100 Broad Street New York, NY 10004 tele 212.612.9205

norm.nelson@theclearinghouse.org





August 7, 2008

Mr. Russell G. Golden Technical Director Financial Accounting Standards Board 401 Merritt 7 Norwalk, CT 06856-5116

Re: <u>Proposed Statement of Financial Accounting Standards – Disclosure</u>

of Certain Loss Contingencies - File Reference No. 1600-100

Dear Mr. Golden:

The Clearing House Association L.L.C. ("The Clearing House"), an association representing many of the largest banks operating in the United States, appreciates the opportunity to comment on the proposal (the "Proposal") by the Financial Accounting Standards Board (the "FASB") to promulgate a statement of Financial Accounting Standards on Disclosure of Certain Loss Contingencies through amendment of FASB Statements No. 5 ("FAS 5")

The members of the Clearing House are ABN AMRO Bank N.V.; Bank of America, National Association; The Bank of New York Mellon; Citibank, N.A.; Deutsche Bank Trust Company Americas; HSBC Bank USA, National Association; JPMorgan Chase Bank, National Association; UBS AG; U.S. Bank National Association; Wachovia Bank, National Association; and Wells Fargo Bank, National Association.

and 141(R). Our comments focus on the proposal to revise significantly the approach to dealing with litigation contingencies reflected in FAS 5.

We share the FASB's objective of ensuring that financial statements contain accurate and useful information regarding contingencies arising from litigation. We respectfully suggest, however, that the approach embodied in the Proposal is flawed and would prove counterproductive. In summary, we believe that:

- (i) the approach embodied in current FAS 5 is sound;
- the proposed approach would frustrate rather than promote useful disclosure of litigation exposure;
- (iii) there is a simpler and obvious alternative to address concerns that disclosure of litigation exposure in some cases is not prompt or appropriately specific;
- (iv) the proposed approach would result in substantive harm to the issuers of financial statements and their shareholders;
- the proposed approach does not promote convergence with international accounting standards;
- (vi) the proposed approach would be extremely difficult to implement in practice; and
- (vii) adoption of the proposed approach is likely to discredit, rather than bolster confidence in, U.S. accounting and disclosure requirements.

We believe the fundamental flaw of the Proposal is that it fails to consider the fundamental nature of our litigation system. The reality is not that issuers are withholding from the market reliable estimates of litigation exposure. Rather, the reality is that issuers often cannot make reliable estimates of their exposure. Any disclosure requirements for loss contingencies should reflect, not try to rebut, this reality.

## I. The Current Approach Reflected in FAS 5 Is Appropriate

The FASB notes several criticisms of FAS 5 as a basis for its Proposal. These include the observation that some issuers of financial statements have failed to disclose a litigation contingency until a material accrual is recognized, the limited universe of contingencies disclosed under the "reasonably possible" threshold, the frequent assertion by issuers that a reasonable estimate cannot be made, and lack of transparency about litigation reserves. We respectfully suggest that the inability of issuers to assess many litigation exposures at their early stages and estimate their potential financial impact to any meaningful degree is genuine and reflects the facts of life – the highly uncertain nature of the litigation process, especially in the United States, and not an intent to avoid transparency. The current approach embodies a careful consideration of the realities of our adversarial dispute resolution processes, which often involves baseless claims and/or damage demands that as a matter of practice exceed, by a wide margin, actual damages suffered and even the plaintiffs' own assessment of the true damages. Compelling disclosure of preliminary assessments of litigation exposure, often based on very limited information, in the modern litigation setting will lead to the dissemination of speculative and unreliable information – not useful disclosures. Shareholder and other public market participants would not have the benefit of more useful information but rather would have the additional burden of sifting through additional unreliable information.

Moreover, FAS 5 currently reflects a delicate balance struck among issuers, the accounting profession and the legal profession that provides for the prompt public disclosure and, when meaningful, quantification of material litigation exposure while limiting the potential negative effect of the accounting standard on the issuer's litigation posture. In addition, the current balance largely accommodates the need of issuers and their attorneys to preserve the

attorney-client privilege, a cornerstone of our legal system and an essential element of effective legal representation. To destabilize this balance, particularly in the midst of the current storm of litigation facing U.S. financial institutions, would have seriously adverse consequences.

### II. The Proposal Would Produce Worse, Not Better, Disclosure of Litigation Risk

The Proposal would require early quantification of an expanded range of litigation contingencies. Quantification of a contingency may be appealing in the abstract because it conveys a sense of certainty. Given the realities of the U.S. litigation process, however, the truly quantifiable information available to issuers is sparse. Accordingly, we believe that the proposed disclosure would create an appearance of certainty and precision that would be unwarranted.

It may be helpful to explain in more detail why we believe early assessments of litigation are so often speculative and unreliable. At the outset of a litigation matter, the defendant often does not have the facts necessary to make even a preliminary assessment of the case. This is especially true in the age of e-mail and electronic discovery. It may take months or even years to assemble and review the entire record, and discovery of even a very limited number of "harmful" or "helpful" documents can cause the assessment of the potential loss related to a litigation exposure to change dramatically.

Furthermore, modern civil litigation is often conducted in the context of broader issues, often involving regulators and, frequently, law enforcement. The settlement value of a litigation exposure can gyrate wildly depending on developments in the related governmental matters. Even the law itself can evolve in significant ways over the life of a prolonged case. An example is the effect the U.S. Supreme Court's decision in *Stoneridge Investment Partners, LLC* v. *Scientific-Atlanta, Inc.*, 128 S. Ct. 761 (2008) had on similar securities class actions. Prior to that decision, defendants were sued on an aiding and abetting theory and settled claims by

plaintiffs in the *Enron* litigation for billions of dollars; after the decision, the settlement value plunged to near zero.

The uncertainty, moreover, does not end even when a judgment is rendered. For example, recently the award of over \$500 million in damages rendered against Exxon was reduced to less than ten percent of that amount on appeal. Given these uncertainties, interim assessments of litigation are subject to such dramatic changes as to be of little value.

In the same vein of inappropriate quantification requirements, we also wish to highlight our concern regarding an especially troubling aspect of the Proposal. The Proposal requires disclosure about loss contingencies, regardless of the likelihood of loss, if the contingencies are expected to be resolved in the near term (*i.e.*, within 12 months) and if the contingencies could have a severe impact on the issuer's financial position, cash flows or results of operations. Severe in this context is meant to encompass a result that would be more than merely material but less than catastrophic. This requirement goes well beyond what has been historically required or is required today under the international financial reporting standards ("IFRS"). While we agree that it is appropriate to provide disclosures for loss contingencies that are probable and estimable, no useful purpose is served by compelling disclosure of meritless claims giving rise to no expectation of loss. The only consequences of such disclosure would be to increase the risk of harmful volatility in the issuer's stock price and to force the issuer to explain to the press and the market why the matter poses no real risk and why it disclosed a matter that posed no real risk – in essence forcing the issuer to explain that the disclosure is required but meaningless.

In short, we fear that the result of adopting the Proposal would be that issuers will be compelled to disclose highly speculative and unreliable information. Indeed, as these

disclosures prove inaccurate over time, they may themselves expose issuers to additional litigation risk. The concern about liability arising from application of the proposed approach is especially acute because the information disclosed will not benefit from the safe harbor provisions in the Federal securities laws for forward-looking statements, as these disclosures would be in the financial statement footnotes which are not covered by the safe harbor provisions.

# III. There Is a Simple Alternative to Address Certain Concerns Raised About the Application of FAS 5

We have stressed that disclosure should not be mandated in the absence of reliable information to support it. To the extent such information is available, it should be disclosed, and FAS 5 currently requires its disclosure. If issuers fail to disclose and estimate material litigation liabilities when they have the information to do so, it is not a failure of FAS 5. It is a failure to comply with it. That failure should be addressed by enforcement, not the introduction of a sweeping new accounting statement that would force premature and potential misleading disclosure.

# IV. Adoption of the Proposal May Result in Significant Substantive Damage to Issuers and Their Shareholders, and, Indeed, the U.S. Financial Markets

As discussed above, we believe that the proposed standard will result in more speculative and less reliable disclosure. This will result both in an erosion of confidence in an issuer's disclosure and potential additional litigation exposure.

Moreover, the Proposal would force disclosure of preliminary assessments of liability and potential damages, as well as a series of qualitative analyses, that, while of little use to investors, could benefit plaintiffs greatly. Although we recognize that the Proposal provides

an exclusion for certain "prejudicial" disclosures, that exclusion cannot adequately address the problem created by the overall thrust of the Proposal. Nor will the alternative of providing aggregate information meaningfully alleviate the damage the Proposal will do to issuers. For most issuers, facing only one or a limited number of significant litigation exposures at any one time, it will not be difficult for plaintiffs to discern how new disclosure, or changes in disclosure, relate to developments in their cases. In short, we seriously doubt shareholders would want to receive a detailed preliminary assessment of litigation exposure when the price for receiving that speculative information is to enhance the ability of plaintiffs to litigate against the enterprise in which they have invested.

We also believe that any value of disclosing information on what may be available from insurance or indemnification, to the extent it can even be meaningfully estimated at the early stage of a litigation matter, would be far outweighed by the prejudicial effect of such disclosure. Such disclosure would materially change the dynamics of settlement discussions, both with plaintiffs and the providers of the insurance and indemnification, to the detriment of issuers.

Finally, we strongly believe that the U.S. litigation environment has a major negative impact on the competitiveness of U.S. markets. Adoption of the Proposal, in our view, would exacerbate this problem by further empowering meritless litigation and forcing unjustified settlements by plaintiffs' counsel.

## V. The Proposal Would Not Promote Convergence of GAAP and IFRS

We agree with the overall accounting objective of convergence between GAAP and IFRS. The Proposal appears, however, to be moving toward "divergence", as there are significant differences between the FASB proposal on FAS 5 and the related IASB proposal on

IAS 37. The FASB Exposure Draft is quite prescriptive, wherein an entity would be required to disclose remote loss contingencies, if both of the following criteria are met:

- The contingency (or group of contingencies) is expected to be resolved within one year from the date of the financial statements.
- The contingency (or group of contingencies) "could have a severe impact on the entity's financial position, cash flows or results of operations."

This language is not found in the IASB proposed amendment to IAS 37 Provisions, Contingent Liabilities and Contingent Assets. Indeed, FASB introduces a new term "severe impact" and defines it as a "higher threshold than material," a "significant financially disruptive effect on the normal functioning of an entity." The Proposal even acknowledges that it "would require disclosures about a broader population of contingencies than required by IAS 37".

The Proposal deals with the issue by suggesting that when the IASB next considers IAS 37, such reconsideration "will provide a potential convergence opportunity". The IASB is reviewing feedback on its proposal from respondents and participants in round-table meetings, many of whom expressed uncertainty surrounding lawsuit disclosure. Since the IASB plans to discuss disclosures again later in 2008, its final position is unknown at this time. Furthermore, the IASB is not expected to publish a final standard until sometime in the first half of 2010, while the proposed effective date for the FASB proposal is for fiscal years ending after December 15, 2008. We cannot understand the logic of creating a new inconsistency between GAAP and IFRS as a means to promote their future convergence.

Another element of the Proposal's shortcomings arises because of the differences between the U.S. litigation environment and that of all other jurisdictions. The more difficult U.S. environment argues that any divergence between GAAP and IFRS concerning the disclosure of litigation contingencies is justified in terms of less, rather than more, disclosure

under GAAP. The Proposal, however, addresses those jurisdictional differences in the reverse manner, creating more disclosure under GAAP.

### VI. There Would be Serious Problems Implementing the Proposal

The premature and speculative disclosures that the Proposal requires would also be problematic for issuers and counsel required to draft public disclosure in reliance on, at best, limited information. It will also prove to be a problem, in our judgment, for auditors called on to satisfy themselves with respect to what is essentially speculative information. Without doubt, in order to attempt to satisfy themselves, auditors will seek a more granular understanding of the issuer's litigation posture. This process will almost inevitably lead to conflict between the auditor, on the one hand, and issuers and counsel understandably trying to preserve the attorney-client privilege. Loss of that privilege, of course, would substantially damage the ability of issuers to defend litigation and add to the cost of defending or settling litigation.

# VII. Adoption of the Proposal Is Likely to Erode Rather Than Bolster Confidence in the U.S. Accounting Regime

The FASB seeks to promote confidence among users of GAAP financial statements. Occasionally, accounting standards in practice have the reverse effect when they sacrifice logic and common sense. Respectfully, we believe this Proposal, if approved, would be such a standard. It is difficult to understand what benefit it would bring to investors and other financial statement users and we know it would be difficult if not impractical for issuers and their attorneys and auditors to apply. We firmly believe that the Proposal, at least as applied to litigation contingencies, has many characteristics that suggest that it will be a failed initiative.

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In conclusion, we strongly support continuance of the current FAS 5 standard, at least with respect to litigation contingencies. Our representatives are available to meet with you to discuss our concerns.

Sincerely yours,

Kerman R. Nelson