

E-ALERT | Securities & Capital Markets

January 9, 2012

SEC STAFF ISSUES DISCLOSURE GUIDANCE REGARDING EUROPEAN DEBT EXPOSURES

Relevant to Financial Institutions and Other Registrants

On January 6, 2012, the Division of Corporation Finance of the SEC (the “Division”) issued [guidance](#) for disclosure by public companies, most particularly financial institutions, with exposure to debt of European sovereign and non-sovereign issuers. In the guidance, the Division addresses its concerns about risks for financial institutions that have direct and indirect exposures to holdings of European sovereign debt and the inconsistency in disclosures it has observed in this area. In an effort to help such registrants provide more consistent disclosure, and also to guide disclosures of other registrants with exposures to the European region generally, the staff provides an unusually detailed series of disclosure topics that it “encourages registrants to consider” including in their upcoming annual reports and other SEC disclosure documents.

The Division first rolled out what it calls “CF Disclosure Guidance” in September 2011, and this “European Sovereign Debt Exposures” issue is Topic No. 4. Generally, these guidance publications are an attempt by the Division to address both common comments that it is making in reviewing filings and related materials and also inconsistencies that it is observing in responses to those comments and disclosure practices by public companies more generally. Senior staff members have said that the Division will use disclosure guidance to help registrants in preparing filings and in other disclosure practices. This may reduce the need for subsequent comments in the areas addressed. It likely telegraphs near term increases in limited reviews of filings (particularly of financial institutions) to assess the effectiveness of the guidance.

Topic No. 4 provides a detailed roadmap for disclosures that public companies with material exposure to the European region should consider. We believe that, unless a particular line item in the guidance clearly is not applicable to a registrant or a compelling case can be made it is immaterial despite its applicability, the Division staff will expect to see responsive disclosure in upcoming filings.

The Division believes that disclosures should be provided separately by country, segregated between sovereign and non-sovereign debt exposures and by financial statement category, to arrive at gross funded exposure. Also, the Division believes registrants should consider separately providing disclosure of the gross unfunded commitments made. Finally, registrants are encouraged to provide information regarding hedges in order to facilitate evaluation of net funded exposure. In organizing relevant disclosure, the Division lays out the following topical framework:

1. Gross funded exposure to European debt and other instruments by country, type of counterparty (sovereign/non-sovereign) and type of financial instrument, with specific quantification guidelines for different types of instruments
2. Unfunded exposure by country and type of counterparty
3. Total gross exposure, funded and unfunded
4. Effects of credit default swap protection in calculating aggregate net exposures
5. Other risk management practices
6. Significant post-reporting date events

The disclosure guidance also points out the need to address the European financial situation in MD&A, Industry Guide 3, risk factor and market risk disclosures.

In addition, we recommend that registrants consider the potential impact of events in Europe on any forecasts or other forward-looking disclosures in their SEC filings. This could include providing additional meaningful cautionary statements addressing the European financial situation to ensure availability of safe harbor protections for forward-looking statements provided by Sections 27A of the Securities Act and 21E of the Exchange Act.

Because this guidance represents the Division's views generally about appropriate disclosure, all registrants, and not just financial institutions, need to focus on disclosures to the extent of any material exposure to ongoing events in Europe. While it may be unusual for a non-financial institution registrant to have direct or indirect exposure to European debt, there are other means by which such a registrant could be exposed to uncertainties in the European markets. This could include, for example, a registrant for which Europe is a significant geographic segment from a cash flow and revenue point of view, and thus has customers or lines of business that may be affected by events in the region. Similarly, a non-financial institution registrant should consider the extent that it has material financial commitments to or from institutions with exposures to European sovereign or other debt.

Underwriters will also want to focus on how they approach the diligence exercise as it relates to disclosures provided by registrants in response to the Division's guidance. In particular, given the numerical granularity of the recommended disclosures, we anticipate that this data will become part of the discussion of the scope of coverage provided by a registrant's auditor in its comfort letter.

As noted in our December 16, 2011 e-alert regarding the European financial crisis, Covington has created an interdisciplinary and global team of attorneys and advisers to assist clients as they evaluate their response to the crisis. That e-alert can be accessed [here](#). This team includes members of our Securities practice group, who have extensive experience advising issuers and underwriters on disclosures in SEC filings.

While the SEC staff's new disclosure guidance on the European financial crisis is, as noted above, surprisingly detailed in its approach, the guidance provides a road map that affected

registrants (and, in capital formation transactions, underwriters) may find useful as they develop disclosures for upcoming SEC filings.

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