

May 25, 2018

Via E-Mail

Basel Committee
on Banking Supervision
Centralbahnplatz 2
4051 Basel
Switzerland

Ladies and Gentlemen:

This letter is submitted by the Advanced Operational Risk Group (“AORG”) of The Risk Management Association (“RMA” or the “Association”) in respect of the Consultative Document, “Pillar 3 disclosure requirements – updated framework” issued by the Basel Committee on Banking Supervision in February 2018 (the “Disclosure Requirements”).

Background

RMA is a 501(c)(6) not for-profit, member-driven professional association whose sole purpose is to advance the use of sound risk management principles in the financial services industry. RMA helps its members use sound risk management principles to improve institutional performance and financial stability and enhance the risk competency of individuals through information, education, peer-sharing and networking. RMA has 2,500 institutional members that include banks of all sizes as well as nonbank financial institutions. They are represented in the Association by more than 18,000 risk management professionals who are chapter members in financial centers throughout North America, Europe, and Asia/Pacific.

The AORG f/k/a the Advanced Measurement Approaches Group was formed in 2005 by RMA at the suggestion of senior U.S. regulators. The purpose of the AORG is to foster a dialogue with the federal U.S. financial services regulatory agencies and share industry views on advanced operational risk measurement and management, including those aspects of CCAR / DFAST. The AORG consists of operational risk management professionals working at financial service organizations operating in the United States. The AORG is open to any financial firm, which is a member of RMA that is regulated in the United States and is pursuing advanced practices and/or is required to conduct CCAR / DFAST exercises. A senior officer responsible for operational risk management serves as the primary representative of each member institution.

The members of the AORG are listed on Exhibit A attached. They are provided for identification purposes only. This letter does not necessarily represent the views of RMA’s institutional

membership at large, or the views of the individual institutions whose staff have participated in the AORG.

For reference, the terms “attorney,” “lawyer,” and “counsel” are used interchangeably to mean any person who prosecutes or defends causes of action in courts of record or other tribunals or whose business it is to render legal advice or assistance in relation to any cause or matter.

Introduction

The AORG is concerned that the term “Accompanying narrative” is so broad and vague that, when coupled with the exercise by the prudential regulators of their visitorial powers, it could be misconstrued to require disclosure, either directly or indirectly, of information regarding a bank’s sensitive litigation and legal reserves in derogation of the attorney-client privilege and the attorney work product doctrine.

Specifically the Disclosure Requirements provide:

“Accompanying narrative: Banks are expected to supplement the template with narrative commentary explaining the rationale for new loss exclusions since the previous disclosure. In addition, banks must describe recent large losses from operational risk, their context and management. If recoveries are material, banks should make additional disclosures regarding such recoveries, including their amount. Banks should disclose any other material information that would help inform users as to its historical losses.”

The instruction to **“disclose any other material information that would help inform users as to its historical losses”** is particularly vexing as the term “other material information” is so broad that could be used by the prudential regulators to learn not only the amount of legal reserves for specific cases, but also, how a bank’s legal counsel thinks about litigation generally and individual cases in particular.

A financial institution or other corporate defendant upon being sued undertakes a litigation assessment, which is tantamount to the lawyer’s underlying thinking about the case. At the outset, counsel will evaluate the case from multiple perspectives, including, management’s; the business unit’s; the public’s; the regulators’; and the lawyers’. Counsel will consider the type of case, whether the corporate defendant is the sole defendant or whether there are multiple defendants; what the key issues are; who the plaintiff is; whether there are similar cases and the outcomes of such cases.

The attorney-client privilege enables corporations and other limited liability entities, through their employees, to communicate with their lawyers in confidence, and it encourages corporations to seek out and obtain guidance in how to conform their conduct to the law. The privilege facilitates

self-investigation into past conduct to identify shortcomings and remedy problems, to the benefit of corporate institutions, the investing community and society-at-large. The work product doctrine underpins our adversarial justice system and allows attorneys to prepare for litigation without fear that their work product and mental impressions will be revealed to adversaries. The lawyer's evaluation of the case will shape his or her litigation strategy and budget.

Accordingly, we respectfully suggest that the Disclosure Requirements be revised to read as follows:

“Accompanying narrative: Banks are expected to supplement the template with narrative commentary explaining the rationale, in the aggregate, for new loss exclusions since the previous disclosure. Banks should disclose any other material information, in the aggregate, that would help inform users as to its historical losses, with the exception of sensitive legal loss information, including information about legal reserves.”

Analysis

For all of the reasons set forth below, the AORG respectfully suggests that the “Accompanying Narrative” requirement be revised to expressly provide that there is no requirement that a bank disclose reserves for concluded (whether by verdict or settlement), pending and/or probable litigation. The rationale for this request is simple: the present instruction would erode the attorney-client privilege, as well as the attorney work product doctrine, and, accordingly, would be unwise, unsound and highly prejudicial.

The recording of a reserve for pending or probable litigation is a matter of attorney-client privilege and is an important manifestation of attorney work product and should not be subject to disclosure, except in the most exigent circumstances. This is equally true of concluded litigation. The importance and sanctity of the attorney-client privilege and attorney work product doctrine simply cannot be overstated. It is the attorney-client privilege which enables lawyers to consult with a bank's employees and to render advice to the bank. Obviously, one key piece of advice is the amount which should be reserved for a particular litigation matter, which advice may change from time to time as facts become known and trends become apparent. Moreover, with respect to concluded litigation, disclosure of reserves serves to illustrate counsel's thinking, which may be indicative of counsel's thinking in similar, related or future matters, and which may be different from the public posture taken by counsel in litigation.

A bank will record a reserve for an individual case following legal counsel's completion of a litigation assessment, which will include his/her opinion regarding a number of factors, including, but not limited to:

- (a) The nature of the case (e.g., contract, securities, infringement, etc.);

- (b) The known facts;
- (c) Key issues on which the outcome of the case may turn;
- (d) The named defendants; i.e., parent company, subsidiaries/affiliates, officers, directors, vendors;
- (e) The nature of the plaintiff and whether the bank has an ongoing relationship with the plaintiff;
- (f) Opposing counsel;
- (g) The settlement value of the case;
- (h) The best, likely and worst case scenarios;
- (i) The overall disposition strategy of the case; i.e., whether the primary objective is trying the case or settling the case;
- (j) Whether the case is one of a series of similar cases involving the bank; and
- (k) Whether the case is particular to the bank or is of a type brought against banks generally, such as patent infringement suits brought by non-practicing entities.

These factors are not outcome determinative, but together with counsel's judgement and experience, form the basis of a recommendation regarding reserves in a given litigation matter. Moreover, the relative weight given to such factors may change over the course of litigation as counsel's thinking about the litigation evolves. As such, the amount recorded as a reserve is the manifestation or embodiment of counsel's perspective about a case.

The attorney work product doctrine forms the basis of the U.S. legal system, permitting lawyers to prepare for litigation, including settlement discussions, without fear that their work product and mental impressions will be revealed to the government or to opposing parties. In short, legal counsel's assessment of a case, which may evolve over time, will determine the bank's litigation strategy, budget and reserves.

AORG member institutions believe that including legal reserve information in the Accompanying Narrative would, thus, be highly problematic. In particular, AORG member institutions concerns center upon discoverability of the information once released in regulatory reports. Discovery of such information could quite possibly compromise an institution's legal position.

The AORG respectfully submits that requiring banks to disclose their legal reserves for closed, pending and/or probable litigation claims would be unwise, unsound and highly prejudicial, and should not be pursued because no exigency exists. Legal reserves for litigation claims are established by banks based upon the advice of counsel and always entail the exercise of significant professional judgement by experienced legal counsel in weighing the relative strengths of claims and defenses in light of existing law and factual developments.

Hence, as stated above, legal reserves are both privileged and highly confidential. Any public disclosure of legal reserves would subject banks to significant prejudice, as it would inform their adversaries of how the bank weighs the strength/weaknesses of the subject claims and establish a floor for plaintiffs' settlement demands on those claims. Potential prejudice to the bank also looms in the risk that adversaries could seek to introduce the reserves as evidence in the litigation as admissions of liability or the amount of damages.

Other Issues

As stated above, the Disclosure Requirements are overly broad and vague and are, thus, subject to a myriad of interpretations. For example, the requirement that "banks must describe recent large losses from operational risk, their context and management" causes potential confusion. For example, the term "large losses," is undefined. We note that the threshold for disclosure has been set at \$250,000 by the U.S. regulators for descriptions of loss events in the FR Y 14Q filings. In addition, the term "management" also requires definition: does management mean what changes a bank made in its control environment in response to a large loss? Does it mean a bank's mitigation strategy? Does it include how the bank is managing any resulting litigation – if so, there exists another potential avenue for the improper requirement to disclose litigation strategy in violation of the attorney-client privilege and the attorney work product doctrine.

Finally, in recent years, banks have entered into very restrictive confidentiality agreements associated with client activity. While clients understand the need for non-public reporting to regulators, query whether the nature of the Required Disclosures puts institutions at risk of litigation if disclosed loss activity can be associated to a client.

For the reasons discussed above, we respectfully suggest that the Disclosure Requirements be revised to read as follows:

"Accompanying narrative: Banks are expected to supplement the template with narrative commentary explaining the rationale, in the aggregate, for new loss exclusions since the previous disclosure. Banks should disclose any other material information, in the aggregate, that would help inform users as to its historical losses, with the exception of sensitive legal loss information, including information about legal reserves."



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We appreciate the opportunity to comment and ask that you 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 blue ink, appearing to read "Edward J. DeMarco, Jr.", followed by a long horizontal line extending to the right.

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

Exhibit A

- Bank of America
- Bank of the West
- BB&T
- BMO Financial
- BNY Mellon
- Capital One Bank
- Citigroup
- Citizens Financial
- Credit Suisse
- Deutsche Bank
- Goldman Sachs
- HSBC North America
- JP Morgan Chase
- Keycorp
- M&T Bank
- Morgan Stanley
- MUFG Union Bank
- Northern Trust
- PNC
- Royal Bank of Canada
- State Street
- SunTrust
- TD Bank Financial Group
- U.S. Bank
- Wells Fargo