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# BANK & LENDER LIABILITY

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## WHAT'S INSIDE



MORTGAGES

## Borrower sues BofA over modification of Countrywide loan

A Massachusetts woman says in a lawsuit that Bank of America violated state law by failing to modify her mortgage in compliance with two settlements the institution entered into with the government over loans issued by Countrywide Home Loans.

***Lawrence v. Bank of America*, No. 15-CV-11486, complaint filed (D. Mass. Apr. 2, 2015).**

Vinieta Lawrence also says BofA, which acquired Countrywide in 2008, did not follow the rules of the government's Home Affordable Modification Program when it modified her mortgage.

As a result of these violations, the bank should take Lawrence's mortgage out of delinquency status and be stopped from taking any steps toward foreclosure, according to the complaint, filed in the U.S. District Court for the District of Massachusetts.

Lawrence says she took out a "predatory" mortgage from Countrywide in 2005. The loan had an adjustable interest rate that exceeded 13 percent, the suit says.


REUTERS/Rick Wilking

Lawrence also took out a home equity line of credit from Countrywide, which was secured by her property as a second-lien mortgage, according to the suit.

CONTINUED ON PAGE 15

COMMENTARY

## Trading complexity for transparency: A financial solution for lenders and regulators

**By Rick M. Smetanka, Haskell & White**

Rick M. Smetanka of accounting, auditing and tax consulting firm Haskell & White offers ideas on how corporate financial reporting can be simplified for the benefit of regulators and end users, including lenders.

SEE PAGE 3

COMMENTARY

## When banks don't do the right thing: Employee options

R. Scott Oswald and Adam Augustine Carter of The Employment Law Group discuss protections in place for bank employees who report fraud and noncompliance with banking regulations.

SEE PAGE 6

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## TABLE OF CONTENTS



 

# Trading complexity for transparency: A financial solution for lenders and regulators

**By Rick M. Smetanka,**
***Haskell & White***

With the second quarter of the year well under way, people involved in the financial-reporting process are catching their breath from the rush last March. Since the vast majority of U.S. companies follow the calendar for the end of their business years, accountants and certified public accountants are frantically closing their books, scrutinizing numbers, completing audits and reporting to their boards.

They are doing this each quarter so that financial-statement users such as lenders, investors, private-equity and venture capital firms and the U.S. Securities and Exchange Commission can analyze financial reports that will assist in their investment, credit and governance decisions. Adding to the recent rush, the Internal Revenue Service required corporate tax returns to be on file by the middle of March.

Yet, with so many professionals working hard to prepare and ensure accurate and transparent financial reports, investors and creditors continue to clamor for more timely (faster) and meaningful (simpler) financial reporting. Users continue to seek additional insight about a company's performance, strategic direction and exposure to risk. And, by the way, they needed this information yesterday!

I would suggest that given the current state of our voluminous disclosure framework, combined with overly complex accounting rules, it would be very difficult to increase the timeliness and transparency of financial reporting in any meaningful way.

Therefore, in the spirit of the current baseball season, I would like to propose a trade — one that is sure to be beneficial for all stakeholders. This trade involves decreasing the volumes of required disclosures and the complexities within generally accepted accounting principles. In exchange, companies will report more transparent financial data and these data will be reported on a timelier basis. Greater detail about this trade proposal follows.

Preparers and users of financial statements cannot deny that the proliferation of accounting rules and securities regulations has created information overload.

## LESS IS MORE

Preparers and users of financial statements cannot deny that the proliferation of accounting rules and securities regulations has created information overload. The SEC, which oversees the reporting of our public companies (including the more than 6,000 businesses listed on the New York Stock Exchange and Nasdaq) and often sets the tone for private-firm reporting, is taking a hard look at its disclosure requirements. The agency is also reaching out to companies, investors and other market participants for ideas on how to improve disclosures and make them more meaningful.

Unfortunately, or perhaps luckily, a congressional mandate by the 2012 Jumpstart Our Business Startups Act, commonly called the JOBS Act, required the SEC to comprehensively analyze current disclosure rules and develop ideas to modernize and simplify requirements. Regardless, this important initiative presents a much-needed opportunity for the financial-reporting community to consider how disclosures can be improved, including areas in which they can be streamlined, for the benefit of all stakeholders.

The SEC says it will begin its review of disclosure requirements by focusing on the business and financial disclosures in Forms 10-K (annual report), 10-Q (quarterly report) and 8-K (special event).

Over the years, there have been many calls for the SEC to ease disclosure requirements. In the mid-2000s, the agency eliminated Regulation S-B in an effort to reduce the burden on smaller public companies, and the more recent JOBS Act provides for scaled disclosure by emerging growth companies. Although these efforts have largely achieved their objectives, many new lengthy and detailed disclosure requirements were initiated for topics such as executive compensation, fair value and the sourcing of "conflict minerals."

Although the volume of disclosures has consistently grown over the years, an "easy win" is to simply eliminate boilerplate verbiage and the repetitive disclosures that often make it difficult to find the most important information. Certain SEC disclosure requirements may no longer be

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necessary because GAAP may have since evolved (for example, in the complex area of off-balance-sheet arrangements).

As another example, why should the SEC require the disclosure of a stock's high and low quarterly price when this information is readily available on a daily basis via the Internet? Why do companies include detailed disclosures about recently issued accounting standards only to conclude that the new standards did not have a material effect on their financial statements?

> The SEC says it will begin its review of disclosure requirements by focusing on the business and financial disclosures in Forms 10-K (annual report), 10-Q (quarterly report) and 8-K (special event).

One logical explanation for such voluminous disclosures is the significant legal and compliance risk faced by public companies. The constant threat of litigation has caused a default position of "defensive disclosure" that overloads SEC reports without communicating meaningful information. Many executives admit that legal pressures result in compliance-driven disclosures that ultimately do not help users.

As part of the agency's disclosure-effectiveness initiative, SEC commissioners and staff members have said that they will consider how to leverage technology to eliminate redundancy and facilitate user access to meaningful information. One particular volume-busting idea put forth would require that more static corporate information be segregated in a "company profile" or "core disclosure" that links to information appearing on a company's website. This idea could potentially be expanded to include required disclosures that typically do not change frequently, such as significant accounting policies and descriptions of classes of authorized stock.

Let's be real — today's investors have grown up in the digital age. They expect instant access to information and are bombarded with information on social media. Online content is expected to be eye-catching and clear, and it is expected to have impact. Therefore, why not provide financial data as they appear on a company website, where information is presented in manageable pieces? Data could be provided in a way that utilizes appealing graphics, with tabs and hyperlinks to help users quickly find the information that is most important to them. Financial data in an annual report or offering document could be similarly constructed to help individual investors research an investment opportunity or search data dynamically and compare multiple companies by slicing and dicing the information.

Also, smaller companies may find greater trading volume in their shares, since analysts would be able to use data more effectively and therefore cover more companies.

If there were to be a poster child for the SEC's disclosure-effectiveness initiative, a popular choice would be "risk factors." These disclosures are required by the SEC in every issuer's annual report and in documents on securities offerings, and, in the most extreme cases, they can exceed 30 or 40 pages. Many stakeholders believe that, in practice, the risk factors reported by companies are not sufficiently tailored to the entity and include too much boilerplate verbiage that is designed primarily to protect the company rather than to inform investors.

> Although the volume of disclosures has consistently grown over the years, an "easy win" is to simply eliminate boilerplate verbiage and the repetitive disclosures that often make it difficult to find the most important information.

The cautionary language in risk factors has become more and more extensive — not because of SEC rules, but primarily because of advice from attorneys who are assisting companies with agency filings. The SEC has pleaded with companies for years to make disclosed risk factors less generic and more tailored, and to explicitly explain how the risks would affect the company if they came to pass. However, the reality remains that companies have very little incentive to limit the number of disclosed risk factors.

Another required item that is in dire need of a disclosure overhaul is a company's "critical accounting estimates," which the SEC requires to be disclosed in the very important "management's discussion and analysis" section of an annual report. Critical accounting estimates are those that are most important to the financial-statement presentation and that require the most difficult, subjective and complex judgments. The SEC staff has commented that rather than providing illuminating insight in these disclosures, registrants often repeat verbatim portions of their notes on significant accounting policies, which are already disclosed as part of the basic financial statements.

As a result, the end product is an increased volume of disclosures with very little added value. Yet, the SEC's guidance in this key area is simple and plainly describes MD&A as "a discussion and analysis of a company's business as seen through the eyes of those who manage that business. Management has a unique perspective on its business that only it can present."

Although most stakeholders agree that improvement is needed to reduce duplication and enhance disclosures about critical accounting policies and estimates, it seems that existing SEC rules are sufficient to require informative disclosures; management teams just need to do better at executing the requirements.

Many people are focused on lessening corporate disclosures, and a growing number of investors are demanding information on sustainability and social responsibility. Although the SEC has not yet implemented disclosure requirements in this emerging area, many people are now voicing support for sustainability reporting that addresses environmental, social and governance matters and board diversity.

Sustainability disclosures may be important to certain users, but let's hope that regulators follow a path that is different than when they decided to require issuers to publicly disclose whether they were sourcing certain "conflict minerals" from the Congo or nearby countries.

Aside from the debate over whether regulators should be attempting to affect social change through such public disclosures, several studies have shown that the costs of complying with the SEC's required disclosures range from hundreds of millions of dollars to more than $1 billion.

## KEEP IT SIMPLE

If the growing volume of disclosures is not daunting enough, increasingly complex accounting standards and financial statements are making financial reports difficult to comprehend. Even savvy investors have difficulty understanding U.S. GAAP financial statements.

Further, accounting standards and required disclosures are increasingly burdensome to research and then prepare. In fact, new revenue recognition rules that are going to be applicable to most private companies in 2018 and to most public companies in 2017 are included in a document that spans more than 700 pages!

The Financial Accounting Standards Board is seeking to simplify accounting and disclosure requirements with a number of initiatives, including one to reduce the cost and complexity of financial reporting. Under this simplification initiative, the FASB is revisiting certain topics, including stock-based compensation and income taxes.

We have already seen the FASB exempt private companies from complying with certain complex accounting standards, including those for goodwill, derivatives and hedging and variable-interest entities. Although the promotion of a "GAAP light" is sure to create certain issues (for example, what happens when a private company wishes to "go public"), the idea of simplification makes good business sense for both the preparers of financial statements and the users.

## SHORTER, SIMPLER AND FASTER

Armed with streamlined, condensed disclosures and a more user-friendly, easier-to-understand U.S. GAAP, it would be reasonable for investors and creditors to expect accurate and transparent financial reports on an accelerated basis. Today, the SEC expects the largest public companies to report annual financial information within 60 days after their fiscal year-end, whereas smaller public companies can take up to 75 or 90 days to report, depending on their market capitalization.

What's somewhat astonishing is that these time periods have not changed in more than a decade despite significant leaps in technology and software tools. Although it would necessitate a change in the closing process of a business, as well as in a company's engagement with its advisors such as auditors and securities counsel, I believe that companies could halve the amount of time they need to report accurate and transparent financial information.

## TEAMWORK

In a speech last year to the American Bar Association, a director in the SEC's Division of Corporate Finance emphasized the importance of teamwork in reforming and improving the effectiveness of our disclosure framework. To defeat the specter of information overload and increase the relevance of financial reporting, stakeholders will need to work together to encourage investors to speak, regulators to listen and then act, and companies to execute.

## CONCLUSION

Simplifying the required disclosures and overly complex accounting regulations is crucial. From the professionals working to prepare accurate financial reports to the investors, lenders and regulators looking for more timely and straightforward financial reporting, trading complexity for transparency will benefit all stakeholders involved. WJ