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Satisfying the Banking Regulators' "Right to Know" While Maintaining Confidentiality of Privileged Material: The Privileges and Protections Available to Banking Institutions

Financial institutions are daily under the microscope of myriad government regulators that must supervise our banking system while also seeking to protect the system's end-users—investors, customers, consumers, and other financial institutions. Indeed, representatives of one or more prudential regulators may be stationed onsite at all times. Although it is important to cooperate with regulators in the context of a supervisory examination (or enforcement investigation), financial institutions must also take care to protect confidential information and records to minimize their risks in the event of parallel enforcement actions and litigation. Navigating strategic decisions while balancing these two sometimes seemingly contradictory objectives—cooperation and confidentiality—can be challenging. The authors discuss means for addressing and preserving certain privileges and other protections that may be available to financial institutions in the context of internal investigations, supervisory examinations, enforcement inquiries, and civil litigation.

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Financial institutions often face situations that may put confidential information at risk of disclosure. Using a hypothetical scenario, this article addresses commonly confronted issues and identifies privileges and protections that may be at financial institutions' disposal—or, alternatively, be unenforceable. Furthermore, the case analyses we provide, while not exhaustive, can help to inform the decision-making of management and counsel who encounter these situations.

We focus primarily on the attorney–client and bank examination privileges, discussing the scope and limitations of those privileges and exploring how they may serve to protect confidential information in various contexts. Simply put, decisions made by a financial institution in the early stages of an internal investigation or regulatory examination may affect its ability to assert later a privilege.

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OVERVIEW OF APPLICABLE PRIVILEGES

Attorney–Client Privilege. The attorney–client privilege (ACP) applies to confidential communications, oral or written, between an attorney and his or her client that

relate to the provision or receipt of legal advice. The privilege allows for "full and frank communications" between attorneys and their clients.[1] Once deemed applicable, the ACP is absolute. But the privilege cannot be used as both a sword and a shield. The Federal Rules of Evidence provide that, if the client voluntarily waives the privilege in a federal proceeding and produces privileged material, the waiver extends to communications concerning the same subject matter that "ought in fairness to be considered together."[2] And, in general, waiver to one party constitutes waiver to all.[3]

In the supervisory context, financial institutions have a unique benefit with respect to the ACP. Under federal law,[4] a financial institution's disclosure of privileged information to a supervisory agency does not amount to waiver when the disclosure is in the course of the agency's supervisory or regulatory processes. In other words, providing privileged materials to a supervisory agency during an examination or investigation will not generally expose the financial institution to discovery of these materials during private litigation.

Work Product Doctrine. The work product doctrine (WPD) protects documents created by or at the direction of counsel in anticipation of litigation. The doctrine provides attorneys with a "zone of privacy" for developing their mental impressions and legal theories, "free from unnecessary intrusion by adversaries."[5] Codified by Rule 26 of the Federal Rules of Civil Procedure, the WPD may be overcome in discovery if the requesting party demonstrates "substantial need" for the protected materials and cannot obtain equivalent information without "undue hardship."[6]

Bank Examination Privilege. In addition to the protections that commonly arise during an attorney's representation of his or her client—namely, the ACP and the WPD—financial institutions, unlike other entities, may also receive the benefits of the bank examination privilege (BEP).

Originating in the common law, the BEP generally protects from disclosure communications between financial institutions and the agencies that supervise them. The privilege exists to "preserve candor" in these communications and, in turn, to facilitate effective supervision.[7] Importantly, the privilege and the information subject to the privilege belong to the regulator, not the financial institution. Thus, the regulator must be given the opportunity to assert and defend the privilege.[8] Furthermore, the privilege is qualified. The BEP does not cover "purely factual" material—i.e., materials that do not reflect the conclusions, opinions, or deliberations of the regulator.[9] And a court may override the BEP if the party requesting the protected documents demonstrates good cause, that is, a public interest in disclosure that outweighs the regulator's interest in confidentiality. Initially set forth in *In re Franklin National Bank Securities Litigation*, the five factors (referred to here as the "*Franklin* factors") that courts generally apply when balancing these interests include: (1) the relevance of the evidence at issue; (2) the availability of other evidence; (3) the seriousness of the litigation and the issues involved; (4) the role of the government in the litigation; and (5) the potential chilling effect on government employees that disclosure may cause.[10]

The following supervisory agencies may assert the BEP:

- The Office of the Comptroller of the Currency (OCC), which has supervisory authority over the national banking system;
- The Board of Governors of the Federal Reserve System (FRB), which has supervisory authority over bank holding companies, state member banks, savings and loan holding companies, and foreign banks operating in the United States, among other entities;
- The Federal Deposit Insurance Corporation (FDIC), which has supervisory authority over state chartered banks and savings institutions; and
- The Consumer Financial Protection Bureau (CFPB), which has supervisory authority over banks, thrifts, and credit unions with assets over

[1] Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 348 (1985).

[2] Fed. R. Evid. 502(a).

[3] See, e.g., In re Pac. Pictures Corp., 679 F.3d 1121, 1127 (9th Cir. 2012) (joining the majority of courts in rejecting the "selective waiver" theory and holding that disclosure of privileged communications to the government waives privilege "as to the world at large").

[4] 12 U.S.C. § 1828(x).

[5] United States v. Adlman, 134 F.3d 1194, 1196 (2d Cir. 1998).

[6] Fed. R. Civ. P. 26(b)(3).

[7] In re Bankers Trust Co., 61 F.3d 465, 471 (6th Cir. 1995). See also In re Subpoena Served Upon Comptroller of Currency, & Sec'y of Bd. of Governors of Fed. Reserve Sys., 967 F.2d 630, 634 (D.C. Cir. 1992) ("Because bank supervision is relatively informal and more or less continuous, so too must be the flow of communication between the bank and the regulatory agency.").

[8] *In re Bankers Trust*, 61 F.3d at 472.

[9] See In re Providian Fin. Corp. Sec. Litig., 222 F.R.D. 22, 26–28 (D.D.C. 2004) (quoting *In re Subpoena*, 967 F.2d at 634).

[10] 478 F. Supp. 577, 583 (E.D.N.Y. 1979). See also, e.g., Wultz v. Bank of China Ltd., 61 F. Supp. 3d 272, 283 (S.D.N.Y. 2013).

$10 billion, non-bank mortgage originators and servicers, payday lenders, private student lenders, and large participants of other consumer financial markets.

Each of these agencies has promulgated regulations to define the particular information subject to its privilege (known as "confidential supervisory information") and the parameters of disclosure.[11]

LEADING AN INTERNAL INVESTIGATION

Consider a scenario wherein an employee in ABC State Bank's accounting department reports to the in-house legal department possible instances of improper accounting fraud with respect to the treatment of certain real estate loans in the bank's financial statements. In response to this whistleblower complaint, ABC's general counsel directs her deputy to initiate an internal investigation of the bank's accounting and reporting of real estate loan values. How can the deputy general counsel ensure that the investigation and any work product remain confidential?

Identifying the "Client" and Staffing the Investigation. As an initial matter, the deputy should seek to identify the "client"—is it ABC State Bank, its board of directors, the general counsel function, or someone else? This will establish the holder of the ACP and clarify the primary lines of authority and supervision for the investigation.

The department responsible for conducting the investigation can be a crucial factor in the preservation of privilege. The U.S. Supreme Court has held that, when in-house counsel undertakes an internal investigation, the ACP extends to counsel's confidential communications with employees that concern matters within the scope of the employees' duties.[12] The same protection, however, would not apply if, for example, the accounting or human resources department led the investigation. Accordingly, by taking the lead or engaging external counsel at the outset, the deputy general counsel may increase the likelihood of protection over the investigative findings.

[11] State banking authorities have also codified the protection of confidential supervisory information. See, e.g., Mo. Ann. Stat. § 361.080 (requiring the Missouri Division of Finance to "keep secret all facts and information obtained in the course of all examinations and investigations"); Md. Code Ann., Fin. Inst. § 2-117.1 (providing that the Commissioner of Financial Regulation "may not disclose any information obtained or generated in the course of exercising the Commissioner's authority to examine banking institutions or credit unions").

[12] Upjohn Co. v. United States, 449 U.S. 383, 394–95 (1981).

Interviewing Employees Under *Upjohn*. When initiating an interview of a company employee as part of an internal investigation, the deputy or other counsel conducting the interview should provide what is commonly known as an "*Upjohn* warning" in order to avoid misunderstandings with respect to the scope of representation and the application of the ACP. An *Upjohn* warning notifies the employee that counsel represents the company (or the board, the audit committee, etc.) and not the company's employees, and that, while the interview is confidential and subject to the ACP, the company holds the privilege and may waive it at any time by sharing information with one or more third parties. In the context of interviews related to a government investigation, it generally is also advisable to inform the employee witness that the subject governmental agency is among the third parties to which information may be disclosed.

The U.S. Supreme Court has held that, when in-house counsel undertakes an internal investigation, the ACP extends to counsel's confidential communications with employees that concern matters within the scope of the employees' duties. The same protection, however, would not apply if, for example, the accounting or human resources department led the investigation.

The deputy counsel of ABC State Bank should memorialize the *Upjohn* warning and the employee's understanding and acknowledgement of it. This may prove useful if the employee later tries to claim privilege as to the interview record on the ground that he believed the investigating counsel represented him personally. In *United States v. Nicholas*, for example, the court expressed "serious doubts" as to whether an *Upjohn* warning was provided, given that the employee "did not remember being given any warning, no warning is referenced in [counsel's] notes from the meeting, and no written record of the warning even exists."[13] The court concluded that the employee had reason to believe the lawyers represented him personally. And, because counsel failed to consult the employee prior to disclosing his statements to third parties, the court held that counsel violated the duty of loyalty owed to the employee.

[13] 606 F. Supp. 2d 1109, 1116 (C.D. Cal. 2009), *rev'd on other grounds*, United States v. Ruehle, 583 F.3d 600 (9th Cir. 2009).

Also keep in mind that, if an employee could face individual liability (such as the employee responsible for overseeing the accounting of the Bank's real estate loans in the hypothetical), it may be appropriate for him to retain separate counsel for purposes of the interview.[14]

Considerations With Respect to Reporting the Investigation. Although a written investigative report is often a useful tool for making remedial or disciplinary decisions following an internal investigation, the bank may have difficulty maintaining the confidentiality of the report in the event of a regulatory investigation or private litigation, as illustrated below. Thus, ABC's general counsel may prefer to receive an oral report.

In 2006, Congress codified selective waiver as applicable to financial institutions, allowing their privileges to survive even after producing to certain supervisory agencies. Nevertheless, the bank may want to consider negotiating a confidentiality agreement with the FRB regarding the sharing of disclosed information or, alternatively, conveying to the FRB in writing the bank's expectations with respect to Section 1828(x).

Reporting the investigation to ABC's independent auditors could also jeopardize the privilege. When the conclusions of the investigation necessarily coincide with auditor reporting requirements, as in the case of potential accounting fraud, monitoring the flow of information to the auditor will become significant in preserving the ACP. Specifically, the Bank could provide the auditor with the facts developed through the investigation and the remedial steps taken afterward, without disclosing the deputy general counsel's conclusions, analysis, opinions, or recommendations.

CLAIMING PRIVILEGE (OR NOT) DURING EXAMINATION BY A PRUDENTIAL REGULATOR

Assume that, rather than conducting the investigation in-house, ABC State Bank's general counsel hires outside counsel to handle the investigation at the direction of the audit committee of ABC's board of directors. At the committee's request, outside counsel drafts a confidential investigative report ("the Report"), finding multiple supervisory deficiencies surrounding ABC's accounting procedures applicable to real estate loans. The Report is then provided to the bank's full board of directors.

A few months later, in a routine exam, the FRB requests, among other things, any written reports provided to ABC's board of directors in the past year. Can the bank claim that the ACP protects the Report? If so, should the bank make this claim? If not, is the Report nevertheless protected by the BEP?

Regulators' Recognition of the Attorney–Client Privilege. The Report, drafted by outside counsel for the purpose of providing legal advice to ABC State Bank, would almost certainly fall under the protection of the ACP and the WPD. Historically, the harder question was whether the bank should (or could) claim privilege over the Report and withhold it from the FRB. The concerns are twofold:

1. By disclosing the Report to the FRB, will ABC effectively waive privilege over the Report in connection with subsequent private litigation?
2. If ABC withholds the Report, will the FRB view the bank as uncooperative and thus be more inclined to open an investigation should the examination reveal possible misconduct?

As to the first issue, companies facing similar circumstances previously have tried to claim that disclosure of privileged information to the government does not constitute waiver as to third parties. But most courts historically rejected this "selective waiver" theory on the ground that it "does not serve the purpose of encouraging full disclosure to one's attorney in order to obtain informed legal assistance" and "extend[s] the privilege beyond its intended purpose."[15] In doing so, the courts have found unpersuasive the purported importance of governmental cooperation.[16] Consequently, under the common law, ABC, having already disclosed the Report to the FRB, would have had difficulty claiming the ACP over it in future litigation.

The legal landscape has changed, however. In 2006, Congress codified selective waiver as applicable to

[14] This becomes particularly important in criminal investigations, given increased focus by the Department of Justice, through the "Yates Memorandum," on disclosures by companies of individual officers and employees who may be culpable in return for cooperation credit. See Sally Q. Yates, Deputy Attorney General, U.S. Dep't of Just., "Individual Accountability for Corporate Wrongdoing" [the "Yates Memorandum"] (Sept. 9, 2015), available at https://www.justice.gov/dag/file/769036/download.

[15] *In re Pac. Pictures Corp.*, 679 F.3d at 1127 (quoting Westinghouse Elec. Corp. v. Republic of the Phil., 951 F.2d 1414, 1425 (3d Cir. 1991)).

[16] Id.

financial institutions, allowing their privileges to survive even after producing to certain supervisory agencies.[17] Federal law now provides that

> [t]he 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.[18]

Accordingly, courts likely will not consider ABC's production of the report to the FRB as a waiver in the event the Report is subsequently requested by other third parties. Nevertheless, to better ensure protection of information produced in reliance on Section 1828(x), the bank may want to consider negotiating a confidentiality agreement with the FRB regarding the sharing of disclosed information or, alternatively, conveying to the FRB in writing the bank's expectations with respect to Section 1828(x).[19] Either way, ABC should stamp produced documents as "privileged" and subject to Section 1828(x).

Given the protection of Section 1828(x), regulators may not be amenable to assertions of ACP, which goes to the second issue listed above. The FRB has suggested that its "statutory authority to conduct on-site examinations overrides any legal privilege the financial institution may have not to disclose the information," and requires an examiner to contact the FRB general counsel when a financial institution asserts privilege over books and records the examiner deems "reasonably necessary to carry out an effective examination."[20] Likewise, the OCC allows its examiners to request privileged materials when necessary for the evaluation of pending and potential litigation exposure.[21] Invoking privilege over protected materials, therefore, may be fruitless and, more pointedly, may be interpreted by the regulator as unwillingness to cooperate with the examination or investigation. If the regulator perceives a lack of cooperation, it may feel compelled to expand or intensify its review.[22]

If the privileged material is particularly sensitive, a financial institution may consider exploring alternatives to production of privileged materials, such as providing oral reports or factual presentations to the regulators, preparing executive summaries of the materials, or offering access to and inspection of the materials, among other things. Though the FRB will retain its discretion, the financial institution can propose these steps so as to position itself for maximum possible protection.

Protection Under the Bank Examination Privilege. The BEP may also protect materials provided to a supervisory agency during an examination.

The FRB defines "confidential supervisory information" to include, among other things, reports of examination, inspection, and visitation; confidential operating and condition reports; any information derived from, related to, or contained in such reports; information gathered by the FRB in the course of any investigation; and documents prepared by, on

[17] 12 U.S.C. § 1828(x).

[18] Id. The CFPB has promulgated a regulation that mirrors U.S.C. § 1828(x) and makes clear that the CFPB will not consider the submission of information to the CFPB in the course of its supervisory or regulatory process as a waiver of privilege. 12 C.F.R. § 1070.48(a).

[19] See, e.g., Maruzen Co., Ltd. v. HSBC USA, Inc., No. 00 CIV 1079, 2002 WL 1628782, at *1–2 (S.D.N.Y. July 23, 2002) (denying plaintiffs' motion to compel because the defendant had entered into confidentiality agreements with regulatory and investigative authorities (including the FRB) regarding documents produced in connection with its internal investigation) (citing In re Steinhardt Partners, L.P., 9 F.3d 230 (2d Cir. 1993); see also U.S. v. Wilson, 493 F. Supp. 2d 348, at 362 ("[A] question of selective waiver must be decided on a case-by-case basis, and . . . the existence of an express non-waiver agreement is a critical element of the analysis."). But see *In re Pac. Pictures Corp.*, 679 F.3d at 1128–29 (holding that the ACP had been waived as to documents produced to the Department of Justice, notwithstanding the existence of a confidentiality agreement).

[20] FRB, "Access to Books and Records of Financial Institutions During Examinations and Inspections" (SR 97-17, June 6, 1997), available at https://www.federalreserve.gov/boarddocs/srletters/1997/SR9717.HTM [herinafter "FRB SR 97-17"].

[21] OCC, *Comptroller's Handbook: Litigation and Other Legal Matters*, at 8 (Jan. 2015), available at https://www.occ.gov/publications/publications-by-type/comptrollers-handbook/pub-ch-m-litigation-and-other-legal-matters.pdf.

[22] The Securities and Exchange Commission (SEC) has considered a corporation's decision to waive the ACP over its internal investigation in deciding to forego an enforcement action. See SEC, "Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions" (Exchange Act Release No. 44696, Oct. 23, 2001), available at https://www.sec.gov/litigation/investreport/34-44969.htm [hereinafter the "Seaboard Report"]. Since the Seaboard Report, the SEC has evolved to accepting assertions of privilege, even while providing credit for cooperation, where the relevant non-privileged information was provided and the company took steps to assist the SEC with its investigation. SEC, Enforcement Manual, at 76 (Oct. 28, 2016) ("Voluntary disclosure of information need not include a waiver of privilege to be an effective form of cooperation and a party's decision to assert a legitimate claim of privilege will not negatively affect their claim to credit for cooperation."), available at https://www.sec.gov/divisions/enforce/enforcementmanual.pdf.

behalf of, or for the use of the FRB, a Federal Reserve Bank, or a federal or state supervisory agency.[23] The FRB has interpreted this regulation broadly to cover all documents "obtained from financial institutions during the course of examinations or inspections."[24] This definition, however, does not extend to documents "prepared by a supervised financial institution for its own business purposes and that are in its possession."[25]

The materials provided by ABC State Bank in furtherance of the FRB's examination likely fall under the FRB's BEP and thus receive additional protection from disclosure to third parties. The Report may not be covered by the privilege because ABC arguably prepared it "for its own business purposes." The bank should confirm with the FRB, preferably in writing, that the FRB would assert privilege over the Report and related materials if necessary. As will be discussed later, courts considering a discovery request may still decline to enforce the FRB's invocation of privilege.

Confidential supervisory information is the property of the supervisory agency, and a supervised financial institution cannot disclose it without authorization from the agency. Indeed, a supervised financial institution can face fines and other criminal or civil penalties for disclosing confidential supervisory information without authorization.

It also may be helpful to consider the parameters of "confidential supervisory information" as defined by other supervisory regulators.[26] To supplement the regulatory definition,[27] the CFPB has issued a bulletin providing examples of confidential supervisory information. These include:

- CFPB examination reports and supervisory letters;
- Information contained in, derived from, or related to those documents;
- Communications between the CFPB and the supervised financial institution relating to the CFPB's examination; and
- Other information created by the CFPB in exercise of its supervisory authority, including information requests and the supervised financial institution's responses.[28]

Like the FRB, the CFPB omits documents prepared by a financial institution for a business purpose.[29] Thus, if the CFPB conducted an examination of ABC State Bank, materials produced and exchanged would be similarly protected as "confidential supervisory information," though further clarification may be needed with respect to the Report.[30]

EVALUATING DISCLOSURE IN AN ENFORCEMENT ACTION

Next, suppose that the whistleblower reported his concerns to the CFPB. And in the midst of the FRB's examination, ABC receives a Civil Investigatory Demand (CID) from the CFPB. The CID requests all documents that contain communications with the FRB in connection with its examination. What steps should ABC State Bank take to respond to the CID without waiving the FRB's privilege?

Rules Governing the Disclosure of Confidential Supervisory Information Protected by the Bank Examination Privilege. Applicable regulations make clear that confidential supervisory information is the property of the supervisory agency, and a supervised financial institution cannot disclose it without authorization from the agency.[31] Indeed, pursuant to the OCC's regulations and longstanding policies joined by the OCC, FDIC, and FRB, a supervised financial institution can face fines and other criminal or civil penalties for disclosing confidential supervisory information without authorization.[32] Furthermore, the FRB has brought administrative actions against

[23] 12 C.F.R. § 261.2(c)(1).

[24] See FRB SR 97-17, supra note 20.

[25] 12 C.F.R. § 261.2(c)(2).

[26] For the OCC's and FDIC's definitions of "confidential supervisory information," see 12 C.F.R. § 4.32(b) and § 309.5(g)(8), respectively.

[27] 12 C.F.R. § 1070.2(i)(1).

[28] CFPB, "Treatment of Confidential Supervisory Information," Compliance Bull. 2015-01 (Jan. 27, 2015).

[29] 12 C.F.R. § 1070.2(i)(2).

[30] See CFPB, "Amendments Relating to Disclosure of Records and Information," 81 Fed. Reg. 58310, 58320 (Aug. 24, 2016) (emphasizing that the submission of business documents to the CFPB "does not convert" copies that remain in the possession of the financial institution into confidential information) [hereinafter "CFPB Proposed Rulemaking"].

[31] See 12 C.F.R. §§ 261.2(g) (FRB); 1070.47(a) (CFPB); 309.6(a) (FDIC); and § 4.36(d) (OCC).

[32] 12 C.F.R. § 4.37(b)(1)(ii); OCC, FDIC, FRB & Office of Thrift Supervision (OTS), "Interagency Advisory on the Confidentiality of the Supervisory Rating and Other Nonpublic Supervisory Information," at 1–2 (Feb. 28, 2005), available at https://www.federalreserve.gov/boarddocs/srletters/2005/SR0504a1.pdf.

entities for using and disclosing confidential supervisory information without authorization.[33]

There are certain exceptions, however, to this rule of nondisclosure:

- First, a financial institution can generally disclose confidential supervisory information in its possession to its affiliates without securing approval from the regulator, as well as to its directors, officers, and employees where the disclosure is relevant to the performance of their respective duties.[34]
- Second, a financial institution can generally disclose such information to certain consultants and service providers that it employs, e.g., public accountants and legal counsel.[35]

Otherwise, anyone seeking to make disclosure to a third party must request permission from the agency in accordance with the procedures promulgated by the agency.[36] The regulator has the authority to make confidential supervisory information available to nearly anyone who properly requests it. For example, upon request, the "Director of the Division of Banking Supervision and Regulation or the appropriate Federal Reserve Bank" may make BEP information available to other federal supervisory agencies (including the OCC, the FDIC, and the Federal Home Loan Bank Board), state supervisory agencies, and others as determined "necessary" by the FRB.[37] OCC regulations similarly allow the Comptroller to make non-public OCC information available to the FRB, the FDIC, and "in the Comptroller's sole discretion," other federal and state agencies, as well as foreign governments, "when necessary, in the performance of their official duties."[38]

To avoid inappropriate disclosure of the FRB's confidential supervisory information, ABC State Bank should involve the FRB in responding to the CID, and obtain the FRB's permission before disclosing potentially privileged information. The bank should also keep the CFPB apprised of these steps and make clear its intention to cooperate fully with the CID to the extent permitted by the FRB.

Note that regulators may also disclose confidential supervisory information to law enforcement and other supervisory agencies, such as the SEC, upon request. Specifically, FRB regulations provide that the FRB may disclose confidential supervisory information to "appropriate law enforcement agencies and to other nonfinancial institution supervisory agencies for use where necessary in the performance of official duties."[39] Any such agency seeking access to this information must "address a letter request to the Board's General Counsel" outlining the particular information sought, the reasons why information must be obtained from the FRB, a statement of purpose for the information, whether disclosure is permitted or restricted by law, and a commitment to non-disclosure.[40]

Accordingly, if the SEC, for example, begins an investigation of ABC State Bank as a result of the whistleblower's complaint and seeks documents exchanged between the bank and the FRB during the FRB's examination, the SEC could possibly gain access to this information by writing to the FRB general counsel. If satisfied that disclosure conforms to applicable law and regulations and that the information sought would remain confidential and assist the SEC with its official duties, the FRB may disclose the information.[41]

The Bank Examination Privilege in the Context of Enforcement Investigations. ABC State Bank should next consider the extent to which the BEP will serve to protect documents produced to the CFPB in response to the CID. The CFPB's definition of

[33] See In the Matter of Goldman Sachs Grp., Inc., Order to Cease and Desist (Aug. 2, 2016), available at https://www.federalreserve.gov/newsevents/press/enforcement/enf20160803a1.pdf (ordering the payment of $36.3 million as a civil penalty and ordering implementation of an enhanced program to ensure the proper use of confidential supervisory information).

The CFPB, in a proposed rulemaking posted last August, has considered regulations requiring "any person in possession of confidential information to immediately notify" the CFPB upon discovery of an unauthorized disclosure. See CFPB Proposed Rulemaking, supra note 30, at 58320. If promulgated, violations of this rule could potentially give rise to civil penalties pursuant to the CFPB's litigation authority under the Dodd-Frank Act. See 12 U.S.C. § 5564(a).

[34] 12 C.F.R. §§ 1070.42(b)(1) (CFPB); 261.20(b)(1) (FRB); 4.37(b)(2) (OCC); 309.6(a) (FDIC).

[35] 12 C.F.R. §§ 1070.42(b)(2) (CFPB); 261.20(b)(2) (FRB); 4.37(b)(2) (OCC). FDIC regulations *do not* provide for disclosure to consultants, but, under an interagency policy joined by the FDIC, supervised entities may grant external auditors access to confidential supervisory information when under audit. See FDIC, OCC, FRB, and OTC, "Interagency Policy Statement on Coordination and Communication Between External Auditors and Examiners" (July 24, 1992), available at https://www.fdic.gov/regulations/laws/rules/5000-3200.html.

[36] Under certain federal courts of appeals' interpretation of the Administrative Procedure Act, litigants may have to exhaust these procedures before moving to compel production from the agency. See *Wultz*, 61 F. Supp. 3d at 278–79 (discussing the circuit split on this issue).

[37] 12 C.F.R. §§ 261.20(c)–(e).

[38] 12 C.F.R. § 4.37(c). See also 12 C.F.R. § 309.6(b) (allowing the FDIC to disclose "exempt records" to state banking agencies, federal supervisory agencies, and foreign bank regulatory or supervisory authorities, for "good cause" and at the discretion of the FDIC Division with primary authority over the records).

[39] 12 C.F.R. § 261.21(a).

[40] 12 C.F.R. § 261.21(c).

[41] 12 C.F.R. § 261.21(d).

"confidential supervisory information" incorporates any documents "prepared by, or on behalf of, or for the use of the CFPB or any other Federal, State, or foreign government agency in the exercise of supervisory authority over a financial institution, and any information derived from such documents."[42] Accordingly, the CFPB's privilege likely overlaps the FRB's privilege and protects from disclosure those documents exchanged between ABC and the FRB during the FRB examination.

But, like the FRB, the CFPB has the discretion to disclose confidential supervisory information to others, including federal or state agencies with jurisdiction over the bank (upon written request) and "to law enforcement agencies and other government agencies in summary form to the extent necessary to notify such agencies of potential violations of laws subject to their jurisdiction."[43] In connection with the latter point, therefore, the CFPB could also disclose information received from ABC State Bank to the SEC without the SEC requesting it and without providing notice to the bank. Though the CFPB can "negotiate the terms governing the exchange of confidential information" with the SEC and other agencies,[44] it is possible that courts would view the disclosure as a waiver in relation to third parties.

The courts that have considered the application of Section 1828(x) have enforced it without question. Therefore, notwithstanding the disclosure to the supervisory agencies, the bank should claim the attorney–client privilege over the Report and the information and exchanges underlying it.

The scope of the CFPB's privilege is less clear with respect to the documents that are responsive to the CID but outside the scope of the FRB examination. However, the CFPB has promulgated regulations to govern the disclosure of "confidential investigative information," i.e., CID material and any material prepared by or provided to the CFPB in investigating or pursuing an enforcement action.[45] And, as a general matter, the CFPB treats confidential investigative information the same way as confidential supervisory information.[46] That said, case law appears to focus on the examination function of a supervisory agency in defining and applying the BEP, and in justifying the privilege, courts usually point to the need for candor specifically between banks and examiners.[47]

ASSERTING PRIVILEGE IN PRIVATE LITIGATION

The CFPB ultimately brings an enforcement action against ABC State Bank, and, without admitting or denying any violation, the bank settles charges related to its accounting with respect to real estate loans. The multimillion dollar settlement is published and publicly disclosed. Subsequently, shareholders of the bank bring suit, arguing that ABC has made corresponding misrepresentations in its public filings. Their discovery requests call for production of documents submitted to the FRB and the CFPB. Does the Bank have solid ground on which to object to this request?

Attorney–Client Privilege Protection. As explained above, even if ABC resolved to produce the Report to the FRB and/or the CFPB, Section 1828(x) allows the bank to assert privilege over the Report against third parties such as private litigants. The courts that have considered the application of Section 1828(x) have enforced it without question.[48] Therefore, notwithstanding the disclosure to the supervisory agencies, the bank should claim the ACP over the Report and the information and exchanges underlying it.

Bank Examination Privilege Protection. Recall that the BEP belongs to the regulator. Consequently, the bank cannot assert it over the requested documents. At the same time, the agencies' regulations prohibit disclosure to third parties. Indeed, FRB regulations require the holder of protected information to

[42] 12 C.F.R. § 1070.2(i)(1).

[43] 12 C.F.R. §§ 1070.43(b); 1070.45(a)(5). See also 12 C.F.R. § 309.6(b)(4) (authorizing the FDIC to disclose "to the proper federal or state prosecuting or investigatory authorities . . . copies of exempt records pertaining to irregularities discovered" and believed to constitute violations of the law or unsafe or unsound banking practices).

[44] 12 C.F.R. § 1070.43(d).

[45] 12 C.F.R. § 1070.2(h). The CFPB has proposed expanding the definition of "confidential investigative information" to include "any information obtained or generated in the course of Bureau enforcement activities, including general investigative activities that may not pertain to a specific institution." CFPB Proposed Rulemaking, supra note 30, at 58312.

[46] 12 C.F.R. §§ 1070.41(a) (policy of non-disclosure); 1070.43 (provisions for disclosure to law enforcement and other government agencies); 1070.45 (additional provisions for affirmative disclosure).

[47] See, e.g., *In re Bankers Trust Co.*, 61 F.3d at 471.

[48] See Alaska Elec. Pension Fund v. Bank of Am. Corp., No. 14-cv-7126, 2016 WL 6779901, at *4 (S.D.N.Y. Nov. 16, 2016); United States v. Heine, No. 3:15-cr-00238, 2016 WL 1270907, at *11 (D. Or. Mar. 31, 2016).

decline disclosure, even if ordered by the court.[49] Discovery requests targeting confidential supervisory information can thus leave financial institutions in a conflicted position.

Agency regulations attempt to address this conflict, providing means to notify and involve the agency in the event that its confidential supervisory information is the subject of a litigation request. FRB regulations require recipients of a demand for protected information to inform the FRB general counsel of the demand.[50] Similarly, OCC regulations require a supervised entity to notify the OCC's litigation division immediately upon receiving a request, subpoena, order, or motion to compel the production of nonpublic OCC information.[51] OCC regulations further provide that, if a party properly requested disclosure of protected information from the OCC and was denied, the party cannot disclose the information unless ordered by a federal court in a judicial proceeding where the OCC had an opportunity to appear and oppose discovery.[52] The FDIC likewise requires a person or entity in control of protected records to advise the FDIC general counsel promptly upon receiving a subpoena, court order, or other process requiring production.[53]

Though not as prescriptive, CFPB regulations also state that a supervised financial institution "should" inform the CFPB general counsel of a legally enforceable demand or request for confidential information "as soon as practicable after receiving it."[54] The provision further encourages supervised financial institutions to "consult with" the CFPB general counsel before complying with the request and, where possible, to give the CFPB "a reasonable opportunity to respond," assert appropriate legal exemptions or privileges on the CFPB's behalf, and consent to a motion by the CFPB to intervene.[55]

In general, agency regulations suggest an inclination toward non-disclosure as a matter of public policy. Under federal rules,[56] the CFPB and its employees, contractors, and consultants are barred from disclosing confidential information except as required by law or as otherwise provided in the regulations. Further, the FRB views confidential supervisory information as confidential and privileged" and "will not normally disclose this information to the public."[57]

Recently, the FRB successfully intervened in a federal case against a financial institution to assert the BEP over documents purportedly containing confidential supervisory information.[58] The financial institution had objected to the plaintiffs' discovery request and withheld these documents from production, asserting that it did not have authority from the FRB to waive the BEP. When the plaintiffs objected to this unilateral assertion of the BEP, the financial institution invited the plaintiffs to seek the documents from the FRB. The plaintiffs then filed a motion to compel. The FRB moved to intervene for the purpose of determining whether the documents contain confidential supervisory information subject to the FRB's disclosure regulations and, if so, asserting privilege over the documents. The court held that the FRB had a substantial legal interest in advancing the BEP and that, because the privilege belongs to the FRB, "no meaningful adversarial testing of the privilege will occur unless the Federal Reserve is given the opportunity to intervene."[59] The court thus granted the FRB's motion.

Note, however, that in evaluating the application of the BEP, courts may not exercise as broad an approach as the regulators and may discount competing regulations in favor of federal discovery rules. A key case from the U.S. Court of Appeals for the Sixth Circuit, *In re Bankers Trust Co.*, illustrates this conflict.[60] The plaintiff had moved to compel defendants to produce "all documents submitted to or received from the Federal Reserve," including those relating to examination and inspection of the bank.[61] The district court granted the motion. The defendant sought a writ of mandamus to vacate, arguing that, if it complied with the district court's order, it would violate the FRB's regulations prohibiting disclosure of confidential supervisory information, but if it did

[49] See 12 C.F.R. § 261.23(b). But see 12 C.F.R. § 1070.47(a)(4) ("Nothing in this section shall prevent a supervised financial institution . . . from complying with a legally valid and enforceable order of a court of competent jurisdiction compelling production of the CFPB's confidential information.").

[50] 12 C.F.R. § 261.23(a).

[51] 12 C.F.R. § 4.37(b)(3).

[52] 12 C.F.R. § 4.37(b)(1).

[53] 12 C.F.R. § 309.7(b).

[54] 12 C.F.R. § 1070.47(a)(3).

[55] Id.

[56] 12 C.F.R. § 1070.41(a).

[57] 12 C.F.R. §§ 261.22(a); see also 12 C.F.R. §§ 4.36(b) (providing that the OCC will not normally disclose nonpublic OCC information to third parties); 309.6(b)(10) ("All steps practicable shall be taken [by the FDIC] to protect the confidentiality of exempt records and information.").

[58] Local 295/Local 851 IBT Employer Group Pension Trust and Welfare Funds v. Fifth Third Bankcorp, No. 1:08-cv-421, 2012 WL 346658, at *1 (S.D. Ohio Feb. 2, 2012).

[59] Id. at *3 (citing *In re Bankers Trust Co.*, 61 F.3d at 472).

[60] 61 F.3d 465 (6th Cir. 1995).

[61] Id. at 467.

not comply, it would be subject to sanctions under the Federal Rules of Civil Procedure. The Sixth Circuit reasoned that "Congress did not empower the [FRB] to prescribe regulations that direct a party to deliberately disobey a court order, subpoena, or other judicial mechanism requiring the production of information."[62] To the extent the FRB regulations require this, the Sixth Circuit held, they "cannot be recognized by this court."[63] Nevertheless, the Sixth Circuit reversed the district court's order on the grounds that it did not separately consider application of the BEP under the common law.[64]

This case demonstrates that, if ABC State Bank contacts the FRB and CFPB, withholds the requested documents under their direction, and consents to their intervention in the case, there is some possibility that a court still may not give full credence to the regulations governing the protection of the confidential supervisory information, particularly if they conflict with a prior discovery order. Although courts generally may be expected to give weight to a regulator's position, financial institutions should take care to create an appropriate record of the factors supporting protection of the confidential documents.

Although courts generally may be expected to give weight to a regulator's position, financial institutions should take care to create an appropriate record of the factors supporting protection of the confidential documents.

A Qualified Privilege. As previously mentioned, the BEP is a qualified privilege that does not cover factual material and may succumb to a good cause showing evaluated under the *Franklin* factors. Therefore, ABC State Bank will probably have to produce the purely factual portions of the documents requested by the shareholders.

Notably, many courts consider bank examination reports as partially, if not entirely, factual. In another case, the plaintiffs moved to compel the defendant bank and the OCC to produce investigative files and regulatory communications related to the OCC's enforcement actions against the bank.[65] The court first determined that the OCC had not adequately asserted the privilege as to two categories of documents. With respect to the third category, the bank examination reports, the court found that the reports primarily contain factual, i.e., non-privileged information. The court ordered the bank to produce the factual portions of the OCC bank examination reports.[66]

Turning to the non-factual communications at issue, which included portions of the bank examination reports, certain submissions to the OCC, and related communications, the court held that the plaintiffs had established good cause in favor of disclosure. First, the court found that the documents were relevant to allegations of scienter, specifically, whether the bank knew of deficiencies in its anti-money laundering and counter-terrorism practices. Second, the court stated, plaintiffs could not substitute this evidence regarding scienter or collect it elsewhere. With respect to the third and fourth factors, the court stressed that "depriving international terrorist organizations of funding that could be used to kill American citizens [is] a profound and compelling interest."[67] Finally, the court characterized this case as one where the other *Franklin* factors outweigh the public interest in candor between banking regulators and banks.

Here, depending on the extent and import of the accounting deficiencies, a court may reach a similar conclusion with respect to the documents requested by shareholders, even if the CFPB and FRB assert the BEP. In short, the BEP is far from a foolproof privilege. When preparing documents for a banking regulator, banks should not count on it to fully protect their records in the event of future litigation. Given this risk,

[62] Id. at 470.

[63] Id.

[64] See also Houston Bus. J., Inc. v. OCC, 86 F.3d 1208, 1212 (D.C. Cir. 1996) ("This court has held that the district court owes no deference to the Comptroller in ruling on whether the documents are covered by the bank-examination privilege."); Newton v. Am. Debt. Servs., Inc., No. 11-cv-03228, 2014 WL 2452743, at *5 (N.D. Cal. May 13, 2014) (emphasizing that OCC and FDIC regulations governing the release of non-public information do not constitute independent privileges); Marketing Investors Corp. v. New Millennium Bank, Report & Recommendation, No. 3:11-cv-1696-D, 2012 WL 1357502, at *6–8 (N.D. Tex. Apr. 16, 2012) (holding that Congress "did not empower the FDIC to prescribe regulations that direct a party to deliberately disobey a subpoena or other legal process requiring the production of information" but allowing the FDIC the opportunity to review the relevant documents and assert protection under the BEP), *affirmed in relevant part*, 2012 WL 2900606, at *1–2 (N.D. Tex. June 5, 2012).

[65] *Wultz*, 61 F. Supp. 3d at 277–78.

[66] See also *In re Providian*, 222 F.R.D. at 27 (finding multiple pages of the OCC's bank examination report to be factual and outside of the BEP); Principe v. Crossland Sav., FSB, 149 F.R.D. 444, 448 (E.D.N.Y. 1993) (finding FDIC bank examination reports "to be factual either in whole or in part").

[67] *Wultz*, 61 F. Supp. 3d at 290 (internal quotation marks omitted).

banks should (at least) engage experienced counsel, record the materials provided to the regulator, and keep the regulator informed on third party requests for materials, among other things.

CONCLUSION

A financial institution should seek to cooperate with its prudential regulators by facilitating the flow of information necessary for their supervision. At the same time, the financial institution should seek to reduce the risk that disclosures of potentially privileged information may cause in the context of parallel enforcement proceedings and/or private litigation. Careful control over the use and dissemination of confidential information in the early stages of a supervisory examination may better position a financial institution in dealing with adverse parties—whether they are government agencies or private litigants. In some, but not all, cases, the benefits of disclosing privileged information to a regulator in the course of an examination may outweigh the risks associated with potential waiver of a privilege with respect to other parties and other proceedings. By safeguarding all privileges at an early stage, a financial institution retains control over disclosure decisions as well as the ability to properly evaluate in an orderly fashion whether they are in the best interests of the institution. ■