

# YEAR-END REPORTING CONSIDERATIONS FOR FINANCIAL INSTITUTIONS



JANUARY 14, 2010

# Agenda

- Introduction
- Presentation
  - Brian W. Smith, Latham & Watkins
  - Joel H. Trotter, Latham & Watkins
  - Donald A. Walker, Jr., FTI Forensic and Litigation Consulting
  - Thomas G. Rees, FTI Forensic and Litigation Consulting
- Questions and Answers — (*anonymous*)
- Slides — now available on front page of Securities Docket
  - > [www.securitiesdocket.com](http://www.securitiesdocket.com)
- Wrap-up



# Webcast Series

- Series of webcasts — every other week
- [www.securitiesdocket.com/webcasts](http://www.securitiesdocket.com/webcasts)
- January 21— **TARP Update: Current Opportunities and Pitfalls**



# Panel



Brian W. Smith



Joel H. Trotter



Donald A. Walker



Thomas G. Rees



Bruce Carton



# Year-end Reporting Considerations For Financial Institutions

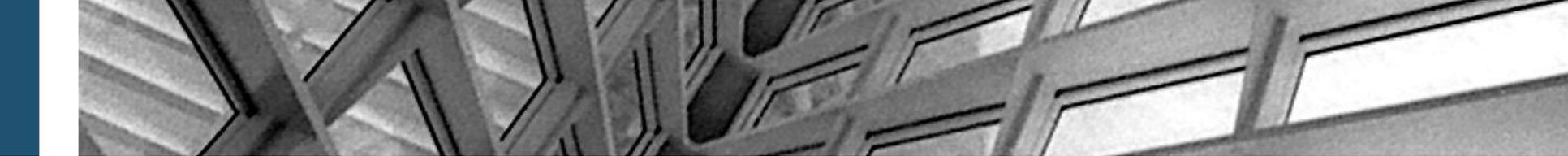
January 14, 2010

**Brian W. Smith**

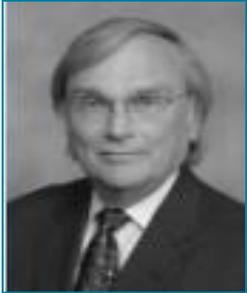
**Donald A. Walker, Jr.**

**Joel H. Trotter**

**Thomas G. Rees**



# Panel



Brian W. Smith



Thomas G. Rees



Joel H. Trotter



Bruce Carton



Donald A. Walker, Jr.

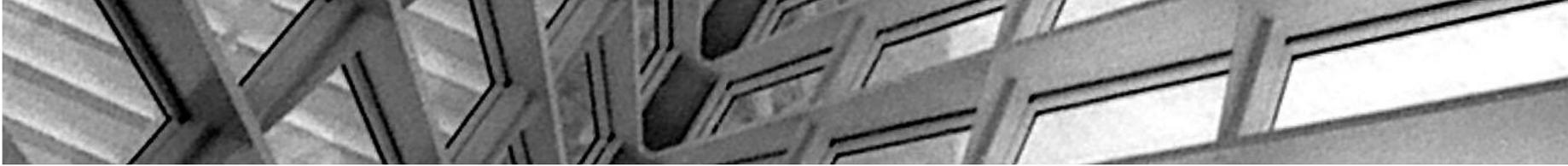


# Year-end Reporting Considerations For Financial Institutions

January 14, 2010

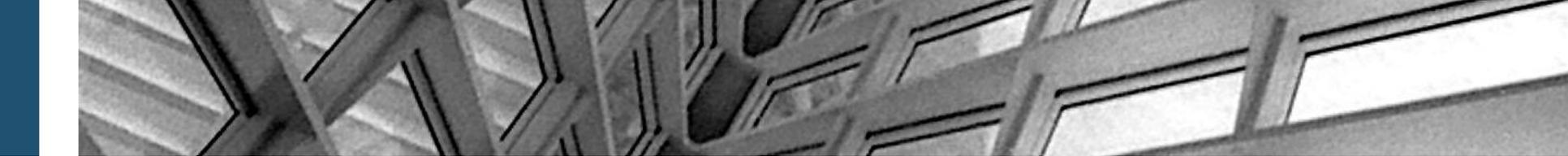
**Brian W. Smith**

**Joel H. Trotter**



---

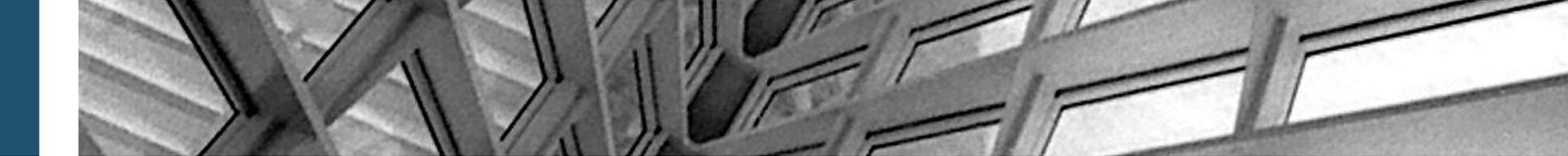
# Background and Themes



# Regulatory Climate

---

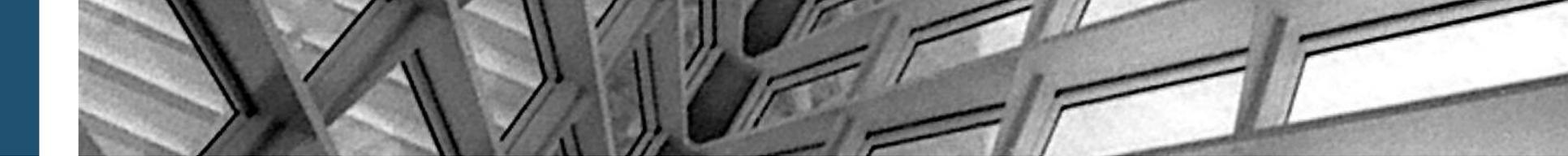
- Increasing Numbers of Problem Banks ! 140 failures in 2009 ! 200+ in 2010??
- Shifting Focus in Size of Banks Impacted
  - From Mega to Large Midsize to Community
- Regulatory Orders/Capital Directives Outstanding and More Expected for 2010
- Shifting Asset Issues
  - From Investment to Loan
  - From Mortgage to Card to CRE to ???



# “Patience” of 2009 Runs out in 2010

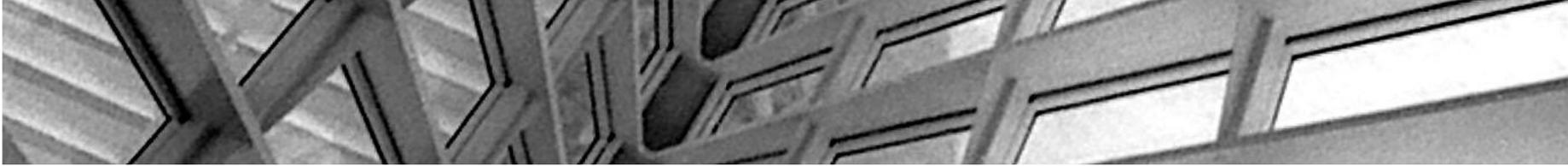
---

- Regulatory Actions taken in 2009 are ‘due’ to be Satisfied in 2010!
  - Few Banks Have Resolved Asset Deficiencies by Removal from Books ( and fewer got new capital)
  - Events and Facts Trigger Recognition of Deficiencies and 2010 is an ‘eventful’ year for CRE and other classes.
  - Regulatory Reform Debate will Fuel Congressional Inquiry Into Effectiveness of Agency Oversight and Enforcement.



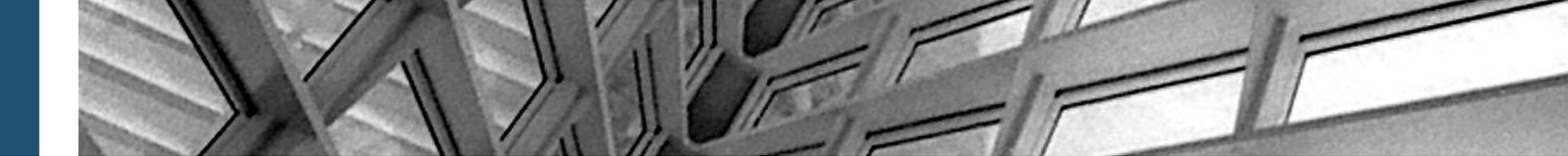
---

**SERIOUS DECISIONS ABOUT  
RECOGNITION OF ASSET VALUES  
AND DEFICIENCIES WON'T  
WAIT ANY LONGER**



---

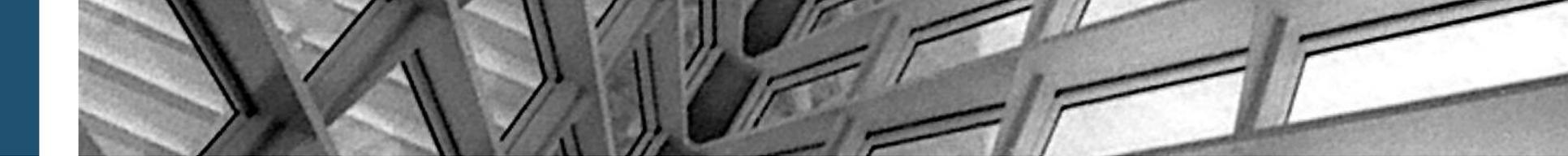
# SEC Reporting Issues



# Financial Regulatory Reform Goals

---

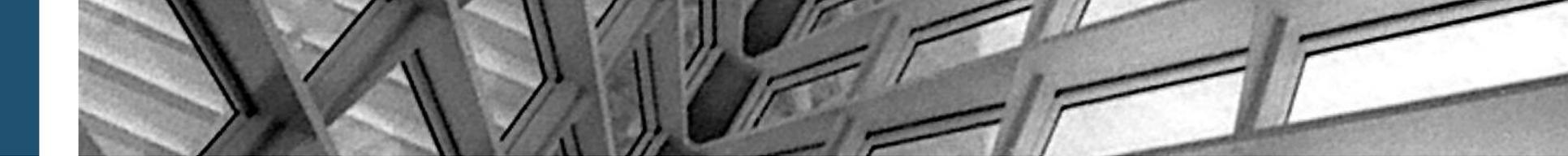
- Robust regulation of financial firms
- Comprehensive supervision of financial markets
- Investor protection from financial abuse
- Heightened international standards and cooperation



## Some Key SEC Goals

---

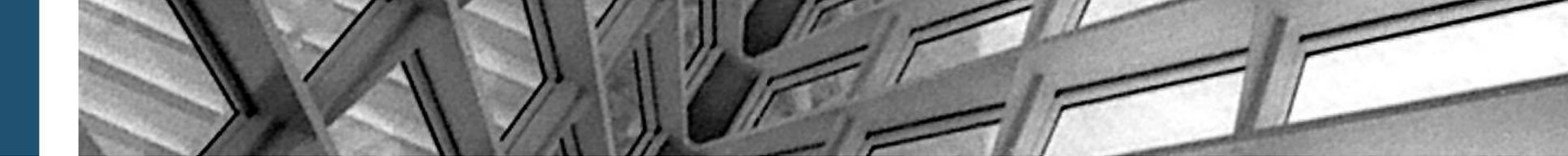
- Fill regulatory gaps exposed by economic crisis
- Enhance disclosures provided to investors
- Streamlined, high-impact enforcement focus
- Revamp system for handling tips and complaints
- Improve risk assessment and internal training



# Increased Proxy Disclosures

---

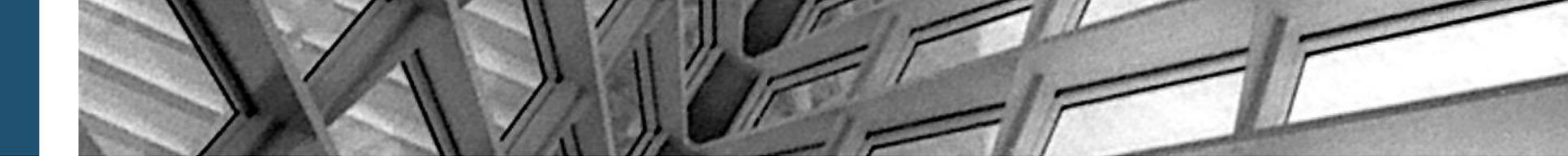
- Compensation Discussion & Analysis
- Increased director and nominee disclosures
- Disclosure regarding leadership structure and Board of Directors role in risk management
- Voting results reported on Form 8-K
- Additional changes for 2010 proxy season



# Frequent SEC Comments

---

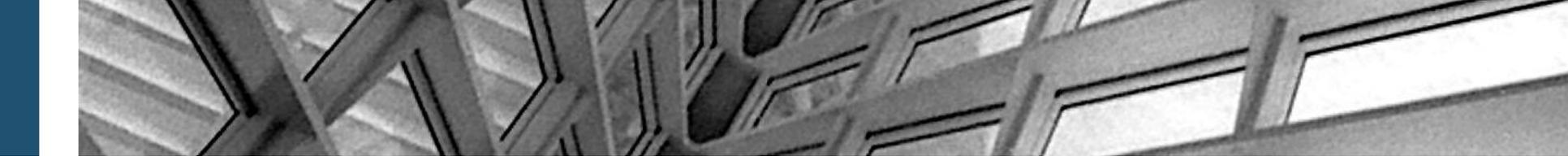
- Allowance for loan losses
- Troubled debt restructurings (TDRs)
- Other real estate owned (OREO)
- Purchased loans
- U.S. Treasury mortgage modification programs
- Securities impairment
- Goodwill impairment
- Deferred tax asset valuation
- Fair value disclosures
- TARP transactions
- Regulatory actions or recommendations
- FDIC assisted transactions



# Focus on Market Conditions

---

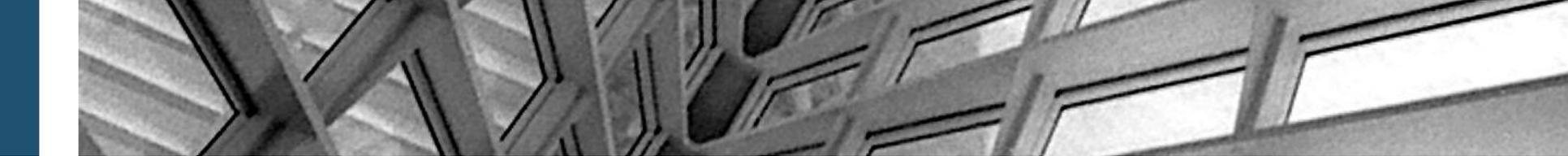
- SEC focus on adequacy of disclosure regarding current market conditions and known risks and uncertainties
- Risks that compensation plans encourage
- Impact on customers, suppliers, creditors, financing sources, counterparties, capital spending and business development



# MD&A

---

- Executive overview
- Significant drivers and reasons underlying variances
- Critical accounting estimates (areas of judgment and related sensitivity analysis)
- Trends that could affect operating results or liquidity
- Special focus on liquidity



# Segment Reporting

---

- Aggregation of operating segments
- Economic environment vs. continued ability to demonstrate economic similarity required for aggregation
- Staff may request CODM reports
- Staff will review other sources, such as website, press releases, analyst information
- Linkage to impairment analysis

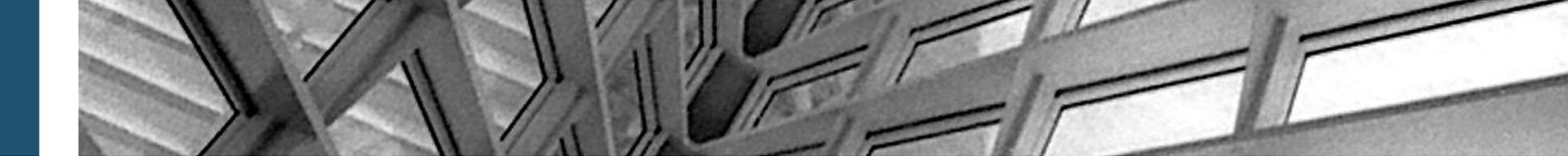


# Year-end Reporting Considerations For Financial Institutions

January 14, 2010

Donald A. Walker, Jr.

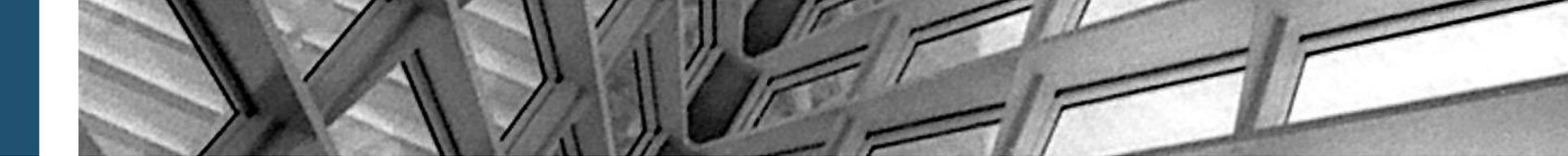
Thomas G. Rees



# Financial Reporting

---

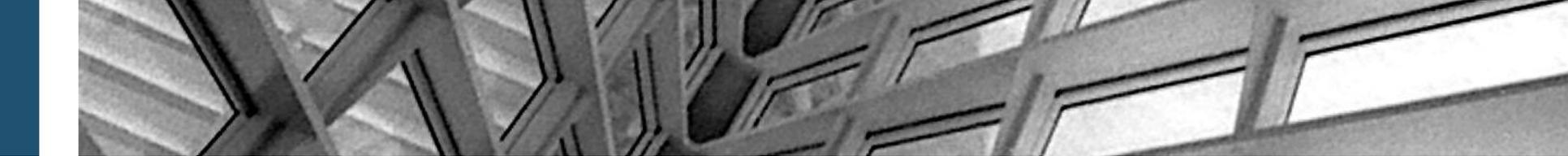
- ✓ Allowance for Loan Losses
- ✓ “Other Than Temporary” Impairment and Related Securities Accounting Issues
- ✓ Other Potential Impairment Issues
  - ✓ Goodwill
  - ✓ Deferred Tax Assets
- ✓ Impact of New Accounting rules for Securitizations and Consolidations (FAS 166/167)



# Financial Reporting Spotlight

---

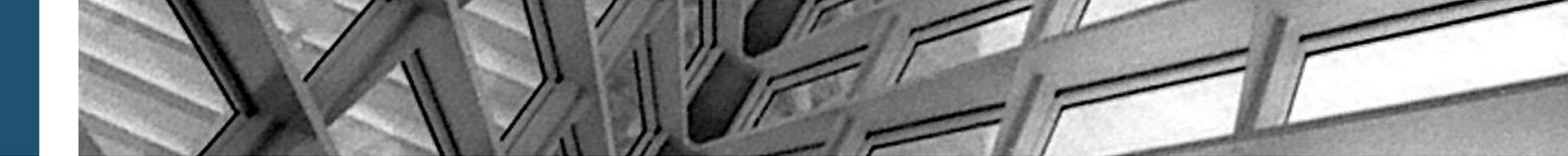
- Entities need to prepare for increased scrutiny of financial reporting by regulators, law enforcement agencies, investors and others
  - Search for financial frauds arising from financial crisis
  - Potential plaintiff litigation claims
- Continued emphasis on thinly traded and hard-to-value financial assets and valuations, in particular, loans (ALLL) and investment securities (OTTI)



# Allowance for Loan Losses

---

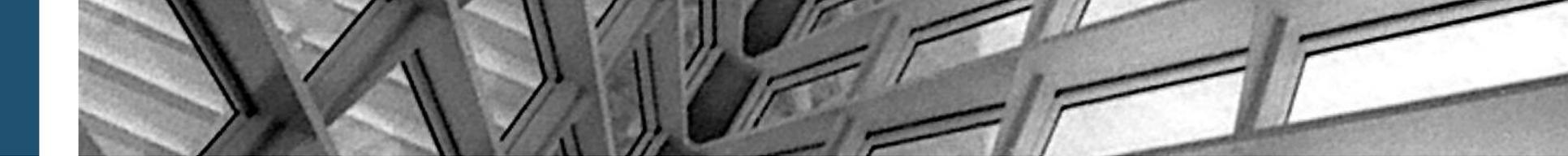
- Appropriate segmentation of loan portfolio
- Updated information about value of collateral and borrower condition
- Adequate information about market-area economic conditions
- Correlations and risk concentrations
- Does methodology still fit economic conditions?  
Change vs refinement
- Regulatory concerns



# New OTTI Guidance

---

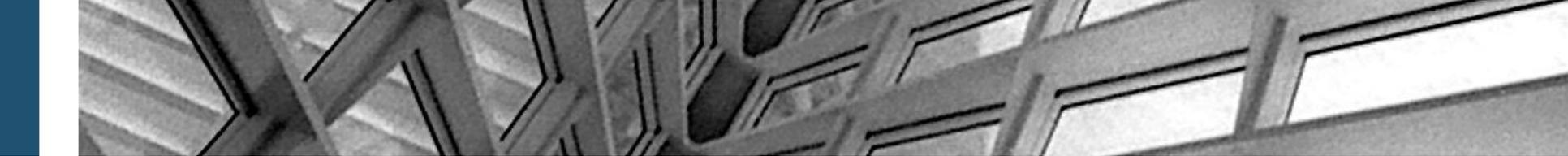
- FSP FAS 115-2
- Significantly changed the accounting requirements for assessing impairment on debt securities
  - Requires entities to separate impairment into amounts due to credit loss and amounts attributable to all other factors
  - Reporting entities must estimate the present value of cash flows expected to be collected
  - Changed the presentation of OTTI in income statements
  - Required enhanced disclosures
- New guidance incorporated in ASC-320-10-35



## When OTTI?

---

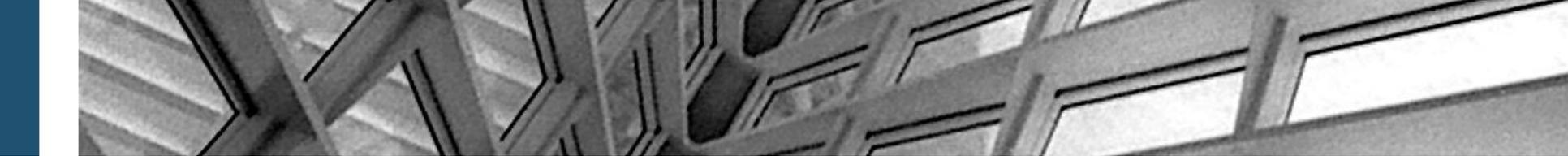
- Impairment is “Other Than Temporary,” if:
- entity has decided to sell the security, or
- no intent to sell, but entity cannot assert that it is not “more likely than not” the entity will be required to sell the security before recovery of cost basis occurs
- entity does not expect to recover the entire amortized cost basis (i.e. present value of cash flows expected to be collected is less than the amortized cost basis of the security).



# Calculation of Credit Loss Example

---

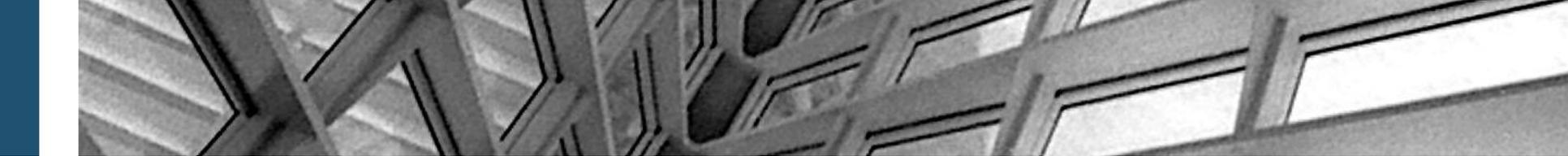
- Assume amortized cost basis of a debt security is \$100, FV is \$50 and present value of cash flows expected to be collected is \$80
- Total impairment = \$50 (Amortized cost – fair value)
- Credit loss = \$20 (Amortized cost – present value of cash flows expected to be collected). This amount is recognized in earnings.
- Impairment due to other factors = \$30 (Present value of cash flows expected to be collected minus fair value). This amount is recognized in OCI.



# Regulatory Focus on OTTI

---

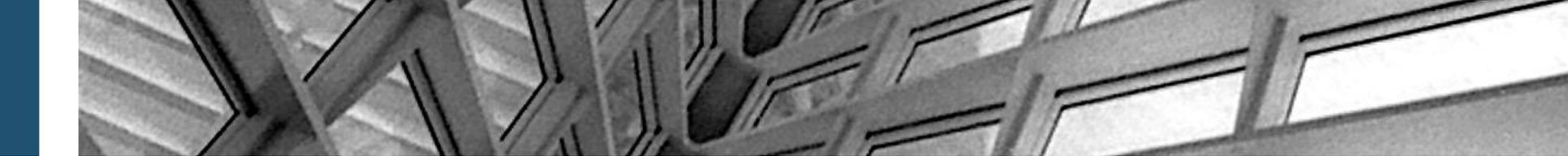
- Bank regulators and the SEC have focused on certain securities, including Pooled Trust Preferreds (i.e., “Alescos,” “Pretsls” etc.) and private-label MBS
  - Methodology for determining fair value
  - Methodology for estimating credit impairment
- SEC focus on disclosures about assumptions, nature and performance of investments and the potential effects on bank capital and operations
- Increased risk-based capital requirement for some securities that are one level below investment grade



# Goodwill

---

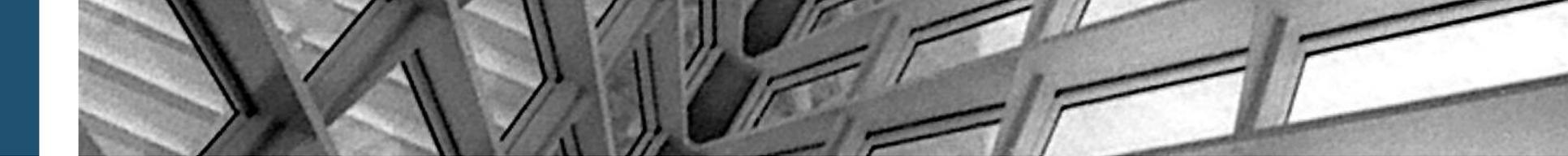
- Impairment testing requires appropriate segment reporting
- Valuation methodologies should be consistent with other similar valuations
- Cash flows and discount rates should be consistent with other asset valuations
- Regulatory agreements and understandings affect valuation assumptions



# Deferred Tax Assets

---

- Amount of deferred tax assets have increased
- Under GAAP, deferred tax assets should be recognized at the amount that is more likely than not to be realized
- Deferred tax assets that are dependent upon future taxable income are limited in regulatory capital to:
  - The amount expected to be realized in one year
  - 10% of the bank's Tier 1 capital
- Deferred Tax assets which can be realized from taxes paid in prior carryback years are not included in limit



## Impact of New Accounting Rules for Securitizations and Consolidations

---

- Implementation of SFAS 166 and 167 requires re-evaluation of SPE's, SIV's and similar structures
- Key changes include:
  - elimination of QSPEs
  - new requirements for loan participations
  - changes in how the primary beneficiary is determined, and
  - quarterly assessments of the primary beneficiary
- Banks should consider operational implications
- Regulatory capital effects phased in over 1-year period

# Donald A. Walker, Jr.



**Don Walker** is a Senior Managing Director and is based in Washington, D.C. Mr. Walker has over 40 years of professional experience and recently joined FTI after 17 years of service at the Washington, D.C. headquarters of the United States Securities and Exchange Commission (“SEC”), where he was the Senior Assistant Chief Accountant responsible for accounting reviews in the Financial Services group in the Division of Corporation Finance. In that capacity, Mr. Walker was responsible for resolving technical accounting, financial reporting and disclosure issues, primarily in the financial services industry. Mr. Walker had significant responsibilities for reviewing the initial registrations of many large foreign private issuers, and for reviewing IFRS-based financial statements in foreign private issuer annual reports filed with the SEC.

While at the SEC, Mr. Walker worked closely with the Commission’s Office of the Chief Accountant, the Division of Enforcement, and the federal banking regulators, as well as outside counsel and companies’ independent auditors. He was a member of the interagency working group on loan loss allowances which included SEC and bank regulatory officials, and was a coauthor of SEC Staff Accounting Bulletin No. 102 regarding loan loss allowances. Mr. Walker also was a leader in technical accounting training for US and international filings for SEC accounting and legal staff.

Mr. Walker is a frequent speaker at the AICPA National Banking Conference and at various panels and premier providers of continuing education and CLE seminars. He has also spoken on loan loss allowances to the large bank examiner training of the Office of the Comptroller of the Currency. Mr. Walker is presently an adjunct professor teaching accounting in Georgetown University’s L.L.M. and J.D. programs. He previously served as an adjunct professor in managerial accounting at Georgetown University and Colby College.



# Thomas G. Rees



**Thomas G. Rees** is a Managing Director in FTI's Forensic and Litigation Consulting practice located in King of Prussia, PA. He provides clients with a variety of consulting and litigation related services, including determining the accounting for complex transactions, conducting forensic accounting examinations and preparing expert testimony. Mr. Rees has extensive experience researching and interpreting generally accepted accounting principles (GAAP) and specific expertise in capital markets and financial instruments including derivatives and securitization. He specializes in banking and SEC matters, including fair value accounting, valuing complex securities, preparation of SEC filings, and accounting position papers, responding to SEC comment letters and helping to resolve the accounting and disclosure issues in SEC enforcement actions.

Mr. Rees previously served as the Deputy Chief Accountant at the Office of the Comptroller of the Currency (OCC), a Division of the U.S. Treasury Department responsible for regulating national banks. In his ten years with the OCC, Mr. Rees held management positions in the Chief Accountant's Office and the Treasury and Market Risk Division and was responsible for developing and interpreting supervisory policy relating to accounting, auditing, financial reporting, capital markets, risk-based capital and risk management.

Tom is a frequent speaker at industry conferences on emerging accounting issues. Currently, he leads accounting seminars for the Center for Professional Education, Inc. and is an adjunct faculty member of the University of Maryland, University College. Mr. Rees holds an M.B.A. from the University of Delaware and a B.S. in Accounting from Arizona State University. He is a Certified Public Accountant, a Certified Fraud Examiner and a Chartered Financial Analyst and is a member of the CFA Institute and the American Institute of Certified Public Accountants.

# Brian W. Smith



**Brian W. Smith** is a partner in the Finance Department of Latham & Watkins' Washington, D.C. office. Mr. Smith has more than 38 years experience in the financial services industry as a partner of an international law firm, as a senior federal regulator and as a senior corporate officer of a multinational financial services company. Mr. Smith's work involves financial institutions regulation, corporate, securities and electronic commerce. Mr. Smith's experience includes representation of financial services firms and technology companies in transactional and regulatory matters, retail and institutional product development and distribution, electronic commerce, capital markets, asset management and fiduciary products.

Immediately prior to joining Latham & Watkins Mr. Smith was a partner at Mayer, Brown, Rowe & Maw LLP in Washington, D.C. His career has also included the following positions: managing partner at Stroock & Stroock & Lavan in Washington, D.C.; chief counsel & member of policy group, Office of the Comptroller of the Currency, US Department of Treasury, Washington, D.C.; senior vice president, general counsel & corporate secretary, MasterCard International, Inc., New York; CIT Financial Corporation, New York and American Express Company, New York.

Mr. Smith is a frequent commentator/author/lecturer on the financial services industry and the law and regulations affecting it. He is a member of the American Bar Association's Banking Law Committee, and serves on the board of advisors of several leading industry publications.



# Joel H. Trotter

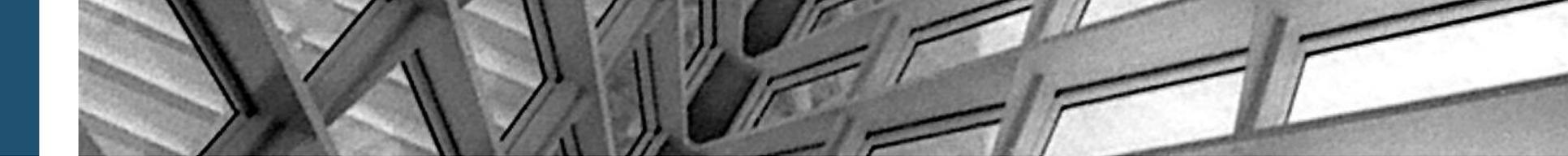


**Joel H. Trotter** is a partner in the Washington D.C. office of Latham & Watkins, where he serves as Deputy Chair of the Corporate Department. His practice focuses on corporate finance, mergers and acquisitions, securities regulation and general corporate matters. Mr. Trotter represents major New York Stock Exchange listed companies and counsels both issuers and underwriters in the public offering process and in corporate compliance matters involving SEC reporting and disclosure requirements. He also serves as special counsel for boards of directors, audit committees and special committees on governance issues, corporate crises and business combination proposals.

Mr. Trotter is the co-author of the chapters of *The Practitioner's Guide to the Sarbanes-Oxley Act* (American Bar Association) on "Disclosure of Internal Control over Financial Reporting" and "Corporate Internal Investigations after Sarbanes-Oxley" and is a contributor to *Securities Law Techniques* (Matthew Bender). He has also published articles on securities law issues in *Insights* and *The Corporate Governance Advisor* and has authored Client Alerts on topics including the SEC's securities offering reform rules and financial statement requirements for securities offerings.

Mr. Trotter was an Echols Scholar at the University of Virginia and, during law school, served on the Editorial Board of the *Virginia Law Review*.

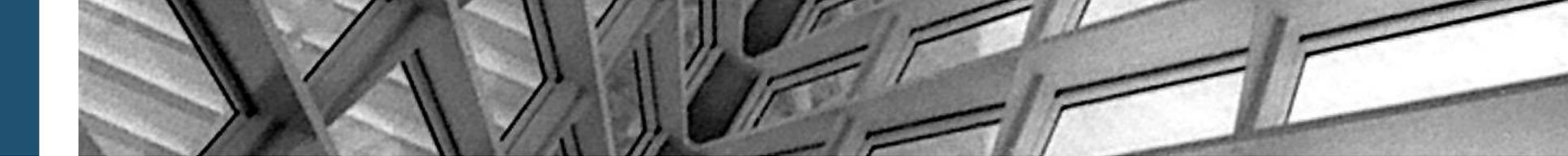




# FTI Forensic & Litigation Consulting Practice (FLC)

---

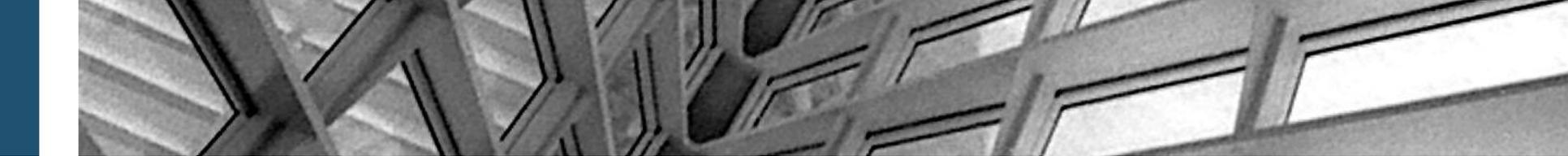
- **Assists Clients with:**
- SEC Enforcement and Accounting Matters
- Technical Accounting Consultations
- Internal Forensic Accounting Investigations
- Due Diligence on Purchase Acquisitions
- Accountants' Malpractice
- Litigation Support and Expert Witness Services
- Other Financially Oriented Litigation



# FTI: The Company Behind the Headlines

---

- Founded in 1982
- NYSE-listed company (Symbol: FCN)
- Over \$1 billion in annual revenue
- More than 3,500 professionals worldwide
- Offices in more than 50 cities throughout the world and in every major business center



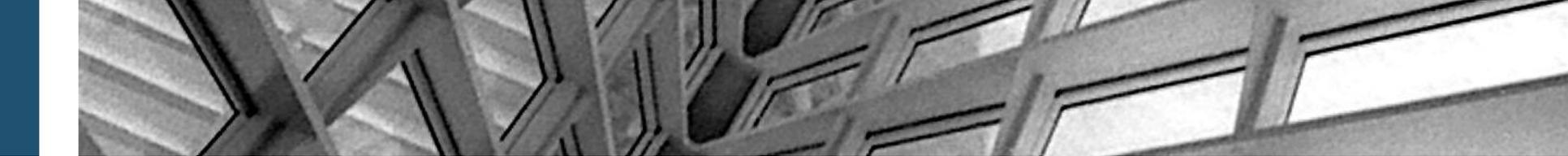
# Latham's Securities Disclosure Practice

## Public Company Reporting & Disclosure

- Earnings guidance, releases and Regulation FD
- Proxy Solicitation
  - E-Proxy
  - Proxy contests
- NYSE, Nasdaq, LSE and AIM listing and compliance
- Sarbanes-Oxley
- Periodic reporting obligations
- Disclosure controls and procedures
- Internal control over financial reporting
- Non-GAAP financial measures

## Securities Regulation

- Registered public offerings of equity and debt securities
- Private offerings and PIPEs
- Registration rights and resales
- Private placement of debt securities
- Rule 144, Section 16 and other securities matters impacting affiliates
- Share plans and programs
  - Insider trading policies
  - 10b5-1 trading plans
  - Share repurchase plans
  - Dividend reinvestment plans
- Securities repurchases and exchanges



# Latham's Financial Regulatory Practice

---

- The partners and counsel of the Financial Regulatory Group are internationally recognized for their reputation and experience in the financial services industry.
- The group advises banks, securities firms, insurance companies and their parent holding companies and affiliates, as well as companies engaged in financial services across the globe, and financial sector professional organizations and industry groups, on the full range of financial regulations affecting their activities and operations. The group's principal practice areas include:
  - Regulatory Compliance
  - Corporate Finance Transactions
  - Corporate Governance and Transactions in the financial sector, including M&A, restructuring and liquidations
  - Consumer Financial Services
  - Asset Management, Fiduciary Services & Capital Markets
  - Retail and Corporate Payments
  - Electronic Financial Services

# Questions?



# Thank You

Thank you for attending this webcast.

