

**Meeting Between Federal Reserve Staff and
Various Industry Participants
July 16, 2012**

Participants: Jane Yao (American Bankers Association), Kieran Fallon (PNC), David Wagner (The Clearing House), Michael Coyne (JPMorgan Chase), Dennis Black (Comerica Bank), Bernie Mason (RMA), Benjamin Rosenthal (Northern Trust), Nedim Baruh (JPMorgan Chase), and other industry participants¹

Eric Caban, Andrew Felton, Alex Frank, Phil Gledhill, Benjamin McDonough, Joe Peter, and Lisa Ryu (Federal Reserve)

Summary: Federal Reserve staff participated in a telephonic discussion with various industry participants in order to solicit feedback on three options for collecting data on legal reserves. These options were developed in response to comments received on the proposal to collect operational risk data published in the Federal Register on February 22, 2012 and extended for comment on June 4, 2012.

Copies of the two documents provided to meeting participants are attached.

¹ Other industry representatives that participated by phone may not be identified.

Agenda: Legal Reserves

1. Ben McDonough provides legal disclaimer and recap of the notice + comment history
2. The banks provide an overview of their objections to the original proposal
3. The banks outline some issues around legal reserves reporting that they want to be aware of
4. Joe Peter explains two of the three options that we provided
5. Andy Felton (or Phil Gledhill?) explains the third option (randomization)
6. The banks (JPM and NTRS representatives) discuss their views of the options
7. Open discussion

Introduction

On February 22, 2012, the Federal Reserve published a notice in the Federal Register requesting public comment on revisions to the Capital Assessments and Stress Testing information collection. Among the proposed revisions was the collection of data on legal reserves for pending and probable litigation claims. On June 4, 2012, the Federal Reserve published a notice in the Federal Register finalizing the revisions to the FR Y-14 data collection. In response to public concerns over sensitivity of this data, the Federal Reserve did not require legal reserves to be submitted as part of the Q2 2012 collection and reopened the comment period on legal reserves for an additional 30 days (later extended by an additional 30 days).

The Federal Reserve has requested a meeting with industry representatives to assess various methods of collecting this data that would address concerns over the sensitivity of the data. Below are three methods of collection proposed for discussion purposes. The Federal Reserve would appreciate feedback on whether each of these methods would address the concerns previously discussed, as well as suggestions for other methods that would allow the Federal Reserve to collect data on legal reserves in as granular a format as possible while respecting their sensitive nature.

Method 1: Event Level Data Excluding Firm Specific Information

For each legal reserve, provide the following:

- **Reference Number** - each "legal event" should be assigned a unique reference number. Multiple legal reserves recorded for the same legal event should have the **same** reference number
- **Accounting Date** - the date the legal reserve was recorded to the financial statements
- **Reserve Amount** - the recorded reserve amount for each legal event as of the end of the reporting quarter
- **Basel Event Type Category (Level 1)**
- **Basel Business Line (Level 1)**
- Is this legal reserve included in the institution's most recently reported operational risk estimate? (**Yes or No**)

Note: "Detailed Descriptions", "Internal Business Line classification", and "UOM" are **not requested** in this scenario.

EXAMPLE – Scenario 1:

Reference #	Accounting Date	Basel Event Type Category	Basel Business Line –Level 1	Included in model?	Gross Loss Amount
B223456	12/31 2011	CPBP	Trading & Sales	Y	400,020,300
A578422	02/04/2012	EPWS	Retail Banking	Y	25,000,245
A578422	03/31/2012	EPWS	Retail Banking	Y	5,100,000
FG19093	02/30/2012	CPBP	Asset Management	Y	420,350,002

Method 2 – Aggregated Quarterly Data

Provide the following:

- Total number of outstanding/pending “legal events” for which a legal reserve(s) has been established, by quarter. Report each event according to the quarter/year in which the first legal reserve for the respective event was recorded, based on the total number of outstanding legal events, not the number of legal reserve entries (e.g., a legal event which had three separate reserves recorded should be reported as only one event). Further, provide this information by Basel “Business Line (Level 1)” and Basel “Event Type Category (Level 1)”. See **Table A** in the example below.
- The total dollar value of legal reserves recorded for outstanding/pending legal events, by quarter. Multiple legal reserves associated with the same legal event should be aggregated and reported under the quarter/year in which the first legal reserve for that event was recorded. Further provide this information by Basel “Business Line (Level 1)” and Basel “Event Type Category (Level 1)”. See **Table B** in the example below
- Settled legal events and the associated reserves should be removed from these tables when necessary.

Examples- Illustrative Purposes Only

	Q1 2011	Q2 2011	Q3 2011	Q4 2011	Q1 2012	Q2 2012
Retail Banking						
IF	1	4	1	4	0	7
EF	11	3	6	3	6	5
EPWS	3	10	12	7	15	6
CPBP	15	8	14	5	0	4
DPA	4	5	3	12	15	9
BDSF	12	0	3	2	2	6
EDPM	7	6	11	12	3	6
Trading and Sales						
IF	0	6	3	11	4	3
EF	7	10	13	7	13	0
EPWS	13	2	4	8	8	8
CPBP	7	1	6	2	15	13
DPA	10	0	15	1	13	15
BDSF	3	9	0	15	11	7
EDPM	15	10	15	12	13	13
Asset Management						
IF	0	0	13	11	12	9
EF	3	10	12	8	10	11
EPWS	7	1	12	6	4	9
CPBP	15	5	6	7	14	9
DPA	4	9	15	2	6	13
BDSF	14	7	0	0	10	4
EDPM	8	12	9	0	14	5

Table B: EXAMPLE - Total Dollar Value of Outstanding Legal Reserves
(Total \$, Thousands)

	Q1 2011	Q2 2011	Q3 2011	Q4 2011	Q1 2012	Q2 2012
Retail Banking						
IF	12983	17008	1780	18393	0	15890
EF	15580	15231	2690	6156	13053	16377
EPWS	19936	12544	19586	11996	7050	19981
CPBP	10670	1096	19684	15753	0	1627
DPA	24884	21506	21574	9842	19500	22224
BDSF	23362	0	15003	14034	8754	18652
EDPM	19717	22385	9277	5238	22845	24665
Trading and Sales						
IF	0	10998	14330	19759	1616	12397
EF	17776	24488	8661	23761	16982	0
EPWS	24667	2707	19048	3732	3137	6089
CPBP	8279	8985	24914	7445	2878	8074
DPA	18797	0	9465	23006	10633	4832
BDSF	18271	14163	0	11269	7158	22979
EDPM	11733	15038	6063	3791	19591	21105
Asset Management						
IF	0	0	19173	13548	12134	6256
EF	6910	5808	20367	14489	4815	7373
EPWS	12660	20025	11305	12527	12161	23601
CPBP	15437	20501	8726	23857	1138	2415
DPA	7671	10600	5409	20076	15163	1107
BDSF	17139	14772	0	0	20334	1217
EDPM	3037	10641	19892	0	3286	8540

Method 3 – Event Level Data with Randomized Severities

This method requires non-aggregated data on each legal reserve, as well as all requested FRY14-Q Operational Risk Loss Data submission fields. Note that each "legal event" should be assigned a unique Reference Number (multiple legal reserves recorded for the same legal event should have the *same* reference number). In addition, this method requires use of the Accounting Date for each legal event, which is the date each legal reserve was recorded to the financial statements.

Methodology

- **Randomize the Legal Reserves Dataset:** For each recorded legal reserve, the firm determines whether to submit the actual severity of the reserve or a random number representing the reserve's severity as follows:
 - Choose a "salt" between 1 and 100 (e.g. 42). ("Salt" methodology under discussion.)
 - Take the date of the event and convert to a number using Excel (e.g. February 17, 2012 = 40956).
 - Subtract the salt (e.g. 40956 – 42 = 40914) and convert the result back into a date using Excel (40914 => January 6, 2012).
 - Look up the last digit of the closing figure of the Dow Jones Industrial Average that day (on January 6, 2012, it was 12,359.92, so the last digit was 2).
 - If the digit is odd, submit the actual severity data as of the actual event date.
 - If the digit is even, submit randomized severity data using the following algorithm.
 - Take the last two digits of the DJIA as computed above (e.g. .92).
 - Use this as a percentage of the bank's Tier 1 capital of the quarter previous to the event (e.g. if the bank reported \$50,000,000 of T1 capital on Q4 2011 then take 92% of that, or \$46,000,000) and divide by 100 (to get \$460,000). Report \$460,000 as the severity of the individual legal reserve, as of the actual event date.
 - *N.B - Once the severity for each event is determined (either true or randomized) it must remain constant over the entire period that the legal event remains outstanding.*
- **Scale the Dataset to the GL:** Compare the total of the legal reserves dataset that will be submitted (the sum of the randomized data) to the actual General Ledger amount for legal reserves as of reporting date.
 - Adjust each individual legal reserve, whether true or randomized, by a percentage (up or down) that will scale the sum of the randomized legal reserves data equal to the legal reserves balance in the GL.
- **Report the data on the FRY14-Q Operational Loss Data Submission:** Report each individual, scaled, randomized legal reserve on the FRY14-Q schedule, in accordance with the instructions for all other operational loss data.