

Safety and Soundness

Capital
Adequacy
(C)

Asset
Quality
(A)

**Management
(M)**

Earnings
(E)

Liquidity
(L)

Sensitivity to
Market Risk
(S)

Other
Activities
(O)

Litigation and Other Legal Matters

January 2015

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Introduction

The Office of the Comptroller of the Currency's (OCC) *Comptroller's Handbook* booklet, "Litigation and Other Legal Matters," is prepared for use by OCC examiners in connection with their examination and supervision of national banks and federal savings associations (collectively, banks). Each bank is different and may present specific issues. Accordingly, examiners should apply the guidance in this booklet consistent with each bank's individual circumstances. When it is necessary to distinguish between them, national banks and federal savings associations will be referred to separately.

Overview

Pending or potential litigation can pose significant risks to banking organizations. Legal issues, such as lawsuits, unenforceable contracts, and adverse judgments, can disrupt bank operations, potentially reduce a bank's earnings and capital, and result in the loss of corporate focus, and forgone business opportunities. Therefore, bank management should develop timely and informative reports that ensure the board of directors remains fully informed of litigation and other legal issues. Bank management should establish effective processes to identify, monitor, and control litigation exposure. During an examination, the examiner should identify any pending or potential litigation involving the bank, assess the liabilities and potential impact from the litigation exposure, and determine whether the bank is effectively identifying, measuring, monitoring, and controlling the potential risks.

Types of Litigation Exposure

Litigation exposure can result from either bank-initiated or external-party-initiated lawsuits. Bank-initiated litigation occurs when bank management initiates legal proceedings for such reasons as to enforce contract rights, including loan and lease covenants; recover debts or obligations owed to the bank; foreclose on property in which the bank holds a security or ownership interest; or recover damages caused by insiders or third parties. In some cases, bank-initiated litigation results in a countersuit. External-party-initiated litigation occurs when an action has been threatened or initiated against the bank. This litigation may involve allegations of errors, omissions, violations of law, damages, or personal injury caused by the bank, its management, or its staff.

Risks Associated With Litigation and Other Legal Matters

From a supervisory perspective, risk is the potential that events, expected or unexpected, will have an adverse effect on a bank's earnings, capital, or franchise or enterprise value.¹ The OCC has defined eight categories of risk for bank supervision purposes: credit, interest rate, liquidity, price, operational, compliance, strategic, and reputation. These categories are not

¹ Enterprise value is an assessment of a bank's overall worth based on market perception of its ability to effectively manage operations and mitigate risk.

mutually exclusive. Any product or service may expose a bank to multiple risks. Risks also may be interdependent and may be positively or negatively correlated. The examiner should be aware of this interdependence and assess the effect in a consistent and inclusive manner. Refer to the “Bank Supervision Process” booklet of the *Comptroller’s Handbook* for an expanded discussion of banking risks and their definitions.

The primary risks associated with litigation and other legal matters are compliance and reputation. Litigation, however, can result from strategic, credit, compliance, and operational factors that should be managed to reduce its likelihood.

Compliance Risk

The OCC considers exposure to litigation (known as legal risk) a component of compliance risk. This exposure includes the cost of defending and settling lawsuits. Management should attempt to quantify the bank’s material exposure and associated liabilities that may result from pending or potential legal actions.

Reputation Risk

Litigation can expose a bank to negative public opinion. A damaged reputation may affect the bank’s ability to establish new relationships or services or to continue servicing existing relationships, which may adversely affect current and future earnings. Widely publicized litigation, regardless of its ultimate outcome, can affect a bank’s community standing, limit its business opportunities, and impair its basic franchise value. Some banks have elected to settle litigation rather than be subject to prolonged court cases. Settlement is designed to limit negative publicity and avoid prolonged reputation damage. Limiting reputation damage is particularly important for business lines, such as asset management, that depend on a sound reputation.

Other Factors

Strategic Factors

Litigation can result from improper strategic decisions, such as when a bank introduces new products or services. The bank should perform adequate due diligence to assess the risks of these new offerings and implement the appropriate internal control infrastructure to support the activity.

Credit Factors

Expenses associated with lender liability litigation can be substantial and potentially result in significant losses.² A bank must be able to demonstrate rational behavior consistent with past

² Lender liability refers to lawsuits between a lender and a borrower alleging that the lender failed to fully honor the terms of the loan contract.

practices, written policies and procedures, legal precedent, and standard industry practice to avert costly lawsuits and losses. Litigation can also involve derivative instruments, such as when a dealer bank must enforce contract terms against counterparties. As derivative contract terms lengthen, become more structurally complex, or involve higher-risk counterparties, the potential for litigation may increase.

Risk exposure is usually limited to the actual value of the transaction agreed to in the contract, but in certain cases, the potential liability from litigation can exceed the contractual amount. For example, a borrower who alleges that the bank violated the terms, conditions, or implied spirit of a credit agreement may further allege that the bank's actions caused damages through a resulting bankruptcy or liquidation that exceed the contract amount.

Compliance Factors

Banks may be subject to lawsuits for failure to comply with applicable laws and regulations. Litigation resulting from noncompliance can be costly as plaintiffs can seek actual and punitive damages as well as compensation for lost opportunity. For example, some Regulation Z (Truth in Lending Act) violations can result in treble damages.³ Similarly, litigation arising from a bank's failure to comply with fair-lending laws can have a significant monetary impact on the bank. In addition, if noncompliance with applicable statutes and regulations is pervasive, a bank may be exposed to class action litigation.

Operational Factors

A bank's operations can pose significant exposure to litigation. This exposure includes pending or potential litigation arising from flawed products, employee misconduct, internal and external fraud, inappropriate business practices, disruptions due to cyber-related attacks, improperly managed outsourcing, breach of fiduciary responsibility, unsafe workplaces, inappropriate employment practices, failures of internal processes or systems, incorrect or failed transaction execution, and disrupted business systems.

Risk Management

The OCC expects each bank to identify, measure, monitor, and control risk by implementing an effective risk management system appropriate for the bank's size and the complexity of its operations. When examiners assess the effectiveness of a bank's risk management system, they consider the bank's policies, processes, personnel, and control systems. Refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for an expanded discussion of risk management.

³ Treble damages can occur when a statute permits a court to triple the amount of the actual or compensatory damages to be awarded to a plaintiff following a favorable judgment.

Policies and Processes

Bank management should have policies and processes in place to reduce the likelihood of litigation prevent undue harm to the bank's reputation, control expenses associated with litigation, and mitigate potential liabilities.

For example, exposure to litigation from strategic decisions can be mitigated by a corporate culture that promotes high ethical standards, appropriate planning, sound due diligence, well-planned and well-executed implementation, appropriate delivery networks, compensation structures that do not encourage excessive risk taking, and effective risk management systems. A bank should develop policies and procedures that clearly define the role of the bank's legal counsel and other independent control functions in the approval process for new, expanded, or modified products and services, third-party relationships, and other strategic decisions.⁴

In addition, banks should develop a process for centralized oversight of all communication with bank customers and other groups regarding matters of pending and potential litigation. Management should initiate this process at the first indication that potential litigation may develop and should ensure that all communications are timely and appropriate.

Some private litigation may have importance to the entire banking industry. Management should notify the OCC's district counsel or Litigation Division if the bank is involved in lawsuits that raise significant legal or policy issues within the scope of the OCC's supervisory responsibility, such as the proper interpretation of federal banking laws.⁵ More formal notification is required for banks and their operating subsidiaries that are defendants in proposed class action settlements involving activities regulated by the OCC.⁶ In addition, banks and their operating subsidiaries should establish procedures to ensure that counsel representing them receive OCC Bulletin 2006-20, "Class Action Fairness Act of 2005: Guidance for Filing Notices of Proposed Class Action Settlements."

⁴ Refer to OCC Bulletin 2004-20, "Risk Management of New, Expanded, or Modified Bank Products and Services: Risk Management Process" (Note: OCC Bulletin 2004-20 has not been applied to FSAs as of the publication date of this booklet, but its concepts are broadly applicable) and OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance."

⁵ OCC Bulletin 1996-40, "Notice of Important Litigation: Message to Bankers," provides guidance for supervisory communication and notification around lawsuits.

⁶ OCC Bulletin 2006-20, "Class Action Fairness Act of 2005: Guidance for Filing Notices of Proposed Class Action Settlements," provides guidance for filing notices of proposed class action settlements set forth in 28 USC 1715.

To identify potential litigation and reduce its likelihood, a bank should have legal counsel (internal or external) participate in reviews of

- new products and services, to identify areas of potential legal exposure. These reviews should encompass existing products, services, and processes that are significantly modified and the use of third parties in delivering products and services.
- loan or investment documents the bank uses to ensure compliance with legal requirements or evaluate the legality of particular transactions.
- all correspondence for potential liability issues.
- identified emerging risk issues and root cause analyses of large loss events.⁷

To measure and monitor litigation and its impact, a bank should

- establish and maintain a management information system (MIS) that informs the board and management of pending and potential litigation in a timely and accurate manner.
- assess realistic potential losses posed by pending or potential litigation.
- incorporate a review system that tracks and evaluates litigation exposure for every product and service offered.

To control litigation and mitigate its impact, a bank should

- establish a culture of ethical standards and ensure that compensation systems are aligned with risk management objectives.
- develop written policies for monitoring and managing litigation.
- maintain adequate capital or specific contingency reserves⁸ to cover potential judgments or settlements consistent with generally accepted accounting principles.⁹
- implement systems and controls to ensure continual and full compliance with current laws, regulations, and other legal requirements.
- implement training programs and internal control processes to identify, limit, and manage litigation exposure.
- seek legal advice and assistance to reduce the risk of potential claims becoming actively litigated claims.
- oversee and monitor any outsourcing of or third-party arrangements for legal services.

⁷ The purpose of root cause analysis is to determine the specific reasons a loss event occurred, including losses related to litigation, through identifying any specific control breakdowns that were contributing factors in the loss event and, following this analysis, to develop corrective action plans to mitigate such future losses.

⁸ OCC Bulletin 2011-21, “Advanced Measurement Approaches for Operational Risk: Interagency Guidance on the Advanced Measurement Approaches for Operational Risk,” provides specific guidance on how banks subject to the Basel III Advanced Approaches Capital Standards should address legal loss contingencies.

⁹ ASC 450, “Contingencies for Gain or Loss,” calls for establishing a reserve for loss contingencies, including those that may result from pending or potential litigation, when it is probable that a liability has been incurred, when it is probable that the fact of the loss will be confirmed by future events, and when the amount of loss can be reasonably estimated.

Insurance Coverage

Insurance coverage is a risk mitigating control against adverse legal settlements. The adequacy and type of insurance coverage should take into consideration the bank's financial capacity to self-insure, the bank's overall risk profile, complexity of its operations, and its methods of assessing and controlling risk. Insurance deductibles should be reasonable and attention should be given to maintaining sufficient coverage. See the *Comptroller's Handbook* booklet "Risk Management and Insurance" for further details on the various types of insurance. Insurance coverage should never be relied on to mitigate poor operational controls or the absence of proper managerial attention.

Internal and External Audit Activities

An evaluation of risks goes beyond just those activities executed by the legal counsel. Any area of the bank that is subject to litigation and other legal matters should be considered in the bank's audit program coverage. When assessing the risk posed by the bank's business functions, the auditor should consider

- the nature of the operation and related assets and liabilities.
- whether the operation's policies and internal control standards are adequate.
- whether operating procedures and internal controls are effective.
- whether errors or irregularities associated with the business function could be material.
- the appropriateness of insurance coverage.

Examiner Guidance

Evaluating Litigation

To evaluate a bank's exposure to litigation and its impact on the bank's risk profile, the examiner must know about any significant pending or potential litigation against the bank. As part of the safety and soundness examination, the examiner should obtain from the bank a list of any such litigation. Between examinations, bank management has a responsibility to keep the examiner apprised of significant pending litigation changes and any significant potential new litigation.

The Class Action Fairness Act requires national banks and federal savings associations, their operating subsidiaries, and federal branches and agencies to notify the OCC of proposed class action settlements involving activities regulated by the OCC, such as deposit-taking or lending practices, or practices associated with other bank products or services. The examiner should discuss significant pending or potential litigation with management and request information on claims, contingent liabilities, and other legal matters that have a reasonable likelihood of impairing assets or incurring liabilities. Contingent liabilities should include unsettled and outstanding claims or assessments and the anticipated cost of defending such claims.

These materials, and the examiner's evaluation of relevant internal controls, are the principal basis for evaluation of litigation exposure. In evaluating the bank's litigation exposure, the examiner should consider the duration and likely outcome of the litigation and whether management has effectively managed the litigation process.

The examiner should consider whether individual suits concerning the same or similar issues indicate a pattern or practice that requires management and supervisory attention. When finding unanticipated risks or what appears to be a recurring pattern of litigation, the examiner should discuss the matter with the board and management. The examiner should consult with OCC legal counsel when assessing litigation activities to determine whether an action plan is needed to eliminate or mitigate the litigation's potential impact and the risk exposure to the bank.

When assessing bank-initiated litigation, the examiner should rely on bank management discussions, internal bank reports, and materials provided by internal or external legal counsel. The examiner should not attempt to make complex legal judgments based on such information. Depending on the significance of the events or conditions, the examiner should interview bank personnel who, according to the bank, are knowledgeable about the matters in litigation. If the information provided does not adequately address the examiner's concerns, the examiner should, upon consulting with the supervisory office and OCC legal counsel, request that management obtain a letter from the bank's attorneys that corroborates and evaluates the information. Requests should be limited to issues or matters in litigation that are significant or potentially significant to the bank's earnings or capital and may include information regarding exposures associated with certain external-party-initiated litigation.

If litigation initiated by external parties is significant, the examiner should interview bank personnel who, according to the bank, are knowledgeable about the matters in litigation to properly identify and assess the litigation's associated risks. In addition, the examiner should obtain a determination from bank management whether its insurance coverage mitigates potential losses or legal costs.

The examiner should make all requests to bank management for information from external legal counsel, because the bank is likely to incur legal fees for the time required to research and respond to such inquiries. For this reason, the examiner should weigh the cost of gathering the requested information against the litigation's overall risk to the bank. The OCC should not place an undue burden on the bank if the risk exposure is known to be, or is likely to be, nominal.

The examiner should not assume that the bank's legal counsel (internal or external) will keep the OCC informed of developments after the initial response. If it is believed that material litigation may evolve, the examiner should ensure that bank management reports significant information to the portfolio manager or Examiner-In-Charge as part of ongoing supervision. The examiner may also consider following up later, depending on the nature and significance of pending or potential litigation.

Banks are occasionally involved in private litigation on an issue of importance to the entire industry. Accordingly, the examiner should determine, based on information received from the bank and the bank's legal counsel, whether a lawsuit raises significant legal or policy issues within the scope of the OCC's supervisory responsibility, such as the proper interpretation of federal banking laws. Bankers and the examiner should bring such litigation to the attention of OCC legal counsel.

Access to Privileged Materials

The examiner should request any MIS to be able to evaluate pending and potential litigation exposure and legal analysis of the bank's products and services. Depending on the type of product, service, or transaction being evaluated and the level of risk exposure to the bank, the examiner may find it necessary to discuss with the supervisory offices and OCC legal staff to request access to the bank counsel's legal opinions and reviews. Such opinions and reviews, whether they are the work of internal or external legal counsel, may be protected by attorney-client or work-product privilege.

The examiner should seek to obtain needed information from sources that are not privileged. In those few instances when access to privileged materials or information is considered necessary, the examiner, in consultation with OCC legal counsel, should evaluate how to obtain the needed information. Procedural guidelines that the examiner and legal counsel should consider include the following:

- Requesting privileged documents only when there is material risk exposure to the bank's earnings or capital.
- Limiting the form and scope of requests for privileged documents.
- Exchanging written communications with the bank that
 - set forth the precise identity of the materials being provided,
 - confirm the OCC's and the bank's expectations that the privileged materials are being provided pursuant to the agency's examination authority,¹⁰ and
 - confirm that the confidentiality of the materials will be maintained to the extent required or permitted by law.

When a bank discloses privileged information to an examiner during an examination, the bank does not waive its privileges.¹¹ Nevertheless, the OCC recognizes that its and the bank's common interest in encouraging forthright and open communications is best maintained by taking appropriate steps during an examination to safeguard a bank's privileged materials.

¹⁰ The OCC examines national banks and federal savings associations pursuant to authority conferred by 12 USC 481 (with respect to national banks) and 12 USC 1463(a)(1) and 12 USC 1464 (with respect to federal savings associations) and the requirements of 12 USC 1820(d) (with respect to national banks and federal savings associations). The OCC examines federal branches and agencies pursuant to the authority conferred by 12 USC 3105(c)(1)(C).

¹¹ 12 USC 1828(x)

Examination Procedures

This booklet contains expanded procedures for examining specialized activities or specific products or services that warrant extra attention beyond the core assessment contained in the “Community Bank Supervision,” “Large Bank Supervision,” and “Federal Branches and Agencies Supervision” booklets of the *Comptroller’s Handbook*. Examiners determine which expanded procedures to use, if any, during examination planning or after drawing preliminary conclusions during the core assessment.

Scope

These procedures are designed to help the examiner tailor the examination to the specific bank being examined and determine the scope of the litigation and other legal matters examination. In developing the examination procedures, the examiner should also consider work performed by internal and external auditors, by other independent risk control functions, and by other examiners on related areas. Examiners need to perform only those objectives and steps that are relevant to the scope of the examination as determined by the following objective. Seldom will every objective or step of the expanded procedures be necessary.

Objective: To determine the scope of the examination of litigation and other legal matters and to identify examination objectives and activities necessary to meet the needs of the supervisory strategy for the bank.

1. Review the following sources of information, and note any previously identified problems related to litigation and other legal matters that require follow-up:
 - Supervisory strategy
 - Examiner-in-Charge’s (EIC) scope memorandum
 - Information obtained from ongoing supervision
 - Previous reports of examination (ROE) or supervisory letters (SL) and work papers
 - Bank management’s responses to previous ROEs or SLs
 - Customer complaints
2. Obtain from bank management a list of significant pending litigation. What qualifies as “significant” should be determined after consultation with the EIC. Consider
 - the nature of the litigation.
 - the background of the parties involved (individuals, corporations, advocacy groups, etc.).
 - the progress of the case to date.
 - bank management’s response or intended response.
 - the likelihood of an unfavorable outcome.
 - the cost to pursue the litigation and an estimate of the potential losses.

3. Obtain from the examiner assigned to review bank audits a list of any significant litigation noted in the latest review performed by the internal or external auditors.
4. Obtain from management a list of any potential litigation or claims for damages that have been or may be asserted and the outcomes of which would likely be unfavorable to the bank. Consider
 - the nature of the matter.
 - the relationship of the involved parties.
 - how management intends to respond if litigation is commenced or a formal claim for damages asserted.
 - the potential exposure if the claim is asserted and the estimated cost of defending the claim.
5. Obtain and review the list of attorneys and legal firms to whom or which the bank has referred litigation and related matters. Consider
 - potential conflicts of interest between attorneys or legal firms and the bank, for example, insider or lending relationships.
 - approval by the board of directors to contract counsel to represent the bank.
6. Review findings from other areas under examination and identify any litigation risks. Consider especially areas where litigation is prevalent. Examples of these areas include
 - asset management.
 - Bank Secrecy Act/Anti-Money Laundering management.
 - fair lending.
 - insider activity.
 - third-party relationships.
 - consumer protection related to deposits.
7. Based on an analysis of information obtained in the previous steps, as well as input from the EIC, determine the scope and objectives of the litigation and other legal matters examination.

Quantity of Risk

Conclusion: The quantity of each associated risk is (low, moderate, or high).

Objective: To determine the associated risks by assessing whether pending or potential litigation, claims, or contingent liabilities against the bank exist and quantifying their potential effect on capital, earnings, and financial soundness.

1. Evaluate management's list of pending litigation and analysis of potential litigation risks for their impact on the financial condition of the bank. Consider whether
 - the bank maintains adequate insurance coverage for errors and omissions, liability, personal injury, and related risks.
 - a contingency reserve would be appropriate.
 - a common or recurring pattern or practice or a concentration of legal actions points to a systemic problem in an area of the bank.
2. After consulting with the supervisory office and OCC legal counsel, request management provide a briefing paper or synopsis from the bank's legal counsel. This document summarizes the material facts, legal issues, and likelihood of success of significant or potentially significant pending or potential litigation. If the document is not provided or does not contain sufficient information to properly assess the risks, contact the appropriate OCC legal counsel for assistance.
3. Review the level of actual legal expenses versus potential expenses to measure the possible effect on earnings and capital levels.
4. Assess the nature of pending and potential litigation to evaluate the level of reputation risk.

Quality of Risk Management

Conclusion: The quality of risk management is
(strong, satisfactory, or weak).

The conclusion on risk management considers all risks associated with litigation and other legal matters.

Policies

Policies are statements of actions adopted by the bank to pursue certain objectives. Policies often set standards (on risk tolerances, for example) and should be consistent with the bank's underlying mission, values, and principles. A policy review should always be triggered when the bank's objectives or standards change.

Objective: To determine whether the board and management have established appropriate guidelines for managing the risks of litigation and other legal matters.

1. Review the bank's policies on litigation and other legal matters. Determine whether the policies provide guidance to
 - establish procedures for reviewing the risks of potential litigation.
 - establish procedures for reviewing the bank's products and services for legal compliance.
 - establish procedures for creating legal loss contingencies.
 - efficiently address risk.
2. Determine whether the policies are reviewed and approved by the board or a board designated committee.
3. Determine whether the policies are communicated in a proper and timely manner to appropriate personnel.

Processes

Processes are the procedures, programs, and practices that impose order on the bank's pursuit of its objectives. Processes define how daily activities are carried out. Effective processes are consistent with the underlying policies and are governed by appropriate checks and balances (such as internal controls).

Objective: To determine whether board and management have established adequate and effective processes and systems to identify and manage litigation risk.

1. Determine the adequacy of processes for monitoring litigation. Consider whether

- the board receives sufficient information and discusses significant pending and potential litigation.
 - management communicates significant pending and potential litigation with legal counsel in a timely manner.
 - litigation loss contingency reserves are established in accordance with bank policy and ASC 450, “Contingencies for Gain or Loss.”
2. Determine whether the bank’s processes for obtaining legal review of the bank’s new products, services, and systems are adequate. Consider whether these processes
 - ensure full compliance with applicable laws, rules, and regulations.
 - take into account the potential for litigation associated with product liability.
 3. Determine whether management engages the bank’s general legal counsel, or outside legal counsel, to review documents (for example, contracts, agreements, or disclosure statements) that the bank uses to ensure that all bank activities comply with current legal requirements.
 4. Determine whether the bank uses independent legal counsel when a member of bank management is involved in litigation in an official capacity and uses highly specialized legal counsel when significant litigation is threatened.
 5. Determine whether management is alert to new legislation and regulatory rules to ensure the bank’s compliance practices are current.
 6. Determine whether the bank has processes in place to track regulatory changes and obtain updates on current legal interpretations relevant to its operations.
 7. Evaluate bank notification processes and practices to determine that appropriate officials and agencies are notified in a timely manner of any pending class action litigation.

Personnel

Personnel are the bank staff members and managers who execute or oversee processes. Personnel should be qualified and competent to appropriately conduct their duties. They should understand the bank’s mission, values, principles, policies, and processes. Banks should design compensation programs to attract, develop, and retain qualified personnel. In addition, compensation programs should be structured in a manner that encourages strong risk management practices.

Objective: To determine whether the board, management, and affected personnel adequately understand the concepts of risk associated with litigation and other legal matters and whether they can adequately manage such risk.

1. Determine whether established training programs ensure that employees are thoroughly trained and understand their responsibilities regarding the legal requirements of the bank's products and services.
2. Evaluate how well the bank's staff members understand conflicts of interest and whether they have the technical skills to avoid such conflicts. To test staff members' understanding, determine, for example, whether the bank conducts educational programs to foster staff members' awareness of the importance of not only avoiding conflicts but also the appearance of such conflicts.
3. If the bank uses external counsel, determine whether oversight is consistent with OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance."

Control Systems

Control systems are the functions (such as internal and external audits, independent risk management, and quality assurance) and information systems that bank managers use to measure performance, make decisions about risk, and assess the effectiveness of processes. Control functions should have clear reporting lines, adequate resources, and appropriate authority. MIS should provide timely, accurate, and relevant feedback.

Objective: To determine whether management has established appropriate control systems for litigation and other legal matters and whether these controls and overall insurance protection are sufficient.

1. Review copies of recent reports prepared by internal or external auditors regarding litigation and other legal matters. Consider
 - the significance of disclosed litigation issues.
 - the audit scope of internal controls and adequacy of MIS regarding litigation-related issues.
 - whether audit reviews verify management's analysis of litigation risk.
 - recommendations for resolving problems or weaknesses in the process for assessing litigation-related risk.
 - management's responses and whether corrective actions have been initiated or completed.
 - any audit follow-up activities.
2. Determine whether any pending litigation initiated by the bank or an external party indicates weakness in controls.
3. Determine whether the bank's legal counsel has reviewed new products, services, systems, and processes to ensure compliance with current regulations and legal requirements. Such reviews should take place whether the innovations are purchased or developed and before the innovations are introduced to the public. If such reviews have not taken place, determine whether the board and management have

- evaluated risks adequately.
 - made informed decisions with regard to potential legal exposure.
4. Determine whether legal counsel periodically reviews all of the bank's products, services, systems, and processes to ensure continuing and full compliance with current regulations and legal requirements. If not, determine whether management has evaluated risks and made informed decisions regarding potential legal exposure.
 5. Determine the appropriateness of the bank's overall insurance coverage. Consider
 - the type of coverage.
 - the amount of coverage relative to the historical level of external-party litigation and the significance of pending or potential litigation.
 - the reasonableness of the deductibles.
 - if the bank does not have insurance coverage, the bank's capacity to self-insure, taking into consideration the bank's financial condition, overall risk profile, staff capability, and the complexity of its operations.

Conclusions

Conclusion: The aggregate level of each associated risk is
 (low, moderate, or high).
 The direction of each associated risk is
 (increasing, stable, or decreasing).

Objective: To determine, document, and communicate overall findings and conclusions regarding the examination of litigation and other legal matters.

1. Determine preliminary examination findings and conclusions and discuss the following with the EIC:
 - Quantity of associated risks (as noted in this booklet’s “Introduction” section).
 - Quality of risk management.
 - Aggregate level and direction of associated risks.
 - Overall risk of litigation and other legal matters.
 - Violations and other concerns.

Summary of Risks Associated With Litigation and Other Legal Matters				
Risk category	Quantity of risk (Low, moderate, high)	Quality of risk management (Weak, satisfactory, strong)	Aggregate level of risk (Low, moderate, high)	Direction of risk (Increasing, stable, decreasing)
Compliance				
Reputation				

2. Discuss examination findings with bank management, including violations, recommendations, and conclusions about risks and risk management practices. If necessary, obtain commitments for corrective action.
3. Compose conclusion comments, highlighting any issues that should be included in the ROE or SL. If necessary, compose a matters requiring attention comment.
4. Update the OCC supervisory information system and any applicable ROE schedules or tables.
5. Write a memorandum specifically setting out what the OCC should do in the future to effectively supervise litigation and other legal matters in the bank, including time periods, staffing, and workdays required.

6. Update, organize, and reference work papers in accordance with OCC policy.
7. Ensure that any paper or electronic media that contain sensitive bank or customer information are appropriately disposed of or secured.

References

Law

- 12 USC 481, “Appointment of Examiners; Examination of Member Banks, State Banks, and Trust Companies; Reports”
- 12 USC 1463(a)(1), “Supervision of Savings Associations”
- 12 USC 1464, “Federal Savings Associations”
- 12 USC 1820(d), “Administration of Corporation”
- 28 USC 1711 et seq, “The Class Action Fairness Act of 2005”
- 28 USC 1715, “Notifications to Appropriate Federal and State Officials”

Comptroller’s Handbook

Examination Process

- “Bank Supervision Process”
- “Community Bank Supervision”
- “Federal Branches and Agencies Supervision”
- “Large Bank Supervision”

Safety and Soundness, Management

- “Risk Management and Insurance”

OCC Issuances

- OCC Bulletin 1996-40, “Notice of Important Litigation: Message to Bankers”
(July 29, 1996)
- OCC Bulletin 2004-20, “Risk Management of New, Expanded, or Modified Bank Products and Services: Risk Management Process” (May 10, 2004)
- OCC Bulletin 2006-20, “Class Action Fairness Act of 2005: Guidance for Filing Notices of Proposed Class Action Settlements” (April 21, 2006)
- OCC Bulletin 2011-21, “Advanced Measurement Approaches for Operational Risk: Interagency Guidance on the Advanced Measurement Approaches for Operational Risk”
(June 3, 2011)
- OCC Bulletin 2013-29, “Third-Party Relationships: Risk Management Guidance”
(October 30, 2013)

Other

- FASB Accounting Standards Codification 450, “Contingencies for Gain or Loss”