SULLIVAN & CROMWELL LLP

August 5, 2020

# Federal Reserve Finalizes Amendments to CSI and FOIA Regulations

## Changes Clarify and Update Rules Governing the Protection and Disclosure of CSI and Other Nonpublic Information

### SUMMARY

On July 24, 2020, the Federal Reserve issued amendments (the "final rule")[1] to "clarify and update" the rules governing confidential supervisory information ("CSI") and other nonpublic information of the Federal Reserve, as well as to provide "technical updates" to its regulations implementing the Freedom of Information Act ("FOIA"). The final rule is largely similar to the 2019 proposal (the "proposal"), but certain changes were made in response to public comments. For more detailed background information on the Federal Reserve's CSI and FOIA regulations, please refer to our June 2019 client memorandum on the proposed rule. The final rule will be effective 30 days after publication in the Federal Register.

The amendments significantly simplify much of the day-to-day handling of CSI, particularly by easing the process for providing CSI to affiliates, attorneys, auditors, and service providers, and clarifying that CSI may be used when it is "necessary or appropriate for business purposes" or "necessary or appropriate in connection with the provision of legal and auditing services," as applicable. However, the Federal Reserve did not address the recurring issue of when CSI may be disclosed to parties in mergers and acquisitions.

Key provisions of the final rule include the following:

- **Changes to the Rules Regarding the Protection and Disclosure of CSI.** The final rule adopts revisions to the exception for sharing CSI with auditors and outside legal counsel, as well as a new exception for affiliate sharing. These revisions should simplify compliance with the Federal Reserve's CSI regulations for supervised financial institutions, although institutions will continue to face compliance challenges due to the lack of uniformity on these issues among the various federal and state banking regulators.

- **Sharing with Affiliates.** On the proposed expansion of the scope of authorized disclosures to include affiliates[2] of supervised financial institutions, the Federal Reserve agreed with public comments suggesting that it harmonize this standard with the OCC's CSI rules. Accordingly, the final rule permits supervised financial institutions to disclose CSI to their directors, officers, and employees and to the directors, officers, and employees of their affiliates "when necessary or appropriate for business purposes."[3]

- **Sharing with Auditors and Outside Legal Counsel.** The final rule does not include the proposed provision that conditioned disclosures to legal counsel and auditors on their executing a written agreement addressing the use and handling of CSI.[4] Consistent with the OCC standard, the final rule permits disclosures to the supervised financial institution's outside legal counsel and auditors when the disclosures are "necessary or appropriate in connection with the provision of legal or auditing services."[5] In addition, in response to public comments, the final rule provides that the supervised financial institution may also disclose CSI to service providers of its legal counsel or auditors, such as a litigation vendor, if the service provider is subject to a written agreement with the legal counsel or auditor meeting certain requirements.[6] Consistent with the proposal, the final rule also eliminates the outdated restrictions requiring that the CSI be reviewed on the premises of the supervised financial institution, and prohibiting auditors and outside legal counsel from making or retaining copies of the CSI.

- **Sharing with Other Supervisory Authorities.** Consistent with the proposal, the final rule provides that a supervised financial institution is permitted to share CSI with the FDIC, the OCC, and the CFPB, as well as "the state financial supervisory agency that supervises the institution," provided that—prior to sharing the CSI—the supervised financial institution receives the concurrence[7] of its "Reserve Bank Point of Contact" (or "Reserve Bank POC") that the receiving agency has a legitimate supervisory or regulatory interest in the information.[8] Reserve Bank POC is defined in the final rule to include, in addition to the "CPC" (as referenced in the proposal)[9] or equivalent supervisory team leader, any "other designated Reserve Bank Employee."

    - In response to concerns expressed by commenters that Reserve Bank POCs would not be able to "grant blanket approval for recurring disclosures," the Federal Reserve confirms in supplementary information to the final rule (the "supplementary information") that "Reserve Bank POCs will, when consistent with internal supervisory procedures, have latitude to approve requests to disclose [CSI] contained in specified categories of internally-prepared business documents with the FDIC, the OCC, the CFPB, and state banking agencies on a recurring basis."[10]

    - The Federal Reserve declined to permit the same process for a financial institution to share supervisory information with foreign supervisors. Financial institutions wishing to share Federal Reserve CSI with their foreign supervisors must use the existing processes for individual approval upon a proper showing.[11] Consistent with the proposal, the final rule clarifies that the Federal Reserve's disclosures of CSI to foreign supervisory authorities are governed by 12 C.F.R. § 211.27, which authorizes the Federal Reserve to approve the request if disclosure is appropriate for bank supervisory or regulatory purposes and will not prejudice the interests of the United States.[12]

    - Consistent with the proposal, the final rule also updates the regulations governing CSI made available by the Federal Reserve to other governmental agencies and entities exercising governmental authority. The final rule revises the list of agencies with which the Federal Reserve may share information (*i.e.*, adding the CFPB) and clarifies that, with respect to both federal and state supervisory authorities, disclosures of CSI are based on the same standard: "legitimate supervisory or regulatory purposes."[13] These disclosures may be made by the Federal Reserve with or without a request for the CSI from the receiving federal or state authority. Consistent with the current rule, the final rule continues to permit U.S. and "properly accredited" foreign law enforcement agencies to file written requests with the Federal Reserve to obtain CSI, with the required contents of such requests identical to the former requirements except for the removal of a requirement for the requestor to indicate whether the requested disclosure is permitted or restricted in any way by applicable law or regulation.[14]

- **Sharing with Other Service Providers.** The Federal Reserve did not adopt the suggestion that contingent workers and independent contractors functioning as employees be treated as employees for purposes of access to CSI. Instead, consistent with the OCC's and CFPB's standards, the final rule does not include the requirement in the proposal that supervised financial institutions obtain prior Federal Reserve approval to disclose CSI to their service providers, such as consultants, contractors, and contingent workers. Under the final rule, a supervised financial institution is authorized to disclose CSI to a service provider if the service provider is under a written contract to provide services to the institution, the disclosure of CSI is deemed necessary by the institution to the provision of the services, and the service provider has a written agreement with the institution that meets certain requirements.[15] Unlike the exception applicable to outside legal counsel and auditors, the service provider exception does not expressly permit sharing by a service provider with a vendor or subcontractor of that service provider. Importantly for compliance purposes, the final rule will also require supervised financial institutions to maintain a log (referred to in the final rule as a "written account") of CSI disclosures to service providers, which will be subject to examiner review.[16]
- **No Provisions for Disclosing CSI in the M&A Context or in Securities Filings.** The proposal did not discuss the criteria for disclosing CSI pursuant to the securities laws or in the context of mergers and acquisitions, including for both pre-merger announcement due diligence and post-merger announcement integration. Nor, despite public comments requesting guidance in these areas, did the final rule address disclosures of CSI in these contexts. Noting that because "[t]he proposal did not address disclosures in the M&A context or pursuant to securities laws," the Federal Reserve states in the supplementary information that any "guidance establishing parameters for such disclosures requires additional consideration" that "should be addressed on a consistent basis across the federal and state banking agencies and the CFPB."

- **Requests to Disclose CSI in Connection with Litigation.** The final rule also adopts the proposal's heightened requirements for requests to disclose CSI in connection with litigation.[17] The party making the request is required to provide a "narrow and specific"[18] description of the CSI and its relevance to the litigation, and an explanation of why the information sought, or "equivalent information adequate to the needs of the case,"[19] cannot be obtained from any other source. The final rule also clarifies that a person served by subpoenas or other legal processes to appear is not expected to defy a federal court order to produce the CSI, provided that the Federal Reserve has had an opportunity to appear and to oppose the discovery of the CSI; otherwise, the person served must continue to decline to disclose the information and promptly report to the Federal Reserve.[20]
- **Amendments to FOIA Regulations.** Largely consistent with the proposal, the final rule also amends the Federal Reserve's FOIA regulations governing the disclosure of nonpublic information through the FOIA process.
  - **Records of the Board.** The final rule revises the definition of "records of the Board" to incorporate the two-part test for agency records set forth in the *U.S. Department of Justice* v. *Tax Analysts* decision: (i) the agency has created or obtained the material and (ii) is in control of the material at the time a request is received.[21]
  - **Conformance to DOJ Guidance.** Several aspects of the Federal Reserve's FOIA regulations have been updated under the final rule to conform to guidance published by the Department of Justice,[22] including with respect to expedited processing, the time limits applicable to the Federal Reserve's responses to FOIA requests, descriptions of withheld information, the time to file an appeal to an adverse determination and clarifying that confidential treatment requests generally expire 10 years after submission, unless the submitter justifies a longer period.[23]
  - **Standards for Addressing Confidential Treatment Requests.** The final rule also revises the Federal Reserve's standards and process for addressing a submitter's request for confidential treatment by clarifying that such requests may be made on the basis of the relevant material containing personal privacy information, and by imposing two new requirements at the time the request is submitted.

- The final rule authorizes submitters to make confidential treatment requests for "personal privacy information," in addition to proprietary commercial information. This change is incorporated by reference to the Federal Reserve's regulation implementing FOIA exemption 6, which covers "information contained in personnel and medical files and similar files the disclosure of which would constitute a clearly unwarranted invasion of personal privacy."
- Additionally, "[f]or further consistency with the DOJ guidance," the request must "use good faith efforts to designate by appropriate markings any portion of the submission" for which confidential treatment is requested and include an affirmative statement that the information is not available publicly.[24] In the supplementary information, the Federal Reserve states that replacing the requirement in the proposal to "identify the specific information" for which confidential treatment is requested with the "good faith efforts" requirement noted above "eliminate[s] any implication that the submitter needs to do a line-by-line review for confidential information or submit a public version of a document each time the submitter seeks confidential treatment."[25]

- **FOIA Exemption 4.** With respect to those records that implicate exemption 4 under FOIA, the Federal Reserve removed all references to the "competitive harm" test, consistent with the Supreme Court's decision in *Food Marketing Institute v. Argus Leader Media*[26]—issued after the proposed rule was published—in which the Supreme Court rejected the long-standing "competitive harm" criterion used to determine whether information is confidential under exemption 4. In the supplementary information, the Federal Reserve notes that because the Supreme Court "did not reach the question of whether an assurance of confidentiality by the government is a necessary condition for information to be treated confidentially under exemption 4," the final rule does not incorporate an explicit assurance of privacy with respect to commercially sensitive information provided to the Federal Reserve.[27] Instead, the Federal Reserve states that it plans to use the DOJ's step-by-step guide for exemption 4 analysis,[28] which the DOJ issued following the decision in *Argus Leader*.[29]
- **No Waiver of Discretion or Applicable Privilege.** The final rule adopts the proposed language clarifying that a decision by the Federal Reserve to release particular nonpublic information does not waive the Federal Reserve's ability to withhold similar nonpublic information in response to the same or a different request.[30] The final rule also adopts the proposed language indicating that any disclosure under Subpart C of the Federal Reserve's regulations (including CSI) does not constitute a waiver by the Federal Reserve of any applicable privileges.[31]

The Federal Reserve also declined to make certain changes suggested by public comments, including:

- **Removal of the Added Prohibition Against "Unauthorized Use."** The Federal Reserve rejected the request to remove the proposed prohibition in section 261.20(a) against both the *use* and disclosure of CSI, noting that "use of confidential supervisory information by directors, officers, and employees for a necessary or appropriate business purpose consistent with the final rule, in the [Federal Reserve's] view, constitutes use for an authorized purpose" and that the prohibition "against use for unauthorized purposes is necessary to proscribe impermissible uses such as use of the [Federal Reserve's] confidential information for personal gain."[32]
- **Decriminalization of Conduct in Violation of CSI Rules.** The Federal Reserve declined to state that "conduct in violation of the rule's prohibition on unauthorized use and disclosure of CSI" should not be a federal crime under 18 U.S.C. § 641. The Federal Reserve rejected the suggestion that the threat of criminal sanctions inhibits beneficial sharing internally and with third parties, observing that the CSI rules have been revised to allow internal disclosures "'when necessary or appropriate for business purposes'" as well as "to outside legal counsel and auditors 'when necessary or appropriate' in connection with the provision of legal or auditing services and to service providers when the 'disclosure is deemed necessary' to the service providers' provision of services."[33] The Board also pointed out that "unauthorized disclosures that lack criminal intent, such as those made inadvertently, would not be subject to prosecution under section 641."[34]

## IMPLICATIONS

The amendments update and simplify the handling of Federal Reserve CSI in several ways, but controls on CSI dissemination are still critical. Supervised financial institutions and their external advisors and service providers should consider certain practical implications of the final rules, including:

- **Review of Policies, Procedures and Training Materials.** As discussed in our June 2019 memorandum on the proposal, given the importance of robust policies, procedures and training materials related to CSI, supervised financial institutions should review these existing documents to identify revisions that may be required or advisable in light of the final rule. In particular, supervised financial institutions may wish to review the scope of these documents to see if they would apply to (and contemplate sharing of CSI with) affiliates under common control, and also to adopt procedures to ensure that an accurate "log" is maintained of the disclosure of CSI to service providers.
- **M&A-Related Disclosures and Securities Law Filings.** The Federal Reserve did not discuss in the release its policies with respect to disclosures of CSI in the M&A context or pursuant to the securities laws. The Federal Reserve suggested that these policies should be addressed on a consistent basis across the federal and state banking agencies and the CFPB. It remains to be seen whether the Federal Reserve or another supervisor will take the initiative in formulating an interagency policy on these questions, either in the form of guidance or a further revision to the regulation.
- **Confidential Treatment Requests.** Institutions and their advisors should consider whether new formulations are necessary for confidential treatment requests, particularly in light of the requirement to specifically identify at the time of submission of the request which information it covers and affirmatively state that the information is not available publicly. In addition, institutions may wish to review existing confidential treatment requests to see if any warrant the submission of a request to continue confidential treatment beyond the expiration of the standard 10-year period (*e.g.*, personal or business information that remains sensitive beyond 10 years).

* * *

## ENDNOTES

1 Board of Governors of the Federal Reserve System, *Rules Regarding Availability of Information*, Draft Final Rule (July 24, 2020), *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200724a1.pdf (the "final rule release").

2 As "affiliates" is defined in Regulation Y; 12 C.F.R. § 261.2(a).

3 12 C.F.R. § 261.21(b)(1).

4 The proposal would have imposed new restrictions, to be set forth in a written agreement, requiring the auditor or outside legal counsel, to, among other things:

- Not use the CSI for any purpose other than in connection "with the particular engagement" with the supervised financial institution;
- At the conclusion of the engagement, return or certify the destruction of the CSI, or, in the case of electronic files, "render the files effectively inaccessible through access control measures or other means"; and
- Strictly limit access to the CSI within its staff to those who have a need to know and who are bound by written agreement to keep the information confidential in accordance with the Federal Reserve's regulations.

5 12 C.F.R. § 261.21(b)(3).

6 The service provider to the attorney or auditor must agree in writing to treat the CSI in accordance with § 261.20(a) and that it will not use the information for any purpose other than as necessary to provide services to the supervised financial institution. *Id*. Section 261.21(b)(4) does not include a similar provision permitting disclosure of CSI without Federal Reserve approval to service providers (*e.g.*, sub-contractors) of "other service providers" such as consultants.

7 Although the final rule does not specify in section 261.21(b)(2) that concurrence of the Reserve Bank POC must be in writing, written concurrence is advisable in practice.

8 Although commenters suggested that the final rule be revised to eliminate this Reserve Bank POC prior approval requirement, the Federal Reserve declined to do so, noting that "[b]ecause the regulators have different scopes of authority, Federal Reserve review of proposed disclosures is necessary to ensure that the information provided is relevant to the agency's supervisory responsibilities." The Federal Reserve does note in the final rule release that requests for materials prepared by the Federal Reserve, such as examination reports, will be handled by the Federal Reserve so that supervised financial institutions are not expected to "act as an intermediary between the [Federal Reserve] and other agencies." Final rule release, at 27-28.

9 This term was defined in the proposal as the institution's central point of contact with the Reserve Bank or equivalent supervisory team leader. The final rule instead uses the broader defined term "Reserve Bank POC."

10 Final rule release, at 29.

11 Commenters also requested that the final rule include "procedures for supervised financial institutions to disclose [CSI] to foreign bank supervisors," which the Federal Reserve declined to adopt, noting that "Section 261.21(b)(2) is intended to facilitate the disclosure of [CSI] to the primary banking agencies and the CFPB—the regulators with whom the [Federal Reserve] interacts most closely in its day-to-day supervisory activities. All other disclosures are best handled on an individual basis." Final rule release, at 31. Disclosure to foreign bank supervisors will continue to be considered by the Federal Reserve on a case-by-case basis, and the Federal Reserve "may conduct an appropriate review to ensure that the information that is proposed to be shared is needed in connection with the agency's supervisory and other statutory responsibilities."

12 12 C.F.R. § 261.22(c).

ENDNOTES (CONTINUED)

13 12 C.F.R. § 261.22(a). Commenters also requested that the Federal Reserve add "state insurance regulatory authorities to the regulators included at § 261.22(a)." The Federal Reserve declined to make this change in the final rule, noting that "[d]isclosures to . . . state insurance supervisors . . . are better addressed by the General Counsel on a case-by-case basis under § 261.22(a) or in accordance with written memoranda of understanding between the agencies." Final rule release, at 37.

14 12 C.F.R. § 261.22(c).

15 The service provider must agree in writing to treat CSI confidentially and not use CSI for any purpose other than providing services to the institution, as set forth in 12 C.F.R. § 261.21(b)(4)(i)-(ii).

16 12 C.F.R. § 261.21(b)(4).

17 12 C.F.R. § 261.23(b).

18 12 C.F.R. § 261.23(b)(2)(iii).

19 12 C.F.R. § 261.23(b)(2)(v).

20 12 C.F.R. § 261.24(b). For reasons that are not discussed in either the proposal or the final rule, the amended rule limits the "safe harbor" specifically to federal court proceedings, and not to state court proceedings. The proposal explained the change as follows: "the Board does not expect parties to defy court orders where the Board has had an opportunity to appear and oppose disclosure of its information." 84 Fed. Reg. 27976, 27980 (June 17, 2019). It is possible that the Federal Reserve believed that a CSI disclosure issue arising in state court would be removed to federal court in the ordinary course under federal question jurisdiction.

21 492 U.S. 136 (1989).

22 U.S. Dep't of Justice, *Template for Agency FOIA Regulations*, https://www.justice.gov/oip/template-agency-foia-regulations (updated Feb. 22, 2017) ("DOJ Guidance").

23 Areas in which the DOJ Guidance has been incorporated include:

- *Expedited Processing* – Among other changes, the conforming revisions broaden the public dissemination basis for requesting expedited processing to include situations where there is an urgent need to inform the public of actual or alleged federal government activity, and is no longer limited to Federal Reserve activity covered by the existing Federal Reserve regulation.
- *Time Limits* – The changes, in accordance with the DOJ Guidance, provide a more detailed description of the Federal Reserve's obligations in responding to requests subject to expedited treatment. An additional change related to time limits (but not made to conform to DOJ Guidance) clarifies that the usual 20-day time limit runs from the date on which the Federal Reserve receives sufficient identifying information about the requester, an adequate description of the records sought, and a statement that the requester will pay the applicable fees or justification for a fee waiver or reduction.
- *Estimate of Amount of Information Withheld* – The final rule requires the Federal Reserve to provide the requesting party with an estimate of the amount of information withheld in a response to its FOIA request unless: (i) the estimate is not needed because the amount of information withheld is indicated by deletions marked on disclosed records, or (ii) providing the estimate would harm an interest protected by an applicable exemption.
- *Time to File an Appeal* – The final rule clarifies that, to be considered timely, an appeal must be postmarked, or, in the case of electronic submissions, transmitted, within 90 calendar days after the date of the adverse determination.

24 12 C.F.R. § 261.17(a)-(b).

25 Final rule release, at 18.

**ENDNOTES (CONTINUED)**

[26] 139 S. Ct. 2356 (2019).

[27] Final rule release, at 21.

[28] U.S. Dep't of Justice, *Step-by-Step Guide for Determining if Commercial or Financial Information Obtained from a Person is Confidential Under Exemption 4 of the FOIA* (Oct. 7, 2019), *available at* https://www.justice.gov/oip/step-step-guide-determining-if-commercial-or-financial-information-obtained-person-confidential.

[29] Final rule release, at 22.

[30] 12 C.F.R. § 261.15(b)(2).

[31] 12 C.F.R. § 261.20(b).

[32] Final rule release, at 22-23.

[33] Final rule release, at 22-23.

[34] Final rule release, at 22-23.

## ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

## CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.

## CONTACTS

### New York


| | | |
|---|---|---|
| Thomas C. Baxter Jr. | +1-212-558-4324 | baxtert@sullcrom.com |
| Whitney A. Chatterjee | +1-212-558-4883 | chatterjeew@sullcrom.com |
| H. Rodgin Cohen | +1-212-558-3534 | cohenhr@sullcrom.com |
| Elizabeth T. Davy | +1-212-558-7257 | davye@sullcrom.com |
| Mitchell S. Eitel | +1-212-558-4960 | eitelm@sullcrom.com |
| Michael T. Escue | +1-212-558-3721 | escuem@sullcrom.com |
| Jared M. Fishman | +1-212-558-1689 | fishmanj@sullcrom.com |
| C. Andrew Gerlach | +1-212-558-4789 | gerlacha@sullcrom.com |
| Wendy M. Goldberg | +1-212-558-7915 | goldbergw@sullcrom.com |
| Joseph A. Hearn | +1-212-558-4457 | hearnj@sullcrom.com |
| Shari D. Leventhal | +1-212-558-4354 | leventhals@sullcrom.com |
| Erik D. Lindauer | +1-212-558-3548 | lindauere@sullcrom.com |
| Mark J. Menting | +1-212-558-4859 | mentingm@sullcrom.com |
| Camille L. Orme | +1-212-558-3373 | ormec@sullcrom.com |
| Stephen M. Salley | +1-212-558-4998 | salleys@sullcrom.com |
| Rebecca J. Simmons | +1-212-558-3175 | simmonsr@sullcrom.com |
| William D. Torchiana | +1-212-558-4056 | torchianaw@sullcrom.com |
| Donald J. Toumey | +1-212-558-4077 | toumeyd@sullcrom.com |
| Marc Trevino | +1-212-558-4239 | trevinom@sullcrom.com |
| Benjamin H. Weiner | +1-212-558-7861 | weinerb@sullcrom.com |
| Mark J. Welshimer | +1-212-558-3669 | welshimerm@sullcrom.com |
| Stephanie G. Wheeler | +1-212-558-7384 | wheelers@sullcrom.com |

| | | |
|---|---|---|
| Michael M. Wiseman | +1-212-558-3846 | wisemanm@sullcrom.com |
| **Washington, D.C.** | | |
| James A. Earl | +1-202-956-7566 | earlja@sullcrom.com |
| Eric J. Kadel, Jr. | +1-202-956-7640 | kadelej@sullcrom.com |
| Stephen H. Meyer | +1-202-956-7605 | meyerst@sullcrom.com |
| Jennifer L. Sutton | +1-202-956-7060 | suttonj@sullcrom.com |
| Adam J. Szubin | +1-202-956-7528 | szubina@sullcrom.com |
| Andrea R. Tokheim | +1-202-956-7015 | tokheima@sullcrom.com |
| Samuel R. Woodall III | +1-202-956-7584 | woodalls@sullcrom.com |
| **Los Angeles** | | |
| Patrick S. Brown | +1-310-712-6603 | brownp@sullcrom.com |
| **Paris** | | |
| William D. Torchiana | +33-1-7304-5890 | torchianaw@sullcrom.com |
| **Tokyo** | | |
| Keiji Hatano | +81-3-3213-6171 | hatanok@sullcrom.com |