The Bank Examination Privilege – Current Developments

Eric Epstein
Beth Forsythe
Nicholas Vlietstra

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Program Materials

Panel PowerPoint

Ten Key Points about the Bank Examination Privilege, Eric B. Epstein, David A. Scheffel, and Nicholas A.J. Vlietstra, Business Law Today (February 2017)

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1

Overview of the Privilege

- **Protects bank examination records during litigation**
- **Federal common law**
- **Recognized in every federal circuit – at circuit court level or district court level**

The SAR Privilege

- **Bank Secrecy Act: Do not notify "any person involved in the transaction that the transaction has been reported." 31 U.S.C. § 5318(g)(2).**
- **"A SAR, and any information that would reveal the existence of a SAR, are confidential," and "shall not be disclosed." 12 C.F.R. § 21.11(k).**
- **"[A]n unqualified discovery and evidentiary privilege" with respect to SARs. *Whitney Nat'l Bank v. Karam*, 306 F. Supp.2d 678, 682 (S.D.Tx. 2004).**

FOIA Exemption 8

- **Information "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." 5 U.S.C. § 552(b)(8).**
- **Proposed Federal Rule of Evidence 509 – information "not otherwise available to the public pursuant to 5 U.S.C. §552."**

28 U.S.C. § 1828x

- **"Privileges not affected by disclosure to banking agency or supervisor."**
- **Submitting privileged information during a bank examination ≠ waiver.**

BERPA

- **Bank Examination Report Protection Act (BERPA)**
- **Would have added a "Bank Supervisory Privilege" to federal statutory law.**
- **"All confidential supervisory information shall be the property of the Federal banking agency that created or requested the information and shall be privileged from disclosure to any other person."**
- **Prohibit litigants from requesting bank examination reports from banks.**

Regulatory Policy

- "Non-public OCC information" includes examination records. 12 C.F.R. § 4.32(b)(1).
- "It is the OCC's policy regarding non-public OCC information that such information is confidential and privileged." 12 C.F.R. § 4.36(b).
- "Unauthorized disclosures prohibited. All non-public OCC information remains the property of the OCC. No supervised entity . . . may disclose non-public OCC information without the prior written permission of the OCC . . ." 12 C.F.R. § 4.36(d).

Origins 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

Origins 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."

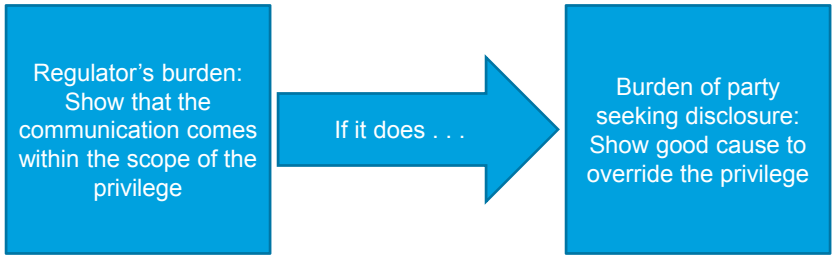
Rationale for the Privilege

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).**

Scope of the Privilege

- **"[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).**
- **"[P]urely factual material falls outside the privilege, whereas opinions and deliberative processes do not." *Merchants Bank v. Vescio*, 205 B.R. 47, 42 (D.Vt. 1997).**

Burden-Shifting Framework



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

Latest Developments

- **Extending the bank examination privilege to consumer protection exams?**
- **Interplay between bank examination privilege and state privilege law.**
- **The role of sovereign immunity.**

Consumer Protection Exams

***U.S. v. Ocwen Loan Servicing*, U.S. District Court, E.D.Tx., No. 4:12-cv-00543.**

- **June 2016: CFPB intervenes to assert the bank examination privilege.**
- **The CFPB's position: The privilege does cover CFPB supervisory information.**
- **Case settled before Court resolves the issue.**

Consumer Protection Exams

***Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc.*, 239 F.R.D. 508 (N.D.Ill. 2006).**

- **Securities fraud class action**
- **Plaintiff seeks state regulatory documents with respect to various Household branch offices.**
- **Several states assert the bank examination privilege.**
- **The Court rejects these assertions of the bank examination privilege because "it is undisputed that the regulated entities at issue here are not banks."**

Consumer Protection Exams

***Federal Housing Finance Agency v. JPMorgan Chase & Co.*, 978 F. Supp.2d 267 (S.D.N.Y. 2013): FHFA may assert the bank examination privilege.**

***Fairholme Funds, Inc. v. United States*, 128 Fed. Cl. 410 (2016), *aff'd in relevant part*, 2017 U.S. App. LEXIS 2059 (Fed. Cir. Jan. 30, 2017): Agrees that FHFA may assert the bank examination privilege.**

State Law

Example – 5 Del. C. § 145, entitled "Financial Institution Supervisory Privilege":

"[A]ll confidential supervisory information shall be the property of the [State Bank] Commissioner and shall be privileged and protected from disclosure to any other person and shall not be discoverable or admissible into evidence in any civil action; . . ."

State Law

Federal Rule of Evidence 501:

"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."

State Law

***United States ex rel. Fisher v. Ocwen Loan Servicing, LLC*, 2016 U.S. Dist. LEXIS 73759 (E.D.Tx. Jun. 7, 2016).**

- **Party seeks non-public examination records from West Virginia Department of Financial Services.**
- **The Court notes: "Clearly, these communications originated with an understanding that they would not be disclosed under state law."**
- **But the Court applies federal privilege law.**
- **The Court finds good cause to override the privilege.**

State Law

***SBAV LP v. Porter Bancorp. Inc.*, No. 3:13-CV-00710, U.S. District Court, W.D.Ky.**

- **Diversity-jurisdiction case.**
- **Party seeks records of examinations conducted by FDIC and Federal Reserve.**
- **Mar. 31, 2015 decision: The Court defers to Kentucky privilege law – which does not shield bank examinations – so the records are non-privileged.**

State Law

***SBAV LP v. Porter Bancorp. Inc.*, No. 3:13-CV-00710, U.S. District Court, W.D.Ky.**

- **Nov. 20, 2015: FDIC and Federal Reserve move for reconsideration (Dkt. No. 241-1).**
- **Their argument: The bank examination privilege isn't *just* a privilege. It's a substantive federal policy. So, it should override state law.**
- **Dec. 1, 2015: Based on settlement of case, Court vacates the Mar. 31 decision as moot – does not resolve the motion for reconsideration (Dkt. No. 244).**

State Law

- It really boils down to an *Erie v. Tomkins* issue.
- To overcome *Erie*, must show that there are "uniquely federal interests at stake." *Ungaro-Benages v. Dresdner Bank AG*, 379 F.3d 1227, 1233 (11th Cir. 2004).

Sovereign Immunity

Serving a subpoena on a federal regulator.

- *Yousuf v. Samantar*, 451 F.3d 248, 257 (D.C. Cir. 2006): No need to "graft onto discovery law a broad doctrine of sovereign immunity."
- *U.S. E.P.A. v. Gen. Elec. Co.*, 197 F.3d 592, 597 (2d Cir. 1999): A subpoena would "compel [an agency] to act and therefore is barred by sovereign immunity in the absence of a waiver."
- But the Second Circuit leaves open the possibility of using the Administrative Procedure Act (APA).

Sovereign Immunity

***Manzo v. Stanley Black & Decker, Inc.*, 2017 U.S. Dist. LEXIS 48038 (E.D.N.Y. Mar. 30, 2017).**

- **Notes that the Circuit split is still unresolved.**
- **"Some circuits utilize the arbitrary and capricious standard" set forth in the APA.**
- **But other circuits "rely on the standards set forth in Fed. R. Civ. P. 26 and 45, which federal courts typically apply in analyzing non-party subpoenas."**

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BUSINESS LAW TODAY

Ten Key Points about the Bank Examination Privilege

By Eric B. Epstein, David A. Scheffel, and Nicholas A.J. Vlietstra

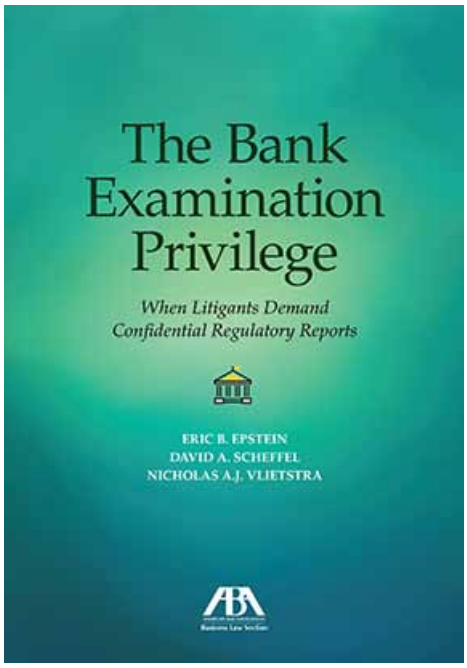
In January, the Business Law Section published The Bank Examination Privilege: When Litigants Demand Confidential Regulatory Reports *by Eric B. Epstein, David A. Scheffel, and Nicholas A.J. Vliestra, a practical, user-friendly resource to understand the intricacies of the bank examination privilege. The book is available to order at the Section member price of $69.95* here.

* * *

Bank examinations are integral to the government's supervision of the banking industry. A bank examination is an inspection of a bank or other financial institution by a federal or state regulator. The purpose of a bank examination is to assess the institution's financial health and/or its compliance with applicable laws and regulations.

Bank examinations generally are nonpublic. Typically, an examination report is not shared beyond the regulator and the bank. However, when a bank is involved in a lawsuit, keeping such records confidential can be difficult. In a lawsuit, a party may seek copies of such records in the hope of using them as evidence as trial.

That's where the bank examination privilege comes into the picture. The privilege



is a federal rule that shields examination records, to an extent, in federal litigation.

The bank examination privilege is an evidentiary privilege. Evidentiary privileges exempt specific types of evidence from disclosure during a lawsuit. The bank examination privilege evolved from federal judicial decisions, and thus can be classified as a federal common-law evidentiary privilege. In many states, state law also shields examination records. The term "bank examination privilege" usually is understood to refer to the overarching federal rule, rather than the rule that exists in any particular state.

The privilege has a number of nuances that counsel should keep in mind when representing a financial institution in a federal lawsuit. We review ten of them below. A more comprehensive overview of the privilege can be found in our new treatise, *The Bank Examination Privilege* (American Bar Association 2017).

1. The Privilege Belongs to Regulators

The privilege belongs to regulators, not banks. Therefore, in a lawsuit, when a party asks a bank to turn over confidential examination records, the bank should promptly reach out to the regulator that conducted the examination. If the regulator asserts the privilege, one of two things may happen next. First, the bank's adversary may back down. Second, the bank's adversary may ask the court to override the regulator's decision.

If the bank's adversary asks the court to

override the regulator's decision, the bank can remain neutral and let the dispute play itself out between the regulator and the bank's adversary. Often, however, the bank will actively work with the regulator to defend the privilege, and will submit arguments in support of the regulator's position.

2. Courts Follow a Specific Procedure When Applying the Privilege

To resolve disputes related to the privilege, courts follow a specific procedure. First, the court considers whether the examination records fall within the scope of the privilege. Different judicial decisions use different wording to describe the exact boundaries of the privilege. In essence, the privilege protects an examiner's confidential opinions and recommendations, and other deliberative aspects of the examination process.

The regulator bears the burden of showing that the records fall within the scope of the privilege. To determine whether the regulator has met this burden, a court may directly review the records, or a sampling of the records, in camera.

Next, if the records are privileged, the court will consider whether there is good cause to require disclosure of the records. The party seeking disclosure bears the burden of showing good cause. The good cause analysis usually focuses on five main factors: (1) the relevance of the records to the case; (2) whether the party can obtain the same information from other sources; (3) the seriousness of the case; (4) the government's role in the lawsuit, and (5) whether disclosure will have a chilling effect on future bank examinations.

In some cases, after conducting this analysis, the court makes an across-the-board determination that the privilege shields all, or none, of the sought-after examination records. In other cases, the court finds that the privilege protects some documents but not others, or covers particular portions of documents.

3. The Privilege Is Not Limited to ROEs

Often, at the conclusion of a bank examination, the examiner will prepare a formal report known as a Report of Examination, or ROE. Much of the case law regarding the privilege concerns the applicability of the privilege to ROEs.

However, the privilege is not limited to ROEs. The privilege can extend to any type of communication. When applying the privilege, the relevant question is not what form the communication takes. The relevant question is whether the substance of the communication reveals privileged information.

For example, the privilege can encompass:

- Regulator-to-bank communications other than ROEs, such as letters, e-mails, or oral communications;
- Internal agency communications that are not shared with banks;
- Bank-to-regulator communications, such as a response to an ROE; and/or,
- Internal bank communications that are not shared with regulators, such as internal bank e-mails discussing communications with an examiner.

4. The Privilege Is Not Only about Documents

The majority of judicial decisions regarding the privilege concern the applicability of the privilege to documents. But the privilege is equally applicable to oral testimony. When giving oral testimony at a deposition or at trial, a bank employee may be entitled to withhold privileged information about the bank's interactions with examiners.

5. Various Regulators May Assert the Privilege

Many of the legal precedents regarding the bank examination privilege involve three specific federal regulators: the Office of the Comptroller of the Currency (OCC), the Federal Reserve, and/or the FDIC. But that does not mean that the privilege is necessarily limited to these three regulators. Other federal regulators, such as the Consumer Financial Protection Bureau, also have taken the position that the privilege encompasses their communications with supervised institutions. Financial institutions should not assume that the privilege is confined to examinations by the OCC, Federal Reserve and/or FDIC.

6. The Privilege Is Distinct from FOIA Exemption 8

Outside of the litigation context, members of the public may ask administrative agencies to release records under the Federal Freedom of Information Act (FOIA). FOIA contains various exemptions that permit agencies to withhold specific types of records. Exemption 8 allows agencies to withhold records related to bank examinations.

At times, FOIA Exemption 8 is mistakenly conflated with the bank examination privilege. Clearly, FOIA Exemption 8 and the privilege stem from the same underlying concern: the need to preserve the confidentiality of bank examinations.

However, the exemption and the privilege focus on two different procedural situations. FOIA Exemption 8 applies to FOIA requests. The privilege governs the exchange of information in a lawsuit under the Federal Rules of Civil Procedure.

The exemption and the privilege also differ substantively. For example, as noted earlier, parties potentially can show good cause to override the privilege. By contrast, FOIA Exemption 8 does not contain a good cause exception.

7. The Privilege Is Not an Administrative Regulation

A variety of federal administrative regulations restrict the disclosure of bank examination records. For example, the OCC's policy is that such records are "non-public OCC information," and therefore are "confidential and privileged." *See* 12 C.F.R. § 4.36(b). As a result, the OCC "will not normally disclose this information to third parties."

The bank examination privilege is not a direct application of such regulations. The privilege recognizes that such regulations are grounded in reasonable concerns. However, the privilege is a common-law doctrine, not an administrative regulation.

8. The Privilege Is Related to the Deliberative Process Privilege

The deliberative process privilege shields the internal deliberations of administrative agencies. Some courts have described the bank examination privilege as an exten-

sion of the deliberative process privilege. In effect, the bank examination privilege extends the deliberative process privilege to cover a specific type of external agency communication: communications between agencies and financial institutions.

9. State Statutes Sometimes Displace the Privilege

In federal litigation, when the parties' claims and defenses are based solely in federal law, courts generally resolve privilege disputes by applying federal privilege law. By contrast, when the parties' claims and defenses are based solely on state law, federal courts usually decide privilege disputes by applying state privilege law.

Based on this rule, when a case involves federal-law claims and defenses, federal courts routinely apply the federal bank examination privilege. But in some state-law cases, federal courts instead have looked to state privilege law to determine whether bank examination records are privileged. Depending on the state, state privilege law may offer more, less, or the same degree of protection for examination records.

10. There Often Are Other grounds for Withholding Examination Records

The bank examination privilege is an important tool for keeping bank examination records confidential during a federal lawsuit. However, in many cases, there also are other valid reasons to withhold such records. For example, a bank may be able to show that such records are entirely irrelevant to the lawsuit. Such records also may come within the scope of other evidentiary privileges. For instance, if such records reflect communications between a bank and the bank's counsel, they may be subject to the attorney-client privilege. Because the bank examination privilege is not an absolute privilege, it is important for financial institutions to assert all applicable bases for withholding examination records.

The authors are partners at Dorsey & Whitney LLP and the authors of the new legal treatise, The Bank Examination Privilege *(American Bar Association 2017). Mr. Epstein may be reached at epstein.eric@ dorsey.com. Mr. Scheffel may be reached at scheffel.david@dorsey. com. Mr. Vlietstra may be reached at vlietstra.nicholas@dorsey.com.*