Financial Reporting Alert 23-2
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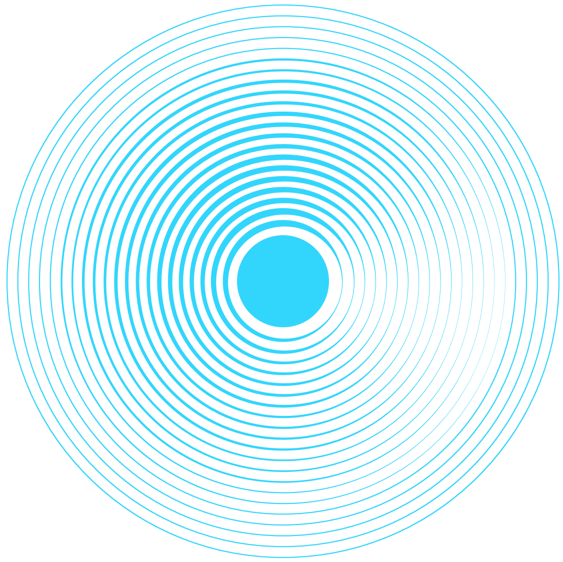

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Accounting and Financial Reporting Considerations Related to Recent Banking-Sector Developments

1 Executive Summary

In recent weeks, we have seen banks fail, be taken over, and be subject to challenges that underscore the need for banking and nonbanking companies to assess their exposures to these events and determine the related accounting and reporting impacts. These developments are occurring against a backdrop of ongoing challenges and uncertainty related to the current macroeconomic and geopolitical environment. To determine their exposure to recent events, companies should consider the accounting, financial reporting, and internal control matters described in Deloitte's December 1, 2022, *Financial Reporting Alert* on the current macroeconomic and geopolitical environment. Companies that invest in or are counterparties to transactions with these financial institutions should consider the accounting and reporting topics described in Section 2 of this *Financial Reporting Alert*. In addition, see Section 3 for more specific guidance on accounting and reporting topics that apply to the banking and capital markets industry.

The timeline below highlights some of the recent events in the banking industry as well as actions taken by regulators:

March 2023

- **8** — Silicon Valley Bank announces financing: Silicon Valley Bank (SVB) announces its intention to raise $2.25 billion in financing along with a $1.8 billion after-tax first-quarter 2023 loss from the sale of available-for-sale securities. Depositors begin to withdraw funds from SVB, causing a bank run and liquidity squeeze.
- **9**
- **10** — Silicon Valley Bank enters receivership: Silicon Valley Bank is shut down as a result of inadequate liquidity and insolvency. The Federal Deposit Insurance Corporation (FDIC) is appointed as the receiver.
- **11**
- **12** — Signature Bank enters receivership: Signature Bank is closed and enters FDIC receivership.
- **12** — FDIC announces full protection of all Silicon Valley Bank and Signature Bank deposits: FDIC announces that all depositors (for both insured and uninsured deposits) will be fully protected from loss related to the SVB and Signature Bank closures.
- **13** — Bridge banks[1] open for business: FDIC opens Silicon Valley Bridge Bank, N.A, and Signature Bridge Bank, N.A, for business, which gives depositors and borrowers full access to funds and lines of credit.
- **14**
- **15**
- **16** — 11 banks deposit $30 billion with First Republic Bank: FDIC announces a consortium of 11 U.S. private banks that deposit $30 billion into First Republic Bank.
- **17**
- **18**
- **19** — UBS takeover of Credit Suisse: After a sharp decline in stock price, the Swiss government forces a takeover of Credit Suisse by UBS for 3 billion Swiss francs (approximately $3.2 billion USD). As part of the takeover, the Swiss Financial Market Supervisory Authority (FINMA) announces that the deal will trigger a complete write-down of all additional tier 1 debt[2] (known as "AT1 bonds") of Credit Suisse, causing bondholders to lose their investment.
- **26** — First–Citizens Bank & Trust Company agrees to purchase all deposits and loans of Silicon Valley Bridge Bank, N.A.: The transaction includes the purchase of about $72 billion of Silicon Valley Bridge Bank, National Association's assets at a discount of $16.5 billion. Approximately $90 billion in securities and other assets will remain in the receivership for disposition by the FDIC.

These recent events have added to the challenges that consumers and companies are facing in the evolving macroeconomic and geopolitical environment. Certain of these challenges may result in operational and financial difficulties, often with unique accounting and financial reporting implications. For example, a liquidity squeeze triggered by a bank failure could temporarily affect a company's ability to access capital and make scheduled payments from bank accounts.

1 Bonds created in response to the 2008 financial crisis, which are generally designed to convert from debt into equity if a lender encounters a liquidity problem.

2 In its March 13, 2023, press release, the FDIC states, "A bridge bank is a chartered national bank that operates under a board appointed by the FDIC. It assumes the deposits and certain other liabilities and purchases certain assets of a failed bank. The bridge bank structure is designed to 'bridge' the gap between the failure of a bank and the time when the FDIC can stabilize the institution and implement an orderly resolution."

Companies should ask themselves the following questions related to how their potential exposure to bank failure and counterparty nonperformance may affect accounting, reporting, or internal controls at their organization:

- Does my company have cash deposits concentrated with a single financial institution? (Section 2.1)
- Did my company take action that potentially breached its existing debt covenants? (Sections 2.2.1 and 2.2.2)
- Did my company, or does it plan to, modify, exchange, or otherwise alter its debt agreements or obtain alternative financing? (Sections 2.2.3 and 2.2.4)
- Does my company have loan commitments or standby letters of credit exposed to bank failure? (Sections 2.3 and 2.5.4)
- Will changes in credit risk, or my company's response thereto, affect my company's existing derivative contracts? (Section 2.4.1)
- Will exposure to bank failure, changes in credit risk, or my company's response thereto, affect my company's existing hedging relationships? (Sections 2.2.5, 2.2.6, and 2.4.2)
- Does my company hold investments, or have lending relationships, that have been exposed to bank failure? (Section 2.5)
- Does my company have alternative access to sufficient liquidity? (Section 2.6)
- Should my company provide incremental disclosures? (Section 2.6)
- For SEC registrants, does my company have additional reporting requirements? (Section 2.7)
- Has my company considered the impact of exposure to bank failure or counterparty nonperformance on internal controls over financial reporting? (Section 2.8.1)
- Has my company reevaluated its cyber and fraud risks? (Section 2.8.2)
- Could my company be required to sell investment securities before recovering their amortized cost basis? (Section 3.1.2)
- Does my company have other nonfinancial assets, such as long-lived assets or intangible assets that may be impaired? (Sections 2.5.5 and 3.1.5)

In response to these questions and recent changes in the macroeconomic and geopolitical environment, companies should consider the following:

- Evaluating and disclosing, in a timely manner, information about their liquidity, financial and operating status, and expectations for the future.
- Assessing specific accounts that may be impaired or affected by changes in fair value attributable to exposure to bank failures or changes in credit risk.
- Carefully evaluating, for potential subsequent-event recognition and disclosure, information that becomes available after the balance sheet date but before the issuance of the financial statements.
- Determining whether they need to either identify new controls or modify existing ones in response to new or modified financial reporting risks that have emerged as a result of the current macroeconomic and geopolitical environment.

2 Accounting, Reporting, and Internal Control Matters for Entities With Direct or Indirect Exposure to Bank Failures

The guidance in the sections below may apply to all entities, regardless of their primary industry. For further discussion of the topics that are most relevant to financial institutions, see Section 3.

2.1 Depository Relationships

2.1.1 Insured Deposits

FDIC deposit insurance, which is backed by the full faith and credit of the U.S. government, fully protects depositors against loss. Therefore, insured depositors continue to have access to their insured deposits and no losses are expected to be incurred.

2.1.2 Uninsured Deposits

In general, when a bank enters receivership, uninsured depositors could receive a receivership certificate from the appointed receiver. There have been cases in which uninsured depositors of bridge banks were fully protected by the FDIC and no receivership certificates were obtained. However, if a receivership certificate was received, the instrument would be viewed as a financing receivable in accordance with ASC 310[3] rather than as cash or a cash equivalent. Entities that have adopted ASC 326 (the FASB's standard on current expected credit losses [CECL]) should consider the expected credit losses on the receivable in accordance with that standard. Entities that have not yet adopted the CECL standard should consider the guidance in ASC 450.

For uninsured deposits in bridge banks that have not been fully protected,[4] it would be inappropriate to believe that there is no risk of loss under an assumption that regulatory agencies[5] would provide similar protection for uninsured deposits. Companies should also consider whether additional risks are present if provisions are in place that restrict the timing of withdrawing deposits.

2.1.3 Cash Equivalents (e.g., Money Markets) Held With a Custodian and Cash Sweep Accounts

Cash sweep accounts are generally FDIC-insured up to the established limit and are treated similarly to a deposit account (whether insured or uninsured, respectively). These accounts are designed to sweep funds to money market accounts held in custody by the counterparty separately from that counterparty's assets. Securities (including money market accounts) held in custody of a bridge bank are expected to be transferable to another third-party custodian. Companies should contact the bridge bank or appointed receiver to determine whether to expect any access delays to the funds as a result of business interruption.

2.2 Debt

2.2.1 Balance Sheet Classification

Certain debt agreements have covenants that (1) require deposit accounts to be held with a particular bank (e.g., a specified liquidity metric involving cash or securities held in a qualifying account) and (2) may have been breached by a company's response to a bank failure (e.g., to transfer cash to another bank). Bank failure may affect the enforceability of debt covenants by the lender on the basis of contractual terms; however, the legal rights of the receiver should be considered (e.g., the Federal Deposit Insurance Act (FDIA) gives the FDIC the

[3] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

[4] The SVB and Signature Bank deposits that were uninsured before the failures were subsequently insured according to the March 12, 2023, press release on the FDIC's Web site.

[5] Independent organizations created by government legislation to maintain stability and public confidence in financial systems.

ability to enforce contracts). If a covenant is breached, its remedies may permit the lender (or receiver) to call the debt, causing it to be considered due on demand. Section 13.3.4.5 of Deloitte's Roadmap *Issuer's Accounting for Debt* (the "Debt Roadmap") discusses balance sheet classification upon violation of a provision. Companies are also encouraged to consult with legal advisers to understand the impact of bank failure on debt covenants.

2.2.2 Disclosure Requirements

See Section 14.4.5 of the Debt Roadmap for information about the requirements for SEC registrants to disclose debt in default, covenant violations, and waivers of defaults.

2.2.3 Debtor Replacement of "Defaulting Lender" and Transactions Among Debtholders

Under many debt agreements, the debtor has the ability, among other rights, to replace a "defaulting lender" upon the occurrence of certain events, which often include FDIC receivership. Companies are encouraged to consult with their legal advisers to understand the impact of lender default.

To the extent that such "defaulting lender" clauses are exercised (and the lender of outstanding debt, and potentially any unfunded commitments, is replaced), companies should consider the accounting framework for debt modifications and extinguishments on the basis of the specific facts and circumstances. ASC 470-50 does not apply to transactions in which the debtor is not a party; however, if a debtor initiates the transaction and the funds pass through the debtor or its agent, the transaction may be, in substance, a repayment of the existing debt and the issuance of new debt to a different holder (see Section 10.2.8 of the Debt Roadmap for more information). Alternatively, a receiver may sell the loans of a bridge bank to willing third-party market participants. A debtor to a loan sold to a third party by a bank in receivership would generally not be required to recognize a debt modification or extinguishment upon sale (since the contractual terms of the original debt agreement generally remain the same). However, if additional changes are made to the contract (e.g., the contractual benchmark interest rate or other terms are modified), a company should consider the provisions in ASC 848 on contract modifications related to rates affected by reference rate reform.

2.2.4 Refinancing and New Financing Transactions

In an effort to reduce liquidity risk, debtors may seek to refinance existing debt with another third-party lender they believe to be a more reliable counterparty. A refinance transaction of an existing debt arrangement that involves the debtor and satisfies the extinguishment conditions in ASC 405-20-40-1 is accounted for as a debt extinguishment.

2.2.5 Debt Designated as a Hedged Item in a Qualifying Hedging Relationship

Debt that is owed to a bridge bank may be designated as a hedged item in a qualifying hedging relationship. Companies should consider whether their response to bank failures affects their hedging relationships. For example, issuance of replacement debt may cause an entity to discontinue its hedging relationship, depending on how it identified the hedged item in its designation documentation. Further, with respect to liquidity constraints that may arise from a bank failure, a company should consider:

- Whether it remains probable that both the company and the counterparty will be able to perform under the derivative contract (the hedging instrument).
- For fair value hedges, the impact of changes in the company's own credit risk, if any, on hedge effectiveness (with respect to changes in fair value of the derivative or

hedged item attributable to credit or overall hedged risks, if applicable). Changes in counterparty credit risk should also be considered.

- For cash flow hedges, whether it remains probable that hedged interest payments will be made.
- For certain cash flow hedges, the impact of changes in the company's own credit risk, if any, on hedge effectiveness.

2.2.6 Forecasted Issuance of Debt Designated as a Hedged Transaction in a Qualifying Hedging Relationship

A forecasted issuance of debt (or underlying forecasted interest payments) may be designated in a qualifying cash flow hedging relationship that is interrupted by a bank failure (e.g., ongoing negotiations are halted). Companies should consider, on the basis of their hedge designation documentation, the impact of such an interruption on the timing or terms of the forecasted transaction. A company may be required to discontinue all or a portion of the hedging relationship as a result of a change in timing of a forecasted transaction. (See Section 4.1.4.1 of Deloitte's Roadmap *Hedge Accounting* [the "Hedge Accounting Roadmap"] for more information.) Similarly, if there is a change in terms other than timing of a forecasted transaction, discontinuation of a hedge may be required given the nature of a revised forecasted transaction in relation to the hedge designation documentation. (See Section 4.1.4.2 of the Hedge Accounting Roadmap for more information.)

Regarding the impact of missed forecasts on future forecasts, ASC 815-30-40-5 states, in part, that "[a] pattern of determining that hedged forecasted transactions are probable of not occurring would call into question both an entity's ability to accurately predict forecasted transactions and the propriety of using hedge accounting in the future for similar forecasted transactions." We generally do not believe that one instance related to an event associated with macroeconomic conditions outside the company's control would constitute a "pattern." (See Section 4.1.5.2.1 of the Hedge Accounting Roadmap for more information.)

2.3 Loan Commitments

2.3.1 Unrecognized Loan Commitments

Debtors generally do not recognize loan commitments on the basis of the guidance in ASC 815-10-15-69 through 15-71.[6] However, debtors should consider the potential disclosure impacts related to liquidity and going concern discussed in Section 2.6.

2.3.2 Standby Letters of Credit

Section 6.6.3.1.1.4 of the Hedge Accounting Roadmap explains that standby letters of credit (LCs) are often provided or "posted" to derivative counterparties in lieu of collateral. A bridge bank may be unable to honor an LC guarantee and, in many credit agreements, the counterparty (the LC beneficiary) may be able to demand that the obligor cash collateralize the notional amount of a defaulting guarantor's LC. Companies should consider whether they may be obligated to post cash collateral for LCs guaranteed by a bridge bank and whether they have any associated deferred fee asset related to the initial costs of setting up the LC that could be impaired.

[6] See Chapter 5 of the Debt Roadmap for discussion of any costs and fees incurred to obtain loan commitments and Section 2.5.4 of this *Financial Reporting Alert* for noncash financial assets (e.g., loan commitments) received as proceeds in certain arrangements.

2.4 Derivatives and Hedging

2.4.1 Derivative Contracts Not Designated as Hedging Instruments

Companies may be party to derivatives (e.g., interest rate and foreign currency contracts) held with a bridge bank or counterparty that is otherwise in default or that has increased credit risk. In these situations, companies are encouraged to consult with their legal advisers to understand the impact of counterparty default.

Companies should evaluate the contractual terms of such a derivative contract to determine whether an event of default has occurred and is continuing, whether the contract remains in effect, the rights of nondefaulting parties, and the impact of such contractual terms on fair value measurement. (See Section 10.2.5.2 of Deloitte's Roadmap *Fair Value Measurements and Disclosures (Including the Fair Value Option)* [the "Fair Value Roadmap"] for more information.) Further, companies should evaluate the fair value measurement of such derivative contracts with respect to counterparty performance risk. (See Section 10.2.7.4.3 of the Fair Value Roadmap for more information.)

2.4.2 Derivative Contracts Designated as Hedging Instruments

The derivative contracts described in Section 2.4.1 may be designated in one or more hedging relationships as a hedging instrument. Companies are required to evaluate whether it is probable that both parties to the derivative contract will perform; to the extent that such performance is not probable, hedge accounting must cease. (See Section 2.5.2.1.2.6 of the Hedge Accounting Roadmap for more information.) Further, ASC 815-25-40-1(b) and ASC 815-30-40-1(b) require an entity to discontinue hedge accounting for a given fair value or cash flow hedging relationship, respectively, if the hedging derivative "expires or is sold, terminated, or exercised." Moreover, if any of the critical terms of a derivative that is designated in a hedging relationship are modified, the hedging relationship should be dedesignated and discontinued. However, the novation of a derivative from one counterparty to another counterparty is not, in and of itself, a change in the critical term of the hedging relationship. (See Sections 3.5.1.1.1 and 3.5.1.1.2 of the Hedge Accounting Roadmap for more information.)

If performance by both parties under the hedging instrument is probable and the derivative remains in effect, companies should consider the impact on hedge effectiveness attributable to counterparty credit risk. (See Section 2.5.2.1.2.6 of the Hedge Accounting Roadmap for more information.) Depending on the method used for hedge effectiveness, an impact on assessment or measurement may be associated with changes in counterparty credit risk.

2.5 Fair Value Measurement and Impairment

The sections below provide guidance on evaluating the fair value measurement and impairment of certain financial assets more likely to be exposed to bank failure as well as the impairment of nonfinancial assets. In most cases, the equity and debt securities issued by failed banks are not transferred to the bridge bank.

2.5.1 Investments in Common Stock and Preferred Stock

Companies with investments in the common stock or preferred stock of a failed bank should evaluate whether this bank failure affects the subsequent measurement of such investments. The subsequent measurement will depend on the area of GAAP that applies to the accounting for the investment (i.e., whether the investment is classified as an equity security or a debt security). Depending on the classification of the investment, the company should evaluate the impacts of the failed bank on changes in the fair value, as well as any potential impairment, of the investment.

2.5.2 Investments in Debt Securities

Companies may hold investments in debt (whether secured or unsecured) of a failed bank. As discussed above, debt securities are accounted for under ASC 320 and subsequent measurement depends on the investment's classification (as trading, available-for-sale, or held-to-maturity, which may be precluded depending on the nature of the debt security).

Accordingly, in evaluating debt securities, companies should apply the fair value measurement and impairment concepts; such an evaluation would include consideration of collateral, if any, related to the debt security.

2.5.3 Loans and Other Receivables

Certain financial institutions and other parties may have issued loans to a bridge bank or have other receivables (e.g., cash collateral posted for a derivative contract or securities sold under repurchase agreements). Bank failure could affect the collectibility of loans and other receivables; accordingly, such collectibility should be considered in subsequent measurement under the CECL standard or ASC 450.[7]

2.5.4 Warrants Subject to Exercise Contingencies

Companies may have issued warrants or other equity-linked freestanding financial instruments to a lender with exercise contingencies associated with future draws on one or more term loan commitments (which may be drawn at the option of the debtor or upon achievement of certain contractual milestones). To the extent that such equity-linked freestanding financial instruments must be classified as liabilities and subsequently measured at fair value through earnings, a company should evaluate the likelihood of exercise due to any exercise contingencies (e.g., the occurrence of a future debt draw) when determining fair value (see Section 10.4.6 of the Fair Value Roadmap).

In some cases, such equity-linked freestanding financial instruments may have been exchanged in arrangements that include noncash financial asset proceeds (e.g., a tranche debt financing that includes the issuance of debt with detachable warrants and the receipt of loan commitments at inception). To the extent that a company has recognized a noncash financial asset when allocating the proceeds in such an arrangement, the company should assess the noncash financial asset for impairment if it concludes that the bridge bank or appointed receiver will not honor the remaining loan commitment (see Section 3.3.3.4 of the Debt Roadmap).

2.5.5 Impairment of Nonfinancial Assets, Including Goodwill

Entities that have exposure, or relationships with entities that have exposure, to failed banks may need to consider whether any nonfinancial assets, including long-lived assets or intangible assets, are impaired. See Deloitte's December 1, 2022, *Financial Reporting Alert* for discussion of impairment considerations related to inventory, long-lived assets, intangible assets other than goodwill, and goodwill.

2.6 Disclosure Considerations

2.6.1 Going Concern

Companies are required to perform a going-concern analysis as of the date the financial statements are issued (or are available to be issued). If a company's material banking relationships are with a financial institution for which events or circumstances have raised concerns about failure, there may be indicators of substantial doubt about the company's ability to continue as a going concern in accordance with ASC 205-40.

[7] The allowance for credit losses on loans recorded on an amortized cost basis should be determined in accordance with ASC 326-20 for entities that have adopted the CECL standard and in accordance with the incurred loss model in ASC 450 for entities that have not.

A company may need to consider the following in performing a going-concern analysis:

- Management's ability to draw on loan commitments (e.g., whether commitments written by a bank in FDIC receivership transferred to a bridge bank may be drawn, including consideration of necessary consents or approvals).
- Affirmative and negative debt covenant status (e.g., impact of a breach of covenant due to withdrawal of liquidity that must be held in counterparty-controlled deposit or securities accounts) and status of covenant waivers, if necessary.
- Access to uninsured deposits (e.g., ability to access cash and cash equivalents transferred to a bridge bank or the expected timing and amount of receipt of advanced dividends and amounts recoverable from receivership certificates).

2.6.2 Subsequent Events

Given the evolving nature of bank closures and as further details on bank resiliency unfold, entities should carefully evaluate information that becomes available after the balance sheet date but before the issuance of the financial statements.

In general, when events such as the SVB FDIC receivership and other bank closures (e.g., Signature Bank) occur after period-end, they should be viewed as Type 2 nonrecognized subsequent events.[8] Accordingly, entities should evaluate whether they must provide disclosures and whether omitting them would cause the financial statements to be misleading.

2.6.3 Concentration of Credit Risk

ASC 825-10-50-20 requires disclosure of "all significant concentrations of credit risk arising from all financial instruments, whether from an individual counterparty or groups of counterparties." Companies that rely on cash deposits in excess of insured limits at an individual bank or group of banks with similar economic characteristics should consider whether disclosure of such concentration risk is warranted.

2.7 SEC Reporting Considerations

2.7.1 Management's Discussion and Analysis (MD&A)

Section 3.1 of Deloitte's Roadmap *SEC Comment Letter Considerations, Including Industry Insights* (the "SEC Comment Letter Roadmap") addresses the objectives of MD&A and frequent SEC staff comments, which have focused on the impacts of evolving market conditions. Accordingly, in their MD&A, registrants should discuss quantitative and qualitative information related to any current material direct or indirect impacts of the current banking environment on their operations, financial condition, or liquidity. Further, registrants should discuss any known trends, events, or uncertainties that have had, or are reasonably likely to have, a material impact on their financial condition, results of operations, or liquidity. For example, registrants that have material loan commitments, lines of credit, or other lending arrangements with bridge banks should discuss the impact on their liquidity and capital resources, including any alternative sources of capital, changes in the cost of capital, and changes to the registrants' ability to continue as a going concern. Such registrants should also disclose risks related to the concentration of credit risk. A registrant without direct exposure to bridge banks should consider whether its liquidity could be significantly affected if either

[8] ASC 855-10-20 defines subsequent events as follows:

> Events or transactions that occur after the balance sheet date but before financial statements are issued or are available to be issued. There are two types of subsequent events:
>
> a. The first type consists of events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements (that is, recognized subsequent events).
>
> b. The second type consists of events that provide evidence about conditions that did not exist at the date of the balance sheet but arose subsequent to that date (that is, nonrecognized subsequent events).

(1) the registrant's access to debt, equity, or supply chain finance programs is limited in the evolving banking environment or (2) its significant customers or suppliers relied on bridge banks.

In addition, registrants should consider updating, in their quarterly report on Form 10-Q, the critical accounting estimates previously disclosed in their Form 10-K if there have been material changes in key assumptions and estimates.

2.7.2 Risk Factors

Section 3.3 of the SEC Comment Letter Roadmap provides guidance on risk factor disclosure requirements, including aspects of this topic that the SEC staff frequently comments on. In the evolving banking environment, registrants should continually evaluate whether they need to update their risk factor disclosures to add more specific information about the direct and indirect impacts such conditions may have on their business, even if such registrants already more broadly disclose general risks related to potential disruptions to their liquidity and capital markets. Registrants with direct exposure to such risks, including those that rely on bridge banks for financing, should update their risk factor disclosures to clarify risks associated with liquidity, access to capital, and their ability to continue as a going concern. Registrants should also consider whether their disclosures about credit risk concentration are sufficient in disclosing risks related to cash deposits above the FDIC limits.

2.7.3 Form 8-K Considerations

Form 8-K, Item 2.06, "Material Impairments," requires registrants to provide disclosures if they conclude that a material impairment charge for an asset (including securities) is required and such a determination is not made in connection with the preparation of quarterly or annual financial statements. The Form 8-K is due within four business days and must disclose the date the impairment conclusion was reached, a description of the impaired assets, and the amount of the impairment (including separate disclosure of any amount that will result in future cash expenditures).

We have observed that many registrants have filed press releases under Form 8-K, Item 8.01, "Other Events," to publicly disclose their exposure (or lack thereof) to failed banks. These disclosures have generally included (1) the amount of cash on deposit at bridge banks (or that such an amount is not material) and (2) any credit facilities, letters of credit, or loan commitments with bridge banks. Registrants should consult with their legal advisers regarding the Form 8-K filing requirements.

Registrants that plan to issue securities should ensure that appropriate disclosures related to any of the above topics are either included in the offering document or incorporated in it by reference from a previously issued Form 8-K, Form 10-K, or Form 10-Q.

2.7.4 Acquisition of Distressed Assets

A registrant that acquires distressed assets from a closed bank should consider the SEC's guidance in Staff Accounting Bulletin Topic 1.K[9] and Regulation S-X, Rule 3-05,[10] to determine its reporting obligations. Because of the complexities involved, consultation with accounting advisers is recommended in these circumstances.

[9] SEC Staff Accounting Bulletin Topic 1.K, "Financial Statements of Acquired Troubled Financial Institutions."

[10] SEC Regulation S-X, Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired."

2.8 Internal Controls Over Financial Reporting and Risk Assessment

2.8.1 Internal Controls Over Financial Reporting

Entities should consider providing disclosures about the effects, if material, of the recent banking-sector events on their internal controls and disclosure controls and procedures. Entities may need to either identify new controls or modify existing ones in response to new or modified financial reporting risks that have emerged in the current macroeconomic or geopolitical environment. Such controls may include those related to how companies interact with financial institutions. The operating effectiveness of existing controls should also be considered in light of recent banking-sector events. If an existing control is no longer effective, management may need to identify alternative appropriately designed controls and could potentially need to identify and evaluate control deficiencies.

Importantly, SEC registrants must disclose in their quarterly or annual filings any changes in internal controls that have materially affected, or are reasonably likely to materially affect, their internal control over financial reporting. Such disclosures would be provided in Item 4 of Form 10-Q or Item 9A of Form 10-K (or Item 15 of Form 20-F for foreign private issuers).

2.8.2 Cyber Risks and Fraud

Entities must carefully consider their unique circumstances and risk exposures when analyzing how recent events may affect their financial reporting. It is also critical that management understand the risks that entities are dealing with and how such risks may affect them, including whether the current environment leads to fraud or cybersecurity risks and whether existing controls appropriately mitigate those risks. Examples of areas in which fraud risks may need to be updated or reconsidered include external wire fraud schemes, asset misappropriation, loan covenants, and going concern.

3 Considerations for the Banking Industry

The guidance in the below sections is most relevant to financial institutions; however, certain topics, such as those related to debt securities and impairment of nonfinancial intangible assets, may also apply to operating companies. Financial institutions should also consider the other accounting, reporting, and internal control matters discussed in Section 2.

3.1 Liquidity-Related Matters

3.1.1 Held-to-Maturity Debt Securities

In light of the recent bank failures and related macroeconomic environment, financial institutions may have reevaluated their liquidity as well as the potential need to reclassify debt securities from held-to-maturity portfolios (to ones that are available for sale). Under ASC 320-10-35-8, a sale or transfer of a security classified as held to maturity that occurs for a reason other than certain exceptions calls into question (taints) the entity's intent for all securities that remain in the held-to-maturity category. The exceptions include a significant deterioration in the issuer's creditworthiness (see ASC 320-10-25-6(a)), and a run on a bank (see ASC 320-10-25-10). We generally believe that a run on another bank (that is not the reporting entity) does not meet the criteria in ASC 320-10-25-9[11] related to selling or

[11] ASC 320-10-25-9 states:

> In addition to the changes in circumstances listed in paragraph 320-10-25-6(a) through (f), certain other events may cause the entity to sell or transfer a held-to-maturity security without necessarily calling into question (tainting) its intent to hold other debt securities to maturity. Such events must meet all of the following four conditions to avoid tainting its intent to hold other debt securities to maturity in the future:
>
> a. The event is isolated.
> b. The event is nonrecurring.
> c. The event is unusual for the reporting entity.
> d. The event could not have been reasonably anticipated.

transferring held-to-maturity securities without calling into question (tainting) the reporting entity's intent to hold other debt securities to maturity.

Because of rising interest rates, the fair value of many held-to-maturity debt security portfolios is below their amortized cost basis. This difference between fair value and amortized cost basis is not recognized in the financial statements. However, companies should evaluate whether such a difference may be attributed to credit risk for which an allowance for credit losses recorded is required under the CECL standard.[12] Companies should evaluate whether such a difference may partially be attributable to credit risk that is necessary to reserve for.

3.1.2 Available-for-Sale Debt Securities

The liquidity position of certain financial institutions (regional banks, in particular) and operating companies may have been weakened because of consumers' responses to recent bank failures and the related macroeconomic environment. In performing an impairment analysis of available-for-sale debt securities, reporting entities should consider whether they intend to sell such securities or whether it is more likely than not that they would be required to sell the securities before recovery of their amortized cost basis. In either case, ASC 326-30-35-10 requires that "any allowance for credit losses . . . be written off and the amortized cost basis . . . be written down to the debt security's fair value at the reporting date with any incremental impairment reported in earnings."[13]

3.1.3 Bank Term Funding Program

On March 12, 2023, the Federal Reserve Board announced that it will make additional funding available to eligible depository institutions to help manage liquidity constraints through the creation of a new Bank Term Funding Program (BTFP). The BTFP offers loan terms up to one year to eligible depository institutions that pledge qualifying assets as collateral (e.g., U.S. Treasuries, agency debt and mortgage-backed securities, and high-quality securities). The size of BTFP advances will be based on the value of qualifying assets pledged as collateral under the BTFP, which will be valued at par. Advances may be requested under the BTFP until at least March 11, 2024. The U.S. Department of the Treasury made available $25 billion to backstop the BTFP (that the Federal Reserve does not anticipate will be necessary to draw upon).

BTFP advances are similar to advances drawn from the Federal Reserve discount window. Eligible financial institutions should account for such draws as a borrower under the debt arrangement.

3.1.4 Short-Term Deposits Between Banks

On March 16, 2023, in a plan involving the U.S. regulatory agencies, a consortium of 11 U.S. private banks pledged to contribute $30 billion, in aggregate, of uninsured deposits to First Republic Bank, which was facing liquidity constraints because depositors were moving deposits to larger super-regional and national banks. The uninsured deposits are reported to have a term of 120 days and yield a market interest rate. While the scope of this transaction is limited to the 11 U.S. private banks involved, companies or financial institutions evaluating this transaction or similar transactions should consider:

- Balance sheet classification of such uninsured short-term deposits.
- Application of the CECL standard.
- Application of the fair value option if it has been elected.

[12] Under ASC 320-10, an entity that has not adopted the CECL guidance must record an other-than-temporary impairment if it (1) intends, or will more likely than not that be required, to sell a security before recovery of its amortized cost basis or (2) does not expect to recover the entire amortized cost basis of the security.

[13] See footnote 12.

We generally believe that assets with a term of 120 days that are not callable on demand would not meet the definition of "cash and cash equivalents" and would instead be considered receivables that are within the scope of the CECL standard or ASC 450[14] (unless the fair value option is otherwise elected).

3.1.5 *Impairment of Nonfinancial Intangible Assets, Including Goodwill*

Financial institutions may have nonfinancial intangible assets, such as goodwill, core deposit intangibles,[15] asset management and brokerage-related contracts and relationships, or credit card holder and merchant relationships recognized from a previous acquisition. ASC 350-20 requires a reporting entity to consider (among other factors) macroeconomic conditions, limitations on accessing capital, and industry and market conditions when evaluating whether goodwill is impaired. In doing so, financial institutions should consider whether recent events have adversely affected the fair value of their reporting units as a result of, for example, a decline in market capitalization or an outflow of deposit balances. Further, financial institutions should evaluate whether customer and third-party relationships underlying certain intangible assets have been affected by consumer behavior in response to recent bank failures that could be indicative of impairment. For example, a regional bank may have experienced an outflow of deposit customers associated with a core deposit intangible, since such customers may have transferred their balances to another financial institution. See Deloitte's December 1, 2022, *Financial Reporting Alert* for additional considerations related to impairment of nonfinancial assets.

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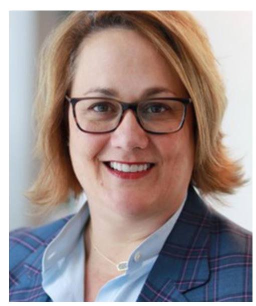

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[14] See footnote 7.

[15] Core deposit intangibles represent the value of long-term relationships with depositors, since such depositors provide financial institutions with access to capital that may be non-interest-bearing or carry interest rates below the financial institution's incremental borrowing rate.