

September 10, 2014

VIA EMAIL AND U.S. MAIL

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Re: Supplemental AMAG Comment on 2014 Agency Information Collection Proposals
Operational Risk Data Reporting FR Y-14A/Q/M – OMB No. 7100-0341

Ladies and Gentlemen:

The AMA Group of The Risk Management Association is writing this letter to supplement its letter submitted August 19, 2014 (the “August 19 Letter”), to request that the Board of Governors of the Federal Reserve System (“Federal Reserve”) reconsider the Federal Reserve’s proposed changes to the Operational Risk aspects of Agency Information Collection Proposals under FR Y-14A (Notice dated July 15, 2014), which would require large bank holding companies to provide litigation reserve information to the Federal Reserve as part of the Comprehensive Capital Analysis and Review (“CCAR”) process (the “Proposal”).

The August 19 letter reflects the AMA Group’s reasoned and considered judgment regarding the Proposal, which the AMA Group continues to stress would erode the attorney-client privilege and attorney work product doctrine, and, accordingly, would be unsound and potentially highly prejudicial. In addition, the AMA Group respectfully requests that the Federal Reserve consider the following additional comments to the Proposal in order to avoid any unintended consequence or potential prejudice to large bank holding companies in connection with the CCAR process.

Setting of Legal Reserves

The purpose of such Proposal is to “provide the Federal Reserve with the additional information *and perspective* needed to help ensure that large BHC’s have strong, firm-wide risk measurement and management processes support in their internal assessment of capital adequacy and that their capital resource are sufficient given their business focus.” (Emphasis added). The use of the word “perspective” in the Proposal goes to the very heart of the matter – with respect to litigation reserves, the Federal Reserve is undertaking to learn not only the amounts of reserves but also,

and perhaps most importantly, how a bank's legal counsel thinks about litigation generally and individual cases in particular, which would clearly violate the attorney-client privilege and the attorney work product doctrine. *See* the August 19 Letter.

Under Accounting Standards Codification, Topic 450-20, "Loss Contingencies" formerly and more commonly known as FAS 5 ("ASC 450-20), an institution is required to set a litigation loss reserve for a particular case *if* (a) a loss is probable, and (b) the amount of the expected loss is both material and reasonably estimable. The determination of whether a reserve is required to be set requires the exercise of considerable judgment on the part of legal counsel (which, as stated in the August 19 Letter, is subject to the attorney-client privilege and the attorney work product doctrine).

Under ASC 450-20, an adverse result in litigation may be probable (which requires setting a reserve); reasonably possible; or remote. A result would be characterized as "probable" if the result is *likely* to occur. Determining whether a result may be probable is a question of judgment given that ASC 450-20 does not define the term "likely."

In the event that counsel determines, in the exercise of his or her professional judgment, that an adverse result is likely or probable, counsel would then need to determine whether any resulting loss is material and, if so, whether it is reasonably estimable. It is important to note the role that legal counsel's considered judgment plays in the reserving process. Under ASC 450-20 an institution may not delay setting legal reserve for a matter if a single amount cannot be readily estimated. Instead, ASC 450-20 requires that an institution estimate the range of possible losses, and, if there is no best estimate, then the institution may reserve an amount at the low end of the range while disclosing the high end of the range as a "reasonably possible loss."

Thus, both prongs of the ASC 450-20 determination of litigation reserves for a matter are subject to the exercise of profound judgment and experience. In that regard, the AMA Group respectfully suggests that the Proposal could lead to a significant unintended consequence, namely, that the Federal Reserve could substitute its judgment for that of a bank's legal counsel and require the bank to either revise its previously stated legal reserves or revise its reserve methodology altogether based upon the Federal Reserve's own model, which itself would be fraught with subjectivity and judgment. In either instance, the utilization of mere data points by the Federal Reserve would not be sufficient or proper to substitute for the knowledge, judgment and experience of sophisticated legal counsel nor for counsel's intimate knowledge of the facts or strategy giving rise to the amount reserved.

Practical Problems Concerning the Proposal

Another major concern is that the current FR Y-14 Q submission request is for reserve frequency by quarter, event type. And business line each quarter. For institutions with comparatively few

legal reserves, this granular request results in frequency tables with several single reserves noted in a given combination of quarter, event type and business line. Accordingly, changes in the submission from quarter to quarter are few such that the addition of a single new reserve is easily identifiable. The only protection afforded a smaller institution in such an event is the annual submission of the total amount of reserves. The change of the frequency of this submission of the total amount to quarterly would have the unintended consequence of exposing institutions with few legal reserves to the risk of a breach of client-attorney privilege (See the August 19 letter) in the situation that from one quarter to the next, only one new reserve is taken. This situation is not uncommon to some of the respondent institutions. The proposed addition of gross increase and decrease of reserves by quarter increases the risk further and affects all respondent institutions equally. Additionally, the request for 20 previous quarters of this type of submission is highly burdensome and largely impractical. Furthermore, it exposes the institutions to a very high level of the risk of a breach of client-attorney privilege in a very short time span (time of submission).

The AMA Group has noted several other practical problems associated with the Proposal, which are enumerated in Appendix A attached.

In conclusion, AMAG members have very serious concerns about the details of this new proposal relative to FR Y-14A/Q submission requirements and requests that the Federal Reserve Board reconsider its adoption. The broad reach and increased frequency of data collection is untenable for the industry. In the spirit of preserving regulatory objectives of safety and soundness in the industry, however, AMAG welcomes a dialogue about the subject between the industry and regulatory community.

Should there be any questions concerning the comments reflected above, kindly contact Edward J. DeMarco, Jr., General Counsel and Director of Operational Risk and Regulatory Relations at (215) 446-4052 or edemarco@rmahq.org.

Very truly yours,

A handwritten signature in black ink, appearing to read "Edward J. DeMarco, Jr.", with a long horizontal line extending to the right.

Edward J. DeMarco, Jr.,
General Counsel and
Director of Operational Risk & Regulatory Relations

APPENDIX A

1. The Federal Reserve has proposed (1) adding a Unique Identifier item for each row in order to clearly identify record submissions with the same information that are unique records; and, effective December 31, 2014 (2) for each closed/ settled legal event above \$250,000 adding (i) date of awareness, (ii) date on which a claim was filed, proceedings were instituted, or settlement negotiations began, (iii) date of settlement, fine, or final judgment, (iv) cause of action, (v) the reserve history, and (vi) terminal outcome, which would all provide greater insight into reserving practices and changes in reserves. *See* (Federal Register, Vol. 79, No. 135, July 15, 2014 Notices, p. 41281); *See also* the August 19 Letter.

Adding a Unique Identifier item for each row of the Operational Risk Schedule is impracticable given that the historical information may not be readily available in respect of historical losses and would require the expenditure of significant resources to retrieve and/or ascertain. We would note that certain items of information may not be available because they were not captured at the relevant point in time, for example, where the underlying litigation involves an acquired institution. In such cases, the applicable records may well not have been kept in a form that would allow for simple compliance, and instead would require significant manual intervention.

2. The concept of “date of awareness” is not clearly defined in the Proposal nor is a concept generally recognized by legal counsel specifically or operational risk practitioners generally. The usage of this or any other ambiguous term could lead to conflicting results when applied across business lines in a bank and would certainly lead to inconsistent results across institutions. Moreover, this concept of date of awareness could prove to be incompatible with an institution’s reporting obligations under ASC 450-20, which recognizes that loss contingencies are by their very nature vague and difficult to estimate.