely affected by COVID-19. For example, certain industries, such as hospitality, travel, food service and restaurants and bars, may have suffered, or are expected to suffer, greater losses as a result of COVID-19. A public company does not have to predict which industries will be hardest hit. Rather, the company can give information as to its loan portfolio such that an investor can make their own determination as to the risk inherent in the loan portfolio (e.g., dollar value of loans by certain industry types; breakdown of commercial real estate portfolio by industry type). Of course, if the company perceives weakness in a specific industry, it may disclose such information as well. Additionally, tabular data can provide geographical information if the company maintains loans in areas that have been harder hit by COVID-19, such as the New York Metropolitan area, or areas that are undergoing mandatory lockdowns and travel restrictions.

An example of this disclosure, which can be used for a commercial and industrial loan portfolio, and/or a commercial real estate loan portfolio, is as follows. A company can tailor the line items to provide more specific information with respect to different borrower concentrations.

> The following table provides information with respect to our **[commercial and industrial/commercial real estate**] loans by type at March 31, 2020.

Type of Loan	Number of Loans	Balance (In thousands)
Residential non-owner occupied		$
Office		
Retail		
Industrial/manufacturing/warehouse		
Gas station		
Restaurant/food service/bar		
Hospitality and tourism		
Religious/house of worship		
Self-storage facility		
Mixed use		
Other		
Total		$

[3] The risk factor prepared for the Form 10-Q can also be used to satisfy the disclosure requirement in a Form 8-K that a company files with respect to an extension for certain SEC filings due between March 1 and July 1. For more information regarding such extensions, see our alert, which can be accessed **here**.

C. Paycheck Protection Program

A significant number of financial institutions are originating loans through the Paycheck Protection Program, or "PPP." The following disclosure could be added to the March 31 earnings release and Form 10-Q, tailored to reflect your specific situation.

> The Coronavirus Aid, Relief, and Economic Security Act, or CARES Act, was signed into law on March 27, 2020, and provides over $2.0 trillion in emergency economic relief to individuals and businesses impacted by the COVID-19 pandemic. The CARES Act authorized the Small Business Administration ("SBA") to temporarily guarantee loans under a new 7(a) loan program called the Paycheck Protection Program ("PPP").
>
> Option 1: As a qualified SBA lender, we were automatically authorized to originate PPP loans.
>
> Option 2: Although we were not already a qualified SBA lender, we enrolled in the PPP by completing the required documentation.
>
> Option 3: We determined not to participate in the PPP.

An institution that has chosen to participate in the PPP could then add the following disclosure:

> An eligible business can apply for a PPP loan up to the greater of: (1) 2.5 times its average monthly "payroll costs;" or (2) $10.0 million. PPP loans will have: (a) an interest rate of 1.0%, (b) a two-year loan term to maturity; and (c) principal and interest payments deferred for six months from the date of disbursement. The SBA will guarantee 100% of the PPP loans made to eligible borrowers. The entire principal amount of the borrower's PPP loan, including any accrued interest, is eligible to be reduced by the loan forgiveness amount under the PPP so long as employee and compensation levels of the business are maintained and 75% of the loan proceeds are used for payroll expenses, with the remaining 25% of the loan proceeds used for other qualifying expenses.
>
> As of __________, 2020, we had received approximately _______ applications for up to $________________ of loans under the PPP. We intend to limit our investment in PPP loans to up to $______________.

D. Loan Modification/Troubled Debt Restructurings

Financial institutions have received significant numbers of requests to modify loan terms and/or defer principal and/or interest payments, and have agreed to such deferrals or are in the process of doing so. The banking regulatory agencies, through an Interagency Statement dated April 7, 2020 (which can be found **here**), are encouraging financial institutions to work "prudently" with borrowers who request loan modifications or deferrals as a result of COVID-19.

Under Section 4013 of the CARES Act, loans less than 30 days past due as of December 31, 2019 will be considered current for COVID-19 modifications. A financial institution can then suspend the requirements under GAAP for loan modifications related to COVID-19 that would otherwise be categorized as a troubled debt restructuring ("TDR"), and suspend any determination of a loan modified as a result of COVID-19 as being a TDR, including the requirement to determine impairment for accounting purposes. Financial institutions wishing to utilize this authority must make a policy election, which applies to any COVID-19 modification made between March 1, 2020 and the earlier of either December 31, 2020 or the 60th day after the end of the COVID-19 national emergency. Similarly, the Financial Accounting Standards Board has confirmed that short-term modifications made on a good-faith basis in response to COVID-19 to loan customers who were current prior to any relief are not TDRs. Lastly, prior to the enactment of the

CARES Act, the banking regulatory agencies provided guidance as to how certain short-term modifications would not be considered TDRs, and have subsequently confirmed that such guidance could be applicable for loans that do not qualify for favorable accounting treatment under Section 4013 of the CARES Act.

A financial institution may want to include some of this information, either in its earnings release or its March 31, 2020 Form 10-Q, and then provide specific information with respect to loan modifications.

To the extent a financial institution has established a formal modification program, then the terms of that program should be described. Even in the absence of a formal program, a financial institution should describe its current loan modification practices. It is important that a public company confirm the accounting treatment of modifications with its independent accountants.

Sample disclosure with respect to loan modifications could be as follows:

> As of _______, 2020, we had received requests to modify _____________ loans aggregating $______________. As of ______________, 2020, we had modified _____________ loans aggregating $______________, primarily consisting of **[the deferral of principal and/or interest payments/the extension of the maturity date/reduction in the interest rate]**. Of these modifications, $___________, or ____%, were performing in accordance with their modified terms. Details with respect to actual loan modifications are as follows:

Type of Loan	Number of Loans	Balance	Weighted Average Interest Rate
		(In thousands)	
One- to four-family residential real estate (1)		$	%
Commercial real estate			%
Multi-family real estate			%
Commercial and industrial			%
Consumer			%
Other			%
Total		$	%

(1) Includes home equity loans and lines of credit.

E. Allowance for Loan Losses

Prior to the adoption of the Current Expected Credit Loss ("CECL") method of calculating the allowance for loan losses, a financial institution generally had to maintain the allowance at a level that was adequate to absorb all estimated inherent losses in the loan and lease portfolio. Many smaller public companies are not yet subject to CECL and, under Section 4014 of the CARES Act, financial institutions are exempt from CECL until the earlier of December 31, 2020 or the 60th day after the end of the COVID-19 national emergency. Public companies that were already subject to CECL should disclose what they are doing with respect to the permitted exemption. And, regardless of whether a financial institution was already subject to CECL, the COVID-19 pandemic is expected to materially affect an institution's determination of its allowance for loan losses.

In addition to utilizing quantitative loss factors, a financial institution will consider qualitative factors, such as changes in underwriting policies, current economic conditions, delinquency statistics, the adequacy of the underlying collateral and the financial strength of the borrower. All of these factors are likely to be affected by the COVID-19 pandemic. To the extent a financial institution increased its allowance for loan losses as of March 31, 2020 or expects to do so for future periods, in either case due to the COVID-19 pandemic, the institution should describe the related reasons and any quantification of the increase if available.

F. Liquidity and Capital Resources

Whether through significant deposit withdrawals, reductions in interest and principal payments on loans, or the tightening of the capital markets, it is likely that the COVID-19 pandemic has had a negative effect on the liquidity and capital resources of financial institutions. A public company may have a fairly robust discussion of its liquidity and capital resources in its annual report on Form 10-K, but a more limited discussion in a Form 10-Q. A financial institution should consider enhancing its quarterly disclosures of liquidity and capital resources to disclose changes in its cash position as well as levels of deposit inflows/outflows and loan originations when compared to prior similar periods. A financial institution should also disclose any increases in borrowings or changes in borrowing capacity as a result of COVID-19. Such changes could result from the financial institution's inability to comply with borrowing requirements, or a lender's tightening its lending criteria, or the amount(s) it is willing to lend.

In their discussion of liquidity and capital resources, many public companies discuss the payment of regular quarterly cash dividends, provide information with respect to their dividend policy and/or provide information as to stock repurchases. To the extent a company is considering suspension of, or has suspended, stock repurchases, or may need to suspend or reduce the level of quarterly dividends, then it should provide investors with this information in its earnings release and upcoming Form 10-Q. The ability to pay dividends or conduct stock repurchases may be limited under applicable banking regulations and regulatory policies, due to losses for the period, expected losses for future periods and/or the inability to upstream funds from a financial institution to its holding company as a result of lower income or regulatory capital levels. Institutions should be mindful of the Federal Reserve's Policy Statement SR 09-4 regarding capital distributions, which can be accessed **here**, when they have incurred losses for the dividend period, they expect future losses or have capital maintenance issues, as they may be required to obtain Federal Reserve non-objection for dividend payments (even at amounts that have historically been paid to stockholders), and such Federal Reserve review and non-objection may not be provided or may take longer than usual.

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