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Mr. Russell Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116
Via email: director@fasb.org

Re: File Reference No. 1840-100 —

Disclosure of Certain Loss Contingencies

Dear Mr. Golden:

The Clearing House Association L.L.C. ("<u>The Clearing House</u>"), an association of major commercial banks, appreciates the opportunity to comment on the Financial Accounting Standards Board's (the "<u>FASB</u>") Exposure Draft — Proposed Accounting Standards Update — Contingencies (Topic 450): Disclosure of Certain Loss Contingencies (the "<u>Exposure Draft</u>"). The Clearing House recognizes that the complex issues relating to the disclosure of loss contingencies are important to all entities, not just financial institutions. However, given the wide array of relationships and regulations affecting financial institutions, financial institutions are likely to be impacted by requirements to disclose loss contingencies to a greater extent than other entities.

Executive Summary

Established in 1853, The Clearing House is the nation's oldest banking association and payments company. It is owned by the world's largest commercial banks, which collectively employ 1.4 million people in the United States and hold more than half of all U.S. deposits. The Clearing House Association is a nonpartisan advocacy organization representing – through regulatory comment letters, amicus briefs and white papers – the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing and settlement services to its member banks and other financial institutions, clearing almost \$2 trillion daily and representing nearly half of the automated-clearing-house, fundstransfer and check-image payments made in the U.S. See The Clearing House's web page at www.theclearinghouse.org.

The Clearing House appreciates the work of the FASB in carefully considering the input received on this topic following the release of the initial exposure draft in June 2008 and in improving upon those proposals with the Exposure Draft. However, although The Clearing House supports the FASB's efforts to provide investors and other users of financial statements with adequate and timely information to assist them in assessing the likelihood, timing and magnitude of potential future cash outflows associated with loss contingencies, we believe that the disclosure objective must be balanced against the prejudicial effects of certain disclosures, particularly the disclosure of accruals. In summary, The Clearing House:

- > believes that the expanded disclosure of accruals for loss contingencies mandated by the Exposure Draft will require that prejudicial information be disclosed and therefore should not be required;
- > believes that any perceived benefits of the proposed tabular disclosure of loss contingency accruals are greatly outweighed by the prejudicial effects of the disclosure of accruals within that tabular disclosure;
- > believes that an explicit exemption to disclosure for "significantly prejudicial" information should be retained;
- believes that when assessing the materiality of loss contingencies to determine whether disclosure is required, an entity should be permitted to consider the possibility of recoveries from insurance or other indemnification arrangements;
- > believes that the requirement to disclose possible recoveries from insurance if they are discoverable should be modified to require the disclosure of such information only if already publicly disclosed;
- > disagrees that disclosing certain remote loss contingencies furthers the objectives of the Exposure Draft; and
- believes that, if adopted, the effective date of the Update should be postponed to allow time to prepare to implement controls and procedures to collect and analyze the required information or at a minimum be postponed for any newly proposed disclosures.

Understanding that many of the views of The Clearing House members have previously been articulated and presumably rejected in preparing the current Exposure Draft, The Clearing House feels that it is not necessarily constructive to repeat all its views, but does strongly believe that the following critical items should be highlighted for your consideration or reconsideration.

1. The Expanded Disclosure of Accruals for Loss Contingencies Mandated by the Exposure Draft Will Require that Prejudicial Information be Disclosed and Therefore Should not be Required

Under paragraph 450-20-50-1 of the FASB Accounting Standards Codification (the "ASC"), disclosure of the nature of an accrual for a loss contingency and the amount accrued is to be made if necessary for the financial statements not to be misleading. The Clearing House believes

that the current disclosure standard strikes the appropriate balance between, on one hand, the legitimate interests of investors and other users of financial statements to receive adequate and timely information to assist them in assessing the potential future cash outflows associated with loss contingencies and, on the other hand, the interests of an entity to manage its potential exposure(s) related to litigation and investigations without the disclosure requirements prompting additional claims or themselves leading to additional losses as a result of prejudicial information provided to adversaries.

The disclosure standard proposed in the Exposure Draft goes significantly further than the existing disclosure standard² and for the first time would require detailed disclosure of accruals for loss contingencies and changes to accruals through a tabular reconciliation, even if the disclosure is not necessary to make the financial statements not misleading.

The expansion from the current standard of disclosure of accruals for loss contingencies contemplated in the Exposure Draft, with or without a tabular reconciliation, makes it much more likely that prejudicial information will be required to be disclosed. In the litigation context, the disclosure of this prejudicial information will be used as a tool for plaintiff's attorneys throughout a proceeding and will increase the cost of settling litigation – cost ironically that will be borne by the very same stakeholders that the Exposure Draft is intended to benefit. For example,

- if plaintiff's attorneys are aware of the amount of the accrual for their case based on the loss contingency disclosure, that amount will undoubtedly become the floor for any settlement discussions and thereby increase the cost of settlements for the reporting company and its investors;
- the existence of an accrual implies that the reporting entity has determined that a loss in that amount is probable and the disclosure of loss accruals for specific matters will make the amount(s) disclosed non-privileged and possibly admissible; and
- if juries are aware of the amount of the accrual for the case they are hearing, they may confuse the accounting requirements for an admission of liability, and may be unduly prejudiced if the evidence they are considering includes public disclosure of a loss contingency.

Aggregation, either in textual disclosure or in a table, does not solve this problem. It is entirely conceivable that a reporting company may have only one large loss contingency or has large loss contingencies not easily aggregated with other loss contingencies, such that any increase in its accrual would be completely transparent to the company's adversaries, and thereby prove significantly prejudicial to the reporting company in resolving the issue. Even if additions or other changes in an accrual fall within an aggregated group, the timing of additions to aggregated accruals—for example, in a period with a significant adverse ruling in a particular case—may make it easy for plaintiffs' attorneys to derive a good approximation of the accrual in individual matters.

See paragraph 450-20-50-IF(e)(2) of the Exposure Draft.

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The Clearing House strongly believes that the current standard – disclosure of accruals if the disclosure is necessary to make the financial statements not misleading – is the correct standard to balance the interests of users of financial statements and investors, who would be substantially harmed by disclosure of prejudicial information. To require the disclosure of loss contingency accruals as proposed in the Exposure Draft will act to compound the severity of the accrued loss by providing valuable prejudicial information to an adversary, which will be able to use that information to advantage its position at the expense of the reporting entity and its shareholders. This furthers the principle that disclosure of loss contingencies should report events and should not affect the outcome of the contingency itself to the detriment of the reporting entity.

2. The Tabular Reconciliation of Loss Contingency Accruals Presents the Same Risks of Disclosure of Prejudicial Information and Should be Eliminated

The disclosure requirements proposed in the Exposure Draft would require detailed disclosure of accruals for loss contingencies and changes to accruals through a tabular reconciliation. Although the Exposure Draft provides that the tabular reconciliation will be "by class" and further provides that an entity may aggregate loss contingencies that "are sufficiently similar to be in one class primarily on the basis of their nature, terms and characteristics," the Exposure Draft suggests that aggregation will be narrow. By example, the Exposure Draft says that it may not be appropriate to aggregate individual litigations with class actions, may not be appropriate to aggregate items with different timing of cash outflows. The selection of loss contingencies for aggregation will require difficult judgments by management and may lead to uneven application because the criteria for aggregation are not well-defined. In addition, the aggregation criteria will require reconsideration and adjustment over time, making period-to-period comparisons not meaningful.

The combination of the disclosure of accruals for loss contingencies in a tabular reconciliation and the narrow aggregation principles makes it much more likely that prejudicial information will be required to be disclosed if the disclosure requirements of the Exposure Draft are adopted. The Exposure Draft states that in determining the appropriate level of aggregation, an entity

The disclosure of loss contingencies also creates a significant informational disadvantage for defendants, who are required to make the disclosure while plaintiffs are not. So, the plaintiff may be able to decipher the defendant's settlement strategy based on its loss contingency disclosure without the defendant obtaining the same information from the plaintiff.

See paragraph 450-20-50-1F(g) of the Exposure Draft, which requires a quarterly reconciliation, by class, in a tabular format, of accrued loss contingencies, including (1) beginning accruals, (2) accruals for new loss contingencies, (3) increases for changes in estimates for loss contingencies recognized in prior periods, (4) decreases for changes in estimates for loss contingencies recognized in prior periods, and (5) decreases for cash payments and settlements.

See paragraph 450-20-55-1A of the Exposure Draft.

needs to strike a balance between "obscuring important information" and "overburdening financial statement users with excessive detail" that may not serve the disclosure objective. The disclosure of prejudicial information is not mentioned as a consideration. The Exposure Draft states that the exemption for prejudicial information was eliminated from the June 2008 exposure draft because the provisions calling for disclosure of speculative and predictive information had been limited. With due respect, this is a *non sequitur*, as information can be prejudicial even if it is not speculative. Although it is acknowledged that the disclosure of information regarding accruals is not speculative, it is predictive and is very likely to be prejudicial, because, in most cases, even if broader aggregation were permitted, it will not be difficult for adversaries to identify the particular loss contingency to which the accrual or change in accrual relates.

As noted above, even a broader aggregation standard or aggregation at a higher level would not eliminate the risk of disclosure of prejudicial information, the negative impact of which would outweigh the benefit of disclosure to users.

To respond to two of the specific questions posed by the FASB in the Exposure Draft:

- There has been no opportunity to estimate the operational difficulties and costs involved in implementing the tabular reconciliation. The comment period provided for the Exposure Draft (taking into account the extension of that period until September 20, 2010) is not sufficient to estimate the operational difficulties and costs. It is a virtual certainty, however, that the additional costs of collecting the quantitative information required by the Exposure Draft for all disclosed loss contingencies will add substantial costs to reporting entities and their investors. Moreover, the real cost is, as described above, the additional litigation/settlement expense.
- Auditing the tabular reconciliation will itself create risk of prejudice given that the
 entity's auditors may be required to review more information than is currently provided,
 some of which may raise waiver of privilege or work product concerns, all within the
 tight quarterly time frames between the dates of financial statements and dates required
 for regulatory filings.

The Clearing House believes that the tabular reconciliation, even with aggregation, would substantially harm reporting entities and their current stakeholders by the disclosure of prejudicial information. Further, the likely significant costs to collect the quantitative and qualitative information necessary to prepare the tabular reconciliation also needs to be balanced against the perceived benefit to end users of such a reconciliation.⁸

See paragraph 450-20-55-1B of the Exposure Draft.

The ability of adversaries to identify the particular loss contingencies that have changed is exacerbated further by the requirement that the tabular reconciliation be prepared on a quarterly basis.

Although we strongly urge that the current standard be retained and the tabular reconciliation requirement be withdrawn, if a tabular reconciliation is retained, given the

3. The Exemption for Disclosure of Prejudicial Information Should Not be Eliminated

The prior proposal permitted an exemption from disclosure for information that was prejudicial. In addition, IAS 37 permits the exclusion of prejudicial information. Although the Exposure Draft often calls for disclosure of only non-privileged information, it does not allow an explicit exemption for prejudicial information. The Exposure Draft seeks comment on whether the explicit exemption is necessary given the changes from the prior exposure draft.

As described above (with respect to loss contingency accruals and below (with respect to insurance or other recoveries and remote loss contingencies), loss contingency accruals, ranges of loss, determinations of remote loss contingencies, and disclosure as to insurance or other recoveries are by their nature predictive and will be prejudicial. We firmly believe that the current standard for disclosing accruals should be retained and therefore tabular disclosure of loss contingency accruals should not be required, and we believe that the disclosures relating to insurance or other recoveries should be limited and remote loss contingencies should be eliminated. Nonetheless, regardless of the FASB's decision on those issues we believe that, at a minimum, an exemption for disclosure of "significantly prejudicial" information should be retained. This higher standard for an exemption, expressly including a materiality concept, could appropriately balance the concerns about a "prejudicial exemption" expressed in the Exposure Draft against a reporting entity's legitimate need not to have disclosure affect the outcome of the contingency itself to its detriment. This exemption would particularly relate to disclosure of loss contingency accruals, ranges of loss, disclosures relating to insurance or other recoveries and determinations of remote loss contingencies. As part of that, entities should be permitted to aggregate in a manner that does not create the prejudice.

4. When Assessing the Materiality of Loss Contingencies to Determine Whether Disclosure is Required, an Entity Should be Permitted to Consider the Possibility of Recoveries from Insurance or Other Indemnification Arrangements

The June 2008 exposure draft did not specifically address whether an entity should consider the possibility of insurance recoveries when assessing whether a loss contingency would be disclosed. According to the Exposure Draft, it was noted that insurance coverage often is uncertain and may be subject to litigation with the insurer, and therefore an entity may be

implementation and audit/privilege issues, The Clearing House believes that it should be deferred until December 31, 2011 for all entities (not just private companies) so that entities can begin to implement the necessary controls and processes to collect and report such information.

- The Exposure Draft states that the FASB decided not to provide a prejudicial exemption because the proposed amendments would eliminate many of the speculative or predictive disclosures that were in the prior exposure draft and because some of the respondents were concerned that the proposed exemption would be difficult to interpret and apply.
- "Significantly prejudicial" information should be defined as prejudicial information that could materially adversely affect the amount of the applicable loss contingency.

exposed to loss even when it believes that the loss contingency is fully covered by insurance. In response, the FASB added the following language to the Exposure Draft: "When assessing the materiality of loss contingencies to determine whether disclosure is required, an entity shall not consider the possibility of recoveries from insurance or other indemnification arrangements."

The Clearing House does not believe that disregarding potential insurance and other recoveries is the appropriate approach to dealing with the materiality determination. We agree with the observation that insurance coverage can be uncertain and may be subject to litigation with the insurer, but we do not agree that it should follow that insurance recoveries therefore should be ignored when assessing materiality and proper disclosure. Instead, like other materiality determinations, all relevant facts available to the reporting entity should be considered. These facts may include the availability of insurance, taking into account any uncertainties about the recovery. Therefore, the Clearing House would propose that paragraph 450-20-50-1E be revised to state: "When assessing the materiality of loss contingencies to determine whether disclosure is required, an entity may consider the availability of insurance or other indemnification arrangements (including the possibility that coverage will be denied)."

5. The Requirement to Disclose Possible Recoveries From Insurance and Other Indemnification Arrangements if That Information is Discoverable Should be Modified to Require the Disclosure of That Information Only if Already Publicly Disclosed

The Exposure Draft provides for disclosure of "possible recoveries from insurance" and other indemnification arrangements if that information "is discoverable by either the plaintiff or a regulatory agency." ¹² The proposed standard is too broad because such communications are unlikely to be privileged and therefore will in most cases be "discoverable" even though discovery may not be available for a significant period of time. ¹³ Further, even when disclosure of insurance and other recoveries occurs, the disclosure is often made to a limited audience under a protective or similar order or under the confidentiality of a regulatory supervision process, in each case only to limited parties so the details of available insurance coverage or other indemnification arrangements are not disclosed to other persons.

Requiring disclosure of insurance recoveries and other indemnification arrangements in publicly available financial statements inevitably will attract claims by other litigants. As a result, the disclosure will prejudice the reporting entity by benefitting plaintiffs in existing litigation (where the Exposure Draft requirements will accelerate the disclosure of insurance and other recoveries to an earlier stage in the judicial process) and prompt new litigation (by other litigants seeking the additional resources of the insurance coverages). The Clearing House believes that the

See paragraph 450-20-50-1E.

See paragraphs 450-20-50-1F(e)(5) and 450-20-50-1F (e)(6).

For a highly regulated entity, such as a financial institution, where the regulators have broad access to information, the "discoverable by a regulatory agency standard" renders the condition meaningless and would require the disclosure of virtually all information.

appropriate standard for disclosure of insurance recoveries is disclosure of publicly available information that has already been provided.

6. Disclosure of Remote Loss Contingencies Frustrates, Rather Than Achieves, the Objective of Transparency

The proposed disclosure of remote loss contingencies expands loss contingency disclosure to a much broader area. For the reasons stated below, The Clearing House believes that requiring disclosure of remote loss contingencies frustrates, rather than achieves, the disclosure objective of providing investors and other users of financial statements with adequate and timely information to assist them in assessing the likelihood, timing and magnitude of potential future cash outflows associated with loss contingencies.

Firstly, it will be difficult for entities to determine what constitutes a remote loss contingency with a severe impact. The proposed severe impact standard (i.e., more than material but less than catastrophic) presents a very difficult judgment for management to make when dealing with an event that is by its nature remote. In addition, the inherently subjective nature of the stated disclosure criteria for establishing remote loss contingencies (i.e., potential impact, cost of defending, effort and resources management may have to devote) will lead to uneven application of the standard and frustrate the intent of the standard to provide clear and transparent disclosures to users.

Second, although the Exposure Draft provides that the amount claimed is not by itself determinative in designating a litigation matter as a remote loss contingency, it does state that the amount claimed may be one of the factors to be considered. This will encourage inflation of claimed damages by plaintiffs' attorneys to give their matters more prominence and to give themselves more leverage in negotiating higher settlement amounts.

The Clearing House believes that requiring disclosure of remote loss contingencies frustrates, rather than achieves, the disclosure objective of the Exposure Draft. Expanding the required loss contingency disclosure potentially adds pages of additional loss contingency disclosure, diluting the effectiveness for investors of the disclosure of other loss contingencies required under the current disclosure standard. Further, the costs to reporting entities and their current stakeholders of collecting such additional pages of information under the proposed new quantitative standards in the Exposure Draft need to be carefully considered. Given their remote nature, expanded and potentially confusing disclosure of such loss contingencies is not necessary to achieve the overall objective of the amendments.

7. If Adopted, the Effective Date of the Update Should be Postponed to Allow Time to Prepare to Implement Controls and Procedures to Collect and Analyze the Required Information or at a Minimum be Postponed for any Newly Proposed Disclosures

Comment has been requested on whether the proposed effective date for the Update is operational. We are responding, although, for all of the reasons mentioned, we believe the Update should not be implemented without major changes. For all the reasons we have stated above, we believe that the effective date of the Update should be deferred until December 31, 2011 to allow time to (1) begin tracking and collecting the required information, (2) implement

controls and procedures to capture and analyze the required information, and (3) test those controls and procedures. At a minimum, the effective date for any newly proposed disclosures (including disclosure of remote loss contingencies, accruals for loss contingencies, tabular presentation of accruals and additional disclosure on loss contingencies other than litigation contingencies) should be deferred until December 31, 2011.

Conclusion

The Clearing House believes that the proposed additional disclosures will harm reporting entities and the investors that the FASB is seeking to protect in proposing these additional disclosures by leading to higher litigation settlements. Although the purpose of the proposed amendments is to "provide adequate and timely information to assist [investors and other users of financial reporting] in assessing the likelihood, timing, and magnitude of future cash outflows associated with loss contingencies," that objective needs to be balanced against the prejudicial effects of that disclosure, and, in addition, the costs of that disclosure. We hope that our comments provide constructive input to you and the FASB in your analysis in striking that balance.

Thank you for considering the comments provided in this letter. If you have any questions or are in need of any further information, please contact David Wagner, Senior Vice President, Financial and Tax Affairs, at (212) 613-9883 or david.wagner@theclearinghouse.org.

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Sincerely yours,

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