May 8, 2017

Office of the Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: File No. S7-02-17, Request for Comment on Possible Changes to Industry Guide 3

Introduction

On March 1, 2017, the SEC issued a press release seeking comments by May 8, 2017 on its *Industry Guide 3, Statistical Disclosure by Bank Holding Companies*.[1] This paper is focused on the issues cited on page 74 of the request for comment, regarding the conflicting objectives between banking and securities laws and regulations and the resulting consequences vis-à-vis the public interest. These issues also tie into page 16, which states, "We also are considering how Guide 3's disclosures can be most effectively presented from the perspective of both investor protection and promoting efficiency, competition and capital formation.[57] [57]Section 3(f) of the Exchange Act requires that, whenever the Commission is engaged in rulemaking under the Exchange Act and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall consider, ***in addition to the protection of investors, promotion of efficiency, competition and capital formation***. Section 2(b) of the Securities Act also sets forth this same requirement. *See also* Section 23(a)(2) of the Exchange Act." (emphasis added)

The issue of public interest is cited by both federal banking and securities regulations with an imbalanced application by the regulators, that favors the federal banking regulators, since 1999. This has resulted in a bifurcated market with limited transparency and market discipline for large depository institution holding companies (DIHCs) (assets over $10 billion) and the opposite factors for small DIHCs. 3 types of material omissions have developed with large DIHCs that are known by federal banking regulators and the boards, management, and outside auditors of the large DIHCs but not by investors. These issues are similar to but different than other cases of material omissions, such as Enron, Refco, and Vivendi, as they impact an entire industry. This includes over 1,100 global DIHC investors that are registered investment advisers (RIAs) of the SEC as well as the largest DIHCs that report approximately $4.3 trillion of counterparty exposures in their FR Y-15 Systemic Risk Reports. These issues are also indicators of material weaknesses (PCAOB's Auditing Standard No 5) and fraudulent statements (17 C.F.R. §240.3b-6(d)).

Summary

Conflicting disclosure requirements between banking and securities laws and regulations have created a bifurcated market for depository institution holding companies (DIHCs) and their investors, including other DIHCs.

The market for large DIHCs (assets above $10 billion) is inefficient with limited transparency concerning material compliance violations for safety and soundness, 12 U.S.C. § 1818(b), source of strength, 12 C.F.R. § 225.4(a), well managed, 12 U.S.C. § 1841(o)(9)B, and internal fraud, 12 C.F.R. §217.101(b).

The market for small DIHCs (assets below $10 billion) is more efficient with significant transparency on material compliance violations for safety and soundness and source of strength.

During 2002 to 2017, 11 large DIHCs and 554 small DIHCs disclosed formal enforcement actions (FEAs) for violations of safety and soundness and source of strength. FEAs, also known as regulatory events, are material disclosure events as they qualify as events of default in many credit agreements and credit annexes of ISDA Master Agreements. The SEC also requires their disclosure as a material contract, 17 C.F.R. 229.601(b)(10).

Disclosure of 565 FEAs resulted in an average default or failure rate of 39%.

With the FDIC experiencing an average loss of 19% of total assets for failed banks, the FDIC's Deposit Insurance Fund would not be able to afford the failure of one or more of the largest DIHCs. At the peak of the financial crisis, federal bank regulators provided systemic risk financial assistance for two large banks and their DIHCs. They also apparently applied, 12 U.S.C. § 1818(u)(1)(A), to withhold and not disclose FEAs for many of the large DIHCs that have identical risk profiles to the 100 small DIHCs, with assets above $1 billion, that did disclose FEAs.

As part of an industry consolidation, 80% of the banking industry's assets of $16 trillion are now owned by 100 large DIHCs. The largest DIHCs include 60 financial holding companies (FHCs), 24 bank holding companies (BHCs), 9 savings and loan holding companies (SLHCs), and 7 intermediate holding companies (IHCs). The Dodd-Frank Act identifies large interconnected DIHCs as a potential threat to the financial stability of the U.S.[2] Parties impacted by the bifurcated market include DIHC counterparties plus over 1,100 global equity investors that are registered investment advisers (RIAs) with the SEC. Those RIAs own 76% or $1.4 trillion of the $1.8 trillion of public equity in the 100 largest DIHCs.

Background

Omissions of material information by many of the 100 large U.S. DIHCs as well as by federal bank regulators, since the repeal of the Glass-Steagall Act in 1999, have created an inefficient market, *based on government policies*.

These policies attempt to protect the FDIC's Deposit Insurance Fund and the stability of the financial markets by intentionally withholding material information from investors, including other DIHCs. This creates **asymmetric** or **superior information**[3] that is known to DIHC bank regulators, DIHC Boards and management as well as outside auditors and outside counsel but not to investors.

Omission of these apparent violations also conflicts with disclosures by DIHCs under Regulation S-K, that affirm compliance with Sarbanes-Oxley's (SOX) 17 C.F.R. 229.406 (Code of Ethics), 17 C.F.R. 229.308 (Internal Control Over Financial Reporting), and 17 C.F.R. 229.307 (Disclosure Controls and Procedures). These disclosures respectively affirm that (1) the DIHC complies with laws and regulations, (2) internal control over financial reporting (ICFR) is effective, and (3) disclosures and control procedures are effective. Quarterly certifications under 17 C.F.R. 229.601(31) affirm the effectiveness of

(2) and (3) and further state that the financial statements are not omitting any material information.

DIHC investors, including DIHC counterparties, are thus potentially misled *twice*; first by material omissions by DIHCs and then by representations that a DIHC complies with laws and regulations and that it is not omitting material information.

Superior Information in 3 Contexts: Corporate Governance, Market Efficiency, Fraud

In the context of corporate governance and Delaware law, a “duty of candor applies to officers and directors as well as those who are privy to material information obtained in the course of representing corporate interests. Fiduciaries may not use superior information to materially mislead others in the performance of their fiduciary obligations. *Mills*, 559 A.2d 1251 (Del. 1988).”[3]

In the context of market efficiency, asymmetric or superior information creates a “lemons market” as defined in 1970 by George A. Akerlof’s Nobel Prize-winning paper, *The Market for “Lemons”: Quality Uncertainty and the Market Mechanism*.[4] Asymmetric information exists “where car sellers have more knowledge about the quality of the car than the buyers. But good cars and bad cars must still sell at the same price – since it is impossible for a buyer to tell the difference between a good car and a bad car.”[5] The paper also cites relevant examples in credit and money markets.

In the context of a fraudulent business transaction, “a party to a business transaction may have a duty to disclose, even in the absence of a fiduciary relationship, if the party (1) "has made a partial or ambiguous statement, on the theory that once a party has undertaken to mention a relevant fact to the other party it cannot give only half of the truth," or (2) "possesses superior knowledge, not readily available to the other, and knows that the other is acting on the basis of mistaken knowledge." *Brass v. Am. Film Tech., Inc.*, 987 F.2d 142, 150 (2d Cir.1993).[6]

Conflicting federal laws and regulations on disclosures for DIHCs are cited below.

On the one hand, the following banking laws and regulations:

- **12 U.S.C. § 1818(u)(1)(A)** grants the Federal Reserve discretion to disclose or withhold FEAs on material compliance violations;
- **12 C.F.R. § 261.2(c)(1)** defines Confidential Supervisory Information (CSI) for DIHCs that includes supervisory exams and FEAs (cease and desist orders); and
- **12 C.F.R. § 261.20** requires that CSI be disclosed to and known by directors, management, outside auditors and outside counsel.

On the other hand, the following securities laws and regulations:

- **17 C.F.R. 210.4-01(a)(1)** requires SEC registered firms to submit financial statements in accordance with generally accepted accounting principles;
- **Regulation S-K, 17 C.F.R. 229,** requires disclosure of material information to investors; and
- **12 U.S.C. § 1831m(d)** requires banks to submit an annual independent audit of the institution’s financial statements by an independent public accountant in accordance with generally accepted auditing standards and **Section 1831n** of this title.

Intentional omission of material information, such as material compliance violations, is a material misstatement as defined in the PCAOB's **AU Section 316, .06**.[7] **Three broad categories of omissions by large** DIHCs include:

- Omission by many large FHCs on whether they are in compliance as a FHC and its dual requirements, 12 U.S.C. § 1843(L), of being well managed and well capitalized;
- Omission of FEAs (written agreements and/or cease and desist orders) on violations of safety and soundness, 12 U.S.C. § 1818(b) and source of strength, 12 C.F.R. § 225.4(a). The violations in this analysis involve unsafe or unsound practices with respect to financial and compliance factors and not anti-money laundering, trading and/or mortgage servicing; and
- Omission by large DIHCs of internal fraud, 12 C.F.R. §217.101, as the information is classified as confidential supervisory information.

These apparent omissions and material misstatements should nullify effective internal control over financial reporting (ICFR). The SEC's **17 C.F.R. 229.308(a)(3)** does not permit management to certify that ICFR is effective if there are one or more material weaknesses.

Material misstatements and fraud are two of the four **material weaknesses** that are defined by paragraph 69 of PCAOB's **Auditing Standard No 5.**, June 12, 2007 to December 30, 2016: "69. Indicators of material weaknesses in internal control over financial reporting include

- Identification of fraud, whether or not material, on the part of senior management;14/
- Restatement of previously issued financial statements to reflect the correction of a material misstatement;15/
- Identification by the auditor of a material misstatement of financial statements in the current period in circumstances that indicate that the misstatement would not have been detected by the company's internal control over financial reporting; and
- Ineffective oversight of the company's external financial reporting and internal control over financial reporting by the company's audit committee."[8]

In an apparent effort to reconcile these conflicts, federal bank regulations state under Disclosures, 12 C.F.R. 217.61 and 217.62, that DIHCs with assets of $50 billion or more must have a formal disclosure policy for their disclosures on internal controls and disclosure controls and procedures. The supporting Federal Register, Vol 78, No. 198, October 13, 2013, includes footnote 190 that states, "Other public disclosure requirements would continue to apply, such as federal securities law, and regulatory reporting requirements for banking organizations."[9]

Discovering these apparent violations is nearly impossible for investors as the information is classified as confidential supervisory information.

Mechanisms, however, do exist for discovery. Confidential supervisory information is made available to law enforcement agencies and other nonfinancial institution supervisory agencies through 12 C.F.R. § 261.21 and 12 U.S.C. § 5234. The SEC, PCAOB and DOJ have the primary authority to enforce matters relating to SOX.

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Overview

This paper analyses each of the 3 disclosure risks by DIHCs and their implications for investors, including other DIHCs. This is a risk analysis of defined terms from recent DIHC enforcement cases by the SEC that highlight how similar risks have not been disclosed by many large DIHCs, that investors have limited recourse to address these material omissions and it appears the SEC is the primary agency with standing to address these evident material omissions.

The order of the analysis is along a timeline from 1999 to the present. This shows the progression of the issues and relevant cases.

Issue # 1

Omission by many large FHCs of disclosure about whether they are in compliance as a FHC and its dual requirements, 12 U.S.C. § 1843(l)(1), of being well managed and well capitalized, (*subsection (l)(1) of* 12 U.S.C. § 1843).

Analyzing disclosures by 60 publicly-traded FHCs from 2005 to the present, in their 10K SEC filings, reveals many of the 59 FHCs fail to disclose if they are well managed and if they remain qualified as a FHC. Nearly all the FHCs disclose they are well capitalized. Those DIHCs, that appear to be in violation of the well managed and/or well capitalized standards and are not disclosing these facts, are failing to disclose two material facts; i.e., that the FHC has:

- breached the requirements for being a FHC and has lost its status as a FHC (See PNC case, 2002)
- not disclosed the negative change in its regulatory classification with the loss of its FHC status (See Hampton Roads, 2013).

The FHC, 12 U.S.C. § 1843(l), was created with the repeal of Glass-Steagall through the Gramm-Leach Bliley Act of 1999 so that a BHC could combine commercial banking and investment banking activities into a new FHC providing each insured depository institution (IDI) of the BHC was well capitalized and well managed.

The Dodd-Frank Act modified this as of July 11, 2011 whereby the FHC and each IDI must always be well managed and well capitalized. Failure to comply with these laws and regulations results, as defined in 12 U.S.C. § 1843(m) (see below) and 12 C.F.R. § 225.83, in the loss of FHC status and a prohibition on new financial activities (also known as investment banking services). It also requires remediation as documented in formal enforcement actions (FEAs), 12 U.S.C. § 1818(b), that include written agreements and cease and desist orders.

Minor modifications since 1999 require the following, as of 2011, for FHCs that fail to comply with either the well managed or well capitalized standards of *subsection (l)(1) of* 12 U.S.C. § 1843.

12 U.S.C. § 1843(m), Provisions applicable to financial holding companies that fail to meet certain requirements:

> (1) *In general*. If the Board finds that—(A) a financial holding company is engaged, directly or indirectly, in any activity under subsection (k), (n), or (o) of this section, other than activities that are permissible for a bank holding company under subsection (c)(8) of this section; and(B) such financial holding company is *not in compliance with the requirements of subsection (l)(1) of this section*; the Board shall give notice to the financial holding company to that effect, describing the conditions giving rise to the notice. [emphasis added; also, please note: *subsection (l)(1) of this section* requires the well managed and well capitalized standards.]
>
> (2) *Agreement to correct conditions required*. Not later than 45 days after the date of receipt by a financial holding company of a notice given under paragraph (1) (or such additional period as the Board may permit), the *financial holding company shall execute an agreement with the Board to comply with the requirements applicable to a financial holding company under subsection (l)(1) of this section.* [emphasis added; also, please note: the agreement is a FEA or written agreement from 12 U.S.C. § 1818(b).]
>
> (3) *Board may impose limitations*. Until the conditions described in a notice to a financial holding company under paragraph (1) are corrected, the Board may impose such limitations on the conduct or activities of that financial holding company or any affiliate of that company as the Board determines to be appropriate under the circumstances and consistent with the purposes of this chapter.
>
> (4) *Failure to correct*. If the conditions described in a notice to a financial holding company under paragraph (1) are not corrected within 180 days after the date of receipt by the financial holding company of a notice under paragraph (1), the Board may require such financial holding company, under such terms and conditions as may be imposed by the Board and subject to such extension of time as may be granted in the discretion of the Board, either—(A) to divest control of any subsidiary depository institution; or(B) at the election of the financial holding company instead to cease to engage in any activity conducted by such financial holding company or its subsidiaries (other than a depository institution or a subsidiary of a depository institution) that is not an activity that is permissible for a bank holding company under subsection (c)(8) of this section.
>
> (5) *Consultation*. In taking any action under this subsection, the Board shall consult with all relevant Federal and State regulatory agencies and authorities."

PNC's 8-K filing[10], July 18, 2002, disclosed a coordinated enforcement action by the Federal Reserve and the Securities and Exchange Commission (SEC).

Eight essential points are that:

1.1. PNC disclosed that it had lost its FHC status due to its violation of GLB that requires well managed and well capitalized. "As a result of regulatory, supervisory and examination activities, PNC and PNC Bank have been advised by the FRB and the OCC, respectively, that PNC and PNC Bank no longer satisfy financial holding company and financial subsidiary requirements for purposes of the GLB Procedures and Powers."[11]

1.2. The FRB issued a FEA, or a written agreement[12] under 12 U.S.C. § 1818, requiring remediation of factors that contributed to securities law violations cited by the SEC.

1.3. The SEC issued, with PNC's consent, an order[13] to cease and desist violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, Sections 10(b), 13(a) and 13(b)(2)(A) of the Exchange Act and Exchange Act Rules 10b-5, 12b-20, 13a-1 and 13a-13.

1.4. The SEC's order stated clearly that PNC must comply with federal banking and securities laws by *disclosing* such further *material information as may be necessary to make the required statements not misleading.* "Section 13(a) of the Exchange Act requires issuers of registered securities to file periodic reports with the Commission containing information prescribed by specific Commission rules. Rule 13a-1 requires the filing of annual reports on Form 10-K. Rule 13a-13 requires the quarterly filing of a Form 10-Q. Rule 12b-20 requires, in addition to information required by Commission rules to be included in periodic reports, such further material information as may be necessary to make the required statements not misleading. These reports are required to be complete and accurate. See SEC v. Savoy Industries, 587 F.2d 1149, 1165 (D.C. Cir. 1978). Under both the federal banking laws (4) and the federal securities laws, (5) PNC is, and was at all relevant times, required to comply with GAAP in its filings with the Board and with the Commission.[14] (emphasis added)

- (4) See, instructions to Form Y-9C.
- (5) 17 C.F.R.ss.210.4-01(a)(1) "Financial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate, despite footnote or other disclosures, unless the Commission has otherwise provided. This article and other articles of Regulation S–X provide clarification of certain disclosures which must be included in any event, in financial statements filed with the Commission."

1.5. PNC disclosed, on 12/9/02, that PNC was back in compliance, as a FHC, with the well-capitalized and well-managed criteria under the Gramm-Leach-Bliley Act (GLB Act). See 8-K filing, dated 12/9/02.[15]

1.6. Defining Material Information.

1.6.1. *Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) is cited in many SEC enforcement cases: "Information is material where there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision."

1.6.2. *Material* is defined by the SEC in 17 C.F.R. § 240.12b–2: "The term ''material,'' when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered."

1.7. SEC's Guidance on Materiality. The SEC Staff Accounting Bulletin No 99 – Materiality, August 12, 1999[16], was cited by the Deputy Chief Accountant of the SEC during a speech[17] on 12/09/2015 as a resource for defining and providing examples of material omissions or misstatements for internal control over financial reporting (ICFR). Relevant examples, from Bulletin No 99, for DIHCs include:

1.7.1. "*whether the misstatement affects the registrant's compliance with regulatory requirements*"[18] (emphasis added)

1.7.2. *"whether the misstatement affects the registrant's compliance with loan covenants or other contractual requirements."*[19] (emphasis added)

1.8. PCAOB's Guidance on Materiality.

1.8.1. A "Description and Characteristics of Fraud" is provided by the PCAOB's AU Section 316, Consideration of Fraud in a Financial Statement Audit.[20]

1.8.1.1. Paragraph .05 states, "Fraud is a broad legal concept and auditors do not make legal determinations of whether fraud has occurred. Rather, the auditor's interest specifically relates to acts that result in a *material misstatement* of the financial statements. The primary factor that distinguishes fraud from error is whether the underlying action that results in the misstatement of the financial statements is *intentional or unintentional*. For purposes of the section, *fraud* is an intentional act that results in a material misstatement in financial statements that are the subject of an audit. **fn 4**"[21]

1.8.1.2. Paragraph .06 states, "Two types of misstatements are relevant to the auditor's consideration of fraud—misstatements arising from fraudulent financial reporting and misstatements arising from misappropriation of assets.

- Misstatements arising from fraudulent financial reporting are *intentional* misstatements or *omissions* of amounts or disclosures in financial statements designed to deceive financial statement users where the effect causes the financial statements not to be presented, in all material respects, in conformity with generally accepted accounting principles (GAAP). Fn 5, Fraudulent financial reporting may be accomplished by the following:
    - Manipulation, falsification, or alteration of accounting records or supporting documents from which financial statements are prepared

- Misrepresentation in or *intentional omission* from the financial statements of events, transactions, *or other significant information,*

- Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure."[22]

1.8.2. *Assessing the materiality of misstatements* is addressed in the PCAOB's "Auditing Standard No. 14, Evaluating Audit Results."[23]

1.8.2.1 Paragraph 17 states:

"Evaluation of the Effect of Uncorrected Misstatements. The auditor should evaluate whether uncorrected misstatements are material, individually or in combination with other misstatements. In making this evaluation, the auditor should evaluate the misstatements in relation to the specific accounts and disclosures involved and to the financial statements as a whole, taking into account relevant quantitative and qualitative factors.[7/] (See Appendix B.)[24]

> [7/] If the financial statements contain material misstatements, AU sec. 508, Reports on Audited Financial Statements, indicates that the auditor should issue a qualified or an adverse opinion on the financial statements. AU sec. 508.35 discusses situations in which the financial statements are materially affected by a departure from the applicable financial reporting framework. [25]
>
> > AU sec. 508.35 Departure From a Generally Accepted Accounting Principle .35 states:
> >
> > "When financial statements are materially affected by a departure from generally accepted accounting principles and the auditor has audited the statements in accordance with generally accepted auditing standards, he or she should express a qualified (paragraphs .36–.57) or an adverse (paragraphs .58– .60) opinion. The basis for such opinion should be stated in the report. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]"[26]

Note: In interpreting the federal securities laws, the Supreme Court of the United States has held that a fact is material if there is "a substantial likelihood that the …fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."8/ As the Supreme Court has noted, determinations of materiality require "delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him…."9/

> 8/ *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 449 (1976). See also *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).

9/ *TSC Industries*, 426 U.S. at 450."[27]

1.8.2.2. "Appendix B – Qualitative Factors Related to the Evaluation of the Materiality of Uncorrected Misstatements"[28]

1.8.2.2.1. "B2. Qualitative factors to consider in the auditor's evaluation of the materiality of uncorrected misstatements, if relevant, include the following:

a) The potential effect of the misstatement on trends, especially trends in profitability.

b) A misstatement that changes a loss into income or vice versa.

c) The effect of the misstatement on segment information, for example, the significance of the matter to a particular segment important to the future profitability of the company, the pervasiveness of the matter on the segment information, and the impact of the matter on trends in segment information, all in relation to the financial statements taken as a whole.

d) <u>*The potential effect of the misstatement on the company's compliance with loan covenants, other contractual agreements, and regulatory provisions*</u>. (emphasis added)

e) The existence of statutory or regulatory reporting requirements that affect materiality thresholds.

f) A misstatement that has the effect of increasing management's compensation, for example, by satisfying the requirements for the award of bonuses or other forms of incentive compensation.

g) <u>*The sensitivity of the circumstances surrounding the misstatement, for example, the implications of misstatements involving fraud and possible illegal acts, violations of contractual provisions, and conflicts of interest*</u>. (emphasis added)

h) <u>*The significance of the financial statement element affected by the misstatement,*</u> for example, a misstatement affecting recurring earnings as contrasted to one involving a non-recurring charge or credit, such as an extraordinary item. (emphasis added)

i) The effects of misclassifications, for example, misclassification between operating and non-operating income or recurring and non-recurring income items.

j) <u>*The significance of the misstatement or disclosures relative to known user needs*</u>, for example:
* The significance of earnings and earnings per share to public company investors.
* The magnifying effects of a misstatement on the calculation of purchase price in a transfer of interests (buy/sell agreement).

* The effect of misstatements of earnings when contrasted with expectations. (emphasis added)

k) The definitive character of the misstatement, for example, the precision of an error that is objectively determinable as contrasted with a misstatement that unavoidably involves a degree of subjectivity through estimation, allocation, or uncertainty.

l) The motivation of management with respect to the misstatement, for example, (i) an indication of a possible pattern of bias by management when developing and accumulating accounting estimates or (ii) a misstatement precipitated by management's continued unwillingness to correct weaknesses in the financial reporting process.

m) The existence of offsetting effects of individually significant but different misstatements.

n) The likelihood that a misstatement that is currently immaterial may have a material effect in future periods because of a cumulative effect, for example, that builds over several periods.

o) The cost of making the correction – it may not be cost-beneficial for the client to develop a system to calculate a basis to record the effect of an immaterial misstatement. On the other hand, if management appears to have developed a system to calculate an amount that represents an immaterial misstatement, it may reflect a motivation of management as noted in paragraph B2.l above.

p) The risk that possible additional undetected misstatements would affect the auditor's evaluation."[29]

Issue #1 Risk Conclusion: Violation of either the well managed or well capitalized standards breaches the compliance standard for being a FHC, thus triggering the loss of FHC status. Failing to disclose those facts qualifies as an intentional omission and material misstatement according to the SEC and PCAOB. The Hampton Roads case, (see below) reinforces this outcome as the SEC there found that failure to disclose a negative change in the regulatory classification of a DIHC is also a material omission. Relevant qualitative factors from Appendix B of the PCAOB's Auditing Standard 14 include:

- Paragraph B2-d, as confirmed by the issuance and disclosure of the FEA under 12 U.S.C. § 1818(b) for violation of the well managed and/or well capitalized standards under 12 U.S.C. § 1843(l) and 12 U.S.C. § 1843(m).

- Paragraph B2-h, as violation of the well managed and/or well capitalized standards for an FHC results in the loss of FHC status (PNC, 2002), an inability to engage in new financial activities and the potential requirement to dispose of depository institutions. 12 U.S.C. § 1843(m).

- Paragraph B2-j addresses the significance of the material omission. In this case, investors are deprived of information on events that qualify for FEAs as events of default within certain credit agreements and credit annexes of ISDA Master Agreements, which potentially impact the noncore borrowing or liquidity of the DIHC. *Please consider the analysis for Issue #2.*

Hampton Roads Bankshares, Inc. (HMBR), is a case study for Issues #1 and #2.

Issue #2

Omission of FEAs (written agreements and/or cease and desist orders) on violations of safety and soundness, 12 U.S.C. § 1818(b) and source of strength, 12 C.F.R. § 225.4(a) present significant conflicts as they may be intentionally withheld as confidential supervisory information under the federal bank regulations, but doing so then satisfies the SEC's definition of a material misstatement through intentional withholding of material information. This tension gives rise to the bifurcated market for DIHCs with assets above and below $10 billion. The violations in this analysis involve unsafe or unsound practices concerning financial and compliance factors and not anti-money laundering, trading and/or mortgage servicing.

The Hampton Roads case contributes 4 essential points:

2.1 An FEA (written agreement and/or cease and desist) qualifies as material contract with a specific duty to disclose in accordance with the SEC's *Regulation S-K (17 C.F.R. 229.601(b)(10) Material Contracts and Item 1.01 Material Definitive Agreement. Meeting this standard has a three-prong test: the agreement must be approved by the board and management; it must be enforceable against the company; and it must not be made in the ordinary course of business.* FEAs are Material Contracts that are required to be disclosed by the SEC as they are issued for violations of federal bank regulations. In accordance with 12 U.S.C. § 1818 (b), they require written consent and agreement by the Board and management of a DIHC and they are not issued in the ordinary course of business.

2.1.1. On June 17, 2010, HMBR disclosed in an 8-K filing, in *Item 1.01: Entry into a Material Definitive Agreement*, that it had entered into a FEA or Written Agreement, under 12 U.S.C. § 1818 (b), with the Federal Reserve on June 7, 2010.[30]

2.1.2. HMBR correctly used Form 8-K, *Entry into a Material Definitive Agreement* to disclose the FEA based upon the SEC's Final Rule, effective August 23, 2004, for Additional Form 8-K Disclosure Requirements[31] under SEC's Regulation S-K (17 C.F.R. Part 229, 17 C.F.R. § 249.308 Form 8–K, for current reports). That Final Rule states,

2.1.2.1. "On July 29, 2002, Congress enacted the Sarbanes-Oxley Act of 2002. Section 409 of this Act requires public companies to disclose "on a rapid and current basis" material information regarding changes in a company's financial condition or operations as we, by rule, determine to be necessary or useful for the protection of investors and in the public interest. These amendments also further the goals of Section 409 of the Sarbanes-Oxley Act.

…any disclosure made in a report on Form 8-K must include all other material information, if any, that is necessary to make the required disclosure, in the light of the circumstances under which it is made, not misleading.[56]

> [56] See Rule 12b-20 under the Exchange Act, as well as Exchange Act Section 10(b) [15 U.S.C. 78j(b)] and Rule 10b-5 [17 C.F.R. 240.10b-5] thereunder.[32]

2.1.2.2. Item 1.01 *Entry into a Material Definitive Agreement* is defined as follows

> "(a) *If the registrant has entered into a material definitive agreement not made in the ordinary course of business of the registrant,* or *into any amendment of such agreement that is material to the registrant*, disclose the following information:
>
> (1) the date on which the agreement was entered into or amended, the identity of the parties to the agreement or amendment and a brief description of any material relationship between the registrant or its affiliates and any of the parties, other than in respect of the material definitive agreement or amendment; and
>
> (2) a brief description of the terms and conditions of the agreement or amendment that are material to the registrant.
>
> (b) For purposes of this Item 1.01, a material definitive agreement means an agreement that provides for obligations that are *material to and enforceable against the registrant*, or rights that are material to the registrant and enforceable by the registrant against one or more other parties to the agreement, in each case whether or not subject to conditions.
>
> Instructions.
>
> 1. Any material definitive agreement of the registrant not made in the ordinary course of the registrant's business must be disclosed under this Item 1.01. An agreement is deemed to be not made in the ordinary course of a registrant's business even if the agreement is such as ordinarily accompanies the kind of business conducted by the registrant if it involves the subject matter identified in Item 601(b)(10)(ii)(A) – (D) of Regulation S-K (17 C.F.R. 229.601(b)(10)(ii)(A) – (D)). An agreement involving the subject matter [compensation] identified in Item 601(b)(10)(iii)(A) or (B) also must be disclosed unless Item 601(b)(10)(iii)(C) would not require the registrant to file a material agreement involving the same subject matter as an exhibit.

2. A registrant must provide disclosure under this Item 1.01 if the registrant succeeds as a party to the agreement or amendment to the agreement by assumption or assignment (other than in connection with a merger or acquisition or similar transaction)."[33]

2.1.2.2.1. *Regulation S-K, 17 C.F.R. 229.601(b)(10) Material Contracts* is defined below:

"(10) *Material contracts.* (i) Every contract not made in the ordinary course of business which is material to the registrant and is to be performed in whole or in part at or after the filing of the registration statement or report or was entered into not more than two years before such filing. Only contracts need be filed as to which the registrant or subsidiary of the registrant is a party or has succeeded to a party by assumption or assignment or in which the registrant or such subsidiary has a beneficial interest.

(ii) If the contract is such as ordinarily accompanies the kind of business conducted by the registrant and its subsidiaries, it will be deemed to have been made in the ordinary course of business and need not be filed *unless it falls within one or more of the following categories,* in which case it shall be filed except where immaterial in amount or significance:

(A) *Any contract to which directors, officers, promoters, voting trustees, security holders named in the registration statement or report, or underwriters are parties* other than contracts involving only the purchase or sale of current assets having a determinable market price, at such market price;

(B) *Any contract upon which the registrant's business is substantially dependent,* as in the case of continuing contracts to sell the major part of registrant's products or services or to purchase the major part of registrant's requirements of goods, services or raw materials or any franchise or license or other agreement to use a patent, formula, trade secret, process or trade name upon which registrant's business depends to a material extent;

(C) Any contract calling for the acquisition or sale of any property, plant or equipment for a consideration exceeding 15 percent of such fixed assets of the registrant on a consolidated basis; or

(D) Any material lease under which a part of the property described in the registration statement or report is held by the registrant." […]"[34]

2.2. *Regulation S-K, Item 303: Duty to Disclose*

2.2.1. The law firm, Baker Botts, wrote on March 28, 2017, that "It has long been the law that issuers may be silent, even concerning material information, in the absence of a specific duty to disclose, such as when an omission makes other affirmative statements misleading. Under the Supreme Court's 1988 *Basic, Inc. v. Levinson* decision, "[s]ilence, absent a duty to disclose, is not misleading under Rule 10b-5." Accordingly, courts of appeal have recognized that "firms are entitled to keep silent (about good news as well as bad news) unless positive law creates a duty to disclose." *Gallagher v. Abbott Labs.*, 269 F.3d 806, 808 (7th Cir. 2001). This ability to keep silent absent an affirmative duty to disclose applies even as to information "a reasonable investor would very much like to know." *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1432 (3d Cir. 1997) (Alito, J.)."[35]

2.2.1.2. A specific duty to disclose an FEA, as a material contract, is found, as noted above, in *Regulation S-K (17 C.F.R. 229.601(b)(10) Material Contracts.*[36]

2.2.2. A summary of <u>fact patterns for FEA Disclosures 2002 to 2017</u> on unsafe or unsound practices concerning financial and compliance factors is derived from the Federal Reserve's Search Engine for enforcement actions.[37] Information about related SEC enforcement actions is from the SEC's search engine.[38] The results are provided below:

2002 to 2017 Analysis of Publicly Disclosed FRB Formal Enforcement Actions (FEAs) for DIHCs										
FEAs: Source of Strength Violations: Unsafe and Unsound Practices on Financial and Compliance Factors. See 12 U.S.C. § 1818(b)										
1.0	DIHC Peer Group (PG)	PG1	PG2	PG3	PG4	PG5	PG6	PG7	Summary	
2.0	PG Range of Total Assets	> $10B	$10B - $3B	$3B - $1B	$1B - $500M	<$500M	<$300M	<$150M		
3.0	# of DIHCs in PG (4Q 2015)	90	139	343	464				1036	Total
4.0	Total DIHCs with Publicly Disclosed FEAs	11	21	81	113	116	141	82	565	
5.0	DIHCs with FEAs / DIHCs by PG	12%	15%	24%	24%					
6.0	# of DIHCS Failed or Acquired within 1 year of FEA	6	14	38	44	37	53	29	221	Total
7.0	# of DIHCs Acquired +365 Days After FEA	2	1	18	27	25	27	18	118	
8.0	# of DIHCS Failed/Acquired DIHCs with FEAs	8	15	56	71	62	80	47	339	Total
6.1	DIHC Failure Rate (Row 6 / Row 4)	55%	67%	47%	39%	32%	38%	35%	39%	Avg.
7.1	DIHC Acquisition Rate (Row 7 / Row 4)	18%	5%	22%	24%	22%	19%	22%	21%	
8.1	DIHC Failure - Acquisition Rate (Row 8 / Row 4)	73%	71%	69%	63%	53%	57%	57%	60%	Avg
9.0	DIHC Disclosure of FEAs as a Material Contract (Material Definitive Agreement; SEC 17 C.F.R. §249.308) (effective 8/23/04)	8	12	46					66	Total
10	SEC Litigation Cases + FRB FEAs Publicly Disclosed	3	0	7					10	Total
					Regu- lator	Date of FRB FEA	Date of SEC Action	Days Elapsed		
	Colonial BancGroup, Inc.			$26,439,895,000	FRB	7/2/09	3/2/11	608	1	
	UCBH Holdings, Inc.			$12,789,793,000	FRB	9/10/09	10/11/11	761	2	
	First Banks, Inc., St. Louis, Mo			$10,549,701,000	FRB	3/25/10	7/16/09	-252	3	
	Hampton Roads			$2,982,139,000	FRB	6/17/10	12/5/14	1632	4	
	Trinity Capital Corporation			$1,543,627,000	FRB	9/26/13	9/28/15	732	5	
	Orrstown Financial Services, Inc			$1,440,782,000	FRB	3/22/12	9/27/16	1650	6	
	Mercantile Bancorp			$1,407,621,000	FRB	2/16/10	9/26/13	1318	7	
	PAB Bankshares, Inc.			$1,345,924,000	FRB	7/14/09	4/27/15	2113	8	
	First National Community Bancorp, Inc.			$1,307,769,000	FRB	12/1/10	1/28/15	1519	9	
	Commonwealth Bankshares, Inc.			$1,245,456,000	FRB	7/2/10	3/12/15	1714	10	

2.2.2.1. Bifurcated Market above and below $10 billion in total assets. *See Rows 4 & 6.1*.

A bifurcated market exists with limited transparency for large DIHCs (assets above $10 billion) and significant transparency for small DIHCs (assets below $10 billion) based on the disclosure pattern of FEAs.

- Only 1.9% or 11 of the 565 FEAs were disclosed for large DIHCs representing 12% of the Peer Group 1 DIHCs (assets above $10B).
- 6 large DIHCS or 55% of the 11 of the large DIHCs failed or were acquired within 365 days of the disclosure of the FEA.
- Another 2 DIHCs were acquired beyond a year of the FEA disclosure resulting in combined failure/acquisition rate of 73%.
- With the FDIC Deposit Insurance Fund (DIF) experiencing an average loss rate of 19% of total assets for failed banks[39], the DIF could not afford the failure of any one of the largest DIHCs. The largest DIHCs were too big to fail.

<u>2.2.2.3. Public disclosure patterns of FEAs by publicly traded DIHCs.</u> *See Row 9.*

- 66 publicly traded DIHCs, with assets above $1 billion, disclosed their FEAs as a material contract in either their SEC Form 8-K Item 1.01 or in their 10-Q and 10-K filings.

2.2.2.4. SEC initiated 10 enforcement cases from the universe of 565 publicly disclosed FEAs. The largest DIHC had $28 billion of total assets. *See Row 10.*

2.2.2.5 SEC initiated 6 enforcement cases involving SLHC's based on supervisory enforcement actions issued by the Office of Thrift Supervision:

		Regu-lator	Date of OTS FEA	Date of SEC Action	Days Elapsed		
Indymac	$32,734,000,000	OTS[1]	6/20/08	2/11/11	966	11	
Wilmington Trust Corp	$10,932,000,000	OTS	2/7/11	9/11/14	1312	12	
BankAtlantic	$6,378,817,000	OTS	2/23/11	1/18/12	329	13	
Franklin Bank Corp	$5,746,641,000	OTS	11/7/08	7/15/16	2807	14	
Tierone Bank	$3,160,553,000	OTS	1/5/09	9/25/12	1359	15	
Superior Bancorp	$2,977,290,000	OTS	11/2/10	1/13/16	1898	16	

[1] OTS issued an informal enforcement action, an Memorandum of Understanding

2.2.2.6. 3 SEC enforcement actions, without the benefit of FEAs, on similar violations of unsafe and unsound practices, involving financial and compliance factors associated with CAMELs, by large DIHCs, at the DIHC level, include the following DIHCs:

- Capital One, April 23, 2013,[40]
- Fifth Third, December 4, 2013,[41]
- Regions Bank June 25, 2014[42] and Regions Financial, June 10, 2014.[43]

2.2.2.7. Many other SEC enforcement actions concerning other issues during the financial crisis are presented by the SEC on their website.[44]

2.2.2.8. Patterns from publicly available information suggest that

- federal bank regulators applied, 12 U.S.C. § 1818(u)(1)(A), to withhold and not disclose FEAs for many of the large DIHCs that have identical risk profiles to the 100 small DIHCs, with assets above $1 billion, that did disclose FEAs, and

- the SEC's enforcement actions on these matters focused on the smaller DIHCs with assets below $32 billion that did disclose FEAs.

2.2.2.9. Sources of asymmetric or superior information and a bifurcated market:

2.2.2.9.1. Source #1: 12 U.S.C. § 1818(u)(1)(A). Public disclosures of final orders and agreements. The Federal Reserve discloses FEAs or written agreements by relying upon the first part of 12 U.S.C. § 1818(u)(1)(A). It then applies the last phrase (in italics for emphasis) to withhold FEAs: "Public disclosures of final orders and agreements. (1) In general. The appropriate Federal banking agency shall publish and make available to the public on a monthly basis— (A) any written agreement or other written statement for which a violation may be enforced by the appropriate Federal banking agency, *unless the appropriate Federal banking agency, in its discretion, determines that publication would be contrary to the public interest*;"

2.2.2.9.2. Source #2: 12 C.F.R. § 261.2(c)(1). Confidential Supervisory Information. FEAs or cease and desist orders are defined as Confidential Supervisory Information (CSI) in 12 C.F.R. § 261.2(c)(1):

"(i) Exempt information consisting of reports of examination, inspection and visitation, confidential operating and condition reports, and any information derived from, related to, or contained in such reports;

(ii) Information gathered by the Board in the course of any investigation, suspicious activity report, cease and desist orders, civil money penalty enforcement orders, suspension, removal or prohibition orders, or other orders or actions under the Financial Institutions Supervisory Act of 1966, Public Law 89–695, 80 Stat. 1028 (codified as amended in scattered sections of 12 U.S.C.), the Bank Holding Company Act of 1956, 12 U.S.C. 1841 et seq., the Home Owners' Loan Act, 12 U.S.C. 1461 et seq., the Federal Reserve Act, 12 U.S.C. 221 et seq., the International Banking Act of 1978, Public Law 95–369, 92 Stat. 607 (codified as amended in scattered sections of 12 U.S.C.), and the International Lending Supervision Act of 1983, 12 U.S.C. 3901 et seq.; except—

(iii) Any documents prepared by, on behalf of, or for the use of the Board, a Federal Reserve Bank, a federal or state financial institutions supervisory agency, or a bank or bank holding company or other supervised financial institution."

2.2.2.9.2.1. Others that have knowledge of CSI. Confidential Supervisory Information is required to be provided to the Board, management and outside auditors and outside counsel of DIHCs. See 12 C.F.R. § 261.20.

2.2.2.9.2.2. Penalties for the disclosure of CSI can be quite severe. Two recent examples include:

2.2.2.9.2.2.1. Goldman Sachs was fined $55 million by the State of New York Department of Finance for stealing confidential supervisory information, on October 28, 2015.[45]

2.2.2.9.2.2.2. *"Richmond Fed President Resigns, Admitting He Violated Confidentiality",* NY Times headline of April 4, 2017.[46]

2.2.3.0. The Federal Reserve issued 565 FEAs for DIHCs from 2002 to 2017 for violations of safety and soundness regulations on capital, asset quality, management, earnings and liquidity and for violations of source of strength. These do not include FEAs for anti-money laundering or mortgage servicing.

2.2.3.1. The HMBR FEA[47] was one of the 565 FEAs.

2.3 FEAs are material as they are (1) events of default within credit agreements and (2) evidence of violations of federal bank regulations within subsequent SEC enforcement cases and class-action lawsuits.

2.3.1. The examples for this section come from many sources:

2.3.1.1. The Federal Reserve's *Commercial Bank Supervisory Manual* cites publicly disclosed formal enforcement actions[48] as a risk that could trigger the loss of volatile liabilities[49] or noncore funding that includes "the sum of time deposits with balances of $100,000 or more, deposits in foreign offices and Edge or Agreement subsidiaries, federal funds purchased and securities sold under agreements to repurchase, commercial paper, other borrowings (including mortgage indebtedness and obligations under capitalized leases), and brokered deposits less than $100,000."[50]

2.3.1.1.1. Noncore funding is a significant source of funding for many of the largest DIHCs. The 100 largest DIHCs have over $4 trillion of noncore funding as of 12/31/16.

2.3.1.2. Credit agreements, that include representations and warranties and related events of default, regarding compliance with laws and regulations, would be impacted by the disclosure of FEAs. *FEAs are confirmation of a material violation of federal laws and regulations*.

2.3.1.2.1. FEA defined as a Regulatory Event by TARP. An example includes the U.S. Treasury's agreement to sell preferred stock that it purchased from a DIHC (Company) through its TARP Program. That agreement states, as a condition of the sale, that the Company cannot be subject to a Regulatory Event that includes an FEA as defined in (iv) below.

2.3.1.2.1.1. "Regulatory Event" means, with respect to the Company, that (i) the Federal Deposit Insurance Corporation or any other applicable Governmental Entity shall have been appointed as conservator or receiver for the Company or any Subsidiary; (ii) the Company or any Subsidiary shall have been considered in "troubled condition" for the purposes of 12 U.S.C. Sec. 1831i or any regulation promulgated thereunder; (iii) the Company or any Subsidiary shall qualify as "Undercapitalized," "Significantly Undercapitalized," or "Critically Undercapitalized" as those terms are defined in 12 U.S.C. Sec. 1831o or other applicable Law; or (iv) *the Company or any Subsidiary shall have become subject to any formal or informal regulatory action requiring the Company or any Subsidiary to materially improve its capital, liquidity or safety and soundness.*[51]

2.3.1.3. Derivative counterparty agreements may cite FEAs, as in the case, of regulatory events or cease and desist orders, as termination events. "In connection with the interest rate swap program with commercial customers, the Bank has agreements with its derivative counterparties that contain a provision where if the Bank defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Bank could also be declared in default on its derivative obligations. The Bank also has agreements with its derivative counterparties that contain a provision where if the Bank fails to maintain its status as a well/adequately capitalized institution, then the counterparty could terminate the derivative positions and the Bank would be required to settle its obligations under the agreements. Similarly, the Bank could be required to settle its obligations under certain of its agreements if *specific* ***regulatory events*** occur, such as if the Bank were issued a prompt corrective action directive or a ***cease and desist order***, or if certain regulatory ratios fall below specified levels. If the Bank had breached any of these provisions at December 31, 2014, it could have been required to settle its obligations under the agreements at the termination value."[52]

2.3.1.4. Bank Term Loans may cite FEAs or Regulatory Events as an event of default. As an example, one large DIHC, **Synchrony Financial**, cited a $8 billion "New Bank Term Loan" in their Form S-1 dated August 4, 2014. "The New Bank Term Loan Facility includes customary events of default, including the occurrence of a change of control (which will not be triggered by the Split-off) and the occurrence of certain material adverse regulatory events."[53]

2.3.1.5. Credit Agreements may cite FEAs or ***Regulatory Actions*** as an event of default. The active Credit Agreement for a large DIHC, **Wintrust**, cites FEAs or ***Regulatory Actions*** as an event of default.[54]

2.3.2. FEAs and their underlying violations are material as they are cited as evidence within subsequent SEC enforcement cases and class-action lawsuits.

2.3.2.1. FEAs cited as evidence for class-action lawsuit involving **Smithtown Bancorp**.

2.3.2.1.1. Smithtown Bancorp disclosed its FEA with the FDIC as a material contract and its FEA with the NYDFS as a material contract under Form 8-K, Item 1.01: Entry into a Material Definitive Agreement, on 1/29/2009.[55]

2.3.2.1.1.1. Smithtown Bancorp disclosed its FEA with the Federal Reserve as a material contract under Form 8-K, Item 1.01: Entry into a Material Definitive Agreement, on 6/22/10.[56]

2.3.2.1.1.1.1. Relevant quotes from the class action lawsuit include:

- "In response to this announcement (1/29/10), on the next trading day, the price of Smithtown Bancorp stock fell approximately 15%, to close at $4.60 per share, on extremely heavy trading volume.
- *Smithtown Bancorp Enters into Consent Order with the FDIC and NY Banking Department*. On January 29, 2010, Smithtown Bancorp entered into a Consent Agreement with the FDIC and the parallel Consent Order. The Consent Order articulated the FDIC's findings that the Bank had been engaged in a myriad of unsafe and/or unsound banking practices and violations of banking laws and/or regulations. To correct these unsafe and/or unsound banking practices, Smithtown Bancorp was forced to correct the massive understatement of its ALLL and recorded a $10 million and a $38 million charge for losses incurred on its loan portfolio in the third and fourth quarters of 2009."[57]

2.3.2.2. FEAs, and their underlying violations, cited as evidence for 17 SEC enforcement cases. See Paragraphs 2.2.2. and 2.2.2.5.

2.3.2.2.1. The common theme in the 17 SEC enforcement cases is a combination of factors that included elevated non-performing loans and insufficient allowances for non-performing loan, that, when adjusted, negatively impacted earnings and capital adequacy for the DIHCs. The SEC's litigation cases first lagged, by up to five years, the disclosure of the FEAs by the DIHCs and then either cited facts from the FEAs and/or acknowledged assistance provided by the bank regulators.

2.4. Failing to disclose a negative change in a regulatory classification is a material omission.

2.4.1. In the Hampton Roads case, the SEC found that *"Changes in regulatory classification are material information to investors."*[58] The supporting fact pattern involved Hampton Roads failing to disclose a downgrade in its capital adequacy standards and the increased restrictions associated with this violation. "Accordingly, HRBS violated the reporting, books and records and internal controls provisions of the Exchange Act."[59]

2.4.2. The SEC's finding that *"Changes in regulatory classification are material information to investors"* has broad, industry-wide applications for FHCs that fail to disclose changes in their regulatory classification as a FHC and the loss of FHC status with the undisclosed violation of the well managed standard. ***See Issue #1***.

Issue #3

Omission by large DIHCs of internal fraud, 12 C.F.R. §217.101, as the information is classified as confidential supervisory information.

3.1. A subset of the largest DIHCs is required to quantify and report instances of internal fraud as one of 7 operational loss events to bank regulators, but not to the public, as part of their capital adequacy standards. The information is classified as confidential information so that the DIHC and bank regulators have knowledge of the risks, but not the public.

3.1.1. Internal fraud is one of 7 operational loss events

3.1.1.1. Operational loss event means an event that results in loss and is associated with any of the following seven operational loss event type categories:

3.1.1.1.1. "(1) Internal fraud, which means the operational loss event type category that comprises operational losses resulting from an act involving at least one internal party of a type intended to defraud, misappropriate property, or circumvent regulations, the law, or company policy, excluding diversity-and discrimination-type events."

3.1.1.2. Internal fraud has been defined in 3 locations of the C.F.R. since 2008:

- APPENDIX F TO PART 208—CAPITAL ADEQUACY GUIDELINES FOR BANKS: INTERNAL- RATINGS-BASED AND ADVANCED MEASUREMENT APPROACHES [EFFECTIVE DATE NOTE: By Reg. H, 72 FR 69396 and 69430, Dec. 7, 2007, part 208 was amended by adding appendix F, effective Apr. 1, 2008].
- APPENDIX G TO PART 225—CAPITAL ADEQUACY GUIDELINES FOR BANK HOLDING COMPANIES: INTERNAL-RATINGSBASED AND ADVANCED MEASUREMENT APPROACHES [EFFECTIVE DATE NOTES: By Reg. Y, 72 FR 69397 and 69431-69432, Dec. 7, 2007, part 225 was amended by adding and amending appendix G, effective Apr. 1, 2008.]
- Internal fraud was moved to 12 C.F.R. §217.101(b) by the Dodd Frank Act, effective January 1, 2014. It is now located in Subpart E to Part 217 which replaces Appendix F to Part 208 (2013).

3.1.2. The aggregate Operational Loss values are classified as confidential information in the FFIEC 101 report under "Expected Operational Loss", Schedule S-Operational Risk, AASAJ081. This can be confirmed by searching for "J081" in the MDRM Data Dictionary: https://www.federalreserve.gov/apps/mdrm/data-dictionary

4.0. Other Examples of Material Omissions since 2002

Historical examples of material omissions cited by the SEC include:

Ashford.com	"Ashford.com's September 2000 Form 10-Q contained material omissions, because it failed to disclose the reclassification." 6/10/02.[60]
Enron	"Enron's purported disclosure of this transaction in its year-end 1999 filings failed to disclose fully that the partnership was created in

	December to fund a transaction that lasted just long enough to achieve a year-end financial reporting effect. Enron's disclosure was also misleading because it created the false impression that this transaction related to Enron's regular-course-of-business investments in energy and technology companies." 7/28/03.[61]
Arabian	"Between June 30, 2000 and September 30, 2002, Arabian omitted material information about the possible termination of the Al Masane lease from quarterly and annual reports that Arabian filed with the Commission. El-Khalidi caused those omissions by failing to disclose the material information to Arabian. In addition, El-Khalidi certified the accuracy of Arabian's Form 10-Q for the quarter ended September 30, 2002, even though he knew that that 10-Q failed to disclose material information about the possibility of termination of the Al Masane lease." 10/16/03.[62]
Vivendi	"Vivendi failed to disclose future financial commitments regarding two of its subsidiaries. Vivendi failed to disclose the commitments in Commission filings and in meetings with analysts. If Vivendi had revealed those commitments, they would have raised doubts about the company's ability to meet its cash needs." 12/24/03.[63]
Refco	"The filings failed to disclose the debt and the period end transactions." 2/19/08.[64]
Beazer	"In order to circumvent GAAP, and deceive its outside auditor, Beazer, acting through certain officers and employees, caused the model home sale-leaseback written agreements with the Investor Pools to omit any reference to Appreciation Rights and recorded the model home transactions as sale-leasebacks, recognizing home sales revenue in fiscal 2006." 9/24/08.[65]
Dell	"The SEC alleges that Dell did not disclose to investors large exclusivity payments the company received from Intel Corporation not to use central processing units (CPUs) manufactured by Intel's main rival." 7/22/10.[66]
Bank of America	"Bank of America failed to disclose these known uncertainties in its Forms 10-Q for the second and third quarters of 2009 (filed on August 7, and November 6, 2009). A Bank of America registration statement supplement effective in December 2009 incorporated by reference the periodic filings. In each of these filings, Bank of America's MD&A failed to comply with the disclosure requirements of Item 303 of Regulation S-K. As a result of its failure to comply with Regulation S-K, Bank of America violated Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder." 8/21/14.[67]

Hampton Roads	"Changes in regulatory classification are material information to investors." 12/5/14.[68]

5.0. Tensions Between the Disclosure Regimes of the SEC and U.S. Banking Agencies

Page 74 of the SEC's *Request for Comment on Possible Changes to Industry Guide 3 (Statistical Disclosure by Bank Holding Companies)* includes this paragraph:

"We also are mindful of how our disclosure regime interacts with the various disclosure requirements of the U.S. banking agencies. In some cases, our disclosure regime and the regimes of the U.S. banking agencies require different types of information or present information in inconsistent ways; in other cases, the various regimes may overlap with or duplicate one another. Guide 3 was originally intended to conform to the information required in reports to the U.S. banking agencies to the "fullest extent possible, consistent with the ***public interest*** (emphasis added) and the protection of investors," [232] although gaps between the two regimes have formed over the decades. We are interested in understanding the interrelationships between the securities and banking disclosure regimes, how they differ and whether and how the existing banking disclosures can be leveraged to improve our own disclosure regime. We are cognizant of the fact that securities and banking disclosures serve different purposes in light of the different missions of their respective regulatory regimes. Where our disclosure regime serves our core missions of investor protection, fair, orderly, and efficient markets, and capital formation, the U.S. banking agency regulatory regime is premised largely on ensuring safety and soundness of banking organizations."

[232] Guide 3 Release. Guides for Statistical Disclosure by Bank Holding Companies, Release No. 33-5735 (Aug. 31, 1976) [41 FR 39007] (Guide 3 Release). Guide 3 was originally published as Securities Act Guide 61 and Exchange Act Guide 3. In 1982, Securities Act Guide 61 and Exchange Act Guide 3 were redesignated as Securities Act Industry Guide 3 and Exchange Act Industry Guide 3. See Rescission of Guides and Redesignation of Industry Guides, Release No. 33-6384 (Mar. 16, 1982) [47 FR 11476]. When it published the Guide 3 Release, the Commission stated that "[t]he Guides are not Commission rules nor do they bear the Commission's official approval; they represent policies and practices followed by the Commission's Division of Corporation Finance in administering the disclosure requirements of the federal securities laws."[69]

6.0. Tension over the Public Interest between SEC and Federal Banking Agencies

6.1. The issue of public interest is cited by both federal banking and securities regulations.

6.2. The SEC applies the term "public interest" in the context of rulemaking by citing Section 2(b) of the Securities Act and Section 3(f) of the Exchange Act. This require(s) "us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, **in**

addition to the protection of investors, whether the action will promote efficiency, competition and capital formation.”[70] (emphasis added)

6.3. Those guiding words, when combined with the application of “public interest” by the SEC in Section 409 of Sarbanes-Oxley and Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m), create a clear requirement to disclose material information on a rapid basis in the public interest.

- ‘‘(l) REAL TIME ISSUER DISCLOSURES.—Each issuer reporting under section 13(a) or 15(d) ***shall disclose to the public on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer,*** in plain English, which may include trend and qualitative information and graphic presentations, as the Commission determines, by rule, is necessary or useful for the protection of investors and in the ***public interest***.’’[71] (emphasis added)

6.4. A significant conflict arises on disclosure of material information by bank holding companies under federal banking regulation, 12 U.S.C. § 1818(u)(1)(A), whereby:

- “Public disclosures of final orders and agreements. (1) In general. The appropriate Federal banking agency shall publish and make available to the public on a monthly basis— (A) any written agreement or other written statement for which a violation may be enforced by the appropriate Federal banking agency***, unless the appropriate Federal banking agency, in its discretion, determines that publication would be contrary to the public interest*****;”**[72] (emphasis added)

6.5. The issue of public interest is cited by both federal banking and securities regulations with an imbalanced application by the regulators, that favors the federal banking regulators, since 1999. This has resulted in a bifurcated market with limited transparency and market discipline for large depository institution holding companies (DIHCs) (assets over $10 billion) and the opposite factors for small DIHCs.

7.0. Hierarchy of Regulation S-K and Subpart 229.800 List of Industry Guides

PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975—REGULATION S-K

Part 229 - STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF...

Subpart 229.1 - General

Subpart 229.100 - Business

Subpart 229.200 - Securities of the Registrant

Subpart 229.300 - Financial Information

Section 229.301 - (Item 301) Selected financial data.

Section 229.302 - (Item 302) Supplementary financial information.

Section 229.303 - (Item 303) Management's discussion and analysis of financial condition and results of operations.

Section 229.304 - (Item 304) Changes in and disagreements with accountants on accounting and financial disclosure.

Section 229.305 - (Item 305) Quantitative and qualitative disclosures about market risk.

Section 229.306 - [Reserved]

Section 229.307 - (Item 307) Disclosure controls and procedures.

Section 229.308 - (Item 308) Internal control over financial reporting.

Subpart 229.400 - Management and Certain Security Holders

Subpart 229.500 - Registration Statement and Prospectus Provisions

Subpart 229.600 - Exhibits

Subpart 229.700 - Miscellaneous

Subpart 229.800 - List of Industry Guides

Section 229.801 - Securities Act industry guides.

Section 229.802 - Exchange Act industry guides.

8.0. A Common Disclosure in Many 10-K's issued by DIHCs

8.1. Bank regulatory oversight protects the FDIC's Deposit Insurance Fund, the stability of the financial markets, not investors.

8.2. This theme is featured in various forms in the 10-K Annual Reports of many of the largest DIHCs.

8.2.1. "This regulatory oversight focuses on the protection of depositors, the FDIC's Deposit Insurance Fund, and the banking system as a whole, not security holders, and in some instances may be contrary to their interests." ALLY, 4Q15

8.2.2. “Regulation of banks, BHCs and FHCs is intended primarily for the protection of depositors, the DIF and the stability of the financial system, rather than for the protection of shareholders and creditors.” BBT, 4Q15

8.2.3. “Banking regulators have broad enforcement power, but regulations are meant to protect depositors and not investors.” HMPR, 4Q15

8.2.4. “This regulatory oversight is established to protect depositors, federal deposit insurance funds and the banking system as a whole, not security holders.” BAC, 4Q15

8.2.5. “Supervision and regulation of bank holding companies, financial holding companies, and their subsidiaries are intended primarily for the protection of depositors and other clients of banking subsidiaries, the Deposit Insurance Fund of the Federal Deposit Insurance Corporation (FDIC), and the banking system as a whole, not for the protection of stockholders or other nondepository creditors.” NTRS, 4Q15

8.2.6. “Government regulation of banks and bank holding companies is intended primarily for the protection of depositors of the banks, rather than for the shareholders of the institutions and therefore may, in some cases, be adverse to the interests of those shareholders.” STT, 4Q15

8.2.7. “Our bank and bank holding company operations are subject to extensive regulation by federal and state regulatory agencies. This regulation is intended primarily for the stability of the U.S. banking system as well as the protection of depositors and the Deposit Insurance Fund (the “DIF”). This regulation is not intended for the benefit of our security holders.” SIVB, 4Q15

9.0. Conclusion

We offer our comments to:

9.1. address the conflicting regulatory goals and objectives of federal bank and securities regulators as described on page 74 of the March 1st *Request for Comment*,

9.2. assist all DIHC investors, including other DIHCs, in understanding 3 types of material omissions that have created a bifurcated market that is inefficient and opaque for large DIHCs and their investors while being more transparent and efficient for small DIHCs,

9.3. identify relevant qualitative factors from Appendix B of the PCAOB’s Auditing Standard 14. These include:

9.3.1. Paragraph B2-d as confirmed by the issuance and disclosure of the FEA under 12 U.S.C. § 1818(b) for violation of the well managed and/or well capitalized standards under 12 U.S.C. § 1843(l) and 12 U.S.C. § 1843(m).

9.3.2. Paragraph B2-h as violations of the well managed and/or well capitalized standards for an FHC result in the loss of FHC status (PNC, 2002), an inability to engage in new financial activities and the potential requirement to dispose of depository institutions. 12 U.S.C. § 1843(m).

9.3.3. Paragraph B2-j addresses the significance of the material omission. In this case, investors are deprived information on events that qualify for FEAs, which are events of default within certain credit agreements and credit annexes of ISDA Master Agreements, which potentially impacts the noncore borrowing or liquidity of the DIHC. With over $4 trillion of noncore borrowing amongst the 100 largest DIHCs, this is a material issue that has been obfuscated by federal bank regulators and many large DIHCs by apparently omitting FEAs on many of the large DIHCs that have identical risk profiles to the 100 small DIHCs with assets between $10 billion and $1 billion that did disclose FEAs. Having knowledge of the FEAs and not disclosing these material contracts based on the federal banking regulations for confidentiality, 12 C.F.R. § 261.2(c)(1), and exemptions in the public interest, 12 U.S.C. § 1818(u)(1)(A), conflicts with the SEC disclosure requirements for material information in the public interest[73] and with 17 C.F.R. § 229.303(a)(1) on liquidity: "Identify any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way. If a material deficiency is identified, indicate the course of action that the registrant has taken or proposes to take to remedy the deficiency. Also identify and separately describe internal and external sources of liquidity, and briefly discuss any material unused sources of liquid assets."

The issue of public interest is cited by both banking and securities regulations with opposite applications, resulting in a bifurcated market with limited transparency and market discipline for large DIHCs and the opposite factors for small DIHCs.

Ethics Metrics is a boutique research firm specializing in measuring and rating undisclosed governance, compliance and related risks in DIHCs with assets above $10 billion and their potential impact on over 1,100 global registered investment advisers that own 76% or $1.4 trillion of the $1.8 trillion of public equity of the 100 largest DIHCs. The information in our research only comes from publicly available data. Ratings are private.

We appreciate the opportunity to comment on this important topic. Please contact us with any questions or comments.

We are also enclosing as Addendum 1 a comparative analysis of the issues cited above on BHC Disclosures in the U.S financial markets with the relevant standards on Disclosures and Transparency within the G20/OECD's Corporate Governance Principles of 2015 (Principles). These Principles are cited as the standard for the Financial Stability Board's Thematic Review of Corporate Governance[74] in each of the relevant countries and financial systems, including the U.S., as of April 28, 2017.

Sincerely,

Beckwith B. Miller
Managing Member
Ethics Metrics LLC
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Charlottesville, Virginia 22902

Addendum 1: Comparative Analysis of U.S. BHC Disclosure Risks (2017) vis-à-vis the G20/OECD Principles of Corporate Governance, OECD (2015)

<table>
<tr><th>G20/OECD Principles of Corporate Governance,
OECD (2015)</th><th></th></tr>
<tr><td>OECD (2015), G20/OECD Principles of Corporate Governance, OECD Publishing, Paris.
http://dx.doi.org/10.1787/9789264236882-en
ISBN: 978-92-64-23687-5 (print)
ISBN: 978-92-64-23688-2 (PDF)</td><td></td></tr>
<tr><td>The information in this column is quoted directly from the OECD (2015) document. Emphasis has been added by Ethics Metrics to draw attention to relevant statements.</td><td>Comments by Ethics Metrics are in this column</td></tr>
<tr><td><table>
<tr><td>Principle 1</td><td>Ensuring the Basis for an Effective Corporate Governance Framework</td></tr>
<tr><td>Principle 2</td><td>The rights and equitable treatment of shareholders and key ownership functions</td></tr>
<tr><td>Principle 3</td><td>Institutional investors, stock markets, and other intermediaries</td></tr>
<tr><td>Principle 4</td><td>The role of stakeholders in corporate governance</td></tr>
<tr><td>Principle 5</td><td>Disclosure and Transparency</td></tr>
<tr><td>Principle 6</td><td>The Responsibilities of the Board</td></tr>
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<tr><td></td><td></td></tr>
<tr><td>I. Ensuring the Basis for an Effective Corporate Governance Framework</td><td></td></tr>
<tr><td>The corporate governance framework should promote transparent and fair markets, and the efficient allocation of resources. It should be consistent with the rule of law and support effective supervision and enforcement.</td><td>Current Risks: See below</td></tr>
<tr><td>1.A. The corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and well-functioning markets.</td><td>Current Risks: See below</td></tr>
<tr><td>1.B. The legal and regulatory requirements that affect corporate governance practices should be consistent with the rule of law, transparent and enforceable.</td><td></td></tr>
<tr><td>Public authorities should have effective enforcement and sanctioning powers to deter dishonest behaviour and provide for sound corporate governance practices. In addition, enforcement can also be pursued through private action, and the effective balance between public and</td><td>Current Risks: See analysis of bifurcated market for FEAs</td></tr>
</table>

private enforcement will vary depending upon the specific features of each jurisdiction.	
1.C. The division of responsibilities among different authorities should be clearly articulated and designed to ***serve the public interest.***	
Corporate governance requirements and practices are typically influenced by an array of legal domains, such as company law, securities regulation, accounting and auditing standards, insolvency law, contract law, labour law and tax law. Corporate governance practices of individual companies are also often influenced by human rights and environmental laws. Under these circumstances, there is a ***risk that the variety of legal influences may cause unintentional overlaps and even conflicts***, which may frustrate the ability to pursue key corporate governance objectives. It is important that policy-makers are aware of this risk and take measures to limit it. Effective enforcement also requires that the allocation of responsibilities for supervision, implementation and enforcement among different authorities is clearly defined so that the competencies of complementary bodies and agencies are respected and used most effectively. Potentially conflicting objectives, for example where the same institution is charged with attracting business and sanctioning violations, should be avoided or managed through clear governance provisions. ***Overlapping and perhaps contradictory regulations between jurisdictions is also an issue that should be monitored so that no regulatory vacuum is allowed to develop (i.e. issues slipping through in which no authority has explicit responsibility)*** and to minimise the cost of compliance with multiple systems by corporations. When regulatory responsibilities or oversight are delegated to non-public bodies, it is desirable to explicitly assess why, and under what circumstances, such delegation is desirable. ***In addition, the public authority should maintain effective safeguards to ensure that the delegated authority is applied fairly, consistently, and in accordance with the law.*** It is also essential that the governance structure of any such delegated institution be transparent and encompass the public interest.	Current Conflict U.S. Laws on Disclosures: Banking v. Securities Current Risk: Bifurcated Market
1.D. Stock market regulation should support effective corporate governance.	
1.E. Supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfil their duties in a professional and objective manner. ***Moreover, their rulings should be timely, transparent and fully explained.***	Current Risk: Bifurcated Market on FEAs
1.F. Cross-border co-operation should be enhanced, including through bilateral and multilateral arrangements for exchange of information.	
II. The rights and ***equitable treatment*** of shareholders and key ownership functions	Current Risk: See II.A.

II.A. ***Basic shareholder rights should include*** the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and ***material information*** on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect and remove members of the board; and 6) share in the profits of the corporation.	Current Risk: Omissions of Material Information for Investors
III. Institutional investors, stock markets, and other intermediaries	
IV. The role of stakeholders in corporate governance	
V. Disclosure and Transparency	
The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.	
The Principles support timely disclosure of all material developments that arise between regular reports. They also support simultaneous reporting of material or required information to all shareholders in order to ensure their ***equitable treatment.*** In maintaining close relations with investors and market participants, companies must be careful not to violate this fundamental principle of equitable treatment.	Current Risk: See II.A.
Disclosure requirements are not expected to place unreasonable administrative or cost burdens on enterprises. Nor are companies expected to disclose information that may endanger their competitive position ***unless disclosure is necessary to fully inform the investment decision and to avoid misleading the investor***. In order to determine what information should be disclosed at a minimum, many countries apply the ***concept of materiality***. Material information can be defined as information whose omission or misstatement could influence the economic decisions taken by users of information. ***Material information can also be defined as information that a reasonable investor would consider important in making an investment or voting decision.***	Current Risk: Omissions of Material Information for Investors
A strong disclosure regime that promotes real transparency is a pivotal feature of market-based monitoring of companies and is central to shareholders' ability to exercise their shareholder rights on an informed basis. Experience shows that disclosure can also be a powerful tool for influencing the behaviour of companies and for protecting investors. A strong disclosure regime can help to attract capital and maintain confidence in the capital markets. ***By contrast, weak disclosure and non-transparent practices can contribute to unethical behaviour and to a loss of market integrity at great cost, not just to the company and its shareholders but also to the economy as a whole. Shareholders and potential investors require access to regular, reliable and comparable information in sufficient detail for them to assess the stewardship of management, and make informed decisions about the valuation, ownership and voting of shares.***	Current Risk: Omissions of Material Information for Investors

Insufficient or unclear information may hamper the ability of the markets to function, increase the cost of capital and result in a poor allocation of resources.	
Disclosure also helps improve public understanding of the structure and activities of enterprises, corporate policies and performance with respect to environmental and ethical standards, and companies' relationships with the communities in which they operate. The OECD Guidelines for Multinational Enterprises may, in many jurisdictions be relevant for multinational enterprises.	
V.A. Disclosure should include, but not be limited to, **material information** on:	
V.A.1. The financial and operating results of the company.	
V.A.2. Company objectives and non-financial information.	
V.A.3. Major share ownership, including beneficial owners, and voting rights.	
V.A.4. Remuneration of members of the board and key executives.	
V.A.5. Information about board members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board.	
V.A.6. Related party transactions.	
V.A.7. Foreseeable risk factors.	
V.A.8. Issues regarding employees and other stakeholders.	
V.A.9. Governance structures and policies, including the content of any corporate governance code or policy and the process by which it is implemented.	
V.B. ***Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial reporting.***	Current Risks; Apparent violations of SEC Regulation S-K and related PCAOB Auditing Standards on intentional omissions, material weaknesses and ineffective Internal Control Over Financial Reporting

V.C. An annual audit should be conducted by an independent, competent and qualified, auditor in accordance with high-quality auditing standards in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.	
V.D. External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.	Current Risks: Conflict of interests due to confidentiality restrictions by federal banking regulations
V.E. Channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users.	
VI. ***The Responsibilities of the Board***	
The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.	
VI.A. Board members ***should act on a fully informed basis, in good faith, with due diligence and care,*** and in the best interest of the company and the shareholders.	
VI.B. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.	
VI.C. The board should apply high ethical standards. It should take into account the interests of stakeholders.	
VI.D. The board should fulfil certain key functions, including:	
VI.D.7. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.	Current Risks: See all of above
Companies are also well advised to ***establish and ensure the effectiveness of internal controls, ethics, and compliance programmes or measures to comply with applicable laws, regulations, and standards***, including statutes criminalising the bribery of foreign public officials, as required under the OECD Anti-Bribery Convention, and other forms of bribery and corruption. ***Moreover, compliance must also relate to other laws and regulations such as those covering securities, competition and work and safety conditions.*** Other laws that may be applicable include those relating to taxation, human rights, the environment, fraud, and money laundering. ***Such compliance programmes will also underpin the company's***	Current Risks: See all of above

ethical code. To be effective, the incentive structure of the business needs to be aligned with its ethical and professional standards so that adherence to these values is rewarded and breaches of law are met with dissuasive consequences or penalties. Compliance programmes should also extend to subsidiaries and where possible to third parties, such as agents and other intermediaries, consultants, representatives, distributors, contractors and suppliers, consortia, and joint venture partners.	

Endnotes:

[1] Request for Comment on Possible Changes to Industry Guide 3 (Statistical Disclosure by Bank Holding Companies), File Number S7–02–17, March 7, 2017, Federal Register, Available at: www.sec.gov/rules/other/2017/33-10321.pdf

[2] The Dodd-Frank Act, SEC. 112(a)(1)(A), Available at: www.gpo.gov/fdsys/pkg/PLAW-111publ203/html/PLAW-111publ203.htm

[3] Mills, 559 A.2d 1251 (Del. 1988), Superior Information, Fiduciary Duty to Disclose; STATE LAW - CORPORATE GOVERNANCE OVERVIEW, © 2010 National Association of Insurance Commissioners

[3] Mills, 559 A.2d 1251 (Del. 1988), Available at: https://scholar.google.com/scholar_case?case=13999029374890752084&q=Fiduciaries+may+not+use+superior+information+to+materially+mislead+others+in+the+performance+of+their+fiduciary+obligations&hl=en&as_sdt=6,47

[4] The Market for "Lemons": Quality Uncertainty and the Market Mechanism, George A. Akerlof, The Quarterly Journal of Economics, Vol. 84, No. 3. (Aug., 1970), pp. 488-500. Available at: www.econ.yale.edu/~dirkb/teach/pdf/akerlof/themarketforlemons.pdf

[5] Ibid.

[6] *Abbateillo v. Mansanto Co.*, 522 F. Supp. 2d 524 – Dist. Court, SD New York 2007, Available at: https://scholar.google.com/scholar_case?case=6427685329178578663&

[7] PCAOB, AU Section 316 Consideration of Fraud in a Financial Statement Audit; Paragraph .06, Available at: https://pcaobus.org/Standards/Auditing/pages/au316.aspx

[8] PCAOB, Auditing Standard No. 5**,** An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements**,** Available at: https://pcaobus.org/Standards/Auditing/pages/auditing_standard_5.aspx

[9] Federal Reserve, Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule, Final Rule, October 13, 2013. Available at: https://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf

[10] PNC 8-K Filing dated July 18, 2002. Available at: www.sec.gov/Archives/edgar/data/713676/000095012802000519/0000950128-02-000519-index.htm

[11] PNC 8-K Filing dated July 18, 2002. Available at:

www.sec.gov/Archives/edgar/data/713676/000095012802000519/j9544701e8vk.txt

[12] Federal Reserve's Written Agreement with The PNC Financial Services Group, Inc., July 12, 2002. Available at:
www.sec.gov/Archives/edgar/data/713676/000095012802000519/j9544701exv99w1.txt

[13] SEC's Accounting and Auditing Enforcement Release No. 1597 with The PNC Financial Services Group, Inc., July 18, 2002. Available at:
www.sec.gov/Archives/edgar/data/713676/000095012802000519/j9544701exv99w3.txt

[14] Ibid.

[15] PNC 8-K Filing, December 9, 2002. Available at:
www.sec.gov/Archives/edgar/data/713676/000095015202009477/j9791101exv99w1.txt

[16] SEC Staff Accounting Bulletin No 99 – Materiality, August 12, 1999. Available at:
www.sec.gov/interps/account/sab99.htm

[17] Remarks before the 2015 AICPA National Conference on Current SEC and PCAOB Developments, Brian T. Croteau, Deputy Chief Accountant, Office of the Chief Accountant, December 9, 2015. Available at:
www.sec.gov/news/speech/croteau-2015-aicpa.html

[18] Ibid. 16.

[19] Ibid.

[19] Ibid.

[20] PCAOB's AU Section 316, Consideration of Fraud in a Financial Statement Audit, Effective for audits of financial statements for periods beginning on or after December 15, 2002 until December 30, 2016.
https://pcaobus.org/Standards/Auditing/pages/au316.aspx

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