



## The Basics of the Bank Examination Privilege

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### Structure of Today's Presentation

- Nature of the privilege
- Burden-shifting framework
- Scope of the privilege
- State law
- Practice tips for financial institutions



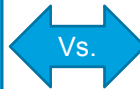
## Nature of the Privilege

- Federal evidentiary privilege
- Confidential regulatory examinations of banks
- Recognized in every federal circuit – at circuit level or district court level

## Nature of the Privilege

### Regulatory examinations of the financial industry:

- Share factual findings, recommendations
- Dialogue
- Non-adversarial
- Confidential
- Regulations prohibit public dissemination



### Litigation against the financial industry:

- Examination records as evidence
- Party will argue need for such evidence outweighs expectation of confidential treatment

## Nature of the Privilege

The privilege encompasses:

- “[A]gency opinions and recommendations and banks’ responses thereto.” *In re Bankers Trust Co.*, 61 F.3d 465, 471 (6th Cir. 1995).
- The “iterative process of comment by the regulators and response by the bank.” *In re Subpoena Served upon Comptroller of Currency*, 967 F.2d 630, 633 (D.C.Cir. 1992).
- “[M]aterials relating to bank examination reports.” *Principe v. Crossland Savings, FSB*, 149 F.R.D. 444 (E.D.N.Y. 1993).

## Nature of the Privilege

Two underlying policy concerns:

1. “Bank management must be open and forthcoming in response to the inquiries of bank examiners, and the examiners must in turn be frank in expressing their concerns about the bank.” *In re Subpoena Served upon Comptroller of the Currency*, 967 F.2d 630 (D.C.Cir. 1992).
2. “[D]isclosure of confidential portions of a bank report might breed public misunderstanding and unduly undermine confidence in the bank.” *Delozier v. First Nat’l Bank of Gatlinburg*, 113 F.R.D. 522 (E.D.Tenn. 1986).

## Nature of the Privilege

### Relationship to Federal Statutes and Regulations

Relationship to Federal Statutes	Relationship to Regulatory Policy
No federal statute expressly requires courts to recognize a bank examination privilege. But . . .	Federal financial regulators consider examination records confidential.
The privilege helps regulators fulfill their statutory duties. And . . .	Regulatory policy regarding this matter does not create an evidentiary privilege in federal court.
FOIA Exemption 8 categorically exempts records “contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions.”	The bank examination privilege is a judicial doctrine administered by judges. The scope does not always mirror regulatory policy precisely – and the results do not always conform to the wishes of regulators.

## Nature of the Privilege

### Standing to Defend the Privilege

- Only the government has standing to assert – or waive.
- Therefore, when the privilege is litigated:
  1. Agency official must make formal privilege claim;
  2. “[b]ased on actual personal consideration”;
  3. and must provide “a detailed specification of the information for which the privilege is claimed, with an explanation why it properly falls within the scope of the privilege.” *Landry v. FDIC*, 204 F.3d 1125 (D.C. Cir. 2000).
- Ultimately, “[t]he court itself must determine whether the circumstances are appropriate for the claim of privilege,” as “[j]udicial control over the evidence in a case cannot be abdicated to the caprice of executive officers.” *U.S. v. Reynolds*, 345 U.S. 1 (1953).

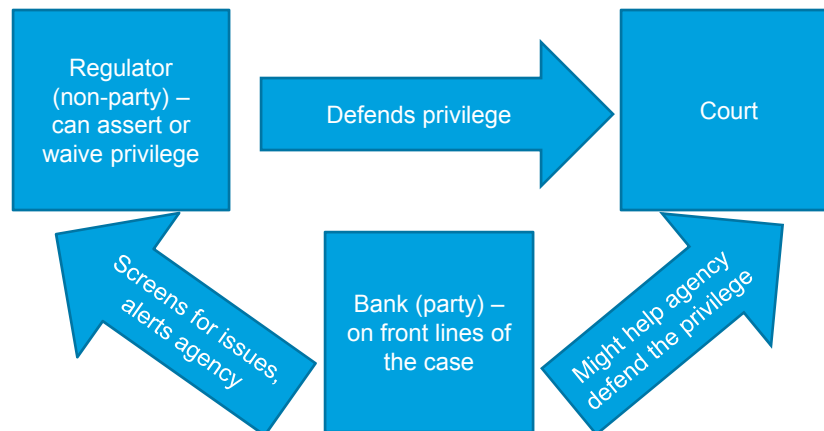
## Nature of the Privilege

Agencies have standing in all procedural situations:

Procedural Scenario	Role of Agency and Bank in the Case	Adversary Seeks Records from the . . .	Standing to Assert or Waive
1	Agency is party, bank is non-party	Agency	Agency
2	Agency is non-party, bank is party	Agency	Agency
3	Agency is non-party, bank is party	Bank	Agency – courts will not resolve until agency has been given notice and opportunity to be heard

## Nature of the Privilege

When the bank is a party but the agency is not, the agency relies on the bank to help defend the privilege.



## Nature of the Privilege

Regulatory framework for the bank's role:

- “Without OCC approval, no person [or entity] . . . may disclose [non-public OCC] information . . . except: (A) After the requester has sought the information from the OCC . . . ; and (B) As ordered by a Federal court in a judicial proceeding in which the OCC has had the opportunity to appear and oppose discovery.” 12 C.F.R. § 4.37(b)(1)(i).
- Violators “may be subject to the penalties provided in 18 U.S.C. 641.” 12 C.F.R. § 4.37(b)(1)(ii).
- Practical take-away: As a party to a lawsuit, bank withholds potentially-privileged information – *pending* regulatory review.

## Nature of the Privilege

*In re Subpoena Served upon Comptroller of the Currency*, 967 F.2d 630 (D.C.Cir. 1992).

- Shareholders' class action and derivative suit against bank and bank officers – in federal court in Rhode Island
- Demanded that bank produce confidential communications with OCC and Federal Reserve
- “[A] unique and objective contemporaneous chronicle of the true financial status of [the bank] and defendants' knowledge.”
- Bank refused – plaintiffs then made a similar demand on OCC and Federal Reserve – and then sued to enforce in District of Columbia federal court

## Nature of the Privilege

***In re Subpoena Served upon Comptroller of the Currency*, 967 F.2d 630 (D.C.Cir. 1992).**

### District Court

- Rejects assertion of privilege
- Sending examination reports to banks = waiver of privilege
- "Don't send [examination reports] to the banks, then you don't have a problem."

### Appellate Court

- Sending examination reports to banks ≠ waiver
- Providing examination reports to the bank "is a fundamental part of the regulatory process."
- "To hold that the privilege is waived or even weakened merely because the regulator provides the report to the bank would quickly render the privilege a dead letter."

## Nature of the Privilege

**Relationship to deliberative process privilege:**

- The deliberative process privilege "protects the deliberative and decisionmaking processes of the executive branch." *Dudman Communs. Corp. v. Dep't of Air Force*, 815 F.2d 1565 (D.C. Cir. 1987).
- The deliberative process privilege ordinarily focuses on inter- and intra-agency communications. *Center for Biological Diversity v. Office of U.S. Trade Representative*, 450 Fed.Appx. 605 (9th Cir. 2011).
- "Under the penumbra of government deliberations, courts have recognized a privilege for materials relating to bank examination reports." *Principe v. Crossland Sav., FSB*, 149 F.R.D. 444 (E.D.N.Y. 1993).
- But the bank examination privilege is not limited to inter- or intra-agency communications – it also extends to *external* agency-bank communications.

## Burden-Shifting Framework



## Burden-Shifting Framework

### The good cause test:

- A 5-factor balancing test
- No single factor is dispositive
- Courts “undertake a fresh balancing” of the factors from one document to the next. *In re Subpoena Served upon the Comptroller of the Currency*, 967 F.2d 630 (D.C.Cir.1992).
- A party must “show that it has a particularized need for the documents.” *Lawrence E. Jaffe Pension Plan v. Household Intl, Inc.*, 239 F.R.D. 508 (N.D.Ill. 2006).
- Court will “balance the interests in nondisclosure against the interest in document production.” *In re Fin. Corp. of Am.*, 119 B.R. 728 (Bankr. D.Cal. 1990).



## Burden-Shifting Framework

### The good cause test:

Factor	Significance
1. Relevance	More relevant = favors disclosure
2. Availability of other, non-privileged sources of evidence	Other evidence available = weighs against disclosure
3. Seriousness of the litigation	Serious case = favors disclosure
4. Role of government in litigation	Governmental role = favors disclosure
5. Possible chilling effect of disclosure on future examinations	Likely chilling effect = weighs against disclosure

## Burden-Shifting Framework

**Example of disclosure denied – *In re Bank One Securities Litigation, First Chicago Shareholder Claims*, 209 F.R.D. 418, 427 (N.D.Ill. 2002).**

- Securities fraud class action against bank.
- Plaintiffs demand that bank and OCC (non-party) produce confidential examination records.

## Burden-Shifting Framework

Example of disclosure denied – *In re Bank One Securities Litigation, First Chicago Shareholder Claims*, 209 F.R.D. 418, 427 (N.D.Ill. 2002).

- **Step 1: Court reviews sample documents *in camera* – they “predominantly contain opinions and / or recommendations as opposed to facts” – therefore the privilege applies.**
- **Step 2: Good cause test – plaintiffs are unable to show good cause.**

## Burden-Shifting Framework

Example of disclosure denied – *In re Bank One Securities Litigation, First Chicago Shareholder Claims*, 209 F.R.D. 418, 427 (N.D.Ill. 2002).

Factor	Analysis
1. Relevance	“address potential regulatory infractions by the defendant”
2. Other evidence	Plaintiffs already have “the raw factual materials”
3. Seriousness	The “need to promote sound, reliable financial data”
4. Government’s role	None
5. Chilling effect	Could make examiners “reluctant to capture the full breadth of their opinions and thoughts in written format for fear of future disclosure”
Court’s conclusion	Plaintiffs cannot meet burden

## Burden-Shifting Framework

Example of disclosure compelled – *In re Powell*, 227 B.R. 61, 63 (Bankr. D.Vt. 1998).

- Personal bankruptcy case – trustee sues bank on behalf of debtors – alleges that bank made misrepresentations to debtors in connection with commercial loan.
- Trustee seeks any *factual* information contained in supervisory correspondence regarding the institution’s “credit administration practices.”
- Step 1: Privilege inapplicable because “[a]ny opinions which might be contained in these materials can be redacted out or separated from the factual material.”

## Burden-Shifting Framework

Example of disclosure compelled – *In re Powell*, 227 B.R. 61, 63 (Bankr. D.Vt. 1998).

### Step 2: Good cause test

Factor	Analysis
1. Relevance	Regulators “likely have come across evidence of [such] negligence.”
2. Other evidence	Examination reports “likely to be the best and most complete evidence of any negligence.”
3. Seriousness	“serious allegations against a licensed banking institution”
4. Government’s role	None
5. Chilling effect	Minimal, because opinions or recommendations will be redacted
Court’s conclusion	Compel disclosure

## Scope of Privilege

### Examination Process

- Who conducts examinations?
- What do examiners examine?
- When do examinations take place?
- Where do examinations take place?
- Why are examinations conducted?
- How do examiners convey their findings?

## Scope of Privilege

### Primary bank regulators:

- Office of the Comptroller of the Currency (OCC)
- Board of Governors of the Federal Reserve System (Federal Reserve)
- Federal Deposit Insurance Corporation (FDIC)
- State banking regulators
- Consumer Financial Protection Bureau (CFPB)

## Scope of Privilege

Bank Charter Type and Examiners		
<u>Charter Type</u>	<u>Chartering Regulator</u>	<u>Primary Examiner</u>
National (Federal)	OCC	OCC and possibly CFPB
State	State banking department	State banking regulator and FDIC or Federal Reserve and possibly CFPB
Bank Holding Companies	Federal Reserve Board/relevant state agency	Federal Reserve Board and possibly state regulator and CFPB

## Scope of Privilege

- **Focus of bank examinations**
  - Safety and soundness examinations
  - Targeted and horizontal examinations
  - CFPB examinations
- **Formal examination reports**
  - Factual findings
  - Opinions and recommendations
- **Informal supervisory communications**
- **Remedial actions**
- **Confidentiality of the supervisory process**

## Scope of Privilege

Early case law regarding the privilege dealt principally with requests for the disclosure of:

- Formal reports of examination
- Regarding bank safety and soundness
- Issued by the OCC or other prudential regulators.

## Scope of Privilege

- But the privilege extends beyond that area.
- Courts also apply the privilege to:
  - Communications other than formal examination reports
  - Communications from banks to regulators
  - Internal bank communications
  - Examinations that do not concern safety and soundness
  - Examinations of non-bank financial institutions, by non-bank regulators
- In each instance, the legal test remains the same: whether the communication reveals the confidential opinions or recommendations of an examiner.

## Scope of Privilege

**Example – *Federal Housing Finance Agency v. JPMorgan Chase & Co.*, 978 F. Supp.2d 267, 274 (S.D.N.Y. 2013).**

- Action brought by Federal Housing Finance Agency (“FHFA”) against financial institutions involved in residential mortgage-backed securities industry
- Defendants seek records regarding confidential examinations conducted by the FHFA with respect to Fannie Mae and Freddie Mac (the “GSEs”)
- The FHFA invokes the bank examination privilege

## Scope of Privilege

**Example – *Federal Housing Finance Agency v. JPMorgan Chase & Co.*, 978 F. Supp.2d 267, 274 (S.D.N.Y. 2013).**

- “The defendants argue that the bank examination privilege cannot apply to FHFA because the GSEs are not *banks* and FHFA is not a *bank* regulator.”
- “FHFA emphasizes that its authority over the GSEs includes the exact powers of bank examiners. It asserts that the defendants’ argument that ‘GSEs are not banks’ is semantic and not substantive. And it contends that the GSEs it regulates engage in banking related activities such that the rationale animating the banking examination privilege applies equally to FHFA’s communications with the GSEs it regulates.”

## Scope of Privilege

**Example – *Federal Housing Finance Agency v. JPMorgan Chase & Co.*, 978 F. Supp.2d 267, 274 (S.D.N.Y. 2013).**

- Court finds that the FHFA can invoke the privilege
- “The question here is whether the distinctive necessity for candid and informal regulation of the banking sector – stemming from both practical necessity of day-to-day bank regulation, as well as from necessity to maintain public confidence in the financial system – which undergirds the bank examination privilege, applies also to [the] FHFA’s regulation of the GSEs. It does.”
- There is “no authority for the proposition that the privilege turns on the nature of the regulated entity.”

## Scope of Privilege

**Example – *Federal Housing Finance Agency v. JPMorgan Chase & Co.*, 978 F. Supp.2d 267, 274 (S.D.N.Y. 2013).**

- Conducts *in camera* review of documents.
- Deems privilege applicable to:
  - Communications from GSEs to the FHFA “that reflect recommendations of items to be discussed at a joint meeting.”
  - Communications from GSEs to FHFA “which provide narrative answers to questions . . . when those narrative answers describe GSE policies or purposes or explain GSE practices.”
  - Communications from the FHFA to the GSEs “that provide qualitative reviews of their operations or directions as to the conduct of future operations.”



## State Law

### Background

- In most states, the privilege (if it exists) is statutory.
- Three types of statutes:
  1. Bank examinations are confidential but not privileged.
  2. Absolute privilege.
  3. Qualified privilege – similar to the federal rule.

## State Law

### FRE 501 – Summary

- “The common law – as interpreted by United States courts in the light of reason and experience – governs a claim of privilege unless any of the following provides otherwise: the United States Constitution; a federal statute; or rules prescribed by the Supreme Court. But in a civil case, state law governs privilege regarding a claim or defense for which state law supplies the rule of decision.”
- Many federal courts interpret FRE 501 to mean that:
  - Pure diversity case = state privilege law.
  - Purely federal-law case = federal privilege law.
- This reading of FRE 501 can produce strange results with respect to the bank examination privilege

## State Law

### FRE 501 – Examples

***In re Powell*, 227 B.R. 61 (Bankr. D.Vt. 1998) – parties’ claims and defenses based in Vermont state law.**

- Party seeks examination records from FDIC.
- FDIC objects based on federal common-law bank examination privilege.
- Court holds that Vermont statute displaces federal privilege because parties’ claims and defenses are based in state law.
- Court further holds that Vermont statute treats bank examinations as confidential but not privileged.
- Court orders FDIC to produce the requested records in their entirety, based on state law.

## State Law

### FRE 501 – Examples

***Rouson ex rel. Estate of Rouson v. Eicoff*, 2006 WL 2927161, at \*4 (E.D.N.Y. Oct. 11, 2006) – a RICO case.**

- Party seeks non-public examination records from New York State Department of Financial Services (“NYDFS”).
- The NYDFS objects based on New York statutory law, which strictly protects bank examination records.
- The court instead applies federal law, because the parties’ claims and defenses are based in federal law. As a result, the court requires the NYDFS to produce records that a New York state court likely would not have compelled.

## State Law

### FRE 501 – Another perspective

- “The common law – as interpreted by United States courts in the light of reason and experience – governs a claim of privilege unless any of the following provides otherwise: the United States Constitution; a federal statute; or rules prescribed by the Supreme Court. But in a civil case, state law governs privilege regarding a claim or defense for which state law supplies the rule of decision.”
- Wright & Miller: The underscored phrase “obviously applies to both the general rule and the state law proviso.” 23 Fed. Prac. & Proc. Evid. § 5436.
- Under this interpretation of FRE 501, a court might have to grapple with the relationship between the bank examination privilege and federal statutory law.

## Practice Tips

### *Tip 1:*

The bank examination privilege is not only about documents. It also can extend to oral testimony.

## Practice Tips

### Tip 2:

Various other evidentiary privileges also can apply to bank examination reports.

“The submission by any person of any information to the Bureau of Consumer Financial Protection, any Federal banking agency, State bank supervisor, or foreign banking authority for any purpose in the course of any supervisory or regulatory process of such Bureau, agency, supervisor, or authority shall not be construed as waiving, destroying, or otherwise affecting any privilege such person may claim with respect to such information under Federal or State law as to any person or entity other than such Bureau, agency, supervisor, or authority.” 12 U.S.C. § 1828(x)(1).

## Practice Tips

### Tip 3:

When a bank is litigating a case, and issues arise in relation to the privilege, the bank should communicate with its regulator

- The case otherwise might not be on the regulator’s radar.
- The issue might involve a large volume of documents – and the regulator might need time to complete the review.
- A regulator might need time to learn about the case and the discovery dispute, and to formulate a position.



Questions?

